



**FOOTHILL/EASTERN TRANSPORTATION
CORRIDOR AGENCY**

Financial Statements

June 30, 2005

(With Independent Auditors' Report Thereon)

**FOOTHILL/EASTERN TRANSPORTATION
CORRIDOR AGENCY**

Financial Statements

June 30, 2005

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KPMG LLP
Suite 700
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Costa Mesa, CA 92626-7651

Independent Auditors' Report

Honorable Board of Directors
Foothill/Eastern Transportation Corridor Agency

We have audited the accompanying financial statements of the Foothill/Eastern Transportation Corridor Agency (the Agency) as of and for the year ended June 30, 2005, as listed in the table of contents. These financial statements are the responsibility of the Agency's management. 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 of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Agency's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Foothill/Eastern Transportation Corridor Agency as of June 30 2005 and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 2 of the financial statements, the Agency adopted Governmental Accounting Standards Board (GASB) Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*.

In accordance with Government Auditing Standards, we have also issued our report dated August 26, 2005 on our consideration of the Agency's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 3 through 8 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United State of America. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

August 26, 2005

**FOOTHILL/EASTERN TRANSPORTATION
CORRIDOR AGENCY**

Management's Discussion and Analysis

June 30, 2005
(In thousands)

This discussion and analysis of the Foothill/Eastern Transportation Corridor Agency's (the Agency) financial performance provides an overview of the Agency's financial activities for the fiscal year ended June 30, 2005. Please read it in conjunction with the Agency's financial statements.

Background

The Foothill/Eastern Transportation Corridor Agency was formed in 1986 as a Joint Powers Authority by the County of Orange and cities in Orange County, California. The Agency was created to plan, design, finance, construct, and operate the Foothill (State Route 241) and Eastern (State Route 241, State Route 261, and State Route 133) Toll Roads.

Planning began in the 1970s when local transportation studies identified the need for new highways, including the Foothill and Eastern Transportation Corridors (State Route 241, State Route 261, and State Route 133), to serve Orange County's growing population. In the early 1980s, the corridor was envisioned as a free highway funded through state or federal gas-tax revenues, but with a shortage of gas-tax revenues to fund transportation improvements and increasing costs of building new roads, local officials began to study alternative ways to fund road projects.

In the mid 1980s, two state laws were passed authorizing the Agency to collect tolls and development impact fees to fund road construction. With a pledged revenue stream from future tolls, the Agency issued nonrecourse, toll-revenue bonds to fund road construction, rather than relying on the uncertainty of state gas-tax revenue. The Agency also reached an agreement with the California Department of Transportation (Caltrans) to assume ownership, liability, and maintenance of the State Route 241, State Route 261, and State Route 133 Toll Roads as part of the state highway system. This agreement eliminated the need for the Agency to seek additional funding sources for road maintenance.

In 1993, the first 3.2-mile segment of the Foothill (State Route 241) Toll Road opened to traffic, the first toll road in Southern California to use FasTrak®, an electronic toll-collection system that allowed drivers to pay tolls without stopping at a tollbooth. Today, more than 200,000 transactions are recorded on the State Route 241, State Route 261, and State Route 133 Toll Roads every weekday, serving as an important, timesaving alternative route to local freeways and arterial roads.

Financial Highlights

Tolls, fees, and fines collected in Fiscal Year 2005 (FY 2005) totaled \$98,895 compared to \$90,803 in the prior fiscal year, an increase of 8.9%.

Interest payments of \$54,543 and principal payments of \$7,915 on the Agency's long-term debt were made in FY 2005 compared to \$54,770 and \$5,175, respectively, in the prior fiscal year. Accretion on the Agency's capital appreciation bonds and convertible capital appreciation bonds totaled \$60,670 in FY 2005, compared to \$57,221 in the prior fiscal year.

As of June 30, 2005, the Agency had \$470,047 in restricted cash and investments governed under the 1995 and 1999 Master Indentures of Trust. The Agency also had \$125,432 in unrestricted cash.

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Management's Discussion and Analysis

June 30, 2005
(In thousands)

Total net assets (deficit) at June 30, 2005 were \$(1,383,527). The deficit results primarily from the recording of long-term debt, proceeds of which funded the construction of the corridors. Ownership was transferred to the State of California upon completion. The net deficit was also a result of accretion recorded on the capital appreciation bonds and convertible capital appreciation bonds, which was greater than principal payments made.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Agency's financial statements, which are comprised of the Statement of Net Assets (Deficit), Statement of Revenues, Expenses and Changes in Net Assets (Deficit), the Statement of Cash Flows, and notes to the financial statements.

The financial statements present the financial picture of the Agency from the economic resources measurement focus using the accrual basis of accounting. These statements include all recordable assets of the Agency as well as all liabilities. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid. The Statement of Cash Flows provides information about the Agency's cash receipts, cash payments and net changes in cash resulting from operations, capital financing activities and investing during the reporting period.

The Statement of Net Assets (Deficit) and the Statement of Revenues, Expenses and Changes in Net Assets (Deficit) report the Agency's net assets and related changes in them. Net assets are the difference between the recorded assets and liabilities. The recorded activities include all toll revenues and operating expenses related to the operation of the Foothill/Eastern Transportation Corridors. In addition, all of the Agency's construction related activities, including the design, construction and mitigation on the Foothill/Eastern Transportation Corridors, as well as all financing costs and administration of the project, are reflected in the statements. The activities are financed by toll revenues, development impact fees, remaining bond proceeds, fees and fines, investment income, and federal grants.

During fiscal year 2005, the Agency adopted Governmental Accounting Standards Board (GASB) Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which addresses accounting treatment for events or circumstances that impair the value of capital assets. The Agency holds title to various environmental mitigation parcels that will ultimately be conveyed to other owners for no consideration. The value of these parcels was written down to zero to reflect the development cycle of the mitigation parcels and the current reporting requirements. More detailed information about the implementation of GASB Statement No. 42 can be found in note 2 to the financial statements.

