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

## FINANCIAL STATEMENTS

**June 30, 2012**

**ADELANTO PUBLIC UTILITY AUTHORITY**
**(A Component Unit of the City of Adelanto, California)**
**BASIC FINANCIAL STATEMENTS**
**June 30, 2012**

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# INDEPENDENT AUDITOR'S REPORT

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

We were engaged to audit 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, 2012, 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 were unable to obtain detail supporting documents for certain capital assets of the business-type activities and each major fund acquired prior to June 30, 2001. As a result, we were not able to satisfy ourselves as to the related capital assets cost of $20,599,540 and the accumulated depreciation of these assets in the amount of approximately $2,888,007 by other auditing procedures.

The Authority's system of internal controls as a result of insufficient staffing levels, in our opinion, is not adequate to assure proper recording of transactions. Accordingly, it was impracticable to extend our procedures sufficiently to determine the extent to which the financial statements may have been affected by these conditions.

Because of the significance of the matters discussed in the preceding paragraphs, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion of the financial statements referred to above, the respective financial position of the business-type activities and each major fund of the Authority as of June 30, 2012, 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.

The accompanying financial statements have been prepared assuming that the Authority will continue as a going concern. As discussed in Note 12 of the notes to the financial statements the Wastewater Authority has a deficit of total net assets of ($4,204,868). In addition, the Authority does not currently have the financial resources to pay the settlement agreement in the amount of $4,524,000 plus additional interest and fees to be determined at a future time to Ambac Assurance Corporation as a result of the litigation detailed in Note 5 of these financial statements. These conditions raise substantial doubt about its ability to continue as a going concern. Management's plans regarding those matters also are described in Note 12. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in note 1 of the notes to basic financial statements effective July 1, 2011, The Authority adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 64, *"Derivative Instruments: Application of Hedge Accounting Termination Provisions."*


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In accordance with *Government Auditing Standards*, we have also issued a report dated February 18, 2013, 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.

Management has omitted the management's discussion and analysis (MD&A) that accounting principles generally accepted in the United States of America requires to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.

Moss, Levy & Hartzheim, LLP
Culver City, California
February 18, 2013

**ADELANTO PUBLIC UTILITY AUTHORITY**
**STATEMENT OF NET ASSETS**
**June 30, 2012**

| ASSETS | Business-type Activities |
|---|---|
| **Current Assets:** | |
| Cash and investments | $ 6,404,853 |
| Receivables: | |
| Accounts, net | 2,960,021 |
| Interest | 3,856 |
| Prepaid expenses | 8,088 |
| Inventories | 66,959 |
| Due from City of Adelanto | 210,696 |
| Total Current Assets | 9,654,473 |
| **Restricted Assets:** | |
| Cash and investments with fiscal agents | 20,736,614 |
| Total Restricted Assets | 20,736,614 |
| **Capital Assets:** | |
| Capital assets not being depreciated | 21,823,773 |
| Capital assets being depreciated, net of accumulated depreciation | 20,650,018 |
| Total Capital Assets | 42,473,791 |
| **Other Assets:** | |
| Investment in Adelanto Public Financing Authority Bonds | 13,905,492 |
| Deferred bond issuance costs, net of accumulated amortization | 1,320,375 |
| Total Other Assets | 15,225,867 |
| Total Assets | $ 88,090,745 |

(Continued)

See accompanying notes to basic financial statements

**ADELANTO PUBLIC UTILITY AUTHORITY**
**STATEMENT OF NET ASSETS**
**June 30, 2012**
**(Continued)**

| **LIABILITIES** | Business-type Activities |
|---|---|
| **Current Liabilities:** | |
| Accounts payable | $ 2,159,108 |
| Accrued liabilities | 67,161 |
| Deposits payable | 469,405 |
| Total Current Liabilities | 2,695,674 |
| **Current Liabilities (payable from restricted assets):** | |
| Accrued interest payable | 2,412,453 |
| Total Current Liabilities (payable from restricted assets) | 2,412,453 |
| **Long-Term Liabilities:** | |
| Accrued employee leave benefits | 94,470 |
| Advances from the City of Adelanto | 6,683,256 |
| Settlement payable | 4,524,000 |
| Bonds payable, non-current | 68,640,015 |
| Total Long-Term Liabilities | 79,941,741 |
| Total Liabilities | 85,049,868 |
| **NET ASSETS** | |
| **Net Assets:** | |
| Invested in capital assets, net of related debt | 9,796,257 |
| Unrestricted | (6,755,380) |
| Total Net Assets | $ 3,040,877 |

