

ANNUAL FINANCIAL REPORT
WITH INDEPENDENT AUDITOR'S REPORT
BY CERTIFIED PUBLIC ACCOUNTANTS
JUNE 30, 2016

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VALLECITOS WATER DISTRICT

TABLE OF CONTENTS
JUNE 30, 2016

Independent Auditor's Report	1
Management's Discussion and Analysis	4
Basic Financial Statements:	
Statements of Net Position	12
Statements of Revenues, Expenses and Changes in Net Position	13
Statements of Cash Flows	14
Notes to the Basic Financial Statements	16
Required Supplementary Information:	
Schedule of the District's Proportionate Share of the Plan's Net Pension Liability and the Related Ratios as of the Measurement Date	54
Schedule of Plan Contributions	55
Schedule of Funding Progress for OPEB	56
Supplementary Information:	
Schedule of Operating Expenses - Water Division	58
Schedule of Operating Expenses - Wastewater Division	61

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ROGERS, ANDERSON, MALODY & SCOTT, LLP
CERTIFIED PUBLIC ACCOUNTANTS, SINCE 1948

INDEPENDENT AUDITOR'S REPORT

735 E. Carnegie Dr. Suite 100
San Bernardino, CA 92408
909 889 0871 T
909 889 5361 F
ramscpa.net

Board of Directors
Vallecitos Water District
San Marcos, California

Report on the Financial Statements

We have audited the accompanying financial statements of the Vallecitos Water District (the District) as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

PARTNERS

Brenda L. Odle, CPA, MST
Terry P. Shea, CPA
Kirk A. Franks, CPA
Scott W. Manno, CPA, CGMA
Leena Shanbhag, CPA, MST, CGMA
Bradferd A. Welebir, CPA, MBA, CGMA
Jay H. Zercher, CPA (Partner Emeritus)
Phillip H. Waller, CPA (Partner Emeritus)

MANAGERS / STAFF

Jenny Liu, CPA, MST
Seong-Hyea Lee, CPA, MBA
Charles De Simoni, CPA
Nathan Statham, CPA, MBA
Gardenya Duran, CPA
Brianna Schultz, CPA
Daniel Hernandez, CPA, MBA
Lisa Dongxue Guo, CPA, MSA

MEMBERS

American Institute of
Certified Public Accountants

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Quality Center

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

Opinion

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the District as of June 30, 2016 and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America, as well as the accounting systems prescribed by the State Controller's Office and State Regulations governing Special Districts.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, the schedule of the District's proportionate share of the Plan's net pension liability and the related ratios as of the measurement date, the schedule of plan contributions and the schedule of funding progress for OPEB, as listed in the 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 the 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.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the District's basic financial statements. 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 basic financial statements.

The supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated in all material respects in relation to the basic financial statements as a whole.

Rogers, Anderson, Malody & Scott, LLP

San Bernardino, California
November 28, 2016

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MANAGEMENT’S DISCUSSION AND ANALYSIS

Fiscal Year Ended June 30, 2016

Our discussion and analysis of the Vallecitos Water District’s (VWD) financial performance provides an overview of the District’s financial activities for the fiscal year ended June 30, 2016. 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, 2016 (2015/16), the following highlights impacted, or have the potential to impact, the finances of the District.

- On July 8, 2015, VWD refinanced and converted the majority of the 2007 Fixed Rate Bonds into 2015 Revenue Bonds. The refinancing will result in a \$3.4 million savings over the life of the bonds.
- The Claude “Bud” Lewis Carlsbad Desalination Plant became operational on December 15, 2015. In 2013, Vallecitos agreed to receive 3,500 acre feet of desalinated water directly from the plant and installed 250 feet of pipeline and a 20 cubic feet per second metering facility. The pipeline and metering facility were budgeted at \$1.33 million and completed within budget at \$1.25 million.
- On April 11, 2016, the San Elijo Hills Pump Station was brought online to serve approximately 5,500 households. Under an agreement with Olivenhain Municipal Water District (OMWD), signed in 2012, OMWD will treat a minimum of 2,750 acre-feet of water per year at a rate 20% lower than San Diego County Water Authority treatment surcharge. As of June 30, 2016, the District saved \$156,371 in water purchase costs through this agreement.
- On April 20, 2016, the District received both the “District Transparency Certificate of Excellence” and the “District of Distinction” accreditation by the Special District Leadership Foundation. The Certificate of Excellence is a biannual accreditation for sound fiscal management policies and practices. Whereas, the District of Distinction accreditation is awarded after an independent audit of the last three years of operations to ensure prudent fiscal practices.
- Water sales declined by 2,320 acre feet, or 17.9%, from the previous fiscal year due to vigilant conservation efforts by customers. The water sales revenue decline of \$4.6 million was only partially offset by a decline in water purchases of \$141,707. Overall operating revenues decreased year-to-year by \$4.2 million or - 7.5%, primarily due to decreased water sales while total operating expenses increased by \$698,296 or 1.6% over the prior year.
- Operating revenues were not sufficient to cover operating expenses and depreciation, resulting in an operating loss of \$806,851, for the first time since fiscal year 2011/12.
- The investment in Encina Wastewater Authority (EWA) decreased by \$5.6 million due to EWA reallocating the value of its assets among member agencies. The District holds a 23% ownership investment in the assets and capacity of EWA’s sewerage system.
- Multiple capital projects were completed in fiscal year 2015/16 such as the Meadowlark Solids Force Main Replacement \$2.8 million; Linda Vista Sewer Upgrade \$2.6 million; San Elijo Hills Pump Station \$2.1 million and the Desalinated Water Connection \$1.2 million.
- Certificates of Participation decreased by \$2.5 million as the District paid down principal on all debt.
- The District’s net position increased \$1.4 million as capital contributions of \$7.1 million offset the adjustment to EWA’s value and the operating loss.

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.

Statement of Net Position

The Statement of Net Position presents the District's financial position (assets and liabilities) as of June 30, 2016. Assets in excess of liabilities (Net Position) are \$249,393,147. 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.

Statement of Revenues, Expenses, and Changes in Net Position

The Statement of Revenues, Expenses, and Changes in Net Position presents the District's results of operations for the year ended June 30, 2016. Revenues are recognized (recorded) when 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 treatment and disposal services, and processing and delivering recycled water). Non-operating revenues and expenses (e.g. investment income and interest expense) are not directly related to the core activities of the District. Operating loss for the year ended June 30, 2016, of \$806,851 is combined with net non-operating expenses of \$4,884,002 and capital contributions of \$7,083,887 to arrive at an increase in net position of \$1,393,034. The increase in net position is added to restated beginning net position of \$248,000,113 to arrive at ending net position of \$249,393,147 as of June 30, 2016.

	2015/16	2014/15
Operating Income/(Loss)	\$ (806,851)	\$ 4,535,154
Net Nonoperating Revenues/(Expenses)	(4,884,002)	(3,996,773)
Capital contributions	7,083,887	5,143,239
Change in net position	1,393,034	5,681,620
Net Position, Beginning of Year as Previously Stated	251,271,134	242,318,493
Prior Period Adjustment	(3,271,021)	-
Total Net Position, Beginning of Year	248,000,113	242,318,493
Total Net Position, End of Year	\$ 249,393,147	\$ 248,000,113

Statement of Cash Flows

The Statement 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, 2016, is the increase in cash and cash equivalents of \$1,715,461 which is combined with beginning cash and cash equivalents of \$24,985,067 to arrive at ending cash and cash equivalents of \$26,700,528. 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, 2016.

Beginning cash & cash equivalents	\$ 24,985,067
Increase in cash & cash equivalents	1,715,461
Ending cash & cash equivalents	\$ 26,700,528

VALLECITOS WATER DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

OVERVIEW OF THE FINANCIAL STATEMENTS (continued)

As of June 30, 2016, the total cash and cash equivalents are as follows. Restricted cash and cash equivalents are to pay debt service.

	2015/16	2014/15
Cash and cash equivalents (unrestricted)	\$ 23,665,659	\$ 21,918,398
Restricted cash and cash equivalents	3,034,869	3,066,669
Total cash & cash equivalents	<u>\$ 26,700,528</u>	<u>\$ 24,985,067</u>

ANALYSIS OF FINANCIAL POSITION AND RESULTS OF OPERATIONS

During the fiscal year 2016 the increase in net position of \$1,393,034 on page 13 resulted from the increase in total assets and deferred outflows combined with the decrease in total liabilities and increase in deferred inflows. Deferred outflows/inflows are defined in Note 1(D) of the Notes to the Financial Statements.

Operating activities, capital facility fees, property taxes, and other sources helped fund \$10.6 million in capital acquisitions and construction, and \$5.6 million in debt service. The following table summarizes how these capital projects and debt service were financed during the year.

Sources and Uses of Cash & Investments <i>in millions</i>		
	2015/16	2014/15
Sources:		
Operating activities	\$ 9.6	\$ 12.3
Property tax	3.8	3.5
Capital facility fees	3.1	4.0
Other receipts	1.6	0.6
Uses:		
Capital construction and acquisition	(10.6)	(9.1)
Debt service	(5.6)	(5.6)
Increase in cash and investments	<u>\$ 1.9</u>	<u>\$ 5.7</u>

CURRENT-TO-PRIOR YEAR ANALYSIS

Analysis of Net Position

The increase in net position of \$1.4 million is attributable to contributed capital in excess of the operating loss and adjustment in EWA.

Vallecitos Water District's Net Position				
	2015/16	2014/15	Change	
			Amount	%
Cash and investments	\$ 51,223,654	\$ 49,176,454	\$ 2,047,200	4.2%
Capital assets	272,973,229	277,700,512	(4,727,283)	-1.7%
Other assets	10,916,306	9,198,466	1,717,840	18.7%
Total Assets	<u>335,113,189</u>	<u>336,075,432</u>	<u>(962,243)</u>	<u>-0.3%</u>
Deferred Outflows of Resources	4,727,494	1,676,216	3,051,278	182.0%
Current liabilities	14,047,333	13,329,604	717,729	5.4%
Noncurrent liabilities	74,873,342	73,033,119	1,840,223	2.5%
Total Liabilities	<u>88,920,675</u>	<u>86,362,723</u>	<u>2,557,952</u>	<u>3.0%</u>
Deferred Inflows-PERS Contributions	1,526,861	3,388,812	(1,861,951)	-54.9%
Net Position				
Net investment in capital assets	206,775,864	211,866,038	(5,090,174)	-2.4%
Restricted	2,120,022	1,846,519	273,503	14.8%
Unrestricted	38,710,870	34,287,556	4,423,314	12.9%
Total Net Position	<u>\$ 249,393,147</u>	<u>\$ 248,000,113</u>	<u>\$ 1,393,034</u>	<u>0.6%</u>

MANAGEMENT’S DISCUSSION AND ANALYSIS (Continued)

CURRENT-TO-PRIOR YEAR ANALYSIS (Continued)

Analysis of Net Position (continued)

- Cash and investments increased by \$2 million during fiscal year 15/16 inclusive of the market value adjustment on investments.
- The capital assets decrease was the result of the reallocation of assets between member agencies in EWA.
- Receivables for both water and wastewater sales and capital facility fees increased by \$2.6 million which drove the other assets category higher in fiscal year 2015/16.
- Deferred Outflows of Resources increased by \$3 million mainly due to deferred charges from debt retirement resulting from the refinancing of the 2007 Fixed Rate Bonds into 2015 Revenue Bonds.
- Current liabilities increased as a result of payables related to increased water costs and the purchase of a dump truck at year end.
- The premium on refunding the 2005A COPS was higher than the principal paid on outstanding debt in fiscal year 2015/16 thus increasing non-current liabilities.
- The Deferred Inflows-PERS represents changes in actuarial assumptions as of June 30, 2015.

