

LAGUNA BEACH COUNTY WATER DISTRICT

FINANCIAL STATEMENTS

**WITH REPORT ON AUDIT
BY INDEPENDENT
CERTIFIED PUBLIC ACCOUNTANTS**

JUNE 30, 2012 AND 2011

LAGUNA BEACH COUNTY WATER DISTRICT

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INDEPENDENT AUDITORS' REPORT

The Board of Directors
Laguna Beach County Water District
Laguna Beach, California

We have audited the basic financial statements of the Laguna Beach County Water District (the District) as of June 30, 2012 and 2011 as listed in the table of contents. These financial statements are the responsibility of the Laguna Beach County Water District's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States and the Minimum Audit Requirements for California Special Districts. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Laguna Beach County Water District as of June 30, 2012 and 2011 and its changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America as well as the accounting systems prescribed by the California State Controller's Office and California regulations governing Special Districts.

In accordance with Government Auditing Standards, we have also issued a report dated November 13, 2012 on our consideration of the Laguna Beach County Water District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

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 the audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

White Nelson Dick Evans LLP

Irvine, California
November 13, 2012

LAGUNA BEACH COUNTY WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2012 and 2011

This section of the District's annual financial report presents our analysis of the District's financial performance during the fiscal year that ended on June 30, 2012. Please read it in conjunction with the financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

Fiscal Year 2012

- The District's net assets increased by \$593,308 or 0.92 percent.
- During the year the District's total revenues increased by \$804,404 or 7.66 percent, and expenses increased by \$475,628 or 4.65 percent.

Fiscal Year 2011

- The District's net assets increased by \$264,532 or 0.41 percent.
- During the year the District's total revenues decreased by \$54,573 or 0.52 percent, and expenses increased by \$116,299 or 1.15 percent.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of two parts: Management's Discussion and Analysis and the Financial Statements. The Financial Statements also include notes that explain in more detail some of the information in the financial statements.

REQUIRED FINANCIAL STATEMENTS

The Financial Statements of the District report information about the District using accounting methods similar to those used by private sector companies. These statements offer short-term and long-term financial information about its activities. The Statement of Net Assets includes all of the District's investments in resources (assets) and the obligations to creditors (liabilities). It also provides the basis for computing rate of return, evaluating the capital structure of the District and assessing the liquidity and financial flexibility of the District. All of the current year's revenues and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Assets. This statement measures the success of the District's operations over the past year and can be used to determine whether the District has successfully recovered all its costs through its user fees and other charges, profitability, and credit worthiness. The final required financial statement is the Statement of Cash Flows. The primary purpose of this statement is to provide information about the District's cash receipts and cash payments during the reporting period. The Statement of Cash Flows reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities and provides answers to such questions as where did cash come from, what was cash used for, and what was the change in cash balance during the reporting period.

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
(CONTINUED)

June 30, 2012 and 2011

FINANCIAL ANALYSIS OF THE DISTRICT

Our analysis of the District begins on page 10 of the Financial Statements. One of the most important questions asked about the District's finances is "Is the District as a whole better off or worse off as a result of the year's activities?" The Statement of Net Assets, and the Statement of Revenues, Expenses and Changes in Net Assets report information about the District's activities in a way that will help answer this question. These two statements report the net assets of the District and changes in them. You can think of the District's net assets - the difference between assets and liabilities - as one way to measure financial health or financial position. Over time, increases or decreases in the District's net assets are one indicator of whether its financial health is improving or deteriorating. However, you will need to consider other nonfinancial factors such as changes in economic conditions, population growth, zoning and new or changed government legislation.

NET ASSETS

To begin our analysis, a summary of the District's Statement of Net Assets are presented in Table 1.

TABLE 1
Condensed Statements of Net Assets

	Fiscal Year 2012	Fiscal Year 2011	Dollar Change	Fiscal Year 2010	Dollar Change
Assets:					
Current and other assets	\$ 20,661,830	\$ 20,466,543	\$ 195,287	\$ 20,103,045	\$ 363,498
Capital assets	<u>46,215,581</u>	<u>45,729,390</u>	<u>486,191</u>	<u>45,420,218</u>	<u>309,172</u>
Total Assets	<u>66,877,411</u>	<u>66,195,933</u>	<u>681,478</u>	<u>65,523,263</u>	<u>672,670</u>
Liabilities:					
Current liabilities	820,907	899,759	(78,852)	668,293	231,466
Noncurrent liabilities	<u>692,839</u>	<u>525,817</u>	<u>167,022</u>	<u>349,145</u>	<u>176,672</u>
Total Liabilities	<u>1,513,746</u>	<u>1,425,576</u>	<u>88,170</u>	<u>1,017,438</u>	<u>408,138</u>
Net Assets:					
Invested in capital assets	46,215,581	45,729,390	486,191	45,420,218	309,172
Unrestricted	<u>19,148,084</u>	<u>19,040,967</u>	<u>107,117</u>	<u>19,085,607</u>	<u>(44,640)</u>
Total Net Assets	<u>\$ 65,363,665</u>	<u>\$ 64,770,357</u>	<u>\$ 593,308</u>	<u>\$ 64,505,825</u>	<u>\$ 264,532</u>

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
(CONTINUED)

June 30, 2012 and 2011

NET ASSETS (CONTINUED)

As can be seen from the Table 1, net assets increased by \$593,308 from fiscal year 2011 to 2012. Looking more carefully at the table you can see that the change in net asset position was the Assets Invested in Capital Assets, which increased \$486,191 in fiscal year 2012. This increase reflects capital assets which were primarily financed from current cash flows during fiscal year 2012.

Unrestricted Net Assets (those that can be used to finance day-to-day operations) increased by \$91,201 due to an increase in operating revenue during the fiscal year.

TABLE 2
Condensed Statements of Revenues,
Expenses and Changes in Net Assets

	Fiscal Year 2012	Fiscal Year 2011	Dollar Change	Fiscal Year 2010	Dollar Change
Revenues:					
Operating revenues	\$ 8,461,044	\$ 7,707,388	\$ 753,656	\$ 7,708,562	\$ (1,174)
Nonoperating revenues	2,843,865	2,793,117	50,748	2,846,516	(53,399)
Total Revenues	<u>11,304,909</u>	<u>10,500,505</u>	<u>804,404</u>	<u>10,555,078</u>	<u>(54,573)</u>
Expenses:					
Depreciation	1,737,643	1,737,682	(39)	1,681,921	55,761
Other operating expenses	8,973,958	8,498,291	475,667	8,437,753	60,538
Total Expenses	<u>10,711,601</u>	<u>10,235,973</u>	<u>475,628</u>	<u>10,119,674</u>	<u>116,299</u>
Change in Net Assets	593,308	264,532	328,776	435,404	(170,872)
Beginning Net Assets	<u>64,770,357</u>	<u>64,505,825</u>	<u>264,532</u>	<u>64,070,421</u>	<u>435,404</u>
Ending Net Assets	<u>\$ 65,363,665</u>	<u>\$ 64,770,357</u>	<u>\$ 593,308</u>	<u>\$ 64,505,825</u>	<u>\$ 264,532</u>

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
(CONTINUED)

June 30, 2012 and 2011

NET ASSETS (CONTINUED)

A closer examination of the source of changes in net assets reveals that the District's operating revenues increased by \$753,656 in fiscal year 2012 due to an increase in water sales and a rate increase during the current fiscal year. In addition, other revenues increased by \$50,748 in fiscal year 2012 due to a grant received for the Laguna Canyon Recycling Project. Operating costs (exclusive of depreciation) increased by \$475,667 in fiscal year 2012 due to the cost of water purchased, labor and benefits, various studies and reports, and write off of unrecovered December 2010 storm damage costs.

