



**ANNUAL FINANCIAL REPORT**  
**WITH REPORT ON AUDIT BY INDEPENDENT**  
**CERTIFIED PUBLIC ACCOUNTANTS**  
**JUNE 30, 2010 AND 2009**

**< Page Intentionally Left Blank >**

	<b>Page Number</b>
Independent Auditors' Report	1 - 2
Management's Discussion and Analysis	3 -9
Basic Financial Statements:	
Statements of Net Assets	10
Statements of Revenues, Expenses and Changes in Net Assets	11
Statements of Cash Flows	12 - 13
Notes to the Basic Financial Statements	14 - 37
Required Supplementary Information:	
Schedule of Funding Progress for OPEB	38
Supplementary Information:	
Schedule of Operating Expenses – Water Division	39 - 41
Schedule of Operating Expenses – Wastewater Division	42 - 44



**DIEHL, EVANS & COMPANY, LLP**  
CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

A PARTNERSHIP INCLUDING ACCOUNTANCY CORPORATIONS

2965 ROOSEVELT STREET  
CARLSBAD, CALIFORNIA 92008-2389  
(760) 729-2343 • FAX (760) 729-2234  
www.diehlevents.com

\*PHILIP H. HOLTkamp, CPA  
\*THOMAS M. PERLOWSKI, CPA  
\*HARVEY J. SCHROEDER, CPA  
KENNETH R. AMES, CPA  
WILLIAM C. PENTZ, CPA  
MICHAEL R. LUDIN, CPA  
CRAIG W. SPRAKER, CPA  
NITIN P. PATEL, CPA  
ROBERT J. CALLANAN, CPA

\* A PROFESSIONAL CORPORATION

November 30, 2010

**INDEPENDENT AUDITORS' REPORT**

Board of Directors  
Vallecitos Water District  
San Marcos, California

We have audited the accompanying basic financial statements of Vallecitos Water District as of and for the year ended June 30, 2010, as listed in the table of contents. These basic financial statements are the responsibility of the Vallecitos Water District's management. Our responsibility is to express an opinion on these financial statements based on our audit. The basic financial statements of Vallecitos Water District as of June 30, 2009 were audited by other auditors whose report dated September 25, 2009 expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Vallecitos Water District as of June 30, 2010, and the changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

Our audit was conducted for the purpose of forming an opinion on the accompanying basic financial statements of Vallecitos Water District. The supplementary information, as identified in the accompanying table of contents, is presented for purposes of additional analysis and is not a required part of the financial statements. The Schedule of Operating Expenses – Water Division and the Schedule of Operating Expenses – Wastewater Division are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information, for the year ended June 30, 2010, has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

*Diehl, Evans and Company, LLP*

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### Fiscal Year Ended June 30, 2010

Our discussion and analysis of the Vallecitos Water District's financial performance provides an overview of the District's financial activities for the fiscal year ended June 30, 2010. 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, 2010 (2009/10), the following highlights impacted, or have the potential to impact, the finances of the District.

- The District's Board of Directors declared a Stage 2 drought alert and a 10% mandatory demand reduction effective July 1, 2009. Water sales in acre feet for 2009/10 were 15,208.1 compared to 18,313.4 in 2008/09, a 17% reduction.
- A wholesale increase of 17% on commodity (per acre-foot) charges effective September 1, 2009, and a wholesale increase of 26% on fixed monthly charges effective January 1, 2010 were passed through to District ratepayers. With normalized demands the new rates would have resulted in increased costs of \$2.9 million, but conservation mitigated the increase down to \$1.1 million.
- On June 24, 2009, the District adopted two years of rate increases – effective July 1, 2009, 9.7% sewer increase, a 15.3% ready-to-serve increase, and a drought rate structure with additional tiers and accelerated rates in higher tiers to encourage conservation and cover costs associated with high usage (conservation, wholesale surcharges, etc.) and to cover the loss from lower demands. A 6% sewer increase and a 15.3% ready-to-serve increase are effective July 1, 2010. Eighty percent of the commodity rate increase was from the pass-through of wholesale costs.
- Capital spending during 2009/10 included \$1.8 million on the Discovery Street sewer replacement, \$1.2 million to the Encina Wastewater Authority's (EWA) for treatment plant expansion and other EWA projects, \$1 million for tertiary filter piping and a recycled water main at the District's Meadowlark Reclamation Facility, and \$3 million in other projects. Total capital spending for the year amounted to \$7 million compared to \$9.4 million in the prior year, \$27.3 million two years prior, and \$50.6 million three years prior.
- The increase in operating expenses of \$2.5 million from 2008/09 to 2009/10 consisted of a \$1.2 million increase in treatment costs at the District's wastewater reclamation facility, and \$1.1 million in wholesale water costs. Also, fewer costs were capitalized due to the lack of new development.
- During the fiscal year ended June 30, 2010, new development contributed \$6.7 million in capital assets and cash to be used to fund planned capital facilities, compared to \$2.7 million in the prior year, \$3.7 million two years prior, and \$8.5 million three years prior. The FY 2010 increase is due to recognizing capital contributions attributable to development projects in process, including contributions accumulated from prior years, and not from increased construction activity.
- The District added 12 active meters during the fiscal year ended June 30, 2010, compared to 181 meters in the prior year, and 409 meters two years prior. The City of San Marcos issued building permits for 1,344 residential units in 2005, 447 in 2006, 273 in 2007, 55 in 2008, 152 in 2009, and 97 through August 2010.

**MANAGEMENT’S DISCUSSION AND ANALYSIS (Continued)**

**OVERVIEW OF THE FINANCIAL STATEMENTS**

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

Statements of Net Assets

The Statements of Net Assets present the District’s financial position (assets and liabilities) as of June 30, 2010, and 2009. Assets in excess of liabilities (Net Assets) were \$238,426,592 and \$236,577,523 as of June 30, 2010, and 2009, respectively. In accordance with generally accepted accounting principles, capital assets acquired through purchase or construction by the District are recorded at historical cost. Capital assets contributed by development are recorded at fair value or developers’ construction cost.

Statements of Revenues, Expenses, and Changes in Net Assets

The Statements of Revenues, Expenses, and Changes in Net Assets present the District’s results of operations for the years ended June 30, 2010, and 2009. Revenues are recognized (recorded) when water or services are provided, and expenses are recognized when incurred. Operating revenues and expenses are related to the District’s core activities (providing water and related services, wastewater services, and processing and delivering recycled water). Non-operating revenues and expenses (e.g. interest income, interest expenses, etc.) are not directly related to the core activities of the District. The operating loss for the year ended June 30, 2010, of \$4,347,831 is combined with a net non-operating loss of \$512,725 and capital contributions of \$6,709,625 to arrive at an increase in net assets of \$1,849,069. The increase in net assets is added to beginning net assets of \$236,577,523 to arrive at ending net assets of \$238,426,592 as of June 30, 2010.

	2009/10	2008/09
Operating income / (loss)	\$ (4,347,831)	\$ (5,954,479)
Nonoperating revenues / (expenses)	(512,725)	55,793
Capital contributions	6,709,625	2,658,167
Change in net assets	1,849,069	(3,240,519)
Beginning net assets	236,577,523	239,818,042
Ending net assets	<u>\$238,426,592</u>	<u>\$236,577,523</u>

Statements of Cash Flows

The Statements of Cash Flows presents the amounts of cash provided or used by the District’s operating, financing, and investing activities. Every cash flow has been categorized into one of the following activities: operating, noncapital and related financing, capital and related financing, or investing. The total of these categories for the year ended June 30, 2010, represents the decrease in cash and cash equivalents of \$332,449, which is combined with beginning cash and cash equivalents of \$14,712,444 to arrive at ending cash and cash equivalents of \$14,379,995. 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, 2010.

Beginning cash & cash equivalents	\$ 14,712,444
Decrease in cash & cash equivalents	(332,449)
Ending cash & cash equivalents	<u>\$ 14,379,995</u>

As of June 30, 2010, the ending cash and cash equivalents are represented on the Statements of Net Assets as follows:

	2009/10	2008/09
Unrestricted cash & cash equivalents	\$ 11,500,301	\$ 11,861,648
Cash & cash equivalents restricted - current	2,879,694	2,850,796
Total cash & cash equivalents	<u>\$ 14,379,995</u>	<u>\$ 14,712,444</u>

# VALLECITOS WATER DISTRICT

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

### ANALYSIS OF FINANCIAL POSITION AND RESULTS OF OPERATIONS

During the fiscal year ended June 30, 2010, the increase in total assets of \$362,738 and the decrease in total liabilities of \$1.5 million resulted in an increase in net assets of \$1.8 million.

Operating activities, property taxes, capital facility fees, and other sources helped fund \$4.5 million in debt service, \$1.8 million on the Discovery Street sewer replacement, \$1.2 million to the Encina Wastewater Authority (EWA) for treatment plant expansion and other EWA projects, \$1 million for tertiary filter piping and a recycled water main at the District's Meadowlark Reclamation Facility, and \$3 million for the construction and acquisition of other capital assets. These projects provide for needed capacity, replacement, and operating efficiencies that will result in long-term cost savings to the District. The following table summarizes how these capital projects and debt service were financed during the year.