Selected Financial Ratios:

The table below 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 4.41 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 4.31 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 days of operations in cash is a common measure scrutinized by the

	<u>2015/16</u>	<u>2014/15</u>
Current ratio	4.41	4.36
Quick ratio	4.31	4.25
Days of operations in cash	405	395
Capital assets-to-Long-term liabilities	3.65 / 1	3.80 / 1
Debt-to-equity	1 / 2.80	1 / 2.87

rating agencies and investment community. It measures the number of days the District can operate without any cash inflow. The capital-assets-to-long-term-liabilities ratio indicates that for every dollar of debt the District has \$3.65 in capital assets (infrastructure, land, buildings, vehicles, 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 \$2.80 of net position (equity).

Analysis of Revenues and Expenses

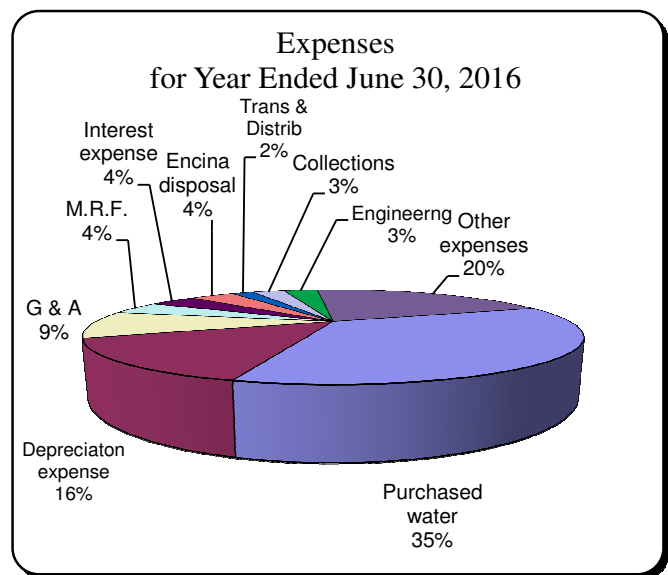
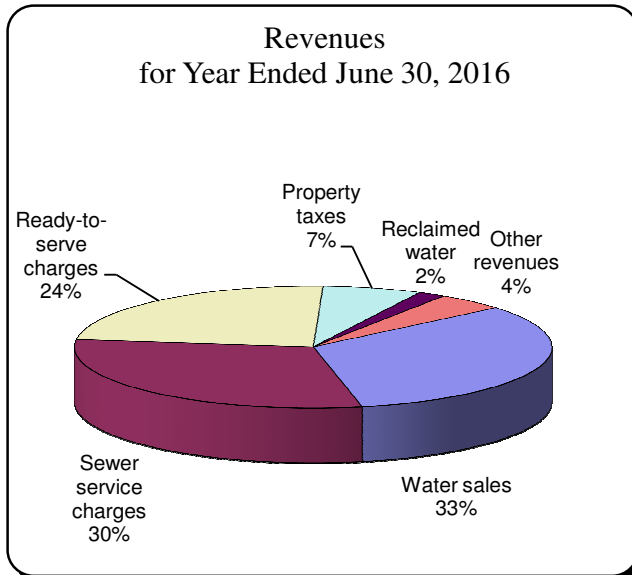
The composition of revenues and expenses for the 2015/16 fiscal year is illustrated in the following graphs. Water sales, ready-to-serve charges, and wastewater service charges continue to be the main sources of revenue funding District operations. Water sales are commodity charges assessed to cover 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.

Deductions from revenue to arrive at the operating loss of \$806,851 include non-cash depreciation and amortization expense of \$9,189,604. Depreciation is the systematic allocation of a capital asset’s cost to expense over a specified period of time. The District has established reserve floors and ceilings for the replacement of aging infrastructure.

VALLECITOS WATER DISTRICT

MANAGEMENT’S DISCUSSION AND ANALYSIS (Continued)

CURRENT-TO-PRIOR YEAR ANALYSIS (Continued)



A comparative analysis of revenues, expenses and discussion of variances between fiscal years are presented below.

Vallecitos Water District's Revenues and Expenses				
	For Fiscal Year:		Change	
	2015/16	2014/15	Amount	%
Water sales	\$ 18,797,274	\$ 23,399,045	\$ (4,601,771)	-19.7%
Wastewater service charges	17,286,888	16,817,149	469,739	2.8%
Ready-to-serve charges	13,602,800	12,958,338	644,462	5.0%
Property taxes	3,830,522	3,460,439	370,083	10.7%
Reclaimed water sales	1,069,074	1,725,650	(656,576)	-38.0%
Other revenues	2,667,926	1,741,710	926,216	53.2%
Total Revenues	57,254,484	60,102,331	(2,847,847)	-4.7%
Purchased water	22,190,912	22,332,619	(141,707)	-0.6%
Depreciation expense	9,189,604	8,847,957	341,647	3.9%
General and administrative	5,851,489	5,197,584	653,905	12.6%
Meadowlark Reclamation Facility (M.R.F.)	2,750,187	2,930,822	(180,635)	-6.2%
Interest expense	2,512,597	2,508,693	3,904	0.2%
Encina disposal	2,485,765	2,493,629	(7,864)	-0.3%
Engineering	1,889,037	1,939,139	(50,102)	-2.6%
Collections	1,756,927	1,878,791	(121,864)	-6.5%
Transmission & Distribution	1,195,405	1,279,927	(84,522)	-6.6%
Other expenses	13,123,414	10,154,789	2,968,625	29.2%
Total Expenses	62,945,337	59,563,950	3,381,387	5.7%
Net Income/(Loss) before contributions	(5,690,853)	538,381	(6,229,234)	-1157.0%
Capital contributions	7,083,887	5,143,239	1,940,648	37.7%
Change in Net Position	1,393,034	5,681,620	(4,288,586)	-75.5%
Total Net Position, Beginning of Year as Previously Stated	251,271,134	242,318,493	8,952,641	-
Prior Period Adjustment	(3,271,021)	-	(3,271,021)	-
Total Net Position at Beginning of Year Restated	248,000,113	242,318,493	5,681,620	2.3%
Total Net Position, End of Year	\$ 249,393,147	\$ 248,000,113	\$ 1,393,034	0.6%

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

CURRENT-TO-PRIOR YEAR ANALYSIS (Continued)

- The decrease in water sales is the result of extraordinary conservation and no rate increase.
- Property tax receipts continue to increase primarily from discontinued Redevelopment Agencies in fiscal year 15/16. The District anticipates receipts from discontinued Redevelopment Agencies to decrease in subsequent years.
- Reclaimed water sales recover the tertiary treatment costs. During fiscal year 2015/16, flows going into the Meadowlark Reclamation Facility decreased significantly due to improvements to the sewer lift station feeding the facility and overall reduced flows from customers using less water in response to the drought restrictions. The reduced costs are further illustrated in the Meadowlark Reclamation Facility line item.
- Other revenues are a mixture of new annexations; investment income received and market valuation increases; pumping charges; recovery of damaged property and delinquency fee receipts.
- General and administration costs increased due to staff directed conservation efforts; rate study; project activity; and regulatory fees.
- Other expenses increased significantly due to recognizing the operating change in Encina Wastewater Authority joint venture assets and the reallocation of overall assets. The District recognizes the change in EWA's assets, liabilities and net position based on the District's ownership percentage of EWA.
- The prior period adjustment is the result of accruing capital facility fee revenue and receivable in fiscal year 14/15. Resolution No. 1441, passed February 5, 2014, allows delay of payment of capacity fees until final building inspection. Thus the District is not owed the fees until such time and therefore no basis exists to record the receivable and related revenue.

RESTRICTIONS, COMMITMENTS, AND LIMITATIONS

The District's net revenue requirement is 1.15 times the total debt service of the District. The District's 2015/16 net revenue was 3.43 times debt service as calculated per the official statement for the bonds. Debt per capita within the District is \$650 exclusive of other debt such as San Diego County Water Authority and Metropolitan Water District.

2015 Revenue Refunding Bonds

On July 9, 2015, the District refunded the majority of the 2005 Certificates of Participation totaling \$45.3 million with Revenue Bonds containing interest rates ranging between 4% and 5%. The District is obligated to transfer semi-annually debt service payments each June 25th (maximum of \$3.9 million in year 2030) and each December 26th (maximum of \$980 thousand in year 2021) to the trustee for payment to bondholders for both the remaining 2005 COPs and 2015 Revenue Bonds. Total debt service paid in fiscal year 15/16 related to the 2005 COPs was \$4.2 million. The outstanding principal balance at June 30, 2016 was \$45,315,000 and \$3,720,000 for the 2015 Revenue Bonds and the 2005 Certificates of Participation respectively.

2012 Certificates of Participation

In December 2012, the District received \$7.1 million in proceeds as the Board of Directors executed the 2nd Installment Purchase Agreement of the Master Agreement of the 2005 Certificates of Participation. The proceeds were used toward the following sewer projects: San Marcos Interceptor, Linda Vista, Encina Land Parallel Outfall and Rock Springs. The District pays debt service semi-annually on the certificates issued at a fixed rate of 1.98%. Interest payments are due each April and October 1st and principal is due each October 1st. Total debt service paid in fiscal year 15/16 related to the COPs was \$781,078. The outstanding principal balance at June 30, 2016, is \$5.1 million.

VALLECITOS WATER DISTRICT

MANAGEMENT’S DISCUSSION AND ANALYSIS (Continued)

RESTRICTIONS, COMMITMENTS, AND LIMITATIONS (continued)

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 1.375953%. 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 15/16 related to the loan was \$476,449. The outstanding principal balance at June 30, 2016, of \$5 million is subordinate to existing certificates of participation.

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, 2016, the water capacity fund had a deficit of \$10,315,457 and the sewer capacity had a deficit of \$6,245,765. (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 2015/16:

Project Description	2016/17 Budget	Spent Through June 30, 2016	Remaining
Encina Land Parallel Outfall	\$ 28,150,000	\$ 148,756	\$ 28,001,244
San Marcos interceptor sewer	19,700,000	13,282,009	6,417,991
Meadowlark Tank #3	4,552,000	488,961	4,063,039
Mountain Belle Pump Station & Pipeline Design	3,860,000	99,350	3,760,650
Rock Springs Sewer Replacement	2,460,000	423,396	2,036,604
Chlorine Contact Tank Expansion	1,950,000	23,801	1,926,199
Montiel Gravity Outfall	1,750,000	1,051	1,748,949

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. Construction of the land outfall, Meadowlark tank, and Mountain Bell project will not commence unless there is significantly more growth than anticipated. Details are provided in the District’s 2016/17 Budget on these and several other committed projects less than \$1 million in scope.

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.

Sewer mains, manholes, and cleanouts	\$ 5,880,119
Water mains, service lines, meters, valves & fire hydrants	3,140,355
Buildings & Improvements	2,319,615
Tank refurbishment	868,701
Reclamation Equipment	453,730

The \$45.3 million in 2015 Revenue Bonds, the \$3.7 million in 2005 COPS, the \$5 million loan and the \$5.1 million in 2012 COPS balance are the only long-term debts owed by the District as of June 30, 2016.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

The District considered the following economic factors in establishing 2016/17 budget amounts:

- Increases to wholesale water rates as the Carlsbad desalination plant is operational
- Slow increases in water usage by customers due to continuing drought conditions
- Slow but steady recovery in construction
- Increasing regulatory compliance

As a result of these factors, the 2016/17 budget includes:

- An increase in water costs to absorb the receipt of desalinated water for the entire year
- Water sales reflective of a slow bounce back from continued drought conservation efforts by customers
- Staffing level decreases from the 2015/16 budget as positions are eliminated through attrition.

