Palmdale Water District

Annual Financial Report

December 31, 2012 and 2011



Mission Statement

The Mission of the Palmdale Water District is to provide high quality water to our current and future customers at a reasonable cost.

Vision Statement

The District will strive for excellence in providing high quality, reasonably priced water in a growing Antelope Valley by being a strong advocate for our customers in local water issues, public education, asset management, water conservation, planning and securing additional water supplies, continuing our commitment to operate efficiently with the help of emerging technologies, challenging, motivating and rewarding our employees and offering premium customer service in all that we do.

Palmdale Water District

Board of Directors as of December 31, 2012

Name	Division	Title	Elected/ Appointed	Term Expires
Robert Alvarado	1	Secretary	Elected	12/15
Gordon Dexter	2	President	Elected	12/13
Gloria Dizmang	3	Vice President	Elected	12/15
Kathy Mac Laren	4	Treasurer	Elected	12/15
Steve Cordova	5	Director	Elected	12/13

Palmdale Water District
Dennis LaMoreaux, General Manager
2029 East Avenue Q
Palmdale, California 93550
(661) 947-4111 – www.palmdalewater.org

Palmdale Water District

Annual Financial Report

For the Years Ended December 31, 2012 and 2011

Palmdale Water District
Annual Financial Report
For the Years Ended December 31, 2012 and 2011

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Financial Section

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Certified Public Accountants
An Accountancy Corporation

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Independent Auditor's Report

Board of Directors
Palmdale Water District
Palmdale, California

Report on the Financial Statements

We have audited the accompanying financial statements of the Palmdale Water District (District), which comprise the statement of net position as of December 31, 2012, and the related statement of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements, which collectively comprise the District's basic financial statements. The comparative financial information as of December 31, 2011, was audited by other auditors whose report dated May 8, 2012, expressed an unqualified opinion on those basic financial statements.

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 controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these basic financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the State Controller's Minimum Audit Requirements for California Special Districts. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the 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 accounting 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 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 December 31, 2012, and the changes in its net position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other-Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 7 and the schedule of funding progress on page 40 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 inquires of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquires, 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 Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued a report dated April 30, 2013, on our consideration of the District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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* in considering the District's internal control over financial reporting and compliance. This report can be found on pages 41 and 42.



Charles Z. Fedak and Company, CPA's – An Accountancy Corporation
Cypress, California
April 30, 2013

The following Management's Discussion and Analysis (MD&A) of activities and financial performance of the Palmdale Water District (District) provides an introduction to the financial statements of the District for the years ended December 31, 2012 and 2011. We encourage readers to consider the information presented here in conjunction with the basic financial statements and related notes, which follow this section.

Financial Highlights

- In 2012, the District's net position decreased 2.77% or $3,115,637 from $112,548,342 to $108,844,190. In 2011, the District's net position decreased 2.88% or $3,336,630 from $115,884,972 to $112,548,342.
- The District's 2012 operating revenues increased 4.32% or $936,524 due to an increase in water service revenues, while in 2011 the District's operating revenues increased 0.09% or $19,862 due to an increase in miscellaneous related water service fees.
- The District's 2012 non-operating revenues increased 12.92% or $797,332 due primarily to a $797,301 increase in the property tax assessment for the State Water Project and a one-time fixed-charge recovery of $549,374 from the Dept. of Water Resources. In 2011, non-operating revenues decreased 14.15% or $1,017,270 due primarily to no gain on the sale of capital assets in 2011 unlike the 2010 gain of $977,979 and a decrease in property tax revenue.
- The District's 2012 total expenses increased 8.48% or $2,654,323 due primarily to a $1.73 million increase in operating expenses, a $434,327 decrease in overhead absorption, a $482,956 increase in depreciation expense, and a $2,260 increase in non-operating expenses, while in 2011 the District's total expenses decreased $2,587,637 or 7.64% due primarily to a $2.61 million decrease in operating expenses.
- Also in 2011, a prior period adjustment was made to account for the District's pension related debt (CalPERS Side-Fund) obligation of $1,185,361. See Note 15 for further details.

Required Financial Statements

This annual report consists of a series of financial statements. The Statement of Net Position, Statement of Revenues, Expenses and Changes in Net Position and Statement of Cash Flows provide information about the activities and performance of the District using accounting methods similar to those used by private sector companies.

The Statement of Net Position includes all of the District's investments in resources (assets), deferred outflows of resources, the obligations to creditors (liabilities), deferred inflows of resources and net position. It also provides the basis for computing a 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 revenue and expenses are accounted for in the Statement of Revenues, Expenses and Changes in Net Position. This statement measures the success of the District's operations over the past year and can be used to determine if the District has successfully recovered all of its costs through its rates and other charges. This statement can also be used to evaluate profitability and credit worthiness. The final required financial statement is the Statement of Cash Flows, which provides information about the District's cash receipts and cash payments during the reporting period. The Statement of Cash Flows reports cash receipts, cash payments and net changes in cash resulting from operations, investing, non-capital financing, and capital and related financing activities and provides answers to such questions as where did cash come from, what was cash used for, and what was the change in cash balance during the reporting period.

Financial Analysis of the District

One of the most important questions asked about the District's finances is, "Is the District better off or worse off as a result of this year's activities?" The Statement of Net Position and the Statement of Revenues, Expenses and Changes in Net Position report information about the District in a way that helps answer this question. These statements include all assets and liabilities using the *accrual basis of accounting*, which is similar to the accounting used by most private sector companies. All of the current year's revenues and expenses are taken into account regardless of when the cash is received or paid.

These two statements report the District's *net position* and changes in them. You can think of the District's net position – the difference between assets plus deferred outflows of resources less liabilities and deferred inflows of resources – as one way to measure the District's financial health, or *financial position*. Over time, *increases or decreases* in the District's net position are one indicator of whether its *financial health* is improving or deteriorating. However, one will need to consider other non-financial factors such as changes in economic conditions, population growth, zoning and new or changed government legislation, such as changes in Federal and State water quality standards.

Notes to the Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the basic financial statements can be found on pages 13 through 39.

Statement of Net Position

Condensed Statements of Net Assets

	2012	2011	Change	2010	Change
Assets:					
Current assets	$ 16,911,413	16,298,271	613,142	14,538,547	1,759,724
Capital assets, net	156,809,338	158,808,157	(1,998,819)	162,207,271	(3,399,114)
Total assets	173,720,751	175,106,428	(1,385,677)	176,745,818	(1,639,390)
Deferred outflows of resources	1,582,279	1,427,144	155,135	1,526,569	(99,425)
Total assets and deferred outflows of resources	$ 175,303,030	176,533,572	(1,230,542)	178,272,387	(1,738,815)
Liabilities:					
Current liabilities	$ 10,619,967	10,066,614	553,353	10,051,718	14,896
Non-current liabilities	55,012,002	53,669,301	1,342,701	52,075,423	1,593,878
Total liabilities	65,631,969	63,735,915	1,896,054	62,127,141	1,608,774
Deferred inflows of resources	238,356	249,315	(10,959)	260,274	(10,959)
Net position:					
Net investment in capital assets	109,085,439	110,700,986	(1,615,547)	113,018,566	(2,317,580)
Restricted for debt service	-	1,494,920	(1,494,920)	1,449,982	44,938
Unrestricted	347,266	352,436	(5,170)	1,416,424	(1,063,988)
Total net position	109,432,705	112,548,342	(3,115,637)	115,884,972	(3,336,630)
Total liabilities, deferred inflows of resources and net position	$ 175,303,030	176,533,572	(1,230,542)	178,272,387	(1,738,815)

As noted earlier, net position may serve over time as a useful indicator of a government's financial position. In the case of the District, assets plus deferred outflows of resources exceeded liabilities and deferred inflows of resources by $109,085,439 and $110,700,986 as of December 31, 2012 and 2011, respectively.

A portion of the District's net position, 99% and 98% as of December 31, 2012 and 2011, respectively, reflects the District's investment in capital assets (net of accumulated depreciation) less any related debt or related deferred outflow of resources or deferred inflow of resources used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to customers within the District's service area; consequently, these assets are *not* available for future spending.

At the end of year 2012 and 2011, the District showed a positive balance in its unrestricted net position of $347,266 and $352,436, respectively.

Statement of Revenues, Expenses and Changes in Net Position

Condensed Statements of Revenues, Expenses and Changes in Net Assets

	2012	2011	Change	2010	Change
Revenues:					
Operating revenues	$ 22,596,968	21,660,444	936,524	21,640,582	19,862
Non-operating revenues	6,967,305	6,169,973	797,332	7,187,243	(1,017,270)
Total revenues	29,564,273	27,830,417	1,733,856	28,827,825	(997,408)
Expenses:					
Operating expenses	22,215,659	20,480,879	1,734,780	23,092,131	(2,611,252)
Overhead absorption	(42,639)	(476,966)	434,327	(576,109)	99,143
Depreciation expense	7,768,448	7,285,492	482,956	7,010,721	274,771
Non-operating expenses	3,996,260	3,994,000	2,260	4,344,299	(350,299)
Total expenses	33,937,728	31,283,405	2,654,323	33,871,042	(2,587,637)
Net loss before capital contributions	(4,373,455)	(3,452,988)	(920,467)	(5,043,217)	1,590,229
Capital contributions	1,257,818	1,301,719	(43,901)	55,967	1,245,752
Change in net position	(3,115,637)	(2,151,269)	(964,368)	(4,987,250)	2,835,981
Net position, beginning of year	112,548,342	115,884,972	(3,336,630)	121,123,712	(5,238,740)
Prior period adjustment	-	(1,185,361)	1,185,361	(251,490)	(933,871)
Net position, end of year	$ 109,432,705	112,548,342	(3,115,637)	115,884,972	(3,336,630)

The statement of revenues, expenses and changes of net position shows how the District's net position changed during the years. In the case of the District, net position decreased by $3,115,637 and $3,336,630 for the years ended December 31, 2012 and 2011, respectively.

