

**MUNICIPAL WATER DISTRICT
OF ORANGE COUNTY**

Financial Statements

June 30, 2010

Table of Contents

	Page
Independent Auditors' Report	1
Management's Discussion and Analysis (Unaudited)	2-8
Basic Financial Statements:	
▪ Statement of Net Assets	9-10
▪ Statement of Revenues, Expenses and Changes in Net Assets	11
▪ Statement of Cash Flows.....	12-13
▪ Notes to Financial Statements	14-23
Required Supplementary Information (Unaudited):	
▪ Other Post-employment Benefit Plan Schedule of Funding Progress	24



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

A PARTNERSHIP INCLUDING ACCOUNTANCY CORPORATIONS

5 CORPORATE PARK, SUITE 100
 IRVINE, CALIFORNIA 92606-5165
 (949) 399-0600 • FAX (949) 399-0610
www.diehlevents.com

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

*A PROFESSIONAL CORPORATION

November 29, 2010

INDEPENDENT AUDITORS' REPORT

Board of Directors
 Municipal Water District of Orange County
 Fountain Valley, California

We have audited the basic financial statements of the Municipal Water District of Orange County as of and for the year ended June 30, 2010 as listed in the table of contents. These basic financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these basic financial statements based on our audit. The prior year partial comparative information has been derived from the financial statements of the District for the year ended June 30, 2009 and in our report dated November 3, 2009, we expressed an unqualified opinion on these financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and 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 includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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

In accordance with Government Auditing Standards, we have also issued our report dated November 29, 2010 on our consideration of the Municipal Water District of Orange County's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

The management's discussion and analysis and the schedule of funding progress for the other post-employment benefit plan, as identified in the accompanying table of contents are not a required part of the basic financial statements but are supplementary information required by the accounting principles generally accepted in the United States of America. This information is an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during the audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance on them.

Diehl, Evans and Company, LLP

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the District's annual financial report presents our analysis of the District's financial performance during the Fiscal Year that ended on June 30, 2010. Please read it in conjunction with the financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

- The District's net assets decreased by \$935,000 or 8.5 percent.
- During the year the District's revenues increased by \$7.0 million or 5.3 percent while expenses increased by \$9.7 million or 7.5 percent, mainly due to higher collected amount for water sales and purchases.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

BASIC FINANCIAL STATEMENTS

The financial statements of the District report information about the District using accounting methods similar to those used by private sector companies. These statements offer short-term and long-term financial information about its activities. The Statement of Net Assets includes all of the District's assets and liabilities, and provides information about the nature and amounts of investments in resources (assets) and the obligations to the District's creditors (liabilities). It also provides the basis for computing rate of return, evaluating the capital structure of the District, and assessing the liquidity and financial flexibility of the District.

All of the current year's revenues and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Assets. This statement measures the District's operations over the past year and can be used to determine the District's credit worthiness and whether the District has successfully recovered all its costs through its user fees and other charges.

The final required financial statement is the Statement of Cash Flows. The primary purpose of this statement is to provide information about the District's cash receipts and cash payments during the reporting period. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations and investments. It also provides answers to such questions as: "Where did cash come from?", "What was cash used for?", and "What was the change in cash balance during the reporting period?"

FINANCIAL ANALYSIS OF THE DISTRICT

Our analysis of the District begins on page 3 of the Management's Discussion and Analysis. One of the most important questions asked about the District's finances is: "Is the District, as a whole, better off or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets report information about the District's activities in a way that will help answer this question. These two statements report the net assets of the District and changes in them. You can think of the District's net assets (the difference between assets and liabilities) as one way to measure financial health or financial position. Over time, increases or decreases in the District's net assets are one indicator of whether its financial health is improving or deteriorating. However, you will need to consider other non-financial factors, such as changes in economic conditions, population growth, zoning, changes in rates and charges and new or changed government legislation.

NET ASSETS

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

Table 1
Condensed Statements of Net Assets
(In thousands of dollars)

	<u>FY 2010</u>	<u>FY 2009</u>	<u>Variance</u>	<u>Total Percent Change</u>
Current and Other Assets	\$ 42,889	\$ 41,312	\$ 1,577	3.8%
Capital Assets	<u>1,255</u>	<u>1,374</u>	<u>(119)</u>	<u>(8.7%)</u>
Total Assets	44,144	42,686	1,458	3.4%
Long-term Liabilities	272	139	133	95.7%
Other Liabilities	<u>33,786</u>	<u>31,526</u>	<u>2,260</u>	<u>7.2%</u>
Total Liabilities	34,058	31,665	2,393	7.6%
Net Assets:				
Investment in Capital Assets, Net of Related Debt	1,255	1,374	(119)	(8.7%)
Restricted for Trustee Activities	4,823	4,863	(40)	(0.8%)
Unrestricted	<u>4,008</u>	<u>4,784</u>	<u>(776)</u>	<u>(16.2%)</u>
Total Net Assets	<u>\$ 10,086</u>	<u>\$ 11,021</u>	<u>\$ (935)</u>	<u>(8.5%)</u>

As can be seen from the table above, net assets decreased by \$935,000 from Fiscal Year 2009 to 2010. This decrease is the result of the following:

- Unrestricted Net Assets decreased by \$776,000 due mainly to the lower interest earnings on the District's investment portfolio and lower water sales caused by water conservation efforts, the weak economy and higher rainfall.
- Restricted for Trustee Activities decreased by \$40,000.
- Investment in Capital Assets decreased by \$119,000 mainly due to the annual depreciation expenses.

REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

While the Statement of Net Assets shows the change in financial position of net assets, the Statement of Revenues, Expenses, and Changes in Net Assets provides answers as to the nature and source of these changes. As can be seen in Table 2, the loss of \$935,000 is the source of the decrease in net assets in Fiscal Year 2010.

Table 2
Condensed Statements of Revenues,
Expenses, and Changes in Net Assets
(In thousands of dollars)

	<u>FY 2010</u>	<u>FY 2009</u>	<u>Variance</u>	<u>Total Percent Change</u>
Operating Revenues	\$ 138,316	\$ 130,964	\$ 7,352	5.6%
Non-operating Revenues	506	821	(315)	(38.4%)
Total Revenues	138,822	131,785	7,037	5.3%
Depreciation Expense	142	131	11	8.4%
Other Operating Expense	139,546	129,900	9,646	7.4%
Non-Operating Expense	69	-	69	100.0%
Total Expenses	139,757	130,031	9,726	7.5%
Change in Net Assets	(935)	1,754	(2,689)	(153.3%)
Beginning Net Assets	11,021	9,267	1,754	18.9%
Ending Net Assets	\$ 10,086	\$ 11,021	\$ (935)	(8.5%)

A closer examination of the source of changes in net assets reveals that the District's operating revenues increased by \$7.4 million in Fiscal Year 2010 due mainly to a sizeable water rate increase from Metropolitan Water District of Southern California (Metropolitan) while actual water sales were lower caused by water conservation efforts, the weak economy and higher rainfall. In addition, non-operating revenues decreased by \$315,000 due mostly to the lower interest earnings on the District's investment portfolio.

Total expenses increased by \$9.7 million due mainly to:

- Higher cost of water purchased from Metropolitan.
- A refund of \$69,000 to agencies for excess funds collected for Hazard Mitigation Mapping Plan.

BUDGETARY HIGHLIGHTS

The District's Board of Directors adopts an operating budget prior to the start of the fiscal year. The budget may be revised by Board action during the year. A Fiscal Year 2010 budget comparison and analysis is presented in Table 3.

Table 3
FY 2010 Actual vs FY 2010 Budget

(In thousands of dollars)

	<u>Actual</u>	<u>Budget</u>	<u>Variance</u>	<u>Total Percent Change</u>
Revenues:				
From Operations	\$ 138,316	\$ 152,795	\$ (14,479)	(9.5%)
Non-operating Revenues	506	506		
Total Revenues	138,822	153,301	(14,479)	(9.4%)
Expenses:				
From Operations				
Cost of Water	133,315	143,715	(10,400)	(7.2%)
Other Operating	6,231	6,016	215	3.6%
Depreciation	142	131	11	8.4%
Non operating Expenses	69	-	69	0.0%
Total Expenses	139,757	149,862	(10,105)	(6.7%)%
Change In Net Assets	\$ (935)	\$ 3,439	\$ (4,374)	(127.2%)

Total revenues were \$14 million lower than budget caused mainly by:

- Lower water sales due to water conservation efforts, the weak economy and higher rainfall.
- Cancellation of Tier 2 rate surcharge due to adoption of the Drought Allocation Plan.

Total expenses were \$10 million lower than budget as a result of lower than budgeted water purchased.

Overall, the District's change in net assets was \$4,374,000 lower than budgeted.

CAPITAL ASSETS AND LONG TERM DEBT

Capital Assets

At the end of Fiscal Year 2010, the District had invested \$1.3 million in net capital assets as shown in Table 4.

**Table 4
Capital Assets
(In thousands of dollars)**

	<u>FY 2010</u>	<u>FY 2009</u>	<u>Variance</u>	<u>Total Percent Change</u>
Leasehold Improvements	\$ 2,675	\$ 2,661	\$ 14	0.5%
Furniture & Fixtures	632	623	9	1.4%
Subtotal	3,307	3,284	23	0.7%
Less Accumulated Depreciation	(2,052)	(1,910)	(142)	(7.4%)
Net Capital Assets	\$ 1,255	\$ 1,374	\$ (119)	(8.7%)

Additional information regarding capital assets can be found in Note 3 to the financial statements.

Long Term Debt

There is no debt outstanding as of June 30, 2010. No new long-term debt was incurred in Fiscal Year 2010 and the District does not plan to issue new debt in Fiscal Year 2011.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

The District's Board of Directors and management considered many factors when setting the Fiscal Year 2011 budget and user rate charges. The proposed Fiscal Year 2011 budget is driven by the "services" provided to the 28 member agencies within our service area and the desire for 100% Water Service Reliability, which means avoiding having to ration water in Orange County. The overarching goals include:

- Water Supply Reliability
- Water System Reliability
- Rates Management and Efficiency

The District's revenues are from four major sources: 1) the cost of water sold, 2) the incremental water charge applied to per acre-foot of water delivered, 3) the retail meter charge imposed annually on each retail water meter served by a member agency, and 4) interest income earned from the District's investment portfolio. Table 5 compares Fiscal Year 2011 budget with Fiscal Year 2010 actual revenues, expenses, and changes in net assets.

