FALLBROOK PUBLIC UTILITY DISTRICT

Annual Financial Report

For the Years Ended
June 30, 2013 and 2012

MGO Certified Public Accountants.

FALLBROOK PUBLIC UTILITY DISTRICT
Annual Financial Report

For the Years Ended June 30, 2013 and 2012

Table of Contents

INDEPENDENT AUDITOR’S REPORT

MGO Certified Public Accountants.

Sacramento
3000 S Street, Suite 300
Sacramento, CA 95816
916.928.4600

Walnut Creek

Oakland

LA/Century City

Newport Beach

San Diego

Seattle

Independent Auditor's Report

The Board of Directors of the
Fallbrook Public Utility District

Report on the Financial Statements

We have audited the accompanying financial statements of the Fallbrook Public Utility District (District) as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the District, as of June 30, 2013 and 2012, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

www.mgocpa.com

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the OPEB schedule of funding progress, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during 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.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the District's basic financial statements. The Schedules of Revenues and Expenses by Operating Department and miscellaneous statistical information, as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements.

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

The miscellaneous statistical information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 3, 2013, on our consideration of the District's internal control over financial reporting and on 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

Macias Gini & O'Connell LLP

San Diego, California
December 3, 2013

MANAGEMENT’S DISCUSSION AND ANALYSIS

FALLBROOK PUBLIC UTILITY DISTRICT
Management's Discussion and Analysis
(Unaudited)

This Management's Discussion and Analysis (MD&A) of the Fallbrook Public Utility District's (District) financial performance offers readers of the District's financial statements the following narrative overview and analysis of the District's financial activities for the years ended June 30, 2013 and 2012. Please read it in conjunction with the District's basic financial statements, which begin immediately following this analysis.

Financial Highlights (FY 12-13)

- The assets of the District exceeded its liabilities at the close of the June 30, 2013 fiscal year by $76.8 million (net position).

- Design of the Wastewater Treatment Plant's rehabilitation was completed during the fiscal year. Costs for design and planning of the rehabilitation were $1.6 million with construction scheduled to begin before December 31, 2013.

- The District began an aggressive program of water pipeline and valve replacements which will continue into the future. Also during the fiscal year, the Red Mountain Pressure Regulating Station was designed and constructed as a pressure control facility to replace the existing deteriorated valve structure. Total capitalized expenses for these projects were approximately $1.64 million.

- Beginning in FY 12-13 a program of sewer pipelines and manhole replacement began and will continue. In FY 12-13 $347,000 in sewer pipeline projects were completed.

- The District's operating income of $13,987 when netted with the nonoperating revenue of $4.05 million results in a $4.07 million increase in net position before accounting for capital contributions. The largest sources of nonoperating revenues are property taxes, water and wastewater capital improvement charges and the California Solar Initiative rebate. These combined account for $3.6 million of the $4.05 million in nonoperating revenue. During FY 12-13 the District sold 10 new water meters and 30 sewer permits collecting $247,600 in connection fee revenues. Depreciation expense of $3.5 million is charged as an operating expense.

- For FY 12-13 the District's total operating revenue increased by $3.9 million due largely to increased water and recycled water sales. Sales were budgeted to remain at FY 11-12 levels, or 10,600 acre feet (AF) of potable water and 600 AF of recycled water. Actual sales for FY 12-13 were 12,188 AF and 735 AF respectively. Actual sales in FY 11-12 were 11,258 AF and 545 AF, respectively. The District uses a 3 tiered rate structure for potable water sales so that as certain thresholds of water usage are exceeded, the rate charged increases to the next tier. When sales exceed budgeted acre feet, a larger proportion of this water is sold at the higher priced tiers. The 3 tier structure was established in FY 08-09 in response to water shortages and potential mandatory cutbacks. Should mandatory cutbacks take place, based on the level of the water shortage, the percent increase between tiers will be increased based on the District's Water Shortage Response Plan, which encourages conservation. The District passes through all San Diego County Water Authority increases in the wholesale cost of water. The District's wholesale cost of water increased 9.7%

- The Board of Directors formed a North County Joint Powers Authority (JPA) with the Rainbow Municipal Water District (Rainbow). The formation of the JPA is expected to result in the decrease of expenses for both districts as resources such as employees and heavy equipment are shared. Beginning in April 2013, a leasing agreement was finalized where the District's General Manager salary is split between the two districts and other services such as Engineering and Safety services are also shared based on actual hours worked on specific projects. The JPA Board voted to continue resource sharing through FY 13-14 when the JPA Board and both the Fallbrook Public Utility District Board and Rainbow Municipal Water District Board will consider a consolidation.

Financial Highlights (FY 11-12)

- The assets of the District exceeded its liabilities at the close of the June 30, 2012 fiscal year by $72.2 million (net position).

- The $7.3 million solar facility located at the Wastewater Treatment Plant is fully functional. Cost savings were realized during the fiscal year to include approximately $350,000 of reductions in utility expenses and payments to San Diego Gas & Electric (SDG&E). Additionally, the District began receiving the California Solar Initiative (CSI) rebate of $.32/kilowatt hour (kwh), which amounted to $535,000 for FY 11-12. This revenue is reported as CSI Rebate in the Nonoperating Revenues (Expenses) section of the Statements of Revenues, Expenses and Changes in Net Position. This revenue plus the SDG&E savings along with a Federal government interest subsidy should fully cover the debt service requirement for this facility.

- The District's operating loss of $2.2 million when netted against the nonoperating revenue of $2.97 million results in a $774,308 increase in net position before accounting for capital contributions. The $2.2 million operating loss is due to depreciation expense in the amount of $3.08 million being included as an operating expense.

- For FY 11-12, the District's total operating revenue increased by $2.4 million due largely to increased water and recycled water sales. Potable water sales were budgeted to be 10,600 acre feet, actual sales were 11,258 acre feet. Both mandatory cutbacks for agricultural customers and voluntary cutbacks for Municipal & Industrial (M&I) customers ended in April 2011. The District's wholesale cost of water increased by 14.7%, an increase which was passed onto the District's customers. As a result, operating expenses increased by $2.05 million mostly due to the increased wholesale cost of water. At the direction of the Board of Directors, all controllable costs were held to a net zero increase, which meant that the monthly Operations Charge was held at FY 08-09 levels. The Wastewater division implemented a new rate structure beginning in FY 09-10. Single family residences' sewer charges were based on each home's lowest month of winter water usage for the period of November through March during the previous year. All other customer sewer charges are billed based on flow of water used each month combined with an RTS (Return to Sewer) percentage and strength classification, which was calculated based on standard industrial classifications. An extensive appeals process was also implemented and is still in place. Overall, the results have been a sewer rate methodology, which is more equitable based on the actual sewage put into the system per customer. Wastewater revenues increased by $168,368 due to the increased water sales and resultant increased flows into the Wastewater Treatment Plant.

- Nonoperating revenues, net of nonoperating expenses, increased by approximately \$780,000 mostly due to the California Solar Initiative (CSI) rebate of \$535,000. When water restrictions were eased in April 2011, the District's demand offset fees were also eliminated. The FY 11-12 connection fee revenue from water meter sales and sewer permit fees was \$190,900. The District sold 14 new water meters and 25 sewer permits.

Overview of the Basic Financial Statements

The MD&A is intended to serve as an introduction to the District's basic financial statements. The District operates as a utility enterprise. The District's basic financial statements include two components: (1) enterprise fund financial statements and (2) notes to the basic financial statements.

Basic Financial Statements

The financial statements are designed to provide readers with a broad overview of the District's finances, in a manner similar to a private-sector business. The basic financial statements can be found on pages 16-19 of this report.

The *Statement of Net Position* presents information on all of the District's assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the District is improving or deteriorating.

The *Statement of Revenues, Expenses and Changes in Net Position* presents information showing how the District's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows.

The *Statement of Cash Flows* presents relevant information about the cash receipts and cash payments for the period categorized according to whether they stem from operating, noncapital financing, capital and related financing, or investing activities. This statement helps users assess the District's ability to generate future net cash flows, its ability to meet its obligations as they come due, and its needs for financing. It also helps assess the effects on the District's financial position and changes in its cash and noncash investing, capital and financing transactions during the period.

The *Notes to the Basic Financial Statements* provide additional information that is essential to a full understanding of the data provided in the basic financial statements and are an integral part of the financial statements. The notes to the financial statements can be found on pages 20-40 of this report.

Financial Analysis of the District

The Statements of Net Position and the Statements of Revenues, Expenses and Changes in Net Position report information about the District's activities in a way that will help answer questions as to whether the District, as a whole, is better or worse off as a result of this year's activities. These two statements report the ne position of the District and changes in it. One can think of the District's net position as the difference between assets (what is owned) and liabilities (what is owed) and is one way to measure its financial health or position.

Condensed Statements of Net Position

	June 30, 2013	June 30, 2012*	Change
Assets:			
Current Assets	$ 19,487,033	$ 15,092,262	$ 4,394,771
Restricted Assets	1,466,499	1,441,720	24,779
Capital Assets, net	73,421,598	73,409,418	12,180
Deferred Charges, net	143,738	154,385	(10,647)
Total Assets	94,518,868	90,097,785	4,421,083
Liabilities:			
Current Liabilities	4,009,552	4,698,119	(688,567)
Noncurrent Liabilities	13,687,225	13,240,164	447,061
Total Liabilities	17,696,777	17,938,283	(241,506)
Net Position:			
Net Investment in Capital Assets	60,195,379	60,609,683	(414,304)
Restricted	1,213,780	1,213,780	-
Unrestricted	15,412,932	10,336,039	5,076,893
Total Net Position	$ 76,822,091	$ 72,159,502	$ 4,662,589

**Amounts have been reclassified from those previously reported to conform with the current year's presentation*

The largest and most significant portion of the District's net position are its investment in capital assets, which are used to provide services to its customers. Water assets include the pipeline distribution system, the dam at the Red Mountain reservoir and equipment and structures. Wastewater assets include the sewage collections system, wastewater treatment plant, solar generating plant, equipment and ownership of the Oceanside Ocean Outfall.