BUDGETARY HIGHLIGHTS

TABLE 3
Fiscal Year 2012 Actual vs. Fiscal Year 2012 Budget

	Fiscal Year 2012		
	Actual	Budget	Variance
Revenues:			
Operating revenues	\$ 8,461,044	\$ 8,745,340	\$ (284,296)
Nonoperating revenues	2,843,865	2,831,090	12,775
Total Revenues	<u>11,304,909</u>	<u>11,576,430</u>	<u>(271,521)</u>
Expenses:			
Operating Expenses:			
Water purchased	3,014,175	3,297,340	283,165
Source of supply	111,192	139,880	28,688
Pumping	461,941	520,500	58,559
Transmission and distribution	2,418,895	2,240,640	(178,255)
Customer service	389,387	471,660	82,273
General and administrative	2,388,062	1,953,080	(434,982)
Other operation and maintenance	190,306	266,200	75,894
Depreciation	1,737,643	-	(1,737,643)
Total Expenses	<u>10,711,601</u>	<u>8,889,300</u>	<u>(1,822,301)</u>
Change in Net Assets	<u>\$ 593,308</u>	<u>\$ 2,687,130</u>	<u>\$ (2,093,822)</u>

As Table 3 shows, actual change in net assets is \$(2,093,822) less than the budgeted change in net assets. The difference was primarily due to the fact that the District did not budget depreciation expenses.

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
(CONTINUED)

June 30, 2012 and 2011

CAPITAL ASSETS AND DEBT ADMINISTRATION

CAPITAL ASSETS

At the end of fiscal year 2012, the District had invested approximately \$81 million in a broad range of infrastructure as shown in Table 4.

TABLE 4
Capital Assets

	Fiscal Year 2012	Fiscal Year 2011	Dollar Change	Fiscal Year 2010	Dollar Change
Capital Assets:					
Land and land rights	\$ 1,309,155	\$ 1,309,155	\$ -	\$ 1,309,155	\$ -
Source of supply plant	9,689,489	9,626,246	63,243	9,579,605	46,641
Pumping plant	5,432,833	5,397,148	35,685	5,272,069	125,079
Transmission and distribution system	53,925,332	53,201,493	723,839	52,050,209	1,151,284
General plant and equipment	8,523,860	8,382,331	141,529	8,109,242	273,089
Construction in progress	2,197,187	943,655	1,253,532	492,894	450,761
Total Capital Assets	<u>81,077,856</u>	<u>78,860,028</u>	<u>2,217,828</u>	<u>76,813,174</u>	<u>2,046,854</u>
Less accumulated depreciation	<u>(34,862,275)</u>	<u>(33,130,638)</u>	<u>(1,731,637)</u>	<u>(31,392,956)</u>	<u>(1,737,682)</u>
Net Capital Assets	<u>\$ 46,215,581</u>	<u>\$ 45,729,390</u>	<u>\$ 486,191</u>	<u>\$ 45,420,218</u>	<u>\$ 309,172</u>

The major capital asset additions for the fiscal year 2012 were pipeline installations included in the District's Master Plan Improvement and Replacement Programs, meter, valve and fire hydrant replacements, and general plant addition of office furnishings and miscellaneous office and operation equipment.

Additional information on the District's capital assets can be found in Note 5 to the financial statements on pages 27 and 28 of this report.

DEBT ADMINISTRATION

At year-end, the District had no debt outstanding.

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
(CONTINUED)

June 30, 2012 and 2011

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

The District's Board of Directors and management considered many factors when setting the fiscal year 2013 budget, user fees, and charges. The District tries to balance revenues with operating expenses that have increased due to factors such as the availability of water, cost-of-water and water quality requirements.

The poor economy continues to impact CALPERS plan assets value causing employers contribution rates to fluctuate. For fiscal year 2012, the District's contribution rate increased to 8.208% and the contribution rate for fiscal year 2013 is estimated to increase to 8.299%.

These indicators were taken into consideration when adopting the District's budget for fiscal year 2013. The budget has been structured to contain costs, but at the same time, continue the District's philosophy of providing the highest level of service.

TABLE 5
Fiscal Year 2012 Actual vs. Fiscal Year 2013 Budget

	Fiscal Year 2012 Actual	Fiscal Year 2013 Budget	Variance
Revenues:			
Operating revenues	\$ 8,536,044	\$ 8,919,290	\$ 383,246
Nonoperating revenues	2,768,865	2,789,400	20,535
Total Revenues	<u>11,304,909</u>	<u>11,708,690</u>	<u>403,781</u>
Expenses:			
Depreciation	1,737,643	-	1,737,643
Other operating expenses	8,973,958	9,325,980	(352,022)
Total Expenses	<u>10,711,601</u>	<u>9,325,980</u>	<u>1,385,621</u>
Change in Net Assets	593,308	2,382,710	1,789,402
Beginning Net Assets	<u>64,770,357</u>	<u>65,363,665</u>	<u>593,308</u>
Ending Net Assets	<u>\$ 65,363,665</u>	<u>\$ 67,746,375</u>	<u>\$ 2,382,710</u>

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
(CONTINUED)

June 30, 2012 and 2011

CONTACTING THE DISTRICT'S FINANCIAL MANAGER

This financial report is designed to provide our citizens, customers, investors, and creditors with a general overview of the District's finances and to demonstrate the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact Robert L. Westphal, Manager of Finance at Laguna Beach County Water District.

