

**LIGHT AND POWER DEPARTMENT FUND
(AN ENTERPRISE FUND OF THE CITY OF
VERNON, CALIFORNIA)**

Annual Financial Report

For the Fiscal Year Ended June 30, 2011

**CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
For the Fiscal Year Ended June 30, 2011**

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INDEPENDENT AUDITOR'S REPORT

To the City Council
City of Vernon, California

We have audited the accompanying basic financial statements of the Light and Power Department Fund, an Enterprise Fund of the City of Vernon, California (City), as of and for the fiscal year ended June 30, 2011, as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1 to the financial statements, the financial statements present only the Light and Power Department Fund and do not purport to, and do not, present fairly the financial position of the City as of June 30, 2011, and the changes in its financial position, or, where applicable, its cash flows for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Light and Power Department Fund of the City of Vernon, California, as of June 30, 2011, and the changes in its financial position and its cash flows for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 12 to the financial statements, there are various matters that result in uncertainties of the Light and Power Department Fund and the City.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 9 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of

management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Macias Fini & O'Connell LLP

Los Angeles, California
December 15, 2011

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2011
(Unaudited)

The management of the Light and Power Department Fund ("L&P"), a department of the City of Vernon ("the City"), offers the following overview and analysis of the basic financial statements of L&P for the fiscal year ended June 30, 2011. Management encourages readers to utilize information in the Management's Discussion and Analysis (MD&A) in conjunction with the accompanying basic financial statements.

OVERVIEW OF BASIC FINANCIAL STATEMENTS

The MD&A is intended to serve as an introduction to L&P's basic financial statements. Included as part of the financial statements are three separate statements.

The *statement of fund net assets* presents information on L&P's asset and liabilities, with the difference between the two reported as net assets.

The *statement of revenues, expenses and changes in fund net assets* presents information showing how L&P's net assets changed during the most recent fiscal year. Financial results are recorded using the accrual basis of accounting. Under this method, all changes in net assets are reported as soon as the underlying events occur, regardless of the timing of cash flows. Thus, revenues and expenses reported in this statement for some items may affect cash flows in a future fiscal period (examples include billed but uncollected revenues and employee earned but unused vacation leave).

The *statement of cash flows* reports cash receipts, cash payments, and net changes in cash and cash equivalents from operations, noncapital financing, capital and related financing, and investing activities.

The *notes to the basic financial statements* provide additional information that is essential to fully understand the data provided in the financial statements.

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Management's Discussion and Analysis (Continued)
For the Fiscal Year Ended June 30, 2011
(Unaudited)

FINANCIAL HIGHLIGHTS

Net Assets

The table below summarizes L&P's net assets as of the current fiscal year ended June 30, 2011 and prior fiscal year ended June 30, 2010. The details of the current year's summary can be found on page 9 of this report.

Fund Net Assets
June 30, 2011 and 2010

	2011	2010	Change
Assets:			
Current and other assets	\$ 409,400,281	\$ 477,272,645	\$ (67,872,364)
Restricted assets	55,875,012	56,274,028	(399,016)
Capital assets	158,026,213	128,987,587	29,038,626
Total assets	<u>623,301,506</u>	<u>662,534,260</u>	<u>(39,232,754)</u>
Liabilities			
Current liabilities	74,418,326	85,321,117	(10,902,791)
Long-term liabilities	436,858,844	467,417,744	(30,558,900)
Total liabilities	<u>511,277,170</u>	<u>552,738,861</u>	<u>(41,461,691)</u>
Net Assets:			
Invested in capital assets, net of related debt	114,529,968	85,226,509	29,303,459
Restricted*	-	6,996,471	(6,996,471)
Unrestricted (deficit)	(2,505,632)	17,572,419	(20,078,051)
Total net assets	<u>\$ 112,024,336</u>	<u>\$ 109,795,399</u>	<u>\$ 2,228,937</u>

* The 2010 amount for restricted net assets for debt service was offset by an equivalent amount of outstanding bonds payable to conform with the current year's presentation.

The assets of L&P exceeded its liabilities at the close of the most recent fiscal year by \$112,024,336 (*net assets*).

The category of L&P's net assets with the largest balance totaling \$114,529,968 (102%) represents resources that are invested in capital assets, net of related debt.

The remaining category of net assets, totaling \$(2,505,632) (-2%) represents a deficit in unrestricted net assets that is expected to be recovered from L&P's future revenues.

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Management's Discussion and Analysis (Continued)
For the Fiscal Year Ended June 30, 2011
(Unaudited)

Activities, net assets:

- Current and other assets decreased \$67,872,364 from the prior year due primarily to a \$17,117,637 decrease in cash and investments, now restricted for debt service, a \$20,145,886 decrease in advance to City, to account for environmental emission credits, a \$28,578,342 decrease in prepaid natural gas, as a result of amortization during the year, and a \$3,921,843 decrease in deposits and prepaid expenses due to collateral transactions on investment derivatives.
- Capital assets increased \$29,038,626 from the prior year due primarily to a \$7,420,200 addition to non-depreciable capital assets, a \$1,798,047 addition to depreciable capital assets net of accumulated depreciation, and an increase in intangible capital assets of \$20,145, 886, in the form of environmental emission credits that L&P received from the City as repayment of advances (See Notes 4 and 5).
- Current liabilities decreased \$10,902,791 from the prior year due primarily to a \$5,557,219 decrease in the fair value of derivative liabilities and a \$5,738,399 decrease in deferred gain from sale of generation assets, due to the annual amortization of the gain (See Notes 7 and 10).
- Long-term liabilities decreased \$30,558,900 from the prior year due primarily to a \$3,985,174 decrease in the deferred gain from the sale of generation assets due to a reclassification to current and a \$26,594,810 decrease in long-term bonds payable, net, due to annual principal payments.
- Unrestricted net assets (deficit) decreased \$20,078,051 from the prior year due primarily to a \$29,303,459 increase in investment in capital assets, net of related debt, offset by an increase in net assets from current year's activities of \$2,228,937. In addition, restricted net assets decreased from the prior year because the restriction on amounts set aside for capacity payments expired in the current year.

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Management's Discussion and Analysis (Continued)
For the Fiscal Year Ended June 30, 2011
(Unaudited)

Changes in Net Assets

The table below summarizes L&P's changes in net assets over the current and prior fiscal years. The details of the current year's changes in net assets can be found on page 10 of this report.

