

ACCOUNTING AND FINANCIAL REPORTING FOR DISSOLUTION
OF CALIFORNIA REDEVELOPMENT AGENCIES

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ACCOUNTING AND FINANCIAL REPORTING FOR DISSOLUTION OF CALIFORNIA REDEVELOPMENT AGENCIES

INTRODUCTION AND BACKGROUND

On December 29, 2011, the California Supreme Court upheld Assembly Bill 1X 26 (“the Bill”) that provides for the dissolution of all redevelopment agencies in the State of California. Many cities (and some counties) in California had established a redevelopment agency. In many cases, such redevelopment agencies were included within the reporting entity of the city or county as a blended component unit (since the governing board of the city or county, in many cases, also served as the governing board of the redevelopment agency).

The Bill provides that upon dissolution of a redevelopment agency, the entity that established the redevelopment agency may elect to serve as the “successor agency” to hold the assets of the former redevelopment agency until they are distributed to other units of state and local government after the payment of enforceable obligations that were in effect as of the signing of the Bill. If the entity that established the redevelopment agency declines to accept the role of successor agency, other local agencies may elect to perform this role. If no local agency accepts the role of successor agency, the Governor is empowered by the Bill to establish a “designated local authority” to perform this role. Accordingly, the successor agency role may be served by a city, a county or by another unit of local government. For simplicity of discussion, this white paper will refer to the entity that elects to serve the role of successor agency as “the City” although that entity may in fact be another unit of local government.

After enactment of the law, which occurred on June 28, 2011, redevelopment agencies in the State of California cannot enter into new projects, obligations or commitments. Subject to the control of a newly established Oversight Board, remaining assets can only be used to pay enforceable obligations in existence as of February 1, 2012, the date of dissolution (including the completion of any unfinished projects that were subject to legally enforceable contractual commitments). The Bill sets forth a process for each agency to identify and report these enforceable obligations on a Enforceable Obligation Payment Schedule (EOPS) and a Recognized Obligation Payment Schedule (ROPS).

In future fiscal years, successor agencies will only be allocated property tax revenue in the amount that is necessary to pay the estimated annual installment payments on enforceable obligations of the former redevelopment agency until all enforceable obligations of the prior redevelopment agency have been paid in full and all assets have been liquidated.

Application of Professional Judgment

The recommendations in this white paper represent the professional judgment of the members of CCMA. Other positions may be taken by preparers of financial statements that are consistent with generally accepted accounting principles.

Some redevelopment agencies may have been reported as discretely presented component units or have other unique characteristics that merit special consideration. The recommendations in this white paper should be modified, as necessary, to reflect the facts and circumstances of each situation. Professional judgment should also be exercised to reflect the continued development of the various legal issues associated with the dissolution of redevelopment agencies for which considerable uncertainty currently exists.

Legal Status of Successor Agencies

Section 34171(j) of the Bill states that “successor agency means the county, city, or city and county that authorized the creation of each redevelopment agency or another entity as provided in Section 34173”.

Based on the language in the Bill, it does not appear that successor agencies are separate legal entities per se. Rather, the term successor agency refers to a *role* that an existing unit of government (often the City that created the redevelopment agency) may play as custodian for the assets and activities of the former redevelopment agency post-dissolution.

Although the term “successor agency” refers to a role rather than an entity, for purposes of this white paper, the term “successor agency” will be used to refer to the combination of funds that are maintained to report the assets and activities of the former redevelopment agency.

Control of the Former Redevelopment Agency/Successor Agency by the Oversight Board

Upon the date of the dissolution (February 1, 2012), significant matters previously controlled by the city councils of the cities that created each redevelopment agency are now subject to the control of a seven-member Oversight Board. Generally, the City controls the appointment of only two representatives (representing the City and employees of the City) to this Oversight Board. City employees will perform the necessary day-to-day activities to bring existing project commitments to completion, provide the Oversight Board with information and analysis regarding negotiated offers for sale of agency assets, draft an administrative budget for approval by the Oversight Board, etc. However, a City Council can take no action with respect to the assets held by the city in its role as successor agency without the approval of the Oversight Board. Enforceable obligations to be paid by the successor agency are subject to the approval of the Oversight Board and the California Department of Finance. The following significant matters previously controlled by the City Council with respect to redevelopment agency assets are now controlled by the Oversight Board:

- Approval of the sale and distribution of all assets
- Approval of any change in obligation terms
- Approval of any prepayment or defeasance of debt
- Approval of acceptance of grants
- Approval of funding of debt service reserves
- Approval of the budget for any remaining activities

REPORTING IN THE FINANCIAL STATEMENTS OF THE CITY

The following sets forth the impact of dissolution on the financial statements of the entities that have accepted the role to serve as successor agency with respect to the assets and activities of the former redevelopment agency.