A closer examination of the sources of changes in net assets reveals that:

The District's 2012 operating revenues increased 4.32% or $936,524 due to an increase in water service revenues, while in 2011 the District's operating revenues increased 0.09% or $19,862 due to an increase in miscellaneous related water service fees.

The District's 2012 non-operating revenues increased 12.92% or $797,332 due primarily to a $797,301 increase in the property tax assessment for the State Water Project and a one-time fixed-charge recovery of $549,374 from the Dept. of Water Resources. In 2011, non-operating revenues decreased 14.15% or $1,017,270 due primarily to no gain on the sale of capital assets in 2011 unlike the 2010 gain of $977,979 and a decrease in property tax revenue.

The District's 2012 total expenses increased 8.48% or $2,654,323 due primarily to a $1.73 million increase in operating expenses, a $434,327 decrease in overhead absorption, a $482,956 increase in depreciation expense, and a $2,260 increase in non-operating expenses, while in 2011 the District's total expenses decreased $2,587,637 or 7.64% due primarily to a $2.61 million decrease in operating expenses.

Also in 2011, a prior period adjustment was made to account for the District's pension related debt (CalPERS Side-Fund) obligation of $1,185,361. See Note 15 for further details.

Capital Asset Administration

At the end of year 2012 and 2011, the District's investment in capital assets amounted to $156,809,338 and $158,808,157 (net of accumulated depreciation), respectively. This investment in capital assets includes land, land rights, transmission and distribution systems, wells, tanks, reservoirs, pumps, buildings and structures, equipment, vehicles, State Water Project entitlement, and construction-in-process. There were numerous capital asset additions in the years 2012 and 2011 (See Note 5).

Changes in capital asset amounts for 2012 were as follows:

	Balance 2011	Additions	Transfers/ Deletions	Balance 2012
Capital assets:				
Non-depreciable assets	$ 6,325,459	4,997,254	(5,593,787)	5,728,926
Depreciable assets	262,196,234	7,945,102	(3,022,301)	267,119,035
Accumulated depreciation	(109,713,536)	(9,347,388)	3,022,301	(116,038,623)
	$ 158,808,157	3,594,968	(5,593,787)	156,809,338

Changes in capital asset amounts for 2011 were as follows:

	Balance 2010	Additions	Transfers/ Deletions	Balance 2011
Capital assets:				
Non-depreciable assets	$ 12,143,131	2,921,582	(8,739,254)	6,325,459
Depreciable assets	251,039,059	11,157,175	-	262,196,234
Accumulated depreciation	(100,974,919)	(8,738,617)	-	(109,713,536)
	$ 162,207,271	5,340,140	(8,739,254)	158,808,157

Debt Administration

In 2012, long-term debt decreased by $261,498, due to regular principal payments on the District's outstanding debts. In 2011, long-term debt increased by $15,361, due to regular principal payments on the District's outstanding debts and the addition of the pension-related debt obligation. (See Note 8).

Changes in long-term debt amounts for 2012 were as follows:

	Balance 2011	Additions/ Deletions	Principal Payments	Balance 2012
Long-term debt:				
1998 – COP's	$ 13,345,000	(12,505,000)	(840,000)	-
2004 – COP's	35,940,000	-	(380,000)	35,560,000
2012 – Refunding COP's	-	12,765,208	-	12,765,208
Capital lease payable	-	863,876	(121,262)	742,614
Pension-related debt	1,185,361	-	(44,320)	1,141,041
Total long-term debt	$ 50,470,361	1,124,084	(1,385,582)	50,208,863

Changes in long-term debt amounts for 2011 were as follows:

	Balance 2010	Additions/ Deletions	Principal Payments	Balance 2011
Long-term debt:				
1998 – COP's	$ 14,145,000	-	(800,000)	13,345,000
2004 – COP's	36,310,000	-	(370,000)	35,940,000
Pension-related debt	-	1,185,361	-	1,185,361
Total long-term debt	$ 50,455,000	1,185,361	(1,170,000)	50,470,361

Requests for Information

This financial report is designed to provide the District's funding sources, customers, stakeholders and other interested parties with an overview of the District's financial operations and financial condition. Should the reader have questions regarding the information included in this report or wish to request additional financial information, please contact the District's Finance Manager at 2029 East Avenue Q, Palmdale, CA 93550 or by phone (661) 947-4111.

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Basic Financial Statements

Palmdale Water District
Statements of Net Position
December 31, 2012 and 2011

		2012	2011
Current Assets:			
Cash and cash equivalents (note 2)	$	7,240,103	5,376,403
Restricted – cash and cash equivalents (note 2)		-	182,107
Investments (note 2)		2,019,050	2,425,116
Restricted – investments (note 2)		-	1,479,625
Accrued interest receivable		5,416	30,945
Accounts receivable – water sales and services, net (note 3)		2,053,085	1,760,767
Accounts receivable – property taxes		3,835,818	3,835,848
Accounts receivable – other		419,161	10,296
Note receivable – property taxes from state (note 4)		167,267	164,519
Materials and supplies inventory		938,813	712,744
Prepaid expenses and other deposits		232,700	319,901
Total current assets		16,911,413	16,298,271
Non-current assets:			
Capital assets – not being depreciated (note 5)		5,728,926	6,325,459
Capital assets – being depreciated, net (note 5)		151,080,412	152,482,698
Total non-current assets		156,809,338	158,808,157
Total assets		173,720,751	175,106,428
Deferred outflows of resources:			
Deferred charges, net (note 6)		786,956	704,158
Discount on certificates-of-participation, net (note 6)		-	188,216
Deferred loss on debt defeasance, net (note 6)		795,323	534,770
Total deferred outflows of resources		1,582,279	1,427,144
Total assets and deferred outflows of resources	$	175,303,030	176,533,572

Palmdale Water District
Statements of Net Position, continued
December 31, 2012 and 2011

		2012	2011
Current liabilities:			
Accounts payable and accrued expenses	$	2,097,670	1,289,084
Customer deposits for water service		2,339,642	2,394,026
Construction and developer deposits		1,700,426	1,702,807
Deferred property tax assessments		2,500,000	2,500,000
Accrued interest payable		491,010	603,548
Long-term liabilities – due in one year:			
Compensated absences (note 7)		244,437	312,829
Capital lease payable (note 9)		163,487	-
Certificates of participation (note 8)		1,027,277	1,220,000
Pension-related debt (note 10)		56,018	44,320
Total current liabilities		10,619,967	10,066,614
Non-current liabilities:			
Long-term liabilities – due in more than one year:			
Compensated absences (note 7)		81,479	104,276
Capital lease payable (note 9)		579,127	-
Certificates of participation (note 8)		47,297,931	48,065,000
Other post employment benefits payable (note 11)		5,968,442	4,358,984
Pension-related debt (note 10)		1,085,023	1,141,041
Total non-current liabilities		55,012,002	53,669,301
Total liabilities		65,631,969	63,735,915
Deferred inflows of resources:			
Premium on certificates-of-participation, net (note 6)		238,356	249,315
Total deferred inflows of resources		238,356	249,315
Net position:			
Net investment in capital assets (note 12)		109,085,439	110,700,986
Restricted for debt service (note 13)		-	1,494,920
Unrestricted (note 14)		347,266	352,436
Total net position		109,432,705	112,548,342
Total liabilities, deferred inflows of resources and net position	$	175,303,030	176,533,572

See accompanying notes to the basic financial statements

Palmdale Water District
Statements of Revenues, Expenses and Changes in Net Position
For the Years Ended December 31, 2012 and 2011

	2012	2011
Operating revenues:		
Water sales – commodity charge	$ 8,782,455	7,828,995
Monthly water service charge	10,318,032	10,331,401
Water quality fees	1,658,418	1,544,001
Elevation fees	563,499	514,356
Other water service charges	1,274,564	1,441,691
Total operating revenues	22,596,968	21,660,444
Operating expenses:		
Source of supply – purchased water	4,770,143	1,921,397
Operations and production	5,181,634	5,141,790
Facilities	3,786,537	3,686,533
Engineering	1,346,680	1,366,272
Water conservation	322,307	368,826
Administration	3,542,508	4,608,946
Finance and customer service	3,265,850	3,387,115
Total operating expenses	22,215,659	20,480,879
Operating income(loss) before overhead absorption	381,309	1,179,565
Overhead absorption	42,639	476,966
Operating income(loss) before depreciation expense	423,948	1,656,531
Depreciation expense	(7,768,448)	(7,285,492)
Operating loss	(7,344,500)	(5,628,961)
Non-operating revenue(expense):		
Property taxes – ad valorum	1,518,943	1,652,729
Property tax assessment for State Water Project	4,394,572	3,597,271
Successor agency component of property taxes	185,432	312,065
Investment earnings	24,866	78,519
Rental income	146,420	123,406
Legal and insurance refunds/settlements	68,811	282,808
State Water Project amortization expense	(1,578,940)	(1,453,125)
Interest expense – long-term debt	(2,323,207)	(2,452,409)
Amortization of deferred resources – inflows/(outflows), net (note 6)	(94,113)	(88,466)
Dept. of Water Resources fixed-charge recovery	549,374	-
Other non-operating revenues/(expenses), net	78,887	123,175
Total non-operating revenues, net	2,971,045	2,175,973
Net loss before capital contributions	(4,373,455)	(3,452,988)
Capital contributions:		
Capital improvement fees	1,257,818	1,225,519
State capital grants	-	76,200
Total capital contributions	1,257,818	1,301,719
Change in net position	(3,115,637)	(2,151,269)
Net position, beginning of year	112,548,342	115,884,972
Prior period adjustment (note 15)	-	(1,185,361)
Net position, end of year	$ 109,432,705	112,548,342

