

ALAMEDA CORRIDOR-EAST CONSTRUCTION AUTHORITY

FINANCIAL STATEMENTS WITH INDEPENDENT AUDITOR'S REPORT

**For the Fiscal Year Ending
June 30, 2006**

Reservoir Grade Separation



Before



After

Alameda Corridor East Construction Authority
General Purpose Financial Statements

Year ended June 30, 2006

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Alameda Corridor-East Construction Authority FY 2006 Financial Statements

Management Discussion and Analysis

The Management Discussion and Analysis section of the Alameda Corridor-East (ACE) Construction Authority's annual financial report for the fiscal year ended June 30, 2006 contains a narrative discussion and analysis of the financial activities of the Authority within the context of the following financial statements and notes.

Background:

The Alameda Corridor-East (ACE) Construction Authority was created by the San Gabriel Valley Council of Governments (COG) in 1998 to mitigate the effects increasing train traffic would have on congestion, the local environment, and safety in the San Gabriel Valley. The major component of the project is the construction of 21 grade separations along a 35-mile freight rail corridor through the San Gabriel Valley from East Los Angeles to Pomona. A grade separation is typically either a road underpass or overpass that separates vehicle and pedestrian traffic from crossing the Union Pacific Railroad (UPRR) tracks,

The ACE Project also includes safety improvements at 39 grade crossings located throughout the San Gabriel Valley and the implementation of modern traffic control technology to minimize congestion at remaining grade crossings. The project is in two phases. Phase I includes a test deployment of the modernized traffic control system, the safety improvements, and 11 grade separations. (Two of the grade separations are assigned to other agencies.) ACE is now actively planning for the ten additional grade separations in the second phase,

Alameda Corridor-East Construction Authority FY 2006 Financial Statements

Management Discussion and Analysis

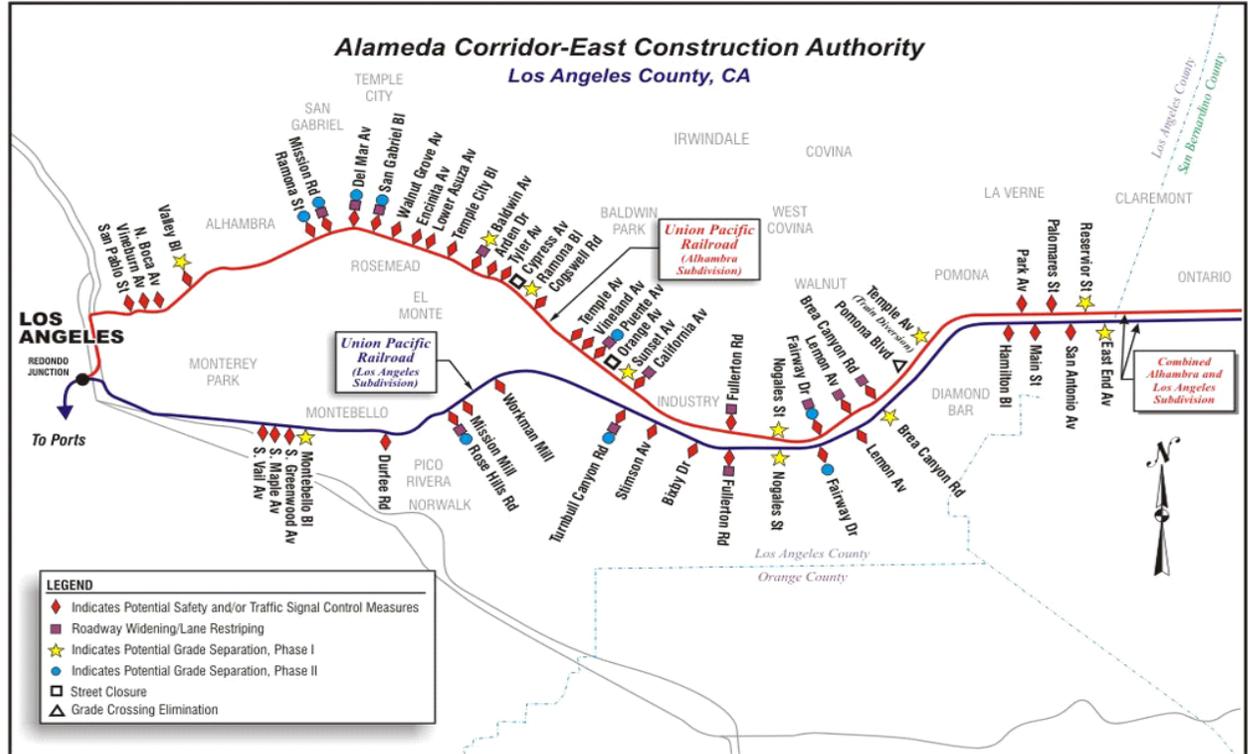
ACE had five grade separations under construction in FY 2006 and saw the completion of its first project, Nogales Street, in September 2005. Two projects completed substantial right-of-way acquisition and utility relocation work and in preparation for beginning construction.

