PALMDALE RECYCLED WATER AUTHORITY

ANNUAL FINANCIAL REPORT

FOR THE YEAR ENDED DECEMBER 31, 2013

PALMDALE RECYCLED WATER AUTHORITY

ANNUAL FINANCIAL REPORT
DECEMBER 31, 2013

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Palmdale Recycled Water Authority
Palmdale, California

Report on the Financial Statements

We have audited the accompanying financial statements of the Palmdale Recycled Water Authority (Authority) as of and for the year ended December 31, 2013, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of December 31, 2013, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

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Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 5 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated May 13, 2014, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

Vavrinek, Trine, Day & Co. LLP

Rancho Cucamonga, California
May 13, 2014

PALMDALE RECYCLED WATER AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2013

The following is a brief discussion of the Palmdale Recycled Water Authority (Authority) activities and financial performance for the year ended December 31, 2013. Please read in conjunction with the Authority's basic financial statements and accompanying notes which follow this section.

FINANCIAL HIGHLIGHTS

- 2013 is the Authority's first full year of operations as it was created under a joint powers agreement between the City of Palmdale and the Palmdale Water District on September 26, 2012.
- The Authority's revenues were $200,000 in 2013.
- The Authority's Expenses were $69,194 in 2013.
- The Authority's total assets at December 31, 2013 were $181,184.
- The Authority's total liabilities at December 31, 2013 were $50,343.
- The Authority's net position at December 31, 2013 was $130,841.

MEASUREMENT FOCUS AND BASIS OF ACCOUNTING

Measurement focus is a term used to describe which transactions are recorded within the various financial statements. Basis of accounting refers to when transactions are recorded regardless of the measurement focus applied. The accompanying financial statements are reported using the economic resources measurement focus, and the accrual basis of accounting.

Under the economic resources measurement focus all assets and liabilities (whether current or noncurrent) associated with these activities are included on the statement of Net Position. The Statement of Revenues, Expenses and Changes in net Position presents increases (revenues) and decreases (expenses) in total net position. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

The Authority's financial statements, prepared in accordance with generally accepted accounting principles (GAAP), offer key, high-level financial information about Authority's activities during the reporting period. The financial statements of the Authority consist of three interrelated statements designed to provide the reader with relevant information on the Authority's financial condition and operating results. These statements offer short-term and long-term financial information about the Authority's activities utilizing the full accrual basis of accounting.

The *Statement of Net Position* includes all of the Authority's assets, less liabilities, and provides information about the nature and amounts of investments in resources (assets) and the obligations to the Authority's creditors (liabilities), with the difference being reported as net position. It also provides the basis for computing rate of return, evaluating the capital structure of the Authority, and assessing the liquidity and financial flexibility of the Authority.

All the current year's revenues and expenses are accounted for in the *Statement of Revenues, Expenses, and Changes in Net Position.* This statement measures the Authority's operations over the past year and

can be used to determine whether the Authority has successfully recovered all its projected costs through its member contributions.

The final required financial statement is the *Statement of Cash Flows* which presents information about the Authority's cash receipts and cash payments during the reporting period classified as cash receipts, cash payments, and net changes in cash resulting from operations, and investing, non-capital financing and capital and related financing activities.

FINANICAL ANALYSIS OF THE AUTHORITY

Our analysis of the Authority begins on page 3 of the Management's Discussion and Analysis. One of the most important questions asked about the Authority's finances is: "Is the Authority, as a whole better off or worse off as a result of the year's activities?" The Statement of Net Position and the Statement of Revenues, Expenses, and Changes in Net Position report information about the Authority's activities in a way that will help answer this question. These two statements report the net position of the Authority and changes in them. You can think of the Authority's net position the difference between assets and liabilities as one way to measure financial health or financial position. Over time, increases or decreases in the Authority's net position are one indicator of whether its financial health is improving or deteriorating. However, you will need to consider other non-financial factors such as changes in economic conditions, population growth, changes in rates and charges and new or changed government legislation or accounting standards.