Table 5
Fiscal Year 2011 Budget vs Fiscal Year 2010 Actual
(In thousands of Dollars)

	<u>FY 2011</u> <u>Budget</u>	<u>FY 2010</u> <u>Actual</u>	<u>Variance</u>	<u>Total</u> <u>Percent</u> <u>Change</u>
Operating Revenues	\$ 154,754	\$ 138,316	\$ 16,438	11.9%
Non-operating Revenues	312	506	(194)	(38.3%)
Total Revenues	155,066	138,822	16,244	11.7%
Depreciation Expense	145	142	3	2.0%
Other Operating Expense	155,015	139,546	15,469	11.1%
Non-operating Expense	-	69	(69)	(100.0%)
Total Expenses	155,160	139,756	15,403	11.0%
Change in Net Assets	(94)	(935)	841	(89.9%)
Beginning Net Assets	10,086	11,021	(935)	(8.5%)
Ending Net Assets	\$ 9,992	\$ 10,086	\$ (94)	(0.9%)

Operating Revenues available for recovering operating costs are projected to be \$155 million, an increase of \$16.4 million due to a water rate increase imposed by Metropolitan Water District of Southern California (Metropolitan) in Fiscal Year 2011.

Non-operating Revenues are projected to decrease by \$0.2 million due to lower interest earnings.

Other Operating Expenses are expected to increase by \$15.5 million due to higher cost of water purchase forecast in Fiscal Year 2011.

These indicators were taken into consideration when adopting the District's budget for Fiscal Year 2011

CONTACTING THE DISTRICT'S FINANCIAL MANAGER

This financial report is designed to provide our citizens, customers, investors, and creditors with a general overview of the District's finances and to demonstrate the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Municipal Water District of Orange County, Finance Department at 18700 Ward Street, Fountain Valley, CA 92708, (714) 963-3058.

MUNICIPAL WATER DISTRICT OF ORANGE COUNTY

Statement of Net Assets

June 30, 2010

(with comparative data as of June 30, 2009)

	<u>2010</u>	<u>2009</u>
<u>ASSETS</u>		
Current Assets:		
Restricted Assets:		
Cash and Cash Equivalents (Note 2)	\$ 5,581,710	\$ 6,394,216
Accounts Receivable Other	3,181,090	2,293,896
Accrued Interest Receivable	6,288	18,012
Unrestricted Assets:		
Cash and Cash Equivalents (Note 2)	4,506,300	6,077,813
Investments (Note 2)	3,597,307	2,588,767
Accounts Receivable:		
Water Sales	25,658,832	23,560,030
Other	247,672	248,477
Accrued Interest Receivable	51,007	62,601
Deposits and Prepaid Expenses	59,099	68,340
Total Current Assets	<u>42,889,305</u>	<u>41,312,152</u>
Noncurrent Assets:		
Unrestricted Assets:		
Capital Assets, Net (Note 3)	<u>1,255,077</u>	<u>1,373,790</u>
Total Noncurrent Assets	<u>1,255,077</u>	<u>1,373,790</u>
TOTAL ASSETS	<u>44,144,382</u>	<u>42,685,942</u>

See accompanying independent auditors' report and notes to financial statements

MUNICIPAL WATER DISTRICT OF ORANGE COUNTY
Statement of Net Assets (Continued)
June 30, 2010
(with comparative data as of June 30, 2009)

<u>LIABILITIES</u>	<u>2010</u>	<u>2009</u>
Current Liabilities:		
Restricted Liabilities:		
Accrued Liabilities	1,157,920	456,716
Advances from Participants	1,520,784	1,515,959
Due to Participants (Note 4c)	1,266,986	1,869,573
Unrestricted Liabilities:		
Accounts Payable, Metropolitan Water District of Southern California	28,883,395	26,629,862
Accrued Liabilities	956,432	1,053,764
Total Current Liabilities	33,785,517	31,525,874
Long Term Liabilities		
Unrestricted Liabilities:		
Accrued Other Post Employment Benefits (OPEB) Liability (Note 7)	272,493	138,732
Total Long Term Liabilities	272,493	138,732
TOTAL LIABILITIES	34,058,010	31,664,606
 <u>NET ASSETS</u>		
Investment in Capital Assets	1,255,077	1,373,790
Restricted for Trustee Activities	4,823,398	4,863,876
Unrestricted	4,007,897	4,783,670
TOTAL NET ASSETS	\$ 10,086,372	\$ 11,021,336

See accompanying independent auditors' report and notes to financial statements

MUNICIPAL WATER DISTRICT OF ORANGE COUNTY
Statement of Revenues, Expenses and
Changes in Net Assets
For Year Ended June 30, 2010
(with comparative data for Year Ended June 30, 2009)