See accompanying notes to the basic financial statements

Palmdale Water District
Statements of Cash Flows
For the Years Ended December 31, 2012 and 2011

		2012	2011
Cash flows from operating activities:			
Cash receipts from customers for water sales and services	$	22,250,266	21,947,669
Cash receipts from others		432,246	59,814
Cash paid to vendors and suppliers for materials and services		(13,370,958)	(12,056,798)
Cash paid to employees for salaries and wages		(6,614,075)	(6,577,418)
Net cash provided by operating activities		2,697,479	3,373,267
Cash flows from non-capital financing activities:			
Proceeds from property taxes		6,098,977	4,826,073
Net cash provided by non-capital financing activities		6,098,977	4,826,073
Cash flows from capital and related financing activities:			
Acquisition and construction of capital assets		(6,460,470)	(5,339,503)
Proceeds from capital improvement fees		1,257,818	1,225,519
Proceeds from state capital grants		-	76,200
Principal paid on long-term debt		(1,385,582)	(1,170,000)
Proceeds from refunding issuance		12,765,208	-
Cost of escrowed security		(12,642,208)	-
Cost of refunding issuance		(123,000)	-
Interest paid on long-term debt		(2,435,745)	(2,465,142)
Net cash used in capital and related financing activities		(9,023,979)	(7,672,926)
Cash flows from investing activities:			
Proceeds from sale of investments		1,885,691	411,356
Interest and investment earnings		23,425	72,975
Net cash provided by investing activities		1,909,116	484,331
Net increase in cash and cash equivalents		1,681,593	1,010,745
Cash and cash equivalents, beginning of year		5,558,510	4,547,765
Cash and cash equivalents, end of year	$	7,240,103	5,558,510

Reconciliation of cash and cash equivalents to statements of net position:		**2012**	**2011**
Cash and cash equivalents	$	7,240,103	5,376,403
Restricted – cash and cash equivalents		-	182,107
Total cash and cash equivalents	$	7,240,103	5,558,510

Continued on next page

Palmdale Water District
Statements of Cash Flows, continued
For the Years Ended December 31, 2012 and 2011

	2012	2011
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	$ (7,344,500)	(5,628,961)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Deprecation expense	7,768,448	7,285,492
Rental income	146,420	123,406
Legal and insurance refunds/settlements	68,811	282,808
Dept. of Water Resources fixed-charge recovery	549,374	-
Other non-operating revenues/(expenses), net	78,887	123,175
Changes in assets and liabilities:		
(Increase)Decrease in assets:		
Accounts receivable – water sales and services, net	(292,318)	108,155
Accounts receivable – other	(408,865)	(429,362)
Materials and supplies inventory	(226,069)	(27,874)
Prepaid expenses and other deposits	87,201	(70,023)
Increase(Decrease) in liabilities:		
Accounts payable and accrued expenses	808,586	(228,971)
Customer deposits for water service	(54,384)	179,070
Construction and developer deposits	(2,381)	(40,213)
Compensated absences	(91,189)	31,637
Other post employment benefits payable	1,609,458	1,664,928
Total adjustments	10,041,979	9,002,228
Net cash provided by operating activities	$ 2,697,479	3,373,267

See accompanying notes to the basic financial statements

(1) Reporting Entity and Summary of Significant Accounting Policies

A. Organization and Operations of the Reporting Entity

The Palmdale Water District (District) was formed as an Irrigation District under Division 11 of the California Water Code in 1918. The District provides potable water service to a portion of the City of Palmdale, California, and surrounding unincorporated areas of the County of Los Angeles. The District is operated under the direction of a five-member board of directors. The board members are elected by the public for staggered four-year terms.

The Palmdale Water District Public Facilities Corporation (Corporation) was organized on August 22, 1991 pursuant to the Nonprofit Public Benefit Corporation Law of the State of California (Title 1, Division 2, Part 2 of the California Corporations Code), solely for the purpose of acquiring and or constructing various public facilities and providing financial assistance to the District.

The criteria used in determining the scope of the reporting entity is based on the provisions of GASB Statement 14, as amended by GASB Statement 39. The District is the primary government unit. Component units are those entities which 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 the Corporation as a blended component unit. Despite being legally separate, this entity is so intertwined with the District that it is in substance part of the District's operations. Accordingly, this component unit is included within the financial statements of the District.

B. Basis of Accounting and Measurement Focus

The District is accounted for as an enterprise fund type of the proprietary fund group and therefore accounts for its operations in a manner similar to a private enterprise since it is the intent of the District to recover its cost of providing goods and services to the public on a continuing basis primarily through user charges.

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The basic financial statements reflect the flow of economic resources measurement focus and the full accrual basis of accounting. Under the full accrual basis of accounting, revenues are recorded when earned and expenses are recorded at the time the liabilities are incurred regardless of the timing of related cash flows.

C. Financial Reporting Presentation

In 2012, the District implemented GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* (GASB 63). Implementation of this statement has resulted in a change to the format of the basic financial statements and has been applied retroactively.

The preparation of the basic financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, deferred outflows of resources, liabilities and deferred inflows of resources and disclosures of contingent assets and liabilities at the date of the basic financial statements and the reported changes in net position during the reporting period. Therefore, actual results may differ from those estimates.

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

D. Assets, Deferred Outflows, Liabilities, Deferred Inflows and Net Position

1. Use of Estimates

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

2. Cash and Cash Equivalents

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

3. Investments and Investment Policy

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

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

4. Accounts Receivable and Allowance for Uncollectible Accounts

The District extends credit to customers in the normal course of operations. When management deems customer accounts uncollectible, the District uses the allowance method for the reservation and write-off of those accounts.

5. Property Taxes and Assessments

The County of Los Angeles Assessor's Office assesses all real and personal property within the County each year. The County of Los Angeles Tax Collector's Office bills and collects the District's share of property taxes and assessments. The County of Los Angeles Treasurer's Office remits current and delinquent property tax collections to the District throughout the year. Property tax in California is levied in accordance with Article 13A of the State Constitution at one percent (1%) of countywide assessed valuations.

Property taxes receivable at year-end are related to property taxes collected by the County of Los Angeles, which have not been credited to the District's cash balance as of December 31. The property tax calendar is as follows:

Lien date	March 1
Levy date	July 1
Due dates	November 1 and March 1
Collection dates	December 10 and April 10

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

D. Assets, Deferred Outflows, Liabilities, Deferred Inflows and Net Position, continued

6. Materials and Supplies

Materials and supplies consist primarily of water meters, pipe and pipefittings for construction and repair to the District's water transmission and distribution system. Materials and supplies are valued at cost using a weighted average method. Materials and supplies items are charged to expense at the time that individual items are consumed.

7. Prepaid Expenses

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

8. Restricted Assets

Certain assets of the District are restricted for use by ordinance or debt covenant and, accordingly are shown as restricted assets on the accompanying statement of net assets. The District uses restricted resources, prior to using unrestricted resources, to pay expenditures meeting the criteria imposed on the use of restricted resources by a third party.

9. Capital Assets

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

Littlerock Dam	50 years
Buildings, wells and distribution system	40 years
Machinery and equipment	3-20 years

10. State Water Project – Participation Rights

The District participates in the State Water Project (Project) entitling it to certain participation rights. The District's participation in the Project is through cash payments. Monies used for the construction of capital assets, such as pipelines, pumping facilities, storage facilities, etc., are recorded as participation rights and amortized over the life of the agreements. Certain projects also require payments for on-going maintenance; those payments are charged to expense as incurred.

11. Deferred Charges

The deferred charges are from bond issuance costs that will be amortized using the straight-line method over the remaining life of the respective debt service.

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

D. Assets, Deferred Outflows, Liabilities, Deferred Inflows and Net Position, continued

12. Compensated Absences

The District's personnel policies provide for accumulation of vacation and sick leave. Liabilities for vacation and sick leave are recorded when benefits are earned. Cash payment of unused vacation is available to those qualified employees when retired or terminated.

13. Customer Deposits

Based on a customer's credit, the District may require a deposit deemed reasonable by the District. These deposits are held to pay off close out bills or to cover delinquent payments.

14. Net Position

The financial statements utilize a net position presentation. Net position is categorized as follows:

- **Net Investment in Capital Assets Component of Net Position**– This component of net position consists of capital assets, net of accumulated depreciation and reduced by any debt outstanding against the acquisition, construction or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt is included in this component of net position
- **Restricted Component of Net Position** – This component of net position consists of restricted assets reduced by liabilities and deferred inflows of resources related to those assets.
- **Unrestricted Component of Net Position** – This component of net position is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of the net investment in capital assets or restricted component of net position.

15. Water Sales

Most water sales are billed on a monthly cyclical basis. Estimated unbilled water revenue through year-end has been accrued.

16. Capital Improvement Fees

Capital improvement fees represent cash and capital asset additions contributed to the District by property owners, granting agencies or real estate developers desiring services that require capital expenditures or capacity commitment.