During FY 12-13, $4.04 million in water, wastewater and recycling projects were completed. The largest water projects were the Red Mountain Pressure Regulating Station and the various pipeline replacement projects as well as the valve replacement project along Mission Road. These projects accounted for $1.64 million in capital improvements. The largest wastewater project was the completion of the design and planning of the wastewater treatment plant rehabilitation. Construction will begin in September 2013 and take until approximately December 2015 to complete. The treatment plant will continue to operate while it is being rehabilitated, contributing to the total expected $28 million cost of the project. Low cost State Revolving Fund (SRF) financing has been approved. Current assets increased by $4.4 million in FY 12-13 over FY 11-12. All of the increase is from an increase in cash and investments as the water, wastewater and recycled operations all had revenues greater than expenses as the Board continues to attempt to reach equity goals as established in the District's Administrative Code. In FY 12-13 the Water and Recycled operations exceeded the Board's equity goals, and the full Board will determine where to allocate the overages. Accounts Receivable increased by $317,763 mostly due to the increase in water sales along with an increase in water rates for FY 12-13. Inventory of water stored in the Red Mountain reservoir decreased by $395,290 from the prior year, which was offset by an increase in the District's materials inventory of $109,140. During FY 13-14 a capital improvement project to replace the Red

Mountain liner will begin and as a result, the water level is being lowered so that minimal water will be drained and not sold.

Current Liabilities decreased by $668,567, of which $559,492 was due to the decrease in Accounts Payable. At June 30, 2012 the District was still paying two vendor contracts for design and planning for the wastewater treatment plant rehabilitation, a project that was completed prior to June 30, 2013. Another $162,013 is due to a decrease in developer construction projects. There were four developer projects ongoing as of June 30, 2012 which were completed prior to June 30, 2013, with all developer deposits being used for completion of the projects. These projects costs were capitalized in FY 12-13, and reported as Capital Assets.

Noncurrent liabilities increased by $447,061. During FY 12-13, $1.3 million of design expenses incurred for the wastewater treatment plant were eligible for reimbursement from the new Wastewater Treatment Plant State Revolving Fund (SRF) loan, increasing the liability. As construction begins, contractor invoices will be sent to the State Water Resources Control Board for reimbursement pursuant to the SRF program.

Total net position increased by $4.6 million. Contributing to the increase in the District's net position was the increase in operating revenues generated from the rate increase, which resulted in the District realizing operating income of $13,987, in comparison to the operating loss in FY 11-12 in the amount of $2,199,297. The increase of the California Solar Initiative (CSI) rebate in the amount of $245,000 and the implementation of the Wastewater Capital Improvement charge, producing $750,000 in additional revenue in comparison to FY 11-12, also contributed to the increase in net position.

Condensed Statements of Net Position

	June 30, 2012*	June 30, 2011	Change
Assets:			
Current Assets	$ 15,092,262	$ 14,288,844	$ 803,418
Restricted Assets	1,441,720	2,927,734	(1,486,014)
Capital Assets, net	73,409,418	72,699,273	710,145
Deferred Charges, net	154,385	165,032	(10,647)
Total Assets	90,097,785	90,080,883	16,902
Liabilities:			
Current Liabilities	4,698,119	5,298,320	(600,201)
Noncurrent Liabilities	13,240,164	14,009,525	(769,361)
Total Liabilities	17,938,283	19,307,845	(1,369,562)
Net Position:			
Net Investment in Capital Assets	60,609,683	60,487,772	121,911
Restricted	1,213,780	1,213,780	-
Unrestricted	10,336,039	9,071,486	1,264,553
Total Net Position	$ 72,159,502	$ 70,773,038	$ 1,386,464

**Amounts have been reclassified from those previously reported to conform with the current year's presentation.*

During FY 11-12, $11.1 million in water, wastewater and recycling projects were completed. The largest water projects were the Gheen reservoir lining and repair and various District pipeline replacement projects. The largest wastewater project was the completion of the $7.3 million solar generating project. Additionally during the fiscal year, the design phase of the rehabilitation of the wastewater treatment plant began. Construction will take approximately 2.5 years. Low cost SRF financing has been approved with project costs expected to be approximately $22 million. Current assets increased by $803,418 in FY 11-12 over FY 10-11 due to an increase in Cash and Investments of $722,834, an increase in Accounts Receivable of $250,502 and a decrease in Inventory of $170,136. Restricted assets decreased by $1,486,014 due mainly to a decrease of $1,384,124 in assets restricted for capital improvements, specifically for completion of the solar facility. An increase in restricted cash in the amount of $54,023 was mainly due to an increase to restricted cash for the Health Reimbursement Account (HRA). An employee retired in FY 11-12 and the value of sick time was converted to the HRA upon retirement to pay for retiree and dependent medical benefits until Medicare eligibility. Current liabilities decreased by $600,201 due to a decrease in Accounts Payable of $436,225 and a decrease in developer construction deposits of $205,000. Construction deposits are held for developer jobs and are refunded to the developer net of the project cost at project completion. A combined increase in the current portion of long-term debt and interest payable accounted for an increase in current liabilities of $22,000. Noncurrent liabilities decreased by $769,361 mainly due to a decrease in long-term debt of $795,893. Principal and interest payments for the solar project and the Red Mountain UV facility began in FY 11-12. The District's Other Postemployment Benefits (OPEB) liability increased by $82,821 due to the District funding the obligation on a pay-as-you-go basis, as opposed to paying the actuarially determined Annual Required Contributions (ARC). At the end of FY 11-12, the balance in the HRA liability account was $48,557 greater than at June 30, 2011. Net capital assets increased by $710,145, as assets not being depreciated decreased by $7.2 million and capital assets being depreciated increased by $7.9 million. This net increase is due to ongoing costs incurred related to construction in progress jobs, which were not capitalized in FY 10-11, but were completed and capitalized in FY 11-12, including the $7.3 million solar facility at the wastewater treatment plant. Net position increased $1.39 million primarily due to the receipt of the CSI rebate in the approximate amount of $535,000, $338,000 in capital grants and capital asset contributions received from developers in the amount of $274,000.

Condensed Statements of Revenues, Expenses and Changes in Net Position

	For the Year Ended June 30, 2013	For the Year Ended June 30, 2012	Change
Operating Revenues	$ 27,582,160	$ 23,661,715	$ 3,920,445
Operating Expenses	27,568,173	25,861,012	1,707,161
Operating Income (Loss)	13,987	(2,199,297)	2,213,284
Nonoperating Revenue, Net	4,053,397	2,973,605	1,079,792
Change in Net Position before Capital Contributions	4,067,384	774,308	3,293,076
Capital Contributions	595,205	612,156	(16,951)
Change in Net Position	4,662,589	1,386,464	3,276,125
Net Position - beginning of year	72,159,502	70,773,038	1,386,464
Net Position - end of year	$ 76,822,091	$ 72,159,502	$ 4,662,589

While the Statement of Net Position shows the change in financial position of the District's net position, the Statement of Revenues, Expenses and Changes in Net Position provides answers as to the nature and source of these changes. As previously mentioned the District's net position increased by $4.6 million for the year ended June 30, 2013.

The District's operating income of $13,987 when netted against the net nonoperating revenues of $4.05 million results in a $4,067,384 increase in net position before accounting for capital contributions. The $13,987 operating income is due an increase in operating revenues generated from the rate increase. Revenue from water sales increased by $3.2 million for the year ended June 30, 2013. Revenue is comprised of potable water and reclaimed water sales and reclaimed rebates, monthly service charges as well as the Readiness to Serve (RTS) and Infrastructure Access Charge (IAC), which are pass-through charges. Potable water sales increased by $2.68 million as sales rose by 930 AF, to 12,188 AF. Operating expenses increased by $1.7 million due to the increase in the wholesale cost of potable water and the increased potable water purchases. Water purchases increased from 11,948 AF to 12,499 AF. While sales rose 903 acre feet, purchases increased by 551 AF, the differential being used from the Red Mountain Reservoir, reducing the water in storage which is accounted for as inventory. The revenue from monthly water operations charge increased $177,720 due to an increase of 1% in monthly operations charge for agricultural customers and 1.5% for all other customer classifications. The District's monthly wastewater operations charges increased by $619,735, primarily as a result of the additional costs to operate an older, less efficient treatment plant. The sewer methodology implemented in FY 09-10, charging most customers based on actual flow, is still in place.

The cost to purchase M&I water increased by 9.7% on January 1, 2013 over January 1, 2012 rates. Projections by both the San Diego County Water Authority (SDCWA) and Metropolitan Water District (MWD) indicate that rates will continue to increase for the foreseeable future. Operating costs for water, wastewater and recycled departments (excluding Cost of Water Sold) held steady between FY 12-13 and FY 11-12. General and Administration expenses decreased by $231,162 due in part to cost savings from resource sharing with Rainbow pursuant to the North County JPA and a decrease in expenses such as legal fees, Watermaster support and building maintenance versus what was budgeted.

Recycled sales revenue increased $312,197 due to increased sales of 735 AF as compared to 545 AF in FY 11-12. $106,000 of this increase is due to Metropolitan Water District and San Diego County Water Authority reclaimed water rebates of $250 and $200 per AF, respectively. The Recycled operating department showed net revenue greater than expenses for the second straight year, mostly due to the contract with Orange Grove Energy to fill tanker trucks with recycled water for cooling of their power plant in Pala.

Nonoperating revenues are comprised of 1% property taxes, water and wastewater connection fees, water and wastewater capital improvement charges, CSI rebate, investment income and lease revenue. Nonoperating revenues increased $1.1 million, primarily due to two reasons. First, the District implemented a Wastewater capital improvement charge which raised $750,000, the proceeds of which are being used for the wastewater treatment plant rehabilitation, and an increase in the CSI rebate of $245,000, as FY 12-13 was the first full year that the District was eligible to receive the rebates. Although connection fee revenue increased by $56,700 these revenues were offset by the decrease in investment income of the approximately same amount due to the continued low interest rate environment.