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT

STATEMENTS OF NET ASSETS

June 30, 2012 and 2011

ASSETS	<u>2012</u>	<u>2011</u>
CURRENT ASSETS:		
Cash and cash equivalents (Note 2)	\$ 1,914,069	\$ 2,056,702
Investments (Note 2)	9,955,978	9,366,292
Accounts receivable	1,384,357	1,585,652
Interest receivable	63,500	49,850
Taxes receivable	52,629	48,334
Notes receivable, current portion (Note 3)	21,335	21,058
Inventory	113,691	158,968
Prepaid expenses	100,891	99,983
Computer loans to employees (Note 4)	9,941	12,930
	<u>13,616,391</u>	<u>13,399,769</u>
TOTAL CURRENT ASSETS		
NONCURRENT ASSETS:		
CAPITAL ASSETS (NOTE 5):		
Land and land rights	1,309,155	1,309,155
Source of supply plant	9,689,489	9,626,246
Pumping plant	5,432,833	5,397,148
Transmission and distribution system	53,925,332	53,201,493
General plant and equipment	8,523,860	8,382,331
Construction in progress	2,197,187	943,655
Subtotal	<u>81,077,856</u>	<u>78,860,028</u>
Less accumulated depreciation	<u>(34,862,275)</u>	<u>(33,130,638)</u>
	46,215,581	45,729,390
TOTAL CAPITAL ASSETS		
OTHER NONCURRENT ASSETS:		
Notes receivable (Note 3)	<u>7,045,439</u>	<u>7,066,774</u>
	53,261,020	52,796,164
TOTAL NONCURRENT ASSETS		
	<u>66,877,411</u>	<u>66,195,933</u>
TOTAL ASSETS		

(Continued)

See independent auditors' report and notes to financial statements.

LAGUNA BEACH COUNTY WATER DISTRICT

STATEMENTS OF NET ASSETS
(CONTINUED)

June 30, 2012 and 2011

LIABILITIES AND NET ASSETS	<u>2012</u>	<u>2011</u>
LIABILITIES:		
CURRENT LIABILITIES:		
Accounts payable	\$ 696,597	\$ 732,456
Accrued payroll and related costs	139	93
Water related deposits	3,525	2,625
Tenant deposit	-	2,000
Construction deposit	49,924	97,666
Accrued vacation, current portion (Note 6)	70,722	64,919
TOTAL CURRENT LIABILITIES	<u>820,907</u>	<u>899,759</u>
NONCURRENT LIABILITIES:		
Accrued vacation (Note 6)	212,165	194,757
Other post-employment benefits liability (Note 8)	480,674	331,060
TOTAL NONCURRENT LIABILITIES	<u>692,839</u>	<u>525,817</u>
TOTAL LIABILITIES	<u>1,513,746</u>	<u>1,425,576</u>
NET ASSETS:		
Invested in capital assets	46,215,581	45,729,390
Unrestricted (Note 9)	19,148,084	19,040,967
NET ASSETS	<u>\$ 65,363,665</u>	<u>\$ 64,770,357</u>

See independent auditors' report and notes to financial statements.

LAGUNA BEACH COUNTY WATER DISTRICT

STATEMENTS OF REVENUES, EXPENSES
AND CHANGES IN NET ASSETS

For the years ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
OPERATING REVENUES:		
Water sales	\$ 7,964,905	\$ 7,138,727
Fire service charges	10,047	9,689
Equipment rental	18,354	41,811
Overhead expense charged out	6,454	27,669
Penalties	55,814	51,775
Customer administration fees	10,039	9,342
Rental income	331,264	328,097
Miscellaneous income	16,577	72,278
Reserve storage charges	47,590	28,000
TOTAL OPERATING REVENUES	<u>8,461,044</u>	<u>7,707,388</u>
OPERATING EXPENSES:		
Water purchased	3,014,175	2,997,593
Source of supply	111,192	151,043
Pumping	461,941	470,653
Transmission and distribution	2,418,895	2,050,785
Customer service	389,387	369,481
General and administrative	2,388,062	2,292,251
Other operation and maintenance	190,306	166,485
Depreciation	1,737,643	1,737,682
TOTAL OPERATING EXPENSES	<u>10,711,601</u>	<u>10,235,973</u>
OPERATING LOSS	<u>(2,250,557)</u>	<u>(2,528,585)</u>
NONOPERATING REVENUES:		
Grants	75,000	-
Interest income	671,395	694,495
Property taxes	2,097,470	2,098,622
TOTAL NONOPERATING REVENUES	<u>2,843,865</u>	<u>2,793,117</u>
CHANGES IN NET ASSETS	593,308	264,532
NET ASSETS - BEGINNING OF YEAR	<u>64,770,357</u>	<u>64,505,825</u>
NET ASSETS - END OF YEAR	<u>\$ 65,363,665</u>	<u>\$ 64,770,357</u>

See independent auditors' report and notes to financial statements.

LAGUNA BEACH COUNTY WATER DISTRICT

STATEMENTS OF CASH FLOWS

For the years ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from customers	\$ 8,613,497	\$ 7,953,328
Payment to suppliers	(5,483,221)	(5,041,399)
Payment to employees	(3,306,365)	(3,118,841)
NET CASH USED BY OPERATING ACTIVITIES	<u>(176,089)</u>	<u>(206,912)</u>
CASH FLOWS FROM NONCAPITAL AND RELATED FINANCING ACTIVITIES:		
Proceeds from taxes	<u>2,093,175</u>	<u>2,119,246</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Proceeds from grants	75,000	-
Acquisition and construction of capital assets	(2,223,836)	(2,046,854)
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(2,148,836)</u>	<u>(2,046,854)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment income	657,745	699,516
Principal payments received on notes receivable	21,058	20,774
(Purchase) sale of investments, net	(589,686)	(1,534,084)
NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES	<u>89,117</u>	<u>(813,794)</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(142,633)	(948,314)
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	<u>2,056,702</u>	<u>3,005,016</u>
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$ 1,914,069</u>	<u>\$ 2,056,702</u>

See independent auditors' report and notes to financial statements.

(Continued)

LAGUNA BEACH COUNTY WATER DISTRICT

STATEMENTS OF CASH FLOWS
(CONTINUED)

For the years ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
RECONCILIATION OF OPERATING LOSS TO		
NET CASH USED BY OPERATING ACTIVITIES:		
Operating loss	\$ (2,250,557)	\$ (2,528,585)
Depreciation	1,737,643	1,737,682
Change in assets and liabilities:		
(Increase) decrease in receivables - customer accounts	201,295	203,199
(Increase) decrease in inventories	45,277	(18,709)
(Increase) decrease in prepaid expenses and deposits	2,083	(8,637)
Increase (decrease) in accounts payable - current	(35,859)	185,004
Increase (decrease) in accrued liabilities	23,257	14,863
Increase (decrease) in other post-employment benefits liability	149,614	165,530
Increase (decrease) in deposits	(48,842)	42,741
	<u> </u>	<u> </u>
NET CASH USED BY OPERATING ACTIVITIES	<u>\$ (176,089)</u>	<u>\$ (206,912)</u>

See independent auditors' report and notes to financial statements.

