

ADELANTO PUBLIC UTILITY AUTHORITY
(A Component Unit of the City of Adelanto, California)

FINANCIAL STATEMENTS

June 30, 2009

ADELANTO PUBLIC UTILITY AUTHORITY
(A Component Unit of the City of Adelanto, California)
BASIC FINANCIAL STATEMENTS
June 30, 2009

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CERTIFIED PUBLIC ACCOUNTANTS

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INDEPENDENT AUDITOR'S REPORT

Members of the Governing Board
of the Adelanto Public Utility Authority,
Adelanto, California

We have audited the accompanying financial statements of the business-type activities and each major fund of the Adelanto Public Utility Authority (Authority), a component unit of the City of Adelanto, California (City), as of and for the fiscal year ended June 30, 2009, which collectively comprise the Authority's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express opinions on these 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. 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and each major fund of the Authority as of June 30, 2009, and the respective changes in financial position and cash flows, where applicable, thereof, for the fiscal year then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 1 of the notes to basic financial statements effective July 1, 2008, the Authority adopted the provisions of Government Accounting Standards Board (GASB) Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*, GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, and GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements of Auditing Standards*.

The Authority has not presented a management's discussion and analysis that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of the basic financial statements.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 26, 2010, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Moss, Levy & Hartzheim

Moss, Levy & Hartzheim, LLP
Beverly Hills, California
February 26, 2010

ADELANTO PUBLIC UTILITY AUTHORITY
STATEMENT OF NET ASSETS
June 30, 2009

| ASSETS | <u>Business-type Activities</u> |
|-------------------------------------------------------------------|-------------------------------------|
| Current Assets: | |
| Cash and investments | \$ 11,649,859 |
| Receivables: | |
| Accounts, net | 1,683,590 |
| Interest | 30,431 |
| Inventories | <u>72,420</u> |
| Total Current Assets | <u>13,436,300</u> |
| Restricted Assets: | |
| Cash and investments with fiscal agents | <u>18,358,412</u> |
| Total Restricted Assets | <u>18,358,412</u> |
| Capital Assets: | |
| Capital assets not being depreciated | 14,137,173 |
| Capital assets being depreciated, net of accumulated depreciation | <u>22,651,027</u> |
| Total Capital Assets | <u>36,788,200</u> |
| Other Assets: | |
| Investment in Adelanto Public Financing Authority Bonds | 13,849,905 |
| Deferred bond issuance costs, net of accumulated amortization | 1,907,782 |
| Deferred loss on bond refunding, net of accumulated amortization | <u>6,209,121</u> |
| Total Other Assets | <u>21,966,808</u> |
| Total Assets | <u>\$ 90,549,720</u> |

(Continued)

See accompanying notes to basic financial statements

ADELANTO PUBLIC UTILITY AUTHORITY
STATEMENT OF NET ASSETS

June 30, 2009

(Continued)

| LIABILITIES | <u>Business-type Activities</u> |
|----------------------------------------------------------------------|-------------------------------------|
| Current Liabilities: | |
| Accounts payable | \$ 1,053,887 |
| Accrued liabilities | 147,673 |
| Deposits payable | <u>432,591</u> |
| Total Current Liabilities | <u>1,634,151</u> |
| Current Liabilities (payable from restricted assets): | |
| Accrued interest payable | 177,841 |
| Current portion of long-term liabilities | <u>1,580,000</u> |
| Total Current Liabilities (payable from restricted assets) | <u>1,757,841</u> |
| Long-Term Liabilities: | |
| Accrued employee leave benefits | 44,879 |
| Advances from City of Adelanto | 4,584,025 |
| Bonds payable, non-current | <u>67,535,000</u> |
| Total Long-Term Liabilities | <u>72,163,904</u> |
| Total Liabilities | <u>75,555,896</u> |
| NET ASSETS | |
| Net Assets: | |
| Invested in capital assets, net of related debt | 592,279 |
| Restricted for debt service | 7,228,300 |
| Unrestricted | <u>7,173,245</u> |
| Total Net Assets | <u>\$ 14,993,824</u> |

See accompanying notes to basic financial statements

ADELANTO PUBLIC UTILITY AUTHORITY
STATEMENT OF ACTIVITIES
For the Fiscal Year Ended June 30, 2009

| | Expenses | Program Revenue Charges for Services | Net (Expense) Revenue and Changes in Net Assets |
|-------------------------------------------------|---------------------|--------------------------------------------|----------------------------------------------------------|
| <u>Business-type Activities</u> | | | |
| Expenses: | | | |
| Public utility activities | \$ (5,335,615) | \$ 1,696,283 | \$ (3,639,332) |
| Water activities | (10,980,081) | 6,081,002 | (4,899,079) |
| Total | \$ (16,315,696) | \$ 7,777,285 | (8,538,411) |
| General Revenues and Transfers: | | | |
| Use of money and property | | | 552,860 |
| Transfers to the City of Adelanto | | | (3,711,372) |
| Total General Revenues and Transfers | | | (3,158,512) |
| Change in Net Assets | | | (11,696,923) |
| Net Assets - July 1, 2008 | | | 27,210,408 |
| Prior Period Adjustments | | | (519,661) |
| Net Assets - July 1, 2008 (restated) | | | 26,690,747 |
| Net Assets - June 30, 2009 | | | \$ 14,993,824 |

See accompanying notes to basic financial statements

ADELANTO PUBLIC UTILITY AUTHORITY
STATEMENT OF NET ASSETS - PROPRIETARY FUNDS
June 30, 2009

| <u>Assets</u> | <u>Adelanto Public Utility Authority</u> | <u>Adelanto Water Authority</u> | <u>Totals</u> |
|---------------------------------------------------------------------|--------------------------------------------------|-----------------------------------------|-----------------------|
| Current Assets: | | | |
| Cash and investments | \$ - | \$ 11,649,859 | \$ 11,649,859 |
| Receivables: | | | |
| Accounts, net | 592,004 | 1,091,586 | 1,683,590 |
| Interest | 2,606 | 27,825 | 30,431 |
| Inventories | | 72,420 | 72,420 |
| | <u>594,610</u> | <u>12,841,690</u> | <u>13,436,300</u> |
| Restricted Assets: | | | |
| Cash and investments with fiscal agents | <u>18,358,412</u> | | <u>18,358,412</u> |
| | <u>18,358,412</u> | | <u>18,358,412</u> |
| Capital assets, net of accumulated depreciation | <u>18,468,856</u> | <u>18,319,344</u> | <u>36,788,200</u> |
| Other Assets: | | | |
| Advances to Water Authority | 26,759,356 | | 26,759,356 |
| Advances to Public Utility Authority | | 5,448,444 | 5,448,444 |
| Advances to City of Adelanto | 239,765 | 2,163,608 | 2,403,373 |
| Investment in Adelanto Public Financing Authority Bonds | | 13,849,905 | 13,849,905 |
| Deferred bond issuance costs, net of accumulated amortization | 1,907,782 | | 1,907,782 |
| Deferred loss on bond refunding, net of accumulated amortization | <u>6,209,121</u> | | <u>6,209,121</u> |
| | <u>35,116,024</u> | <u>21,461,957</u> | <u>56,577,981</u> |
| Total Other Assets | <u>35,116,024</u> | <u>21,461,957</u> | <u>56,577,981</u> |
| Total Assets | <u>\$ 72,537,902</u> | <u>\$ 52,622,991</u> | <u>\$ 125,160,893</u> |

(Continued)

