

**Audited Financial Statements
and Supplementary Information
San Gabriel Valley Council of Governments
Year ended June 30, 2011
*with Report of Independent Auditors***

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Report of Independent Auditors

Board of Directors San Gabriel Valley Council of Governments

We have audited the accompanying financial statements of the business-type activities and discretely presented component unit of San Gabriel Valley Council of Governments (the "COG"), as of and for the year ended June 30, 2011, which collectively comprise the COG's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the COG's management. Our responsibility is to express an opinion 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the COG's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to previously present fairly, in all material respects, the financial position of the business-type activities and the discretely presented component unit of the San Gabriel Valley Council of Governments as of June 30, 2011, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 17, 2012, on our consideration of San Gabriel Valley Council of Governments' 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.

The management's discussion and analysis on pages 3 through 9 and budgetary comparison information on page 31 are not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries with management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Varguez + Company LLP

Los Angeles, California
January 17, 2012

Our discussion and analysis of the San Gabriel Valley Council of Governments (the "COG") financial performance presents an overview of the COG's financial activities during the fiscal year ended June 30, 2011. We encourage readers to consider information presented here in conjunction with the financial statements (beginning on page 10). The financial statements, notes and this discussion and analysis were prepared by the management and are the responsibility of management.

Background

The COG was created effective March 17, 1994 by a Joint Powers Agreement (JPA) among various member San Gabriel Valley Cities to promote cooperation, exchange ideas, coordinate regional government programs and to provide recommendations and solutions to common problems and to general concern of member governments.

In 1998, the COG created the Alameda Corridor-East (ACE) Construction Authority to mitigate the effects of increasing Union Pacific Railroad (UPRR) train traffic in the San Gabriel Valley. There were 55 "at-grade" crossings in the Valley where vehicular and pedestrian traffic cross directly over railroad tracks and must stop while trains pass by. This creates congestion, degrades the local environment, and compromises safety. The ACE Project will separate 20 crossings at the busiest intersections – by either raising or lowering the railroad or the intersecting street – along the 35-mile freight rail corridor from East Los Angeles to Pomona.

Financial Highlights

FY 2010-11 marks the end of the second year of the COG's three-year strategic planning cycle. One of the major focuses of the current Strategic Plan is the implementation of the San Gabriel Valley's Energywise Partnership Program. This is a contractual relationship with Southern California Edison (SCE) focused on increasing energy-efficiency throughout the San Gabriel Valley. This effort has a number of specific objectives including: 1) assisting local governments in identifying and implementing energy-efficiency projects in their municipal facilities; 2) providing training to city staff on energy efficiency issues and initiatives including Title 24, AB 811, AB 32 and Demand Response; and 3) educating and outreaching to the public to increase knowledge of energy-efficiency in their homes and businesses and provide information on SCE's residential programs and rebates. While a third party implementer and qualified technical consultants are utilized to manage and implement specific energy-efficiency retrofit projects, the COG, as the local government partner, is primarily responsible for administration, marketing and outreach for the Partnership.

Overview of Financial Statements

In FY 2010-11 income from dues decreased slightly from the previous year. This was due to changes in population figures associated with 2010 census and reconciliation of those numbers with State Department of Finance. FY 2010-11 marks the 5th consecutive year the COG has not increased dues for member agencies. Revenues from grants increased slightly due to the increased activity associated with the various programs using grant funds.

The financial statements present the financial picture of the COG from the economic resources measurement focus using the accrual basis of accounting. These statements include all recordable assets of the COG as well as all liabilities. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid. The statement of cash flows provides information about the COG's cash receipts, cash payments, and net changes in cash resulting from operating, capital and related investing activities during the reporting period.

San Gabriel Valley Council of Governments
Management's Discussion and Analysis
Year ended June 30, 2011

The statement of net assets and the statement of revenues, expenses and changes in net assets report the COG's net assets and related changes in them. Net assets are the difference between the recorded assets and liabilities. The recorded activities include all revenues from dues and operating expenses related to the operation of the COG. In addition, all of the COG's revenues and expenses related to its other programs and services are reflected in the statements.

Various disclosures accompany the financial statements in order to provide a full picture of the COG's finances. The notes to the financial statements are on pages 13 - 30.

Financial Analysis

Statements of Net Assets

The following table summarizes the assets, liabilities, and net assets of COG's primary government as of June 30, 2011 and 2010:

| | <u>2011</u> | <u>2010</u> |
|----------------------------|--------------------------|--------------------------|
| Current assets | \$ 775,491 | \$ 765,331 |
| Capital assets | - | - |
| Total assets | <u>775,491</u> | <u>765,331</u> |
| Current liabilities | <u>190,500</u> | 214,831 |
| Total liabilities | <u>190,500</u> | <u>214,831</u> |
| Net assets | | |
| Invested in capital assets | - | - |
| Restricted | 15,922 | - |
| Unrestricted | <u>569,069</u> | 550,500 |
| Total net assets | \$ <u><u>584,991</u></u> | \$ <u><u>550,500</u></u> |

Current assets increased this year by \$10,160 or 1% primarily because of higher receivables from cost reimbursable grants.

Current liabilities decreased this year by \$24,331 or 11% primarily because of decreased project work being done by COG.

As mentioned earlier, net assets can serve as an indicator of financial health. The COG's assets exceeded liabilities by \$584,991 and \$550,500 as of June 30, 2011 and 2010, respectively.

Statement of Activities

The following table presents the COG's revenues, expenses, and changes in net assets for the years ended June 30, 2011 and 2010:

San Gabriel Valley Council of Governments
Management's Discussion and Analysis
Year ended June 30, 2011

| | <u>2011</u> | <u>2010</u> |
|---|-------------------|-------------------|
| Revenues: | | |
| Dues | | |
| Air Quality | \$ 50,060 | \$ 143,687 |
| Transportation | 279,719 | 242,905 |
| General fund | 381,428 | 333,207 |
| Grants and matches from other governments | | |
| County of Los Angeles - Energy Upgrade | 21,993 | - |
| Water Quality Improvement | 31,582 | 223,451 |
| Southern California Edison - California Energy Efficiency Strategic Plan Implementation | 33,024 | - |
| Southern California Edison - Energywise | 102,878 | 99,588 |
| California Department of Resources - CalRecycle | 133,216 | 98,847 |
| California Department of Conservation - Watershed Coordinator Program | 79,320 | 59,006 |
| County of Los Angeles - Homeless Services | - | 15,682 |
| County of Los Angeles - Arrow Highway | - | 12,000 |
| Total revenues | <u>1,113,220</u> | <u>1,228,373</u> |
| Expenses: | | |
| Administrative | 349,288 | 170,199 |
| Air Quality | 50,502 | 143,687 |
| Transportation | 280,007 | 242,905 |
| Energy Upgrade | 21,993 | - |
| Water Quality Improvement | 15,660 | 223,494 |
| California Energy Efficiency Strategic Plan Implementation | 33,261 | - |
| Energywise | 112,208 | 99,588 |
| CalRecycle | 137,431 | 101,583 |
| Watershed Coordinator Program | 80,449 | 60,122 |
| Homeless Services | 1,210 | 17,437 |
| Arrow Highway | - | 12,000 |
| Total expenses | <u>1,082,009</u> | <u>1,071,015</u> |
| Operating income | 31,211 | 157,358 |
| Nonoperating income | <u>3,280</u> | <u>4,056</u> |
| Change in net assets | 34,491 | 161,414 |
| Net assets - beginning of year | <u>550,500</u> | <u>389,086</u> |
| Net assets - end of year | <u>\$ 584,991</u> | <u>\$ 550,500</u> |

**San Gabriel Valley Council of Governments
Management's Discussion and Analysis
Year ended June 30, 2011**

Revenues for COG consist primarily of dues from each member city, water districts and county, which comprised 64% of total operating revenue in FY 2011 compared to 59% of total operating revenue in FY 2010. Dues decreased \$8,592 or 1% over the prior year primarily because of the cancellation of the dues from Three Valleys Municipal Water District. Grants and matches from other governments were \$402,013 in FY2011 compared to \$508,574 in FY 2010, a decrease of \$106,561 or 21%. This decrease was due to the substantial completion of the Water Quality Improvement project. The revenues earned by the COG during the year would have been sufficient to cover its current obligations, including operating expenses.