**FOOTHILL/EASTERN TRANSPORTATION
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Management's Discussion and Analysis

June 30, 2005
(In thousands)

Financial Analysis

The following table summarizes the assets, liabilities, and net assets (deficit) for the Agency as of June 30, 2005 and 2004:

	<u>2005</u>	<u>2004</u>	<u>Percent increase (decrease)</u>
Assets:			
Current assets	\$ 208,448	198,740	4.9%
Capital assets, net	123,318	177,502	(30.5)
Noncurrent assets	398,011	353,947	12.4
Total assets	<u>729,777</u>	<u>730,189</u>	(0.1)
Liabilities:			
Bonds payable	2,067,222	2,014,467	2.6
Other liabilities	46,082	45,293	1.7
Total liabilities	<u>2,113,304</u>	<u>2,059,760</u>	2.6
Total net assets (deficit)	<u>\$ (1,383,527)</u>	<u>(1,329,571)</u>	4.1

The purpose of the Agency is to plan, finance, design and construct the remaining portions of the corridor system, and to operate and collect tolls from the patrons of the corridors to extinguish the related long-term bond debt. The debt, issued in the form of tax-exempt bonds, was issued initially to construct the roads. Subsequent to completion, the roads are transferred to Caltrans. The net assets (deficit) results primarily from using bond proceeds to construct the corridors, which were then contributed to Caltrans, and from the accretion of interest on the outstanding bonds.

Current assets have increased this year mainly due to higher toll, fee, and fine revenue collected during the year.

Capital assets, net have decreased as a result of writing down the value of mitigation parcels from \$25,987 to zero. The write-down was in conjunction with adopting GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. The decrease in value did not result from a physical change in the properties; rather, it was to reflect the development cycle of mitigation assets.

The increase in bonds payable results from the current year accretion on the capital appreciation bonds and the convertible capital appreciation bonds totaling \$60,670 offset by a principal payment of \$7,915. Other liabilities have increased as a result of increased deferred revenue from FasTrak patrons as well as an increase in amounts owed by the Agency to San Joaquin Hills Transportation Corridor Agency related to toll road patrons driving on State Route 73.

**FOOTHILL/EASTERN TRANSPORTATION
CORRIDOR AGENCY**

Management's Discussion and Analysis

June 30, 2005
(In thousands)

The following is a summary of the Agency's revenues, expenses and changes in net assets (deficit) for the years ended June 30, 2005 and 2004:

	<u>2005</u>	<u>2004</u>	<u>Percent of increase (decrease)</u>
Operating revenues:			
Tolls, fees, and fines	\$ 98,895	90,803	8.9%
Development impact fees	16,648	17,932	(7.2)
Other revenue	250	599	(58.3)
Total operating revenues	<u>115,793</u>	<u>109,334</u>	5.9
Operating expenses	<u>95,044</u>	<u>44,944</u>	111.5
Operating income	20,749	64,390	(67.8)
Nonoperating revenue (expenses)	<u>(74,705)</u>	<u>(103,808)</u>	(28.0)
Change in net assets (deficit)	(53,956)	(39,418)	36.9
Net assets (deficit) at beginning of year	<u>(1,329,571)</u>	<u>(1,290,153)</u>	3.1
Net assets (deficit) at end of year	<u><u>\$ (1,383,527)</u></u>	<u><u>(1,329,571)</u></u>	4.1

Revenues for the Agency consist primarily of tolls, fees, and fines, which comprised 85.4% of total revenue in FY 2005 compared to 83.1% of total revenue in FY 2004. Tolls, fees, and fines increased 8.9% over the prior year primarily due to increased transactions.

The largest operating expense in the current year is the contribution of capital improvements to Caltrans of \$46,344, compared to \$19,503 in FY 2004. Capital improvement projects completed during the year were transferred to Caltrans, whereas in FY 2004, many of these projects were included in construction in progress. The other primary operating expense is the impairment loss on right-of-way acquisitions, grading, or improvements of \$25,987 compared to \$0 in FY 2004. This noncash expense is the result of adopting Statement No. 42 as discussed above. Also included in operating expenses are payments to third-party contractors for systems and equipment, violation processing, service center and toll collection operations and the noncash expense of depreciation on fixed assets of \$3,337 compared to \$4,932 in FY 2004.

Nonoperating revenue (expenses) consists of investment income of \$38,168 and grant revenue of \$2,037, offset by interest expense of \$114,910. For FY 2004, nonoperating revenue (expenses) consists of investment income of \$8,732 and grant revenue of \$371, offset by interest expense of \$112,911. The increase in investment income is primarily related to the change in fair market value of investments held during each year. Interest expense is comprised of both interest payments and the change in accrued interest on long-term debt, net of amounts capitalized, and accretion of bonds outstanding.

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June 30, 2005
(In thousands)

The increase in net deficit is primarily a result of three large noncash expenses; the accretion of bonds outstanding, impairment loss on right-of-way acquisitions, grading, or improvements, and the depreciation of capital assets. The revenues earned by the Agency were sufficient to cover its current obligations, including debt service and operating expenses, excluding depreciation.

Capital Assets, Net

The following table summarizes the capital assets, net at June 30:

	2005	2004
Construction in progress	\$ 85,681	115,425
Right-of-way acquisitions, grading, or improvements	16,539	40,523
Furniture, equipment, and vehicles	2	12
Facility and toll revenue equipment	21,096	21,542
Total capital assets	\$ 123,318	177,502

Construction in progress at June 30, 2005 primarily represents improvements in progress related to the Foothill South Corridor and capital improvements, including the State Route 133 East Leg widening and Eastern landscaping. Right-of-way acquisitions include easements and environmental mitigation parcels related to the construction projects, and is shown net of impairment loss on right-of-way acquisitions, grading, or improvements as a result of writing down the value of mitigation parcels as previously discussed above in Financial Analysis. Facility and toll revenue equipment includes the corridor operations facility, transponders, toll and violations collection equipment, toll booths and buildings, and changeable message signs.

