

**McKinleyville Community  
Services District  
Basic Financial Statements  
June 30, 2010**

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Basic Financial Statements  
June 30, 2010**

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**Terry E. Krieg, CPA**  
Certified Public Accountant

**Independent Auditor's Report**

Board of Directors  
McKinleyville Community Services District  
McKinleyville, California

I have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the McKinleyville Community Services District, California, (the District) as of and for the year ended June 30, 2010, which collectively comprise the District's basic financial statements as listed in the Table of Contents. These financial statements are the responsibility of the McKinleyville Community Services District management. My responsibility is to express an opinion on these financial statements based on my audit.


I conducted my audit in accordance with auditing standards generally accepted in 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 I plan and perform the audit 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 significant estimates made by management as well as evaluating the overall financial statement presentation. I believe that my audit provides a reasonable basis for my opinions.

In my 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 McKinleyville Community Services District, California, as of June 30, 2010, 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.

The Management Discussion and Analysis, Budgetary Comparison Information, and Schedule of Funding Progress on pages 2 through 5 and pages 32 through 34 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. I have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, I did not audit the information and express no opinion on it.

In accordance with Government Auditing Standards, I have also issued my report dated January 31, 2011 on my consideration of the McKinleyville Community Services District's, California internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of my audit.

As discussed in note 5F to these financial statements, the District in fiscal year 2010 implemented the provisions of Governmental Accounting Standards Board Statement 45, titled, Accounting and Financial Reporting for Post Employment Benefits Other Than Pensions.

  
Certified Public Accountant  
January 31, 2011

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The management of the McKinleyville Community Services District offer readers of the McKinleyville Community Service District's financial statements this narrative overview and analysis of the District's financial activity for the year ended June 30, 2010. Please read it in conjunction with the Report of the Independent Auditor and the District's financial statements.

### FINANCIAL HIGHLIGHTS

- The District's Net Assets increased by \$397,598 or 1.75%, as a result of this year's operation. The District's Net Assets are now \$23,086,459. Net Assets of business-type activities (providing water and sewer services) increased by \$198,875 or 1.06%.
- Over the past five years, the District's Net Assets have increased by \$3,587,234, for an average increase of 3.68% per year.
- The District invested \$1,068,279 in capital improvements (including \$307,550 of developer contributed assets) and equipment upgrades during the fiscal year. Projects during the year included the addition to the Sutter Road office building, engineering and design of the Ramey Pump Station upgrade, and engineering and design work on the Waste Water Management Facility upgrade project. Parks projects included construction of the bocce ball courts at Pierson Park, acquisition of additional land adjacent to Pierson Park, a new play structure at Hiller Park, and various improvements and replacements to buildings and grounds. Infrastructure upgrades included replacement and upgrades to operating equipment (trucks, radios, computers, etc.). Additional information regarding capital assets can be found starting on page 22 of the notes to the financial statements.
- The total cost of District programs was \$4.4 million for the fiscal year compared to \$4.1 million for the prior year.
- During the fiscal year, the District increased its cash and cash equivalents by \$64,036 while decreasing its liabilities (loans, notes payable, leases, and other amounts due to customers, vendors and others) by \$226,285.
- Over the past five years, the District has increased its cash and cash equivalents by \$2,502,350 while decreasing its liabilities by \$1,986,080.

### USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. The Statement of Net Assets and the Statement of Activities provide information about the activities of the District as a whole and present a longer-term view of the District's finances. The fund financial statements for governmental activities explains how these services were financed in the short term as well as what remains for future spending. Fund financial statements also report the District's operations in more detail than the government-wide statements by providing information about the District's most significant operating funds.

#### The Statement of Net Assets and the Statement of Activities

The Statement of Net Assets and the Statement of Activities report activities of the District as a whole and about its activities in a way that indicates whether the financial position of the District has improved during the fiscal year. These statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the changes in the District's net assets. The District's net assets - the difference between its assets and liabilities - are a measure of the District's financial position, or financial health. Over time, increases or decreases in the District's net assets are an indicator of whether its financial health remains consistent. Other considerations not of a financial nature, such as changes in the District's property tax base and the condition of the District's physical infrastructure, should also be considered while assessing the overall financial health of the District.

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, the Activity Center, the Library and the Law Enforcement Facility), Hiller Park (sports fields, playgrounds, dog park, etc.), Larissa Park, and 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 sewer systems are reported herein.

### **Fund Financial Statements**

The fund financial statements provide information about the most significant operating funds of the District individually. The District's fund types - governmental and business-type - use different accounting approaches.