Operating expenses were \$1,082,009 in FY1011 compared to \$1,071,015 in FY 2010, an increase of \$10,994 or 1%. Administrative expenses increased by \$179,089 or 105% because of one-time legal and audit expenses related to the Caltrans audit and litigation mentioned under Notes 7 and 11.

Nonoperating income consists of investment income of \$3,280 in FY 2011 compared to \$4,056 for FY 2010, a decrease of \$766 or 19%. The decrease is directly attributed to lower rates paid by Local Agency Investment Fund (LAIF) in 2011.

Capital Assets

The COG had \$0 invested in capital assets, net of depreciation, as of June 30, 2011 and 2010. The capital assets are fully depreciated as of June 30, 2011.

The COG's capital assets consist of office equipment only. Capital assets are purchased with governmental resources.

Component Unit

Financial Highlights

ACE Construction Authority's financial highlights for the fiscal year ended June 30, 2011:

- Net assets decreased \$4.3 million, a decrease of 42.19% primarily as a result of arbitrage rebate payments on net interest generated by net proceeds from the investment of commercial paper.
- Construction in progress decreased \$47.5 million, a decrease of 20.5%.
- Total revenue decreased \$31.3 million, a decrease of 41.2%.
- Total project expense decreased \$34.8 million, a decrease of 43.8%.

**San Gabriel Valley Council of Governments
Management's Discussion and Analysis
Year ended June 30, 2011**

Statements of Net Assets

| | June 30 | |
|---|-----------------------------|-----------------------------|
| | 2011 | 2010 |
| Current and other assets | \$ 45,329,675 | \$ 123,817,067 |
| Capital assets | 23,160 | 43,208 |
| Construction in progress | 183,999,655 | 231,505,012 |
| Less due to member cities and Union Pacific Railroad | <u>(183,999,655)</u> | <u>(231,505,012)</u> |
| Total assets | 45,352,835 | 123,860,275 |
| Current liabilities | 39,431,887 | 113,617,868 |
| Net assets | \$ <u>5,920,948</u> | \$ <u>10,242,407</u> |

All organizations are required to report construction in progress (that is, the sum of prior and current year's construction expense) on the Statement of Net Assets as an asset. This would normally be done by treating each year's construction as a capital expense which would be excluded from the Statement of Activities. However, the grant reimbursements generated by construction would be included in the Statement of Activities as revenue. The ACE Construction Authority is obligated to transfer components of completed projects to the UPRR and the cities so that they can be included in their financial statements. The resulting reduction in assets would flow through the Statement of Activities as a loss. The net effect would be to produce widely fluctuating Net Assets and Fund Balances depending on whether ACE Construction Authority was constructing (Surplus) or transferring assets to member cities (Deficit).

Therefore, the ACE Construction Authority elected to treat construction in progress as a matching asset and liability. This shows the total cost of ACE Construction Authority's projects and the resulting liability to transfer the assets upon completion while not unduly impacting the Statement of Activities.

Assets decreased by 63.4% to \$45.4 million mainly due to reducing the amount held in investments to pay down outstanding GANs to match lower levels of project activity, lower grants and unbilled receivables as a result of lower grant reimbursable incurred expenditures.

Construction in progress decreased 21% to \$184 million primarily as a result of the completion of the Sunset project without offsetting construction.

Deferred revenue (unearned and unavailable) increased 22.9% to \$5.6 million primarily due to having to recognize \$1.8 million of surplus rental property generating revenue after project was closed. Sale of this property is expected to take place within the next fiscal year.

COG, on behalf of the Authority, had \$27.35 million in variable rate, tax-exempt commercial paper outstanding as of June 2011. The decision as to how much to issue is made periodically by the ACE Construction Authority management in consultation with its financial advisors taking into account current and prospective cash flow needs.

Grants and unbilled receivables decreased 48.6% to \$4 million and 56.19% to \$7.6 million respectively due to lower reimbursable grant expenditures.

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Management's Discussion and Analysis
Year ended June 30, 2011

The FY2011 revised Budget for operating expenditures was \$82.7 million compared to \$97.5 million in FY2010. Actual total operating expenditures are \$44.2 million compared to \$78.5 million in FY2010.

Project revenues continue to closely track expenditures. ACE Construction Authority's policy is to avoid where possible costs not reimbursable under State and Federal guidelines; the Los Angeles County Metropolitan Transportation Authority (Metro) also provides project funds and, under separate agreement, continues to fund certain administrative expenses not reimbursable under federal and state regulations; Cities requesting work in excess of Caltrans guidelines (referred to as betterments) are paid for by the requesting city.

Statements of Activities

| | Years ended June 30 | |
|---|----------------------------|---------------|
| | 2011 | 2010 |
| Project expenses | | |
| Direct (construction) | \$ 40,879,495 | \$ 74,840,690 |
| Indirect expenses charged to operations | 3,735,496 | 4,554,512 |
| Total project expenses | 44,614,991 | 79,395,202 |
| Revenues | | |
| Grant reimbursements | 44,181,756 | 74,623,951 |
| Other operating revenues | 475,871 | 1,359,697 |
| Total revenues | 44,657,627 | 75,983,648 |
| Income/(loss) from operations | 42,636 | (3,411,554) |
| Nonoperating income (expense) | | |
| Financing income | 543,560 | 692,556 |
| Financing expense | (4,907,655) | (624,971) |
| Net financing income (expense) | (4,364,095) | 67,585 |
| Change in net assets | (4,321,459) | (3,343,969) |
| Net assets at beginning of year | 10,242,407 | 13,586,376 |
| Net assets at end of year | \$ 5,920,948 | \$ 10,242,407 |

The ACE Construction Authority is reimbursed for indirect expenses based on Caltrans approved Indirect Cost Allocation Plan (ICAP) rate. The reimbursement is added to all Caltrans and Metro invoices and is calculated by applying the ICAP rate to direct salaries and wages and fringe benefits. The applied indirect expense to projects was lower than the actual indirect expense incurred, resulting in a deferral of \$298,293 to future years.

Economic Factors and Next Year's Budget

The primary government's budget for fiscal year 2012 assumes that all on-hand net assets as of June 30, 2011 will be required and available to fulfill the program and administrative expense requirements.

Further Information

This report has been designed to provide a general overview to our stakeholders of the COG's financial condition and related issues. Inquires should be directed to Mr. Nicholas T. Conway, Executive Director.