	<u>2010</u>	<u>2009</u>
Operating Revenues:		
Water Sales	\$ 138,315,895	\$ 130,964,400
Cost of Water Sold	(133,314,548)	(123,371,724)
Gross Margin	<u>5,001,347</u>	<u>7,592,676</u>
Operating Expenses:		
Salaries and Employee Benefits	3,893,247	4,056,381
Engineering	167,051	173,079
General and Administrative	2,170,215	2,298,127
Depreciation	142,501	131,106
Total Operating Expenses	<u>6,373,014</u>	<u>6,658,693</u>
Net Operating Income (Loss)	<u>(1,371,667)</u>	<u>933,983</u>
Non-Operating Revenues:		
Investment Income	279,074	516,020
Reimbursement from Participants (Note 5)	226,997	304,628
Total Non-Operating Revenues	<u>506,071</u>	<u>820,648</u>
Non-Operating Expenses:		
Special Project Expenses	69,368	-
Total Non-Operating Expenses	<u>69,368</u>	<u>-</u>
Net Non-Operating Income	<u>436,703</u>	<u>820,648</u>
Change in Net Assets	<u>(934,964)</u>	<u>1,754,631</u>
NET ASSETS, BEGINNING OF YEAR	<u>11,021,336</u>	<u>9,266,705</u>
NET ASSETS - END OF YEAR	<u>\$ 10,086,372</u>	<u>\$ 11,021,336</u>

See accompanying independent auditors' report and notes to financial statements

MUNICIPAL WATER DISTRICT OF ORANGE COUNTY

Statement of Cash Flows
For Year Ended June 30, 2010
(with comparative data as of June 30, 2009)

	<u>2010</u>	<u>2009</u>
Cash Flows from Operating Activities:		
Cash received from member agencies-water deliveries	\$ 136,217,093	\$ 126,253,923
Cash payments to Metropolitan Water District of Southern California	(131,061,015)	(116,899,316)
Cash payments for salaries, employee benefits, engineering services, general and administrative expenses	(6,184,843)	(6,516,196)
	<hr/>	<hr/>
Net Cash (Used) Provided by Operating Activities	(1,028,766)	2,838,411
	<hr/>	<hr/>
Cash Flows from Noncapital and Related Financing Activities:		
Reimbursements from Participants	226,997	304,628
	<hr/>	<hr/>
Cash Flows from Capital and Related Financing Activities:		
Acquisition of capital assets	(23,788)	(23,069)
Proceeds from participants	(602,587)	68,685
Proceeds paid for trustee activities	(180,359)	(79,863)
Payment to Member Agencies	(69,368)	-
	<hr/>	<hr/>
Net Cash Used by Capital and Related Financing Activities	(876,101)	(34,247)
	<hr/>	<hr/>
Cash Flows from Investing Activities:		
Income from investment	251,388	498,721
Investments sold	(957,536)	1,006,689
	<hr/>	<hr/>
Net Cash Provided (Used) by Investing Activities	(706,148)	1,505,410
	<hr/>	<hr/>
Net increase (decrease) in cash and cash equivalents	(2,384,018)	4,614,202
Cash and Cash Equivalents at Beginning of Year	12,472,029	7,857,827
	<hr/>	<hr/>
Cash and Cash Equivalents at End of Year	\$ 10,088,010	\$ 12,472,029
	<hr/> <hr/>	<hr/> <hr/>

See accompanying independent auditors' report and notes to financial statements

MUNICIPAL WATER DISTRICT OF ORANGE COUNTY

Statement of Cash Flows (Continued)
For Year Ended June 30, 2010
(with comparative data as of June 30, 2009)

	<u>2010</u>	<u>2009</u>
Reconciliation of Operating Income (Loss) to Net Cash Provided By Operating Activities		
Operating Income (Loss)	\$ (1,371,667)	\$ 933,983
Adjustments to Reconcile Operating Income (Loss) to Net Cash Used by Operating Activities:		
Depreciation	142,501	131,106
Change in Assets and Liabilities:		
(Increase) decrease in accounts receivable-water deliveries	(2,098,803)	(4,710,477)
(Increase) decrease in deposits and prepaid expenses	9,241	(9,245)
Increase (Decrease) in accrued liabilities	36,429	20,636
Increase (Decrease) in accounts payable to Metropolitan Water District of Southern California	2,253,533	6,472,408
Total Adjustments	342,902	1,904,428
Net Cash Provided (Used) by Operating Activities	\$ (1,028,766)	\$ 2,838,411

See accompanying independent auditors' report and notes to financial statements

Municipal Water District of Orange County
Notes to Financial Statements
June 30, 2010

(1) Summary of Significant Accounting Policies

Reporting Entity

The Municipal Water District of Orange County (the District) was formed on January 11, 1951 as a public district under the Municipal Water District Act of 1911 for the primary purpose of providing wholesale imported water to various contracting agencies. The District obtains its water from the Metropolitan Water District of Southern California (Metropolitan) and is empowered to derive revenues from water sales.

The District is a municipal corporation governed by an elected seven-member board. These financial statements include the District and its component unit. The component unit is included in the District's reporting entity because of the significance of its operational or financial relationship with the District.

On January 2001, the District merged with the Coastal Municipal Water District (Coastal) under the recommendation of the Local Agency Formation Commission of Orange County (LAFCO) as part of an effort to streamline local government. The consolidation of the two agencies allows the new district to more efficiently provide wholesale water services at a reduced cost for the benefit of residents living throughout the service area.

