BORREGO WATER DISTRICT

ANNUAL FINANCIAL REPORT

WITH REPORT ON AUDIT BY INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

JUNE 30, 2012 AND 2011

For the Years Ended June 30, 2012 and 2011

October 18, 2012

To the Honorable President and Members of the Board of Directors and Customers of the Borrego Water District:

State law requires that all general-purpose local governments and special districts publish each fiscal year a complete set of financial statements presented in conformity with generally accepted accounting principles (GAAP) and audited in accordance with generally accepted auditing standards by a firm of licensed certified public accountants. The Annual Financial Report of the Borrego Water District (District) for fiscal year ended June 30, 2012 is hereby submitted as required. White Nelson Diehl Evans, a firm of licensed certified public accountants, has audited the District's financial statements.

Generally Accepted Accounting Principles (GAAP) requires that management provide a narrative introduction, overview, and analysis to accompany the financial statements in the form of the Management's Discussion and Analysis (MD&A) section. This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The District's MD&A can be found immediately after the Independent Auditors' Report.

Management assumes full responsibility for the completeness and reliability of the information contained in this letter, the MD&A and the accompanying financial statements, based upon a comprehensive framework of internal control that it has established for this purpose. Because the cost of internal control should not exceed anticipated benefits, the objective is to provide reasonable, rather than absolute, assurance that the financial statements are free of any material misstatements.

The goal of the independent audit was to provide reasonable assurance that the financial statements of the District for the fiscal year ended June 30, 2012 are free of material misstatements. The independent audit involved examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; assessing the accounting principles used and significant estimates made by management; and evaluating the overall financial statement presentation. The independent auditor concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that the District's financial statements for the fiscal year ended June 30, 2012 are fairly presented in conformity with GAAP. The Independent Auditors' Report is presented as the first component of the financial section of this report.

PROFILE OF THE DISTRICT

The Borrego Water District is a small public water and wastewater district serving approximately 2,000 customers in beautiful Borrego Springs, California, a retirement and resort community located about 70 miles NE of San Diego and surrounded by the Anza-Borrego Desert State Park, the largest state park in California. The District was established in 1962 as a California water district to provide water, sewer, flood control and gnat abatement for areas in the unincorporated community of Borrego Springs located in San Diego County. Additionally, the District adopted a groundwater management plan under Assembly Bill 3030 in 2002 and obtained the authority of a groundwater replenishment district. This designation allows the District to do planning for groundwater management and provides the authority, among others, to (a) buy and sell water, (b) exchange water (c) distribute water in exchange for ceasing or reducing groundwater extraction (d) recharge the basin and (e) build necessary works to achieve groundwater replenishment. The District is not a member of the San Diego County Water Authority (SDCWA), the regional member of the Metropolitan Water District of Southern California (MWD) that imports supplemental water into San Diego County.

Governance

The affairs of the District are governed by a five-member Board of Directors. This Board is elected at large by the registered voters residing within the District's boundaries with vacant positions that occur between elections appointed by the existing Board. The directors, who are elected or appointed, are residents and have the same concerns as their constituents. The board members, who serve four-year staggered terms, are responsible for establishing policy and ordinances, adopting the annual budget, and hiring the District's General Manager and other advisors to the Board, such as the District's General Counsel, financial and other advisors. The General Manager is responsible for carrying out the policies and ordinances of the District board, for overseeing the day-to-day operations of the District and for meeting or exceeding the financial objectives set forth in the annual budget approved by the Board.

Groundwater Supply, Usage & Availability

The District is the only appropriator of groundwater from the unmanaged Borrego Valley Groundwater Basin (the Basin), which has been in overdraft since around 1945. Present overdraft is estimated at approximately 16,000 acre-feet/year (AFY). The natural annual recharge is around 4,800 AFY. The District accounts for about 3,000 AFY or less than 15% of annual withdrawals. Unmetered recreational use by overlyers (3 golf courses) annually account for about 15% of the annual withdrawals and unmetered agricultural use by overlyers accounts for about 70% of annual withdrawals. Preliminary results from current United States Geological Survey (USGS) *Evaluation of Groundwater Conditions and Land Subsidence in the Borrego Valley, California* (2009-2012) study projects a complete dewatering of the upper aquifer of the Basin within approximately 50-years. Presently, there is uncertainty concerning the amount and potential cost of economically extractable potable water that will be available from the middle and lower aquifers once the upper aquifer of the Basin is dewatered.

During FY 2012, the Board continued to work with the USGS study team and United States Bureau of Reclamation (Reclamation) study team conducting the *Southeast California Regional Basin Study* (2011-2013) to ensure that the physical parameters of the Basin are fully defined and that options for managing the Basin and for importing water for storage, recharge, and supplemental supply are fully evaluated on a timely basis. The USGS *Evaluation of Groundwater Conditions* report should be completed by the fourth quarter of calendar year 2012. Reclamation's *Southeast Basin Study* report will include economic analyses of the cost for importing water from viable regional sources. The Reclamation report should be completed by the second quarter calendar year 2013 with a preliminary discussion of finding occurring in November 2012.

FACTORS AFFECTING FINANCIAL CONDITION

The information presented in the financial statements is perhaps best understood when it is considered from the broader perspective of the specific environment within which the District operates.

Local Economy

The local economy and the income of retirees living in the Borrego community has been affected by the general downturn in the economy of California and the nation. In addition, uncertainty over long-term water supply availability and San Diego County's slowness to update its Groundwater Mitigation Ordinance and proposed Agreement with the District to accept water credits as a means to bank the fallowing of active agricultural land has slowed new development in the Borrego Valley.

Previous Fiscal Years Spending by the District

The District continues to work itself out of the financial situation that was inherited from the past Board and general manager who between FY 2008 – FY 2011 spent more than $6 million of the District's reserves. This spending resulted in the District losing its good credit rating. It could no longer borrow in the public bond market. It could no longer obtain temporary bank financing. It was even facing running out of cash by the 3rd quarter of calendar year 2011.

Long-Term Financial Planning

The District's present Board of Directors is aware of the need to restore the District's financial stability and return to creditworthiness. Through a coordinated strategic process, the Board has established a series of policies and plans to effectively meet the District's anticipated future revenue needs. The principles the District has adopted for returning to revenue sufficiency include: (a) the active management and projection of monthly cash flow during the year; (b) holding expenditures below the annual budget; (c) no increases in salaries and benefits for employees; (d) deference of large capital expenditures until the District is able to borrow again in the public bond markets; and (e) implementing a thirty percent (30%) revenue increase in FY 2012 that took effect July 1, 2011 and another twenty percent (20%) revenue increase for FY 2013 that will take effect after August 18th, 2012 and be reflected initially in the September 2012 water and sewer bills. Additionally, the District has another Proposition 218-approved thirty-five percent (35%) of potential revenue increases available to it, if necessary to re-establish its creditworthiness for borrowing, which may be instituted between FY 2014 – FY 2016. These revenue increases were approved under the public Proposition 218 process the District underwent in June 2011.

The primary driver for the long-term financial viability of the District, as well as the economy of the Borrego Valley is the necessity of addressing the overdraft of the Borrego Valley Groundwater Basin (see section on Groundwater Supply, Usage & Availability above). Although almost every community in the U.S. today has water problems, it is somewhat unusual for water supply problems of the scale facing the Borrego Valley to go on for so long without resolution. The good news is that similar problems have been successfully solved for a reasonable cost in many other communities in California. A portion of the $800,000 planning grant application to the California Department of Water Resources (DWR) by the Anza Borrego Desert (ABD) Integrated Regional Water Management (IRWM) region is to develop the analytical foundation for a managed basin plan necessary to resolve the overdraft of the Borrego Valley Groundwater Basin. Representatives of the District and its IRWM consultants, RMC Water and Environment, met with DWR in August 2012 to protest the preliminary scoring by DWR of the ABD planning grant proposal that recommended that the ABD region not receive this grant request. DWR's final decision concerning the ABD planning grant request is expected by the 4th quarter of calendar year 2012.

RELEVANT FINANCIAL POLICIES

Reserve Policy

The District has established a Reserve Fund Policy to anticipate and prepare for future funding requirements as well as for unforeseen events. The Reserve Fund Policy establishes restricted and unrestricted reserves and describes the flow of funds to and from the various reserves.