See accompanying notes to basic financial statements

ADELANTO PUBLIC UTILITY AUTHORITY
STATEMENT OF NET ASSETS - PROPRIETARY FUNDS

June 30, 2009
(Continued)

| <u>Liabilities and Net Assets</u> | <u>Adelanto Public Utility Authority</u> | <u>Adelanto Water Authority</u> | <u>Totals</u> |
|-------------------------------------------------------------------|--------------------------------------------------|-----------------------------------------|----------------------|
| Current Liabilities: | | | |
| Accounts payable | \$ 507,976 | \$ 545,911 | \$ 1,053,887 |
| Accrued liabilities | 121,404 | 26,269 | 147,673 |
| Deposits payable | 83,797 | 348,794 | 432,591 |
| Total Current Liabilities | <u>713,177</u> | <u>920,974</u> | <u>1,634,151</u> |
| Current Liabilities: (payable from restricted assets): | | | |
| Accrued interest payable | 177,841 | | 177,841 |
| Current portion of long-term liabilities | 1,580,000 | | 1,580,000 |
| Total Current Liabilities (payable from restricted assets) | <u>1,757,841</u> | | <u>1,757,841</u> |
| Long-Term Liabilities: | | | |
| Advances from Public Utility Authority | | 26,759,356 | 26,759,356 |
| Advances from Water Authority | 5,448,444 | | 5,448,444 |
| Advances from City of Adelanto | | 6,987,398 | 6,987,398 |
| Accrued employee leave benefits | | 44,879 | 44,879 |
| Bonds payable, non-current | 67,535,000 | | 67,535,000 |
| Total Long-Term liabilities | <u>72,983,444</u> | <u>33,791,633</u> | <u>106,775,077</u> |
| Total Liabilities | <u>75,454,462</u> | <u>34,712,607</u> | <u>110,167,069</u> |
| Net Assets (Deficit): | | | |
| Invested in capital assets, net of related debt | (31,576,970) | 32,169,249 | 592,279 |
| Restricted for debt service | 7,228,300 | | 7,228,300 |
| Unrestricted | 21,432,110 | (14,258,865) | 7,173,245 |
| Total Net Assets (Deficit) | <u>\$ (2,916,560)</u> | <u>\$ 17,910,384</u> | <u>\$ 14,993,824</u> |

See accompanying notes to basic financial statements

ADELANTO PUBLIC UTILITY AUTHORITY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS -
PROPRIETARY FUNDS
For The Fiscal Year Ended June 30, 2009

| | Adelanto Public Utility Authority | Adelanto Water Authority | Totals |
|-------------------------------------------|--------------------------------------------------|-----------------------------------------|----------------------|
| Operating Revenues: | | | |
| Charges for services | \$ 1,696,283 | \$ 5,024,927 | \$ 6,721,210 |
| Other revenue | | 1,056,075 | 1,056,075 |
| Total Operating Revenues | <u>1,696,283</u> | <u>6,081,002</u> | <u>7,777,285</u> |
| Operating Expenses: | | | |
| Salaries and benefits | | 1,005,118 | 1,005,118 |
| Contract services | 1,027,704 | 981,517 | 2,009,221 |
| Sewer operations | 238,357 | | 238,357 |
| Water operations | | 514,269 | 514,269 |
| Utilities | 199,356 | 805,755 | 1,005,111 |
| Administration | 168,811 | 82,124 | 250,935 |
| Depreciation | 251,432 | 353,755 | 605,187 |
| Total Operating Expenses | <u>1,885,660</u> | <u>3,742,538</u> | <u>5,628,198</u> |
| Operating Income (Loss) | <u>(189,377)</u> | <u>2,338,464</u> | <u>2,149,087</u> |
| Nonoperating Revenues (Expenses): | | | |
| Amortization expense | (320,404) | | (320,404) |
| Interest expense and fiscal charges | (3,129,551) | (7,237,543) | (10,367,094) |
| Interest revenue | 322,877 | 229,983 | 552,860 |
| Total Nonoperating Revenues (Expenses) | <u>(3,127,078)</u> | <u>(7,007,560)</u> | <u>(10,134,638)</u> |
| Net income (loss) before transfers | (3,316,455) | (4,669,096) | (7,985,551) |
| Transfers to City of Adelanto | <u>(125,000)</u> | <u>(3,586,372)</u> | <u>(3,711,372)</u> |
| Change in Net Assets | <u>(3,441,455)</u> | <u>(8,255,468)</u> | <u>(11,696,923)</u> |
| Net Assets - July 1, 2008 | 4,061,541 | 23,148,867 | 27,210,408 |
| Prior Period Adjustments | <u>(3,536,646)</u> | <u>3,016,985</u> | <u>(519,661)</u> |
| Net Assets - July 1, 2008 restated | <u>524,895</u> | <u>26,165,852</u> | <u>26,690,747</u> |
| Net Assets (Deficit) - June 30, 2009 | <u>\$ (2,916,560)</u> | <u>\$ 17,910,384</u> | <u>\$ 14,993,824</u> |

See accompanying notes to basic financial statements

ADELANTO PUBLIC UTILITY AUTHORITY
STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS
For the Fiscal Year Ended June 30, 2009

| | Adelanto Public Utility Authority | Adelanto Water Authority | Totals |
|--------------------------------------------------------------------------------------------------------|--------------------------------------------------|-----------------------------------------|----------------------|
| Cash flows from operating activities: | | | |
| Receipts from customers and users | \$ 1,642,458 | \$ 5,591,883 | \$ 7,234,341 |
| Payments to suppliers | (1,201,360) | (2,289,912) | (3,491,272) |
| Payments to employees | | (983,741) | (983,741) |
| Net cash provided (used) by operating activities | <u>441,098</u> | <u>2,318,230</u> | <u>2,759,328</u> |
| Cash flows from noncapital financing activities: | | | |
| Transfers to the City of Adelanto | (125,000) | (3,586,372) | (3,711,372) |
| Payments received (paid) to/(from) other funds or City | (3,177,637) | 1,926,045 | (1,251,592) |
| Net cash provided (used) in noncapital financing activities | <u>(3,302,637)</u> | <u>(1,660,327)</u> | <u>(4,962,964)</u> |
| Cash flows from capital and related financing activities: | | | |
| Purchase of capital assets | (7,297,512) | (348,385) | (7,645,897) |
| Principal payments on long-term debt | (1,520,000) | | (1,520,000) |
| Interest paid on long-term debt | (3,079,342) | (7,237,543) | (10,316,885) |
| Net cash provided in capital and related financing activities | <u>(11,896,854)</u> | <u>(7,585,928)</u> | <u>(19,482,782)</u> |
| Cash flows from investing activities: | | | |
| Principal repayment on bond investment | | 1,192,123 | 1,192,123 |
| Interest on investments | 325,481 | 257,775 | 583,256 |
| Net cash provided by investing activities | <u>325,481</u> | <u>1,449,898</u> | <u>1,775,379</u> |
| Net increase (decrease) in cash and cash equivalents | (14,432,912) | (5,478,127) | (19,911,039) |
| Cash and cash equivalents, beginning of fiscal year | <u>32,791,324</u> | <u>17,127,986</u> | <u>49,919,310</u> |
| Cash and cash equivalents, end of fiscal year | <u>\$ 18,358,412</u> | <u>\$ 11,649,859</u> | <u>\$ 30,008,271</u> |
| Reconciliation of cash and cash equivalents to amounts reported on the statement of net assets: | | | |
| Reported on the Statement of Net Assets: | | | |
| Cash and investments | \$ - | \$ 11,649,859 | \$ 11,649,859 |
| Cash and investments with fiscal agents | 18,358,412 | | 18,358,412 |
| Cash and cash equivalents - June 30, 2009 | <u>\$ 18,358,412</u> | <u>\$ 11,649,859</u> | <u>\$ 30,008,271</u> |
| Reconciliation of operating income (loss) to net cash provided by operations: | | | |
| Operating income (loss) | <u>\$ (189,377)</u> | <u>\$ 2,338,464</u> | <u>\$ 2,149,087</u> |
| Adjustments to reconcile operating income (loss) to net cash provided by operating activities: | | | |
| Depreciation | 251,432 | 353,755 | 605,187 |
| Decrease (increase) in accounts receivable | (64,232) | (121,184) | (185,416) |
| Decrease (increase) in inventory | | (12,168) | (12,168) |
| Increase (decrease) in accounts payable | 432,868 | 105,921 | 538,789 |
| Increase (decrease) in accrued liabilities | | 7,910 | 7,910 |
| Increase (decrease) in deposits payable | 10,407 | (367,935) | (357,528) |
| Increase (decrease) in accrued employee leave benefits | | 13,467 | 13,467 |
| Total adjustments | <u>630,475</u> | <u>(20,234)</u> | <u>610,241</u> |
| Net Cash Provided by Operating Activities | <u>\$ 441,098</u> | <u>\$ 2,318,230</u> | <u>\$ 2,759,328</u> |

See accompanying notes to basic financial statements

ADELANTO PUBLIC UTILITY AUTHORITY

Notes to Basic Financial Statements

June 30, 2009

Note 1 **Organization and Summary of Significant Accounting Policies**

The financial statements of the Adelanto Public Utility Authority (Authority), a component unit of the City of Adelanto, have been prepared in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) as promulgated by the Governmental Accounting Standards Board (GASB). The GASB is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The significant accounting policies of the Authority are described below.