17. Budgetary Policies

The District adopts an annual non-appropriated budget for planning, control, and evaluation purposes. Budgetary control and evaluation are affected by comparisons of actual revenues and expenses with planned revenues and expenses for the period. Encumbrance accounting is not used to account for commitments related to unperformed contracts for construction and services.

18. Reclassification

The District has reclassified certain prior year information to conform to current year presentations as well as conforming to the implementation of GASB No. 63 and 65.

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

E. Implementation of New Accounting Pronouncements

For the year ended December, 2012, the District implemented the following Governmental Accounting Standards Board Pronouncements:

Governmental Accounting Standards Board Statement No. 60 – *Accounting and Financial Reporting for Service Concession Arrangement*s. This standard address how to account for and report service concession arrangements, a type of public-private or public-public partnership that state and local governments are increasingly entering into.

Governmental Accounting Standards Board Statement No. 61 – *The Financial Reporting Entity, Omnibus.* This standard is designed to improve financial reporting for governmental entities by amending the requirements of GASB Statement No. 14, *The Financial Reporting Entity*, and GASB Statement No. 34, *Basic Financial Statement and Management's Discussion and Analysis for State and local Governments*.

Governmental Accounting Standards Board Statement No. 62 – *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements.* The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements:

1. Financial Accounting Standards Board (FASB) Statements and Interpretations
2. Accounting Principles Board Opinions
3. Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure.

Hereinafter, these pronouncements collectively are referred to as the "FASB and AICPA pronouncements." This Statement also supersedes Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting,* thereby eliminating the election provided in paragraph 7 of that Statement for enterprise funds and business-type activities to apply post-November 30, 1989 FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements. However, those entities can continue to apply, as other accounting literature, post-November 30, 1989 FASB pronouncements that do not conflict with or contradict GASB pronouncements, including this Statement.

Governmental Accounting Standards Board Statement No. 63 – *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position.* This standard is designed to improve financial reporting by standardizing the presentation of deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets.

Governmental Accounting Standards Board Statement No. 65 – *Items Previously Reported as Assets and Liabilities.* This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.

(2) Cash and Investments

Cash and investments as of December 31, are classified in the accompanying financial statements as follows:

		2012	2011
Cash and cash equivalents	$	7,240,103	5,376,403
Restricted – cash and cash equivalents		-	182,107
Investments		2,019,050	2,425,116
Restricted – investments		-	1,479,625
Total cash and investments	$	9,259,153	9,463,251

Cash and investments as of December 31, consist of the following:

		2012	2011
Cash on hand	$	3,700	3,700
Deposits with financial institutions		259,404	414,342
Deposits in money market funds		6,965,326	5,128,838
Deposits with the Local Agency Investment Fund (LAIF)		11,673	11,630
Investments		2,019,050	3,904,741
Total cash and investments	$	9,259,153	9,463,251

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

The following table identifies the investment types that are authorized by the District in accordance with 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 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
U.S. Treasury Obligations	5 years	None	None
District Issued Bonds	5 years	None	None
Federal Agency Obligations	5 years	None	None
Negotiable Certificates of Deposit	5 years	30%	None
Money Market Mutual Funds	N/A	None	None
Local Agency Investment Fund (LAIF)	N/A	None	None

Investments Authorized by Debt Agreements

Investment of debt proceeds held by bond trustees are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the District's investment policy. The table below identifies the **investment types** that are authorized for investments held by bond trustee. The table also identifies certain provisions of these debt agreements that address **interest rate risk**, **credit risk**, and **concentration of credit risk**.

Authorized Investment Type	Maximum Maturity	Maximum Percentage Of Portfolio	Maximum Investment in One Issuer
Investment Contracts	None	None	None
Money Market Mutual Funds	N/A	None	None

(2) Cash and Investments, continued

Custodial Credit Risk

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. With respect to investments, custodial credit risk generally applies only to direct investments in marketable securities. Custodial credit risk does not apply to a local government's indirect investment in securities through the use of mutual funds or government investment pools (such as LAIF).

The 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. Of the bank balances, federally insured is unlimited for non-interest bearing accounts through December 31, 2012 and the remaining balance is collateralized in accordance with the Code; however, the collateralized securities are not held in the District's name.

Investment in State Investment Pool

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

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 matures or comes close to maturity evenly over time as necessary to provide requirements for cash flow and liquidity needed for operations. Information about the sensitivity of the fair values of the District's investments to market interest rate fluctuations is provided by the following table that shows the distribution of the District's investments by maturity date:

(2) Cash and Investments, continued

Interest Rate Risk, continued

Investment maturities as of December 31, 2012, were as follows:

Investment Type	Amount	Remaining Maturity (in Months) 12 Months Or Less	13 to 24 Months	25-60 Months
Government sponsored agency obligations	$ 2,019,050	-	517,255	1,501,795
Total	$ 2,019,050	-	517,255	1,501,795

Investment maturities as of December 31, 2011, were as follows:

Investment Type	Amount	Remaining Maturity (in Months) 12 Months Or Less	13 to 24 Months	25-60 Months
Government sponsored agency obligations	$ 2,425,116	506,250	-	1,918,866
Investments with fiscal agent:				
Investment contracts	1,479,625	-	1,479,625	-
Total	$ 3,904,741	506,250	1,479,625	1,918,866

Credit Risk

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

Credit ratings as of December 31, 2012, were as follows:

Investment Type	Amount	Minimum Legal Rating	Rating as of year-end Moody's Aaa	Not Rated
Government sponsored agency obligations	$ 2,019,050	Aaa	$ 2,019,050	-
Total	$ 2,019,050		$ 2,019,050	-

Credit ratings as of December 31, 2011, were as follows:

Investment Type	Amount	Minimum Legal Rating	Rating as of year-end Moody's Aaa	Not Rated
Government sponsored agency obligations	$ 2,425,116	Aaa	$ 2,425,116	-
Investments with fiscal agent:				
Investment contracts	1,479,625	Aaa	1,479,625	-
Total	$ 3,904,741		$ 3,904,741	-

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. Investments in any one issuer (other than U.S. Treasury securities, mutual funds, and external investment pools) that represent 5% or more of total District investments are as follows:

Issuer	Investment Type	Invested Amount 2012	2011
Government sponsored agency obligations	Government sponsored agency	$ 2,019,050	2,425,116
Investment contracts	Government sponsored agency	-	1,479,625
Total		$ 2,019,050	3,904,741

(3) Accounts Receivable – Water Sales and Services, Net

The balance at December 31, consists of the following:

		2012	2011
Accounts receivable – water sales and services	$	2,102,402	2,025,104
Allowance for uncollectible accounts		(49,317)	(264,336)
Accounts receivable – water sales and services, net	$	2,053,085	1,760,768

(4) Note Receivable – Property Taxes from State

Under the provisions of the State of California Proposition 1A and as part of the 2010 fiscal year State of California budget package passed by the California State Legislature on July 28, 2009, the State of California borrowed 8.0% of the amount of property tax revenue apportioned to cities, counties and special districts. The State of California is required to repay this borrowing plus interest by June 30, 2013. After repayment of this initial borrowing, the California State Legislature may consider only one additional borrowing within a ten-year period. The borrowing by the State of California was recognized as a note receivable in the accompanying financial statements are as follows:

The balance at December 31, consists of the following:

		2012	2011
Property taxes from state	$	161,817	161,817
Accrued interest		5,450	2,702
Note receivable – property taxes from state	$	167,267	164,519

(5) Capital Assets

Changes in capital assets for 2012, were as follows:		Balance 2011	Additions/ Transfers	Deletions/ Transfers	Balance 2012
Non-depreciable assets:					
Land and land rights	$	1,156,263	628,095	-	1,784,358
Construction-in-process		5,169,196	4,369,159	(5,593,787)	3,944,568
Total non-depreciable assets		6,325,459	4,997,254	(5,593,787)	5,728,926
Depreciable assets:					
Buildings, wells and distribution system		198,936,518	3,212,474	(438,209)	201,710,783
SWP – participation rights		51,704,834	3,333,293	-	55,038,127
Machinery and equipment		11,554,882	1,399,335	(2,584,092)	10,370,125
Total depreciable assets		262,196,234	7,945,102	(3,022,301)	267,119,035
Accumulated depreciation:					
Buildings, wells and distribution system		(85,225,386)	(5,947,592)	438,209	(90,734,769)
SWP – participation rights		(16,829,846)	(1,578,940)	-	(18,408,786)
Machinery and equipment		(7,658,304)	(1,820,856)	2,584,092	(6,895,068)
Total accumulated depreciation		(109,713,536)	(9,347,388)	3,022,301	(116,038,623)
Total depreciable assets, net		152,482,698	(1,402,286)	-	151,080,412
Total capital assets, net	$	158,808,157	3,594,968	(5,593,787)	156,809,338

(5) Capital Assets, continued

Changes in capital assets for 2011, were as follows:		Balance 2010	Additions/ Transfers	Deletions/ Transfers	Balance 2011
Non-depreciable assets:					
Land and land rights	$	1,155,763	500	-	1,156,263
Construction-in-process		10,987,368	2,921,082	(8,739,254)	5,169,196
Total non-depreciable assets		12,143,131	2,921,582	(8,739,254)	6,325,459
Depreciable assets:					
Buildings, wells and distribution system		192,394,453	6,542,065	-	198,936,518
SWP – participation rights		49,479,086	2,225,748	-	51,704,834
Machinery and equipment		9,165,520	2,389,362	-	11,554,882
Total depreciable assets		251,039,059	11,157,175	-	262,196,234
Accumulated depreciation:					
Buildings, wells and distribution system		(79,146,155)	(6,079,231)	-	(85,225,386)
SWP – participation rights		(15,376,721)	(1,453,125)	-	(16,829,846)
Machinery and equipment		(6,452,043)	(1,206,261)	-	(7,658,304)
Total accumulated depreciation		(100,974,919)	(8,738,617)	-	(109,713,536)
Total depreciable assets, net		150,064,140	2,418,558	-	152,482,698
Total capital assets, net	$	162,207,271	5,340,140	(8,739,254)	158,808,157

