



ANNUAL FINANCIAL REPORT
WITH REPORT ON AUDIT BY INDEPENDENT
CERTIFIED PUBLIC ACCOUNTANTS
JUNE 30, 2011

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November 7, 2011

INDEPENDENT AUDITORS' REPORT

Board of Directors
Vallecitos Water District
San Marcos, California

We have audited the accompanying basic financial statements of Vallecitos Water District as of and for the year ended June 30, 2011 as listed in the table of contents. These basic financial statements are the responsibility of the Vallecitos Water District's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year partial comparative information has been derived from the financial statements of the District for the year ended June 30, 2010 and in our report dated November 30, 2010, we expressed an unqualified opinion on these financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the State Controller's Minimum Audit Requirements for California Special Districts. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 District's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides 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 Vallecitos Water District as of June 30, 2011, and the respective changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

Our audit was conducted for the purpose of forming an opinion on the accompanying basic financial statements of Vallecitos Water District. The supplementary information, as identified in the accompanying table of contents, is presented for purposes of additional analysis and is not a required part of the financial statements. The Schedule of Operating Expenses – Water Division and the Schedule of Operating Expenses – Wastewater Division are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information, for the year ended June 30, 2011, has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

White Nelson Diehl Evans LLP

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal Year Ended June 30, 2011

Our discussion and analysis of the Vallecitos Water District's financial performance provides an overview of the District's financial activities for the fiscal year ended June 30, 2011. Management's Discussion and Analysis (MD&A) presents financial highlights; an overview of the accompanying financial statements; an analysis of financial position and results of operations; current-to-prior year analysis; discussion on restrictions, commitments and limitations; and discussion on significant activity involving capital assets and long-term debt.

FINANCIAL HIGHLIGHTS

During the fiscal year ended June 30, 2011 (2010/11), the following highlights impacted, or have the potential to impact, the finances of the District.

- Effective January 1, 2011, the wholesale cost per acre foot of treated water increased by 9%. Fixed wholesale costs increased 24.9%. The cost of water increased by \$865k, even though purchases declined by 875 acre feet (5.4%).
- The District's Board of Directors rescinded Level 2 Drought Declaration on May 4, 2011. The District returned to the non-drought rate structure with no restrictions on water use.
- In June 2011, California Governor Jerry Brown signed a budget-related bill eliminating redevelopment agencies in their existing form. Starting in 2013/14 the District will no longer receive the RDA pass-through from The City of San Marcos. The District received a \$734k pass-through in 2011/12.
- Capital spending during 2010/11 decreased to \$2.8 million compared to \$7 million in the prior year, \$9.4 million two years prior, and \$27.3 million three years prior.
- On June 15, the Board of Directors adopted the District budget for 2011/12 which included a reduction in operating costs from the previous budget of \$1.9 million or 5% mainly due to a projected decline in water demand and consequent wholesale water cost reduction, and a reduction in salaries and benefits. The reduction in benefits is reflective of the Last Best and Final Offer to the District's Employees Association adopted the same day. The reduction in salaries is due to attrition from retirements.
- On June 30, 2011, the District transferred \$3,013,545 to CalPERS to pay off a side fund created in 2003 when agencies with like pension formulas were pooled. The side fund had a 15-year amortization period. Payment of the side fund was facilitated by adding principal payments and interest at 7.75% to the annual required pension contribution (ARC). The ARC decreased by \$506k in 2011/12. The District intends to seek variable rate debt financing to replenish reserves from which the side pay-off was drawn.
- On July 20, 2011, the District adopted two years of rate increases – effective August 1, 2011, 5.6% sewer increase, and a 9.3% ready-to-serve increase (all from a wholesale increase passed through). A 28¢ (10.6%) per unit (12¢ retail, 16¢ wholesale) increase will be effective on January 1, 2012. On July 1, 2012, 5.5% sewer increase, and an 8.3% ready-to-serve increase (mostly from a wholesale increase passed through) will be effective. A 28¢ (9.6%) per unit (15¢ retail, 13¢ estimated wholesale) will be effective January 1, 2013. The actual wholesale increase that will pass through to retail customers is not known at this time.
- On July 26, 2011, Fitch Ratings affirmed the District's AA+ rating with a stable outlook.

VALLECITOS WATER DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

OVERVIEW OF THE FINANCIAL STATEMENTS

The financial statements present the financial position, results of operations, and changes in cash flow from the economic resources measurement focus using the accrual basis of accounting, which is similar to the accounting basis used by for-profit entities. Each financial statement is identified and defined in this section and analyzed in subsequent sections of this MD&A.

Statements of Net Assets

The Statements of Net Assets present the District's financial position (assets and liabilities) as of June 30, 2011, and 2010. Assets in excess of liabilities (Net Assets) were \$237,670,785 and \$238,426,592 as of June 30, 2011, and 2010, respectively. In accordance with generally accepted accounting principles, capital assets acquired through purchase or construction by the District are recorded at historical cost. Capital assets contributed by development are recorded at fair value or developers' construction cost.

Statements of Revenues, Expenses, and Changes in Net Assets

The Statements of Revenues, Expenses, and Changes in Net Assets present the District's results of operations for the years ended June 30, 2011, and 2010. Revenues are recognized (recorded) when water or services are provided, and expenses are recognized when incurred. Operating revenues and expenses are related to the District's core activities (providing water and related services, wastewater services, and processing and delivering recycled water). Non-operating revenues and expenses (e.g. interest income, interest expenses, etc.) are not directly related to the core activities of the District. The operating loss for the year ended June 30, 2011, of \$3,220,250 is combined with a net non-operating loss of \$1,814,152 and capital contributions of \$4,278,595 to arrive at a decrease in net assets of \$755,807. The decrease in net assets is deducted from beginning net assets of \$238,426,592 to arrive at ending net assets of \$237,670,785 as of June 30, 2011.

	2010/11	2009/10
Operating loss	\$ (3,220,250)	\$ (4,347,831)
Nonoperating revenues / (expenses)	(1,814,152)	(512,725)
Capital contributions	4,278,595	6,709,625
Change in net assets	(755,807)	1,849,069
Beginning net assets	<u>238,426,592</u>	<u>236,577,523</u>
Ending net assets	<u>\$237,670,785</u>	<u>\$238,426,592</u>

Statements of Cash Flows

The Statements of Cash Flows presents the amounts of cash provided or used by the District's operating, financing, and investing activities. Every cash flow has been categorized into one of the following activities: operating, non-capital financing, capital and related financing, or investing. The total of these categories for the year ended June 30, 2011, is the increase in cash and cash equivalents of \$1,000,943, which is combined with beginning cash and cash equivalents of \$14,379,995 to arrive at ending cash and cash equivalents of \$15,380,938. Investments in the California Local Agency Investment Fund, San Diego County Investment Pool, and open-ended money market mutual funds, are the only cash equivalents held by the District as of June 30, 2011.

Beginning cash & cash equivalents	\$ 14,379,995
Decrease in cash & cash equivalents	<u>1,000,943</u>
Ending cash & cash equivalents	\$ 15,380,938

As of June 30, 2011, the ending cash and cash equivalents are represented on the Statements of Net Assets as follows:

	2010/11	2009/10
Unrestricted cash & cash equivalents	\$ 12,470,142	\$ 11,500,301
Cash & cash equivalents restricted - current	<u>2,910,796</u>	<u>2,879,694</u>
Total cash & cash equivalents	<u>\$ 15,380,938</u>	<u>\$ 14,379,995</u>

VALLECITOS WATER DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

ANALYSIS OF FINANCIAL POSITION AND RESULTS OF OPERATIONS

During the fiscal year ended June 30, 2011, the increase in total assets of \$378,289 and the increase in total liabilities of \$1,134,096 resulted in a decrease in net assets of \$755,807.

Operating activities, property taxes, capital facility fees, and other sources helped fund \$4.8 million in debt service and \$2.8 million in capital acquisitions and construction. The following table summarizes how these capital projects and debt service were financed during the year.

Sources (in millions)		Uses (in millions)	
Operating activities	\$ 3.3	Debt service	\$ 4.8
Property taxes	2.4	Capital construction and acquisition	2.8
Capital facility fees	2.1	Increase in cash and investments	0.6
Investment activities and other receipts	<u>0.4</u>		
	<u>\$ 8.2</u>		<u>\$ 8.2</u>

The operating loss of \$3,220,250 includes non-cash depreciation expense of \$8,220,514. Depreciation is the systematic allocation of a capital asset's cost to expense over a specified period of time. Depreciation on contributed assets, for which the District never realized cash outflows, is also included in the \$8.2 million of depreciation. Accounting pronouncements do not recognize that operating losses of growth agencies created by depreciation on contributed assets have no negative impact on financial performance. The District has established reserve floors for the replacement of aging infrastructure.

CURRENT-TO-PRIOR YEAR ANALYSIS

Analysis of Net Assets

The increase in assets noted in the table below is primarily attributed to contributed capital recognized as developer projects were closed during the fiscal year and the capitalization of interest on long-term debt.

Vallecitos Water District's Net Assets				
	2010/11	2009/10	Change	
			Amount	%
Cash and investments	\$ 21,760,924	\$ 21,207,487	\$ 553,437	2.6%
Capital assets	284,252,162	286,932,647	(2,680,485)	-0.9%
Other assets	<u>12,376,198</u>	<u>9,870,861</u>	<u>2,505,337</u>	<u>25.4%</u>
Total Assets	318,389,284	318,010,995	378,289	0.1%
Current liabilities	12,437,047	10,084,462	2,352,585	23.3%
Noncurrent liabilities	<u>68,281,452</u>	<u>69,499,941</u>	<u>(1,218,489)</u>	<u>-1.8%</u>
Total Liabilities	<u>80,718,499</u>	<u>79,584,403</u>	<u>1,134,096</u>	<u>1.4%</u>
Net Assets				
Invested in capital assets, net of related debt	214,976,399	217,362,952	(2,386,553)	-1.1%
Restricted	1,427,825	1,366,993	60,832	4.5%
Unrestricted	<u>21,266,561</u>	<u>19,696,647</u>	<u>1,569,914</u>	<u>8.0%</u>
Total Net Assets	<u>\$ 237,670,785</u>	<u>\$ 238,426,592</u>	<u>\$ (755,807)</u>	<u>-0.3%</u>

VALLECITOS WATER DISTRICT

MANAGEMENT’S DISCUSSION AND ANALYSIS (Continued)

CURRENT-TO-PRIOR YEAR ANALYSIS (Continued)