Risk Management

The District is a member of the California Joint Powers Insurance Authority (JPIA).

Pension and Other Post-Employment Benefits

The District contributes to the California Public Employees Retirement System (CalPERS), an agent multiple-employer public employees defined benefit pension plan for its personnel. CalPERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Additional information about the District's pension arrangements and post-employment benefits can be found in the notes to the financial statements. In FY 2012, the Board changed the pension program from its present three percent (3%) per year of active service at retirement that was instituted by the prior Board in 2009 back to its original two percent (2%) per year of active service at retirement. This new pension policy goes into effect for new employees of the District only. Legally, it is not possible to change current employees to this new pension policy.

Investment Policy

The Investment Policy establishes guidelines for the investment of available funds. The Investment Policy incorporates the Prudent Investor Standards. The primary objectives, in priority order, of the District's investment activities are the following: 1) safety, 2) liquidity, and 3) yield. The District's funds are invested in a variety of investments, in accordance with California government code, as described in the notes to the financial statements. The District minimizes interest rate risk by investing a greater portion of its funds in short term investments and minimizes credit risk by investing a majority of its funds in diversified investment pools.

Internal Controls

The District is responsible for establishing and maintaining an internal control structure designed to ensure that the District's assets are protected from loss, theft, or misuse, and to ensure that adequate accounting data are compiled for the preparation of financial statements in conformity with GAAP. The internal structure is designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that; 1) the cost of control should not exceed the benefits likely to be derived; and 2) the valuation of costs and benefits requires estimates and judgments by management.

Respectfully submitted,

Jerry Rolwing

General Manager

WHITE NELSON DIEHL EVANS LLP
Certified Public Accountants & Consultants

INDEPENDENT AUDITORS' REPORT

Board of Directors
Borrego Water District
Borrego, California

We have audited the accompanying basic financial statements of Borrego Water District as of and for the years ended June 30, 2012 and 2011, as listed in the table of contents. These basic financial statements are the responsibility of the Borrego Water District's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

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

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

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Offices located in Orange and San Diego Counties

Our audit was conducted for the purpose of forming opinions on the accompanying basic financial statements of the Borrego Water District. The Introductory Section, as identified in the accompanying table of contents, is presented for purposes of additional analysis and is not a required part of the financial statements. The Introductory Section has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

White Nelson Diehl Evans LLP

October 18, 2012
Carlsbad, California

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal years ended June 30, 2012 and 2011

Our discussion and analysis of the Borrego Water District (the District) basic financial statements provide general readers with an overview of the District's financial position and results of operations for the fiscal year ended June 30, 2012. The Management's Discussion and Analysis (MD&A) should be read in conjunction with the audited financial statements. These statements are located in the section following the MD&A. This discussion and analysis, as well as the basic financial statements that it accompanies have been prepared by management of the District and are its responsibility.

FINANCIAL HIGHLIGHTS

During the fiscal year ended June 30, 2012, the following events impacted, or have the potential to impact, the finances of the District:

- The District's Board of Directors approved a revenue adjustment of thirty percent (30%) for its water and sewer services for all customers of the District starting July 1, 2011. This increased rates previously in effect in FY 2011 for all customers. It should be noted that revenue adjustments are not necessarily the same as rate increases. Some customers had bill impacts higher than the overall revenue adjustment while other customers had lower bill impacts.

- On July 8, 2011, the District approved a second Amendment to the Bargain Sale and Donation Agreement (the "Agreement") with Lundavid LLC, a Connecticut limited liability company (the "Seller'). The original Agreement was entered into October 22, 2010 to purchase 125 acres and 312.5 water credits associated with the property located at the north end of DiGeorgio road, Borrego Springs, California for $1,500,000. The terms of the purchase called for a down payment of $75,000 and issuance of a note for a principal amount of $1,425,000. The terms of the note called for interest to be paid quarterly at the rate of four percent (4%) per annum. A principal payment of $150,000 is due on the fifth anniversary and the remaining principal balance is to be repaid over 25 years. In conjunction with the Agreement the seller pledged to donate 86 acres to the District upon the earlier of the following (i) the three-year anniversary of the conveyance of the Water Credits and conveyance of Parcel 2 or (ii) the final approval by the County of San Diego of the seller's compliance with the water mitigation requirements. The Amendment modified the original Agreement in two material ways: (a) instead of quarterly interest only payments for the first four years of the Agreement, the interest shall accrue without an obligation of repayment prior to the fourth anniversary of the Agreement and (b) the Seller agreed to purchase water credits from the District for San Diego County water mitigation requirements applicable to the Seller's Yaqui Pass Development or any other development within the District's boundaries at no less than $5,500 per credit.

- On August 18, 2011, The District entered into an agreement for development of a planning grant application proposal to the California Department of Water Resources (DWR) Integrated Regional Water Resources (IRWM) planning grants program with RMC Water & Environment, a California corporation located in San Diego. The total cost for this consulting work was $53,462. A planning grant proposal for $841,779 was submitted to DWR in March 2012.

- On November 1, 2011 the District entered into a lease agreement to maintain a golf course located at Club Circle, Borrego Springs, California. This lease terminated a prior 20-year lease and easement entered into November 23, 2010. The term of the new lease commenced on November 1, 2011 and will terminate June 30, 2015. The District has the option to extend the lease for an additional period of five (5) years from the original expiration date of the lease. The District will pay $1 rent per year the lease is in effect.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

FINANCIAL HIGHLIGHTS (Continued)

- On November 1, 2011 the District also entered into a maintenance agreement with Green Desert Landscape to maintain and operate a golf course located at Club Circle, Borrego Springs, California. The term of the maintenance agreement commenced on November 1, 2011 and will terminate June 30, 2015. The agreement may be renewed by mutual agreement of the parties for an additional period of five (5) years from the original expiration date of the agreement. The agreement calls for Green Desert Landscape to maintain and operate the golf course at Club Circle. The District pays a management fee to Green Desert Landscape of $5,400 per month. Green Desert Landscape is entitled to all revenues produced by the operations of the golf course under the terms of the lease.

- In March 2012, the Operations & Management Committee of the Board completed a review of the potential cost savings from an Automated Meter Reading System (AMR). The conclusion of the review is that AMR is not a cost saving option for the District at this time.

- The loss from operating activities for the year ended June 30, 2012 was $218,645 compared with a loss from operation activities of $1,262,672 for FY 2011.

- Cash and cash equivalents were lower at the end of fiscal year ended June 30, 2012 by $8,296 compared with $1,695,187 less cash and cash equivalents at the end of FY 2011 than at the beginning of FY 2011.

- The change in net assets decreased at the end of fiscal year ended June 30, 2012 by $258,207 compared to a decrease in net assets of $2,813,340 at the end of FY 2011.

More information about the overall analysis of the District's financial position and results of operations is provided in the following sections.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

OVERVIEW OF THE FINANCIAL STATEMENTS

The financial statements accompanying the Management's Discussion and Analysis present the financial position, the results of operations, and cash flow using the accrual basis of accounting, which is similar to the accounting basis used by for-profit entities.

Statement of Net Assets

The Statement of Net Assets presents the District's financial position (assets and liabilities) as of June 30, 2012. Assets in excess of liabilities (Net Assets) were $12,860,887 and $13,119,094 as of June 30, 2012 and 2011, respectively. In accordance with generally accepted accounting principles (GAAP), capital assets are recorded at historical cost. Net assets are accumulated from revenues in excess of expenses, and contributed capital combined with the beginning balance of net assets as presented in the Statement of Revenues, Expenses and Changes in Net Assets.

Statement of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets presents the District's results of operations for the year ended June 30, 2012 and 2011. In accordance with GAAP, revenues are recognized (recorded) when water or services are provided, and expenses are recognized when incurred. Operating revenues and expenses are related to the District's core activities (providing water, sewer, pest control and flood control services). Nonoperating revenues and expenses are not directly related to the core activities, e.g. investment income, interest expense, etc. The operating loss for the year ended June 30, 2012 ($218,645) is combined with net non operating revenues and expenses of ($57,562) and capital contributions of $18,000 to arrive at the change of net assets of ($258,207). The decrease in net assets is subtracted from beginning net assets of $13,119,094 to arrive at the ending net assets of $12,860,887 as of June 30, 2012.