The District now provides imported water to 2.3 million residents through 28 cities and water entities throughout Orange County with a service area of 600 square-miles.

Component Unit

The District formed the Municipal Water District of Orange County Water Facilities Corporation (WFC) as a California nonprofit corporation on April 20, 1978. WFC is governed by a seven-member board comprised of the District's board members. WFC was formed to assist in the financing of the Allen-McColloch Pipeline (AMP) and the Flow Augmentation Project (FAP) (see note 4) and as such has no employees.

The reporting entity "Municipal Water District of Orange County" includes the accounts of the District and WFC. The criteria used in determining the scope of the reporting entity is based on the provisions of GASB Statement No. 14. The District is the primary government unit. Component units are those entities that are financially accountable to the primary government, either because the District appoints a voting majority of the component unit's board, or because the component unit will provide a financial benefit or impose a financial burden on the District. The District has accounted for WFC as a "blended" component unit. Despite being legally separate, this entity is intertwined with the District and, in substance is part of the District's operations. Accordingly, the statement of net assets accounts and operations of this component unit are reported within the financial statements of the District. There are no separate audited financial statements for WFC.

Basis of Presentation

The District accounts for its activities as an enterprise fund. An enterprise fund is a proprietary type fund used to account for operations (a) that are financed and operated in a manner similar to private business enterprises - where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

The District has opted under Governmental Accounting Standards Board (GASB) Statement 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, to apply all GASB pronouncements as well as any applicable pronouncements of the Financial Accounting Standards Board (FASB), the Accounting Principles Board (APB), or any Accounting Research Bulletins (ARB) issued on or before November 30, 1989, unless they contradict or conflict with GASB pronouncements.

Municipal Water District of Orange County
Notes to Financial Statements
June 30, 2010

Measurement Focus and Basis of Accounting

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

When both restricted and unrestricted resources are available, it is the District's policy to use restricted resources first, and then unrestricted resources as they are needed.

Operating Revenues and Expenses

Operating revenues, such as charges for services (water sales less the cost of water) result from exchange transactions associated with the principal activity of the District. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as reimbursement from participants and investment income, result from nonexchange transactions or ancillary activities in which the District gives (receives) value without directly receiving (giving) equal value in exchange.

Operating expenses include the cost of services, administrative expenses and depreciation on capital assets.

Estimates

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

Budgetary Policy and Control

The District's Board approves each year's budget submitted by the General Manager prior to the beginning of the new fiscal year. All amendments to the budget or transfers of operating budget appropriations to or from reserve accounts require the approval of the Board. The General Manager is authorized to transfer budgeted amounts within departments. Because the District is not required to legally adopt a budget for its enterprise fund, budgetary data is not presented in the accompanying financial statements. The District maintains budgetary controls to ensure compliance with the District's administrative provisions embodied in the appropriated budget approved by the Board.

Investments

The District accounts for investments in debt securities at fair value (the value at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale).

Cash and Cash Equivalents

Cash and cash equivalents are defined as cash and short-term, highly liquid investments (i.e., Local Agency Investment Fund and Money Market Funds) which are readily convertible to cash and mature within three months of original purchase.

Accounts Receivable

The District extends credit to customers in the normal course of operations. Management believes all accounts receivable are collectible. Management evaluates all accounts receivable and if it is determined that they are uncollectible they are written off as a bad debt expense.

See accompanying independent auditors' report

Municipal Water District of Orange County
Notes to Financial Statements
June 30, 2010

Capital Assets

Capital Assets are defined by the District as assets with an initial, individual cost of more than \$5,000 and useful life greater than one year. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which range from 3 to 5 years for furniture, fixtures, and equipment, and 30 years for leasehold improvements.

Risk Management

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

At June 30, 2010, the District participated in the self-insurance programs of the Insurance Authority as follows:

Property Loss - The Insurance Authority has pooled self-insurance up to \$50,000 per occurrence and has purchased excess insurance coverage up to \$100,000,000 (total insurable value of \$665,029). The District has a \$1,000 deductible for buildings, personal property and fixed equipment.

General Liability - The District has self-insured retention level of \$100,000. A self-insured retention is similar to a deductible. The Insurance Authority has pooled self-insurance up to \$1,000,000 per occurrence and has purchased excess insurance coverage up to \$60,000,000.

Auto Liability - The District has self-insured retention level of \$100,000. A self-insured retention is similar to a deductible. The Insurance Authority has pooled self-insurance up to \$1,000,000 per occurrence and has purchased excess insurance coverage up to \$60,000,000.

Public Officials' Liability - The Insurance Authority has pooled self-insurance up to \$1,000,000 per occurrence and has purchased excess insurance coverage up to \$60,000,000.

Fidelity Bond - The Insurance Authority has pooled self-insurance up to \$100,000 per occurrence and the District has purchased excess insurance coverage up to \$2,000,000. The District has a \$1,000 deductible.

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

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

Compensated Absences

The District is obligated to compensate employees for all earned but unused vacation days. Employees' vacation days are accrued each pay period and reported as accrued liabilities. Depending on the length of employment, employees earn a minimum of 10 to a maximum of 26 vacation days per year. Accumulated vacation days may not exceed 1.5 times the number of days earned per year without prior approval of the General Manager. The non-vested sick leave benefits (those that are not payable in the event of employee termination) are considered contingent liabilities and are not reflected in the accompanying financial statements.