Fund Type to Be Used for Reporting Successor Agency Activities in City Financial Statements

Under the Bill, agencies that accept the role of successor agency will serve as a custodian for the assets of the dissolved redevelopment agency pending distribution to the appropriate taxing entities after the payment of enforceable obligations that were in effect as of the signing of the

Bill. Based upon the nature of this custodial role, upon dissolution the assets and liabilities of the dissolved redevelopment agency should be reported in a fiduciary fund (private-purpose trust fund) of the City. This determination was made by CCMA after consultation with senior staff members of GASB and GFOA.

Basis for Conclusions

Paragraph 69 of GASB Statement No. 34 states that “fiduciary funds should be used to report assets held in a trustee or agency capacity for others and therefore cannot be used to support the government’s own programs...Trust funds should be used to report the resources held and administered by the reporting government when it is acting in a fiduciary capacity for individuals, private organizations, or other governments.”

Further, paragraph 69 of GASB No. 34 states that trust funds *generally* are associated with a trust agreement. A formal trust agreement is not required by the Bill. However, the use of the term “generally” in paragraph 69 of GASB No. 34 suggests that there are circumstances when professional judgment would lead to a proper reporting of a private-purpose trust fund without the existence of a trust agreement. Because of the fiduciary responsibilities that are assigned to successor agencies by the Bill, the Bill may be considered to effectively function as an informal trust arrangement for the purposes of applying this definition.

Economic Resources Measurement Focus and Accrual Accounting for Trust Funds

Because the *economic resources measurement focus* and the *accrual basis of accounting* is used for trust funds, the Trust Fund will report all of the assets (including capital assets) and liabilities (including long-term indebtedness) of the former redevelopment agency. It should also be noted that fiduciary funds are not included in the government-wide financial statements of a City.

Unlike the limited reporting typically utilized for fiduciary funds (agency fund type), private-purpose trust funds report a Statement of Fiduciary Net Assets (“balance sheet”) and a Statement of Changes in Fiduciary Net Assets (“income statement”).

Accounting for Transfer of Assets and Liabilities From the Former Redevelopment Agency to the Successor Agency Trust Fund

In accordance with the timeline set forth in the Bill (as modified by the California Supreme Court on December 29, 2011) all redevelopment agencies in the State of California were dissolved and ceased to operate as a legal entity as of February 1, 2012.

Prior to that date, the final seven months of the activity of the redevelopment agency will continue to be reported in the governmental funds of the City. After the date of dissolution, the assets and activities of the dissolved redevelopment agency will be reported in a fiduciary fund (private-purpose trust fund) in the financial statements of the City. This position aligns with the guidance proposed for government combinations and dispositions that is set forth in GASB’s exposure draft entitled *Government Combinations and Disposals of Government Operations*.

The dissolution of all redevelopment agencies in the State of California appears to qualify as an extraordinary item since this state-wide dissolution was both unusual and infrequent. Accordingly, the movement of the assets and liabilities of the former redevelopment agency as of February 1, 2012 (effectively the same date as January 31, 2012) from governmental funds of the City to fiduciary funds will be recorded as an extraordinary loss (or gain) in the governmental fund financial statements and in the government-wide financial statements. The receipt of these assets and liabilities as of January 31, 2012 will be reported in the Trust Fund as an extraordinary gain (or loss) or, alternatively, as an addition with a title such as “net assets received upon dissolution of redevelopment agency”.

