

City of Vernon

WATER FUND

(An Enterprise Fund of the City of Vernon, California)

Annual Financial Report

Year Ended June 30, 2019

City of Vernon

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City of Vernon, California
Water Fund
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Introduction

A message from Abraham Alemu, General Manager of Vernon Public Utilities

As the newly appointed General Manager of Vernon Public Utilities, I'd like to say "Thank You" to the City Council and City Management for the incredible opportunity to serve as the General Manager of one of the most consequential departments in the City.

I am excited to join a very talented management team and contribute to advancing the City's goals and values of business friendliness, government transparency, high-quality-low-cost service, and community accountability. During my term as Interim General Manager and now as General Manager, the City Management and other department heads have supported me and given me advice, assuring me that I can lean on them whenever I need their assistance. Most importantly, I have the support and confidence of the VPU family. VPU employees have shown me the utmost respect and support both in person and through their performance. They have worked diligently and efficiently as we tackled major critical projects in the water, electric, and gas operations. As we continue to fill vacancies, VPU staff have worn multiple hats and covered responsibilities outside of their normal duties. For all of this, I am profoundly grateful. I will continue to depend on them for their expertise and professionalism.

Surrounded by the City management team and my VPU family, I envision a number of exciting "locally focused" projects and programs that will shape our resource procurement strategy, service delivery model, financial and service accountability, and customer engagement. Building on the City's most business-friendly model, the central theme will be local investment and customer engagement. I am very thankful to the City Council and City management for their trust in me to lead a very important city department. I will work with all of my capabilities to execute the duties entrusted with me.

Thank you,



Abraham Alemu
General Manager, Vernon Public Utilities

FY 2018-2019 Vernon Public Utilities – Water Division at a Glance

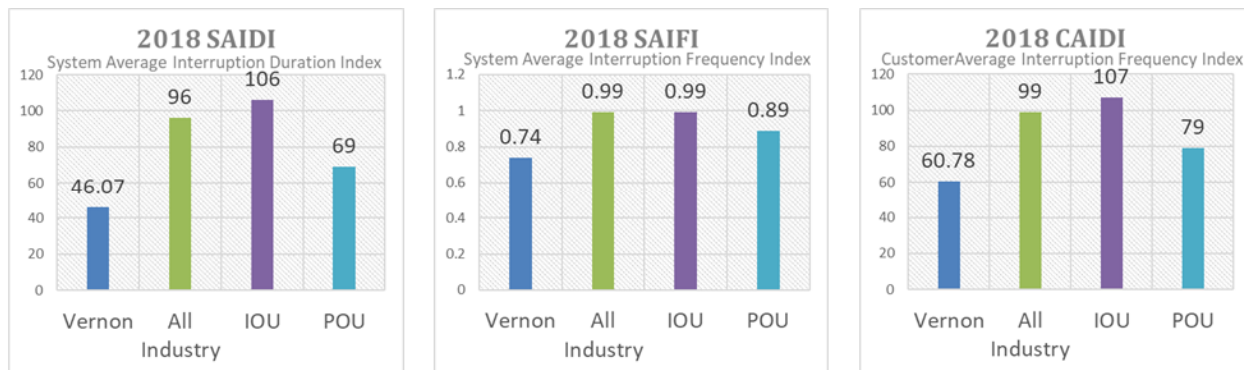
Water	
Service area	4.2 square miles
Service meters	978 meters
Number of miles of water mains	45
Number of wells	8
Number of reservoirs	8
Total reservoir capacity (gallons)	16.375 MG
Number of booster stations	3
Average day demand	18.5 acre feet
Maximum day peak factor	1.6

Major Initiatives and Accomplishments

Department Wide

- Earned APPA RP3 Diamond Level Recognition of Operational Excellence in the key areas of Reliability, Safety, Workforce Development, System Improvement
- VPU was recognized for its outstanding safety record during the 2018 calendar year. VPU received First Place in the APPA 2018 Safety Award of Excellence for group category D, as well as winner of the 2019 Safety Award from the American Public Gas Association (low incidence rate/Exposure Hours)
- Served in California Utilities Emergency Association Board of Directors
- Positive credit article in Moody’s Credit Outlook April 2018 publication
- Benchmarking study ranks VPU electric reliability top 10% nationwide
- Served on SCPPA Executive Committee

Figure 1: Nation-wide Reliability Metrics Benchmarking for 2018



Water Division

- One of only two cities awarded Water Replenishment District New Well Construction and Rehabilitation loan of \$1.5 million
- Began implementation of program to automate efficient operation of water production, storage, and conveyance facilities
- Initiated a meter upgrade program
- Revised the 5-year Capital Improvement Plan
- Performed first proactive maintenance-based bi-directional flushing program
- Repaired pump and motor of Well 11 and 16 which feeds the City's 10 million gallon reservoir

Compliance

- Performed Gas System Compliance Gap Analysis
- Participated in American Public Power Association (APPA) Legislative Rally in Washington, DC
- Elected to APPA's Reliable Public Power Provider grading panel
- Reliability Metrics benchmarked among the highest in the country in 2017
- Featured participant in national APPA Mutual Assistance Table Top Exercise.