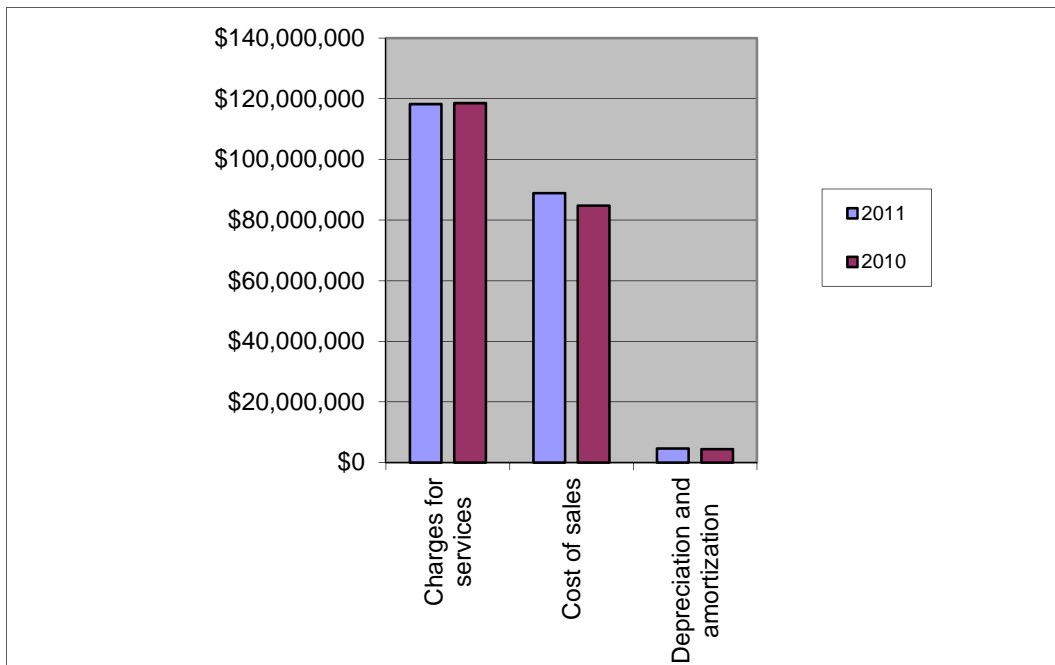
	2011	2010	Change
Operating revenues:			
Charges for services	\$ 118,186,124	\$ 118,589,706	\$ (403,582)
Operating expenses:			
Cost of sales	88,451,984	84,727,883	3,724,101
Depreciation and amortization	4,579,467	4,364,408	215,059
Total operating expenses	93,031,451	89,092,291	3,939,160
Operating income	25,154,673	29,497,415	(4,342,742)
Nonoperating revenues (expenses):			
Investment loss	(4,404,954)	(10,281,703)	5,876,749
Net increase (decrease) in fair value of investments	5,064,029	(9,966,275)	15,030,304
Interest expense	(20,435,035)	(21,340,935)	905,900
Other expense	(3,149,776)	(13,730,038)	10,580,262
Total nonoperating revenues (expenses), net	(22,925,736)	(55,318,951)	32,393,215
Income (loss) before special item	2,228,937	(25,821,536)	28,050,473
Special item:			
Gain on sale of land	-	6,892,938	(6,892,938)
Change in net assets	2,228,937	(18,928,598)	21,157,535
Net assets- beginning of year	109,795,399	128,723,997	(18,928,598)
Net assets- end of year	\$ 112,024,336	\$ 109,795,399	\$ 2,228,937

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Management's Discussion and Analysis (Continued)
For the Fiscal Year Ended June 30, 2011
(Unaudited)

L&P's activities increased net assets by \$2,228,937. The key reasons for this increase in change in net assets are as follows:

- L&P's operating expenses were \$93,041,451 for the current year, which is \$3,939,160 higher than the previous year. This increase was mainly due to an increase in capacity cost offset by a decrease in natural gas price used to generate energy during the year.
- Investment loss was \$4,404,954 for the current year, which is \$5,876,749 lower than the previous year. This decrease was mainly due to termination of interest rate swaps during 2010. (See Note 7 for additional information on derivative instruments).
- Net increase in fair value of investments was \$5,064,029 for the current year, which is \$15,030,304 higher than the previous year. This increase was caused by an increase in long-term interest rates during the year, which decreased the derivatives liability. (See Note 7 for additional information on derivative instruments).
- Other expense was \$3,149,776 for the current year, which is \$10,580,262 lower than the previous year. The decrease resulted from a reduction in transfers to the City General and Gas Fund. (See Note 4 for additional information on related party transactions).

Operating Revenues and Expenses
For the Fiscal Years Ended June 30, 2011 and 2010



L&P's unrestricted net assets at the end of the year amounted to a deficit of \$2,505,632 after the increase in net assets of \$2,228,937 in the current year. L&P expects to eliminate this deficit balance through future rate increases, cost reduction, and revenues from renewable energy projects.

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Management's Discussion and Analysis (Continued)
For the Fiscal Year Ended June 30, 2011
(Unaudited)

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital assets.

L&P's investment in capital assets as of June 30, 2011 amounted to \$158,026,213 (net of accumulated depreciation). This investment in capital assets includes land, intangible assets, construction in progress, building, utilities system improvements, and machinery and equipment. The total increase in L&P's investment in capital assets for the current fiscal year was \$29,038,626, due primarily to increases in L&P's intangible assets of \$20,145,886 related to the City's contribution of environmental emission credits, construction in progress for renewable energy and an addition to its distribution plant (See Note 5).

Additional information on the L&P's capital assets can be found in Note 5 on page 22 of this report.

Outstanding debt

During the fiscal year 2009, a total of \$463,165,000 in long-term obligations were issued and as of June 30, 2011, \$431,615,000 remained outstanding consisting of the following (See Note 6 for additional information on long-term obligations):

- \$43,500,000 City of Vernon Electric System Revenue Bonds, 2008 Taxable Series A
- \$388,115,000 City of Vernon Electric System Revenue Bonds, 2009 Series A

The City of Vernon Electric System Revenue Bonds, 2008 Taxable Series A were issued to provide funds to (i) finance the cost of certain capital improvements to the City's Electric System, (ii) fund a deposit to the Debt Service Reserve Fund, and (iii) to pay costs of issuance of the 2008 Bonds.

The City of Vernon Electric System Revenue Bonds, 2009 Series A were issued to provide funds to (i) refinance certain obligations payable from the City's Electric System Revenues, (ii) fund a deposit to the Debt Service Reserve Fund, and (iii) to pay costs of issuance of the 2009 Bonds.

As of June 30, 2011, all bonds issued by L&P had a rating of A- by S&P and A3 by Moody's and have not changed from the prior year.

On December 9, 2010, Moody's Investors Service put on a Watchlist for a possible downgrade, the A3 ratings on the City of Vernon's, Electric System Revenue Bonds, 2008 Taxable Series A and Electric System Revenue Bonds 2009 Series A.

On March 21, 2011, Moody's Investors Service affirmed the A3 ratings with negative outlook.

On December 2, 2011, Moody's Investors Service downgraded the A3 ratings to Baa1.

The change in outstanding debt for the year ended June 30, 2011 was due to the principal payments of \$26,550,000 on the Electric System Revenue Bonds.

Additional information on the City's long-term debt can be found in Note 6 on pages 23-25 of this report.

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Management's Discussion and Analysis (Continued)
For the Fiscal Year Ended June 30, 2011
(Unaudited)

ECONOMIC FACTORS AND NEW YEAR'S BUDGET AND RATES

These factors were considered in preparing L&P's budget for the 2012 fiscal year.

- The City is strictly industrial and does not maintain an unemployment rate study of its small population. However, the unemployment rate of adjacent communities is currently 11.6%. This compares favorably to the state's average unemployment rate of 11.8% but unfavorably to the national average unemployment rate of 9.2%.
- The occupancy rate of the City's central business district has remained at 96.7% 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 L&P's finances for all those with an interest in L&P's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Director of Finance, City of Vernon, 4305 Santa Fe Avenue, Vernon, California, 90058.