- **Governmental funds** - The District's parks, recreation programs, open space zones, streetlight zones and building management functions are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for future expenditures. These funds are reported using the modified accrual basis of accounting, which measures cash and all other financial assets that can be readily converted to cash. The governmental fund statements provide a detailed short-term view of the District's general governmental operations and the basic services it provides. Governmental fund information demonstrates whether there are greater or fewer financial resources, available in the near future to finance the District's programs. A description of relationship between governmental activities is shown in the reconciliation at the bottom of the Statement of Net Assets and the Statement of Activities.
- **Business-type funds** - As the District charges customers for the services provided, these services are generally reported in Business-type funds. Business-type funds are reported in the same manner that all activities are reported in the Statement of Net Assets and the Statement of Activities.

### **THE DISTRICT AS A WHOLE**

For the year ended June 30, 2010, net assets changed as follows:

	Governmental Activities	Business-type Activities	Total
Beginning Net Assets	\$ 3,929,672	\$ 18,759,189	\$ 22,688,861
Increase in Net Assets	198,723	198,875	397,598
Ending Net Assets	<u>\$ 4,128,395</u>	<u>\$ 18,958,064</u>	<u>\$ 23,086,459</u>

This reflects an increase of 5.06% for governmental activities and an increase of 0.11% for business-type activities. The overall increase of \$397,598 represents a 1.75% increase in the net assets of the District as a whole. Over the past five years the net assets of the District have increased by \$3,587,234, an average annual increase of 3.68%.

### **THE DISTRICT'S FUNDS**

#### **Governmental Funds**

Following is a comparison of revenues and expenditures for governmental activities, which includes operation of the District's parks, recreation programs, open space zones, streetlight zones and building management functions. It also includes revenues from fees assessed for operation of those programs, general property tax revenues and property assessments for the development and operation of the District's sports fields and recreation programs.

Recreation program revenues of \$265,596 were lower than the prior year, which reflected a corresponding decrease in recreation program costs of \$236,075 for the fiscal year. Revenues from donations and grants, as well as interest revenues, were lower than in the prior year due to prevailing economic conditions. The District purchased property on Gwin Road (adjacent to Pierson Park) late in the fiscal for \$125,743, causing a deficit of revenues over expenditures for the fiscal year.

**Governmental Funds (General, Parks and Streetlighting) (Deficit) of Revenues Over Expenditures**

	FYE 6/30/10 Amount	Percent of Total	Increase (Decrease) From FYE 6/30/09	Percent Increase (Decrease)
<b>Revenues:</b>				
Recreation programs fees	\$ 265,596	22.44%	\$ (18,266)	-6.84%
Property taxes	460,625	38.93%	(25,672)	-6.36%
Measure B assessments	201,114	17.00%	7,390	3.88%
Donations and grants	10,479	0.89%	(45,422)	-33.92%
Park and building rentals and services	55,186	4.66%	(1,131)	-1.50%
Streetlight zone fees	81,289	6.87%	3,032	5.28%
Open space zone fees	52,884	4.47%	2,853	4.42%
Interest income	19,021	1.61%	(11,443)	-50.74%
Other revenues	37,014	3.13%	6,422	10.39%
<b>Total revenues</b>	<b>\$1,183,208</b>	<b>100.00%</b>	<b>\$ (82,237)</b>	<b>-6.44%</b>
<b>Expenditures:</b>				
Principal and interest on debt	\$ 251,465	19.33%	\$ -	0.00%
Recreation programs	236,075	18.14%	(34,074)	-15.65%
Capital expenditures	186,355	14.32%	167,217	207.43%
Building operations	256,603	19.72%	8,613	7.26%
Streetlight zones	71,224	5.47%	46,927	77.07%
Open space zone maintenance	30,722	2.36%	(4,814)	-10.80%
Other salaries and benefits	225,953	17.36%	12,930	6.03%
Other expenditures	42,975	3.30%	(23,788)	-33.90%
<b>Total expenditures</b>	<b>\$1,301,372</b>	<b>100.00%</b>	<b>\$ 173,011</b>	<b>16.74%</b>
<b>(Deficit) of revenues over expenditures</b>	<b>\$ (118,164)</b>		<b>\$ (255,248)</b>	

**Business-Type Funds**

The District has sustained an approximate 2% population growth rate over the past ten years. It is clear that there will be increasing demand on the District's facilities as McKinleyville continues to grow. However the District has seen a decrease in connection and processing fees as construction activity has slowed. While total operating revenues for the fiscal year increased by 8.61% over the prior year, operating expenses increased by 11.28% during the same period. The largest increase was due to an increase of \$215,802 (61.14%) in the cost of purchased water. An increase in user fees for water and sewer will be needed to avoid continuing operating losses.

