ALAMEDA CORRIDOR-EAST CONSTRUCTION AUTHORITY

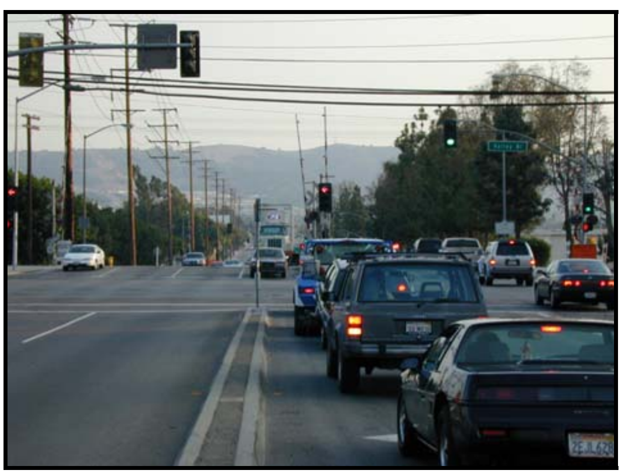
FINANCIAL STATEMENTS

WITH INDEPENDENT AUDITOR'S REPORT

For the Fiscal Year Ending

June 30, 2005

Nogales Grade Separation



Before

After

Alameda Corridor East Construction Authority
General Purpose Financial Statements

Year ended June 30, 2005

Table of Contents

Management Discussion and Analysis	1
Independent Auditor's Report	7
General Purpose Financial Statements	
Statement of Net Assets	9
Balance Sheet – Governmental Funds	10
Reconciliation of Statement of Net Assets & Balance Sheet – Governmental Funds	11
Statement of Activities and Changes in Net Assets	12
Statement of Revenues, Expenditures and Changes in Fund Balance	13
Reconciliation of Statement of Activities and Statement of Revenues, Expenditures and Changes in Fund Balance	14
Notes to the Financial Statements	14
Supplemental Information	
Statement of Revenues and Expenditures – Budget to Actual	27

Alameda Corridor-East Construction Authority
FY 2005 Financial Statements

Management Discussion and Analysis

This section of the Alameda Corridor-East (ACE) Construction Authority's annual financial report contains a narrative discussion and analysis of the financial activities of the Authority for the fiscal year ended June 30, 2005. The Authority's financial performance is discussed and analyzed within the context of the accompanying financial statements and disclosure following this section.

Background:

Trade activity through the Ports of Long Beach and Los Angeles to downtown Los Angeles will increase 300% by 2020. The Alameda Corridor provides the necessary rail infrastructure to absorb a major share of that growth. Projected increases in the number of trains operating on the Union Pacific Railroad (UPRR) lines in the San Gabriel Valley range as high as 160% over the next two decades. Not only will the number of trains increase, but the length of the trains has increased to up to 8,000 feet.

A feasibility study done by the San Gabriel Valley Council of Governments in the mid-1990s confirmed that this posed a threat to the San Gabriel Valley in terms of safety, congestion and economic vitality. The Alameda Corridor-East Construction Authority of the San Gabriel Valley Council of Governments was created in September 1998 to implement a project to mitigate the effects of increased train traffic. The major component of the project is the construction of 20 grade separations along a 35-mile freight rail corridor through the San Gabriel Valley from East Los Angeles to Pomona. A grade separation separates vehicle and pedestrian traffic from crossing the UPRR tracks, typically by constructing either a road underpass or overpass.