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 POSITION
JUNE 30, 2016 (with prior year data for comparison only)**

	<u>2016</u>	<u>2015</u>
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 23,665,659	\$ 21,918,398
Restricted cash and cash equivalents	3,034,869	3,066,669
Investments	24,523,126	24,191,387
Accounts receivable:		
Water and wastewater sales and services	6,067,691	5,434,819
Taxes and assessments	102,479	109,074
Other governmental entities	386,474	1,147,915
Restricted capital facility fees receivable	2,063,749	127,480
Other	464,367	416,254
Accrued interest receivable	95,448	83,500
Current portion of note receivable	133,788	126,813
Inventories	1,062,930	1,053,859
Prepaid expenses	341,962	377,773
Total Current Assets	<u>61,942,542</u>	<u>58,053,941</u>
Noncurrent Assets:		
Restricted capital facility fees receivable	56,273	46,047
Note receivable from City of San Marcos, net of current portion	141,146	274,932
Investment in Encina Wastewater Authority capital assets	25,687,566	31,271,621
Capital assets not being depreciated	25,275,070	29,402,943
Net capital assets being depreciated	<u>222,010,592</u>	<u>217,025,948</u>
Total Noncurrent Assets	<u>273,170,647</u>	<u>278,021,491</u>
Total Assets	<u>335,113,189</u>	<u>336,075,432</u>
DEFERRED OUTFLOWS OF RESOURCES		
Pension related	1,690,587	1,676,216
Deferred charges from debt retirement	3,036,907	-
	<u>4,727,494</u>	<u>1,676,216</u>
LIABILITIES		
Current Liabilities:		
Accounts payable	7,440,746	6,785,848
Accrued compensation	1,850,353	1,804,710
Construction and service deposits	562,856	557,369
Accrued interest payable from restricted assets	1,248,478	1,393,677
Current portion of long term debt	2,898,000	2,788,000
Current portion of capital lease	46,900	-
Total Current Liabilities	<u>14,047,333</u>	<u>13,329,604</u>
Noncurrent Liabilities:		
Other post employment benefits obligation, net	153,980	19,596
Loan payable, net of current portion	4,600,000	5,000,000
Certificates of participation, net of amortized discount and current portion	58,626,003	58,046,475
Capital lease	26,461	-
Net pension liability	<u>11,466,898</u>	<u>9,967,048</u>
Total Noncurrent Liabilities	<u>74,873,342</u>	<u>73,033,119</u>
Total Liabilities	<u>88,920,675</u>	<u>86,362,723</u>
DEFERRED INFLOWS OF RESOURCES		
Pension related	<u>1,526,861</u>	<u>3,388,812</u>
NET POSITION		
Net investment in capital assets	206,775,864	211,866,038
Restricted for future capital projects	2,120,022	173,527
Restricted for debt service	1,786,391	1,672,992
Unrestricted	<u>38,710,870</u>	<u>34,287,556</u>
Total Net Position	<u>\$ 249,393,147</u>	<u>\$ 248,000,113</u>

See accompanying notes to the basic financial statements.

VALLECITOS WATER DISTRICT

**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
FOR THE YEAR ENDED JUNE 30, 2016 (with prior year data for comparison only)**

	<u>2016</u>	<u>2015</u>
OPERATING REVENUES		
Water sales	\$ 18,797,274	\$ 23,399,045
Wastewater service charges	17,286,888	16,817,149
Ready-to-serve charges	13,602,800	12,958,338
Reclaimed water sales	1,069,074	1,725,650
Pumping charges	138,870	170,806
Other services and abatements	945,648	955,635
Total operating revenues	<u>51,840,554</u>	<u>56,026,623</u>
OPERATING EXPENSES		
Purchased water	22,190,912	22,332,619
General and administrative	5,851,489	5,197,584
Meadowlark wastewater treatment plant	2,750,187	2,930,822
Encina disposal	2,485,765	2,493,629
Collection and conveyance	1,756,927	1,878,791
Engineering	1,889,037	1,939,139
Transmission and distribution	1,195,405	1,279,927
Customer accounts	904,015	914,372
Information technology	1,347,023	1,045,315
Meter reading and repairs	713,164	661,883
Buildings and grounds	546,043	529,042
Equipment and vehicles	485,403	566,737
Other water operating expenses	503,378	363,922
Other wastewater operating expenses	539,112	545,551
Water quality and treatment	522,191	489,034
Tanks and reservoirs	371,156	279,886
Pumping	531,774	436,432
Total operating expenses	<u>44,582,981</u>	<u>43,884,685</u>
Operating income before overhead absorption	7,257,573	12,141,938
Overhead absorption	1,125,180	1,241,173
Operating income before depreciation and amortization	8,382,753	13,383,111
Depreciation and amortization	<u>(9,189,604)</u>	<u>(8,847,957)</u>
Operating income	<u>(806,851)</u>	<u>4,535,154</u>
NON-OPERATING REVENUES (EXPENSES)		
Property taxes	3,830,522	3,460,439
Interest Income	338,373	337,472
Unrealized appreciation of investments	139,216	7,659
Annexation fees	1,105,819	117,852
Change in Encina Joint Venture assets	(6,789,867)	(5,559,372)
Interest expense	(2,512,597)	(2,508,693)
Other non-operating revenues/(expenses), net	(995,468)	147,870
Total non-operating revenues (expenses), net	<u>(4,884,002)</u>	<u>(3,996,773)</u>
Net income before capital contributions	(5,690,853)	538,381
Capital contributions	7,083,887	5,143,239
Change in net position	<u>1,393,034</u>	<u>5,681,620</u>
Total Net Position, Beginning of Year	251,271,134	242,318,493
Prior Period Restatement	<u>(3,271,021)</u>	<u>-</u>
Total Net Position, Beginning of Year as Restated	248,000,113	242,318,493
Total Net Position, End of Year	<u>\$ 249,393,147</u>	<u>\$ 248,000,113</u>

See accompanying notes to the basic financial statements.

VALLECITOS WATER DISTRICT**STATEMENTS OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2016 (with prior year data for comparison only)**

	<u>2016</u>	<u>2015</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from water and wastewater customers	\$ 51,921,006	\$ 56,246,453
Payments for water	(21,177,471)	(23,668,023)
Payments for services and supplies	(8,166,276)	(7,879,779)
Payments for employee wages, benefits and related costs	(13,011,519)	(12,406,838)
	<u>9,565,740</u>	<u>12,291,813</u>
Net Cash Provided by Operating Activities		
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Receipts from taxes and assessments	<u>3,837,118</u>	<u>3,450,783</u>
Net Cash Provided by Noncapital Financing Activities	<u>3,837,118</u>	<u>3,450,783</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Receipts relating to annexation fees and cell tower rentals	1,146,717	170,862
Acquisition and construction of utility plant	(9,269,828)	(6,456,756)
Principal paid on long-term debt	(3,183,947)	(2,695,000)
Interest payments on long-term debt	(2,367,734)	(2,917,335)
Principal paid on capital lease	(20,132)	-
Investment in Encina Wastewater Authority	(1,318,751)	(2,666,552)
Capacity fees received	<u>3,065,561</u>	<u>4,050,700</u>
Net Cash Used for Capital and Related Financing Activities	<u>(11,948,114)</u>	<u>(10,514,081)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	(20,076,820)	(13,667,988)
Proceeds from calls and maturities of investments	19,884,298	15,371,753
Investment earnings received	326,426	320,338
Collections on note receivable from City of San Marcos	<u>126,813</u>	<u>120,202</u>
Net Cash Provided by Investing Activities	<u>260,717</u>	<u>2,144,305</u>
Net Increase in Cash and Cash Equivalents	1,715,461	7,372,820
Cash and Cash Equivalents, Beginning of Year	<u>24,985,067</u>	<u>17,612,247</u>
Cash and Cash Equivalents, End of Year	<u>\$ 26,700,528</u>	<u>\$ 24,985,067</u>
Reconciliation of cash and cash equivalents to statement of net position:		
Cash and cash equivalents	\$ 23,665,659	\$ 21,918,398
Restricted cash and cash equivalents	<u>3,034,869</u>	<u>3,066,669</u>
Total cash and cash equivalents	<u>\$ 26,700,528</u>	<u>\$ 24,985,067</u>

See accompanying notes to the basic financial statements.

VALLECITOS WATER DISTRICT

**STATEMENTS OF CASH FLOWS (Continued)
FOR THE YEAR ENDED JUNE 30, 2016 (with prior year data for comparison only)**

Reconciliation of Operating Income (Loss) to Net Cash Provided by Operating Activities:	2016	2015
Operating income (loss)	\$ (806,851)	\$ 4,535,154
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation expense	9,189,604	8,847,957
Changes in operating assets and liabilities:		
Accounts receivable from water and wastewater sales and services	(632,872)	670,015
Accounts receivable from other governmental entities	761,441	(412,645)
Accounts receivable - other	(48,113)	(37,541)
Inventories	(9,071)	61,495
Prepaid expenses	35,811	(14,910)
Accounts payable	1,272,236	(1,057,938)
Accrued compensation	45,643	99,280
Deferred outflows of resources - pension related	(14,371)	(72,428)
Deferred inflows of resources - pension related	(1,861,951)	3,335,311
Net pension liability	1,499,850	(3,651,524)
Other post employment benefits obligation, net	134,384	(10,413)
Total Adjustments	10,372,591	7,756,659
Net Cash Provided by Operating Activities	\$ 9,565,740	\$ 12,291,813
Noncash Investing Capital and Financing Activities:		
Contributions of assets by developers	\$ 1,508,402	\$ 549,078
Unrealized appreciation of investments	139,216	7,659

See accompanying notes to the basic financial statements.

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS

JUNE 30, 2016 (with select prior year data for comparison only)

Note 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 has 21,401 active water meters and 20,621 active sewer accounts at June 30, 2016.

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 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 Position. The Statement of Revenues, Expenses and Changes in Net Position present increases (revenues) and decreases (expenses) in total Net Position. 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).

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS

JUNE 30, 2016 (with select prior year data for comparison only)

Note 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 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 Position of the District are classified into three components: (1) net investment in capital assets, (2) restricted net position, and (3) unrestricted net position. These classifications are defined as follows:

Net Investment in Capital Assets

This component of net position 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 net investment in capital assets.

Restricted Net Position

This component of net position consists of constraints placed on net position 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 Position

This component of net position consists of net position that does not meet the definition of "net investment in capital assets" or "restricted net position."

C. New Accounting Pronouncements

During the fiscal year ended June 30, 2016, the District implemented the following Governmental Accounting Standards Board (GASB) standards:

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)

Note 1 – Reporting Entity and Summary of Significant Accounting Policies (continued)

C. New Accounting Pronouncements (continued)

- *GASB 72 – Fair Value Measurement and Application* This Statement addresses accounting and financial reporting issues related to fair value measurements. The definition of *fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.
- *GASB 82 – Pension Issues – An Amendment of GASB Statements No. 67, 68 and 73.* This Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

D. Deferred Outflows/Inflows of Resources

In addition to assets, the statement of net position reports a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources*, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense) until then.

In addition to liabilities, the statement of net position reports a separate section for deferred inflows of resources. This separate financial statement element, *deferred inflows of resources*, represents an acquisition of net position that applies to a future period(s) and will not be recognized as an inflow of resources (revenue) until that time.

E. 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 position during the reporting period. Actual results could differ from those estimates.

F. Statement of Cash Flows

For the purpose of the statement of cash flows, the District's cash is invested in interest bearing accounts. The District considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)

Note 1 – Reporting Entity and Summary of Significant Accounting Policies (continued)

G. Investments and Investment Policy

The District has adopted an investment policy directing the District's 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.

H. 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.

I. 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 Position and as capital grant contribution or operating grant revenue, as appropriate, on the Statement of Revenues, Expenses and Changes in Net Position.

