

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT

BASIC FINANCIAL STATEMENTS,

REQUIRED SUPPLEMENTARY INFORMATION,

AND

SUPPLEMENTARY INFORMATION

Year Ended June 30, 2011

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INDEPENDENT AUDITORS' REPORT

The Board of Directors
McKinleyville Community Services District
McKinleyville, California

We have audited the accompanying financial statements of the governmental activities, business-type activities, each major fund and the aggregate remaining fund information of McKinleyville Community Services District (the District) as of and for the year ended June 30, 2011, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audits 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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 the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the District as of June 30, 2011, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 23, 2012, on our consideration of McKinleyville Community Services District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 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.

Accounting principles generally accepted in the United State of America require that the management's discussion and analysis on pages 3 through 9, budgetary comparison

information on page 38 and 39, and the Other Post Employment Benefits Schedule of Funding Progress on page 40, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the District's financial statements as a whole. The combining financial statements listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining financial statements are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Hunter, Hunter + Hunt

January 23, 2012

MANAGEMENT'S DISCUSSION AND ANALYSIS

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT MANAGEMENT'S DISCUSSION AND ANALYSIS

Management offers to the readers of the McKinleyville Community Services District's (the District) basic financial statements this narrative overview and analysis of the District's financial activities for the year ended June 30, 2011. This discussion and analysis should be read in conjunction with the accompanying basic financial statements and the notes thereto.

Overview of the Basic Financial Statements

The District's basic financial statements and required supplementary information consist of the following:

- Government-wide Financial Statements (accrual basis of accounting):
 - 1) Statement of Net Assets
 - 2) Statement of Activities and Changes in Net Assets
- Governmental Fund Financial Statements (modified accrual basis of accounting):
 - 1) Balance Sheet
 - 2) Reconciliation of the Governmental Funds Balance Sheet to the Government-wide Statement of Net Assets
 - 3) Statement of Revenues, Expenditures, and Changes in Fund Balances
 - 4) Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances to the Statement of Activities
- Proprietary Fund Financial Statements (accrual basis of accounting):
 - 1) Statement of Net Assets
 - 2) Statement of Revenues, Expenses, and Changes in Net Assets
 - 3) Statement of Cash Flows
- Notes to Basic Financial Statements
- Required Supplementary Information:
 - 1) Budgetary Comparison Schedule – General Fund (Parks & Recreation)
 - 2) Budgetary Comparison Schedule – Streetlight Fund
 - 3) Other Post Employment Benefits Schedule of Funding Progress

The government-wide financial statements are designed to provide readers with a broad overview of the District's finances. The Statement of Net Assets presents the District's financial position at a point in time, June 30, and includes information on all of the District's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the District is improving or declining. The Statement of Activities presents information showing how the District's net assets changed during the most recent fiscal year.

The Statement of Net Assets and the Statement of Activities divide District operations into two types of activities:

- **Governmental Activities** – Included are the District's parks, recreation programs, open space zones and streetlight zones. This also accounts for management of the District's buildings at Pierson Park (Azalea Hall, activity center, library, and law enforcement facility), Hiller Park (sports fields, playgrounds, dog park, etc.), Larissa Park, trails and open spaces. These activities are funded by property taxes, the Measure B Assessments (for recreational facility development), zone assessments, grants, donations and user fees.
- **Business-type Activities** – These are activities that the District charges fees to customers to cover the cost of services it provides. The District's water and wastewater systems are reported herein.

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT MANAGEMENT'S DISCUSSION AND ANALYSIS

The District, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The fund financial statements report the District's operations in more detail than the government-wide financial statements by providing information about the District's most significant funds which include: (1) general fund, including parks and recreation, (2) street lighting fund, (3) water utility fund, and (4) wastewater utility fund. Additionally, the proprietary fund financial statements provide cash flow information for the District's water and wastewater funds. The District's fund financial statements encompass two fund types as follows:

- **Governmental Funds** - Governmental funds are used to account for the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflow and outflows of spendable resources, as well as the balances of spendable resources available at the end of the fiscal year. Such information is useful in evaluating the District's near-term financing requirements.
- **Proprietary Funds** - Proprietary funds provide the same type of information as the business-type activities in the government-wide financial statements, only in more detail.

Financial Highlights

- Current assets decreased by approximately \$1,058,000 in comparison to the prior year while capital and other non-current assets increased by approximately \$981,000.
- Current liabilities increased by approximately \$231,000 over the prior year while long-term liabilities decreased by approximately \$153,000.
- Overall, the District's net assets decreased by \$154,578 or 0.7% as a result of this year's operations.
- Total program revenues equaled \$4,078,329 in comparison to \$4,017,990 in the prior year while program expenses equaled \$5,019,865 in comparison to \$4,437,818 in the prior year.
- The District's general revenues and transfers decreased from the prior year by approximately \$30,000, from \$817,426 to \$786,958.

Government-wide Financial Statement Analysis

The discussion and analysis of the District's overall financial position and results of operations will focus on the following condensed statement of net assets (Table 1 and 2) and condensed statement of revenues, expenses, and changes in net assets (Table 3 and 4) for both governmental and business-type activities.

**MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Table 1 - Condensed Statement of Net Assets (Governmental Activities)

	Fiscal Year Ended June 30,		
	2011	2010	Change
Assets			
Current	\$ 985,836	\$ 1,191,280	\$ (205,444)
Non-current:			
Net Capital Assets	3,327,854	3,368,504	(40,650)
Other	39,325	39,325	-
Total Assets	4,353,015	4,599,109	(246,094)
Liabilities			
Current	155,798	269,943	(114,145)
Non-current	72,208	200,767	(128,559)
Total Liabilities	228,006	470,710	(242,704)
Net Assets			
Investment in Capital			
Assets, Net of Related Debt	3,327,854	3,044,305	283,549
Unrestricted	797,155	1,084,094	(286,939)
Total Net Assets	\$ 4,125,009	\$ 4,128,399	\$ (3,390)

Table 2 - Condensed Statement of Net Assets (Business-type Activities)

	Fiscal Year Ended June 30,		
	2011	2010	Change
Assets			
Current	\$ 4,744,831	\$ 5,597,474	\$ (852,643)
Net Capital Assets	18,281,086	17,353,988	927,098
Non-current	885,382	790,372	95,010
Total Assets	23,911,299	23,741,834	169,465
Liabilities			
Current	855,604	510,905	344,699
Non-current	4,082,516	4,106,562	(24,046)
Total Liabilities	4,938,120	4,617,467	320,653
Net Assets			
Investment in Capital			
Assets, Net of Related Debt	14,184,822	13,167,371	1,017,451
Restricted	750,081	751,341	(1,260)
Unrestricted	4,038,276	5,205,655	(1,167,379)
Total Net Assets	\$ 18,973,179	\$ 19,124,367	\$ (151,188)

**MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

As can be seen from Table 1 (Condensed Statement of Net Assets – Governmental Activities), the following can be noted when comparing the current year to the prior year:

- Non-capital assets decreased by \$205,444 or 17.2%;
- Net capital assets decreased by \$40,650 or 1.2%;
- Total liabilities decreased by \$242,704 or 51.6%;
- Investment in capital assets, net of related debt increased by \$283,549 or 9.3%;
- Unrestricted net assets decreased by \$286,939 or 26.5%.

As can be seen from Table 2 (Condensed Statement of Net Assets – Business-type Activities), the following can be noted when comparing the current year to the prior year:

- Non-capital assets decreased by \$757,633 or 13.5%;
- Net capital assets increased by \$927,098 or 5.3%;
- Total liabilities increased by \$320,653 or 6.9%;
- Investment in capital assets, net of related debt increased by \$1,017,451 or 7.7%;
- Unrestricted net assets decreased by \$1,167,379 or 22.4%.

**Table 3 - Condensed Statement of Revenues, Expenses, and Changes in Net Assets
Governmental Activities**

	Fiscal Year Ended June 30,		
	2011	2010	Change
Revenues and Transfers			
Charges for Services and Facilities	\$ 478,806	\$ 491,169	\$ (12,363)
Operating Grants and Contributions	18,968	-	18,968
Capital Grants and Contributions	105,730	11,500	94,230
Property Taxes	489,313	499,950	(10,637)
Special Assessments	209,068	201,114	7,954
Other Income	7,259	11,279	(4,020)
Unrestricted Investment Earnings	5,901	19,021	(13,120)
Loss on Sale of Asset	(1,005)	-	(1,005)
Transfers-in	56,696	42,551	14,145
Total Revenues	1,370,736	1,276,584	94,152
Expenses			
Recreation, Parks, Open Space, Facilities, and Other Activities	1,255,784	995,586	260,198
Street Lighting	118,342	82,275	36,067
Total Expenses	1,374,126	1,077,861	296,265
Change in Net Assets	(3,390)	198,723	(202,113)
Net Assets - Beginning of Year	4,128,399	3,929,676	198,723
Net Assets - End of Year	\$ 4,125,009	\$ 4,128,399	\$ (3,390)

**MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

**Table 4 - Condensed Statement of Revenues, Expenses, and Changes in Net Assets
Business-type Activities**

	Fiscal Year Ended June 30,		Change
	2011	2010	
Revenues and Transfers			
Charges for Services -- Water	\$ 1,729,146	\$ 1,664,876	\$ 64,270
Charges for Services - Wastewater	1,663,829	1,434,590	229,239
Capital Contributions	81,850	415,855	(334,005)
Other Income	23,100	-	23,100
Unrestricted Investment Earnings	46,922	86,062	(39,140)
Gain (Loss) on Sale of Asset	6,400	-	6,400
Transfers-out	(56,696)	(42,551)	(14,145)
Total Revenues	3,494,551	3,558,832	(64,281)
Expenses			
Water	1,975,818	1,762,390	213,428
Wastewater	1,669,921	1,597,567	72,354
Total Expenses	3,645,739	3,359,957	285,782
Change in Net Assets	(151,188)	198,875	(350,063)
Net Assets - Beginning of Year	19,124,367	18,925,492	198,875
Net Assets - End of Year	\$ 18,973,179	\$ 19,124,367	\$ (151,188)

As can be seen from Table 3 (Condensed Statement of Revenues, Expenses, and Changes in Net Assets -- Governmental Activities), the following can be noted when comparing the current year to the prior year:

- Total revenues and transfers increased by \$94,152 or 7.4%;
- Total expenses increased by \$296,265 or 27.5%;
- Net assets decreased by \$3,390 or .1%.