Project	06/05	09/05	12/05	03/06	06/06	
Nogales	Construction		Open to traffic			
Reservoir	Construction					
East End	Utility Relocation					
Ramona	Construction					
Temple	Construction					
Brea Canyon	Right-of-way/Utility Relocation				Construction	
Sunset/Orange	Right-of-way/Utility Relocation					

Alameda Corridor-East Construction Authority FY 2006 Financial Statements

Management Discussion and Analysis

Project Map



The current estimated cost for Phase I is approximately \$487 million. As of June 30, 2006 the following funding had been committed for Phase I:

Alameda Corridor-East Construction Authority FY 2006 Financial Statements

Management Discussion and Analysis

Funding Source	(\$ millions) Committed /Estimated
Federal TEA-21 Demonstration Earmark	\$ 130.5
Federal Trade Corridor Grants and Appropriations	14.9
Federal SAFETEA-LU Demonstration Earmark	73.9
State ITIP Funds	38.0
State General Funds (AB 2928)	130.3
MTA	128.9
Railroad Contribution	19.5
Total Phase I Funding	\$ 536.0

The Committed/Estimated amounts may differ slightly from authorized funding due to budgetary holdbacks on multi-year grants and reflect management’s best guess as to the amount that will ultimately be available. Railroad contribution reflects the federally required 5% contribution of construction cost pro-rated over the construction phase of the various projects.

ACE manages its projects to avoid R: to avoid????? risk wherever possible. All projects are designed to be within the scope allowed by federal, state and local guidelines. The host city of a project is responsible for paying for any “betterments” not needed for the basic grade separation. In addition, each phase - design, right-of-way acquisition and utility relocation, and construction - must be approved by the appropriate regulatory agencies and fully funded before work begins.

While all projects are fully funded, working capital remains a major consideration as all of our grants are cost reimbursable. This means that ACE must first pay contractors and vendors

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Management Discussion and Analysis

before invoicing grantors for reimbursement. Reimbursements are currently running between two to six weeks for Caltrans (Federal and State funding) and the Los Angeles County Metropolitan Transportation Authority (local funding). ACE's parent organization, the San Gabriel Valley Council of Governments therefore authorized the issuance of up to \$100 million in grant anticipation notes to satisfy working capital requirements.

Overview of Basic Financial Statements:

The Authority's basic financial statements consist of 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 found on pages 9 and 12 are designed to give readers a broad overview of the Authority's financial position. These include all of the Authority's assets and liabilities, revenues and expenses. The accounting basis is full accrual (similar to private sector companies) where the Authority's revenues and expenses are reported as the causal event occurs, instead of when the revenue was received or expense paid.

The "Statement of Net Assets" presents all of the Authority's assets and liabilities, with the difference reported as net assets (or equity in the private sector). While large net assets might indicate that a governmental agency has not spent available revenues and other resources, a negative net assets indicates that the agency has overspent. It is management's position to maintain sufficient net assets to compensate for any disallowed costs, but to allocate any surplus to construction activities.

The "Statement of Activities" presents the Authority's revenues and expenses for the fiscal year ending on June 30, 2006. The statement has four primary areas: Operating Expenditures, Operating Revenues, Financing Income and Change in Net Assets. Expenses are broken out into Direct (those expenses that can be identified directly to individual projects) and Indirect, while Financing Income is the interest earned on cash balances less interest and fees paid on the corresponding debt.

Fund Financial Statements

Alameda Corridor-East Construction Authority FY 2006 Financial Statements

Management Discussion and Analysis

The fund financial statements can be found on pages 10 and 13 of this report. 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 ACE Construction Authority, unlike municipalities, county or State governments, has one activity – construction. All of ACE’s activities are classified as a Construction (Capital Projects) Fund with the exception of the amount invested in a deferred compensation plan for staff.

Differences between the two sets of financial statements are normally determined by the complexity of the reporting agency and usually revolve around different treatments for fixed assets and depreciation, and debt issuance and repayment. The Authority’s focus on a single activity results in the two statements being very similar.

Notes to the Basic Financial Statements

This report includes notes to the basic financial statements. They provide additional information that is important to a complete understanding of the data contained in the government-wide and fund financial statements. The notes can be found on pages 15 through 25 of this report.