J. 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

K. 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.

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)

Note 1 – Reporting Entity and Summary of Significant Accounting Policies (continued)

L. 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.

M. Prepaid Expenses

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

N. 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 Position. 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 expenses meeting the criteria imposed on the use of restricted resources by a third party.

O. 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 \$10,000. 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	7-15 years
Field and shop equipment	5-20 years
Office equipment	3-10 years

P. 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.

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS

JUNE 30, 2016 (with select prior year data for comparison only)

Note 1 – Reporting Entity and Summary of Significant Accounting Policies (continued)

Q. Construction Deposits

Construction deposits represent deposits received in aid of construction, which are refundable if the applicable construction does not take place. Construction deposits 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, 2016 the District expensed \$2,512,597 of interest incurred and capitalized \$144,497 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, Olivenhain Municipal Water District, and the Claude “Bud” Lewis Carlsbad Desalination Plant via 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. Pension Plan

For purposes of measuring the net pension liability, deferred outflows and inflows of resources related to pensions, and pension expense, information about the fiduciary net position and additions to/deductions from the fiduciary net position have been determined on the same basis as they are reported by the CalPERS Financial Office. For this purpose, benefit payments (including refunds of employee contributions) are recognized when currently due and payable in accordance with the benefit terms.

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)

Note 1 – Reporting Entity and Summary of Significant Accounting Policies (continued)

W. Pension Plan (continued)

Investments are reported at fair value. CalPERS audited financial statements are publicly available reports that can be obtained at CalPERS' website under Forms and Publications.

GASB 68 requires that the reported results must pertain to liability and asset information within certain defined timeframes. For this report, the following timeframes are used.

Valuation Date (VD)	June 30, 2014
Measurement Date (MD)	June 30, 2015
Measurement Period (MP)	July 1, 2014 to June 30, 2015

Note 2 – Cash and Investments

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

	<u>2016</u>	<u>2015</u>
Cash and cash equivalents	\$ 23,665,659	\$ 21,918,398
Restricted cash and cash equivalents	3,034,869	3,066,669
Investments	<u>24,523,126</u>	<u>24,191,387</u>
Total cash and investments	<u>\$ 51,223,654</u>	<u>\$ 49,176,454</u>

Cash and Investments consist of the following:

	<u>2016</u>	<u>2015</u>
Cash on hand	\$ 2,000	\$ 1,700
Deposits with financial institutions	3,446,184	3,366,313
Investments	<u>47,775,470</u>	<u>45,808,441</u>
Total cash and investments	<u>\$ 51,223,654</u>	<u>\$ 49,176,454</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.

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS JUNE 30, 2016 (with select prior year data for comparison only)

Note 2 – Cash and Investments (continued)

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio	Maximum Investment in One Issuer
U.S. Treasury Obligations	5 years	75%	None
U.S. Government Sponsored Entities	5 years	20%	20%
Commercial Paper	270 days	20%	10%
Certificates of Deposit	5 years	20%	5%
Repurchase Agreements	1 year	10%	10%
Local Government Investment Pools	N/A	40%	20%
Local Agency Investment Fund (LAIF)	N/A	60%	\$ 65,000,000
State and Local Agency Bonds	5 years	20%	25%
FDIC - Backed Medium-Term Notes	4 years	20%	FDIC limit
Savings Accounts	N/A	10%	10%

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 \$589,091 as of June 30, 2016.

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS JUNE 30, 2016 (with select prior year data for comparison only)

Note 2 – Cash and Investments (continued)

Custodial Credit Risk (continued)

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.

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 any time 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 23.

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.

VALLECITOS WATER DISTRICT

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)**

Note 2 – Cash and Investments (continued)

Interest Rate Risk (continued)

Maturities of investments at June 30, 2016 are as follows:

Investment Type	Total	Remaining Maturity (in months)		
		12 months or less	13-24 Months	26-60 Months
Federal Farm Credit Banks	\$ 2,603,074	\$ 101,862	\$ 1,000,020	\$ 1,501,192
Federal Home Loan Bank	2,510,415	1,004,990	-	1,505,425
Federal Home Loan Mortgage Association	6,272,924	1,002,340	1,000,190	4,270,394
Federal National Mortgage Association	5,026,370	1,765,935	1,505,460	1,754,975
Certificates of Deposit	4,615,447	1,226,534	1,233,658	2,155,255
Commercial Paper	3,483,760	3,483,760	-	-
Local Agency Investment Fund (LAIF)	18,127,480	18,127,480	-	-
San Diego County Pooled Investment Fund	5,136,000	5,136,000	-	-
	<u>\$ 47,775,470</u>	<u>\$ 31,848,901</u>	<u>\$ 4,739,328</u>	<u>\$ 11,187,241</u>

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, 2016 were as follows:

Investment Type	Total	Minimum Legal Rating	Rating as of Year End		
			AAA	AA+	Not Rated
Federal Farm Credit Banks	\$ 2,603,074	AA+	\$ -	\$ 2,603,074	\$ -
Federal Home Loan Bank	2,510,415	AA+	-	2,510,415	-
Federal Home Loan Mortgage Association	6,272,924	AA+	-	6,272,924	-
Federal National Mortgage Association	5,026,370	AA+	-	5,026,370	-
Certificates of Deposit	4,615,447	N/A	-	-	4,615,447
Commercial Paper	3,483,760	N/A	-	-	3,483,760
Local Agency Investment Fund (LAIF)	18,127,480	N/A	-	-	18,127,480
San Diego County Pooled Investment Fund	5,136,000	N/A	5,136,000	-	-
	<u>\$ 47,775,470</u>		<u>\$ 5,136,000</u>	<u>\$ 16,412,783</u>	<u>\$ 26,226,687</u>

VALLECITOS WATER DISTRICT

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)**

Note 2 – Cash and Investments (continued)

Credit Risk (continued)

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 at June 30, 2016 are as follows:

Issuer	Investment Type	Reported Amount
Federal Farm Credit Banks	U.S. Government Sponsored Entities	\$ 2,603,074
Federal Home Loan Bank	U.S. Government Sponsored Entities	2,510,415
Federal Home Loan Mortgage Association	U.S. Government Sponsored Entities	6,272,924
Federal National Mortgage Association	U.S. Government Sponsored Entities	5,026,370

Fair Value Measurements

The District categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

The District has the following recurring fair value measurements as of June 30, 2016:

Investments by Fair Value Level	Fair Value Measurement Using			
	Total	Level 1	Level 2	Level 3
U.S. Treasury Obligations	\$ 16,412,783	\$ -	\$ 16,412,783	\$ -
Commercial Paper	3,483,760	-	3,483,760	-
San Diego County Pooled Investment Fund	5,136,000	-	5,136,000	-
Total investments by fair value	25,032,543	\$ -	\$ 25,032,543	\$ -
Investments measured at the Net Asset Value (NAV)				
Local Agency Investment Fund (LAIF)	18,127,480			
Investments not subject to GASB 72				
Certificates of Deposit	4,615,447			
Total	\$ 47,775,470			

The U.S. Treasury obligations and commercial paper classified in Level 2 of the fair value hierarchy are valued using a matrix pricing technique. Matrix pricing is used to value securities based on the securities' relationship to benchmark quoted prices.

VALLECITOS WATER DISTRICT

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)**

Note 3 – Accounts Receivable

The balance at June 30, 2016 consists of the following:

	<u>2016</u>	<u>2015</u>
Accounts receivable - water and wastewater sales and services	\$ 6,106,139	\$ 5,473,280
Allowance for uncollectible accounts	<u>(38,448)</u>	<u>(38,461)</u>
Accounts receivable - water sales, net	<u>\$ 6,067,691</u>	<u>\$ 5,434,819</u>

Property Tax Receivable

Taxes and assessments receivable of \$106,211 have been reduced by an allowance for estimated uncollectible taxes of \$3,732 at June 30, 2016.

Note 4 – Capital Assets

Changes in capital assets for 2016 are as follows:

	<u>Balance at June 30, 2015</u>	<u>Additions/ Transfers</u>	<u>Deletions/ Transfers</u>	<u>Balance at June 30, 2016</u>
Capital assets, not being depreciated:				
Land	\$ 4,761,505	\$ 220,000	\$ -	\$ 4,981,505
Construction in progress	<u>24,641,438</u>	<u>12,767,407</u>	<u>(17,115,280)</u>	<u>20,293,565</u>
Total capital assets, not being depreciated	<u>29,402,943</u>	<u>12,987,407</u>	<u>(17,115,280)</u>	<u>25,275,070</u>
Capital assets, being depreciated:				
Water transmission and distribution system	190,810,104	6,353,458	(222,086)	196,941,476
Wastewater system	117,102,203	6,422,745	(46,604)	123,478,344
Buildings	15,311,551	115,710	-	15,427,261
Transportation equipment	4,130,159	452,637	(67,138)	4,515,658
Field and shop equipment	10,709,739	882,085	(389,850)	11,201,974
Office equipment	<u>2,277,078</u>	<u>151,578</u>	<u>(85,031)</u>	<u>2,343,625</u>
Total capital assets, being depreciated	<u>340,340,834</u>	<u>14,378,213</u>	<u>(810,709)</u>	<u>353,908,338</u>
Less accumulated depreciation for:				
Water transmission and distribution system	(62,489,051)	(4,499,804)	18,401	(66,970,454)
Wastewater system	(37,206,829)	(2,279,546)	46,324	(39,440,051)
Buildings	(11,152,707)	(1,270,047)	-	(12,422,754)
Transportation equipment	(2,656,443)	(346,580)	67,138	(2,935,885)
Field and shop equipment	(8,171,940)	(567,179)	389,850	(8,349,269)
Office equipment	<u>(1,637,916)</u>	<u>(226,448)</u>	<u>85,031</u>	<u>(1,779,333)</u>
Total accumulated depreciation	<u>(123,314,886)</u>	<u>(9,189,604)</u>	<u>606,744</u>	<u>(131,897,746)</u>
Total capital assets, being depreciated, net	<u>217,025,948</u>	<u>5,188,609</u>	<u>(203,965)</u>	<u>222,010,592</u>
Total capital assets, net	<u>\$ 246,428,891</u>	<u>\$ 18,176,016</u>	<u>\$ (17,319,245)</u>	<u>\$ 247,285,662</u>

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)

Note 4 – Capital Assets (continued)

In 2016, major capital assets additions during the year included vehicles, sewer and water mains, manholes, sewer buildings and improvements, and valves and fire hydrants.