Municipal Water District of Orange County
Notes to Financial Statements
June 30, 2010

(2) Cash and Investments

Cash and investments at June 30, 2010, are classified in the accompanying financial statements as follows:

Statement of net assets:	
Cash and Cash Equivalents (Restricted)	\$ 5,581,710
Cash and Cash Equivalents (Unrestricted)	4,506,300
Investments (Unrestricted)	<u>3,597,307</u>
Total Cash and Investments	<u>\$13,685,317</u>

Cash and investments as of June 30, 2010 consist of the following:

Cash on hand	\$ 500
Deposits with financial institutions	47,414
Investments	<u>13,637,403</u>
Total Deposits and Investments	<u>\$13,685,317</u>

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

The table below identifies the investment types that are authorized for the District by the California Government Code (or the District's investment policy, where more restrictive). The table also identifies certain provisions of the California Government Code (or the District's investment policy, where more restrictive) that address interest rate risk, credit risk, and concentration of credit risk. This table does not address investments of debt proceeds held by bond trustee 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.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage of Portfolio</u>	<u>Maximum Investment in One Issuer</u>
U.S. Treasury Obligations	1 year	None	None
U.S. Government Sponsored Entities Securities	1 year	None	None
U.S. Government Sponsored Entities Securities- (Reserve Funds)	5 years	None	None
Corporate Securities (Reserve Fund)	5 years	20%	None
Commercial Paper	31 days	20%	10%
Negotiable Certificates of Deposit	None	20%	None
Banker's Acceptances	180 days	20%	20%
Repurchase Agreements	180 days	10%	None
Money Market Mutual Funds	N/A	15%	10%
County Investment Pool	N/A	None	None
State Investment Pool	N/A	None	None

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the District manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

Municipal Water District of Orange County
Notes to Financial Statements
June 30, 2010

Information about the sensitivity of the fair values of the District's investments to market interest rate fluctuations is provided by the following table that shows the distribution of the District's investments by maturity:

<u>Investment Type</u>		<u>Remaining Maturity (in Months)</u>		
		<u>12 Months or Less</u>	<u>13 to 24 Months</u>	<u>25-60 Months</u>
U.S. Government Sponsored				
Entities Securities	\$ 1,765,015			\$ 1,765,015
Negotiable Certificates of Deposits	302,027	\$ 99,748		202,279
Repurchase Agreement	18,483	18,483		
Corporate Securities	1,530,265		\$1,032,740	497,525
County Investment Pool	20,334	20,334		
State Investment Pool	<u>10,001,279</u>	<u>10,001,279</u>		
	<u>\$13,637,403</u>	<u>\$10,139,844</u>	<u>\$ 1,032,740</u>	<u>\$2,464,819</u>

Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by (where applicable) the California Government

Code, the District's investment policy, or debt agreements, and the actual rating by Standard and Poor's as of the year end of each investment type.

<u>Investment Type</u>		<u>Minimum Legal Rating</u>	<u>Ratings as of Year End</u>			
			<u>AAA</u>	<u>AA</u>	<u>A/A+</u>	<u>Not Rated</u>
U.S. Government Sponsored						
Entities Securities	\$ 1,765,015	N/A	\$1,765,015			
Negotiable Certificates of Deposits	302,027	N/A				\$ 302,027
Repurchase Agreement	18,483	N/A				18,483
Corporate Securities	1,530,265	A		\$515,065	\$1,015,200	
County Investment Pool	20,334	N/A				20,334
State Investment Pool	<u>10,001,279</u>	N/A				<u>10,001,279</u>
	<u>\$13,637,403</u>		<u>\$1,765,015</u>	<u>\$515,065</u>	<u>\$1,015,200</u>	<u>\$10,342,123</u>

Concentration of Credit Risk

The investment policy of the District contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. At June 30, 2010 the District had no investment in any one issuer (other than U.S. Treasury securities, mutual funds, external investment pools) that represent 5% or more of total District investments.

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

See accompanying independent auditors' report

Municipal Water District of Orange County
Notes to Financial Statements
June 30, 2010

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 City deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

As of June 30, 2010, the District's deposits with financial institutions are covered by FDIC.

Investment in State and County Investment Pool

The District is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by California Government Code Section 16429 under the oversight of the Treasurer of the State of California and in the Orange County Investment Fund (OCIF) under the oversight of the Orange County Treasurer. The fair value of the District's investment in these pools are reported in the accompanying financial statements at amounts based upon the District's pro-rata share of the fair value provided by LAIF and OCIF for the entire LAIF and OCIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF and OCIF, which are recorded on an amortized cost basis.