STATEMENT OF NET POSITION

The Net Position is the difference between assets, less liabilities, and may serve over time as a useful indicator of a government's financial position. The following is a summary of the Authority's Statement of Net Position.

Condensed Statement of Net Position

	2013
Cash and Cash Equivalents	$ 181,184
Total Assets	181,184
Current Liabilities	50,343
Total Liabilities	50,343
Total Unrestricted Position	$ 130,841

As can be seen from the financial statement above, 2013 is the first full operating year for the Authority and the Net Position increased by $130,841. This increase is the result of the following:

- Current Assets increased by $181,184 as the result of receiving $200,000 of member contributions during the year to defray the operating costs of the Authority.
- Current Liabilities for operating cost totaled $50,343 at the end of the year.

STATEMENT OF REVENUES, EXPENSES, AND NET POSITION

While the Statement of Net Position shows the net position, the Statement of Revenues, Expenses, and Changes in Net Position provides information as to the nature and source of these changes. The Authority reported for its first year of operations an increase in net position of $130,841 for the year ended December 31, 2013. The following is a summary of the change in the Authority's net position.

Condensed Statements of Revenues, Expenses, and Changes in Net Position

	2013
Revenues:	
Membership Contributions	$ 200,000
Total Revenues	200,000
Expenses:	
Operating Expenses	69,194
Total Expenses	69,194
Non-operating Revenue	
Interest Revenue	35
Total Non-operating revenue	35
Change in Net Position	130,841
Net Position - January 1, 2013	-
Net Position - June 30, 2013	$ 130,841

2013 is the first year of operations for the Authority and the source of changes in net position is directly related to member contributions received offset by first year operating cost for preparation of a Recycled Water Facilities Master Plan, related CEQA/NEPA Documentation and rate study.

CONTACTING THE AUTHORITY'S FINANICAL MANAGEMENT

This financial report is intended to provide the Board of Directors, customers, taxpayers, creditors, and other interested parties with general overview of the Authority's financial operations and condition at the year ended December 31, 2013, and to demonstrate the Authority's accountability for the funds it receives. If you have any questions about this report or need additional information, you may contact City of Palmdale, Finance Department, at 38300 Sierra Highway, Suite D, Palmdale, CA 93550. 661/267/5414,
http://www.cityofpalmdale.org/city_hall/prwa.html

PALMDALE RECYCLED WATER AUTHORITY
Statement of Net Position
December 31, 2013

ASSETS

Current Assets:	
Cash and Cash Equivalents	$ 181,184
Total Assets	181,184

LIABILITIES

Current Liabilities:	
Accounts payable	50,343
Total Liabilities	50,343

NET POSITION

Unrestricted	130,841
Total Net Position	$ 130,841

See accompanying notes to the financial statements

PALMDALE RECYCLED WATER AUTHORITY
Statement of Revenues, Expenses and Changes in Net Position
For the Year Ended December 31, 2013

OPERATING REVENUES	
Member Agency Contributions	$ 200,000
Total Operating Revenues	200,000
OPERATING EXPENSES	
Contract Services-Engineering Services	58,646
Marketing and Outreach	1,496
Utilities-Water	9,052
Total Operating Expenses	69,194
Operating Income	130,806
NON-OPERATING REVENUE	
Investment Income	35
Total Non-Operating Revenue	35
Change in Net Position	130,841
Net Position-Beginning of Year	-
Net Position-End of Year	$ 130,841

See accompanying notes to the financial statements

PALMDALE RECYCLED WATER AUTHORITY
Statement of Cash Flows
For the Year Ended December 31, 2013