More detailed information about the Agency's capital assets is presented in note 5 to the financial statements.

Debt Administration

The Agency has outstanding bonds payable of \$2,067,222 at June 30, 2005, an increase from the prior year of \$52,755 due to the accretion of principal on convertible capital appreciation bonds and capital appreciation bonds offset by a principal payment of \$7,915. All the Agency's toll revenue, less certain expenses, as defined in the Indentures of Trust, is pledged to repay these bonds. There were no changes to the debt structure during fiscal year 2005.

The Agency has several debt covenants contained in the Master Indentures of Trust. The Agency was in compliance with all of its covenants during and as of the year ended June 30, 2005.

Economic Factors

The Agency is continuing to seek ways to increase revenue and encourage more drivers to use FasTrak, which is considered the most cost-effective way for the Agency to collect tolls. A minor increase in cash tolls only at selected locations is currently planned for FY 2006.

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Management's Discussion and Analysis

June 30, 2005

Since May 2004, the San Joaquin Hills and Foothill/Eastern Boards have been negotiating the terms of an agreement that would assist the San Joaquin Hills Agency in its efforts to comply with its covenants to its bondholders. Both Boards have retained independent financial advisors and legal counsel to provide advice and counsel during the development of this agreement.

In addition to the proposal above, the Agency is also focused on the completion of the extension of State Route 241, known as Foothill South, and several ongoing capital improvement projects. A draft Environmental Impact Statement/Supplemental Environmental Impact Report was released for public review in FY 2004 for Foothill-South, an extension of State Route 241 Toll Road south from its current end near Rancho Santa Margarita and Mission Viejo to the I-5 Freeway near San Clemente. In accordance with state law, the Agency's Board of Directors is expected to select a locally preferred Foothill South alignment and certify the environmental document in the second quarter of fiscal year 2006. Once an alignment is chosen, the Agency will pursue the required state and federal permits and develop a finance plan before construction begins. If permits and financing are secured by 2007, Foothill-South could open as early as 2009.

Contacting The Agency's Financial Management

This financial report is designed to provide a general overview of the Agency's finances for all those with an interest in its finances. Questions concerning any of the information provided in this report or request for additional financial information should be addressed to the Controller, Foothill/Eastern Transportation Corridor Agency, 125 Pacifica, Suite 100, Irvine, California 92618 or to <http://www.thetollroads.com/>.

**FOOTHILL/EASTERN TRANSPORTATION
CORRIDOR AGENCY**

Statement of Net Assets (Deficit)

June 30, 2005

(In thousands)

Assets

Current assets:	
Cash and investments	\$ 125,432
Restricted cash and investments	72,036
Receivables:	
Accounts, net of allowance of \$1,027	1,154
Fees, net of allowance of \$10	475
Interest	7,892
Total receivables	9,521
Due from San Joaquin Hills Transportation Corridor Agency	811
Other assets	648
Total current assets	208,448
Noncurrent assets:	
Restricted cash and investments	398,011
Capital assets, net	123,318
Total assets	729,777

Liabilities

Current liabilities:	
Accounts payable	5,528
Deferred revenue	9,427
Due to San Joaquin Hills Transportation Corridor Agency	2,657
Compensated employee absences payable	396
Interest payable	27,074
Current portion of bonds payable	14,720
Total current liabilities	59,802
Long-term bonds payable	2,052,502
Long-term note payable	1,000
Total liabilities	2,113,304

Net Assets (Deficit)

Invested in capital assets, net of related debt	(1,944,904)
Restricted	435,945
Unrestricted	125,432
Total net assets (deficit)	\$ (1,383,527)

See accompanying notes to financial statements.

**FOOTHILL/EASTERN TRANSPORTATION
CORRIDOR AGENCY**

Statement of Revenues, Expenses, and Changes in Net Assets (Deficit)

Year ended June 30, 2005

(In thousands)

Operating revenues:	
Tolls, fees, and fines	\$ 98,895
Development impact fees	16,648
Other revenue	250
Total operating revenues	115,793
Operating expenses:	
Contribution of capital improvements to Caltrans	46,344
Impairment loss on right-of-way acquisitions, grading, or improvements	25,987
Toll customer service	4,170
Depreciation	3,337
Toll systems	3,213
Toll evasion	2,909
Salaries and wages	2,684
Toll collections	2,451
Marketing	940
Toll facilities	863
Insurance	794
Professional services	470
Transportation studies	300
Facilities operations, maintenance, and repairs	208
Other operating expenses	374
Total operating expenses	95,044
Operating income	20,749
Nonoperating revenue (expenses):	
Investment income	38,168
Grant revenue	2,037
Interest expense	(114,910)
Nonoperating expenses, net	(74,705)
Change in net assets (deficit)	(53,956)
Net assets (deficit) at beginning of year	(1,329,571)
Net assets (deficit) at end of year	\$ (1,383,527)

See accompanying notes to financial statements.