Water sales and monthly water operations charges total 80% of District operating revenues, with water sales increasing to 12,188 AF. Wastewater revenues are 18% of the total operating revenues. The remaining 2% of operating revenues include billing to the Naval Weapons Station for water transmission and wastewater processing, fees for delinquent account processing and repairs paid by others for damage done to District property.

Supplemental information for each of the three divisions can be found on page 42 of this report.

Condensed Statements of Revenues, Expenses and Changes in Net Position

	For the Year Ended June 30, 2012	For the Year Ended June 30, 2011	Change
Operating Revenues	$ 23,661,715	$ 21,255,448	$ 2,406,267
Operating Expenses	25,861,012	23,812,425	2,048,587
Operating Loss	(2,199,297)	(2,556,977)	357,680
Nonoperating Revenue, Net	2,973,605	2,193,567	780,038
Change in Net Position before Capital Contributions	774,308	(363,410)	1,137,718
Capital Contributions	612,156	3,094,483	(2,482,327)
Change in Net Position	1,386,464	2,731,073	(1,344,609)
Net Position - beginning of year	70,773,038	68,041,965	2,731,073
Net Position - end of year	$ 72,159,502	$ 70,773,038	$ 1,386,464

The District's operating loss of $2.20 million when netted against the net nonoperating revenues of $2.97 million results in a $774,308 increase in net position before accounting for capital contributions. The $2.20 million operating loss is due to depreciation expense in the amount of $3.1 million being included as an operating expense. Revenue from water sales increased by $2.4 million for the year ended June 30, 2012. Revenue is comprised of potable water and reclaimed sales and reclaimed rebates, monthly service charges as well as the Readiness to Serve (RTS) and Infrastructure Access Charge (IAC), which are pass-through charges. Potable water sales increased by $2 million and sales rose by 580 AF to 11,258 AF. Operating expenses increased by $2.05 million mostly due to the increase in wholesale potable water costs. The revenue from monthly water operations charges did not change significantly. Monthly wastewater services revenue increased by $168,000 (4%) as a result of the increased water sales and resultant increase in wastewater treated at the plant. All customers with the exception of single family residences have sewer bills based on actual water purchased. Given the District's methodology of charging most customers wastewater fees based upon actual flow, an increase in revenues is to be expected when water sales increase.

There was no increase in the monthly operations charge from FY 10-11 to FY 11-12 due to the Board of Directors directive that no controllable costs be increased. The majority of the District's controllable costs are in wages and fringe benefits. The District imports nearly 100% of its water and is the District's single largest uncontrollable cost.

The cost to purchase M&I water increased by 14.7% on January 1, 2012 over January 1, 2011 rates. Projections by both the San Diego County Water Authority (SDCWA), the District's water provider, and Metropolitan Water District indicate that rates will increase annually for the foreseeable future. Operating costs for water and recycled departments (excluding Cost of Water Sold and General and Administration Expenses) held steady between FY 10-11 and FY 11-12.

Recycled sales revenues increased $202,000 due to increased sales of 50 acre feet to a total of 545 acre feet, Metropolitan Water District and San Diego County Water Authority reclaimed water rebates, and rate increases. Expenses to produce and distribute reclaimed water increased by $32,000 or 7%.

Nonoperating revenues are comprised of 1% property taxes, connection fees, capital improvement charge, investment income and lease revenue. Nonoperating revenues increased $780,000, primarily due to two reasons. For the first time, the District received $535,000 in CSI rebates, revenue which is used to pay the debt service for the solar facility at the wastewater treatment plant. Secondly, connection fee revenue increased by $78,000, resulting from 14 water meters and 25 sewer permits being sold during FY 11-12. The water and wastewater funds use nonoperating revenues as a source of income to fund capital projects and cover annual debt service obligations.

Operating loss of $2.20 million occurred in FY 11-12 due to $3.08 million in depreciation expense which is recorded as an Operating Expense. If depreciation were excluded, the Water, Wastewater, Recycled divisions had a combined net gain of $880,008.

Water sales and service charges total 70% of District revenues, with water sales increasing to 11,258 acre feet. Wastewater revenues are 16.1% of the total and the remaining 13.9% is attributable to the other operating and nonoperating revenues. Other operating revenues include billing to the Naval Weapons Station for water transmission and wastewater processing, the capital improvement charge, fees collected for delinquent account processing and repairs paid by others for damage done to District property. Other nonoperating revenues include revenues for flat fee items, such as fire hydrants and sewer lateral installations.

Supplemental information for each of the three divisions can be found on page 43 of this report.

Capital Asset and Debt Administration

Capital Assets

	Balance at June 30, 2012	Additions and Transfers In	Retirements and Transfers Out	Balance at June 30, 2013
Capital Assets				
Nondepreciable assets	$ 11,213,823	$ 2,975,345	$ (4,044,754)	$ 10,144,414
Depreciable assets	117,121,702	4,640,532	(499,367)	121,262,867
Accumulated depreciation	(54,926,107)	(3,558,943)	499,367	(57,985,683)
Total capital assets, net	$ 73,409,418	$ 4,056,934	$ (4,044,754)	$ 73,421,598

The District's investment in capital assets as of June 30, 2013 increased by $12,179 to $73,421,597 as seen in the table above.

Major capital asset events during the fiscal year included the following:

- Completion of the Red Mountain Pressure Regulating Station of $798,000. This project was for design and construction of a pressure control facility to replace an existing deteriorated valve structure.

- Completion of the planning and design phase of the wastewater treatment plant rehabilitation of $1.6 million. Construction of the facility will begin in September 2013.

- The District began an aggressive program of water pipeline and valve replacements which will continue into the future. Total capitalized expenses for these projects were approximately $844,000.

- Beginning in FY 12-13 a program of sewer pipelines and manhole replacement began and will continue. In FY 12-13 $347,000 in sewer pipeline projects were completed.

- Conjunctive Use – District staff have been developing a joint project with Camp Pendleton for development of water supplies on the Santa Margarita River. The project is anticipated to supply an average of 3,100 AF/year. Camp Pendleton will be responsible for development of additional groundwater recharge facilities on Camp Pendleton, pumping facilities on Camp Pendleton, and conveyance facilities to deliver water from Camp Pendleton to Fallbrook. For FY 12-13, approximately $316,000 was spent on this project, with a project-to-date of capitalized expenses in the amount of $2,768,000. The District will be responsible for construction of the pipeline required to deliver the water from the Fallbrook gate on the Naval Weapons Station to Red Mountain Reservoir and any necessary treatment facilities. The final feasibility study was completed by the United States Bureau of Reclamation for the project. A draft agreement between Camp Pendleton and the District is being finalized and a draft Environment Impact Report/Environment Impact Statement (EIR/EIS) is being prepared. The District applied and has been approved for Prop 50 state grants for water projects and expects to receive a total of approximately $2.4 million in reimbursements over the upcoming 2-3 years.

Additional information on the District's capital asset activity can be found at Note 5 of the Notes to the Basic Financial Statements.

	Balance at June 30, 2011	Additions and Transfers In	Retirements and Transfers Out	Balance at June 30, 2012
Capital Assets				
Nondepreciable assets	$ 18,385,275	$ 3,596,214	$ (10,767,666)	$ 11,213,823
Depreciable assets	106,765,579	10,960,901	(604,778)	117,121,702
Accumulated depreciation	(52,451,581)	(3,079,304)	604,778	(54,926,107)
Total capital assets, net	$ 72,699,273	$ 11,477,811	$ (10,767,666)	$ 73,409,418

At June 30, 2012, the District's investment in capital assets totaled $128.3 million, with accumulated depreciation of $54.9 million, leaving a net book investment of $73.4 million, an increase in net book value of $710,145 over June 30, 2011.

Major capital asset events during the fiscal year included the following:

- Construction in progress for the Bird Cage design of $798,000. This was a replacement of old valve structure and installation of a new pressure control facility adjacent to Red Mountain Reservoir.

- Construction in progress for the Wastewater Treatment Plant Solar Facility of $502,000. The project was operational and generating power during FY 11-12.

- Construction in progress for the design of the Wastewater Treatment Plant Rehabilitation of $749,000. Construction of the project should begin in FY 12-13 and last for approximately 2.5 years. Total cost estimate for the project is $22 million.

- Conjunctive Use – District staff have been developing a joint project with Camp Pendleton for development of water supplies on the Santa Margarita River. The project is anticipated to supply an average of 3,100 acre feet (AF)/year. Camp Pendleton will be responsible for development of additional groundwater recharge facilities on Camp Pendleton, pumping facilities on Camp Pendleton, and conveyance facilities to deliver water from Camp Pendleton to Fallbrook. For FY 11-12 approximately $280,000 was spent on this project with a project to date total capitalized expenditures of $2,452,000. The District will be responsible for construction of the pipeline required to deliver the water from the Fallbrook gate on the Naval Weapons Station to Red Mountain Reservoir and any necessary treatment facilities. A draft agreement between Camp Pendleton and the District is being finalized and a draft Environment Impact Report/Environment Impact Statement (EIR/EIS) is being prepared.

- The largest project completed during the fiscal year in the water capital budget was the Gheen reservoir relining and repair, a $636,000 project. The solar facility at the Wastewater Treatment plant was completed and operational in July 2011. Other pipeline projects totaled $400,000. The Recycled division completed a developer financed project valued at $182,000 for a recycled water fill station at the Wastewater Treatment Plant.