(a) Reporting Entity

The Authority was formed by action of the Adelanto City Council on October 22, 1996. The Authority was formed for the purpose of purchasing and operating the City's wastewater operations. In conjunction with that purchase, the Authority issued bonds to finance the down payment to the City and the construction of a wastewater treatment plant. The Authority also issued a note payable to the City to finance the purchase of the existing wastewater assets.

On February 29, 2000, the Adelanto Public Utility Authority entered into a purchase agreement with the Adelanto Water Authority (the Water Authority) to purchase the Water Authority's water system (Water Enterprise), including the Water Enterprise's total assets and assumption of its total liabilities. The purchase price consisted of amounts sufficient to refund all of the outstanding prior water bonds and assumption of the Water Authority's obligations under the original agreement dated January 9, 1996, under which the Water Authority was first formed by the City.

The Authority is an integral part of the reporting entity of the City. The funds of the Authority are included within the scope of the basic financial statements of the City because the City Council is the governing board over the operations of the Authority. Only the funds of the Authority are included herein; therefore, these financial statements do not purport to represent the financial position, results of operations, or cash flows of the City of Adelanto.

(b) Fund Accounting

The activities of the Authority are accounted for as enterprise funds. In governmental accounting, enterprise funds are used to account for operations that are financed and operated in a manner similar to private business enterprises-where the intent is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis are to be financed or recovered primarily through user charges; or where periodic determination of revenues earned, expenses incurred, and/or net income is deemed appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

(c) Basis of Accounting

The financial records of the Authority are maintained on the flow of economic resources measurement focus using the accrual basis of accounting, wherein revenues are recognized in the accounting period in which they are earned, regardless of when they are received, and expenses are recognized in the period incurred.

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Government Entities That Use Proprietary Fund Accounting*, for proprietary fund accounting, the Authority applies all applicable GASB pronouncements, as well as pronouncements of the Financial Accounting Standards Board (FASB) and predecessor entities issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

ADELANTO PUBLIC UTILITY AUTHORITY

Notes to Basic Financial Statements

June 30, 2009

Note 1 **Organization and Summary of Significant Accounting Policies (Continued)**

(d) Government-wide and Fund Financial Statements

The government-wide financial statements (ie, the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the Authority.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segments are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include: charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

The Authority reports the following major funds:

The Adelanto Water Authority Fund – This fund accounts for the operation and maintenance of the Authority’s water distribution system.

The Adelanto Public Utility Authority – This fund accounts for the operation and maintenance of the Authority’s wastewater collection system including operating costs of the wastewater treatment facility.

(e) Other Accounting Policies

Cash and Investments

The Authority’s cash and investments are governed by and in compliance with the California Government Code. For purpose of the statement of cash flows, the Authority considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

The Authority has adopted the provisions of Statement No. 31 of the Governmental Accounting Standards Board, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools* (GASB No. 31). This statement requires that certain investments and external investment pools be reported at fair value.

Investments with Bond Trustee

In accordance with terms of the bond indenture related to the 2005 Utility Authority Bonds, reserve and other funds are invested with the Bond Trustee. The Bond Trustee invests these funds in accordance with the terms of the bond indenture; accordingly, such funds are invested primarily in U.S. government and government agency securities and money market funds, which invest in such securities. Such investments are stated at fair value.

ADELANTO PUBLIC UTILITY AUTHORITY

Notes to Basic Financial Statements

June 30, 2009

Note 1 **Organization and Summary of Significant Accounting Policies (Continued)**

(e) Other Accounting Policies (Continued)

Advances to/from the City of Adelanto

Receivables and payables, representing operating advances between the City and the Authority, have been classified as “advances from City of Adelanto” or “advances to City of Adelanto”, respectively, on the accompanying financial statements. Such activities have been eliminated on the statement of Net Assets.

Capital Assets

Upon the original formation of the Authority on October 22, 1996, the Authority purchased the existing wastewater capital assets of the City of Adelanto. On January 9, 1996, the Adelanto Water Authority, now consolidated with the Authority, purchased the water delivery system assets of the City.

Capital assets are defined by the Authority as assets with an initial individual cost of \$5,000 (\$100,000 for infrastructure) or more and an estimated useful life in excess of one year. Additions to capital assets are carried at historical cost or, for donated capital assets, at appraised fair value on the date donated.

In accordance with the terms of the water delivery system purchase agreement, water rights and the related note payable balance to the City may be adjusted based upon the final outcome of litigation related to water rights on George Air Force Base.

Normal maintenance and repair costs that do not add to the value of the capital assets or materially extend capital asset lives are not capitalized. Improvements that extend the life of the wastewater and water delivery systems are capitalized and depreciated over the remaining useful lives of the related capital assets, as applicable.

In accordance with accounting principles generally accepted in the United States of America, depreciation is not recorded for land, water rights, sewer rights-of-way, or construction in progress. Depreciation is recorded on a straight-line basis over the estimated useful lives of the capital assets as follows:

| | |
|------------------------------|----------|
| Buildings and improvements | 50 years |
| Pipes and storage facilities | 50 years |
| Sewers | 50 years |
| Machinery and equipment | 10 years |
| Vehicles | 10 years |

Use of Estimates

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

Inventories

Inventories of materials and supplies are carried at cost on an average cost basis. The Authority uses the consumption method of accounting for inventories.

ADELANTO PUBLIC UTILITY AUTHORITY
Notes to Basic Financial Statements
June 30, 2009

Note 1 **Organization and Summary of Significant Accounting Policies (Continued)**

(e) Other Accounting Policies (Continued)

Bond Discounts/Issuance Costs/Deferred Losses on Refunding

Bond discounts, issuance costs, and deferred losses on refunding, for proprietary fund types and on the government-wide financial statements are deferred and amortized over the term of the bonds using the straight line method, which approximates the effective interest method.

Other

The Public Utility Authority accrues for all capital appreciation/depreciation due and adds/subtracts such amounts to the account balance under the financial statements caption, "Investment in Adelanto Public Financing Authority Bonds," in the accompanying financial statements. In this regard, the Public Utility Authority has accrued \$545,755 of capital depreciation during the fiscal year ended June 30, 2009. Additionally, there was a prior period adjustment of capital depreciation of \$646,369. The Public Utility Authority records its investment in Adelanto Public Financing Authority Bonds at cost at June 30, 2009.

Management's projections indicate that incremental property tax revenues of the Redevelopment Agency, as the underlying revenue base for the Financing Authority Bonds, should grow sufficiently to fund the scheduled principal and interest payments for the Financing Authority loans; however, the Agency loans are third and fourth subordinated loans and have lower priority to Agency tax revenues than other Agency indebtedness.

In addition, the Redevelopment Agency and County of San Bernardino have amended their pass-through agreement for incremental property taxes in the Merged Project Area. Under the amended agreement, the Redevelopment Agency is to relinquish approximately 33% of its incremental property taxes to the County, of which approximately half (16.26%) will be subordinate to the existing Redevelopment Agency debt.

During fiscal year 1996, the Agency and the County amended the pass-through agreement for incremental property taxes in the Project Area. Under the revised agreement, the Agency is required to relinquish approximately 33% of incremental property taxes to the County, of which approximately one-half (16.26%) would be subordinated to the Agency's existing long-term debt. The County will loan to the Agency, at the rate of 7% per annum, the amount of the deferred incremental property taxes needed to meet debt service requirements on the refunding bonds plus amounts needed, up to \$100,000 annually, to administer the Agency's long-term debt. Any such loans are subordinate to Series A, B, and C of the Adelanto Public Financing Authority refunding bonds, but senior to the Series D Bonds. During the fiscal year ended June 30, 2009, the County loaned the Agency its share of incremental property taxes aggregating approximately \$2,552,544, and the balance outstanding was \$17,291,314.

(f) New Accounting Pronouncements

Governmental Accounting Standards Board Statement No. 45

For the fiscal year ended June 30, 2009, the Authority implemented Governmental Accounting Standards Board (GASB) Statement No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions". This Statement is effective for periods beginning after December 15, 2007. This Statement establishes standards for accounting and financial reporting for state and local government employers that offer "Other Postemployment Benefits" (OPEB) and requires accrual basis measurement and recognition of OPEB expenses and liabilities that will result in recognition of expenses over periods that approximate employees' years of service.