**Business-Type Funds (Water and Sewer  
Enterprise) Operating (Loss)**

	FYE 6/30/10 Amount	Percent of Total	Increase (Decrease) from FYE 6/30/09	Percent Increase (Decrease)
<b>Operating revenues:</b>				
User fees for water	\$1,549,371	49.99%	\$ 189,202	14.49%
User fees for sewer	1,346,776	43.45%	48,261	4.15%
Connection, extension and other fees	95,706	3.09%	(41,914)	-10.41%
Leases and other	107,613	3.47%	55,525	120.19%
<b>Total operating revenues</b>	<b>\$3,099,466</b>	<b>100.00%</b>	<b>\$ 251,074</b>	<b>8.61%</b>
<b>Operating expenses:</b>				
Salaries and benefits	\$1,484,893	45.91%	\$ 121,230	10.17%
Purchased water	533,961	16.51%	215,802	61.14%
Utilities, maintenance and repairs	246,255	7.61%	(17,296)	-5.20%
Depreciation of plant	636,328	19.67%	14,753	2.38%
Other operating expenses	333,246	10.30%	(31,943)	-17.43%
<b>Total operating expenses</b>	<b>\$3,234,683</b>	<b>100.00%</b>	<b>\$ 302,546</b>	<b>11.28%</b>
<b>Net operating (loss)</b>	<b>\$ (135,217)</b>		<b>\$ (51,472)</b>	

**THE DISTRICT'S FUNDS**

**Debt**

As of June 30, 2010, the District had \$4,510,818 in outstanding State, Federal and commercial loans and a capital lease agreement compared with \$4,981,466 as of the end of the prior year. This represents a retirement of \$470,648 of principal during the fiscal year. The District anticipates that additional long term debt will be required in order to meet its impending capital improvements. Additional information regarding the District's long-term debt can be found starting on page 24 of the notes to the financial statements.

**Variations from Final Budget for the General Fund**

The District's budget authority was amended during the fiscal year to provide for the purchase of the Gwin Road property and a consultant to provide the district guidance with the Measure B assessment. General Fund operating revenues were \$3,756 above budgeted amounts, and operating expenditures were \$32,331 below budgeted amounts.

**CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT**

These financial statements are provided for the District's customers, creditors and the public in order that they may have a general overview of the District's finances and to demonstrate the District's accountability for funds in its care. Additional information about the District is available on the website; [www.mckinleyvillecsd.com](http://www.mckinleyvillecsd.com). Questions regarding the contents of this report may be directed to the District's General Manager, care of the business office at 1656 Sutter Road (Post Office Box 2037), McKinleyville, California.

**MCKINLEYVILLE COMMUNITY SERVICES DISTRICT**  
**Statement of Net Assets**  
**June 30, 2010**

	<u>Governmental Activities</u>	<u>Business Type Activities</u>	<u>Total</u>
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	\$ 1,181,139	\$ 5,213,731	\$ 6,394,870
Net receivables	10,137	94,334	104,471
Inventory	-	123,106	123,106
Total current assets	<u>1,191,276</u>	<u>5,431,171</u>	<u>6,622,447</u>
Noncurrent assets:			
Restricted cash and cash equivalents	-	751,341	751,341
Proposition 1A receivable	39,325	-	39,325
Debt issuance costs	-	39,031	39,031
Net capital assets	<u>3,368,504</u>	<u>17,353,988</u>	<u>20,722,492</u>
Total noncurrent assets	<u>3,407,829</u>	<u>18,144,360</u>	<u>21,552,189</u>
Total assets	<u>\$ 4,599,105</u>	<u>\$ 23,575,531</u>	<u>\$ 28,174,636</u>
<b>LIABILITIES</b>			
Current liabilities:			
Accounts payable	\$ 16,306	\$ 148,550	\$ 164,856
Accrued liabilities	66,438	-	66,438
Deposits	8,100	44,720	52,820
Compensated absences	15,107	59,550	74,657
Interest payable	4,728	19,108	23,836
Capital leases, bonds and loans due within one year	<u>159,264</u>	<u>238,977</u>	<u>398,241</u>
Total current liabilities	<u>269,943</u>	<u>510,905</u>	<u>780,848</u>
Noncurrent liabilities:			
Davis Grunsky Act Loan	-	2,457,755	2,457,755
State revolving loans	-	381,097	381,097
Bonds payable	-	805,000	805,000
Bank loan	-	303,788	303,788
Capital lease obligations	164,937	-	164,937
Net other post employment benefit obligation	23,902	95,608	119,510
Compensated absences payable	<u>11,928</u>	<u>63,314</u>	<u>75,242</u>
Total noncurrent liabilities	<u>200,767</u>	<u>4,106,562</u>	<u>4,307,329</u>
Total liabilities	<u>470,710</u>	<u>4,617,467</u>	<u>5,088,177</u>
<b>NET ASSETS</b>			
Invested in capital assets, net of related debt	3,044,303	13,167,371	16,211,674
Restricted for:			
Debt service	-	751,341	751,341
Unrestricted	<u>1,084,092</u>	<u>5,039,352</u>	<u>6,123,444</u>
Total net assets	<u>4,128,395</u>	<u>18,958,064</u>	<u>23,086,459</u>
Total liabilities and net assets	<u>\$ 4,599,105</u>	<u>\$ 23,575,531</u>	<u>\$ 28,174,636</u>