Depreciation expense for the ended June 30, 2016 was \$9,189,604 and is included in Depreciation and Amortization expense on the Statement of Revenues, Expense and Changes in Net Position. The difference between deletions from CIP and capital asset additions is made up of the following:

Contributed capital	\$ 1,630,607
Loss on land	(1,052,765)
Investment in Encinca Wastewater Authority	(1,381,022)
Corrections to projects	(770,078)
Expensed projects/other	<u>(1,163,809)</u>
	<u>\$ (2,737,067)</u>

Assets acquired through capital leases are as follows:

Equipment	\$ 93,493
Less: accumulated depreciation	<u>(4,675)</u>
Total	<u>\$ 88,818</u>

VALLECITOS WATER DISTRICT

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)**

Note 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>2016</u>	<u>2015</u>
<i>District Financed</i>		
SM interceptor - SM Blvd/Discovery	\$ 13,282,009	\$ 13,103,661
Lift Station No 1 Pump Improvements	1,035,335	380,979
Water & Sewer Master Plan	745,708	425,473
San Elijo Road Facilities	641,279	641,279
Meadowlark Tank #3	488,961	488,961
Rock Springs Sewer Replacement	423,396	366,557
Audio Visual Upgrade	408,098	-
Land Outfall Clearing & Access Road	336,422	77,709
Knoll Road Sewer Replacement	229,397	22,768
Encina Land Parallel Outfall	148,756	146,462
Mountain Belle Pump Station & Pipeline Design	99,350	99,350
HVAC Improvements	76,287	76,287
Lift Station 1 Perimeter Fencing	75,782	15,051
MRF Potable Water Pump Station	63,641	-
Palos Vista Pump Station	61,081	44,477
Permanent Environmental Mitigation Property	59,646	59,646
Linda Vista Sewer Upgrade	-	2,513,608
San Elijo Hills Pump Station Project	-	1,627,898
Wulff Reservoir/Pressure Reducing Station	-	1,258,394
Desalinated Water Connection	-	582,176
MRF Solids Force Main Replacement	-	303,530
Mobile Maximo	-	132,823
Master Plc Replacement & Programming Updates	-	127,406
Mechanical Electrical Department Offices	-	112,132
Twin Oaks Resv. On-Site Sodium Hypo Generation	-	100,161
Mahr Reservoir Chlorine Injection System	-	74,673
San Marino Drive Sewer Replacement	-	73,008
Mrf Nutrient Removal Study	-	72,237
Scada Radio Antenna Masts Fy12/13	-	60,230
Sluice Gate Dam	-	53,676
Subtotal - District Financed	<u>\$ 18,175,148</u>	<u>\$ 23,040,612</u>

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)

Note 4 – Capital Assets (continued)

	<u>2016</u>	<u>2015</u>
<i>Developer Financed</i>		
High Point Hydropneumatic Pump	\$ 113,477	\$ 102,594
Recycled Water Business Plan	101,368	99,738
Twin Oaks Corner Improvements	71,709	9,176
Block C North City East Unit 1	71,205	40,545
Palos Vista Estates	59,792	59,792
Promenade At Creekside	55,876	26,769
San Marcos Unified School District K-8	50,873	13,024
San Marcos Creek Improvement Plan	22,107	20,123
Grand Avenue City	14,879	14,879
Pump Station Meadowlark	12,860	10,920
Mulberry Residential	-	26,259
Palomar College Waterline Relocation	-	25,664
Fairfield Inn - Carlsbad	-	21,281
Seh Ph5 Pa S U5 - San	-	18,105
Seh Ph5 Pa S U4 - San	-	11,481
Subtotal - Developer Financed	<u>574,146</u>	<u>500,350</u>
Various Other Projects	<u>1,544,271</u>	<u>1,100,478</u>
Total	<u>\$ 20,293,565</u>	<u>\$ 24,641,438</u>

Note 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, 2016, the Member Agencies have the following approximate ownership interest:

City of Vista	25%
City of Carlsbad	24%
Vallecitos Water District	23%
Leucadia Wastewater District	17%
Buena Sanitation District	7%
City of Encinitas	4%

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)

Note 5 – Encina Wastewater Authority (continued)

The latest available financial statements of EWA, dated June 30, 2015 and 2014 are available directly from EWA (6200 Avenida Encinas, Carlsbad, California 92009), and show the following:

	<u>2015</u>	<u>2014</u>
Total assets	\$ 136,169,841	\$ 122,157,791
Deferred outflows of resources	1,399,418	-
Total liabilities	12,873,486	3,044,612
Deferred inflows of resources	<u>1,982,996</u>	<u>-</u>
Total net position	<u>\$ 122,712,777</u>	<u>\$ 119,113,179</u>
Increase (decrease) in net position	<u>\$ 3,599,598</u>	<u>\$ (4,822,053)</u>

Note 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, 2016, the following amounts are due to the District:

<u>Fiscal Year</u>	<u>Principal Amount</u>
2017	\$ 133,788
2018	<u>141,146</u>
Total	274,934
Current Portion	<u>(133,788)</u>
Non-Current Portion	<u>\$ 141,146</u>

VALLECITOS WATER DISTRICT

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)**

Note 7 – 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.

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 5.50%. 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 2016, the District was in compliance with this rate covenant.

Changes in the 2005 Certificates of Participation during fiscal year 2016, and the balance at June 30, 2016 net of unamortized premiums and discounts were as follows:

	Balance June 30, 2015	Additions	Deletions	Balance June 30, 2016
2005 Series A COP	\$ 53,775,000	\$ -	\$ (50,055,000)	\$ 3,720,000
Add: Bond premium	1,236,842	-	(1,192,653)	44,189
Less: Unamortized discount	(324,857)	-	313,251	(11,606)
	<u>\$ 54,686,985</u>	<u>\$ -</u>	<u>\$ (50,934,402)</u>	<u>\$ 3,752,583</u>
Total				
Less: Current portion	<u>(1,715,000)</u>			<u>(1,810,000)</u>
Long-term portion	<u>\$ 52,971,985</u>			<u>\$ 1,942,583</u>

VALLECITOS WATER DISTRICT

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)**

Note 7 – Long Term Debt (continued)

2005 Certificates of Participation (continued)

Annual debt service payments are as follows:

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2017	\$ 1,810,000	\$ 2,609,013	\$ 4,419,013
2018	<u>1,910,000</u>	<u>2,509,463</u>	<u>4,419,463</u>
Total	3,720,000	<u>\$ 5,118,476</u>	<u>\$ 8,838,476</u>
Less current portion	<u>(1,810,000)</u>		
Total non-current portion	<u>\$ 1,910,000</u>		

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.

2012 Certificates of Participation

On December 5, 2012, the Board of Directors of the Vallecitos Water District authorized the issuance of debt. The District received \$7.1 million of proceeds at a 1.98% fixed interest rate over the ten year life of the loan. The proceeds will support the San Marcos Sewer Interceptor and Linda Vista Sewer Line projects.

Changes in the 2012 Certificates of Participation amounts for the 2016 fiscal year were as follows:

	<u>June 30, 2015</u>	<u>Additions</u>	<u>Deletions</u>	<u>June 30, 2016</u>
2012 COP	\$ 5,795,000	\$ -	\$ (673,000)	\$ 5,122,000
Less: Current portion				<u>(688,000)</u>
Long-term portion	<u>\$ 5,122,000</u>			<u>\$ 4,434,000</u>

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)

Note 7 – Long Term Debt (continued)

2012 Certificates of Participation (continued)

Annual debt service payments are as follows:

Fiscal Year	Principal	Interest	Total
2017	\$ 688,000	\$ 94,605	\$ 782,605
2018	702,000	80,844	782,844
2019	741,000	66,558	807,558
2020	725,000	52,044	777,044
2021	739,000	37,550	776,550
2022-2023	1,527,000	30,403	1,557,403
Total	5,122,000	<u>\$ 362,004</u>	<u>\$ 5,484,004</u>
Less current portion	<u>(688,000)</u>		
Total non-current portion	<u>\$ 4,434,000</u>		

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% (1.37953% at June 30, 2016). Principal payments of \$200,000 plus interest are payable semi-annually and maturing in 2028.

Changes in the 2008 loan payable for the year ended June 30, 2016 were as follows:

	<u>June 30, 2015</u>	<u>Additions</u>	<u>Deletions</u>	<u>June 30, 2016</u>
2008 UBOC loan	\$ 5,400,000	\$ -	\$ (400,000)	\$ 5,000,000
Less: Current portion	<u>(400,000)</u>			<u>(400,000)</u>
Long-term portion	<u>\$ 5,000,000</u>			<u>\$ 4,600,000</u>

VALLECITOS WATER DISTRICT

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)**

Note 7 – Long Term Debt (continued)

2008 Loan Payable (continued)

Annual debt service payments are as follows:

Fiscal Year	Principal	Interest	Total
2017	\$ 400,000	\$ 70,649	\$ 470,649
2018	400,000	68,832	468,832
2019	400,000	66,531	466,531
2020	400,000	63,694	463,694
2021	400,000	60,266	460,266
2022-2026	2,000,000	224,549	2,224,549
2027-2029	1,000,000	37,194	1,037,194
Total	5,000,000	<u>\$ 591,715</u>	<u>\$ 5,591,715</u>
Less current portion	<u>(400,000)</u>		
Total non-current portion	<u>\$ 4,600,000</u>		

2015 Refunding Revenue Bonds

On July 9, 2015, the District issued \$45,315,000 of Refunding Revenue Bonds, due July 1, 2035. The 2015 Bonds were issued to provide funds to provide a portion of the money to prepay a portion of the currently outstanding 2005A Certificates of Participation, and to pay costs of the issuance of the 2015 Bonds.

Changes in the 2015 Refunding Revenue Bonds for the year ended June 30, 2016 were as follows:

	June 30, 2015	Additions	Deletions	June 30, 2016
2015 Refunding Revenue Bonds	\$ -	\$ 45,315,000	\$ -	\$ 45,315,000
Add: Bond premium	-	7,299,390	(364,970)	6,934,420
Less: Current portion	-			-
Long-term portion	<u>\$ -</u>			<u>\$ 52,249,420</u>

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)

Note 7 – Long Term Debt (continued)

2015 Refunding Revenue Bonds (continued)

Annual debt service payments are as follows:

Fiscal Year	Principal	Interest	Total
2017	\$ -	\$ 2,246,700	\$ 2,246,700
2018	-	2,246,700	2,246,700
2019	1,905,000	2,208,600	4,113,600
2020	2,020,000	2,120,000	4,140,000
2021	2,125,000	2,016,375	4,141,375
2022-2026	12,355,000	8,332,625	20,687,625
2027-2031	15,850,000	4,824,500	20,674,500
2032-2036	11,060,000	1,438,250	12,498,250
Total	45,315,000	<u>\$25,433,750</u>	<u>\$70,748,750</u>
Less current portion	<u>-</u>		
Total non-current portion		<u>\$45,315,000</u>	

Capital Lease

The District entered into a 24-month lease agreement with APG Nueros on December 17, 2015 for the purchase of a Turbo Blower. Changes in the capital lease payable for the year ended June 30, 2016 were as follows:

	Balance June 30, 2015	Additions	Deletions	Balance June 30, 2016
Capital lease	\$ -	\$ 93,493	\$ (20,132)	\$ 73,361
Less: Current portion	<u>-</u>			<u>(46,900)</u>
Long-term portion	<u>\$ -</u>			<u>\$ 26,461</u>

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)

Note 8 – Net Position

a. Net Investment In Capital Assets

Net Investment in Capital Assets at June 30 consists of the following:

	<u>2016</u>	<u>2015</u>
Investment in Encina Wastewater Authority capital assets	\$ 25,687,566	\$ 31,271,621
Capital assets not being depreciated	25,275,070	29,402,943
Net capital assets being depreciated	222,010,592	217,025,948
Certificates of participation - current portion	(2,498,000)	(2,388,000)
Loan payable - UBOC - current portion	(400,000)	(400,000)
Certificates of participation - noncurrent portion	(58,626,003)	(58,046,474)
Loan payable - UBOC - noncurrent portion	(4,600,000)	(5,000,000)
Capital lease payable - current portion	(46,900)	-
Capital lease payable - noncurrent portion	(26,461)	-
Total net investment in capital assets	<u>\$ 206,775,864</u>	<u>\$ 211,866,038</u>

b. Restricted Net Position

Restricted net position at June 30 consists of the following:

	<u>2016</u>	<u>2015</u>
Restricted for debt service	\$ 1,786,391	\$ 1,672,992
Restricted for future capital projects	2,120,022	173,527
Total restricted net position	<u>\$ 3,906,413</u>	<u>\$ 1,846,519</u>

c. Unrestricted Net Position

Unrestricted net position at June 30 consists of the following:

	<u>2016</u>	<u>2015</u>
Nonspendable net position		
Inventories	\$ 1,062,930	\$ 1,053,859
Prepaid expenses	341,962	377,773
Total nonspendable net position	<u>1,404,892</u>	<u>1,431,632</u>
Spendable net position		
Unrestricted net position	<u>37,305,978</u>	<u>32,855,924</u>
Total unrestricted net position	<u>38,710,870</u>	<u>34,287,556</u>
Total net position	<u>\$ 249,393,147</u>	<u>\$ 248,000,113</u>

VALLECITOS WATER DISTRICT

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)**

Note 9 – Defined Benefit Pension Plan

A. General Information about the Pension Plan

Plan Description

All qualified permanent and probationary employees are eligible to participate in the Public Agency Cost-Sharing Multiple-Employer Defined Benefit Pension Plan (Plan) administered by the California Public Employees' Retirement System (CalPERS.) The Plan consists of individual rate plans (benefit tiers) within a safety risk pool (police and fire) and a miscellaneous risk pool (all other). Plan assets may be used to pay benefits for any employer rate plan of the safety and miscellaneous pools. Accordingly, rate plans within the safety or miscellaneous pools are not separate plans under GASB Statement No. 68. Individual employers may sponsor more than one rate plan in the miscellaneous or safety risk pools. The District sponsors two miscellaneous rate plans. Benefit provisions under the Plan are established by State statute and District resolution. CalPERS issues publicly available reports that include a full description of the pension plan regarding benefit provisions, assumptions and membership information that can be found on the CalPERS' website.