Financial Highlights:

Statement of Activities

The FY 06 Budget for operating expenditures is \$65.3 million compared to \$55.3 million in FY 05. Actual total operating expenditures are \$68.1 million compared to \$41.4 million in FY 05.

Project revenues continue to closely track expenditures. ACE’s policy is to minimize costs not reimbursable under Federal guidelines. The Los Angeles County MTA also provides project funds and, under separate agreement, continues to fund certain administrative expenses not reimbursable under federal and state regulations. Cities requesting work in excess of Caltrans guidelines (often called betterments) are paid for by the requesting city. Any remaining costs are paid from interest income.

Other revenues. Rental revenue from acquired properties prior to demolition at the various construction sites continued to decline as we most projects entered the construction phase and totaled \$8,509. The Union Pacific Railroad is required to contribute five percent of relevant construction cost for each of five projects. \$1,908,970 was recognized in FY 06.

ACE earnings from its commercial paper program increased dramatically from \$8,148 in FY 05 to \$587,783 in FY 06 as the amount outstanding increased from \$80 million to \$100 million, the difference between the rates earned on investments and paid on debt continued to

Alameda Corridor-East Construction Authority FY 2006 Financial Statements

Management Discussion and Analysis

increase and interest expense is recognized on a cash basis according to government accounting rules.

ACE is reimbursed for indirect expense by grantors by adding a pre-approved percentage of direct cost to all invoices. Caltrans approved an Indirect Rate of 6.3% for ACE for FY 06. Since ACE spent more than budgeted it was possible to recover \$286,437 more in indirect expense than was incurred in FY 06 and thereby reduce the prior year's deferred indirect expense.

Balance Sheet (Statement of Net Assets)

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

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

Total assets increased from \$94.9 million to \$120.4 million. Total construction-in-progress (CIP) increased to \$151.4 million from \$141.1 million in FY 05 as ongoing construction was partially offset by the transfer of ACE's Nogales Avenue grade separation to the UPRR and the Cities of Industry and West Covina.

ACE has \$100 million in variable rate, tax-exempt commercial paper outstanding as of June 2006. The decision as to how much to issue is made periodically by ACE management in consultation with its financial advisors taking into account current and prospective cash flow needs.

Grants Receivable increased from \$1.9 million to \$2.4 million. Unbilled Receivables increased from \$10.7 million to \$22.9 million. The increase reflects having more projects in construction and renegotiation of certain contracts with the Union Pacific Railroad.

Deferred Costs Incurred decreased to \$1,586,286 as \$286,437 in previously deferred indirect was expensed. (See Statement of Activities, above.)

Alameda Corridor-East Construction Authority FY 2006 Financial Statements

Management Discussion and Analysis

Economic Factors and Next Year's Budget

The Federal government passed a multi-year transportation improvement bill in August 2005 that allocated \$42.6 million directly to the Authority, and an additional \$125 million to be divided by the four counties (Los Angeles, Orange, Riverside and San Bernardino) impacted by the increased rail traffic. ACE Construction anticipates using \$31.25 million of this money for unfunded projects when the Federal regulations are published.

Sufficient funds were available at the close of FY 2006 to proceed with the remaining seven grade separation projects. Construction contracts were let for Brea Canyon in March 2006 and for Sunset in August 2006. The construction phase of the newer contracts will last approximately two years. Two other grade separations that were in the original plan for Phase I are the responsibility of the City of Los Angeles and the County of Los Angeles.

Based on current estimates of forecasted expenditures, ACE believes it will be within 10% of the FY 07 Approved Budget of \$71.1 million.

**Alameda Corridor-East Construction Authority
FY 2006 Financial Statements**

Management Discussion and Analysis

Statement of Net Assets (in thousands)

	Governmental Activities	
	<u>2006</u>	<u>2005</u>
Current and other assets	\$ 120,431	\$ 94,871
Construction in progress	151,413	141,086
Less: Due to cities	151,413	141,086
Total Assets	120,431	94,871
Liabilities	116,201	92,934
Net Assets	<u>\$ 4,230</u>	<u>\$ 1,937</u>

Requests for Information:

These financial statements are designed to provide citizens, taxpayers, customers, and creditors with a general overview of the Authority's finances and to demonstrate accountability for the money it receives. If there are any questions about this report or a need for additional information, please contact The ACE Construction Authority, 4900 Rivergrade Road, Suite A120, Irwindale, CA 91706, or call (626) 962-9292.