**FOOTHILL/EASTERN TRANSPORTATION
CORRIDOR AGENCY**

Statement of Cash Flows

Year ended June 30, 2005

(In thousands)

Cash flows from operating activities:	
Cash received from toll road patrons	\$ 101,911
Cash received from development impact fees	16,929
Cash received from property rental	213
Cash received from miscellaneous revenue sources	37
Cash payments to suppliers	(15,010)
Cash payments to employees	(2,788)
	<hr/>
Net cash provided by operating activities	101,292
Cash flows from capital and related financing activities:	
Cash payments for toll related equipment	(3,095)
Cash payments for right-of-way, grading, or improvements	(1,994)
Cash payments for construction in progress	(18,944)
Cash payments for interest and principal	(62,458)
Cash received from grants	2,060
	<hr/>
Net cash used in capital and related financing activities	(84,431)
Cash flows from investing activities:	
Cash received for interest, net of realized gains and losses	17,894
Cash payments for purchase of investments	(283,859)
Cash received from the maturity and sale of investments	285,496
	<hr/>
Net cash provided by investing activities	19,531
Net increase in cash and cash equivalents	36,392
Cash and cash equivalents at beginning of year	258,880
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Cash and cash equivalents at end of year (note 4)	\$ 295,272
	<hr/> <hr/>
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ 20,749
Adjustments to reconcile operating income to net cash provided by operating activities:	
Contribution of capital improvements to Caltrans	46,344
Impairment loss on right-of-way acquisitions, grading, or improvements	25,987
Depreciation	3,337
Write-off of fixed assets	178
Changes in operating assets and liabilities:	
Accounts receivable	643
Fees receivable	281
Accounts payable, less accounts payable for fixed assets and construction in progress	1,415
Deferred revenue	1,132
Due from San Joaquin Hills Transportation Corridor Agency	357
Due to San Joaquin Hills Transportation Corridor Agency	884
Other assets	(47)
Compensated employee absences payable	32
	<hr/>
Total adjustments	80,543
Net cash provided by operating activities	\$ 101,292
	<hr/> <hr/>
Noncash transactions:	
Interest expense recorded for accretion of bonds outstanding	\$ (60,670)
Unrealized gain on investments	13,807
Amortization of discount/premium on investments	5,682

See accompanying notes to financial statements.

**FOOTHILL/EASTERN TRANSPORTATION
CORRIDOR AGENCY**

Notes to Financial Statements

June 30, 2005

(In thousands)

(1) Reporting Entity

In recognition of the regional transportation needs in the County of Orange (County), the California State Legislature has enacted various amendments to the California Government Code to authorize the financing of bridges and major thoroughfares by joint powers agencies. Pursuant to such authorization, the Foothill/Eastern Transportation Corridor Agency (Agency) was created in January 1986 by a joint exercise of powers agreement. Current members are the County and the Cities of Anaheim, Dana Point, Irvine, Lake Forest, Mission Viejo, Orange, Rancho Santa Margarita, San Clemente, San Juan Capistrano, Santa Ana, Tustin, and Yorba Linda (collectively, the member agencies). The purpose of the Agency is to plan, design, construct, finance, and administer funds for development of the Foothill and Eastern Transportation Corridors, including thoroughfares and bridges. The Agency is governed by a board of directors comprised of representatives from the member agencies. The Agency has the power to, among other things, incur debt and establish and collect tolls.

These financial statements comprise the activity of the Agency. There are no other organizations for which the Agency is financially accountable or for which it is fiscally responsible. This Agency and the San Joaquin Hills Transportation Corridor Agency (SJHTCA) are under common management and together are called the Transportation Corridor Agencies. However, each agency has an independent governing board.

(2) Summary of Significant Accounting Policies

The accounting policies of the Agency are in conformity with accounting principles generally accepted in the United States of America applicable to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing accounting and financial reporting principles.

(a) Basis of Presentation

The Agency records revenue in part from fees and other charges for services to external users, and accordingly, has chosen to present its financial statements using the reporting model for special purpose governments engaged in business-type activities. This model allows all financial information for the Agency to be reported in a single column in each of the accompanying financial statements.

The Agency distinguishes operating revenues and expenses from nonoperating items in the preparation of its financial statements. Operating revenues and expenses generally result from the collection of tolls, fees, and fines on the corridors. The Agency's operating expenses include contribution expense, depreciation, impairment loss on right-of-way acquisitions, grading, or improvements, materials, services, and other expenses related to the operation of the corridors. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

**FOOTHILL/EASTERN TRANSPORTATION
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June 30, 2005

(In thousands)

(b) Basis of Accounting

The financial statements are prepared using the accrual basis of accounting. Revenues are recognized when earned, and expenses are recognized when incurred. As provided in GASB Statement No. 20, the Agency does not apply Financial Accounting Standards Board pronouncements issued after November 30, 1989.

Restricted resources are used in accordance with the Agency's Master Indentures of Trust. Unrestricted resources are used at the Agency's discretion. When both restricted and unrestricted resources are available for use, it is the Agency's policy to determine on a case-by-case basis when to use restricted or unrestricted resources.

(c) Budget

Fiscal year budgets are prepared by the Agency staff for estimated revenues and expenses. The Board of Directors adopts the annual budget at the June Board meeting for the fiscal year commencing the following July. The approval of the budget requires the consent of at least two-thirds of the Board members. No expenditures in excess of the total budget for each Board designated category are made without the approval of at least two-thirds of the Board members, at which time a revised and amended budget is required to be submitted to the Board of Directors. All budgets are adopted on a basis consistent with accounting principles generally accepted in the United States of America. All budget appropriations lapse at year-end. Any budgeted expenses not incurred by each year-end must be reappropriated in the next fiscal year.

(d) Cash and Cash Equivalents

Cash and cash equivalents generally consist of cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

(e) Investments

Investments in U.S. government securities, U.S. agency securities, and corporate notes are carried at fair value based on quoted market prices. Treasury mutual funds are carried at fair value based on the fund's share price.

The Agency classifies investments as current or noncurrent based on how readily the investment is expected to be converted to cash and whether any restrictions limit the Agency's ability to use the resources.

(f) Receivables

Receivables include amounts due from member agencies for development impact fees collected on behalf of the Agency, credit card receivables, interagency receivables, patron violation receivables, and interest.

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June 30, 2005

(In thousands)

(g) Capital Assets

Capital assets include construction in progress, environmental mitigation sites, easements, the corridor operations facility, transponders, toll and violations collection equipment, tollbooths, buildings, changeable message signs, vehicles, furniture, and construction in progress. Capital assets are defined by the Agency as assets with an initial, individual cost of more than five thousand dollars and an estimated useful life in excess of three years. Such assets are recorded at cost.