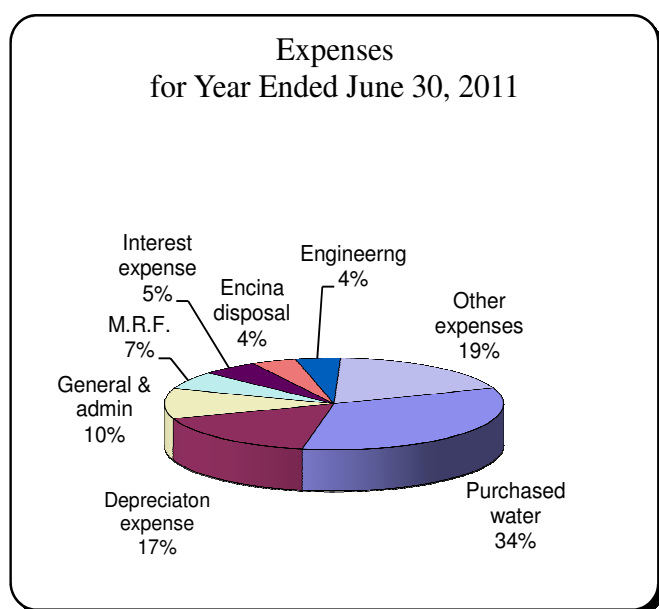
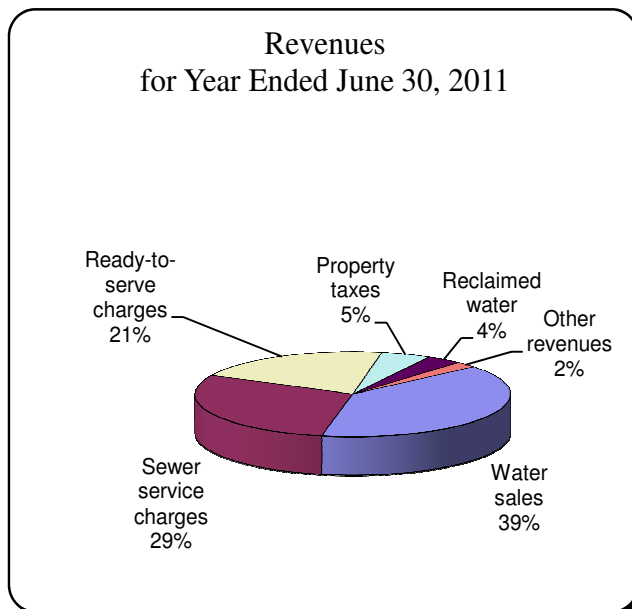
Analysis of Net Assets (continued)

Vallecitos Water District Selected Financial Ratios		
	2010/11	2009/10
Current ratio	2.43	2.93
Quick ratio	2.29	2.80
Capital assets-to-Long-term liabilities	4.16 / 1	3.61 / 1
Debt-to-equity	1 / 2.94	1 / 3.00

The table at the left illustrates how effectively the District can meet its current obligations, and the margin of safety to creditors. The current ratio (current assets divided by current liabilities) indicates that the District can pay 2.43 times its current debt from current assets. However, some current assets are not easily, or will never be, converted to cash (e.g. inventories and prepaid insurance). The quick

ratio, quick assets (cash, liquid investments, accounts receivable) divided by current liabilities, measures how effectively the District can meet current obligations with assets that are readily convertible to cash. The District can pay 2.29 times its current obligations with assets readily convertible to cash. The District’s current and quick ratios show a high degree of solvency and a strong current position. The decline from the prior year is a result of estimating a pending construction litigation claim at \$1.5 million, but not paid as of the draft of this report. The capital-assets-to-long-term-liabilities ratio indicates that for every dollar of debt the District has \$4.16 in capital assets (infrastructure, land, building, vehicles, equipment, furniture, etc., net of depreciation). The significantly higher numerator in this ratio and the higher denominator in the debt-to-equity ratio indicate the District’s ability to cash fund some degree of capital projects. The debt-to-equity ratio indicates that for every dollar of debt the District has \$2.94 of net assets (equity).

Analysis of Revenues and Expenses



The composition of revenues and expenses for the 2010/11 fiscal year is graphically illustrated above. Water sales, ready-to-serve charges, and wastewater service charges continue to be the main sources of revenue funding District operations. Water sales are commodity charges assessed to cover the variable costs of purchasing and delivering water to customers. Ready-to-serve charges are intended to cover fixed costs in the wholesale water rate, and costs related to being able to provide water to customers. A comparative analysis of revenues and expenses with a discussion of significant and unanticipated variances from the prior year is presented on the following page.

VALLECITOS WATER DISTRICT

MANAGEMENT’S DISCUSSION AND ANALYSIS (Continued)

CURRENT-TO-PRIOR YEAR ANALYSIS (Continued)

Analysis of Revenues and Expenses (continued)

Vallecitos Water District's Revenues and Expenses				
	For Fiscal Year:		Change	
	2010/11	2009/10	Amount	%
Water sales	\$ 17,298,173	\$ 16,798,224	\$ 499,949	3.0%
Wastewater service charges	12,855,742	12,013,152	842,590	7.0%
Ready-to-serve charges	9,080,597	7,833,940	1,246,657	15.9%
Property taxes	2,245,553	2,438,173	(192,620)	-7.9%
Reclaimed water sales	1,604,276	2,151,145	(546,869)	-25.4%
Other revenues	982,827	1,742,186	(759,359)	-43.6%
Total Revenues	<u>44,067,168</u>	<u>42,976,820</u>	1,090,348	2.5%
Purchased water	16,468,792	15,603,958	864,834	5.5%
Depreciation expense	8,220,514	8,125,933	94,581	1.2%
General and administrative	5,224,802	5,216,874	7,928	0.2%
Meadowlark Reclamation Facility (M.R.F.)	3,116,849	3,456,133	(339,284)	-9.8%
Interest expense	2,645,778	2,793,178	(147,400)	-5.3%
Encina disposal	2,097,610	2,162,753	(65,143)	-3.0%
Engineering	2,078,053	2,006,925	71,128	3.5%
Other expenses	9,249,172	8,471,622	777,550	9.2%
Total Expenses	49,101,570	47,837,376	1,264,194	2.6%
Loss before contributions	(5,034,402)	(4,860,556)	(173,846)	-3.6%
Capital contributions	4,278,595	6,709,625	(2,431,030)	-36.2%
Change in Net Assets	(755,807)	1,849,069	(2,604,876)	140.9%
Beginning Net Assets	238,426,592	236,577,523	1,849,069	0.8%
Ending Net Assets	<u>\$ 237,670,785</u>	<u>\$ 238,426,592</u>	(755,807)	-0.3%

- The \$1.2 million increase in ready-to-serve charges (RTS) was due to rate increases (mostly to pass through increase wholesale fixed costs). Continued extraordinary conservation efforts did not impact RTS since RTS charges are a fixed monthly charge.
- The District recovers costs of tertiary sewer treatment from reclaimed water sales to the City of Carlsbad and the Olivenhain Municipal Water District. These costs, included in MRF expenses, increased significantly in the prior year due to the start-up of the new treatment plant and reduced flow from extraordinary conservation. Costs are now beginning to stabilize.
- Other revenues from the previous year include a \$405k settlement, \$202k more in annexation fees, and \$117k more in investment income.
- Other expenses include the change in the net assets of the Encina Wastewater Authority (EWA), a joint powers authority for the purpose of collecting and treating wastewater from its five member agencies. The District accounts for its share in EWA as an investment and recognized an allocated share of the decline in EWA’s net assets of \$964k more than the prior year’s decline.
- Capital contributions from the prior year includes adjustments to recognize contributions accumulated in projects not yet completed, including contributed capital incurring in prior years.

VALLECITOS WATER DISTRICT

MANAGEMENT’S DISCUSSION AND ANALYSIS (Continued)

RESTRICTIONS, COMMITMENTS, AND LIMITATIONS

2008 Union Bank Tax-Exempt Private Placement Loan

On November 12, 2008, the District received \$7.9 million in proceeds from a variable rate tax-exempt private placement loan from Union Bank of California to fund a portion of EWA’s treatment plant expansion. The District’s share in solids capacity at EWA increased from 7.5 million gallons per day (MGD) to 10.5 MGD. The variable rate on the loan is indexed to LIBOR with the District’s option to periodically change the LIBOR period and associated rate (adjusted by the bank’s formula for a tax-exempt borrowing) currently at 1.09%. Principal payments of \$200,000 are due every March 31st and September 30th. Interest payments are due at the end of the LIBOR period chosen by the District. Total debt service paid in fiscal year 10/11 related to the loan was \$476,901. The outstanding principal balance at June 30, 2011, of \$7 million is subordinate to existing certificates of deposit.

2005 Certificates of Participation

The District pays debt service semi-annually on certificates issued as variable-rate in 2005 and converted to a fixed rate of 4.736% (total-all-in-cost) in 2007. The January 1st payment of interest only is \$1.5 million and the July 1st principal and interest payment is \$2.9 million. Total debt service paid in fiscal year 10/11 related to the loan was \$4.4 million. The outstanding principal balance at June 30, 2011, is \$59.9 million. The net revenue requirement is 1.15 times the total debt service of the District. The District’s 2010/11 net revenue was 1.98 times debt service.

Capital Facility Fees

The District collects capital facility fees from new development and increased demands from existing customers, maintains the collected fees in separate funds (one for water and one for wastewater), and uses the funds exclusively to provide capacity to serve new development and fund future construction of facilities identified in the District’s Master Plan and capital budget. As of June 30, 2011, the water capacity fund had a deficit of \$1,943,071 and the sewer capacity had a deficit of \$3,228,414. (The District maintains separate funds for specific purposes. Funds are combined for financial statement presentation.)

Capital Projects

The following budgeted projects have been contracted for at least the design phase before 2011/12:

Project Description	2011/12 Budget	Spent Through	
		June 30, 2011	Remaining
San Marcos interceptor sewer line	\$ 15,400,000	\$ 3,922,287	\$ 11,477,713
Meadowlark Tank #3	4,434,000	487,537	3,946,463
Mountain Belle pump station and pipeline	3,860,000	99,350	3,760,650
Wulff Reservoir/Pressure Reducing Station	1,565,000	1,104,606	460,394

The budget amounts in the previous table indicate the amount anticipated for completion of the projects. For some of these projects the District has only committed to the design phase through contractual obligations, and the construction has not yet been through the bidding process. Details are provided in the District’s 2011-12 Budget on these and several other committed projects less than \$1 million in scope.

VALLECITOS WATER DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

CAPITAL ASSETS AND LONG-TERM DEBT

The following represents the most significant additions to capital assets which were largely the result of reclassifying construction-in-progress to capital assets placed in service and depreciated.

Treatment plant building & improvements	\$ 1,864,296
Water mains, service lines, and meters	1,527,250
Treatment equipment	788,477
Sewer mains, manholes, and leanouts	784,404

The \$59.9 million in re-issued COPs and the \$7 million loan balance are the only long-term debts owed by the District.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The District considered the following economic factors in establishing 2011/12 budget amounts:

- Continued extraordinary conservation,
- Increases to wholesale water rates,
- District retirements and reduction in force from attrition, and
- Last, best and final offer to the District's employee association concerning benefits

As a result of these factors, the 2011/12 budget includes:

- Decreased water sales and water costs from continued conservation partially mitigated from rate increase,
- 7.8% reduction in salaries and benefits from the 2010/11 budget, and
- Increased wastewater service charges from an adopted 5.6% increase in rates effective August 1, 2011.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to give ratepayers, customers, investors, and creditors a general overview of the District's finances and to demonstrate the District's accountability for the money it receives and the stewardship of the facilities it maintains. If you have questions about this report or need additional information, contact the Vallecitos Water District's Finance Department, 201 Vallecitos de Oro, San Marcos, CA 92069, call (760) 744-0460, or visit our website at www.vwd.org.

