

CITY OF VERNON, CALIFORNIA
Annual Financial Report
Fiscal Year Ended June 30, 2006

CITY OF VERNON
For the Fiscal Year Ended June 30, 2006

Table of Contents

	<u>Page(s)</u>
FINANCIAL SECTION:	
Independent Auditor’s Report.....	1
Management’s Discussion and Analysis (Required Supplementary Information-Unaudited)	2
Basic Financial Statements:	
Government-wide Financial Statements:	
Statement of Net Assets	13
Statement of Activities	14
Fund Financial Statements:	
Governmental Funds:	
Balance Sheet.....	15
Reconciliation of the Governmental Funds Balance Sheet to the Government-wide Statement of Net Assets-Governmental Activities	16
Statement of Revenues, Expenditures, and Changes in Fund Balances	17
Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances to the Government-wide Statement of Activities- Governmental Activities.....	18
Proprietary Funds:	
Statement of Fund Net Assets (Deficit).....	19
Statement of Revenues, Expenses, and Changes in Fund Net Assets (Deficit)	20
Statement of Cash Flows	21
Notes to the Basic Financial Statements	22-58
Required Supplementary Information (Other than Management’s Discussion and Analysis-Unaudited):	
General Fund Budgetary Comparison Schedule.....	59
Notes to General Fund Budgetary Comparison Schedule.....	60



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INDEPENDENT AUDITOR'S REPORT

City Council
City of Vernon, California

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Vernon, California (City) as of and for the fiscal year ended June 30, 2006, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 City'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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City as of June 30, 2006, and the respective changes in financial position and, where applicable, cash flows thereof for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and budgetary comparison information on pages 3 through 15 and 61 through 62, are not a required part of the basic financial statements but are 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 of 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.

Macias Gini & O'Connell LLP

Certified Public Accountants

Los Angeles, California
December 15, 2006

CITY OF VERNON, CALIFORNIA
Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2006
(Unaudited)

As management of the City of Vernon ("the City"), we offer readers of the financial statements this narrative overview and analysis of the financial activities of the City for the fiscal year ended June 30, 2006.

Financial Highlights

- The assets of the City exceeded its liabilities at the close of the most recent fiscal year by \$308,808,855 (*net assets*). Of this amount, \$61,260,285 (*unrestricted net assets*) may be used to meet the City's ongoing obligations to citizens and creditors.
- The City's total net assets decreased by \$26,823,957. This decrease is attributable to the governmental activities generating a decrease in net assets before transfers of \$12,300,323 and the business-type activities generating a decrease in net assets before transfers of \$14,523,634.
- As of the close of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$59,741,236, a decrease of \$4,554,758 in comparison with the prior year. Approximately 21% of the governmental funds balances, \$12,808,623, are *available for spending* at the City's discretion (*unreserved fund balances*).

Overview of the Financial Statements

This discussion and analysis are intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the basic financial statements.

Government-wide financial statements. The *government-wide financial statements* are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business.

The *statement of net assets* presents information on all of the City's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The *statement of activities* presents information showing how the City's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of the City include general government, public safety, public works, and health services. The business-type activities of the City include the Light and Power Department, Gas Department and Water Department.

The government-wide financial statements can be found on pages 13-14 of this report.

Fund financial statements. A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and

local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into two categories: governmental funds and proprietary funds.

Governmental funds. *Governmental funds* are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The City adopts an annual appropriated budget for its General Fund. A budgetary comparison schedule has been provided for the general fund to demonstrate compliance with this budget.

The basic governmental funds financial statements can be found on pages 15-18 of this report.

Proprietary funds. The City maintains two different types of proprietary funds. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the government-wide financial statements. The City uses enterprise funds to account for its Light and Power Department, Water Department, Gas Department and Fiber Optic Department. *Internal service funds* are an accounting device used to accumulate and allocate costs internally among the City's various functions. The City uses internal service funds to account for its fleet of vehicles, insurance, and retirement. Because these services predominantly benefit governmental rather than business-type functions, they have been included within *governmental activities* in the government-wide financial statements.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the Light and Power Fund and the Gas Fund, which are considered to be major funds of the City. Conversely, the internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements.

The basic proprietary fund financial statements can be found on pages 19-21 of this report.

Government-wide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City, assets exceeded liabilities by \$308,808,855 at the close of the most recent fiscal year.

City's Net Assets

At the end of the current fiscal year, the City is able to report positive balances in all categories of net assets, both for the government as a whole, as well as for its separate governmental and business-type activities.

The category of the City's net assets with the largest balance totaling \$213,975,958 (69%) represents resources that are invested in capital assets, net of related debt.

The second largest category of net assets, \$61,260,285 (20%) represents unrestricted net assets that can be used to meet the City's ongoing obligations to its citizens and creditors.

The last remaining category of net assets, totaling \$33,572,612 (11%) represents the City's restricted assets, which is restricted for special purposes and payment of long-term debt.

Changes in Net Assets

Governmental activities' net assets decreased by \$33,745,927 and business-type activities' net assets increased by \$6,921,970 for a net decrease of \$26,823,957 for the City. The decrease in the governmental activities was caused by the governmental activities reporting a \$12,300,323 decrease in net asset before transfers and a \$21,445,604 operating transfer out to the business-type activities. The increase in the business-type activities was caused by the \$21,445,604 of operating transfer in from the governmental activities less the \$14,523,634 of decrease in net asset reported by the business-type activities.

City of Vernon
Net Assets
June 30, 2006 and 2005

	Governmental Activities		Business-type Activities		Totals	
	2006	2005	2006	2005	2006	2005
Assets:						
Current and other assets	\$ 51,354,912	\$ 81,468,279	\$ 561,097,165	\$ 123,914,496	\$ 612,452,077	\$ 205,382,775
Restricted assets	40,015,669	388,508	47,550,737	73,744,545	87,566,406	74,133,053
Capital assets	89,343,037	74,614,172	316,293,591	282,137,513	405,636,628	356,751,685
Total assets	180,713,618	156,470,959	924,941,493	479,796,554	1,105,655,111	636,267,513
Liabilities						
Current liabilities	13,378,105	7,244,297	29,528,656	23,916,473	42,906,761	31,160,770
Long-term liabilities	55,183,416	3,328,638	698,756,079	266,145,293	753,939,495	269,473,931
Total liabilities	68,561,521	10,572,935	728,284,735	290,061,766	796,846,256	300,634,701
Net Assets:						
Invested in capital assets, net of related debt	89,889,751	74,614,172	124,086,207	114,353,358	213,975,958	188,967,530
Restricted	3,296,917	338,664	30,275,695	42,935,885	33,572,612	43,274,549
Unrestricted	18,965,429	70,945,188	42,294,856	32,445,545	61,260,285	103,390,733
Total net assets	\$ 112,152,097	\$ 145,898,024	\$ 196,656,758	\$ 189,734,788	\$ 308,808,855	\$ 335,632,812

City of Vernon
Changes in Net Assets
Fiscal Year Ended June 30, 2006 and 2005

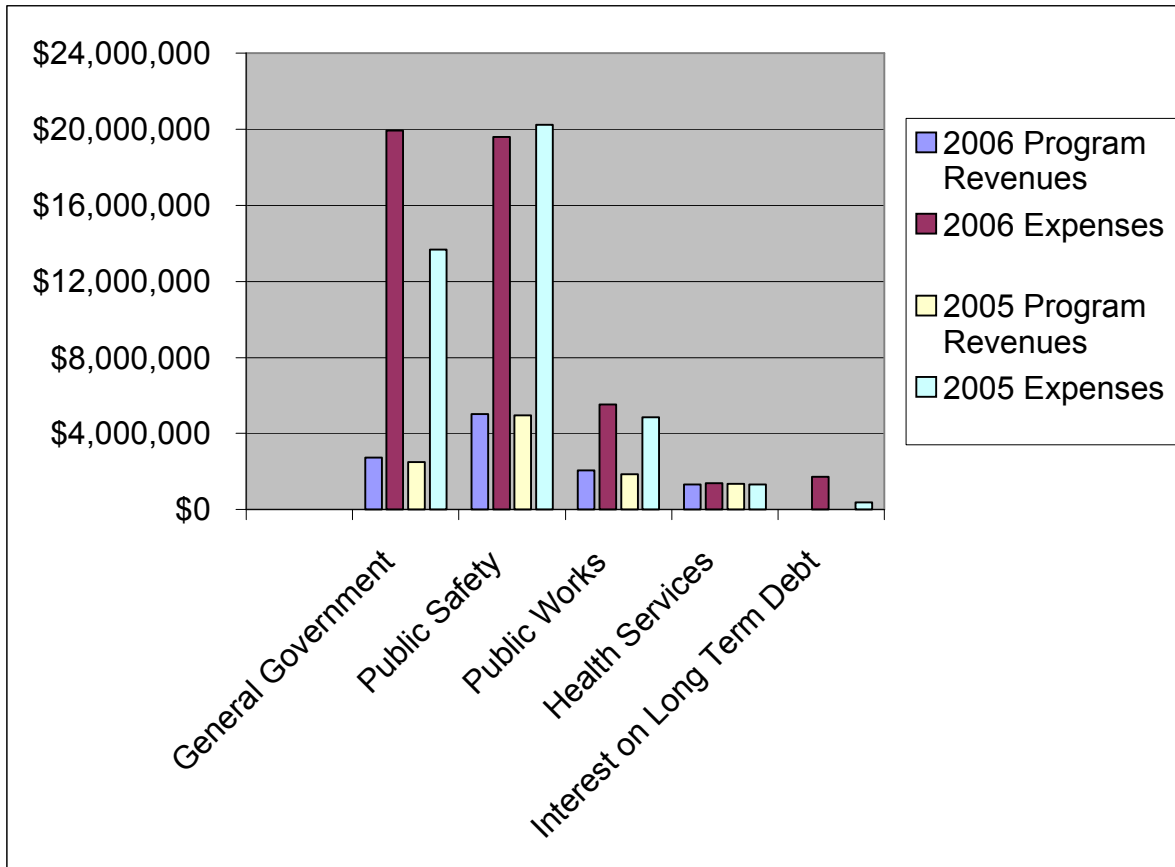
	Governmental Activities		Business-type Activities		Totals	
	2006	2005	2006	2005	2006	2005
Revenues:						
Program Revenues:						
Charges for services	\$ 10,850,093	\$ 10,691,792	\$ 175,611,547	\$ 116,681,653	\$ 186,461,640	\$ 127,373,445
Operating grants and contributions	290,414	192,335	-	-	290,414	192,335
General Revenues:						
Taxes	17,021,021	17,093,349	-	-	17,021,021	17,093,349
State allocations	4,685,752	4,835,991	-	-	4,685,752	4,835,991
Investment income	2,624,478	902,085	2,254,436	4,771,013	4,878,914	5,673,098
Gain on sale of property	43,985	1,659,870	-	-	43,985	1,659,870
Other revenues	406,334	738,463	-	-	406,334	738,463
Total revenues	35,922,077	36,113,885	177,865,983	121,452,666	213,788,060	157,566,551
Program Expenses						
Governmental activities						
General government	19,944,193	13,667,855	-	-	19,944,193	13,667,855
Public safety	19,613,951	20,240,186	-	-	19,613,951	20,240,186
Public works	5,542,660	4,857,135	-	-	5,542,660	4,857,135
Health services	1,397,083	1,311,479	-	-	1,397,083	1,311,479
Interest on long-term debt	1,724,513	373,879	-	-	1,724,513	373,879
Business-type activities						
Light and Power	-	-	149,424,972	97,683,923	149,424,972	97,683,923
Gas	-	-	36,953,697	-	36,953,697	-
Other	-	-	6,010,948	5,845,618	6,010,948	5,845,618
Total expenses	48,222,400	40,450,534	192,389,617	103,529,541	240,612,017	143,980,075
Increase (decrease) in net assets before transfers	(12,300,323)	(4,336,649)	(14,523,634)	17,923,125	(26,823,957)	13,586,476
Transfers	(21,445,604)	72,515,570	21,445,604	(72,515,570)	-	-
Increase (decrease) in net assets	(33,745,927)	68,178,921	6,921,970	(54,592,445)	(26,823,957)	13,586,476
Net assets- beginning of year	145,898,024	77,719,103	189,734,788	244,327,233	335,632,812	322,046,336
Net assets- end of year	\$ 112,152,097	\$ 145,898,024	\$ 196,656,758	\$ 189,734,788	\$ 308,808,855	\$ 335,632,812

Governmental activities. Governmental activities decreased the City's net assets by \$33,745,927. This is a decrease of \$101,924,848 from the prior year. The key reasons for this decrease and change in net assets are as follows:

- In the prior year, the Light and Power Fund transferred \$66,846,257 of its 2004 Taxable Series D Bond proceeds to the General Fund to reimburse the General Fund for costs incurred in connection with the City's Electric System since inception (1934).
- In the current year, the governmental funds transferred a net of \$21,445,604 to the enterprise funds. The main reason for this transfer was to complete the construction of the Malburg Generating Station and to upgrade the City's electric transmission and distribution systems.
- In the current year, decrease in net assets before transfers increased \$7,963,674 from the prior year. The main reasons for this increase are as follows:

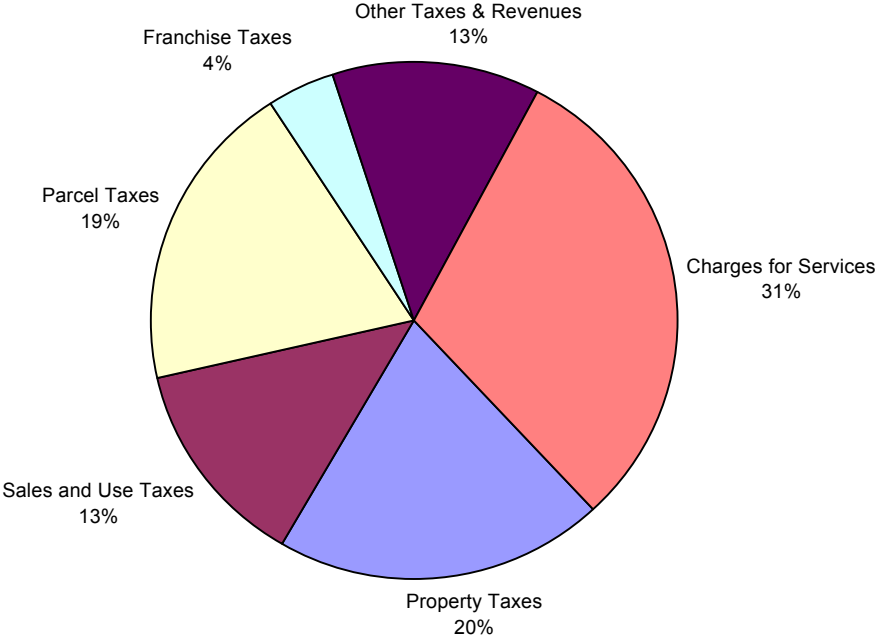
- In the current year, program expenses of the general government increased \$6,276,338 from the prior year. The key components of the increases were as follows:
 - Administration costs increased \$1,050,749 from the prior year due to an administrative reorganization, legal and consultant fees and the installation of 9-11 security measures, including personnel, at the City's new power plant facility.
 - Finance costs increased \$1,058,715 from the prior year due to the additional consulting cost related with the implementation of a new finance system.
 - Insurance costs increased \$956,965 from the prior year due to additional property being insured.
 - Legal costs increased \$1,001,828 from the prior year due to various legal matters of the City.
 - Personnel costs related to the City Clerk, Elections, Treasurer, and Personnel increased in total \$1,068,848 from the prior year due management reorganization and various legal matters of the City.
- The City earned a higher return on its investments as compared to the prior year due to additional debt proceeds invested in the current year. However, this higher return was offset with the higher interest expense associated with the debt.

Expenses and Program Revenues — Governmental Activities
For the Fiscal Years Ended June 30, 2006 and 2005

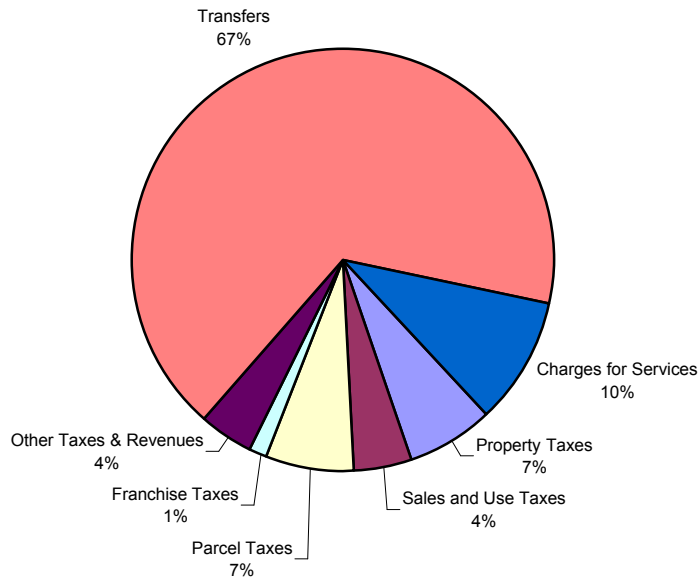


Revenues by Source — Governmental Activities
For the Fiscal Years Ended June 30, 2006 and 2005

2006 Governmental Activities Revenues



2005 Governmental Activities Revenues

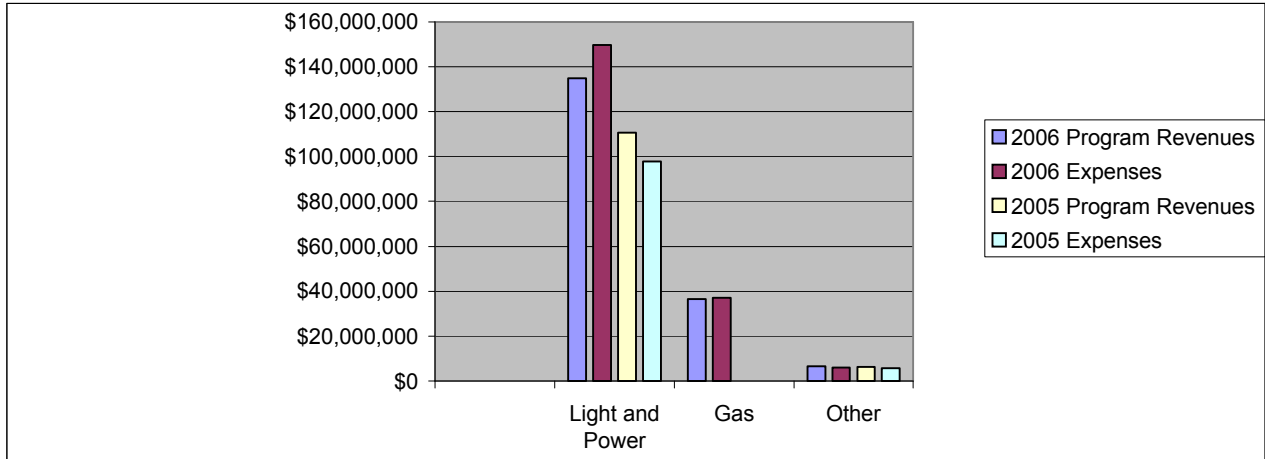


Business-type activities.