One of the most important questions asked about the District's finances is, "How has the District's position changed as the result of this year's activities?" The Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets present information about the District's activities that help answer this question. These two statements report the net assets of the District and the changes to them. The District's net assets, the difference between assets and liabilities, may be thought of as one way to measure its financial health or financial position. Over time, increases or decreases in net assets can be an indicator as to whether the financial health is improving or deteriorating. However, it is incumbent upon the observer to consider other non-financial factors such as the regulatory climate, economic conditions, population growth, zoning changes, environmental changes, etc.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

Analysis of Net Assets

Our analysis will start with a summary of the District's Net Assets as presented in the following table:

Borrego Water District's Net Assets

	2012	2011	2010	2011/2012 Change $	2011/2012 Change %
Cash and investments	$ 1,017,355	$ 1,025,651	$ 2,720,838	$ (8,296)	-0.81%
Capital assets	14,827,998	15,166,652	16,705,978	(338,654)	-2.23%
Other assets	824,251	802,130	780,781	22,121	2.76%
Total assets	16,669,604	16,994,433	20,207,597	(324,829)	-1.91%
Current liabilities	318,531	317,709	325,594	822	0.26%
Noncurrent liabilities	3,490,186	3,557,630	3,949,569	(67,444)	-1.90%
Total liabilities	3,808,717	3,875,339	4,275,163	(66,622)	-1.72%
Net assets					
Invested in capital assets net of related debt	11,442,616	11,864,985	13,563,426	(422,369)	-3.56%
Restricted	-	-	187,887	-	0.00%
Unrestricted	1,418,271	1,254,109	2,181,121	164,162	13.09%
Total net assets	$ 12,860,887	$ 13,119,094	$ 15,932,434	$ (258,207)	-1.97%

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

Analysis of Revenues and Expenses

Borrego Water District's Revenues, Expenses and Changes in Net Assets

	2012	2011	2010	2011/2012 Change $	2011/2012 Change %
OPERATING REVENUES:					
Water revenue	$ 2,136,794	$ 2,017,147	$ 2,076,154	$ 119,647	5.93%
Sewer service charges	457,568	408,889	400,897	48,679	11.91%
Availability charges	340,828	275,946	285,316	64,882	23.51%
Golf revenue	77,855	70,802	-	7,053	9.96%
Other income	22,981	20,551	160,629	2,430	11.82%
Total operating revenues	3,036,026	2,793,335	2,922,996	242,691	8.69%
NONOPERATING REVENUES:					
Property taxes	88,792	123,071	78,306	(34,279)	-27.85%
Investment income	255	2,503	6,186	(2,248)	-89.81%
Gain on sale of asset	-	-	1,500	-	0.00%
Grant income	31,881	234,869	-	(202,988)	-86.43%
Total nonoperating revenues	120,928	360,443	85,992	(239,515)	-66.45%
CAPITAL CONTRIBUTIONS	18,000	-	43,302	18,000	100.00%
TOTAL REVENUES:	3,174,954	3,153,778	3,052,290	21,176	0.67%
OPERATING EXPENSES:					
Water operations	1,031,970	1,104,916	1,327,177	(72,946)	-6.60%
Sewer operatons	283,719	212,471	197,941	71,248	33.53%
Golf operations	95,229	111,737	-	(16,508)	-14.77%
Depreciation expense	584,166	637,474	605,092	(53,308)	-8.36%
General and administrative	1,259,587	1,989,409	1,585,275	(729,822)	-36.69%
Total operating expenses	3,254,671	4,056,007	3,715,485	(801,336)	-19.76%
NONOPERATING EXPENSES:					
Loss on disposal of assets	4,146	1,744,420	-	(1,740,274)	-99.76%
Interest expense	167,856	160,203	159,739	7,653	4.78%
Amortization expense	6,488	6,488	6,488	-	0.00%
Total nonoperating expenses	178,490	1,911,111	166,227	(1,732,621)	-90.66%
TOTAL EXPENSES:	3,433,161	5,967,118	3,881,712	(2,533,957)	-42.47%
Change in net assets	(258,207)	(2,813,340)	(829,422)	2,555,133	-90.82%
TOTAL NET ASSETS BEGINNING	13,119,094	15,932,434	16,761,856	(2,813,340)	-17.66%
TOTAL NET ASSETS ENDING	$ 12,860,887	$ 13,119,094	$ 15,932,434	$ (258,207)	-1.97%

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

A discussion of the significant variances of the Borrego Water District's Revenues and Expenses are presented below.

- Total operating revenue increased due to the increase in water rates for FY 2012 netted with a decrease in other income due to change in an agreement for maintaining the Club Circle Golf Course.
- Total nonoperating income decreased due to a decrease in grant income.
- The County of San Diego quitclaimed a piece of property to the District located at the lift station to increase capital contributions of $18,000.
- Sewer operations expense increased due to various items including $10,000 for cutting blades and $9,100 to repair a splitter box at the waste water treatment plant.
- General and Administrative expense decreased primarily from cost-cutting measures – Decrease in salaries, contract labor, groundwater study, administrative services, insurance, employee benefits, office expenses, legal expenses and conference/travel expenses.

BUDGET HIGHLIGHTS

Fiscal Year 2012 Actual vs. Fiscal Year 2012 Budget

	2012 Actual	2012 Budget	Variance $	Variance %
Revenues:				
From operations	$ 3,036,026	$ 2,435,548	$ 600,478	24.65%
Nonoperating	120,928	82,673	38,255	46.27%
Total revenue	3,156,954	2,518,221	638,733	25.36%
Expenses				
Water operations	1,031,970	835,012	196,958	23.59%
Sewer operations	283,719	208,752	74,967	35.91%
Depreciation expense	584,166	-	584,166	100.00%
General and administrative and golf operations	1,354,816	1,274,582	80,234	6.29%
Loss on disposal of assets	4,146	-	4,146	100.00%
Other nonoperating expenses	174,344	199,875	(25,531)	-12.77%
Total expenses	3,433,161	2,518,221	914,940	36.33%
Capital contributions	18,000	-	18,000	100.00%
Change in net assets	$ (258,207)	$ -	$ (258,207)	100.00%

- Borrego Water District does not budget for depreciation, but prefers to budget for actual capital assets using the internally generated 10 year Capital Improvement Budget.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

CAPITAL ASSETS AND DEBT ADMINISTRATION

CAPITAL ASSETS

At the end of the fiscal year the District had a net investment in various categories of Capital Assets as shown in the following table.

Borrego Water District's Capital Assets

				2011/2012 Change	
	2010	2011	2012	$	%
Land and land improvements	$ 949,829	$ 949,829	$ 967,829	$ 18,000	1.90%
Flood control facilities	4,319,604	4,319,604	4,319,604	-	0.00%
Sewer facilities	5,836,290	5,776,212	5,780,431	4,219	0.07%
Water facilities	9,517,058	9,672,863	9,899,186	226,323	2.34%
Pipelines, wells and tanks	1,273,895	1,273,895	1,273,895	-	0.00%
General facilities	1,009,060	1,009,060	1,009,060	-	0.00%
Telemetry	67,530	67,530	29,081	(38,449)	-56.94%
Equipment and furniture	341,989	341,989	294,673	(47,316)	-13.84%
Vehicles	480,074	480,074	480,074	-	0.00%
Construction in progress	1,330,937	235,263	181,778	(53,485)	-22.73%
Fallowed water cedits	798,214	792,714	802,714	10,000	1.26%
Water rights-ID #4	185,000	185,000	185,000	-	0.00%
Total assets	26,109,480	25,104,033	25,223,325	119,292	0.48%
Less accumulated depreciation	(9,403,502)	(9,937,381)	(10,395,327)	457,946	4.61%
Net capital assets	$ 16,705,978	$ 15,166,652	$ 14,827,998	$ (338,654)	-2.23%

- Increase in water facilities is due to the Well 12 agreement water rate increase escalator of $118,387, pipeline replacements and well motor repairs.
- Decrease in Telemetry and Equipment /Furniture is due to assets no longer in service.
- Decrease in Construction in progress is due to pipeline project completion.