See accompanying notes to the basic financial statements



**MCKINLEYVILLE COMMUNITY SERVICE DISTRICT**  
**Statement of Activities**  
**For the Fiscal Year Ended June 30, 2010**

Functions/Programs	Program Revenues					Net (Expenses) Revenue and Changes in Net Assets		
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-type Activities	Total	District Government
District government:								
Governmental activities:								
Parks and recreation services	\$ 983,550	\$ 409,880	\$ -	-	(573,670)	-	(573,670)	
Street lighting	82,275	81,289	-	11,500	10,514	-	10,514	
Interest	12,036	-	-	-	(12,036)	-	(12,036)	
Total governmental activities	1,077,861	491,169	-	11,500	(575,192)	-	(575,192)	
Business-Type Activities:								
Water	1,762,390	1,664,876	-	166,301	-	68,787	68,787	
Wastewater	1,597,567	1,434,590	-	249,554	-	86,577	86,577	
Total business-type activities	3,359,957	3,099,466	-	415,855	-	155,364	155,364	
Total District government	\$ 4,437,818	\$3,590,635	\$ -	\$ 427,355	(575,192)	155,364	(419,828)	
<b>General revenues and transfers</b>								
Property taxes					\$ 499,950	\$ -	\$ 499,950	
Special assessments					201,114	-	\$ 201,114	
Unrestricted investment earnings					19,021	86,062	105,083	
Other general revenues					11,279	-	11,279	
Transfers					42,551	(42,551)	-	
Total general revenues					773,915	43,511	817,426	
<b>Change in net assets</b>					198,723	198,875	397,598	
Net assets, beginning					3,929,672	18,759,189	22,688,861	
Net assets, ending					\$ 4,128,395	\$ 18,958,064	\$ 23,086,459	

See accompanying notes to the basic financial statements

**MCKINLEYVILLE COMMUNITY SERVICES DISTRICT**

**Balance Sheet  
Governmental Funds  
June 30, 2010**

	<b>General Fund (Parks and Recreation)</b>	<b>Street Lighting Fund</b>	<b>Total Governmental Funds</b>
<b>ASSETS</b>			
Cash and investments	\$ 1,169,265	\$ 11,874	\$ 1,181,139
Interest receivable	5,380	-	5,380
Accounts receivable	1,736	3,021	4,757
Proposition 1A receivable	39,325	-	39,325
Total assets	<u>\$ 1,215,706</u>	<u>\$ 14,895</u>	<u>\$ 1,230,601</u>
<b>LIABILITIES AND FUND BALANCES</b>			
Liabilities:			
Accounts payable	\$ 15,591	\$ 715	\$ 16,306
Accrued liabilities	81,545	-	81,545
Deposits	8,100	-	8,100
Deferred revenue	39,325	-	39,325
Total liabilities	<u>144,561</u>	<u>715</u>	<u>145,276</u>
Fund balances:			
Unreserved:			
Undesignated	<u>1,071,145</u>	<u>14,180</u>	<u>1,085,325</u>
Total fund balances	<u>1,071,145</u>	<u>14,180</u>	<u>1,085,325</u>
Total liabilities and fund balances	<u>\$ 1,215,706</u>	<u>\$ 14,895</u>	<u>\$ 1,230,601</u>
Total Governmental Fund Balances			\$ 1,085,325
Amounts reported for governmental activities in the statement of net assets are different because:			
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds			3,368,504
Long-term receivables do not provide current financial resources and are therefore deferred in the funds			39,325
Some liabilities, including compensated absences are not due and payable in the current period and, therefore, are not reported in the funds			<u>(364,759)</u>
Net Assets of Governmental Activities			<u>\$ 4,128,395</u>

