

# Notes to Financial Statements – Water Enterprise Fund

## 1. Summary of Significant Accounting Policies

The following is a summary of significant accounting policies of the City of Glendale (the City) as they pertain to the Water Enterprise Fund.

### Funds and Account Groups

The basic accounting and reporting entity of the City is a “fund.” A fund is defined as an independent fiscal and accounting entity with a self-balancing set of accounts for recording cash and other resources together with all related liabilities, obligations, reserves and equities that are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations.

### Basis of Presentation

The City’s Water Enterprise Fund (the Fund) is used to account for the construction, operation and maintenance of the City-owned water utility. The Fund is considered to be enterprise funds, proprietary fund types, as defined under accounting principles generally accepted in the United States of America. The measurement focus is upon financial position, changes in financial position and cash flows. Accordingly, the accrual basis of accounting is followed by the Fund. In accordance with Government Accounting Standards Board (GASB) statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Government Entities that Use Proprietary Fund Accounting, the Fund has elected to apply all applicable pronouncements of the Financial Accounting Standards Board (FASB) including those issued on or before November 30, 1989, except for those pronouncements that conflict with or contradict GASB pronouncements. The Fund is included in the City’s Comprehensive Annual Financial Report (CAFR), and therefore, these financial statements do not purport to represent the financial position and changes in financial position of the City.

### Capital Assets

The capital assets of the Fund are capitalized at historical cost. Donated assets representing utility service assets, which are donated to the City by independent contractors, are recorded at actual installation cost to the donor. Depreciation for both purchased and contributed assets are computed using a straight-line method, based upon average estimated useful life of an asset.

A summary of the useful lives of the capital assets of the Fund is as follows:

Production plant	15 to 40 years
Transmission & distribution plant	25 to 75 years
General plant	10 to 50 years

### Inventories

Inventories, consisting primarily of construction and maintenance materials and tools for the production and distribution system of the Water utility, are carried at weighted average cost.

### **Compensated Absences**

The Water Fund has a fully funded liability for earned but unused accumulated vacation and overtime. As of June 30, 2004, the Water Fund had \$402,003 of the Water employees' earned unused accumulated vacation and overtime.

### **Post-Employment Benefit**

All City Employees that are eligible for retirement with accumulated sick leave are entitled to convert their sick leave hours valued at the rate stated in their respective MOU or Ordinance, into a Retiree Health Savings Plan (RHSP). This RHSP account is controlled by the retiree and money deposited into the account is non-taxable. Money withdrawn from this account, when used for eligible medical expenses as specified in IRS Publication 502 are non-taxable to the retiree. As of June 30, 2004, \$5,061,393 had been set aside in the Internal Service Fund-Employee Benefits Fund of the City related to such benefits.

### **Unbilled Receivables**

The Fund record utility services delivered to customers but not billed. As of June 30, 2004, the Water Fund's unbilled receivables were \$2,235,385.

### **Deposits**

The Fund requires all new or existing utility customers that have not or failed to establish their credit worthiness with the Fund to place a deposit. The deposits are refunded after these customers establish their credit worthiness to the Fund.

### **Contracts – Retained Amount Due**

The Fund records 10% of each progress payment on construction contracts. These retained amounts are not released until final inspection is completed and sufficient time has elapsed for sub-contractors to file claims against the contractor.

### **Transfers**

The City's charter provides for certain percentages of operating revenues in the Water Fund to be transferred to the City's General Fund and have been reflected in the financial statements as transfers out.

### **Net Assets**

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowings used for the acquisition, construction or improvement of those assets. Net assets invested in capital assets, net of related debt, excludes unspent debt proceeds. Net assets are reported as restricted when there are limitations imposed on their use either through the enabling legislation adopted by the City or through external restrictions imposed by creditors, grantors or laws or regulations of other governments. The City first applied restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

## **Revenue Recognition**

The Water Utility uses the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred. Water Utility customers are billed either monthly or bi-monthly. Unbilled water service charges are recorded at year-end and are included in accounts receivable. Unbilled accounts receivable totaled \$2,235,385 at June 30, 2004.

An allowance for doubtful accounts is maintained for utility and miscellaneous accounts receivable. The balance in this account is adjusted at fiscal year-end to approximate the amount anticipated to be uncollectible. As of June 30, 2004, the balance in this account was \$25,000.

## **Budgets and Budgetary Accounting**

The Water Utility presents and the City Council adopts an annual budget. The proposed budget includes estimated expenses and forecasted revenues. The City Council adopts the Water Utility's budget in June each year via a resolution.