See accompanying notes to basic financial statements

**ADELANTO PUBLIC UTILITY AUTHORITY**
**STATEMENT OF ACTIVITIES**
**For the Fiscal Year Ended June 30, 2012**

| Business-type Activities | Expenses | Program Revenue Charges for Services | Net (Expense) Revenue and Change in Net Assets |
|---|---|---|---|
| **Expenses:** | | | |
| Wastewater activities | $ (6,075,699) | $ 6,103,692 | $ 27,993 |
| Water activities | (7,809,449) | 7,697,852 | (111,597) |
| Total | $ (13,885,148) | $ 13,801,544 | (83,604) |
| **General Revenues and Transfers:** | | | |
| Use of money and property | | | 1,280,879 |
| Transfers to the City of Adelanto | | | (1,178,478) |
| Total General Revenues and Transfers | | | 102,401 |
| Change in Net Assets Before Extraordinary Item | | | 18,797 |
| Loss on Settlement Agreement | | | (4,524,000) |
| Change in Net Assets | | | (4,505,203) |
| **Net Assets - July 1, 2011** | | | 7,546,080 |
| **Net Assets - June 30, 2012** | | | $ 3,040,877 |

See accompanying notes to basic financial statements

**ADELANTO PUBLIC UTILITY AUTHORITY**
**STATEMENT OF NET ASSETS - PROPRIETARY FUNDS**
**June 30, 2012**

| Assets | Adelanto Public Utility Authority | Adelanto Water Authority | Totals |
|---|---|---|---|
| **Current Assets:** | | | |
| Cash and investments | $ 1,315,717 | $ 5,089,136 | $ 6,404,853 |
| Receivables: | | | |
| Accounts, net | 1,229,186 | 1,730,835 | 2,960,021 |
| Interest | 628 | 3,228 | 3,856 |
| Prepaid expenses | | 8,088 | 8,088 |
| Inventories | | 66,959 | 66,959 |
| Due from City of Adelanto | | 210,696 | 210,696 |
| Total Current Assets | 2,545,531 | 7,108,942 | 9,654,473 |
| **Restricted Assets:** | | | |
| Cash and investments with fiscal agents | 8,156,177 | 12,580,437 | 20,736,614 |
| Total Restricted Assets | 8,156,177 | 12,580,437 | 20,736,614 |
| **Capital assets, net of accumulated depreciation** | 25,401,160 | 17,072,631 | 42,473,791 |
| **Other Assets:** | | | |
| Advances to other funds | | 12,286,116 | 12,286,116 |
| Advances to the City of Adelanto | 3,121,401 | 12,383,240 | 15,504,641 |
| Investment in Adelanto Public Financing Authority Bonds | | 13,905,492 | 13,905,492 |
| Deferred bond issuance costs, net of accumulated amortization | 541,353 | 779,022 | 1,320,375 |
| Total Other Assets | 3,662,754 | 39,353,870 | 43,016,624 |
| Total Assets | $ 39,765,622 | $ 76,115,880 | $ 115,881,502 |

(Continued)

See accompanying notes to basic financial statements

**ADELANTO PUBLIC UTILITY AUTHORITY**
**STATEMENT OF NET ASSETS - PROPRIETARY FUNDS**
**June 30, 2012**
**(Continued)**

| | Adelanto Public Utility Authority | Adelanto Water Authority | Totals |
|---|---|---|---|
| **Liabilities and Net Assets** | | | |
| **Current Liabilities:** | | | |
| Accounts payable | $ 607,739 | $ 1,551,369 | $ 2,159,108 |
| Accrued liabilities | | 67,161 | 67,161 |
| Deposits payable | 90,282 | 379,123 | 469,405 |
| Total Current Liabilities | 698,021 | 1,997,653 | 2,695,674 |
| **Current Liabilities:** | | | |
| **(payable from restricted assets):** | | | |
| Accrued interest payable | 989,106 | 1,423,347 | 2,412,453 |
| Total Current Liabilities (payable from restricted assets) | 989,106 | 1,423,347 | 2,412,453 |
| **Long-Term Liabilities:** | | | |
| Advances from the Water Authority | 12,286,116 | | 12,286,116 |
| Advances from the City of Adelanto | | 22,187,897 | 22,187,897 |
| Accrued employee leave benefits | | 94,470 | 94,470 |
| Settlement payable | 1,854,840 | 2,669,160 | 4,524,000 |
| Bonds payable, non-current | 28,142,407 | 40,497,608 | 68,640,015 |
| Total Long-Term liabilities | 42,283,363 | 65,449,135 | 107,732,498 |
| Total Liabilities | 43,970,490 | 68,870,135 | 112,840,625 |
| **Net Assets (Deficit):** | | | |
| Invested in capital assets, net of related debt | 5,956,283 | 3,839,974 | 9,796,257 |
| Unrestricted | (10,161,151) | 3,405,771 | (6,755,380) |
| Total Net Assets (Deficit) | $ (4,204,868) | $ 7,245,745 | $ 3,040,877 |