Insert Auditor's Report – Page 1
(hard copy only)

Insert Auditor's Report – Page 2
(hard copy only)

Alameda Corridor-East Construction Authority
Statement of Net Assets
June 30, 2006

Account	Governmental Activities
Assets	
Cash and cash equivalents (Note 4)	92,696,924
Grants Receivable	2,345,847
Unbilled receivables	22,847,973
Accrued interest	716,952
Deferred costs incurred	
Indirect	1,586,286
Prepaid expenses	
Utility relocation	144,808
Insurance	114,614
Cost of issuance, commercial paper	167,289
Investments - Deferred compensation plan	398,154
Leasehold improvements and equipment	244,724
Less: Accumulated depreciation (Note 3)	(181,158)
Construction in Progress (Note 9)	151,412,627
Less: Due to member cities & Union Pacific Railroad	(151,412,627)
Total Assets	121,082,413
Liabilities	
Accounts payable and accrued expense	12,168,109
Accrued retention payable	1,484,058
Deferred revenue	787,194
Compensated absences	56,362
Deferred compensation payable (Note 7)	398,154
Commercial paper	100,000,000
City of Industry Loan and other noncurrent liabilities	2,000,000
Total Liabilities	116,893,877
Net Assets	\$ 4,188,536

The accompanying notes are an integral part of these financial statements.

Alameda Corridor-East Construction Authority
Balance Sheet - Governmental Funds

June 30, 2006

Account	Fund Type		Total Governmental Funds
	Capital Projects	Fiduciary Fund	
Assets			
Cash and cash equivalents (Note 4)	92,696,924	\$ -	\$ 92,696,924
Grants Receivable	2,345,847	-	2,345,847
Unbilled receivables	22,847,973	-	22,847,973
Interest Receivable	716,952	-	716,952
Deferred costs incurred	1,586,286	-	1,586,286
Prepaid Expenses			
Utility relocation	144,808	-	144,808
Insurance	114,614	-	114,614
Cost of issuance, commercial paper	167,289	-	167,289
Investments - Deferred compensation plan	-	398,154	398,154
Total Assets	120,620,693	\$ 398,154	\$ 121,018,847
Liabilities and Fund Equity			
Liabilities			
Accounts payable and accrued expense	12,168,109	\$ -	\$ 12,168,109
Accrued retention payable	1,484,058	-	1,484,058
Deferred revenue	787,194	-	787,194
Compensated absences & employee benefits	56,362	-	56,362
Deferred compensation payable (Note 7)	-	398,154	398,154
Proceeds from issuance of Commercial Paper owing the San Gabriel Valley Council of Governments (Note 5)	100,000,000	-	100,000,000
City of Industry Loan and other noncurrent liabilities	2,000,000	-	2,000,000
Total Liabilities	116,495,723	398,154	116,893,877
Fund Balance			
Fund Balance	4,124,970	-	4,124,970
Total Fund Balance	4,124,970	-	4,124,970
Total Liabilities and Fund Balance	120,620,693	\$ 398,154	\$ 121,018,847

The accompanying notes are an integral part of these financial statements.

Reconciliation of the Statement of Net Assets & Balance Sheet - Governmental Funds
June 30, 2006

Balance Sheet - Governmental Funds

Total Fund Balance	\$ 4,124,970
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Statement of Net Assets

Total Net Assets	4,188,536
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Difference	<u><u>\$ (63,566)</u></u>
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Net Fixed Assets

\$ 63,566 is the difference between the amount capitalized as leasehold improvements and office equipment net of accumulated depreciation.

The accompanying notes are an integral part of these financial statements.

**Alameda Corridor-East Construction Authority
Statement of Activities and Changes in Net Assets**

Project Expenses	
Construction	\$ 63,822,379
Indirect expenses charged to operations	4,306,911
Total project expenses	68,129,290
 Less:	
Grant reimbursements	67,984,637
Other operating revenues	1,917,479
Net income/(loss) from operations	1,772,826
 Plus:	
Financing income	3,562,227
Less: Financing expense	2,974,444
Net financing income	587,783
Change in net assets	2,360,609
 Net Assets - beginning of year	 1,933,456
Capital Contribution	(105,529)
Net Assets - end of year (06/30/06)	\$ 4,188,536

The accompanying notes are an integral part of these financial statements.