LAGUNA BEACH COUNTY WATER DISTRICT

NOTES TO FINANCIAL STATEMENTS

June 30, 2012 and 2011

1. DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

a. Reporting Entity:

The Laguna Beach County Water District (the District) was incorporated in 1925, under the County Water District Act of the State Water Code, and is the second oldest operating district of its type in California. The District is governed by the publicly-elected Laguna Beach City Council members, serving as the District's Board of Directors. In 1943, the District joined the Metropolitan Water District of Southern California to import water from Northern California and the Colorado River. The local supply is currently a blend of these two water sources delivered to customers through more than 134 miles of its local transmission and distribution mains.

The District currently serves an area of approximately nine square miles, providing water for municipal and industrial purposes. The 8,045 metered customer services are largely residential and commercial. On January 1, 2004, Emerald Bay Services District was deannexed from the District's service area. This represents approximately 547 customers or 6% of the services served by the District, and accounts for approximately 274 acre feet water provided by the District. The District continues to provide water service and administrative support through an agreement with Emerald Bay Services District.

The District has no production wells. However, it does own one inactive irrigation well in Sycamore Hills, one well site in Fountain Valley, and three well sites in Huntington Beach. The supply source is 100% imported from the Colorado River and State Water Project. The supply lines and control facilities are managed by the District, which also serves water to four neighboring water purveyors.

A network of 21 storage reservoirs, with a total storage capacity of 33.5 million gallons, are placed in five strategic pressure zones to provide regulation, emergency, and peak storage.

b. Change in Organization:

On June 29, 1997, the Board of Directors adopted Resolution No. 564. This Resolution was directed toward an application submitted to the Local Agency Formation Commission of the County of Orange, California (LAFCO) for a change in organization, pursuant to the California Government Code. On September 2, 1998, LAFCO approved the District's application to become a subsidiary district of the City of Laguna Beach, which became effective November 1, 2000.

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

June 30, 2012 and 2011

1. DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

c. Water Rights:

In June 1933, the Superior Court of Orange County entered a judgment decreeing the District's annual right to extract and export 2,025 acre-feet of water from the Santa Ana River Coastal Basin. The District is presently working to resume the exercise of its right to produce and export that water to serve the customers of the District.

d. Method of Accounting:

The District reports its activities as an enterprise fund, which is used to account for operations that are financed and operated in a manner similar to a private business enterprise, where the intent of the District is that the costs (including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. Revenues and expenses are recognized on the accrual basis. 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 flow takes place.

Operating revenues, such as charges for services (water sales) 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. Nonoperating revenues, such as property taxes, and investment income, result from nonexchange transactions or ancillary activities in which the District gives (receives) value without directly receiving (giving) equal value in exchange.

When both restricted and unrestricted resources are available, it is the District's policy to use unrestricted resources first, and then restricted resources as they are needed. As of June 30, 2012, the District had no restricted resources.

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

June 30, 2012 and 2011

1. DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

d. Method of Accounting (Continued):

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

Invested in Capital Assets, Net of Related Debt

This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of notes or borrowings that are attributable to the acquisition of the asset, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds are not included in the calculation of invested in capital assets, net of related debt. The District has no debt attributable to capital assets.

Restricted Net Assets

This component of net assets consists of constraints placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation. The District has no restrictions on net assets.

Unrestricted Net Assets

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

e. Investments:

The District has stated investments at fair value, which is the value at which a financial instrument could be exchanged in a current transaction between willing parties other than forced or liquidation sales.

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

June 30, 2012 and 2011

1. DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

f. Cash and Cash Equivalents:

For the purposes of the statement of cash flows and carrying value purposes, the District considers all highly liquid debt instruments purchased with maturity of three months or less to be cash equivalents.

g. Accounts Receivable:

The District extends credit to customers in the normal course of operations. Management has evaluated the accounts and believes they are all collectible. Management evaluates all accounts receivable and, if it is determined that they are uncollectible, they are written off as bad debt expense. A charge of \$9,712 and \$8,012 was made to bad debt expense for the fiscal years ended June 30, 2012 and 2011, respectively.

h. Inventory:

Material inventory is valued at cost, using the weighted average method.

i. Capital Assets:

Capital assets are stated at historical cost or at fair market value in the case of properties acquired by contribution. Such costs include material, labor, engineering, supervision, payroll taxes and employee benefits. District policy has set the capitalization threshold for reporting capital assets at \$2,000. Expenditures for routine maintenance and repairs are charged to expense as incurred. Depreciation is computed on the straight-line basis over the estimated useful lives of the assets.

Estimated useful lives of the assets for financial reporting purposes are:

Autos and trucks	4 - 10 years
Office furniture and equipment	10 years
Pumping plant	20 years
Meters and services	20 years
Source of supply	10 - 50 years
Transmission mains	20 - 50 years
Reservoirs and tanks	50 - 100 years

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

June 30, 2012 and 2011

1. DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

j. Property Taxes:

Property taxes in California are levied in accordance with Article XIII A of the State Constitution at 1% of countywide assessed valuations. This levy is allocated pursuant to state law to the appropriate units of local government.

The property tax calendar is as follows:

Lien date:	January 1
Levy date:	July 1
Due date:	First installment - November 11 Second installment - February 11
Delinquent date:	First installment - December 12 Second installment - April 9

Taxes are collected by the County of Orange and are remitted to the District periodically according to the following schedule (dates and percentages may vary slightly from year to year):

November 7	7%
December 6	13%
December 20	34%
January 17	2%
March 13	5%
April 24	37%
May 22	2%
July 17	1%

k. Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the statement of net assets date, and reported amounts of revenues and expenses during the reporting period. Estimates are used to determine depreciation expense, the allowance for doubtful account and certain liabilities. Actual results may differ from those estimates.

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

June 30, 2012 and 2011

2. CASH AND INVESTMENTS:

Cash and Investments

Cash and investments reported in the statement of net assets are as follows:

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
Cash and cash equivalents	\$ 1,914,069	\$ 2,056,702
Investments	9,955,978	9,366,292
Total cash and investments	<u>\$ 11,870,047</u>	<u>\$ 11,422,994</u>

Cash and investments consisted of the following:

Cash on hand	\$ 500	\$ 500
Deposits with financial institutions	468,817	366,491
Investments	11,400,730	11,056,003
Total cash and investments	<u>\$ 11,870,047</u>	<u>\$ 11,422,994</u>

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

The table below identifies the investment types that are authorized for the District by the California Government Code (or the District's investment policy, where more restrictive). The table also identifies certain provisions of the California Government Code (or the District's investment policy, where more restrictive) that address interest rate risk, credit risk, and concentration of credit risk.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Allowed</u>	<u>Maximum Investment in One Issuer</u>
United States Treasury Obligations	5 years	100%	None
United States Government Sponsored Agency Securities	5 years	100%	None
Banker's Acceptances Notes	180 days	40%	30%
Certificates of Deposit	5 years	100%	None
Negotiable Certificates of Deposit	5 years	30%	None
Commercial Paper	270 days	25%	10%
Medium-Term Corporate Notes	5 years	30%	None
Local Agency Investment Fund (LAIF)	N/A	100%	\$ 50,000,000
Money Market Mutual Funds	N/A	20%	None
Municipal Notes or Bonds	5 years	20%	\$ 500,000

As of June 30, 2012, the District's investments included \$775,000 in municipal bonds of local agencies located in states other than California. Municipal bonds of this type are not authorized by California Government Code Section 53601.