Sources (in millions)		Uses (in millions)	
Operating activities	\$ 3.4	Capital construction and acquisition	\$ 7.0
Decrease in cash and investments	2.6	Debt service	4.5
Property taxes	2.5		
Capital facility fees	2.3		
Settlement, annexations, and other receipts	0.4		
Investment Earnings	0.3		
	<u>\$11.5</u>		<u>\$11.5</u>

The operating loss of \$4,347,831 includes non-cash depreciation expense of \$8,125,933. Depreciation is the systematic allocation of a capital asset's cost to expense over a specified period of time. Depreciation on contributed assets, for which the District never realized cash outflows, is also included in the \$8.1 million of depreciation. Accounting pronouncements do not recognize that operating losses of growth agencies created by depreciation on contributed assets have no negative impact on financial performance. The District has established reserve floors for the replacement of aging infrastructure.

### CURRENT-TO-PRIOR YEAR ANALYSIS

#### Analysis of Net Assets

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

Vallecitos Water District's Net Assets				
	2009/10	2008/09	Change	
			Amount	%
Cash and investments	\$ 21,207,487	\$ 23,775,462	\$ (2,567,975)	-10.8%
Capital assets	286,932,647	285,383,053	1,549,594	0.5%
Other assets	9,870,861	8,489,742	1,381,119	16.3%
Total Assets	318,010,995	317,648,257	362,738	0.1%
Current liabilities	10,084,462	10,203,187	(118,725)	-1.2%
Noncurrent liabilities	69,499,941	70,867,547	(1,367,606)	-1.9%
Total Liabilities	79,584,403	81,070,734	(1,486,331)	-1.8%
Net Assets				
Invested in capital assets, net of related debt	217,362,952	214,074,472	3,288,480	1.5%
Restricted	1,366,993	1,858,518	(491,525)	-26.4%
Unrestricted	19,696,647	20,644,533	(947,886)	-4.6%
Total Net Assets	<u>\$ 238,426,592</u>	<u>\$ 236,577,523</u>	<u>\$ 1,849,069</u>	<u>0.8%</u>



**VALLECITOS WATER DISTRICT**

**MANAGEMENT’S DISCUSSION AND ANALYSIS (Continued)**

**CURRENT-TO-PRIOR YEAR ANALYSIS (Continued)**

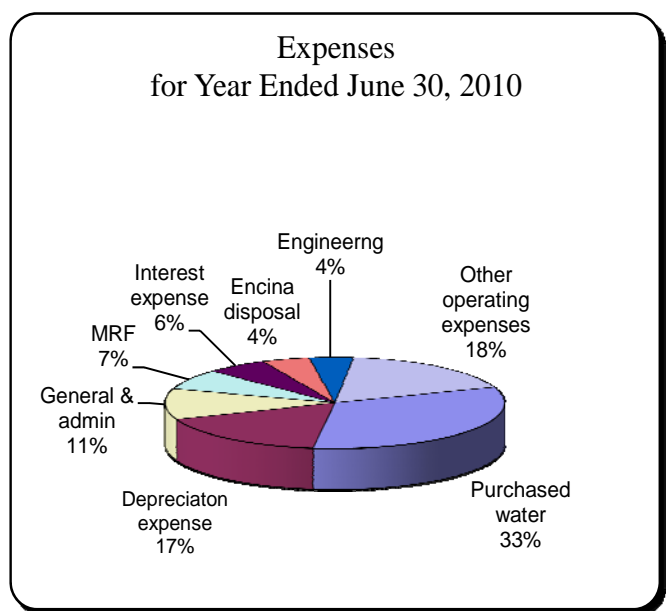
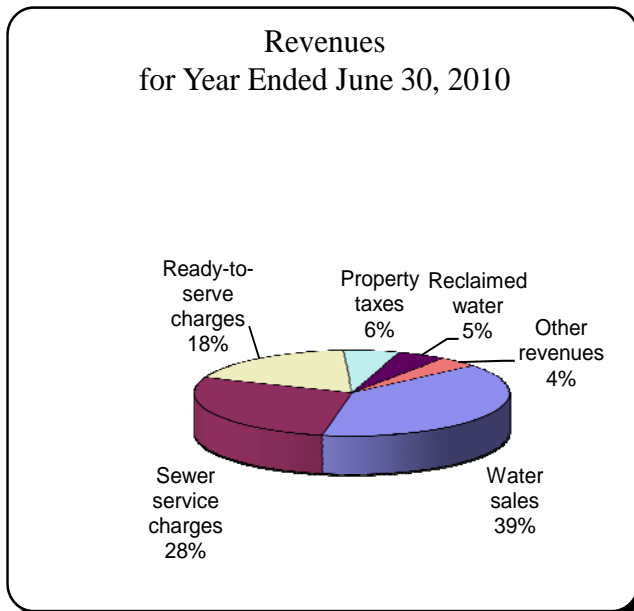
Analysis of Net Assets (continued)

Vallecitos Water District Selected Financial Ratios		
	2009/10	2008/09
Current ratio	2.93	2.95
Quick ratio	2.80	2.80
Capital assets-to-Long-term liabilities	4.13 / 1	4.03 / 1
Debt-to-equity	1 / 3.00	1 / 2.92

The table at the left illustrates how effectively the District can meet its current obligations, and the margin of safety to creditors. The current ratio (current assets divided by current liabilities) indicates that the District can pay 2.93 times its current debt from current assets. However, some current assets are not easily, or will never be, converted to cash (e.g. inventories and prepaid insurance). The quick

ratio, quick assets (cash, liquid investments, accounts receivable) divided by current liabilities, measures how effectively the District can meet current obligations with assets that are readily convertible to cash. The District can pay 2.80 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 capital-assets-to-long-term-liabilities ratio indicates that for every dollar of debt the District has \$4.13 in capital assets (infrastructure, land, building, vehicles, equipment, furniture, etc., net of depreciation). The significantly higher numerator in this ratio and the higher denominator in the debt-to-equity ratio indicate the District’s ability to cash fund some degree of capital projects. The debt-to-equity ratio indicates that for every dollar of debt the District has \$3.00 of net assets (equity).

Analysis of Revenues and Expenses



The composition of revenues and expenses for the 2009/10 fiscal year is graphically illustrated above. Water sales, ready-to-serve charges, and wastewater service charges continue to be the main sources of revenue funding District operations. Water sales are commodity charges assessed to cover the variable costs of purchasing and delivering water to customers. Ready-to-serve charges are intended to cover fixed costs in the wholesale water rate, and costs related to being able to provide water to customers. A comparative analysis of revenues and expenses with a discussion of significant and unanticipated variances from the prior year is presented on the following page.

**VALLECITOS WATER DISTRICT**

**MANAGEMENT’S DISCUSSION AND ANALYSIS (Continued)**

**CURRENT-TO-PRIOR YEAR ANALYSIS (Continued)**

Analysis of Revenues and Expenses (continued)

Vallecitos Water District's Revenues and Expenses				
	For Fiscal Year:		Change	
	2009/10	2008/09	Amount	%
Water sales	\$ 16,798,224	\$ 15,538,356	\$ 1,259,868	8.1%
Wastewater service charges	12,013,152	11,061,701	951,451	8.6%
Ready-to-serve charges	7,833,940	6,746,058	1,087,882	16.1%
Property taxes	2,438,173	2,685,570	(247,397)	-9.2%
Reclaimed water sales	2,151,145	841,056	1,310,089	155.8%
Other revenues	1,742,186	1,471,752	270,434	18.4%
Total Revenues	42,976,820	38,344,493	4,632,327	12.1%
Purchased water	15,603,958	14,480,887	1,123,071	7.8%
Depreciation expense	8,125,933	7,097,658	1,028,275	14.5%
General and administrative	5,216,874	6,796,343	(1,579,469)	-23.2%
Meadowlark Reclamation Facility (MRF)	3,456,133	2,291,535	1,164,598	50.8%
Interest expense	2,793,178	2,190,675	602,503	27.5%
Encina disposal	2,162,753	2,517,278	(354,525)	-14.1%
Engineering	2,006,925	1,497,011	509,914	34.1%
Other expenses	8,471,622	7,371,792	1,099,830	14.9%
Total Expenses	47,837,376	44,243,179	3,594,197	8.1%
Loss before contributions	(4,860,556)	(5,898,686)	1,038,130	17.6%
Capital contributions	6,709,625	2,658,167	4,051,458	152.4%
Change in Net Assets	1,849,069	(3,240,519)	5,089,588	N/A
Beginning Net Assets	236,577,523	239,818,042	(3,240,519)	-1.4%
Ending Net Assets	\$ 238,426,592	\$ 236,577,523	1,849,069	0.8%

- The \$1.3 million increase in water sales is the net effect of rate increases and conservation. Water sales include a wholesale commodity increase of 17%. The increase per unit (748 gallons) to Tier 1 water during the year was 27¢ for wholesale effective September 1, 2009, and 7¢ for retail effective January 1, 2010. A new rate structure was also implemented effective July 1, 2009, coinciding with the Board declaration of drought stage 2 and a 10% mandatory cutback. Increased revenue from the rate increase was partially offset by conservation – sales in acre feet for 2009/10 were 15,208.1 compared to 18,313.4 in 2008/09, a 17% reduction.
- The \$1 million increase in wastewater service charges was anticipated due to an increase in customers and rates (9.7% effective in July of 2009).
- Declining property values and a decrease in City of San Marcos’ RDA revenue available for pass-through attributed to a 9% decrease in property taxes.
- The District recovers costs of tertiary sewer treatment from reclaimed water sales to the City of Carlsbad and the Olivenhain Municipal Water District. These costs increased significantly due to start up of the new treatment plant.
- A wholesale increase of 17% on commodity (per acre-foot) charges effective September 1, 2009, and a wholesale increase of 26% on fixed monthly charges effective January 1, 2010 were passed through to District ratepayers. With normalized demands the new rates would have resulted in increased purchased water costs of \$2.9 million, but conservation mitigated the increase down to \$1.1 million.