ADELANTO PUBLIC UTILITY AUTHORITY
Notes to Basic Financial Statements
June 30, 2009

Note 1 **Organization and Summary of Significant Accounting Policies (Continued)**

(f) New Accounting Pronouncements (Continued)

Governmental Accounting Standards Board Statement No. 49

For the fiscal year ended June 30, 2009, the Authority implemented Governmental Accounting Standards Board (GASB) Statement No. 49, "Accounting and Financial Reporting for Pollution Remediation Obligations". This Statement is effective for periods beginning after December 15, 2007. The Statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. The scope of the document excludes pollution prevention or control obligations with respect to current operations, and future pollution remediation activities that are required upon retirement of an asset, such as landfill closure and post-closure care and nuclear power plant decommissioning.

Governmental Accounting Standards Board Statement No. 52

For the fiscal year ended June 30, 2009, the Authority implemented GASB Statement No. 52, "Land and Other Real Estate Held as Investments by Endowments". This Statement is effective for periods beginning after June 15, 2008. The Statement establishes consistent standards for the reporting of land and other real estate held as investments by essentially similar entities. It requires endowments to report their land and other real estate investments at fair value. Governments also are required to report the changes in fair value as investment income and to disclose the methods and significant assumptions employed to determine fair value, and other information that they currently present for other investments reported at fair value.

Governmental Accounting Standards Board Statement No. 55

For the fiscal year ended June 30, 2009, the Authority implemented GASB No. 55, "The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments". This Statement is effective as of April 2, 2009. The objective of this Statement is to incorporate the hierarchy of generally accepted accounting principles (GAAP) for state and local governments into the Governmental Accounting Standards Board's authoritative literature. The "GAAP hierarchy" consists of the sources of accounting principles used in the preparation of financial statements of state and local governmental entities that are presented in conformity with GAAP, and the framework for selecting those principles.

Governmental Accounting Standards Board Statement No. 56

For the fiscal year ended June 30, 2009, the Authority implemented GASB No. 56, "Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements of Auditing Standards". This Statement is effective as of April 16, 2009. The objective of this Statement is to incorporate into the Governmental Accounting Standards Board's (GASB) authoritative literature certain accounting and financial reporting guidance presented in the American Institute of Certified Public Accountants' Statements on Auditing Standards. This Statement addresses three issues not included in the authoritative literature that establishes accounting principles – related party transactions, going concern considerations, and subsequent events. The presentation of principles used in the preparation of financial statements is more appropriately included in accounting and financial reporting standards rather than in the auditing literature.

ADELANTO PUBLIC UTILITY AUTHORITY

Notes to Basic Financial Statements

June 30, 2009

Note 2 **Purchase of Operations**

(a) Water Operations

Water System Purchase Note

As part of the original purchase of the City's water operation by the Adelanto Water Authority, which was acquired by the Public Utility Authority in 2000, the Water Authority issued bonds to purchase the City's water delivery system. In conjunction with the original purchase of the City's water operation, the Authority issued a note payable in the amount of \$34,113,079 with minimum annual payments of \$500,000 plus any additional funds available after payment of operating and debt service requirements of the Water Authority plus establishment of reasonable reserve. This note was originally subordinated to the 1995 and 1998 Water Bonds. The outstanding balance on the Water System Purchase Note is \$18,255,019 at June 30, 2009.

The original purchase note accrued interest at 7.5% on the outstanding balance. Because the purchase note payable to the City is subordinate to the Water Authority Bonds, interest on the note would be substantially in excess of the minimum annual payment. Prior to January 26, 1998, management did not anticipate that any payment in excess of the minimum annual payments due on the note would be made prior to the final maturity date. Accordingly, on January 26, 1998, the Governing Board of the Water Authority and the City Council agreed to amend the purchase note on a retroactive basis to eliminate the accrual of interest from July 1, 1996 until such time as all outstanding bonds are repaid, presently scheduled for September 1, 2028. As per this agreement, the unpaid balance of this note at that time will accrue interest at 7.5%. Interest accrued through June 30, 1996 amounting to \$1,219,659 was unaffected by the purchase note amendment. In a subsequent amendment dated September 2005, the purchase agreement was amended and the interest rate was changed to accrue on the unpaid balance at the rate of 5.0% per annum, from the date of delivery of the 2005 Bonds, to the date on which the full balance has been paid. Additionally, subsequent to the fiscal year ended June 30, 2009, an amendment dated November 2009 was issued that updates the terms of the agreement to reflect the issuance of the 2009 Adelanto Public Utility Authority Fixed Rate Refunding Revenue Bonds and the issuance of the amendment dated November 2009 and replaces the 2009 Bond information in place of the 2005 Bond.

Further, as described above, the Adelanto Public Utility Authority is required to fix, prescribe, revise and collect rates, fees and charges for the water system for the services and improvements furnished by the water system during each fiscal year which are sufficient to meet all debt service requirements, including the minimum annual payments required under this note.

(b) Wastewater Operations

Wastewater System Purchase Note

The Authority was formed in October, 1996, and on November 1, 1996 issued Public Utility Authority Bonds to finance the construction of a wastewater treatment plant. In conjunction with the original purchase of the City's water operations, the Authority issued a note payable to the City, which is subordinate to the Public Utility Authority Bonds and accrues interest at 7.5% on the outstanding balance. Annual payments on this note are equal to surplus revenues, which are defined as gross wastewater receipts plus amounts on deposit in the wastewater rate stabilization fund and less payment of operating and maintenance costs and debt service requirements of the Public Utility Authority.

ADELANTO PUBLIC UTILITY AUTHORITY

Notes to Basic Financial Statements

June 30, 2009

Note 2 **Purchase of Operations (Continued)**

(c) Wastewater Operations

Wastewater System Purchase Note

As part of the purchase of the City's wastewater operations by the Adelanto Public Utility Authority, the Authority issued a note payable in the amount of \$10,267,874, which originally accrued interest at 7.5% per annum with annual payments payable from wastewater system revenues. Such annual payments on this note are equal to surplus revenues, which are defined as gross wastewater receipts plus amounts on deposit in the wastewater rate stabilization fund less payment of operating and maintenance costs and debt service requirements of the Authority. This note was originally subordinated to the 1996 Public Utility Bonds.

As the annual payment on the note as originally stated was insufficient to pay accrued interest on the note, management anticipated that accrued interest on the note would grow substantially until final repayment of the 1996 Public Utility Bonds in 2026. Prior to January 26, 1998, management did not anticipate that any payment in excess of the annual payments due on the note would be made prior to the final repayment of the Public Utility Authority Bonds in 2026. Accordingly, on January 26, 1998, the governing Board of the Authority and the City Council agreed to amend the purchase note on a retroactive basis to eliminate any accrual of interest payable to the City until such time as all outstanding bonds are repaid, presently scheduled for November 1, 2026. As per this agreement, any unpaid balance at that time will accrue interest at 7.5%. In September 2005, the interest rate was amended to accrue on the unpaid balance at the rate of 5.0% per annum, from the date of delivery of the 2005 Bonds, to the date on which the full balance has been paid. The outstanding balance on the Wastewater System Purchase Note is \$6,431,169 at June 30, 2009. Subsequent to the fiscal year ended June 30, 2009, an amendment dated November 2009 was issued that updates the terms of the agreement to reflect the issuance of the 2009 Adelanto Public Utility Authority Fixed Rate Refunding Revenue Bonds and the issuance of the amendment dated November 2009 and replaces the 2009 Bond information in place of the 2005 Bond.

(c) Other

The notes issued represent an amount equivalent to the fair value of the assets at date of purchase. Due to the fact that the purchase was between related parties, the City and the Authority, the notes payable and related fair value adjustments have been eliminated from the statements. The Authority presently makes minimum annual payments on the notes which are recorded as transfers to the City of Adelanto.