As can be seen from Table 4 (Condensed Statement of Revenues, Expenses, and Changes in Net Assets -- Business-type Activities), the following can be noted when comparing the current year to the prior year:

- Total revenues and transfers decreased by \$64,281 or 1.8%;
- Total expenses increased by \$285,782 or 8.5%;
- Net assets decreased by \$151,188 or 0.8%.

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT MANAGEMENT'S DISCUSSION AND ANALYSIS

Fund Financial Statement Analysis

Governmental Funds

Detailed information about the District's governmental funds balance sheet and statement of revenues, expenditures, and changes in fund balance can be found on pages 12 and 14, respectively of the District's basic financial statements. The following can be noted when comparing the current fund financial statements to the prior year:

- Total assets decreased by \$235,635 or 19.1%;
- Total liabilities increased by \$19,652 or 13.5%;
- Total fund balance decreased by \$255,287 or 23.5%;
- Total revenues increased by \$26,107 or 2.2%;
- Total expenditures increased by \$219,926 or 16.9%.

Proprietary Funds

Detailed information about the District's proprietary funds statement of net assets and statement of revenues, expenditures, and changes in fund balance can be found on pages 16 and 17, respectively of the District's basic financial statements. The following can be noted when comparing the current fund financial statements to the prior year:

- Total water fund assets increased by \$387,977 or 4.8%;
- Total wastewater fund assets decreased by \$52,209 or 0.03%;
- Total water fund liabilities increased by \$429,750 or 15.5%;
- Total wastewater fund liabilities decreased by \$107,097 or 5.8%;
- Total water fund net assets decreased by \$41,773 or 0.08%;
- Total wastewater fund nets assets increased by \$56,888 or 0.04%;
- Total water fund operating revenues increased by \$64,270 or 3.9% while operating expenses increased by \$215,336 or 12.6%;
- Total wastewater fund operating revenues increased by \$229,239 or 16.0% while operating expenses increased by \$77,102 or 5.0%.

General Fund Budgetary Highlights

Actual revenues were significantly lower than budgetary estimates by approximately \$4.7 million primarily due to lower than anticipated property tax revenues, recreation program fees, and capital grant revenues. Actual expenditures were significantly lower than budgetary estimates by approximately \$4.5 million primarily due to the postponement of capital outlays into future years.

The original budget was amended once during the fiscal year as approved by the Board of Directors to reflect additional debt service expenditures related to the pay-off of its capital lease.

Capital Assets

The District's investment in capital assets (net of accumulated depreciation) for its governmental and business-type activities as of June 30, 2011 equaled \$3,327,854 and \$18,281,086, respectively. Detailed information about the components of capital assets is included in Note 3 to the basic financial statements. Net capital assets decreased by \$40,650 (1.2%) for the District's governmental activities as depreciation exceeded capital asset purchases. Conversely, net capital assets increased by \$927,098 (5.3%) as capital asset purchases exceeded depreciation as the District made significant capital outlays related to water and wastewater infrastructure as well as the replacement of equipment and vehicles.

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT MANAGEMENT'S DISCUSSION AND ANALYSIS

Debt

The District's debt for its governmental and business-type activities as of June 30, 2011 totaled \$0 and \$4,096,264, respectively. Overall, the District experienced a net decrease in its debt balance from the prior year equal to \$90,352 (2.2%). The net decrease was the result of \$238,942 in principal repayment which was offset by the receipt of \$148,590 in loan proceeds which were received for the purpose of financing water system improvements. Detailed information about the components of debt is included in Note 4 to the basic financial statements.

Currently Known Facts

Looking forward, the District continues to plan for replacement and upgrade of its water and wastewater infrastructure. At the same time, purchased water costs are expected to continue to increase as the District's wholesale water supplier continues to raise rates. Increased operating costs, along with the District's need to build capital reserves for the replacement and upgrade of its water and wastewater systems, will require an increase in user fees. Moreover, the District anticipates that additional long-term debt will be required in order to meet its capital replacement and expansion needs.

Contacting the District

The District's annual financial report is designed to provide the District's customers, creditors and the public with a general overview of the District's finances and to demonstrate the District's accountability for the funds it receives. Additional information about the District is available at www.mckinleyvillecsd.com. Questions regarding this report may be directed to the following:

McKinleyville Community Services District
Attention: General Manager
PO Box 2037
McKinleyville, CA 95519

BASIC FINANCIAL STATEMENTS

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
STATEMENT OF NET ASSETS
June 30, 2011

	Governmental Activities	Business-Type Activities	Totals
Assets			
Current Assets:			
Cash and Cash Equivalents	\$ 959,276	\$ 4,296,049	\$ 5,255,325
Accounts Receivable	4,798	279,871	284,669
Interest Receivable	1,693	15,286	16,979
Prepays	20,069	52,200	72,269
Inventory	-	101,425	101,425
Total Current Assets	<u>985,836</u>	<u>4,744,831</u>	<u>5,730,667</u>
Non-current Assets:			
Restricted Cash and Cash Equivalents	-	847,852	847,852
Proposition 1A Receivable	39,325	-	39,325
Debt Issuance Costs	-	37,530	37,530
Net Capital Assets	<u>3,327,854</u>	<u>18,281,086</u>	<u>21,608,940</u>
Total Non-current Assets	<u>3,367,179</u>	<u>19,166,468</u>	<u>22,533,647</u>
Total Assets	<u>4,353,015</u>	<u>23,911,299</u>	<u>28,264,314</u>
Liabilities			
Current Liabilities:			
Accounts Payable	57,493	452,586	510,079
Accrued Liabilities	76,382	-	76,382
Deposits	7,200	80,270	87,470
Interest Payable	-	20,201	20,201
Compensated Absences Payable	14,723	59,164	73,887
Bonds and Loans, Due Within One Year	-	243,383	243,383
Total Current Liabilities	<u>155,798</u>	<u>855,604</u>	<u>1,011,402</u>
Non-current Liabilities:			
Revenue Bonds	-	755,000	755,000
Loans, Due in More Than One Year	-	3,097,881	3,097,881
Net Other Post Employment Benefit Obligation	60,787	169,857	230,644
Compensated Absences Payable	<u>11,421</u>	<u>59,778</u>	<u>71,199</u>
Total Non-current Liabilities	<u>72,208</u>	<u>4,082,516</u>	<u>4,154,724</u>
Total Liabilities	<u>228,006</u>	<u>4,938,120</u>	<u>5,166,126</u>
Net Assets			
Investment in Capital Assets, Net of Related Debt	3,327,854	14,184,822	17,512,676
Restricted for Debt Service	-	750,081	750,081
Unrestricted	<u>797,155</u>	<u>4,038,276</u>	<u>4,835,431</u>
Total Net Assets	<u>\$ 4,125,009</u>	<u>\$ 18,973,179</u>	<u>\$ 23,098,188</u>

See accompanying notes.

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS
For the Year Ended June 30, 2011

Functions/Programs	Program Revenues			Net (Expense) Revenue and Changes in Net Assets			
	Expenses	Charges For Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-Type Activities	Totals
Governmental Activities:							
Parks and Recreation Services	\$ 1,255,784	\$ 397,173	\$ 18,968	\$ 105,730	\$ (733,913)	\$ -	\$ (733,913)
Streetslights	118,342	81,633	-	-	(36,709)	-	(36,709)
Total Governmental Activities	<u>1,374,126</u>	<u>478,806</u>	<u>18,968</u>	<u>105,730</u>	<u>(770,622)</u>	<u>-</u>	<u>(770,622)</u>
Business-Type Activities:							
Water	1,975,818	1,729,146	-	81,850	-	(164,822)	(164,822)
Wastewater	1,669,921	1,663,829	-	-	-	(6,092)	(6,092)
Total Business-Type Activities	<u>3,645,739</u>	<u>3,392,975</u>	<u>-</u>	<u>81,850</u>	<u>-</u>	<u>(170,914)</u>	<u>(170,914)</u>
Total	<u>\$ 5,019,865</u>	<u>\$ 3,871,781</u>	<u>\$ 18,968</u>	<u>\$ 187,580</u>	<u>(770,622)</u>	<u>(170,914)</u>	<u>(941,536)</u>
General Revenues, Expenses and Transfers:							
Property Taxes					489,313	-	489,313
Special Assessments					209,068	-	209,068
Other Income					7,259	23,100	30,359
Gain (Loss) on Sale of Asset					(1,005)	6,400	5,395
Unrestricted Investment Earnings					5,901	46,922	52,823
Transfers In (Out)					56,696	(56,696)	-
Total Revenues and Transfers					<u>767,232</u>	<u>19,726</u>	<u>786,958</u>
Change in Net Assets					<u>(3,390)</u>	<u>(151,188)</u>	<u>(154,578)</u>
Net Assets - Beginning of Year as Previously Reported							
					4,128,399	18,958,063	23,086,462
Prior Period Adjustment					-	166,304	166,304
Net Assets - Beginning of Year as Adjusted					<u>4,128,399</u>	<u>19,124,367</u>	<u>23,252,766</u>
Net Assets - End of Year					<u>\$ 4,125,009</u>	<u>\$ 18,973,179</u>	<u>\$ 23,098,188</u>

See accompanying notes.