## ***2. Cash and Invested Cash***

Cash resources of the individual funds are combined to form a pool of cash and investments, which is managed by the City Treasurer under a formal investment policy that is reviewed by the Investment Committee and adopted annually by the City Council. Therefore, individual investments cannot be identified with any single fund. The Fund's interest in this pool is entirely insured or collateralized as of June 30, 2004. Income from the investment of pooled cash is allocated to the Fund on a monthly basis, based upon the month-end cash balance of the fund as a percent of the month-end total pooled cash balance. Of this total, \$10,221,634 pertains to the Water Fund for fiscal year 2004. Invested cash is stated at the fair value. An increase (decrease) in the fair value of investments is recognized as an increase (decrease) to Interest Income Revenue. The City normally holds the investment to term; therefore, no realized gain/loss is recorded.

The carrying amount of the City's cash and invested cash at June 30, 2004, and reconciliation to amounts shown on the City's Balance Sheet are as follows:

<b>Cash and Investments:</b>	
Historical cost of net investments	\$ 583,453,409
Net increase in fair value	(6,231,168)
Sub-total	577,222,241
Cash on hand	6,494,160
Imprest cash	37,280
Total	583,753,681
<b>Statement of net assets:</b>	
Cash and invested cash	410,366,903
Designated cash and invested cash	158,200,000
Cash with fiscal agent	15,186,778
Total	\$ 583,753,681

At June 30, 2004, the carrying amount of the City's cash deposits totaled \$6,494,160 and the bank balance of the City's cash deposits maintained in financial institutions is \$19,081,116. The City's agent in the City's name holds the cash deposits. The first \$100,000 of cash deposits is insured by the Federal Depository Insurance Corporation and the remainder \$18,981,116 is collateralized with securities held by the pledging financial institution, or by its trust department or agent but not in the City's name (Category 3). The primary differences between the carrying amount and the bank balance are deposits in transit and outstanding checks. In accordance with state statutes, the City maintains deposits at those depository institutions insured by the Federal Deposit Insurance Corporation. The California Government Code requires California banks and savings and loan associations to collateralize the deposits of governmental entities by pledging government securities as collateral. The market value of pledged securities must equal at least 110% of those deposits. California law also allows financial institutions to secure the deposits of governmental entities by pledging first trust deed mortgage notes having a collateral value of 150% of a City's total deposits.

Investments: State statutes authorize the City to invest any available funds in securities issued or guaranteed by the United States Treasury or agencies of the United States, bank certificates of deposit, bankers acceptances, negotiable certificates of deposit, the State Treasurer's Investment Pool (LAIF), repurchase agreements, commercial paper and bonds, and registered warrants or treasury notes of the State of California and its local agencies. An advisory board has been established to monitor LAIF's compliance with regulations and investment alternatives established by the State.

The City is authorized by its investment policy, in accordance with Section 53601 of the California Government Code, to invest in the following instruments:

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- Securities issued or guaranteed by the Federal Government or its agencies
- Bankers' acceptances, issued by the 20 largest domestic or the 50 largest international banks
- Commercial paper, rated A-1/P-1, secured by an irrevocable line of credit or government securities

In accordance with GASB Statement 3, the City's investments are categorized, according to the following criteria, to give an indication of the level of risk assumed by the City at year-end:

CATEGORY 1 includes investments that are insured or registered or for which the securities are held by the City or its agent in the City's name.

CATEGORY 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the City's name.

CATEGORY 3 includes uninsured and unregistered investments for which the securities are held by the counterparty or by its trust department or agent but not in the City's name.

**The following is a summary of the City's investments as of June 30, 2004:**

	Category			Uncategorized	Total Fair Value
	1	2	3		
<b>City-held investments</b>					
U.S. Government securities		\$ 479,712,172			479,712,172
Corporate notes		36,259,244			36,259,244
Federal Agency Discount Notes		6,999,038			6,999,038
Total	-	-	522,970,454	-	522,970,454
<b>Trustee-held investments</b>					
U.S. Government Securities		10,277,644			10,277,644
Guaranteed Investment Contract				4,909,098	4,909,098
Total	-	-	10,277,644	4,909,098	15,186,742
<b>Investment in pool</b>					
Investment (LAIF)				39,065,045	39,065,045
Total investments	-	-	\$ 533,248,098	43,974,143	577,222,241

Fair Value of Investments: Accounting pronouncement GASB Statement No. 31 generally applies to investments in external investment pools, investments purchased with maturities greater than one year, mutual funds, and certain investment agreements. Generally, governmental entities need to report the fair value changes for these investments at year-end and record these gains or losses on their income statement.

Methods and assumptions used to estimate fair value: The City maintains investment accounting records on amortized cost and adjusts those records to fair value on an annual basis.