Construction-In-Process

The District has been involved in various construction projects throughout the year. The balances of the various construction projects that comprise the construction-in-process balances at December 31 are as follows:

The balance at December 31, consists of the following projec		2010	2011	2012
Palmdale ditch enclosure	$	2,663,891	-	-
Distribution telemetry upgrade		2,171,479	-	-
10 M.G.D. Treatment plant (New Facility)		913,674	913,674	-
30th Street/Avenue Q main replacement		815,018	-	-
Well 24A drill and equipment		619,129	619,129	-
12th Street/Avenue Q4 main replacement		-	598,923	-
30th Street/Palm Blvd. main replacement		596,184	-	-
Sediment removal – Littlerock Dam		588,134	707,859	946,305
Distribution master plan		532,335	532,335	532,335
Barrel Springs Road waterline replacement		325,105	-	-
Well 11A rehabilitation project		-	70	323,119
Recycled facilities master plan		269,654	270,739	291,543
Avenue S10/40th Street waterline replacement		-	150,011	-
Well 36 drill and equipment		149,602	149,602	-
Well 37 drill and equipment		148,634	148,634	-
Well 2 rehabilitation		147,162	161,143	-
Maintenance yard and building (New Facility)		124,197	-	-
Q7/Standridge		115,227	-	-
Garden bar study		92,187	148,069	162,630
Division Street/Avenue Q3 waterline replacement		50,599	108,756	1,030,161
3600' Zone tank replacement project		-	-	100,904
Various other minor projects >$100,000		665,157	660,252	557,571
Construction-in-process	$	10,987,368	5,169,196	3,944,568

(5) Capital Assets, continued

State Water Project – Participation Rights

In 1963, the District contracted with the State of California (State) for 1,620 acre-feet per year of water from the State Water Project (SWP). In subsequent years, the annual entitlement increased to 21,300 acre feet. The SWP distributes water from Northern California to Southern California through a system of reservoirs, canals, pumps stations and power generation facilities.

The District is one of many participants contracting with the State of California Department of Water Resources (DWR) for a system to provide water throughout California. Under the terms of the State Water Contract, as amended, the District is obligated to pay allocable portions of the cost of construction of the system and ongoing operations and maintenance costs through at least the year 2035, regardless of the quantities of water available from the project. The District and the other contractors may also be responsible to the State for certain obligations by any contractor who defaults on its payments to the State.

Management's present intention is to exercise the District's option to extend the contractual period to at least 2052, under substantially comparable terms. This corresponds to an estimated 80-year service life for the original facilities. The State is obligated to provide specific quantities of water throughout the life of the contract, subject to certain conditions.

In addition to system on-aqueduct power facilities, the State has, either on its own or though joint venture, financed certain off-aqueduct power facilities (OAPF). The power generated is utilized by the system for water transportation and distribution purposes. Power generated in excess of system needs is marketed to various utilities and California's power market. The District is entitled to a proportionate share of the revenues resulting from sales of excess power. The District and the other water providers are responsible for repaying the capital and operating costs of the OAPF regardless of the amount of power generated.

The District capitalizes its share of system construction costs as participation rights in the State water facilities when such costs are billed by the DWR. Unamortized participation rights essentially represent a prepayment for future water deliveries through the State system. The District's share of system operations and maintenance costs is charged to expense as incurred.

The District amortizes a portion of capitalized participation rights each year using a formula that considers the total estimated cost of the project, estimated useful life and estimated production capacity of the assets based upon information provided by the State of California. GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, requires that all intangible assets not specifically excluded by their scope provisions be classified as capital assets. Accordingly, the participation rights have been included with the District's capital assets as shown in the schedule of changes in capital assets.

(6) Deferred Outflows and Deferred Inflows of Resources

Changes in deferred resources outflows and inflows for 2012, were as follows:

	Balance 2011	Additions	Transfers	Amortization	Balance 2012
Deferred outflows of resources:					
Deferred charges, net	$ 704,158	123,000	-	(40,202)	786,956
Discount on certificates-of-participation, net	188,216	-	(174,868)	(13,348)	-
Deferred loss on debt defeasance, net	534,770	137,207	174,868	(51,522)	795,323
Total deferred outflows of resources	$ 1,427,144	260,207	-	(105,072)	1,582,279
Deferred inflows of resources:					
Premium on certificates-of-participation, net	$ 249,315	-	-	(10,959)	238,356
Total deferred inflows of resources	$ 249,315	-	-	(10,959)	238,356
Amortization of deferred resources – inflows/(outflows), net				$ (94,113)	

Changes in deferred resources outflows and inflows for 2011, were as follows:

	Balance 2010	Additions	Transfers	Amortization	Balance 2011
Deferred outflows of resources:					
Deferred charges, net	$ 742,052	-	-	(37,894)	704,158
Discount on certificates-of-participation, net	204,235	-	-	(16,019)	188,216
Deferred loss on debt defeasance, net	580,282	-	-	(45,512)	534,770
Total deferred outflows of resources	$ 1,526,569	-	-	(99,425)	1,427,144
Deferred inflows of resources:					
Premium on certificates-of-participation, net	$ 260,274	-	-	(10,959)	249,315
Total deferred inflows of resources	$ 260,274	-	-	(10,959)	249,315
Amortization of deferred resources – inflows/(outflows), net				$ (88,466)	

(7) Compensated Absences

Changes in compensated absences for 2012, were as follows:

Balance 2011	Earned	Taken	Balance 2012	Current Portion	Long-term Portion
$ 417,105	541,774	(632,963)	325,916	244,437	81,479

Changes in compensated absences for 2011, were as follows:

Balance 2010	Earned	Taken	Balance 2011	Current Portion	Long-term Portion
$ 385,468	494,403	(462,766)	417,105	312,829	104,276

(8) Long-term Debt

Changes in long-term debt amounts for 2012, were as follows:

		Balance 2011	Additions/ Deletions	Principal Payments	Balance 2012
Long-term debt:					
1998 – Certificates of participation	$	13,345,000	(12,505,000)	(840,000)	-
2004 – Certificates of participation		35,940,000	-	(380,000)	35,560,000
2012 – Refunding certificates of participation		-	12,765,208	-	12,765,208
Capital lease payable		-	863,876	(121,262)	742,614
Pension-related debt		1,185,361	-	(44,320)	1,141,041
Total long-term debt		50,470,361	1,124,084	(1,385,582)	50,208,863
Less: current portion		(1,264,320)			(1,246,782)
Total non-current portion	$	49,206,041			48,962,081

Changes in long-term debt amounts for 2011, were as follows:

		Balance 2010	Additions/ Deletions	Principal Payments	Balance 2011
Long-term debt:					
1998 – Certificates of participation	$	14,145,000	-	(800,000)	13,345,000
2004 – Certificates of participation		36,310,000	-	(370,000)	35,940,000
Pension-related debt		-	1,185,361	-	1,185,361
Total long-term debt		50,455,000	1,185,361	(1,170,000)	50,470,361
Less: current portion		(1,170,000)			(1,264,320)
Total non-current portion	$	49,285,000			49,206,041

Certificates of Participation

1998 Certificates of Participation

In April 1998, the District issued $21,925,000 of Refunding Revenue Certificates of Participation, Series 1998 (1998 COP's), with maturities from 1998 through 2023 and an average interest rate of 4.73%. The net proceeds of approximately $21,150,000 (plus an additional $2.9 million of District funds) were used to accomplish an advance refunding (an in-substance defeasance) of $23,210,000 aggregate principal amount of the District's Certificates of Participation (Refunding and Water Facilities and Improvement Project) Series 1991 and Certificates of Participation (Littlerock Dam Project) Series 1993A, with an average interest rate of 5.78%. The initial escrow deposit was used to purchase state and local government securities. These securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the Series 1991 and Series 1993A Certificates of Participation.

The advance refunding resulted in a different between the reacquisition price and the net carrying value amount of the old debt of $1,160,564. This difference is being amortized through 2023 (the life of the debt) using the straight-line method as a deferred loss on debt defeasance. The District completed the advance refunding to reduce its total debt service payments over the next 25 years by approximately $6.5 million and to obtain an economic gain (the difference between the present values of the old and new debt service payments) of approximately $3.4 million.

In 2012, the District advanced refunded the remaining $12,505,000 of the 1998 COP's into the 2012 Refunding Certificates of Participation issuance.