The transfer of the assets and liabilities of the former redevelopment agency as of February 1, 2012 (effectively the same date as January 31, 2012) from governmental funds of the City to fiduciary funds will be recorded as an extraordinary loss (or gain) in the governmental fund financial statements. Prior to recording this transfer, accruals through January 31, 2012 for expenditures incurred and revenues that are subject to the measurable and available criteria applicable to governmental funds should be recorded, if material, in the governmental funds of the former redevelopment agency.

An extraordinary item will also be reported in the government-wide financial statements of the City. Because of the different measurement focus of the governmental funds (*current financial resources measurement focus*) and the measurement focus of the government-wide financial statements (*economic resources measurement focus*), the extraordinary item recognized in the governmental funds will not be the same amount as the extraordinary item that will be recognized in the government-wide financial statements. This difference will typically be due to the capital assets, long-term debt, and certain long-term accruals that are reflected in the government-wide financial statements, but that are not recognized in the financial statements of the governmental funds. The notes to the financial statements should reconcile the difference between these two amounts.

In many cases, the government-wide financial statements may recognize a net extraordinary gain due to the removal of the long-term debt of the former redevelopment agency for recording in the Successor Agency Trust Fund.

Generally, the extraordinary item recognized in the government-wide financial statements will agree with that recognized in the fiduciary fund financial statements, due to their using the same measurement focus and basis of accounting.

Fund Structure in City's Accounting System

Due to the many legal uncertainties that continue to exist with respect to the Bill, some Cities are retaining in their accounting system the same fund structure that was utilized by that City prior to the dissolution of the redevelopment agency. The titles of those funds may have been changed to identify them with the City's role as successor agency. Other Cities have established new funds for the successor agency activities.

All of the funds established for the successor agency should be combined for financial statement purposes when the private-purpose trust fund is presented in the City's financial statements.

Presentation in the City's Financial Statements

In the City's financial statements, these funds will be reported as a private-purpose trust fund, for the various activities that are maintained in the accounting system of the successor agency. Although not required, some Cities may include a supplemental combining schedule in the City's financial statements that shows the composition of the various activities (i.e. "funds" in the accounting system) that are reported as a single trust fund in the basic financial statements.

It is envisioned that there will be a discussion of the dissolution and transfer of the operations to the successor agency in management's discussion and analysis as well as the notes to the basic financial statements.

Major Fund Calculation for 2012 and Forward

The dissolution of the former redevelopment agency and the establishment of the Successor Agency Trust Funds during fiscal year 2012 will change the presentation of funds in a government's annual financial report. Many governments blended the former operations of redevelopment agencies into funds of the primary government. As part of the blending process,

the governmental funds of the redevelopment agencies were taken into consideration in the major fund calculation. For 2012, seven months of revenues and expenditures of the former redevelopment agency will be included in governmental funds, and, therefore, potentially result in their classification as major funds for that fiscal year. Once moved into the Successor Agency Trust Fund, the activities of the former redevelopment agency will no longer be reported as major funds, since fiduciary funds are excluded from such determination.

Closing of Revenues and Expenditures at January 31, 2012

From a practical standpoint, some Cities may have simply changed the name of the funds of the former redevelopment agency in their accounting system so that their fund title is now identified with the City's role as successor agency. Other Cities may choose to establish new funds in their accounting system to account for the activity of the former redevelopment agency in its post-dissolution stage.

Regardless of the method used to establish the successor agency funds, the revenues and expenditures of the former redevelopment agency will need to be distinguished from the revenues ("additions") and expenses ("deletions") of the successor agency trust. The City's accounting system should be used to determine the balance sheet of each of the funds of the former redevelopment agency as of January 31, 2012. These balance sheets will need to reflect appropriate material accruals as of January 31, 2012 to properly distinguish the activity pre- and post-dissolution.

Once the balance sheet of the former redevelopment agency as of January 31, 2012 has been established, the revenue and expenditure balances representing the seven month activity of the former redevelopment agency should be closed to the fund balances of the various funds of the former redevelopment agency. As a result of this closure, the funds of the former redevelopment agency will then be in a position to report the remaining five months of activity that is required for the proper reporting of the successor agency in the fiduciary financial statements of the City.