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

CURRENT-TO-PRIOR YEAR ANALYSIS (Continued)

Analysis of Revenues and Expenses (continued)

- Depreciation expense increased by \$1 million mainly due to the first full year of depreciation on the Meadowlark Reclamation Facility expansion and Twin Oaks 40 million-gallon reservoir.
- General and administrative expenses decreased while other functional expenses increased, such as Meadowlark plant, engineering, collections and conveyance, and other expenses. The 2009/10 year was the first full year using the new accounting system enabling more accurate posting to specific cost centers rather than posting shared costs to general and administrative.
- The start up of the Meadowlark Reclamation Facility caused more resources to be expended than anticipated. Additional costs were incurred for chemicals and outside services to facilitate multiple attempts of new treatment process start-ups.
- The interest expense increase is due to less interest capitalized (recorded to assets in construction) \$341,699 during 2009/10 as compared to \$980,782 in interest being capitalized in the 2008/09 fiscal year.
- Capital contributions increase is due to recognizing capital contributions throughout a development project's life, including contributions accumulated from prior years, and not from increased construction activity.

RESTRICTIONS, COMMITMENTS, AND LIMITATIONS

2008 Union Bank Tax-Exempt Private Placement Loan

On November 12, 2008, the District received \$7.9 million in proceeds from a variable rate tax-exempt private placement loan from Union Bank of California to fund a portion of EWA's treatment plant expansion. The District's share in solids capacity at EWA increased from 7.5 million gallons per day (MGD) to 10.5 MGD. The variable rate on the loan is indexed to LIBOR with the District's option to periodically change the LIBOR period and associated rate (adjusted by the bank's formula for a tax-exempt borrowing) currently at 0.97%. Principal payments of \$200,000 are due every March 31<sup>st</sup> and September 30<sup>th</sup>. Interest payments are due at the end of the LIBOR period chosen by the District. Total debt service paid in fiscal year 09/10 related to the loan was \$503,950. The outstanding principal balance at June 30, 2010, of \$7.4 million is subordinate to existing certificates of deposit.

2005 Certificates of Participation

The District pays debt service semi-annually on certificates issued as variable-rate in 2005 and converted to a fixed rate of 4.736% (total-all-in-cost) in 2007. The January 1<sup>st</sup> payment of interest only is \$1.5 million and the July 1<sup>st</sup> principal and interest payment is \$2.9 million. Total debt service paid in fiscal year 09/10 related to the certificates was \$4.4 million. The outstanding principal balance at June 30, 2009, is \$61.2 million. The net revenue requirement is 1.15 times the total debt service of the District. The District's 2009/10 net revenue was 1.87 times debt service.

Capital Facility Fees

The District collects capital facility fees from new development and increased demands from existing customers, maintains the collected fees in separate funds (one for water and one for wastewater), and uses the funds exclusively to provide capacity to serve new development and fund future construction of facilities identified in the District's Master Plan and capital budget. As of June 30, 2010, the water capacity fund had a deficit of \$105,077 and the sewer capacity had a deficit of \$8,544,096. (The District maintains separate funds for specific purposes. Funds are combined for financial statement presentation.)

**MANAGEMENT’S DISCUSSION AND ANALYSIS (Continued)**

Capital Projects

The following budgeted projects have been contracted for at least the design phase before 2010/11:

Project Description	2010/11 Budget	Spent Through	
		June 30, 2010	Remaining
San Marcos interceptor sewer line	\$ 16,150,000	\$ 3,658,913	\$ 12,491,087
Meadowlark Tank #3	4,463,000	413,011	4,049,989
Mountain Belle pump station and pipeline	3,860,000	99,350	3,760,650
Wulff Reservoir/Pressure Reducing Station	1,415,000	1,077,814	337,186

The budget amounts in the previous table indicate the amount anticipated for completion of the projects. For some of these projects the District has only committed to the design phase through contractual obligations, and the construction has not yet been through the bidding process. Details are provided in the District’s 2009-10 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.

Water transmission and distribution mains	\$ 3,901,422
Sewer mains	3,452,537
Financial & customer information systems	729,717
Vehicles	705,432
Recycled water distribution main	608,905

The \$61.2 million in re-issued COPs and the \$7.4 million loan balance are the only long-term debts owed by the District.

**ECONOMIC FACTORS AND NEXT YEAR’S BUDGETS AND RATES**

The District considered the following economic factors in establishing 2010/11 budget amounts:

- District reorganization – elimination of Assistant General Manager and other positions
- Slowed to no growth,
- Continued mandatory cut-backs on water demand, and
- Increases to wholesale water rates, and

As a result of these factors, the 2010/11 budget includes:

- 8.8% reduction in salaries and wages from the 2009/10 budget,
- The District anticipates adding 48 meters and three additional employment positions in the 2011 fiscal year,
- Increased water sales and water costs from rate increases partially mitigated from conservation efforts, and
- Increased wastewater service charges from an adopted 6% increase in rates effective July 1, 2010,

**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](http://www.vwd.org).

**VALLECITOS WATER DISTRICT**STATEMENTS OF NET ASSETS  
June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 11,500,301	\$ 11,861,648
Restricted cash and cash equivalents	2,879,694	2,850,796
Investments	6,827,492	8,555,518
Accounts Receivable:		
Water and wastewater sales and services, net	4,550,657	3,583,478
Taxes and assessments	998,749	1,091,134
From other governmental entities	1,298,389	577,954
Other	146,135	59,498
Accrued interest receivable	62,286	133,842
Current portion of note receivable	97,028	91,971
Inventories	923,757	1,033,855
Prepaid expenses	297,822	260,409
Total current assets	<u>29,582,310</u>	<u>30,100,103</u>
Non-current assets:		
Restricted investments	-	507,500
Restricted capital facility fees receivable	6,993	46,014
Note receivable from City of San Marcos, net of current portion	846,247	943,273
Debt issuance costs, net	642,798	668,269
Investment in Encina Wastewater Authority capital assets	35,752,124	35,343,836
Capital assets not being depreciated	15,287,849	15,538,901
Net capital assets being depreciated	<u>235,892,674</u>	<u>234,500,361</u>
Total non-current assets	<u>288,428,685</u>	<u>287,548,154</u>
Total Assets	<u>318,010,995</u>	<u>317,648,257</u>
<b>LIABILITIES</b>		
Current Liabilities:		
Accounts payable	4,780,131	4,661,838
Accrued compensation	1,569,896	1,206,093
Construction and service deposits	454,741	1,084,464
Accrued interest payable from restricted assets	1,519,694	1,545,792
Current portion of long-term debt	<u>1,760,000</u>	<u>1,705,000</u>
Total current liabilities	<u>10,084,462</u>	<u>10,203,187</u>
Non-current liabilities:		
Deposit from San Marcos Unified School District	-	189,400
Other post employment benefits obligation, net	1,690,246	1,074,521
Loan payable, net of current portion	7,000,000	7,400,000
Certificates of participation, net of amortized discount and current portion	<u>60,809,695</u>	<u>62,203,626</u>
Total non-current liabilities	<u>69,499,941</u>	<u>70,867,547</u>
Total Liabilities	<u>79,584,403</u>	<u>81,070,734</u>
<b>NET ASSETS</b>		
Invested in capital assets, net of related debt	217,362,952	214,074,472
Restricted for future capital projects	6,993	46,014
Restricted for debt service	1,360,000	1,812,504
Unrestricted	<u>19,696,647</u>	<u>20,644,533</u>
Total net assets	<u>\$ 238,426,592</u>	<u>\$ 236,577,523</u>