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
BALANCE SHEET
GOVERNMENTAL FUNDS
June 30, 2011

	General Fund (Parks and Recreation)	Street Lighting Fund	Total Governmental Funds
Assets			
Cash and Cash Equivalents	\$ 959,276	\$ -	\$ 959,276
Accounts Receivable	1,790	3,008	4,798
Due From Other Funds	9,130	-	9,130
Interest Receivable	1,693	-	1,693
Prepays	17,459	2,610	20,069
Total Assets	<u>\$ 989,348</u>	<u>\$ 5,618</u>	<u>\$ 994,966</u>
Liabilities and Fund Balance			
Liabilities:			
Accounts Payable	\$ 27,908	\$ 29,585	\$ 57,493
Due to Other Funds	-	9,130	9,130
Accrued Liabilities	76,382	-	76,382
Deposits	7,200	-	7,200
Compensated Absences Payable	14,723	-	14,723
Total Liabilities	<u>126,213</u>	<u>38,715</u>	<u>164,928</u>
Fund Balance:			
Nonspendable	17,459	2,610	20,069
Unassigned	845,676	(35,707)	809,969
Total Fund Balance	<u>863,135</u>	<u>(33,097)</u>	<u>830,038</u>
Total Liabilities and Fund Balance	<u>\$ 989,348</u>	<u>\$ 5,618</u>	<u>\$ 994,966</u>

See accompanying notes.

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
RECONCILIATION OF GOVERNMENTAL FUNDS BALANCE SHEET TO
THE GOVERNMENT-WIDE STATEMENT OF NET ASSETS
June 30, 2011

Total Fund Balances - Government Funds	\$ 830,038
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Amounts reported for governmental activities in the Statement of Net Assets are different because:

Long-term receivables do not provide current financial resources and, therefore, are not reported in the Governmental Funds Balance Sheet but are reported in the governmental activities in the Statement of Net Assets.	39,325
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Capital assets used in governmental activities are not current financial resources and, therefore, are not reported in the Governmental Funds Balance Sheet but are reported in the governmental activities in the Statement of Net Assets. The total capital assets, net of accumulated depreciation, are:	3,327,854
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Long-term liabilities are not due and payable in the current period and, therefore, are not reported in the Governmental Funds Balance Sheet but are reported in the governmental activities in the Statement of Net Assets.

Other Post Retirement Benefit Obligation	(60,787)
Long-term Portion of Compensated Absences	<u>(11,421)</u>

Net Assets for Governmental Activities	<u>\$ 4,125,009</u>
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See accompanying notes.

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
STATEMENT OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS
For the Year Ended June 30, 2011

	General Fund (Parks and Recreation)	Street Lighting Fund	Total Governmental Funds
Revenues			
General Revenues:			
Property Taxes	\$ 489,313	\$ -	\$ 489,313
Special Assessments	209,068	-	209,068
Total General Revenues	698,381	-	698,381
Charges for Services	397,173	81,633	478,806
Grants	18,968	-	18,968
Other Income	4,394	2,865	7,259
Unrestricted Investment Earnings	5,889	12	5,901
Total Revenues	1,124,805	84,510	1,209,315
Expenditures			
Current:			
Recreation Programs, Parks, Open Space, Facilities and Other Cultural Activities	1,049,937	106,874	1,156,811
Debt Service:			
Principal	324,201	-	324,201
Interest	10,870	-	10,870
Capital Outlay	27,559	1,857	29,416
Total Expenditures	1,412,567	108,731	1,521,298
Excess of Expenditures over Revenues	(287,762)	(24,221)	(311,983)
Other Financing Sources (Uses)			
Transfers In	79,752	-	79,752
Transfers Out	-	(23,056)	(23,056)
Total Other Financing Sources (Uses)	79,752	(23,056)	56,696
Net Change in Fund Balance	(208,010)	(47,277)	(255,287)
Fund Balance - Beginning of Year	1,071,145	14,180	1,085,325
Fund Balance - End of Year	\$ 863,135	\$ (33,097)	\$ 830,038

See accompanying notes.

**MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES TO THE STATEMENT OF ACTIVITIES
For the Year Ended June 30, 2011**

Net Change in Fund Balances - Governmental Funds \$ (255,287)

Amounts reported for governmental activities in the Statement of Activities are different because:

Governmental funds report capital outlays as expenditures since they consume the current financial resources of governmental funds. However, in the government-wide Statement of Activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays were less than depreciation in the current period. 29,416

Contributions of capital assets are reported in the government-wide statement of activities, however, since they do not provide current financial resources they are not reported as revenues in the governmental funds. This amount represents the contribution of capital assets in the current period. 105,730

Governmental funds report the repayment of the principal of long-term debt as expenditures since they consume the current financial resources of governmental funds. The repayment, however, does not effect the governmental-wide Statement of Activities, but rather reduces the long-term liabilities in the government-wide Statement of Net Assets. This amount represents the effect of these differences in the current period. 324,201

Changes in long-term liabilities are reported as expenses in the government-wide Statement of Activities, however, since they do not require the use of current financial resources they are not reported as expenditures in the governmental funds. The effect of these differences in the current period were as follows:

Interest Payable	4,728
Other Post Retirement Benefit Obligation	(36,886)
Long-term portion of Compensated Absences	507

Gains and losses from capital asset dispositions are not reported in the governmental funds, however, in the government-wide Statement of Activities a gain or loss is recognized to the extent that the capital assets carrying value at the time of disposition is either greater than or less than any sales proceeds received. This amount represents the net effect of capital dispositions in the current period. (1,005)

Some expenses do not require the use of current financial resources, and therefore, are not reported as expenditures in the governmental funds but are reported in the government-wide Statement of Activities. Those expenses include depreciation. (174,794)

Change in Net Assets of Governmental Activities \$ (3,390)

See accompanying notes.

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
June 30, 2011

	Water	Wastewater	Totals
Assets			
Current Assets:			
Cash and Cash Equivalents	\$ 1,077,306	\$ 3,218,743	\$ 4,296,049
Accounts Receivable	177,935	101,936	279,871
Interest Receivable	5,735	9,551	15,286
Prepays	26,100	26,100	52,200
Inventory	70,322	31,103	101,425
Total Current Assets	<u>1,357,398</u>	<u>3,387,433</u>	<u>4,744,831</u>
Non-current Assets:			
Restricted Cash and Cash Equivalents	592,111	255,741	847,852
Debt Issuance Costs	-	37,530	37,530
Net Capital Assets	6,442,864	11,838,222	18,281,086
Total Non-current Assets	<u>7,034,975</u>	<u>12,131,493</u>	<u>19,166,468</u>
Total Assets	<u>8,392,373</u>	<u>15,518,926</u>	<u>23,911,299</u>
Liabilities			
Current Liabilities:			
Accounts Payable	366,798	85,788	452,586
Deposits	80,270	-	80,270
Interest Payable	986	19,215	20,201
Compensated Absences Payable	29,582	29,582	59,164
Bonds and Loans, Due Within One Year	89,203	154,180	243,383
Total Current Liabilities	<u>566,839</u>	<u>288,765</u>	<u>855,604</u>
Non-current Liabilities:			
Revenue Bonds, Due in More Than One Year	-	755,000	755,000
Loans, Due in More Than One Year	2,517,141	580,740	3,097,881
Net Other Post Employment Benefit	84,712	85,145	169,857
Compensated Absences Payable	29,889	29,889	59,778
Total Non-current Liabilities	<u>2,631,742</u>	<u>1,450,774</u>	<u>4,082,516</u>
Total Liabilities	<u>3,198,581</u>	<u>1,739,539</u>	<u>4,938,120</u>
Net Assets			
Investment in Capital Assets, Net of Related Debt	3,836,520	10,348,302	14,184,822
Restricted for Debt Service	592,111	157,970	750,081
Unrestricted	765,161	3,273,115	4,038,276
Total Net Assets	<u>\$ 5,193,792</u>	<u>\$ 13,779,387</u>	<u>\$ 18,973,179</u>

See accompanying notes.

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND
CHANGES IN NET ASSETS
PROPRIETARY FUNDS
For the Year Ended June 30, 2011

	Water	Wastewater	Totals
Operating Revenues:			
Sale of Water	\$ 1,536,661	\$ -	\$ 1,536,661
Service Fees	-	1,442,589	1,442,589
Other Operating Revenue	192,485	221,240	413,725
Total Operating Revenues	<u>1,729,146</u>	<u>1,663,829</u>	<u>3,392,975</u>
Operating Expenses:			
Personnel Services	737,395	748,348	1,485,743
Purchased Water	620,976	-	620,976
Utilities	46,393	92,826	139,219
Insurance	25,038	25,038	50,076
Other Supplies and Expenses	227,703	290,865	518,568
Depreciation and Amortization	264,365	448,174	712,539
Total Operating Expenses	<u>1,921,870</u>	<u>1,605,251</u>	<u>3,527,121</u>
Operating Income (Loss)	<u>(192,724)</u>	<u>58,578</u>	<u>(134,146)</u>
Non-operating Revenues (Expenses):			
Interest Expense	(53,948)	(64,670)	(118,618)
Unrestricted Investment Earnings	19,437	27,485	46,922
Gain (Loss) on Capital Assets	3,200	3,200	6,400
Other Income	3,700	19,400	23,100
Total Non-operating Revenues (Expenses)	<u>(27,611)</u>	<u>(14,585)</u>	<u>(42,196)</u>
Income (Loss) Before Capital Contributions and Transfers	<u>(220,335)</u>	<u>43,993</u>	<u>(176,342)</u>
Transfers and Capital Contributions			
Transfers Out	-	(56,696)	(56,696)
Capital Contributions	81,850	-	81,850
Total Transfers and Capital Contributions	<u>81,850</u>	<u>(56,696)</u>	<u>25,154</u>
Net Income (Loss)	<u>(138,485)</u>	<u>(12,703)</u>	<u>(151,188)</u>
Net Assets - Beginning of Year	5,235,564	13,722,499	18,958,063
Prior Period Adjustment	96,713	69,591	166,304
Net Assets - Beginning of Year as Adjusted	<u>5,332,277</u>	<u>13,792,090</u>	<u>19,124,367</u>
Net Assets - End of Year	<u>\$ 5,193,792</u>	<u>\$ 13,779,387</u>	<u>\$ 18,973,179</u>

See accompanying notes.