DEBT ADMINISTRATION

On October 1, 2008, the District issued $2,775,000 of 2008 Bonds while concurrently redeeming all of its outstanding 1997 & 1998 Certificates of Participation.

The bonds are payable in annual principal installments of $25,000 to $245,000 on October 1 of each year beginning 2013 through 2028. Interest is payable semi-annually on April 1 and October 1 at an interest rate of 6.000% per annum. The bonds are payable solely from installment payments to be made by the District to the Borrego Water District Public Facilities Corporation. The installment payments are a special obligation of the District payable solely from revenues of Improvement District No. 4 and certain funds and accounts created by agreement.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

The annual requirements to amortize the Installment Purchase Agreement are as follows:

For the Year Ending June 30	Principal	Interest	Total
2013	$ -	$ 124,875	$ 124,875
2014	25,000	124,313	149,313
2015	135,000	120,713	255,713
2016	140,000	114,525	254,525
2017	145,000	108,113	253,113
2018-2022	830,000	434,250	1,264,250
2023-2027	1,025,000	226,013	1,251,013
2028-2030	475,000	21,713	496,713
Totals	$ 2,775,000	$ 1,274,515	$ 4,049,515

During the year ended 2012, the Montesoro note payable increased from $689,234 to $762,946 due to a clause in the note which states that in the event the District increases water rates the annual payments increase by the same percentage.

ECONOMIC FACTORS AND FUTURE YEAR'S BUDGET AND RATES

The District's Board of Directors and management considered many factors when setting the fiscal year 2012/2013 budget, user fees and charges. The District attempts to balance revenues with operating expenses that have increased due to inflationary factors, such as cost of living, cost of water, and insurance coverage.

These indicators were taken into consideration when adopting the District's budget for the fiscal year 2012/2013. The budget has been structured to contain costs, but at the same time, continue the District's philosophy of providing the highest levels of service and continue efforts towards securing a sustainable water supply for the community.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

Fiscal Year 2012 Actual vs. Fiscal Year 2013 Budget

	2012 Actual	2013 Budget	2012/2013 Change $	2012/2013 Change %
Revenues:				
Operating Revenue	$ 3,036,026	$ 3,365,033	$ 329,007	10.84%
Nonoperating	120,928	68,174	(52,754)	-43.62%
Total revenue	3,156,954	3,433,207	276,253	8.75%
Expenses				
Operating expenses excluding depreciation	2,670,505	2,552,932	(117,573)	-4.40%
Depreciation	584,166	-	(584,166)	-100.00%
Loss on disposal of assets	4,146	-	(4,146)	-100.00%
Other nonoperating expenses	174,344	231,560	57,216	32.82%
Total expenses	3,433,161	2,784,492	(648,669)	-18.89%
Capital contributions	18,000	-	(18,000)	-100.00%
Change in net assets	(258,207)	648,715	906,922	351.24%

- Borrego Water District does not budget for depreciation, but prefers to budget for actual capital assets using the internally generated 10 year Capital Improvement Budget.

CONTACTING THE DISTRICT'S FINANCIAL MANAGER

This financial report is designed to give ratepayers, customers, investors, and creditors a general overview of the District's finances and to demonstrate the District's accountability for the money it receives and the stewardship of the facilities it maintains. If you have questions about this report or need additional information, contact Jerry Rolwing, General Manager or Kim Pitman, Fiscal Officer at the Borrego Water District.

Statements of Net Assets
June 30, 2012 and 2011

	2012	2011
Assets		
Current Assets:		
Cash and cash equivalents (Notes 1 and 2)	$ 871,863	$ 751,785
Restricted cash and cash equivalents (Notes 1 and 2):		
Customer deposits	27,571	27,571
Accounts receivable, net of allowance (Note 1):		
Water and sewer charges	413,073	335,692
Property taxes	3,478	2,870
Availability charges	78,070	55,556
Grant receivable	-	99,869
Other	17,211	23,604
Inventory (Note 1)	132,739	124,942
Prepaid expenses	41,218	47,679
Total Current Assets	1,585,223	1,469,568
Noncurrent Assets:		
Water and sewer charges receivable	33,032	-
Deferred debt issuance costs, net of amortization	105,430	111,918
Fiduciary fund:		
Restricted cash and cash equivalents (Notes 1, 2 and 5)	117,921	246,295
Capital assets not being depreciated (Notes 1 and 3):		
Land	967,829	949,829
Construction in progress	181,778	235,263
Fallowed water credits	802,714	792,714
Water rights - ID4	185,000	185,000
Depreciable capital assets, net of accumulated depreciation (Notes 1 and 3)	12,690,677	13,003,846
Total capital assets, net of accumulated depreciation	14,827,998	15,166,652
Total Noncurrent Assets	15,084,381	15,524,865
Total Assets	16,669,604	16,994,433

(continued)

(continued)

Statements of Net Assets
June 30, 2012 and 2011

	2012	2011
Liabilities		
Current Liabilities:		
Unrestricted:		
Accounts payable	$ 76,320	$ 102,220
Compensated absences (Notes 1 and 4)	83,226	86,699
Accrued interest payable	64,195	56,543
Current portion of note payable (Note 4)	67,219	44,676
Restricted:		
Customer deposits	27,571	27,571
Total Current Liabilities	318,531	317,709
Noncurrent Liabilities:		
Compensated absences (Notes 1 and 4)	54,102	54,344
Fiduciary fund:		
Amount payable to community facilities dist 2007-1 bondholders (Note 5)	117,921	246,295
Installment purchase agreement (Note 4)	2,622,437	2,612,433
Note payable (Note 4)	695,726	644,558
Total Noncurrent Liabilities	3,490,186	3,557,630
Total Liabilities	3,808,717	3,875,339
Net Assets		
Invested in capital assets, net of related debt	11,442,616	11,864,985
Unrestricted (Note 6)	1,418,271	1,254,109
Total Net Assets	$ 12,860,887	$ 13,119,094

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

Statements of Revenues, Expenses & Changes in Net Assets
For the Years Ended June 30, 2012 and 2011

	2012	2011
Operating Revenues		
Water revenue	$ 2,136,794	$ 2,017,147
Sewer service charges	457,568	408,889
Availability charges	340,828	275,946
Golf revenue	77,855	70,802
Other income	22,981	20,551
Total Operating Revenues	3,036,026	2,793,335
Operating Expenses		
Water operations	1,031,970	1,104,916
Sewer operations	283,719	212,471
Golf operations	95,229	111,737
Depreciation expense	584,166	637,474
General and administrative	1,259,587	1,989,409
Total Operating Expenses	3,254,671	4,056,007
Operating Income (Loss)	(218,645)	(1,262,672)
Nonoperating Revenues (Expenses)		
Property taxes	88,792	123,071
Investment income	255	2,503
Grant income	31,881	234,869
Loss on disposal of assets	(4,146)	(1,744,420)
Interest expense	(167,856)	(160,203)
Amortization expense	(6,488)	(6,488)
Total Nonoperating Revenues (Expenses)	(57,562)	(1,550,668)
Income before capital contributions	(276,207)	(2,813,340)
Capital contributions	18,000	-
Change in Net Assets	(258,207)	(2,813,340)
Net Assets, Beginning	13,119,094	15,932,434
Net Assets, Ending	$ 12,860,887	$ 13,119,094