Value of Assets Recorded in the Successor Agency Trust Fund

Assets will be transferred to the Trust Fund at their carrying value (for example, historical cost of capital assets less accumulated depreciation through January 31, 2012). This is consistent with the guidance proposed by GASB in its recently issued exposure draft *Government Combinations and Disposals of Government Operations* dealing with government combinations.

Housing Funds

Section 34176(a) of the Bill provides that:

The city, county, or city and county that authorized the creation of a redevelopment agency *may elect to retain the housing assets and functions* previously performed by the redevelopment agency. If a city, county, or city and county elects to retain the responsibility for performing housing functions previously performed by redevelopment agency, all rights, powers, duties, and obligations, *excluding any amount on deposit in the Low and Moderate Income Housing Fund*, shall be transferred to the city, county, or city and county.

Section 34177(d) provides that successor agencies must:

Remit unencumbered balances of redevelopment agency funds to the County Auditor-Controller for distribution to the taxing entities, *including, but not limited to, the unencumbered balance of the Low and Moderate Income Housing Fund of a former redevelopment agency.*

The cash balances of the Low and Moderate Income Housing Fund may be remitted to the Successor Agency Trust Fund pending appropriate disposition by the Oversight Board in accordance with the directives of the Bill.

If the City elects to take over the housing function previously performed by the redevelopment agency, the *non-cash assets* (land capital assets, rehabilitation loans, etc.) of the Low and Moderate Income Housing Fund may be transferred to the fund of the City established for the purposes of the City's assumption of the housing program.

Borrowings Between the City and the Former Redevelopment Agency

Section 34171(d)(2) of the Bill states that

For purposes of this part, "enforceable obligation" does not include any agreements, contracts, or arrangements between the city, county, or city and county that created the redevelopment agency and the former redevelopment agency. However, written agreements entered into (A) at the time of issuance, but in no event later than December 31, 2010, of indebtedness obligations, and (B) solely for the purpose of securing or repaying those indebtedness obligations may be deemed enforceable obligations for purposes of this part. Notwithstanding this paragraph, loan agreements entered into between the redevelopment agency and the city, county, or city and county that created it, within two years of the date of creation of the redevelopment agency, may be deemed to be enforceable obligations.

This language is the subject of varying interpretation by different attorneys and other parties, as well as legislation pending as of the date of this document. Accordingly, each City should seek the advice of legal counsel with respect to these borrowings. Where legal counsel indicates that it is probable that the collection of these loans will not be honored, these loans should be written off by an adjustment to the extraordinary item that was recognized as a result of the dissolution of the redevelopment agency.

Funds (such as the General Fund) that previously reported an interfund receivable for loans made to the redevelopment agency, should recognize an extraordinary loss if legal counsel determines that it is probable that the courts will not uphold the enforceability of previously executed interagency loans.

If legal counsel opines that it is reasonably possible that the enforceability of these interagency loans will be upheld, the notes should, nevertheless, disclose the possibility of loss resulting from the final resolution of this legal uncertainty.

Generally, a receivable reported by the former redevelopment agency for prior borrowings by the City from the agency represent an asset that should be transferred to the Successor Agency Trust for collection, liquidation, and remittance of the collected amounts to the County.

AUDIT REQUIREMENTS

Audit Requirements Under the California Health and Safety Code

The State Controller's Office has communicated to CCMA that there is currently no legislative basis to require a financial and compliance audit of the financial statements of the former redevelopment agency for the period from July 1, 2011 through January 31, 2012 or for any current or future periods associated with the successor agency. There is also no legislative basis to require any further filings of Annual Reports of Financial Transactions (the "State Controller's Report") or Statement of Indebtedness by either the former redevelopment agency or the successor agency. Also discontinued are the schedules that previously accompanied the State Controller's Report for use by the California Department of Housing and Community

Development. The current status of these legislative requirements may be modified by legislation pending as of the date of this document.

In certain circumstances, other agencies, such as the county Auditor-Controller's Office, may request separate financial statements for the final reporting period of the former Redevelopment Agency. This would cover the period from July 1, 2011 through January 31, 2012 and include the transfer of balances to the Successor Agency and Housing Successor.

Inclusion in the Audited Financial Statements of the City

The presentation of the Successor Agency Trust Fund within the published financial statements of the City will provide transparency to users of the financial statements regarding the activities of the successor agency trust funds.