(3) Capital Assets

The following is a summary of capital assets at June 30, 2010 with changes therein:

	<u>2009</u>	<u>Additions</u>	<u>Deletions</u>	<u>2010</u>
Furniture and fixtures	\$ 621,904	\$ 10,000	\$ -	\$ 631,904
Leasehold improvements	<u>2,661,476</u>	<u>13,788</u>	<u>-</u>	<u>2,675,264</u>
	3,283,380	23,788	-	3,307,168
Less accumulated depreciation	<u>(1,909,590)</u>	<u>(142,501)</u>	<u>-</u>	<u>(2,052,091)</u>
Net Capital Assets	<u>\$1,373,790</u>	<u>\$(118,713)</u>	<u>\$ -</u>	<u>\$1,255,077</u>

**(4) Municipal Water District of Orange County
Water Facilities Corporation**

Since 1978, the District has acted under various agreements as managing agent for WFC and as trustee for certain local water agencies in the financing, construction and operation of a water system and facilities necessary to improve water quality and provide capacity for urban expansion in a portion of the District's service area. The original 1979 pipeline project consisted of the construction of a 26-mile pipeline, which was augmented in 1989 with the construction of a 3-mile parallel pipeline and flow control facility. Together these projects known as the Allen-McColloch Pipeline (AMP) and Flow Augmentation Project (FAP) were funded through tax-exempt debt issues of the WFC and cash participation.

(a) AMP and FAP Financing

In March 1979, WFC issued \$79,400,000 principal amount of 1979 Leasehold Mortgage Bonds to assist in the financing of the Allen-McColloch Pipeline (AMP). The 1979 Leasehold Mortgage Bonds were advance refunded by the 1992 Adjustable/ Fixed Rate Certificates of Participation (1992 COPS) and subsequently refunded by the 1996 Certificates of Participation (1996 COPS).

In August 1989, the 1989 Adjustable/Fixed Rate Certificates of Participation (1989 COPS) were issued by WFC to assist in the financing of Phase I and II of the Flow Augmentation Project (FAP). Participation in the project entitles each entity to sublease capacity in the FAP. The FAP began initially in 1988 with planning, design, and financing arrangements and a goal to increase the overall delivery capacity of the AMP in southeastern Orange County.

Under the terms of the master lease and sublease agreements between WFC, the District and participating water agencies (Participants), the District leased the site to WFC for construction of the AMP & FAP. Upon

Municipal Water District of Orange County
Notes to Financial Statements
June 30, 2010

completion of construction, WFC subleased the site and the improvements to the District, which simultaneously subleased the capacity in the AMP to the Participants.

On July 3, 2006, the 1996 COPS were fully paid off and the leases were terminated.

(b) AMP and FAP Sale

The AMP and FAP were sold to Metropolitan in Fiscal Year 1995. Pursuant to the sale agreement that is retroactive to July 1, 1994, Metropolitan assumed ownership and control of the entire pipeline and facilities, and title to the facilities will be vested upon final payment from member agencies of all outstanding debt in 2016 or sooner.

Under the terms and conditions of the sale, WFC remains the issuer of the debt (the 1989 and 1992 COPS) with Metropolitan assuming responsibility for the actual 1989 COPS debt payment and \$4.6 million due to the District annually on July 1st towards the 1992 COPS debt. The 1989 COPS were retired in Fiscal Year 1996. Also related under the terms and conditions of the sale agreement, the master lease of the AMP was assigned to Metropolitan and the sublease agreements serve as collateral in the event Metropolitan defaults on their commitments.

As part of the sale agreement, all proceeds from the sale of the pipeline are to be distributed to the Participants based on an agreed Revised Percentage of Investment (RPOI). During the year, proceeds of \$6,497,642 were received and \$5,230,626 was distributed. As of June 30, 2010, the balance of \$1,266,986 included in "Due to Participants" is to be distributed at the beginning of the following Fiscal Year. Estimated future collections are \$9,663,063.

(5) Reimbursement from Participants

General and administrative expenses of the District and special project expense are passed through to the Participants by the District. These reimbursed expenses are treated as revenues and recorded as a reimbursement from participants. Payments and reimbursed expenses amounted to \$226,997 for Fiscal Year 2010.

(6) District Employees Retirement Plan

(a) Defined Contribution Plan

On January 1, 1997, the District adopted a defined contribution, private Money Purchase Pension Plan (Plan) which all employees and directors are eligible to participate. Under the plan, participating employees are not allowed to make any contributions. The District is required to contribute 10.50% of the participating employees' gross salary increasing to 13.50% after one year of service. The District's Board of Directors has the authority to amend or terminate the plan at any time. A summary of this plan's contribution and District payroll information follows:

District contributions	\$23,061
District contributions as a percent of covered payroll	10.50% / 13.50%
Total District payroll	\$3,104,202
Total covered payroll	\$175,301

Participants become vested in the District's Plan 20% per year of service until they become fully vested after 5 years of service.

(b) Change in Defined Contribution Plan

The District joined CalPERS on March 1, 2003. The Money Purchase Pension Plan remains open and no contributions are to be made on the employees' behalf. The District continues to make contributions to the Plan on behalf of the members of the District's Board of Directors.

Municipal Water District of Orange County
Notes to Financial Statements
June 30, 2010

(c) Defined Benefit Plan (CalPERS Retirement Plan)

Plan Description:

Effective March 1, 2003, the District contributes to the California Employees Retirement System (CalPERS), a cost sharing multiple-employer 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. Copies of CalPERS' annual financial report may be obtained from their Executive Office located at, 400 P Street, Sacramento, CA 95814.