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, 2012**

| | Adelanto Public Utility Authority | Adelanto Water Authority | Totals |
|---|---|---|---|
| **Operating Revenues:** | | | |
| Charges for services | $ 6,103,692 | $ 7,697,852 | $ 13,801,544 |
| Total Operating Revenues | 6,103,692 | 7,697,852 | 13,801,544 |
| **Operating Expenses:** | | | |
| Salaries and benefits | | 1,343,971 | 1,343,971 |
| Contract services | 1,618,812 | 174,585 | 1,793,397 |
| Sewer operations | 1,255,069 | | 1,255,069 |
| Water operations | | 1,210,494 | 1,210,494 |
| Utilities | 184,317 | 653,692 | 838,009 |
| Administration | 280,932 | 269,378 | 550,310 |
| Depreciation | 251,432 | 415,571 | 667,003 |
| Total Operating Expenses | 3,590,562 | 4,067,691 | 7,658,253 |
| Operating Income | 2,513,130 | 3,630,161 | 6,143,291 |
| **Non-operating Revenues (Expenses):** | | | |
| Amortization expense | (132,249) | (190,309) | (322,558) |
| Interest expense and fiscal charges | (2,352,888) | (3,551,449) | (5,904,337) |
| Interest and investment revenue | 80,359 | 1,200,520 | 1,280,879 |
| Total Non-operating Revenues (Expenses) | (2,404,778) | (2,541,238) | (4,946,016) |
| Excess (Deficiency) of Revenues Over (Under) Expenditures | 108,352 | 1,088,923 | 1,197,275 |
| Transfers to the City of Adelanto | (125,000) | (1,053,478) | (1,178,478) |
| Change in Net Assets Before Extraordinary Item | (16,648) | 35,445 | 18,797 |
| **Extraordinary Item:** | | | |
| Loss on settlement agreement | (1,854,840) | (2,669,160) | (4,524,000) |
| Change in Net Assets | (1,871,488) | (2,633,715) | (4,505,203) |
| Net Assets (Deficit) - July 1, 2011 | (2,333,380) | 9,879,460 | 7,546,080 |
| Net Assets (Deficit) - June 30, 2012 | $ (4,204,868) | $ 7,245,745 | $ 3,040,877 |

See accompanying notes to basic financial statements

## ADELANTO PUBLIC UTILITY AUTHORITY
## STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS
**For the Fiscal Year Ended June 30, 2012**

| | Adelanto Public Utility Authority | Adelanto Water Authority | Totals |
|---|---|---|---|
| **Cash flows from operating activities:** | | | |
| Receipts from customers and users | $ 6,018,336 | $ 7,642,397 | $ 13,660,733 |
| Payments to suppliers | (6,148,521) | (756,780) | (6,905,301) |
| Payments to employees | | (1,303,506) | (1,303,506) |
| Net cash provided (used) by operating activities | (130,185) | 5,582,111 | 5,451,926 |
| **Cash flows from noncapital financing activities:** | | | |
| Transfers to the City of Adelanto | (125,000) | (1,264,174) | (1,389,174) |
| Payments received (paid) to/(from) other funds or the City | | (447,780) | (447,780) |
| Net cash provided (used) in noncapital financing activities | (125,000) | (1,711,954) | (1,836,954) |
| **Cash flows from capital and related financing activities:** | | | |
| Purchase of capital assets | (1,410,231) | | (1,410,231) |
| Interest paid on long-term debt | (2,322,287) | (3,474,106) | (5,796,393) |
| Net cash provided (used) in capital and related financing activities | (3,732,518) | (3,474,106) | (7,206,624) |
| **Cash flows from investing activities:** | | | |
| Interest and investment revenue | 80,566 | 1,201,405 | 1,281,971 |
| Net cash provided by investing activities | 80,566 | 1,201,405 | 1,281,971 |
| Net increase (decrease) in cash and cash equivalents | (3,907,137) | 1,597,456 | (2,309,681) |
| Cash and cash equivalents, beginning of fiscal year | 13,379,031 | 16,072,117 | 29,451,148 |
| Cash and cash equivalents, end of fiscal year | $ 9,471,894 | $ 17,669,573 | $ 27,141,467 |
| **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 | $ 1,315,717 | $ 5,089,136 | $ 6,404,853 |
| Cash and investments with fiscal agents | 8,156,177 | 12,580,437 | 20,736,614 |
| **Cash and cash equivalents - June 30, 2012** | $ 9,471,894 | $ 17,669,573 | $ 27,141,467 |
| **Reconciliation of operating income to net cash provided by operations:** | | | |
| Operating income | $ 2,513,130 | $ 3,630,161 | $ 6,143,291 |
| Adjustments to reconcile operating income to net cash provided (used) by operating activities: | | | |
| Depreciation | 251,432 | 415,571 | 667,003 |
| Decrease (increase) in accounts receivable | (86,863) | (64,406) | (151,269) |
| Increase (decrease) in accounts payable | (2,809,391) | 1,551,369 | (1,258,022) |
| Increase (decrease) in accrued liabilities | | 23,774 | 23,774 |
| Increase (decrease) in deposits payable | 1,507 | 8,951 | 10,458 |
| Increase (decrease) in accrued employee leave benefits | | 16,691 | 16,691 |
| Total adjustments | (2,643,315) | 1,951,950 | (691,365) |
| Net Cash Provided (Used) by Operating Activities | $ (130,185) | $ 5,582,111 | $ 5,451,926 |