CITY OF VERNON, CALIFORNIA
Light and Power Department Fund
Statement of Fund Net Assets
June 30, 2011

ASSETS:

Current assets:

Cash and investments	\$	50,848,937
Accounts receivable, net of allowances of \$50,000		1,873,918
Accrued unbilled revenue		7,477,754
Accrued interest receivable		267,520
Bond issuance costs		246,533
Due from City		17,236,990
Inventories		10,564,158
Prepaid natural gas		28,631,088
Note receivable		200,060
Deposits and prepaid expenses		6,929,812
Total current assets		124,276,770

Noncurrent assets:

Restricted cash and investments		55,875,012
Advances to City		25,144,192
Prepaid natural gas		254,359,472
Note receivable		2,418,748
Bond issuance costs		3,201,099
Capital assets:		
Nondepreciable		64,720,406
Depreciable, net		93,305,807
Total noncurrent assets		499,024,736
Total assets		623,301,506

LIABILITIES:

Accounts payable		7,156,542
Customer deposits		440,375
Derivative liabilities		25,677,872
Bond interest		10,374,076
Long-term liabilities:		
Due within one year:		
Deferred gain from sale of generation assets		3,945,235
Bonds payable, net		26,594,810
Compensated absences		229,416
Total current liabilities		74,418,326
Due in more than one year:		
Deferred gain from sale of generation assets		43,043,813
Bonds payable, net		393,356,199
Compensated absences		458,832
Total noncurrent liabilities		436,858,844
Total liabilities		511,277,170

NET ASSETS:

Invested in capital assets, net of related debt		114,529,968
Unrestricted (deficit)		(2,505,632)
Total net assets		\$ 112,024,336

See accompanying notes to the basic financial statements.

CITY OF VERNON, CALIFORNIA
Light and Power Department Fund
Statement of Revenues, Expenses and Changes in Fund Net Assets
For the Fiscal Year Ended June 30, 2011

OPERATING REVENUES:	
Charges for services	\$ 118,186,124
Total operating revenues	<u>118,186,124</u>
OPERATING EXPENSES:	
Cost of sales	88,451,984
Depreciation and amortization	4,579,467
Total operating expenses	<u>93,031,451</u>
Operating income	25,154,673
NONOPERATING REVENUES (EXPENSES):	
Investment loss	(4,404,954)
Net increase in fair value of investments	5,064,029
Interest expense	(20,435,035)
In-lieu taxes to City	(3,149,776)
Total nonoperating (expenses)	<u>(22,925,736)</u>
Change in net assets	2,228,937
Net assets, beginning of the year	<u>109,795,399</u>
Net assets, end of the year	<u>\$ 112,024,336</u>

See accompanying notes to the basic financial statements.

CITY OF VERNON, CALIFORNIA
Light and Power Department Fund
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2011

Cash flows from operating activities:	
Cash received from customers and City	\$ 116,140,460
Cash paid to suppliers for goods and services	(59,032,764)
Cash paid to City for administrative and overhead costs	(2,872,661)
Cash paid to employees for services	(3,923,869)
Net provided by operating activities	<u>50,311,166</u>
Cash flows from noncapital financing activities:	
Transfer of in-lieu taxes to City	(3,149,776)
Collection of note receivable	334,236
Net cash used in noncapital financing activities	<u>(2,815,540)</u>
Cash flows from capital and related financing activities:	
Repayment of bonds	(26,550,000)
Bond interest paid	(23,466,355)
Acquisition and construction of capital assets	(10,196,836)
Net cash used in capital and related financing activities	<u>(60,213,191)</u>
Cash flows from investing activities:	
Purchases and sales of investments, net	(873,554)
Investment loss net of interest rate swap payments on investment derivatives	(4,344,629)
Net cash used in investing activities	<u>(5,218,183)</u>
Net decrease in cash and cash equivalents	(17,935,748)
Cash and cash equivalents, beginning of year	<u>77,693,031</u>
Cash and cash equivalents, end of year	<u>\$ 59,757,283</u>
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ 25,154,673
Adjustments to reconcile operating income to net cash used in operating activities:	
Depreciation and amortization	4,579,467
Changes in operating assets and liabilities:	
Decrease (increase) in:	
Accounts receivable and due from City	(1,374,630)
Accrued unbilled revenue	(671,034)
Inventories	(186,774)
Prepaid expenses and deposits	3,921,843
Prepaid natural gas	28,578,342
Increase (decrease) in:	
Accounts payable	180,222
Accrued wages and benefits	(126,736)
Customer deposits	(52,260)
Compensated absences	31,626
Deferred gain from sale of generation assets	(9,723,573)
Net cash provided by operating activities	<u>\$ 50,311,166</u>
Reconciliation of cash and cash equivalents to Statement of Net Assets	
Cash and investments	\$ 50,848,937
Noncurrent restricted cash and investments	<u>55,875,012</u>
Total	106,723,949
Less: Investments with maturities of more than 90 days	<u>(46,966,666)</u>
Total cash and cash equivalents	<u>\$ 59,757,283</u>
Noncash Capital, Investing and Financing Activities	
Acquisition of capital assets in accounts payable	\$ 480,237
Increase in fair value of investments	5,064,029
Amortization of deferred gain from sale of generation assets	2,728,773
Advance from City	20,145,886

See accompanying notes to the basic financial statements.

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
June 30, 2011

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Light and Power Department Fund (L&P), an Enterprise Fund, 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 L&P's accounting policies are described below.

Reporting Entity

The City of Vernon (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.

The City's L&P exists as a separate department of the City under and by virtue of the City Charter enacted in 1988. L&P was established, as a separate department by Section 2.64 of the City Code to be used for the collection of revenues and the payment of expenses for the City's electric utility plant.

As required by generally accepted accounting principles, the accompanying basic financial statements present the L&P and its component unit, an entity for which the City is considered to be financially accountable. In accordance with GASB Statement No. 14, the City's component unit is considered a blended component unit in the L&P fund. Although a legally separate entity, it is, in substance, part of L&P's operations, and therefore, data from this unit is combined with data of L&P.

Blended Component Unit

Vernon Natural Gas Financing Authority

On April 1, 2006, the City and the Vernon Redevelopment Agency (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 L&P. 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. The Authority bonds were refunded in fiscal year 2009 and replaced with fixed rate Electric System bonds. As a result of this financing arrangement, the debt and related asset (prepaid natural gas) associated with the Authority have been blended with L&P for financial reporting purposes.

Basis of Presentation

L&P accounts for the maintenance and operations of the City's electric utility plant. Revenue for L&P is primarily from charges for services.

L&P's 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.

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
June 30, 2011

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

L&P distinguishes *operating* revenues and expenses from *nonoperating* items. *Operating* revenues, such as charges for services, result from exchange transactions associated with the sale of electricity. 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.

For the L&P financial statements, under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, L&P applies 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. L&P has elected to not apply private-sector accounting standards issued after November 30, 1989.

L&P's policy regarding whether to first apply restricted or unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available is to use restricted resources first.

Cash Deposits and Investments

For purposes of the statement of cash flows, L&P considers amounts on deposit in the L&P's cash and investment pool and 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 L&P 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.

Receivables

Short-term receivables from the City are classified as "due from City" on the statement of fund net assets. Long-term receivables from the City are classified as "advances to City," on the statement of fund net assets.

Trade receivables are shown net of an allowance for uncollectible accounts. Allowances for uncollectibles were \$50,000 as of June 30, 2011. Utility customers are billed monthly. The estimated value of services provided, but unbilled at year-end has been included in the accompanying financial statements.

Inventories

All inventories are valued at cost using the first-in/first-out (FIFO) method. Inventory costs are recorded as an expense when used.

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
June 30, 2011

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 value on the date contributed. Capital assets include land, intangible assets, construction in progress, and plant assets including building, improvements, and machinery and equipment. 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. Intangible assets with an indefinite useful life are not amortized but are evaluated annually for any impairment.