Cash Flows from Operating Activities:	
Cash Received from member agencies	$ 200,000
Cash payments for operating expenses	(18,851)
Net Cash Provided by Operating Activities	$ 181,149
Cash Flows from Investing Activities:	
Investment Income	35
Net Cash Provided by Investing Activities	35
Net increase in cash and cash equivalents	181,184
Cash and cash equivalents at the beginning of the year	-
Cash and cash equivalents at the end of the year	$ 181,184
Reconciliation of operating income to net cash provided for operating activities:	
Operating Income	$ 130,806
Change in liabilities:	
Increase in accounts payable	50,343
Net cash provided by operating activities	$ 181,149

See accompanying notes to the financial statements

Note 1- Organization and Summary of Significant Accounting Policies

A. Reporting Entity

The Palmdale Recycled Water Authority (Authority) was formed under a Joint Exercise of Powers Authority on September 26, 2012, pursuant to Sections 6506 and 6507 of the Exercise of Powers Act, codified at California Government Code sections 6500, authorizes public agencies by agreement to exercise jointly any power common to the contracting parties. The Authority was formed between the City of Palmdale, a California Charter City (City) and Palmdale Water District, an Irrigation District under Division 11 of the California Water Code (PWD). The Authority is an independent public agency separate from the Members.

The purpose of the Authority is to establish an independent public agency to study, promote, develop, distribute, construct, install, finance, use and manage recycled water resources created by the Los Angeles County Sanitation District Nos. 14 and 20 for any and all reasonable and beneficial uses, including irrigation and recharge, and to finance the acquisition and construction or installation of recycled water facilities, recharge facilities and irrigation systems.

B. Basic Financial Statements

The Authority's basic financial statements consist of the Statement of Net Position, the Statement of Revenues, Expenses and Changes in Net Position, the Statement of Cash Flows, and the Notes to the Basic Financial Statements.

C. Basis of Presentation

The Authority accounts for its activities as an enterprise fund. An enterprise fund is a proprietary type fund used to account for operations (a) that are financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes. The Authority's basic financial statements have been prepared on the accrual basis of accounting, and are presented on an economic measurement focus reporting all economic resources and obligation for the period ended December 31, 2013.

The accounting policies of the Authority are in conformity with generally accepted accounting principles applicable to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing accounting and financial reporting principles. The fiscal year ended December 31, 2013 is the first year of operations of the Authority. As of January 1, 2013, the Authority has applied all applicable GASB pronouncements.

D. Net Position

In the Statement of Net Position, net position is classified in the following categories:

- Net investment in capital assets – This amount consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets as applicable.

- Restricted net position – This amount consists of restricted assets reduced by liabilities. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported.

- Unrestricted net position – This amount is the net amount of the assets and liabilities that are not included in the determination of net investment in capital assets or the restricted component of net position.

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

E. Operating and Non-Operating Revenues and Expenses

The Authority's primary purpose is to promote, develop, and distribute recycled water resources created by the Los Angeles County Sanitation District Nos. 14 and 20 for beneficial uses by the member agencies and by local residential and commercial customers. Future operating revenues will consist of charges for water sales to customers for recycled water and currently operating revenues consist of member contributions to defray the cost of the Authority's operation. Operating expenses include the cost of sales and services, maintenance of capital assets and depreciation on capital assets.

F. Cash and Cash Equivalents

Cash and cash equivalents include demand deposits. For the purpose of the Statement of Cash Flows, cash and cash equivalents are defined as short-term deposits with original maturities of three months or less from the date of acquisition.

G. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

H. Implemented Accounting Pronouncements

During 2013, the Authority adopted GASB Statement No. 61 – In November 2010 GASB issued Statement no. 61, *The Financial Reporting Entity: Omnibus – an amendment of GASB Statement No. 14. and No. 34.* The objective of this Statement is to improve financial reporting for a governmental financial reporting entity and modifies certain requirements for inclusion of component units in the financial reporting entity. The implementation did not have any significant impact on the Authority's financial statements.

During 2013, the Authority adopted GASB Statement No. 65 – In March 2012 GASB issued Statement No. 65 – *Items Previously Reported as Assets and Liabilities.* This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The implementation did not have any significant impact on the Authority's financial statements.