At June 30, 2013, the District has the following commitments with respect to unfinished capital projects:

Capital Commitments

Capital Projects	Remaining Construction Commitment	Expected Completion Date
Water Reclamation Plant	$ 25,507,000	2015
Wastewater Treatment Plant Construction Management	917,200	2014
Wastewater Treatment Plant Rehabilitation Project Design	470,578	2014
Sachse Reservoir Painting	914,000	2013
Office Transfer Switch Electrical Project	99,710	2013

At June 30, 2012, the District has the following commitments with respect to unfinished capital projects:

Capital Projects	Remaining Construction Commitment	Expected Completion Date
Wastewater Treatment Plant Rehabilitation Project Design	$ 552,641	2014
Red Mountain Pressure Regulating Station	57,389	2012

Debt Administration

At June 30, 2013, the District had $13.2 million of long-term debt outstanding. $6.16 million of this debt is attributable to the wastewater QECB solar loan. An additional $5.67 million of indebtedness is attributable to the Red Mountain Filtration Plant SRF loan. A new Wastewater Treatment Plant SRF loan in the amount of $22 million was approved by the State. District design and planning costs of $1.32 million have been reimbursed through this loan. The loan is for a term of 20 years at an interest rate of 2.2%. Payments on the loan will commence in May 2016. In September 2013, the $22 million loan was increased to $28.7 million. Other indebtedness includes a loan for the expansion of the recycled water production and distribution system which will be paid off in FY 13-14. During the year ended June 30, 2013, $895,875 of principal payments were made.

At June 30, 2012, the District had $12.8 million of long-term debt outstanding. $6.74 million of this debt is attributable to the wastewater QECB solar loan. This loan is for a term of 16.5 years, with 15.5 years remaining, and with a net interest rate of 1.85% to the District. An additional $5.92 million indebtedness is attributable to the Red Mountain UV Filtration Plant SRF loan. This loan is for the term of 20 years, with 19 years remaining, and with an interest rate of 2.57%. Other indebtedness includes a loan for the expansion of the recycled water production and distribution system which will be paid off in FY 13-14. During the year ended June 30, 2012, $795,893 of principal payments were made.

More detailed information about the District's debt structure is found in Note 6 to the Financial Statements.

Economic Factors

The District's Board of Directors uses a budget philosophy of collecting 80% of fixed costs through the monthly water operations charge and 20% of fixed costs through the mark up of the wholesale cost of water sold to our M&I customers. Because of this philosophy, fluctuating water sales have minimal impact on the District's ability to cover 80% of its operating expenses and the District remains in a very stable, financially sound condition, due to management's conservative budgeting and spending strategies. The FY 12-13 budgeted operating revenues included Board objectives to reach equity goals which occurred in the water and recycled operations. Additionally, 100% of fixed costs are collected from the wastewater monthly operations charges.

Since the District purchases all of its water supply from SDCWA, and since SDCWA projects annual water rate increases over the next decade, water costs will continue to rise. For FY 12-13 a 9.7% increase in the cost of water was implemented by SDCWA on January 1, 2013.

San Diego County Water Authority and its member agencies are currently challenging two components of Metropolitan Water District's rate structure. From a July 24, 2013 SDCWA press release:

"The Water Authority sued MWD in 2010 and again in 2012 for imposing illegal rates that are not based on the costs of providing the services for which they are collected. Numerous California statutes, the California Constitution and common law all require that public water agencies such as MWD set rates based on the actual costs of services rendered.

The Water Authority's two lawsuits against MWD present common factual and legal elements. In both cases, the Water Authority asserts that MWD assigns water supply costs to transportation rates in violation of state law, the state constitution and common law. The lawsuits also allege that MWD's rates discriminate against the Water Authority by artificially inflating the price MWD charges for transporting the Water Authority's independent Colorado River water supplies through MWD's pipelines."

Contacting the District's Financial Management

This financial report is designed to provide our citizens, taxpayers, customers, investors and creditors with a general overview of the District's finances and to demonstrate the District's accountability for the financial resources it manages. If you have questions about this report or need additional financial information, contact the Fallbrook Public Utility District Finance Department at 990 East Mission Road, Fallbrook, California.

____________________________	_______________________________
Brian J. Brady	Marcie Eilers
General Manager	Administrative Services Manager/Treasurer
Fallbrook Public Utility District	Fallbrook Public Utility District

BASIC FINANCIAL STATEMENTS

FALLBROOK PUBLIC UTILITY DISTRICT
Statements of Net Position
June 30, 2013 and 2012

	2013	2012
Assets:		
Current assets:		
Cash and investments (Note 3)	$ 15,476,148	$ 11,107,707
Receivables (Note 4)	2,787,059	2,469,296
Inventory	1,144,189	1,430,339
Other current assets	79,637	84,920
Total current assets	19,487,033	15,092,262
Noncurrent assets:		
Restricted cash and investments (Note 3):		
Debt service	236,764	211,981
Held for 1958 Annex Projects	1,213,780	1,213,780
Capital improvements	15,955	15,959
Total restricted cash and investments	1,466,499	1,441,720
Capital assets (Note 5):		
Capital assets, not being depreciated	10,144,414	11,213,823
Capital assets being depreciated, net	63,277,184	62,195,595
Total capital assets, net	73,421,598	73,409,418
Deferred charges, net	143,738	154,385
Total noncurrent assets	75,031,835	75,005,523
Total assets	94,518,868	90,097,785
Liabilities:		
Current liabilities:		
Accounts payable	2,880,720	3,440,212
Accrued wages	100,747	103,912
Construction and other deposits	5,467	167,480
Accrued interest payable	100,470	90,640
Current portion of other long-term liabilities (Note 6)	922,148	895,875
Total current liabilities	4,009,552	4,698,119
Noncurrent liabilities:		
HRA liability (Note 10)	107,447	155,910
OPEB liability (Note 10)	376,808	349,622
Other long-term liabilities - net of current portion (Note 6)	13,202,970	12,734,632
Total noncurrent liabilities	13,687,225	13,240,164
Total liabilities	17,696,777	17,938,283
Net position:		
Net investment in capital assets	60,195,379	60,609,683
Restricted for:		
1958 Annex projects	1,213,780	1,213,780
Unrestricted	15,412,932	10,336,039
Total net position	$ 76,822,091	$ 72,159,502

See accompanying Notes to the Basic Financial Statements.

FALLBROOK PUBLIC UTILITY DISTRICT
Statements of Revenues, Expenses and Changes in Net Position
For the Years Ended June 30, 2013 and 2012

	2013	2012
Operating revenues:		
Water sales	$ 22,142,528	$ 18,911,177
Wastewater services	4,950,757	4,331,022
Other	488,875	419,516
Total operating revenues	27,582,160	23,661,715
Operating expenses:		
Cost of water sold	14,860,665	13,140,795
General and administration	3,735,693	3,911,299
Depreciation	3,558,943	3,079,304
Transmission and distribution	2,440,553	2,623,689
Wastewater operations and maintenance	2,272,161	2,494,189
Customer accounts	700,158	611,736
Total operating expenses	27,568,173	25,861,012
Operating income (loss)	13,987	(2,199,297)
Nonoperating revenues (expenses):		
Property taxes	1,582,219	1,552,911
Capital improvement charges	1,252,501	414,910
California Solar Initiative rebate	779,786	534,835
Connection fees	247,607	190,932
Water availability charges	201,037	200,906
Lease revenue	181,100	177,095
Other revenue	77,458	79,285
Investment income	30,507	87,217
Gain on disposal of capital assets	3,550	29,976
Interest expense and amortization of bond issue costs	(302,368)	(294,462)
Total nonoperating revenues (expenses), net	4,053,397	2,973,605
Changes in net position before capital contributions	4,067,384	774,308
Capital contributions:		
Capital grant	-	338,331
Capital asset contributions - donated from developers	595,205	273,825
Change in net position	4,662,589	1,386,464
Net position - beginning	72,159,502	70,773,038
Net position - ending	$ 76,822,091	$ 72,159,502

See accompanying Notes to the Basic Financial Statements.

FALLBROOK PUBLIC UTILITY DISTRICT
Statements of Cash Flows
For the Years Ended June 30, 2012 and 2011

	2013	2012
Cash flows from operating activities:		
Receipts from customers	$ 26,778,917	$ 22,977,352
Receipts from others	752,716	677,976
Payments to suppliers and vendors	(16,136,736)	(14,249,056)
Payments to employees	(7,854,658)	(7,863,325)
Net cash provided by operating activities	3,540,239	1,542,947
Cash flows from noncapital financing activities:		
Property taxes	1,582,219	1,552,911
California Solar Initiative rebate	779,786	534,835
Net cash provided by noncapital financing activities	2,362,005	2,087,746
Cash flows from capital and related financing activities:		
Acquisitions and construction of capital assets	(4,203,547)	(3,079,179)
Capital grants received	-	338,331
Proceeds from contracts payable	1,322,354	-
Principal payments on long-term debt	(895,875)	(795,893)
Interest paid	(281,891)	(359,715)
Capital improvement charges and connection fees	1,500,108	605,842
Water availability charges	201,037	200,906
Cash proceeds from sale of capital assets	3,550	29,976
Net cash used by capital and related financing activities	(2,354,264)	(3,059,732)
Cash flows from investing activities:		
Purchases of investments	(3,429,560)	(2,687,922)
Sales of investments	3,722,153	2,792,904
Interest received	27,112	101,562
Net cash provided by investing activities	319,705	206,544
Net increase in cash and cash equivalents	3,867,685	777,505
Cash and cash equivalents - beginning	5,280,084	4,502,579
Cash and cash equivalents - ending	$ 9,147,769	$ 5,280,084

See accompanying Notes to the Basic Financial Statements.