(8) Long-Term Debt, continued

Certificates of Participation, continued

2004 Certificates of Participation

In August 2004, the District issued $38,285,000 of Revenue Certificates of Participation, Series 2004 (2004 COP's), with maturities from 2008 through 2034 and an average interest rate of 4.90%. The net proceeds are to be used to finance the acquisition, construction and improvement of certain water facilities and to pay issuance costs of the debt. Issuance of the 2004 COP's resulted in a premium of $328,767 which is being amortized over the life of the issue using the straight-line method. Annual debt service requirements for the 2004 Certificates of Participation are as follows:

Year		Principal	Interest	Total
2013	$	395,000	1,733,642	2,128,642
2014		410,000	1,718,830	2,128,830
2015		430,000	1,702,430	2,132,430
2016		445,000	1,685,230	2,130,230
2017		465,000	1,667,430	2,132,430
2018-2022		2,620,000	8,033,079	10,653,079
2023-2027		9,750,000	6,918,800	16,668,800
2028-2032		14,280,000	3,902,500	18,182,500
2033-2034		6,765,000	511,500	7,276,500
Total	$	35,560,000	27,873,441	63,433,441
Less: current		(395,000)		
Total non-current	$	35,165,000		

2012 Refunding Certificates of Participation

In November 2012, the District issued $12,765,208 of Refunding Revenue Certificates of Participation, Series 2012 (2012 COP's), with maturities from 2013 through 2023 and an interest rate of 3.100%. The net proceeds of the issuance were used to accomplish an advance refunding (an in-substance defeasance) of $12,505,000 aggregate principal amount of the District's 1998 COP's with an average interest rate of 4.73%. The initial escrow deposit was used to purchase government sponsored agency obligation securities. These securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the Series 1998 Certificates of Participation.

The advance refunding resulted in a different between the reacquisition price and the net carrying value amount of the old debt of $312,075. This difference is being amortized through 2023 (the life of the debt) using the straight-line method as a deferred loss on debt defeasance. The District completed the advance refunding to reduce its total debt service payments over the next 11 years by approximately $1.293 million and to obtain an economic gain (the difference between the present values of the old and new debt service payments) of approximately $1.154 million.

(8) Long-Term Debt, continued

Certificates of Participation, continued

2012 Refunding Certificates of Participation, continued

Annual debt service requirements for the 2012 Refunding Certificates of Participation are as follows:

Year		Principal	Interest	Total
2013	$	632,277	339,624	971,901
2014		998,893	368,439	1,367,332
2015		1,028,947	337,234	1,366,181
2016		1,060,094	305,106	1,365,200
2017		1,092,291	271,987	1,364,278
2018-2022		5,970,160	827,669	6,797,829
2023		1,982,546	51,426	2,033,972
Total	$	12,765,208	2,501,485	15,266,693
Less: current		(632,277)		
Total non-current	$	12,132,931		

(9) Capital Lease Payable

The District has leased $863,876 in equipment under a capital lease agreement, upon which the District will take ownership of the equipment at the end of the lease-term. Capital lease payments of $15,868 are due on a monthly-basis from April 2012 to March 2017 at an annual interest rate of 4.030%. Annual debt service requirements for the capital lease payable are as follows:

Year		Principal	Interest	Total
2013	$	163,487	26,929	190,416
2014		170,198	20,218	190,416
2015		177,185	13,231	190,416
2016		184,459	5,957	190,416
2017		47,286	318	47,604
Total	$	742,615	66,653	809,268
Less: current		(163,487)		
Total non-current	$	579,128		

(10) Pension-Related Debt – CalPERS Side-Fund

As of June 30, 2003, CalPERS implemented risk-pooling for the District's agent multiple-employer public employee defined benefit pension plan. As a result, the District's defined benefit pension plan with CalPERS converted from an agent multiple-employer plan to a cost sharing multiple-employer plan. This change in the type of the plan created the CalPERS Side-Fund, which CalPERS financed at a 7.75% interest rate. CalPERS actuarially calculated the amount needed to bring the District into the cost sharing multiple-employer plan on an equal basis with other governmental agencies who had less than 100 active and retired employees combined. The reason that CalPERS switched these governmental agencies into the cost sharing multiple-employer plan was to smooth the annual costs related to the pension benefit over a longer period of time resulting in a lower cost of service to the governmental agencies.

A portion of the District's annual required contributions to CalPERS are actuarially determined and shared by all governmental agencies within the cost sharing risk pool. Also, the District is required to make annual payments to pay-down the CalPERS Side-Fund, as well. The responsibility for paying-down the District's CalPERS Side-Fund is specific to the District and is not shared by all governmental agencies within the cost sharing risk pool. Therefore, the Side Fund falls under the definition of pension-related debt, as described in GASB Statement No. 27 and recorded as liability on the District's financial statements.

Annual payments on the CalPERS Side-Fund represent principal and interest payments on the pension-related debt. Debt principal and interest expense is blended into the CalPERS pension benefit rate by individual class of District employee and repaid to CalPERS each payroll period throughout the fiscal year. The following is a pay-down schedule of the remaining payments of the District's CalPERS Side-Fund at a 7.50% interest rate, which was reduced by CalPERS in fiscal year 2012 for fiscal years 2013 and beyond as follows:

Year		Principal	Interest	Total
January 1, 2013 to December 31, 2013	$	56,018	80,692	136,710
January 1, 2014 to June 30, 2014		30,820	41,244	72,064
July 1, 2014 to June 30, 2015		69,436	73,791	143,227
July 1, 2015 to June 30, 2016		79,100	68,425	147,525
July 1, 2016 to June 30, 2017		89,620	62,330	151,950
July 1, 2017 to June 30, 2018		101,068	55,441	156,509
July 1, 2018 to June 30, 2019		113,517	47,688	161,205
July 1, 2019 to June 30, 2020		127,045	38,966	166,011
July 1, 2020 to June 30, 2021		141,737	29,284	171,021
July 1, 2021 to June 30, 2022		157,688	18,465	176,153
July 1, 2022 to June 30, 2023		174,992	6,562	181,554
Total	$	1,141,041	522,888	1,663,929
Less: current		(56,018)		
Total non-current	$	1,085,023		

(11) Other Post Employment Benefits Payable

During the year ended December 31, 2008, the District implemented GASB Statement No. 45, which changed the accounting and financial reporting used by local government employers for post employment benefits. Previously, the costs of such benefits were generally recognized as expenses of local government employers on a pay-as-you-go basis. The new reporting requirements for these benefit programs as they pertain to the District are set forth below.

Plan Description – Eligibility

The District administers its post-employment benefits plan, a single-employer defined benefit plan (Plan). The following requirements must be satisfied in order to be eligible for post employment medical, dental and vision benefits: (1) Attainment of age 55, and 20 years for full-time service, and (2) Retirement from the District (the District must be the last employer prior to retirement).

Membership in the OPEB plan consisted of the following members as of December 31:

	2012	2011	2010
Active plan members	90	90	90
Retirees and beneficiaries receiving benefits	10	10	10
Separated plan members entitled to but not yet receiving benefits	-	-	-
Total plan membership	100	100	100

Plan Description – Benefits

The District offers post employment medical, dental and vision benefits to retired employees who satisfy the eligibility rules. Spouses and surviving spouses are also eligible to receive benefits. Retirees may enroll in any plan available through the ACWA-JPIA medical, dental and vision programs. The contribution requirements of Plan members and the District are established and may be amended by the Board of Directors.

Funding Policy

The District is required to contribute the *Annual Required Contribution (ARC) of the Employer*, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The current ARC rate is 29.97% for 2012 and 30.14% for 2011 of the annual covered payroll.

The District will pay 100% of the cost of the post-employment benefit plan. The District funds the plan on a pay-as-you-go basis and maintains reserves (and records a liability) for the difference between pay-as-you-go and the actuarially determined ARC cost.

Annual Cost

For the years ended December 31, 2012 and 2011, the District's ARC cost was $1,902,341 and $1,933,024, respectively. The District's net OPEB payable obligation amounted to $5,968,442 and $4,358,984 for the years ended December 31, 2012 and 2011, respectively. The District contributed $292,883 and $268,096 in age adjusted contributions for current retiree OPEB premiums for the years ended December 31, 2012 and 2011, respectively.

(11) Other Post Employment Benefits Payable, continued

Annual Cost, continued

The balance at December 31, consists of the following:		2012	2011	2010
Annual OPEB expense:				
Annual required contribution (ARC)	$	1,982,672	1,982,672	1,963,042
Interest on net OPEB obligation		89,796	55,498	19,494
Adjustment to annual required contribution		(170,127)	(105,146)	(36,933)
Total annual OPEB expense		1,902,341	1,933,024	1,945,603
Change in net OPEB payable obligation:				
Age adjusted contributions made		(292,883)	(268,096)	(197,855)
Total change in net OPEB payable obligation		1,609,458	1,664,928	1,747,748
OPEB payable – beginning of year		4,358,984	2,694,056	946,308
OPEB payable – end of year	$	5,968,442	4,358,984	2,694,056

The District's annual OPEB cost, the percentage of the annual OPEB cost contributed to the Plan, and the net OPEB obligation for 2012 and the two preceding years were as follows:

Three-Year History of Net OPEB Obligation

Fiscal Year Ended		Annual OPEB Cost	Age Adjusted Contribution	Percentage of Annual OPEB Cost Contributed		Net OPEB Obligation Payable
2012	$	1,902,341	292,883	15.40%	$	5,968,442
2011	$	1,933,024	268,096	13.87%	$	4,358,984
2010	$	1,945,603	197,855	10.17%	$	2,694,056

Funded Status and Funding Progress of the Plan

The most recent valuation (dated December 31, 2010) includes an Actuarial Accrued Liability and Unfunded Actuarial Accrued Liability of $16,234,820. There are no plan assets because the District funds on a pay-as-you-go basis and maintains no reserves equal to the remaining net post-employment benefits payable obligation. The covered payroll (annual payroll of active employees covered by the plan) for the year ended December 31, 2010 was $6,572,271. The ratio of the unfunded actuarial accrued liability to annual covered payroll was 247.02% as of December 31, 2010.