San Gabriel Valley Council of Governments
Statement of Net Assets
June 30, 2011

| | Primary Government | | Component Unit | |
|--|-------------------------------------|---------------------------------|-----------------------|-----------------------------|
| | Business-type Activities | Capital Project Fund | Adjustment | Government- wide |
| Current assets | | | | |
| Cash and cash equivalents | \$ 591,923 | \$ 24,378,470 | \$ - | \$ 24,378,470 |
| Grants receivable | 140,098 | 4,032,710 | - | 4,032,710 |
| Unbilled receivables | - | 7,617,163 | - | 7,617,163 |
| Interest receivable | 586 | 16,430 | - | 16,430 |
| Retention receivable | - | 4,960,642 | - | 4,960,642 |
| Receivable - other | 5,751 | 120,656 | - | 120,656 |
| Deferred cost incurred | - | 2,331,369 | - | 2,331,369 |
| Prepaid expenses: | | | | |
| Administration | 37,133 | - | - | - |
| Insurance | - | 34,693 | - | 34,693 |
| Cost of issuance, commercial paper | - | 74,351 | - | 74,351 |
| Property held for sale | - | 1,763,191 | - | 1,763,191 |
| Total current assets | 775,491 | 45,329,675 | - | 45,329,675 |
| Noncurrent assets | | | | |
| Leasehold improvements and equipment | 8,645 | - | 332,897 | 332,897 |
| Less accumulated depreciation and amortization | (8,645) | - | (309,737) | (309,737) |
| Construction in progress | - | - | 183,999,655 | 183,999,655 |
| Less due to member cities and Union Pacific Railroad | - | - | (183,999,655) | (183,999,655) |
| Total assets | 775,491 | \$ 45,329,675 | \$ 23,160 | 45,352,835 |
| Current liabilities | | | | |
| Accounts payable and accrued expense | 67,808 | \$ 5,456,811 | \$ - | 5,456,811 |
| Accrued retention payable | - | 895,520 | - | 895,520 |
| Due to government agencies | 42,687 | - | - | - |
| Deferred revenue | 80,005 | 5,622,131 | - | 5,622,131 |
| Compensated absences | - | 107,425 | - | 107,425 |
| Commercial paper | - | 27,350,000 | - | 27,350,000 |
| Total current liabilities | 190,500 | 39,431,887 | - | 39,431,887 |
| FUND BALANCES/NET ASSETS | | | | |
| Fund balance | | | | |
| Nonspendable for: | | | | |
| Deferred cost incurred | | 2,331,369 | - | |
| Prepaid expenses | | 109,044 | - | |
| Assigned: | | | | |
| Capital project fund | | 3,457,375 | - | |
| Total fund balance | | 5,897,788 | - | |
| Net assets | | | | |
| Invested in capital assets | - | | \$ 23,160 | 23,160 |
| Restricted | 15,922 | | | - |
| Unrestricted | 569,069 | | | 5,897,788 |
| Total net assets | \$ 584,991 | | | \$ 5,920,948 |
| Total liabilities and fund balance | | \$ 45,329,675 | | |

See notes to financial statements.

San Gabriel Valley Council of Governments
Statement of Activities
Year ended June 30, 2011

| | | | | | | | Component Unit | | |
|--|---------------|-----------------------------------|-------------------------|--|--|--|---|-------------|--|
| Functions/Programs | Expenses | Indirect Expense Allocation | Program Revenues | | | Primary Government | Deficiency of Revenues over Expenditures | Adjustments | Net (Expense) Revenue and Changes in Net Assets |
| | | | Charges for Services | Operating Grants and Contributions | Capital Grants and Contributions | Business-type Activities Net (Expense) Revenue and Changes in Net Assets | | | |
| Primary government: | | | | | | | | | |
| Business-type activities: | | | | | | | | | |
| General government | \$ 349,288 | \$ - | \$ 381,428 | \$ - | \$ - | \$ 32,140 | | | |
| Air Quality | 50,502 | - | 50,060 | - | - | (442) | | | |
| Transportation | 280,007 | - | 279,719 | - | - | (288) | | | |
| Energy Upgrade | 21,993 | - | - | 21,993 | - | - | | | |
| Water Quality Improvement | 15,660 | - | - | 31,582 | - | 15,922 | | | |
| California Energy Efficiency Strategic Plan Implementation | 33,261 | - | - | 33,024 | - | (237) | | | |
| Energywise | 112,208 | - | - | 102,878 | - | (9,330) | | | |
| Calrecyle | 137,431 | - | - | 133,216 | - | (4,215) | | | |
| Watershed Coordinator Program | 80,449 | - | - | 79,320 | - | (1,129) | | | |
| Homeless services | 1,210 | - | - | - | - | (1,210) | | | |
| Total business-type activities | \$ 1,082,009 | \$ - | \$ 711,207 | \$ 402,013 | \$ - | 31,211 | | | |
| Component unit: | | | | | | | | | |
| Project expenses | \$ 40,879,495 | \$ 3,715,448 | \$ - | \$ - | \$ 44,657,627 | - | \$ 62,684 | \$ (20,048) | \$ 42,636 |
| Financing expense | 4,907,655 | - | - | - | - | - | (4,907,655) | - | (4,907,655) |
| Total component unit | \$ 45,787,150 | \$ 3,715,448 | \$ - | \$ - | \$ 44,657,627 | - | (4,844,971) | (20,048) | (4,865,019) |
| General revenues: | | | | | | | | | |
| Interest income/ financing income | | | | | | 3,280 | 543,560 | - | 543,560 |
| Change in net assets | | | | | | 34,491 | (4,301,411) | (20,048) | (4,321,459) |
| Fund balance/Net assets, beginning of year | | | | | | 550,500 | 10,199,199 | 43,208 | 10,242,407 |
| Fund balance/Net assets, end of year | | | | | | \$ 584,991 | \$ 5,897,788 | \$ 23,160 | \$ 5,920,948 |

See notes to financial statements.

San Gabriel Valley Council of Governments
Statement of Cash Flows
Year ended June 30, 2011

Cash flows from operating activities

| | |
|--|------------------------|
| Cash receipts from cities | \$ 718,327 |
| Cash receipts from all others | 374,779 |
| Cash paid for operating expenses | <u>(1,103,239)</u> |
| Net cash used in operating activities | <u>(10,133)</u> |

Cash flows from investing activities

| | |
|--|---------------------|
| Cash receipts from interest | <u>3,404</u> |
| Cash provided by investing activities | <u>3,404</u> |

Net decrease in cash and cash equivalents (6,729)

Cash and cash equivalents - beginning of year 598,652

Cash and cash equivalents - end of year \$ 591,923

Reconciliation of operating income to net cash

used in operating activities:

Operating income \$ 31,211

Adjustment to reconcile operating income to net cash

used in operating activities:

Changes in operating assets and liabilities:

| | |
|---------------------------------------|---------------|
| Accounts receivable | 10,000 |
| Grants receivable | (27,234) |
| Other receivable | (5,751) |
| Prepaid expenses | 5,972 |
| Accounts payable and accrued expenses | (64,138) |
| Deferred revenue | (2,880) |
| Due to government agencies | <u>42,687</u> |

Net cash used in operating activities \$ (10,133)

NOTE 1 SUMMARY OF SIGNIFICANT POLICIES

Organization and activities

The San Gabriel Valley Council of Governments (the "COG") was created effective March 17, 1994 by a Joint Powers Agreement (JPA) among various member San Gabriel Valley Cities to promote cooperation, exchange ideas, coordinate regional government programs and to provide recommendations and solutions to common problems and to general concern of member governments. It is the immediate successor to the San Gabriel Valley Association of Cities, an unincorporated association. Its members organized the COG because they recognized a need for a more permanent and formalized structure.