ADELANTO PUBLIC UTILITY AUTHORITY

Notes to Basic Financial Statements

June 30, 2009

Note 3 Cash and Investments

Cash and investments as of June 30, 2009 are classified in the accompanying financial statements as follows:

Statement of net assets:

| | |
|---------------------------------------------------------|----------------------|
| Cash and investments | \$ 11,649,859 |
| Cash and investments with fiscal agents | 18,358,412 |
| Investment in Adelanto Public Financing Authority Bonds | <u>13,849,905</u> |
| Total cash and investments | <u>\$ 43,858,176</u> |

Cash and investments as of June 30, 2009 consist of the following:

| | |
|--------------------------------------|----------------------|
| Petty cash | \$ 850 |
| Deposits with financial institutions | 3,552,288 |
| Investments | <u>40,305,038</u> |
| Total cash and investments | <u>\$ 43,858,176</u> |

(a) Investments Authorized by the California Government Code and the Authority's Investment Policy

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

| Authorized Investment Type | Maximum Maturity | Maximum Percentage of Portfolio | Maximum Investment in One Issuer |
|----------------------------------------------------------------------------------------------|---------------------|---------------------------------------|----------------------------------------|
| Local Agency Investment Fund (State Pool) | N/A | None | \$40 million |
| Local Agency Bonds | N/A | None | None |
| U.S. Treasury Obligations | N/A | None | None |
| Insured Passbook on Demand Deposits with Banks and Savings and Loans | N/A | None | \$100,000 |
| Certificates of Deposit | 1 year | None | \$100,000 |
| Bankers Acceptances | | | |
| Commercial Paper | N/A | None | None |
| Mutual Funds (must be comprised of eligible securities permitted under this policy) | N/A | None | None |
| Money Market Funds (must be comprised of eligible securities permitted under this policy) | N/A | None | None |
| Public Financing Authority Bonds | N/A | None | None |

(b) 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 Authority's investment policy. The table below identifies the Investment types that are authorized for investments held by bond trustees. The table also identifies certain provisions of these debt agreements that address interest rate risk, credit risk, and concentration of credit risk.

ADELANTO PUBLIC UTILITY AUTHORITY

Notes to Basic Financial Statements

June 30, 2009

Note 3 Cash and Investments (Continued)

(b) Investments Authorized by Debt Agreements (Continued)

| Authorized Investment Type | Maximum Maturity | Maximum Percentage of Portfolio | Maximum Investment in One Issuer |
|-------------------------------------------------------------------------------------------|------------------|---------------------------------|----------------------------------|
| U.S. Treasury Obligations | N/A | None | None |
| U.S. Government Agency Issues | N/A | None | None |
| Insured Passbook on Demand Deposits with Banks and Savings and Loans | N/A | None | \$100,000 |
| Certificates of Deposit | 1 year | None | \$100,000 |
| Commercial Paper | 270 days | None | None |
| Money Market Funds (must be comprised of eligible securities permitted under this policy) | N/A | None | None |
| Investment Agreements | N/A | None | None |
| Repurchase Agreements | N/A | None | None |
| State Bonds | N/A | None | None |

(c) 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 Authority manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time, as necessary, to provide the cash flow and liquidity needed for operations.

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

| Investment Type | Totals | Remaining maturity (in Months) | | | |
|-----------------------------------|----------------------|--------------------------------|-----------------|-----------------|----------------------|
| | | 12 Months or Less | 13 to 24 Months | 25 to 60 Months | More Than 60 Months |
| State Investment Pool | \$ 8,096,721 | \$ 8,096,721 | \$ - | \$ - | \$ - |
| Held by Bond Trustees: | | | | | |
| Money Market Funds | 14,078,318 | 14,078,318 | | | |
| Investment Agreement | 4,280,094 | | | | 4,280,094 |
| Public Financing Authority Bonds* | 13,849,905 | | | | 13,849,905 |
| | <u>\$ 40,305,038</u> | <u>\$ 22,175,039</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 18,129,999</u> |

* The value of the bonds are stated at cost as no fair value is readily available.

(d) Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations

The Authority has no investments (including investments held by bond trustee) that are highly sensitive to interest rate fluctuations to a greater degree than already indicated in the information provided above.

ADELANTO PUBLIC UTILITY AUTHORITY

Notes to Basic Financial Statements

June 30, 2009

Note 3 Cash and Investments (Continued)

(e) Disclosures Relating to Credit Risk

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

| Investment Type | Amount | Minimum Legal Rating | Exempt From Disclosure | Rating as of Fiscal Year End | | | |
|----------------------------------|---------------|----------------------------|------------------------------|------------------------------|------|------|---------------|
| | | | | AAA | AA | A | Not Rated |
| State Investment Pool | \$ 8,096,721 | N/A | \$ - | \$ - | \$ - | \$ - | \$ 8,096,721 |
| Held by bond trustee: | | | | | | | |
| Money Market Funds | 14,078,318 | N/A | | 14,078,318 | | | |
| Investment Agreements | 4,280,094 | N/A | | | | | 4,280,094 |
| Public Financing Authority Bonds | 13,849,905 | N/A | | | | | 13,849,905 |
| Total | \$ 40,305,038 | | \$ - | \$ 14,078,318 | \$ - | \$ - | \$ 26,226,720 |

(f) Concentration of Credit Risk

The investment policy of the Authority contains limitations on the amount that can be invested in any one issuer. Investments in any one issuer (other than U.S. Treasury securities, mutual funds, and external investment pools) that represent 5% or more of total Authority investments are as follows:

| Issuer | Investment Type | Reported Amount |
|-------------------------------------------|----------------------|-----------------|
| IXIS Funding Corp Investment Agreements | Investment Contracts | \$ 4,280,094 |
| Adelanto Public Financing Authority Bonds | Bonds | 13,849,905 |

Investments in any one issuer that represent 5% or more of total investments by reporting unit (primary government, governmental activities, business type activities, fiduciary funds, major funds, nonmajor funds in the aggregate, etc.) are as follows:

The Adelanto Public Utility Authority holds investments in IXIS Investment Contracts equal to \$4,280,094. The agreements mature on September 30, 2015 and pay interest of 4.360%.

The Adelanto Water Authority holds investments (including amounts held by bond trustees) in Public Financing Authority bonds in the amount of \$13,849,905. This investment is in the 1995 Series C Bonds.

(g) 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 Authority's investment policy do not contain legal or policy requirements that

ADELANTO PUBLIC UTILITY AUTHORITY
Notes to Basic Financial Statements
June 30, 2009

Note 3 Cash and Investments (Continued)

(g) Custodial Credit Risk (Continued)

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

As of June 30, 2009, Authority's investments in the following investment types were held by the same broker-dealer (counterparty) that was used by the Authority to buy the securities:

| <u>Investment Type</u> | <u>Reported Amount</u> |
|------------------------|----------------------------|
| Money market funds | \$ 14,078,318 |
| Investment Agreements | 4,280,094 |

The Authority pools its deposits with the City of Adelanto. See the City's annual report for more information regarding pooled cash and investments.

Note 4 Capital Assets

Capital asset activity for the fiscal year ended June 30, 2009 was as follows:

| | <u>Balance July 1, 2008</u> | <u>Additions</u> | <u>Deletions</u> | <u>Prior Period Adjustment</u> | <u>Balance June 30, 2009</u> |
|------------------------------------------------|---------------------------------|---------------------|------------------|------------------------------------|----------------------------------|
| <u>Wastewater Activity:</u> | | | | | |
| Capital Assets, not being depreciated: | | | | | |
| Land | \$ 363,040 | \$ 2,500 | \$ - | \$ - | \$ 365,540 |
| Construction in progress | 2,496,412 | 7,295,012 | | 63,354 | 9,854,778 |
| Total Capital Assets, not being depreciated | <u>2,859,452</u> | <u>7,297,512</u> | | <u>63,354</u> | <u>10,220,318</u> |
| Capital Assets, being depreciated: | | | | | |
| Fields and grounds | 7,105,847 | | | | 7,105,847 |
| Machinery and equipment | 369,490 | | | | 369,490 |
| Pipelines | 3,618,320 | | | | 3,618,320 |
| Less - Accumulated depreciation | (2,593,687) | (251,432) | | | (2,845,119) |
| Total Capital Assets, being depreciated | <u>8,499,970</u> | <u>(251,432)</u> | | | <u>8,248,538</u> |
| Total Wastewater Capital Assets, net | <u>\$ 11,359,422</u> | <u>\$ 7,046,080</u> | <u>\$ -</u> | <u>\$ 63,354</u> | <u>\$ 18,468,856</u> |

ADELANTO PUBLIC UTILITY AUTHORITY
Notes to Basic Financial Statements
June 30, 2009

Note 4 Capital Assets (Continued)