N/A- Not Applicable

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

June 30, 2012 and 2011

2. CASH AND INVESTMENTS (CONTINUED):

Disclosures Relating to 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 to changes in market interest rates. One of the ways that the District manages its exposure to interest rate risk is 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 is maturing or coming close to maturity evenly over time as necessary to provide the 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:

June 30, 2012

<u>Investment Type</u>	<u>Remaining Maturity (in Months)</u>			<u>Total</u>
	<u>12 Months or Less</u>	<u>13 - 24 Months</u>	<u>25 - 60 Months</u>	
United States Government Sponsored				
Agency Securities	\$ -	\$ -	\$ 1,133,653	\$ 1,133,653
Negotiable Certificates of Deposit	100,742	-	2,392,863	2,493,605
Certificates of Deposit	389,000	300,000	398,000	1,087,000
Medium Term Corporate Notes	822,701	412,273	1,867,505	3,102,479
Municipal Notes or Bonds	476,474	295,825	1,366,944	2,139,243
Local Agency Investment Fund	1,444,750	-	-	1,444,750
	<u>\$ 3,233,667</u>	<u>\$ 1,008,098</u>	<u>\$ 7,158,965</u>	<u>\$ 11,400,730</u>

June 30, 2011

<u>Investment Type</u>	<u>Remaining Maturity (in Months)</u>			<u>Total</u>
	<u>12 Months or Less</u>	<u>13 - 24 Months</u>	<u>25 - 60 Months</u>	
United States Government Sponsored				
Agency Securities	\$ -	\$ -	\$ 2,496,288	\$ 2,496,288
Negotiable Certificates of Deposit	393,337	204,447	1,251,439	1,849,223
Certificates of Deposit	497,000	389,000	498,000	1,384,000
Medium Term Corporate Notes	253,298	263,478	2,041,785	2,558,561
Municipal Notes or Bonds	100,914	475,199	502,107	1,078,220
Local Agency Investment Fund	1,689,711	-	-	1,689,711
	<u>\$ 2,934,260</u>	<u>\$ 1,332,124</u>	<u>\$ 6,789,619</u>	<u>\$ 11,056,003</u>

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

June 30, 2012 and 2011

2. CASH AND INVESTMENTS (CONTINUED):

Disclosures Relating to 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 legal rating required by (where applicable) the California Government Code, the District's investment policy, and the Standard and Poor's credit ratings as of year end for each investment type.

June 30, 2012

Investment Type	Total	Minimum Legal Rating	AA+	Other	Unrated	Not Required to be Rated
United States Government Sponsored						
Agency Securities	\$ 1,133,653	N/A	\$ 1,133,653	\$ -	\$ -	\$ -
Negotiable Certificates of Deposit	2,493,605	N/A	-	-	2,493,605	-
Certificates of Deposit	1,087,000	N/A	-	-	-	1,087,000
Medium-term Corporate Notes (MTN)	3,102,479	A	251,690	2,850,789	-	-
Municipal Notes or Bonds (MNB)	2,139,243	A	231,100	1,908,143	-	-
Local Agency Investment Funds	<u>1,444,750</u>	N/A	-	-	1,444,750	-
Total	<u>\$ 11,400,730</u>		<u>\$ 1,616,443</u>	<u>\$ 4,758,932</u>	<u>\$ 3,938,355</u>	<u>\$ 1,087,000</u>

N/A - Not Applicable

The actual ratings for the Medium-Term Corporate Notes (MTN) and Municipal Notes or Bonds (MNB) are as follows:

Other:	<u>MTN</u>	<u>MNB</u>
AA	\$ 247,098	\$ 151,974
AA-	-	509,713
Aa3 (Moody's credit rating)	-	361,120
A+	507,103	587,494
A	665,442	297,842
A-	<u>1,431,146</u>	<u>-</u>
	<u>\$2,850,789</u>	<u>\$1,908,143</u>

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

June 30, 2012 and 2011

2. CASH AND INVESTMENTS (CONTINUED):

Disclosures Relating to Credit Risk (Continued)

June 30, 2011

Investment Type	Total	Minimum Legal Rating	AAA	Other	Unrated	Not Required to be Rated
United States Government Sponsored						
Agency Securities	\$ 2,496,288	N/A	\$ 2,496,288	\$ -	\$ -	\$ -
Negotiable Certificates of Deposit	1,849,223	N/A	-	-	1,849,223	-
Certificates of Deposit	1,384,000	N/A	-	-	-	1,384,000
Medium-term Corporate Notes (MTN)	2,558,561	A	250,148	2,308,413	-	-
Municipal Notes or Bonds (MNB)	1,078,220	A	-	1,078,220	-	-
Local Agency Investment Funds	<u>1,689,711</u>	N/A	-	-	<u>1,689,711</u>	-
Total	<u>\$ 11,056,003</u>		<u>\$ 2,746,436</u>	<u>\$ 3,386,633</u>	<u>\$ 3,538,934</u>	<u>\$ 1,384,000</u>

N/A - Not Applicable

The actual ratings for the Medium-Term Corporate Notes (MTN) and Municipal Notes or Bonds (MNB) are as follows:

Other:	<u>MTN</u>	<u>MNB</u>
AA+	\$ 253,298	\$ 250,329
AA-	-	101,992
Aa3 (Moody's credit rating)	254,310	150,731
A+	246,558	330,202
A	1,554,247	144,055
MIG2 (Moody's credit rating)	<u>-</u>	<u>100,911</u>
	<u>\$2,308,413</u>	<u>\$1,078,220</u>

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

June 30, 2012 and 2011

2. CASH AND INVESTMENTS (CONTINUED):

Concentration of Credit Risk

The investment policy of the District contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. At June 30, 2012, investments in any one issuer that represent 5% or more of total District's investments are as follows:

<u>Issuer</u>	<u>Investment Type</u>	<u>Reported Amount</u>	<u>Percent of Investments</u>
Federal National Mortgage Association	United States Government Sponsored Agency Securities	\$ 1,008,653	8.85 %

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. The California Government Code and the District's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: 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. At June 30, 2012, all of the District's deposits are insured or collateralized.