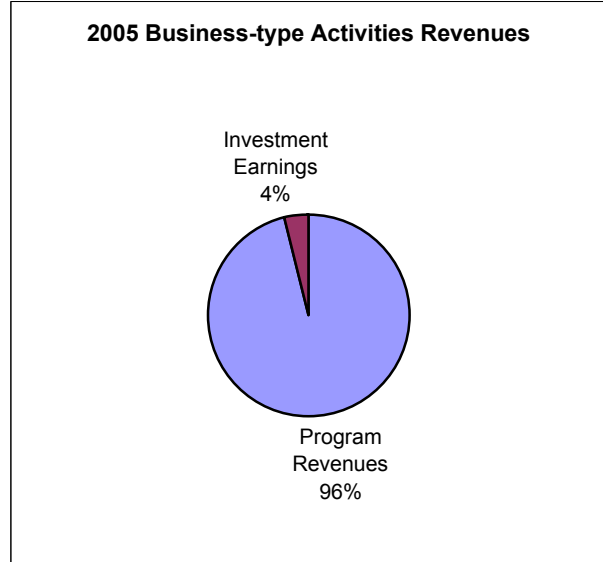
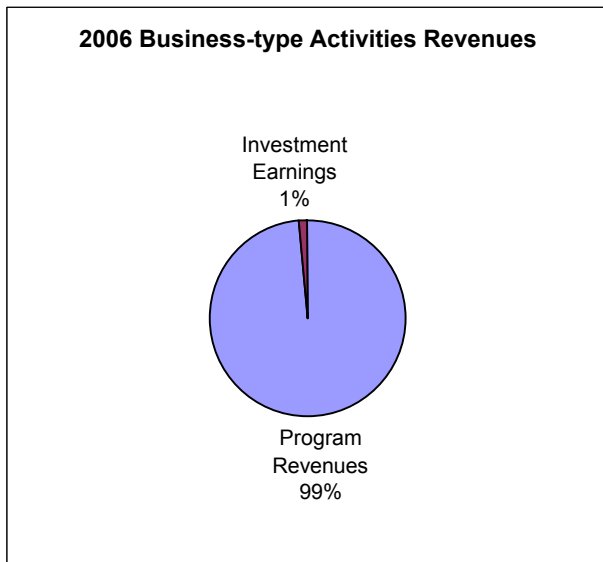
Business-type activities decreased the City's net assets by \$14,523,634 before transfers. The key reasons for this decrease and change in net assets are as follows:

- Light and Power's operating revenue was \$132,565,018 for the current year which is \$22,080,123 higher than the previous year. This increase in revenue was mainly due to the Malburg Generating Station becoming operational on October 17, 2005. However, the cost of sales was \$127,551,769 which is \$38,959,701 higher than the previous year. The increase in cost of sales was mainly due to the unfavorable cost of fuel and wholesale energy market.
- Light and Power's depreciation expense was \$7,203,894 for the current year which is \$2,972,874 higher than the previous year. This increase was due to the Malburg Generating Station becoming operational on October 17, 2005.
- Light and Power's interest expense was \$9,179,326 for the current year which is \$7,868,491 higher than the previous year. The main reason for this increase is that the interest expense related to the Light and Power 2004 Taxable Series A, Series B, and Series C Bonds are no longer being capitalized since October 17, 2005 when Malburg Generating Station became operational.
- Light and Power's net legal settlement loss was \$5,257,580 for the current year. In July 2006, Light and Power settled a dispute over wholesale power purchase contracts with Mirant Americas Energy Marketing, LP for incurring a loss of \$15,000,000, and in November 2006, Light and Power settled a dispute over contract obligations with its former electric distribution system maintenance provider, Resource Management International, Inc., for a gain of \$7,400,000.
- The Gas Fund became operational in the current year with its main customer being the Light and Power Fund. The Gas Fund generated operating revenue of \$36,509,697 with a cost of sales of \$36,671,275. Services were provided primarily to the Light & Power fund.

Expenses and Program Revenues — Business-type Activities
For the Fiscal Years Ended June 30, 2006 and 2005



Revenues by Source — Business-type Activities
For the Fiscal Years Ended June 30, 2006 and 2005



Financial Analysis of the Governmental Funds

As noted earlier, the City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds. The focus of the City's *governmental funds* is to provide information on near-term inflows, outflows, and balances of *spendable* resources. Such information is useful in assessing the City's financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

At the end of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$59,741,236, a decrease of \$4,554,758 in comparison with the prior year. Approximately 21% of total fund balance amount, \$12,808,623, constitutes *unreserved fund balance*, which is available for spending at the City's discretion. The remainder of fund balance, \$46,932,613, is *reserved* to indicate that it is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the current period (\$1,812,002), 2) advances and loans receivable in the event of a default by other funds (\$4,975,646), 3) to be used for debt service (\$2,984,715), 4) to be used for special purpose (\$36,007,050), and 5) for a variety of other purposes (\$1,153,200).

The General Fund is the operating fund of the City. At the end of the current fiscal year, the total fund balance was \$20,960,762 of which \$14,019,385 (67%) is unreserved.

Proprietary funds. The City's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

Unrestricted net assets for the Light and Power Fund at the end of the year amounted to \$69,763,390. Unrestricted net assets of the Gas Fund at the end of the year amounted to a deficit of \$27,725,222. Unrestricted net assets of the non-major enterprise funds (Water and Fiber Optic Funds) amounted to a deficit of \$477,760. This deficit balance in unrestricted net assets for the Gas Fund is primarily due to the Gas Fund heavily invested in capital assets for which it has not yet recovered the cost of capital invested. The natural gas lines are currently operational and the Gas Fund expects to eliminate this deficit balance through increased revenues from customers on future gas sales, including the Light & Power fund.

Total increase(decrease) in net assets for the Light and Power Fund, Gas Fund, and the non-major enterprise funds was \$7,027,023, (\$444,000), and \$338,947, respectively. Other factors concerning the finances of these funds have already been addressed in the discussion of the City's business-type activities.

Governmental Funds Budgetary Highlights

For the current year, the City's original and final budget for general fund expenditures was \$46,456,421. The General Fund's total variance between the final budgeted amount and actual amount was \$6,530,042. The key reason for this variance was excess expenditures over appropriations for capital outlay expenditures of \$7,274,739 incurred by the City in its current industrial development programs. The excess expenditures over appropriations in the general government were \$6,338,061. However, these excess expenditures over appropriations were offset by the under expenditures of \$3,615,057 in public safety and \$3,205,155 in public works.

Capital Asset and Debt Administration

Capital assets. The City's investment in capital assets for its governmental and business-type activities as of June 30, 2006, amounts to \$405,636,628 (net of accumulated depreciation). This investment in capital assets includes land, buildings, utilities system improvements, machinery and equipment, and infrastructure such as roads. The total increase in the City's investment in capital assets for the current fiscal year was \$48,884,943 (net of depreciation).

Major capital asset events during the current fiscal year included the following:

- Construction on the Malburg Generating Station and City's electric system; construction in progress costs for the fiscal year were \$17,836,584. On October 17, 2005, the Malburg Generating Station

became operational and its entire construction cost of \$208,352,126 was reclassified from construction in progress to a utility plant in service.

- Construction in progress costs related to a variety of construction projects were \$36,339,669.
- In the current year, the Redevelopment Agency Fund has elected to reclassify \$8,401,673 of its land to land held for resale.
- As of June 30, 2006, there were no significant construction commitments outstanding.

Additional information on the City's capital assets can be found in Note 5 on pages 35-37 of this report.

Outstanding Debt

During the fiscal year 2006, the City issued a total of \$480,265,000 in long-term obligations consisting of the following:

- \$49,420,000 Redevelopment Agency of the City of Vernon Industrial Redevelopment Project Tax Allocation Bonds, 2005 Series
- \$200,000,000 Vernon Gas Project Variable Rate Revenue Bonds, 2006 Series A
- \$115,440,000 Vernon Gas Project Variable Rate Revenue Bonds, 2006 Series B, and
- \$115,405,000 Vernon Gas Project Variable Rate Revenue Bonds, 2006 Series C

The Industrial Redevelopment Project Tax Allocation Bonds, Series 2005 were issued to provide funds to (i) finance various redevelopment projects in or benefiting the Agency's Industrial Redevelopment Project area, (ii) fund the reserve requirement for the Series 2005 Bonds, and (iii) pay the costs of issuance related to the Series 2005 Bonds.

On April 1, 2006, the City and the RDA created the Vernon Natural Gas Financing Authority (Authority) pursuant to the Joint Powers Agreement, for the express purpose of undertaking projects and programs that promote economic development within the City. Such projects and programs include assisting the City in procuring natural gas for use as fuel for electric generating units that are part of the City's Electric System, which is accounted for in the City's Light and Power fund. During the year ended June 30, 2006, the Authority issued \$430,845,000 in variable rate bonds and subsequently purchased natural gas in accordance with the Natural Gas Agreement between the Authority and the City. As a result of this financing arrangement, the debt and related asset (prepaid natural gas) associated with the Authority have been blended with the City's Light and Power fund for financial reporting purposes.

Bonds outstanding at June 30, 2006 and issued in the prior year consist of \$90,150,000, 2004 Series A, \$83,575,000, 2004 Series B, \$39,875,000, 2004 Series C, and \$61,825,000, 2004 Series D, Electric System Revenue Bonds. The 2004 Bonds were issued to provide funds (i) to refund \$162,610,000 of outstanding Electric System Revenue Bonds of the City; (ii) to finance the costs of improvements to the City's substation and distribution facilities and certain costs of completion of the City's Malburg Generating Station; (iii) to finance the reimbursement to the City of certain costs incurred in connection with the City's electric system facilities; (iv) to fund a deposit to the Debt Service Reserve Fund; and (v) to pay the costs of issuance of the 2004 Bonds.

As of June 30, 2006, all bonds issued by the City, Vernon Redevelopment Agency, and Authority had a rating of "Aaa" by Moody's.

Additional information on the City's long-term debt can be found in Notes 6 and 7 on pages 38-50 of this report.

Economic Factors and Next Year's Budgets and Rates

These factors were considered in preparing the City's budget for the 2007 fiscal year.

- The unemployment rate for the City and adjacent communities is currently 2.2%. This compares favorably to the state's average unemployment rate of 4.9% and the national average rate of 4.6%.
- The occupancy rate of the City's central business district has remained at 98% for the current year.
- Inflationary trends in the region compare favorably to national indices.

Requests for Information

This financial report is designed to provide a general overview of the City's finances for all those with an interest in the City's finances. Questions concerning any of the information provided in this report of requests for additional financial information should be addressed to the Office of the Finance Director, 4305 Santa Fe Avenue, Vernon, California 90058.

CITY OF VERNON, CALIFORNIA
Statement of Net Assets
June 30, 2006

	Governmental Activities	Business-type Activities	Total
ASSETS:			
Cash and investments	\$ 55,722,859	\$ 50,806,818	\$ 106,529,677
Receivables, net of allowances of \$1,400,000	4,317,781	13,852,228	18,170,009
Legal settlement receivable	-	7,400,000	7,400,000
Accrued unbilled revenue	-	7,737,303	7,737,303
Accrued interest receivable	226,988	1,431,950	1,658,938
Inventories	773,684	81,480	855,164
Internal balances	(21,212,306)	21,212,306	-
Prepaid natural gas	-	423,374,475	423,374,475
Deposits and prepaid expenses	672,815	471,698	1,144,513
Restricted cash and investments	40,015,669	47,550,737	87,566,406
Note receivable	-	4,113,951	4,113,951
Bond issuance costs	2,451,418	13,836,974	16,288,392
Other assets	-	16,777,982	16,777,982
Land held for resale	8,401,673	-	8,401,673
Capital assets:			
Nondepreciable	65,422,758	16,743,478	82,166,236
Depreciable, net	23,920,279	299,550,113	323,470,392
Total assets	<u>180,713,618</u>	<u>924,941,493</u>	<u>1,105,655,111</u>
LIABILITIES:			
Accounts payable	6,696,563	14,048,501	20,745,064
Accrued wages and benefits	1,397,177	283,574	1,680,751
Customer deposits and funds held for others	261,993	776,754	1,038,747
Unearned revenue	932,844	-	932,844
Long-term liabilities:			
Due within one year:			
Legal settlement payable	-	9,666,667	9,666,667
Bonds payable, net	44,345	3,567,547	3,611,892
Bond interest	663,800	985,445	1,649,245
Claims payable	2,452,858	-	2,452,858
Compensated absences	928,525	200,168	1,128,693
Due in more than one year:			
Legal settlement payable	-	5,333,333	5,333,333
Bonds payable, net	50,277,701	693,422,746	743,700,447
Claims payable	4,905,715	-	4,905,715
Total liabilities	<u>68,561,521</u>	<u>728,284,735</u>	<u>796,846,256</u>
NET ASSETS:			
Invested in capital assets, net of related debt	81,488,078	124,086,207	205,574,285
Restricted for:			
Grants	312,202	-	312,202
Alternative energy	-	16,532,856	16,532,856
Debt service	2,984,715	13,742,839	16,727,554
Unrestricted	27,367,102	42,294,856	69,661,958
Total net assets	<u>\$ 112,152,097</u>	<u>\$ 196,656,758</u>	<u>\$ 308,808,855</u>

See accompanying notes to the basic financial statements.

CITY OF VERNON, CALIFORNIA
Statement of Activities
For the Fiscal Year Ended June 30, 2006

	Program Revenues			Net (Expenses) Revenues and Change in Net Assets		
	Expenses	Charges for Services	Operating Grants and Contributions	Governmental Activities	Business-	
					type Activities	Total
FUNCTION/PROGRAM ACTIVITIES:						
Governmental activities:						
General government	\$ 19,944,193	\$ 2,450,172	\$ 290,414	\$ (17,203,607)	\$ -	\$ (17,203,607)
Public safety	19,613,951	5,008,884	-	(14,605,067)	-	(14,605,067)
Public works	5,542,660	2,064,894	-	(3,477,766)	-	(3,477,766)
Health services	1,397,083	1,326,143	-	(70,940)	-	(70,940)
Interest on long-term debt	1,724,513	-	-	(1,724,513)	-	(1,724,513)
Total governmental activities	<u>48,222,400</u>	<u>10,850,093</u>	<u>290,414</u>	<u>(37,081,893)</u>	<u>-</u>	<u>(37,081,893)</u>
Business-type activities:						
Light and power	149,424,972	132,565,018	-	-	(16,859,954)	(16,859,954)
Gas	36,953,697	36,509,697	-	-	(444,000)	(444,000)
Other	6,010,948	6,536,832	-	-	525,884	525,884
Total business-type activities	<u>192,389,617</u>	<u>175,611,547</u>	<u>-</u>	<u>-</u>	<u>(16,778,070)</u>	<u>(16,778,070)</u>
Total	<u>\$ 240,612,017</u>	<u>\$ 186,461,640</u>	<u>\$ 290,414</u>	<u>(37,081,893)</u>	<u>(16,778,070)</u>	<u>(53,859,963)</u>
General Revenues:						
Property taxes				7,270,383	-	7,270,383
Parcel taxes				7,001,828	-	7,001,828
Franchise taxes				1,479,619	-	1,479,619
Business license taxes				1,159,618	-	1,159,618
Other license taxes				109,573	-	109,573
Investment income				2,631,641	4,128,341	6,759,982
Net decrease in fair value of investments				(7,163)	(1,873,905)	(1,881,068)
State contribution - sales and use taxes				4,685,752	-	4,685,752
Gain on sale of property				43,985	-	43,985
Other revenues				406,334	-	406,334
Transfers				(21,445,604)	21,445,604	-
Total general revenues and transfers				<u>3,335,966</u>	<u>23,700,040</u>	<u>27,036,006</u>
Change in net assets				(33,745,927)	6,921,970	(26,823,957)
NET ASSETS, BEGINNING OF YEAR				<u>145,898,024</u>	<u>189,734,788</u>	<u>335,632,812</u>
NET ASSETS, END OF YEAR				<u>\$ 112,152,097</u>	<u>\$ 196,656,758</u>	<u>\$ 308,808,855</u>

See accompanying notes to the basic financial statements.

CITY OF VERNON, CALIFORNIA

Balance Sheet
Governmental Funds
June 30, 2006

	General Fund	Redevelopment Agency Fund	Other Governmental Funds	Total Governmental Funds
ASSETS:				
Cash and investments	\$ 27,136,100	\$ 521,925	\$ 17,605,525	\$ 45,263,550
Receivables	1,424,205	889,126	2,004,450	4,317,781
Accrued interest receivable	9,129	217,859	-	226,988
Advances to other funds	4,975,646	-	-	4,975,646
Inventories	773,684	-	-	773,684
Restricted cash and investments	360,104	39,655,565	-	40,015,669
Other assets	115,815	557,000	-	672,815
Land held for resale	-	8,401,673	-	8,401,673
Total assets	<u>\$ 34,794,683</u>	<u>\$ 50,243,148</u>	<u>\$ 19,609,975</u>	<u>\$ 104,647,806</u>
LIABILITIES AND FUND BALANCES:				
Liabilities:				
Accounts payable	\$ 4,715,489	\$ 1,071,149	\$ 836,151	\$ 6,622,789
Accrued wages and benefits	1,391,554	268	5,355	1,397,177
Advances from other funds	-	16,860	19,739,433	19,756,293
Due to other funds	6,314,779	8,665	34,100	6,357,544
Customer deposits and funds held for others	261,993	-	-	261,993
Deferred revenue	1,150,106	8,401,673	958,995	10,510,774
Total liabilities	<u>13,833,921</u>	<u>9,498,615</u>	<u>21,574,034</u>	<u>44,906,570</u>
Fund balances:				
Reserved for:				
Federal forfeiture funds	312,202	-	-	312,202
Advances to other funds	4,975,646	-	-	4,975,646
Inventories	773,684	-	-	773,684
Encumbrances	812,531	806,742	192,729	1,812,002
Employee loans receivable	67,314	-	-	67,314
Debt service	-	2,984,715	-	2,984,715
Redevelopment projects	-	36,007,050	-	36,007,050
Unreserved	14,019,385	946,026	-	14,965,411
Unreserved, reported in nonmajor:				
Special revenue funds	-	-	15,528,565	15,528,565
Capital projects funds	-	-	(17,685,353)	(17,685,353)
Total fund balances	<u>20,960,762</u>	<u>40,744,533</u>	<u>(1,964,059)</u>	<u>59,741,236</u>
Total liabilities and fund balances	<u>\$ 34,794,683</u>	<u>\$ 50,243,148</u>	<u>\$ 19,609,975</u>	<u>\$ 104,647,806</u>

See accompanying notes to the basic financial statements.