Capital asset activity for the fiscal year ended June 30, 2009 was as follows (Continued):

| | Balance July 1, 2008 | Additions | Deletions | Transfers | Prior Period Adjustments | Balance June 30, 2009 |
|---------------------------------------------|-------------------------|---------------------|-------------|-------------|-----------------------------|--------------------------|
| <u>Water Activity:</u> | | | | | | |
| Capital Assets, not being depreciated: | | | | | | |
| Land | \$ 792,056 | \$ - | \$ - | \$ - | \$ - | \$ 792,056 |
| Water rights | 3,124,799 | | | | | 3,124,799 |
| Construction in progress | 4,003,913 | 253,564 | | (4,320,831) | 63,354 | |
| Total Capital Assets, not being depreciated | 7,920,768 | 253,564 | | (4,320,831) | 63,354 | 3,916,855 |
| Capital Assets, being depreciated: | | | | | | |
| Buildings and improvements | | | | 130,128 | | 130,128 |
| Wells and pump stations | 4,669,378 | | | 4,190,703 | | 8,860,081 |
| Reservoirs | 387,863 | | | | | 387,863 |
| Machinery and equipment | 16,774 | | | | | 16,774 |
| Pipelines | 8,935,541 | | | | | 8,935,541 |
| Vehicles | 389,178 | 94,821 | | | | 483,999 |
| Less - Accumulated depreciation | (4,058,142) | (353,755) | | | | (4,411,897) |
| Total Capital Assets, being depreciated | 10,340,592 | (258,934) | | 4,320,831 | | 14,402,489 |
| Total Water Capital Assets, net | <u>\$ 18,261,360</u> | <u>\$ (5,370)</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 63,354</u> | <u>\$ 18,319,344</u> |
| <u>Total Authority:</u> | | | | | | |
| Capital assets, not being depreciated: | | | | | | |
| Land | \$ 1,155,096 | \$ 2,500 | \$ - | \$ - | \$ - | \$ 1,157,596 |
| Water rights | 3,124,799 | | | | | 3,124,799 |
| Construction in progress | 6,500,325 | 7,548,576 | | (4,320,831) | 126,708 | 9,854,778 |
| Total Capital Assets, not being depreciated | 10,780,220 | 7,551,076 | | (4,320,831) | 126,708 | 14,137,173 |
| Capital Assets, being depreciated: | | | | | | |
| Buildings and improvements | | | | 130,128 | | 130,128 |
| Fields and grounds | 7,105,847 | | | | | 7,105,847 |
| Wells and pump stations | 4,669,378 | | | 4,190,703 | | 8,860,081 |
| Reservoirs | 387,863 | | | | | 387,863 |
| Machinery and equipment | 386,264 | | | | | 386,264 |
| Pipelines | 12,553,861 | | | | | 12,553,861 |
| Vehicles | 389,178 | 94,821 | | | | 483,999 |
| Less - Accumulated depreciation | (6,651,829) | (605,187) | | | | (7,257,016) |
| Total Capital Assets, being depreciated | 18,840,562 | (510,366) | | 4,320,831 | | 22,651,027 |
| Total Authority Capital Assets, net | <u>\$ 29,620,782</u> | <u>\$ 7,040,710</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 126,708</u> | <u>\$ 36,788,200</u> |

ADELANTO PUBLIC UTILITY AUTHORITY
Notes to Basic Financial Statements
June 30, 2009

Note 4 Capital Assets (Continued)

Depreciation expense has been included by function in the Statement of Revenues, Expenses, and Changes in Net Assets as follows:

| | | |
|---------------------------|----|---------|
| Public Utility Activities | \$ | 251,432 |
| Water Activities | | 353,755 |

Note 5 Long-Term Liabilities

The following is a schedule of changes in long-term liabilities of the Authority for the fiscal year ended June 30, 2009:

| | Balance July 1, 2008 | Additions/ accretions | Principal payments | Balance June 30, 2009 | Due in 1 year |
|--------------------------------------------------------------------------|-------------------------|--------------------------|-----------------------|--------------------------|---------------------|
| Adelanto Public Utility Authority Refunding Revenue Bonds, 2005 Series A | \$ 55,615,000 | \$ - | \$ (1,220,000) | \$ 54,395,000 | \$ 1,270,000 |
| Adelanto Public Utility Authority Refunding Revenue Bonds, 2005 Series B | 15,020,000 | | (300,000) | 14,720,000 | 310,000 |
| Compensated Absences | 31,412 | 13,467 | | 44,879 | |
| Advances from the City of Adelanto | 5,189,248 | | (605,223) | 4,584,025 | |
| | \$ 75,855,660 | \$ 13,467 | \$ (2,125,223) | \$ 73,743,904 | \$ 1,580,000 |

In regards to the 2005A and 2005B Bonds, the Authority has entered into interest rate swap agreements pursuant to a master agreement, effective September 7, 2005. The swap provider is Piper Jaffray Financial Products Inc. Under the swap associated with the Series A Bonds, the Authority will pay a fixed rate of 3.387% and receive amounts based upon a variable rate (based on 63% of the One-Month London Interbank Offering Rate (LIBOR) plus 30 basis points). In regards to the 2005B Bonds, there are two separate swaps. The first swap's period started on September 7, 2005, through but excluding September 1, 2008. The Authority will pay a fixed rate of 4.485% and receive amounts based upon a variable rate (based on 63% of LIBOR plus 30 basis points). The second swap for the 2005 B Bonds begins on September 1, 2008 and continues for the remaining life of the 2005B Bonds. The Authority will pay a fixed rate of 3.447% and receive amounts based upon a variable rate (based on 63% of LIBOR plus 30 basis points). The payment obligations of the Authority under the 2005 SWAP (excluding Termination Payments thereunder) will constitute Parity Obligations and the payments received by the Authority under the 2005 Swap will be pledged to the payment of the 2005A Bonds and the 2005B Bonds. The payment obligations of the Authority under the 2005 Swap that constitute Termination Payments constitute Subordinate Obligations under the Indenture.

Ambac Assurance Corporation has issued a financial guaranty insurance policy in regards to the issuance of the 2005A and 2005B Bonds. Ambac Assurance will pay the Bank of New York (or any successor) the portion of the principal and interest on the Bonds that become due and remain unpaid. The insurance will extend for the term of the Bonds and cannot be canceled.

Please see the disclosure under Commitments and Contingencies for additional information regarding the 2005A and 2005 B Bonds.

ADELANTO PUBLIC UTILITY AUTHORITY
Notes to Basic Financial Statements
June 30, 2009

Note 5 Long-Term Debt (Continued)

A description of individual long-term obligations outstanding at June 30, 2009 is as follows:

• **Adelanto Public Utility Authority Refunding Revenue Bonds, 2005 Series A**

In September, 2005, the Adelanto Public Utility Authority issued \$55,615,000 of Variable Rate Refunding Revenue Bonds to advance refund \$30,670,000 of outstanding Revenue Bonds 2000 Series A and B. Interest on the 2005 Series A Revenue Bonds is payable initially on October 1, 2005, and monthly thereafter until November 1, 2034.

Net proceeds of approximately \$30.9 million (after payment of a \$436,578 underwriter's discount, \$1,254,983 in issuance costs, and \$3,308,384 to a reserve fund) plus an additional \$817,710 of 2000 Series A and B debt service reserve fund monies were used to purchase state and local government securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the 2000 Series A and B Revenue Bonds. As a result, the 2000 Series A and B Revenue Bonds are considered to be defeased and the liability for those bonds has been removed from the accompanying financial statements.

The remaining amount of \$20.5 million is to be used to finance improvements to both the Water and Wastewater Systems.

After the fixed rate conversion date, the Bonds are subject to redemption at the option of the Public Utility Authority in whole or in part in integral multiples of \$5,000, at a redemption price equal to the principal amount plus premium (expressed as a percentage of the principal amount of such bonds to be prepaid) plus accrued interest to the date fixed for prepayment, as set forth below:

The Public Utility Authority is required to create and maintain a separate Rate Stabilization Fund to be held by the Trustee. The minimum rate stabilization requirement for the 2005 Bonds Series A and B is \$700,000. As of June 30, 2009, the total balance in the Rate Stabilization Fund was \$2,100,000 and is included in restricted cash and investments.

The Public Utility Authority is required under the Bond Indenture to fix, prescribe, revise and collect rates, fees, and charges for the services and facilities furnished by the wastewater system during each fiscal year, which are at least sufficient, after making allowances for contingencies and error in the estimates, to yield gross wastewater revenues to pay the following amounts in the following order of priority:

- All wastewater operation and maintenance costs estimated by the Authority to become due and payable in such fiscal year.
- The 2005 Series A Public Utility Authority Revenue Bonds debt service payments as they become due and payable during such fiscal year.
- All amounts, if any, required to restore the balance in the Rate Stabilization Fund.
- All amounts required by the Wastewater Purchase Agreement for payment of Wastewater Purchase Payments.
- All other payments required to meet any other obligations of the Public Utility Authority which are payable from gross revenues during such fiscal year.