Alameda Corridor-East Construction Authority Financial Statements

Notes To Financial Statements June 30, 2006

Alameda Corridor-East Construction Authority Statement of Revenues, Expenditures and Changes in Fund Balance

Revenues	
Reimbursements	
Federal Grants	\$ 32,029,573
State Grants	28,688,806
Local Grants	7,266,258
Other Revenue	1,917,479
Total Revenues	69,902,116
Operating Expenditures	
Direct	
Design	541,268
Right-of-Way Acquisition	10,681,370
Construction Management	8,271,472
Construction	43,226,793
Betterments	1,101,476
Total Construction	63,822,379
Indirect	
Personnel	
Salaries and Wages	784,655
Fringe Benefits	398,780
Employee Related Expenses	43,792
Board Related Expenses	18,106
Professional Services	
Auditing/Accounting	23,883
Disadvantaged business/Outreach	141,860
Legal	29,158
Other	71,720
Program Management	1,556,150
Representation	220,733
Brokerage	54,600
Insurance	381,595
Equipment Expense	40,951
Office Rental Expense	201,280
Office Operations	31,276
Deferred Indirect Expense	282,615
Total Indirect	4,281,154
Total Operating Expenditures	68,103,533
Excess of Revenue over Expenditures before Financing	1,798,583
Financing Income	
Investment Revenue	3,562,227
Interest and Related Expenses	2,974,444
Net Financing Income/Expense	587,783
Excess of Revenues over Expenditures	2,386,366
Fund Balance Beginning of Period	1,844,134
Capital Contribution	(105,529)
Fund Balance End of Period	4,124,970

The accompanying notes are an integral part of these financial statements.

**Alameda Corridor-East Construction Authority
Financial Statements**

**Notes To Financial Statements
June 30, 2006**

**Alameda Corridor-East Construction Authority
Reconciliation of the Statement of Activities to the Statement of Revenues,
Expenditures and Changes in Fund Balances**

Statement of Revenues, Expenditures and Changes in Fund Balance

Net Change in Fund Balances - Total Governmental Funds	\$	2,386,366
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Statement of Activities

Change in Net Assets of Governmental Activities	2,360,609
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Difference

\$	<u>25,757</u>
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The change of \$25,757 represents the difference between the cost of acquisition, \$ 0 and depreciation expense of \$25,757.

Alameda Corridor-East Construction Authority Financial Statements

Notes To Financial Statements June 30, 2006

Note 1. Summary of Significant Accounting Policies

Accounting policies

A. The Reporting Entity

The ACE Construction Authority is a component unit of the San Gabriel Valley Council of Governments, the COG.

B. Basis of Accounting

Government wide reporting uses the full accrual basis of accounting. The Statement of Activities presents changes in Net Assets. (This is equivalent to an Income and Changes in Equity Statement in private sector companies.). Revenues are recorded when earned and expenses are recognized at the time of the causal event.

ACE recognizes reimbursements from grants as revenues to the extent reimbursing obligations are on or before June 30, 2006 and are therefore the same under both modified accrual and full accrual basis. Major interest bearing debt is short-term in nature so there is no difference relating to accrued interest owed.

C. Description of Funds and Account Groups

The Authority uses funds and account groups to report on its financial position and results of its operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

Governmental fund

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

Fiduciary fund

Deferred Compensation Fund - The Authority provides employees the opportunity to contribute to a qualified deferred compensation plan administered by the International Cities Management Corporation (ICMA). Contributions are made pursuant to a salary reduction plan. Individual accounts are maintained for each individual employee. See Note 7b for a summary of transactions.

Alameda Corridor-East Construction Authority Financial Statements

Notes To Financial Statements June 30, 2006

D. Budgetary Reporting

The Board approved the FY 2007 budget in May 2006.

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

It is the Authority's policy not to start any project unless there are sufficient funds to complete the project. As such, all project related expenses are reimbursable from existing grants and as such, budgeted revenues were not budgeted separately, but derived from budgeted expenditures.

E. Cash Equivalents

Cash equivalents are those short-term investments readily converted into cash. Deposits with the State of California's Local Agency Investment Fund (LAIF) Operating Fund and the Bond portfolio managed by Citizen's Business Bank meet that description.

F. Grant Revenues and Expenditures

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

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

G. Short-Term Notes (Commercial Paper)

All project related funding is, as mentioned above, cost reimbursable. ACE initially obtained a \$2,000,000 loan from the City of Industry for working capital.

On March 6, 2001, COG authorized the issuance of up to \$100,000,000 in short-term variable rate tax-exempt grant anticipation notes. The notes were originally guaranteed by Toronto-Dominion Bank and starting in July 2005 by Bayern LB.

ACE management and financial advisors review on a periodic basis the current and prospective cash requirements in determining the amount of commercial paper to be issued. Arbitrage has been earned on the differential between interest earned on investment with the

Alameda Corridor-East Construction Authority

Financial Statements

Notes To Financial Statements

June 30, 2006

State Treasurer's Local Agency Fund (LAIF) and local bank, and to holders of the commercial paper. Arbitrage earned may be required to be refunded unless certain specific Internal Revenue Code requirements are met. Management believes it is meeting those requirements. Specific provisions of the borrowing are described in Note 4 (Advances by the San Gabriel Valley Council of Governments).