CITY OF VERNON, CALIFORNIA
 Reconciliation of the Governmental Funds Balance Sheet to
 Statement of Net Assets - Governmental Activities
 June 30, 2006

Fund balances - total governmental funds (page 15)	\$	59,741,236
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the governmental funds.		89,343,037
Because the focus of governmental funds is on short-term financing, some assets will not be available to pay for current period expenditures. Those assets are offset by deferred revenue in the governmental funds.		8,401,673
Other assets used in governmental activities do not consume current financial resources and therefore are not reported in the governmental fund.		
Unamortized bond issuance costs		2,451,418
Compensated absences are not due and payable in the current period and therefore, are not reported in the funds.		(928,525)
Internal service funds are used by management to charge the costs of employee benefits for health insurance, workers compensation, etc., to individual funds. The assets and liabilities of these funds are included in governmental activities in the statement of net assets		2,952,847
Long-term liabilities are not due and payable in the current period and therefore are not reported in the governmental fund.		
Bonds payable		(49,420,000)
Bond interest payable		(663,800)
Unamortized bond premium		(902,046)
The City recognized uncollected property taxes that were earned but unavailable as of June 30, 2006.		1,176,257
		<hr style="border-top: 1px solid black;"/>
Net assets of governmental activities (page 13)	\$	<u><u>112,152,097</u></u>

See accompanying notes to the basic financial statements.

CITY OF VERNON, CALIFORNIA
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Fiscal Year Ended June 30, 2006

	General Fund	Redevelopment Agency Fund	Other Governmental Funds	Total Governmental Funds
REVENUES:				
Taxes	\$ 8,943,668	\$ 6,469,211	\$ 6,509,334	\$ 21,922,213
Special assessments	736,221	-	-	736,221
Licenses and permits	1,161,188	-	518,260	1,679,448
Fines, forfeitures and penalties	188,988	-	-	188,988
Investment income	1,725,347	906,066	228	2,631,641
Net (decrease) increase in fair value of investments	(24,546)	17,383	-	(7,163)
Intergovernmental revenues	290,414	-	-	290,414
Charges for services to enterprise funds	8,674,077	-	-	8,674,077
Other revenues	697,254	118,780	383,878	1,199,912
Total revenues	<u>22,392,611</u>	<u>7,511,440</u>	<u>7,411,700</u>	<u>37,315,751</u>
EXPENDITURES:				
General government	15,754,912	556,609	197,604	16,509,125
Public safety	18,657,690	-	71,585	18,729,275
Public works	5,010,187	-	282,475	5,292,662
Health services	1,246,963	-	87,106	1,334,069
Capital outlay	11,504,180	3,595,389	13,406,141	28,505,710
Interest on advances	-	213,603	-	213,603
Interest on bonds	-	878,522	-	878,522
Bond issuance cost	-	2,536,782	-	2,536,782
Total expenditures	<u>52,173,932</u>	<u>7,780,905</u>	<u>14,044,911</u>	<u>73,999,748</u>
Deficiency of revenues under expenditures	(29,781,321)	(269,465)	(6,633,211)	(36,683,997)
Other financing sources (uses):				
Sale of land	-	3,267,400	-	3,267,400
Sale of property	43,985	-	-	43,985
Proceeds from long-term debt	-	49,420,000	-	49,420,000
Bond premium	-	933,458	-	933,458
Transfers in	2,975,870	-	624,824	3,600,694
Transfers out	(24,511,474)	(624,824)	-	(25,136,298)
Total other financing sources (uses)	<u>(21,491,619)</u>	<u>52,996,034</u>	<u>624,824</u>	<u>32,129,239</u>
NET CHANGE IN FUND BALANCES	(51,272,940)	52,726,569	(6,008,387)	(4,554,758)
FUND BALANCES, BEGINNING OF YEAR	<u>72,233,702</u>	<u>(11,982,036)</u>	<u>4,044,328</u>	<u>64,295,994</u>
FUND BALANCES, END OF YEAR	<u>\$ 20,960,762</u>	<u>\$ 40,744,533</u>	<u>\$ (1,964,059)</u>	<u>\$ 59,741,236</u>

See accompanying notes to the basic financial statements.

CITY OF VERNON, CALIFORNIA
 Reconciliation of the Statement of Revenues, Expenditures, and
 Changes in Fund Balances of Governmental Funds to the
 Statement of Activities - Governmental Activities
 For the Fiscal Year Ended June 30, 2006

Net change in fund balances - total governmental funds (page 17)	\$	(4,554,758)
<p>Amounts reported for governmental activities in the statement of activities are different because:</p>		
Expenditures for capital assets	\$ 28,505,710	
Less current year depreciation	<u>(2,092,732)</u>	26,412,978
Change in long-term compensated absences		16,243
<p>The effect of various miscellaneous transactions involving capital assets (i.e., sales, trade-ins, and donations) is to decrease net assets.</p>		
Sale of and loss on capital assets		(3,282,440)
<p>Internal service funds are used by management to charge the costs of certain activities to individual funds. The net loss of the internal service funds is reported with governmental activities.</p>		
		(2,349,622)
<p>Other assets used in governmental activities do not consume current financial resources and therefore, are not reported in the governmental fund.</p>		
Unamortized bond issuance costs		2,451,418
<p>Long-term debt proceeds provide current financial resources to governmental funds, but issuing debt increases long-term liabilities in the statement of net assets.</p>		
Accrued interest expense on bond payable		(663,800)
Bond issuance		(49,420,000)
Unamortized bond premium		(902,046)
Revenue timing differences result in less revenue in government-wide statements.		<u>(1,453,900)</u>
Change in net assets of governmental activities (page 14)	\$	<u><u>(33,745,927)</u></u>

See accompanying notes to the basic financial statements.

CITY OF VERNON, CALIFORNIA
Statement of Fund Net Assets (Deficit)
Proprietary Funds
June 30, 2006

	Business-type Activities Enterprise Funds				Governmental Activities - Internal Service Funds
	Light and Power	Gas Fund	Other	Totals	
	Fund		Enterprise Funds		
ASSETS:					
Current assets:					
Cash and investments	\$ 43,415,460	\$ 829,395	\$ 6,561,963	\$ 50,806,818	\$ 10,459,309
Receivable, net of allowances of \$1,400,000	13,775,644	-	76,584	13,852,228	-
Legal settlement receivable	7,400,000	-	-	7,400,000	-
Accrued unbilled revenue	7,318,063	-	419,240	7,737,303	-
Accrued interest receivable	1,431,950	-	-	1,431,950	-
Bond issuance costs	232,403	-	-	232,403	-
Due from other funds	6,760,148	-	-	6,760,148	-
Inventories	81,480	-	-	81,480	-
Prepaid natural gas	423,374,475	-	-	423,374,475	-
Deposits and prepaid expenses	471,698	-	-	471,698	-
Restricted cash and investments	31,017,881	-	-	31,017,881	-
Other assets	16,777,982	-	-	16,777,982	-
Total current assets	<u>552,057,184</u>	<u>829,395</u>	<u>7,057,787</u>	<u>559,944,366</u>	<u>10,459,309</u>
Noncurrent assets:					
Restricted cash and investments	16,532,856	-	-	16,532,856	-
Advances to other funds	45,307,418	-	-	45,307,418	-
Note receivable	4,113,951	-	-	4,113,951	-
Bond issuance costs	13,604,571	-	-	13,604,571	-
Capital assets:					
Nondepreciable	13,580,995	-	3,162,483	16,743,478	-
Depreciable, net	273,342,132	21,200,011	5,007,970	299,550,113	-
Total noncurrent assets	<u>366,481,923</u>	<u>21,200,011</u>	<u>8,170,453</u>	<u>395,852,387</u>	<u>-</u>
Total assets	<u>918,539,107</u>	<u>22,029,406</u>	<u>15,228,240</u>	<u>955,796,753</u>	<u>10,459,309</u>
LIABILITIES:					
Accounts payable	9,344,599	3,322,164	1,381,738	14,048,501	73,774
Accrued wages and benefits	214,296	5,970	63,308	283,574	-
Customer deposits	372,276	-	404,478	776,754	-
Due to other funds	-	-	328,489	328,489	74,115
Long-term liabilities:					
Due within one year:					
Claims payable	-	-	-	-	2,452,858
Legal settlement payable	9,666,667	-	-	9,666,667	-
Bonds payable, net	3,567,547	-	-	3,567,547	-
Bond interest	985,445	-	-	985,445	-
Compensated absences	142,922	1,569	55,677	200,168	-
Total current liabilities	<u>24,293,752</u>	<u>3,329,703</u>	<u>2,233,690</u>	<u>29,857,145</u>	<u>2,600,747</u>
Due in more than one year:					
Claims payable	-	-	-	-	4,905,715
Advances from other funds	-	25,224,914	5,301,857	30,526,771	-
Legal settlement payable	5,333,333	-	-	5,333,333	-
Bonds payable, net	693,422,746	-	-	693,422,746	-
Total noncurrent liabilities	<u>698,756,079</u>	<u>25,224,914</u>	<u>5,301,857</u>	<u>729,282,850</u>	<u>4,905,715</u>
Total liabilities	<u>723,049,831</u>	<u>28,554,617</u>	<u>7,535,547</u>	<u>759,139,995</u>	<u>7,506,462</u>
NET ASSETS:					
Invested in capital assets, net of related debt	95,450,191	21,200,011	8,170,453	124,820,655	-
Restricted for alternative energy	16,532,856	-	-	16,532,856	-
Restricted for debt service	13,742,839	-	-	13,742,839	-
Unrestricted (deficit)	69,763,390	(27,725,222)	(477,760)	41,560,408	2,952,847
Total net assets (deficit)	<u>\$ 195,489,276</u>	<u>\$ (6,525,211)</u>	<u>\$ 7,692,693</u>	<u>\$ 196,656,758</u>	<u>\$ 2,952,847</u>

See accompanying notes to the basic financial statements.

CITY OF VERNON, CALIFORNIA
Statement of Revenues, Expenses and Changes in Fund Net Assets (Deficit)
Proprietary Funds
For the Fiscal Year Ended June 30, 2006

	Business-type Activities - Enterprise Funds				Governmental Activities - Internal Service Funds
	Light and Power Fund	Gas Fund	Other Enterprise Funds	Totals	
	Fund	Fund	Enterprise Funds	Totals	
OPERATING REVENUES:					
Charges for services	\$ 132,565,018	\$ 36,509,697	\$ 6,536,832	\$ 175,611,547	\$ 10,262,058
Total operating revenues	<u>132,565,018</u>	<u>36,509,697</u>	<u>6,536,832</u>	<u>175,611,547</u>	<u>10,262,058</u>
OPERATING EXPENSES:					
Cost of sales	127,551,769	36,671,275	5,649,885	169,872,929	-
Depreciation and amortization	7,436,297	282,422	361,063	8,079,782	-
Claims expense	-	-	-	-	3,157,196
Employee benefits	-	-	-	-	9,544,484
Total operating expenses	<u>134,988,066</u>	<u>36,953,697</u>	<u>6,010,948</u>	<u>177,952,711</u>	<u>12,701,680</u>
Operating (loss) income	(2,423,048)	(444,000)	525,884	(2,341,164)	(2,439,622)
NONOPERATING REVENUE (EXPENSES):					
Investment income	4,128,341	-	-	4,128,341	-
Net decrease in fair value of investments	(1,873,905)	-	-	(1,873,905)	-
Bond interest expense	(9,179,326)	-	-	(9,179,326)	-
Legal settlements, net	(5,257,580)	-	-	(5,257,580)	-
Total nonoperating expenses	<u>(12,182,470)</u>	<u>-</u>	<u>-</u>	<u>(12,182,470)</u>	<u>-</u>
Income before transfers	(14,605,518)	(444,000)	525,884	(14,523,634)	(2,439,622)
Transfers in	24,421,474	-	-	24,421,474	90,000
Transfers out	<u>(2,788,933)</u>	<u>-</u>	<u>(186,937)</u>	<u>(2,975,870)</u>	<u>-</u>
Change in net assets	7,027,023	(444,000)	338,947	6,921,970	(2,349,622)
Net assets (deficit), beginning of the year	<u>188,462,253</u>	<u>(6,081,211)</u>	<u>7,353,746</u>	<u>189,734,788</u>	<u>5,302,469</u>
Net assets (deficit), end of the year	<u>\$ 195,489,276</u>	<u>\$ (6,525,211)</u>	<u>\$ 7,692,693</u>	<u>\$ 196,656,758</u>	<u>\$ 2,952,847</u>

See accompanying notes to the basic financial statements.

CITY OF VERNON
Statement of Cash Flows
Proprietary Funds
For the Fiscal Year Ended June 30, 2006

	Business-type Activities - Enterprise Funds				Governmental Activities - Internal Service Funds
	Light & Power Fund	Gas Fund	Other Enterprise Funds	Total	
	Fund	Gas Fund	Enterprise Funds	Total	
Cash flows from operating activities:					
Cash received from customers/other funds	\$ 128,032,121	\$ 36,509,697	\$ 6,615,562	\$ 171,157,380	\$ 10,262,058
Cash paid to suppliers for goods and services	(140,183,714)	(33,725,691)	(4,374,533)	(178,283,938)	-
Cash paid to City general fund for services	(11,911,194)	-	(460,665)	(12,371,859)	-
Cash paid for prepaid natural gas	(423,374,475)	-	-	(423,374,475)	-
Cash paid for claims expense and employee benefits	-	-	-	-	(10,350,924)
	<u>(447,437,262)</u>	<u>2,784,006</u>	<u>1,780,364</u>	<u>(442,872,892)</u>	<u>(88,866)</u>
Net cash provided by (used in) operating activities					
Cash flows from noncapital financing activities:					
Transfers received (paid)	21,632,541	-	(186,937)	21,445,604	90,000
Proceeds from 2006 Bonds	430,845,000	-	-	430,845,000	-
Advances from (to) other funds	(4,781,504)	459,966	(135,165)	(4,456,703)	-
Bond related costs	(6,970,536)	-	-	(6,970,536)	-
Collection of note receivable	237,045	-	-	237,045	-
	<u>440,962,546</u>	<u>459,966</u>	<u>(322,102)</u>	<u>441,100,410</u>	<u>90,000</u>
Net cash provided by noncapital financing activities					
Cash flows from capital and related financing activities:					
Repayment of 2004 bonds	(3,800,000)	-	-	(3,800,000)	-
Bond interest paid	(8,213,377)	-	-	(8,213,377)	-
Acquisition and construction of capital assets	(38,235,888)	(2,414,577)	(1,360,933)	(42,011,398)	-
	<u>(50,249,265)</u>	<u>(2,414,577)</u>	<u>(1,360,933)</u>	<u>(54,024,775)</u>	<u>-</u>
Net cash used in capital and related financing activities					
Cash flows from investing activities:					
Purchases and sales of investments, net	(68,124,268)	-	-	(68,124,268)	-
Investment income	4,847,915	-	-	4,847,915	-
	<u>(63,276,353)</u>	<u>-</u>	<u>-</u>	<u>(63,276,353)</u>	<u>-</u>
Net cash used in investing activities					
Net increase (decrease) in cash and cash equivalents	(120,000,334)	829,395	97,329	(119,073,610)	1,134
Cash and cash equivalents, beginning of year	140,199,903	-	6,464,634	146,664,537	10,458,175
Cash and cash equivalents, end of year	<u>\$ 20,199,569</u>	<u>\$ 829,395</u>	<u>\$ 6,561,963</u>	<u>\$ 27,590,927</u>	<u>\$ 10,459,309</u>
Reconciliation of operating income to net cash provided by (used in) operating activities:					
Operating income (loss)	\$ (2,423,048)	\$ (444,000)	\$ 525,884	\$ (2,341,164)	\$ (2,439,622)
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:					
Depreciation and amortization	7,436,297	282,422	361,063	8,079,782	-
Provision for doubtful accounts	1,400,000	-	-	1,400,000	-
Changes in operating assets and liabilities:					
Decrease (increase) in:					
Receivables	(3,933,391)	-	(44,626)	(3,978,017)	-
Inventories	(78,813)	-	-	(78,813)	-
Prepaid expenses and deposits	(272,251)	-	-	(272,251)	-
Prepaid Natural Gas	(423,374,475)	-	-	(423,374,475)	-
Other assets	(12,233,112)	-	-	(12,233,112)	-
Increase (decrease) in:					
Accounts payable	(6,327,279)	2,965,889	156,973	(3,204,417)	(14,860)
Claims payable	-	-	-	-	2,365,616
Accrued wages and benefits	(308,807)	(20,305)	10,294	(318,818)	-
Due (to) from other funds	(6,760,148)	-	647,420	(6,112,728)	-
Customer deposits	(599,507)	-	123,356	(476,151)	-
Compensated absences	17,776	-	-	17,776	-
Other payables	19,496	-	-	19,496	-
Net cash provided by (used in) operating activities	<u>\$ (447,437,262)</u>	<u>\$ 2,784,006</u>	<u>\$ 1,780,364</u>	<u>\$ (442,872,892)</u>	<u>\$ (88,866)</u>
Reconciliation of cash and cash equivalents to Statement of Net Assets					
Cash and investments	\$ 43,415,460	\$ 829,395	\$ 6,561,963	\$ 50,806,818	\$ 10,459,309
Current restricted cash and investments	31,017,881	-	-	31,017,881	-
Noncurrent restricted cash and investments	16,532,856	-	-	16,532,856	-
Total	<u>\$ 90,966,197</u>	<u>\$ 829,395</u>	<u>\$ 6,561,963</u>	<u>\$ 98,357,555</u>	<u>\$ 10,459,309</u>
Less: Investment with maturities of more than 90 days	<u>\$ (70,766,628)</u>	<u>-</u>	<u>-</u>	<u>\$ (70,766,628)</u>	<u>-</u>
Total cash and cash equivalents	<u>\$ 20,199,569</u>	<u>\$ 829,395</u>	<u>\$ 6,561,963</u>	<u>\$ 27,590,927</u>	<u>\$ 10,459,309</u>
Noncash Capital, Investing and Financing Activities					
Acquisition of capital assets in accounts payable	\$ 422,845	\$ -	\$ -	\$ 422,845	\$ -
Decrease in fair value of investments	(1,381,619)	-	-	(1,381,619)	-

See accompanying notes to the basic financial statements.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements
June 30, 2006

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the City of Vernon, California (City) have been prepared in conformity with U.S. generally accepted accounting principles (GAAP). The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the City's accounting policies are described below.