VALLECITOS WATER DISTRICT

STATEMENTS OF NET ASSETS

June 30, 2011

(with prior year data for comparison only)

	2011	2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 12,470,142	\$ 11,500,301
Restricted cash and cash equivalents	2,910,796	2,879,694
Investments	6,379,986	6,827,492
Accounts Receivable:		
Water and wastewater sales and services, net	4,801,965	4,550,657
Taxes and assessments	872,594	998,749
From other governmental entities	637,061	1,298,389
Other	264,373	146,135
Accrued interest receivable	65,975	62,286
Current portion of note receivable	102,366	97,028
Inventories	963,980	923,757
Prepaid expenses	715,817	297,822
Total current assets	<u>30,185,055</u>	<u>29,582,310</u>
Non-current assets:		
Restricted capital facility fees receivable	7,823	6,993
Note receivable from City of San Marcos, net of current portion	743,880	846,247
Prepaid PERS contribution	2,583,039	-
Debt issuance costs, net	617,325	642,798
Investment in Encina Wastewater Authority capital assets	35,210,864	35,752,124
Capital assets not being depreciated	14,618,351	15,287,849
Net capital assets being depreciated	<u>234,422,947</u>	<u>235,892,674</u>
Total non-current assets	<u>288,204,229</u>	<u>288,428,685</u>
Total Assets	<u>318,389,284</u>	<u>318,010,995</u>
LIABILITIES		
Current Liabilities:		
Accounts payable	5,919,480	4,780,131
Accrued compensation	1,576,680	1,569,896
Construction and service deposits	130,093	454,741
Construction litigation payable	1,500,000	-
Accrued interest payable from restricted assets	1,490,794	1,519,694
Current portion of long-term debt	<u>1,820,000</u>	<u>1,760,000</u>
Total current liabilities	<u>12,437,047</u>	<u>10,084,462</u>
Non-current liabilities:		
Other post employment benefits obligation, net	2,325,689	1,690,246
Loan payable, net of current portion	6,600,000	7,000,000
Certificates of participation, net of amortized discount and current portion	<u>59,355,763</u>	<u>60,809,695</u>
Total non-current liabilities	<u>68,281,452</u>	<u>69,499,941</u>
Total Liabilities	<u>80,718,499</u>	<u>79,584,403</u>
NET ASSETS		
Invested in capital assets, net of related debt	214,976,399	217,362,952
Restricted for future capital projects	7,823	6,993
Restricted for debt service	1,420,002	1,360,000
Unrestricted	<u>21,266,561</u>	<u>19,696,647</u>
Total net assets	<u>\$ 237,670,785</u>	<u>\$ 238,426,592</u>

See accompanying independent auditors' report and notes to basic financial statements.

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VALLECITOS WATER DISTRICT

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

For the year ended June 30, 2011

(with prior year data for comparison only)

	<u>2011</u>	<u>2010</u>
OPERATING REVENUES		
Water sales	\$ 17,298,173	\$ 16,798,224
Wastewater service charges	12,855,742	12,013,152
Ready-to-serve charges	9,080,597	7,833,940
Reclaimed water sales	1,604,276	2,151,145
Pumping charges	171,875	194,907
Other services and abatements	562,212	1,006,167
Total operating revenues	<u>41,572,875</u>	<u>39,997,535</u>
OPERATING EXPENSES		
Purchased water	16,468,792	15,603,958
General and administrative	5,224,802	5,216,874
Meadowlark wastewater treatment plant	3,116,849	3,456,133
Encina disposal	2,097,610	2,162,753
Engineering	2,078,053	2,006,925
Collection and conveyance	1,737,012	1,664,388
Transmission and distribution	1,122,921	1,079,479
Customer accounts	995,965	1,009,342
Information technology	758,418	781,409
Building and grounds	565,199	581,514
Meter reading and repairs	511,121	545,029
Tanks and reservoirs	400,277	519,649
Equipment and vehicles	373,264	438,358
Pumping	266,670	395,716
Water quality and treatment	336,759	310,718
Other water operating expenses	427,874	404,873
Other wastewater operating expenses	394,043	400,230
Total operating expenses	<u>36,875,629</u>	<u>36,577,348</u>
Operating income before overhead absorption	4,697,246	3,420,187
Overhead absorption	303,018	357,915
Operating income before depreciation and amortization	5,000,264	3,778,102
Depreciation and amortization	<u>(8,220,514)</u>	<u>(8,125,933)</u>
Operating loss	<u>(3,220,250)</u>	<u>(4,347,831)</u>
NON-OPERATING REVENUES (EXPENSES)		
Property taxes	2,245,553	2,438,173
Investment income	166,307	283,172
Annexation fees	44,370	246,110
Change in Encina Joint Venture assets	(1,662,667)	(698,832)
Interest expense	(2,645,778)	(2,793,178)
Other non-operating revenues/(expenses), net	38,063	11,830
Total non-operating revenues (expenses), net	<u>(1,814,152)</u>	<u>(512,725)</u>
Net income (loss) before capital contributions	(5,034,402)	(4,860,556)
Capital contributions	4,278,595	6,709,625
Change in net assets	(755,807)	1,849,069
Total Net Assets, Beginning of Year	<u>238,426,592</u>	<u>236,577,523</u>
Total Net Assets, End of Year	<u>\$ 237,670,785</u>	<u>\$ 238,426,592</u>

See accompanying independent auditors' report and notes to basic financial statements.

VALLECITOS WATER DISTRICT

STATEMENTS OF CASH FLOWS For the year ended June 30, 2011 (with prior year data for comparison only)

	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from water and wastewater customers	\$ 41,864,657	\$ 38,223,284
Payments for water	(16,262,142)	(15,046,128)
Payments for services and supplies	(5,809,818)	(6,656,024)
Payments for employee wages, benefits and related costs	(16,458,843)	(13,107,997)
	<u>3,333,854</u>	<u>3,413,135</u>
Net cash provided by operating activities		
CASH FLOWS FROM NONCAPITAL AND RELATED FINANCING ACTIVITIES		
Receipts from taxes and assessments	2,371,708	2,530,558
	<u>2,371,708</u>	<u>2,530,558</u>
Net Cash Provided by Noncapital and Related Financing Activities		
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Receipts from annexation fees	78,013	271,455
Acquisition and construction of utility plant	(2,047,280)	(5,794,664)
Principal paid on long-term debt	(1,760,000)	(1,705,000)
Interest payments on long-term debt	(3,089,577)	(2,829,861)
Investment in Encina Wastewater Authority	(721,574)	(1,216,444)
Capacity fees received	2,128,646	2,316,149
	<u>(5,411,772)</u>	<u>(8,958,365)</u>
Net Cash (Used) by Capital and Related Financing Activities		
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	(7,425,937)	(4,152,510)
Proceeds from sale, call and maturity of investments	7,933,965	6,419,598
Investment earnings	102,096	323,166
Collections on note receivable from City of San Marcos	97,029	91,969
	<u>707,153</u>	<u>2,682,223</u>
Net cash provided by investing activities		
Net Increase (Decrease) in Cash and Cash Equivalents	1,000,943	(332,449)
Cash and Cash Equivalents, Beginning of Year	<u>14,379,995</u>	<u>14,712,444</u>
Cash and Cash Equivalents, End of Year	<u>\$ 15,380,938</u>	<u>\$ 14,379,995</u>

(Continued)

See accompanying independent auditors' report and notes to basic financial statements.

VALLECITOS WATER DISTRICT

STATEMENTS OF CASH FLOWS (Continued)

For the year ended June 30, 2011

(with prior year data for comparison only)

	<u>2011</u>	<u>2010</u>
Reconciliation of operating income (loss) to net cash flows provided by operating activities:		
Operating income (loss)	\$ (3,220,250)	\$ (4,347,831)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation and amortization of capital assets	8,220,514	8,125,933
Changes in operating assets and liabilities:		
(Increase) Decrease in assets:		
Accounts receivable from water and wastewater sales	(251,308)	(967,179)
Accounts receivable from other governments	661,328	(720,435)
Accounts receivable – other	(118,236)	(86,637)
Inventories	(40,223)	110,098
Prepaid expenses	(3,001,034)	(37,413)
Increase (Decrease) in liabilities:		
Accounts payable	440,838	357,071
Accrued compensation	6,782	363,803
Other post employment benefits obligation, net	635,443	615,725
Total adjustments	<u>6,554,104</u>	<u>7,760,966</u>
Net cash provided by operating activities	<u>\$ 3,333,854</u>	<u>\$ 3,413,135</u>

Financial Statement Classification

Cash and cash equivalents

Current assets:

Cash and cash equivalents	\$ 12,470,142	\$ 11,500,301
Restricted cash and cash equivalents	<u>2,910,796</u>	<u>2,879,694</u>
Total Cash and Cash Equivalents	<u>\$ 15,380,938</u>	<u>\$ 14,379,995</u>

Supplemental Disclosures:

Noncash Investing and Financing Activities

Contributions of assets by developers	\$ 1,957,086	\$ 3,878,464
Amortization related to long-term debt	\$ 34,969	\$ 32,186
Unrealized appreciation (depreciation) of investments	\$ 60,522	\$ 31,562

June 30, 2011

1. Reporting Entity and Summary of Significant Accounting Policies

A. Organization and Operations of the Reporting Entity

The Vallecitos Water District was organized in March of 1955 under the provisions of the California Water Code. By Board action in 1989, the District's name changed from the San Marcos County Water District to the Vallecitos Water District. The District was organized to finance, construct, operate, and maintain a water and wastewater system serving portions of northern San Diego County. Currently, the District services approximately 29,000 acres and provides water and wastewater service to the City of San Marcos, portions of the cities of Escondido and Carlsbad, and portions of surrounding unincorporated areas.

The District is the primary governmental unit based on the foundation of a separately elected governing board elected by geographic division of the citizens in a general popular election. Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. The District is financially accountable if it appoints a voting majority of the organization's governing body and: 1) It is able to impose its will on that organization, or 2) There is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary government.

The Vallecitos Water District Financing Corporation (Corporation) was incorporated in March 1998. The Corporation is a California nonprofit public benefit corporation formed to assist the District by acquiring, constructing, operating and maintaining facilities, equipment, or other property needed by the District and leasing or selling such property to the District and as such has no employees or other operations. Although the Corporation is legally separate, it is included as a blended component unit of the District, as it is in substance part of the District's operations. No separate financial statements are prepared for the Corporation.