The COG is supported by contributions from its members and also receives grant funds to conduct regional studies on Transportation, Air Quality, Environmental Matters, as a sub-grantee of other governmental entities. The COG is a non-profit California Public Agency and it is tax exempt.

Reporting entity

The accompanying financial statements present the COG (the primary government) and its component unit, the Alameda Corridor-East Construction Authority (ACE Construction Authority). As defined by GASB Statement No. 14, component units are legally separate entities that are included in the primary government's reporting entity because of the significance of their operating or financial relationships with the primary government. The discretely presented component unit is reported in a separate column in the government-wide financial statements (see note below for description) to emphasize that it is legally separate from the COG. The COG and its component unit are together referred to herein as the *reporting entity*.

The ACE Construction Authority is a single purpose construction authority created by the COG in 1998 to mitigate the effects of increasing Union Pacific Railroad train traffic in the San Gabriel Valley. Separate financial statements for the ACE Construction Authority are issued.

Government-wide and fund financial statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information about the primary government (the COG) and its component unit (ACE Construction Authority). The financial statements are prepared using the accrual basis of accounting.

NOTE 1 SUMMARY OF SIGNIFICANT POLICIES (CONTINUED)

Measurement focus, basis of accounting and financial statement presentation

The government-wide and proprietary fund financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. The Statement of Activities presents changes in Net Assets. (This is equivalent to an Income and Changes in Equity Statement in private sector companies.) Revenues are recorded when earned and expenses are recognized at the time of the causal event.

As provided in GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, COG does not apply Financial Accounting Standards Board pronouncements issued after November 30, 1989.

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. ACE Construction Authority recognizes reimbursements from grants as revenues to the extent reimbursing obligations are earned on or before June 30, 2011 and are therefore the same under both modified accrual and full accrual basis. Major interest bearing debt is short-term in nature so there is no difference relating to accrued interest owed.

Based upon the nature of the operations of ACE Construction Authority, only a capital projects fund is utilized (a governmental fund type). Amounts reflected in the adjustment column in the financial statements of ACE Construction Authority represents capital assets and construction in progress (less due to member cities and Union Pacific Railroad) used on governmental activities that are not current financial resources and therefore are not reported as assets in the governmental fund balance and the related depreciation expense on the capital assets reported in the government-wide statement of activities do not require the use of current financial resources and therefore not reported as an expenditure in the governmental funds.

Description of funds

Proprietary Funds

The focus of proprietary fund measurement is upon determination of operating income, changes in net assets, financial position, and cash flows. The generally accepted accounting principles applicable are those similar to businesses in the private sector. The following are revenue components of the COG's proprietary funds:

Air Quality (AB 2766), Transportation (Proposition A&C) & Other - Funds to foster consensus among cities in the San Gabriel Valley regarding policies and programs that address issues relating to land use, air quality, transportation, solid waste and other matters deemed essential.

County of Los Angeles - Energy Upgrade - Funds that enables single-family homeowners to make upgrades to reduce energy use, conserve resources and create more comfortable and efficient homes.

NOTE 1 SUMMARY OF SIGNIFICANT POLICIES (CONTINUED)

Description of funds (continued)

Proprietary Funds (continued)

Water Quality Improvement - Funds to prepare and implement a Coordinated Implementation Plan (CIP) to reduce the amount of metal pollutants in the Los Angeles River and its Tributaries.

Southern California Edison - California Energy Efficiency Strategic Plan Implementation - Funds for the implementation of certain energy efficiency programs under the Decision 09-09-47 of the California Public Utilities Commission including the Energy Leader Partnership Program.

Southern California Edison – Energywise - Funds to implement a program to reduce energy usage in the region by providing enhanced rebates for installing energy efficiency measures in municipal facilities, technical assistance, and various training and educational opportunities.

California Department of Resources – CalRecycle – Funds to improve the management of household hazardous waste.

California Department of Conservation – Watershed Coordinator Program - Funds to finance a Watershed Coordinator position for the COG. The watershed that is intended to benefit from the activities of COG's Watershed Coordinator is the San Gabriel Valley Watershed.

Governmental Fund

Capital Projects Fund - Accounts for the activity of obtaining support from governmental groups, determining funding and specifications for structures needed and to fund the contracts for the grade crossing improvements. This fund accounts for most of the activities of ACE Construction Authority.

Fund balance reporting

During the fiscal year ended June 30, 2011, ACE Construction Authority has implemented Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. This Statement establishes the following fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds:

Nonspendable fund balance includes amounts that cannot be spent because they are either (a) not in spendable form or (b) legally or contractually required to be maintained intact. Examples are inventories, prepaid expenses, long-term receivables, or non-financial assets held for resale.

Restricted fund balance includes resources that are subject to externally enforceable legal restrictions. It includes amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers, or through enabling legislation.

NOTE 1 SUMMARY OF SIGNIFICANT POLICIES (CONTINUED)

Fund balance reporting (continued)

Committed fund balance includes amounts that can be used only for the specific purposes determined by a formal action of ACE Construction Authority's highest level of decision-making authority (Board of Directors).

Assigned fund balance consists of funds that are set aside for specific purposes by ACE Construction Authority's highest level of decision making authority or a body or official that has been given the authority to assign funds. Assigned funds cannot cause a deficit in unassigned fund balance.

Unassigned fund balance - is the residual classification for ACE Construction Authority's general fund and includes all spendable amounts not contained in the other classifications. This category also provides the resources necessary to meet unexpected expenditures and revenue shortfalls.

The Board of Directors, as ACE Construction Authority's highest level of decision-making authority, may commit fund balance for specific purposes pursuant to constraints imposed by formal actions taken. Committed amounts cannot be used for any other purpose unless the Board of Directors removes or changes the specific use through the same type of formal action taken to establish the commitment. ACE Construction Authority does not have any fund balance that meet this classification as of June 30, 2011.

The Board of Directors delegates the authority to assign fund balance to the Chief Executive Officer for purposes of reporting in the annual financial statements.

ACE Construction Authority considers the restricted fund balances to have been spent when expenditure is incurred for purposes for which both unrestricted and restricted fund balance is available. ACE Construction Authority considers unrestricted fund balances to have been spent when an expenditure is incurred for purposes for which amounts in any of the unrestricted classifications of fund balance could be used. When expenditures are incurred for purposes for which amounts in any of the unrestricted fund balance classifications could be used, it is the policy of ACE Construction Authority to reduce the committed amounts first, followed by assigned amounts, and then unassigned amounts.

Budgetary reporting

ACE Construction Authority's Board approved the FY 2011 budget in July 2010.

The budget was based on estimated expenditures over the operating period. Significant under-runs were initially encountered as the Authority experienced delays in obtaining various Caltrans' required approvals for major design contracts from Federal and State grantors.

NOTE 1 SUMMARY OF SIGNIFICANT POLICIES (CONTINUED)

Budgetary reporting (continued)

It is the ACE Construction Authority's policy not to start any phase of a project (i.e., design, right-of-way acquisition, or construction), unless there are sufficient funds to complete that phase. All project related expenses are reimbursable from existing grants and, as such, budgeted revenues were not budgeted separately, but derived from budgeted expenditures.

Cash and investments

The COG considers money market funds and all equivalent liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Grants receivable

Grants receivable relate to expense reimbursement from governmental agencies and are expected to be fully collectible. Accordingly, an allowance for doubtful accounts is not provided.

Grant revenues and expenditures

All grants are between the COG and the granting authority. ACE Construction Authority has been given authority to obtain and administer funding in the name of COG. The MTA grant was in existence when ACE Construction Authority was created and all subsequent grants therefore are administered by ACE Construction Authority.