REPORT OF INDEPENDENT AUDITORS

The Honorable Mayor and the Members of the City Council City of Vernon, California

Report on the Financial Statements

We have audited the accompanying financial statements of the Water Fund of the City of Vernon, California (City), which comprise the statement of fund net position as of June 30, 2019, and the related statement of revenues, expenses and changes in fund net position and cash flows for the year then ended, and the related notes to financial statements, which collectively comprise the Water Fund's basic financial statements.

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 Water Fund of the City of Vernon, California, as of June 30, 2019, and the changes in its financial position and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

As discussed in Note 1 to the financial statements, the financial statements present only the Water Fund of the City of Vernon, California and do not purport to, and do not, present fairly the financial position of the City of Vernon, California as of June 30, 2019, and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 6 through 10 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.

**Glendale, California
March 6, 2020**

The management of the Water Fund of the City of Vernon ("the City") offers the following overview and analysis of the basic financial statements of the Water Fund for the fiscal year ended June 30, 2019. Management encourages readers to utilize information in the Management's Discussion and Analysis (MD&A) in conjunction with the accompanying basic financial statements.

OVERVIEW OF BASIC FINANCIAL STATEMENTS

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

The *statement of fund net position* presents information on the Water Fund's total assets and deferred outflows of resources and total liabilities and deferred inflows of resources, with the difference between the two reported as net position.

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

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

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

City of Vernon, California
Water Fund
Management's Discussion and Analysis (Unaudited)
Year ended June 30, 2019

FINANCIAL HIGHLIGHTS

Fund Net Position

The table below summarizes the Water Fund's net position as of the current fiscal year ended June 30, 2019 and prior fiscal year ended June 30, 2018. The details of the current year's summary can be found on page 11 of this report.

City of Vernon Water Fund Fund Net Position June 30, 2019 and 2018				
	2019	2018	Change	
			Amount	%
Assets:				
Current and other assets	\$ 8,259,653	\$ 2,163,531	\$ 6,096,122	282%
Advances to the City	6,447,171	11,311,300	(4,864,129)	-43%
Capital assets	7,378,550	7,270,208	108,342	1%
Total assets	22,085,374	20,745,039	1,340,335	6%
Deferred Outflows of Resources	675,417	1,096,048	(420,631)	-38%
Liabilities:				
Current liabilities	1,570,672	1,097,097	473,575	43%
Long-term liabilities	4,320,474	5,686,283	(1,365,809)	-24%
Total liabilities	5,891,146	6,783,380	(892,234)	-13%
Deferred Inflows of Resources	441,542	95,444	346,098	363%
Net Position:				
Net investment in capital assets	7,378,550	7,270,207	108,343	1%
Unrestricted	9,049,553	7,692,056	1,357,497	18%
Total net position	\$ 16,428,103	\$ 14,962,263	\$ 1,465,840	10%

The assets and deferred outflows of resources of the Water Fund exceeded its liabilities and deferred inflows of resources at the close of the most recent fiscal year by \$16,428,103 (*net position*).

The category of the Water Fund's net position with the second largest balance totaling \$7,378,550 represents resources that are invested in capital assets, net of related debt.

The remaining category of net position, having the largest balance totaling \$9,049,553, represents the unrestricted net position that is expected to be used for future project or other purpose.

Activities, Net Position:

- Current assets increased by \$6.1 million from the prior year mainly due to return by the City of the Water Fund's advances to the City by \$4.9 million and current year operating income of \$1.5 million. Accordingly, Advances to the City decreased by \$4.9 million.
- Capital assets increased \$108 thousand from the prior year mainly due to additional construction expenses and purchase of equipment totaling \$440 thousand, net of depreciation of \$332 thousand (See Note 5).
- Deferred outflows of resources increased by \$421 thousand in 2019 due to changes in assumptions in the pension plans valuation.
- Current liabilities increased by \$474 thousand from the prior year mainly due to an increase in the accounts payable balance by \$723 thousand, offset by a decrease in the customer deposits balance by \$236 thousand.
- Long-term liabilities decreased by \$1.4 million from the prior year mainly due to decreases in the allocated amounts of net pension liability and OPEB liability.
- Deferred inflows of resources increased by \$346 thousand largely due to the increase in the OPEB-related deferred inflows of resources balance as a result of changes in the assumptions and differences in the expected and actual experience in premiums and claimed costs in the valuation of the OPEB liability.
- Unrestricted net position increased by \$1.4 million from the prior year due primarily to current year's operating income.

City of Vernon, California
Water Fund
Management's Discussion and Analysis (Unaudited)
Year ended June 30, 2019

Changes in Fund Net Position

The table below summarizes the Water Fund's changes in net position over the current and prior fiscal years. The details of the current year's changes in net position can be found on page 12 of this report.