See accompanying notes to basic financial statements

## 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.

## 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 2009 Adelanto Public 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.

## 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 the City of Adelanto" or "advances to the 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.

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 |

The Authority's water rights that are listed under capital assets do not have a finite period of useful life to the Authority and so there is no expiration date for the Authority's rights to the water.

**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.

## 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 Authority has accrued $1,070,867 of capital appreciation during the fiscal year ended June 30, 2012. The Public Utility Authority records its investment in Adelanto Public Financing Authority Bonds at cost at June 30, 2012.

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.

During fiscal year 1996, the Redevelopment Agency and the County of San Bernardino amended their pass-through agreement for incremental property taxes in the Merged Project Area. Under the amended 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.

### (f) New Accounting Pronouncements

The Authority has implemented the requirements of Governmental Accounting Standards Board (GASB) Statement No. 64 during the fiscal year ended June 30, 2012.

Governmental Accounting Standards Board Statement No. 64

For the fiscal year ended June 30, 2012, the City implemented Governmental Accounting Standards Board (GASB) Statement No. 64, "Derivative Instruments: Application of Hedge Accounting Termination Provisions." This statement is effective for periods beginning after June 15, 2011. The objective of this statement is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. This statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied. Implementation of the GASB Statement No. 64, did not have an impact on the City's financial statements for the fiscal year ended June 30, 2012.

## 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 $11,831,875 at June 30, 2012.

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, which at that time was 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, 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. Surplus revenues is defined as all of the net water revenues as of the second business day minus the amount required to pay debt service on or before the business day immediately preceding the first business day of each month on the 2009 Bonds.

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.

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 all of the net wastewater revenues as of the second business day of each month, minus the amount required to pay debt service on or before the business day immediately preceding the first business day of each month on the 2009 Bonds.

## Note 2 Purchase of Operations (Continued)

### (b) 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 all of the net wastewater revenues as of the second business day of each month minus the amount required to pay debt service on or before the business day immediately preceding the first business day of each month on the 2009 Bonds. 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, which at that time was 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. Subsequently, 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. The outstanding balance on the Wastewater System Purchase Note is $6,431,169 at June 30, 2012.

### (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.

## Note 3 Cash and Investments

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

| | |
|---|---|
| Statement of net assets: | |
| Cash and investments | $ 6,404,853 |
| Cash and investments with fiscal agents | 20,736,614 |
| Investment in Adelanto Public Financing Authority Bonds | 13,905,492 |
| Total cash and investments | $ 41,046,959 |

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

| | |
|---|---|
| Petty cash | $ 850 |
| Deposits with financial institutions | 2,062,965 |
| Investments | 38,983,144 |
| Total cash and investments | $ 41,046,959 |

### (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 | $50 million |
| Local or Government 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 | N/A | None | None |
| 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.

## 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:

| | | Remaining maturity (in Months) | | | |
|---|---|---|---|---|---|
| Investment Type | Totals | 12 Months or Less | 13 to 24 Months | 25 to 60 Months | More Than 60 Months |
| State Investment Pool | $ 4,341,038 | $ 4,341,038 | $ - | $ - | $ - |
| Held by Bond Trustees: | | | | | |
| Money Market Funds | 16,456,520 | 16,456,520 | | | |
| Investment Agreement | 4,280,094 | | | | 4,280,094 |
| Public Financing Authority Bonds* | 13,905,492 | | | | 13,905,492 |
| | $ 38,983,144 | $ 20,797,558 | $ - | $ - | $ 18,185,586 |

* 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.

