

**PASSAIC COUNTY UTILITIES AUTHORITY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The Authority's financial transactions are recorded in accounts that are created by various resolutions adopted by the Authority to meet bond covenant requirements (more fully defined in Note 2).

The financial statements of the Passaic County Utilities Authority have been prepared on the accrual basis of accounting in conformity with generally accepted accounting principles (GAAP) applicable to enterprise funds of state and local governmental units. Enterprise funds are used to account for operations that are financed and operated in a manner similar to private business enterprises - where the intent of the governing body is that the costs (expenses, including depreciation) of providing services to the general public on a continuing basis be financed or recovered primarily through user charges, or where the governing body has decided that the periodic determination of revenues earned, expenses incurred, and or net income is appropriate for capital maintenance, public policy, accountability or other purposes. The Governmental Accounting Standards Board GASB is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The Authority also applies Financial Accounting Standards Board (FASB) statements and interpretations issued on or before November 30, 1989, provided they do not conflict with or contradict GASB pronouncements.

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NOTE 8 - SOLID WASTE MANAGEMENT PLAN

Pursuant to and in accordance with the provisions of the Solid Waste Management Act, constituting Chapter 39 of the Pamphlet Laws of 1970 of the State of New Jersey and the acts amendatory thereof and supplemental thereto (the "Solid Waste Act"), the County has been designated as a "solid waste management district." As such, it was required, among other things, to develop and formulate a Solid Waste Management Plan (the "Plan") providing for the disposal of solid waste generated within the Passaic County Solid Waste Management District (the "Passaic County District"). The County ultimately designated the Authority to supervise the implementation of the Plan.

Pursuant to the provisions of the Solid Waste Act, the Plan and a franchise granted to the Authority by the New Jersey Board of Public Utilities ("BPU") and under the authority of the New Jersey Department of Environmental Protection ("DEP") pursuant to the Solid Waste Utilities Control Act, N.J.S.A. 48: 13A-1 et seq. (the "Franchise"), the Authority had the power and authority to control the flow of solid waste through the County solid waste system (the "Solid Waste System"). In order to secure the repayment of its debt obligations and its administrative and operational expenses, the Authority relied primarily on a system of waste flow controls consisting of waste flow rules promulgated by the DEP pursuant to *NJA. C. 7:26-6.5* and the Franchise granted by the DEP to the Authority, which waste flow rules were declared unconstitutional by the Third Circuit Court of Appeals in Atlantic Coast Demolition and Recycling Co., Inc. v. Board of Chosen Freeholders of Atlantic County, 112 F. 3rd 652 (1997) (certiorari denied by the Supreme Court on November 10, 1997).

As a result of concerns regarding the validity and enforceability of the DEP waste flow rules and the Franchise due to the decisions in C&A Carbone v. Town of Clarkstown, 113 U.S. 2411 (1993), and an early unfavorable decision in Atlantic Coast in 1995, and the Authority's resulting inability to direct certain classifications of solid waste through its Solid Waste System, the Authority was unable to collect the tipping fees necessary to satisfy its contractual obligations, including debt service, and to meet its administrative and operating expenses. On March 3, 1995, the Authority filed with the DEP a verified petition seeking to unbundle its solid waste rate in order to segregate the debt service component of that rate in a manner that would permit it to be paid from a separate stand-by assessment or user charge (referred to herein as the "Environmental Investment Charge" or "EIC"). The Authority applied to the

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NOTE 8 - SOLID WASTE MANAGEMENT PLAN, (continued)

Local Finance Board for approval of a Financial Plan to authorize, among other things, the assessment of an EIC. Following hearings in December, 1991, the LFB approved and ordered the implementation of a Financial Plan that included, among other things, the assessment, billing and collection of an EIC.

Prior to the implementation of the EIC, the City of Paterson filed three (3) lawsuits, challenging, among other things, the Authority's legal authority to implement the Financial Plan, including the imposition and collection of the EIC. The Appellate Division of the New Jersey Superior Court found the EIC to be a valid charge under existing law in a decision issued on May 13, 1999. The City of Paterson filed a Notice of Petition for Certification with the New Jersey Supreme Court, which accepted the petition and reversed the decision of the Appellate Division, holding that the EIC was not authorized by the Act and its imposition and issued on May 13, 1999. The City of Paterson filed a Notice of Petition for Certification with the New Jersey Supreme Court, which accepted the petition and reversed the decision of the Appellate Division, holding that the EIC was not authorized by the Act and its imposition and collection are unconstitutional and violative of the Commerce Clause. U.S.C.A. Const. Art. I, §8, cl. 3; City of Paterson v. Passaic County Board of Chosen Freeholders and Passaic County Utilities Authority, 164 N.J. 270 (2000).