B. Measurement Focus, Basis of Accounting and Financial Statement Presentation

Measurement focus is a term used to describe "which" transactions are recorded within the various financial statements. Basis of accounting refers to "when" transactions are recorded regardless of the measurement focus applied. The accompanying financial statements are reported using the economic resources measurement focus, and the accrual basis of accounting. Under the economic measurement focus all assets and liabilities (whether current or noncurrent) associated with these activities are included on the Statement of Net Assets. The Statement of Revenues, Expenses and Changes in Net Assets present increases (revenues) and decreases (expenses) in total net assets. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

The District reports its activities as an enterprise fund and accounts for operations that are financed and operated in a manner similar to a private business enterprise. The intent of the District is to provide water, wastewater and recycled water services to its customers on a continuing basis and finance or recover costs of providing services primarily through user charges (water and wastewater sales and services).

1. Reporting Entity and Summary of Significant Accounting Policies (Continued)

B. Measurement Focus, Basis of Accounting and Financial Statement Presentation (Continued)

Operating revenues and expenses, such as water sales and water purchases and wastewater service charges, result from exchange transactions associated with the principal activity of the District. Exchange transactions are those in which each party receives and gives up essentially equal values. Management, administration and depreciation expenses are also considered operating expenses. Other revenues and expenses not included in the above categories are reported as non-operating revenues and expenses.

The District has elected under GASB Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Activities That Use Proprietary Fund Accounting, to apply all GASB pronouncements as well as any applicable pronouncements of the Financial Accounting Standards Board (FASB), the Accounting Principles Board (APB), or any Accounting Research Bulletins (ARB) issued on or before November 30, 1989, unless they contradict or conflict with GASB pronouncements.

The basic financial statements of the Vallecitos Water District have been prepared in conformity with accounting principles generally accepted in the United States of America. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for governmental accounting financial reporting purposes.

Net assets of the District are classified into three components: (1) invested in capital assets, net of related debt, (2) restricted net assets, and (3) unrestricted net assets. These classifications are defined as follows:

Invested in Capital Assets, Net of Related Debt

This component of net assets consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of notes or borrowing that are attributable to the acquisition of the asset, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds are not included in the calculation of invested in capital assets, net of related debt.

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 law through constitutional provisions or enabling legislation.

Unrestricted Net Assets

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

1. Reporting Entity and Summary of Significant Accounting Policies (Continued)

C. Use of Estimates

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

D. Cash and Cash Equivalents

Substantially all of the District’s cash is invested in interest bearing accounts. The District considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

E. Investments and Investment Policy

The District has adopted an investment policy directing the Treasurer to deposit funds in financial institutions.

Changes in fair value that occur during a fiscal year are recognized as investment income reported for that fiscal year. Investment income includes interest earnings, changes in fair value, and any gains or losses realized upon the liquidation or sale of investments.

F. Accounts Receivable and Allowance for Uncollectible Accounts

The District extends credit to customers in the normal course of operations. When management deems customer accounts uncollectible, the District uses the allowance method for the reservation and write-off of those accounts.

G. Federal and State Capital and Operating Grants

If a grant agreement were approved and eligible expenditures were incurred, the amount is recorded as a capital or operating grant receivable on the statement of net assets and as capital grant contribution or operating grant revenue, as appropriate, on the statement of revenues, expenses and changes in net assets.

H. Property Taxes and Assessments

Property taxes and assessments are billed by the County of San Diego to property owners. The District’s property tax calendar is as follows:

Lien date	January 1
Levy date	July 1
Due date	
First installment	November 1
Second installment	February 1
Delinquent date	
First installment	December 10
Second installment	April 10

1. Reporting Entity and Summary of Significant Accounting Policies (Continued)

I. Water-In-Storage Inventory

The District owns the water within its transmission and distribution system. This water has been recorded on the District’s books at the cost at which the water was purchased using the FIFO method.

J. Materials and Supplies Inventory

Materials and supplies inventory consists primarily of water meters, pipe and pipefittings for construction and repair to the District’s water transmission and distribution system and wastewater system. Inventory is valued at cost using a weighted average cost method. Inventory items are charged to expense or work-in-process at the time that individual items are withdrawn from inventory or consumed.

K. Prepaid Expenses

Certain payments to vendors reflects costs or deposits applicable to future accounting periods and are recorded as prepaid items in the basic financial statements.

L. Restricted Assets

Certain assets of the District are restricted in use by law or debt covenant and, accordingly are shown as restricted assets on the accompanying statement of net assets. Certificates of Participation construction funds set aside from Certificates of Participation proceeds are restricted for construction projects. The District uses restricted resources, prior to using unrestricted resources, to pay expenditures meeting the criteria imposed on the use of restricted resources by a third party.

M. Capital Assets

Capital assets acquired and/or constructed are capitalized at historical cost. District policy has set the capitalization threshold for reporting capital assets expected to have a useful life of more than one year at \$5,000. Donated assets are recorded at estimated fair market value at the date of donation. Upon retirement or other disposition of capital assets, the cost and related accumulated depreciation are removed from the respective balances and any gains or losses are recognized. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets as follows:

Transmission and distribution system	10 - 75 years
Wastewater system	5 - 50 years
Buildings	50 years
Transportation equipment	8 - 15 years
Field and shop equipment	5 - 20 years
Office equipment	5 - 10 years

N. Encina Wastewater Authority

The District’s participation in the Encina Wastewater Authority (EWA) is included in the accompanying financial statements. The District’s investment in EWA is capitalized as a percentage of ownership of capital expenditures incurred by EWA. Ownership percentages are determined by joint agreements at the time the assets are acquired.

O. Deferred Charges

Deferred charges from bond issuance costs are amortized using the straight-line method over the remaining life of the respective debt service.

1. Reporting Entity and Summary of Significant Accounting Policies (Continued)**P. Compensated Absences**

The District's personnel policies provide for accumulation of vacation and sick leave. Liabilities for vacation and sick leave are recorded when benefits are earned. Cash payment equal to 100% of unused vacation and 25% or 50% of sick leave, depending on length of service, is available upon retirement or termination.

Q. Construction Advances and Deposits

Construction advances represent deposits received in aid of construction, which are refundable if the applicable construction does not take place. Construction advances are transferred to contributed capital when the District is no longer liable for the applicable construction project.

R. Water and Wastewater Sales and Services

Water and wastewater sales and services are billed on a monthly cyclical basis. Estimated unbilled water revenue through June 30 has been accrued at year-end.

S. Interest Expense

The District incurs interest charges on long-term debt. For fiscal year ended June 30, 2011 the District expensed \$2,645,778 of interest incurred and capitalized \$404,250 as part of the cost of construction projects.

T. Capital Contributions

Capital contributions represent cash and capital asset additions contributed to the District by property owners, granting agencies or real estate developers desiring services that require capital expenditures or capacity commitment.

U. Economic Dependency

The District purchases all of its water from the San Diego County Water Authority. A sustained interruption of this source could impact the District negatively.

V. Budgetary Policies

The District adopts an annual budget for planning, control, and evaluation purposes. Budgetary control and evaluation are affected by comparisons of actual revenues and expenses with planned revenues and expenses for the period. Encumbrance accounting is not used to account for commitments related to unperformed contracts for construction and services.

W. Reclassifications

Certain reclassifications have been made to prior year amounts to conform to the current year presentation.

X. Prior Year Data

Selected information regarding the prior year has been included in the accompanying financial statements. This information has been included for comparison purposes only and does not represent a complete presentation in accordance with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the District's prior year financial statements, from which this selected financial data was derived.

2. Cash and Investments

Cash and Investments are classified in the accompanying financial statements as follows:

	<u>2011</u>	<u>2010</u>
Cash and cash equivalents	\$ 12,470,142	\$ 11,500,301
Restricted cash and cash equivalents	2,910,796	2,879,694
Investments	<u>6,379,986</u>	<u>6,827,492</u>
Total Cash and Investments	<u>\$ 21,760,924</u>	<u>\$ 21,207,487</u>

Cash and Investments consist of the following:

	<u>2011</u>	<u>2010</u>
Cash on hand	\$ 1,700	\$ 1,700
Deposits with financial institutions (over draft)	(186,342)	(63,297)
Investments	<u>21,945,566</u>	<u>21,269,084</u>
Total cash and investments	<u>\$ 21,760,924</u>	<u>\$ 21,207,487</u>

Investments Authorized by the California Government Code and the District’s Investment Policy

The table below identifies the investment types that are authorized by the District in accordance with the District’s investment policy, which is more restrictive than the California Government Code. The table also identifies certain provisions of the District’s investment policy that address interest rate risk, credit risk, and concentration of credit risk. This table does not address investments of debt proceeds that are governed by the provisions of debt agreements of the District, rather than the general provisions of the District’s investment policy.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Of Portfolio</u>	<u>Maximum Investment in One Issuer/Institution</u>
U.S. Treasury Obligations	5 years	75%	None
Federal Agency Obligations	5 years	60%	25%
Commercial Paper	270 days	20%	10%
Certificates of Deposit	4 years	20%	FDIC limit
Repurchase Agreements	1 year	10%	25%
Local Government Investment Pools	N/A	40%	25%
Local Agency Investment Fund (LAIF)	N/A	60%	None
State and Local Agency Bonds	5 years	20%	25%
FDIC - Backed Medium - Term Notes	4 years	20%	25%
Savings Accounts	N/A	10%	25%

2. Cash and Investments (Continued)

Investments Authorized by Debt Agreements

Investment of debt proceeds are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the District's investment policy. Appendix B of the official statements note the investment types that are authorized for investments and identifies certain provisions of these debt agreements that address interest rate risk, credit risk and concentration of credit risk. The District maintains and invests the 2005 Certificates of Participation debt proceeds in accordance with debt covenants.

Custodial Credit Risk

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. With respect to investments, custodial credit risk generally applies only to direct investments in marketable securities. Custodial credit risk does not apply to a local government's indirect investment in securities through the use of mutual funds or government investment pools (such as LAIF). The District's investment policy considers aversion to custodial credit risk by requiring all participants in the investment process to invest no more than 25% of the portfolio with one financial institution, with the exception of LAIF, the U.S. Treasury and funds advanced or in trustee accounts for project construction. The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure District deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits. The District had deposits with bank balances of \$228,164 and \$171,608 as of June 30, 2011 and 2010, respectively. Of the bank balances, up to \$250,000 is federally insured and the remaining balance is collateralized in accordance with the Code; however, the collateralized securities are not held in the District's name.

Investment in State Investment Pool

The District is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The fair value of the District's investment in this pool is reported in the accompanying financial statements at amounts based upon the District's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis.

2. Cash and Investments (Continued)

San Diego County Pooled Investment Fund

The San Diego County Pooled Investment Fund (SDCPIF) is a pooled investment fund program governed by the County of San Diego Board of Supervisors, and administered by the County of San Diego Treasurer and Tax Collector. Investments in SDCPIF are highly liquid as deposits and withdrawals can be made at anytime without penalty. SDCPIF does not impose a maximum investment limit; however, the District’s investment policy limits investment in SDCPIF to 20% of the District’s total portfolio.