(11) Other Post Employment Benefits Payable, continued

Actuarial Methods and Assumptions

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

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

Valuation date	December 31, 2010
Actuarial cost method	Entry age normal cost method
Amortization method	Level percent of payroll amortization
Remaining amortization period	27 Years as of the valuation date
Asset valuation method	30 Year smoothed market
Actuarial assumptions:	
Investment rate of return	2.50% – Current LAIF rating (rounded)
Projected salary increase	1.00%
Inflation - discount rate	2.06%
Individual salary growth	District annual COLA

(12) Net Investment in Capital Assets

The balance at December 31, consists of the following:		2012	2011
Capital assets – not being depreciated	$	5,728,926	6,325,459
Capital assets – being depreciated, net		151,080,412	152,482,698
Deferred outflows of resources		1,582,279	1,427,144
Capital lease payable – current portion		(163,487)	-
Certificates of participation – current portion		(1,027,277)	(1,220,000)
Capital lease payable – non-current portion		(579,127)	-
Certificates of participation – non-current portion		(47,297,931)	(48,065,000)
Deferred inflows of resources		(238,356)	(249,315)
Net investment in capital assets	$	109,085,439	110,700,986

(13) Restricted Net Position

The balance at December 31, consists of the following:		2012	2011
Restricted – cash and cash equivalents	$	-	182,107
Restricted – investments		-	1,479,625
Accrued interest payable – 1998 COPs		-	(166,812)
Total restricted net position	$	-	1,494,920

(14) Reservations of Unrestricted Net Position

The balance at December 31, consists of the following:		2012	2011
Prepaid assets:			
Materials and supplies inventory	$	938,813	712,744
Prepaid expenses and other deposits		232,700	319,901
Total non-spendable unrestricted net position		1,171,513	1,032,645
Undesignated net position(deficit)		(824,247)	(680,209)
Total unrestricted net position	$	347,266	352,436

(15) Prior Period Adjustment

The prior period adjustment consisted of the following:

Net position – beginning of fiscal year	$	115,884,972
Pension-related debt – CalPERS side-fund		(1,185,361)
Net position – beginning of fiscal year, as restated	$	114,699,611

Pension-Related Debt – CalPERS Side-Fund

At December 31, 2011, the District's liability for the pension-related debt – CalPERS side-fund amounted to $1,185,361 and was recorded as a prior period adjustment and a liability on the District's accompanying financial statements. During 2012, the District paid-down $44,320 in debt principal. See note 10 for a further explanation of this liability.

(16) Deferred Compensation Savings Plan

For the benefit of its employees, the District participates in a 457 Deferred Compensation Program (Program). The purpose of this Program is to provide deferred compensation for public employees that elect to participate in the Program. Generally, eligible employees may defer receipt of a portion of their salary until termination, retirement, death or unforeseeable emergency. Until the funds are paid or otherwise made available to the employee, the employee is not obligated to report the deferred salary for income tax purposes.

Federal law requires deferred compensation assets to be held in trust for the exclusive benefit of the participants. Accordingly, the District is in compliance with this legislation. Therefore, these assets are not the legal property of the District, and are not subject to claims of the District's general creditors. Market value of all plan assets held in trust by the Lincoln Financial Group at December 31, 2012 and 2011 was $3,002,661 and $2,830,944, respectively.

The District has implemented GASB Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*. Since the District has little administrative involvement and does not perform the investing function for this plan, the assets and related liabilities are not shown on the statement of net assets.

(17) Defined Benefit Pension Plan

Plan Description

The District contributes to the California Public Employees Retirement System (CalPERS), a cost-sharing multiple-employer defined benefit pension plan. CalPERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. CalPERS acts as a common investment and administrative agent for participating public agencies within the State of California. Benefit provisions and all other requirements are established by state statute and the District. Copies of CalPERS annual financial report may be obtained form their executive Office: 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 amounts necessary to fund the benefits for its members. The required employer contribution rates for years 2012, 2011 and 2010 were as follows:

Time Period	2012	2011	2010
Jan. 1 - June 30	11.913%	11.004%	10.392%
July 1 - Dec. 31	12.385%	11.913%	11.004%

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 2012, 2011 and 2010, the District's annual contribution was $1,190,148, $1,086,497, and $968,147, respectively, for CalPERS and was equal to the District's required and actual contributions for each year.

(18) Risk Management

The District is exposed to various risks of loss related to torts, theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District is a member of the Association of California Water Agencies/Joint Powers Insurance Authority (ACWA/JPIA), an intergovernmental risk sharing joint powers authority created to provide self-insurance programs for California water agencies. The purpose of the ACWA/JPIA is to arrange and administer programs of self-insured losses and to purchase the appropriate amount of insurance coverage. At December 31, 2012, the District participated in the liability and property programs of the ACWA/JPIA as follows:

- General and auto liability: The District has a zero deductible for general and auto liability. The District purchased additional excess coverage layers: $60 million for general, auto and public officials liability, which increases the limits on the insurance coverage noted above.

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

- Employee dishonesty coverage up to $100,000 per loss includes public employee dishonesty, forgery or alteration and theft, computer fraud coverage's.
- Property loss is paid based on the replacement cost or actual cash value for the property on file. If the property is replaced within two years after the loss or otherwise paid on an actual cash value basis, to a combined total of $100 million per occurrence it is subject to a $2,500 deductible per occurrence.
- Boiler and machinery coverage for the replacement cost up to $50 million per occurrence, subject to various deductibles depending on the type of equipment.

(18) Risk Management, continued

- Public officials' liability coverage up to $1 million for each occurrence subject to the policy term.
- Workers' compensation insurance provides coverage with a self-insured retention limit of $2 million for all work related injuries/illnesses covered by California law. The District has purchased an excess insurance policy for an additional $2 million to statutory limits.

In addition, the District in August 2012 continued a separate policy from ACWA/JPIA with underwriters at Lloyd's for commercial earthquake/business income interruption insurance. This insurance was purchased to safeguard the District in case of a major earthquake until disaster relief funds are made available by state and federal agencies. This policy has provisions as follows:

- The loss limit is $5,000,000 per occurrence and in the annual aggregate.
- Deductible is 20% of values per unit of insurance subject to $25,000 minimum per occurrence.
- Coverage for 2029 East Avenue Q location is $2,780,625 building limit and $378,000 contents, including $6,000,000 business income.

Settled claims have not exceeded any of the coverage amounts in any of the last three fiscal years and there were no reductions in the District's insurance coverage during the years ending December 31, 2012, 2011 and 2010. Liabilities are recorded when it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated net of the respective insurance coverage. Liabilities include an amount for claims that have been incurred but not reported (IBNR). There were no IBNR claims payable as of December 31, 2012, 2011 and 2010.

(19) Governmental Accounting Standards Board Statements Issued, Not Yet Effective

The Governmental Accounting Standards Board (GASB) has issued several pronouncements prior to December 31, 2012, that have effective dates that may impact future financial presentations.

Governmental Accounting Standards Board Statement No. 66

In March 2012, the GASB issued Statement No. 66 – *Technical Corrections—2012—an amendment of GASB Statements No. 10 and No. 62.* The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions,* and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements.* The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. The District estimates that this statement will not have a material impact on the presentation of the basic financial statements.

Governmental Accounting Standards Board Statement No. 68

In June 2012, the GASB issued Statement No. 68 – *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27.* The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency.

(19) Governmental Accounting Standards Board Statements Issued, Not Yet Effective, continued

Governmental Accounting Standards Board Statement No. 68, continued

This Statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers,* as well as the requirements of Statement No. 50, *Pension Disclosures,* as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statements 27 and 50 remain applicable for pensions that are not covered by the scope of this Statement. The provisions of Statement 68 are effective for fiscal years beginning after June 15, 2014. The impact of the implementation of this Statement to the District's financial statements has not been assessed at this time.

(20) Commitments and Contingencies

State Water Contract

Estimates of the District's share of the project fixed costs of the State Water Project (SWP) are provided annually by the State. The estimates are subject to future increases or decreases resulting from changes in planned facilities, refinements in cost estimates and inflation. During the next five years payments under the State Water Contract, exclusive of variable power costs, are currently estimated by the State to be as follows:

Fiscal Year		Amount
2013	$	4,564,051
2014		5,171,841
2015		4,568,680
2016		4,738,280
2017		4,618,600

As of December 31, 2012, the District has expended approximately $82,944,057 since the District started participating in the State Water Contract.

According to the State's latest estimates, the District's long-term obligations under the contract, for capital and minimum operations and maintenance costs, including interest to the year 2035, are as follows:

Type of Long-Term Obligation		Amount
State Water Project Contract:		
Transportation facilities	$	78,246,502
Conservation facilities		22,696,653
Off-aqueduct power facilities		4,683,703
Revenue bond surcharge		1,140,588
Total	$	106,767,446

The amounts shown above do not contain any escalation for inflation and are subject to significant variation over time because the amounts are based on a number of assumptions and are contingent on future events. Accordingly, none of the estimated long-term obligations are recorded as liabilities in the accompanying basic financial statements.

(20) Commitments and Contingencies, continued

State Water Contract, continued

Bay/Delta Regulatory and Planning Activities

The State Water Resources Control Board (State Board) is the agency responsible for setting water quality standards and administering water rights throughout California. Decisions of the State Board can affect the availability of water to the District and other water users by means of public proceedings leading to regulations and decisions. In 1995, the State Board adopted a Water Quality Control Plan establishing water quality standards and flow improvements in the Bay/Delta watershed.