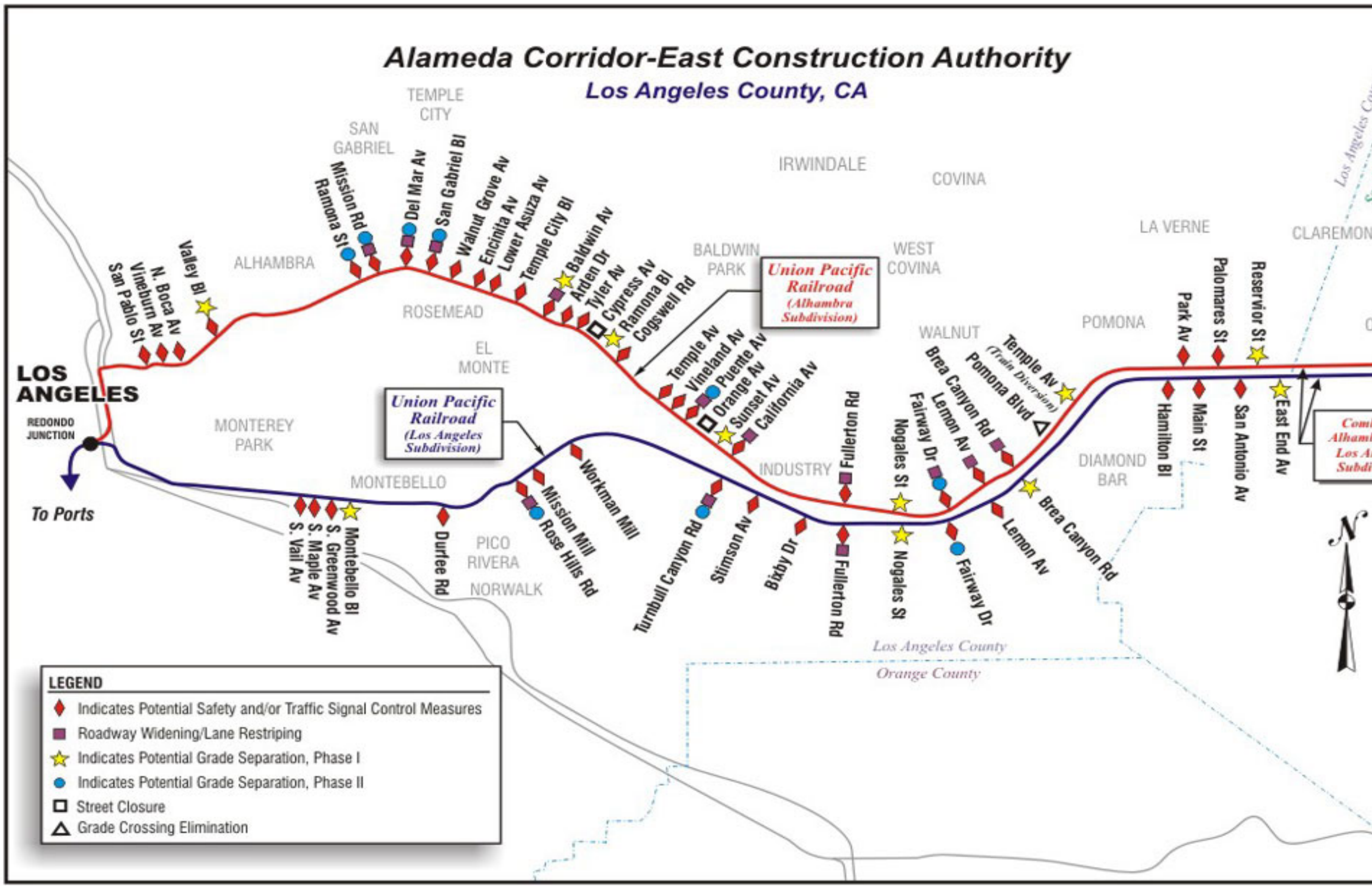
The adopted $950 million ACE Project also includes transportation safety improvements at 39 grade crossings located throughout the San Gabriel Valley and use of modern traffic control technology to minimize congestion at grade crossings, in addition to the 20 grade separations. The project is in two phases. Phase I, includes near-term, low cost mobility improvements that encompass safety upgrades, traffic signal control measures and 10 grade separations, eight of which are the responsibility of the Authority. The second phase (originally scheduled for 2004-2008) includes ten additional grade separations.

FY 2005 was a period of continuing construction at five sites, and the beginning of real estate acquisition at two other sites as funding became available. At the close of FY 2005, the safety program was completed, the signal coordination project was in acceptance testing and seven of the eight grade separations were either in construction or ready to go out to bid.