City of Vernon				
Water Fund				
Changes in Fund Net Position				
Years Ended June 30, 2019 and 2018				
	2019	2018	Change	
			Amount	%
Operating revenues:				
Charges for services	\$ 9,345,045	\$ 9,392,814	\$ (47,769)	-1%
Operating expenses:				
Cost of sales	7,560,751	7,861,103	(300,352)	-4%
Depreciation	331,922	350,695	(18,773)	-5%
Total operating expenses	<u>7,892,673</u>	<u>8,211,798</u>	<u>(319,125)</u>	-4%
Operating income	<u>1,452,372</u>	<u>1,181,016</u>	<u>271,356</u>	23%
Nonoperating revenues:				
Investment income	13,468	1,796	11,672	650%
Total nonoperating revenues	<u>13,468</u>	<u>1,796</u>	<u>11,672</u>	650%
Change in net position	1,465,840	1,182,812	283,028	24%
Net position - beginning of year	<u>14,962,263</u>	<u>13,779,451</u>	<u>1,182,812</u>	9%
Net position - end of year	<u>\$ 16,428,103</u>	<u>\$ 14,962,263</u>	<u>\$ 1,465,840</u>	10%

The Water Fund's operating income of \$1.5 million resulted in the increase in net position of the same amount during the current year.

The Water Fund's operating activities increased net position by \$1.5 million which is \$283 thousand higher than the prior year. The key reason for this change was due to the decrease in operating expenses by \$319 thousand largely from the adjustment of the net pension and net OPEB liabilities.

CAPITAL ASSET

The Water Fund's investment in capital assets as of June 30, 2019 amounted to \$7.4 million (net of accumulated depreciation). This investment in capital assets includes land, construction in progress, building, utilities system improvements, and machinery and equipment. The total increase in the Water Fund's investment in capital assets for the current fiscal year was \$440 thousand, offset by depreciation of \$332 thousand, for a net increase of \$108 thousand.

Additional information on the Water Fund's capital assets can be found in Note 5 on page 23 of this report.

ECONOMIC FACTORS AND NEW YEAR'S BUDGET AND RATES

These factors were considered in preparing the Water Fund's budget for the 2020 fiscal year.

- The City is strictly industrial and does not maintain an unemployment rate study of its small population. However, the unemployment rate of adjacent communities is currently 4.1%, which is slightly lower than the State of California's average unemployment rate of 4.2%, and higher than the national average unemployment rate of 3.7%.
- Inflationary trends in the region compare favorably to national indices.
- The occupancy rate of the City's central business district ranges between 96% and 98%.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the Water Fund's finances for all those with an interest in the Water Fund's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Director of Finance, City of Vernon, 4305 Santa Fe Avenue, Vernon, California, 90058.

City of Vernon, California
Water Fund
Statement of Fund Net Position
June 30, 2019

ASSETS:

Current assets:

Cash and cash equivalents	\$ 7,292,358
Accounts receivable, net of allowances of \$88,000	605,269
Accrued unbilled revenue	362,026
Total current assets	8,259,653

Noncurrent assets:

Advances to other funds	6,447,171
Nondepreciable	1,722,764
Depreciable, net	5,655,786
Total noncurrent assets	13,825,721
Total assets	22,085,374

DEFERRED OUTFLOWS OF RESOURCES:

Noncurrent deferred outflows of resources:

Deferred outflows related to pensions	581,241
Deferred outflows related to other postemployment benefit liability	94,176
Total deferred outflows of resources	675,417

LIABILITIES:

Current liabilities:

Accounts payable	1,372,685
Accrued wages and benefits	107,524
Customer deposits	56,384
Compensated absences	34,079
Total current liabilities	1,570,672

Noncurrent liabilities:

Compensated absences	68,159
Other postemployment benefit liability	719,107
Net pension liability	3,533,208
Total noncurrent liabilities	4,320,474
Total liabilities	5,891,146

DEFERRED INFLOWS OF RESOURCES:

Noncurrent deferred inflows of resources:

Deferred inflows related to pensions	39,440
Deferred inflows related to other postemployment benefit liability	402,102
Total deferred inflows of resources	441,542

NET POSITION:

Net investment in capital assets	7,378,550
Unrestricted	9,049,553
Total net position	\$ 16,428,103

See notes to the financial statements.

City of Vernon, California
Water Fund

Statement of Revenues, Expenses, and Changes in Fund Net Position
Year ended June 30, 2019

OPERATING REVENUES:	
Charges for services	\$ 9,345,045
Total operating revenues	<u>9,345,045</u>
OPERATING EXPENSES:	
Cost of sales	7,560,751
Depreciation	331,922
Total operating expenses	<u>7,892,673</u>
Operating income	<u>1,452,372</u>
NONOPERATING REVENUES:	
Investment income	13,468
Total nonoperating revenues	<u>13,468</u>
Change in net position	1,465,840
Net position, beginning of the year	<u>14,962,263</u>
Net position, end of the year	<u>\$ 16,428,103</u>

See notes to the financial statements.