Investment in State Investment Pool

The District is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by California Government Code section 16429 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.

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

June 30, 2012 and 2011

3. NOTES RECEIVABLE:

Related Party Notes Receivable

On April 23, 2002, the Board of Directors approved a loan to the District's general manager for purchase of a residence, the location of which is restricted within the parameters listed in the agreement. The loan was funded on August 15, 2002. The loan is payable in biweekly payments, beginning on the 1st day of October 2002 and amortized over a period of 25 years. Interest rate is variable and is payable biweekly at rates of 0.25% over Local Agency Investment Fund (LAIF) rate with a cap rate of 7%. The loan is secured by a deed of trust on the residence. At June 30, 2012, the outstanding balance on the note was \$316,774.

The following is a schedule of principal and interest payments due on the related party notes receivable:

Year Ending June 30,	Principal	Interest	Total
2013	\$ 21,335	\$ 4,582	\$ 25,917
2014	21,616	4,301	25,917
2015	21,902	4,015	25,917
2016	22,191	3,726	25,917
2017	22,485	3,432	25,917
2018 - 2022	117,977	9,773	127,750
2023 - 2026	89,268	4,164	93,432
	<u>\$ 316,774</u>	<u>\$ 33,993</u>	<u>\$ 350,767</u>

Promissory Note Receivable

On January 28, 2005, the District sold the property that was formerly occupied by K-Mart. As part of the sale, the District received a promissory note in the amount \$6,750,000. The note is secured by a deed of trust on the property. The note calls for monthly interest payments, computed at a rate ranging from 6% to 7%, for the first ten years. On the first day of the first calendar month following the tenth year, the note calls for monthly payments equal to the amount required to fully amortize the principal balance over a twenty-five year period at an interest rate of 7.25%. Starting on the first day of the first calendar month following the fifteenth year, the note calls for monthly payments equal to the amount required to fully amortize principal balance over a twenty-five year period at an interest rate of 7.50%. At the end of the twenty-fifth year, the remaining principal and any accrued interest are due.

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LAGUNA BEACH COUNTY WATER DISTRICT

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

June 30, 2012 and 2011

3. NOTES RECEIVABLE (CONTINUED):

Promissory Note Receivable (Continued)

The District modified the terms of the note dated January 28, 2005 with a modification agreement dated June 24, 2009. Under the modified agreement, the interest rate for the period July 1, 2009 through June 30, 2013 was reduced to 5.75%, resulting in deferred interest of \$275,625. The deferred interest of \$275,625 is to be repaid in the amount of \$3,445 commencing July 1, 2013 and the following 79 months. Under the modification, the time during which the borrower may make interest only payments under the note was extended from the first day of the first calendar month following the tenth anniversary of the recording date to February 1, 2017. At June 30, 2012, the outstanding balance on the note was \$6,750,000.

The following is a schedule of principal and interest payments due on the promissory note receivable:

Year Ending June 30,	Principal	Interest	Total
2013	\$ -	\$ 388,125	\$ 388,125
2014	-	513,844	513,844
2015	-	519,469	519,469
2016	-	530,719	530,719
2017	42,655	530,334	572,989
2018 - 2022	732,125	2,450,899	3,183,024
2023 - 2027	994,529	2,068,930	3,063,459
2028 - 2032	1,445,343	1,618,115	3,063,458
2033 -2037	2,100,510	962,949	3,063,459
2038 - 2040	1,434,838	147,950	1,582,788
	<u>\$ 6,750,000</u>	<u>\$ 9,731,334</u>	<u>\$ 16,481,334</u>

4. COMPUTER LOANS TO EMPLOYEES:

In March 1999, the District started the Employee Personal Computer Purchase Plan to encourage computer literacy of full-time District employees through the purchase and use of personal computers and software. Any full-time employee in good standing who has completed the probationary period and agrees to the provisions of the plan is eligible for a maximum 24-month noninterest loan of \$2,000. The District has allocated a limit of \$50,000 for this program. As of June 30, 2012 and 2011, there were fifteen and sixteen participants in the plan, respectively. Outstanding balances as of June 30, 2012 and 2011 are \$9,941 and \$12,930 respectively.

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

June 30, 2012 and 2011

5. CAPITAL ASSETS:

The following is a summary of changes in capital assets at June 30, 2012.

	<u>Balance</u> <u>July 1, 2011</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2012</u>
Capital assets, not being depreciated:				
Land and land rights	\$ 1,309,155	\$ -	\$ -	\$ 1,309,155
Construction in progress	<u>943,655</u>	<u>2,333,382</u>	<u>(1,079,850)</u>	<u>2,197,187</u>
Total capital assets, not being depreciated	<u>2,252,810</u>	<u>2,333,382</u>	<u>(1,079,850)</u>	<u>3,506,342</u>
Capital assets, being depreciated:				
Source of supply plant	9,626,246	63,243	-	9,689,489
Pumping plant	5,397,148	36,441	(756)	5,432,833
Transmission and distribution system	53,201,493	729,089	(5,250)	53,925,332
General plant and equipment	<u>8,382,331</u>	<u>141,529</u>	<u>-</u>	<u>8,523,860</u>
Total capital assets being depreciated	<u>76,607,218</u>	<u>970,302</u>	<u>(6,006)</u>	<u>77,571,514</u>
Less accumulated depreciation:				
Source of supply plant	(4,608,572)	(224,596)	-	(4,833,168)
Pumping plant	(3,767,225)	(207,373)	756	(3,973,842)
Transmission and distribution system	(17,543,845)	(1,069,987)	5,250	(18,608,582)
General plant and equipment	<u>(7,210,996)</u>	<u>(235,687)</u>	<u>-</u>	<u>(7,446,683)</u>
Total accumulated depreciation	<u>(33,130,638)</u>	<u>(1,737,643)</u>	<u>6,006</u>	<u>(34,862,275)</u>
Total capital assets being depreciated, net	<u>43,476,580</u>	<u>(767,341)</u>	<u>-</u>	<u>42,709,239</u>
Total capital assets, net	<u>\$ 45,729,390</u>	<u>\$ 1,566,041</u>	<u>\$ (1,079,850)</u>	<u>\$ 46,215,581</u>

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

June 30, 2012 and 2011

5. CAPITAL ASSETS (CONTINUED):

The following is a summary of changes in capital assets at June 30, 2011.