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

**VALLECITOS WATER DISTRICT**

## STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

For the years ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
<b>OPERATING REVENUES</b>		
Water sales	\$ 16,798,224	\$ 15,538,356
Wastewater service charges	12,013,152	11,061,701
Ready-to-serve charges	7,833,940	6,746,058
Reclaimed water sales	2,151,145	841,056
Pumping charges	194,907	284,176
Other services and abatements	1,006,167	434,536
Total operating revenues	<u>39,997,535</u>	<u>34,905,883</u>
<b>OPERATING EXPENSES</b>		
Purchased water	15,603,958	14,480,887
General and administrative	5,216,874	6,796,343
Meadowlark wastewater treatment plant	3,456,133	2,291,535
Encina disposal	2,162,753	2,517,278
Engineering	2,006,925	1,497,011
Collection and conveyance	1,664,388	1,156,900
Transmission and distribution	1,079,479	1,004,251
Customer accounts	1,009,342	824,632
Information technology	781,409	496,417
Building and grounds	581,514	498,643
Meter reading and repairs	545,029	338,364
Tanks and reservoirs	519,649	394,375
Equipment and vehicles	438,358	384,714
Pumping	395,716	476,873
Water quality and treatment	310,718	255,824
Other water operating expenses	404,873	317,913
Other wastewater operating expenses	400,230	286,869
Total operating expenses	<u>36,577,348</u>	<u>34,018,829</u>
Operating income before overhead absorption	3,420,187	887,054
Overhead absorption	357,915	256,125
Operating income before depreciation and amortization	3,778,102	1,143,179
Depreciation and amortization	<u>(8,125,933)</u>	<u>(7,097,658)</u>
Operating loss	<u>(4,347,831)</u>	<u>(5,954,479)</u>
<b>NON-OPERATING REVENUES (EXPENSES)</b>		
Property taxes	2,438,173	2,685,570
Investment income	283,172	667,485
Annexation fees	246,110	60,394
Change in Encina Joint Venture assets	(698,832)	(1,192,142)
Interest expense	(2,793,178)	(2,190,675)
Other non-operating revenues/(expenses), net	11,830	25,161
Total non-operating revenues (expenses), net	<u>(512,725)</u>	<u>55,793</u>
Net income (loss) before capital contributions	(4,860,556)	(5,898,686)
Capital contributions	<u>6,709,625</u>	<u>2,658,167</u>
Change in net assets	1,849,069	(3,240,519)
Total Net Assets, Beginning of Year	<u>236,577,523</u>	<u>239,818,042</u>
Total Net Assets, End of Year	<u>\$ 238,426,592</u>	<u>\$ 236,577,523</u>

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

# VALLECITOS WATER DISTRICT

## STATEMENTS OF CASH FLOWS For the years ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from water and wastewater customers	\$ 38,223,284	\$ 35,749,051
Payments for water	(15,046,128)	(14,815,212)
Payments for services and supplies	(6,656,024)	(6,534,659)
Payments for employee wages, benefits and related costs	(13,107,997)	(13,027,530)
	<u>3,413,135</u>	<u>1,371,650</u>
Net cash provided by operating activities		
	<u>3,413,135</u>	<u>1,371,650</u>
<b>CASH FLOWS FROM NONCAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Receipts from taxes and assessments	2,530,558	2,733,032
	<u>2,530,558</u>	<u>2,733,032</u>
Net Cash Provided by Noncapital and Related Financing Activities		
	<u>2,530,558</u>	<u>2,733,032</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Receipts from annexation fees	271,455	91,002
Acquisition and construction of utility plant	(5,794,664)	(4,467,662)
Proceeds from loans payable	-	7,941,552
Principal paid on long-term debt	(1,705,000)	(1,455,000)
Interest payments on long-term debt	(2,829,861)	(3,208,034)
Investment in Encina Wastewater Authority	(1,216,444)	(4,925,505)
Capacity fees received	2,316,149	1,777,952
	<u>(8,958,365)</u>	<u>(4,245,695)</u>
Net Cash (Used) by Capital and Related Financing Activities		
	<u>(8,958,365)</u>	<u>(4,245,695)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of investments	(4,152,510)	(9,491,763)
Proceeds from sale, call and maturity of investments	6,419,598	12,314,767
Investment earnings	323,166	700,639
Collections on note receivable from City of San Marcos	91,969	87,178
	<u>2,682,223</u>	<u>3,610,821</u>
Net cash provided by investing activities		
	<u>2,682,223</u>	<u>3,610,821</u>
Net Increase (decrease) in Cash and Cash Equivalents	(332,449)	3,469,808
Cash and Cash Equivalents, Beginning of Year	14,712,444	11,242,636
Cash and Cash Equivalents, End of Year	<u>\$ 14,379,995</u>	<u>\$ 14,712,444</u>

(Continued)

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

# VALLECITOS WATER DISTRICT

## STATEMENTS OF CASH FLOWS (Continued) For the years ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
<b>Reconciliation of operating income (loss) to net cash flows provided by operating activities:</b>		
Operating income (loss)	\$ (4,347,831)	\$ (5,954,479)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation and amortization of capital assets	8,125,933	7,097,658
Changes in operating assets and liabilities:		
(Increase)Decrease in assets:		
Accounts receivable from water and wastewater sales	(967,179)	654,869
Accounts receivable from other governments	(720,435)	8,613
Accounts receivable – other	(86,637)	179,686
Inventories	110,098	(504,352)
Prepaid expenses	(37,413)	1,359
Increase(Decrease) in liabilities:		
Accounts payable	357,071	(385,707)
Accrued compensation	363,803	(84,953)
Other post employment benefits obligation, net	615,725	358,956
	<u>7,760,966</u>	<u>7,326,129</u>
Total adjustments		
	<u>\$ 3,413,135</u>	<u>\$ 1,371,650</u>

### Financial Statement Classification

#### Cash and cash equivalents

##### Current assets:

Cash and cash equivalents	\$ 11,500,301	\$ 11,861,648
Restricted cash and cash equivalents	<u>2,879,694</u>	<u>2,850,796</u>
	<u>\$ 14,379,995</u>	<u>\$ 14,712,444</u>

### Supplemental Disclosures:

#### Noncash Investing and Financing Activities

Contributions of assets by developers	\$ 3,878,464	\$ 359,730
Amortization related to long-term debt	\$ 32,186	\$ 32,185
Unrealized appreciation (depreciation) of investments	\$ 31,562	\$ (19,133)



June 30, 2010 and 2009

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 criteria used in determining the scope of the financial reporting entity is based on the provisions of Governmental Accounting Statements No. 14, *The Financial Reporting Entity*, and No. 39, *Determining Whether Certain Organizations Are Component Units* (an amendment of No. 14). The District is the primary governmental unit based on the foundation of a separately elected governing board elected by geographic division of the citizens in a general popular election. Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. The District is financially accountable if it appoints a voting majority of the organization's governing body and: 1) It is able to impose its will on that organization, or 2) There is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary government.

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

B. Basis of Accounting and Measurement Focus

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). Revenues and expenses are recognized on the full accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period incurred, regardless of when the related cash flows take place.

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.

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

C. Financial Reporting

The District's basic financial statements are presented in conformance with the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, "*Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*" (GASB No. 34). This statement established revised financial reporting requirements for state and local governments throughout the United States for the purpose of enhancing the understandability and usefulness of financial reports.

GASB No. 34 and its related GASB pronouncements provide for a revised view of financial information and restructure the format of financial information provided prior to its adoption. A statement of net assets replaces the balance sheet and reports assets, liabilities, and the difference between them as net assets, not equity. A statement of revenues, expenses and changes in net assets replaces both the income statement and the statement of changes in retained earnings and contributed capital. GASB No. 34 also recommends that the statement of cash flows be prepared using the direct method. Under the direct method, cash flows from operating activities are presented by major categories. Under GASB No. 20, enterprise funds, such as the District, have the option of consistently following or not following pronouncements issued by the Financial Accounting Standards Board (FASB) subsequent to November 30, 1989. The District has elected not to follow FASB standards issued after that date, unless such standards are specifically adopted by GASB.

D. Assets, Liabilities, and Net Assets

1. Use of Estimates

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

2. Cash and Cash Equivalents

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

3. Investments and Investment Policy

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

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

4. 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.

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

D. Assets, Liabilities, and Net Assets (Continued)

5. Federal and State Capital and Operating Grants

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

6. 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

7. 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.

8. 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.

9. Prepaid Expenses

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

10. Restricted Assets

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

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

D. Assets, Liabilities, and Net Assets (Continued)

11. Capital Assets

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

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

12. 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 current year capital expenditures incurred by EWA. Ownership percentages are determined by joint agreements at the time the assets are acquired.

13. Deferred Charges

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

14. Compensated Absences

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

15. Construction Advances and Deposits

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

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

## D. Assets, Liabilities, and Net Assets (Continued)

## 16. Net Assets

The financial statements utilize a net assets presentation. Net assets are categorized as follows:

- Invested in Capital Assets, net of Related Debt – This component of net assets consists of capital assets, net of accumulated depreciation and reduced by any debt outstanding against the acquisition, construction or improvement of those assets.
- Restricted Net Assets – This component of net assets consists of constraints placed on net assets use through external constraints imposed by creditors, grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- Unrestricted Net Assets – This component of net assets consists of net assets that do not meet the definition of *restricted* or *net investment in capital assets*.