The City's investment custodian provides market values on each investment instrument on a monthly basis. The investments held by the City are widely traded in the financial markets, and trading values are readily available from numerous published sources.

Unrealized gains and losses are recorded on an annual basis, and the carrying value of its investments is considered fair value. A separate line item on the statement of activities indicates the amount of investment income.

State of California State Treasurer's Local Agency Investment Fund (LAIF): The City holds an investment in LAIF that is subject to being adjusted to fair value. The City is required to disclose its methods and assumptions used to estimate the fair value of its holdings in LAIF. The City relied upon information provided by the State Treasurer in estimating the City's fair value position of its holdings in LAIF. The City had a contractual withdrawal value of \$39,128,270 whose pro-rata share of fair value was estimated by the State Treasurer to be \$39,065,045. The fair value change in the City's investment of \$30,701, the GRA's investment of \$30,701 and the GRA 2002 Bond's investment of \$1,823 for the year ended June 30, 2004 is included in investment income in the statement of activities.

The State Treasurer's Local Agency Investment Fund (LAIF) is a governmental investment pool managed and directed by the California State Treasurer and is not registered with the Securities and Exchange Commission. An oversight committee, comprised of California State officials and various participants, provides oversight to the management of the fund. The daily operations and responsibilities of LAIF fall under the auspices of the State Treasurer's office. The City is a voluntary participant in the investment pool. The management of the State of California Pooled Investment Account (generally referred to as LAIF) has indicated to the City that as of June 30, 2004, the carrying amount of the pool was \$57,630,116,554 and the estimated market value for the pool (including accrued interest) was \$57,637,500,817. Included in LAIF's investment portfolio are certain derivative securities or similar products in the form of asset-backed securities totaling \$923,459,000. LAIF's (and the City's) exposure to risk (credit, market or legal) is not currently available.

### **3. Pension Plan**

Full-time employees of GWP participate with other City employees in the Public Employees Retirement System (PERS) of the State of California, which is an agent multiple-employer public employee retirement system. GWP's contributions represent a pro rata share of the City's contribution, including the employees' contribution that is paid by GWP, which is based on PERS's actuarial determination as of July 1 of the current fiscal year. PERS does not provide data to participating organizations in such a manner so as to facilitate separate disclosure for GWP's share of the actuarial computed pension benefit obligation, the plan's net assets available for benefit obligation and the plan's net assets available for benefits. Approximately 22% of full-time City workers are employed by GWP.

## **Plan Description**

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

All full-time employees are required to participate in CalPERS, and related benefits vest after five years of service. Upon five years of service, employees who retire at age 50 or older are entitled to receive an annual retirement benefit. The benefit is payable monthly for life. The benefit is calculated as follows: years of credited service multiplied by their highest twelve consecutive months of salary multiplied by a percentage factor. This factor is age-based – public safety employees use the 3% at age 50 factor while all others use the 2% at age 55 factor. The system also provides death and disability benefits. CalPERS issues a publicly available financial report that includes financial statements and required supplemental information of participating public entities within the state of California. Copies of the CalPERS annual financial report may be obtained from the CalPERS Executive Office – 400 P Street, Sacramento, CA 95814.

## **Funding Policy**

CalPERS is a contributory plan deriving funds from employee contributions as well as from employer contributions and earnings from investments. According to the plan, City employees are required to contribute 7% of annual salary for general members and 9% of annual salary for public safety members. The City is also required to contribute at an actuarially determined rate; the current public safety rate and the current general employee rates are 5.812% and 0% respectively of annual covered payroll, as the City's retirement is fully funded. The contribution requirements of plan members are established by State statute and the employer contribution rate is established and may be amended by CalPERS. The City's rate for safety members that CALPERS charges have dramatically increased in fiscal year 2004-05 from 5.812% to 24.99%; the rate for general employees remained at zero percent.

## **Annual Pension Cost**

Contributions to CalPERS totaling \$11,054,452 were made during the fiscal year ended June 30, 2004 in accordance with actuarially determined contribution requirements through an actuarial valuation performed at June 30, 2002. The actuarial assumptions included (a) a rate of return on the investment of present and future assets of 8.25% a year compounded annually (net of administrative expenses), (b) projected salary increases that vary by duration of service ranging from 4.27% to 11.59%, (c) no additional projected salary increases attributable to seniority/merit and (d) no post-retirement benefit increases. The actuarial value of the City's assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a three-year period depending on the size of investment gains and/or losses. CalPERS uses the entry-age-normal-actuarial-cost method, which is a projected-benefit-cost method. That is, it takes into account those benefits that are expected to be earned in the future as well as those already accrued. According to this cost method, the normal cost for an employee is the level amount which would fund the projected benefit if it were paid annually from date of employment until retirement. In addition, the employer's total normal cost is expressed as a level percentage of payroll. CalPERS