	<u>Balance</u> <u>July 1, 2010</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2011</u>
Capital assets, not being depreciated:				
Land and land rights	\$ 1,309,155	\$ -	\$ -	\$ 1,309,155
Construction in progress	<u>492,894</u>	<u>2,093,651</u>	<u>(1,642,890)</u>	<u>943,655</u>
Total capital assets, not being depreciated	<u>1,802,049</u>	<u>2,093,651</u>	<u>(1,642,890)</u>	<u>2,252,810</u>
Capital assets, being depreciated:				
Source of supply plant	9,579,605	46,641	-	9,626,246
Pumping plant	5,272,069	125,079	-	5,397,148
Transmission and distribution system	52,050,209	1,151,284	-	53,201,493
General plant and equipment	<u>8,109,242</u>	<u>273,089</u>	<u>-</u>	<u>8,382,331</u>
Total capital assets being depreciated	<u>75,011,125</u>	<u>1,596,093</u>	<u>-</u>	<u>76,607,218</u>
Less accumulated depreciation:				
Source of supply plant	(4,385,426)	(223,146)	-	(4,608,572)
Pumping plant	(3,560,920)	(206,305)	-	(3,767,225)
Transmission and distribution system	(16,468,595)	(1,075,250)	-	(17,543,845)
General plant and equipment	<u>(6,978,015)</u>	<u>(232,981)</u>	<u>-</u>	<u>(7,210,996)</u>
Total accumulated depreciation	<u>(31,392,956)</u>	<u>(1,737,682)</u>	<u>-</u>	<u>(33,130,638)</u>
Total capital assets being depreciated, net	<u>43,618,169</u>	<u>(141,589)</u>	<u>-</u>	<u>43,476,580</u>
Total capital assets, net	<u>\$ 45,420,218</u>	<u>\$ 1,952,062</u>	<u>\$ (1,642,890)</u>	<u>\$ 45,729,390</u>

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

June 30, 2012 and 2011

6. COMPENSATED ABSENCES:

In accordance with Governmental Accounting Standards Board Codification C60.110, "Accounting for Compensated Absences" requirements, the District has accrued the potential liability for accrued vacation pay totaling \$282,887 and \$259,676 as of June 30, 2012 and 2011, respectively. Employees earn vacation and sick leave each month at various rates depending on length of service. Sick leave can be accumulated and rolled over into the retirement plan (see Note 7). The CalPERS system includes an estimate for this amount in its actuarial calculations. There is no material amount of sick leave accrued that is not provided for by the CalPERS calculation, therefore, no sick leave amount has been accrued in the District's financial statements.

7. EMPLOYEE'S RETIREMENT PLAN:

a. Plan Description:

The District participates in the Miscellaneous 2% at 55 Risk Pool of the California Public Employee's Retirement System (CalPERS), a cost-sharing, multiple-employer defined benefit pension plan administered by CalPERS. CalPERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Benefit provisions and all other requirements are established by State statute and District ordinance. Copies of the CalPERS' annual financial report may be obtained from the CalPERS Executive Office - 400 P Street, Sacramento, California 95814.

b. Funding Policy:

The contribution requirements of the plan members are established by State statute and the employer contribution rate is established and may be amended by CalPERS. Active District employees are required to contribute 7% of their annual salary to CalPERS, of which the District paid 7%. The District is required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The current rate is 8.208% of covered payroll. The District's contributions to CalPERS for the years ending June 30, 2012, 2011 and 2010 were \$491,720, \$401,802 and \$353,983, respectively and were equal to the required contribution for each year.

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

June 30, 2012 and 2011

8. OTHER POST-EMPLOYMENT BENEFITS (OPEB):

a. Plan Description:

The District, through a single employer defined benefit plan, provides post-employment health care benefits. Specifically, the District provides health insurance for its retired employees and their dependent spouses (if married and covered on the District's plan at time of retirement). Medical coverage is provided for retired employees who are in the age range of between 60 and 64 and who have served the District on a full-time basis for ten continuous years. The employee must have participated in the District's CalPERS plan during their tenure with the District. The employee must have applied for and be receiving service retirement benefits pursuant to the terms and conditions of the District's CalPERS plan. The District pays 100% of the plan premium for retiree coverage from the date of retirement until the date the retired employee becomes eligible to receive Medicare benefits. Coverage for retired employee's spouse under the health insurance plan is at the sole cost of the employee. District's obligation to provide benefits ceases upon death of retiree or medicare eligibility, whichever is earlier. The plan does not provide a publicly available financial report.

b. Funding Policy:

The contribution requirements of plan members and the District are established and may be amended by the District, District's Board of Directors, and/or the employee associations. Currently, contributions are not required from plan members. The District is currently funding this OPEB obligation on a pay-as-you-go basis. For the year ended June 30, 2012, the District had three eligible retired employees.

c. Annual OPEB Cost and Net OPEB Obligation:

The District's annual OPEB cost (expense) is calculated based on the annual required contribution of the employer (ARC). The District has elected to calculate the ARC and related information using the alternative measurement method permitted by GASB Statement 45 for employers in plans with fewer than one hundred plan members. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded liabilities of the plan over a period not to exceed thirty years.

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

June 30, 2012 and 2011

8. OTHER POST-EMPLOYMENT BENEFITS (OPEB) (CONTINUED):

c. Annual OPEB Cost and Net OPEB Obligation (Continued):

The following table shows the components of the District's annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the District's net OPEB obligation to the Retiree Health Plan:

Annual required contribution	\$	165,530
Interest on net OPEB obligation		-
Adjustment to annual required contribution		-
Annual OPEB cost (expense)		<u>165,530</u>
Actual contributions made		<u>(15,916)</u>
Increase in net OPEB obligation		149,614
Net OPEB Obligation - beginning of year		<u>331,060</u>
Net OPEB Obligation - end of year	\$	<u><u>480,674</u></u>

The District's annual OPEB cost, the percentage of annual OPEB costs contributed to the plan, and the net OPEB obligation for the year ended June 30, 2012, the third year in which GASB Statement 45 is required to be implemented, were as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Costs Contributed	Net OPEB Obligation
6/30/10	\$ 165,530	0%	\$ 165,530
6/30/11	165,530	0%	331,060
6/30/12	165,530	9.62%	480,674

d. Funded Status and Funding Progress:

As of July 1, 2009, the first actuarial valuation date, the plan was zero percent funded. The actuarial accrued liability for benefits was \$995,637, and the actuarial value of assets was zero, resulting in an unfunded accrued liability (UAL) of \$995,637. The covered payroll (annual payroll of active employees covered by the plan) was \$2,962,352 and the ratio of the UAL to the covered payroll was 33.6%.

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

June 30, 2012 and 2011

8. OTHER POST-EMPLOYMENT BENEFITS (OPEB) (CONTINUED):

d. Funded Status and Funding Progress (Continued):

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about rates of employee turnover, retirement, mortality, as well as economic assumptions regarding claim costs per retiree, healthcare inflation and interest rates. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. 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 benefits.

e. Actuarial Methods and Assumptions:

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. In the July 1, 2009 actuarial investment valuation, the projected unit credit method was used. The actuarial assumptions included a 5% investment rate of return and the District's share of health care trend rates will increase at a rate of 7% for the year 2009, 6% for the year 2010 and 5% for the years 2011 and thereafter. The District's unfunded actuarial accrued liability will be amortized over thirty years.