Benefits Provided

CalPERS provides service retirement and disability benefits, annual cost of living adjustments and death benefits to plan members, who must be public employees and beneficiaries. Benefits are based on years of credited service, equal to one year of full time employment. Members with five years of total service are eligible to retire at age 50 with statutorily reduced benefits. All members are eligible for non-duty disability benefits after 5 years of service. The death benefit is one of the following: the Basic Death Benefit, the 1957 Survivor Benefit, or the Optional Settlement 2W Death Benefit. The cost of living adjustments for each plan are applied as specified by the Public Employees' Retirement Law.

The Plan operates under the provisions of the California Public Employees' Retirement Law (PERL), the California Public Employees' Pension Reform Act of 2013 (PEPRA), and the regulations, procedures and policies adopted by the CalPERS Board of Administration. The Plans' authority to establish and amend the benefit terms are set by the PERL and PEPRA, and may be amended by the California state legislature and in some cases require approval by the CalPERS Board.

The Plan's provisions and benefits in effect at June 30, 2016 are summarized as follows:

Hire date	Prior to January 1, 2013	On or after January 1, 2013
Benefit formula	3% @ 60	2% @ 62
Benefit vesting schedule	5 years service	5 years service
Benefit payments	monthly for life	monthly for life
Retirement age	50 - 60	52 - 62
Monthly benefits, as a % of eligible compensation	2.0% to 3.0%	1.0% to 2.0%
Required employee contribution rates	8%	6.25%
Required employer contribution rates	18.822%	6.25%

VALLECITOS WATER DISTRICT

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)**

Note 9 – Defined Benefit Pension Plan (continued)

A. General Information about the Pension Plans (continued)

Contributions

Section 20814(c) of the California Public Employees' Retirement Law (PERL) requires that the employer contribution rates for all public employers be determined on an annual basis by the actuary and shall be effective on the July 1 following notice of a change in the rate. The total plan contributions are determined through CalPERS' annual actuarial valuation process. For public agency cost-sharing plans covered by Miscellaneous risk pools, the Plan's actuarially determined rate is based on the estimated amount necessary to pay the Plan's allocated share of the risk pool's costs of benefits earned by employees during the year, and any unfunded accrued liability. The employer is required to contribute the difference between the actuarially determined rate and the contribution rate of employees. Employer contribution rates may change if plan contracts are amended. Employer Contributions for the fiscal year ended June 30, 2016 were \$1,465,868. The actual employer payments of \$1,304,486 made to CalPERS by the District during the measurement period ended June 30, 2015 differed from the District's proportionate share of the employer's contributions of \$1,730,592 by \$426,106, which is being amortized over the expected average remaining service lifetime in the Public Agency Cost-Sharing Multiple Employer Plan.

B. Net Pension Liability

The District's net pension liability for the Plan is measured as the total pension liability, less the pension plan's fiduciary net position. The net pension liability of the Plan is measured as of June 30, 2015, using an annual actuarial valuation as of June 30, 2014 rolled forward to June 30, 2015 using standard update procedures. A summary of principal assumptions and methods used to determine the net pension liability is as follows.

VALLECITOS WATER DISTRICT

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)**

Note 9 – Defined Benefit Pension Plan (continued)

B. Net Pension Liability (continued)

Actuarial Methods and Assumptions Used to Determine Total Pension Liability

Valuation Date	June 30, 2014
Measurement Date	June 30, 2015
Actuarial Cost Method	Entry Age Normal
Asset Valuation Method	Market Value of Assets
Actuarial Assumptions:	
Discount Rate	7.65%. For measurement date June 30, 2014, 7.50%.
Inflation	2.75%
Salary Increases (1)	3.3% - 14.2%
Investment Rate of Return (2)	7.65%. For measurement date June 30, 2014, 7.50%.
Mortality Rate Table (3)	Derived using CALPERS' membership data for all Funds
Post Retirement Benefit Increase	Contract COLA up to 2.75% until purchasing power protection allowance floor on purchasing power applies, 2.75% thereafter

(1) Annual increases vary by category, entry age, and duration of service

(2) Net of pension plan investment and administrative expenses; includes inflation

(3) The mortality table used was developed based on CalPERS' specific data. The table includes 20 years of mortality improvements using Society of Actuaries Scale BB. For more details on this table, please refer to the 2014 experience study report.

All other actuarial assumptions used in the June 30, 2014 valuation were based on the results of an actuarial experience study for the period from 1997 to 2011, including updates to salary increase, mortality and retirement rates. The experience study report can be obtained at CalPERS' website under Forms and Publications.

Change of Assumptions

GASB 68, paragraph 68 states that the long long-term expected rate of return should be determined net of pension plan investment expense but without reduction for pension plan administrative expense. The discount rate of 7.50 percent used for the June 30, 2014 measurement date was net of administrative expenses. The discount rate of 7.65 percent used for the June 30, 2015 measurement date is without reduction of pension plan administrative expense.

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)

Note 9 – Defined Benefit Pension Plan (continued)

B. Net Pension Liability (continued)

Discount Rate

The discount rate used to measure the total pension liability for measurement date June 30, 2015 was 7.65 percent. The discount rate used to measure the total pension liability in the previous year was 7.50 percent. To determine whether the municipal bond rate should be used in the calculation of a discount rate for each plan, CalPERS stress tested plans that would most likely result in a discount rate that would be different from the actuarially assumed discount rate. Based on the testing of the plan, the test revealed the assets would not run out. Therefore, the current 7.65 percent discount rate is appropriate and the use of the municipal bond rate calculation is not deemed necessary. The long-term expected discount rate of 7.65 percent is applied to all plans in the Public Employees Retirement Fund. The stress test results are presented in a detailed report called "GASB Crossover Testing Report" that can be obtained at CalPERS' website under the GASB 68 section.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class.

In determining the long-term expected rate of return, CalPERS took into account both short-term and long-term market return expectations as well as the expected pension fund (Public Employees' Retirement Fund) cash flows. Such cash flows were developed assuming that both members and employers will make their required contributions on time and as scheduled in all future years. Using historical returns of all the funds' asset classes, expected compound (geometric) returns were calculated over the short-term (first 10 years) and the long-term (11-60 years) using a building-block approach. Using the expected nominal returns for both short-term and long-term, the present value of benefits was calculated for each fund. The expected rate of return was set by calculating the single equivalent expected return that arrived at the same present value of benefits for cash flows as the one calculated using both short-term and long-term returns. The expected rate of return was then set equivalent to the single equivalent rate calculated above and rounded down to the nearest one quarter of one percent.

The following table reflects long-term expected real rate of return by asset class. The rate of return was calculated using the capital market assumptions applied to determine the discount rate and asset allocation. The target allocation shown was adopted by the CalPERS Board effective on July 1, 2014.

VALLECITOS WATER DISTRICT

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)**

Note 9 – Defined Benefit Pension Plan (continued)

B. Net Pension Liability (continued)

Discount Rate (continued)

<u>Asset Class</u>	<u>New Strategic Allocation</u>	<u>Real Return Years 1 - 10¹</u>	<u>Real Return Years 11+²</u>
Global Equity	47.0%	5.25%	5.71%
Global Fixed Income	19.0%	0.99%	2.43%
Inflation Sensitive	6.0%	0.45%	3.36%
Private Equity	12.0%	6.83%	6.95%
Real Estate	11.0%	4.50%	5.13%
Infrastructure and Forestland	3.0%	4.50%	5.09%
Liquidity	2.0%	(0.55%)	(1.05%)
Total	<u>100%</u>		

¹ An expected inflation of 2.5% used for this period

² An expected inflation of 3.0% used for this period

Pension Plan Fiduciary Net Position

Information about the pension plan's assets, deferred outflows of resources, liabilities, deferred inflows of resources, and fiduciary net position are presented in CalPERS' audited financial statements, which are publicly available reports that can be obtained at CalPERS' website, at www.calpers.ca.gov. The plan's fiduciary net position and additions to/deductions from the plan's fiduciary net position have been determined on the same basis used by the pension plan, which is the economic resources measurement focus and the accrual basis of accounting. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. Investments are reported at fair value.

The plan fiduciary net position disclosed in the GASB 68 accounting valuation report may differ from the plan assets reported in the funding actuarial valuation report due to several reasons. First, for the accounting valuations, CalPERS must keep items such as deficiency reserves, fiduciary self-insurance and Other Post-Employment Benefits (OPEB) expense included as assets. These amounts are excluded for rate setting purposes in the funding actuarial valuation. In addition, differences may result from early Comprehensive Annual Financial Report closing and final reconciled reserves.

VALLECITOS WATER DISTRICT

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)**

Note 9 – Defined Benefit Pension Plan (continued)

C. Proportionate Share of Net Pension Liability

The following table shows the Plan’s proportionate share of the net pension liability over the measurement period.

	Increase (Decrease)		
	Total Pension Liability (a)	Plan Fiduciary Net Position (b)	Net Pension Liability (c) = (a) - (b)
Balance at: 6/30/2014 (Valuation Date)	\$ 58,729,003	\$ 48,761,955	\$ 9,967,048
Balance at: 6/30/2015 (Measurement Date)	\$ 61,497,246	\$ 50,030,348	\$ 11,466,898
Net Changes during 2014-15	\$ 2,768,243	\$ 1,268,393	\$ 1,499,850

The District’s net pension liability for each Plan is measured as the proportionate share of the net pension liability. The net pension liability of the Plan is measured as of June 30, 2015, and the total pension liability for the Plan used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2014 rolled forward to June 30, 2015 using standard update procedures. The District’s proportion of the net pension liability determined by CalPERS using the output from the Actuarial Valuation System and the fiduciary net position, as provided in the CalPERS Public Agency Cost-Sharing Allocation Methodology Report, which is a publicly available report that can be obtained at CalPERS’ website under Forms and Publications, at www.calpers.ca.gov. The District’s proportionate share of the net pension liability for the Plan as of June 30, 2014 and 2015 was as follows:

	<u>Miscellaneous</u>
Proportionate Share - June 30, 2014	0.40328%
Proportionate Share - June 30, 2015	0.41797%
Change - Increase (Decrease)	0.01469%

VALLECITOS WATER DISTRICT

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)**

Note 9 – Defined Benefit Pension Plan (continued)

C. Proportionate Share of Net Pension Liability (continued)

Sensitivity of the Proportionate Share of the Net Pension Liability to Changes in the Discount Rate

The following presents the District’s proportionate share of the net pension liability for each Plan as of the measurement date, calculated using the discount rate of 7.65 percent, as well as what the net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower (6.65 percent) or 1 percentage-point higher (8.65 percent) than the current rate:

<i>Miscellaneous Plan</i>	Discount Rate - 1% (6.65%)	Current Discount Rate (7.65%)	Discount Rate + 1% (8.65%)
Plan's Net Pension Liability	\$ 19,842,003	\$ 11,466,898	\$ 4,552,275

Subsequent Events

There were no subsequent events that would materially affect the results presented in this disclosure.