GASB Statement No. 66 – In March 2012, GASB issued Statement No. 66-*Technical Corrections – 2012 – an amendment of GASB Statements No. 10 and No. 62.* The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, Fund Balance Reporting and Governmental Fund Type Definitions and No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements. The implementation did not have any significant impact on the Authority's financial statements.

I. New Accounting Pronouncements

GASB Statement No. 67 – In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25*. The objective of this Statement is to improve financial reporting by state and local governmental pension plans. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency. This Statement replaces the requirements of Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, and* Statement No. 50, *Pension Disclosures*, as they relate to pension plans that are not administered through trust covered by the scope of this Statement and to defined contribution plans that provide postemployment benefits other than pension. The Statement is effective for periods beginning after June 15, 2013. The Authority is not a plan therefore it is not applicable.

GASB Statement No. 68 – In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency. The Statement is effective for periods beginning after June 15, 2014, or December 31, 2015. The Authority has not determined the effect on the financial statements.

GASB Statement No. 69 – In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*. The objective of this Statement is to establish reporting standards related to government combinations and disposals of government operations. The Statement is effective for periods beginning after December 15, 2013, or December 31, 2014. The Authority has not determined the effect on the financial statements.

GASB Statement No. 70 – In April 2013, GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. The objective of this Statement is to improve the recognition, measurement, and disclosure guidance for state and local governments that have extended or received financial guarantees that are nonexchange transactions. The Statement is effective for periods beginning after June

15, 2013, or December 31, 2014. The Authority has not determined the effect on the financial statements.

Note 2-Cash and Investments

Cash and investments at December 31, 2013 are classified in the accompanying financial statements as follows:

Statement of net position:	
Cash and Cash Equivalents	$181,184

Cash and investments as of December 31, 2013 consist of the following:

Deposits with financial institutions	$181,184

A. Investment Policy and Authorized Investments

The Authority is authorized under California Code to make direct investments in local agency bonds, notes, or warrants within the State; U.S. Treasury instruments; registered State warrants or treasury notes; securities of the U.S. Government, or its agencies; bankers acceptances; commercial paper; certificates of deposit placed with commercial banks and/or savings and loan companies; repurchase of reverse repurchase agreements; medium term corporate notes; shares of beneficial interest issued by diversified management companies, certificates of participation, obligations with first priority security; and collateralized mortgage obligations as specified in Section 5366. The Authority does not have a formal policy for investments that is more restrictive than the noted Government Code.

B. Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the Authority 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 Authority does not have a policy of custodial credit risk for deposits. The California Government Code does not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits, other than the following provision for

deposits. The California Government Code requires that a financial institution secure deposits made by state or local government units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the government 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 deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

Note 3-Contributions from Member Agencies

Section 5.2 of the Joint Exercise of Powers Agreement Creating the Palmdale Recycled Water Authority provides that any Member may make contributions of money or assets to the Authority; make or advance payments of public funds to defray the cost of Authority operation; and contribute personnel, equipment or property instead of or in addition to other contributions or advances. Such contributions shall be paid to and disbursed by the Authority as set out in separate agreements between the Authority and the member and approved by the Board and the governing body of the Member. During 2013, each member agency contributed $100,000.

Note 4-Related Party Transactions

The Board of the Authority has assigned staff from the Palmdale Water District and the City of Palmdale to serve in various administrative duties of the Authority. All payroll cost related to staff time while serving the Palmdale Recycled Water Authority is incurred by the respective agencies and none of the payroll costs are incurred by the Authority nor are they charged to the Authority for such services

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors
Palmdale Recycled Water Authority
Palmdale, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial statements contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Palmdale Recycled Water Authority (Authority), as of and for the year ended December 31, 2013, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated May 13, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Authority's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Authority's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Vavrinek, Trine, Day & Co. LLP

Rancho Cucamonga, California
May 13, 2014