also uses the level-percentage-of-payroll method to amortize any unfunded actuarial liabilities. Initial unfunded liabilities are amortized over a closed period that depends on the plan's date of entry into CalPERS. Subsequent plan amendments are amortized as a level percentage of pay over a closed 20 year period. Gains and losses that occur in the operation of the plan are amortized over a rolling period, which results in an amortization of 10% of unamortized gains and losses each year. If the plan's accrued liability exceeds the actuarial value of plan assets, then the amortization payment on the total unfunded liability may not be lower than the payment calculated over a 30-year amortization.

### Three-Year Trend Information

Fiscal year ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
6/30/02	\$ 8,291,590	100%	0
6/30/03	\$ 9,457,653	100%	0
6/30/04	\$ 11,054,452	100%	0

### REQUIRED SUPPLEMENTARY INFORMATION - Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets <a>	Actuarial Accrued Liability <AAL> – Entry Age <b>	(Unfunded AAL) / Overfunded AAL <a-b>	Funded Ratio <a/b>	Covered Payroll <c>	(Unfunded AAL)/ Overfunded AAL as a Percentage of Covered Payroll <(a-b)/c>
06/30/2000	794,954,969	639,884,600	155,070,369	124.2%	95,697,086	162.0%
06/30/2001	815,521,178	687,539,962	127,981,216	118.6%	101,369,092	126.3%
06/30/2002	766,978,940	732,667,128	34,311,812	104.7%	109,853,251	31.2%

## 4. Self-Insurance Program

The City is self-insured for Workers' Compensation claims up to \$2,000,000 per occurrence and general public liability up to \$2,000,000 per occurrence. Additional coverage in excess of these limits has been purchased from third-party insurance companies. Workers' Compensation and general public liability insurance protection is provided through internal service funds maintained by the City. The City is also self-insured for unemployment insurance and general auto liability through separate Internal Service Funds. The Internal Service Funds charge the Water Fund for its estimated share of the liability. At June 30, 2004, such liability has been fully funded to the City.

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A claims payable liability has been established in these funds on case basis estimates of reported claims and an estimate for claims incurred but not reported. Management believes that provisions for claims at June 30, 2004 are adequate to cover the net cost of claims incurred to date. However, such liabilities are, by necessity, based upon estimates and there can be no assurance that the ultimate cost will not exceed such estimates.

## 5. Net Assets

Net assets are reported as restricted when there are limitations imposed on their use either through the enabling legislation adopted by the City or through external restrictions imposed by creditors, grantors or laws or regulations of other governments. Net assets are reported as unrestricted when there are no limitations imposed on their use.

In December of 2003, GWP management received approval from the City Council to implement a cash reserve policy for the Water Fund to ensure a long term sustainable financial health of the water operation. The policy calls for annual review of the reserves to determine if the recommended levels are sufficient. The annual review of the Cash Reserve Policy for fiscal year ending June 30, 2004, established a target of \$13,300,000 of designated cash in the following categories: \$5,900,000 for contingency reserve; \$2,400,000 for rate stabilization reserve; and \$5,000,000 for capital reserve. As of June 30, 2004, \$6,900,000 is designated with the goal of meeting the remaining \$6,400,000 with future available cash.

## 6. Capital Assets

A summary of the changes in Water Fund 2003 - 2004 Capital Assets is as follows:

	Balance at July 1, 2003	Additions	Retirements	Reclassification	Balance at June 30, 2004
Production plant	\$ 23,323,995	1,243,093	356,817	(1,697,011)	22,513,260
Transmission and distribution plant	74,660,475	4,593,371	10,887	264,383	79,507,342
General plant	9,544,111	326,428	53,057	1,518,562	11,336,044
Total water fund	107,528,581	6,162,892	420,761	85,934	113,356,646
Less allowance for accumulated depreciation	41,123,987	2,590,456	420,761	46,674	43,340,356
Net book value of water fund	66,404,594	3,572,436	-	39,260	70,016,290

## **7. Contingent Liabilities**

### **Litigation**

The City is a defendant in several general damage and personal injury lawsuits and claims. These claims arise primarily from injuries sustained by the claimants while on property owned or maintained by the City. While litigation is by nature uncertain, management believes, based on consultation with the City Attorney, that these cases in the aggregate are not expected to result in a material adverse impact on the City. Additionally, City management believes that sufficient reserves are available to the City to cover any potential losses should an unfavorable outcome materialize.