City of Vernon, California
Water Fund
Statement of Cash Flows
Year ended June 30, 2019

Cash flows from operating activities:	
Cash received from customers	\$ 9,045,942
Cash paid to suppliers for goods and services	(5,309,515)
Cash paid to employees for services	<u>(2,140,635)</u>
Net cash provided by operating activities	<u>1,595,792</u>
Cash flows from noncapital financing activities:	
Payment of advances to other funds	<u>4,864,129</u>
Cash provided by noncapital financing activities	<u>4,864,129</u>
Cash flows from capital and related financing activities:	
Acquisition and construction of capital assets, net	<u>(440,264)</u>
Cash used in capital and related financing activities	<u>(440,264)</u>
Cash flows from investing activities:	
Investment income	<u>13,468</u>
Cash provided by investing activities	<u>13,468</u>
Change in cash and cash equivalents	6,033,125
Cash and cash equivalents, beginning of year	<u>1,259,233</u>
Cash and cash equivalents, end of year	<u>\$ 7,292,358</u>
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ 1,452,372
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	331,922
Changes in operating assets and liabilities:	
Accounts receivable	(27,716)
Accrued unbilled revenue	(35,281)
Deferred outflows of resources	420,631
Accounts payable	722,578
Accrued wages and benefits	4,465
Customer deposits	(236,106)
Compensated absences	(52,084)
Other postemployment benefit liability	(763,507)
Net pension liability	(567,580)
Deferred inflows of resources	<u>346,098</u>
Net cash provided by operating activities	<u>\$ 1,595,792</u>

See notes to the financial statements.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements present only the Water Fund of the City of Vernon, California (the City). The Water Fund accounts for the independent operations and the maintenance of the City's Water utility. The Water Fund is administered as an independent fiscal and accounting entity with a self-balancing set of accounts recording resources, related liabilities, obligations, reserves and equities, segregated for the purpose of carrying out specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations.

For additional information regarding the City of Vernon, refer to the City's annual financial report.

The financial statements of the Water Fund have been prepared in conformity with U.S. generally accepted accounting principles (GAAP). The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The Water Fund's significant accounting policies are described below.

As of June 30, 2019, the Water Fund had no blended component units or any discretely presented component units.

Basis of Presentation

The Water Fund's financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place.

The Water Fund distinguishes *operating* revenues and expenses from *nonoperating* items. *Operating* revenues, such as charges for services, result from exchange transactions associated with the sale of Water. Exchange transactions are those in which each party receives and gives up essentially equal values. *Nonoperating* revenues, such as subsidies and investment earnings, result from nonexchange transactions or ancillary activities. *Operating* expenses include the cost of sales and services, administrative expenses and depreciation on capital assets. All expenses not meeting this definition are reported as nonoperating expenses.

For the Water Fund financial statements, under Governmental Accounting Standards Board (GASB) Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, the Water Fund applies all applicable GASB pronouncements as well as any applicable pronouncements of the Financial Accounting Standards Board and AICPA pronouncements issued on or before November 30, 1989 unless those pronouncements conflict with or contradict GASB pronouncements.

The Water Fund's policy regarding whether to first apply restricted or unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net position are available is to use restricted resources first.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Pooled Cash

The Water Fund's operating cash balance is pooled with various other City funds for deposit purposes. The share of each fund in the pooled cash account is recorded in each of the fund's books of accounts, and interest income is apportioned to the participating funds based on the relationship of their average monthly balances to the total of the pooled cash.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Water Fund considers all highly liquid investments (including restricted cash and investments) with an original maturity of three months or less when purchased to be cash equivalents.

Receivables

Receivables from the City are classified as "Advances to the City" on the statement of fund net position.

Trade receivables are shown net of an allowance for uncollectible accounts. Allowances for uncollectible accounts were \$88,000 as of June 30, 2019. The Water Fund's customers are billed monthly. The estimated value of services provided, but unbilled at year-end has been included in the accompanying financial statements.

Capital Assets

Capital assets (including infrastructure) are recorded at historical cost or at estimated historical cost if actual historical cost is not available. Contributed capital assets are valued at their estimated fair value on the date contributed. Capital assets include land, construction in progress, and plant assets including building, improvements, and machinery and equipment. The capitalization threshold for all capital assets is \$5,000. Capital assets used in operations are depreciated using the straight-line method over their estimated useful lives.