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
For the Year Ended June 30, 2011

	Water	Wastewater	Total
Cash Flows from Operating Activities:			
Cash Received from Customers	\$ 1,717,253	\$ 1,672,664	\$ 3,389,917
Cash Paid for Operating Expenses	(629,887)	(425,436)	(1,055,323)
Cash Paid to Employees for Services	(702,448)	(712,968)	(1,415,416)
Net Cash Provided (Used) by Operating Activities	<u>384,918</u>	<u>534,260</u>	<u>919,178</u>
Cash Flows from Capital and Related Financing Activities:			
Principal Payments on Long-term Debt	(87,444)	(151,498)	(238,942)
Transfers to Governmental Funds	-	(56,696)	(56,696)
Proceeds from Long-term Borrowing	148,590	-	148,590
Acquisition and Construction of Capital Assets	(1,286,021)	(270,266)	(1,556,287)
Proceeds from Sale of Equipment	2,915	3,485	6,400
Interest Paid on Long-Term Debt	(52,962)	(64,563)	(117,525)
Net Cash Provided (Used) in Capital Financing Activities	<u>(1,274,922)</u>	<u>(539,538)</u>	<u>(1,814,460)</u>
Cash Flows from Non-operating Activities:			
Other Income	3,700	19,400	23,100
Net Cash Provided (Used) by Non-operating Activities	<u>3,700</u>	<u>19,400</u>	<u>23,100</u>
Cash Flows from Investing Activities:			
Proceeds from Investment Earnings	22,862	28,149	51,011
Net Cash Provided (Used) by Investing Activities	<u>22,862</u>	<u>28,149</u>	<u>51,011</u>
Increase (Decrease) in Cash and Cash Equivalents	<u>(863,442)</u>	<u>42,271</u>	<u>(821,171)</u>
Unrestricted Cash, Beginning of Year	1,940,748	3,176,428	5,117,176
Restricted Cash, Beginning of Year	592,111	255,785	847,896
Total Restricted and Unrestricted Cash and Cash Equivalents, Beginning of Year	<u>2,532,859</u>	<u>3,432,213</u>	<u>5,965,072</u>
Unrestricted Cash, End of Year	1,077,306	3,218,743	4,296,049
Restricted Cash, End of Year	592,111	255,741	847,852
Total Restricted and Unrestricted Cash and Cash Equivalents, End of Year	<u>\$ 1,669,417</u>	<u>\$ 3,474,484</u>	<u>\$ 5,143,901</u>
Reconciliation of Operating Loss to Net Cash			
Flows from Operating Activities			
Operating Income (Loss)	\$ (192,724)	\$ 58,578	\$ (134,146)
Adjustments to Reconcile Operating Loss to Net Cash			
Flows Provided by Operating Activities:			
Depreciation	264,365	448,174	712,539
Change in Assets and Liabilities:			
Accounts Receivable	(47,443)	8,835	(38,608)
Prepays	(26,100)	(26,100)	(52,200)
Inventory	19,203	2,478	21,681
Accounts Payable	297,120	6,915	304,035
Client Deposits	35,550	-	35,550
Payroll Related Liabilities	34,947	35,380	70,327
Net Cash Flows from Operating Activities	<u>\$ 384,918</u>	<u>\$ 534,260</u>	<u>\$ 919,178</u>
Noncash Investing, Capital and Financing Activities:			
Contribution of Capital Assets	<u>\$ 81,850</u>	<u>\$ -</u>	<u>\$ 81,850</u>

See accompanying notes.

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2011

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of McKinleyville Community Services District (the District) have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles.

This summary of significant accounting policies of the District is presented to assist in understanding the financial statements. The financial statements and notes are representations of management, who is responsible for their integrity and objectivity. These accounting policies have been consistently applied in the preparation of the financial statements.

Reporting Entity

The McKinleyville Community Services District is a Community Services District governed by an elected five member Board of Directors. The District is an independent governmental unit organized under the Community Services District Law, pursuant to Title 6 Division 3 of the California Government Code Section 61000, et seq. There are several other governmental agencies that provide services within the District's boundaries, including the McKinleyville Union School District, Northern Humboldt Union High School District, and the County of Humboldt. These other entities have independently elected boards and the District has no oversight or financial responsibility for these entities. Consequently, financial information for these agencies is not included in the basic financial statements of the District.

Nature of Activities

The District operates a water utility, sewage collection system, street lighting, open space maintenance, and recreational services in the unincorporated community of McKinleyville in the County of Humboldt, State of California. The governmental activities are funded by property taxes, assessments, grants, donations and user fees. The County of Humboldt collects tax revenue for the general fund. The District charges fees to utility customers to cover the cost of the services it provides. The District's highest level of decision-making authority is its elected Board of Directors.

Basis of Presentation

Government-Wide Financial Statements

The statement of net assets and statement of activities and changes in net assets display information about the reporting government as a whole. They include all funds of the reporting entity. The statements distinguish between governmental and business-type activities. Governmental activities generally are financed through taxes and other non-exchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for services.

The statement of activities demonstrates the degree to which the direct expenses of given functions or segments are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. The direct costs of providing services to the District's customers are charged directly to the program or activity benefited. Joint costs of providing services, or costs that are not identifiable with any specific program or activity, are allocated to programs or activities based on Management's estimate of the benefits

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2011

received by each program or activity. Program revenues include charges to customers who purchase, use, or directly benefit from goods, services, or privileges provided by a given function and grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not included among program revenues are reported instead as general revenues.

Fund Financial Statements

Financial statements of the District are organized into funds, each of which is considered to be a separate accounting entity. Each fund is accounted for by providing a separate set of self-balancing accounts which constitute its assets, liabilities, net assets/fund equity, revenues, and expenditures/expenses.

Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental funds and major individual proprietary funds are reported as separate columns in the fund financial statements.

The District reports the following major funds:

Major Governmental Fund

General Fund - The General Fund is the general operating fund of the District. It is used to account for all financial resources except those required to be in another fund.

Major Enterprise Funds

Wastewater Utility Fund - The Wastewater Utility Fund accounts for the operations of the wastewater disposal system.

Water Utility Fund - The Water Utility Fund accounts for the operations of the water system.

The District reports the following non-major fund:

Street Lighting Fund, a special revenue fund, is maintained to account for the fees collected and used to fund street lighting services.

Measurement Focus/Basis of Accounting

Measurement focus refers to what is being measured; basis of accounting refers to the timing of the recognition of revenues and expenditures in the accounts and their reporting in the financial statements.

Government-Wide Financial Statements

The government-wide statement of net assets and statement of activities are reported using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used.

When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first when there is an expenditure for which restricted resources are available.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are payments-in-lieu of taxes and

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2011

other charges between the District's water and wastewater function and other functions of the District. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Fund Financial Statements

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the government.

The proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the water and wastewater utilities are charges to customers for sales and services. Operating expenses for proprietary funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. Proprietary fund types are accounted for on an economic resources measurement focus using the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when the related liabilities are incurred.

Cash, Cash Equivalents, and Investments

The District is authorized by its most recent investment policy to invest in the State of California Local Agency Investment Fund; U.S. Treasury bonds, bills, and notes; obligations issued by US Government agencies; bankers' acceptances; repurchase agreements; time deposits, savings, and demand accounts and the Humboldt County Treasurer's Investment Fund.

For purposes of the statement of cash flows, the proprietary fund types consider cash on hand, demand deposits, and short term investments with original maturities of three months or less from the date of acquisition to be cash equivalents. Cash deposited in external investment pools are considered to be cash equivalents when deposits and withdrawals may be made at any time without prior notice or penalty.

Investments for the District are reported at fair value. The State Treasurer's Investment Pool and the Humboldt County Treasurer's Investment Pool operate in accordance with appropriate state laws and regulations. The reported value of the pools is the same as the fair value of the pool shares.

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2011

Accounts Receivable

Management considers accounts receivable to be fully collectible; accordingly, no allowance for doubtful accounts is required. If amounts become uncollectible, they will be charged to operations as a bad debt expense.

Interfund Activity and Transfers

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

Advances between funds, as reported in the fund financial statements, are offset by a fund balance reserve account in applicable government funds to indicate that they are not available for appropriation and are not expendable available financial resources.

<u>Receiving Fund</u>	<u>Transferring Fund</u>	<u>Purpose</u>	<u>Amount</u>
General	Wastewater	Debt Service	\$ 56,696
General	Street lighting	Debt Service	23,056
Total			<u>\$ 79,752</u>

Inventories and Prepaid Items

All inventories are valued at cost using the first-in/first-out (FIFO) method. Inventories of governmental funds are recorded as expenditures when used or consumed.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure assets e.g., roads, bridges, sidewalks, and similar items, are reported in the applicable governmental-type or business-type activities columns in the government-wide financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$1,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation. Under the GASB 34 Implementation Rules, the District is a Phase 3 entity and was not required to record infrastructure assets existing or acquired prior to July 1, 2003, the date these new financial reporting standards were implemented; and the District has not recorded such assets. The costs of normal maintenance and repairs that do not add to the value of the assets or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of the business-type activities is included as part of the capitalized value of the assets constructed.