## 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.

| | | | | Rating as of Fiscal Year End | | | |
|---|---|---|---|---|---|---|---|
| Investment Type | Amount | Minimum Legal Rating | Exempt From Disclosure | AAA | AA | A | Not Rated |
| State Investment Pool | $ 4,341,038 | N/A | $ - | $ - | $ - | $ - | $ 4,341,038 |
| Held by bond trustee: | | | | | | | |
| Money Market Funds | 16,456,520 | N/A | | 16,456,520 | | | |
| Investment Agreements | 4,280,094 | N/A | | | | | 4,280,094 |
| Public Financing Authority Bonds | 13,905,492 | N/A | | | | | 13,905,492 |
| Total | $ 38,983,144 | | $ - | $ 16,456,520 | $ - | $ - | $ 22,526,624 |

### (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 | 13,905,492 |

Investments in any one issuer that represent 5% or more of total investments by reporting unit (primary government, business type activities, and major funds) are as follows:

The Adelanto Public Utility Authority holds investments in IXIS Investment Contracts equal to $1,754,839. The agreements mature on September 30, 2015 and pay interest of 4.360%.

The Adelanto Water Authority holds investments in IXIS Investment Contracts equal to $2,525,255. 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 $13,905,492. 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

## Note 3 Cash and Investments (Continued)

### (g) Custodial Credit Risk (Continued)

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 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, 2012, the 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:

| Investment Type | Reported Amount |
|---|---|
| Money market funds | $ 16,440,172 |
| 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, 2012 was as follows:

| | Balance July 1, 2011 | Additions | Deletions | Balance June 30, 2012 |
|---|---|---|---|---|
| Wastewater Activity: | | | | |
| Capital Assets, not being depreciated: | | | | |
| Land | $ 1,023,325 | $ 6,563 | $ - | $ 1,029,888 |
| Construction in progress | 15,473,362 | 1,403,668 | | 16,877,030 |
| Total Capital Assets, not being depreciated | 16,496,687 | 1,410,231 | | 17,906,918 |
| 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 | (3,347,983) | (251,432) | | (3,599,415) |
| Total Capital Assets, being depreciated | 7,745,674 | (251,432) | | 7,494,242 |
| Total Wastewater Capital Assets, net | $ 24,242,361 | $ 1,158,799 | $ - | $ 25,401,160 |

## Note 4 Capital Assets (Continued)

Capital asset activity for the fiscal year ended June 30, 2012 was as follows (Continued):

| Water Activity: | Balance July 1, 2011 | Additions | Deletions | Balance June 30, 2012 |
|---|---|---|---|---|
| Capital Assets, not being depreciated: | | | | |
| Land | $ 792,056 | $ - | $ - | $ 792,056 |
| Water rights | 3,124,799 | | | 3,124,799 |
| Total Capital Assets, not being depreciated | 3,916,855 | | | 3,916,855 |
| Capital Assets, being depreciated: | | | | |
| Buildings and improvements | 130,128 | | | 130,128 |
| Wells and pump stations | 8,860,081 | | | 8,860,081 |
| Reservoirs | 387,863 | | | 387,863 |
| Machinery and equipment | 16,774 | | | 16,774 |
| Pipelines | 8,935,541 | | | 8,935,541 |
| Vehicles | 483,999 | | | 483,999 |
| Less - Accumulated depreciation | (5,243,039) | (415,571) | | (5,658,610) |
| Total Capital Assets, being depreciated | 13,571,347 | (415,571) | | 13,155,776 |
| Total Water Capital Assets, net | $ 17,488,202 | $ (415,571) | $ - | $ 17,072,631 |

| Total Authority: | | | | |
|---|---|---|---|---|
| Capital assets, not being depreciated: | | | | |
| Land | $ 1,815,381 | $ 6,563 | $ - | $ 1,821,944 |
| Water rights | 3,124,799 | | | 3,124,799 |
| Construction in progress | 15,473,362 | 1,403,668 | | 16,877,030 |
| Total Capital Assets, not being depreciated | 20,413,542 | 1,410,231 | | 21,823,773 |
| Capital Assets, being depreciated: | | | | |
| Buildings and improvements | 130,128 | | | 130,128 |
| Fields and grounds | 7,105,847 | | | 7,105,847 |
| Wells and pump stations | 8,860,081 | | | 8,860,081 |
| Reservoirs | 387,863 | | | 387,863 |
| Machinery and equipment | 386,264 | | | 386,264 |
| Pipelines | 12,553,861 | | | 12,553,861 |
| Vehicles | 483,999 | | | 483,999 |
| Less - Accumulated depreciation | (8,591,022) | (667,003) | | (9,258,025) |
| Total Capital Assets, being depreciated | 21,317,021 | (667,003) | | 20,650,018 |
| Total Authority Capital Assets, net | $ 41,730,563 | $ 743,228 | $ - | $ 42,473,791 |

## Note 4 Capital Assets (Continued)

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

| | |
|---|---|
| Wastewater Activities | $ 251,432 |
| Water Activities | 415,571 |