FALLBROOK PUBLIC UTILITY DISTRICT
Statements of Cash Flows (Continued)
For the Years Ended June 30, 2013 and 2012

	2013	2012
Reconciliation of cash and cash equivalents to the Statement of Net Position:		
Cash and investments	$ 15,476,148	$ 11,107,707
Restricted cash and investments	1,466,499	1,430,339
Less investments not meeting the definition of cash and cash equivalents	(7,794,878)	(7,257,962)
Cash and cash equivalents	$ 9,147,769	$ 5,280,084
Reconciliation of operating income (loss) to net cash provided by operating activities:		
Operating income (loss)	13,987	$ (2,199,297)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation	3,558,943	3,079,304
Lease revenue	181,100	177,095
Other revenue	77,458	79,285
(Increase) decrease in:		
Receivables	(314,368)	(264,847)
Inventory	286,150	170,136
Other assets	5,283	(218)
Increase (decrease) in:		
Accounts payable	(312,004)	355,932
Accrued wages	(3,165)	18,678
Construction and other deposits	-	2,080
HRA liability	(48,463)	48,557
OPEB liability	27,186	82,821
Compensated absences	68,132	(6,579)
Net cash provided by operating activities	$ 3,540,239	$ 1,542,947
Noncash capital and related financing activities:		
Capital assets contributed	$ 595,205	$ 273,825
Capital asset acquisitions included in accounts payable	135,310	382,798
Capitalized construction deposits	162,013	-
Change in fair value of investments	(61,250)	(16,813)
Amortizaton of deferred charges	10,647	10,647

See accompanying Notes to the Basic Financial Statements.

NOTES TO THE BASIC FINANCIAL STATEMENTS

(1) ORGANIZATION AND OPERATIONS OF THE DISTRICT

Fallbrook Public Utility District (District) was incorporated as a political subdivision of the State of California in 1922 and operates under the provisions of the Public Utility District Code as adopted in 1953. The District constructs, operates and maintains facilities to supply water to the town of Fallbrook and the surrounding residential and agricultural areas comprising approximately 27,963 acres, which includes the former De Luz Heights Municipal Water District (annexed in 1990). The District is a member of the San Diego County Water Authority, and as that organization is a member of the Metropolitan Water District of Southern California, the District is entitled to prorata participation in all water supplies available to those agencies. The District is governed by a Board of Directors consisting of five board members, each of whom is elected to office for a term of four years by the registered voters of the District.

In November 1994, the citizens of the Fallbrook Sanitary District (which is wholly included within the Fallbrook Public Utility District) voted to dissolve that district and have the Fallbrook Public Utility District become the provider of wastewater services in Fallbrook. The provisions of the dissolution and assumption of services established a separate improvement district to identify the tax base and debt obligations of the former Fallbrook Sanitary District.

Under the terms and conditions of the Local Agency Formation Commission (LAFCO), a San Diego County agency that oversees special districts, the debt of the former Fallbrook Sanitary District, now identified as Improvement District S, existing at the time of the merger was paid from taxes and other revenues raised within the Improvement District "S". The debt of the former De Luz Heights Municipal Water District was also paid from revenues and taxes paid in the De Luz area.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Accounting

The accounting methods and procedures adopted by the District conform to generally accepted accounting principles as applied to governmental enterprise funds as prescribed by the Governmental Accounting Standards Board (GASB).

The District, as an enterprise fund, accounts for its operations in a manner similar to private business enterprises. The intent of the governing body is that the costs (including depreciation and amortization) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. The District's operating revenues and expenses are those that result from providing services and producing and delivering goods. The focus of enterprise fund measurement is upon determination of operating income, changes in net position, and cash flows.

(b) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

(c) Revenue Recognition

The District recognizes water and wastewater revenue on the accrual basis and includes an accrual for services provided in June but not yet billed. Property taxes are collected by the County of San Diego through the property tax billings. Real property taxes are levied on October 15 against owners of record at January 1, the lien date. The taxes are due in two installments on November 1 and February 1 and become delinquent after December 10 and April 10, respectively. Property tax revenues are recognized when levied to the extent that they are available to the District's current operations. Other revenues such as grants and similar items are recognized in the fiscal year in which all eligibility requirements have been satisfied. When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first and then use unrestricted resources as needed.

(d) Investments

Investments are recorded at fair value. Changes in the fair value of investments, both realized and unrealized, are recognized in the statements of revenues, expenses and changes in net position as a component of investment income.

(e) Inventory

Inventory consists of water stored at Red Mountain Reservoir and various warehouse materials, supplies and equipment necessary for the District's operations. Inventory is stated at the lower of cost or market determined on a first-in, first-out basis.

(f) Capital Assets, Depreciation and Amortization

Capital assets are stated at cost. Contributed pipelines are valued at estimated fair value on the date of contribution and recorded as capital contributions. Generally, capital asset purchases in excess of $2,000 are capitalized if they have an expected useful life of one year or more.

Interest costs incurred while constructing capital assets are capitalized as part of the specific capital assets. The District did not capitalize any interest costs during the years ended June 30, 2013 and 2012.

Depreciation is charged to expense for all capital assets, including assets contributed to the District, and is computed using the straight-line method over the estimated useful asset lives as follows:

Water transmission and distribution system:	
Impounding dams and reservoirs	50 Years
Pipelines	50 Years
Other	20-25 Years
Wastewater collection, treatment and disposal system	20-50 Years
Buildings and structures	45 Years
Equipment	3-10 Years

(g) Deferred Charges

Deferred charges represents unamortized bond issuance costs associated with the District's loan from the California Alternative Energy and Advanced Transportation Financing Authority, which were used to finance the construction of a solar project at the District's wastewater treatment plant. Issuance costs are amortized using the straight-line method over the life of the related debt.

(h) Net Position

In the *statement of net position*, the District's net position is classified into three components, which are defined as follows:

- **Net investment in capital assets -** This component of net position consists of capital assets, net of accumulated depreciation, and reduced by the outstanding balances of any bonds, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

- **Restricted -** This component of net position consists of restricted assets which are reduced by liabilities related to those assets.

- **Unrestricted -** This component of net position do not meet the definition of "net investment in capital assets" or "restricted".

(i) Connection Fees and Water Availability Charges (Capacity Fees)

Connection and water availability charges (capacity fees) for water and sewer represent purchases of water meters and fees to connect to the water distribution system or connection to the wastewater collections system by developers or landowners. Connection fees are to be used strictly for capital improvements.

(j) Capital Contributions

Capital contributions for water and wastewater represent contributions of capital assets from developers. Capital contributions are recorded in the statements of revenues, expenses and changes in net position at fair value at the date ownership is transferred to the District.

(k) Cash and Cash Equivalents

For purposes of the statements of cash flows, the District considers highly liquid debt instruments (including cash and investments whose use is limited and reported as restricted cash and investments) purchased with a maturity of three months or less to be cash equivalents. Funds invested with the Local Agency Investment Fund and the County Treasurer's investment pool are considered to be cash equivalents because amounts can be withdrawn on demand.

(3) CASH AND INVESTMENTS

The District accounts for various activities in separate funds in its accounting records and consolidates all of its funds into a single enterprise fund for financial reporting purposes. The District follows the practice of pooling cash and investments of all funds except funds for those required to be held separately by debt restrictions. Pooling is for the purpose of increasing interest earnings and administrative efficiency.

Restricted cash and investments represents amounts held with third party fiscal agents that are restricted for the payment of debt service and capital improvements.

Cash and investments as of June 30, 2013 and 2012 are classified in the accompanying statements of net position as follows:

	2013	2012
Statement of net assets:		
Cash and investments	$ 15,476,148	$ 11,107,707
Restricted cash and investments	1,466,499	1,441,720
Total cash and investments	$ 16,942,647	$ 12,549,427

Cash and investments as of June 30, 2013 and 2012 consist of the following:

	2013	2012
Cash on hand	$ 850	$ 850
Deposits with financial institutions	2,858,689	1,729,853
Investments	14,083,108	10,818,754
Total cash and investments	$ 16,942,647	$ 12,549,457

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

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

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio*	Maximum Investment in One Issuer	Minimum Credit Rating (S&P / Moody's)
U.S. Treasury securities	5 Years	None	None	None
U.S. Agency securities	5 Years	None	75%	None
State obligations	5 Years	25%	5%	BBB/Baa2
Bankers' acceptances	180 Days	25%	25%	A1/P1
Commercial paper	270 Days	15%	10%	A1/P1
Negotiable certificates of deposit	5 Years	30%	None	None
Repurchase agreements	1 year	10%	10%	None
Medium-term notes	5 Years	30%	10%	A/A
Passbook and money market savings account	N/A	None	None	None
Local Agency Investment Fund (LAIF)	N/A	None	None	None
County pooled investment funds	N/A	None	None	None
California local agency obligations	5 years	25%	5%	BBB/Baa2
Joint Powers Authority Pool	5 years	None	None	None
Money Market Mutual Funds	5 years	20%	10%	AAA/Aaa
Mutual Funds	5 years	20%	10%	10%
Mortgage Pass-Through Securities	5 years	20%	None	AA

* Excluding amounts held by bond trustees that are not subject to California Government Code restrictions.

In addition to the allowable investments noted in the preceding table pursuant to the District's investment policy, the California Government Code also permits the following investments: reverse repurchase agreements; securities lending agreements; California Voluntary Investment Program Fund; and local agency bonds of other states. However, the District does not permit investments in these additional types of investments. Also, California Government Code and the District's investment policy prohibits investments in inverse floaters, range notes, interest-only strips derived from a pool of mortgages, and any security that might result in zero interest accrual.

The table below compares the maximum percentage of the District's investments and maximum investment by any one issuer allowable per the California Government Code to the District's investment policy, which is more restrictive. There are no differences between the minimum credit ratings for allowable investments pursuant to the District's investment policy and California Government Code.

	Maximum Percentage of the Portfolio		Maximum Investment in One Issuer	
Authorized Investment Type	California Government Code	District's Investment Policy	California Government Code	District's Investment Policy
U.S. Agency securities	None	None	None	75%
State obligations	None	25%	None	5%
Bankers' acceptances	40%	25%	30%	25%
Commercial paper	25%	15%	10%	10%
Repurchase agreements	None	10%	None	10%
California local agency obligations	None	25%	None	5%

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 its fair value is 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 the District's operations.

Information about the sensitivity of the fair values of the District's investments (including investments held by bond trustee) to market interest rate fluctuations is provided by the following tables that shows the distribution of the District's investments by maturity.