The estimated useful lives are as follows:

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. Interest 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 for both taxable and tax-exempt securities. For tax-exempt securities, interest income on unspent bond proceeds is also capitalized during the construction phase.

Compensated Absences

Accumulated vacation is accrued when incurred. Upon termination of employment, the City will pay the employee all accumulated vacation leave at 100% of the employee's base hourly rate.

Long-term Obligations

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

L&P 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 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.

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
June 30, 2011

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- Unrestricted Net Assets – This category represents net assets of L&P not restricted for any project or other purpose.

Use of Estimates

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

NOTE 2 – CASH AND INVESTMENTS

Cash and Investments

Cash and investments as of June 30, 2011 are classified in the accompanying statement of fund net assets as follows:

Statement of fund net assets:	
Cash and investments	\$ 50,848,937
Restricted cash and investments	55,875,012
Total cash and investments	<u>\$ 106,723,949</u>

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

Deposits with financial institutions	\$ 29,133,101
Investments	77,590,848
Total cash and investments	<u>\$ 106,723,949</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.

**CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
June 30, 2011**

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

The Investment Policy also requires that when following the investing actions cited above, 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

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	Minimum Rating
Securities of the U.S. Government, or it agencies	5 years	None	None	None
Certain Asset-Backed Securities	5 years	None	None	AA
Certificates of Deposit	5 years	30%	None	None
Bankers' Acceptances	180 days	40%	30%	None
Commercial Paper	270 days	25%	10%	P-1
Repurchase Agreements	1 year	None	None	None
Reverse Repurchase Agreements	92 days	20%	None	None
Medium-Term Notes	5 years	30%	None	A
Mutual Funds investing in eligible securities	N/A	20%	10%	AAA
Money Market Mutual Funds	N/A	20%	10%	AAA
Mortgage Pass-Through Securities	5 years	20%	None	AA
State Administered Pool Investment	N/A	None	None	None

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

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
June 30, 2011

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

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	Minimum Rating
Securities of the U.S. Government, or it agencies	None	None	None	None
Certain Asset-Backed Securities	None	None	None	AA
Certificates of Deposit	None	None	None	None
Bankers' Acceptances	1 year	None	None	None
Commercial Paper	None	None	None	P-1
Money Market Mutual Funds	N/A	None	None	AAA
State Administered Pool Investment	N/A	None	None	None
Investment Contracts	None	None	None	None

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 has no specific limitations with respect to this metric.

Investment Type	Fair Value as of June 30, 2011	Investment Maturities (in Months)					% of Total
		Less Than 12 Months	13 to 24 Months	25 to 36 Months	37 to 48 Months	49 to 60 Months	
Federal Home Loan	\$ 9,140,388	\$ -	\$ 9,140,388	\$ -	\$ -	\$ -	11.78%
Federal National Mortgage Association	4,473,987	-	4,473,987	-	-	-	5.77%
Local Agency Investment Fund	536,296	536,296	-	-	-	-	0.69%
Money Market Mutual Fund	30,087,886	30,087,886	-	-	-	-	38.78%
United States Treasury Notes	33,352,291	2,169,953	20,142,887	11,039,451	-	-	42.98%
Total investments	\$ 77,590,848	\$ 32,794,135	\$ 33,757,262	\$ 11,039,451	\$ -	\$ -	100.00%

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
June 30, 2011

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 Moody's / S&P	Actual Credit Rating Moody's / S&P	Fair Value as of June 30, 2011	% of Total
In custody of Treasurer:				
Investments held by Treasurer:				
Local Agency Investment Fund	Not Rated	Not Rated	\$ 536,296	0.69%
Money Market Mutual Fund	Aaa/AAA	Aaa/AAA	41,433	0.05%
Total in custody of Treasurer			577,729	0.74%
In custody of Trustee:				
Investments held by Trustee:				
Money Market Mutual Fund	Aaa / AAA	Aaa / AAA	\$ 30,046,453	38.73%
Federal Home Loan Bank	Aaa / AAA	Aaa / AAA	9,140,388	11.78%
Federal National Mortgage Association	Aaa / AAA	Aaa / AAA	4,473,987	5.77%
United States Treasury Notes	Aaa / AAA	Aaa / AAA	33,352,291	42.98%
Total in custody of Trustee			77,013,119	99.26%
Total investments			\$ 77,590,848	100.00%

**CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
June 30, 2011**

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 and a 30% limitation on bankers acceptances. The City's Investment Policy also places no limit on the amount of debt proceeds held by bond trustee that the trustee may invest in one issuer 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. As of June 30, 2011, the L&P's investments in any one issuer exceeding 5% were as follows:

Issuer	In Custody of	Fair Value as of June 30, 2011	%
			of Total
Federal National Mortgage Association	FNMA	Trustee \$ 4,473,987	5.77%
Federal Home Loan	FHLB	Trustee 9,140,388	11.78%

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. Under the California Government Code, a financial institution is required to secure deposits in excess of FDIC insurance of \$250,000 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.

At year-end, the carrying amount of the L&P's deposits was \$29,133,101 and the bank balance was \$29,278,483. The difference between the bank balance and the carrying amount represents outstanding checks and deposits in transit. As of June 30, 2011, none of L&P's deposits with financial institutions in excess of federal depository insurance limit were held in uncollateralized accounts. \$28,778,483 was collateralized by the pledging financial institution as required by Section 53652 of the California Government Code.

**CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
June 30, 2011**

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

Local Agency Investment Fund (LAIF)

L&P also maintained cash balances with the State of California Local Agency Investment Fund (LAIF) amounting to \$536,296 at June 30, 2011. 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 L&P's position in the pool.

The total amount invested by all public agencies in LAIF at June 30, 2011 was \$23,983,771,875. LAIF is part of the State of California Pooled Money Investment Account (PMIA) whose balance was \$66,352,783,817 at June 30, 2011. Of this amount, 5.01% was invested in structured 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 0.65 years as of June 30, 2011. LAIF does not maintain a credit rating.

NOTE 3 – ACCOUNTS RECEIVABLES

The L&P's accounts receivables at June 30, 2011 are as follows:

Accounts	\$ 1,923,918
Allowances	<u>(50,000)</u>
Total receivables	<u><u>\$ 1,873,918</u></u>

NOTE 4 – RELATED PARTY TRANSACTIONS

Transactions between L&P and the City commonly occur in the normal course of business for services received or furnished (accounting, management, engineering, and legal services).

The following table summarizes L&P's short-term balances and transactions at June 30, 2011:

Due To/From City

Due from City, July 1, 2010	\$ 16,129,388
Amounts paid on behalf of City	<u>1,107,602</u>
Due from City, June 30, 2011	<u><u>\$ 17,236,990</u></u>

**CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
June 30, 2011**

NOTE 4 – RELATED PARTY TRANSACTIONS (CONTINUED)

Transactions between L&P and the City occur occasionally to fund capital projects on behalf of one another such as the City’s natural gas system and the development of the City’s base load electric generating station.

The following table summarizes L&P’s long-term loan balances and transactions at June 30, 2011:

Advances to City

Advance to City, July 1, 2010	\$ 45,290,078
Loan repayment from City	<u>(20,145,886)</u>
Advance to City, June 30, 2011	<u>\$ 25,144,192</u>

The loan between the City and L&P does not accrue interest due to the nature of capital projects funded by L&P that benefit both. During the current year, the City repaid L&P \$20,145,886 in the form of environmental emission credits. The environmental emission credits are reported as part of capital assets under the intangible assets-environmental credits category.