Alameda Corridor-East Construction Authority
FY 2005 Financial Statements

Management Discussion and Analysis

Project Map



The current estimated cost for Phase I is approximately $432.4 million. As of June 30, 2005 the following funding had been committed for Phase I:

Federal TEA-21 Demonstration Earmark	$121.0 million
Federal Trade Corridor Grants and Appropriations	12.5
State ITIP Funds	38.0
State General Funds (AB 2928)	61.7
MTA "Call for Projects"	43.9
MTA "Advance"	85.0
Railroad Contribution	12.0
Total Phase I Funding	$374.1 million

Alameda Corridor-East Construction Authority
FY 2005 Financial Statements

Management Discussion and Analysis

Previously committed funding has been withheld from Federal ($8.7 million) and State ($68.7 million) sources. Offsetting this has been an offer from the MTA to advance fund $85 million of their total project commitment of $162 million. The Board has endorsed a project implementation strategy of a reduced scope that reflects these changes. Note: In September 2005 the State re-allocated the $68.7 million (AB 2928) funds to ACE for Phase I projects.

ACE continues to manage projects conservatively – only beginning each phase of a project when funding and approvals from regulatory agencies are available. However, working capital remains a major consideration as all of our projects continue to be 100% grant funded on a cost reimbursable basis. This means that ACE must first pay contractors and vendors 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).

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.

<u>Government-wide Financial Statements</u>

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, 2005. The statement has four primary areas: Operating Expenditures, Operating Revenues, Financing Income and Change in Net Assets. Expenses are broken out into Construction (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.

Alameda Corridor-East Construction Authority
FY 2005 Financial Statements

Management Discussion and Analysis

Fund Financial Statements

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 05 Budget for Expenditures is $55.3 million compared to $48.7 million in FY 04. Actual expenditures are $41.4 million compared to $48.1 million in FY 04.

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. 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 totaled $39,513. The Union Pacific Railroad is required to contribute five percent of relevant construction cost. $484,360 was recognized in FY 05.

ACE earned $8,148 in FY 05 Net Financing Income compared to a loss of $26,468 in FY 04, primarily due to lower working capital requirements. Market rates have slowly been climbing throughout FY 05, although the difference between the rates earned on investments and the rates paid on debt has not increased significantly.

Alameda Corridor-East Construction Authority
FY 2005 Financial Statements

Management Discussion and Analysis

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 11.7% for ACE for FY 05. This represents both FY 05 budgeted indirect expense and the portion of indirect expense deferred in FY 03 (4.0% of the 11.7%).

ACE was able to recover $ 409,938 more than indirect expense incurred in FY 05 and therefore was able to reduce prior year's deferred indirect expense.

<u>Balance Sheet (Statement of Net Assets)</u>

ACE is now required to recognize prior and current year's construction on the Balance Sheet as Construction in Progress. Typically, this would be done by treating construction in progress as a capital expense and not included in the Statement of Activities. However, revenue generated by construction would still be included in the Statement of Activities. ACE has signed agreements with member cities and the UPRR obligating ACE to transfer completed projects no cost. The resulting reduction in assets would also 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 and the UPRR (Deficit).

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

Total assets decreased to $94.9 million from $95.2 million. Total construction-in-progress (CIP) increased to $141.1 million from $99.3 million in FY 04.

ACE has $80 million in variable rate, tax-exempt commercial paper outstanding as of June 2005. ACE increased the outstanding amount to $100 million in July 2005. 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.

The guarantor of our paper, the Toronto-Dominion Bank, notified ACE that it is withdrawing from public sector finance and will not extend our current agreement past the original five year term ending in March, 2006. ACE took advantage of a favorable market conditions and contracted with Bayern LB to guarantee our paper for up to ten years beginning July 12, 2005. There should not be any impact on the marketability of our paper.

Grants Receivable decreased from $8.2 million to $1.9 million. Unbilled Receivables decreased from $13.0 million to $10.7 million. The reductions reflect the faster invoicing cycles of our vendors as the project shifts from design to construction.

Alameda Corridor-East Construction Authority
FY 2005 Financial Statements

Management Discussion and Analysis

Deferred Costs Incurred decreased to $1,872,723 as $409,938 in previously deferred indirect was expensed. (See above.)

Economic Factors and Next Year's Budget

In September, the State released $68.6 million of Traffic Congestion Relief Program (TCRP) funds that had previously been retained. In August, the Federal government passed the HR 3 (SAFETEA-LU), a multi-year transportation improvement bill. The Authority was awarded $42.6 million directly, and an additional $125 million will 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 Phase II projects when the Federal regulations are published.