As of June 30, 2013, the District had the following investments and maturities:

		Remaining Maturity (in Months)		
Investment Type	**Fair Value**	**12 Months or Less**	**13 - 24 Months**	**25-60 Months**
Local Agency Investment Fund	$ 6,510,660	$ 6,510,660	$ -	$ -
San Diego County Treasurer Pool	14,333	14,333	-	-
Medium-Term Notes	2,876,538	744,736	837,464	1,294,338
Negotiable Certificates of Deposit	1,825,666	454,682	460,158	910,826
Federal National Mortgage Association	298,449	-	-	298,449
Federal Home Loan Bank	495,990	-	-	495,990
Federal Home Loan Mortgage Corporation	1,003,345	501,795	-	501,550
Municipal Investments	142,110	142,110	-	-
Money Market Mutual Fund	916,017	916,017	-	-
Total investments	$ 14,083,108	$ 9,284,333	$ 1,297,622	$ 3,501,153

As of June 30, 2012, the District had the following investments and maturities:

		Remaining Maturity (in Months)		
Investment Type	**Fair Value**	**12 Months or Less**	**13 - 24 Months**	**25-60 Months**
Local Agency Investment Fund	$ 3,747,083	$ 3,747,083	$ -	$ -
San Diego County Treasurer Pool	14,279	-	14,279	-
Medium-Term Notes	2,307,333	1,403,592	748,806	154,935
Commercial Paper	299,562	299,562	-	-
Negotiable Certificates of Deposit	1,225,666	-	454,707	770,959
Federal National Mortgage Association	1,593,238	1,224,726	-	368,512
Federal Farm Credit Bank	403,484	403,484	-	-
Federal Home Loan Mortgage Corporation	1,006,855	-	504,200	502,655
Municipal Investments	143,018	-	143,018	-
Money Market Mutual Fund	78,236	78,236	-	-
Total investments	$ 10,818,754	$ 7,156,683	$ 1,865,010	$ 1,797,061

Disclosure Relating to Credit Risk

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

A summary of disclosures relating to credit risk at June 30, 2013:

		Minimum		Credit Rating (Moody's/Standard & Poors)					
Investment Type	**Fair Value**	**Legal Rating**	**Not Rated**	**AAA/ AA+**	**A3/A-**	**A1/AA+**	**A2/A**	**A1/A+**	**A1/A**
Local Agency Investment Fund	$ 6,510,660	N/A	$ 6,510,660	$ -	$ -	$ -	$ -	-	-
San Diego County Treasurer Pool	14,333	N/A	-	14,333	-	-	-	-	-
Medium-Term Notes	2,876,538	A	-	-	327,629	1,082,685	1,313,786	152,438	-
Negotiable Certificates of Deposit	1,825,666	N/A	1,825,666	-	-	-	-	-	-
Federal National Mortgage Association	298,449	N/A	-	298,449	-	-	-	-	-
Federal Home Loan Bank	495,990	N/A	-	495,990	-	-	-	-	-
Federal Home Loan Mortgage Corporation	1,003,345	N/A	-	1,003,345	-	-	-	-	-
State of California Obligations	142,110	BBB	-	-	-	-	-	-	142,110
Money Market Mutual Funds	916,017	AAA	916,017	-	-	-	-	-	-
	$ 14,083,108		$ 9,252,343	$ 1,812,117	$ 327,629	$ 1,082,685	$ 1,313,786	$ 152,438	$ 142,110

A summary of disclosures relating to credit risk at June 30, 2012:

Investment Type	Fair Value	Minimum Legal Rating	Not Rated	Credit Rating (Moody's/Standard & Poors) AAA/ AA+	A2/A-	A1/AA+	Aa3/AA+	A2/A	A1/A-	P1/A1
Local Agency Investment Fund	$ 3,747,083	N/A	$ 3,747,083	$ -	$ -	$ -	$ -	-	-	-
San Diego County Treasurer Pool	14,279	N/A	-	14,279	-	-	-	-	-	-
Medium Term Corporate Notes	2,307,333	A	-	-	507,025	456,300	440,267	748,806	154,935	-
Commercial Paper	299,562	P1/A1	-	-	-	-	-	-	-	299,562
Negotiable Certificates of Deposit	1,225,666	N/A	1,225,666	-	-	-	-	-	-	-
Federal National Mortgage Association	1,593,238	N/A	-	1,593,238	-	-	-	-	-	-
Federal Farm Credit Bank	403,484	N/A	-	403,484	-	-	-	-	-	-
Federal Home Loan Mortgage Corporation	1,006,855	N/A	-	1,006,855	-	-	-	-	-	-
State of California Obligations	143,018	BBB	-	-	-	-	-	-	143,018	-
Money Market Mutual Funds	78,236	AAA	78,236	-	-	-	-	-	-	-
	$ 10,818,754		$ 5,050,985	$ 3,017,856	$ 507,025	$ 456,300	$ 440,267	$ 748,806	$ 297,953	$ 299,562

Concentration of Credit Risk

Investments in any one issuer (other than U.S. Treasury securities, mutual funds, and external investment pools) that represents 5% or more of the District's total investments as of June 30, 2013 and 2012 are as follows:

A summary of disclosures related to concentration of credit risk as of June 30, 2013:

Issuer	Investment Type	Fair Value
JP Morgan Chase & Company	Medium-Term Notes	$ 1,313,786
General Electric Capital Corporation	Medium-Term Notes	1,082,685
Federal Home Loan Mortgage Corporation	U.S. Agency Securities	1,003,345

A summary of disclosures related to concentration of credit risk at June 30, 2012:

Issuer	Investment Type	Fair Value
Federal National Mortgage Association	U.S. Agency Securities	$ 1,593,238
Federal Home Loan Mortgage Corporation	U.S. Agency Securities	1,006,855
General Electric Capital Corporation	Medium-Term Notes	896,567
JP Morgan Chase & Company	Medium-Term Notes	748,806

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.

Local Agency Investment Fund (LAIF)

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 the 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. The balance available for withdrawal is based on the accounting records maintained by LAIF, which is recorded on an amortized cost basis.

The total amount invested by all public agencies in LAIF as of June 30, 2013 and 2012 was $21.2 billion and $21.8 billion, respectively. LAIF is part of the California Pooled Money Investment Account (PMIA), which at June 30, 2013 and 2012 had a balance of $58.8 and $60.5 billion, respectively, and of those amounts, 1.96% and 3.47% were invested in medium-term and short-term structured notes and asset-backed securities as of June 30, 2013 and 2012, respectively. The average maturity of PMIA investments as of June 30, 2013 and 2012 was 278 and 268 days, respectively.

(4) RECEIVABLES

Receivables of the District as of June 30, 2013 and 2012 were as follows:

	2013	2012
Water and wastewater billings	1,953,609	$ 1,711,597
Unbilled water sales	717,128	653,888
Accrued interest receivable	43,723	40,328
Metropolitan Water District - agricultural discount	-	29,033
Other	72,599	34,450
Total Receivables	$ 2,787,059	$ 2,469,296

(5) CAPITAL ASSETS

Changes in capital assets for the year ended June 30, 2013 were as follows:

	Balance July 1, 2012	Additions and Transfers In	Retirements and Transfers Out	Balance June 30, 2013
Capital assets, not being depreciated:				
Land and property rights-water	$ 4,155,170	$ 101,013	$ -	$ 4,256,183
Land and property rights-wastewater	2,422,706	-	-	2,422,706
Construction in progress	4,635,947	2,874,332	(4,044,754)	3,465,525
Total capital assets, not being depreciated	11,213,823	2,975,345	(4,044,754)	10,144,414
Capital assets, being depreciated:				
Water operations:				
Impounding dam	12,006,272	-	-	12,006,272
Distribution system	48,219,710	1,152,502	(270,784)	49,101,428
Buildings and structures	12,778,234	919,723	-	13,697,957
Equipment	3,323,223	164,373	(125,365)	3,362,231
Total water operations	76,327,439	2,236,598	(396,149)	78,167,888
Wastewater operations:				
Collection system	6,637,464	697,730	(19,488)	7,315,706
Treatment facilities	21,629,997	1,679,792	(75,997)	23,233,792
Disposal facilities	12,482,915	-	(7,733)	12,475,182
Equipment	43,887	26,412	-	70,299
Total wastewater operations	40,794,263	2,403,934	(103,218)	43,094,979
Total capital assets being depreciated	117,121,702	4,640,532	(499,367)	121,262,867
Less accumulated depreciation	(54,926,107)	(3,558,943)	499,367	(57,985,683)
Total capital assets being depreciated, net	62,195,595	1,081,589	-	63,277,184
Total capital assets, net	$ 73,409,418	$ 4,056,934	$ (4,044,754)	$ 73,421,598

Changes in capital assets for the year ended June 30, 2012 were as follows:

	Balance July 1, 2011	Additions and Transfers In	Retirements and Transfers Out	Balance June 30, 2012
Capital assets, not being depreciated:				
Land and property rights-water	$ 4,057,735	$ 97,435	$ -	$ 4,155,170
Land and property rights-wastewater	2,378,878	43,828	-	2,422,706
Construction in progress	11,948,662	3,454,951	(10,767,666)	4,635,947
Total capital assets, not being depreciated	18,385,275	3,596,214	(10,767,666)	11,213,823
Capital assets, being depreciated:				
Water operations:				
Impounding dam	12,006,272	-	-	12,006,272
Distribution system	46,353,131	2,192,102	(325,523)	48,219,710
Buildings and structures	11,973,682	903,819	(99,267)	12,778,234
Equipment	3,300,686	126,350	(103,813)	3,323,223
Total water operations	73,633,771	3,222,271	(528,603)	76,327,439
Wastewater operations:				
Collection system	6,513,614	131,347	(7,497)	6,637,464
Treatment facilities	14,029,594	7,607,283	(6,880)	21,629,997
Disposal facilities	12,544,713	-	(61,798)	12,482,915
Equipment	43,887	-	-	43,887
Total wastewater operations	33,131,808	7,738,630	(76,175)	40,794,263
Total capital assets being depreciated	106,765,579	10,960,901	(604,778)	117,121,702
Less accumulated depreciation	(52,451,581)	(3,079,304)	604,778	(54,926,107)
Total capital assets being depreciated, net	54,313,998	7,881,597	-	62,195,595
Total capital assets, net	$ 72,699,273	$ 11,477,811	$ (10,767,666)	$ 73,409,418

(6) LONG-TERM LIABILITIES

District long-term liabilities consist of notes payable, contracts payable, and compensated absences. All debt was issued to finance District capital improvements.