Statements of Cash Flows
For The Years Ended June 30, 2012 and 2011

	2012	2011
Cash Flows from Operating Activities		
Receipts from water and sewer customers	$ 2,483,949	$ 2,398,911
Receipts from availability charges	136,624	101,432
Receipts from golf course	77,855	70,802
Payments to suppliers	(308,452)	(406,248)
Payments to employees	(1,298,886)	(1,444,335)
Payments for general and administration	(793,595)	(1,183,317)
Payments for golf course	(95,229)	(111,737)
Other receipts	5,770	20,551
Net Cash Provided (Used) by Operating Activities	208,036	(553,941)
Cash flows from Noncapital Financing Activities		
Taxes received	88,184	122,203
Proceeds from Grant	131,750	135,000
Deposits paid	-	(8,815)
Net Cash Provided (Used) by Noncapital and Related Financing Activities	219,934	248,388
Cash Flows From Capital and Related Financing Activities		
Acquisition and construction of capital assets	(239,983)	(848,067)
Proceeds on sale of asset	8,325	5,500
Proceeds from debt issuance	118,387	194,251
Principal paid on long-term debt	(44,676)	(45,140)
Interest payments on long-term debt	(150,200)	(149,735)
Community facilities dist 2007-1 receipts and payments, net	(128,374)	(548,946)
Net Cash Provided (Used) by Capital and Related Financing Activities	(436,521)	(1,392,137)
Cash Flows from Investing Activities		
Interest received	255	2,503
Net Cash Provided (Used) by Investing Activities	255	2,503
Net Increase (Decrease) in Cash and Cash Equivalents	(8,296)	(1,695,187)
Cash and Cash Equivalents, Beginning of the Year	1,025,651	2,720,838
Cash and Cash Equivalents, End of the Year	$ 1,017,355	$ 1,025,651
Reconciliation of Operating Income (Loss) to Net Cash Flows Provided by Operating Activities:		
Operating income (Loss)	$ (218,645)	$ (1,262,672)
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	584,166	637,474
Changes in operating assets and liabilities:		
(Increase) Decrease in accounts receivable, water and sewer charges	(110,413)	(27,125)
(Increase) Decrease in other receivable	6,393	-
(Increase) Decrease in availability charges receivable	(22,514)	102,720
(Increase) Decrease in inventories	(7,797)	5,807
(Increase) Decrease in prepaid expenses	6,461	(8,502)
Increase (Decrease) in accounts payable	(25,900)	(6,557)
Increase (Decrease) in compensated absences	(3,715)	4,914
Net Cash Provided (Used) by Operating Activities	$ 208,036	$ (553,941)
Noncash Capital, Investing and Financing Activities:		
Amortization related to long term debt	$ 16,492	$ 16,492
Contributed capital for water and sewer system	18,000	-

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

a. Reporting Entity:

The reporting entity "Borrego Water District" (District) includes the accounts of the general District, the related improvement districts within the service area of the general District, and the Borrego Water District Public Facilities Corporation (Corporation).

The Borrego Water District was formed in 1962, under provisions of the California Water District Act Division 13 of the California Water Code. The District was inactive until December 31, 1979 when the San Diego County Local Agency Formation Commission reactivated the District to provide construction funding, and to operate and maintain water, sewer, and flood control facilities of the District.

The Borrego Water District Public Facilities Corporation (Corporation) is a California public benefit non-profit corporation formed May 31, 1996. The Corporation was formed for the purpose of facilitating the purchase of the Borrego Springs Water Company by the District.

The criteria used in determining the scope of the reporting entity are based on the provisions of GASB Statement 14. The District is the primary government unit. Component units are those entities that are financially accountable to the primary governmental unit, either because the District appoints a voting majority of the component unit's Board, or because the component unit will provide 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 unit is so intertwined with the District that it is in substance, part of the District's operations. Accordingly, the balances and transactions of the Corporation are included in the District's financial statements.

The District is governed by an elected board of directors. At June 30, 2012, the board consisted of:

Beth Hart – President
Lyle Brecht- Vice President
Marshal Brecht - Secretary/Treasurer
Ray Delahay - Director
Lee Estep - Director

b. Measurement Focus and Basis of Accounting and Financial Statement Presentation:

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

The basic financial statements of the Borrego Water District have been prepared in conformity with accounting principles generally accepted in the United States of America. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for governmental accounting financial reporting purposes.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

b. Measurement Focus and Basis of Accounting and Financial Statement Presentation (continued):

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

- Invested in capital assets, net of related debt – This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds are not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.

- Restricted – This component of net assets consists of constraints placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation. The District had no restricted net assets as of June 30, 2012 and 2011.

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

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

The District distinguishes between operating and nonoperating revenues and expenses. Operating revenues and expenses of the District consist of charges for services and the cost for providing for these services, including depreciation and excluding interest costs. All other revenues and expenses are reported as nonoperating.

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

c. Capital Assets and Depreciation:

Capital assets are valued at cost when constructed or purchased. Donated assets are valued at their estimated fair market value on the date accepted. The District capitalizes all assets with a historical cost of at least $5,000 and a useful life of more than one year. The cost of normal maintenance and repairs that do not add to the value of assets or materially extend asset lives are not capitalized. Depreciation on capital assets in service, excluding land, is computed using the straight-line method over the estimated useful lives of such assets and is reported as an operating expense. Capital projects are subject to depreciation when completed and placed in service. The ranges of estimated useful lives of capital assets are as follows:

Flood control facilities	100 years
Sewer facilities	5 - 75 years
Water facilities	7 - 40 years
Pipelines, wells and tanks	5 - 50 years
Equipment and general facilities	5 - 20 years

d. Water and Sewer Service Fees:

The District assesses water revenue and sewer service charges on all of its customers billed and collected by the District. These fees are assessed in order to provide operating revenue to cover the District's current operating expenses.

e. Claims and Judgments:

When it is probable that a claim liability has been incurred at year-end, and the amount of the loss can be reasonably estimated, the District records the estimated loss, net of any insurance coverage under its self-insurance program. Liabilities include an amount for claims that have been incurred but not reported (IBNR). At June 30, 2012, in the opinion of District counsel and management, the District had no IBNR claims which would require loss provision in the financial statements. Small dollar claims and judgments are recorded as expenses when paid.

f. Cash and Cash Equivalents:

For purposes of the statement of cash flows, the District considers all highly liquid investments with a maturity of three months or less when purchased to be cash and cash equivalents. The District considers investment pool deposits held in the California Local Agency Fund (Note 2) and deposits held in money market funds at US Bank and Wells Fargo to be highly liquid.

g. Investments:

Investments are stated at fair value (quoted market price or best estimate thereof, see Note 2). There was no significant difference between the fair value of investments and the basis at June 30, 2012 or June 30, 2011.

h. Maintenance Costs:

All expenditures for maintenance and repair of property, including renewals of minor items, are charged to the appropriate maintenance expense accounts. A betterment or replacement of a unit of property is accounted for as an addition and retirement of property.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

i. Property Taxes and Availability Charges:

Property tax in California is levied in accordance with Article 13A of the State Constitution at one percent of county-wide assessed valuations. This levy is allocated pursuant to state law to the appropriate units of local government. In addition, the District assesses property taxes for payments of bond principal and interest and assesses availability charges for operating revenue through the property tax rolls. Property tax revenue and availability charges are recognized in the fiscal year in which they have been levied.

The property tax calendar is as follows:

Lien Date:	January 1st
Levy Date:	July 1st
Due Date:	First Installment - November 1st
	Second Installment - February 1st
Delinquent Date:	First Installment - December 10th
	Second Installment - April 10th

j. Budgets and Budgetary Accounting:

An annual budget is adopted for the District. Monthly comparisons between actual and budgeted amounts are made by management. The budget is prepared on a cash basis and the financial statements are presented on the accrual basis of accounting. A comparison of the two has not been presented.

k. Restricted Assets:

Amounts shown as restricted assets have been restricted by either bond indentures, law, or contractual obligations to be used for specified purposes, such as servicing bonded debt and expansion of the sewer system.

l. Allowance for Doubtful Accounts:

An allowance for doubtful accounts is provided based on anticipated collectability of the outstanding utility receivables and other receivables at year-end. At fiscal year ended June 30, 2012 and June 30, 2011 management has estimated an allowance for doubtful accounts for availability charges at $458,910 and $277,233, respectively. Management estimates all other receivables at June 30, 2012 to be collectible, as any receivables deemed uncollectible have been written off.

m. Use of Estimates:

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

n. Inventory:

Inventory is valued at average cost. It consists of meters, pipes and other parts required to provide water and sewer service to customers. Inventory uses the consumption method whereby it is reported as an asset and expensed when consumed.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

   o. Compensated Absences:

      A liability is recorded for unused vacation and sick leave balances since the employees' entitlement to these balances are attributable to services already rendered and it is probable that virtually all of these balances will be liquidated by either paid time-off or payment upon termination or retirement.