## E. 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.

## F. 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.

## G. Economic Dependency

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

## H. 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.

## I. Reclassifications

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

2. Cash and Investments

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

	<u>2010</u>	<u>2009</u>
Cash and cash equivalents	\$ 11,500,301	\$ 11,861,648
Restricted cash and cash equivalents - current position	2,879,694	2,850,796
Investments - current position	6,827,492	8,555,518
Restricted investments	-	507,500
Total Cash and Investments	<u>\$ 21,207,487</u>	<u>\$ 23,775,462</u>

Cash and Investments consist of the following:

	<u>2010</u>	<u>2009</u>
Cash on hand	\$ 1,700	\$ 1,700
Deposits with financial institutions (overdraft)	(63,296)	34,212
Investments	21,269,084	23,739,550
Total cash and investments	<u>\$ 21,207,488</u>	<u>\$ 23,775,462</u>

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

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

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Of Portfolio</u>	<u>Maximum Investment in One Issuer/Institution</u>
U.S. Treasury Obligations	5 years	75%	None
U.S. Agency Securities	5 years	60%	25%
Commercial Paper	270 days	20%	10%
Certificates of Deposit	4 years	20%	FDIC limit
Repurchase Agreements	1 year	10%	10%
San Diego County Pooled Investment Funds	N/A	20%	20%
Local Agency Investment Fund (LAIF)	N/A	60%	None
California Asset Management Program	N/A	30%	25%
State and Local Agency Bonds	5 years	20%	20%
FDIC - Backed Medium - Term Notes	4 years	20%	20%
Savings Accounts	N/A	10%	10%

## 2. Cash and Investments (Continued)

Investments Authorized by Debt Agreements

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

Custodial Credit Risk

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. With respect to investments, custodial credit risk generally applies only to direct investments in marketable securities. Custodial credit risk does not apply to a local government's indirect investment in securities through the use of mutual funds or government investment pools (such as LAIF). The District's investment policy considers aversion to custodial credit risk by requiring all participants in the investment process to invest no more than 25% of the portfolio with one financial institution, with the exception of LAIF, the U.S. Treasury and funds advanced or in trustee accounts for project construction. The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure District deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits. The District had deposits with bank balances of \$171,608 and \$151,538 as of June 30, 2010 and 2009, respectively. Of the bank balances, up to \$250,000 is federally insured and the remaining balance is collateralized in accordance with the Code; however, the collateralized securities are not held in the District's name.

Investment in State Investment Pool

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

2. Cash and Investments (Continued)

*San Diego County Pooled Investment Fund*

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

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

*Interest Rate Risk*

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

Maturities of investments at June 30, 2010, are as follows:

Investment Type	Total	Remaning Maturity (in Months)		
		12 Months Or Less	13 - 24 Months	25 - 60 Months
Federal Farm Credit Banks	\$ 1,035,630	\$ 500,940	\$ 534,690	\$ -
Federal Home Loan Bank	1,205,855	500,315	705,540	-
Federal Home Loan Mortgage Association	205,166	205,166	-	-
Federal National Mortgage Association	503,750	503,750	-	-
Certificates of Deposit	2,349,950	2,349,950	-	-
Corporate Notes	1,527,140	504,005	1,023,135	-
Local Agency Investment Fund (LAIF)	6,542,082	6,542,082	-	-
San Diego County Investment Pool	5,019,815	5,019,815	-	-
Held by bond trustee:				
Money market funds	2,879,696	2,879,696	-	-
<b>Total</b>	<b>\$ 21,269,084</b>	<b>\$ 19,005,719</b>	<b>\$ 2,263,365</b>	<b>\$ -</b>



2. Cash and Investments (Continued)

Credit Risk

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

Credit ratings of investments as of June 30, 2010 were as follows:

Investment Types	Total	Minimum Legal Rating	Rating as of Year End		
			AAA	AA+	Not Rated
Federal Farm Credit Banks	\$ 1,035,630	N/A	# \$ 1,035,630	\$ -	\$ -
Federal Home Loan Bank	1,205,855	AA+	1,205,855	-	-
Federal Home Loan Mortgage Corporation	205,166	AA+	205,166	-	-
Federal National Mortgage Association	503,750	AA+	503,750	-	-
Certificates of Deposit	2,349,950	N/A	-	-	2,349,950
Corporate Notes	1,527,140	A1	1,527,140	-	-
Local Agency Investment Fund (LAIF)	6,542,082	N/A	-	-	6,542,082
San Diego County Investment Pool	5,019,815	N/A	5,019,815	-	-
Held by bond trustee:	-				-
Money market funds	2,879,696	N/A	-	2,879,696	-
<b>Total</b>	<b>\$ 21,269,084</b>		<b>\$ 9,497,356</b>	<b>\$ 2,879,696</b>	<b>\$ 8,892,032</b>

Concentration of Credit Risk

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

Issuer	2010	
	Reported Amount	Portfolio Percentage
Federal Home Loan Bank	\$ 1,205,855	6%

3. Accounts Receivable

The balance at June 30, consists of the following:

	2010	2009
Accounts receivable - water and wastewater sales and services	\$ 4,572,378	\$ 3,612,226
Allowance for uncollectible accounts	(21,721)	(28,748)
Accounts receivable - water sales, net	<u>\$ 4,550,657</u>	<u>\$ 3,583,478</u>

Property Tax Receivable

Taxes and assessments receivable of \$1,011,970 and \$1,105,925 have been reduced by an allowance for estimated uncollectible taxes of \$13,221 and \$14,791 at June 30, 2010 and 2009, respectively.

## 4. Capital Assets

Changes in capital assets for 2010 were as follow:

	<u>Balance 2009</u>	<u>Additions/ Transfers</u>	<u>Deletions/ Transfers</u>	<u>Balance 2010</u>
Capital Assets, Not Depreciated				
Land	\$ 4,744,508	\$ -	\$ -	\$ 4,744,508
Construction-in-process	10,794,393	5,380,120	(5,631,172)	10,543,341
Total Capital Assets, Not Depreciated	<u>\$ 15,538,901</u>	<u>\$ 5,380,120</u>	<u>\$ (5,631,172)</u>	<u>\$ 15,287,849</u>
Capital Assets, Being Depreciated				
Water transmission and distribution system	\$ 176,008,082	\$ 4,510,327	\$ -	\$ 180,518,409
Wastewater system	105,036,430	3,452,537	-	108,488,967
Buildings	14,898,399	-	-	14,898,399
Transportation equipment	3,255,745	705,432	(488,380)	3,472,797
Field and shop equipment	10,143,697	409,577	-	10,553,274
Office equipment	1,439,879	456,407	-	1,896,286
Total Capital Assets, Being Depreciated	<u>\$ 310,782,232</u>	<u>\$ 9,534,280</u>	<u>\$ (488,380)</u>	<u>\$ 319,828,132</u>
Less Accumulated Depreciation:				
Water transmission and distribution system	\$ (37,971,300)	\$ (3,877,988)	\$ -	\$ (41,849,288)
Wastewater system	(25,075,287)	(1,869,779)	-	(26,945,066)
Buildings	(3,610,493)	(1,250,175)	-	(4,860,668)
Transportation equipment	(1,987,347)	(299,047)	472,346	(1,814,048)
Field and shop equipment	(6,649,972)	(712,738)	-	(7,362,710)
Office equipment	(987,472)	(116,206)	-	(1,103,678)
Total Accumulated Depreciation	<u>\$ (76,281,871)</u>	<u>\$ (8,125,933)</u>	<u>\$ 472,346</u>	<u>\$ (83,935,458)</u>
Total Capital Assets, Being Depreciated, net	<u>\$ 234,500,361</u>	<u>\$ 1,408,347</u>	<u>\$ (16,034)</u>	<u>\$ 235,892,674</u>
Total Capital Assets, net	<u>\$ 250,039,262</u>	<u>\$ 6,788,467</u>	<u>\$ (5,647,206)</u>	<u>\$ 251,180,523</u>

In 2010, major capital assets additions during the year included the Discovery Street Sewer Replacement, 24" Recycled Water Distribution Main, Customer Service and Financial Information Systems and several vehicles.

4. Capital Assets (Continued)

Construction-In-Process

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

<b>Project Name</b>	<b>2009</b>	<b>2010</b>
<i>District Financed</i>		
SM interceptor - SM Blvd/Discovery	\$ 3,350,972	\$ 3,658,913
Wulff Reservoir/Pressure Reducing Station	1,026,298	1,077,814
ERP Phase II	495,631	681,760
San Elijo Road Facilities	641,279	641,279
Water & Sewer Master Plan	348,949	576,436
Tertiary Filter Piping	-	548,091
Meadowlark Tank #3	300,196	413,011
Lift Station #1 Upgrades	-	300,453
Mountain Belle Pump Station & Pipeline Design	-	99,350
Encina Land Parallel Outfall	-	54,799
Rock Springs Sewer Replacement	-	49,129
Old Questhaven Sewer Replacement	-	718
40 mg Twin Oaks Reservoir	1,056,710	-
Finance & Customer Information Systems	640,131	-
Discovery St Sewer Replacement	386,329	-
SDCWA N Access Road	348,639	-
Meadowlark Plant expansion design	158,677	-
Meadowlark Tank Refurbishment	110,457	-
24" Recycled Water Dist Main	109,554	-
Subtotal - District Financed	8,973,822	8,101,753
<i>Developer Financed</i>		
High Point Hydropneum	-	85,291
San Marcos Creek Water & Sewer Study	-	69,331
San Elijo Hills 1530 Zone Reservoir	145,265	-
Merriam Mtn / Stonegate WS Study	115,607	-
Subtotal - Developer Financed	260,872	154,622
Various Other Projects	1,559,699	2,286,966
Total	\$ 10,794,393	\$ 10,543,341

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, 2010, the Member Agencies have the following approximate ownership interest:

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

The latest available financial statements of EWA, dated June 30, 2009 and 2008, are available directly from EWA (6200 Avenida Encinas, Carlsbad, California 92009), and show the following:

	<u>2009</u>	<u>2008</u>
Total assets	\$ 132,177,221	\$ 129,616,982
Total liabilities	\$ 5,197,839	\$ 7,773,645
Total net assets	<u>\$ 126,979,382</u>	<u>\$ 121,843,337</u>
Increase (decrease) in net assets	<u>\$ 5,136,045</u>	<u>\$ 21,786,357</u>