Reporting Entity

The City was incorporated on September 16, 1905 as a General Law City. Effective July 1, 1988, the City became a Charter City. The City operates under a Council-City Administrator form of government. As required by generally accepted accounting principles, the accompanying basic financial statements present the City of Vernon (primary government) and its component units, entities for which the primary government is considered to be financially accountable. In accordance with GASB Statement No. 14, the City's component units are considered blended component units. Although legally separate entities, they are, in substance, part of the City's operations, and therefore, data from these units are combined with data of the primary government.

Blended Component Units

Vernon Redevelopment Agency (RDA). The governing body of the RDA is comprised of members of the City Council and the Mayor. Among its duties, it approves the RDA's budget and appoints the management.

Separately issued financial statements for the RDA may be obtained through the City of Vernon, 4305 Santa Fe Avenue, Vernon, California, 90058.

Vernon Natural Gas Financing Authority

On April 1, 2006, the City and the RDA created the Vernon Natural Gas Financing Authority (Authority) pursuant to the Joint Powers Agreement, for the express purpose of undertaking projects and programs that promote economic development within the City. Such projects and programs include assisting the City in procuring natural gas for use as fuel for electric generating units that are part of the City's Electric System, which is accounted for in the City's Light and Power fund. During the year ended June 30, 2006, the Authority issued \$430,845,000 in variable rate bonds and subsequently purchased natural gas in accordance with the Natural Gas Agreement between the Authority and the City. As a result of this financing arrangement, the debt and related asset (prepaid natural gas) associated with the Authority have been blended with the City's Light and Power fund for financial reporting purposes.

Basis of Presentation

Government-wide Financial Statements

The statement of net assets and statement of activities display information about the primary government (the City) and its component units. These statements include the financial activities of the overall government. It is the City's policy to make eliminations to minimize the double counting of internal activities, except for services rendered by governmental activities to business-type activities as well as charges from the Gas Fund to the Light & Power Fund. These statements distinguish between the *governmental* and *business-type activities* of the City. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees charged to external parties.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of Presentation (Continued)

The statement of activities presents a comparison between direct expenses and program revenues for each segment of the business-type activities of the City and for each function of the City's governmental activities. Direct expenses are those that are specifically associated with a program or function; and therefore, are clearly identifiable to a particular function. Expenses by function have been adjusted for any internal service profit/loss existing at fiscal year-end. Program revenues include (1) charges paid by the recipients of goods or services offered by the programs and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including all taxes, are presented instead as general revenues.

Fund Financial Statements

The fund financial statements provide information about the City's funds and blended component units. Separate statements for each fund category – *governmental and proprietary* – are presented. The emphasis of fund financial statements is on major governmental and enterprise funds, each displayed in a separate column. All remaining governmental and enterprise funds are separately aggregated and reported as nonmajor funds.

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* items. Proprietary fund *operating* revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. *Nonoperating* revenues, such as subsidies and investment earnings, result from nonexchange transactions or ancillary activities. *Operating* expenses include the cost of sales and services, administrative expenses and depreciation on capital assets. All expenses not meeting this definition are reported as nonoperating expenses.

The City reports the following major governmental funds:

The *General Fund* is the City's primary operating fund. It is used to account for all revenues and expenditures necessary to carry out basic governmental activities of the City that are not accounted for through other funds. For the City, the General Fund includes such activities as general government, public safety, and public works.

The *Vernon Redevelopment Agency* was activated September 16, 1986, by action of the Vernon City Council pursuant to the Community Redevelopment Law of California. The Agency has the broad authority to acquire, rehabilitate, develop, administer, and sell or lease property. Additionally, the Agency has the right of eminent domain to facilitate acquisition of property. The principal objectives of the Agency are to improve the commercial environment, provide new public improvements, strengthen the City of Vernon's (City) economic base, generate added employment opportunities, and expand the City's industrial base.

The City reports the following major enterprise funds:

- The *Light and Power Fund* accounts for the maintenance and operations of the City's electric utility plant. Revenue for this fund is primarily from charges for services.
- The *Gas Fund* accounts for maintenance and operations of the City's gas utility system. Revenue for this fund is primarily from charges for services. Natural gas is provided primarily to the Light & Power Fund at wholesale cost. In addition, the Gas Fund provides natural gas to several outside companies.

Additionally, the City reports the following fund types:

- The City's *Special Revenue Funds* are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specific purposes.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of Presentation (Continued)

- The City's *Capital Projects Funds* are used to account for financial resources designated for the acquisition or construction of major capital facilities other than those financed by proprietary fund types.

- The City's *Internal Service Funds* are specifically designed to account for goods and services that are provided on a cost-reimbursement basis. That is, the goal of an internal service fund should be to measure the full cost of providing goods and services for the purpose of fully recovering that cost through fees or charges. Some examples of the City's services accounted for in the internal service funds are self-insurance activities for worker's compensation, general liability, group medical and dental, and vehicle replacement. The Internal Service Funds are presented in summary form as part of the proprietary fund financial statements. In the government-wide financial statements, the changes in net assets at the end of the fiscal year, as presented in the statements of activities, were allocated to the user functions of the governmental activities, to reflect the entire activity for the year. Since the predominant users of the internal services are the City's governmental activities, the asset and liability balances of the Internal Service Funds are consolidated into the governmental activities column at the government-wide level.

The government-wide and proprietary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Nonexchange transactions, in which the City gives (or receives) value without directly receiving (or giving) equal value in exchange, include property and sales taxes, grants, entitlements and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenues from sales taxes are recognized when the underlying transactions take place. Revenues from grants, entitlements and donations are recognized in the fiscal year in which all eligible requirements have been satisfied.

Governmental fund type financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues and other governmental fund type financial resources are recognized when they become susceptible to accrual – that is, when they become both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. Property, sales, and other taxes are considered available and are accrued when received within sixty days after fiscal year-end. Additionally, all other revenue sources are considered available and are accrued when received within 60 days of year-end. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due. General capital assets acquisitions are reported as expenditures in governmental fund statements.

For the government-wide financial statements and proprietary fund financial statements, the City has elected under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, to apply all applicable GASB pronouncements as well as any applicable pronouncements of the Financial Accounting Standards Board, the Accounting Principles Board or any Accounting Research Bulletins issued on or before November 30, 1989 unless those pronouncements conflict with or contradict GASB pronouncements. The City has elected not to adopt FASB pronouncements issued after November 30, 1989 for its government-wide and enterprise fund financial statements.

Because the governmental fund financial statements are presented on a different measurement focus and basis of accounting than the government-wide financial statements for governmental activities, reconciliations are presented which briefly explain the adjustments necessary to reconcile the fund financial statements to the governmental-wide statements.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, and then unrestricted resources, as they are needed.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash Deposits and Investments

The City follows the practice of pooling cash and investments of all funds to maximize returns for all funds, except for funds held by trustee or fiscal agents.

For purposes of the statement of cash flows, the City considers all highly liquid investments (including restricted cash and investments) with an original maturity of three months or less when purchased to be cash equivalents. Investment transactions are recorded on the trade date. Investments in nonparticipating interest-earning investment contracts are reported at cost, and all other investments are reported at fair value. Fair value is defined as the amount that the City could reasonably expect to receive for an investment in a current sale between a willing buyer and a seller and is generally measured by quoted market prices.

Interfund Receivables/Payables

Short-term interfund receivables and payables are classified as “due from other funds” and “due to other funds” respectively on the balance sheet/statement of fund net assets. Long-term interfund receivables and payables are classified as “advances to/from other funds,” respectively, on the balance sheet/statement of fund net assets.

Inventories

Inventories consist of consumable supplies and fuel stock, which are stated at cost on a first-in, first-out basis. The cost of inventories is recorded as an expenditures/expense when the items are used.

Capital Assets

Capital assets (including infrastructure) are recorded at historical cost or at estimated historical cost if actual historical cost is not available. Contributed capital assets are valued at their estimated fair market value on the date contributed. Capital assets include public domain (infrastructure) general capital assets consisting of certain improvements including roads and bridges, sidewalks, curbs and gutters, and traffic light system. The capitalization threshold for all capital assets is \$5,000. Capital assets used in operations are depreciated using the straight-line method over their estimated useful lives in the government-wide statements and proprietary funds.

The estimated useful lives are as follows:

Infrastructure	10 to 50 years
Utility plant and buildings	25 to 50 years
Improvements	10 to 20 years
Machinery and equipment	3 to 35 years

Maintenance and repairs are charged to operations when incurred. Betterments and major improvements, which significantly increase values, change capacities or extend useful lives, are capitalized. Upon sale or retirement of capital assets, the cost and related accumulated depreciation are removed from the respective accounts and any resulting gain or loss is included in the changes in financial position. For tax-exempt securities, interest income and expense associated with construction of capital assets is capitalized during the construction phase up until the capital asset is substantially complete and ready for its intended use.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Compensated Absences

Accumulated vacation is accrued when incurred in the government-wide and proprietary fund financial statements. A liability for accrued vacation is recorded in the governmental funds only to the extent that such amounts have matured (i.e., as a result of employee resignations and retirements). Upon termination of employment, the City will pay the employee all accumulated vacation leave at 100% of the employee's base hourly rate.

Deferred Revenue

Deferred revenue arises when a potential revenue transaction does not meet the "available" criteria for recognition in the current period. Deferred revenue also arises when resources are received before the City has a legal claim to them, as when grant monies are received in advance of incurring qualified expenditures.

Long-term Obligations

Certain of the City's governmental fund obligations not currently due and payable at year-end are reported in the government-wide statement of net assets. Long-term debt and other obligations financed by proprietary funds are reported as liabilities in the appropriate proprietary fund and government-wide statement of net assets. Bond issuance costs, discounts and premiums and deferred amounts on refunding are amortized over the life of the bonds using the straight-line method.

Net Assets

The government-wide financial statements and proprietary fund financial statements utilize a net assets presentation. Net assets are categorized as invested in capital assets (net of related debt), restricted and unrestricted.

- ❑ Invested In Capital Assets, Net of Related Debt – This category groups all capital assets, including infrastructure, into one component of net assets. Accumulated depreciation and the outstanding balances of debt that are attributable to the acquisition, construction or improvement of these assets reduce the balance in this category.
- ❑ Restricted Net Assets – This category presents external restrictions imposed by creditors, grantors, contributors or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation.
- ❑ Unrestricted Net Assets – This category represents net assets of the City, not restricted for any project or other purpose.

Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not appropriable or legally restricted for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

Use of Estimates

The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property Taxes

The County of Los Angeles (County) levies, collects and apportions property taxes for all taxing jurisdictions with the County. Property taxes are determined by applying approved rates to the properties' assessed values. The County remits property taxes applicable to the City less an administrative fee throughout the year.

Article XIII A of the State of California Constitution limits the property tax levy to support general government services of the various taxing jurisdictions to \$1.00 per \$100 of assessed value. Taxes levied to service voter-approved debt prior to June 30, 1978 are excluded from this limitation.

Secured property taxes are levied in two installments, November 1 and February 1. They become delinquent with penalties on December 10 and April 10, respectively. The lien date is January 1 of each year for secured and unsecured property taxes and the levy date occurs on the 4th Monday of September of the tax year. Unsecured property taxes on the tax roll as of July 31 become delinquent with penalties on August 31.

GASB Pronouncements

In November 2003, GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This statement establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. This statement also clarifies and establishes accounting requirements for insurance recoveries. This statement had no impact on the City.

In December 2004, GASB issued Statement No. 46, *Net Assets Restricted Enabling Legislation – An amendment of GASB Statement No. 34*. This Statement establishes and modifies requirements related to restrictions of net assets resulting from enabling legislation. It amends GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, paragraph 34. GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets. This Statement clarifies that a legally enforceable enabling legislation restriction is one that a party external to a government—such as citizens, public interest groups, or the judiciary—can compel a government to honor. The Statement states that the legal enforceability of an enabling legislation restriction should be reevaluated if any of the resources raised by the enabling legislation are used for a purpose not specified by the enabling legislation or if a government has other cause for reconsideration. Although the determination that a particular restriction is not legally enforceable may cause a government to review the enforceability of other restrictions, it should not necessarily lead a government to the same conclusion for all enabling legislation restrictions. This Statement also specifies the accounting and financial reporting requirements if new enabling legislation replaces existing enabling legislation or if legal enforceability is reevaluated. Finally, this Statement requires governments to disclose the portion of total net assets that is restricted by enabling legislation. This statement had no impact on the City.

In June 2005, GASB issued Statement No. 47, *Accounting for Termination Benefits*. This Statement provides guidance to governmental employers for measuring, recognizing, and reporting liabilities and expense/expenditures related to all termination benefits, including voluntary termination benefits, without limitation as to the period of time during which the benefits are offered, and involuntary termination benefits. This statement had no impact on the City.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 2 – CASH AND INVESTMENTS

Cash and Investments

Cash and investments as of June 30, 2006 are classified in the accompanying financial statements as follows:

Statement of net assets:

Cash and investments	\$ 106,529,677
Restricted cash and investments	<u>87,566,406</u>
Total cash and investments	<u><u>\$ 194,096,083</u></u>

Cash and investments as of June 30, 2006 consist of the following:

Cash on hand	\$ 1,300
Deposits with financial institutions	18,950,714
Investments	<u>175,144,069</u>
Total cash and investments	<u><u>\$ 194,096,083</u></u>

The City's Investment Policy

The City's Investment Policy sets forth the investment guidelines for all funds of the City. The Investment Policy conforms to the California Government Code Section 53600 et. seq. The authority to manage the City's investment program is derived from the City Council. Pursuant to Section 53607 of the California Government Code, the City Council annually appoints the City Treasurer and approves the City's investment policy. The Treasurer is authorized to delegate this authority as deemed appropriate. No person may engage in investment transactions except as provided under the terms of the Investment Policy and the procedures established by the Treasurer.

This Policy requires that the investments be made with the prudent person standard, that is, when investing, reinvesting, purchasing, acquiring, exchanging selling or managing public funds, the trustee (Treasurer and staff) will act with care, skill, prudence, and diligence under the circumstances then prevailing, including but not limited to, the general economic conditions and the anticipated needs of the City.

The Investment Policy also requires that when following the investing actions cited above, that the primary objective of the trustee be to safeguard the principal, secondarily meet the liquidity needs of depositors, and then achieve a return on the funds under the trustee's control. Further, the intent of the Investment Policy is to minimize risk of loss on the City's held investments from:

- A. Credit risk
- B. Custodial credit risk
- C. Concentration of credit risk
- D. Interest rate risk

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

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

The table below identifies the investment types that are authorized for the City by the California Government Code and the City's Investment Policy. The table also identifies certain provisions of the California Government Code that address interest rate risk, credit risk, and concentration of credit risk. This table does not address investment of debt proceeds held by bond trustee that are governed by the provisions of debt agreements of the City, rather than the general provisions of the California Government Code or the City's Investment Policy.

Authorized Investment Type	Maximum Maturity	Maximum Percentage of *Portfolio	Maximum Investment in One Issuer
Securities of the U.S. Government, or it agencies	None	None	None
Certain Asset-Backed Securities	None	None	None
Certificate of Deposit	None	30%	None
Bankers Acceptances	180 days	40%	30%
Commercial Paper	270 days	25%	10%
Repurchase Agreements	1 year	None	None
Reverse Repurchase Agreements	92 days	20% of base value	None
Medium-Term Notes	None	30%	None
Mutual Funds	N/A	20%	10%
Money Market Mutual Funds	N/A	20%	10%
Mortgage Pass-Through Securities	5 years	20%	None
State Administered Pool Investment	N/A	None	None

* Excluding amounts held by bond trustee that are not subject to California Government Code restrictions.

Investments Authorized by Debt Agreements

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

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio	Maximum Investment in One Issuer
Securities of the U.S. Government, or it agencies	None	None	None
Certain Asset-Backed Securities	None	None	None
Certificate of Deposit	None	None	None
Bankers Acceptances	1 year	None	None
Commercial Paper	None	None	None
Money Market Mutual Funds	N/A	None	None
State Administered Pool Investment	N/A	None	None
Investment Contracts	None	None	None

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

Disclosure 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 City 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. The City monitors the interest rate risk inherent in its portfolio by measuring the weighted average maturity of its portfolio. The City has no specific limitations with respect to this metric.

Investment Type	Amount	Weighted Average Maturity (in years)	% of Total
Commercial Paper	\$ 5,397,750	0.01	3.08%
Local Agency Investment Fund	529,038	0.42	0.30%
United States Treasury Notes	9,818,750	3.16	5.61%
Federal Farm Credit Bank	8,305,250	3.27	4.74%
Federal Home Loan Bank	33,111,250	1.68	18.91%
Federal National Mortgage Association	26,757,180	0.88	15.28%
Federal Home Loan Mortgage Corporation	40,837,533	1.09	23.32%
Medium-Term Corporate Notes	18,007,669	0.36	10.28%
Money Market Mutual Fund	19,848,921	-	11.33%
Investment Contracts	12,530,728	27.77	7.15%
	<u>\$ 175,144,069</u>	3.06	<u>100.00%</u>

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

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 the California Government Code, the City's Investment Policy, or debt agreements, and the actual rating as of the year end for each investment type.