The debt of the Successor Agency Trust Fund is not debt of the primary government and, accordingly, disclosures relating to debt of the Trust Fund should not be part of the debt disclosures of the primary government. As a result, a note should be added to the financial statements of the City that will contain all disclosures relevant to the Successor Agency Trust Fund, including disclosures relating to debt of the Trust Fund. An Example Note for consideration is attached to this white paper. Any legal uncertainties pertaining to positions taken by the reporting government should also be disclosed. This may include a disclosure of certain commitments entered into by the former redevelopment agency for which other funds of the City may become obligated due to the rejection of those obligations by the California Department of Finance.

Separate Trust Fund Financial Statements

Although not required by state law or by generally accepted accounting principles, a successor agency may choose to issue separate financial statements for the Successor Agency Trust. If a City chooses to do this, such fund financial statements may present a single consolidated presentation for the Successor Agency Trust with supplementary schedules to display the components of the Trust by project area, etc. Any separate financial statements issued should include all applicable disclosures. The attached example note (designed for use in the City's financial statements) may be helpful to the preparer in the preparation of such disclosures.

Compliance with Debt Covenants

Successor agencies should consult with bond counsel to ascertain whether the reporting of the Successor Agency Trust Fund in the financial statements of the City (combined with the continuation of all relevant disclosures pertaining to the former redevelopment agency) will meet any audit requirements that might pertain to outstanding debt of the former redevelopment agency. Such consultation should also consider whether the composition of the Trust Fund by project area should be presented as a supplemental schedule in the City financial statements.

County Responsibility for Agreed-Upon Procedures Engagement

Section 34182 of the Bill requires that the Auditor-Controller of each county conduct or cause to be conducted an agreed upon procedures (AUP) engagement with respect to the dissolution of the former redevelopment agency. The primary objectives of this engagement are to compare the obligations listed on the Enforceable Obligation Payment Schedule (EOPS) and Recognized Obligation Payment Schedule (ROPS) prepared by the successor agency to the legal document that gave rise to the obligation. In addition, documents supporting ROPS payments and pass-through obligation payments are inspected. Evidence of transfer of redevelopment agency assets to the successor agency trust is also reviewed. Procedures are performed with respect to certain other administrative actions associated with the establishment of the Oversight Board and the City's acceptance of its role as successor agency. A listing of all assets of the former

redevelopment agency as of June 30, 2010; June 30, 2011; and January 31, 2012 must be attached to the AUP report. Each county's Auditor-Controller must provide a copy of the agreed upon procedures report to the State Controller's Office by July 15, 2012.

State Controller's Office to Review Transfers From Agency to City Executed After January 1, 2011

Section 34167.5 of the Bill authorizes the State Controller to review transfers of assets from redevelopment agencies to the City that occurred after January 1, 2011. If the State Controller determines that the entity that received the transfer is not contractually committed to a third party for the expenditure or encumbrance of those funds, the State Controller may order that the transferred assets be remitted to the successor agency. In cases where such transfers took place, the notes to the financial statements should disclose that the transferred assets are subject to the determination by the State Controller that the assets must be remitted to the successor agency trust.

EXAMPLE NOTE DISCLOSURE

Note X – Successor Agency Trust For Assets of Former Redevelopment Agency

On December 29, 2011, the California Supreme Court upheld Assembly Bill 1X 26 (“the Bill”) that provides for the dissolution of all redevelopment agencies in the State of California. This action impacted the reporting entity of the City of _____ that previously had reported a redevelopment agency within the reporting entity of the City as a blended component unit.

The Bill provides that upon dissolution of a redevelopment agency, either the city or another unit of local government will agree to serve as the “successor agency” to hold the assets until they are distributed to other units of state and local government. On _____, 2011, the City Council elected to become the Successor Agency for the former redevelopment agency in accordance with the Bill as part of City resolution number _____.

After enactment of the law, which occurred on June 28, 2011, redevelopment agencies in the State of California cannot enter into new projects, obligations or commitments. Subject to the control of a newly established oversight board, remaining assets can only be used to pay enforceable obligations in existence at the date of dissolution (including the completion of any unfinished projects that were subject to legally enforceable contractual commitments).