9. UNRESTRICTED NET ASSETS:

Amounts shown as unrestricted net assets have been reserved by Board action to be used for specified purposes as listed below:

	<u>2012</u>	<u>2011</u>
Operating reserve fund	\$ 930,000	\$ 500,000
CIP replacement fund	-	12,400,967
Master plan projects fund	-	700,000
Self insurance/emergency reserve fund	3,895,800	800,000
Rate stabilization reserve fund	330,000	500,000
Reservoir replacement fund	4,500,000	4,140,000
Employee liabilities	525,000	-
Capital replacement	8,767,284	-
Water supply reliability	200,000	-
Totals	<u>\$ 19,148,084</u>	<u>\$ 19,040,967</u>

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

June 30, 2012 and 2011

10. RISK MANAGEMENT:

The District is a member of the Association of California Water Agencies Joint Powers Insurance Authority (Insurance Authority). The Insurance Authority is a risk-pooling self-insurance authority, created under provisions of California Government Code Sections 6500 et. seq. The purpose of the Authority is to arrange and administer programs of insurance for the pooling of self-insured losses and to purchase excess insurance coverage.

At June 30, 2012, the District participated in the self-insurance programs of the Insurance Authority as follows:

Property Loss - The Insurance Authority has pooled self-insurance up to \$50,000 per occurrence and has purchased excess insurance coverage up to \$100,000,000 (total insurable value of \$13,464,645). The District has a \$2,500 deductible for buildings, personal property, fixed and mobile equipment and a \$1,000 deductible for licensed vehicles.

General Liability - The District is insured up to \$60,000,000 with no deductible. The Insurance Authority has pooled self-insurance up to \$2,000,000 per occurrence and has purchased excess insurance coverage up to \$60,000,000.

Auto Liability - The District is insured up to \$60,000,000 with no deductible. The Insurance Authority has pooled self-insurance up to \$2,000,000 per occurrence and has purchased excess insurance coverage up to \$60,000,000.

Public Officials' Liability - The District has coverage for errors and omissions for up to \$60,000,000. The Insurance Authority has pooled self-insurance up to \$2,000,000 per occurrence and has purchased excess insurance coverage up to \$60,000,000.

Fidelity Bond - The Insurance Authority has pooled self-insurance up to \$100,000 per occurrence. The District has a \$1,000 deductible.

Workers' Compensation - Employer's liability is insured up to a \$4,000,000 limit. The Insurance Authority has pooled self-insurance up to \$2,000,000 and has purchased excess insurance coverage up to \$2,000,000.

Underground Storage Tank Pollution Liability - The District is insured up to \$3,500,000 with a \$10,000 deductible, per environmental incident; the Authority is self-insured up to \$500,000 and excess insurance coverage has been purchased to cover losses ranging from \$500,000 to \$3,000,000.

The District pays annual premiums for the coverages. There were no instances in the past three years when a settlement exceeded the District's coverage.

See independent auditors' report.

LAGUNA BEACH COUNTY WATER DISTRICT

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

June 30, 2012 and 2011

11. OPERATING LEASES:

As of June 30, 2012, the District has operating leases with various communication companies to rent space on District occupied property. The operating leases are on a month-to-month basis with the District receiving monthly lease payments totaling \$25,000.

See independent auditors' report.

REQUIRED SUPPLEMENTARY INFORMATION
OTHER POST-EMPLOYMENT BENEFIT PLAN
SCHEDULE OF FUNDING PROGRESS

LAGUNA BEACH COUNTY WATER DISTRICT
 REQUIRED SUPPLEMENTARY INFORMATION

For the year ended June 30, 2012

**OTHER POST-EMPLOYMENT BENEFIT PLAN
 SCHEDULE OF FUNDING PROGRESS**

Retiree Health Plan

Actuarial Valuation Date	Actuarial Accrued Liability (AAL) (a)	Actuarial Value of Assets (AVA) (b)	Unfunded Actuarial Accrued Liability (UAAL) (a) - (b)	Funded Ratio (b)/(a)	Annual Covered Payroll (c)	UAAL as a Percentage of Payroll [(a)-(b)]/(c)
07/01/09	\$ 995,637	\$ -	\$ 995,637	0.00%	\$ 2,962,352	33.61%

See independent auditors' report.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Board of Directors
Laguna Beach County Water District
Laguna Beach, California

We have audited the basic financial statements of the Laguna Beach County Water District (the District) as of and for the year ended June 30, 2012 and have issued our report thereon, dated November 13, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the District is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the District's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance that is required to be reported under Government Auditing Standards. As of June 30, 2012, the District's investments included \$775,000 in municipal bonds of local agencies located in states other than California. Municipal bonds of this type are not authorized by California Government Code Section 53601.

This report is intended solely for the information and use of the District's management, Board of Directors and others within the District and is not intended to be and should not be used by anyone other than these specified parties.

White Nelson Nick Evans LLP

Irvine, California
November 13, 2012

Board of Directors
Laguna Beach County Water District
Laguna Beach, California

We have audited the financial statements of the Laguna Beach County Water District for the year ended June 30, 2012, and have issued our report thereon dated November 13, 2012. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our planning letter dated June 20, 2012 and during our planning meeting on June 21, 2012. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings:

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Laguna Beach County Water District are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of other existing accounting policies was not changed during the year ended June 30, 2012. We noted no transactions entered into by the Laguna Beach County Water District during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

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

The most sensitive estimates affecting the financial statements were:

- a. Management's estimate of the fair market value of investments which is based on market values provided by outside sources.
- b. Management's estimate of the useful lives of capital assets for depreciation purposes is based on industry standards.
- c. The annual required contribution for the District's Other Post-Employment Benefits was based on an actuarial valuation prepared by an outside consultant.

Significant Audit Findings (Continued):

Qualitative Aspects of Accounting Practices (Continued)

We evaluated the key factors and assumptions used to develop these estimates in determining that they were reasonable in relation to the financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosure affecting the financial statements was reported in Note 8 to the financial statements regarding the annual required contribution and the actuarial liability for the District's Other Post-Employment Benefits.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. The attached schedule summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

Disagreements with Management

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

Management Representations

We have requested certain representations from management that are included in the management representation letter dated November 13, 2012.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Laguna Beach County Water District's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

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

This information is intended solely for the use of the Board of Directors and management of the Laguna Beach County Water District and is not intended to be and should not be used by anyone other than these specified parties.

White Nelson Dick Evans LLP

Irvine, California
November 13, 2012