	Minimum Required Rating	Actual Credit Rating Moody's / S&P	Fair Value as of June 30, 2006	% of Total
In custody of Treasurer:				
Cash on hand	Not Rated	Not Rated	\$ 1,300	0.00%
Deposits with financial institutions	Not Rated	Not Rated	18,950,714	9.76%
Investments held by Treasurer:				
Commercial Paper	P-1 / A-1+	P-1 / A-1+	5,397,750	2.78%
Local Agency Investment Fund	Not Rated	Not Rated	529,038	0.27%
Total in custody of Treasurer			24,878,802	12.82%
In custody of Trustee:				
Investments held by Trustee:				
United States Treasury Notes	Not Rated	Not Rated	9,818,750	5.06%
Federal Farm Credit Bank	Aaa / AAA	Aaa / AAA	8,305,250	4.28%
Federal Home Loan Bank	Aaa / AAA	Aaa / AAA	33,111,250	17.06%
Federal National Mortgage Association	Aaa / AAA	Aaa / AAA	26,757,180	13.79%
Federal Home Loan Mortgage Corporation	Aaa / AAA	Aaa / AAA	40,837,533	21.04%
Medium-Term Corporate Notes	P-1 / A-1+	P-1 / A-1+	18,007,669	9.28%
Money Market Mutual Fund	Aaa / AAA	Aaa / AAA	19,848,921	10.23%
Investment Contracts	Not Rated	Not Rated	12,530,728	6.46%
Total in custody of Trustee			169,217,281	87.18%
Total cash and investments held by Treasurer and Trustee			\$ 194,096,083	100.00%

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

Concentration of Credit Risk

The City's Investment Policy places no limit on the amount the City may invest in any one issuer excluding a 10% limitation on commercial paper, mutual funds, and money market mutual funds. As of June 30, 2006, there was no investment in any one issuer that represented 10% or more of the City's total investments. As of June 30, 2006, the City's investments in any one issuer exceeding 5% were as follows:

	Minimum Required Rating	Actual Credit Rating Moody's / S&P	Fair Value as of June 30, 2006	% of Total
Federal Home Loan Bank	Aaa / AAA	Aaa / AAA	\$ 33,111,250	17.06%
Federal National Mortgage Association	Aaa / AAA	Aaa / AAA	26,757,180	13.79%
Federal Home Loan Mortgage Corporation	Aaa / AAA	Aaa / AAA	40,837,533	21.04%
Medium-Term Corporate Notes	P-1 / A-1+	P-1 / A-1+	18,007,669	9.28%
Money Market Mutual Fund	Aaa / AAA	Aaa / AAA	19,848,921	10.23%
Investment Contracts	Not Rated	Not Rated	12,530,728	6.46%

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 to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the City's Investment Policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments.

At year-end, the carrying amount of the City's deposits was \$18,950,714 and the bank balance was \$19,424,101. The difference between the bank balance and the carrying amount represents outstanding checks and deposits in transit. Of the bank balance, \$200,000 was covered by federal depository insurance and \$19,224,101 was collateralized by the pledging financial institution as required by Section 53652 of the California Government Code. Under the California Government Code, a financial institution is required to secure deposits in excess of \$100,000 made by state or local governmental units by pledging government securities held in the form of an undivided collateral pool. 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 City deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits. Such collateral is held by the pledging financial institution's trust department or agent in the City's name.

As of June 30, 2006, the City had some risk in this area.

Local Agency Investment Fund (LAIF)

The Agency also maintained cash balances with the State of California Local Agency Investment Fund (LAIF) amounting to \$529,038 at June 30, 2006. LAIF is an external investment pool sponsored by the State of California. These pooled funds approximate fair value. The administration of LAIF is provided by the California State Treasurer and regulatory oversight is provided by the Pooled Money Investment Board and the Local Investment Advisory Board. The value of the pool shares in LAIF, which may be withdrawn, is determined on an amortized cost basis, which is different than the fair value of the Agency's position in the pool.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

The total amount invested by all public agencies in LAIF at June 30, 2006 was \$16,392,047,241. LAIF is part of the State of California Pooled Money Investment Account (PMIA) whose balance was \$63,616,592,927 at June 30, 2006. Of this amount, 2.567% was invested in structures notes and asset-backed securities. PMIA is not SEC-registered, but is required to invest according to California State Code. The average maturity of PMIA investments was 0.42 years as of June 30, 2006. LAIF does not maintain a credit rating.

NOTE 3 - RECEIVABLES

The City's receivables at June 30, 2006 are as follows:

Receivables - Governmental Activities:	General Fund	Redevelopment Agency Fund	Other Governmental Funds	Total Governmental Activities
Accounts	\$ 536,223	\$ -	\$ 204,228	\$ 740,451
Taxes	820,668	889,126	1,800,222	3,510,016
Notes or loans	67,314	-	-	67,314
Total receivables	<u>\$ 1,424,205</u>	<u>\$ 889,126</u>	<u>\$ 2,004,450</u>	<u>\$ 4,317,781</u>

Receivables - Business-type Activities:	Light and Power Fund	Other Enterprise Funds	Total Business-type Activities
Accounts	\$ 15,175,644	\$ 76,584	\$ 15,252,228
Allowances	(1,400,000)	-	(1,400,000)
Total receivables	<u>\$ 13,775,644</u>	<u>\$ 76,584</u>	<u>\$ 13,852,228</u>

The business-type activities allowances for doubtful accounts consists of \$1,000,000 reserved for the California Power Exchange (See Note 13) and \$400,000 reserved for all other doubtful accounts of Light and Power Fund's retail utility customers.

NOTE 4 – INTERFUND TRANSACTIONS

The following tables summarize the City's interfund balances and transactions at June 30, 2006:

Due To/From Other Funds

Receivable Fund	Payable Fund	Amount
Light and Power Fund	General Fund	\$ 6,314,779
	Redevelopment Agency Fund	8,665
	Other Governmental Funds	34,100
	Other Enterprise Funds	328,489
	Internal Service Funds	74,115
		<u>\$ 6,760,148</u>

The above balances represent interfund borrowings payable due within one year.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 4 – INTERFUND TRANSACTIONS (CONTINUED)

Advances to/from other funds

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Redevelopment Agency Fund	\$ 16,860
	Other Governmental Funds	5,979
	Other Enterprise Funds	4,952,807
		<u>\$ 4,975,646</u>
Light and Power Fund	Other Governmental Funds	\$ 19,733,454
	Gas Fund	25,224,914
	Other Enterprise Funds	349,050
		<u>\$ 45,307,418</u>

The above balances represent interfund borrowings payable beyond one year. These borrowings were for purchase of land and capital improvements.

Transfers

<u>Transfers In</u>	<u>Transfer Out</u>	<u>Amount</u>
General Fund	Light and Power Fund	\$ 2,788,933
	Other Enterprise Funds	186,937
		<u>\$ 2,975,870</u>
Light and Power Fund	General Fund	\$ 24,421,474
		<u>\$ 24,421,474</u>
Other Governmental Funds	Redevelopment Agency Fund	\$ 624,824
		<u>\$ 624,824</u>
Internal Service Funds	General Fund	\$ 90,000
		<u>\$ 90,000</u>

Transfers are used to move revenues from the fund that statute or budget requires to collect them to the fund that statute or budget requires to expend them, or move revenues collected in certain enterprise funds to the General Fund to cover overhead costs provided by the General Fund and for the payment of in-lieu franchise taxes.

For the current year, the Light and Power Fund and the Other Enterprise Funds transferred a total of \$2,975,870 in in-lieu franchise taxes.

For the current year, the General Fund transferred \$24,421,474 to the Light and Power Fund. The main reason for this transfer was to complete the construction of the Malburg Generating Station and to upgrade the City's electric transmission and distribution systems.

For the current year, the City elected to have the Redevelopment Agency Fund transfer \$624,824 to the Parcel Tax Fund (Other Governmental Fund) to reimburse the Parcel Tax Fund for capital expenditures related with the construction of new fire stations.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 5 – CAPITAL ASSETS

Capital asset activity of governmental activities for the year ended June 30, 2006 was as follows:

	Balance July 1, 2005	Additions	Deletions	Transfers & Adjustments	Balance June 30, 2006
<u>Governmental activities:</u>					
<i>Capital assets, not being depreciated:</i>					
Land - General Fund	\$ 28,502,457	\$ 20,180,836	\$ -	\$ -	\$ 48,683,293
Land - Redevelopment Agency Fund (RDA)	23,172,030	864,485	(3,282,440)	(8,401,673)	12,352,402
Total land	51,674,487	21,045,321	(3,282,440)	(8,401,673)	61,035,695
Construction in progress - General Fund	1,266,211	2,446,579	-	(288,610)	3,424,180
Construction in progress - RDA	-	962,883	-	-	962,883
Total construction in progress	1,266,211	3,409,462	-	(288,610)	4,387,063
Total capital assets, not being depreciated	52,940,698	24,454,783	(3,282,440)	(8,690,283)	65,422,758
<i>Capital assets, being depreciated</i>					
Infrastructure - General Fund	23,684,060	312,068	-	288,610	24,284,738
Building and Improvements - General Fund	15,836,515	-	-	-	15,836,515
Building and Improvements - RDA	-	1,768,021	-	-	1,768,021
Machinery and Equipment - General Fund	11,372,970	1,970,838	-	-	13,343,808
Total capital assets, being depreciated	50,893,545	4,050,927	-	288,610	55,233,082
Less accumulated depreciation for:					
Infrastructure - General Fund	(17,685,205)	(595,703)	-	-	(18,280,908)
Building and Improvements - General Fund	(5,556,719)	(353,579)	-	-	(5,910,298)
Building and Improvements - RDA	-	(22,100)	-	-	(22,100)
Machinery and Equipment - General Fund	(5,978,147)	(1,121,350)	-	-	(7,099,497)
Total accumulated depreciation	(29,220,071)	(2,092,732)	-	-	(31,312,803)
Total capital assets, being depreciated, net					
Infrastructure - General Fund	5,998,855	(283,635)	-	288,610	6,003,830
Building and Improvements - General Fund	10,279,796	(353,579)	-	-	9,926,217
Building and Improvements - RDA	-	1,745,921	-	-	1,745,921
Machinery and Equipment - General Fund	5,394,823	849,488	-	-	6,244,311
Total	21,673,474	1,958,195	-	288,610	23,920,279
Governmental activities capital assets, net	\$ 74,614,172	\$ 26,412,978	\$ (3,282,440)	\$ (8,401,673)	\$ 89,343,037

In the current year, the Redevelopment Agency Fund has elected to reclassify \$8,401,673 of its land to land held for resale.

Depreciation

Depreciation expense was charged to governmental functions as follows:

General government	\$ 850,722
Public safety	923,748
Public works	253,970
Health services	64,292
Total depreciation expense - governmental functions	<u>\$ 2,092,732</u>

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 5 – CAPITAL ASSETS (CONTINUED)

Capital asset activity of business-type activities for the year ended June 30, 2006 was as follows:

	Balance July 1, 2005	Additions	Deletions	Transfers & Adjustments	Balance June 30, 2006
Business-type activities:					
<i>Capital assets, not being depreciated:</i>					
Land	\$ 45,000	\$ -	\$ -	\$ -	\$ 45,000
Construction in progress -					
Light and Power	190,514,579	31,417,580	-	(208,351,163)	13,580,996
Construction in progress - Water	839,848	-	-	(2,586)	837,262
Construction in progress - Gas	19,023,822	1,300,849	-	(20,324,671)	-
Construction in progress - Fiber Optic	2,068,442	211,778	-	-	2,280,220
Total capital assets, not being depreciated	<u>212,491,691</u>	<u>32,930,207</u>	<u>-</u>	<u>(228,678,420)</u>	<u>16,743,478</u>
<i>Capital assets, being depreciated</i>					
Production plant - Light and Power	10,015,455	684,659	-	-	10,700,114
Transmission plant - Light and Power	61,448,019	4,212,884	-	-	65,660,903
Distribution plant - Light and Power	49,652,505	1,015,173	-	-	50,667,678
General plant - Light and Power	3,976,419	897,651	-	-	4,874,070
Malburg Generating Station plant -					
Light and Power	-	-	-	208,352,126	208,352,126
Buildings - Light and Power	481,800	-	-	-	481,800
Water utility plant	14,434,164	397,498	-	-	14,831,662
Gas utility plant	46,970	1,113,728	-	20,324,671	21,485,369
Fiber Optic utility plant	-	753,280	-	-	753,280
Total capital assets, being depreciated	<u>140,055,332</u>	<u>9,074,873</u>	<u>-</u>	<u>228,676,797</u>	<u>377,807,002</u>
Less accumulated depreciation for:					
Production plant - Light and Power	(5,495,705)	(372,027)	-	-	(5,867,732)
Transmission plant - Light and Power	(34,446,396)	(2,282,919)	-	-	(36,729,315)
Distribution plant - Light and Power	(17,891,311)	(1,761,630)	-	-	(19,652,941)
General plant - Light and Power	(2,091,418)	(169,464)	-	-	(2,260,882)
Malburg Generating Station plant -					
Light and Power	-	(2,604,402)	-	-	(2,604,402)
Buildings - Light and Power	(265,836)	(13,452)	-	-	(279,288)
Water utility plant	(10,215,908)	(342,231)	-	-	(10,558,139)
Gas utility plant	(2,936)	(282,422)	-	-	(285,358)
Fiber Optic utility plant	-	(18,832)	-	-	(18,832)
Total accumulated depreciation	<u>(70,409,510)</u>	<u>(7,847,379)</u>	<u>-</u>	<u>-</u>	<u>(78,256,889)</u>
Total capital assets, being depreciated, net					
Production plant - Light and Power	4,519,750	312,632	-	-	4,832,382
Transmission plant - Light and Power	27,001,623	1,929,965	-	-	28,931,588
Distribution plant - Light and Power	31,761,194	(746,457)	-	-	31,014,737
General plant - Light and Power	1,885,001	728,187	-	-	2,613,188
Malburg Generating Station plant -					
Light and Power	-	(2,604,402)	-	208,352,126	205,747,724
Buildings - Light and Power	215,964	(13,452)	-	-	202,512
Water utility plant	4,218,256	55,267	-	-	4,273,523
Gas utility plant	44,034	831,306	-	20,324,671	21,200,011
Fiber Optic utility plant	-	734,448	-	-	734,448
Total	<u>69,645,822</u>	<u>1,227,494</u>	<u>-</u>	<u>228,676,797</u>	<u>299,550,113</u>
Business-type activities capital assets, net	<u>\$ 282,137,513</u>	<u>\$ 34,157,701</u>	<u>\$ -</u>	<u>\$ (1,623)</u>	<u>\$ 316,293,591</u>

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 5 – CAPITAL ASSETS (CONTINUED)

Depreciation

Depreciation expense was charged to the business-type functions as follows:

Light and Power depreciation	\$ 7,203,894
Gas Fund depreciation	282,422
Other Enterprise Fund depreciation	361,063
Total depreciation expense - business-type functions	<u>\$ 7,847,379</u>

Capitalized bond interest

For the period July 1, 2005 through October 17, 2005 the City capitalized interest paid in relation to the Series 2004A, 2004B, and 2004C bonds. These bonds were issued in 2004 in order to finance the construction of the Malburg Generating Station which became operational on October 17, 2005. City incurred \$1,659,254 of interest expense that was capitalized during the year ended June 30, 2006 net of tax exempt investment income.

NOTE 6 – LONG-TERM OBLIGATIONS

During the fiscal year 2006, a total of \$480,265,000 in long-term obligations consisting of the following:

- \$49,420,000 Redevelopment Agency of the City of Vernon Industrial Redevelopment Project Tax Allocation Bonds, Series 2005
- \$200,000,000 Vernon Natural Gas Financing Authority Variable Rate Revenue Bonds (Vernon Gas Project), 2006 Series A
- \$115,440,000 Vernon Gas Project Variable Rate Revenue Bonds, 2006 Series B, and
- \$115,405,000 Vernon Gas Project Variable Rate Revenue Bonds, 2006 Series C

The Industrial Redevelopment Project Tax Allocation Bonds, Series 2005 were issued to provide funds to (i) finance various redevelopment projects in or benefiting the Agency's Industrial Redevelopment Project area, (ii) fund the reserve requirement for the Series 2005 Bonds, and (iii) pay the costs of issuance related to the Series 2005 Bonds.

The Vernon Gas Project 2006 Variable Rate Revenue Bonds were issued to provide funds to (i) finance a portion of the purchase by the City of a fifteen-year, prepaid supply of natural gas from Citigroup Energy Inc. pursuant to an Agreement for Purchase and Sale of Natural Gas, between the City and Citigroup Energy Inc.; and (ii) pay the costs of issuing the 2006 Bonds.

During the fiscal year 2005, the City issued \$90,150,000, 2004 Series A, \$83,575,000, 2004 Series B, \$39,875,000, 2004 Series C, and \$69,100,000, 2004 Series D, Electric System Revenue Bonds. The 2004 Bonds were issued to provide funds (i) to refund \$162,610,000 of outstanding Electric System Revenue Bonds of the City; (ii) to finance the costs of improvements to the City's substation and distribution facilities and certain costs of completion of the City's Malburg Generating Station; (iii) to finance the reimbursement to the City of certain costs incurred in connection with the City's electric system facilities; (iv) to fund a deposit to the Debt Service Reserve Fund; and (v) to pay the costs of issuance of the 2004 Bonds.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 6 – LONG-TERM OBLIGATIONS (CONTINUED)

A summary of bonds payable for governmental and business-type activities is as follows:

Bonds	Maturity	Interest Rates	Annual Principal Installments	Original Issue Amount	Outstanding at June 30, 2006
<i>Electric System Revenue Bonds, 2004 Series A</i>	04/01/37	Variable	To begin 04/01/29: \$2,000,000 - \$12,925,000	\$ 90,150,000	\$ 90,150,000
<i>Electric System Revenue Bonds, 2004 Series B</i>	04/01/29	Variable	To begin 04/01/18: \$50,000 - \$9,525,000	83,575,000	83,575,000
<i>Electric System Revenue Bonds, 2004 Series C</i>	04/01/39	Variable	To begin 04/01/37: \$11,500,000 - \$14,400,000	39,875,000	39,875,000
<i>Electric System Revenue Bonds, 2004 Series D</i>	04/01/18	Variable	\$3,800,000 - \$6,525,000	69,100,000	61,825,000
<i>RDA Industrial Redevelopment Project Tax Allocation Bonds, 2005 Series</i>	09/01/35	Fixed	To begin 09/01/09: \$1,160,000 - \$3,460,000	49,420,000	49,420,000
<i>Variable Rate Revenue Bonds (Vernon Gas Project), 2006 Series A</i>	08/01/21	Variable	To begin 08/01/07: \$9,950,000 - \$17,300,000	200,000,000	200,000,000
<i>Variable Rate Revenue Bonds (Vernon Gas Project), 2006 Series B</i>	08/01/21	Variable	To begin 08/01/07: \$5,710,000 - \$10,070,000	115,440,000	115,440,000
<i>Variable Rate Revenue Bonds (Vernon Gas Project), 2006 Series C</i>	08/01/21	Variable	To begin 08/01/07: \$5,710,000 - \$10,070,000	115,405,000	115,405,000
<i>Premium</i>					902,046
<i>Discount</i>					(1,559,893)
<i>Deferred amount on refunding</i>					(7,719,814)
Total Revenue Bonds				<u>\$ 762,965,000</u>	<u>\$ 747,312,339</u>

*The Series 2004 Bonds variable rate is set periodically through an auction process. Rates on the 2004A and 2004B bonds are reset through an auction process every 7 days. Rates on the 2004C and 2004D bonds are reset through an auction process every 28 days. Rates on the Series 2005 Bonds are fixed rates ranging from 3.25% to 5.25%. Rates on the 2006A Bonds are based on 7-day Auction Periods. Rates on the 2006B and 2006C Bonds are based on a Weekly Interest Rate determined by Citigroup Global Markets, Inc. utilizing best efforts to remarket the 2006B and 2006C Bonds which are subject to optional and mandatory tender.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 6 – LONG-TERM OBLIGATIONS (CONTINUED)

As of June 30, 2006, annual debt service requirements of business-type activities to maturity are as follows:

Year ending June 30:	Electric System Revenue Bonds Payable	
	Principal	Interest*
2007	\$ 3,975,000	\$ 11,999,551
2008	4,175,000	11,784,176
2009	4,350,000	11,558,277
2010	4,550,000	11,322,752
2011	4,775,000	11,076,256
2012-2016	27,200,000	51,304,143
2017-2021	34,025,000	43,490,707
2022-2026	41,075,000	35,685,826
2027-2031	49,550,000	26,528,703
2032-2036	59,875,000	15,476,094
2037-2039	41,875,000	3,085,770
Total requirements	\$ 275,425,000	\$ 233,312,255

* As of June 30, 2006, interest on the 2004 Series A, B, and C was calculated at the June 30, 2006 BMA rate of 3.970%. Interest on the 2004 Series D was calculated at the June 30, 2006 one month LIBOR rate of 5.3344%. For additional disclosure on interest rate swaps see Note 7.