The estimated useful lives are as follows:

Utility plant and buildings	25 to 50 years
Improvements	10 to 20 years
Machinery and equipment	3 to 35 years

Maintenance and repairs are charged to operations when incurred. Betterments and major improvements, which significantly increase values, change capacities or extend useful lives, are capitalized. Upon sale or retirement of capital assets, the cost and related accumulated depreciation are removed from the respective accounts and any resulting gain or loss is included in the changes in fund net position.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Compensated Absences

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

Deferred Outflows and Inflows of Resources

Pursuant to GASB Statement No. 63 and 65, the Water Fund recognizes deferred outflows and inflows of resources. A deferred outflow of resources is defined as a consumption of net position by the Water Fund that is applicable to a future reporting period. A deferred inflow of resources is defined as an acquisition of net position by the Water Fund that is applicable to a future reporting period. At June 30, 2019, the Water Fund has deferred outflows and inflows of resources representing deferred amounts on pension-related transactions and postemployment benefit-related transactions.

Net Position

The Water Fund financial statements utilize a net position presentation. Net position is categorized as invested in capital assets (net of related debt), restricted and unrestricted.

- Net Investment in Capital Assets – This category groups all capital assets into one component of net position. Accumulated depreciation and the outstanding balances of debt that are attributable to the acquisition, construction or improvement of these assets reduce the balance in this category.
- Restricted Net Position – This category presents external restrictions imposed by creditors, grantors, contributors or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation.
- Unrestricted Net Position – This category represents net position of the Water Fund not restricted for any project or other purpose.

Use of Estimates

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

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Pensions

For purposes of measuring the net pension liability and deferred outflows/inflows of resources related to pensions and pension expense, information about the fiduciary net position of the City's California Public Employees' Retirement System (CalPERS) plan and additions to/deductions from the Plans' fiduciary net position have been determined on the same basis as they are reported by CalPERS and PARS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Other Postemployment Benefits Other than Pensions (OPEB)

For purposes of measuring the net OPEB liability, deferred outflows of resources and deferred inflows of resources related to OPEB, and OPEB expense information about the fiduciary net position of the City's OPEB Plan and additions to/deductions from the Plan's fiduciary net position have been determined on the same basis as they are reported by the Plan. For this purpose, the Plan recognizes benefit payments when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Implementation of New Accounting Pronouncements

During the fiscal year ended June 30, 2019, the City adopted the following new Statement of the Governmental Accounting Standards Board (GASB):

GASB statement No. 83

In November 2016, the Governmental Accounting Standards Board (GASB) issued Statement No. 83, "*Certain Asset Retirement Obligations.*" This Statement is effective for financial statements for fiscal year beginning after June 15, 2018 and did not impact the Water Fund.

GASB statement No. 88

In March 2018, the Governmental Accounting Standards Board (GASB) issued Statement No. 88, "*Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements.*" The Statement's objective is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt. This Statement is effective for financial statements for the period beginning after June 15, 2018 and did not impact the Water Fund.

NOTE 2 CASH AND CASH EQUIVALENTS

Cash and Cash Equivalents

Cash and cash equivalents as of June 30, 2019 consist of the following:

Deposits with financial institutions	\$ <u>7,292,358</u>
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The City's Investment Policy

The City's Investment Policy sets forth the investment guidelines for all funds of the City. The Investment Policy conforms to the California Government Code Section 53600 et. seq. The authority to manage the City's investment program is derived from the City Council. Pursuant to Section 53607 of the California Government Code, the City Council annually, appoints the City Treasurer to manage the City's investment program, and approves the City's investment policy. The Treasurer is authorized to delegate this authority as deemed appropriate. No person may engage in investment transactions except as provided under the terms of the Investment Policy and the procedures established by the Treasurer.

This Investment Policy requires that the investments be made with the prudent person standard, that is, when investing, reinvesting, purchasing, acquiring, exchanging, selling or managing public funds, the trustee (Treasurer and staff) will act with care, skill, prudence, and diligence under the circumstances then prevailing, including but not limited to, the general economic conditions and the anticipated needs of the City.

The Investment Policy also requires that when following the investing actions cited above, the primary objective of the trustee be to safeguard the principal, secondarily meet the liquidity needs of depositors, and then achieve a return on the funds under the trustee's control. Further, the intent of the Investment Policy is to minimize risk of loss on the City's held investments from:

- A. Credit risk
- B. Custodial credit risk
- C. Concentration of credit risk
- D. Interest rate risk

Investments Authorized by the California Government Code and the City's Investment Policy

The table below identifies the investment types that are authorized for the City by the California Government Code and the City's Investment Policy. The table also identifies certain provisions of the California Government Code that address interest rate risk, credit risk, and concentration of credit risk. This table does not address investment of debt proceeds held by bond trustee that are governed by the provisions of debt agreements of the City, rather than the general provisions of the California Government Code or the City's Investment Policy.