The Foothill/Eastern Corridors and the related purchases of right-of-way, for which title vests with the California Department of Transportation, are not included as capital assets because the Agency does not have title to such assets or right-of-way. The costs of normal maintenance and repairs and mitigation that do not add to the value of the asset or materially extend asset lives are not capitalized.

In fiscal year 2005, the Agency adopted Governmental Accounting Standards Board Statement No. 42 *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This standard requires the Agency to evaluate whether events or changes in circumstances have occurred that would impair its capital assets. If an asset is determined to be impaired, it is recorded at the lower of its cost or net realizable value. As of June 30, 2005, the Agency has recorded a noncash impairment loss on right-of-way acquisitions, grading, or improvements of \$25,987 related to the mitigation parcels held that will ultimately be conveyed to other owners for no consideration and excess parcels that have lost value due to accessibility or other factors. The write-down of the mitigation parcels does not reflect any physical change to the properties; it does however, reflect the development cycle of mitigation assets and the current reporting requirements thereon. The mitigation parcels associated with construction in progress related to the Foothill South project will be evaluated for impairment when construction is complete and transferred to Caltrans.

Capital assets are depreciated using the straight-line method over the following estimated useful lives:

Asset type	Useful life
Toll booths and buildings	28-30 years
Toll revenue equipment	5 years
Changeable message signs	15 years
Vehicles	5 years
Other equipment and furniture	3-5 years

(h) Deferred Revenue

Deferred revenue represents amounts collected from FasTrak patrons for prepaid tolls.

**FOOTHILL/EASTERN TRANSPORTATION
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Notes to Financial Statements

June 30, 2005

(In thousands)

(i) Revenue Recognition

Toll revenue is recognized at the time the vehicle passes through the toll plaza. Other revenues are recognized when they are earned.

(j) Allocation of Common Costs

Expenses have been allocated between administration and construction costs, which are capitalized, in accordance with California Government Code Section 66484.3, paragraph (g). Under this section, the term "construction" is defined as design, acquisition of right-of-way, actual construction including, but not limited to, all direct and indirect costs of environmental, engineering, accounting, legal, administration of construction contracts, and other necessary services. Administration costs are defined as office, personnel, and other customary and normal expenses associated with the direct management and administration of the Agency. Administration expenses, as defined, are limited to a base amount adjusted annually based on the Consumer Price Index.

Expenses directly related to the Agency were charged entirely to the Agency, and those incurred on behalf of both the Agency and SJHTCA were allocated between the two agencies based on the estimated benefit to each. In addition, the Agency also has amounts due from SJHTCA related to SJHTCA FasTrak customers incurring tolls on the Agency's corridors and has amounts due to SJHTCA related to the Agency's FasTrak customers incurring tolls on State Route 73. At June 30, 2005, the Agency has a net payable due to SJHTCA of \$1,846 for such items.

(k) Net Assets

The Agency's net assets are classified into the following net asset categories:

Invested in Capital Assets, Net of Related Debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, and improvement of those assets and assets contributed to Caltrans.

Restricted: Net assets subject to externally imposed conditions that can be fulfilled by the actions of the Agency or by the passage of time. These net assets relate primarily to restricted bond proceeds and certain revenues collected.

Unrestricted: All other categories of net assets.

(l) Use of Estimates

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

**FOOTHILL/EASTERN TRANSPORTATION
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Notes to Financial Statements

June 30, 2005

(In thousands)

(3) Net Development Impact Fees

The sources of net development impact fees were the following for the year ended June 30, 2005:

City of Irvine	\$	7,538
City of San Clemente		2,078
City of Lake Forest		1,746
County of Orange		1,571
City of Tustin		1,467
City of Yorba Linda		1,093
City of Mission Viejo		300
City of Santa Ana		249
City of Anaheim		224
City of Rancho Santa Margarita		202
City of Orange		92
City of San Juan Capistrano		88
	\$	<u><u>16,648</u></u>

(4) Cash and Investments

Cash and investments as of June 30, 2005 are classified in the accompanying financial statements as follows:

Cash and investments	\$	125,432
Current restricted cash and investments		72,036
Noncurrent restricted cash and investments		<u>398,011</u>
	\$	<u><u>595,479</u></u>

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

	<u>Cash and cash equivalents</u>	<u>Investments</u>	<u>Total</u>
Cash on hand	\$ 99	—	99
Demand deposits	14,780	—	14,780
Treasury money market	13,618	—	13,618
U.S. Agency securities	—	123,943	123,943
Cash held with trustee	242,410	—	242,410
Investments held with trustee per debt agreements	<u>24,365</u>	<u>176,264</u>	<u>200,629</u>
Total	<u><u>\$ 295,272</u></u>	<u><u>300,207</u></u>	<u><u>595,479</u></u>

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(In thousands)

(a) Cash Deposits

Custodial Credit Risk Related to Cash Deposits

The custodial credit risk for deposits is the risk that the Agency will not be able to recover deposits or will not be able to recover collateral securities that are in possession of an outside party. This risk is mitigated in that of the total cash balance, \$100 was insured by Federal depository insurance, \$99 was cash on hand, \$28,298 was collateralized in accordance with Section 53652 of the California Government Code with securities held by the pledging financial institution in the Agency's name and \$242,410 was in an investment agreement collateralized with securities held by the Agency's trustee in the Agency's name with a market value of at least 102% for treasury obligations, 104% with respect to Government National Mortgage Association securities, and 105% with respect to Federal National Mortgage Association securities and Federal Home Loan Mortgage Corporation securities.

At June 30, 2005, the carrying amount of the Agency's cash deposits was \$257,190 and the corresponding bank balance was \$258,336. The difference of \$1,146 was principally due to outstanding checks. The Agency's petty cash fund and toll change funds totaled \$99.