See accompanying notes to the basic financial statements

**MCKINLEYVILLE COMMUNITY SERVICES DISTRICT**  
**Statements of Revenues, Expenditures, and**  
**Changes in Fund Balances**  
**Governmental Funds**  
**For the Fiscal Year Ended June 30, 2010**

	<b>General Fund (Parks and Recreation)</b>	<b>Street Lighting Fund</b>	<b>Total Governmental Funds</b>
<b>REVENUES</b>			
Property taxes	\$ 460,625	\$ -	\$ 460,625
Assessments	201,114	-	201,114
Interest	18,993	28	19,021
Charges for services	409,880	81,289	491,169
Miscellaneous	11,279	-	11,279
	<hr/>	<hr/>	<hr/>
Total revenues	1,101,891	81,317	1,183,208
	<hr/>	<hr/>	<hr/>
<b>EXPENDITURES</b>			
Current:			
Recreation programs, parks, open space, facilities and other cultural activities	792,328	-	792,328
Street lighting	-	71,224	71,224
Debt service:			
Principal	235,988	-	235,988
Interest	15,477	-	15,477
Capital outlay	186,355	-	186,355
	<hr/>	<hr/>	<hr/>
Total expenditures	1,230,148	71,224	1,301,372
	<hr/>	<hr/>	<hr/>
Excess (deficiency) of revenues over expenditures	(128,257)	10,093	(118,164)
	<hr/>	<hr/>	<hr/>
<b>OTHER FINANCING SOURCES (USES)</b>			
Transfers in	59,856	-	59,856
Transfers out	-	(17,305)	(17,305)
	<hr/>	<hr/>	<hr/>
Total other financing sources (uses)	59,856	(17,305)	42,551
	<hr/>	<hr/>	<hr/>
Net change in fund balances	(68,401)	(7,212)	(75,613)
	<hr/>	<hr/>	<hr/>
Fund balances, July 1	1,139,546	21,392	1,160,938
	<hr/>	<hr/>	<hr/>
Fund balances, June 30	<u>\$ 1,071,145</u>	<u>\$ 14,180</u>	<u>\$ 1,085,325</u>

See accompanying notes to the basic financial statements

**MCKINLEYVILLE COMMUNITY SERVICE DISTRICT**  
**Reconciliation of the Statement of Revenues,**  
**Expenditures and Changes in Fund Balances of**  
**Governmental Funds to the Statement of Activities**  
**For the Fiscal Year Ended June 30, 2010**

Net Change in Fund Balances - Total Governmental Funds	<u>\$ (75,613)</u>
Amounts reported for governmental activities in the statement of activities are different because:	
Governmental funds report capital outlays as expenditures. However, in the 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 (\$186,539) exceed depreciation (\$174,149) in the current period.	12,390
Changes in accrued interest payable are not a use or source of current financial resources and are therefore not reported in the funds	3,441
Changes in compensated absences payable are not a source or use of current financial uses and are therefore not reported in the funds	(4,406)
Capital assets contributed by developers do not provide current financial resources and are therefore not recorded in the funds	11,500
Long-term obligations for other post employment benefits (OPEB) do not require the use of current financial resources and are therefore not recorded in the funds	(23,902)
Long term receivables do not provide current financial resources and are not reported as revenues in the fund statements	39,325
Repayment of long-term obligations such as capital leases is an expenditure in the governmental funds, but the repayment reduces liabilities in the statement of net assets; and is therefore not reported as an expense in the statement of activities	<u>235,988</u>
Net differences	<u>274,336</u>
Change in Net Assets of Governmental Activities	<u>\$ 198,723</u>