As of the close of FY 2005, the ACE Construction Authority had sufficient Federal, State and local funds available to proceed with seven major grade separation projects. Construction contracts for both Sunset and Brea Canyon, will be awarded in February. Nogales was nearing completion as of June 2005. The construction phase of the newer contracts will last approximately two years. Two remaining grade separations included in 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 06 Approved Budget of $65.3 million.

Statement of Net Assets (in thousands)

	Governmental Activities	
	2005	2004
Current and other assets	$ 94,871	$ 95,189
Construction in progress	141,086	99,256
Less: Due to cities	141,086	99,256
Total Assets	$ 94,871	$ 95,189
Liabilities	92,934	93,832
Net Assets	$ 1,937	$ 1,357

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, 2005

Account		Governmental Activities
Assets		
Cash and cash equivalents (Note 4)		$ 78,292,062
Grants Receivable		1,948,180
Unbillled receivables		10,708,772
Accrued interest		487,601
Deferred costs incurred		
Indirect		1,872,723
Prepaid expenses		
Utility relocation		573,185
Insurance		420,267
Cost of issuance, commercial paper		171,417
Investments - Deferred compensation plan		303,759
Leasehold improvements and equipment	244,723	
Less: Accumulated depreciation (Note 3)	(151,852)	92,872
Construction in Progress (Note 9)	141,085,958	
Less: Due to member cities & Union Pacific Railroad	(141,085,958)	-
Total Assets		$ 94,870,837
Liabilities		
Accounts payable and accrued expense		$ 8,447,449
Accrued retention payable		1,296,300
Deferred revenue		821,854
Compensated absences		64,469
Deferred compensation payable (Note 7)		303,759
Commercial paper		80,000,000
City of Industry Loan and other noncurrent liabilities		2,000,000
Total Liabilities		92,933,832
Net Assets		$ 1,937,005

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

Alameda Corridor-East Construction Authority
Balance Sheet - Governmental Funds

June 30, 2005

Account	Fund Type: Capital Projects	Fund Type: Fiduciary Fund	Total Governmental Funds
Assets			
Cash and cash equivalents (Note 4)	$ 78,292,062	$ -	$ 78,292,062
Grants Receivable	1,948,180	-	1,948,180
Unbillled receivables	10,708,772	-	10,708,772
Accrued interest	487,601	-	487,601
Deferred costs incurred	1,872,723	-	1,872,723
Prepaid Expenses			
Utility relocation	573,185	-	573,185
Insurance	420,267	-	420,267
Cost of issuance, commercial paper	171,417	-	171,417
Investments - Deferred compensation plan	-	303,759	303,759
Total Assets	$ 94,474,206	$ 303,759	$ 94,777,965
Liabilities and Fund Equity			
Liabilities			
Accounts payable and accrued expense	$ 8,447,449	$ -	$ 8,447,449
Accrued retention payable	1,296,300	-	1,296,300
Deferred revenue	821,854	-	821,854
Compensated absences & employee benefits	64,469	-	64,469
Deferred compensation payable (Note 7)	-	303,759	303,759
Proceeds from issuance of Commercial Paper owing the San Gabriel Valley Council of Governments (Note 5)	80,000,000	-	80,000,000
City of Industry Loan and other noncurrent liabilities	2,000,000	-	2,000,000
Total Liabilities	92,630,072	303,759	92,933,831
Fund Balance			
Fund Balance	1,844,134	-	1,844,134
Total Fund Balance	1,844,134	-	1,844,134
Total Liabilities and Fund Balance	$ 94,474,206	$ 303,759	$ 94,777,965

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

Alameda Corridor-East Construction Authority
Reconciliation of the Statement of Net Assets & Balance Sheet - Governmental Funds
June 30, 2005

Balance Sheet - Governmental Funds		
Total Fund Balance	$	1,844,134
Statement of Net Assets		
Total Net Assets		1,937,005
Difference	$	(92,871)