Operating Expenses

The City allocates certain administrative and overhead costs to L&P which L&P financial statements include as part of cost of sales. These costs for the year ended June 30, 2011 were as follows:

City Administration	\$ 288,393
City Garage	183,936
City Warehouse	221,075
Police	238,601
Fire	192,770
Finance	452,768
Treasurer	216,748
Purchasing	249,312
Risk Management / Insurance	<u>829,058</u>
Total	<u>\$ 2,872,661</u>

Nonoperating Expenses

L&P’s electric retail rates are established by the City Council and are not subject to regulation by the California Public Utility Commission or any other state agency. The retail rates include a 3% surcharge for payments in lieu of franchise tax to the City’s General Fund. For the current year, L&P paid the City’s General Fund \$3,149,776 for in lieu of franchise tax.

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
June 30, 2011

NOTE 5 – CAPITAL ASSETS

Capital asset activity of L&P for the fiscal year ended June 30, 2011 was as follows:

	Balance June 30, 2010	Additions	Deletions	Transfers & Adjustments	Balance June 30, 2011
<i>Capital assets, not being depreciated:</i>					
Land	\$ 9,276,596	\$ -	\$ -	\$ -	\$ 9,276,596
Intangibles - Environmental credits	-	-	-	20,145,886	20,145,886
Construction in progress	27,959,849	7,420,200	-	(82,125)	35,297,924
Total capital assets, not being depreciated	<u>37,236,445</u>	<u>7,420,200</u>	<u>-</u>	<u>20,063,761</u>	<u>64,720,406</u>
<i>Capital assets, being depreciated</i>					
Production plant	14,765,324	-	-	19,033	14,784,357
Transmission plant	4,817,929	70,184	-	-	4,888,113
Distribution plant	117,055,045	6,060,797	(328,330)	64,186	122,851,698
General plant	8,087,826	-	-	(1,086)	8,086,740
Total capital assets, being depreciated	<u>144,726,124</u>	<u>6,130,981</u>	<u>(328,330)</u>	<u>82,133</u>	<u>150,610,908</u>
Less accumulated depreciation for:					
Production plant	(5,852,638)	(421,395)	-	(344)	(6,274,377)
Transmission plant	(2,372,128)	(96,472)	-	-	(2,468,600)
Distribution plant	(43,219,234)	(3,339,767)	2,815	127	(46,556,059)
General plant	(1,530,982)	(475,300)	-	217	(2,006,065)
Total accumulated depreciation	<u>(52,974,982)</u>	<u>(4,332,934)</u>	<u>2,815</u>	<u>-</u>	<u>(57,305,101)</u>
Total capital assets, being depreciated, net					
Production plant	8,912,686	(421,395)	-	18,689	8,509,980
Transmission plant	2,445,801	(26,288)	-	-	2,419,513
Distribution plant	73,835,811	2,721,030	(325,515)	64,313	76,295,639
General plant	6,556,844	(475,300)	-	(869)	6,080,675
Total	<u>91,751,142</u>	<u>1,798,047</u>	<u>(325,515)</u>	<u>82,133</u>	<u>93,305,807</u>
Business-type activities capital assets, net	<u>\$ 128,987,587</u>	<u>\$ 9,218,247</u>	<u>\$ (325,515)</u>	<u>\$ 20,145,894</u>	<u>\$ 158,026,213</u>

During the current year, the City repaid \$20,145,886 of advances from L&P in the form of environmental emission credits.

Depreciation

L&P's total depreciation expense for the year was \$4,332,934.

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
June 30, 2011

NOTE 6 – LONG-TERM OBLIGATIONS

During the fiscal year 2009, a total of \$463,165,000 in long-term obligations were issued and as of June 30, 2011, \$431,615,000 remained outstanding consisting of the following:

- \$43,500,000 City of Vernon Electric System Revenue Bonds, 2008 Taxable Series A
- \$388,115,000 City of Vernon Electric System Revenue Bonds, 2009 Series A

The 2008 Electric System Revenue Bonds are special obligations of the City, which are secured by an irrevocable pledge of electric revenues payable to bondholders. The debt service remaining on the bonds is \$116,576,409, payable through 2038. For the current year, debt service and total electric revenues were \$3,975,755 and \$118,186,124, respectively. Under the Indenture of Trust dated September 1, 2008, interest and principal on the bonds are payable from Net Revenues (or Revenues less Operation and Maintenance Expenses) and/or amounts in the L&P (as those terms are defined in the Indenture of Trust). The City of Vernon Electric System Revenue Bonds, 2008 Taxable Series A were issued to provide funds to (i) finance the cost of certain capital improvements to the City's Electric System, (ii) fund a deposit to the Debt Service Reserve Fund, and (iii) to pay costs of issuance of the 2008 Bonds.

The 2009 Electric System Revenue Bonds are special obligations of the City, which are secured by an irrevocable pledge of electric revenues payable to bondholders. The debt service remaining on the bonds is \$506,476,046, payable through 2022. For the current year, debt service and total electric revenues were \$46,040,600 and \$118,186,124, respectively. Under the Indenture of Trust dated September 1, 2008, interest and principal on the bonds are payable from Net Revenues (or Revenues less Operation and Maintenance Expenses) and/or amounts in the L&P (as those terms are defined in the Indenture of Trust). The City of Vernon Electric System Revenue Bonds, 2009 Series A were issued to provide funds to (i) refinance certain obligations payable from the City's Electric System Revenues, (ii) fund a deposit to the Debt Service Reserve Fund, and (iii) to pay costs of issuance of the 2009 Bonds.

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
June 30, 2011

NOTE 6 – LONG-TERM OBLIGATIONS (CONTINUED)

A summary of bonds payable for L&P is as follows:

Bonds	Maturity	Fixed Interest Rates	Annual Principal Installments	Original Issue Amount	Outstanding at June 30, 2011
<i>City of Vernon Electric System Revenue Bonds, 2008 Taxable Series A</i>	07/01/38	7.400% - 8.590%	To begin 07/01/10: \$265,000 - \$4,065,000	\$ 43,765,000	\$ 43,500,000
<i>City of Vernon Electric System Revenue Bonds, 2009 Series A</i>	08/01/21	3.000% - 5.125%	To begin 08/01/09: \$5,000,000 - \$44,895,000	419,400,000	388,115,000
<i>Discounts</i>					(3,467,906)
<i>Deferred amount on refunding</i>					(8,196,085)
<i>Total Revenue Bonds</i>				<u>\$ 463,165,000</u>	<u>\$ 419,951,009</u>

As of June 30, 2011, annual debt service requirements of L&P to maturity are as follows:

Fiscal year ending June 30:	Electric System Revenue Bonds 2008 Taxable Series A	
	Principal	Interest*
2012	\$ 285,000	\$ 3,690,405
2013	305,000	3,668,575
2014	330,000	3,645,080
2015	355,000	3,619,735
2016	385,000	3,592,355
2017-2021	3,000,000	17,408,713
2022-2026	5,640,000	15,553,486
2027-2031	8,670,000	12,525,082
2032-2036	13,315,000	7,872,520
2037-2039	11,215,000	1,500,458
Total requirements	<u>\$ 43,500,000</u>	<u>\$ 73,076,409</u>

*As of June 30, 2011, debt service for 2008 Series A, was calculated based upon fixed coupon rates of 7.40% and 8.59%.