To-date, all grants with the exception of the UPRR contributions are, and are anticipated to be in the future, cost reimbursable. That is, ACE Construction Authority must first expend the money and then bill for reimbursement from the grantors.

Leasehold improvements and equipment

Phases of equipment and other improvements that can be capitalized are recorded as expenditures in the capital projects fund. The threshold for capitalization has been \$5,000 since FY 2005 in accordance with Federal guidelines. On the government- wide financial statements such items are recorded as capital assets and are depreciated based upon their estimated useful lives on a straight-line basis. Useful lives of assets categories are as follows:

| | |
|--|----------|
| Leasehold improvements | 10 years |
| Office furniture | 10 years |
| Computer, office and telephone equipment | 5 years |

Unearned revenue

Some members pay their dues in advance. These amounts are reported in unearned revenue in the basic financial statements.

NOTE 1 SUMMARY OF SIGNIFICANT POLICIES (CONTINUED)

Short-term notes (Commercial paper)

In March 2001, SGVCOG authorized the issuance of up to \$100,000,000 in short-term variable rate tax-exempt grant anticipation notes. The notes are backed by a letter of credit from Bayern LB.

As of June 30, 2011, \$27.35 million in variable rate, tax-exempt commercial paper is outstanding. The decision as to how much to issue is made periodically by the ACE Construction Authority management in consultation with its financial advisors taking into account current and prospective cash flow needs.

ACE Construction Authority management and financial advisors review on a periodic basis the current and prospective cash requirements in determining the amount of commercial paper to be issued.

Arbitrage has been earned on the differential between interest earned on investment with the State Treasurer's Local Agency Fund (LAIF) and a local bank, and to holders of the commercial paper. Arbitrage earned may be required to be refunded unless certain specific Internal Revenue Code requirements are met. Specific provisions of the borrowing are described in Note 5.

Use of estimates

The process of presenting financial information requires the use of estimates and assumptions regarding certain assets and liabilities and their related income and expense items. Grant reimbursements and construction costs are especially vulnerable to such assumptions and accordingly actual results may differ from estimated amounts.

Property held for sale

The property held for sale is recorded at the lower of acquisition cost or estimated net realizable value.

NOTE 2 CASH AND INVESTMENTS

The cash and cash equivalents as of June 30, 2011 are as follows:

Primary government:

| | | |
|-------------------------------------|----|----------------|
| Deposits with financial institution | \$ | 170,978 |
| Investments | | 420,945 |
| Total cash and cash equivalents | \$ | <u>591,923</u> |

NOTE 2 CASH AND CASH EQUIVALENTS (CONTINUED)

Component unit:

| | |
|----------------------------|----------------------|
| Cash in bank | \$ 7,577,692 |
| Pooled funds | 1,543,746 |
| Money market funds | 2,202,259 |
| Medium-term notes | 2,438,260 |
| US Treasury obligations | 10,616,513 |
| Total cash and investments | <u>\$ 24,378,470</u> |

Investments Authorized by the California Government Code and San Gabriel Valley Council of Governments' Investment Policy

The table below identifies the investment types that are authorized for COG by the California Government Code (or COG's investment policy, where more restrictive). The table also identifies certain provisions of the California Government Code (or COG's investment policy, where more restrictive) that address interest rate risk, credit risk, and concentration of credit risk.

Primary government and component unit:

| <u>Authorized Investment Type</u> | <u>Maximum Maturity</u> | <u>Maximum Percentage of Portfolio</u> | <u>Maximum Investment in One Issuer</u> |
|-------------------------------------|-------------------------|--|---|
| Local Agency Bonds | 5 years | None | None |
| U.S. Treasury Obligations | 5 years | None | None |
| U.S. Agency Securities | 5 years | None | None |
| Banker's Acceptances | 180 days | 15% | 5% |
| Commercial Paper | 180 days | 15% | 5% |
| Negotiable Certificates of Deposit | 5 years | 30% | None |
| Repurchase Agreements | 30 days | None | None |
| Reverse Repurchase Agreements | 92 days | 5% | None |
| Medium-Term Notes | 5 years | 20% | None |
| Mutual Funds | N/A | 20% | 10% |
| Money Market Mutual Funds | N/A | 0% | 10% |
| County Pooled Investment Funds | N/A | None | None |
| Local Agency Investment Fund (LAIF) | N/A | None | None |
| JPA Pools (other investment pools) | N/A | None | None |

Investments Authorized by Debt Agreements

Investment of debt proceeds held by bond trustee are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or ACE Construction Authority's investment policy.

NOTE 2 CASH AND CASH EQUIVALENTS (CONTINUED)

The table below identifies the investment types that are authorized for investments held by bond trustee. The table also identifies certain provisions of these debt agreements that address interest rate risk, credit risk, and concentration of credit risk.

| <u>Authorized Investment Type</u> | <u>Maximum Maturity</u> | <u>Maximum Percentage Allowed in</u> | <u>Maximum Investment One Issuer</u> |
|-----------------------------------|-------------------------|--------------------------------------|--------------------------------------|
| U.S. Treasury Obligations | None | None | None |
| U.S. Agency Securities | None | None | None |
| Banker's Acceptances | 180 days | None | None |
| Commercial Paper | 270 days | None | None |
| Money Market Mutual Funds | N/A | None | None |
| Investment Contracts | 30 years | None | None |

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the COG 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 due over time as necessary to provide the cash flow and liquidity needed for operations.

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

Primary government:

| <u>Investment Type</u> | <u>Total</u> | <u>Remaining maturity in months</u> | | | |
|------------------------|--------------|-------------------------------------|---------------------|---------------------|----------------------------|
| | | <u>12 Months or less</u> | <u>13-24 Months</u> | <u>25-60 Months</u> | <u>More than 60 Months</u> |
| LAIF | \$ 420,945 | \$ 420,945 | \$ - | \$ - | \$ - |
| Total | \$ 420,945 | \$ 420,945 | \$ - | \$ - | \$ - |

San Gabriel Valley Council of Governments
Notes to Financial Statements
Year ended June 30, 2011

NOTE 2 CASH AND CASH EQUIVALENTS (CONTINUED)

Component unit:

| Investment Type | Total | Remaining maturity in months | | | |
|-------------------------|---------------|------------------------------|-----------------|-----------------|---------------------|
| | | 12 Months or less | 13 to 24 Months | 25 to 60 Months | More than 60 months |
| LAIF | \$ 1,543,746 | \$ 1,469,646 | \$ 44,769 | \$ 29,331 | - |
| <i>Held by trustee:</i> | | | | | |
| Money market funds | 2,202,259 | 2,202,259 | - | - | - |
| Investment contracts | 13,054,773 | - | 13,054,773 | - | - |
| Total | \$ 16,800,778 | \$ 3,671,905 | \$ 13,099,542 | \$ 29,331 | - |

Investment with Fair Values Highly Sensitive to Interest Rate Fluctuations

The COG and its component unit have no investments that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided above).

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, COG's investment policy, or debt agreements, and the actual rating as of year end for each investment type.