See accompanying notes to the basic financial statements

**MCKINLEYVILLE COMMUNITY SERVICES DISTRICT**

**Statement of Net Assets**

**Proprietary Funds**

**June 30, 2010**

	Enterprise Funds		
	Water	Wastewater	Totals
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	\$ 1,940,748	\$ 3,272,983	\$ 5,213,731
Receivables(net)	42,939	51,395	94,334
Inventory	89,525	33,581	123,106
Total current assets	2,073,212	3,357,959	5,431,171
Noncurrent assets:			
Other assets:			
Cash and cash equivalents	592,111	159,230	751,341
Debt issuance costs	-	39,031	39,031
Total other noncurrent assets	592,111	198,261	790,372
Capital assets:			
Land and land rights	344,798	3,232,589	3,577,387
Buildings and shops	217,870	214,107	431,977
Water treatment plant	2,623,688	-	2,623,688
Water Lines and pumping stations	6,718,045	-	6,718,045
Wastewater lines and collection system	-	9,861,847	9,861,847
Wastewater pumping stations and facilities	-	6,775,848	6,775,848
Vehicles	250,276	451,696	701,972
Equipment and other	420,723	506,183	926,906
Construction in progress	189,754	220,083	409,837
Less accumulated depreciation	(5,426,081)	(9,247,438)	(14,673,519)
Net capital assets	5,339,073	12,014,915	17,353,988
Total noncurrent assets	5,931,184	12,213,176	18,144,360
Total assets	\$ 8,004,396	\$ 15,571,135	\$ 23,575,531
<b>LIABILITIES</b>			
Current liabilities:			
Accounts payable	\$ 69,677	\$ 78,873	\$ 148,550
Deposits and refunds	44,720	-	44,720
Interest payable	-	19,108	19,108
Compensated absences	29,775	29,775	59,550
Bonds and loans due within one year	87,443	151,534	238,977
Total current liabilities	231,615	279,290	510,905
Noncurrent liabilities:			
Davis Grunsky Act Loan	2,457,755	-	2,457,755
State Revolving Fund Loan	-	204,601	204,601
State Revolving Fund Loan	-	176,496	176,496
FMHA bonds payable	-	805,000	805,000
Bank Loan	-	303,788	303,788
Net other post employment benefit obligation	47,804	47,804	95,608
Compensated absences	31,657	31,657	63,314
Total noncurrent liabilities	2,537,216	1,569,346	4,106,562
Total Liabilities	2,768,831	1,848,636	4,617,467
<b>Net Assets</b>			
Invested in capital assets, net of related debt	2,793,875	10,373,496	13,167,371
Restricted	592,111	159,230	751,341
Unrestricted	1,849,579	3,189,773	5,039,352
Total net assets	\$ 5,235,565	\$ 13,722,499	\$ 18,958,064

See accompanying notes to the basic financial statements

**MCKINLEYVILLE CUMMUNITY SERVICES DISTRICT**  
**Statement of Revenues, Expenses, and Changes in Fund Net Assets**  
**Proprietary Funds**  
**For the Fiscal Year Ended June 30, 2010**

	<u>Enterprise Funds</u>		
	<u>Water</u>	<u>Wastewater</u>	<u>Totals</u>
<b>Operating Revenues:</b>			
Sale of water	\$ 1,549,371	\$ -	\$ 1,549,371
Services fees	-	1,346,776	1,346,776
Other operating revenues	115,505	87,814	203,319
Total operating revenues	<u>1,664,876</u>	<u>1,434,590</u>	<u>3,099,466</u>
<b>Operating Expenses:</b>			
Personnel services	729,525	755,851	1,485,376
Purchased water	533,961	-	533,961
Utilities	43,997	91,822	135,819
Insurance	18,372	18,372	36,744
Other supplies and expenses	156,581	249,874	406,455
Depreciation and amortization	224,098	412,230	636,328
Total operating expenses	<u>1,706,534</u>	<u>1,528,149</u>	<u>3,234,683</u>
Operating income (loss)	<u>(41,658)</u>	<u>(93,559)</u>	<u>(135,217)</u>
<b>Non-Operating Revenues</b>			
<b>(Expenses)</b>			
Interest expense	(54,701)	(68,300)	(123,001)
Gain (loss) on capital assets	(1,155)	(1,118)	(2,273)
Interest and investment revenue	39,897	46,165	86,062
Net non-operating revenues			
(expenses)	<u>(15,959)</u>	<u>(23,253)</u>	<u>(39,212)</u>
Income(loss)before capital contributions			
and transfers	<u>(57,617)</u>	<u>(116,812)</u>	<u>(174,429)</u>
<b>Capital Contributions and Transfers</b>			
Transfers out	-	(42,551)	(42,551)
Capital contributions	166,301	249,554	415,855
Total capital contributions and transfers	<u>166,301</u>	<u>207,003</u>	<u>373,304</u>
Change in net assets	108,684	90,191	198,875
Total net assets, July 1	<u>5,126,881</u>	<u>13,632,308</u>	<u>18,759,189</u>
Total net assets, June 30	<u>\$ 5,235,565</u>	<u>\$ 13,722,499</u>	<u>\$ 18,958,064</u>

See accompanying notes to the basic financial statements

**MCKINLEYVILLE COMMUNITY SERVICE DISTRICT**  
**Statement of Cash Flows**  
**Proprietary Funds**  
**For the Fiscal Year Ended June 30, 2010**