In August 2000, the California Federal (CALFED) Bay/Delta Program Record of Decision (Decision) was approved with mandates to improve water quality, enhance water supply reliability, augment ecosystem restoration, and assure long-term protection for Delta levees. During its first three years, CALFED has invested more than $2.0 billion in hundreds of local and regional projects to meet these program goals.

In May 2004, a Delta Improvement Package was proposed to facilitate implementation of the Decision. Funding is expected to be provided by state and federal appropriations and contributions from local users, including the District. CALFED's objective is to allocate project costs based on a beneficiaries pay policy, that is new costs commensurate with benefits received. At this time, the exact allocation of costs between the federal, state, and local users has not been determined, and therefore, the District cannot estimate the extent of timing of its contributions at this time.

There are other pending actions that may adversely impact the District's ability to control the sale of water transported through the SWP into its service area. The impact on future revenues of such actions cannot be determined.

Construction Contracts

The District has a variety of agreements with private parties relating to the installation, improvement or modification of water facilities and distribution systems within its service area. The financing of such construction contracts is being provided primarily from the District's replacement reserves and advances for construction. The District has committed to approximately $995,000 to complete the open construction contracts as of December 31, 2012. These include the following:

Project Name		Cost of Project to Date	Estimated Costs to Complete	Total Expected Project Cost
Sediment removal – Littlerock Dam	$	946,305	50,000	996,305
Distribution master plan		532,335	-	532,335
Well 11A rehabilitation project		323,119	25,000	348,119
Recycled facilities master plan		291,543	10,000	301,543
Garden bar study		162,630	5,000	167,630
Division Street/Avenue Q3 waterline replacement		1,030,161	325,000	1,355,161
3600' Zone tank replacement project		100,904	80,000	180,904
Various other minor projects >$100,000		557,571	500,000	1,057,571
Total	$	3,944,568	995,000	4,939,568

(20) Commitments and Contingencies, continued

City of Palmdale v. Palmdale Water District

On May 13, 2009, the District's Board of Directors adopted a new water rate structure, known as a water budget rate structure. Under this new rate structure, District customers are provided with a monthly allocation of water, as determined by a mathematical formula that applies various factors, including, but not limited to, lot size, number of persons in the household and actual weather data. A customer's monthly usage is then measured against that customer's water allocation for that month and the percentage of usage that exceeds that allocation is then placed in tiers, with increasing water rates applied to each higher tier of usage.

Also at the May 13, 2009 Board meeting, the District and the Palmdale Water District Public Facilities Corporation (Corporation) adopted resolutions approving the issuance of Certificates of Participation (COP's) to finance various District capital projects and to replenish the District's reserves, which had been expended to pay for substantial improvements to the District' s water treatment plant. Those COP's were to be partially secured by the revenue stream derived from the District's new water rate structure.

On May 14, 2009, the City of Palmdale (City) filed a lawsuit, Los Angeles County Superior Court Case No. BC413432 (Rate Litigation), to challenge the District's adoption of the new rate structure. The City contended the District violated Article XIIID, Section 6 of the California Constitution both procedurally and substantively.

Among other things, the City contended that the new water rate structure results in rates that exceed the reasonable cost of the service the District provides, and that the resulting rates charged to a parcel are not proportional to the cost attributable to providing water service to that parcel.

The City also filed a separate lawsuit under Code of Civil Procedure Section 863, known as a reverse validation action (Los Angeles County Superior Court Case No. BC413907 (Validation Action), seeking to invalidate the District's new rate structure and the actions taken by the District and the Corporation to approve the COP's. The City based the Validation Action on the same alleged constitutional violations on which it based the Rate Litigation.

Trial of the Validation Action occurred on February 26, 2010 (the Rate Litigation was stayed, pending the outcome of the Validation Action). On that date, the court issued its tentative ruling, heard oral arguments from the parties and took the matter under submission. On March 12, 2010, the court issued its ruling that rejected the City's challenge in the Validation Action and validated the District's new rate structure and the actions taken in noticing, adopting and implementing that structure.

The City appealed the court's ruling in the Validation Action. On August 9, 2011, the Court of Appeal issued its decision that reversed the trial court's judgment and held that the District violated Article XIIID, Section 6 of the California Constitution. That ruling was based on the court's determination that the different widths of tiers among customer classes in the District's water budget rate structure violated the "proportionality of costs" requirement of Article XIIID, Section 6.

Based on the Court of Appeal's decision, the District cured the defect noted by the court by revising its water budget rate structure so that the tiers among the three customer classes are now equal. District staff has recalculated water charges using those equalized tiers from when the new structure took effect in June 2009 and has been issuing credits back to impacted District customers, including the City.

The City maintains the District's action to cure the defect in its rate structure is not permissible and that the District should apply the rate structure in effect prior to its action in May 2009 to adopt the new structure. The City has submitted a form of judgment in that regard for the trial court to consider.

(20) Commitments and Contingencies, continued

City of Palmdale v. Palmdale Water District, continued

The District subsequently filed a supplemental complaint in the action seeking monetary damages for the taking of its facilities that would have resulted from the City providing recycled water service to existing District accounts.

This case was settled in September 6, 2012 in connection with the global settlement of all existing litigation between the District and the City. As part of that settlement, the District and the City agreed to form a joint powers agency, the Palmdale Recycled Water Authority, to provide recycled water service within the District's service area.

Palmdale Recycled Water Authority – Joint Powers Authority

The City and the District have formed a Joint Powers Authority the Palmdale Recycled Water Authority (Authority) to be the recycled water supplier within the boundaries of the District (both inside and outside City boundaries). While the Joint Powers Agreement is in force, neither the City nor District will individually supply recycled water within the boundaries of the Authority.

The City and the District expect to accomplish a reallocation of the recycled water supply produced by the Los Angeles County Sanitation Districts Nos. 14 and 20 such that the effluent generated within the City that is tributary to the Palmdale Treatment Plant (Sanitation District No. 20) and to the Lancaster Treatment Plant (Sanitation District No. 14), less that previously allocated for environmental projects by both Sanitation Districts Nos. 14 and 20 and 4,000 acre-feet for the Palmdale Power Plant, is available to the Authority for purchase. The City and the District agree to use their best efforts to obtain this result.

The Authority’s allocation will be approximately 6,000 acre-feet. The City, District and Sanitation Districts have calculated the overall "Palmdale" allocation to be 12,800 acre-feet, with 2,800 acre-feet allocated to the above-referenced environmental projects, leaving 10,000 acre-feet available. The City has already committed to 4,000 acre-feet for its Palmdale Power Plant, leaving the entire remaining estimated allocation of 6,000 feet for the Authority's uses. The City and District acknowledge that this reallocation is a significant factor in the decision of both the City and the District to enter into this Agreement. Future recycled water, when available, will be allocated between the West Palmdale-area projects and Authority projects approximately in proportion to the effluent generated by the respective areas.

Prior to the execution of this Agreement, the City's principal focus was on the direct use of recycled water for its Palmdale Power Plant and for the irrigation of parks and landscaped areas, and on the use of recycled water for groundwater recharge. The District's principal focus was on providing recycled water to agricultural users in exchange for the right to produce groundwater for potable uses, and on the use of recycled water for groundwater recharge. By this Agreement, the parties hereby commit themselves to support all three uses of recycled water, and agree that all available recycled water should be put to beneficial use as soon as practicable.

Other Litigation

In the ordinary course of operations, the District is subject to claims and litigation from outside parties. Nevertheless, after consultation with legal counsel, the District believes that these actions, when finally concluded and determined are not likely to have a material adverse effect on the District’s financial position, results of operations, or cash flows.

(21) Subsequent Events

California Public Employees Pension Reform Act of 2013

On September 12, 2012, the California Governor signed the California Public Employees' Pension Reform Act of 2013 (PEPRA) into law. PEPRA took effect January 1, 2013.

Key components of the legislation are as follows:

- Establishes PEPRA which will apply to all public employers and public pension plans on and after January 1, 2013 (Except specific exemptions);
- Establishes new retirement tiers/benefits for new public employees;
- Prohibits certain cash payments from being counted as compensation; and
- Increases retirement age for all new public employees.

Other Events

Events occurring after December 31, 2012 have been evaluated for possible adjustment to the financial statements or disclosure as of April 30, 2013, which is the date the financial statements were available to be issued.

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Required Supplementary Information

Palmdale Water District
Schedule of Funding Progress – Other Post-Employment Benefits Obligation
For the Years Ended December 31, 2012 and 2011

Required Supplemental Information – Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
12/31/2010	$ -	16,234,820	16,234,820	0.00%	$ 6,572,271	247.02%
12/31/2008	$ -	4,497,022	4,497,022	0.00%	$ 6,311,893	71.25%

Funding progress is presented for the year(s) that an actuarial study has been prepared since the effective date of GASB Statement 45. Actuarial review and analysis of the post-employment benefits liability and funding status is performed every three years or annually if there are significant changes in the plan. The next scheduled actuarial review and analysis of the post-employment benefits liability and funding status will be performed in 2013 based on the year ending December 31, 2012.

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Report on Internal Controls and Compliance

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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*

Board of Directors
Palmdale Water District
Palmdale, California

We have audited, 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, the financial statements of the Palmdale Water District (District), which comprise the statement of net position as of December 31, 2012, and the related statement of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements, which collectively comprise the District's basic financial statements.

Internal Control Over Financial Reporting

In planning and performing our audit, 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 a 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 internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in 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 of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants 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.*

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, continued*

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal controls 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.



Charles Z. Fedak & Company, CPA's – An Accountancy Corporation
Cypress, California
April 30, 2013