NOTE 2 CASH AND CASH EQUIVALENTS (CONTINUED)

Investments Authorized by the California Government Code and the City's Investment Policy (Continued)

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio*	Maximum Investment in One Issuer	Minimum Rating
Securities of the U.S. Government, or its Agencies	5 years	None	None	None
Certain Asset-Backed Securities	5 years	None	None	AA
Certificates of Deposit	5 years	30%	None	None
Bankers' Acceptances	180 days	40%	30%	None
Commercial Paper	270 days	25%	10%	P-1
Repurchase Agreements	1 year	None	None	None
Reverse Repurchase Agreements	92 days	20%	None	None
Medium-Term Notes	5 years	30%	None	A
Mutual Funds Investing in Eligible Securities	N/A	20%	10%	AAA
Money Market Mutual Funds	N/A	20%	10%	AAA
Mortgage Pass-Through Securities	5 years	20%	None	AA
State Administered Pool Investment	N/A	None	\$50 million	None

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

Investments Authorized by Debt Agreements

Investments of debt proceeds held by bond trustee are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the City's Investment Policy. The table below identifies the investment types that are authorized for investments held by bond trustee. The table also identifies certain provisions of these debt agreements that address interest rate risk, credit risk, and concentration of credit risk.

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio	Maximum Investment in One Issuer	Minimum Rating
Securities of the U.S. Government, or its Agencies	None	None	None	None
Certain Asset-Backed Securities	None	None	None	AA
Certificates of Deposit	None	None	None	None
Bankers' Acceptances	1 year	None	None	None
Commercial Paper	None	None	None	P-1
Money Market Mutual Funds	N/A	None	None	AAA
State Administered Pool Investment	N/A	None	\$50 million	None
Investment Contracts	None	None	None	None

NOTE 2 CASH AND CASH EQUIVALENTS (CONTINUED)

Disclosure Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the City manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations. The City has no specific limitations with respect to this metric.

Disclosures Relating to Credit Risk

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

	Minimum Required Rating	Actual Credit Rating Moody's / S&P	Fair Value as of June 30, 2019	% of Total
In custody of Treasurer:				
Funds held by Treasurer:				
Deposits with financial institutions	N/A	N/A	\$ 7,292,358	100.0%
Total cash and cash equivalents held by Treasurer			\$ 7,292,358	100.0%

Concentration of Credit Risk

The City's Investment Policy places no limit on the amount the City may invest in any one issuer excluding a 10% limitation on commercial paper, mutual funds, and money market mutual funds and a 30% limitation on bankers' acceptances. The City's Investment Policy also places no limit on the amount of debt proceeds held by bond trustee that the trustee may invest in one issuer that are governed by the provisions of debt agreements of the City, rather than the general provisions of the California Government Code or the City's Investment Policy. As of June 30, 2019, there were no investments held by the Water Fund that exceeded 5% in any one issuer, excluding mutual funds and U.S. Treasury securities.

NOTE 2 CASH AND CASH EQUIVALENTS (CONTINUED)

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the City's Investment Policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments. Under the California Government Code, a financial institution is required to secure deposits in excess of FDIC insurance of \$250,000 made by state or local governmental units by pledging government securities held in the form of an undivided collateral pool. The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure City deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits. Such collateral is held by the pledging financial institution's trust department or agent in the City's name.

At year-end, except for the Water Fund's operating cash of \$1,149,154 that is pooled with the City's operating funds, the carrying amount of the Water Fund's other bank deposits totaling \$6,143,204 was the same as the bank balance. As of June 30, 2019, none of the Water Fund's deposits with financial institutions in excess of the federal depository insurance limit were held in uncollateralized accounts. The amount was collateralized by the pledging financial institution as required by Section 53652 of the California Government Code.

Fair Value Measurement

GASB 72, *Fair Value Measurement and Application*, establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The Water Fund categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset.

- Level 1 inputs are quoted prices for identical assets or liabilities in active markets that government can access at the measurement date.
- Level 2 inputs are other than quoted prices included in Level 1 that are observable for an asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for an asset or liability.

NOTE 2 CASH AND CASH EQUIVALENTS (CONTINUED)

Fair Value Measurement (Continued)

At June 30, 2019, the Water Fund’s financial assets primarily include cash and cash equivalents, receivables, accounts payable and accrued liabilities. The recorded values of cash and cash equivalents approximate their fair values based on their short-term nature. The recorded values of the receivables, account payable and accrued liabilities approximate their fair values, as the risk-free interest approximates market rates.

NOTE 3 ACCOUNTS RECEIVABLES

The Water Fund’s accounts receivable at June 30, 2019 are as follows:

Accounts receivable	\$	693,269
Less: Allowances for uncollectible accounts		(88,000)
Total receivables, net	\$	605,269

NOTE 4 RELATED PARTY TRANSACTIONS

Transactions between the Water Fund and the City’s other funds commonly occur in the normal course of business for services received or furnished (accounting, management, engineering, legal services, and capital projects).

The following table summarizes the Water Fund’s loan balance and transactions with the City’s other funds as of and for the year ended June 30, 2019:

Advances to other funds

Advances to other funds, July 1, 2018	\$	11,311,300
Payment of advances by the other funds during the year		(4,864,129)
Advances to other funds, June 30, 2019	\$	6,447,171

The loan between the City’s other funds and the Water Fund does not accrue interest due to the nature of the operational relationship and capital projects funded by the Water Fund that benefit the other funds. On November 6, 2012, the City adopted Resolution No. 2012-215 extending the repayment term of the loan to the City from 15 months to a period of over 10 years.