	Enterprise Funds		
	Water	Wastewater	Totals
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Receipts from customers	\$1,612,574	\$ 1,363,686	\$ 2,976,260
Payments to suppliers	(703,026)	(257,883)	(960,909)
Other operating receipts	115,505	87,814	203,319
Payments to employees	(722,444)	(748,769)	(1,471,213)
Net cash provided by (used for) operating activities	302,609	444,848	747,457
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>			
Transfers out	-	(42,551)	(42,551)
Net cash provided by (used for) noncapital financing activities	-	(42,551)	(42,551)
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>			
Principal paid on long-term debt	(85,726)	(148,935)	(234,661)
Interest paid on long-term debt	(54,701)	(69,625)	(124,326)
Capital contributions	13,076	106,729	119,805
Purchases of capital assets	(246,394)	(188,188)	(434,582)
Net cash provided by (used for) capital and related financing activities	(373,745)	(300,019)	(673,764)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Interest receipts	39,897	46,165	86,062
Net cash provided by investing activities	39,897	46,165	86,062
Net change in cash and cash equivalents	(31,239)	148,443	117,204
Balances-beginning of the year	2,564,098	3,283,770	5,847,868
Balances-end of the year	\$2,532,859	\$ 3,432,213	\$ 5,965,072

See accompanying notes to the basic financial statements

**MCKINLEYVILLE COMMUNITY SERVICE DISTRICT**  
**Statement of Cash Flows**  
**Proprietary Funds**  
**For the Year Ended June 30, 2010**

	<u>Enterprise Funds</u>		
	<u>Water</u>	<u>Wastewater</u>	<u>Totals</u>
<b>Reconciliation of operating income (loss) to net cash provided by operating activities:</b>			
Operating income (loss)	\$ (41,658)	\$ (93,559)	\$ (135,217)
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation expense	224,098	412,230	636,328
Change in assets and liabilities:			
Receivables, net	31,042	16,910	47,952
Inventory	(13,340)	(892)	(14,232)
Prepayments	-	5,430	5,430
Accounts payable	15,421	49,843	65,264
Other liabilities	87,046	54,886	141,932
Net cash provided by (used for) operating activities	<u>\$ 302,609</u>	<u>\$ 444,848</u>	<u>\$ 747,457</u>

**Noncash capital financing activities:**

In the 2010 fiscal year, the District reported as contributed capital from development \$153,225 and \$142,825, in the water and wastewater enterprises, respectively.

See accompanying notes to the basic financial statements



# MCKINLEYVILLE COMMUNITY SERVICES DISTRICT

## Notes to the Basic Financial Statements June 30, 2010

### 1. Summary of Significant Accounting Policies

#### A. Reporting Entity

The District is a Community Services District governed by an elected five member Board of Directors. The accompanying financial statements present the government and its component units, entities for which the government is considered to be financially accountable.

There are no legally separate component units or entities for which the District is financially accountable.

#### B. Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all of the nonfiduciary activities of the District. For the most part, the effect of interfund activity has been removed from these statements. *Governmental activities*, which normally are supported by taxes and intergovernmental revenues, are reported separately from *business-type activities*, which rely, to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as *general revenues*.

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

#### C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*, as are the *proprietary fund financial statements*. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

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.

# MCKINLEYVILLE COMMUNITY SERVICES DISTRICT

## Notes to the Basic Financial Statements June 30, 2010

### 1. Summary of Significant Accounting Policies (continued)

#### C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation (Continued)

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 District reports the following major governmental funds:

The *General Fund* is the government's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

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

The District reports the following major proprietary funds:

The *water fund* accounts for the operations of the District's water treatment and distribution system. The *wastewater fund* accounts for the operation of the District's wastewater collection activities.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the *option* of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The government has elected not to follow subsequent private-sector guidance.

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 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.

Amounts reported as *program revenues* include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions. Internally dedicated resources are reported as *general revenues* rather than as program revenues. Likewise, general revenues include all taxes.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the proprietary fund's principal ongoing operations. The principal operating revenues of the District's enterprise funds are charges to customers for sales and services. Operating expenses for the enterprise funds include the costs of sales and services, administration costs and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

# **MCKINLEYVILLE COMMUNITY SERVICES DISTRICT**

## **Notes to the Basic Financial Statements**

**June 30, 2010**

### **1. Summary of Significant Accounting Policies (Continued)**

#### **D. Assets, Liabilities, and Net Assets or Equity**

##### **1. Deposits 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, banker's acceptances, repurchase agreements, and time deposits and savings and demand accounts and the Humboldt County Treasurer's Investment Fund.

The District's cash and cash equivalents are considered to be cash on hand, demand deposits, and short term investments with original maturities of three months or less from the date of acquisition.

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.

##### **2. Receivables and Payables**

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.

All trade and property tax receivables are not shown net of an allowance for uncollectibles.