Year ending June 30:	Industrial Redevelopment Project Tax Allocation Bonds Payable	
	Principal	Interest*
2007	\$ -	\$ 2,175,093
2008	-	2,175,093
2009	-	2,175,093
2010	1,160,000	2,157,419
2011	1,285,000	2,120,167
2012-2016	6,720,000	9,928,127
2017-2021	7,720,000	8,452,644
2022-2026	7,300,000	6,679,092
2027-2031	10,020,000	4,837,959
2032-2036	15,215,000	1,931,242
	\$ 49,420,000	\$ 42,631,929

* As of June 30, 2006, debt service was calculated based upon the fixed coupon rates of the bonds ranging from 3.25% to 5.25%. For additional disclosure on basis swap see Note 7.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 6 – LONG-TERM OBLIGATIONS (CONTINUED)

Year ending June 30:	Variable Rate Revenue Bonds Payable	
	Principal	Interest*
2007	\$ -	\$ 18,475,892
2008	21,370,000	17,712,207
2009	22,330,000	16,761,476
2010	23,135,000	15,775,117
2011	24,055,000	14,750,127
2012-2016	136,020,000	56,842,086
2017-2021	166,495,000	24,079,795
2022	37,440,000	267,583
Total requirements	<u>\$ 430,845,000</u>	<u>\$ 164,664,283</u>

* As of June 30, 2006, debt service for 2006 Series A, B, and C was calculated at the June 30, 2006 BMA rate of 3.970%. For additional disclosure on interest rate swaps see Note 7.

Changes in long-term liabilities

The following is a summary of long-term liabilities transactions for the fiscal year ended June 30, 2006:

	Balance July 1, 2005	Additions	Reductions	Balance June 30, 2006	Amounts Due Within One Year
<u>Governmental activities:</u>					
Bonds payable	\$ -	\$ 49,420,000	\$ -	\$ 49,420,000	\$ -
Bond premium	-	933,457	(31,411)	902,046	44,345
Claims payable	4,992,957	2,998,117	(632,501)	7,358,573	2,452,858
Compensated absences	944,768	928,525	(944,768)	928,525	928,525
	<u>\$ 5,937,725</u>	<u>\$ 54,280,099</u>	<u>\$ (1,608,680)</u>	<u>\$ 58,609,144</u>	<u>\$ 3,425,728</u>
<u>Business-type activities:</u>					
Bonds payable	\$ 279,225,000	\$ 430,845,000	\$ (3,800,000)	\$ 706,270,000	\$ 3,975,000
Bond discount	(1,634,532)	-	74,639	(1,559,893)	(74,639)
Deferred amount on refunding	(8,052,628)	-	332,814	(7,719,814)	(332,814)
Compensated absences	125,146	200,168	(125,146)	200,168	200,168
	<u>\$ 269,662,986</u>	<u>\$ 431,045,168</u>	<u>\$ (3,517,693)</u>	<u>\$ 697,190,461</u>	<u>\$ 3,767,715</u>

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 7 – BOND INTEREST RATE SWAP AGREEMENTS

Basis Swap – 2003 Series A and B Bonds

Objective of the interest rate swap: As a means to mitigate its exposure to interest rate risk, the City entered into an interest basis swap in connection with its \$87.5 million 2003 Electric System Series A and Series B bonds (the "2003 Series AB Bonds").

Terms: As originally structured, the 2003 Series AB Bonds and the related swap agreement were scheduled to mature on April 1, 2033, and the swap's aggregate notional amount of \$87.5 million matched the par amount of the 2003 Series AB Bonds. The swap was entered into in July 2003. Under the swap, the City pays the counterparty payments equal to the average of the weekly Bond Market Association (BMA) variable rate index and receives payments equal to 80.2%, the London Interbank Offered Rate (LIBOR) one-month index.

Fair value: Because the differential between the BMA index and LIBOR index has increased since execution of the swaps, the swap has an aggregate positive fair value of \$1,521,441 as of June 30, 2006. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

Credit risk: As the swap's fair value as of June 30, 2006 is positive, the City has credit exposure to the counterparty equal to the fair value amount. The swap counterparty Bank of America, was rated AA by Standard & Poor's and Aa by Moody's Investors Service as of June 30, 2005. To mitigate the potential for credit risk, if the counterparties credit quality falls below A+/Aa2, the fair value of the swap will be fully collateralized by the counterparty with U.S. government securities. Collateral would be posted with a third-party custodian.

Basis risk: The swap exposes the City to basis risk should the relationship between LIBOR and BMA converge to a ratio higher than that stated in the swap. If a change occurs that results in the rates moving to a convergence ratio greater than that stated in the swap, the swap may not provide the expected interest rate risk mitigation.

Termination risk: The City or its counterparty may terminate the swap if the other party fails to perform under the terms of the contract. The swap may be terminated by the City if the counterparty's credit quality rating falls below "A-" as issued by Standard & Poor's or "A3" as issued by Moody's Investors Service. If at the time of termination, the swap has a negative fair value, the City would be liable to the counterparty for a payment equal to the swap's fair value.

Swap payments and associated debt: In December 2004, the City defeased the 2003 Series AB Bonds with proceeds of its 2004 Series A bonds. Because interest payments on the 2004 Series A bonds are determined based on a variable rate short term basis, the City elected to retain the swap. The City expects that as interest rates rise, the difference, or spread, between short-term tax-exempt rates and short-term taxable rates will increase. Under this expectation, the City will receive payments under the swap greater than its payments to the counterparty. As a net receiver on the swap, the City would then have such monies available to offset higher debt service requirements on its 2004 Series A bonds.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 7 – BOND INTEREST RATE SWAP AGREEMENTS (CONTINUED)

Basis Swap – 2003 Series C Bonds

Objective of the interest rate swap: As a means to reduce its bond interest cost, the City entered into an interest basis swap in connection with its \$75.11 million 2003 Electric System Series C bonds (the "2003 Series C Bonds").

Terms: As originally structured, the 2003 Series C Bonds and the related swap agreement mature on April 1, 2033, and the swap's aggregate notional amount of \$75.11 million matches the par amount of the 2003 Series C Bonds. The swap was entered into in August 2003. Under the swap, the City pays the counterparty payments equal to the average of the weekly Bond Market Association (BMA) variable rate index and receives payments equal to 78.6% of the London Interbank Offered Rate (LIBOR) one-month index.

Fair value: Because the differential between the BMA index and LIBOR index has increased since execution of the swaps, the swaps have an aggregate positive fair value of \$624,884 as of June 30, 2006. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

Credit risk: As the swap's fair value as of June 30, 2006 is positive, the City has credit exposure to the counterparty equal to the fair value amount. The swap counterparty, Wachovia, was rated AA- by Standard & Poor's and Aa2 by Moody's Investors Service as of June 30, 2005. To mitigate the potential for credit risk, if the counterparty's credit quality falls below A+/Aa2, the fair value of the swap will be fully collateralized by the counterparty with U.S. government securities. Collateral would be posted with a third-party custodian.

Basis risk: The swap exposes the City to basis risk should the relationship between LIBOR and BMA converge to a ratio higher than that stated in the swap. If a change occurs that results in the rates moving to a convergence ratio greater than that stated in the swap, the swap may not provide the expected interest cost savings.

Termination risk: The City or its counterparty may terminate the swap if the other party fails to perform under the terms of the contract. The swap may be terminated by the City if the counterparty's credit quality rating falls below "A-" as issued by Standard & Poor's or "A3" as issued by Moody's Investors Service. If at the time of termination, the swap has a negative fair value, the City would be liable to the counterparty for a payment equal to the swap's fair value.

Swap payments and associated debt: In December 2004, the City defeased the 2003 Series C with proceeds of its 2004 Series B bonds. Because interest payments on the 2004 Series B bonds are determined based on variable rate short term basis, the City elected to retain the swap. The City expects that as interest rates rise the difference, or spread, between short-term tax-exempt rates and short-term taxable rates will increase. Under this expectation, the City will receive payments under the swap greater than its payments to the counterparty. As a net receiver on the swap, the City would then have such monies available to offset higher debt service requirements on its 2004 Series B bonds.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 7 – BOND INTEREST RATE SWAP AGREEMENTS (CONTINUED)

Fixed to Variable Swap – 2003 Series C Bonds

Objective of the interest rate swap: For this bond issuance the City's asset/liability strategy is to have variable rate debt exposure consistent with its variable rate asset exposure; the result being that as interest rates increase, the City's investment income will offset its increased variable rate debt costs.

Terms: In April 2003, the City entered into a pay-variable, receive-fixed interest rate swap for the term of its \$75,110,000 2003 Series C Electric System revenue bonds. The notional amount of the swap was \$75,110,000. In June 2003, the City elected to terminate the portion of the swap through April 2008 in exchange for a payment of \$4,170,000 from the swap counterparty. Under the remaining terms of the swap, the swap becomes effective in April 2008 and terminates in April 2033; the City pays a variable rate equal to the Bond Market Association Municipal Swap Index (BMA), which was 3.97 percent at June 30, 2006, plus 0.84% and receives fixed-rate payments equal to the actual semi-annual interest payments due on the Series C bonds. In December 2004, the City defeased the 2003 Series C Bonds with proceeds of its 2004 Series B bonds. The City expects to terminate this swap prior to its effective date of April 2008.

Fair value: As of June 30, 2006, the swap had a negative fair value of \$3,023,394. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

Credit risk: As the swap's fair value as of June 30, 2006 is negative, the City does not have any credit exposure to the counterparty. Should the swap's fair value become positive, the City would have credit exposure to the counterparty equal to the fair value amount. As of June 30, 2006, the swap counterparty, Bank of America, was rated AA by Standard & Poor's and Aa by Moody's Investors Service. To mitigate the potential for credit risk, if the counterparty's credit quality falls below A+/Aa2, the fair value of the swap will be fully collateralized by the counterparty with U.S. government securities. Collateral would be posted with a third-party custodian.

Interest rate risk: Beginning in April 2008, if the swap is not previously terminated, the swap increases the City's exposure to interest rate risk. As BMA increases, the City's net payment on the swap increases.

Termination risk: The City or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. In addition, the City may optionally terminate the agreement on any date. If at the time of termination the swap has a negative fair value, the City would be liable to the counterparty for an amount equal to the negative fair value.

Swap payments and associated debt: The debt associated with the swap, 2003 C Bonds, has been defeased. The City expects to terminate this swap prior to its effective date of April 2008.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 7 – BOND INTEREST RATE SWAP AGREEMENTS (CONTINUED)

Variable to Fixed Swap – 2004 Series A Bonds

Objective of the interest rate swap: As a means to reducing its overall exposure to interest rate risk and achieving a lower cost of capital relative to long term fixed rate bonds, the City elected to issue its \$90,150,000 2004 Series A Electric System revenue bonds (the "2004 Series A Bonds") in a variable rate mode and enter to a fixed payer swap to achieve synthetic fixed debt.

Terms: In December 2004, the City entered into a pay-fixed, receive-variable interest rate swap for the term of the 2004 Series A Bonds. The notional amount of the swap is \$90,150,000. Under the original terms of the swap, the City pays the counterparty a fixed rate of 3.637% and receives from the counterparty variable-rate payments equal to 62.87% of the London Interbank Offered Rate (LIBOR) one-month index plus 0.119%. On March 16, 2006, the City amended its fixed payment to 3.607% to the counterparty. The City expects that the variable-rate payments from the swap will approximate the interest payments on the 2004 Series A Bonds, thereby creating synthetic fixed rate debt. The notional amount of the swap and the amortization of the principal of the 2004 A Bonds are exactly matched.

Fair value: As of June 30, 2006, the swap had a positive fair value of \$1,305,648. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

Credit risk: As the swap's fair value as of June 30, 2006 is positive, the City has credit exposure to the counterparty equal to the fair value amount. As of June 30, 2006, the swap counterparty, Morgan Stanley was rated A+ by Standard & Poor's and Aa3 by Moody's Investors Service. To mitigate the potential for credit risk, if the counterparty's credit quality falls below (BBB/Baa2), the fair value of the swap will be fully collateralized by the counterparty with U.S. government securities. Collateral would be posted with a third-party custodian.

Interest rate risk: The swap is structured to reduce the City's exposure to interest rate risk.

Basis risk: The swap exposes the City to basis risk should the relationship between LIBOR and BMA converge to a ratio higher than variable leg of the swap.

Termination risk: The City or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. In addition, the City may optionally terminate the agreement on any date. If at the time of termination the swap has a negative fair value, the City would be liable to the counterparty for an amount equal to the negative fair value.

Swap payments and associated debt: It is expected that the variable payments received by the City on the swap will approximate the variable interest payments on the 2004 Series A Bonds, resulting in the City's net interest exposure being equaled to the fixed payment on the swap to the counterparty. Because the variable payments on the 2004 Series A Bonds and the swap are on different bases, some basis differential is expected from time to time.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 7 – BOND INTEREST RATE SWAP AGREEMENTS (CONTINUED)

The following summarizes the expected net debt service if BMA remains constant 3.970% and 1 Month LIBOR remains constant at 5.334% (actual rates as of June 30, 2006).

Year Ending June 30	Principal Amount	Interest	Interest Rate Swap, Net	Total Debt Service
2007	\$ -	\$ 3,578,955	\$ 121,038	\$ 3,699,993
2008	-	3,578,955	121,038	3,699,993
2009	-	3,578,955	121,038	3,699,993
2010	-	3,578,955	121,038	3,699,993
2011	-	3,578,955	121,038	3,699,993
2012-2016	-	17,894,775	605,189	18,499,964
2017-2021	-	17,894,775	605,189	18,499,964
2022-2026	-	17,894,775	605,189	18,499,964
2027-2031	28,275,000	16,718,166	565,397	45,558,563
2032-2036	59,875,000	7,313,567	247,340	67,435,907
2037	2,000,000	66,167	2,238	2,068,404
	<u>\$ 90,150,000</u>	<u>\$ 95,677,000</u>	<u>\$ 3,235,732</u>	<u>\$ 189,062,732</u>

Variable to Fixed Swap – 2004 Series B Bonds

Objective of the interest rate swap: As a means to reducing its overall exposure to interest rate risk and achieving a lower cost of capital relative to long term fixed rate bonds, the City elected to issue its \$83,575,000 2004 Series B Electric System revenue bonds (the "2004 Series B Bonds") in a variable rate mode and enter to a fixed payer swap to achieve synthetic fixed debt.

Terms: In December 2004, the City entered into a pay-fixed, receive-variable interest rate swap for the term of its 2004 Series B Bonds. The notional amount of the swap is \$83,575,000. Under the terms of the swap, the City pays a fixed rate of 3.572% and receives variable-rate payments equal to 62.87% of the London Interbank Offered Rate (LIBOR) one-month index plus .119%. On March 16, 2006, the City revised its fixed payment to 3.542% to the counterparty. The City expects that the variable-rate payments from the swap will approximate the interest payments on the 2004 Series B Bonds. The notional amount of the swap and the amortization of the principal of the 2004 Series B Bonds are exactly matched.

Fair value: As of June 30, 2006, the swap had a positive fair value of \$1,455,922. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

Credit risk: As the swap's fair value as of June 30, 2006 is positive, the City has credit exposure to the counterparty equal to the fair value amount. As of June 30, 2006, the swap counterparty, Morgan Stanley was rated A+ by Standard & Poor's and Aa3 by Moody's Investors Service. To mitigate the potential for credit risk, if the counterparty's credit quality falls below (BBB/Baa2), the fair value of the swap will be fully collateralized by the counterparty with U.S. government securities. Collateral would be posted with a third-party custodian.

Interest rate risk: The swap is structured to reduce the City's exposure to interest rate risk.

Basis risk: The swap exposes the City to basis risk should the relationship between LIBOR and BMA converge to a ratio higher than variable leg of the swap.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 7 – BOND INTEREST RATE SWAP AGREEMENTS (CONTINUED)

Termination risk: The City or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. In addition, the City may optionally terminate the agreement on any date. If at the time of termination the swap has a negative fair value, the City would be liable to the counterparty for an amount equal to the negative fair value.

Swap payments and associated debt: It is expected that the variable payments received by the City on the swap will approximate the variable interest payments on the 2004 Series B Bonds, resulting in the City's net interest exposure being equal to the fixed payment on the swap to the counterparty. Because the variable payments on the 2004 Series B Bonds and the swap are on different bases, some basis differential is expected from time to time.

The following summarizes the expected net debt service if BMA remains constant 3.970% and 1 Month LIBOR remains constant at 5.334% (actual rates as of June 30, 2006).