The City (general fund) allocates certain administrative and overhead costs to the Water Fund which is included as part of cost of sales. The allocated costs for the year ended June 30, 2019 were \$575,000.

City of Vernon, California
Water Fund
Notes to the Financial Statements
Year ended June 30, 2019

NOTE 5 CAPITAL ASSETS

Capital asset activities of the Water Fund for the fiscal year ended June 30, 2019 were as follows:

	Balance June 30, 2018	Additions	Deletions	Balance June 30, 2019
<i>Capital assets, not being depreciated:</i>				
Land	\$ 467,640	\$ -	\$ -	\$ 467,640
Construction in progress	926,402	328,722	-	1,255,124
Total capital assets, not being depreciated	<u>1,394,042</u>	<u>328,722</u>	<u>-</u>	<u>1,722,764</u>
<i>Capital assets, being depreciated</i>				
Water utility plant	20,500,612	111,542	-	20,612,154
Total capital assets, being depreciated	<u>20,500,612</u>	<u>111,542</u>	<u>-</u>	<u>20,612,154</u>
Less accumulated depreciation for:				
Water utility plant	(14,624,446)	(331,922)	-	(14,956,368)
Total accumulated depreciation	<u>(14,624,446)</u>	<u>(331,922)</u>	<u>-</u>	<u>(14,956,368)</u>
Total capital assets, being depreciated, net				
Water utility plant	5,876,166	(220,380)	-	5,655,786
Total	<u>5,876,166</u>	<u>(220,380)</u>	<u>-</u>	<u>5,655,786</u>
Total capital assets, net	<u>\$ 7,270,208</u>	<u>\$ 108,342</u>	<u>\$ -</u>	<u>\$ 7,378,550</u>

Depreciation

The Water Fund's total depreciation expense for the year was \$331,922.

NOTE 6 LONG-TERM OBLIGATIONS

Changes in long-term liabilities

The following is a summary of long-term liabilities transactions for the fiscal year ended June 30, 2019:

	Balance June 30, 2018	Additions	Reductions	Balance June 30, 2019	Amounts Due Within One Year
Compensated absences	\$ 154,322	\$ -	\$ (52,084)	\$ 102,238	\$ 34,079
Other postemployment benefit (OPEB) liability	1,482,614	-	(763,507)	719,107	-
Net pension liability	4,100,788	-	(567,580)	3,533,208	-
	<u>\$ 5,737,724</u>	<u>\$ -</u>	<u>\$ (1,383,171)</u>	<u>\$ 4,354,553</u>	<u>\$ 34,079</u>

Refer to Notes 8 and 9 for information on net pension liability and OPEB liability, respectively.

NOTE 7 RISK MANAGEMENT

The Water Fund is in the City’s self-insurance program as part of its policy to self-insure certain levels of risk within separate lines of coverage to maximize cost savings.

The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets, errors and omissions; injuries to employees, and natural disasters. The City utilizes Insurance Policy(s) to transfer these risks. Each policy has either a self-insured retention or deductible, which are parts of the City’s Risk Financing Program. These expenses are paid on a cash basis as they are incurred. There have been no significant settlements or reductions in insurance coverage during the past three fiscal years.

Starting in Fiscal 2010, the City chose to establish Risk Financing in the General Fund, whereby assets are set aside for claim-litigation settlements associated with the abovementioned risks up to their self-insured retentions or policy deductibles. Athens Administrators Inc. is the Third Party Administrator for the City’s workers’ compensation program and they provide basic services for general liability claims and litigation.

The insurance limits for fiscal year 2019 are as follows (amounts in thousands):

<u>Insurance Type</u>	<u>Program Limits</u>	<u>Deductible/ SIR (Self-Insured Retention)</u>
Excess Liability Insurance	\$ 20,000	\$2,000 SIR per occurrence
D & O Employment Practice	\$ 2,000	\$250 SIR non-safety; \$250 SIR safety
Excess Workers Compensation	\$ 50,000	\$1,000 SIR per occurrence
Property Insurance	\$ 241,000	various up to \$500
Employee Dishonest- Crime	\$ 1,000	\$25
Pollution- Site Owned	\$ 5,000	\$25
Pollution- Haulers	\$ 5,000	\$25

The City has numerous claims and pending litigations, which generally involve accidents and or liability or damage to City property. The balance of claims/litigations against the City is in the opinion of management, ordinary routine matters, incidental to the normal business conducted by the City. In the opinion of management, such proceedings are substantially covered by insurance, and the ultimate dispositions of such proceedings are not expected to have a material adverse effect on the Water Fund’s financial position, results of operations or cash flows.