   p. Reclassifications:

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

2. CASH, CASH EQUIVALENTS AND INVESTMENTS:

Cash, cash equivalents and investments are classified in the accompanying financial statements at June 30, 2012 and 2011 as follows:

	2012	2011
Statement of Net Assets:		
Cash and cash equivalents	$ 871,863	$ 751,785
Restricted cash and cash equivalents:		
Customer deposits	27,571	27,571
Cash and cash equivalents before fiduciary funds	899,434	779,356
Fiduciary funds:		
Cash and cash equivalents	117,921	246,295
Total cash, cash equivalents and investments	$ 1,017,355	$ 1,025,651

Cash, cash equivalents and investments as of June 30, 2012 and 2011 consist of the following:

	2012	2011
Cash on hand	$ 182	$ 49
Deposits with financial institutions	996,359	1,004,865
Investments	20,814	20,737
Total cash, cash equivalents and investments	$ 1,017,355	$ 1,025,651

2. CASH, CASH EQUIVALENTS AND INVESTMENTS (Continued):

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

The table below identifies the investment types that are authorized for the District by the California Government Code (or the District's investment policy, where more restrictive). The table also identifies certain provisions of the California Government Code (or the District's investment policy, where more restrictive) that address interest rate risk, credit risk, and concentration of credit risk. This table does not address investments of debt proceeds held by bond 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
Local Agency Investment Fund (LAIF)	N/A	98%	$ 50,000,000
Certificates of Deposit and Savings Accounts	N/A	95%	None
U.S. Government Bills, Notes, Bonds, and Money Market Mutual Funds which invest entirely in U.S. Government Bills, Notes, and Bonds	5 years	20%	None

Disclosures Relating to Interest Rate Risk:

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

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

Investment Type	Amount	Weighted Average Duration (in years)
Local Agency Investment Fund	$ 20,814	-

2. CASH, CASH EQUIVALENTS AND INVESTMENTS (Continued):

As of June 30, 2011, the District had the following investments:

Investment Type	Amount	Weighted Average Duration (in years)
Local Agency Investment Fund	$ 20,737	-

Disclosures Relating to Credit Risk:

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented in the following table are the Standard and Poor's credit ratings for the District's investments.

The District's investment policy, or debt agreements and the actual rating as of the year ended June 30, 2012 for each investment type are as follows:

Investment	Total	Minimum Legal Rating	AAA	Unrated
Local Agency Investment Fund	$ 20,814	N/A	$ -	$ 20,814

The District's investment policy, or debt agreements and the actual rating as of the year ended June 30, 2011 for each investment type are as follows:

Investment	Total	Minimum Legal Rating	AAA	Unrated
Local Agency Investment Fund	$ 20,737	N/A	$ -	$ 20,737

2. CASH, CASH EQUIVALENTS 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. The California Government Code and the District's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure District deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits. At June 30, 2012, the District's deposits (bank balances) were insured by the Federal Depository Insurance Corporation up to $250,000 per institution and the remaining balance of the deposits of $679,029 were collateralized under California Law. The difference between the bank balances and deposits represent deposits in transit and outstanding checks.

California Local Agency Investment Fund (LAIF):

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.

3. CAPITAL ASSETS:

A summary of changes in Capital Assets in service is as follows for the year ended June 30, 2012:

	Balance June 30, 2011	Additions	Deletions	Balance June 30, 2012
Capital assets, not depreciated:				
Land	$ 949,829	$ 18,000	$ -	$ 967,829
Construction in progress	235,263	25,114	(78,599)	181,778
Fallowed water credits	792,714	10,000	-	802,714
Water rights - ID 4	185,000	-	-	185,000
Total capital assets not depreciated	2,162,806	53,114	(78,599)	2,137,321
Capital assets, being depreciated:				
Flood control facilities	4,319,604	-	-	4,319,604
Sewer facilities	5,776,212	13,685	(9,466)	5,780,431
Water facilities	9,672,863	240,702	(14,379)	9,899,186
Pipelines, wells and tanks	1,273,895	-	-	1,273,895
General facilities	1,009,060	-	-	1,009,060
Telemetry system	67,530	29,081	(67,530)	29,081
Equipment and furniture	341,989	-	(47,316)	294,673
Vehicles	480,074	-	-	480,074
Total capital assets, being depreciated	22,941,227	283,468	(138,691)	23,086,004
Less accumulated depreciation	(9,937,381)	(584,166)	126,220	(10,395,327)
Total capital assets being depreciated, net	13,003,846	(300,698)	(12,471)	12,690,677
Total capital assets, net	$ 15,166,652	$ (247,584)	$ (91,070)	$ 14,827,998

Depreciation expense for the year ended June 30, 2012 was $584,166.

3. CAPITAL ASSETS (Continued):

A summary of changes in Capital Assets in service is as follows for the year ended June 30, 2011:

	Balance June 30, 2010	Additions	Deletions	Balance June 30, 2011
Capital assets, not depreciated:				
Land	$ 949,829	$ -	$ -	$ 949,829
Construction in progress	1,330,937	650,039	(1,745,713)	235,263
Fallowed water credits	798,214		(5,500)	792,714
Water rights - ID 4	185,000	-	-	185,000
Total capital assets not depreciated	3,263,980	650,039	(1,751,213)	2,162,806
Capital assets, being depreciated:				
Flood control facilities	4,319,604	-	-	4,319,604
Sewer facilities	5,836,290	681,177	(741,255)	5,776,212
Water facilities	9,517,058	216,568	(60,763)	9,672,863
Pipelines, wells and tanks	1,273,895	-	-	1,273,895
General facilities	1,009,060	-	-	1,009,060
Telemetry system	67,530	-	-	67,530
Equipment and furniture	341,989	-	-	341,989
Vehicles	480,074	-	-	480,074
Total capital assets, being depreciated	22,845,500	897,745	(802,018)	22,941,227
Less accumulated depreciation	(9,403,502)	(637,474)	103,595	(9,937,381)
Total capital assets being depreciated, net	13,441,998	260,271	(698,423)	13,003,846
Total capital assets, net	$ 16,705,978	$ 910,310	$ (2,449,636)	$ 15,166,652

Depreciation expense for the year ended June 30, 2011 was $637,474.

4. LONG-TERM DEBT:

A summary of changes in long-term debt for the year ending June 30, 2012 consist of following:

	Balance at June 30, 2011	Additions	Deletions	Balance at June 30, 2012	Due Within One Year
2008 Installment Purchase Agreement	$ 2,775,000	$ -	$ -	$ 2,775,000	$ -
Less deferred amounts: On refunding	(162,567)	-	10,004	(152,563)	-
Total Installment Purchase Agreement	2,612,433	-	10,004	2,622,437	-
Montesoro Note Payable	689,234	118,387	(44,676)	762,945	67,219
Compensated Absences	141,043	76,810	(80,525)	137,328	83,226
Total Long-Term Debt	$ 3,442,710	$ 195,197	$ (115,197)	$ 3,522,710	$ 150,445

A summary of changes in long-term debt for the year ending June 30, 2011 consist of following:

	Balance at June 30, 2010	Additions	Deletions	Balance at June 30, 2011	Due Within One Year
2008 Installment Purchase Agreement	$ 2,775,000	$ -	$ -	$ 2,775,000	$ -
Less deferred amounts: On refunding	(172,571)	-	10,004	(162,567)	-
Total Installment Purchase Agreement	2,602,429	-	10,004	2,612,433	-
Montesoro Note Payable	540,123	194,251	(45,140)	689,234	44,676
Compensated Absences	136,129	76,810	(71,896)	141,043	86,699
Total Long-Term Debt	$ 3,278,681	$ 271,061	$ (107,032)	$ 3,442,710	$ 131,375

4. LONG-TERM DEBT (Continued):

a. 2008 Installment Purchase Agreement:

On October 1, 2008, the District issued $2,775,000 of 2008 Bonds while concurrently redeeming all of its outstanding 1997 Certificates of Participation and 1998 Certificates of Participation. The transaction was a current refunding intended to save the District future interest costs due to lower market interest rates. No new funds were raised by the District. New Installment Purchase Agreements were executed, which will save the District approximately $36,000 per year on debt service. The District reduced its aggregate debt service payments by $312,755 over the next twenty (20) years and obtained an economic gain (difference between the present value of the old and new debt service payments) of $259,110.