The County of San Diego’s bank deposits are either Federally insured or collateralized in accordance with the California Government Code. Pool detail is included in the County of San Diego Comprehensive Annual Financial Report (CAFR). Copies of the CAFR may be obtained from the County of San Diego Auditor-Controller’s Office – 1600 Pacific Coast Highway – San Diego, CA 92101.

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value is to changes in market interest rates. The District manages interest rate risk by limiting terms of investment as noted in the Authorized Investment Type on page 19. The District also manages its exposure to interest rate risk by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio matures or comes close to maturity evenly over time as necessary to provide requirements for cash flow and liquidity needed for operations. Information about the sensitivity of the fair values of the District’s investments to market interest rate fluctuations is provided by the following table that shows the distribution of the District’s investments by maturity date:

Maturities of investments at June 30, 2011, are as follows:

Investment Type	Total	Remaining Maturity (in Months)		
		12 Months Or Less	13 - 24 Months	25 - 60 Months
Federal Farm Credit Banks	\$ 517,590	\$ 517,590	\$ -	\$ -
Federal Home Loan Bank	1,243,711	-	1,243,711	-
Federal Home Loan Mortgage Association	1,008,930	-	1,008,930	-
Federal National Mortgage Association	744,030	-	744,030	-
Certificates of Deposit	1,849,950	1,849,950	-	-
Corporate Notes	1,015,775	1,015,775	-	-
Local Agency Investment Fund (LAIF)	7,633,784	7,633,784	-	-
San Diego County Investment Pool	5,021,000	5,021,000	-	-
Held by bond trustee:				
Money market funds	2,910,796	2,910,796	-	-
Total	\$ 21,945,566	\$ 18,948,895	\$ 2,996,671	\$ -

2. Cash and Investments (Continued)

Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by (where applicable) the California Government Code, the District’s investment policy, or debt agreements, and the Moody’s rating as of year end for each investment type.

Credit ratings of investments as of June 30, 2011 were as follows:

Investment Types	Total	Minimum Legal Rating	Rating as of Year End		
			AAA	AA+	Not Rated
Federal Farm Credit Banks	\$ 517,590	N/A	\$ 517,590	\$ -	\$ -
Federal Home Loan Bank	1,243,711	N/A	1,243,711	-	-
Federal Home Loan Mortgage Corporation	1,008,930	N/A	1,008,930	-	-
Federal National Mortgage Association	744,030	N/A	744,030	-	-
Certificates of Deposit	1,849,950	N/A	-	-	1,849,950
Corporate Notes	1,015,775	N/A	1,015,775	-	-
Local Agency Investment Fund (LAIF)	7,633,784	N/A	-	-	7,633,784
San Diego County Investment Pool	5,021,000	AAA	5,021,000	-	-
Held by bond trustee:	-				
Money market funds	2,910,796	N/A	2,910,796	-	-
Total	\$ 21,945,566		\$ 12,461,832	\$ -	\$ 9,483,734

Concentration of Credit Risk

The investment policy of the District limits the amount that can be invested in any one issuer to 25% of the portfolio, other than U.S. Treasury securities. Investments in any one issuer, other than U.S. Treasury securities, that represent 5% or more of the total District investments are as follows:

Issuer	2011	
	Reported Amount	Portfolio Percentage
Federal Home Loan Bank	\$ 1,243,711	6%

3. Accounts Receivable

The balance at June 30, consists of the following:

	2011	2010
Accounts receivable - water and wastewater sales and services	\$ 4,831,400	\$ 4,572,378
Allowance for uncollectible accounts	(29,435)	(21,721)
Accounts receivable - water sales, net	\$ 4,801,965	\$ 4,550,657

Property Tax Receivable

Taxes and assessments receivable of \$882,894 and \$1,011,970 have been reduced by an allowance for estimated uncollectible taxes of \$10,300 and \$13,221 at June 30, 2011 and 2010, respectively.

4. Capital Assets

Changes in capital assets for 2011 were as follow:

	<u>Balance 2010</u>	<u>Additions/ Transfers</u>	<u>Deletions/ Transfers</u>	<u>Balance 2011</u>
Capital Assets, Not Depreciated				
Land	\$ 4,744,508	\$ -	\$ -	\$ 4,744,508
Construction-in-process	10,543,341	4,530,727	(5,200,225)	9,873,843
Total Capital Assets, Not Depreciated	<u>\$ 15,287,849</u>	<u>\$ 4,530,727</u>	<u>\$ (5,200,225)</u>	<u>\$ 14,618,351</u>
Capital Assets, Being Depreciated				
Water transmission and distribution system	\$ 180,518,409	\$ 2,053,547		\$ 182,571,956
Wastewater system	108,488,967	2,028,737		110,517,704
Buildings	14,898,399	1,831,377		16,729,776
Transportation equipment	3,472,797	97,267	(30,887)	3,539,177
Field and shop equipment	10,553,274	298,960		10,852,234
Office equipment	1,896,286	440,899		2,337,185
Total Capital Assets, Being Depreciated	<u>\$ 319,828,132</u>	<u>\$ 6,750,787</u>	<u>\$ (30,887)</u>	<u>\$ 326,548,032</u>
Less Accumulated Depreciation:				
Water transmission and distribution system	\$ (41,849,288)	\$ (3,989,566)	\$ -	\$ (45,838,854)
Wastewater system	(26,945,066)	(1,956,204)	-	(28,901,270)
Buildings	(4,860,668)	(1,255,766)	-	(6,116,434)
Transportation equipment	(1,814,048)	(317,131)	30,887	(2,100,292)
Field and shop equipment	(7,362,710)	(544,813)	-	(7,907,523)
Office equipment	(1,103,678)	(157,034)	-	(1,260,712)
Total Accumulated Depreciation	<u>\$ (83,935,458)</u>	<u>\$ (8,220,514)</u>	<u>\$ 30,887</u>	<u>\$ (92,125,085)</u>
Total Capital Assets, Being Depreciated, net	<u>\$ 235,892,674</u>	<u>\$ (1,469,727)</u>	<u>\$ -</u>	<u>\$ 234,422,947</u>
Total Capital Assets, net	<u>\$ 251,180,523</u>	<u>\$ 3,061,000</u>	<u>\$ (5,200,225)</u>	<u>\$ 249,041,298</u>

In 2011, major capital assets additions during the year included ERP Phase II, Tertiary Filter Piping, Lift Station #1 Upgrade and several vehicles.

4. Capital Assets (Continued)

Construction-In-Process

The District has been involved in various construction projects throughout the year. The balances of the various construction projects that comprise the construction-in-process balances at June 30 are as follows:

<u>Project Name</u>	<u>2010</u>	<u>2011</u>
<i>District Financed</i>		
SM interceptor - SM Blvd/Discovery	\$ 3,658,913	3,932,797
Wulff Reservoir/Pressure Reducing Station	1,077,814	1,105,536
Water & Sewer Master Plan	576,436	801,689
San Elijo Road Facilities	641,279	641,279
Meadowlark Tank #3	413,011	487,537
MRF 2007 Upgrade Warrantee work done by VWD	-	415,533
Center Drive Sewer Replacement	-	200,549
Linda Vista Sewer Upgrade	-	172,100
VM Ware & Meadowlark Service Room Upgrade	-	128,083
Encina Land Parallel Outfall	54,799	123,762
Wulff Tank Replacement	-	103,503
Rock Springs Sewer Replacement	49,129	99,544
Mountain Belle Pump Station & Pipeline Design	99,350	99,350
Vulnerability Assessment	-	98,189
204330 - Radio/Communication S	-	77,376
Particulate Filters per Carb	-	64,131
Environmental Mitigation Property	-	59,646
205070 - Flow Monitoring Station	-	58,374
204484 - Pavement and Access Roads	-	34,742
Discovery St Sewer Replacement	-	16,754
Old Questhaven Sewer Replacement	718	718
ERP Phase II	681,760	-
Tertiary Filter Piping	548,091	-
Lift Station #1 Upgrades	300,453	-
Meadowlark Plant Expansion	-	186,368
Subtotal - District Financed	<u>\$ 8,101,753</u>	<u>8,907,560</u>
<i>Developer Financed</i>		
High Point Hydropneum	\$ 85,291	87,510
Palos Vista Estates	-	55,548
Developer Impact Fee Study	-	46,425
Arbor Ranch TSM 445-4	-	28,129
Improvement Plans TPM-643	-	25,153
Hunter Industries University Commons PA	-	16,801
Camino De Las Lomas Water Meter Relocation	-	15,832
Grand Avenue City	-	14,879
Autumn Drive and Buelow Park	-	14,206
San Elijo Hills Towncenter On-Site	-	12,662
San Marcos Creek Improvement Plan	-	9,851
Pump Station Meadowlark	-	9,617
San Marcos Creek Water & Sewer Study	69,331	-
Subtotal - Developer Financed	<u>\$ 154,622</u>	<u>336,613</u>
Various Other Projects	<u>\$ 2,286,966</u>	<u>629,670</u>
Total	<u>\$ 10,543,341</u>	<u>9,873,843</u>

5. Encina Wastewater Authority

The Revised Basic Agreement is a joint exercise of powers agreement by and among the cities of Carlsbad, Vista, and Encinitas, the Buena Sanitation District, the Vallecitos Water District, and the Leucadia Wastewater District for the ownership and operation of a joint sewerage system. The Encina Wastewater Authority (EWA) board is composed of representatives of these Member Agencies. Each Member Agency has an investment in EWA’s assets and owns a corresponding proportion of the capacity of the joint system. As of June 30, 2011, the Member Agencies have the following approximate ownership interest:

City of Vista	22%
City of Carlsbad	25%
Buena Sanitation District	8%
Vallecitos Water District	20%
Leucadia Wastewater District	20%
City of Encinitas	5%

The latest available financial statements of EWA, dated June 30, 2010 and 2009, are available directly from EWA (6200 Avenida Encinas, Carlsbad, California 92009), and show the following:

	<u>2010</u>	<u>2009</u>
Total assets	\$ 126,737,698	\$ 132,177,221
Total liabilities	\$ 1,896,221	\$ 5,197,839
Total net assets	<u>\$ 124,841,477</u>	<u>\$ 126,979,382</u>
Increase (decrease) in net assets	<u>\$ (2,137,905)</u>	<u>\$ 5,136,045</u>

6. Note Receivable from City of San Marcos

In February 1998, the District sold 23.6 acres of excess land to the City of San Marcos for \$1,829,520. The District received \$50,000 and an installment note of \$1,779,520. The note is payable in twenty annual installments of \$148,909 including interest of 5.5%. As of June 30, 2011, the following amounts are due to the District:

<u>Fiscal Year</u>	<u>Principal Amount</u>
2012	\$ 102,366
2013	107,996
2014	113,935
2015	120,202
2016	126,813
2017-2018	<u>274,934</u>
Total	846,246
Current Portion	<u>(102,366)</u>
Non-current Portion	<u>\$ 743,880</u>

7. Debt Issuance Costs

The debt issuance costs balance relates to the issuance costs of the 2005A Refunding Certificates of Participation and the 2008 loan payable from Union Bank of California. The balance for the 2005A Refunding Certificate of Participation is being amortized over a thirty-two year period. The balance for the 2008 loan payable from Union Bank of California is being amortized over a twenty-one year period.