See Note 5 for more information.

H. Fixed Assets (Leasehold improvements and equipment)

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

Leasehold improvements	10 years
Office Furniture	10 years
Computer, office and telephone equipment	5 years

I. Use of Estimates

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

J. Reclassifications

Certain reclassifications have been made from previous years' presentations primarily in the Statements of Revenues, Expenditures and Changes in Fund Equity to agree more readily to budget categories.

Note 2. Implementation of new GASB pronouncements

During year ended June 30, 2005, ACE adopted GASB Statement 40 – Deposit and Investment Risk Disclosures – an amendment to GASB Statement No. 3 in order to conform to the following Governmental Accounting Standards Board Statements.

GASB Statement 40 address common deposit and investment risk related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest rate risk, this Statement requires certain disclosures of investments that have fair

Alameda Corridor-East Construction Authority
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Notes To Financial Statements
June 30, 2006

values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks indemnified are also required to be disclosed.

Note 3. Fixed Assets and Depreciation

A summary of fixed asset changes is as follows:

Asset Category	Beginning Balances	Additions	Deletions	Ending Balances
Leasehold Improvements	\$ 19,762	\$ -	\$ -	\$ 19,762
Computer Equipment				
Hardware	113,697	-	-	113,697
Software	63,813	-	-	63,813
Web site	3,393	-	-	3,393
Telephone Equipment	12,086	-	-	12,086
Office Furniture	31,972	-	-	31,972
Total Fixed Assets	\$ 244,723	\$ -	\$ -	\$ 244,723

Fixed Assets (computer equipment, leasehold improvements, office furniture and equipment, etc.) are carried at cost. Repairs and replacements are expensed as incurred.

Note 4. Cash and investments

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

Statement of net assets:

Alameda Corridor-East Construction Authority Financial Statements

Notes To Financial Statements June 30, 2006

Cash and investments	\$ 88,511,538
Cash and investments held by bond trustee	4,185,385
Total cash and investments	\$ 92,696,924

Cash and investments as of June 30, 2005 consist of the following:

Deposits with financial institutions	\$ 26,053,817
Investments	\$ 62,457,722
Total cash and investments	\$ 88,511,538

Investments Authorized by the California Government Code and ACE Construction Authority's Investment Policy

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

Alameda Corridor-East Construction Authority Financial Statements

Notes To Financial Statements

June 30, 2006

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

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

Investments Authorized by Debt Agreements

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

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

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

**Alameda Corridor-East Construction Authority
Financial Statements**

**Notes To Financial Statements
June 30, 2006**

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that ACE Construction Authority manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations. Information about the sensitivity of the fair values of ACE Construction Authority's investments (including investments held by bond trustee) to market interest rate fluctuations is provided by the following table that shows the distribution of ACE Construction Authority's investments by maturity:

Investment Type	Remaining Maturity (in Months)				
		12 Months Or Less	13 to 24 Months	25-60 Months	More Than 60 Months
State investment pool	62,457,722	59,459,751	1,811,274	1,186,697	-
Held by bond trustee:	-	-	-	-	-
Money market funds	978,350	978,350	-	-	-
Investment contracts	3,207,035	2,762,522	444,513	-	-
Total	\$ 66,643,107	\$ 63,200,623	\$ 2,255,787	\$ 1,186,697	\$ -

Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations

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

Disclosures Relating to Credit Risk

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

Alameda Corridor-East Construction Authority Financial Statements

Notes To Financial Statements June 30, 2006

Investment Type		Minimum Legal Rating	Exempt From Disclosure	Rating as of Year End		
				AAA	Aa	Not Rated
State investment pool	\$ 62,457,722	N/A				\$ 62,457,722
Held by bond trustee:	-					
Money market funds	978,350	A		978,350		
Investment contracts	3,207,035	N/A		3,207,035		
Total	\$ 66,643,107		\$ -	\$ 4,185,385	\$ -	\$ 62,457,722

Concentration of Credit Risk

The investment policy of ACE Construction Authority contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. As of June 30, 2006 ACE Construction Authority had no investments in any one issuer (other than U.S. Treasury securities, mutual funds, and external investment pools) that represent 5% or more of total ACE Construction Authority investments.

ACE Construction Authority does not have any investments in any one issuer that represent 5% or more of total investments.

Custodial Credit Risk

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party.