6. Note Receivable from City of San Marcos

In February 1998, the District sold 23.6 acres of excess land to the City of San Marcos for \$1,829,520. The District received \$50,000 and an installment note of \$1,779,520. The note is payable in twenty annual installments of \$148,909 including interest of 5.5%. As of June 30, 2010, the following amounts are due to the District:

<u>Fiscal Year</u>	<u>Principal Amount</u>
2011	\$ 97,028
2012	102,365
2013	107,996
2014	113,935
2015	120,202
2016-2018	<u>401,749</u>
Total	943,275
Current Portion	<u>(97,028)</u>
Non-current Portion	<u>\$ 846,247</u>

7. Debt Issuance Costs

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

The debt issuance costs, net balances are as follows:

	<b>2010</b>	<b>2009</b>
Bond Issuance Costs	\$ 635,294	\$ 635,294
Debt Issuance Costs	58,448	58,448
Accumulated amortization	(50,944)	(25,473)
Debt Issuance Costs, net	<u>\$ 642,798</u>	<u>\$ 668,269</u>

8. Deferred Charges from Debt Retirement

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

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

	<b>2010</b>	<b>2009</b>
Deferred charges from debt retirement	\$ 218,424	\$ 218,424
Accumulated amortization	(18,994)	(9,497)
Deferred charges from debt retirement, net	<u>\$ 199,430</u>	<u>\$ 208,927</u>

9. Long-Term Debt

2005 Certificates of Participation

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

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

9. Long-Term Debt (Continued)

*2005 Certificates of Participation (continued)*

The Series 2005A COPs are payable solely from the net revenues of the District’s water and sewer systems as defined in the 2005 Certificates of Participation. The Certificates are due in annual installments from July 1, 2008 to July 1, 2035 bearing interest at 4.00% to 5.25%. This debt contains a rate covenant which requires the District to maintain annual net revenues of at least 115% of the annual debt service. In Fiscal Year 2010 the District was in compliance with this rate covenant.

The balance at June 30, 2010 net of unamortized premiums, discounts and deferred charges is as follows:

	<b>Balance 2009</b>	<b>Additions</b>	<b>Payments/ Deletions</b>	<b>Balance 2010</b>
2005 Series A COP	\$ 62,545,000	\$ -	\$ 1,305,000	\$ 61,240,000
Add: Bond Premium	1,590,224	-	58,897	1,531,327
Less: Unamortized Discount	(417,671)		(15,469)	(402,202)
Less: Deferred charges	(208,927)	-	(9,497)	(199,430)
<b>Total</b>	<b>\$ 63,508,626</b>	<b>\$ -</b>	<b>\$ 1,338,931</b>	<b>\$ 62,169,695</b>
Less: Current Portion	(1,305,000)			(1,360,000)
<b>Long-Term Portion</b>	<b>\$ 62,203,626</b>			<b>\$ 60,809,695</b>

Annual debt service payments are as follows:

<b>Fiscal Year</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2011	\$ 1,360,000	\$ 4,370,488	\$ 5,730,488
2012	1,420,000	2,951,413	4,371,413
2013	1,485,000	2,884,113	4,369,113
2014	1,565,000	2,807,863	4,372,863
2015	1,635,000	2,736,038	4,371,038
2016-2020	9,540,000	12,288,589	21,828,589
2021-2025	12,425,000	9,439,132	21,864,132
2026-2030	16,000,000	5,859,982	21,859,982
2031-2035	13,140,000	2,178,781	15,318,781
2036	2,670,000	66,750	2,736,750
<b>Total</b>	<b>\$ 61,240,000</b>	<b>\$ 45,583,149</b>	<b>\$ 106,823,149</b>
Less current portion	(1,360,000)		
<b>Total non-current portion</b>	<b>\$ 59,880,000</b>		

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

9. Long-Term Debt (Continued)

2008 Loan Payable

On November 12, 2008, the District entered into a variable rate tax-exempt private placement loan with Union Bank of California (UBOC) in the amount of \$8,000,000 to partially finance the District’s share of the expansion costs at the Encina Wastewater Authority’s treatment plant. Terms of the agreement call for interest to accrue at an interest rate per annum equal to 64.72% of the LIBOR index plus 0.79% (1.072% at June 30, 2010). Principal payments of \$200,000 plus interest are payable semi-annually and maturing in 2028.

Loan payables for the year ended June 30, 2010 is as follows:

	<u>Balance 2009</u>	<u>Additions</u>	<u>Payments/ Deletions</u>	<u>Balance 2010</u>
2008 UBOC Loan	\$ 7,800,000	\$ -	\$ 400,000	\$ 7,400,000
Less: Current Portion	<u>(400,000)</u>			<u>(400,000)</u>
Long-Term Portion	<u>\$ 7,400,000</u>			<u>\$ 7,000,000</u>

Annual debt service payments are as follows:

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest*</u>	<u>Total</u>
2011	\$ 400,000	\$ 78,222	\$ 478,222
2012	400,000	73,936	473,936
2013	400,000	69,649	469,649
2014	400,000	65,363	465,363
2015	400,000	61,077	461,077
2016-2020	2,000,000	241,094	2,241,094
2021-2025	2,000,000	133,941	2,133,941
2026-2030	<u>1,400,000</u>	<u>30,003</u>	<u>1,430,003</u>
Total	\$ 7,400,000	<u>\$ 753,285</u>	<u>\$ 8,153,285</u>
Less current portion	<u>(400,000)</u>		
Total non-current portion	<u>\$ 7,000,000</u>		

\* - Interest rate of 1.07153% used for future years is interest rate paid to Union Bank on 8/6/2010 for effective dates 6/14/2010 – 8/15/2010.

10. Net Assets

a. Invested In Capital Assets, Net of Related Debt

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

	<u>2010</u>	<u>2009</u>
Investment in Encina Wastewater Authority capital assets	\$ 35,752,124	\$ 35,343,836
Capital assets not being depreciated	15,287,849	15,538,901
Net capital assets being depreciated	235,892,674	234,500,361
Certificates of participation - current portion	(1,360,000)	(1,305,000)
Loan payable - UBOC - current portion	(400,000)	(400,000)
Certificates of participation - noncurrent portion	(60,809,695)	(62,203,626)
Loan payable - UBOC - noncurrent portion	<u>(7,000,000)</u>	<u>(7,400,000)</u>
Total net investment in capital assets	<u>\$ 217,362,952</u>	<u>\$ 214,074,472</u>

b. Restricted Net Assets

Restricted Assets at June 30, consists of the following:

	<u>2010</u>	<u>2009</u>
Restricted for debt service	\$ 6,993	\$ 46,014
Restricted for capital projects	<u>1,360,000</u>	<u>1,812,504</u>
Total restricted net assets	<u>\$ 1,366,993</u>	<u>\$ 1,858,518</u>

c. Unrestricted Net Assets

Unrestricted Assets at June 30, consists of the following:

	<u>2010</u>	<u>2009</u>
Non-spendable net assets:		
Inventories	\$ 923,757	\$ 1,033,855
Prepaid expenses	297,822	260,409
Debt issuance costs, net of amortization	<u>642,798</u>	<u>668,271</u>
Total non-spendable net assets	<u>\$ 1,864,377</u>	<u>\$ 1,962,535</u>
Spendable net assets:		
Unrestricted	<u>\$ 17,832,270</u>	<u>\$ 18,681,998</u>
Total spendable net assets	<u>17,832,270</u>	<u>18,681,998</u>
Total unrestricted net assets	<u>\$ 19,696,647</u>	<u>\$ 20,644,533</u>
Total net assets	<u>\$ 238,426,592</u>	<u>\$ 236,577,523</u>



11. Defined Benefit Pension Plan

**Plan Description**

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

**Funding Policy**

The contribution rate for plan members in the CalPERS 3.0% at 60 Risk Pool Retirement Plan is 8% of their annual covered salary. The District makes these contributions required of District employees on their behalf and for their account. The District is required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the CalPERS Board of Administration. The required employer contribution rate for the fiscal year ended June 30, 2010 was 19.122%. The contribution requirements of the Plan members are established by State statute and the employer contribution rate is established and may be amended by the CalPERS.

**Annual Pension Costs**

For the fiscal year ended June 30, 2010, the District’s annual pension cost and actual contribution was \$1,367,344. The required contribution for the fiscal year ended June 30, 2010 was determined as part of the June 30, 2007 actuarial valuation.

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

Valuation Date	June 30, 2007
Actuarial Cost Method	Entry Age Actuarial Cost Method
Amortization Method	Level Percent of Payroll
Average Remaining	Period 16 Years as of the Valuation Date
Asset Valuation Method	15 Year Smoothed Market
Actuarial Assumptions:	
Investment Rate of Return	7.75% (Net of Administrative Expenses)
Projected Salary Increase	3.25% to 14.45% Depending on Age, Service, and Type of Employment
Inflation	3.00%
Payroll Growth	3.25%
Individual Salary Growth	A merit scale varying by duration of employment coupled with an assumed annual inflation component of 3.00% and an annual production growth of 0.25%.