Net Fixed Assets

$ 92,871 is the difference between the amount capitalizedas 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	$	36,815,924
Indirect expenses charged to operations		4,593,905
Total project expenses		41,409,829
Less:		
Grant reimbursements		41,370,358
Other operating revenues		505,444
Net income/(loss) from operations		465,972
Plus:		
Financing income		1,600,474
Less: Financing expense		1,592,325
Net financing income		8,148
Change in net assets		474,120
Net Assets - beginning of year		1,357,355
Capital Contribution		105,529
Net Assets - end of year (06/30/05)	$	1,937,005

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

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

Revenues		
Reimbursements		
Federal Grants	$	12,809,128
State Grants		20,074,408
Local Grants		8,486,821
Other Revenue		505,444
Total Revenues		41,875,801
Operating Expenditures		
Construction		
Design		2,462,596
Right-of-Way Acquisition		6,504,178
Construction Management		4,264,517
Construction		23,199,189
Betterments		385,444
Total Construction		36,815,924.00
Indirect		
Personnel		
Salaries and Wages		861,605
Fringe Benefits		336,919
Employee Related Expenses		43,249
Board Related Expenses		21,126
Professional Services		
Auditing/Accounting		40,548
Disadvantaged business/Outreach		143,743
Legal		45,942
Other		70,044
Program Management		1,645,745
Representation		201,599
Brokerage		64,500
Insurance		385,470
Equipment Expense		43,179
Office Rental Expense		189,809
Office Operations		55,832
Deferred Indirect Expense		409,938
Total Indirect		4,559,248
Total Operating Expenditures		41,375,172
Excess of Revenue over Expenditures before Financing		500,629
Financing Income		
Investment Revenue		1,600,474
Interest and Related Expenses		1,592,325
Net Financing Income/Expense		8,148
Excess of Revenues over Expenditures		508,778
Fund Balance Beginning of Period		1,229,827
Capital Contribution		105,529
Fund Balance End of Period		1,844,134

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

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	$	508,778

Statement of Activities

Change in Net Assets of Governmental Activities		474,120

Difference	$	34,657

The change of $34,657 repsesents the difference between the cost of accquisition, $ 0 and depreciation expense of $34,657.

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

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, 2005 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.

<u>Governmental fund</u>

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.

<u>Fiduciary fund</u>

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.

D. Budgetary Reporting

The Board approved the FY 2005 budget in May 2004.

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. While ACE was required to pay vendors before billing grantors, the Authority was limited to a $2,000,000 loan from the City of Industry for working capital.

On March 6, 2001, COG authorized and The Toronto-Dominion Bank guaranteed the issuance of up to $100,000,000 in short-term variable rate tax-exempt grant anticipation notes..

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 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 4 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 was increased from $500 to $5,000 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 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, 2005 are classified in the accompanying financial statements as follows:

Statement of net assets:

Notes To Financial Statements

June 30, 2005

Cash and investments	$ 74,234,854
Cash and investments held by bond trustee	4,057,208
Total cash and investments	$ 78,292,062

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

Deposits with financial institutions	$ 4,347,646
Investments	$ 73,944,416
Total cash and investments	$ 78,292,062

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.

Authorized Investment Type	Maximum Maturity	Maximum Percentage Of *Portfolio	Maximum Investment in One Issuer
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.

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

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that 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:

Remaining Maturity (in Months)

Investment Type		12 Months Or Less	13 to 24 Months	25-60 Months	More Than 60 Months
State investment pool	69,887,208	69,887,208	-	-	-
Held by bond trustee:	-	-	-	-	-
Money market funds	625,092	625,092	-	-	-
Investment contracts	3,432,116	2,139,330	1,067,738	225,048	-
Total	$ 73,944,416	$ 72,651,630	$ 1,067,738	$ 225,048	$ -

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.

Notes To Financial Statements

June 30, 2005

Investment Type		Minimum Legal Rating	Exempt From Disclosure	Rating as of Year End AAA	Aa	Not Rated
State investment pool	$ 69,887,208	N/A				$ 69,887,208
Held by bond trustee:						
Money market funds	625,092	A		625,092		
Investment contracts	3,432,116	N/A		3,432,116		
Total	$ 73,944,416		$ -	$ 4,057,208	$ -	$ 69,887,208

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, 2005 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, 2005, none of ACE Construction Authority's deposits with financial institutions in excess of Federal depository insurance limits were held in uncollateralized accounts.