The California Government Code and ACE Construction Authority's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by State or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under State law (unless so waived by the governmental unit). The 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. As of June 30, 2006, none of ACE Construction Authority's deposits with financial institutions in excess of Federal depository insurance limits were held in uncollateralized accounts.

Alameda Corridor-East Construction Authority Financial Statements

Notes To Financial Statements June 30, 2006

As of June 30, 2006, the following investment types were held by the same broker-dealer (counterparty) that was used by ACE Construction Authority to buy the securities:

<u>Investment Type</u>	<u>Reported Amount</u>
Federal agency securities	3,207,035

Investment in State Investment Pool

ACE Construction Authority is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The fair value of ACE Construction Authority's investment in this pool is reported in the accompanying financial statements at amounts based upon ACE Construction Authority's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis.

Note 5. Advances by the San Gabriel Valley Council of Governments

A. City of Industry Loan

In August of 1999 the COG borrowed \$2,000,000 from the City of Industry the proceeds to be used by the ACE Construction Authority. The loan is secured by the pledge of the proceeds of grants outstanding. The note was to mature no earlier than eighteen months after issuance, no later than thirty-six months. Prepayment required five days' notice and interest to be paid is not to exceed the LAIF interest rate. Interest is paid by ACE and payments are current.

As part of the agreement to issue short-term notes (Commercial Paper) the City of Industry agreed to subordinate its indebtedness to the short-term borrowings and subsequently has extended the maturity of the note to June 2008.

B. Short-Term Notes Payable (Commercial Paper)

In the Spring of 2001 the COG entered into an agreement to borrow up to \$100,000,000 guaranteed by a letter of credit and collateralized by the pledge of grant revenues. The securities issue is tax exempt. Notes outstanding at June 30, 2006, amounted to \$100,000,000. Interest rates vary according to market conditions and have ranged from .7% to 3.59% over the life of the program and have ranged from 3.33% to 3.59% in FY 2006. As with the note payable to the City of Industry proceeds of the borrowings have been used to pay for construction activities and also to provide a revenue source on the

Alameda Corridor-East Construction Authority

Financial Statements

Notes To Financial Statements

June 30, 2006

differential between interest earned and interest paid.

The current guarantor, the Toronto-Dominion Bank was replaced with Bayern LB in July 2005 with no apparent market reaction. The outstanding amount was increased to \$100 million from \$80 million at that time.

Management and its financial advisors are investigating alternative working capital sources.

C. Capital contribution

Prior to the formation of the Authority, the COG incurred \$105,529 in costs related to the Project. Due to Federal and State restrictions on costs incurred prior to receiving Federal and State grants these funds are not reimbursable by current funding sources. These costs have been reported as an outstanding liability to the COG on the Authority's financial statements since 1999.

Last year the Authority stated that it did not anticipate that repayment would be made in the foreseeable future and would therefore treat this as contributed capital. Payment was made in FY 2006 at the request of the COG. This reduces the contributed capital account to zero.

Note 6. Grant Accounting

In the fiscal year ended June 30, 2006 the Authority was the recipient of reimbursements for costs incurred primarily from the Federal Department of Transportation through the California Department of Transportation (CalTrans). There also were California transportation programs paid through CalTrans. Local share was received from the Metropolitan Transportation Authority (MTA). All of these grants are expenditures driven, funds must be expended before reimbursement is received. Certain amounts have been held back by the grantor agency pending completion of certain phases of contracted work and some costs incurred are subject to disallowance.

Amounts shown as receivable at June 30, 2006 are shown net of disallowed costs. Caltrans approved, under Office of Management and Budget (OMB) Circular A-87, an indirect overhead allocation formula of 6.3% of total direct cost. Indirect costs incurred in fiscal year ended June 30, 2006 were \$3,767.803 and previously deferred indirect expense was reduced by \$286,437.

Note 7. Employee Benefit Plans

**Alameda Corridor-East Construction Authority
Financial Statements**

**Notes To Financial Statements
June 30, 2006**

A. Defined Benefit Pension Plan

Effective June 17, 2002 contributions and earnings of continuing employees previously contributed to Cal Pars, were transferred to Cal PERS. Contribution rates as of June 30, 2006 represent:

Employer rate (Normal cost)	12.007 per cent
Employee rate	7.000 per cent

The authority has agreed to pay for both employer and employee rates. The first contribution occurred in June 2002. Cal PERS is an agent, multiple employer defined benefit pension plan that acts as a common investment and administrative agent for participating public entities within the State of California.

Contributions of \$223,026 were made in fiscal year 2006. Information is not available as to actual assets available or net pension obligation (if any) at June 30, 2006.