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
June 30, 2011

NOTE 6 – LONG-TERM OBLIGATIONS (CONTINUED)

Fiscal year ending June 30:	Electric System Revenue Bonds 2009 Series A	
	Principal	Interest*
2012	\$ 27,370,000	\$ 18,674,350
2013	28,680,000	17,363,100
2014	29,930,000	16,110,638
2015	31,295,000	14,748,957
2016	32,970,000	13,071,088
2017-2021	192,975,000	37,242,479
2022	44,895,000	1,150,434
Total requirements	<u>\$ 388,115,000</u>	<u>\$ 118,361,046</u>

*As of June 30, 2011, debt service was calculated based upon the fixed coupon rates of the bonds ranging from 3.000% to 5.125%.

Changes in long-term liabilities

The following is a summary of long-term liabilities transactions for the fiscal year ended June 30, 2011:

	Balance July 1, 2010	Additions	Reductions	Balance June 30, 2011	Due Within One Year
Bonds payable	\$ 458,165,000	\$ -	\$ (26,550,000)	\$ 431,615,000	\$ 27,655,000
Bond discount	(3,782,997)	-	315,091	(3,467,906)	(315,091)
Deferred amount on refunding	(8,941,184)	-	745,099	(8,196,085)	(745,099)
Compensated absences	656,622	250,500	(218,874)	688,248	229,416
	<u>\$ 446,097,441</u>	<u>\$ 250,500</u>	<u>\$ (25,708,684)</u>	<u>\$ 420,639,257</u>	<u>\$ 26,824,226</u>

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
June 30, 2011

NOTE 7 – DERIVATIVE INSTRUMENTS

In prior years, the City acquired derivative instruments to reduce its overall exposure to interest rate and commodity priced risk and to achieve a lower cost of capital and commodity. As of June 30, 2011, all derivative instruments have been classified as investment derivative instruments under GASB 53, *Accounting and Financial Reporting for Derivative Instruments*, with the following instruments outstanding:

Item	Type	Objective	Notional Amount	Effective Date	Maturity Date	Term	Fair Value
A	Variable to Fixed Swap	Reduce overall exposure to interest rate risk and achieve lower cost of capital for the 2004 Series A Bonds	\$ 90,150,000	December 2004	April 2037	Receive 62.87% of LIBOR one-month index plus 0.119%, pay 3.607%	\$ (14,504,270)
B	Variable to Fixed Swap	Reduce overall exposure to interest rate risk and achieve lower cost of capital for the 2004 Series B Bonds	83,575,000	December 2004	April 2029	Receive 62.87% of LIBOR one-month index plus 0.119%, pay 3.542%	(11,173,602)

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
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NOTE 7 – DERIVATIVE INSTRUMENTS (CONTINUED)

A - 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 rate 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. In April 2008, the City redeemed its 2004 Series A Bonds.

Fair value: As of June 30, 2011, the swap had a negative fair value of \$14,504,270. 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, 2011 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, 2011, the swap counterparty, Morgan Stanley was rated A by Standard & Poor's and A2 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. The City is obligated to post collateral to Morgan Stanley if the City's negative fair value in the aggregate exceeds \$20,000,000. At June 30, 2011, the City posted collateral of \$5,677,872 on the 2004 Series A Bonds and the 2004 Series B Bonds as the aggregate negative fair value of \$25,677,872 exceeded \$20,000,000.

Interest rate risk: The swap increases the City's exposure to interest rate risk. As LIBOR decreases, the City's net payments in 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, the 2004 Series A Bonds, has been redeemed.

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
June 30, 2011

NOTE 7 – DERIVATIVE INSTRUMENTS (CONTINUED)

B - 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 rate 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 original 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 0.119%. On March 16, 2006, the City revised its fixed payment to 3.542% to the counterparty. In April 2008, the City redeemed its 2004 Series B Bonds.

Fair value: As of June 30, 2011, the swap had a negative fair value of \$11,173,602. 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, 2011 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, 2011, the swap counterparty, Morgan Stanley was rated A by Standard & Poor's and A2 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. The City is obligated to post collateral to Morgan Stanley if the City's negative fair value in the aggregate exceeds \$20,000,000. At June 30, 2011, the City posted collateral of \$5,677,872 on the 2004 Series A Bonds and the 2004 Series B Bonds as the aggregate negative fair value of \$25,677,872 exceeded \$20,000,000.

Interest rate risk: The swap increases the City's exposure to interest rate risk. As LIBOR decreases, the City's net payments in 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, the 2004 Series B Bonds, has been redeemed.

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
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NOTE 7 – DERIVATIVE INSTRUMENTS (CONTINUED)

C - Change in Fair Value of Derivative Instruments

The fair value balance and notional amount of the derivative instrument outstanding at June 30, 2011, classified by type, and the change in fair value of such derivative instrument for the year then ended as reported in the current year financial statements are as follows:

	Change in Fair Value		Fair Value at June 30, 2011		Notional
	Classification	Amount	Classification	Amount	
Investment derivative instruments					
Variable to Fixed Swaps					
2004 Series A Bonds	Increase in fair value	\$ 3,555,423	Derivative liability	\$ (14,504,270)	\$ 90,150,000
2004 Series B Bonds	Increase in fair value	2,001,796	Derivative liability	(11,173,602)	83,575,000

The net increase in fair value of investments on the 2004 A and 2004 B swaps during the year was \$5,557,219. The change in fair value subsequent to June 30, 2011 is discussed in Note 13.

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
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NOTE 8 – RISK MANAGEMENT

L&P is in the City's self-insurance program as part of its policy to self-insure certain levels of risk within separate lines of coverage to maximize cost savings.

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 and retirees. The City is self-insured for its general liability, workers' compensation, and property liability. The City has chosen to establish risk financing in the General Fund at the beginning of this fiscal year, 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, 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. In the most recent "Statement of Values" for the City, real and personal property total insured values equaled \$315,558,969. Property & Boiler & Machinery Coverage is written through Travelers Insurance Company.

Crime, which includes Employee Theft, Forgery Alteration, Computer Fraud, etc., coverage is also in force with a limit of \$1,000,000 for each line of coverage with a deductible of \$25,000. Crime coverage is written through Chartis Insurance.

Excess liability coverage is provided by a stand-alone policy purchased by the City. Excess coverage is provided by the Everest National Insurance Company. Excess workers' compensation coverage is provided by a stand-alone policy purchased through New York Marine and General Insurance Company.

The City is self-insured for the first \$1,000,000 of workers' compensation claims and for the first \$2,000,000 of its general liability coverage. Athens Administrators, which was formally known as York Insurance Services Group, Inc., is the Third Party Administrator for the City's workers' compensation claims. The City self-administers its general liability claims. Workers' compensation and general liability loss run reports are prepared by Athens Administrators.

The City is insured for pollution conditions that arise at city owned property with a limit of \$1,000,000 with a deductible of \$25,000.