The debt issuance costs, net balances are as follows:

	<u>2011</u>	<u>2010</u>
Bond Issuance Costs	\$ 635,294	\$ 635,294
Debt Issuance Costs	58,448	58,448
Accumulated amortization	(76,417)	(50,944)
Debt Issuance Costs, net	<u>\$ 617,325</u>	<u>\$ 642,798</u>

8. Deferred Charges from Debt Retirement

The deferred charges from debt retirement balance relate to the defeasance costs of the District’s 1998 Twin Oaks Certificates of Participation. The balance is being amortized over a twenty-six year period. The deferred charges are netted against the long-term portion of the Certificates of Participation on the Statements of Net Assets (see note 9).

The deferred charges from debt retirement, net balances are as follows:

	<u>2011</u>	<u>2010</u>
Deferred charges from debt retirement	\$ 218,424	\$ 218,424
Accumulated amortization	(28,490)	(18,994)
Deferred charges from debt retirement, net	<u>\$ 189,934</u>	<u>\$ 199,430</u>

9. Long-Term Debt

2005 Certificates of Participation

On June 30, 2005, the District issued \$66,700,000 in Water and Wastewater Enterprise Certificates of Participation (Series 2005A COPs). The proceeds of the issue are being used to prepay the 1998 Twin Oaks Reservoir Certificates of Participation and to complete the construction of a second buried prestressed concrete reservoir at the Twin Oaks Reservoir site, including related grating and earthwork, and the upgrade of the District’s Meadowlark Water Reclamation Facility, including the installation of new primary clarifiers, two new filter beds, the reconstruction of the operations and laboratory building, the installation of odor control systems throughout the site, and the addition of a larger emergency generator.

A total of \$23,000,000 from the Series 2005A COPs was used to pay off the outstanding principal, and call premium on the 1998 Twin Oaks Reservoir Certificates of Participation. As a result, the 1998 Twin Oaks Reservoir Certificates of Participation are considered retired and the liability for those obligations has been removed from the financial statements. The District completed the advance refunding to reduce the District’s total debt service payments over the next 25 years by \$1,506,316 and to obtain an economic gain of approximately \$1,111,076.

9. Long-Term Debt (Continued)

2005 Certificates of Participation (continued)

The Series 2005A COPs are payable solely from the net revenues of the District’s water and sewer systems as defined in the 2005 Certificates of Participation. The Certificates are due in annual installments from July 1, 2008 to July 1, 2035 bearing interest at 4.00% to 5.25%. This debt contains a rate covenant which requires the District to maintain annual net revenues of at least 115% of the annual debt service. In Fiscal Year 2011 the District was in compliance with this rate covenant.

The balance at June 30, 2011 net of unamortized premiums, discounts and deferred charges is as follows:

	Balance 2010	Additions	Payments/ Deletions	Balance 2011
2005 Series A COP	\$ 61,240,000	\$ -	\$ 1,360,000	\$ 59,880,000
Add: Bond Premium	1,531,327	-	58,897	1,472,430
Less: Unamortized Discount	(402,202)	-	(15,469)	(386,733)
Less: Deferred charges	(199,430)	-	(9,496)	(189,934)
Total	\$ 62,169,695	\$ -	\$ 1,393,932	\$ 60,775,763
Less: Current Portion	(1,360,000)			(1,420,000)
Long-Term Portion	\$ 60,809,695			\$ 59,355,763

Annual debt service payments are as follows:

Fiscal Year	Principal	Interest	Total
2012	\$ 1,420,000	\$ 2,951,413	\$ 4,371,413
2013	1,485,000	2,884,113	4,369,113
2014	1,565,000	2,807,863	4,372,863
2015	1,635,000	2,736,038	4,371,038
2016	1,715,000	2,656,175	4,371,175
2017-2021	10,060,000	11,772,383	21,832,383
2022-2026	13,080,000	8,779,763	21,859,763
2027-2031	16,800,000	5,061,782	21,861,782
2032-2036	12,120,000	1,563,126	13,683,126
Total	\$ 59,880,000	\$ 41,212,656	\$ 101,092,656
Less current portion	(1,420,000)		
Total non-current portion	\$ 58,460,000		

In 2007, the District converted its remaining \$63.8 million in COPs from variable auction rate to a fixed rate debt to reduce interest rate risk. At the time of conversion the auction rate was 3.5%. The total-all-in cost is 4.736%. The \$1.6 million realized in the issue premium was expended toward the Meadowlark Treatment Plant expansion.

9. Long-Term Debt (Continued)

2008 Loan Payable

On November 12, 2008, the District entered into a variable rate tax-exempt private placement loan with Union Bank of California (UBOC) in the amount of \$8,000,000 to partially finance the District’s share of the expansion costs at the Encina Wastewater Authority’s treatment plant. Terms of the agreement call for interest to accrue at an interest rate per annum equal to 64.72% of the LIBOR index plus 0.79% (1.088% at June 30, 2011). Principal payments of \$200,000 plus interest are payable semi-annually and maturing in 2028.

Loan payables for the year ended June 30, 2011 is as follows:

	<u>Balance 2010</u>	<u>Additions</u>	<u>Payments/ Deletions</u>	<u>Balance 2011</u>
2008 UBOC Loan	\$ 7,400,000	\$ -	\$ 400,000	\$ 7,000,000
Less: Current Portion	<u>(400,000)</u>			<u>(400,000)</u>
Long-Term Portion	<u>\$ 7,000,000</u>			<u>\$ 6,600,000</u>

Annual debt service payments are as follows:

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest*</u>	<u>Total</u>
2012	\$ 400,000	\$ 92,349	\$ 492,349
2013	400,000	86,995	486,995
2014	400,000	81,642	481,642
2015	400,000	76,288	476,288
2016	400,000	70,935	470,935
2017-2021	2,000,000	274,370	2,274,370
2022-2026	2,000,000	140,531	2,140,531
2027-2031	<u>1,000,000</u>	<u>20,076</u>	<u>1,020,076</u>
Total	\$ 7,000,000	<u>\$ 843,186</u>	<u>\$ 7,843,186</u>
Less current portion	<u>(400,000)</u>		
Total non-current portion	<u>\$ 6,600,000</u>		

* - Interest rate of 1.33839% used for future years is interest rate set by Union Bank on 9/30/2011 for effective dates 9/30/2011 – 3/30/2012.

10. Net Assets

a. Invested In Capital Assets, Net of Related Debt

Invested in Capital Assets, Net of Related Debt at June 30, consists of the following:

	<u>2011</u>	<u>2010</u>
Investment in Encina Wastewater Authority capital assets	\$ 35,210,864	\$ 35,752,124
Capital assets not being depreciated	14,618,351	15,287,849
Net capital assets being depreciated	232,922,947	235,892,674
Certificates of participation - current portion	(1,420,000)	(1,360,000)
Loan payable - UBOC - current portion	(400,000)	(400,000)
Certificates of participation - noncurrent portion	(59,355,763)	(60,809,695)
Loan payable - UBOC - noncurrent portion	(6,600,000)	(7,000,000)
Total net investment in capital assets	<u>\$ 214,976,399</u>	<u>\$ 217,362,952</u>

b. Restricted Net Assets

Restricted Assets at June 30, consists of the following:

	<u>2011</u>	<u>2010</u>
Restricted for debt service	\$ 1,420,002	\$ 1,360,000
Restricted for future capital projects	7,823	6,993
Total restricted net assets	<u>\$ 1,427,825</u>	<u>\$ 1,366,993</u>

c. Unrestricted Net Assets

Unrestricted Assets at June 30, consists of the following:

	<u>2011</u>	<u>2010</u>
Non-spendable net assets:		
Inventories	\$ 963,980	\$ 923,757
Prepaid expenses	3,298,856	297,822
Debt issuance costs, net of amortization	617,325	642,798
Total non-spendable net assets	<u>4,880,161</u>	<u>1,864,377</u>
Spendable net assets:		
Unrestricted	16,386,400	17,832,270
Total spendable net assets	<u>16,386,400</u>	<u>17,832,270</u>
Total unrestricted net assets	<u>\$ 21,266,561</u>	<u>\$ 19,696,647</u>
Total net assets	<u>\$ 237,670,785</u>	<u>\$ 238,426,592</u>

11. Defined Benefit Pension Plan

Plan Description

The District contributes to the California Public Employees Retirement System (CalPERS), a cost sharing multi-employer defined benefit pension plan. CalPERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. CalPERS acts as a common investment and administrative agent for participating public agencies within the State of California. Benefit provisions and all other requirements are established by state statute and the Agency. Copies of CalPERS annual financial report may be obtained from their executive Office: 400 P Street, Sacramento, CA, 95814.

Funding Policy

The contribution rate for plan members in the CalPERS 3.0% at 60 Risk Pool Retirement Plan is 8% of their annual covered salary. The District makes these contributions required of District employees on their behalf and for their account. The District is required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the CalPERS Board of Administration. The required employer contribution rate for the fiscal year ended June 30, 2011 was 19.405%. The contribution requirements of the Plan members are established by State statute and the employer contribution rate is established and may be amended by the CalPERS.

Annual Pension Costs

For the fiscal year ended June 30, 2011, the District’s annual pension cost and actual contribution was \$1,376,682. The required contribution for the fiscal year ended June 30, 2011 was determined as part of the June 30, 2008 actuarial valuation.

The following is a summary of the actuarial assumptions and methods:

Valuation Date	June 30, 2008
Actuarial Cost Method	Entry Age Actuarial Cost Method
Amortization Method	Level Percent of Payroll
Average Remaining Period	16 Years as of the Valuation Date
Asset Valuation Method	15 Year Smoothed Market
Actuarial Assumptions:	
Investment Rate of Return	7.75% (Net of Administrative Expenses)
Projected Salary Increase	3.25% to 14.45% Depending on Age, Service, and Type of Employment
Inflation	3.00%
Payroll Growth	3.25%
Individual Salary Growth	A merit scale varying by duration of employment coupled with an assumed annual inflation component of 3.00% and an annual production growth of 0.25%.

Initial unfunded liabilities are amortized over a closed period that depends on the Plan’s date of entry into CalPERS. Subsequent Plan amendments are amortized as a level percentage of pay over a closed 20-year period. Gains and losses that occur in the operation of the plan are amortized over a rolling period, which results in an amortization of 6% of unamortized gains and losses each year. If the plan’s accrued liability exceeds the actuarial value of the plan assets, then the amortization payment of the total unfunded liability may be lower than the payment calculated over a 30-year amortization period.