Year Ending June 30	Principal Amount	Interest	Interest Rate Swap, Net	Total Debt Service
2007	\$ -	\$ 3,317,928	\$ 112,210	\$ 3,430,138
2008	-	3,317,928	112,210	3,430,138
2009	-	3,317,928	112,210	3,430,138
2010	-	3,317,928	112,210	3,430,138
2011	-	3,317,928	112,210	3,430,138
2012-2016	-	16,589,638	561,050	17,150,688
2017-2021	21,225,000	15,623,439	528,374	37,376,813
2022-2026	41,075,000	8,967,403	303,272	50,345,674
2027-2029	21,275,000	1,286,445	43,507	22,604,952
	<u>\$ 83,575,000</u>	<u>\$ 59,056,562</u>	<u>\$ 1,997,253</u>	<u>\$ 144,628,815</u>

Variable to Fixed Swap – 2004 Taxable Series D Bonds

Objective of the interest rate swap: As a means to reducing its overall exposure to interest rate risk, the City elected to enter into a fixed payer swap to achieve synthetic fixed debt with respect to its \$69,100,000 2004 Taxable Series D Electric System revenue bonds (the "2004 Taxable Series D Bonds") issued in a variable rate mode.

Terms: On March 16, 2006, the City entered into a pay-fixed, receive-variable interest rate swap for the term of its 2004 Taxable Series D Bonds. The notional amount of the swap is \$61,825,000. Under the terms of the swap, the City pays a fixed rate of 5.227% and receives variable-rate payments equal to 100.00% of the London Interbank Offered Rate (LIBOR) three-month index. The City expects that the variable-rate payments from the swap will approximate the interest payments on the 2004 Taxable Series D Bonds. The notional amount of the swap and the amortization of the principal of the 2004 Taxable Series D Bonds are exactly matched.

Fair value: As of June 30, 2006, the swap had a positive fair value of \$1,364,979. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

Credit risk: As the swap's fair value as of June 30, 2006 is positive, the City has credit exposure to the counterparty equal to the fair value amount. As of June 30, 2006, the swap counterparty, Morgan Stanley was rated A+ by Standard & Poor's and Aa3 by Moody's Investors Service. To mitigate the potential for credit risk, if the counterparty's credit quality falls below (BBB/Baa2), the fair value of the swap will be fully collateralized by the counterparty with U.S. government securities. Collateral would be posted with a third-party custodian.

Interest rate risk: The swap is structured to reduce the City's exposure to interest rate risk.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 7 – BOND INTEREST RATE SWAP AGREEMENTS (CONTINUED)

Basis risk: The swap exposes the City to basis risk should the three month LIBOR rate be less than the rate on the 2004 Taxable Series D Bonds.

Termination risk: The City or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. In addition, the City may optionally terminate the agreement on any date. If at the time of termination the swap has a negative fair value, the City would be liable to the counterparty for an amount equal to the negative fair value.

Swap payments and associated debt: It is expected that the variable payments received by the City on the swap will approximate the variable interest payments on the 2004 Taxable Series D Bonds, resulting in the City's net interest exposure being equaled to the fixed payment on the swap to the counterparty. Because the variable payments on the 2004 Taxable Series D Bonds and the swap are on different bases, some basis differential is expected from time to time.

The following summarizes the expected net debt service if 1 Month LIBOR remains constant at 5.3344% and the 3 Month LIBOR remains constant at 5.4806% (actual rates as of June 30, 2006).

Year Ending June 30	Principal Amount	Interest	Interest Rate Swap, Net	Total Debt Service
2007	\$ 3,975,000	\$ 3,352,072	\$ (65,689)	\$ 7,261,383
2008	4,175,000	3,132,391	(61,384)	7,246,007
2009	4,350,000	2,901,978	(56,868)	7,195,110
2010	4,550,000	2,661,745	(52,161)	7,159,584
2011	4,775,000	2,410,322	(47,234)	7,138,088
2012-2016	27,200,000	7,892,977	(154,674)	34,938,303
2017-2018	12,800,000	942,206	(18,464)	13,723,742
	<u>\$ 61,825,000</u>	<u>\$ 23,293,691</u>	<u>\$ (456,472)</u>	<u>\$ 84,662,219</u>

Basis Swap – Series 2005

Objective of the interest rate swap: As a means to reduce its bond interest cost, the RDA entered into an interest basis swap in connection with its \$49,420,000 Industrial Redevelopment Project Tax Allocation Bonds, Series 2005 (the "Series 2005 Bonds").

Terms: As originally structured, the Series 2005 Bonds and the related swap agreement mature on September 1, 2035, and the swap's aggregate notional amount of \$49,420,000 million matches the par amount of the Series 2005 Bonds. The swap was entered into on February 16, 2006. Under the swap, the RDA pays the counterparty payments equal to the average of the weekly Bond Market Association (BMA) variable rate index and receives payments equal to 63.0% plus 0.72% of the London Interbank Offered Rate (LIBOR) three-month index.

Fair value: Because the differential between the BMA index and LIBOR index has decreased since execution of the swaps, the swaps have an aggregate negative fair value of \$231,699 as of June 30, 2006. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 7 – BOND INTEREST RATE SWAP AGREEMENTS (CONTINUED)

Credit risk: As the swap's fair value as of June 30, 2006 was negative, the RDA does not have credit exposure to the counterparty. Should the RDA's fair value become positive, the RDA would have credit exposure to the counterparty equal to the fair value amount. The swap counterparty, Lehman Brothers, was rated A+ by Standard & Poor's and A1 by Moody's Investors Service as of June 30, 2006. To mitigate the potential for credit risk, if the counterparty's credit quality falls below "A-" or "A3", the fair value of the swap will be fully collateralized by the counterparty with U.S. government securities. Collateral would be posted with a third-party custodian.

Basis risk: The swap exposes the RDA to basis risk should the relationship between LIBOR and BMA converge to a ratio higher than that stated in the swap. If a change occurs that results in the rates moving to a convergence ratio greater than that stated in the swap, the swap may not provide the expected interest cost savings.

Termination risk: The RDA or its counterparty may terminate the swap if the other party fails to perform under the terms of the contract. The swap may be terminated by the RDA at any time. If at the time of termination, the swap has a negative fair value, the RDA would be liable to the counterparty for a payment equal to the swap's fair value.

The following summarizes the expected net debt service if BMA remains constant 3.970% and 3 Month LIBOR remains constant at 5.4806% (actual rates as of June 30, 2006).

Year Ending June 30	Principal Amount	Interest	Basis Swap, Net	Total Debt Service
2007	\$ -	\$ 2,275,306	\$ (100,213)	\$ 2,175,093
2008	-	2,275,306	(100,213)	2,175,093
2009	-	2,275,306	(100,213)	2,175,093
2010	1,160,000	2,256,456	(99,037)	3,317,419
2011	1,285,000	2,216,725	(96,558)	3,405,167
2012-2016	6,720,000	10,371,369	(443,242)	16,648,126
2017-2021	7,720,000	8,822,491	(369,847)	16,172,644
2022-2026	7,300,000	6,972,025	(292,933)	13,979,092
2027-2031	10,020,000	5,046,719	(208,760)	14,857,959
2032-2036	15,215,000	2,012,875	(81,633)	17,146,242
	<u>\$ 49,420,000</u>	<u>\$ 44,524,578</u>	<u>\$ (1,892,649)</u>	<u>\$ 92,051,929</u>

Variable to Fixed Swap – 2006 Series A Gas Bonds

Objective of the interest rate swap: As a means to reducing its overall exposure to interest rate risk, the Vernon Natural Gas Financing Authority elected to enter into a fixed payer swap to achieve synthetic fixed debt with respect to its \$200,000,000 Variable Rate Revenue Bonds (Vernon Gas Project), 2006 Series A (the "2006 Series A Gas Bonds") issued in a variable rate mode.

Terms: The City entered into four (4) pay-fixed, receive-variable interest rate swaps for the term of its 2006 Series A Gas Bonds. The notional amounts of each of the four (4) swaps is \$50,000,000. Under the terms of the swaps, the City pays a fixed rate of 3.683% and receives variable-rate payments equal to 62.6% of the London Interbank Offered Rate (LIBOR) one month index. The City expects that the variable-rate payments from the swaps will approximate the interest payments on the 2006 Series A Gas Bonds. The notional amount of the swaps and the amortization of the principal of the 2006 Series A Gas Bonds are exactly matched.

Fair value: As of June 30, 2006, the swaps had a negative fair value of \$1,929,994. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 7 – BOND INTEREST RATE SWAP AGREEMENTS (CONTINUED)

Credit risk: As the swap's fair value as of June 30, 2006 is negative, the City does not have credit exposure to the counterparty. Should the City's fair value become positive, the City would have credit exposure to the counterparty equal to the fair value amount. As of June 30, 2006, the swap counterparty, Citibank, N.A. was rated AA by Standard & Poor's and Aa1 by Moody's Investors Service. To mitigate the potential for credit risk, if the counterparty's credit quality falls below (A-/A3), the fair value of the swap will be fully collateralized by the counterparty with U.S. government securities. Collateral would be posted with a third-party custodian.

Interest rate risk: The swap is structured to reduce the City's exposure to interest rate risk.

Basis risk: The swap exposes the City to basis risk should the relationship between LIBOR and BMA converge to a ratio higher than variable leg of the swap.

Termination risk: The City or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. In addition, the City may optionally terminate the agreement on any date. If at the time of termination the swap has a negative fair value, the City would be liable to the counterparty for an amount equal to the negative fair value.

Swap payments and associated debt: It is expected that the variable payments received by the City on the swap will approximate the variable interest payments on the 2006 Series A Gas Bonds, resulting in the City's net interest exposure being equaled to the fixed payment on the swap to the counterparty. Because the variable payments on the 2006 Series A Gas Bonds and the swap are on different bases, some basis differential is expected from time to time.

The following summarizes the expected net debt service if BMA remains constant 3.970% and 1 Month LIBOR remains constant at 5.3344% (actual rates as of June 30, 2006).

Year Ending June 30	Principal Amount	Interest	Interest Rate Swap, Net	Total Debt Service
2007	-	7,940,000	687,331	8,627,331
2008	9,950,000	7,610,821	658,836	18,219,656
2009	10,400,000	7,200,918	623,352	18,224,270
2010	10,775,000	6,775,632	586,537	18,137,169
2011	11,200,000	6,333,804	548,290	18,082,094
2012-2016	63,225,000	24,385,229	2,110,923	89,721,152
2017-2021	77,150,000	10,312,406	892,700	88,355,106
2022	17,300,000	114,468	9,909	17,424,377
	<u>\$ 200,000,000</u>	<u>\$ 70,673,278</u>	<u>\$ 6,117,878</u>	<u>\$ 276,791,156</u>

Variable to Fixed Swap – 2006 Series B and C Gas Bonds

Objective of the interest rate swap: As a means to reducing its overall exposure to interest rate risk, the Vernon Natural Gas Financing Authority elected to enter into a fixed payer swap to achieve synthetic fixed debt with respect to its \$115,440,000 Variable Rate Revenue Bonds (Vernon Gas Project), 2006 Series B and \$115,405,000 Variable Rate Revenue Bonds (Vernon Gas Project), 2006 Series C (the "2006 Series B and C Gas Bonds") issued in a variable rate mode.

Terms: The City entered into a pay-fixed, receive-variable interest rate swap for the term of its 2006 Series B and Series C Gas Bonds. The notional amount for the swap is \$230,845,000. Under the terms of the swaps, the City pays a fixed rate of 3.753% and receives variable-rate payments equal to 64.8% of the London Interbank Offered Rate (LIBOR) one month index. The City expects that the variable-rate payments from the swaps will approximate the interest payments on the 2006 Series B and C Gas Bonds. The notional amount of the swaps and the amortization of the principal of the 2006 Series BC Gas Bonds are exactly matched.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 7 – BOND INTEREST RATE SWAP AGREEMENTS (CONTINUED)

Fair value: As of June 30, 2006, the swaps had a negative fair value of \$1,341,639. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

Credit risk: As the swap's fair value as of June 30, 2006 is negative, the City does not have credit exposure to the counterparty. Should the City's fair market value become positive, the City would have credit exposure to the counterparty equal to the fair value amount. As of June 30, 2006, the swap counterparty, Citibank, N.A. was rated AA by Standard & Poor's and Aa1 by Moody's Investors Service. To mitigate the potential for credit risk, if the counterparty's credit quality falls below (A-/A3), the fair value of the swap will be fully collateralized by the counterparty with U.S. government securities. Collateral would be posted with a third-party custodian.

Interest rate risk: The swap is structured to reduce the City's exposure to interest rate risk.

Basis risk: The swap exposes the City to basis risk should the relationship between LIBOR and BMA converge to a ratio higher than variable leg of the swap.

Termination risk: The City or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. In addition, the City may optionally terminate the agreement on any date. If at the time of termination the swap has a negative fair value, the City would be liable to the counterparty for an amount equal to the negative fair value.

Swap payments and associated debt: It is expected that the variable payments received by the City on the swap will approximate the variable interest payments on the 2006 Series B and Series C Gas Bonds, resulting in the City's net interest exposure being equaled to the fixed payment on the swap to the counterparty. Because the variable payments on the 2006 Series BC Gas Bonds and the swap are on different bases, some basis differential is expected from time to time.

The following summarizes the expected net debt service if BMA remains constant 3.970% and 1 Month LIBOR remains constant at 5.3344% (actual rates as of June 30, 2006).

Year Ending June 30	Principal Amount	Interest	Interest Rate Swap, Net	Total Debt Service
2007	\$ -	\$ 9,164,547	\$ 684,014	\$ 9,848,561
2008	11,420,000	8,786,735	655,815	20,862,550
2009	11,930,000	8,316,488	620,718	20,867,206
2010	12,360,000	7,828,642	584,306	20,772,948
2011	12,855,000	7,321,573	546,460	20,723,033
2012-2016	72,795,000	28,238,312	2,107,622	103,140,935
2017-2021	89,345,000	11,980,501	894,188	102,219,689
2022	20,140,000	133,260	9,946	20,283,206
	<u>\$ 230,845,000</u>	<u>\$ 81,770,057</u>	<u>\$ 6,103,070</u>	<u>\$ 318,718,127</u>

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 8 – OTHER DERIVATIVE FINANCIAL INSTRUMENTS

The City’s Light and Power Fund (Fund), which accounts for the maintenance and operations of the City’s electric utility plant, enters into contracts for electricity and natural gas to meet the expected needs of its retail customers. The Fund also sells excess electricity capacity during periods when it is not needed to meet its retail requirements. Derivative contracts (futures and options) designated as cash flow hedges are entered into by the Fund to hedge variable price risk associated with the purchase and sale of commodities and extend out to March 30, 2007. At June 30, 2006, the Fund’s derivative contracts totaled \$6,109,607 and are recorded at cost in the Fund’s financial statements and are included with other assets. For the year ended June 30, 2006, the City realized a net loss of \$3,433,453 on closed derivative contracts. The fair value of the derivative instruments at June 30, 2006 totaled \$937,615. Unrealized gains and losses on the derivative instruments are not recognized in the accompanying financial statements since the Fund does not apply FASB statements issued after November 1, 1989.

NOTE 9 – RISK MANAGEMENT

The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; natural disasters; unemployment coverage, and providing health benefits to employees, retirees, and their dependents. The City is self-insured for its general liability, workers’ compensation, and property liability. The City has chosen to establish risk financing Internal Service Funds, whereby assets are set aside for claim settlements associated with the above risks of loss up to certain limits.

The City has obtained various insurance policies that provide coverage for “Special Form Perils” against direct physical loss or damage, including earthquake and flood, to all real and personal property of the City, including equipment, business and revenue interruption, errors and omissions, boiler and machinery and pollution legal liability. The earthquake and flood portion of the policies have a 5% deductible of the total insurable values per building, structure or covered item at the time and place of loss. In the most recent “Statement of Values” for the City, real and personal property total insured values equaled \$293,136,673.

Crime (Employee Theft and, Depositors Forgery and Alteration, and Computer and Funds Transfer Fraud) coverage is also in force with a limit \$100,000 for each line of coverage.

The City is self insured for the first \$300,000 of workers’ compensation claims and for the first \$2,000,000 of its general liability coverage.

Excess coverage is provided by the Independent Cities Risk Management Authority (the “ICRMA”), a joint powers authority whose purpose is to develop and fund programs of excess insurance for its member cities. The ICRMA is governed by a board of directors consisting of representatives of its member cities. Excess coverage is provided by ICRMA. Self-insurance and ICRMA limits are as follows:

<u>Type of Coverage</u>	<u>Self-Insurance</u>	<u>ICRMA</u>
General Liability	Up to \$2,000,000	Not Applicable
Workers’ Compensation	Up to \$300,000	\$300,000 to \$10,000,000
Property	Up to \$ 10,000	Not Applicable

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 9 – RISK MANAGEMENT (CONTINUED)

Insured limits are:

Type of Coverage	Limits
Excess General Liability	\$10,000,000 excess of \$2,000,000 (self insured)
Excess General Liability	\$10,000,000 excess of \$10,000,000

Amounts in excess of these limits are self-insured. There have been no significant reductions of coverage from the prior year. There have been no settlements exceeding insurance coverage for each of the past three fiscal years.

The unpaid claims liabilities included in each of the self-insurance Internal Service Funds are based on the results of actuarial studies and third-party administrator claim reports and include amounts for claims incurred but not reported, including loss adjustment expenses. Claims liabilities are calculated considering the effects of inflation and recent claim settlement trends, including frequency and amount of payouts and other economic and social factors.

Changes in the balances of claims liabilities during the past two fiscal years for all self-insurance funds combined are as follows:

	Fiscal Year Ended June 30	
	2006	2005
Claims payable, beginning of fiscal year	\$ 4,992,957	\$ 5,252,825
Incurred claims	2,998,117	409,603
Claims payments	<u>(632,501)</u>	<u>(669,471)</u>
Claims payable, end of fiscal year	<u>\$ 7,358,573</u>	<u>\$ 4,992,957</u>

NOTE 10 – PENSION PLAN

The City contributes to the California Public Employees’ Retirement System (PERS), an agent multiple-employer retirement system that acts as a common investment and administrative agent for participating public entities within the State of California.

All full-time safety (police and fire personnel) and miscellaneous personnel and temporary or part-time employees who have worked 1,000 hours in a fiscal year are eligible to participate in the PERS. Benefits vest after five years of service. Employees who retire at age 50 with five years of credited service are entitled to retirement benefits. Monthly retirement benefits are based on an employee’s average compensation for his or her single highest year of compensation for each year of credited service.

Miscellaneous members with five years of credited service may retire at age 55 with full benefits based on a benefit factor derived from the “2% at 55 Miscellaneous Factor” benefit factor table and between age 50 and 54 with reduced retirement benefits. Safety members may retire at age 50 with full benefits based on a benefit factor derived from the “3% at 50 Safety Factor” for Police Department Employees and “2% at 50 Safety Factor” for Fire Department Employees benefit factor table with five years of credited service. The PERS also provides death and disability benefits. These benefit provisions and all other requirements are established by State statute and City ordinance.