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

11. Defined Benefit Pension Plan (Continued)

**Three Year Trend Information for PERS**

<b><u>Fiscal Year</u></b>	<b><u>Annual Pension Cost (APC)</u></b>	<b><u>Percentage of APC Contributed</u></b>	<b><u>Net Pension Obligation</u></b>	<b><u>APC Percentage of Payroll</u></b>
2008	\$ 1,163,896	100%	-	19.299%
2009	\$ 1,275,874	100%	-	18.692%
2010	\$ 1,367,344	100%	-	19.122%

**Funding Status**

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

12. Other Post Employment Benefits Plan

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

The total expense incurred for these benefits for retired employees for the year ended June 30, 2010 and 2009 was \$160,521 and \$136,877, respectively.

**Plan Description**

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

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

12. Other Post Employment Benefits Plan (Continued)

Funding Policy

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

Annual OPEB Cost

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

The balance at June 30, consists of the following:

	<u>2010</u>	<u>2009</u>
Annual required contribution	\$ 824,870	\$ 513,329
Interest on net post employment benefits payable obligation	42,981	28,623
Adjustment to annual required contribution	<u>(65,800)</u>	<u>(46,159)</u>
Annual post employment benefits payable obligation cost (expense)	802,051	495,793
Contributions made:		
Retired employees post employment medical benefits payments	<u>(186,326)</u>	<u>(136,837)</u>
<b>Increase in net post employment benefits payable obligation</b>	615,725	358,956
Post employment benefits payable, net - beginning of year	<u>1,074,521</u>	<u>715,565</u>
Post employment benefits payable, net - end of year	<u><u>\$ 1,690,246</u></u>	<u><u>\$ 1,074,521</u></u>

Funded Status of the Plan

The most recent valuation (dated July 1, 2009) includes an Actuarial Accrued Liability and Unfunded Actuarial Accrued Liability of \$5,503,793. There are no plan assets because the District funds on a pay as-you-go basis and maintains reserves equal to the remaining net OPEB obligation. The covered payroll (annual payroll of active employees covered by the plan) for the year ended June 30, 2010 is \$8,259,285. The ratio of the unfunded actuarial liability to annual payroll covered is 66.64%. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for the benefits.

12. Other Post Employment Benefits Plan (Continued)

Three Year Trend Information

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

Fiscal Year Ended	Annual OPEB Costs	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
June 30, 2008	\$ 484,730	24.91%	\$ 715,565
June 30, 2009	\$ 495,793	28.07%	\$ 1,074,521
June 30, 2010	\$ 802,051	20.02%	\$ 1,690,246

Actuarial Methods and Assumptions

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

The District’s valuation uses the Projected Unit Credit actuarial cost method to project the Annual Required Contribution and a 4% discount rate. The high rate of annual health care cost increases experienced in recent years is assumed to gradually decrease, 8% in 2010, 7.9% in 2011, and 7.6% in 2012. A level dollar amortization of the Unfunded Actuarial Accrued Liability is used over a closed 30-year period.

13. Risk Management

The District is exposed to various risks of loss related to torts, theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District is a member of the Association of California Water Agencies/Joint Powers Insurance Authority (ACWA/JPIA), an intergovernmental risk sharing joint powers authority created to provide self-insurance programs for California water agencies. The purpose of the ACWA/JPIA is to arrange and administer programs of self-insured losses and to purchase excess insurance coverage. At June 30, 2010, the District participated in the liability and property programs of the ACWA/JPIA as follows:

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

## 13. Risk Management (Continued)

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

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

Settled claims have not exceeded any of the coverage amounts in any of the last three fiscal years and there were no reductions in the District's insurance coverage during the years ending June 30, 2010 and 2009. 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, 2010 and 2009.

14. Segment Information

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

Summary financial information for the water and sewer systems is presented for June 30, 2010.

	<b>Condensed Statement of Net Assets</b>			<b>2009</b>
	<b>2010</b>			
	<b>Water</b>	<b>Sewer</b>	<b>Total</b>	<b>Total</b>
<b>Assets:</b>				
Current assets	\$ 20,747,644	\$ 8,834,666	\$ 29,582,310	\$ 29,772,936
Non-current assets	807,927	688,111	1,496,038	2,701,150
Capital assets, net	154,964,638	131,968,009	286,932,647	285,174,171
<b>Total assets</b>	<b>176,520,209</b>	<b>141,490,786</b>	<b>318,010,995</b>	<b>317,648,257</b>
<b>Liabilities:</b>				
Current liabilities	6,528,622	3,555,840	10,084,462	10,203,187
Non-current liabilities	36,602,963	32,896,978	69,499,941	70,867,547
<b>Total liabilities</b>	<b>43,131,585</b>	<b>36,452,818</b>	<b>79,584,403</b>	<b>81,070,734</b>
<b>Net assets:</b>				
Invested in capital assets, net of related debt	118,559,823	98,803,129	217,362,952	214,074,472
Restricted for future capital facilities	179	6,814	6,993	46,014
Restricted for debt service	818,719	541,281	1,360,000	1,812,504
Unrestricted	14,012,622	5,684,025	19,696,647	20,644,533
<b>Total net assets</b>	<b>\$ 133,391,343</b>	<b>\$ 105,035,249</b>	<b>\$ 238,426,592</b>	<b>\$ 236,577,523</b>

14. Segment Information (Continued):

	<b>Condensed Statement of Revenues, Expenses and Changes in Net Assets</b>			<b>2009</b>
	<b>2010</b>			
	<b>Water</b>	<b>Sewer</b>	<b>Total</b>	
Operating Revenue	\$ 25,751,528	\$ 14,246,007	\$ 39,997,535	\$ 34,905,883
Operating Expenses:				
Water Division	24,722,593	-	24,722,593	23,334,633
Wastewater division	-	11,496,840	11,496,840	10,428,071
Depreciation	4,887,167	3,238,766	8,125,933	7,097,658
Total Operating Expenses	29,609,760	14,735,606	44,345,366	40,860,362
Operating Income (Loss)	(3,858,232)	(489,599)	(4,347,831)	(5,954,479)
Nonoperating Revenues:				
Property taxes	1,312,469	1,125,704	2,438,173	2,685,570
Investment income	163,527	119,645	283,172	667,485
Annexation fees	99,348	146,762	246,110	60,394
Other	9,370	2,460	11,830	26,361
Total Nonoperating Revenues	1,584,714	1,394,571	2,979,285	3,439,810
Nonoperating Expenses:				
Interest	1,781,952	1,011,226	2,793,178	2,190,675
Change in Encina Joint Venture net assets	-	698,832	698,832	1,192,142
Other	-	-	-	1,200
Total Nonoperating Expenses	1,781,952	1,710,058	3,492,010	3,384,017
Capital Contributions	4,089,370	2,620,255	6,709,625	2,658,167
Total Change in Net Assets	33,900	1,815,169	1,849,069	(3,240,519)
Net assets, beginning of year	133,357,443	103,220,080	236,577,523	239,818,042
Net assets, end of year	\$ 133,391,343	\$ 105,035,249	\$ 238,426,592	\$ 236,577,523

	<b>Condensed Statement of Cash Flows</b>			<b>2009</b>
	<b>2010</b>			
	<b>Water</b>	<b>Sewer</b>	<b>Total</b>	
Net cash provided (used) by:				
Operating activities	\$ 968,353	\$ 2,444,782	\$ 3,413,135	\$ 1,371,650
Non-capital financing activities	1,359,231	1,171,327	2,530,558	2,733,032
Capital and related financing activities	(2,923,596)	(6,034,769)	(8,958,365)	(4,245,695)
Investing activities	2,681,026	1,197	2,682,223	3,610,821
<b>Net cash provided</b>	2,085,014	(2,417,463)	(332,449)	3,469,808
Cash and cash equivalents, beginning of year	10,802,010	3,910,434	14,712,444	11,242,636
Cash and cash equivalents, end of year	\$ 12,887,024	\$ 1,492,971	\$ 14,379,995	\$ 14,712,444

15. Commitments and Contingencies

Construction Contracts

The District has a variety of agreements with private parties relating to the installation, improvement or modification of water facilities and distribution systems within its service area. The financing of such construction contracts is being provided primarily from the District’s replacement reserves and advances for construction. The District has committed to approximately \$43,595 in open construction contracts as of June 30, 2010. These include the following:

<u>Project Name</u>	<u>Total Approved Contract(s)</u>	<u>Construction Costs to Date</u>	<u>Remaining Obligation</u>
Tertiary Filter Piping	\$ 435,955	\$ (392,360)	\$ 43,595

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.