In addition, the Public Utility Authority is required to fix, prescribe, revise, and collect rates, fees and charges for the services and improvements furnished by the wastewater enterprise and water enterprise during each fiscal year which are sufficient to yield combined net wastewater revenues and net water revenues at least equal to 125% of the total debt service payments (2005A and 2005B) coming due and payable in such fiscal year.

ADELANTO PUBLIC UTILITY AUTHORITY
Notes to Basic Financial Statements
June 30, 2009

Note 5 Long-Term Debt (Continued)

• **Adelanto Public Utility Authority Refunding Revenue Bonds, 2005 Series A (Continued)**

On December 19, 2007, there was a reoffering of the 2005 Series A bonds. The bonds were reoffered and delivered as auction rate bonds (ARB), in the principal amount set on September 7, 2005. The auction rate for the Bonds will be determined, in most cases, through the implementation of the auction procedures. The initial period for the 2005 Series A bonds shall be the period commencing on and including the reoffering date and ending on and including December 26, 2007, with interest payable for the initial period on December 27, 2007, and thereafter the auction period shall be a 7-day auction period with auctions generally conducted every Wednesday. The applicable auction rate will not exceed the ARB maximum rate of 12% per annum. The interest rate as of June 30, 2009 was 11.867%.

The outstanding balance on the 2005 Series A Revenue Bonds at June 30, 2009 was \$54,395,000.

• **Adelanto Public Utility Authority Revenue Bonds, 2005 Series B**

In September, 2005, the Adelanto Public Utility Authority issued \$15,020,000 of Variable Rate Refunding Revenue Bonds (2005 Series B), approximately \$13.8 million, was used to advance refund \$13,655,000 of outstanding Revenue Bonds, 1990 Series C Bonds. Interest on the 2005 Series B Revenue Bonds is payable initially on October 1, 2005, and monthly thereafter through November 1, 2034.

The issuance resulted in net proceeds of approximately \$13.5 million (after payment of a \$117,907 underwriter's discount, \$495,356 in issuance costs, and \$971,711 in a reserve fund). Of the \$13.5 million in net proceeds and an additional \$300,696 in funds from prior bond reserve funds, \$13.8 million was used to purchase state and local government securities. Those securities were deposited in an irrevocable trust with an escrow agent to be used, to pay principal and interest on the 2000 Series C Revenue Bonds. As a result, the 2000 Series C Revenue Bonds are considered to be defeased and the liability for those bonds has been removed from the accompanying financial statements.

The Public Utility Authority is required under the Bond Indenture to fix, prescribe, revise and collect rates, fees, and charges for the services and facilities furnished by the wastewater system during each fiscal year, which are at least sufficient, after making allowances for contingencies and errors in the estimates, to yield gross wastewater revenues to pay the following amounts in the following order of priority:

- All wastewater operation and maintenance costs estimated by the Authority to become due and payable in such fiscal year.
- The 2005 Series B Public Utility Authority Revenue Bonds debt service payments as they become due and payable during such fiscal year.
- All amounts, if any, required to restore the balance in the Rate Stabilization Fund.
- All amounts required by the Wastewater Purchase Agreement for payment of Wastewater Purchase Payments.
- All other payment required to meet any other obligations of the Public Utility Authority which are payable from gross revenues during such fiscal year.

In addition, the Public Utility Authority is required to fix, prescribe, revise, and collect rates, fees and charges for the services and improvements furnished by the wastewater enterprise and water enterprise during each fiscal year which are sufficient to yield combined net wastewater revenues and net water revenues at least equal to 125% of the total debt service payments (2005A and 2005B) coming due and payable in such fiscal year.

ADELANTO PUBLIC UTILITY AUTHORITY
Notes to Basic Financial Statements
June 30, 2009

Note 5 Long-Term Debt (Continued)

• **Adelanto Public Utility Authority Revenue Bonds, 2005 Series B (Continued)**

On December 19, 2007, there was a reoffering of the 2005 Series A bonds. The bonds were reoffered and delivered as auction rate bonds (ARB), in the principal amount set on September 7, 2005. The auction rate for the Bonds will be determined, in most cases, through the implementation of the auction procedures. The initial period for the 2005 Series B bonds shall be the period commencing on and including the reoffering date and ending on and including December 26, 2007, with interest payable for the initial period on December 27, 2007, and thereafter the auction period shall be a 28-day auction period with auctions generally conducted every fourth Wednesday. The applicable auction rate will not exceed the ARB maximum rate of 12% per annum. The interest rate as of June 30, 2009 was 11.200%.

The outstanding balance on the 2005 Series B Revenue Bonds at June 30, 2009 was \$14,720,000.

• **Debt Service Requirements**

The following schedule illustrates the debt service requirements to maturity for bonds outstanding as of June 30:

| <u>Fiscal year</u> | <u>2005 Public Utility Bonds Series A</u> | <u>2005 Public Utility Bonds Series B</u> | <u>Total</u> |
|--------------------------------------|---------------------------------------------------|---------------------------------------------------|----------------------|
| 2010 | \$ 7,725,147 | \$ 1,958,640 | \$ 9,683,787 |
| 2011 | 7,619,434 | 1,938,920 | 9,558,354 |
| 2012 | 7,513,381 | 1,917,520 | 9,430,901 |
| 2013 | 7,401,394 | 1,894,440 | 9,295,834 |
| 2014 | 7,288,474 | 1,869,680 | 9,158,154 |
| 2015-2019 | 34,565,371 | 8,949,840 | 43,515,211 |
| 2020-2024 | 30,973,468 | 8,172,360 | 39,145,828 |
| 2025-2029 | 26,656,147 | 7,212,360 | 33,868,507 |
| 2030-2034 | 21,455,048 | 6,012,000 | 27,467,048 |
| 2035 | 3,579,749 | 1,034,160 | 4,613,909 |
| | <u>154,777,613</u> | <u>40,959,920</u> | <u>195,737,533</u> |
| Less amount representing interest | <u>100,382,613</u> * | <u>26,239,920</u> * | <u>126,622,533</u> |
| Balance outstanding | <u>\$ 54,395,000</u> | <u>\$ 14,720,000</u> | <u>\$ 69,115,000</u> |

* As the interest rate is variable dependent on the auction rate, the interest rate as of 6/30/09 was used to calculate the interest amounts due from the fiscal year 2010 to 2035.

• **Defeasance of Debt**

At June 30, 2009, the 1995, 1998, and 2000 debt defeased has been paid in full. There are no outstanding debt balances related to these issues.

• **Compensated Absences**

As of the fiscal year ended June 30, 2009, the total accrued employee leave benefits for the Authority was \$44,879.

ADELANTO PUBLIC UTILITY AUTHORITY

Notes to Basic Financial Statements

June 30, 2009

Note 6 **Retirement Plan**

The City of Adelanto terminated the City of Adelanto Money Purchase Pension Plan on March 20, 2003 and contracted with the State of California Public Employees Retirement System to provide retirement benefits for its employees. Each Participant's account was credited with the cash value of his or her life insurance policy. On September 30, 2003, the balance of each member's account was transferred to PenChecks, Inc. who was appointed as agent of the Trustee of the Plan for the purpose of processing benefit distributions for the participants and beneficiaries.

The Authority participates in the City's pension plan, California Public Employees' Retirement System (PERS), an agent multiple-employer defined benefit pension plan. PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. PERS acts as a common investment and administrative agent for participating public entities within the State of California. Benefit provisions and all other requirements are established by state statute and City ordinance. Please refer to the City's basic financial statements as of June 30, 2009, for detailed information regarding the pension plan.

Note 7 **Other Post Employment Benefits**

The City provides postretirement medical insurance benefits for all employees who have worked for the City for a period of ten years and are at least 50 years of age when they separate from the service of the City, and who were employed by the City on July 1, 2004. This coverage includes medical insurance coverage only, for the life of the employee only. Employees hired after July 1, 2004 are not entitled to the retiree medical insurance benefits. Please refer to the City's basic financial statements as of June 30, 2009, for detailed information regarding the other post employment benefits.

Note 8 **Proposition 218**

Proposition 218, which was approved by the voters in November 1996, will regulate the Authority's ability to impose, increase, and extend taxes, assessments, and fees. Any new, increased, or extended taxes, assessments, and fees subject to the provisions of Proposition 218 require voter approval before they can be implemented. Additionally, Proposition 218 provides that these taxes, assessments, and fees are subject to the voter initiative process and may be rescinded in the future years by the voters.