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2011

Property, plant, and equipment of the District are depreciated using the straight-line method over the following estimated useful lives:

Buildings and Improvements	20-50	years
Water and Wastewater Systems	30-50	years
Other Infrastructure	10-50	years
Machinery and Equipment	5-10	years
Improvements	10-20	years

Compensated Absences and Other Post Employment Benefit Obligations

It is the District's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. All vacation pay and applicable sick leave is accrued when incurred in the government-wide and proprietary fund financial statements. In the governmental fund financial statements, a liability for these amounts is reported only if they have matured, for example, as a result of employee resignations and retirements, otherwise, an expenditure is recognized when the obligation is liquidated with current resources. Other post employment benefit obligations are reported as incurred in the proprietary and government-wide financial statements using the accrual basis of accounting.

Long-Term Obligations

In the government-wide financial statements, and the proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities or proprietary fund type statement of net assets.

Net Assets and Fund Balance

The difference between fund assets and liabilities is called "net assets" on the government-wide and proprietary fund financial statements and it is called "fund balance" on the governmental fund financial statements.

Government-wide and proprietary fund financial statements have the following categories of net assets:

Investment in capital assets, net of related debt, represents capital assets, net of accumulated depreciation reduced by the outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets.

Restricted net assets include amounts that can be spent only for specific purposes as stipulated by law, external resource providers, contract, or through enabling legislation.

Unrestricted net assets are neither restricted nor invested in capital assets, net of related debt.

In accordance with the provisions of GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions, the governmental fund financial statements have the following categories of fund balance:

Nonspendable - amounts that cannot be spent either because they are in a nonspendable form or because they are legally or contractually required to be maintained intact.

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2011

Restricted - amounts that can be spent only for specific purposes as stipulated by law, external resource providers, contract, or through enabling legislation.

Committed - amounts that can be spent only for specific purposes determined by a formal action of the District's governing body.

Assigned - amounts that are intended to be spent by the District for specific purposes but do not meet the criteria to be classified as restricted or committed.

Unassigned - the residual classification for the District's general fund and includes all spendable amounts not contained in the other classifications.

Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. Actual results could differ from those estimates.

Budgetary Information

Annual budgets are adopted on a basis consistent with generally accepted accounting principles for all governmental funds and proprietary funds including capital projects. Appropriations lapse at fiscal year end. The appropriated budget is prepared by fund, function, and department. The District Manager may make transfers of appropriations within a department. Transfers between departments and other changes require Board of Directors' approval. The legal level of control is the department and fund level. The District made supplemental appropriations during the fiscal year. Encumbrance accounting is not employed in governmental funds.

The District Manager submits a proposed operating budget for the fiscal year commencing on July 1 to the District's Board of Directors. Public hearings are conducted to obtain taxpayer and ratepayer comments. A preliminary budget is legally adopted in June and a final budget is legally adopted in August, following the closing of the prior period.

The budget is prepared on a detailed line item basis. Revenues are budgeted by source per the California Government Code Section 61110, as amended by Senate Bill 135. In accordance with GASB Statement No. 34, only the general fund budget is presented in the basic financial statements.

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2011

NOTE 2 – CASH AND INVESTMENT FUNDS

Cash and investment funds at June 30, 2011, consist of the following:

	<u>Restricted</u>	<u>Unrestricted</u>	<u>Total</u>
Cash on hand	\$ -	\$ 940	\$ 940
Checking	-	173,437	173,437
Investments in Money Market Accounts	157,970	102,193	260,163
Investments with Humboldt County Treasurer	689,882	4,851,469	5,541,351
Investments with Local Agency Investment Fund (LAIF)	-	127,286	127,286
Total Cash and Investment Funds	<u>\$ 847,852</u>	<u>\$5,255,325</u>	<u>\$6,103,177</u>

Demand deposits and investments in money market accounts are carried at cost.

Custodial Credit Risk

For deposits, custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned to the District. The District's policy for deposits is that they will be made only in institutions in California, they shall be insured or collateralized with United States backed securities, and time certificates of deposit shall have a maturity of less than five years. At June 30, 2011, none of the District's bank balances were exposed to custodial credit risk.

For an investment, custodial credit risk is the risk that, in the event of the failure of a counter party, the District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The District participates in two external investment pools: the County Treasurer's Investment Pool and the Local Agency Investment Fund (LAIF). The District also invests in money market funds. These investments are not evidenced by specific securities in the name of the District and are therefore not subject to custodial credit risk.

LAIF is a fund for pooling surplus cash of local government agencies and is chartered and administered by the California State Treasurer's Office. LAIF has invested a portion of the pool funds in Structured Notes and Asset-Backed Securities. LAIF's investments are subject to credit risk with the full faith and credit of the State of California collateralizing these investments. In addition, these Structured Notes and Asset-Backed Securities are subject to market risk as to changes in interest rates.

The County Treasurer's Investment Pool is administered by the County of Humboldt Treasurer's Office and conforms to the California Government Code. The County's portfolio normally consists of U.S. Treasury issues, U.S. Agency agreements, banker's acceptances, and the LAIF. All cash invested by the County in demand deposit accounts is collateralized to 110% with approved U.S. Government securities, such as Treasury Bills and other U.S. Treasury issues.

The District accounts for investments in these pools at fair value. Both pools determine fair value quarterly.

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2011

At June 30, 2011, the District had the following investments:

<u>Investment</u>	<u>Cost</u>	<u>Fair Value</u>	<u>Maturities</u>
Money Market Accounts	\$ 260,163	\$ 260,163	N/A
Humboldt County Treasurer's Investment Fund	5,541,731	5,541,351	Average 833 days
LAIF	<u>127,086</u>	<u>127,286</u>	Average 237 days
Totals	<u>\$ 5,928,980</u>	<u>\$ 5,928,800</u>	

Interest Rate Risk

As a means of limiting its exposure to fair value losses arising from rising interest rates, the District's investment policy limits the District's investment portfolio to investments in securities having maturities less than five years at the time of purchase.

Credit Risk

State law limits investments in various securities to certain level of risk ratings issued by nationally recognized statistical rating organizations. It is the District's policy to comply with State law in regards to securities ratings. LAIF and the Humboldt County Treasurer's Investment Fund are unrated. The U.S. Bank money market funds were rated as AAA at year end.

NOTE 3 – CAPITAL ASSETS

The change in the governmental activities capital assets for the year ended June 30, 2011, is as follows:

	<u>Balance 6/30/10</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance 6/30/11</u>
Governmental Activities:				
Capital Assets not being Depreciated:				
Land	\$ 1,340,600	\$ -	\$ -	\$ 1,340,600
Capital Assets being Depreciated:				
Buildings and Parking Lots	2,237,755	114,783	-	2,352,538
Street Lighting	343,020	1,857	-	344,877
Furniture and Equipment	253,275	11,352	(13,024)	251,603
Vehicles	54,664	7,154	-	61,818
Park Improvements	<u>1,208,024</u>	<u>-</u>	<u>-</u>	<u>1,208,024</u>
Total Capital Assets				
being Depreciated	4,096,738	135,146	(13,024)	4,218,860
Less Accumulated Depreciation	<u>(2,068,834)</u>	<u>(174,791)</u>	<u>12,019</u>	<u>(2,231,606)</u>
Total Capital Assets, being Depreciated, net	<u>2,027,904</u>	<u>(39,645)</u>	<u>(1,005)</u>	<u>1,987,254</u>
Governmental Activities Capital Assets, net	<u>\$ 3,368,504</u>	<u>\$ (39,645)</u>	<u>\$ (1,005)</u>	<u>\$ 3,327,854</u>

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2011

The change in business-type activities (Water and Wastewater Fund) capital assets for the year ended June 30, 2011, is as follows

	Balance 6/30/10	Increases	Decreases	Balance 6/30/11
Business-type Activities:				
Capital Assets not being Depreciated:				
Land, Easements and Water				
Rights	\$ 3,400,386	\$ -	\$ -	\$ 3,400,386
Construction in Progress	410,945	479,017	(409,834)	480,128
Total Capital Assets not being Depreciated	3,811,331	479,017	(409,834)	3,880,514
Capital Assets being Depreciated:				
Buildings and Parking Lots	431,976	-	-	431,976
Water Infrastructure	9,403,389	1,255,381	-	10,658,770
Wastewater Infrastructure	16,753,041	179,261	-	16,932,302
Tools and Equipment	925,798	78,699	-	1,004,497
Vehicles	701,972	55,612	(35,599)	721,985
Total Capital Assets being Depreciated	28,216,176	1,568,953	(35,599)	29,749,530
Less Accumulated Depreciation	(14,673,519)	(711,038)	35,599	(15,348,958)
Total Capital Assets, being Depreciated, net	13,542,657	857,915	-	14,400,572
Business-type Activities Capital Assets, net	<u>\$ 17,353,988</u>	<u>\$ 1,336,932</u>	<u>\$ (409,834)</u>	<u>\$ 18,281,086</u>

Depreciation expense was charged to functions/programs of the District as follows:

Governmental Activities:	
Street Lighting	\$ 11,465
Parks and Recreation	163,326
Total Depreciation Expense-Governmental Activities	<u>\$ 174,791</u>
Business-type Activities:	
Water	\$ 264,365
Wastewater	446,673
Total Depreciation Expense-Business-type Activities	<u>\$ 711,038</u>

Various beginning balances were grouped and summarized to conform to current year presentation.