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

NOTE 8 PENSION PLANS

General Information about the Pension Plans

Plan Descriptions – All full-time safety (police and fire personnel) and miscellaneous personnel and temporary or part-time employees who have worked a minimum of 1,000 hours in a fiscal year are eligible to participate in the City’s agent multiple-employer defined benefit pension Safety and Miscellaneous Plans administered by the California Public Employees’ Retirement System (CalPERS) that acts as a common investment and administrative agent for participating public entities within the State of California. Benefits vest after five years of service. Employees who retire at the minimum retirement age with five years of credited service are entitled to retirement benefits. Monthly retirement benefits are based on a percentage of an employee’s average compensation for his or her highest consecutive 12 or 36 months of compensation for each year of credited service.

Benefits Provided – Miscellaneous members hired prior to January 1, 2013 with five years of credited service may retire at age 55 based on a benefit factor derived from the 2.7% at 55 Miscellaneous formula or may retire between age 50 and 54 with reduced retirement benefits. New Miscellaneous members (PEPRA) with five years of credited service may retire at age 62 based on a benefit factor derived from the 2% at 62 Miscellaneous formula or may retire between age 52 and 61 with reduced retirement benefits. CalPERS also provides death and disability benefits. These benefit provisions and all other requirements are established by State statute and provided through a contract between the City and CalPERS.

The following amounts were allocated to the Water Fund as of and for the year ended June 30, 2019:

Net Pension Liability	\$ 3,533,208
Deferred Inflows of Resources	39,440
Deferred Outflows of Resources	581,241
Pension Expense	(209,422)

With the implementation of GASB Statement No. 68, the City of Vernon allocates about 3% of the City’s net pension liability and pension-related transactions to the Water Fund based on Water Fund’s share in the pension contribution. Please refer to the City’s audited financial statements for the fiscal year ended June 30, 2019 for more information about the City’s pension plan required note disclosures in accordance with GASB Statement No. 68.

NOTE 9 OTHER POSTEMPLOYMENT BENEFITS (OPEB)

The other postemployment benefits (OPEB) described in the following paragraphs relate to the City in which the Water Fund belongs. Information relating to the City applies to the Water Fund because the pension and other postemployment benefits are maintained by the City for all employees of the City which includes those of the Vernon Public Utilities (VPU).

NOTE 9 OTHER POSTEMPLOYMENT BENEFITS (OPEB) (CONTINUED)

Retiree medical and dental benefits are established through the City's Fringe Benefits and Salary Resolution as well as individual memoranda of understanding between the City and the City's various employee bargaining groups. Generally, the City will provide postemployment benefit plan for the employee only to those who retire at age sixty (60) or later with twenty (20) years of continuous uninterrupted service, up to the age of sixty-five (65). Alternatively, employees who retire before the age of sixty (60) with twenty (20) years of continuous uninterrupted service, will be permitted to pay their medical and dental premium cost and upon reaching the age of sixty (60), the City will pay the premium for the medical and dental plans until they reach the age of sixty-five (65).

Resolution 2012-217 granted specific retiree medical benefits to employees who retired during the 2012-2013 fiscal year in order to provide an incentive for early retirement whereby the City authorized the payment of medical and dental insurance premiums for eligible retiring employees and their eligible dependents with at least ten (10) years of service plus 5% for each additional full year of service above the ten (10) years of service. Resolution 2013-06 declared that the retiree medical benefits which had not been a vested right for employees will continue to be a non-vested right for employees who continue to be employed by the City on or after July 1, 2013 but will be a vested right for those who retire during the 2012-2013 fiscal year. The City's plan is considered a substantive OPEB plan and the City recognizes costs in accordance with GASB Statement No 45. The City may terminate its unvested OPEB in the future. As of June 30, 2019, 350 employees (254 active employees and 96 retired employees), participated in the OPEB plan.

The following amounts were allocated to the Water Fund as of and for the year ended June 30, 2019:

Net OPEB Liability	\$	719,107
Deferred Inflows of Resources		402,102
Deferred Outflows of Resources		94,176
OPEB Expense		(354,936)

The City allocates about 3% of the City's net OPEB obligation to the Water Fund based on the Water Fund's share in pension contribution. Further information regarding the City's participation in OPEB and required disclosure under GASB 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*, can be found in the City's Annual Financial Report.

NOTE 10 CONTINGENCIES

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

NOTE 11 SUBSEQUENT EVENTS

The Water Fund has evaluated events or transactions that occurred subsequent to the balance sheet date through March 6, 2020, the date the accompanying financial statements were available to be issued, for potential recognition or disclosure in the financial statements and determined that, except for the following, no other subsequent matters required disclosure or adjustment to the accompanying financial statements.

In February 2020, the City Council of the City of Vernon, through Resolution Number 2020-05, authorized and approved the issuance of Water System Revenue Bonds 2020 Series A for an aggregate principal amount not to exceed \$15 million payable from the Net Revenues of the Water System for the purposes of financing certain capital improvements to its Water System, paying costs of issuance of the Bonds and, if necessary, funding a deposit to (or procuring a letter of credit, insurance policy or other facility to provide for the funding of) a reserve fund for the Bonds.