Note 9 **Commitments and Contingencies**

General Litigation

In the normal course of operations, the City has been subjected to certain routine litigation matters which are relevant to the Authority. The ultimate outcome of these lawsuits is not presently determinable; however, in the opinion of management, the amount of losses that might be sustained, if any, would not materially affect the financial position of the Authority.

Litigation

The Victorville Water District has a dispute with the City/Authority and is currently in discussions regarding cost claims by the Victorville Water District.

ADELANTO PUBLIC UTILITY AUTHORITY
Notes to Basic Financial Statements
June 30, 2009

Note 9 **Commitments and Contingencies (Continued)**

Litigation (Continued)

On June 1, 2009, Ambac Assurance Corporation filed a lawsuit against the Authority in a federal district court in the Southern District of New York and is seeking \$4,524,000 in damages plus interest and fees, costs and other expenses incurred by Ambac relating to or resulting from the alleged breach of the Authority of the Swap Agreement. In September 2005, the Authority issued \$70,635,000 of variable rate refunding revenue bonds (2005 A and 2005 B-Utility System Project). In order to hedge the risk from the Bonds, the Authority also entered into an interest rate swap agreement with Piper Jaffray Financial Products Incorporated (Piper). Ambac issued a surety bond for the swap agreement. The surety bond stated that if the Authority did not make certain payments pursuant to the swap agreement, Ambac would make those payments. On November 5, 2008, Moody's Investors Service downgraded Ambac's credit rating. The swap agreement provided that it could be terminated early upon the occurrence of certain events and when such early termination occurs, Piper shall be paid a "termination payment" to compensate it for the termination. The downgrade of Ambac's credit rating eventually led Piper on June 1, 2009, to terminate the swap agreement and demanded \$4,524,000 from the Authority as a termination payment. Ambac, as surety per the surety bond, paid Piper the \$4,524,000 on June 3, 2009. Ambac in its lawsuit now seeks repayment of this amount from the Authority. The APUA has brought a motion to either: 1) dismiss the case based upon the John Act and make Ambac refile the case in California state court; or 2) transfer the case to the federal district court in the Central District of California. The Authority is awaiting the Court's ruling.

The Authority is attempting to resolve the matter via settlement, but at this time Ambac has only offered to settle the case for the full amount it has demanded and a full release of any liability against Ambac. The Authority has rejected the settlement offer. There are potential counterarguments as to the validity of the obligation and the priority of payment as compared to other Authority obligations and; hence, whether and when the termination payment is payable. Furthermore, the Authority believes that the actions of Ambac have damaged the Authority. The Authority has hired a financial advisor who prepared an analysis that demonstrates that the Authority has been damaged between \$5.7 and \$7.1 million as a result of higher interest paid by the Authority due to Ambac being downgraded and the Authority intends to bring a counterclaim against Ambac and potentially other parties regarding the overall transaction. Therefore, the final amount either due or owing the Authority in this matter is as of yet undetermined. It is still hoped that the parties reach an overall settlement of the matter. (this information was obtained from legal correspondence from the City of Adelanto's Attorney).

Note 10 **Advances To/From Other Funds**

The Adelanto Water Authority owes the Adelanto Public Utility Authority a net amount of \$21,310,912. These amounts have been eliminated on the Statement of Net Assets. These amounts are shown as advances to/advances from Water Authority/Public Utility Authority on the Statement of Net Assets – Proprietary Funds. The Adelanto Water Authority owes the City of Adelanto \$4,584,025 which was used to fund the ongoing operations of the Adelanto Water Authority. This amount is shown on the Long Term Liabilities portion of the Statement of Net Assets.

ADELANTO PUBLIC UTILITY AUTHORITY
Notes to Basic Financial Statements
June 30, 2009

Note 11 **Net Assets**

GASB Statement No. 34 requires that the difference between assets and liabilities be reported as net assets. Net assets are classified as either invested in capital assets, net of related debt, restricted, or unrestricted.

Net assets that are invested in capital assets, net of related debt, consist of capital assets, net of accumulated depreciation, and reduced by the outstanding principal of related debt. Restricted net assets are those net assets that have external constraints placed on them by creditors, grantors, contributors, laws, or regulations of other governments, or through constitutional provisions or enabling legislation. Unrestricted net assets consist of net assets that do not meet the definition of invested in capital assets, net of related debt, or restricted net assets.

Note 12 **Prior Period Adjustments**

The following prior period adjustments were made to the Statement of Revenues, Expenses, and Changes in Fund Net Assets-Proprietary Funds:

A prior period adjustment of (\$3,600,000) to the Adelanto Public Utility Authority Fund and \$3,600,000 to the Adelanto Water Authority Fund were made in order to show transfers that were made between these funds in prior fiscal years that were used to make debt payments due by the Adelanto Public Utility Authority Fund and the Adelanto Water Authority Fund. In the original calculation that was done in the fiscal year 6/30/08 to allocate the expense of the debt payments (note payments due to the City and the 2005A and 2005B bond payments) between the Adelanto Public Utility Authority Fund and the Adelanto Water Authority Fund, this total transfer amount was not used in the calculation to determine the allocation amount.

A prior period adjustment of (\$646,369) was made to the Adelanto Water Authority Fund for an overstatement of accreted interest.

A prior period adjustment of \$63,354 was made to the Adelanto Public Utility Authority Fund and \$63,354 to the Adelanto Water Authority Fund in order to capitalize a purchase that was expensed instead of capitalized in the prior fiscal year.

The prior period adjustment amount of (\$519,661) was made in the government wide financial statements due to the following:

A prior period adjustment of (\$646,369) was made for an overstatement of accreted interest related to the investment in Adelanto Public Financing Authority Bonds.

A prior period adjustment of \$126,708 was made to capitalize a purchase that was expensed instead of capitalized in the prior fiscal year.

Note 13 **Subsequent Events**

On December 10, 2009, the Adelanto Public Utility Authority issued the 2009 Series A Fixed Rate Refunding Revenue Bonds in the amount of \$76,825,000. The bonds were issued for the purpose of providing funds to i) refund the Authority's outstanding \$53,125,000 Variable Rate Refunding Revenue Bonds, 2005 Series A (Utility System Project) and its outstanding \$14,410,000 Taxable Variable Rate Refunding Bonds, 2005 Series B (Utility System Project) (collectively, the "2005 Bonds"), (ii) finance certain capital improvements to the Authority's water treatment, production, storage and distribution system (the "Water Enterprise") and its wastewater collection and treatment system (the "Wastewater Enterprise", and collectively with the Water Enterprise, the "Utility System"), (iii) fund a debt service reserve fund for the 2009 Bonds and to pay certain other costs, and (iv) pay the costs of issuing the 2009 Bonds.



MOSS, LEVY & HARTZHEIM LLP

CERTIFIED PUBLIC ACCOUNTANTS

PARTNERS:

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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**

Members of the Governing Board
of the Adelanto Public Utility Authority
Adelanto, California

We have audited the financial statements of the business-type activities and each major fund of the Adelanto Public Utility Authority (Authority), a component unit of the City of Adelanto, California (City), as of and for the fiscal year ended June 30, 2009, which collectively comprise the Authority's financial statements, and have issued our report thereon dated February 26, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Authority's ability to initiate, authorize, record, process, or report financial data reliably in accordance with accounting principles generally accepted in the United States of America such that there is more than a remote likelihood that a misstatement of the Authority's financial statements that is more than inconsequential will not be prevented or detected by the Authority's internal control. We consider the deficiencies in the following areas to be significant deficiencies in internal control over financial reporting: 1) cash receipts are not reconciled and deposited timely, 2) bank reconciliations are not prepared timely and reconciled properly, 3) internal control procedures regarding accounts payable processing, payroll processing, journal entries, general ledger entries, system backup, cellular phone, and petty cash have deficiencies, and 4) financial statements are not prepared timely. Please see the separate letter dated February 26, 2010 which contains further information regarding these significant deficiencies and certain other matters that we reported to management of the Authority.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Authority's internal control. Of the significant deficiencies in internal control described above, we consider items 2, 3, and 4 to be material weaknesses.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the financial statements of the Authority are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, others within the organization, and the governing board and is not intended to be and should not be used by anyone other than these specified parties.

Moss, Levy & Hartzheim

Moss, Levy & Hartzheim, LLP
Beverly Hills, California
February 26, 2010