B. Deferred Compensation Plan

As previously discussed in the Summary of Significant Accounting policies the Authority has entered into a salary reduction deferred compensation plan for its employees. Securities held by the plan are valued at market.

Balance at June 30, 2005	\$ 303,759
Add:	
Employee Contributions	66,348
Earnings, Net of Market Write-downs	28,371
Less:	
Fees Charged	324
Balance at June 30, 2006	<u><u>\$ 398,154</u></u>

Note 8. Commitments and Contingencies

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

Alameda Corridor-East Construction Authority Financial Statements

Notes To Financial Statements June 30, 2006

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

C. The Authority rents its office from Washington Mutual Savings subject to a lease expiring May 31, 2008. Monthly rent is \$15,076 plus a pro rata share of facility maintenance and utilities, or approximately \$15,700. The total amounts owing at June 30, 2006 is \$361,100 plus any further increases in utility/maintenance expense.

FY 07	188,400
FY 08	<u>172,700</u>
Total lease payments	<u>361,100</u>

Note 9. Accounting for Construction in Progress and Eventual Disposal of Projects

Except for minor acquisitions that may be sold by the ACE when no longer needed all of the construction projects, when completed, will be deeded to the Union Pacific Railroad and the cities in which it is located at no cost to the acquirer. At June 30, 2006 \$234,431,459 of costs were accumulated on projects in process and \$83,018,832 had been transferred to the railroad and impacted cities.

Under the government funds and modified accrual basis of accounting \$67,843,189 in FY 2006 project expenditures would be reported as expenditures in the year incurred. On the government-wide financial statements conforming to GASB 34 reporting on these transactions presents a challenge. Accumulating those costs as construction in progress (i.e., treated as a cash flow expenditure and not a current year expense) would substantially overstate income while reporting the disposal and expensing the accumulated costs would distort the cost of operations. In both cases, net assets would fluctuate wildly, depending on the timing of construction and disposal.

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

ACE Construction Authority
Statement of Revenues, Expenditures - Budget to Actual

	Capital Projects		
	Budget	Actual	Difference
Revenues			
Reimbursements			
Federal grants	\$ 30,758,637	\$ 32,029,573	\$ 1,270,936
State grants	27,550,431	28,688,806	1,138,375
Local grants	6,977,932	7,266,258	288,326
Other Revenue	-	1,917,479	1,917,479
Total revenues	<u>65,287,000</u>	<u>69,902,116</u>	<u>4,615,116</u>
Operating Expenditures			
Construction			
Design	613,000	541,268	(71,732)
Right-of-way acquisition	10,994,000	10,681,370	(312,630)
Construction management	5,329,000	8,271,472	2,942,472
Construction	43,317,000	43,226,793	(90,207)
Betterments	900,000	1,101,476	201,476
Total construction	<u>61,153,000</u>	<u>63,822,379</u>	<u>2,669,379</u>
Indirect			
Personnel			
Salaries and wages	839,000	784,655	(54,345)
Fringe benefits	358,000	398,780	40,780
Employee Related Expenses	49,000	43,792	(5,208)
Board Related Expenses	20,000	18,106	(1,894)
Professional Services			
Auditing/accounting	30,000	23,883	(6,117)
Disadvantaged business/outreach	219,000	141,860	(77,141)
Legal	80,000	29,158	(50,842)
Other	77,000	71,720	(5,280)
Program management	1,457,000	1,556,150	99,150
Representation	245,000	220,733	(24,267)
Brokerage	55,000	54,600	(400)
Insurance	409,000	381,595	(27,405)
Equipment Expense	34,000	40,951	6,951
Office Expense	200,000	201,280	1,280
Office Operations	62,000	31,276	(30,724)
Deferred Indirect Expense	-	282,615	282,615
Total Indirect	<u>4,134,000</u>	<u>4,281,154</u>	<u>147,154</u>
Total Operating Expenditures	<u>65,287,000</u>	<u>68,103,533</u>	<u>2,816,533</u>
Excess of Revenue over Expenditures before Financing	-	1,798,583	1,798,583
Financing			
Investment revenue	-	3,562,227	3,562,227
Interest and related expenses	-	2,974,444	2,974,444
Net Financing Income/Expense	<u>-</u>	<u>587,783</u>	<u>587,783</u>
Excess of Revenues over Expenditures	-	2,386,366	2,386,366
Fund equity beginning of period	1,844,134	1,844,134	-
Capital Contribution	-	(105,529)	(105,529)
Fund Equity End of Period	<u>\$ 1,844,134</u>	<u>\$ 4,124,970</u>	<u>\$ 2,280,837</u>

See accompanying auditor's report.