Changes in long-term liabilities for the year ended June 30, 2013 consist of the following:

	Balance July 1, 2012	Additions	Retirements	Balance June 30, 2013	Current Portion
Note payable	$ 152,008	$ -	$ (74,918)	$ 77,090	$ 77,090
Contracts payable	12,663,686	1,322,354	(820,957)	13,165,083	845,058
Compensated absences	814,813	607,066	(538,934)	882,945	-
Total long-term liabilities	$ 13,630,507	$ 1,929,420	$ (1,434,809)	$ 14,125,118	$ 922,148

Changes in long-term liabilities for the year ended June 30, 2012 consist of the following:

	Balance July 1, 2011	Additions	Retirements	Balance June 30, 2012	Current Portion
Note payable	$ 224,814	$ -	$ (72,806)	$ 152,008	$ 74,918
Contracts payable	13,386,773	-	(723,087)	12,663,686	820,957
Compensated absences	821,392	504,187	(510,766)	814,813	-
Total long-term liabilities	$ 14,432,979	$ 504,187	$ (1,306,659)	$ 13,630,507	$ 895,875

Notes and contracts payables consist of the following:

	2013	2012
Note Payable:		
Note payable with interest at 2.9% to the State of California Revolving Fund used to finance the construction of a recycled water system; annual payments of $79,326 including interest, through 2014.	$ 77,090	$ 152,008
Contracts Payable:		
On June 21, 2010, the District entered into a Loan Agreement with the State of California Department of Public Health with interest at 2.57% payable semi-annually, principal ranging from $119,623 to $194,251 due semi-annually beginning July 1, 2011 through January 1, 2031. The proceeds of the loan assisted the District in financing construction of the Red Mountain UV Filtration Plant, which enabled the District to meet the Federal safe drinking water standards. This standard is incorporated into the Long-Term Two Enhanced Surface Water Treatment Rule (LT2).	5,675,533	5,920,745
On November 18, 2010, the District borrowed $7,227,000, from the California Alternative Energy and Advanced Transportation Financing Authority, the proceeds of which were used to finance the construction of a solar project. Financing was secured at an interest rate of 5.74%. The Federal government will pay 70% of the Tax Credit Rate, which is 5.56%, or 3.89%. The District's applicable interest rate is the difference between the taxable rate and the Federal Direct Pay rate, equivalent to 1.85% interest with principal payments ranging from $134,593 to $317,071 until November 18, 2027.	6,167,196	6,742,941

	2013	2012
On November 2, 2012, the District entered into a Loan Agreement with the California State Water Resources Control Board in the principal amount of $22,154,148, with interest at 2.20%. Annual payments in the amount of $1,420,678, including principal and interest, is due beginning May 2016 through May 2035. The proceeds of the loan will assist the District fund costs associated with the Fallbrook Wastewater Treatment Plan I Rehabilitation project. As of June 30, 2013, the District has drawn down $1,322,354 of the total loan balance available.	1,322,354	-
Subtotal note payable and contracts payable	13,242,173	12,815,694
Less: Current portion of notes and contracts payable	(922,148)	(895,875)
Total long-term portion of notes and contracts payable	$ 12,320,025	$ 11,919,819

Future long-term debt maturities as of June 30, 2013 are as follows:

Year Ending June 30	Principal	Interest	Total
2014	$ 922,148	$ 253,340	$ 1,175,488
2015	870,056	234,657	1,104,713
2016	895,981	216,496	1,112,477
2017	542,020	199,553	741,573
2018	566,590	187,357	753,947
2019-2023	3,235,886	735,263	3,971,149
2024-2028	3,751,232	344,981	4,096,213
2029-2031	1,135,906	37,045	1,172,951
Total	$ 11,919,819	$ 2,208,692	$ 14,128,511

The long-term debt maturity schedule above does not include the future principal and interest payments associated with the California State Water Resources Control Board (CSWRCB) loan. At the completion of the project, which is anticipated in May 2015, the CSWRCB will complete the District's payment schedule after all loan disbursements have been paid to the District.

(7) CONSTRUCTION COMMITMENTS

At June 30, 2013, the District has the following commitments with respect to unfinished capital projects:

Capital Projects	Remaining Construction Commitment	Expected Completion Date
Water Reclamation Plant	$ 25,507,000	2015
Wastewater Treatment Plant Construction Management	917,200	2014
Wastewater Treatment Plant Rehabilitation Project Design	470,578	2014
Sachse Reservoir Painting	914,000	2013
Office Transfer Switch Electrical Project	99,710	2013

At June 30, 2012, the District has the following commitments with respect to unfinished capital projects:

Capital Projects	Remaining Construction Commitment	Expected Completion Date
Wastewater Treatment Plant Rehabilitation Project Design	$ 552,641	2014
Red Mountain Pressure Regulating Station	57,389	2012

(8) PENSION BENEFITS

Plan Description

The District contributes to the California Public Employees’ Retirement System (CalPERS), a cost-sharing public employee 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 entities within the State of California. Benefit provisions and all other requirements are established by state statute and District ordinance. The District selects optional benefit provisions from the benefit menu by contract with CalPERS and adopts those benefits through board action. CalPERS issues a separate comprehensive annual financial report. Copies of CalPERS' annual financial report may be obtained from the CalPERS Executive Office, 400 Q Street, P.O. Box 942701, Sacramento, CA 94229.

Funding Policy

Active plan members in CalPERS are required to contribute 7% to 8% of their covered salary. The District pays a portion of the contributions required of District employees and makes the required contributions of District employees on their behalf for their account. During FY 12-13 and FY 11-12, active plan members contributed 4% and 2% of their covered salary, respectively, with the District paying the employees remaining share. 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 FY 12-13 and FY 11-12 was 26.499% and 25.718%, respectively. 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.

Annual Pension Cost

For the FY 12-13, the District's annual pension cost was $1,244,521. The District contributed its annual required contribution and a portion of the employees' share, which was $180,927. For the FY 11-12, the District's annual pension cost was $1,199,838. The District contributed its annual required contribution and a portion of the employees' share, which was $274,272.

Three-Year Trend Information for CalPERS

Fiscal Year	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
6/30/2011	$ 1,014,959	100%	$ -
6/30/2012	1,199,838	100%	-
6/30/2013	1,244,521	100%	-

(9) 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 disaster.

The District is a participating member of the Association of California Water Agencies/Joint Powers Insurance Authority (ACWA/JPIA) (Authority), which arranges for and provides general liability, property damage, worker's compensation, and dam failure liability insurance to its member agencies. The District pays a premium commensurate with the level of coverage requested. The District has elected to self-insure for a portion of property damage coverage in the amount of $10,000 per occurrence. During the past three years, there have been no instances where the amount of claims settlements exceeded insurance coverage, nor have there been any significant reductions of insurance coverage.

Noted below are condensed audited financial statements of the Authority as of and for the year ended September 30, 2012, the most recent information available:

Assets	$ 188,033,750
Liabilities:	
Current liabilities	60,219,720
Noncurrent liabilities	40,450,696
Total liabilities	100,670,416
Net assets:	
Invested in capital assets	6,904,191
Unrestricted	80,459,143
Total liabilities and net assets	$ 87,363,334
Revenues	$ 60,136,194
Operating expenses	55,071,111
Special item - net assets acquired from merger	34,986,207
Change in net assets	40,051,290
Net assets, beginning	47,312,044
Net assets, ending	$ 87,363,334

(10) OTHER POSTEMPLOYMENT BENEFITS

The District provides postemployment benefits to certain retired employees. Postemployment benefits consist of medical, dental, and vision coverage. During the years ended June 30, 2013 and 2012, there were five (5) and six (6) retirees whose cash contributions for postemployment benefits of $15,757 and $17,505, respectively, were paid by the District. Also, for the year ended June 30, 2013, the estimated implied subsidy was $55,556, resulting in the District's total contribution of $71,313 for the year ended June 30, 2013.

Other Postemployment Benefits Obligation

Plan Description

The District administers the Other Postemployment Benefits Plan, a single-employer defined benefit plan. The District's Other Postemployment Benefit Plan (OPEB) provides continued medical coverage for an eligible retired employee, spouse or legal dependent. Coverage will continue for the retiree and spouse or legal dependent until they become entitled to Medicare Benefits at age 65. The District's OPEB plan does not issue a separate stand-alone report.

Eligibility

Employees retiring after age 50, with 10 or more years of continuous employment, will have the mandatory amount estimated by the District at the date of retirement to be necessary to pay for 50% of the employee's monthly health insurance premium, and any additional costs for spouse and dependent(s) covered at the time of retirement. The difference between the total value of sick leave at retirement and estimated cost benefit (medical, dental and vision) minus the estimated cost of 50% retiree's medical premium is deposited into a health reimbursement account at the District to pay for retiree benefits until Medicare entitlement or the account is depleted. The District's health reimbursement account (HRA) balance as of June 30, 2013 is $107,447 and $155,910 as of June 30, 2012. The District will pay for half (50%) of the retired employee's monthly premium. As of June 30, 2013, there are five (5) retirees receiving benefits.