**CITY OF VERNON, CALIFORNIA
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Notes to Basic Financial Statements
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NOTE 8 – RISK MANAGEMENT (CONTINUED)

The insurance limits are as follows:

Type of Coverage	Self-Insured Retention	Excess	
		Limit	Carrier
General Liability	\$2,000,000	\$20,000,000	Everest National Insurance Co
Excess Workers' Compensation	\$1,000,000	\$50,000,000	New York Marine & General Insurance Co
Property:	\$100,000 deductible	\$100,000,000	Travelers Insurance Co
Blanket Building & Contents		Included	Travelers Insurance Co
Flood Sublimit – Annual		\$25,000,000	Travelers Insurance Co
Electronic Data Processing			
Equipment:		Included	Travelers Insurance Co
Newly Constructed or Acquired		\$5,000,000 sublimit with a 120 days reporting requirement	Travelers Insurance Co
Machinery Breakdown		\$50,000,000	Travelers Insurance Co
Pollution (City owned property)	\$25,000 deductible	\$1,000,000	Chubb Insurance (pollution legal liability and clean up)
Pollution (Waste Haulers and Landfills)		\$5,000,000	Great American
Crimes	\$25,000 deductible	\$1,000,000	Chartis Insurance

CITY OF VERNON, CALIFORNIA
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NOTE 8 – RISK MANAGEMENT (CONTINUED)

The City is self insured or pays the deductible stated above for general liability, workers' compensation, or property losses. 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 City charges L&P a premium based upon the proportional payroll cost. For the current fiscal year, L&P's proportional premium cost was \$829,058.

Further information regarding the City's self-insurance program may be found in the City's Annual Financial Report.

NOTE 9 – PENSION PLAN

L&P employees participate with other City employees in 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 "2.7% 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 "3% 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.

The State-required City employee salary contributions are 8% for miscellaneous employees and 9% for safety employees. In prior years, employee contributions were subsidized by the City, however, effective April 8, 2010 contributions were made by the employees. 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 and employees contribution to the PERS for the fiscal year ended June 30, 2011 was \$5,794,058 and \$1,864,275, respectively, of which L&P's employer and employees portions were \$499,547 and \$297,561, respectively. City contribution rates as a percentage of covered payroll were 13.475% for miscellaneous plan members and 25.372% for safety plan members.

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
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NOTE 9 – PENSION PLAN (CONTINUED)

The City’s contribution was made in accordance with actuarially determined requirements based on an actuarial valuation performed as of June 30, 2008.

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
2011	\$ 5,794,058	\$ 5,794,058	100%	-
2010	7,405,652	7,405,652	100%	-
2009	7,477,878	7,477,878	100%	-

The following schedules present the funded status as of June 30, 2010 based on actuarial assumptions consistent with the June 30, 2008 valuation described above (dollar amounts in millions).

Safety Plan Schedule of Funding Progress

Valuation Date	Actuarial Accrued Liability (AAL) (a)	Actuarial Value of Assets (b)	Unfunded AAL (a)–(b)	Funded Ratio (b)/(a)	Annual Covered Payroll (c)	UAAL as a % of Covered Payroll [(a)–(b)]/(c)
6/30/2010	\$170,104,557	\$142,251,795	\$27,852,762	83.6%	\$14,221,759	195.8%

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
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NOTE 9 – PENSION PLAN (CONTINUED)

Miscellaneous Plan Schedule of Funding Progress

Valuation Date	Actuarial Accrued Liability (AAL) (a)	Actuarial Value of Assets (b)	Unfunded AAL (a)–(b)	Funded Ratio (b)/(a)	Annual Covered Payroll (c)	UAAL as a % of Covered Payroll [(a)–(b)]/(c)
6/30/2010	\$107,971,777	\$92,640,731	\$15,331,046	85.8%	\$12,685,952	120.9%

Further information regarding the City’s pension plan may be found in the City’s Annual Financial Report.

NOTE 10 – LIGHT AND POWER OPERATIONS AND COMMITMENTS

Asset Sale

On December 13, 2007, the City entered into an Amended and Restated Purchase and Sale Agreement (the “Bicent Agreement”), with Bicent (California) Power LLC (“Bicent”), which is an affiliate of Bicent Holdings and Natural Gas Partners, to sell to Bicent the Malburg Generating Station (“MGS”) and the economic burdens and benefits of the City’s interests in 22 MW from the Hoover Dam Upgrading Project for \$287,500,000. This transaction closed on April 10, 2008.

Bicent has agreed to sell the capacity and the energy of the MGS to the City on the terms set forth in a Power Purchase Tolling Agreement, by and between the City and Bicent, dated as of April 10, 2008 (the “PPTA”). In addition, Bicent has acquired the benefits and burdens of the City’s interest in the Hoover Upgrading Project (described below) on the terms set forth in the Hoover Contract for Differences (“CFD”), between Bicent (California) Hoover LLC, a Delaware limited liability company (“BCH”) and the City, dated as of April 10, 2008 (the “Hoover Differences Contract”). Pursuant to the Bicent Agreement, Bicent has assigned its rights and obligations with respect to the MGS to its affiliate, Bicent (California) Malburg LLC, a Delaware limited liability company (“BCM”). Pursuant to the Bicent Agreement, Bicent has assigned its rights and obligations with respect to the economic benefits and burdens of the Hoover Upgrading Project to its affiliate, BCH. The City treated the PPTA as an asset lease-back transaction due to a 30 year ground lease between the City and BCM by deferring most of the gain from the sale of MGS to be amortized over the 15 year life of the PPTA. The City also deferred the gain from the CFD to be amortized over the 10 year life of the CFD. As of June 30, 2011, a deferred gain of \$46,989,048 remains to be amortized over the life of the PPTA and CFD which will be amortized in proportion to the capacity payments the City will be making under the PPTA and CFD (See Note 12 for disclosure on uncertainties).

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
June 30, 2011

NOTE 10 – LIGHT AND POWER OPERATIONS AND COMMITMENTS (CONTINUED)

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 2008, the Authority issued \$3.266 billion in debt of Power Project Revenue Bonds for the Station to finance the bonds and 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 took its proportionate share of the power generated and its proportionate share of costs during fiscal year 2011 was \$3,470,345. The City expects no significant increases in costs related to its nuclear resources.

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, 2011, the City’s total advances were \$6,690,998 for the upgrading program. At June 30, 2011, the outstanding note receivable was \$2,618,807. 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 \$334,236 due the City on the outstanding note receivable. The contract expires in September 2017.

**CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
June 30, 2011**

NOTE 10 – LIGHT AND POWER OPERATIONS AND COMMITMENTS (CONTINUED)

Power Purchase Commitments

As of June 30, 2011 under the Bicent Agreements, the City had the following long-term commitments to purchase power subject to certain conditions:

Fiscal Year	Amount*
2012	\$ 21,470,765
2013	21,470,765
2014	21,470,765
2015	21,470,765
2016	21,470,765
2017-2021	175,887,158
2022-2023	62,041,921
	<u>\$ 345,282,904</u>

*Commitments under the PPTA and CFD net of amortization of deferred gain.

NOTE 11 – POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS (OPEB)

The postemployment benefit described in the following paragraphs relate to the City in which L&P is a department. Information relating to the City applies to L&P because the pension and postemployment benefits are maintained by the City for all employees of the City which includes those of the departments.

Resolution 2010-193 provided the payment of medical and dental insurance premiums for certain categories of retired employees during the 2010-2011 fiscal year. Resolution 2010-193 goes on to state that the City will provide a single-employer postemployment benefit plan consisting of medical and dental benefits to employees who attain age 60 with 20 years of service. The City plan subsidizes the full cost of the premium for qualified employees beginning at age 60. Alternatively, an employee can retire with 30 years of service, before age 60, but must pay the full cost until age 60 when the City begins to subsidize the payments. These benefits are not vested rights and expire at the conclusion of the fiscal year. However, the City’s plan is considered a substantive OPEB plan and the City recognizes costs in accordance with GASB Statement No. 45. In the future, the City may terminate its unvested OPEB. Sworn safety personnel eligibility requirements are a minimum of 20 years service and a minimum of 10 years of service with the City.