## 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, 2012:

| | Balance July 1, 2011 | Additions/ accretions | Principal payments | Balance June 30, 2012 | Due within one year |
|---|---|---|---|---|---|
| Adelanto Public Utility Authority Fixed Rate Refunding Revenue Bonds 2009 Series A | $ 76,825,000 | $ - | $ - | $ 76,825,000 | $ - |
| Unamortized discount | (1,091,603) | | 56,661 | (1,034,942) | 56,661 |
| Compensated Absences | 77,779 | 41,183 | (24,492) | 94,470 | |
| Settlement Payable | | 4,524,000 | | 4,524,000 | |
| Advances from the City of Adelanto | 5,866,862 | 816,394 | | 6,683,256 | |
| Total long-term debt | $ 73,743,904 | $ 5,381,577 | $ 32,169 | $ 87,091,784 | $ 56,661 |

In regards to the 2005A and 2005B Bonds, the Authority entered into interest rate swap agreements pursuant to a master agreement, effective September 7, 2005. The swap provider was Piper Jaffray Financial Products Inc. Under the swap associated with the Series A Bonds, the Authority paid a fixed rate of 3.387% and received 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 were two separate swaps. The first swap's period started on September 7, 2005, through but excluding September 1, 2008. The Authority paid a fixed rate of 4.485% and received amounts based upon a variable rate (based on 63% of LIBOR plus 30 basis points). The second swap for the 2005 B Bonds began on September 1, 2008 and continued for the remaining life of the 2005B Bonds. The Authority paid a fixed rate of 3.447% and received 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) constituted Parity Obligations and the payments received by the Authority under the 2005 Swap were 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 issued a financial guaranty insurance policy in regards to the issuance of the 2005A and 2005B Bonds. Under the financial guaranty insurance, Ambac Assurance was to pay the Bank of New York (or any successor) the portion of the principal and interest on the Bonds that became due and remain unpaid. The insurance extended for the term of the Bonds and could not be canceled. Please see the disclosure under Commitments and Contingencies for additional information regarding the 2005A and 2005 B Bonds that were issued September 7, 2005.

On December 19, 2007, there was a reoffering of the 2005 Series A and B bonds. The bonds were reoffered and delivered as auction rate bonds (ARB), in the principal amount set on September 7, 2005. Please see below for additional information for the reoffering of the 2005 Series A and B bonds.

## Note 5 Long-Term Debt (Continued)

On December 22, 2009, the Adelanto Public Utility Authority Fixed Rate Refunding Revenue Bonds 2009 Series A were issued which refunded the 2005 A and B Bonds. Please see the note for the Adelanto Public Utility Authority Fixed Rate Refunding Revenue Bonds 2009 Series A for additional information.

- **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 was to be used to finance improvements to both the Water and Wastewater Systems.

After the fixed rate conversion date, the Bonds were 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 was 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 was $700,000.

The Public Utility Authority was 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 was 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.

## 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 were to be determined, in most cases, through the implementation of the auction procedures. The initial period for the 2005 Series A bonds was to 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 was to be a 7-day auction period with auctions generally conducted every Wednesday. The applicable auction rate was not to exceed the ARB maximum rate of 12% per annum.

On December 22, 2009, the Adelanto Public Utility Authority Fixed Rate Refunding Revenue Bonds 2009 Series A were issued and refunded the 2005 A and 2005 B Bonds. The 2005 A and 2005 B Bonds were defeased and are no longer a debt of the Authority. Please see the note for the Adelanto Public Utility Authority Fixed Rate Refunding Revenue Bonds 2009 Series A for additional information.

- **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 was 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 were 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 was 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.

## 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 B 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 were to be determined, in most cases, through the implementation of the auction procedures. The initial period for the 2005 Series B bonds was to 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.

On December 22, 2009, the Adelanto Public Utility Authority Fixed Rate Refunding Revenue Bonds 2009 Series A were issued and refunded the 2005 A and 2005 B Bonds. The 2005 A and 2005 B Bonds were defeased and are no longer a debt of the Authority. Please see the note for the Adelanto Public Utility Authority Fixed Rate Refunding Revenue Bonds 2009 Series A for additional information.

- **Adelanto Public Utility Authority Fixed Rate Refunding Revenue Bonds 2009 Series A**

On or about December 22, 2009, the Adelanto Public Utility Authority issued $76,825,000 Fixed Rate Refunding Revenue Bonds to provide 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), ii) finance certain capital improvements to the Authority's water treatment, production, storage and distribution system and its wastewater collection and treatment system and other related costs, iii) fund a debt service reserve fund for the 2009 Bonds, and iv) pay the costs of issuing the 2009 Bonds. The bonds are composed of serial and term bonds. The serial bonds have various maturity dates with the last maturity date being July 1, 2026. The interest rates range from 4.00% to 6.25%. There are also two term bonds with one term bond in the amount of $14,800,000 (maturity date of July 1, 2031 and an interest rate of 6.625%), and the second term bond in the amount of $36,885,000 (maturity date of July 1, 2039 and an interest rate of 6.750%).