11. Defined Benefit Pension Plan (Continued)

Three Year Trend Information for PERS

<u>Fiscal Year</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>	<u>APC Percentage of Payroll</u>
2009	\$ 1,275,874	100%	-	18.692%
2010	\$ 1,367,344	100%	-	19.122%
2011	\$ 1,376,682	100%	-	17.240%

Funding Status

As of June 30, 2004, the District’s miscellaneous plan became part of a CalPERS Risk Pool for employers with less than 100 active plan members. As part of a cost-sharing multiple-employer defined benefit plan, disclosure of the schedule of funding progress is not required as information is not specific to the District.

12. Other Post Employment Benefits Plan

The District provides post-employment health benefits in accordance with a resolution approved by the Board of Directors, to all employees who retire from the District under the retirement criteria established by CalPERS, up to age 65. Currently, there are ten retired employees who meet these eligibility requirements and are therefore receiving the benefits. The post-retirement health care benefits are financed on a pay as you go basis.

The total expense incurred for these benefits for retired employees for the year ended June 30, 2011 and 2010 was \$211,948 and \$160,521, respectively.

Plan Description

The District administers the Other Post-employment Benefit Plan, a single-employer defined benefit plan. The District’s Other Post-employment Benefit Plan (OPEB) provides continued medical coverage for an eligible retired employee, spouse or registered domestic partner, and eligible dependent at no cost to the retired employee. Coverage will continue for the retiree and spouse or registered domestic partner until they become entitled to Medicare Benefits at age 65. Coverage for the retirees’ eligible dependents will continue until they are eligible for coverage under any other health care plan or public health care program or are no longer eligible for coverage under the District’s group health plans according to the terms and conditions of the agreement between the group health plan and the District.

Employees are eligible OPEB participants upon reaching age 50 with a minimum five years of eligible PERS service with the District. Board members are also eligible to participate. Eligible retirees and board members may enroll in any of the plans available through the ACWA Program or in an Aetna HMO plan provided by the District. The District’s Resolution #788 establishes the authority for the plan. The activity and liability from the OPEB plan are included in these financial statements.

12. Other Post Employment Benefits Plan (Continued)

Funding Policy

The District’s Resolution #788 provides that the District will pay 100% of the cost of the OPEB plan. The District funds the plan on a pay-as-you-go basis and maintains reserves (and records a liability) for the difference between pay-as-you-go and the actuarially determined annual OPEB cost.

Annual OPEB Cost

The following table shows the components of the District’s annual OPEB cost for the year, the amount actually contributed to the plan, and the changes in the District’s net OPEB obligation for the year ended June 30th as follows:

The balance at June 30, consists of the following:

	<u>2011</u>	<u>2010</u>
Annual required contribution	\$ 893,864	\$ 824,870
Interest on net post employment benefits payable obligation	67,610	42,981
Adjustment to annual required contribution	<u>(105,753)</u>	<u>(65,800)</u>
Annual post employment benefits payable obligation cost (expense)	855,721	802,051
Contributions made:		
Retired employees post employment medical benefits payments	<u>(220,278)</u>	<u>(186,326)</u>
Increase in net post employment benefits payable obligation	635,443	615,725
Post employment benefits payable, net - beginning of year	<u>1,690,246</u>	<u>1,074,521</u>
Post employment benefits payable, net - end of year	<u><u>\$ 2,325,689</u></u>	<u><u>\$ 1,690,246</u></u>

Funded Status of the Plan

The most recent valuation (dated July 1, 2009) includes an Actuarial Accrued Liability and Unfunded Actuarial Accrued Liability of \$6,021,763. There are no plan assets because the District funds on a pay as-you-go basis and maintains reserves equal to the remaining net OPEB obligation. The covered payroll (annual payroll of active employees covered by the plan) for the year ended June 30, 2011 is \$7,984,313. The ratio of the unfunded actuarial liability to annual payroll covered is 75.42%. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for the benefits.

12. Other Post Employment Benefits Plan (Continued)

Three Year Trend Information

The District’s annual OPEB cost, the percentage of annual OPEB cost contributions to the plan, and the net OPEB obligation for the following fiscal years ended were as follows:

Fiscal Year Ended	Annual OPEB Costs	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
June 30, 2009	\$ 495,793	28.07%	\$ 1,074,521
June 30, 2010	\$ 802,051	20.02%	\$ 1,690,246
June 30, 2011	\$ 855,721	24.77%	\$ 2,325,689

Actuarial Methods and Assumptions

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. Calculations are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation and the pattern of sharing of costs between the employer and plan members to that point. Consistent with the long-term perspective of actuarial calculations, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities.

The District’s valuation uses the Projected Unit Credit actuarial cost method to project the Annual Required Contribution and a 4% discount rate. The high rate of annual health care cost increases experienced in recent years is assumed to gradually decrease, 7.6% in 2012, 7.3% in 2013 and 7.0% in 2014. A level dollar amortization of the Unfunded Actuarial Accrued Liability is used over a closed 30-year period.

13. Risk Management

The District is exposed to various risks of loss related to torts, theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District is a member of the Association of California Water Agencies/Joint Powers Insurance Authority (ACWA/JPIA), an intergovernmental risk sharing joint powers authority created to provide self-insurance programs for California water agencies. The purpose of the ACWA/JPIA is to arrange and administer programs of self-insured losses and to purchase excess insurance coverage. At June 30, 2011, the District participated in the liability and property programs of the ACWA/JPIA as follows:

- General and auto liability, public officials and employees’ errors and omissions: Total risk financing self-insurance limits of \$1,000,000, combined single limit at \$1,000,000 per occurrence. The District purchased additional excess coverage layers: \$60 million for general, auto and public officials liability, which increases the limits on the insurance coverage noted above.

13. Risk Management (Continued)

In addition to the above, the District also has the following insurance coverage:

- Employee dishonesty coverage up to \$100,000 per loss includes public employee dishonesty, forgery or alteration and theft, disappearance and destruction coverage.
- Property loss is paid at the replacement cost for property on file, if replaced within two years after the loss, otherwise paid on an actual cash value basis, to a combined total of \$100 million per occurrence, subject to a \$10,000 deductible per occurrence.
- Boiler and machinery coverage for the replacement cost up to \$100 million per occurrence, subject to various deductibles depending on the type of equipment.
- Workers' compensation insurance up to California statutory limits for all work related injuries/illnesses covered by California law.

Settled claims have not exceeded any of the coverage amounts in any of the last three fiscal years and there were no reductions in the District's insurance coverage during the years ending June 30, 2011 and 2010. Liabilities are recorded when it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated net of the respective insurance coverage. Liabilities include an amount for claims that have been incurred but not reported (IBNR). There were no IBNR claims payable as of June 30, 2011 and 2010.

14. Segment Information

The District's 2005A COPs are payable solely from the net revenues of the District's water and sewer systems.

Summary financial information for the water and sewer systems is presented for June 30, 2011.

	Condensed Statement of Net Assets			
	2011			2010
	Water	Sewer	Total	Total
Assets:				
Current assets	\$ 13,783,588	\$ 16,401,467	\$ 30,185,055	\$ 29,582,310
Non-current assets	2,384,739	1,567,328	3,952,067	1,496,038
Capital assets, net	152,321,042	131,931,120	284,252,162	286,932,647
Total assets	168,489,369	149,899,915	318,389,284	318,010,995
Liabilities:				
Current liabilities	6,510,046	5,927,001	12,437,047	10,084,462
Non-current liabilities	30,512,012	37,769,440	68,281,452	69,499,941
Total liabilities	37,022,058	43,696,441	80,718,499	79,584,403
Net assets:				
Invested in capital assets, net of related debt	122,207,971	92,768,428	214,976,399	217,362,952
Restricted for future capital facilities	454	7,369	7,823	6,993
Restricted for debt service	727,845	692,157	1,420,002	1,360,000
Unrestricted	8,531,041	12,735,520	21,266,561	19,696,647
Total net assets	\$ 131,467,311	\$ 106,203,474	\$ 237,670,785	\$ 238,426,592

14. Segment Information (Continued):

Condensed Statement of Revenues, Expenses and Changes in Net Assets

	2011			2010
	Water	Sewer	Total	Total
Operating Revenue	\$ 27,022,956	\$ 14,549,919	\$ 41,572,875	\$ 39,997,535
Operating Expenses:				
Water Division	26,093,160	-	26,093,160	24,722,593
Wastewater Division	-	10,479,451	10,479,451	11,496,840
Depreciation	4,935,105	3,285,409	8,220,514	8,125,933
Total Operating Expenses	31,028,265	13,764,860	44,793,125	44,345,366
Operating Income (Loss)	(4,005,309)	785,059	(3,220,250)	(4,347,831)
Nonoperating Revenues:				
Property taxes	1,216,328	1,029,225	2,245,553	2,438,173
Investment income	77,763	88,544	166,307	283,172
Annexation fees	19,866	24,504	44,370	246,110
Other	38,775	(712)	38,063	11,830
Total Nonoperating Revenues	1,352,732	1,141,561	2,494,293	2,979,285
Nonoperating Expenses:				
Interest	1,566,898	1,078,880	2,645,778	2,793,178
Change in Encina Joint Venture net assets	-	1,662,667	1,662,667	698,832
Total Nonoperating Expenses	1,566,898	2,741,547	4,308,445	3,492,010
Capital Contributions	2,295,443	1,983,152	4,278,595	6,709,625
Total Change in Net Assets	(1,924,032)	1,168,225	(755,807)	1,849,069
Net assets, beginning of year	133,391,343	105,035,249	238,426,592	236,577,523
Net assets, end of year	\$ 131,467,311	\$ 106,203,474	\$ 237,670,785	\$ 238,426,592

Condensed Statement of Cash Flows

	2011			2010
	Water	Sewer	Total	Total
Net cash provided (used) by:				
Operating activities	\$ (539,043)	\$ 3,872,897	\$ 3,333,854	\$ 3,413,135
Non-capital financing activities	1,280,594	1,091,114	2,371,708	2,530,558
Capital and related financing activities	(2,920,236)	(2,491,536)	(5,411,772)	(8,958,365)
Investing activities	(4,962,850)	5,670,003	707,153	2,682,223
Net cash provided	(7,141,535)	8,142,478	1,000,943	(332,449)
Cash and cash equivalents, beginning of year	12,887,024	1,492,971	14,379,995	14,712,444
Cash and cash equivalents, end of year	\$ 5,745,489	\$ 9,635,449	\$ 15,380,938	\$ 14,379,995

15. Commitments and Contingencies

Construction Contracts

The District has a variety of agreements with private parties relating to the installation, improvement or modification of water facilities and distribution systems within its service area. The financing of such construction contracts is being provided primarily from the District’s replacement reserves and advances for construction. The District has committed to approximately \$37,581 in open construction contracts as of June 30, 2011. These include the following:

<u>Project Name</u>	<u>Total Approved Contract(s)</u>	<u>Construction Costs to Date</u>	<u>Remaining Obligation</u>
Center Drive Sewer Replacement	\$ 197,451	159,870	37,581
Total	\$ 197,451	159,870	37,581

Grant Awards

Grant funds received by the District are subject to audit by the grantor agencies. Such audit could lead to requests for reimbursements to the grantor agencies for expenditures disallowed under terms of the grant. Management of the District believes that such disallowances, if any, would not be significant.