The City’s plan does not issue a stand-alone financial report but is included in the PERS report, which can be obtained from PERS at Lincoln Plaza, 400 P Street, Sacramento, California 95814.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 10 – PENSION PLAN (CONTINUED)

The State-required City employee salary contributions of 7% for miscellaneous employees and 9% for safety members are subsidized by the City. The City is required to contribute the remaining amounts necessary to fund the benefits for its members, using the actuarial basis adopted by the PERS Board of Administration.

The City's total contribution to the PERS for the year ended June 30, 2006 was \$5,792,468. City contribution rates as a percentage of covered payroll were 8.605% for miscellaneous plan members and 25.426% for safety plan members.

The City's contribution was made in accordance with actuarially determined requirements based on an actuarial valuation performed as of June 30, 2003.

The PERS uses the entry age normal actuarial cost method, which is a projected benefit cost method that takes into account those benefits expected to be earned in the future as well as those already accrued. According to this cost method, the normal cost for an employee is the level amount that would fund the projected benefit if it were paid annually from the date of employment until retirement. The PERS uses a modification of the entry age normal cost method whereby the employer's total normal cost is expressed as a level percentage of payroll. Unfunded liabilities are amortized over a closed, 20-year period.

Significant actuarial assumptions used in the valuation included (a) a rate of return on the investment of present and future assets of 7.75% a year, compounded annually; (b) overall payroll growth of 3.25%, compounded annually; and (c) a merit scale varying by duration of employment coupled with an assumed annual inflation growth of 3.00% and an annual production growth of 0.25%.

The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a 15 year period.

Trend information for the current and two preceding fiscal years is as follows:

Fiscal Year Ended June 30	Annual Pension Cost (APC)	Amount Contributed	Percentage of APC Contributed	Net Pension Obligation
2006	\$ 5,792,468	\$ 5,792,468	100%	-
2005	4,610,702	4,610,702	100%	-
2004	2,742,685	2,742,685	100%	-

The following schedule represents the required supplemental information for the three most recent actuarial valuations. This schedule provides information about progress made in accumulating sufficient assets to pay benefits when due (dollar amounts in millions) (unaudited):

Actuarial Valuation Date June 30	Actuarial Accrued Liability (AAL) (a)	Actuarial Value of Assets (b)	Unfunded (Overfunded) UAAL (OAAL) (a)-(b)	Funded Ratio (b)/(a)	Annual Covered Payroll (c)	UAAL (OAAL) As a % of Covered Payroll [(a)-(b)]/(c)
2004	\$ 180.3	\$ 170.5	\$ 9.8	94.5%	\$ 22.0	44.6%
2003	172.2	164.8	7.4	95.7%	21.6	34.1%
2002	161.6	166.3	(4.6)	102.9	19.9	(23.3)

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 11 – LEGAL SETTLEMENT

In July 2006, the City settled a dispute over a wholesale power purchase contract with Mirant Americas Energy Marketing, LP (“MAEM”) for \$15,000,000. This sum shall be paid to MAEM in installments, beginning in August 2006, over 30 months, plus interest at 7% per annum. The controversy arose in connection with the delivery of power under the contract and the filing by MAEM of a petition in bankruptcy court.

In November 2006, the City settled a dispute over contract obligations with its former electric distribution system maintenance provider, Resource Management International, Inc. (“RMI”). RMI has paid the sum of \$7,400,000 to the City in order to settle all disputes between the parties.

NOTE 12 – DEFICITS IN FUND EQUITY

The Gas Enterprise Fund has negative net assets of \$6,525,211 at June 30, 2006, which will be recovered from future operating revenues from customers.

The Equipment Replacement Internal Service Fund has negative net assets of \$149,848 at June 30, 2006. To the extent such deficit is attributed to shortfalls in charges to other funds, such deficit will be recovered through future rate increases. A deficit arising from decreases in fair value of pooled investments will not be recovered through charges to other funds.

NOTE 13 – EXCESS OF EXPENDITURES OVER APPROPRIATIONS

For the current year, the City’s excess expenditures over appropriations in the general government were \$6,338,061. However, these excess expenditures over appropriations were offset by the under expenditures of \$3,615,057 in public safety and \$3,205,155 in public works. The City’s excess expenditures over appropriations for capital outlay were \$7,274,739. These expenditures were incurred by the City in its current industrial development programs and were funded by available fund balance in the general fund.

NOTE 14 – LIGHT AND POWER OPERATIONS AND COMMITMENTS

Deregulation

Effective April 1, 1998, competition was introduced into California’s electric utility market, and customers of the state’s investor-owned utilities (IOUs) became eligible for direct access. The implementation of competition in accordance with State Assembly Bill 1890 (AB1890) resulted in significant structural changes to the electric power industry, including mandated direct access for IOU customers, energy sales through the California Power Exchange (“CPX”), and management of transmission assets through an Independent System Operator (ISO). AB 1890 also legislated the recovery of stranded investment through the assessment of a non-by passable competition transition charge (CTC). The original deregulation legislation applied to the State’s IOUs and did not compel participation by publicly owned utilities, such as the City’s electric utility.

During the fiscal year 2001, the City made sales of energy to CPX. CPX made minimal payments on these sales and filed for protection under Chapter 11 of the Federal Bankruptcy Statue in January 2001. As of June 30, 2006 a total of \$3,061,069 was due the City from CPX. The City has recorded a \$1,000,000 reserve for uncollectible accounts against this \$3,061,069 receivable at June 30, 2006.

Participating Transmission Owner

On August 30, 2000, the City filed a petition for declaratory order with the Federal Energy Regulatory Commission (FERC) requesting a determination by the FERC that the City’s Transmission Revenue Requirement (TRR), as approved by its rate setting body, the City Council, is proper for purposes of the City becoming a Participating Transmission Owner (PTO) in the California ISO. The FERC issued its order accepting the City’s petition, with certain modification, on October 27, 2000. Certain aspects of the FERC order were challenged by some of the State’s other PTOs. Recently, a federal appeals court ruled that the way the FERC arrived at its decision was improper and remanded the case back to the FERC for further proceedings. The City’s expected outcome of these proceedings is discussed in Note 15. As a PTO, the City has turned over operational control of its transmission entitlements to the ISO effective January 1, 2001 and shall be reimbursed based upon its TRR by the ISO through the ISO’s collection of a transmission access charge (TAC).

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 14 – LIGHT AND POWER OPERATIONS AND COMMITMENTS (CONTINUED)

On December 21, 2000, the ISO filed, on behalf of itself and the Participating Transmission Owners (PTO), a number of changes to its Transmission Control Agreement (TCA) to recognize Vernon's application to become a Participating Transmission Owner. The ISO also filed revisions to identify the transmission interests that the City will be turning over to the ISO's operational control and the inclusion of an explicit contract provision to ensure that all PTOs, including an entity such as the City, which is not subject to the rate jurisdiction or refund jurisdiction of FERC under section 205 and 206 of the Federal Power Act (FPA), make appropriate refunds or payment adjustments to implement any relevant FERC order.

Project Commitments

A. Southern California Public Power Authority

In 1980, the City entered into a joint powers agreement with nine (9) Southern California cities and an irrigation district to form the Southern California Public Power Authority (the "Authority"). The Authority's purpose is the planning, financing, acquiring, constructing and operating of projects that generate or transmit electric energy.

The Authority purchased a 5.91% interest in the Palo Verde Nuclear Generating Station (the "Station"), a nuclear-fired generating station near Phoenix, Arizona, from the Salt River Project Agricultural Improvement and Power District, and a 6.55% share of the right to use certain portions of the Arizona Nuclear Power Project Valley Transmission System. The City has a 4.9% entitlement share of the Authority's interest in the station.

Between 1983 and 2002, the Authority issued \$3.166 billion of Power Project Revenue Bonds to finance the purchase of the Authority's share of the Station and related transmission rights. The bonds are not obligations of any member of the Authority or public agency other than the Authority. Under a power sales contract with the Authority, the City is obligated on a "take or pay" basis for its proportionate share of power generated, as well as to make payments for its proportionate share of the operating and maintenance expenses of the Station, debt service on the bonds and any other debt, whether or not the project or any part thereof or its output is suspended, reduced or terminated. The City's proportionate share of costs during fiscal year 2006 was \$2,300,256.

B. Hoover Dam Power Plant Upgrade Program

In January 1987, the City entered into a contract with the Federal Bureau of Reclamation to fund part of an upgrading program of the Hoover Dam power plant to increase the plant's generating capacity. In exchange, the City will receive its pro rata share of the additional power produced. Total program costs are estimated to be \$155 million.

As of June 30, 2006, the City's total advances were \$6,736,123 for the upgrading program. At June 30, 2006, the outstanding note receivable was \$4,113,951. The City has no obligation to advance funds in the future. The note is being repaid with interest over a period of 30 years. The City must also make payments for its pro rata share of operating and maintenance costs not recovered by the plant through revenues. The amount paid during the current year for purchased power was reduced by principal and interest amounts totaling \$489,356 due the City on the outstanding note receivable. The contract expires in June 2017.

C. California-Oregon Transmission Project

In 1991, the City entered into the Interim Participation Agreement with several Northern California entities and the Western Area Power Administration. This agreement calls for the construction and operation of the project. Each party in the agreement has been allocated a respective share of the construction costs. The City's share is 8.05%. As of June 30, 2006, the City's share of total costs incurred for the project's planning and construction was \$37,316,527.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 14 – LIGHT AND POWER OPERATIONS AND COMMITMENTS (CONTINUED)

Power Purchase Commitments

As of June 30, 2006, the City has entered into long-term commitments to purchase power subject to certain conditions. The following table summarizes the value of the commitments at June 30, 2006 (in thousands):

<u>Fiscal Year</u>	<u>Amount</u>
2006-07	\$ 14,091
2007-08	14,091
2008-09	10,358
2009-10	6,600
2010-11	3,311
	<u>\$ 48,451</u>

Electric Rate Increase

Effective November 1, 2006, the City increased its electric rates 5% charged for electrical energy distributed and supplied by the City within its boundaries.

NOTE 15 – POST-EMPLOYMENT BENEFITS

The City Council approved a post-employment benefit plan for all employees with 20 years of service who retire at 60 or 30 years or more of service to the City. The plan pays for qualified employees' medical and dental insurance premiums and claims from age 60 to 65. Funding of the plan is on a pay-as-you-go basis. During the year ended June 30, 2006, approximately 105 (including HMO and PPO participants, City paid and non-City paid) employees were eligible to receive benefits. Amounts paid for premiums for the year ended June 30, 2006 totaled \$161,421.

NOTE 16 – CONTINGENCIES

At June 30, 2006, a number of lawsuits and claims were pending against the City that arose in the normal course of operations. Management estimates that certain pending lawsuits and claims may result in additional liabilities of approximately \$500,000.

The City is currently in proceedings with the FERC and certain other utilities and agencies regarding the appropriate Transmission Revenue Requirement ("TRR") for the City. The City is currently receiving revenue from the ISO based on a TRR of approximately \$10.6 million annually. In addition, the City is involved in litigation over the market price charged by the City for certain electric energy sales made during the period October 2, 2000 through June 20, 2001. FERC has ordered reductions in certain of the market prices for electric energy during that period, and the legitimacy of that order and its impact on entities such as the City is being litigated before the United States Court of Appeals and other courts. The City cannot predict the outcome of either of these proceedings, but it is possible that those outcomes could affect the level of the City's TRR and/or cause the City to be subject to one or more refund obligations. The ultimate loss related to these matters, if any, is unknown at this time and no amount has been accrued in the accompanying financial statements.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 17 – FUTURE GASB PRONOUNCEMENTS

The City is currently analyzing its accounting practices to determine the potential impact on the financial statements for the following GASB Statements:

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. This statement establishes uniform financial reporting standards for other postemployment benefits (OPEB) plans. The approach followed in this statement generally is consistent with the approach adopted for defined benefit pension plans with modifications to reflect differences between pension plans and OPEB plans. The statement applies for OPEB trust funds included in the financial reports of plan sponsors or employers, as well as for the stand-alone financial reports of OPEB plans or the public employee retirement systems, or other third parties, that administer them. This statement also provides requirements for reporting of OPEB funds by administrators of multiple-employer OPEB plans, when the fund used to accumulate assets and pay benefits or premiums when due is not a trust fund. This statement is effective for the City's fiscal year ending June 30, 2007.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which addresses how state and local governments should account for and report their costs and obligations related to postemployment healthcare and other nonpension benefits. Collectively, these benefits are commonly referred to as other postemployment benefits, or OPEB. The statement generally requires that employers account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in essentially the same manner as they currently do for pensions. Annual OPEB cost for most employers will be based on actuarially determined amounts that, if paid on an ongoing basis, generally would provide sufficient resources to pay benefits as they come due. This statement's provisions may be applied prospectively and do not require governments to fund their OPEB plans. An employer may establish its OPEB liability at zero as of the beginning of the initial year of implementation; however, the unfunded actuarial liability is required to be amortized over future periods. This statement also establishes disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time. This statement is effective for the City's fiscal year ending June 30, 2008.

In June 2005, GASB issued Statement No. 47, *Accounting for Termination Benefits*. This statement provides guidance to governmental employers for measuring, recognizing, and reporting liabilities and expense/expenditures related to all termination benefits, including voluntary termination benefits, without limitation as to the period of time during which the benefits are offered, and involuntary termination benefits. The requirements of this Statement are effective in two parts. For termination benefits provided through an existing defined benefit OPEB plan, the provisions should be implemented simultaneously with GASB Statement No. 45. For all other termination benefits, this Statement is effective for fiscal periods beginning after June 15, 2005. There was no impact on the financial statements for the fiscal year ended June 30, 2006, as a result of implementing this Statement.

In September 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. This Statement establishes criteria that governments will use to ascertain whether the proceeds received should be reported as revenue or as a liability and provides additional guidance for sales of receivables and future revenues within the same financial reporting entity. This Statement includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. This Statement also includes guidance to be used for recognizing other assets and liabilities arising from a sale of specific receivables or future revenues, including residual interests and recourse provisions. The disclosures pertaining to future revenues that have been pledged or sold are intended to provide financial statement users with information about which revenues will be unavailable for other purposes and how long they will continue to be so. This Statement is effective for the City's fiscal year ending June 30, 2008.

CITY OF VERNON, CALIFORNIA
Notes to Basic Financial Statements (Continued)
June 30, 2006

NOTE 17 – FUTURE GASB PRONOUNCEMENTS (CONTINUED)

In December 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. This statement requires state and local governments to provide the public with better information about the financial impact of environmental cleanup and identifies the circumstances under which a governmental entity would be required to report a liability related to pollution remediation and how to measure that liability. The statement also requires governments to disclose information about their pollution obligations associated with clean up efforts in the notes to the financial statements. GASB Statement No. 49 will be effective for financial statements for periods beginning after December 15, 2007, but liabilities will be measured at the beginning of that period so that beginning net assets can be restated.

The City has not determined the impact on the City of the adoption of these statements.

REQUIRED SUPPLEMENTARY INFORMATION

CITY OF VERNON, CALIFORNIA
Required Supplementary Information
Budgetary Comparison Schedule
General Fund
For the Fiscal Year Ended June 30, 2006

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		Positive (Negative)
REVENUES:				
Taxes	\$ 10,108,600	\$ 10,108,600	\$ 8,943,668	\$ (1,164,932)
Special assessments	650,000	650,000	736,221	86,221
Licenses and permits	1,225,000	1,225,000	1,161,188	(63,812)
Fines, forfeitures and penalties	267,000	267,000	188,988	(78,012)
Revenues from use of monies and properties		-	1,725,347	1,725,347
Net decrease in fair value of investments		-	(24,546)	(24,546)
Intergovernmental revenues		-	290,414	290,414
Charges for services	9,000,000	9,000,000	8,674,077	(325,923)
Other revenues	1,552,680	1,552,680	697,254	(855,426)
Total revenues	<u>22,803,280</u>	<u>22,803,280</u>	<u>22,392,611</u>	<u>(410,669)</u>
EXPENDITURES:				
General government	10,229,382	10,229,382	16,567,443	(6,338,061)
Public safety	22,272,747	22,272,747	18,657,690	3,615,057
Public works	8,215,342	8,215,342	5,010,187	3,205,155
Health services	1,509,509	1,509,509	1,246,963	262,546
Capital outlay	4,229,441	4,229,441	11,504,180	(7,274,739)
Total expenditures	<u>46,456,421</u>	<u>46,456,421</u>	<u>52,986,463</u>	<u>(6,530,042)</u>
Deficiency of revenues under expenditures	<u>(23,653,141)</u>	<u>(23,653,141)</u>	<u>(30,593,852)</u>	<u>(6,940,711)</u>
Other financing sources:				
Transfers in / (out)	<u>8,320,505</u>	<u>8,320,505</u>	(21,491,619)	(29,812,124)
Net change	<u>\$ (15,332,636)</u>	<u>\$ (15,332,636)</u>		
Reconciliation of GAAP basis fund balance				
Current year encumbrances			<u>812,531</u>	<u>812,531</u>
NET CHANGE IN FUND BALANCE			(51,272,940)	(35,940,304)
FUND BALANCE, BEGINNING OF YEAR			<u>72,233,702</u>	<u>82,900,733</u>
FUND BALANCE, END OF YEAR			<u>\$ 20,960,762</u>	<u>\$ 46,960,429</u>

See accompanying note to the required supplementary information.

CITY OF VERNON, CALIFORNIA
Notes to Required Supplementary Information
June 30, 2006

NOTE 1 – BUDGET

The City adheres to the following general procedures in establishing its annual budget, which is reflected in the accompanying General Fund budgetary comparison schedule.

- An annual budget is adopted by the City Council that provides for the general operation of the City. The budget includes authorized expenditures and estimated revenues of the General Fund, Special Revenue Funds and Capital Projects Funds;
- The budget is formally integrated into the accounting system and employed as a management control device during the year;
- Encumbrances, which are commitments related to executory contracts for goods and services, are recorded to assure effective budgetary control and accountability;
- Encumbrances outstanding at year-end do not constitute expenditures or liabilities under GAAP. Encumbrances outstanding at year-end are reported as reservations of fund balance for subsequent year expenditures. Unencumbered appropriations lapse at year-end;
- The budget is adopted on a modified accrual basis, except that encumbrances are treated as budgetary basis expenditures in the year of incurrence of the commitment to purchase;
- The City Administrator is authorized to transfer appropriations between activities within any fund. Expenditures may not exceed appropriations at the fund level. Excess expenditures over appropriations are financed by beginning fund balances. The final budgeted amounts used in the accompanying general fund budgetary comparison schedule include any amendments made during fiscal year 2006. Encumbrances carried forward from the prior year are reflected in the original budget.