As of June 30, 2005, the following investment types were held by the same broker-dealer (counterparty) that was used by ACE Construction Authority to buy the securities:

Investment Type	**Reported Amount**
Federal agency securities	3,432,116

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, 2005, amounted to $80,000,000. Interest rates vary according to market conditions and have ranged from 1.13% to 2.75%. 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 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 reimburseable by current funding sources. These costs have been reported as an outstanding liability to the COG on the Authority's financial statements since 1999. The COG does not currently expect repayment of this amount and reports this amount as an investment in component unit. Upon the completion of the Project any unused funds will revert to the COG. Due to the lack of repayment expectation, this amount has been reclassified as a contribution of capital by the Authority.

Note 6. Grant Accounting

In the fiscal year ended June 30, 2005 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, 2005 are shown net of disallowed costs. Caltrans approved, under Office of Management and Budget (OMB) Circular A-87, an indirect overhead allocation formula of 11.7% of total direct cost. Indirect costs incurred in fiscal year ended June 30, 2005 were $3,897,525 and previously deferred indirect expense was reduced by $409,938.

Note 7. Employee Benefit Plans

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, 2005 represent:

Employer rate (Normal cost)	12.581 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 $179,607 were made in fiscal year 2005. Information is not available as to actual assets available or net pension obligation (if any) at June 30, 2005.

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, 2004	$ 232,855
Add:	
Employee Contributions	58,479
Earnings, Net of Market Write-downs	12,749
Less:	
Fees Charged	324
Balance at June 30, 2005	$ 303,759

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.

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, 2005 is $549,500 plus any further increases in utility/maintenance expense.

FY 06	188,400
FY 07	188,400
FY 08	172,700
Total lease payments	549,500

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, 2005 $166,588,271 of costs were accumulated on projects in process and $25,502,312 had been transferred to the railroad and impacted cities.

Under the government funds and modified accrual basis of accounting $41,123,387 in FY 2005 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	$ 17,114,606	$ 12,809,128	$ (4,305,478)
State grants	26,821,934	20,074,408	(6,747,526)
Local grants	11,339,460	8,486,821	(2,852,639)
Other Revenue	-	505,444	505,444
Total revenues	55,276,000	41,875,801	(13,400,199)
Operating Expenditures			
Construction			
Design	3,872,000	2,462,596	(1,409,404)
Right-of-way acquisition	11,624,000	6,504,178	(5,119,822)
Construction management	4,880,000	4,264,517	(615,483)
Construction	30,269,000	23,199,189	(7,069,812)
Betterments	450,000	385,444	(64,556)
Total construction	51,095,000	36,815,924	(14,279,076)
Indirect			
Personnel			
Salaries and wages	822,000	861,605	39,605
Fringe benefits	346,000 -	336,919	(9,081)
Employee Related Expenses	48,000	43,249	(4,751)
Board Related Expenses	20,000	21,126	1,126
Professional Services			
Auditing/accounting	25,000	40,548	15,548
Disadvantaged business/outreach	219,000	143,743	(75,257)
Legal	72,000	45,942	(26,058)
Other	82,000	70,044	(11,956)
Program management	1,460,000	1,645,745	185,745
Representation	239,000	201,599	(37,401)
Brokerage	80,000	64,500	(15,500)
Insurance	410,000	385,470	(24,530)
Equipment Expense	48,000	43,179	(4,821)
Office Expense	197,000	189,809	(7,191)
Office Operations	113,000	55,832	(57,168)
Deferred Indirect Expense	-	409,938	409,938
Total Indirect	4,181,000	4,559,248	378,248
Total Operating Expenditures	55,276,000	41,375,172	(13,900,828)
Excess of Revenue over Expenditures before Financing	-	500,629	500,629
Financing			
Investment revenue	-	1,600,474	1,600,474
Interest and related expenses	-	1,592,325	1,592,325
Net Financing Income/Expense	-	8,149	8,149
Excess of Revenues over Expenditures	-	508,778	508,778
Fund equity beginning of period	1,229,827	1,229,827	-
Capital Contribution	-	105,529	105,529
Fund Equity End of Period	$ 1,229,827	$ 1,844,134	$ 614,307

See accompanying auditor's report.