The bonds are payable in annual principal installments of $25,000 to $245,000 on October 1 of each year beginning 2013 through 2028. Interest is payable semi-annually on April 1 and October 1 at an interest rate of 6.000% per annum. The installment payments are a special obligation of the District payable solely from revenues of Improvement District No. 4.

The future debt service for the Installment Purchase Agreement are as follows:

For the Year Ending June 30	Principal	Interest	Total
2013	$ -	$ 124,875	$ 124,875
2014	25,000	124,313	149,313
2015	135,000	120,713	255,713
2016	140,000	114,525	254,525
2017	145,000	108,113	253,113
2018-2022	830,000	434,250	1,264,250
2023-2027	1,025,000	226,013	1,251,013
2028-2030	475,000	21,713	496,713
Totals	$ 2,775,000	$ 1,274,515	$ 4,049,515

b. Debt Covenants:

The District debt issue described above contains various covenants and restrictions, principally that the District shall fix, prescribe and collect revenues sufficient enough to yield net revenues of Improvement District No. 4 equal to at least 1.15 times the loan installments coming due and payable during any fiscal year. The District was in compliance with this covenant for the fiscal years ended June 30, 2012 and 2011.

c. Compensated absences

Compensated absences represent the estimated liability for employees' accrued vacation and sick leave for which employees are entitled to be paid upon termination.

4. LONG-TERM DEBT (Continued):

d. Note Payable:

In July 2009 the District entered into an agreement to purchase a well and land from Montesoro. For consideration the District paid an initial amount of $400,000 and issued a note that calls for ten (10) annual payments of $70,000 commencing on July 1, 2010. In the event the District increases the water rate charged for water service the annual payments increase by the percentage amount equal to the difference between water rate for water service on August 1, 2009 and the new water rate. For the fiscal year ended June 30, 2011 the present value of these payments at five percent (5%) was $689,234. During the fiscal year ended June 30, 2012 there was an additional rate increase of 20% increasing the annual payments to $120,196 commencing July 1, 2012. At fiscal year ended June 30, 2012 the present value of these payments at five percent (5%) was $762,945.

The future debt service for the Montesoro note payable is as follows:

For the Year Ending June 30	Principal	Interest	Total
2013	$ 67,219	$ 32,977	$ 100,196
2014	85,449	34,786	120,235
2015	89,721	30,514	120,235
2016	94,208	26,027	120,235
2017	98,918	21,317	120,235
2018-2020	327,430	33,274	360,704
Totals	$ 762,945	$ 178,895	$ 941,840

5. FIDUCIARY FUNDS:

Fiduciary funds are used to account for assets held by the District in a trustee capacity or as an agent for individuals, private organizations, other governments, and/or other funds. Fiduciary funds are custodial in nature (assets equal liabilities) and do not involve measurement of results of operations. The District's Fiduciary fund includes the Community Facilities District 2007-1 Mello-Roos Bond Fund. The assets and related liabilities of this Fiduciary fund is included in the accompanying Statement of Net Assets under the captions “Fiduciary fund: restricted cash and cash equivalents,” and “Fiduciary fund: amount payable to Community Facilities Dist 2007-1 bondholders” respectively.

6. JOINT POWERS AUTHORITY:

Since 1983, the District has participated in the Association of California Water Agencies Joint Powers Insurance Authority (JPIA), a risk-pooling self-insurance authority. JPIA is a consortium of public agencies in Southern California established under the provisions of California Government Code. The purpose of the authority is to arrange and administer programs of insurance for the pooling of self-insured losses and to purchase excess insurance coverage. Deposits to JPIA are expensed by the District over the policy term and are subject to retroactive adjustment.

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

Property Loss – Insured up to $8,675,281 replacement value with varying deductibles; the Authority is self-insured up to $50,000 and excess insurance coverage has been purchased from $50,000 to $100,050,000.

General Liability – Insured up to $60,000,000 per occurrence with no deductible; the Authority is self-insured up to $2,000,000 and excess insurance coverage has been purchased from $2,000,000 to $60,000,000.

Auto Liability – Insured up to $60,000,000 per occurrence with a $1,000 deductible; the Authority is self-insured up to $2,000,000 and excess insurance coverage has been purchased from $2,000,000 to $6,000,000.

Public Officials' and Errors and Omissions – Insured up to $60,000,000 per occurrence; the Authority is self-insured up to $2,000,000 and excess insurance coverage has been purchased from $2,000,000 to $60,000,000.

Fidelity – Insured up to $400,000 per occurrence with a $1,000 deductible; the Authority is self-insured up to $100,000 and excess insurance coverage has been purchased up to $400,000.

Earthquake and Flood – Insured up to $8,998,820 replacement values with varying deductibles. Insurance coverage has been purchased up to $10,000,000.

Workers' Compensation – Insured up to the statutory limit per occurrence; the Authority is self-insured up to $2,000,000 and excess insurance coverage has been purchased from $2,000,000 to the statutory limit.

The District has not settled any claims that have exceeded insurance coverage in any of the past three years. There have been no significant reductions in pooled or insured liability coverage in the prior year.

7. PUBLIC EMPLOYEES RETIREMENT SYSTEM (DEFINED BENEFIT PLAN):

Plan Description:

The District's employees participate in the Miscellaneous 3% at 60 Risk Pool (Plan) of the California Public Employees' Retirement System (PERS). This plan is a cost-sharing, multiple-employer defined benefit pension plan administered by PERS. On March 28, 2012, the Board adopted a second tier of retirement benefits which provides for all new hires to participate in the Miscellaneous 2% at 60 Risk Pool (Plan) of the California Public Employees' Retirement System (PERS). This plan is also a cost-sharing, multiple-employer defined benefit pension plan administered by PERS. As of June 30, 2012, there were no employees participating in the second tier plan.

7. PUBLIC EMPLOYEES RETIREMENT SYSTEM (DEFINED BENEFIT PLAN) (Continued):

PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. A menu of benefit provisions as well as other requirements is established by State statutes within the Public Employees' Retirement Law. The District selects optional benefit provisions from the benefit menu by contract with PERS and adopts those benefits through local ordinance. Copies of PERS' annual financial report may be obtained from the PERS Executive Office: 400 P Street, Sacramento, CA 95814.

Funding Policy:

Participants are required to contribute 8% of their annual covered salary. The District makes some of the contributions required of District employees on their behalf and for their account. Currently the District is paying the first 4% leaving the remaining 4% to be paid by the employees. The District is required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the CalPERS Board of Administration. The required employer contribution for the years ended June 30, 2011 and 2012 were 17.898% and 18.534% respectively of their annual covered payroll. The contribution requirements of the plan members are established by State statute and the employer contribution rate is established and may be amended by CalPERS.

Annual Pension Cost:

For the years ended June 30, 2011 and June 30, 2012, the District's annual pension cost of $158,348 and $142,009 were funded. The required contribution for the fiscal year ended June 30, 2012 was determined as part of the June 30, 2009 actuarial valuation using the entry age actuarial cost method with the contributions determined as a percent of pay. The actuarial assumptions included (a) 7.75% investment rate of return (net of administrative expenses); (b) projected salary increases that vary by duration of service ranging from 3.55% to 14.45%, and (c) 3.25% payroll growth. Both (a) and (b) include an inflation component of 3.00%. Asset valuation methods are amortized on a 15 year smoothed market basis. Gains and losses that occur in the operation of the risk pool are amortized over a rolling 30 year period. The remaining amortization period at June 30, 2009 was 18 years for the District.

The District's Plan unfunded actuarial accrued liability (or excess assets) is amortized over a rolling period, which results in an amortization of 10% of unamortized gains and losses each year. If the Plan's accrued liability exceeds the actuarial value of plan assets, then the amortization payment on the total unfunded liability may not be lower than the payment calculated over a 30 year amortization period.