Due to the insignificant amount of postemployment benefits as it relates to the L&P in comparison to the City as a whole, no postemployment benefits obligation has been allocated to L&P by the City at June 30, 2011.

Further information regarding the City’s participation in OPEB may be found in the City’s Annual Financial Report.

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
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June 30, 2011

NOTE 12 – CONTINGENCIES

During the course of normal operations L&P is subjected to various claims. In the opinion of management and legal counsel, the disposition on all litigation pending will not have a material effect on the L&P's financial statements.

Uncertainties

The financial and operational effects of the 2008 sale of generation and transmission assets, while reducing the electric system's debt burden and providing liquidity, puts the utility at some risks in terms of increased fixed-charge obligations and long-term power resource uncertainty.

In 2010, AB 46, an act to disincorporate the City and make it part of the unincorporated territory of Los Angeles County, was introduced into the State Assembly. AB 46 states it was motivated by a desire to eliminate corrupt practices by City officials, including misuse of public funds and excessive salaries. None of the persons accused of wrongdoing continue as City officials or employees and City salaries have been adjusted to more closely reflect salaries for comparable positions in other California cities. A companion bill, AB 781 was also introduced which, among other things, would have transferred the Electric System to a special district governed by the Board of Supervisors of Los Angeles County. The enactment of AB 781 was dependent on the enactment of AB 46. The City noted to the State Legislators that it believed AB 46 violated the provisions of the California Constitution providing that a vote of the City electorate was necessary to repeal a California city charter.

Both bills were opposed by residents and businesses within the City as well as labor unions representing workers within the City. Both bills were passed by the State Assembly. In the Senate, Senator De Leon, who represents the City and was an original sponsor of AB 46, developed a list of reforms (described below) which the City could commit to undertake to avoid disincorporation. The City Council agreed to the reforms and neither AB 46 nor AB 781 was approved by the Senate. As a result, neither bill became law. The City Council placed before the electorate in November 2011 a series of Charter amendments to implement the reform program all of which were approved by the voters. The Charter amendments are now in effect and the City is in the process of implementing the reforms. The City cannot make any guarantees that there will not be any additional attempts to disincorporate the City or to require additional reforms in the future.

The City has recently been the subject of several investigation and audits by overseeing public bodies. The City has fully cooperated with such reviews of the City's policies and practices, and the City plans to continue cooperating with the ongoing investigations and audits or any other related or similar reviews of the City. The recent and/or ongoing audits and investigations include:

- *Attorney General Audit:* On September 15, 2010, the Office of the Attorney General for the State of California began an investigation of the compensation paid from the City to various individuals, including those who may have acted in the capacity of officials, officers and/or employees of the City. The City fully cooperated with the Office of the Attorney General and has not received subsequent communications.

CITY OF VERNON, CALIFORNIA
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Notes to Basic Financial Statements
June 30, 2011

NOTE 12 – CONTINGENCIES (CONTINUED)

- *IRS Audit of 2009 Bonds:* On August 23, 2011, the City published a material event notice regarding an audit by the IRS of the 2009 Bonds. The notice stated in relevant part: “By letter dated August 10, 2011, the City was notified by the Internal Revenue Service (the “IRS”) that the 2009 Bonds have been selected for an examination to determine compliance with Federal tax requirements. According to the IRS letter, the 2009 Bonds were selected for examination because of information IRS received from external sources or developed internally that causes a concern that the debt issuance may fail one or more provisions of section 103, 141-150 of the Internal Revenue Code. The City believes that the 2009 Bonds complied with all applicable provisions of the Internal Revenue Code and the City will cooperate with the IRS in its examination of the 2009 Bonds. The audit is ongoing.
- *State Legislature Audit:* In September 2011, the California State Legislature directed the State Auditor to conduct a performance audit of the City and its Light and Power Department. The audit will include, but is not limited to, a review of revenues and expenditures, contracting practices, city governance, and governance reform measures over the past five years, as well as a review of bond issuance and expenditures over the past seven years. The audit is ongoing.

The impact or outcome of these matters on the City and any potential implications cannot presently be determined.

NOTE 13 – SUBSEQUENT EVENTS

Change in Fair Value of Derivative Instruments

The fair value balance and notional amount of the derivative instruments outstanding at November 30, 2011, classified by type, and the change in fair value of such derivative instruments since June 30, 2011 are as follows:

	Change in Fair Value		Fair Value at November 30, 2011		Notional
	Classification	Amount	Classification	Amount	
Investment derivative instruments					
Variable to Fixed Swaps					
2004 Series A Bonds	Decrease in fair value	\$ (14,124,712)	Derivative liability	\$ (28,628,982)	\$ 90,150,000
2004 Series B Bonds	Decrease in fair value	(6,832,001)	Derivative liability	(18,005,603)	83,575,000

Credit Ratings

On December 2, 2011, Moody's Investors Service downgraded the A3 ratings to Baa1 on the City of Vernon's, Electric System Revenue Bonds, 2008 Taxable Series A and Electric System Revenue Bonds 2009 Series A.

CITY OF VERNON, CALIFORNIA
LIGHT AND POWER DEPARTMENT FUND
Notes to Basic Financial Statements
June 30, 2011

NOTE 13 – SUBSEQUENT EVENTS (CONTINUED)

Interest Rate Swap Transactions

In September 2011, Morgan Stanley transferred its rights and obligations under the interest rate swap transaction in connection with the City's Electric System Revenue Bonds, 2004 Series B to Deutsche Bank AG. To evidence such transfer, the City and Deutsche Bank AG entered into a novation confirmation which incorporates, by reference, the terms and conditions of the ISDA Master Agreement, Schedule and Collateral Support Annex of the original interest rate swap transaction with Morgan Stanley in connection with the City's Electric System Revenue Bonds, 2004 Series B, with certain modifications including an option by Deutsche Bank to terminate the Deutsche Bank Swap Transaction in 2016. The transfer of rights and obligations by Morgan Stanley to Deutsche Bank AG had no impact to L&P other than the change in the requirement of posting collateral. Prior to September 2011, the City was obligated to post collateral to Morgan Stanley if the City's negative fair value in the aggregate exceeded \$20,000,000 (See Note 7). Subsequent to September 2011, the City is obligated to post collateral to Morgan Stanley if the City's negative fair value of the 2004 A swap exceeds \$20,000,000 and to Deutsche Bank AG if the City's negative fair value of the 2004 B swap exceeds \$20,000,000. At November 30, 2011, the City posted collateral of \$8,628,982 to Morgan Stanley on the 2004 Series A Bonds as the negative fair value of \$28,628,982 exceeded \$20,000,000.

Utility Fund Presentation and Repayment of Interfund Receivables

On December 15, 2011, City Council adopted a resolution that in fiscal year 2012, the City will merge two of its enterprise funds, the Light and Power fund and the Gas fund for accounting and financial reporting purposes. Both are utility funds that provide power and gas utilities to the residents and businesses of the City. Over the course of time, these funds have accumulated both short-term and long-term interfund receivable and payable balances, by virtue of the impact of daily operations and the development of the Gas enterprise. The City's plan to merge these funds will result in the elimination of both short-term and long-term interfund receivables and payables.

The December 15, 2011 City Council resolution also adopted a 15-month repayment plan for all amounts owed L&P by the City's General Fund and Water Enterprise Fund.