In future fiscal years, successor agencies will only be allocated revenue in the amount that is necessary to pay the estimated annual installment payments on enforceable obligations of the former redevelopment agency until all enforceable obligations of the prior redevelopment agency have been paid in full and all assets have been liquidated.

The Bill directs the State Controller of the State of California to review the propriety of any transfers of assets between redevelopment agencies and other public bodies that occurred after January 1, 2011. If the public body that received such transfers is not contractually committed to a third party for the expenditure or encumbrance of those assets, the State Controller is required to order the available assets to be transferred to the public body designated as the successor agency by the Bill.

Management believes, in consultation with legal counsel, that the obligations of the former redevelopment agency due to the City are valid enforceable obligations payable by the successor agency trust under the requirements of the Bill. The City’s position on this issue is not a position of settled law and there is considerable legal uncertainty regarding this issue. It is reasonably possible that a legal determination may be made at a later date by an appropriate judicial authority that would resolve this issue unfavorably to the City.

In accordance with the timeline set forth in the Bill (as modified by the California Supreme Court on December 29, 2011) all redevelopment agencies in the State of California were dissolved and ceased to operate as a legal entity as of February 1, 2012.

Prior to that date, the final seven months of the activity of the redevelopment agency continued to be reported in the governmental funds of the City. *[Note – it is optional to name the funds here].* After the date of dissolution, the assets and activities of the dissolved redevelopment agency are reported in a fiduciary fund (private-purpose trust fund) in the financial statements of the City.

The transfer of the assets and liabilities of the former redevelopment agency as of February 1, 2012 (effectively the same date as January 31, 2012) from governmental funds of the City to fiduciary funds was reported in the governmental funds as an extraordinary loss (or gain) in the governmental fund financial statements. The receipt of these assets and liabilities as of January 31, 2012 was reported in the private-purpose trust fund as an extraordinary gain (or loss).

Because of the different measurement focus of the governmental funds (*current financial resources measurement focus*) and the measurement focus of the trust funds (*economic resources measurement focus*), the extraordinary loss (gain) recognized in the governmental funds was not the same amount as the extraordinary gain (loss) that was recognized in the fiduciary fund financial statements.

The difference between the extraordinary loss recognized in the fund financial statements and the extraordinary gain recognized in the fiduciary fund financial statements is reconciled as follows:

Total extraordinary loss reported in governmental funds – increase to net assets of the Successor Agency Trust Fund	\$25,372,655
Capital assets recorded in the government-wide financial statements – increase to net assets of the Successor Agency Trust Fund	12,959,136
Accrued bond interest reported in the government-wide financial statements – decrease to net assets of the Successor Agency Trust Fund	(772,757)
Long-term debt reported in the government-wide financial Statements – decrease to net assets of the Successor Agency Trust Fund	<u>(50,497,296)</u>
Net decrease to net assets of the Successor Agency Trust Fund as a result of initial transfers (equal to amount of extraordinary gain reported in the government-wide financial statements of the City)	<u>(\$12,938,262)</u>

NOTE TO THE PREPARER OF THE SUCCESSOR AGENCY NOTE:

Generally, disclosures pertaining to fiduciary funds are segregated from disclosures that are associated with the primary government and its discretely-presented component units.

Although not required by GAAP, the note for the Successor Agency Trust Fund may be augmented by including additional disclosures to the extent they deal with material matters or provide significant information relevant to the user of the financial statements. Examples of such relevant information for consideration by the preparer include, but are not limited to, the following:

- Cash and investments
- Receivables (where details of composition would be beneficial to the user of the financial statements)
- Changes in capital assets and other capital asset disclosures
- Interfund receivable and payable balances and interfund eliminations associated with the various “funds” contained within the Successor Agency Trust (not needed if this information is presented in a supplemental schedule that presents the various “funds” that were combined together to report the Successor Agency Trust Fund)
- Payable balances (where details of composition would be beneficial to the user of the financial statements)
- Long-term obligations including a schedule of changes in long term obligations, debt service requirements to maturity, and description of the various bonds, notes and leases payable by the successor agency trust, including terms, maturities, and interest rates.
- Commitments and contingencies
- Subsequent events