NOTE 4 – LONG TERM DEBT

Water Fund

Davis Grunsky Act Loan

The District, in 1971, entered into a loan agreement with the State of California for a construction loan to finance improvements to the District's water system. The original loan amount was not to exceed \$3,673,000 and was to bear interest at 2.5% per annum. Under the

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2011

arrangement, the District was permitted to defer payment of interest on the loan for the first 10 years with such interest to be repaid over the remaining 40 year term of the loan. The District was required to establish a reserve fund in an amount specified by the State. The District as an entity is obligated for the repayment of this loan and a specific revenue source is not pledged for its repayment. The District is obligated to levy taxes or assessments for the loan repayments should it not have sufficient resources available to make the scheduled payments.

Future debt service on the loan is:

Year Ending June 30	Principal	Interest	Total
2012	\$ 89,203	\$ 52,075	\$ 141,278
2013	91,008	50,270	141,278
2014	92,857	48,421	141,278
2015	94,753	46,525	141,278
2016	96,695	44,583	141,278
2017 to 2021	514,365	192,026	706,391
2022 to 2026	570,764	135,627	706,391
2027 to 2031	634,574	71,817	706,391
2032 to 2034	273,535	8,927	282,462
Total	2,457,754	650,271	3,108,025
Due within one year	(89,203)	(52,075)	(141,278)
Due after one year	<u>\$ 2,368,551</u>	<u>\$ 598,196</u>	<u>\$ 2,966,747</u>

ARRA Loan

The District, in 2011, entered into a loan agreement with the California Energy Resources Conservation and Development Commission for the purpose of financing water system improvements. The loan was approved for \$165,100 and the District had received loan proceeds of \$148,590 as of June 30, 2011. The loan bears interest at 1% per annum with semi-annual principal and interest payments of \$6,225 due each June and December. Repayment will begin in December 2012 and continue through December 2026. The District as an entity is obligated for the repayment of this loan and a specific revenue source is not pledged for its repayment.

Future debt service on the loan is:

Year Ending June 30	Principal	Interest	Total
2012 Disbursement	\$ (16,510)	\$ -	\$ (16,510)
2013	8,236	4,215	12,451
2014	10,910	1,541	12,451
2015	11,019	1,432	12,451
2016	11,126	1,325	12,451
2017 to 2021	57,341	4,914	62,255
2022 to 2026	60,274	1,981	62,255
2032 to 2034	6,194	31	6,225
Total	148,590	15,439	164,029
Due within one year	-	-	-
Due after one year	<u>\$ 148,590</u>	<u>\$ 15,439</u>	<u>\$ 164,029</u>

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2011

Wastewater Fund

State Revolving Fund Loans

The District, in 1996, obtained an \$810,628 no interest loan from the State Water Resources Control Board for the purpose of financing wastewater treatment plant improvements. The District as an entity is obligated for the repayment of this loan and a specific revenue source is not pledged for its repayment. The District is obligated to levy taxes or assessments for the repayment of this loan should it not have other revenues available for repayment of this obligation.

Future debt service on the loan is:

<u>Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 40,920	\$ -	\$ 40,920
2013	40,920	-	40,920
2014	40,920	-	40,920
2015	40,920	-	40,920
2016	<u>40,920</u>	<u>-</u>	<u>40,920</u>
Total	204,600	-	204,600
Due within one year	<u>(40,920)</u>	<u>-</u>	<u>(40,920)</u>
Due after one year	<u>\$ 163,680</u>	<u>\$ -</u>	<u>\$ 163,680</u>

The District, in 1998, obtained a \$430,293 loan from the State Water Resources Control Board for the purpose of financing Phase 2 of a wastewater capacity expansion project. The loan bears interest at 2.6% per annum. The District as an entity is obligated for the repayment of this loan and a specific revenue source is not pledged for its repayment. The District is obligated to levy taxes or assessments should it not have other revenues available for repayment of the obligation.

Future debt service on the loan is:

<u>Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 23,317	\$ 4,589	\$ 27,906
2013	23,924	3,982	27,906
2014	24,546	3,360	27,906
2015	25,184	2,722	27,906
2016	25,839	2,067	27,906
2017 to 2018	<u>53,686</u>	<u>2,102</u>	<u>55,788</u>
Total	176,496	18,822	195,318
Due within one year	<u>(23,317)</u>	<u>(4,589)</u>	<u>(27,906)</u>
Due after one year	<u>\$ 153,179</u>	<u>\$ 14,233</u>	<u>\$ 167,412</u>

Sewer Revenue Bonds

The District, in 1982, issued \$1,575,000 in 1982 Sewer Revenue Bonds which were purchased by the Rural Development Division of the United States Department of Agriculture. Under the arrangement, the District was to construct wastewater system improvements. The bonds bear interest at 5.0% per annum with semiannual principal and interest payments due each August 1

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2011

and February 1 through August 1, 2022. The District's repayment obligation is secured by a pledge of the net revenues of its wastewater enterprise.

Future debt service on the loan is:

<u>Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 50,000	\$ 40,250	\$ 90,250
2013	60,000	37,750	97,750
2014	60,000	34,750	94,750
2015	60,000	31,750	91,750
2016	60,000	28,750	88,750
2017 to 2021	370,000	93,250	463,250
2022 to 2023	<u>145,000</u>	<u>10,500</u>	<u>155,500</u>
Total	805,000	277,000	1,082,000
Due within one year	(50,000)	(40,250)	(90,250)
Due after one year	<u>\$ 755,000</u>	<u>\$ 236,750</u>	<u>\$ 991,750</u>

Annual principal and interest payments on the bonds are expected to require less than 17% of system net revenues.

Bank Loan

The District, in fiscal year 1998, obtained a \$675,000 loan from Umpqua Bank for the purpose of financing wastewater system improvements. The loan bears interest at 5.5% per annum with monthly principal and interest payments of \$4,644 through maturity on December 4, 2017.

Future debt service on the loan is:

<u>Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 39,943	\$ 15,791	\$ 55,734
2013	42,243	13,491	55,734
2014	44,632	11,102	55,734
2015	47,155	8,579	55,734
2016	49,806	5,928	55,734
2017 to 2018	<u>80,045</u>	<u>3,540</u>	<u>83,585</u>
Total	303,824	58,431	362,255
Due within one year	(39,943)	(15,791)	(55,734)
Due after one year	<u>\$ 263,881</u>	<u>\$ 42,640</u>	<u>\$ 306,521</u>

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2011

Long-term obligations activity for the year ended June 30, 2011, was as follows:

	Balance 6/30/10	Additions	Reductions	Balance 6/30/11	Due Within One Year
Governmental Activities:					
Capital Lease	\$ 324,201	\$ -	\$ (324,201)	\$ -	\$ -
Business-Type Activities:					
Revenue Debt					
Water Fund					
Davis Grunsky Act Loan	\$ 2,545,198	\$ -	\$ (87,444)	\$ 2,457,754	\$ 89,203
ARRA Loan	-	148,590	-	148,590	-
Total Water Fund	2,545,198	148,590	(87,444)	2,606,344	89,203
Wastewater Fund					
State Revolving Fund	245,520	-	(40,920)	204,600	40,920
State Revolving Fund	199,223	-	(22,727)	176,496	23,317
Revenue Bonds	855,000	-	(50,000)	805,000	50,000
Bank Loan	341,675	-	(37,851)	303,824	39,943
Total Wastewater Fund	1,641,418	-	(151,498)	1,489,920	154,180
Total	\$ 4,186,616	\$ 148,590	\$ (238,942)	\$ 4,096,264	\$ 243,383
Due within one year				(243,383)	
Due after one year				\$ 3,852,881	

NOTE 5 – PUBLIC EMPLOYEES RETIREMENT SYSTEM

Plan Description

The District participates in a cost-sharing, multiple-employer, public employee, defined benefit pension plan that is administered by the California Public Employees Retirement System (PERS). PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. PERS acts as a common investment and administrative agent for participating public entities within the State of California. Benefit provision and all other requirements are established by State statute and District ordinance. PERS issues a separate comprehensive annual financial report. Copies of PERS annual financial report may be obtained from the PERS Executive Office, 400 P Street, Sacramento, California, 95814, or on-line at www.calpers.ca.gov.

The District participates in risk pooling, which consists of combining assets and liabilities across employers to produce large groups where the impact of loss is shared among all employers in the same risk pool. The District participates in the Miscellaneous 2% at 55 Risk Pool. Participation in the PERS risk pool is mandatory for all rate plans with less than 100 active members.

Funding Policy

Employer contribution rates are dependent upon the experience of each risk pool with additional consideration for each employer's side fund amortization as well as an adjustment to phase out the difference between the risk pool's normal cost and the employer's normal cost at the time of joining the pool. Side funds were established for each employer plan in order to reflect the excess assets or unfunded liabilities present at the time participation in the risk pool began. Amortization of the side fund began over a closed period of ten years with any subsequent plan

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2011

plan amendments being amortized as a level percentage of pay over a closed twenty-year period. The District's side fund as of the most recent actuarial valuation (June 30, 2010) was \$30,247.

Plan participants are required to contribute 7% of their annual covered salary while the District is required to contribute at an actuarially determined rate of annual covered payroll. The District's required contribution rate for fiscal year 2010-11 was 7.859%.