Recognition of Gains and Losses

Under GASB 68, gains and losses related to changes in total pension liability and fiduciary net position are recognized in pension expense systematically over time.

The first amortized amounts are recognized in pension expense for the year the gain or loss occurs. The remaining amounts are categorized as deferred outflows and deferred inflows of resources related to pensions and are to be recognized in future pension expense.

The amortization period differs depending on the source of the gain or loss:

Difference between projected and actual earnings	5 year straight-line amortization
All other amounts	Straight-line amortization over the average expected remaining service lives of all members that are provided with benefits (active, inactive and retired) as of the beginning of the measurement period

The expected average remaining service lifetime (EARSL) is calculated by dividing the total future service years by the total number of plan participants (active, inactive, and retired) in the Public Agency Cost-Sharing Multiple-Employer Plan (PERF C).

VALLECITOS WATER DISTRICT

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)**

Note 9 – Defined Benefit Pension Plan (continued)

C. Proportionate Share of Net Pension Liability (continued)

Recognition of Gains and Losses (continued)

The EARSL for the Plan for the 2014-15 measurement period is 3.8 years, which was obtained by dividing the total service years of 467,023 (the sum of remaining service lifetimes of the active employees) by 122,410 (the total number of participants: active, inactive, and retired). Note that inactive employees and retirees have remaining service lifetimes equal to 0. Also note that total future service is based on the members' probability of decrementing due to an event other than receiving a cash refund.

D. Pension Expense and Deferred Outflows and Deferred Inflows of Resources Related to Pensions

As of the start of the measurement period (July 1, 2014), the net pension liability for the plan is \$9,967,048. For the measurement period ending June 30, 2015 (the measurement date), the District incurred pension expense of \$793,281 for the Plan.

As of June 30, 2016, the District has deferred outflows and deferred inflows of resources related to pensions as follows:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences Between Expected and Actual Experience	\$ 83,607	\$ -
Changes of Assumptions	-	(791,005)
Net Difference Between Projected and Actual Earnings on Pension Plan Investments	-	(396,540)
Change in Employer's Proportion	141,112	-
Difference in Actual vs Projected Contributions	-	(339,316)
Pension Contributions Subsequent to Measurement Date	1,465,868	-
Total	<u>\$ 1,690,587</u>	<u>\$ (1,526,861)</u>

These amounts above are net of outflows and inflow recognized in the 2014-2015 measurement period expense. The \$1,465,868 reported as deferred outflows of resources related to contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the fiscal year ended June 30, 2017. Amounts reported as deferred outflows and deferred inflows of resources related to pensions will be recognized in future pension expense as follows:

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)

Note 9 – Defined Benefit Pension Plan (continued)

D. Pension Expense and Deferred Outflows and Deferred Inflows of Resources Related to Pensions (continued)

Measurement Period	Deferred
Ended June 30:	Outflows/(Inflows)
Ended June 30:	of Resources
2016	(635,281)
2017	(633,469)
2018	(562,598)
2019	529,206
2020	-
Thereafter	-

E. Payable to the Pension Plan

The District reported a payable of \$-0- for the outstanding amount of contributions to the pension plan required for the year ended June 30, 2016.

Note 10 – Other Post-Employment Benefits (OPEB) 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. At June 30, 2016 there were twenty-eight retired employees who met 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, 2016 was \$417,174.

Plan Description

For employees who retired before July 1, 2013, The District's 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.

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)

Note 10 – Other Post-Employment Benefits (OPEB) Plan (continued)

Plan Description (continued)

For employees who retire after June 30, 2013, the District's OPEB provides continued medical coverage for an eligible retired employee and spouse or registered domestic partner until they become entitled to Medicare Benefits at age 65. Medical premiums paid by the District are established per the most current Memorandum of Understanding (MOU). Plan premiums elected by the retiree above those established in the MOU are paid by the retiree.

To become eligible for partial OPEB benefits, non-retired employees hired before July 1, 2013, must be age 50 and have five years of continuous service with the District. OPEB benefits increase with each year of continuous service up to ten years when the employee becomes 100% vested to receive the maximum amount of premium established in the most current MOU at retirement.

The OPEB benefit is not offered to employees hired after July 1, 2013.

Eligible retirees may enroll in any of the plans the District offers through the ACWA Program. The activity and liability from the OPEB plan are included in these financial statements.

Funding Policy

The District's Resolution No. 788, established the authority for the plan and provides that the District will pay 100% of the cost of the OPEB plan. Resolution No. 1389 authorized the District to establish and maintain an irrevocable trust to fund OPEB and seek reimbursement from the trust to cover current retiree benefit premiums which are paid by the District on a pay-as-you-go basis. The District began funding the trust in March of 2012.

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:

	<u>2016</u>	<u>2015</u>
Annual required contribution	\$ 551,558	\$ 382,547
Contributions made:		
Retired employees post employment medical benefit payments	<u>(417,174)</u>	<u>(392,960)</u>
Increase (decrease) in net post employment benefits payable obligation	134,384	(10,413)
Post employment benefits payable, net - beginning of year	<u>19,596</u>	<u>30,009</u>
Post employment benefits payable, net - end of year	<u>\$ 153,980</u>	<u>\$ 19,596</u>

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS

JUNE 30, 2016 (with select prior year data for comparison only)

Note 10 – Other Post-Employment Benefits (OPEB) Plan (continued)

Funded Status of the Plan

The most recent valuation (dated January 1, 2015) includes an Actuarial Accrued Liability of \$6,620,476 and an Unfunded Actuarial Accrued Liability of \$3,389,038. The covered payroll (annual payroll of active employees covered by the plan) for the year ended June 30, 2016 is \$6,947,911. The ratio of the unfunded actuarial liability to annual payroll covered is 48.77%. 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.

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:

<u>Fiscal Year Ended</u>	<u>Annual OPEB Costs</u>	<u>Percentage of Annual OPEB Cost Contributed</u>	<u>Net OPEB Obligation</u>
June 30, 2014	\$ 387,648	112.96%	\$ 30,009
June 30, 2015	382,547	102.72%	19,596
June 30, 2016	551,558	75.64%	153,980

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 7% discount rate. A level dollar amortization of the Unfunded Actuarial Accrued Liability is used over a closed 30-year period.

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS JUNE 30, 2016 (with select prior year data for comparison only)

Note 11 – 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, 2016, 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 \$2,000,000, combined single limit at \$1,000,000 per occurrence. The District purchased additional excess coverage layers: \$58 million for general, auto and public officials liability, which increases the limits on the insurance coverage noted above.

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. Total risk financed self-insurance limits is \$50,000 with additional insurance purchased with coverage limits of \$100 million.
- 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, with total risk financed self-insurance limits of \$2 million.

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, 2016 and 2015. 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, 2016.

VALLECITOS WATER DISTRICT

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)**

Note 12 – 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, 2016.

Condensed Statement of Net Position

	2016			2015
	Water	Sewer	Total	Total
Assets:				
Current assets	\$ 25,456,132	\$ 36,486,410	\$ 61,942,542	\$ 58,053,941
Non-current assets	92,254	105,165	197,419	320,979
Capital assets, net	143,055,664	129,917,564	272,973,228	277,700,512
Total assets	168,604,050	166,509,139	335,113,189	336,075,432
Deferred Outflows of Resources	2,577,242	2,150,252	4,727,494	1,676,216
Liabilities:				
Current liabilities	8,539,198	5,508,135	14,047,333	13,329,604
Non-current liabilities	34,675,203	40,198,139	74,873,342	73,033,119
Total liabilities	43,214,401	45,706,274	88,920,675	86,362,723
Deferred Inflows of Resources				
Pension related	896,311	630,550	1,526,861	3,388,812
Net assets:				
Net investment in capital assets	114,380,679	92,395,185	206,775,864	211,866,038
Restricted for future capital facilities	633,099	1,486,923	2,120,022	173,527
Restricted for debt service	923,919	862,472	1,786,391	1,672,992
Unrestricted	11,132,882	27,577,988	38,710,870	34,287,556
Total net assets	\$ 127,070,579	\$ 122,322,568	\$ 249,393,147	\$ 248,000,113

VALLECITOS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)

Note 12 – Segment Information (continued)

Condensed Statement of Revenues, Expenses and Changes in Net Position

	2016			2015
	Water	Sewer	Total	Total
Revenues:				
Operating revenues	\$ 33,386,416	\$ 18,454,138	\$ 51,840,554	\$ 56,026,623
Non-operating revenues	1,250,205	3,168,257	5,413,930	4,071,292
Total revenues	34,636,621	21,622,395	57,254,484	60,097,915
Expenses:				
Operating expenses	32,644,859	10,812,942	43,457,801	42,643,512
Depreciation and amortization	5,328,653	3,860,951	9,189,604	8,847,957
Non-operating expenses	1,292,748	8,009,716	10,297,932	8,068,065
Total expenses	39,266,260	22,683,609	62,945,337	59,559,534
Net income/(loss) before capital contributions	(4,629,639)	(1,061,214)	(5,690,853)	538,381
Capital contributions	3,292,175	3,791,712	7,083,887	5,143,239
Change in net position	(1,337,464)	2,730,498	1,393,034	5,681,620
Total Net Position, Beginning of Year	129,426,294	121,844,840	251,271,134	242,318,493
Prior Period Restatement	(1,018,250)	(2,252,771)	(3,271,021)	-
Total Net Position at Beginning of Year as Restated	128,408,044	119,592,069	248,000,113	242,318,493
Total Net Position, End of Year	<u>\$ 127,070,580</u>	<u>\$ 122,322,567</u>	<u>\$ 249,393,147</u>	<u>\$ 248,000,113</u>

Condensed Statement of Cash Flows

	2016			2015
	Water	Sewer	Total	Total
Net cash provided (used) by:				
Operating activities	\$ 1,256,571	\$ 8,309,169	\$ 9,565,740	\$ 12,291,813
Non-capital financing activities	2,031,996	1,805,122	3,837,118	3,450,783
Capital and related financing activities	(4,087,823)	(7,860,291)	(11,948,114)	(10,514,081)
Investing activities	(848,025)	1,108,742	260,717	2,144,305
Net cash provided	(1,647,281)	3,362,742	1,715,461	7,372,820
Cash and cash equivalents, beginning of year	9,186,845	15,798,222	24,985,067	17,612,247
Cash and cash equivalents, end of year	<u>\$ 7,539,564</u>	<u>\$ 19,160,964</u>	<u>\$ 26,700,528</u>	<u>\$ 24,985,067</u>

VALLECITOS WATER DISTRICT

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2016 (with select prior year data for comparison only)**

Note 13 – 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. These include the following:

<u>Project Description</u>	<u>Total Approved Contracts (\$)</u>	<u>Spent Through June 30, 2016</u>	<u>Remaining</u>
Lift Station 1 Pump Improvements	\$ 809,906	\$ 1,035,335	\$ -
Knoll Road Sewer Replacement	177,992	229,397	-
	<u>\$ 987,898</u>	<u>\$ 1,264,732</u>	<u>\$ -</u>

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

Note 14 – Prior Period Adjustment

A prior period adjustment of \$3,271,021 is the result of accruing capital facility fee revenue and receivable in fiscal year 2014-15. Resolution No. 1441, passed February 5, 2014, allows delay of payment of capacity fees until final building inspection. Thus, the District is not owed the fees until such time and therefore no basis exists to record the receivable and related revenue.