Three-year trend information for the District Plan is as follow:

Fiscal Year	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
6/30/10	$180,914	100%	$ -
6/30/11	$158,348	100%	$ -
6/30/12	$142,009	100%	$ -

Funding Status:

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

8. NET WORKING CAPITAL:

Net working capital at June 30, 2012 and 2011 was as follows:

	2012	2011
Current Assets	$ 1,585,223	$ 1,469,568
Current Liabilities Payable from Current Assets	(318,531)	(317,709)
Net Working Capital	$ 1,266,692	$ 1,151,859

9. INTEREST EXPENSE:

Interest expense for the year ended June 30, 2012 and 2011 was as follows:

June 30, 2012	$167,856
June 30, 2011	$160,203

No interest was capitalized for the fiscal year ended June 30, 2012 and 2011.

10. LEASE AGREEMENTS:

On November 1, 2011 the District entered into a lease agreement to maintain a golf course located at Club Circle, Borrego Springs, California. This lease terminated a prior lease and easement entered into November 23, 2010. The term of the lease commenced on November 1, 2011 and will terminate June 30, 2015. The District has the option to extend the lease for an additional period of five (5) years from the original expiration date of the lease. The District pays $1 rent per year the lease is in effect.

On November 1, 2011 the District also entered into a maintenance agreement with Green Desert Landscape to maintain and operate a golf course located at Club Circle, Borrego Springs, California. The term of the maintenance agreement commenced on November 1, 2011 and will terminate June 30, 2015. The agreement may be renewed by mutual agreement of the parties for an additional period of five (5) years from the original expiration date of the agreement. The agreement calls for Green Desert Landscape to maintain and operate the golf course at Club Circle. The District pays a management fee to Green Desert Landscape of $5,400 per month. Green Desert Landscape is entitled to all revenues produced by the operations of the golf course under the term of the lease.

11. SEGMENT INFORMATION:

The 2008 Installment Purchase Agreement as described in Note 4 was issued to finance certain capital improvements in Improvement District Number 4. While water and wastewater services are accounted for in a single fund in these financial statements, the investors in the Installment Purchase agreement rely solely on the revenues of Improvement District Number 4 for repayment.

Summary financial information for Improvement District Number 4 is presented for June 30, 2012, and June 30, 2011.

11. SEGMENT INFORMATION (Continued):

Condensed Statements of Net Assets
June 30, 2012 and 2011

	2012	2011
Assets		
Current Assets	$ 1,161,606	$ 1,084,102
Capital Assets	3,235,017	3,303,263
Other Assets	105,430	111,918
Total Assets	4,502,053	4,499,283
Liabilities		
Current Liabilities	131,458	145,858
Long-Term Liabilities	2,622,437	2,612,433
Total Liabilites	2,753,895	2,758,291
Net Assets		
Invested in capital assets, net of related debt	612,580	690,830
Unrestricted	1,135,578	1,050,162
Total Net Assets	$ 1,748,158	$ 1,740,992

11. SEGMENT INFORMATION (Continued):

Condensed Statements of Revenues, Expenses & Changes in Net Assets
For the Year Ended June 30, 2012 and 2011

	2012	2011
Operating Revenues		
Water Revenue	$ 1,526,066	$ 1,243,149
Other Income	7,422	217
Total Operating Revenues	1,533,488	1,243,366
Operating Expenses		
Water Operations	626,077	485,530
Depreciation Expense	154,976	174,402
General and Administrative	654,723	424,914
Total Operating Expenses	1,435,776	1,084,846
Operating Income	97,712	158,520
Nonoperating Revenues (Expenses)		
Property Taxes	34,752	-
Grant Income	15,941	-
Investment Income	128	41
Interest Expense	(134,879)	(134,879)
Amortization Expense	(6,488)	(6,488)
Total Nonoperating Revenues (Expenses)	(90,546)	(141,326)
Change in Net Assets	7,166	17,194
Net Assets, Beginning	1,740,992	1,723,798
Net Assets, Ending	$ 1,748,158	$ 1,740,992

11. SEGMENT INFORMATION (Continued):

Condensed Statements of Cash Flows
June 30, 2012 and 2011

	2012	2011
Net Cash Provided by Operating Activities	$ 252,688	$ 352,224
Net Cash Provided by Noncapital Financing Activities	50,693	-
Net Cash Used by Capital and Related Financing	(211,605)	(124,875)
Net Cash Provided by Investing Activities	128	41
Net Increase in Cash and Cash Equivalents	91,904	227,390
Cash and Cash Equivalents, Beginning	776,662	549,272
Cash and Cash Equivalents, Ending	$ 868,566	$ 776,662

12. SUBSEQUENT EVENTS:

On July 8, 2011 the District entered into an agreement to purchase 125 acres and 312.5 water credits associated with the property located at the north end of DiGeorgio road, Borrego Springs, California for $1,500,000. The terms of the purchase call for a down payment of $75,000 and issuance of a note for a principal amount of $1,425,000. The terms of the note call for interest to accrue at the rate of four percent (4%) per annum. The interest shall accrue without an obligation of repayment prior to the fourth anniversary of this agreement. Interest thereafter will be paid in quarterly installments. A principal payment of $150,000 is due on the fifth anniversary and the remaining principal balance is to be repaid over 25 years.

In conjunction with the agreement above the seller pledged to donate 86 acres to the District upon the earlier of the following (i) the three-year anniversary of the conveyance of the Water Credits and conveyance of Parcel 2 or (ii) the final approval by the County of San Diego of the sellers compliance with the water mitigation requirements. As of June 30, 2012, title to the land and the water credits has not been transferred to the District.

On July 25, 2012 the District entered into an agreement to sell 236.96 acres of vacant land located in an unincorporated area of San Diego County for $94,784. The District purchased the land September 10, 1997 at a cost of $110,000. The transaction closed escrow September 25, 2012.

On October 2, 2012, the District received $36,000 for the CSD Waste Water Treatment Plant. This plant was abandoned during the fiscal year ended June 30, 2011.

13. NONCOMMITMENT DEBT:

Community Facilities District No. 2007-1 2007 Special Tax Bonds

On March 14, 2007 the Board of Directors adopted a resolution stating its intention to establish Community Facilities District No. 2007-1 and to authorize bonded indebtedness within the Community Facilities District. On April 25, 2007, the Community Facilities District 2007-1 was formed and an election was held to authorize the Community Facilities District 2007-1 to incur bonded indebtedness of up to $11,000,000 to refinance outstanding balances of the Community Facilities District 95-1 1996 Special Tax Bonds. On June 14, 2007 the Community Facilities District No. 2007-1 issued the 2007 Special Tax Bonds in the amount of $9,530,000. The balance of the outstanding 2007-1 bonds at June 30, 2011 and 2012 was $9,320,000.

The bonds consisted of $5,270,000 of 5.75% term bonds due August 1, 2025 with principal payments beginning on August 1, 2010 and $4,260,000 of 5.75% term bonds due August 1, 2032 with principal payments beginning August 1, 2026.

The 2007 Special Tax Bonds do not constitute an indebtedness of the District and are only secured by a pledge of Net Taxes (which consist of the Special Taxes collected minus certain administrative expenses) and amounts on deposit in the Special Tax Fund. In the opinion of the District management and counsel the full faith and credit of the Borrego Water District and the Community Facilities District are not pledged to the payment of the Bonds, nor is the payment of the Bonds secured by any encumbrance, mortgage or other pledge of property of the Borrego Water District or the Community Facilities District.

The Special Tax is to be levied and collected by the county at the same time and in the same manner as general ad valorem property taxes. The Community Facilities District is to receive all Special Taxes in trust and immediately deposit all amounts with the Trustee.

For the fiscal year ending June 30, 2012 there was a special tax delinquency rate of approximately 95.42% in the Community Facilities District. Due to the high delinquency rate, the Community Facilities District made a partial interest payment of $15,725 for the interest payment due August 1, 2011 ($267,950). The Community Facilities District was not able to make the interest payment due February 1, 2012 ($261,625), the principal payment due August 1, 2011 ($220,000), and the principal payment due August 1, 2012 ($235,000). At June 30, 2012 the balance in the reserve fund is $0. The Community Facilities District commenced foreclosure proceedings in the prior year and is continuing proceedings against certain property owners that are delinquent.