Primary government:

| Investment Type | Minimum Legal Rating | Exempt from Disclosure | Rating as of Year End | | |
|-----------------|----------------------|------------------------|-----------------------|------|------------|
| | | | AAA | AA | Not Rated |
| LAIF | \$ 420,945 | N/A | \$ - | \$ - | \$ 420,945 |
| Total | \$ 420,945 | | \$ - | \$ - | \$ 420,945 |

Component unit:

| Investment Type | Minimum Legal Rating | Exempt from Disclosure | Rating as of year end | | |
|-------------------------|----------------------|------------------------|-----------------------|------|--------------|
| | | | AAA | Aa | Not rated |
| LAIF | \$ 1,543,746 | N/A | \$ - | \$ - | \$ 1,543,746 |
| <i>Held by trustee:</i> | | | | | |
| Money market funds | 2,202,259 | A | 2,202,259 | - | - |
| Investment contracts | 13,054,773 | N/A | 13,054,773 | - | - |
| Total | \$ 16,800,778 | | \$ 15,257,032 | \$ - | \$ 1,543,746 |

NOTE 2 CASH AND CASH EQUIVALENTS (CONTINUED)

Concentrations of Credit Risk

The investment policy of the COG contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. As of June 30, 2011, the COG had no investments in any one issuer (other than U.S. Treasury securities, mutual funds, and external investment pools) that represent 5% or more of total COG investments.

The COG does not have any investments in any one issuer that represent 5% or more of total investments.

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and COG's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by State or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under State law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure local government units' deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits. As of June 30, 2011, none of COG's deposits with financial institutions in excess of Federal depository insurance limits were held in uncollateralized accounts.

The COG is a voluntary participant in the Local Agency Investment Fund (LA IF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. At June 30, 2011, the total market value of LAIF, including accrued interest was approximately \$66.49 billion. The fair value of the COG's investment in this pool is \$420,945 at June 30, 2011 based upon the COG's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of the portfolio). LAIF's (and the COG's) exposure to risk (credit, market or legal) is not currently available.

NOTE 2 CASH AND CASH EQUIVALENTS (CONTINUED)

Custodial Credit Risk (Continued)

As of June 30, 2011, the following investment types were held by the same broker-dealer (counterparty) that was used by ACE Construction Authority to buy the securities:

| Investment Type | Reported Amount |
|--------------------|--------------------|
| Money market funds | \$ 2,202,259 |

ACE Construction Authority is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. At June 30, 2011, the total market value of LAIF, including accrued interest was approximately \$66.52 billion. The fair value of ACE Construction Authority's investment in this pool is \$1,543,746 at June 30, 2011 based upon ACE Construction Authority's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of the portfolio). LAIF's (and ACE Construction Authority's) exposure to risk (credit, market or legal) is not currently available.

NOTE 3 LEASEHOLD IMPROVEMENTS AND EQUIPMENT

The leasehold improvement and equipment of the component unit are recorded at cost and consist of the following:

| | Balances at July 1, 2010 | Additions | Deletions | Balances at June 30, 2011 |
|---|-----------------------------|-------------|-----------|------------------------------|
| <i>Cost:</i> | | | | |
| Leasehold improvements | \$ 19,762 | \$ - | \$ - | \$ 19,762 |
| Computer equipment | | | | |
| Hardware | 159,992 | - | - | 159,992 |
| Software | 105,692 | - | - | 105,692 |
| Website | 3,393 | - | - | 3,393 |
| Telephone equipment | 12,086 | - | - | 12,086 |
| Office furniture | 31,972 | - | - | 31,972 |
| Total cost | 332,897 | - | - | 332,897 |
| <i>Less accumulated depreciation for:</i> | | | | |
| Leasehold improvements | 18,774 | 988 | - | 19,762 |
| Computer equipment | | | | |
| Hardware | 142,968 | 9,259 | - | 152,227 |
| Software | 83,186 | 8,376 | - | 91,562 |
| Website | 3,393 | - | - | 3,393 |
| Telephone equipment | 12,086 | - | - | 12,086 |
| Office furniture | 29,282 | 1,425 | - | 30,707 |
| Total accumulated depreciation | 289,689 | 20,048 | - | 309,737 |
| Leasehold improvements and equipment, net | \$ 43,208 | \$ (20,048) | \$ - | \$ 23,160 |

NOTE 3 LEASEHOLD IMPROVEMENTS AND EQUIPMENT (CONTINUED)

Depreciation expense included in indirect expenses for the year ended June 30, 2011 amounted to \$20,048.

NOTE 4 RECEIVABLES

Receivables of the component unit as of June 30, 2011, as shown in the government-wide financial statements, in the aggregate, including retention, are as follows:

| <u>Receivables</u> | <u>Amount</u> |
|--------------------|---------------|
| Grants | \$ 4,032,710 |
| Unbilled | 7,617,163 |
| Retention | 4,960,642 |
| Interest | 16,430 |
| Other | 120,656 |
| | \$ 16,747,601 |

NOTE 5 SHORT-TERM NOTES PAYABLE (COMMERCIAL PAPER)

In the Spring of 2001 the SGVCOG entered into an agreement to borrow up to \$100,000,000 in short-term debt guaranteed by a letter of credit and collateralized by the pledge of grant revenues. The securities issue is tax exempt. Notes outstanding at June 30, 2011, amounted to \$27,350,000. Interest rates vary according to market conditions and have ranged from 0.38% and 0.24% in FY 2011. Proceeds of the borrowings have been used to pay for construction activities and also to provide a revenue source on the differential between interest earned and interest paid. The Commercial Paper is currently guaranteed by Bayern LB.

NOTE 6 GRANT ACCOUNTING

In the year ended June 30, 2011, ACE Construction Authority was the recipient, primarily from the Federal Department of Transportation through the California Department of Transportation (Caltrans), of cost reimbursement type grants. There were also California transportation programs paid through Caltrans. Local share was received from Metro. All of these grants are expenditure driven; funds must be expended before reimbursement is received. Certain amounts have been held back by the grantor agency pending completion of certain phases of contracted work and some costs incurred are subject to disallowance.

NOTE 6 GRANT ACCOUNTING (CONTINUED)

Receivable amounts at June 30, 2011, are shown net of disallowed costs. Caltrans approved, under Office of Management and Budget (OMB) Circular A-87, an indirect overhead allocation formula of 397.1% of total direct salaries and fringe benefit costs. Indirect costs incurred in fiscal year ended June 30, 2011 were \$3,608,604 and previously deferred indirect expense was increased by \$298,293.

NOTE 7 DUE TO GOVERNMENT AGENCY

The California Department of Transportation Audits and Investigation (A& I) audited the costs claimed by COG totaling \$245,130 for work performed under Agreement 74A0238 (Agreement) with California Department of Transportation (Caltrans). The Agreement period was March 1, 2006 through March 31, 2008. Based on the results of the audit, A & I determined that the COG owed \$89,262 of reimbursed costs not adequately supported and not in compliance with the Agreement provisions, and the State and federal regulations.

On December 12, 2011, Caltrans issued a letter to the COG reducing the liability from \$89,262 to \$42,687, provided COG implement certain action plans.

Of the total \$42,687 due to Caltrans, \$5,751 will be collected from the City of Irwindale.

NOTE 8 ADMINISTRATIVE EXPENSES

The following were the administrative expenses of the primary government for the year ended June 30, 2011:

| | |
|------------------------------------|-----------------------|
| Consultant fee | \$ 124,949 |
| Insurance | 4,662 |
| Legal fees | 60,070 |
| Accounting and audit fees | 48,387 |
| Stipends | 11,500 |
| Dues and subscriptions | 514 |
| Meetings | 29,350 |
| Committee support | 19,328 |
| Printing/publications | 5,803 |
| Annual evaluation | 3,930 |
| Information technology | 669 |
| Unreimbursable grant expenses | 1,732 |
| Disallowed costs, net (see Note 7) | 36,936 |
| Miscellaneous | 1,458 |
| Total \$ | <u><u>349,288</u></u> |

NOTE 9 RELATED PARTY TRANSACTION

The COG has an agreement with Arroyo Associates, Inc. (AAI) to conduct COG's day-to-day administration, management and operating activities. As part of the Agreement, the President of AAI assumes the role of the Executive Director for COG.