**REQUIRED SUPPLEMENTARY INFORMATION**  
**YEAR ENDED JUNE 30, 2010**

**Schedule of Funding Progress for OPEB**

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets (A)</u>	<u>Actuarial Accrued Liability (AAL) Entry Age (B)</u>	<u>Unfunded AAL (UAAL) (B - A)</u>	<u>Funded Ratio (A/B)</u>	<u>Covered Payroll (C)</u>	<u>UAAL as a Percentage of Covered Payroll [(B-A)/C]</u>
7/1/2009	\$ 0	\$ 5,503,793	\$ 5,503,793	0%	\$ 8,259,285	66.64%
7/1/2007	\$ 0	\$ 3,678,171	\$ 3,678,171	0%	\$ 8,154,171	45.11%

**SUPPLEMENTARY INFORMATION  
YEARS ENDED JUNE 30, 2010 AND 2009**

## VALLECITOS WATER DISTRICT

### Schedule of Operating Expenses - Water Division For the Fiscal Years Ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Purchased Water	\$ 15,603,958	\$ 14,480,887
Pumping:		
Labor	101,415	112,916
Materials and supplies	8,835	14,535
Outside repair	7,835	6,467
Power	277,631	342,955
Total Pumping	<u>395,716</u>	<u>476,873</u>
Water Quality and Treatment:		
Labor	235,781	185,206
Materials and supplies	33,986	30,156
Outside Repair	40,951	40,235
Power	-	227
Total Water Treatment	<u>310,718</u>	<u>255,824</u>
Tanks and Reservoirs:		
Labor	426,427	311,786
Materials and supplies	31,106	25,438
Outside repair	59,249	47,945
Power	2,867	9,206
Total Tanks and Reservoirs	<u>519,649</u>	<u>394,375</u>
Transmission and Distribution:		
Labor	814,549	674,716
Materials and supplies	122,936	173,224
Outside repair	132,285	147,598
Power	9,709	8,713
Total Transmission and Distribution	<u>1,079,479</u>	<u>1,004,251</u>
Services:		
Labor	117,970	98,060
Materials and supplies	33,652	39,503
Outside repair	23,948	36,664
Total Services	<u>175,570</u>	<u>174,227</u>
Meters:		
Labor	508,440	314,107
Materials and supplies	30,945	23,067
Outside repair	5,644	1,190
Total Meters	<u>545,029</u>	<u>338,364</u>

**VALLECITOS WATER DISTRICT**Schedule of Operating Expenses - Water Division, continued  
For the Fiscal Years Ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Backflow Prevention:		
Labor	68,516	49,741
Materials and supplies	1,420	159
Total Backflow Prevention	<u>69,936</u>	<u>49,900</u>
Customer Accounts:		
Labor	500,447	426,851
Materials and supplies	91,001	88,335
Uncollectible accounts	91,526	61,735
Outside Repair	34,965	15,819
Total Customer Accounts	<u>717,939</u>	<u>592,740</u>
Equipment and Vehicles:		
Labor, fuel and repairs	245,230	105,637
Materials and supplies	37,990	158,425
Allocated to wastewater division	-	(49,528)
Total Equipment and Vehicles	<u>283,220</u>	<u>214,534</u>
Building and Grounds:		
Labor	225,536	201,299
Materials and supplies	42,775	59,378
Outside Repair	73,898	119,891
Power	30,381	46,890
Allocated to wastewater division	-	(90,996)
Total Building and Grounds	<u>372,590</u>	<u>336,462</u>
Engineering:		
Labor	1,139,524	1,146,489
Materials and supplies	7,692	16,702
Outside Repair	26,112	12,082
Allocated to wastewater division	-	(183,667)
Total Engineering	<u>1,173,328</u>	<u>991,606</u>
Safety:		
Labor	147,343	87,739
Materials and supplies	1,946	13,625
Safety support	10,078	15,011
Allocated to wastewater division	-	(22,589)
Total Safety	<u>159,367</u>	<u>93,786</u>

## VALLECITOS WATER DISTRICT

---

### Schedule of Operating Expenses - Water Division, continued For the Fiscal Years Ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Information Technology		
Labor	236,349	193,830
Travel	424	439
Dues and subscriptions	443	240
Meetings and seminars	147	1,280
Other materials and supplies	24,473	40,557
Phone	15,673	23,433
Equipment Rent	21,935	30,487
Outside Repair	150,173	142,800
Allocated to wastewater division	-	(71,758)
Total Information Technology	<u>449,617</u>	<u>361,308</u>
General and Administration:		
Salaries	1,358,458	1,466,680
Other taxes/benefits	11,286	11,418
Social security	213,372	578,719
Group insurance	504,902	1,213,633
Public employees' retirement	353,532	986,473
Workers' compensation insurance	8,037	44,822
District insurance	128,127	202,800
Director's expense	16,073	14,589
Director's fees	33,855	40,474
Public awareness	143,028	90,860
Travel	5,702	23,949
Postage	4,137	11,176
Office supplies	49,169	55,075
Dues and subscriptions	46,298	73,122
Meetings and seminars	15,358	42,592
Legal	133,888	110,310
Auditing	8,741	23,541
Outside services	65,551	147,578
Election and annexations	-	3,935
Other	14,492	26,209
Administrative credits transferred	(111,155)	(107,587)
Allocated to wastewater division	(136,374)	(1,490,872)
Total General and Administration	<u>2,866,477</u>	<u>3,569,496</u>
Total Water Division Expenses	<u>\$ 24,722,593</u>	<u>\$ 23,334,633</u>

**VALLECITOS WATER DISTRICT**

---

Schedule of Operating Expenses - Wastewater Division  
For the Fiscal Years Ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Collection System:		
Labor	\$ 1,363,157	\$ 860,660
Materials and supplies	52,780	133,472
Chemicals	165,635	104,767
Outside repair	81,400	56,437
Power	1,416	1,564
Total Collection System	<u>1,664,388</u>	<u>1,156,900</u>
Lift Stations:		
Labor	128,605	83,367
Materials and supplies	26,688	24,384
Chemicals	15,957	5,374
Outside repair	6,753	6,084
Power	39,058	39,274
Total Lift Stations	<u>217,061</u>	<u>158,483</u>
Peroxide Station:		
Labor	3,174	11,387
Materials and supplies	-	481
Outside repair	-	126
Power	214	216
Total Peroxide Station	<u>3,388</u>	<u>12,210</u>
Industrial Waste:		
Labor	29,037	17,951
Materials and supplies	37,807	46,888
Total Industrial Waste	<u>66,844</u>	<u>64,839</u>
Encina Disposal	<u>2,162,753</u>	<u>2,517,278</u>
Meadowlark Lift Station:		
Labor	96,632	88,322
Materials and supplies	60,019	34,419
Chemicals	180,054	41,270
Outside repair	49,841	39,615
Power	76,225	48,301
Total Meadowlark Lift Station	<u>462,771</u>	<u>251,927</u>

## VALLECITOS WATER DISTRICT

### Schedule of Operating Expenses - Wastewater Division, continued For the Fiscal Years Ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Meadowlark Plant:		
Labor	960,419	673,864
Materials and supplies	259,528	387,059
Chemicals	705,529	305,028
Outside repair	311,796	191,299
Power	381,741	369,591
Telephone	6,081	6,782
Total Meadowlark Plant	<u>2,625,094</u>	<u>1,933,623</u>
Mahr Reservoir:		
Labor	86,755	64,112
Materials and supplies	130,622	4,602
Chemicals	135,839	22,222
Outside repairs	15,052	15,049
Total Mahr Reservoir	<u>368,268</u>	<u>105,985</u>
Customer Accounts:		
Labor	245,810	148,496
Materials and supplies	30,932	28,300
Uncollectible accounts	6,314	50,199
Outside Services	8,347	4,897
Total Customer Accounts	<u>291,403</u>	<u>231,892</u>
Equipment and Vehicles:		
Labor, fuel and repairs	59,287	40,140
Materials and supplies	38,724	25,193
Fuel	57,127	55,319
Allocated from water division	-	49,528
Total Equipment and Vehicles	<u>155,138</u>	<u>170,180</u>
Buildings and Grounds:		
Labor	114,404	51,603
Materials and supplies	27,399	2,596
Outside repair	46,867	123
Power	20,254	16,863
Allocated from water division	-	90,996
Total Buildings and Grounds	<u>208,924</u>	<u>162,181</u>
Engineering:		
Labor	816,835	321,738
Materials and supplies	686	-
Outside repair	16,076	-
Allocated from water division	-	183,667
Total Engineering	<u>833,597</u>	<u>505,405</u>

See accompanying independent auditors' report.



**VALLECITOS WATER DISTRICT**Schedule of Operating Expenses - Wastewater Division, continued  
For the Fiscal Years Ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Safety:		
Labor	97,493	25,908
Materials and supplies	1,297	14
Outside services	14,147	2,826
Allocated from water division	-	22,589
Total Safety	<u>112,937</u>	<u>51,337</u>
Information Technology		
Labor	167,270	77,019
Materials and supplies	39,857	-
Outside services	124,665	15,649
Allocated from water division	-	71,758
Total Information Technology	<u>331,792</u>	<u>164,426</u>
General and Administration:		
Salaries	694,906	792,202
Other taxes/benefits	3,194	4,110
Social security	113,809	141,905
Group insurance	736,766	287,389
Public employees' retirement	194,365	214,582
Workers' compensation insurance	3,859	6,494
District insurance	84,157	40,710
Director's fees	33,659	14,251
Travel	3,679	246
Office supplies	17,998	-
Dues and subscriptions	22,068	2,262
Meetings and seminars	7,114	5,846
Legal	128,953	54,737
Auditing	5,991	1,014
Outside services	33,444	13,036
Other	18,906	20,287
Transfer from water division	136,374	1,490,872
Administrative credits transferred	(246,760)	(148,538)
Total General and Administration	<u>1,992,482</u>	<u>2,941,405</u>
Total Wastewater Division Expenses	<u>\$ 11,496,840</u>	<u>\$ 10,428,071</u>