Annual Pension Cost and Funded Status

For the fiscal year ended June 30, 2011, the District's annual pension cost was \$173,808. The annual pension cost exceeded the District's required contribution due to its election to fund the employees' 7% required contribution. The District's required contribution rate was determined as part of a June 30, 2008, risk pool actuarial valuation. A summary of the principal assumptions and methods used to determine the contractually required contribution is as follows:

Actuarial Cost Method	Entry Age Actuarial Cost Method
Amortization Method	Level percent of Payroll
Average Remaining Period	16 Years as of Valuation Date
Asset Valuation Method	15 Year Smoothed Market
Actuarial Assumptions	(1) 7.75% investment rate of return (net of administrative expenses), (2) 3.25% to 14.45% projected annual salary increases depending on category, entry age, and duration of service, (3) overall payroll growth of 3.25%, and (4) 3.00% annual compounded rate of inflation

SCHEDULE OF CALPERS EMPLOYER CONTRIBUTIONS (THREE-YEAR TREND)

<u>Fiscal Year</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
6/30/09	\$157,025	100%	\$ -0-
6/30/10	\$167,125	100%	\$ -0-
6/30/11	\$173,808	100%	\$ -0-

The funded status of the Miscellaneous 2% at 55 Risk Pool for the three most recent actuarial valuations is as follows (in thousands):

<u>Actuarial Valuation Date</u>	<u>(A) Actuarial Asset Value</u>	<u>(B) Entry Age Actuarial Accrued Liability</u>	<u>(C) Excess Assets/ (Unfunded) (Liability) [(A) - (B)]</u>	<u>(D) Funded Ratio (A)/(B)</u>	<u>(E) Annual Covered Payroll</u>	<u>(F) Unfunded (Excess) Funded Actuarial Liability as Percentage of Covered Payroll (C)/(E)</u>
06/30/08	\$2,547,323	\$2,780,281	\$(232,958)	91.6%	\$688,607	33.8%
06/30/09	\$2,758,511	\$3,104,798	\$(346,287)	88.9%	\$742,982	46.6%
06/30/10	\$2,946,408	\$3,309,065	\$(362,657)	89.0%	\$748,401	48.5%

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2011

NOTE 6 – POST EMPLOYMENT BENEFITS OTHER THAN PENSIONS

Plan Description

The District administers its retired employee's healthcare plan, a single employer defined benefit health care plan. The plan provides medical benefits to eligible retired employees and their beneficiaries. District resolutions and regulations assign responsibility to establish and amend benefit provisions to the District. A separate other post employment benefit (OPEB) trust fund has not been established by the District.

Funding Policy

The contribution requirements of plan members and the District are established and may be amended by the District. The required contribution is based on projected pay-as-you-go financing requirements, with additional amounts to prefund benefits as determined annually by the District's Board of Directors. For the fiscal year ended June 30, 2011, the District contributed \$59,575 (95%) of the current year premiums and zero to prefund benefits. Plan members receiving benefits contributed \$3,123 (5%) of the total current year premiums.

Annual OPEB Costs and the Net OPEB Obligation

The District's annual OPEB cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of Governmental Accounting Standards Board Statement Number 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and to amortize any unfunded liabilities over a period not to exceed 30 years. The following table shows the components of the District's annual OPEB cost for the year, the amounts actually contributed to the plan, and changes in the District's net OPEB obligation to the Plan.

Annual Required Contribution (ARC)	\$ 170,026
Interest on Net OPEB Obligation	5,976
Adjustments to the ARC	<u>(5,293)</u>
Annual OPEB Expense	170,709
Contributions Made	<u>(59,575)</u>
Change in Net OPEB Obligation	111,134
Net OPEB Obligation, Beginning of Year	<u>119,510</u>
Net OPEB Obligation, End of Year	<u><u>\$ 230,644</u></u>

The District's annual OPEB cost, the percentage of the annual OPEB cost contributed to the plan, and the net OPEB obligation for 2011 and 2010 was as follows:

<u>Fiscal Year</u> <u>Ended</u>	<u>Annual OPEB</u> <u>Cost</u>	<u>Percentage</u> <u>Contributed</u>	<u>Net OPEB</u> <u>Obligation</u>
June 30, 2010	\$ 164,733	27.5%	\$ 119,510
June 30, 2011	\$ 170,709	34.9%	\$ 230,644

Funding Status and Funding Progress

As of May 1, 2010, the most recent actuarial valuation date, the plan was zero funded. The actuarial accrued liability for benefits was \$1,710,113, and the actuarial value of plan assets was zero, resulting in an unfunded actuarial accrued liability (UAAL) of the \$1,710,113. The

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2011

covered payroll (annual payroll of active employees covered by the plan) was \$1,131,599, and the ratio of the UAAL to the covered payroll was 151.1%.

Actuarial valuations of an ongoing plan involve estimates of reported amounts and assumptions about the probability of occurrence of events into the future. Examples include assumptions about future employment, mortality, and health care trends. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

The schedule of funding progress, presented as required supplemental information, following the notes to these financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to actuarial liabilities for benefits.

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the Plan as understood by the employer and the plan members) includes the types of benefits provided at the time of each valuation and the historical pattern of sharing benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial liabilities and the actuarial value of plan assets, consistent with the long-term perspective of the calculations. In the May 1, 2010, valuation, the entry age normal actuarial cost method was used. The actuarial assumptions include a 5% investment rate of return based on assumed long-term return on plan assets or employer assets, as appropriate. An annual health care trend rate of 4% was also used in the valuation. There were no plan assets at the valuation date. The UAAL is being amortized as a level percentage of payroll over 30 years, the remaining amortization period at June 30, 2010.

NOTE 7 – RESTRICTED NET ASSETS

At June 30, 2011, restricted net assets (\$750,081) were comprised of assets whose use is limited by financing agreements.

NOTE 8 – PROPERTY TAXES

The lien date for secured property taxes is March 1 of each year. Taxes are levied as of July 1 on all secured real property and are due and payable November 1 and February 1 of the following fiscal year. Humboldt County is responsible for assessing, collecting, and distributing property taxes in accordance with enabling legislation.

Since the passage of California Proposition 13, beginning with fiscal year 1978-79, taxes are based either on a 1% rate applied to the 1975-76 assessed value of the property, or on 1% of the sales price of the property on sales transactions and construction which occur after the 1975-76 assessment. Assessed values on properties (exclusive of increases related to sales transactions and improvements) can rise at a maximum of 2% per year. The amount collected

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
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by the County is distributed in accordance with State law to the various public agencies. Therefore, the District does not levy a specific tax rate but receives a share of the property tax revenue based on State formula. The District's tax rate is \$1.00/\$100 of assessed value, the maximum allowable under Proposition 13.

During fiscal year 1993-94, an alternate method of property tax allocation (the "Teeter Plan") was adopted by the County. Under this plan, the County Auditor/Controller distributes 100% of current secured taxes billed to taxing entities during the current year, whether collected or not. The District recognizes property tax revenues (including tax increment revenues) to the extent of each year's tax allocation received or to be received within 60 days after the end of each fiscal year.

NOTE 9 – PROPOSITION 1A PROPERTY TAX RECEIVABLE

Under the provisions of Proposition 1A and as part of the 2009-10 budget package passed by the California State Legislature on July 28, 2009, the State of California borrowed 8% of the amount of property tax revenue, including those property taxes associated with the in lieu motor license fee, the triple flip sales tax, and the supplemental property tax apportioned to cities, counties and special districts (excluding redevelopment agencies). The State is required to repay this borrowing plus interest by June 20, 2013. After repayment of this initial borrowing, the California Legislature may consider only one additional borrowing within a ten-year period. The amount of the borrowing pertaining to the District was \$39,325.

The borrowing by the State of California was recognized as a receivable in the accompanying financial statements. Under the modified accrual basis of accounting, the borrowed tax revenues are not permitted to be recognized as revenue in the governmental fund financial statements until the tax revenues are received from the State of California (expected to be fiscal 2012-2013). In the government wide financial statements, the tax revenues were recognized in the fiscal year for which they were levied (fiscal year 2009-2010).

NOTE 10 – RISK MANAGEMENT

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters for which the District carries insurance. The District, due to the costs of available coverage, participates as a member of the Special District Risk Management Authority (SDRMA) for purposes of general liability, property coverages, and for workers compensation insurance.

SDRMA provides joint protection programs for public entities covering automobile, general liability, errors, and omissions claims. Under the program, the District has a \$500 retention limit similar to a deductible with the SDRMA being responsible for losses above that amount up to \$2.5 million for liability combined single limit. Property coverage is also provided up to the replacement cost of the property with a combined total for SDRMA members of \$1 billion dollars per occurrence.

The SDRMA also provides employee dishonesty coverage with limits of \$400,000 per loss. Boiler and machinery coverage is provided to members with coverage of up to \$100 million of

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
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SDRMA may pay dividends to members or may make additional assessments depending on loss experience, but no dividends have been declared and no additional assessments have been levied.

The SDRMA provides workers compensation statutory insurance coverage and \$5 million for employer's liability coverage subject to the terms, conditions, and exclusions provided in the memorandum of coverage. Financial information pertaining to SDRMA can be obtained from its administrative offices at 1112 I Street, Suite 300, Sacramento, California 95814.

Liabilities of the District are reported in the statement of net assets when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. The result of the process to estimate the claims liability is not an exact amount as it depends on many complex factors, such as inflation, changes in legal doctrines, and damage awards. Accordingly, claims are reevaluated periodically to consider the effects of inflation, recent claim settlement trends (including frequency and amount of pay-outs), and other economic and social factors. The District's only exposure to claim liabilities would be for losses or additional assessments, if any, not covered by or imposed by SDRMA.

There have been no significant changes in insurance coverages during the fiscal year other than disclosed in the above paragraphs. Settlements have not exceeded coverage for each of the past three fiscal years. The District had no material uninsured claim liabilities at June 30, 2011.

NOTE 11 – CONTINGENCIES AND COMMITMENTS

Litigation

The District is involved in litigation incurred in the normal course of conducting District business. Although the outcome of these lawsuits is not presently determinable, in the opinion of the District's counsel the resolution of these matters will not have a material adverse effect on the financial condition of the District.