For the fiscal year ended June 30, 2011, the total payments to AAI were \$556,443, in accordance with the contract.

NOTE 10 EMPLOYEE BENEFIT PLAN

Defined Benefit Pension Plan

Effective June 17, 2002 contributions and earnings of continuing employees of the ACE Construction Authority previously contributed to CalPars, were transferred to CalPERS.

CalPERS is an agent, multiple employer defined benefit pension plan that acts as a common investment and administrative agent for participating public entities within the State of California; State statutes within the Public Employees Retirement Law establish menus of benefit provisions as well as other requirements. CalPERS issues separate comprehensive annual financial reports. Copies of the CalPERS' annual financial report may be obtained from CalPERS Executive Office - 400 P Street, Sacramento, CA 95814. Since the plan had less than 100 active members and at least one valuation since June 30, 2003, CalPERS requires the Authority's Plan to participate in a risk pool. Mandated pooling was effective with the June 20, 2003 valuation.

Funding Policy

Active plan members as defined by the above statutes are required to contribute 7% of their annual covered salary. The Authority has elected to contribute this amount to CalPERS on behalf of eligible employees. The authority is also required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by CalPERS Board of Administration. The required employer contribution rate to CalPERS for the year ended June 30, 2011 is 8.475%. The contribution requirements of the plan members are established by State statute and the employer contribution rate is established and may be amended by CalPERS.

Annual Pension Cost (APC)

For fiscal year 2011, the Authority's annual pension cost and actual contribution was \$331,340. For the year ended June 30, 2011, the actuarial funding method used by the CalPERS is the Entry Age Normal Cost Method. Under this method, projected benefits are determined for all members and the associated liabilities are spread in a manner that produces level annual cost as the percentage of pay in each year from the age of hire (entry age) to the assumed retirement age.

NOTE 10 EMPLOYEE BENEFIT PLAN (CONTINUED)

The actuarial assumptions included (a) 2% at 55 as the benefit formula; (b) 7.75% investment rate of return compounded annually (net of expenses); (c) projected payroll growth rate of 3.25% and inflation of 3.0% compounded annually; and (d) 2% cost-of-living adjustment.

The actuarial funding process calculates a regular contribution schedule of employee contributions and employer contributions (normal costs) which are designed to accumulate with interest to equal the total present value of benefits by the time every member has left employment. As of each June 30, the actuary calculated the desirable level of plan assets as of that point in time by subtracting the present value of scheduled future employee contributions and future employer normal costs from the total present value of benefits.

Three-Year Trend Information for CalPERS

| Year | (APC) | APC Contributed | Obligation |
|-----------|------------|--------------------|------------|
| 6/30/2009 | \$ 207,868 | 100% | \$ - |
| 6/30/2010 | 353,248 | 100% | - |
| 6/30/2011 | 331,340 | 100% | - |

Postemployment benefits

The ACE Construction Authority did not incur any other liabilities during fiscal year 2011 related to postemployment benefits.

Deferred compensation plan

The Authority has entered into a salary reduction deferred compensation plan for its employees. Securities held by the plan are valued at market. The plan allows employees to defer a portion of their current income from state and federal taxation. Employees may withdraw their participation at any time by giving written notice at least a week in advance prior to the effective date of the withdrawal. At June 30, 2011, plan assets totaling \$1,162,063 were held by independent trustees and, as such, are not reflected in the accompanying basic financial statements.

| | |
|--|---------------------|
| Balance at June 30, 2010 | \$ 806,716 |
| Add employee contribution | 160,881 |
| Add net realized and unrealized appreciation in fair value of investments | 196,968 |
| Less distributions | (2,500) |
| Less fees charged | (2) |
| Balance at June 30, 2011 | \$ <u>1,162,063</u> |

NOTE 10 EMPLOYEE BENEFIT PLAN (CONTINUED)

Deferred compensation plan (continued)

All amounts of compensation deferred under the plans are solely the property and rights of each beneficiary (pursuant to legislative changes effective 1998 to the Internal Revenue Code Section 457, this includes all property and rights purchased and income attributable to these amounts until paid or made available to the employee or other beneficiary).

NOTE 11 COMMITMENTS AND CONTINGENCIES

Primary government:

The COG is currently a party in a legal proceeding. After consultation with legal counsel, management estimates that the matter will be resolved without material effect on the COG's financial position.

Component unit:

As mentioned in Note 6, the Authority receives reimbursement type grants from Federal, State and local sources. Certain expenditures are not allowable and not subject to reimbursement. Also, there may be disallowed costs. Management's experience in this regard indicates disallowances, if any, will not be material.

In June 2009, ACE Construction Authority Board approved suspension of the Integrated Rail Roadway System (IRRIS), a traffic signal system demonstration project. A total of \$6.4 million has been spent on the project since inception. The ACE Construction Authority staff has received a project close out from Caltrans. Management believes that no funds will be returned as a result of the suspension.

Earnings from arbitrage may be subject to rebate under certain provisions of the Internal Revenue Service Code unless certain specific conditions are met. Management is committed to meeting those conditions.

In the ordinary course of its operations, ACE Construction Authority is the subject of claims and litigations from outside parties. In the opinion of management, there is no pending litigation or unasserted claims, the outcome of which would materially affect ACE Construction Authority's financial position.

The ACE Construction Authority rents its office from Metropolitan Life Insurance Company subject to a lease expiring April 30, 2016. Monthly rent and a pro-rata share of facility maintenance and utilities are as follow:

NOTE 11 COMMITMENTS AND CONTINGENCIES (CONTINUED)

| <u>Period from/to</u> | <u>Monthly Rent</u> | <u>Annual Amount</u> |
|-------------------------------|-------------------------|--------------------------|
| May 1, 2011 to April 30, 2012 | \$ 17,448 | \$ 209,376 |
| May 1, 2012 to April 30, 2013 | 17,972 | 215,664 |
| May 1, 2013 to April 30, 2014 | 18,511 | 222,132 |
| May 1, 2014 to April 30, 2015 | 19,066 | 228,792 |
| May 1, 2015 to April 30, 2016 | 19,638 | 235,656 |
| Total lease commitments | \$ | <u>1,111,620</u> |

Escrow Agreements for Contract Retention - The Escrow Agent, Contractor or Owner may terminate this Escrow Agreement, with or without cause, by providing 30 days prior written notice to the other parties. In the event of termination of this Escrow Agreement, all the funds on deposit shall be paid to the Owner and any accrued interest less escrow fees shall be paid to the Contractor. The Authority has recognized as expenditure retention payments totaling \$3,763,151. Funds are deposited in several escrow accounts until release to the Contractor is authorized.

NOTE 12 ACCOUNTING FOR CONSTRUCTION IN PROGRESS AND EVENTUAL DISPOSAL OF PROJECTS

Except for minor acquisitions that may be sold by the ACE Construction Authority when no longer needed, all of the construction projects when completed, will be deeded to the Union Pacific Railroad and the cities in which they are located at no cost to the acquirer. At June 30, 2011, \$574,432,135 of costs was accumulated on projects in process and \$390,432,480 had been transferred to the railroad and impacted cities.