(b) Investments

Credit Risk and Concentration of Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. The Agency mitigates these risks by holding a diversified portfolio of high quality investments. The policy sets specific parameters by type of investment for credit quality, maturity length and maximum percentage investment. Both the policy and the Agency's debt agreements state that generally, all securities must be issued by companies with a long-term debt rating of at least "A" by two of the Nationally Recognized Rating Agencies (NRRA) or at least "AA" by one NRRA. The policy also indicates specific rating requirements for certain types of investments. Percentage limitations on specific types of securities are based on the purchase price of the security, as compared to the market value of the portfolio, at the time of purchase. The policy does not require sales in a portfolio for subsequent changes in market value of the total portfolio to avoid exceeding the prescribed allocation level.

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The table below identifies the investment types that are authorized by the Agency's investment policy. The table also identifies certain provisions of the Agency's investment policy that addresses interest rate risk and concentration of credit risk. This table does not address investments of debt proceeds held by bond trustee that are governed by the provisions of debt agreements of the Agency, rather than the general provisions of the Agency's investment policy.

<u>Authorized investment type</u>	<u>Maximum maturity</u>	<u>Maximum percentage of portfolio*</u>	<u>Maximum investment in one issuer</u>	<u>Specific rating requirement</u>
U.S. Treasury Bills, Notes and Bonds	5 years	100%	100%	
Federal Agency and U.S Government Sponsored Enterprise Notes and Bonds	5 years	100%	25%	
Federal Agency Mortgage- Backed Securities	5 years	20%	20%	
Negotiable Certificates of Deposit	5 years	30%	30%	"AA" or better by two NRRA
Bankers Acceptances	180 days	30%	25%	Drawn on and accepted by a bank which is rated "AA" or better by two NRRA
Commercial Paper	270 days	15%	10% of outstanding paper of an issuing corporation	P1, A1, F1, or D1 by two NRRA
Repurchase Agreements	90 days	25%	25%	
Reverse Repurchase Agreements	30 days	10%	10%	
Medium-Term Maturity Corporate Notes	5 years	30%	30%	

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<u>Authorized investment type</u>	<u>Maximum maturity</u>	<u>Maximum percentage of portfolio*</u>	<u>Maximum investment in one issuer</u>	<u>Specific rating requirement</u>
State of California Local Agency Investment Fund	N/A	30%	30%	
County or Local Agency Investment Pools	N/A	15%	15%	
Asset-Backed Securities	5 years	20%	20%	“AAA” by one NRRA issuer must have underlying rating of “A: or better from two NRRA
Shares in a California Common Law Trust	N/A	None	None	
Money Market Mutual Funds	N/A	15%	15%	
Investment Agreements	10 years	40%	40%	

* Excluding amounts held by trustee, which are subject to provisions of the bond indentures.

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Investment of debt proceeds and toll revenues held by the Agency's trustee are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the Agency's investment policy. The table below identifies the investment types that are authorized for these monies.

Investments authorized by debt agreements*	Specific rating requirement
Government Obligations (including U.S. Treasury strips and RFCO strips)	
Federal Agency debt instruments	
Negotiable Certificates of Deposit insured by FDIC, BIF and SAIF or secured by government obligations	Two highest ratings by 2 NRRA
Bankers Acceptances	Prime-1 or A3 or better by Moody's, A-1 or A or better by S&P and, if rated by Fitch, F-1 or A or better
Commercial Paper	Prime-1 or better by Moody's and A-1 or better by S&P and, if rated by Fitch, F-1 or better
Repurchase Agreements	A or better by both Moody's and S&P and, if rated by Fitch, A or better
Medium-Term Maturity Corporate Notes	One of the three highest applicable rating categories, or approved in writing, by S&P, and, if rated by Fitch, rated in one of the three highest applicable rating categories
Money Market Mutual Funds	AAAm-G; AAA-m or AA-m by S&P and, if rated by Moody's, Aaa, Aa1 or Aa2 and, if rated by Fitch, AAA or AA
Investment Agreements	

* Other investments may be allowed if the Agency certifies to the trustee that the investment was approved in writing by each rating agency, which has assigned a rating to the Agency's bonds, and by the Agency's bond insurer.

At June 30, 2005 all of the Agency's investments held were rated at or above the minimum required rating per the Agency's investment policy and debt agreements. The Federal Agency securities and the RFCO strips that were held by the Agency were rated AAA by Standard & Poors and AAA by Moody's. The money market funds were rated AAA by Standard & Poors. The counterparty to the investment agreement was rated AAA by Standard & Poors and Fitch, and Aaa by Moody's.

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(In thousands)

Custodial Credit Risk

Custodial credit risk for investments is the risk that the Agency will not be able to recover the value of investment securities that are in the possession of an outside party. All securities owned by the Agency are deposited in the Agency's trustee bank, which is different from the Agency's primary bank, in the Agency's name. Securities are not held in broker accounts.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Agency mitigates this risk by matching maturity dates, to the extent possible, with the Agency's expected cash-flow.

A summary of all the Agency's investments governed by both the Agency's investment policy and its bond agreements, including investments held with trustee in the amount of \$24,365, cash held with the trustee of \$242,410 and treasury money market funds of \$13,618 that are all considered cash equivalents held at June 30, 2005 are as follows:

Investment type	Fair value	Remaining maturity			
		12 months or less	13 to 24 months	25 - 60 months	More than 60 months
U.S. Treasury Bills	\$ 31,601	31,601	—	—	—
U.S. Treasury Strips	13,690	4,368	4,208	—	5,114
RFCO Strips	129,988	4,494	4,340	16,112	105,042
Federal Agency Securities	149,293	131,561	—	17,732	—
Investment agreement	242,410	—	—	242,410	—
Money Market Funds	13,618	13,618	—	—	—
Total	\$ 580,600	185,642	8,548	276,254	110,156

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(In thousands)

(5) Capital Assets

Capital assets consist of the following:

	<u>Balance at beginning of year</u>	<u>Additions</u>	<u>Transfers/ deletions</u>	<u>Balance at end of year</u>
Construction in progress	\$ 115,425	16,609	(46,353)	85,681
Right-of-way acquisitions, grading, or improvements	40,523	2,014	(11)	42,526
Furniture, equipment, and vehicles	51	—	—	51
Facility and toll revenue equipment	<u>53,094</u>	<u>3,059</u>	<u>(24,277)</u>	<u>31,876</u>
	209,093	21,682	(70,641)	160,134
Impairment loss on right-of-way acquisitions, grading, or improvements	—	(25,987)	—	(25,987)
Furniture and equipment accumulated depreciation	(39)	(10)	—	(49)
Facility and toll revenue equipment – accumulated depreciation	<u>(31,552)</u>	<u>(3,327)</u>	<u>24,099</u>	<u>(10,780)</u>
	<u>\$ 177,502</u>	<u>(7,642)</u>	<u>(46,542)</u>	<u>123,318</u>

Total interest of \$105 was capitalized as construction in progress during the year ended June 30, 2005.

Transfer of Ownership

Ownership of the Foothill/Eastern Transportation Corridor construction, right-of-way, grading, and improvements were transferred to Caltrans during the year ended June 30, 1999 upon satisfaction of all conditions contained within the Cooperative Agreements between the Agency and Caltrans. For the year ended June 30, 2005, the Agency incurred expenditures for improvements and enhancements to major thoroughfares already transferred to Caltrans. The improvements and enhancements are covered by separate project specific Cooperative Agreements with Caltrans and are transferred on an ongoing basis. The balance of construction in progress represents capital improvements in progress, including Foothill South. Upon completion, these capital assets will also be transferred to Caltrans and recognized as a contribution expense.

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(6) Contributions in Lieu of Development Impact Fees and Fee Credits

The Agency has entered into agreements with developers whereby the developers receive fee credits against future development impact fee assessments for contributions of rights-of-way, grading, or improvements. Fee credits may be utilized by the developer to offset against current or future fees owed to the Agency and, to the extent that the Agency determines that excess funds are available, may be reimbursable at the Agency's discretion. The changes in outstanding fee credits for the year ended June 30, 2005 are as follows:

Outstanding fee credits at beginning of year	\$	4,963	
Interest issued on unused fee credits		6	
Fee credits utilized		(1,404)	
Outstanding fee credits at end of year	\$	3,565	

(7) Long-Term Obligations

The following is a summary of changes in long-term obligations during the year ended June 30, 2005:

	<u>Balance at beginning of year</u>	<u>Additions/ accretions</u>	<u>Reductions</u>	<u>Balance at end of year</u>	<u>Due within one year</u>
Series 1999 Toll Road Refunding Revenue Bonds:					
Current Interest Bonds	\$ 826,790	—	(7,915)	818,875	14,720
Capital Appreciation Bonds	492,038	29,993	—	522,031	—
Convertible Capital Appreciation Bonds	515,649	30,677	—	546,326	—
Series 1995A (fixed rate) Senior Lien Toll Road Revenue Bonds:					
Current Interest Bonds	179,990	—	—	179,990	—
Total bonds payable	2,014,467	60,670	(7,915)	2,067,222	14,720
Notes payable	1,000	—	—	1,000	—
Total long-term obligations	\$ 2,015,467	60,670	(7,915)	2,068,222	14,720

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(In thousands)

(a) Toll Road Revenue Bonds

In August 1999, the Agency issued serial, term, and capital appreciation toll road refunding revenue bonds (1999 Refunding Bonds) in the aggregate principal amount of \$1,588,144 consisting of current interest bonds in the principal amount of \$831,965, convertible capital appreciation bonds in the principal amount of \$388,223, and capital appreciation bonds in the principal amount of \$367,956. The 1999 Refunding Bonds are subordinate to the remaining 1995 bonds (1995 Unrefunded Bonds) of \$179,990 and are collateralized by net revenues, as defined in the Master Indentures, consisting primarily of toll revenues less current expenses.

The 1995 Unrefunded Bonds are current interest bonds. Interest on the bonds is payable semiannually at a rate of 5.00% and is capitalized through January 1, 2032. The bonds mature on January 1, 2035. The bonds are subject to early redemption, at the option of the Agency, beginning January 1, 2005 by payment of accrued interest and principal with no premium.

Interest on the 1999 current interest bonds is payable semiannually at rates ranging from 4.38% to 5.75%. The bonds mature in annual installments from January 15, 2004 to January 15, 2040. The bonds are subject to early redemption, at the option of the Agency, beginning January 15, 2010 by payment of accrued interest, principal, and a premium of up to 1.00%.

The 1999 capital appreciation bonds accrue interest at rates ranging from 5.63% to 6.09% compounded semiannually. The bonds mature in annual installments from January 15, 2017 to January 15, 2038. The bonds are subject to early redemption, at the option of the Agency, beginning January 15, 2010 by payment of accrued interest, principal, and a premium up to 2.00%.

The 1999 convertible capital appreciation bonds accrue interest at rates ranging from 5.80% to 5.88% compounded semiannually. Interest is payable semiannually based on accreted amounts commencing on January 15, 2010. The bonds mature in annual installments from January 15, 2020 to January 15, 2029. The bonds are subject to early redemption, at the option of the Agency, beginning January 15, 2014 by payment of accrued interest, principal, and a premium up to 1.00%.

The Master Indentures of Trust require the trustee to hold bond proceeds, toll revenues, and any other proceeds included in pledged funds for debt service. These monies are included in the restricted cash and investments held by the trustee.