Short-term Disability Insurance

All employees who have one year of service with the District are eligible for short-term disability insurance. This short-term disability insurance provides protection to employees who are prevented from working due to illness or injury not related to their job. This program is self-funded by the District and is comparable to State Disability insurance. Benefits under the plan are based upon wages paid to the employee over the twelve months preceding the quarter ended prior to the disability. An individual's weekly benefit amount is approximately 55% of his or her earnings. He or she may receive up to 52 weeks of benefit payments. Management believes liability under this arrangement, if any, is not material to these financial statements. There were no claims during the year ended June 30, 2011. Accordingly, no liability has been recorded.

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2011

Grants and Allocations

Amounts received or receivable from grant agencies are subject to audit and adjustment by grantor agencies, principally the federal and state government. Any disallowed claims, including amounts already collected, may constitute a liability of the applicable funds. The amount, if any, of expenditures that may be disallowed by the grantor cannot be determined at this time, although the District expects such amounts, if any, to be immaterial.

Wastewater Discharge Permit and the California Toxic Rule

The District was issued a new Discharge permit by the State which contains compliance provisions that may require the District to expend considerable sums of money in order to fulfill compliance requirements. Similar compliance and financing issues surround the District's ability to meet future effluent standards regarding pesticides, insecticides, copper, lead, and other compounds.

NOTE 12 – WATER PURCHASE CONTRACT

The District has a contract with Humboldt Bay Municipal Water District (HBMWD) to purchase water. Under the contract, the District pays HBMWD a rate that includes cost allocations of various factors designed to cover costs associated with the operation, maintenance, repair and replacement of the HBMWD's base water facilities and drinking water treatment facilities.

NOTE 13 – PRIOR PERIOD ADJUSTMENT

An error resulting in the understatement of previously reported accounts receivable and revenues was discovered during the current year. Accordingly, during fiscal year 2010-11, an adjustment of \$166,304 (Water Fund - \$96,713, Wastewater Fund - \$69,591) was made to both the government-wide and proprietary fund financial statements to increase accounts receivable and net assets as of the beginning of the year.

NOTE 14 – SUBSEQUENT EVENTS

The District evaluated subsequent events through January 23, 2012, which is the date the financial statements were available to be issued. Subsequent to fiscal year end, the District borrowed approximately \$973,000 for the purpose of financing water system improvements.

REQUIRED SUPPLEMENTARY INFORMATION

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
BUDGETARY COMPARISON SCHEDULE
PARKS AND RECREATION FUND
For the Year Ended June 30, 2011

	Original Budget Amounts	Final Budget Amounts	Actual Amounts	Positive (Negative) Variance
Fund Balance, July 1	\$ 1,071,145	\$ 1,071,145	\$ 1,071,145	\$ -
Resources (inflows):				
Property Tax Assessments	520,000	520,000	489,313	30,687
Measure B Assessment	214,000	214,000	209,068	4,932
Program Fees	329,306	329,306	263,409	65,897
Facility Rentals	62,400	62,400	60,224	2,176
Unrestricted Investment Earnings	20,000	20,000	5,889	14,111
State Bonds and Grants	4,379,000	4,379,000	12,000	4,367,000
Other Revenues	276,176	276,176	84,902	191,274
Transfers In	-	-	79,752	(79,752)
Amounts available for charges to appropriations	<u>6,872,027</u>	<u>6,872,027</u>	<u>2,275,702</u>	<u>4,596,325</u>
Expenditures				
Salaries and Benefits	800,787	800,787	738,727	62,060
Other Expenses and Expenditures	219,141	219,141	311,210	(92,069)
Debt Service transfer to Long-Term Debt	127,877	255,754	335,071	(79,317)
Capital Outlay	4,629,000	4,629,000	27,559	4,601,441
Total Expenditures	<u>5,776,805</u>	<u>5,904,682</u>	<u>1,412,567</u>	<u>4,492,115</u>
Fund Balance, June 30	<u>\$ 1,095,222</u>	<u>\$ 967,345</u>	<u>\$ 863,135</u>	<u>\$ 104,210</u>

Note 1 - Explanation of Difference between Budgetary Inflows and GAAP Revenues

Resources (inflows):

Actual amounts available for appropriations from budgetary
comparison schedule \$ 2,275,702

Differences - budget to GAAP

Interfund transfers-in are a budgetary financial inflow but are
not revenue for financial reporting purposes (79,752)

The fund balance at the beginning of the year is a budgetary
resource but it not a current year revenue for financial
reporting purposes (1,071,145)

Total revenue as reported in the Statement of Revenues, Expenditures
and Changes in Fund Balances - Government Funds 1,124,805

Total expenditures (1,412,567)

Excess of Expenditures over Revenues (287,762)

Other Financing Sources
Transfers In 79,752

Net Change in Fund Balance \$ (208,010)

See accompanying notes.

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
BUDGETARY COMPARISON SCHEDULE
STREETLIGHT FUND
For the Year Ended June 30, 2011

	Original Budget Amounts	Final Budget Amounts	Actual Amounts	Positive (Negative) Variance
Fund Balance, July 1	\$ 14,180	\$ 14,180	\$ 14,180	\$ -
Resources (inflows):				
Streetlight Charges	80,000	80,000	65,312	14,688
Other Revenue	15,900	15,900	19,186	(3,286)
Interest Revenue	100	100	12	88
Amounts available for charges to appropriations	<u>110,180</u>	<u>110,180</u>	<u>98,690</u>	<u>11,490</u>
Expenditures				
Salaries and Benefits	35,841	35,841	39,195	(3,354)
Other Expenses and Expenditures	69,231	69,231	67,679	1,552
Debt Service transfer to Long-Term Debt	23,098	23,098	23,056	42
Capital Outlay	7,000	7,000	1,857	5,143
Total Expenditures	<u>135,170</u>	<u>135,170</u>	<u>131,787</u>	<u>3,383</u>
Fund Balance, June 30	<u>\$ (24,990)</u>	<u>\$ (24,990)</u>	<u>\$ (33,097)</u>	<u>\$ 8,107</u>

Note 1 - Explanation of Difference between Budgetary Inflows and GAAP Revenues

Resources (inflows):

Actual amounts available for appropriations from budgetary
comparison schedule \$ 98,690

Differences - budget to GAAP

The fund balance at the beginning of the year is a budgetary
resource but it not a current year revenue for financial
reporting purposes (14,180)

Total revenue as reported in the Statement of Revenues, Expenditures
and Changes in Fund Balances - Government Funds 84,510

Budgetary expenditures (131,787)

Interfund transfers out is a budgetary expenditure but is not operating
expenditures for financial reporting purposes 23,056

Total Expenditures (108,731)

Excess of Expenditures over Revenues (24,221)

Other Financing Sources
Transfers Out (23,056)

Net Change in Fund Balance \$ (47,277)

See accompanying notes.

**MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
OTHER POST EMPLOYMENT BENEFITS
SCHEDULE OF FUNDING PROGRESS
June 30, 2011**

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets</u>	<u>Actuarial Accrued Liability - Entry Age</u>	<u>Unfunded Actuarial Accrued Liability</u>	<u>Funded Ratio</u>	<u>Covered Payroll</u>	<u>Unfunded Actuarial Accrued Liability as a Percentage of Covered Payroll</u>
May 1, 2010	\$ -	\$ 1,710,113	\$1,710,113	0.00%	\$1,131,599	151.12%

See accompanying notes.

**REPORT ON INTERNAL CONTROL AND COMPLIANCE
AND OTHER MATTERS**

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Scott E. Hunt, CPA/ABV
Donna L. Taylor, CPA, CFE



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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE
AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors
McKinleyville Community Services District

We have audited the financial statements of the governmental activities and the business-type activities of McKinleyville Community Services District (the District), as of and for the year ended June 30, 2011, and have issued our report thereon dated January 23, 2012. 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.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and responses, finding 2011-1, we identified a certain deficiency in internal control over financial reporting that we consider to be a material weakness.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and responses to be a material weakness. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The District's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the District's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the Board of Directors, the audit committee, the State of California, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Hunter, Hunter & Hunt

January 23, 2012

MCKINLEYVILLE COMMUNITY SERVICES DISTRICT
SCHEDULE OF FINDINGS AND RESPONSES
June 30, 2011

Material Weakness:

2011-1

Criteria - Management is responsible for the selection and application of accounting principles and for the fair presentation of the financial statements in conformity with GAAP. Management is also responsible for ensuring that financial information is reliable and properly recorded and for adjusting the financial statements to correct material misstatements.

Statement of Condition - Control systems in place, did not prevent, detect, or correct an error related to unbilled accounts receivable which resulted in an understatement of accounts receivable and an understatement of net assets for the proprietary funds as of June 30, 2011.

Questioned Costs - Not applicable.

Perspective Information - An audit adjustment to the financial statements was material to the financial statements. Although an independent auditor can assist an auditee with the recording of transactions and the preparation of financial statements, this assistance may not be construed to be an internal control of the auditee. If the auditee receives such assistance from the auditor, and if the financial statements would have been materially misstated without this assistance, this condition will always indicate a material weakness in internal controls.

Cause and Effect - The accrual of unbilled receivables had not been considered at year-end. Without the current year audit adjustment the financial statements would have been materially misstated. There is potential that governing decisions could be based on unreliable financial information.

Recommendation - We recommend the use of a checklist designed to highlight potential issues at year-end to assist with the year-end close and preparation of the financial statements.

Actions Taken - See Management's response and corrective action plan on page 44.

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Management's Response and Corrective Action for Finding 2011-1:

The management of the McKinleyville Community Services District agrees with audit finding number 2011-1 as identified on page 43. Unbilled receivables are now recorded in a separate general ledger asset account. The District's year-end procedures include reconciliation of all balance sheet accounts. Unbilled receivables will be analyzed at each year-end and a related adjustment will be recorded, if considered to be necessary.