Funding Policy:

The contribution rate for plan members in the CalPERS 2.0% at 55 Risk Pool Retirement Plan is 7% of their annual covered salary. The District makes these contributions required of District employees on their behalf and for their account. Also, the District is required to contribute the actuarially determined remaining amount necessary to fund the benefits for its members. The required employer contribution rates for fiscal year 2010, 2009 and 2008 were 16.577%, 17,394%, and 18,038%, 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. For fiscal years ended June 30, 2010, 2009, 2008 and were \$441,195, \$476,015 and \$451,999, respectively and were equal to the required contributions for each year.

(7) Other-Post-employment Benefits

(a) Plan Description:

The District contributes to a single-employer defined benefit plan to provide post-employment health care benefits. Specifically, the District provides health insurance for its retired employees and their dependent spouses (if married and covered on the District's plan at time of retirement), or survivors in accordance with Board resolutions. Medical coverage is provided for retired employees who are age 55 or over and who have a minimum of 10 years service with the District. The District pays 100% of the premium for the single retiree and 80% of the married retiree and spouse until age 65. If a retiree in receipt of these benefits dies before reaching age 65, the surviving spouse will continue to receive coverage that the retiree would have been entitled to until age 65 only. When a retiree reaches age 65 and/or eligible for Medicare, the District will pay the retiree up to \$1,800 per calendar year for disbursement of the cost of Supplemental Medical Insurance and Medicare Prescription Drug (Part D) Insurance. Retirees who had at least 25 consecutive years of full-time service receive District-paid coverage dental and vision benefits besides the above-mentioned medical benefits until the time of retiree and spouse's death. The plan does not provide a publicly available financial report.

(b) Funding Policy:

The contribution requirements of plan members and the District are established and may be amended by the District's Board of Directors. Currently, contributions are not required from plan members. The District is currently funding the OPEB obligation on a pay-as-you-go basis. For the year ended 2010, the District paid \$36,356 in health care costs for its retirees and their covered dependents

(c) Annual OPEB Cost and Net OPEB Obligation:

The District's annual OPEB cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with 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 to amortize any unfunded liabilities of the plan over a period not to exceed thirty years.

Municipal Water District of Orange County
Notes to Financial Statements
June 30, 2010

The following table shows the component of the District's annual OPEB costs for the year, the amount actually contributed to the plan, and changes in the District's net OPEB asset.

Annual required contribution (ARC)	\$ 170,117
Interest on Net OPEB Obligation	0
Adjustment to ARC	<u>0</u>
Annual OPEB cost	170,117
Contribution made	<u>36,356</u>
Increase in Net OPEB Obligation	133,761
Net OPEB Obligation at June 30, 2009	<u>138,732</u>
 Net OPEB obligation at June 30, 2010	 <u>\$ 272,493</u>

The net OPEB liability is included as part of long-term Liability in the District's Statement of Net Assets.

(d) Three-Year Trend Information:

For fiscal year 2010, the District's annual OPEB cost (expense) of \$170,117 was equal to the ARC. Information on the annual OPEB cost, percentage of Annual OPEB

Cost contributed, and Net OPEB Obligation (only available for two fiscal years), are presented below:

<u>Fiscal Year Ended</u>	<u>Annual OPEB Cost</u>	<u>Actual Contribution (Net of Adjustments)</u>	<u>Percentage of Annual OPEB Cost Contributed</u>	<u>Net OPEB Obligation (Liability)</u>
6/30/2009	\$ 170,117	\$ 31,385	18.45%	\$ 138,732
6/30/2010	170,117	36,356	21.37%	272,493

(e) Funded Status and Funding Progress:

As of July 1, 2008, the most recent actuarial valuation date, the plan was zero percent funded. The actuarial accrued liability for benefits was \$1,428,095, and the actuarial value of assets was zero, resulting in an unfunded accrued liability (UAL) of \$1,428,095. The covered payroll (annual payroll of active employees covered by the plan) was \$2,652,721 and the ratio of the UAL to the covered payroll was 53.8%.

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 District are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

(f) Actuarial Methods and Assumptions:

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and the plan members at that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets consistent with the long-term perspective of the calculations.

Municipal Water District of Orange County
Notes to Financial Statements
June 30, 2010

In the July 1, 2008 actuarial valuation, the projected unit credit cost method was used. The actuarial assumptions included a 5.00% investment rate of return (net of administrative expenses) and the District's share of premium cost will increase at a rate of 4% per annum. The District's unfunded actuarial accrued liability will be amortized by level dollar contributions over thirty years.

Required Supplementary Information (Unaudited)

Municipal Water District of Orange County
 Required Supplementary Information (Unaudited)
 For the year ended June 30, 2010

Other Post-employment Benefit Plan
Schedule of Funding Progress

Retiree Health Plan

Actuarial Valuation Date	Accrued Liability (a)	Actuarial Value of Assets (AVA) (b)	Unfunded Liability (UL) (a) – (b)	Funde d Ratio (b)/(a)	Annual Covered Payroll (c)	UL as a % of Payroll Percentage of [(a)-(b)]/(c)
7/1/2008	\$ 1,428,095	\$ -	\$ 1,428,095	0.00%	\$2,652,721	53.84%