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(In thousands)

The following is a summary of the Agency's annual debt service requirements by fiscal year for the 1995 Senior Lien Toll Road Revenue Bonds and the 1999 Toll Road Refunding Bonds as of June 30, 2005:

	<u>Principal⁽¹⁾</u>	<u>Interest⁽¹⁾</u>	<u>Total</u>
2006	\$ 14,720	53,780	68,500
2007	19,260	52,990	72,250
2008	25,525	51,945	77,470
2009	31,360	50,532	81,892
2010	—	90,200	90,200
2011 – 2015	87,000	443,142	530,142
2016 – 2020	216,902	484,944	701,846
2021 – 2025	216,749	644,568	861,317
2026 – 2030	465,985	555,306	1,021,291
2031 – 2035	339,279	844,817	1,184,096
2036 – 2040	650,442	726,807	1,377,249
	<u>\$ 2,067,222</u>	<u>3,999,031</u>	<u>6,066,253</u>

⁽¹⁾ Includes payments on January 1 and January 15 of such fiscal year and July 1 and July 15 of the next fiscal year.

Included in principal is \$312,178 related to accreted principal on convertible capital appreciation bonds and capital appreciation bonds.

The net proceeds of the 1999 Refunding Bonds plus additional 1995 series monies were used to purchase U.S. government securities, which were placed in an irrevocable escrow fund to be used for the debt service payments related to the refunded bonds. The amount of the refunded bonds, which were eliminated in the financial statements in fiscal year 2000, was \$1,082,761.

(b) Line of Credit

The Agency obtained a line of credit from the Federal Highway Administration in the aggregate amount of \$120,000, available upon completion of the toll road. The agreement provides for borrowings of up to \$12,000 per year, which expires at the end of each year if not used, from the date of completion of the construction of the toll road and is scheduled to end on December 31, 2009. The available balance remaining as of June 30, 2005 is \$60,000. Borrowings are available only to the extent revenues from toll operations and standard reserves are less than necessary for debt service.

Borrowings under the facility for debt service shall bear interest at the 30-year United States Treasury Bond rate plus 48 basis points on the date such loans are made and are due within 30 years. Borrowings for operations shall bear interest at a corresponding Treasury Note rate plus 48 basis points and are due within three years. At June 30, 2005, there were no borrowings outstanding on the line of credit.

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(In thousands)

(c) Notes Payable

During a prior fiscal year, the Agency executed a \$1,000 note payable in conjunction with the purchase of a conservation easement. The note payable is due 30 days after the sale of bonds for the acquisition and development of the Foothill Transportation Corridor south of Oso Parkway provided, however, that if the bond sale does not occur by July 1, 2007, the Agency has no obligation to make any payments.

(8) Commitments and Contingencies

(a) Toll Collection and Revenue Management System Agreements

The Agency and SJHTCA entered into agreements with various contractors for a customer service center, hardware maintenance, toll collection systems operation and maintenance, toll attendant staffing and supervision, and violation processing. The agreements expire on various dates through October 31, 2015. Additionally, all agreements are cancelable by the Agency, without further obligation, upon written notice, generally within 90 days.

(b) Project Costs

As of June 30, 2005, the Agency has outstanding commitments and contracts for remaining corridor construction of Foothill South and improvements on existing construction of approximately \$53,355.

(c) Litigation

The Agency is a defendant in various legal actions. Management believes that the ultimate resolution of these actions will not have a significant effect on the Agency's financial position or results of operations.

(d) Risk Management

The Agency maintains insurance coverage for various risks, including but not limited to property, liability, earthquake, and flood coverage. Coverage is purchased at levels in accordance with the Agency's Master Indentures of Trust.

(9) Corridor Operations Facility Lease

In January 2000, the Agency, along with SJHTCA, relocated to the Corridor Operations Facility. At that time, a lease agreement was executed between the Agency (Lessor) and SJHTCA (Lessee). Included on the Statement of Revenue, Expenses, and Change in Fund Net Assets (Deficit) are lease payments by SJHTCA of \$213. The lease agreement expires at the earliest occurrence of 1) dissolution of the Agency, 2) sale of the facility, or 3) dissolution of the SJHTCA. Future minimum lease payments receivable from SJHTCA under the lease agreement at June 30, 2005 are \$399.

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(In thousands)

(10) Employees' Retirement Plan

The Agency's employees participate in the Orange County Employees Retirement System (OCERS), a cost-sharing multiple-employer public employee retirement system established in 1945. OCERS provides for retirement, death, disability, and cost-of-living benefits and is subject to the provisions of the County Employees Retirement Law of 1937 and other applicable statutes. OCERS issues a publicly available financial report that includes financial statements and required supplementary information.

Plan members contribute a percentage of their annual covered salary at actuarially determined rates based on the age of entry into the plan; however, the Agency pays up to 6% of the employee's required contribution. The Agency is required to contribute 12.62% into the plan. The Agency has contributed all of its required contributions of approximately \$464, \$317, and \$158 to the plan for the years ended June 30, 2005, 2004, and 2003, respectively.

(11) Analysis of Financial Alternatives

The Agency's Board of Directors had discussions with the Board of Directors of the San Joaquin Hills Transportation Corridor Agency (SJHTCA) concerning the possible sale of all assets and liabilities of the two Agencies to a newly formed Joint Powers Agency. In April 2003, the Agencies formed an Exploratory Joint Powers Agency, the Transportation Corridor System (TCS), to explore the possibility of purchasing the assets of both the Agency and SJHTCA and managing both toll roads as a single system. The transaction was not executed.

Since May 2004, the San Joaquin Hills and Foothill/Eastern Boards have been negotiating the terms of an agreement whereby the Foothill/Eastern Agency would make payments to the San Joaquin Hills Agency to mitigate future impacts from the extension of the 241 Toll Road. The proposed agreement also calls for the Foothill/Eastern Agency to loan funds from the excess cash flow to the San Joaquin Hills Agency, as needed, to avoid anticipated future debt service coverage ratio shortfalls. Both Boards have retained independent financial advisors and legal counsel to provide advice and counsel during the development of this agreement. Upon completion, the documents will be submitted to both Boards for approval and the detailed terms of the agreement will be released.