The 2009 Bonds are being issued pursuant to an Indenture of Trust, dated as of September 1, 2005, as amended and supplemented including the Fourth Supplemental Indenture dated as of November 1, 2009 by and between the Authority and the Trustee. Interest on the 2009 Bonds are payable on January 1 and July 1 of each year, commencing on July 1, 2010.

The 2009 Bonds are special obligations of the Authority, payable solely from and secured by a pledge of Pledged Utility Revenue and from certain other amounts on deposit in funds and accounts under the Indenture. Pledged Utility Revenues primarily consist of i) Net wastewater revenues and ii) net water revenues. In order to comply with applicable law, each of the Water and Wastewater Enterprises are obligated to pay only its proportionate share of the 2009 Bonds (59% for Water and 41% for Wastewater).

The Authority has covenanted to fix, prescribe and collect fees, tolls, assessments, rates and charges for the Utility System in order to satisfy certain coverage requirements.

The 2009 Bonds maturing on or before July 1, 2019 are not subject to optional redemption prior to maturity. The 2009 Bonds maturing on or after July 1, 2020 are subject to redemption prior to their respective maturity dates, at the option of the Authority, as a whole, or in part, as determined by the Authority, on any date after July 1, 2019, from any source of available funds, at the principal amount of the 2009 Bonds to be redeemed, plus accrued interest to the date of redemption, without premium.

## Note 5 Long-Term Debt (Continued)

- **Adelanto Public Utility Authority Fixed Rate Refunding Revenue Bonds 2009 Series A (Continued)**

The 2009 Term Bonds are subject to redemption in part by lot, on July 1 in each year commencing July 1, 2027 from Sinking Fund Installments made by the Authority into the Debt Service Fund, at a redemption price equal to the principal amount to be redeemed, without premium, in the aggregate respective principal amounts and on July 1 in the respective years set forth in the following tables, or in lieu thereof may be purchased.

The Authority is obligated to maintain an amount in the debt service reserve account equal to the debt service reserve requirement which is equal to the lesser of (a) 10% of the initial offering price to the public of the Bonds, (b) the greatest amount of Bond Debt Service in any Bond Year during the period commencing with the Bond Year in which the determination is being made and terminating with the last Bond Year in which any Bond is due, or (c) 125% of the sum of the Bond Debt Service for all Bond Years during the period commencing with the Bond Year in which such calculation is made and terminating with the last Bond Year in which any Bond debt service is due, divided by the number of such Bond Years. The balance in the debt service reserve account as of June 30, 2012 is $6,159,475.

The Rate Stabilization Fund money are pledged to secure payment, to the extent Gross Wastewater Revenues, Gross Water Revenues and/or purchased securities revenues are insufficient for such purposes, the following amounts in the following order of priority:

1. All wastewater operation and maintenance costs and wastewater operation and maintenance costs to become due and payable in the current fiscal year,
2. Principal of and interest on the outstanding bonds and parity obligations becoming due and payable during the fiscal year, including sinking fund installments,
3. All other payments required for compliance with the indenture and the legal documents pursuant to which any parity obligations were issued,
4. Water purchase payments and wastewater purchase payments up to a maximum of $1 million annually; provided, however, that no amounts will be transferred from the Rate Stabilization Fund for this purpose unless pledged utility revenues plus additional revenues equal 125% of debt service in the current fiscal year,
5. Any termination payments.

The Rate Stabilization Requirement is $2,100,000 and is equal to the amount currently in the Rate Stabilization Account as of June 30, 2012. As of June 30, 2012, the amount due on the Adelanto Public Utility Authority Fixed Rate Refunding Revenue Bonds 2009 Series A is $76,825,000.

- **Debt Service Requirements**

This schedule illustrates the debt service requirements for bonds outstanding as of June 30, 2012:

| Fiscal year | Fixed Rate Refunding Revenue Bonds 2009 Series A |
|---|---|
| 2013 | $ 5,966,606 |
| 2014 | 5,964,106 |
| 2015 | 5,964,706 |
| 2016 | 5,966,562 |
| 2017 | 5,964,243 |
| 2018-2022 | 29,833,554 |
| 2023-2027 | 29,827,681 |
| 2028-2032 | 29,829,786 |
| 2033-2037 | 29,827,602 |
| 2038-2040 | 17,895,033 |
| | 167,039,879 |
| Less amount representing interest | 90,214,879 |
| Balance outstanding | $ 76,825,000 |

## Note 5 Long-Term Debt (Continued)

- **Defeasance of Debt**

  At June 30, 2012, the 1995, 1998, 2000, and 2005 debt amounts have been paid in full. There are no outstanding debt balances related to these issues.