Under the government funds and modified accrual basis of accounting \$44,189,806 in FY 2011 project expenditures would be reported as expenditures in the year incurred. On the government-wide financial statements conforming to GASB 34 reporting on these transactions presents a challenge. Accumulating those costs as construction in progress (i.e., treated as a cash flow expenditure and not a current year expense) would substantially overstate income while reporting the disposal and expensing the accumulated costs would distort the cost of operations. In both cases, net assets would fluctuate wildly, depending on the timing of construction and disposal.

To alleviate this situation, management has elected to record a liability (same amount as the construction in progress) to UPRR and governments likely to be the eventual owner of the improvements/grade separations. This approach will minimize the effects of both on the acquisition of property for construction and the accumulation of construction costs and their eventual disposal.

NOTE 13 ACCOUNTING FOR ARBITRAGE

In February of 2011 ACE received an Information Data Request from the Internal Revenue Service ("IRS") related to arbitrage rebate compliance on ACE Construction Authority's 2005 Series commercial paper draw. Based upon this request, it was discovered that the Series 2005 draw, and the previous three draws, had not met spending exceptions that would avoid the payment of any excess profits made on investing the tax-exempt commercial paper draws in taxable investments prior to these amounts being spent.

ACE Construction Authority contracted with First Southwest Company to perform rebate calculations on all of its outstanding commercial paper draws. Based upon these calculations, as of June 30, 2011, ACE Construction Authority has made payments to the IRS in the amount of \$2,465,791, consisting of \$2,214,731 of rebate liability, and \$251,060 in late interest for required filings prior to June 30, 2011.

As of June 30, 2011, the estimated liability payment on three outstanding commercial paper draws is \$1,836,253. Of this total, \$598,286 was paid on July 5, 2011, \$717,422 was paid on July 29, 2011, and \$412,716 was paid on October 27, 2011, leaving an estimated liability of \$107,829 as of December 5, 2011.

On October 28, 2011, ACE Construction Authority received a notice from the IRS which states that the IRS made a determination to close the examination of ACE Construction Authority's 2005 Series commercial paper draw with no change to the position that interest received by the beneficial owners of the Bonds is excludable from the gross income under section 103 of the Internal Revenue Code. However, the IRS' examination revealed that rebate payments were required and that ACE Construction Authority had no system to monitor the compliance with arbitrage and yield restriction regulations. Future noncompliance could result in penalties and/or the taxability of interest received by the beneficial owners of the Bonds. The accrued liability as of June 30, 2011 covers the rebate payments required and ACE Construction Authority is committed to having a system to monitor the compliance with arbitrage and yield restriction regulations.

NOTE 14 SUBSEQUENT EVENTS

COG has evaluated events subsequent to June 30, 2011 to assess the need for potential recognition or disclosure in the financial statements. Such events were evaluated through January 17, 2012, the date the financial statements were available to be issued. Based upon this evaluation, it was determined that no other subsequent events occurred that require recognition or additional disclosure in the financial statements.

San Gabriel Valley Council of Governments
Statement of Revenues, Expenditures, and Changes in Fund Balances – Component Unit
Budget to Actual
Year ended June 30, 2011

| | Budgeted Amounts | | Actual | Variance |
|---|-------------------------|--------------------------|---------------------|--------------------------------|
| | Original | Amended Final | Amounts | Positive (Negative) |
| Revenues | | | | |
| Reimbursements | | | | |
| Federal grants | \$ 14,631,000 | \$ 11,064,657 | \$ 4,985,702 | \$ (6,078,955) |
| State grants | 26,808,000 | 20,273,482 | - | (20,273,482) |
| Local grants | 67,941,000 | 51,380,209 | 39,196,054 | (12,184,155) |
| Other revenue | 1,333,000 | - | 332 | 332 |
| Total revenues | 110,713,000 | 82,718,348 | 44,182,088 | (38,536,260) |
| Operating expenditures | | | | |
| Construction | | | | |
| Design | 7,698,000 | 7,389,951 | 7,375,691 | 14,260 |
| Right-of-Way acquisition | 43,677,000 | 49,437,809 | 21,472,099 | 27,965,710 |
| Construction management | 1,198,000 | 1,339,913 | 1,060,283 | 279,630 |
| Construction | 51,726,000 | 19,368,157 | 9,665,665 | 9,702,492 |
| Betterments | 970,000 | 1,336,518 | 1,305,757 | 30,761 |
| Total construction | 105,269,000 | 78,872,348 | 40,879,495 | 37,992,853 |
| Indirect | | | | |
| Personnel | | | | |
| Salaries and wages | 1,625,000 | 1,654,000 | 1,571,525 | 82,475 |
| Fringe benefits | 467,000 | 477,000 | 480,984 | (3,984) |
| Employee related expenses | 35,000 | 33,000 | 36,976 | (3,976) |
| Professional services | | | | |
| Auditing/accounting | 35,000 | 35,000 | 41,314 | (6,314) |
| Disadvantaged business/labor compliance | 161,000 | 161,000 | 90,681 | 70,319 |
| Legal | 55,000 | 55,000 | 63,022 | (8,022) |
| Other | - | - | 225,426 | (225,426) |
| Program management | 923,000 | 952,000 | 654,870 | 297,130 |
| Brokerage | 65,000 | 65,000 | 59,346 | 5,654 |
| Insurance | 166,000 | 131,000 | 98,624 | 32,376 |
| Equipment expense | 48,000 | 37,000 | 40,642 | (3,642) |
| Office rental expense | 203,000 | 203,000 | 187,356 | 15,644 |
| Office operations | 38,000 | 38,000 | 57,838 | (19,838) |
| Other | 5,000 | 5,000 | - | 5,000 |
| Deferred indirect expense | - | - | (298,293) | 298,293 |
| Total indirect | 3,826,000 | 3,846,000 | 3,310,311 | 535,689 |
| Total operating expenditures | 109,095,000 | 82,718,348 | 44,189,806 | 38,528,542 |
| Excess (deficiency) of revenues over expenditures | 1,618,000 | - | (7,718) | (7,718) |
| Other financing sources (uses) | | | | |
| Investment revenue | 638,000 | 638,000 | 543,560 | (94,440) |
| Interest and related expenses | (562,000) | (562,000) | (4,907,655) | (4,345,655) |
| Non-project reimburseable funds | 285,000 | 285,000 | 312,798 | 27,798 |
| Non-project reimburseable expense | (285,000) | (285,000) | (312,798) | (27,798) |
| Rental revenue | - | - | 162,741 | 162,741 |
| Rental expense | - | - | (92,339) | (92,339) |
| Net other financing sources (uses) | 76,000 | 76,000 | (4,293,693) | (4,369,693) |
| Change in fund balance | 1,694,000 | 76,000 | (4,301,411) | (4,377,411) |
| Fund balance at beginning of year | 10,199,199 | 10,199,199 | 10,199,199 | - |
| Fund balance at end of year | \$ 11,893,199 | \$ 10,275,199 | \$ 5,897,788 | \$ (4,377,411) |

**Report of Independent Auditors on Internal Control over Financial Reporting
and on Compliance and Other Matters Based on an Audit of Basic Financial Statements
Performed in Accordance with *Government Auditing Standards***

**Board of Directors
San Gabriel Valley Council of Governments**

We have audited the financial statements of San Gabriel Valley Council of Governments (the "COG") as of and for the year ended June 30, 2011, which collectively comprise the basic financial statements of the COG and have issued our report thereon dated January 17, 2012. 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 the *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the COG's financial statements 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 the governing board, management, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Vargay + Company LLP

Los Angeles, California
January 17, 2012