Litigation

In the ordinary course of operations, the District is subject to claims and litigation from outside parties. The District is currently in mediation with a contractor over work performed relating to a construction project. The District hopes to settle this case, and estimates its liability to be approximately \$1,500,000. Accordingly, the District has recorded a current liability “Construction Litigation Payable” on the Statement of Net Assets at June 30, 2011.

After consultation with legal counsel, the District believes, with the exception of the amount noted above, the ultimate outcome of such matters, if any, will not materially affect its financial condition.

16. Prepaid PERS Contribution

During the fiscal year, the District prepaid the accumulated PERS side fund liability resulting from risk pooling as of June 30, 2003, valued at \$3,013,545. This value was determined based on a valuation as of June 30, 2009. The prepayment is amortizable over a seven year period and will result in a decrease to the District’s 2011/2012 PERS employer contribution rate of 6.508%. The amount amortizable during fiscal year 2011/2012 (\$430,506) is reported as current prepaid asset on the Statement of Net Assets. The balance of \$2,583,039 which will be amortizable in years after fiscal year 2011/2012 is shown as the non-current asset Prepaid PERS Contribution on the Statement of Net Assets.

17. Subsequent Event

In August 2011, Standard & Poor’s downgraded the AAA rating of the United States government and all federally backed agencies to AA+. Moody’s Investor Service continues to hold its rating of AAA. All securities held by the District are affected by the downgrade, however the underlying value of the securities has not been affected and interest payments continue to be received as scheduled.

REQUIRED SUPPLEMENTARY INFORMATION
YEAR ENDED JUNE 30, 2011

Schedule of Funding Progress for OPEB

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
6/30/2009	\$ -	\$ 6,021,763	\$ 6,021,763	0.00%	\$ 7,984,313	75.42%
6/30/2007	\$ -	\$ 3,678,171	\$ 3,678,171	0.00%	\$ 8,154,171	45.11%

**SUPPLEMENTARY INFORMATION
YEARS ENDED JUNE 30, 2011 AND 2010**

VALLECITOS WATER DISTRICT

Schedule of Operating Expenses - Water Division For the Fiscal Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Purchased Water	\$ 16,468,792	\$ 15,603,958
Pumping:		
Labor	76,793	101,415
Materials and supplies	7,359	8,835
Outside repair	12,134	7,835
Power	170,384	277,631
Total Pumping	<u>266,670</u>	<u>395,716</u>
Water Quality and Treatment:		
Labor	255,074	235,781
Materials and supplies	46,631	33,986
Outside Repair	35,054	40,951
Total Water Treatment	<u>336,759</u>	<u>310,718</u>
Tanks and Reservoirs:		
Labor	311,540	426,427
Materials and supplies	28,607	31,106
Outside repair	57,260	59,249
Power	2,870	2,867
Total Tanks and Reservoirs	<u>400,277</u>	<u>519,649</u>
Transmission and Distribution:		
Labor	822,961	814,549
Materials and supplies	179,720	122,936
Outside repair	105,800	132,285
Power	9,254	9,709
Total Transmission and Distribution	<u>1,117,735</u>	<u>1,079,479</u>
Services:		
Labor	98,422	117,970
Materials and supplies	35,994	33,652
Outside repair	19,147	23,948
Total Services	<u>153,563</u>	<u>175,570</u>
Meters:		
Labor	466,639	508,440
Materials and supplies	34,680	30,945
Outside repair	9,802	5,644
Total Meters	<u>511,121</u>	<u>545,029</u>

VALLECITOS WATER DISTRICT

Schedule of Operating Expenses - Water Division, continued
For the Fiscal Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Backflow Prevention:		
Labor	74,176	68,516
Materials and supplies	1,895	1,420
Total Backflow Prevention	<u>76,071</u>	<u>69,936</u>
Customer Accounts:		
Labor	507,871	500,447
Materials and supplies	76,988	91,001
Uncollectible accounts	70,318	91,526
Outside Repair	30,383	34,965
Total Customer Accounts	<u>685,560</u>	<u>717,939</u>
Equipment and Vehicles:		
Labor, fuel and repairs	199,391	245,230
Materials and supplies	51,734	37,990
Allocated to wastewater division	-	-
Total Equipment and Vehicles	<u>251,125</u>	<u>283,220</u>
Building and Grounds:		
Labor	242,317	225,536
Materials and supplies	55,876	42,775
Outside Repair	81,123	73,898
Power	26,223	30,381
Total Building and Grounds	<u>405,539</u>	<u>372,590</u>
Engineering:		
Labor	1,349,496	1,139,524
Materials and supplies	53,781	7,692
Outside Repair	63,697	26,112
Total Engineering	<u>1,466,974</u>	<u>1,173,328</u>
Safety:		
Labor	180,178	147,343
Materials and supplies	8,687	1,946
Safety support	9,375	10,078
Total Safety	<u>198,240</u>	<u>159,367</u>

VALLECITOS WATER DISTRICT

Schedule of Operating Expenses - Water Division, continued
For the Fiscal Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Information Technology		
Labor	251,037	236,349
Travel	300	424
Dues and subscriptions	1,916	443
Meetings and seminars	-	147
Other materials and supplies	45,691	24,473
Phone	20,738	15,673
Equipment Rent	23,417	21,935
Outside Repair	139,734	150,173
Total Information Technology	<u>482,833</u>	<u>449,617</u>
General and Administration:		
Salaries	1,439,742	1,358,458
Other taxes/benefits	9,518	11,286
Social security	205,874	213,372
Group insurance	581,610	504,902
Public employees' retirement	375,626	353,532
Workers' compensation insurance	7,495	8,037
District insurance	108,621	128,127
Director's expense	35,120	16,073
Director's fees	30,449	33,855
Public awareness	112,360	143,028
Travel	3,572	5,702
Postage	10,944	4,137
Office supplies	52,342	49,169
Dues and subscriptions	62,163	46,298
Meetings and seminars	15,345	15,358
Legal	86,858	133,888
Auditing	20,025	8,741
Outside services	123,375	65,551
Election and annexations	2,907	-
Other	112,920	14,492
Administrative credits transferred	(124,965)	(111,155)
Allocated to wastewater division	-	(136,374)
Total General and Administration	<u>3,271,901</u>	<u>2,866,477</u>
Total Water Division Expenses	<u>\$ 26,093,160</u>	<u>\$ 24,722,593</u>

VALLECITOS WATER DISTRICT

Schedule of Operating Expenses - Wastewater Division For the Fiscal Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Collection System:		
Labor	\$ 1,405,823	\$ 1,363,157
Materials and supplies	72,277	52,780
Chemicals	195,516	165,635
Outside repair	67,032	81,400
Power	1,550	1,416
Total Collection System	<u>1,742,198</u>	<u>1,664,388</u>
Lift Stations:		
Labor	119,555	128,605
Materials and supplies	22,905	26,688
Chemicals	32,037	15,957
Outside repair	19,935	6,753
Power	39,348	39,058
Total Lift Stations	<u>233,780</u>	<u>217,061</u>
Peroxide Station:		
Labor	2,479	3,174
Outside repair	122	-
Power	189	214
Total Peroxide Station	<u>2,790</u>	<u>3,388</u>
Industrial Waste:		
Labor	27,283	29,037
Materials and supplies	20,102	37,807
Total Industrial Waste	<u>47,385</u>	<u>66,844</u>
Encina Disposal	<u>2,097,610</u>	<u>2,162,753</u>
Meadowlark Lift Station:		
Labor	139,988	96,632
Materials and supplies	33,268	60,019
Chemicals	239,094	180,054
Outside repair	47,836	49,841
Power	62,726	76,225
Total Meadowlark Lift Station	<u>522,912</u>	<u>462,771</u>

VALLECITOS WATER DISTRICT

Schedule of Operating Expenses - Wastewater Division, continued
For the Fiscal Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Meadowlark Plant:		
Labor	949,747	960,419
Materials and supplies	274,050	259,528
Chemicals	530,343	705,529
Outside repair	196,771	311,796
Power	351,304	381,741
Telephone	5,812	6,081
Total Meadowlark Plant	<u>2,308,027</u>	<u>2,625,094</u>
Mahr Reservoir:		
Labor	67,220	86,755
Materials and supplies	156,747	130,622
Chemicals	31,146	135,839
Outside repairs	30,797	15,052
Total Mahr Reservoir	<u>285,910</u>	<u>368,268</u>
Customer Accounts:		
Labor	230,106	245,810
Materials and supplies	44,011	30,932
Uncollectible accounts	22,375	6,314
Outside Services	13,913	8,347
Total Customer Accounts	<u>310,405</u>	<u>291,403</u>
Equipment and Vehicles:		
Labor, fuel and repairs	47,729	59,287
Materials and supplies	30,555	38,724
Fuel	43,855	57,127
Total Equipment and Vehicles	<u>122,139</u>	<u>155,138</u>
Buildings and Grounds:		
Labor	98,059	114,404
Materials and supplies	9,107	27,399
Outside repair	35,012	46,867
Power	17,482	20,254
Total Buildings and Grounds	<u>159,660</u>	<u>208,924</u>
Engineering:		
Labor	587,502	816,835
Materials and supplies	10,863	686
Outside repair	12,714	16,076
Total Engineering	<u>611,079</u>	<u>833,597</u>

VALLECITOS WATER DISTRICTSchedule of Operating Expenses - Wastewater Division, continued
For the Fiscal Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Safety:		
Labor	104,567	97,493
Materials and supplies	773	1,297
Outside services	4,748	14,147
Allocated from water division	-	-
Total Safety	<u>110,088</u>	<u>112,937</u>
Information Technology		
Labor	136,590	167,270
Materials and supplies	38,879	39,857.00
Outside services	100,116	124,665
Total Information Technology	<u>275,585</u>	<u>331,792</u>
General and Administration:		
Salaries	581,725	694,906
Other taxes/benefits	3,892	3,194
Social security	80,869	113,809
Group insurance	744,293	736,766
Public employees' retirement	156,259	194,365
Workers' compensation insurance	2,148	3,859
District insurance	72,414	84,157
Director's fees	31,644	33,659
Travel	1,599	3,679
Office supplies	6,510	17,998
Dues and subscriptions	232	22,068
Meetings and seminars	-	7,114
Legal	94,654	128,953
Auditing	13,350	5,991
Outside services	32,129	33,444
Other	5,918	18,906
Transfer from water division	-	136,374
Administrative credits transferred	(178,053)	(246,760)
Total General and Administration	<u>1,649,583</u>	<u>1,992,482</u>
Total Wastewater Division Expenses	<u>\$ 10,479,151</u>	<u>\$ 11,496,840</u>