As a result of the City of Paterson decision, the Authority worked with representatives of the governor's office and the Department of Treasury to discuss restructuring plans based upon a proposed legislative initiative. On January 7, 2002, this initiative became the Debt Restructuring Act. The State canceled its plans to go forward with the issuance of bonds by the EDA under the Debt Restructuring Act in response to the Supreme Court's decision in the matter of Lonegan v. State of New Jersey, supra. The Supreme Court directed that additional issues be briefed and argued, which, depending upon the Court's final decision in this matter, may enable the State to go forward with its proposed refinancing.

In response to the Third Circuit Court of Appeals Order and Judgment in Atlantic Coast, the State of New Jersey established the Solid Waste Partnership Program (the "Partnership Program"). Under the Partnership Program, in State budget language, the State has acknowledged the need to "subsidize county and county authority debt service payments for environmental investments incurred as of June 30, 1997 ... in accordance with criteria and program guidelines established by the Commissioners of DEP, DCA and the State Treasurer " Under the 1998 State Budget

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Appropriations Act, the New Jersey Legislature appropriated not to exceed \$20,000,000 for these purposes. The expenditure of State moneys pursuant to the Partnership Program for such purposes is conditioned upon the State Treasurer having conducted, or contracted for, an operational audit of the county or county authority (the "Audit"), and the county or county authority having implemented the audit recommendations to the satisfaction of the State Treasurer. In late 1997 or early 1998, the Authority issued a request to the State Treasurer to conduct an audit in order that the Authority could benefit from the Partnership Program. The State audit review team, consisting of representatives from the New Jersey Department of Treasury, the New Jersey Department of Community Affairs and the DEP completed the review and issued audit findings and recommendations in October, 1998.

The Authority has taken all appropriate steps to comply with the recommendations contained in the Audit report, including implementation of recommendations to effectuate operational savings to the Authority. The Authority next made application to the New Jersey Department of Treasury for financial assistance to subsidize a shortfall on its November 15, 1998 debt service payment on the System Revenue Bonds. On November 16, 1998, the State Treasurer and representatives of the Authority and the County executed a grant agreement (the "Grant Agreement") awarding the Authority \$950,000 to pay, together with other Authority moneys on hand, the November 15, 1998 debt service payment on the System Revenue Bonds. In May, 1999, the Grant Agreement was amended to provide an additional grant award in the amount of \$809,680.98 for debt service payments. In November 1999, the Grant Agreement was further amended to provide an additional grant of \$3,065,450 to pay the November 15, 1999 debt service payment on the System Revenue Bonds. During 2000, an additional grant of \$3,680,600 was provided by the State to pay the May, 2000 and November, 2000 payments of principal and interest due on the System Revenue Bonds. The Grant Agreement was again amended in 2001 and 2002 to provide an additional grant of \$3,683,900 from the State to pay the May, 2001 and November, 2001 payments of principal and interest due on the System Revenue Bonds, an additional grant of \$3,680,650 to pay the May, 2002 and November, 2002, an additional \$3,680,650 to pay the May 2003 and November 2003 payments of principal and interest due on the System Revenue Bonds, \$3,682,400 to pay the May 2004 and November 2004 payments of principal and interest on the System Revenue Bonds, an additional grant of \$3,680,300 to pay the May 2005 and November 2005 payments of principal and interest due on System Revenue Bonds and an additional \$3,262,648 to pay the 2006 principal and interest

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payments. The conditions of the Grant Agreement remain the same. The Grant Agreement amended certain of the recommendations in the audit including the recommendation:

(i) regarding the adoption of Plan Amendment 2-1998; and (ii) regarding mandatory negotiations with the Bergen County Utilities Authority and American Ref-Fuel of Essex County. The Grant Agreement also provides that nothing in the Grant Agreement precludes the County from proposing to the State recommendations or plan amendments, inconsistent with the recommendations of the Audit, which may be adopted and implemented upon approval by the State. The failure of the Authority and/or the County to implement the recommendations contained in the Audit constitutes an event of default under the Grant Agreement. Upon the occurrence of an event of default the Authority is obligated to reimburse the grant amount.

Although the Authority received the grant to pay the debt service shortfall on the System Revenue Bonds, there is no assurance that the Authority will receive additional grant or loan funds under the Partnership Program.