- **Settlement Payable**

  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. On or about 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 United States District Court, Southern District of New York has ruled against the Authority, awarding Ambac Assurance Corporation the $4,524,000 termination payment plus interest and fees. A hearing has been scheduled for March of 2013 to determine the exact amount of the settlement payment. As of February 15, 2013, it is unknown what the total settlement payment will total including interest and fees so $4,524,000 has been accrued as a long term liability as of June 30, 2012. As of Feburary 15, 2013, no payment schedule has been determined.

- **Compensated Absences**

  As of the fiscal year ended June 30, 2012, the total accrued employee leave benefits for the Authority was $94,470.

## 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, 2012, 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, 2012, 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

California Regional Water Quality Control Board, Lahontan Region, Cease and Desist Order:
On December 23, 2010, the California Regional Water Quality Control Board, Lahontan Region (Board), issued a proposed Cease and Desist Order (CDO) pertaining to the Authority's wastewater treatment plant. The proposed CDO was revised on January 13, 2011. In summation, the proposed CDO alleged that the Authority was in violation of its permit and previous Board orders due to: 1) the average Biological Oxygen Demand (BOD) levels; 2) the average daily volume of flow to the plant; 3) the maintenance of freeboard levels in the percolation ponds; and 4) unauthorized discharges from the plant either based on the construction of certain trenches or due to a major storm event on December 23, 2010, that led to the discharge of treated effluent from Percolation Pond No. 4-S. The Board sought a connection ban that would have prevented additional connections and discharges to the plant. Such a ban would have devastating impacts to the City and Authority because it would in essence eliminate further development in the City until such ban was lifted. The Authority strenuously opposed the proposed CDO and connection ban. The City Attorney's office argued that the connection ban was not warranted pursuant to Title 23 of the California Code of Regulations section 2244. On March 10, 2011, an administrative trial was conducted before the Board. The Board decided to adopt the proposed CDO but removed the connection ban from the CDO. At the hearing on May 11, 2011, it was ordered that the APUA 1) must complete construction of Pond 5 no later than May 31, 2011, 2) complete its restoring Percolation Pond No. 4 no later than October 2011, 4) complete implementation of its accepted Wastewater Disposal Facilities Work Plan to provide adequate disposal capacity for all wastewater flows, including those diverted to VVWRA, and maintain compliance with freeboard requirement. The Board stated that it will consider adoption of a restriction on additional discharges no later than its November 2011 meeting and it preserves its ability to issue a connection ban at a future meeting, to have the connection ban apply back to May 11, 2011.

## Note 9 Commitments and Contingencies (Continued)

**Litigation (Continued)**

Adelanto Public Utility Authority v. E.J. De La Rosa & Co., Inc.:
In November 2011, Adelanto filed an arbitration under the auspices of the Financial Industry Regulatory Authority (FINRA) against E.J. De La Rosa & Co., Inc. regarding Adelanto's conversion of its debt in December 2007 to Auction Rate Securities ("ARS"). Currently, that case is pending in arbitration, and a final hearing is expected between May and July of this year. Adelanto is claiming in excess of $10,000,000 in damages, based on the excess interest it paid on its ARS, the cost of refinancing, and the cost of terminating an interest rate swap associated with the ARS. At this time, the likelihood of a favorable resolution or award is hard to predict.

## Note 10 Advances To/From Other Funds

The Adelanto Public Utility Authority owes the Adelanto Water Authority the net amount of $12,286,116. 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 and Adelanto Public Utility Authority owe the net amount of $6,683,256 to the City of Adelanto which was used to fund the ongoing operations of the Adelanto Water Authority and Adelanto Public Utility Authority. This amount is shown on the Long-Term Liabilities portion of the Statement of Net Assets.

## 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 Going Concern

The Wastewater Authority has a deficit of total net assets of ($4,204,868) and the Water Authority had positive total net assets of $8,733,473. Continued deficits can result in a going concern and compliance issues with debt covenants. In addition, the Authority does not currently have the financial resources to pay the settlement agreement in the amount of $4,524,000 plus additional interest and fees to be determined at a future time to Ambac Assurance Corporation as a result of the litigation detailed in Note 5 of these financial statements. The Authority is currently making attempts to secure financing and other revenue sources (please see litigations in Note 9) to be able to provide funds to make the settlement payment. Based on this information, the Authority may not be able to continue as a going concern.

## Note 13 Subsequent Events

In preparing the accompanying financial statements, the Authority's management has reviewed all known events that have occurred after June 30, 2012, and through February 18, 2013, the date when this financial statement was available to be issued, for inclusion in the financial statement and footnotes.