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**REQUIRED SUPPLEMENTARY INFORMATION
YEAR ENDED JUNE 30, 2016**

VALLECITOS WATER DISTRICT

**SCHEDULE OF THE DISTRICT'S PROPORTIONATE SHARE OF THE PLAN'S
NET PENSION LIABILITY AND RELATED RATIOS AS OF THE MEASUREMENT DATE
LAST 10 YEARS***

	Measurement Date	
	6/30/2014	6/30/2015
Employer's Proportion of the Collective Net Pension Liability ¹	0.26017%	0.41797%
Employer's Proportionate Share of the Collective Net Pension Liability	\$ 9,967,048	\$ 11,466,898
Employer's Covered Payroll ²	\$ 7,338,541	\$ 8,134,432
Employer's Proportionate Share of the Collective Net Pension Liability as a Percentage of the Employer's Covered Payroll	135.82%	140.97%
Pension Plan's Fiduciary Net Position as a Percentage of the Total Pension Liability	83.03%	81.35%

¹ Proportion of the collective net pension liability represents the plan's proportion of PERF C, which includes both the Miscellaneous and Safety Risk Pools excluding the 1959 Survivors Risk Pool.

² Covered payroll is defined as the payroll on which contributions to a pension plan are based, in accordance with GASB 82

* Measurement period 2013-14 (fiscal year 2015) was the 1st year of implementation, therefore, only two years are shown.

VALLECITOS WATER DISTRICT

**SCHEDULE OF PLAN CONTRIBUTIONS
LAST 10 YEARS***

	Fiscal Year	
	6/30/2015	6/30/2016
Contractually Determined Contributions	\$ 1,304,486	\$ 1,465,868
Contributions in Relation to the Contractually Determined Contributions	(1,304,486)	(1,465,868)
Contribution Deficiency (Excess)	<u>\$ -</u>	<u>\$ -</u>
Employer's Covered Payroll ¹	\$ 8,134,432	\$ 8,404,283
Contributions as a Percentage of Covered Payroll	16.04%	17.44%

¹ Covered payroll is defined as the payroll on which contributions to a pension plan are based, in accordance with GASB 82

* Measurement period 2013-14 (fiscal year 2014-15) was the 1st year of implementation, therefore, only two years are shown.

Notes to Schedule:

Change in Benefit Terms: None

Change in Assumptions: The discount rate was changed from 7.5 percent (net of administrative expense) to 7.65 percent to correct for an adjustment to exclude administrative expense.

VALLECITOS WATER DISTRICT

**SCHEDULE OF FUNDING PROGRESS FOR
OTHER POST-EMPLOYMENT BENEFITS
JUNE 30, 2016**

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)
6/30/2011	\$ -	\$ 4,911,102	\$ 4,911,102	0%	\$ 7,759,756	63.29%
6/30/2013	2,635,608	5,078,124	2,442,516	51.90%	7,445,301	32.81%
6/30/2015	3,231,438	6,620,476	3,389,038	48.81%	7,190,573	47.13%

SUPPLEMENTARY INFORMATION
YEAR ENDED JUNE 30, 2016

VALLECITOS WATER DISTRICT**SCHEDULE OF OPERATING EXPENSES – WATER DIVISION
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

	2016	2015
Purchased Water	\$ 22,190,912	\$ 22,332,619
Pumping:		
Labor	77,021	58,380
Materials and supplies	39,698	46,901
Outside repair	22,253	20,761
Power	392,802	310,390
Total Pumping	<u>531,774</u>	<u>436,432</u>
Water Quality and Treatment:		
Labor	360,705	354,338
Materials and supplies	84,526	57,763
Outside repair	69,902	71,709
Power	7,058	5,224
Total Water Quality and Treatment	<u>522,191</u>	<u>489,034</u>
Tanks and Reservoirs:		
Labor	225,456	179,432
Materials and supplies	28,618	37,436
Outside repair	112,257	58,090
Power	4,825	4,928
Total Tanks and Reservoirs	<u>371,156</u>	<u>279,886</u>
Transmission and Distribution:		
Labor	929,020	860,774
Materials and supplies	176,447	207,537
Outside repair	73,608	196,537
Power	10,362	13,041
Total Transmission and Distribution	<u>1,189,437</u>	<u>1,277,889</u>
Services:		
Labor	108,553	55,887
Materials and supplies	70,813	34,436
Outside repair	40,042	15,456
Total Services	<u>219,408</u>	<u>105,779</u>
Meters:		
Labor	639,288	581,489
Materials and supplies	69,031	42,224
Outside repair	4,845	38,170
Total Meters	<u>713,164</u>	<u>661,883</u>

VALLECITOS WATER DISTRICT**SCHEDULE OF OPERATING EXPENSES – WATER DIVISION (Continued)
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

	<u>2016</u>	<u>2015</u>
Backflow Prevention:		
Labor	\$ 60,066	\$ 49,482
Materials and supplies	144	243
Total Backflow Prevention	<u>60,210</u>	<u>49,725</u>
Customer Accounts:		
Labor	406,606	419,345
Materials and supplies	58,516	51,643
Uncollectible accounts	28,561	33,851
Outside repair	40,223	47,647
Total Customer Accounts	<u>533,906</u>	<u>552,486</u>
Equipment and Vehicles:		
Labor, fuel and repairs	212,658	239,721
Materials and supplies	66,899	86,861
Total Equipment and Vehicles	<u>279,557</u>	<u>326,582</u>
Building and Grounds:		
Labor	175,710	164,926
Materials and supplies	36,373	62,754
Outside repair	71,677	93,694
Power	67,557	31,516
Total Building and Grounds	<u>351,317</u>	<u>352,890</u>
Engineering:		
Labor	1,213,380	1,201,974
Materials and supplies	36,588	30,969
Outside repair	20,230	31,278
Total Engineering	<u>1,270,198</u>	<u>1,264,221</u>
Safety:		
Labor	196,736	178,073
Materials and supplies	16,999	16,734
Safety support	10,025	13,611
Total Safety	<u>223,760</u>	<u>208,418</u>

VALLECITOS WATER DISTRICT

**SCHEDULE OF OPERATING EXPENSES – WATER DIVISION (Continued)
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

	2016	2015
Information Technology		
Labor	\$ 376,974	\$ 324,258
Travel	824	1,937
Dues and subscriptions	147	431
Meetings and seminars	3,788	2,451
Other materials and supplies	39,736	68,843
Phone	22,508	20,199
Equipment rent & repair	33,862	27,559
Outside repair	254,618	164,052
Total Information Technology	<u>732,457</u>	<u>609,730</u>
General and Administration:		
Salaries	1,877,637	1,565,724
Other taxes/benefits	7,996	8,694
Social security	139,762	125,721
Group insurance	699,308	576,051
Public employees' retirement	325,659	286,963
Workers' compensation insurance	40,775	36,382
District insurance	131,220	169,367
Director's expense	58,531	36,047
Director's fees	51,512	31,320
Public awareness	171,822	197,024
Travel	20,551	18,415
Postage	2,607	3,262
Office supplies	81,861	37,888
Dues and subscriptions	77,211	87,621
Meetings and seminars	23,094	23,459
Legal	152,749	138,541
Auditing	12,528	19,965
Outside services	192,136	108,718
Election and annexations	-	2,861
Other	29,119	(18,984)
Administrative credits transferred	(640,668)	(824,748)
Total General and Administration	<u>3,455,410</u>	<u>2,630,291</u>
Total Water Division Expenses	<u>\$ 32,644,857</u>	<u>\$ 31,577,865</u>

VALLECITOS WATER DISTRICT**SCHEDULE OF OPERATING EXPENSES – WASTEWATER DIVISION
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

	<u>2016</u>	<u>2015</u>
Collection System:		
Labor	\$ 1,179,829	\$ 1,437,069
Materials and supplies	75,214	74,483
Chemicals	306,209	305,508
Outside repair	200,232	61,858
Power	1,411	1,910
Total Collection System	<u>1,762,895</u>	<u>1,880,828</u>
Lift Stations		
Labor	152,261	108,718
Materials and supplies	29,291	34,495
Chemicals	-	22,342
Outside repair	43,965	48,733
Power	42,856	42,639
Total Lift Stations	<u>268,373</u>	<u>256,927</u>
Peroxide Station:		
Labor	308	634
Materials and supplies	-	154
Outside repair	-	158
Power	148	162
Total Peroxide Station	<u>456</u>	<u>1,108</u>
Source Control:		
Labor	128,670	114,770
Materials and supplies	3,862	36,398
Total Source Control	<u>132,532</u>	<u>151,168</u>
Encina Disposal	<u>2,485,765</u>	<u>2,493,629</u>
Meadowlark Lift Station:		
Labor	64,322	65,278
Materials and supplies	45,498	21,812
Chemicals	102,613	118,584
Outside repair	67,742	32,283
Power	65,685	83,034
Total Meadowlark Lift Station	<u>345,860</u>	<u>320,991</u>

VALLECITOS WATER DISTRICT**SCHEDULE OF OPERATING EXPENSES – WASTEWATER DIVISION (Continued)
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

	<u>2016</u>	<u>2015</u>
Meadowlark Plant:		
Labor	\$ 861,506	\$ 924,654
Materials and supplies	258,411	317,592
Chemicals	447,358	509,185
Outside repair	265,495	276,913
Power	379,522	449,054
Telephone	1,091	3,281
Total Meadowlark Plant	<u>2,213,383</u>	<u>2,480,679</u>
Mahr Reservoir:		
Labor	81,602	55,424
Materials and supplies	23,861	15,030
Chemicals	8,839	-
Outside repairs	76,642	58,698
Total Mahr Reservoir	<u>190,944</u>	<u>129,152</u>
Customer Accounts:		
Labor	273,567	249,130
Materials and supplies	49,613	49,550
Uncollectible accounts	13,426	17,554
Outside services	33,503	45,652
Total Customer Accounts	<u>370,109</u>	<u>361,886</u>
Equipment and Vehicles:		
Labor, fuel and repairs	126,635	154,039
Materials and supplies	40,089	35,506
Fuel	39,122	50,610
Total Equipment and Vehicles	<u>205,846</u>	<u>240,155</u>
Buildings and Grounds:		
Labor	51,009	46,184
Materials and supplies	22,206	38,647
Outside repair	57,507	62,002
Power	64,004	29,320
Total Buildings and Grounds	<u>194,726</u>	<u>176,153</u>
Engineering:		
Labor	543,886	534,556
Materials and supplies	61,662	21,060
Outside repair	13,291	119,302
Total Engineering	<u>618,839</u>	<u>674,918</u>

VALLECITOS WATER DISTRICT

**SCHEDULE OF OPERATING EXPENSES – WASTEWATER DIVISION (Continued)
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

	<u>2016</u>	<u>2015</u>
Safety:		
Labor	\$ 125,625	\$ 125,541
Materials and supplies	2,315	71
Outside services	9,811	10,736
Total Safety	<u>137,751</u>	<u>136,348</u>
Information Technology		
Labor	254,297	216,084
Materials and supplies	91,665	83,976
Outside services	268,604	135,525
Total Information Technology	<u>614,566</u>	<u>435,585</u>
General and Administration:		
Salaries	719,558	835,001
Other taxes/benefits	4,336	5,106
Social security	58,876	55,655
Group insurance	405,101	337,686
Public employees' retirement	155,619	115,629
Workers' compensation insurance	12,366	11,751
District insurance	126,074	162,725
Director's fees	37,813	25,429
Travel	-	241
Office supplies	18,547	13,089
Dues and subscriptions	421	(130)
Meetings and seminars	1,224	793
Legal	140,797	119,293
Auditing	12,062	19,215
Outside services	59,492	41,062
Other	3,123	-
Administrative credits transferred	(484,512)	(416,425)
Total General and Administration	<u>1,270,897</u>	<u>1,326,120</u>
Total Wastewater Division Expenses	<u>\$ 10,812,942</u>	<u>\$ 11,065,647</u>

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