Funding Policy

The District funds the plan on a pay-as-you-go basis and records a liability for the difference between the pay-as-you-go and the actuarially determined annual OPEB cost. In FY 12-13 and FY 11-12 the District set aside $105,000 and $30,000, respectively, and has designated a cumulative $211,000 of net position to fund the District's OPEB expenses. The District's OPEB cost (expense) is calculated based on the *annual required contribution of the employer* (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) not to exceed thirty years.

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:

	June 30, 2013	**June 30, 2012**
Annual required contribution	$ 104,894	$ 104,894
Interest on net OPEB obligation	17,481	13,340
Adjustment to annual required contribution	(23,876)	(9,665)
Annual OPEB cost (expense)	98,499	100,326
Contributions made	(71,313)	(17,505)
Increase in net OPEB obligation	27,186	82,821
Net OPEB obligation-beginning of year	349,622	266,801
Net OPEB obligation-end of year	$ 376,808	$ 349,622

The District's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for FY 12-13 and two preceding years were as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
June 30, 2011	$ 116,691	12.03%	$ 266,801
June 30, 2012	100,326	17.45%	349,622
June 30, 2013	98,499	72.40%	376,808

Funded Status of the Plan

The most recent valuation (dated July 1, 2010) includes an Actuarial Accrued Liability and Unfunded Actuarial Accrued Liability of $750,706. There are no plan assets because the District funds on a pay as you go basis and has begun to designate net assets in the amount of $105,000 per year. The covered payroll (active payroll of active employees) was $4,810,694 and the ratio of the UAAL for the covered payroll was 15.6% percent. The District is evaluating its options in developing a funding policy for its OPEB obligation.

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 future employment, mortality, and the healthcare cost trend. 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 the benefits.

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 benefits costs between 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 assets, consistent with the long-term respective of the calculations.

The actuarial cost method used for determining the benefit obligation is the Projected Unit Credit method. The actuarial assumptions included a 5% discount rate and an annual healthcare cost trend rate of 8% initially; reduced by decrements of 1% per year to an ultimate rate of 5% after the fourth year. The UAAL is being amortized as a level percentage of projected payroll over an open 30-year period.

(11) JOINTLY GOVERNED ORGANIZATION

On February 26, 2013, the Board of Directors of the Fallbrook Public Utility District and the Rainbow Municipal Water District (Rainbow), as the member agencies, entered into a joint powers agreement, creating the North County Joint Powers Authority (JPA). The JPA was created to provide for the administration of the member agencies by managing their combined resources, including staffing and physical plant/infrastructure, to obtain cost-effective means of providing services to the ratepayers.

The JPA is governed by a seven (7) member Board of Directors. Each member agencies governing board, designates and appoints three (3) members from their respective governing boards to act its representatives on the JPA's Board of Directors. The seventh director is appointed by the remaining six (6) directors from among the residents of the communities served by the member agencies.

Pursuant to GASB Statement No. 14, *The Financial Reporting Entity*, the District is considered to have created a joint venture by establishing the JPA. A joint venture is a legal entity or other organization that results from a contractual arrangement and that is owned, operated, or governed by two or more participants as a separate and specific activity subject to joint control, in which the participants retain (a) an ongoing financial interest or (b) an ongoing financial responsibility. Since each member agency does not have unilateral control over the financial or operating policies of the JPA, the member agencies are considered to have joint control.

In April 2013, the District and Rainbow entered into an Employee Leasing Agreement (Leasing Agreement). Pursuant to the terms of the Leasing Agreement, any leased employees from and to one another will perform functions comparable to those services performed for the lessor. The lessor organization remains financially and operationally responsible for providing the leased employees their salaries and benefits throughout the leased period. During the year ended June 30, 2013, the General Manager of the District was leased to Rainbow, for which Rainbow paid the District $14,735 per month, for a total of $44,205 during FY 12-13.

OTHER REQUIRED SUPPLEMENTARY INFORMATION
(Unaudited)

FALLBROOK PUBLIC UTILITY DISTRICT
Required Supplementary Information
OPEB Schedule of Funding Progress
June 30, 2013
(Unaudited)

Actuarial Valuation Date	(a) Actuarial Accrued Liability (AAL)	(b) Actuarial Value of Assets	(c) Unfunded Actuarial Accrued Liability (UAAL)	(b)/(a) Funded Ratio	(d) Annual Covered Payroll	(c)/(d) UAAL As a % of Covered Payroll
07/01/07	$ 565,654	$ -	$ 565,654	0%	$ 4,691,137	12.1%
07/01/10	750,706	-	750,706	0%	4,810,694	15.6%

SUPPLEMENTARY INFORMATION

FALLBROOK PUBLIC UTILITY DISTRICT
Schedule of Revenues and Expenses - by Operating Department
For the Year Ended June 30, 2013

	Water	Wastewater	Recycled	Total
Operating revenues:				
Water sales	$ 15,458,783	$ -	$ 777,329	$ 16,236,112
Service charges	4,702,564	4,950,757	50,316	9,703,637
Other revenues	1,190,568	5,984	445,859	1,642,411
Total operating revenues	21,351,915	4,956,741	1,273,504	27,582,160
Operating expenses:				
Cost of water sold	14,457,083	-	403,582	14,860,665
Operations and maintenance	2,350,655	2,309,384	52,675	4,712,714
Customer accounts	700,158	-	-	700,158
General and administration (Note 1)	2,056,605	1,529,836	149,252	3,735,693
Other (Note 2)	-	360,000	79,560	439,560
Operating expenses before depreciation	19,564,501	4,199,220	685,069	24,448,790
Depreciation expense	2,328,969	1,229,974	-	3,558,943
Total operating expenses	21,893,470	5,429,194	685,069	28,007,733
Net operating revenues (expenses)	$ (541,555)	(472,453)	$ 588,435	$ (425,573)

Note 1:

General and administration costs are allocated to Water, Recycled and Wastewater operations based on a budgeted annual percentage. For FY 12-13, general and administration costs were allocated as follows: 55% to Water operations, 41% to Wastewater operations and 4% to Recycled operations. Allocation is analyzed and updated annually as part of the budget process.

Note 2:

Recycled operations contributed a total of $79,560 toward payment of the annual debt service obligation for the State Revolving Fund loan, which allowed expansion of the recycled pumping and distribution system. The $79,560 is not reported as an Other expense in the Statement of Revenues, Expenses and Changes in Net Position, as the payment reduces the principal of the State Revolving Fund loan obligation.

Wastewater operations contributed $360,000 towards payment of the annual debt service obligations. The $360,000 is not reported as an Other expense in the Statement of Revenues, Expenses and Changes in Net Position, as the payment reduces the principal of the outstanding long-term obligations.

FALLBROOK PUBLIC UTILITY DISTRICT
Schedule of Revenues and Expenses - by Operating Department
For the Year Ended June 30, 2012

	Water	Wastewater	Recycled	Total
Operating revenues:				
Water sales	$ 12,778,113	$ -	$ 592,986	$ 13,371,099
Service charges	4,524,843	4,331,022	55,373	8,911,238
Other revenues	1,062,054	4,376	312,948	1,379,378
Total operating revenues	18,365,010	4,335,398	961,307	23,661,715
Operating expenses:				
Cost of water sold	12,647,833	-	492,962	13,140,795
Operations and maintenance	2,570,414	2,494,189	53,275	5,117,878
Customer accounts	611,736	-	-	611,736
General and administration (Note 1)	2,148,057	1,606,509	156,733	3,911,299
Other (Note 2)	-	200,000	79,560	279,560
Operating expenses before depreciation	17,978,040	4,300,698	782,530	23,061,268
Depreciation expense	2,171,458	907,846	-	3,079,304
Total operating expenses	20,149,498	5,208,544	782,530	26,140,572
Net operating revenues (expenses)	$ (1,784,488)	$ (873,146)	$ 178,777	$ (2,478,857)

Note 1:

General and administration costs are allocated to Water, Recycled and Wastewater operations based on a budgeted annual percentage. For FY 11-12, general and administration costs were allocated as follows: 56% to Water operations, 40% to Wastewater operations and 4% to Recycled operations. Allocation is analyzed and updated annually as part of the budget process.

Note 2:

Recycled operations contributed a total of $79,560 toward payment of the annual debt service obligation for the State Revolving Fund loan, which allowed expansion of the recycled pumping and distribution system. The $79,560 is not reported as an Other expense in the Statement of Revenues, Expenses and Changes in Net Position, as the payment reduces the principal of the State Revolving Fund loan obligation.

Wastewater operations contributed $200,000 towards payment of the annual debt service obligations. The $200,000 is not reported as an Other expense in the Statement of Revenues, Expenses and Changes in Net Position, as the payment reduces the principal of the outstanding long-term obligations.

MISCELLANEOUS STATISTICAL INFORMATION

FALLBROOK PUBLIC UTILITY DISTRICT
Board of Directors
For the Year Ended June 30, 2013

At June 30, 2013, the Board of Directors consisted of the following:

Name	Office	Term Expires
Bert Hayden	President	December 2016
Al Gebhart	Vice President	December 2016
Don McDougal	Director	December 2016
Archie McPhee	Director	December 2014
Milt Davies	Director	December 2014

FALLBROOK PUBLIC UTILITY DISTRICT
Assessed Valuation
For the Year Ended June 30, 2013

The District's, including the Sanitary District, assessed valuation for the year ended June 30, 2013 is as follows:

Assessed valuation:		
Secured property	$	2,965,554,053
Unsecured property		40,228,753
Total assessed valuation	$	3,005,782,806

Source: County of San Diego Property Tax Services.

OTHER REPORT

Sacramento
3000 S Street, Suite 300
Sacramento, CA 95816
916.928.4600

Walnut Creek

Oakland

LA/Century City

Newport Beach

San Diego

Seattle

Independent Auditor's 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 Honorable Board of Directors
of the Fallbrook Public Utility District

We have audited, in accordance with the 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 United States, the financial statements of the Fallbrook Public Utility District (District), as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated December 3, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

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 a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of the internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in the internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free from 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Macias Gini & O'Connell LLP

San Diego, California
December 3, 2013