Property taxes are levied as of March 1 on property values assessed as of the same date. State statutes provide that the property tax rate be limited generally to one percent of market value, be levied by only the County, and be shared by applicable jurisdictions. The County of Humboldt collects the taxes and distributes them to taxing jurisdictions on the basis of assessed valuations subject to voter-approved debt. Property taxes are due on November 1 and March 1, and become delinquent on December 10 and April 10. The District receives property taxes pursuant to an arrangement with the County known as the "Teeter Plan". Under the plan, the County assumes responsibility for the collection of delinquent taxes and pays the full allocation to the District. The District recognizes property tax revenues in the fiscal year in which they are due to the District.

##### **3. 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.

# MCKINLEYVILLE COMMUNITY SERVICES DISTRICT

## Notes to the Basic Financial Statements June 30, 2010

### 1. Summary of Significant Accounting Policies (Continued)

#### D. Assets, Liabilities, and Net Assets or Equity (Continued)

#### 4. 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 at 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 asset 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. Property, plant, and equipment of the District are depreciated using the straight line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings and improvements	20 to 50
Water system	30 to 50
Other infrastructure	10 to 50
Machinery and equipment	5 – 10
Improvements	10 to 20

#### 5. Compensated Absences and Other Post Employment Benefit Obligations

It is the government's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. There is a liability for a portion of unpaid accumulated sick leave since the District does have a policy to pay certain amounts when employees separate from service with the District. All vacation pay and applicable sick leave is accrued when incurred in the government-wide and proprietary fund financial statements. A liability for these amounts is reported in the governmental funds only if they have matured, for example, as a result of employee resignations and retirements. Other post employment benefit obligations are reported as incurred in the proprietary and government-wide financial statements using the accrual basis of accounting.

#### 6. 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.

#### 7. Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

# MCKINLEYVILLE COMMUNITY SERVICES DISTRICT

## Notes to the Basic Financial Statements June 30, 2010

### 8. Comparative Data

Comparative total data for the prior year have been presented in order to provide an understanding of the changes in net assets. Also, certain amounts presented in the prior year data have been reclassified to be consistent with the current years' presentation.

### 2. Reconciliation of Government-wide and Fund Financial Statements

#### A. Explanation of Certain Differences Between the Governmental Fund Balance Sheet and the Government-wide Statement of Net Assets

The governmental fund balance sheet includes reconciliation between *fund balance – total governmental funds* and *net assets – governmental activities* as reported in the government-wide statements of net assets. One element of that reconciliation explains that "capital assets are not financial resources and are not reported in the funds." The details of this \$ 3,368,504 difference are as follows:

Capital assets	\$ 5,437,337
Less: Accumulated depreciation	<u>(2,068,833)</u>
Net adjustment to increase <i>fund balance – total governmental funds</i> to arrive at <i>net assets – governmental activities</i>	<u>\$ 3,368,504</u>

Another element of the reconciliation explains that "long-term liabilities" are not due and payable in the current period and are therefore not reported in the funds. The details of this \$364,759 difference are as follows:

Long-Term Debt Obligations	
Capital lease obligations	\$ 324,201
Accrued interest payable	4,728
Net OPEB Obligation	23,902
Compensated absences	<u>11,928</u>
Net adjustment to decrease fund balance total governmental Funds to arrive at net assets - governmental activities	<u>\$ ( 364,759)</u>

#### B. Explanation of Certain Differences Between the Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balances and the Government-wide Statement of Activities

The governmental fund statement of revenues, expenditures, and changes in fund balances includes reconciliation between *net changes in fund balances – total governmental funds* and *changes in net assets of governmental activities* as reported in the government-wide statement of activities. One element of that reconciliation explains that "Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of these assets is allocated over their estimated useful lives and reported as depreciation expense." The details of this \$ 274,336 difference and other significant components of the difference are as follows:

Capital outlay	\$ 186,539
Depreciation expense	(174,149)
Other items	25,958
Repayment of long-term debt principal	<u>235,988</u>
Net adjustment to increase <i>net changes in fund balances – total governmental funds</i> to arrive at <i>changes in net assets of governmental activities</i>	<u>\$ 274,336</u>

# MCKINLEYVILLE COMMUNITY SERVICES DISTRICT

## Notes to the Basic Financial Statements June 30, 2010

### 3. Stewardship, Compliance, and Accountability

#### A. Budgetary Information

Annual budgets are adopted on a basis of consistent with generally accepted accounting principles for all governmental funds. 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 Director's 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.

### 4. Detailed Notes on All Funds

#### A. Deposits and Investments

Deposits and investments at June 30, 2010 consisted of the following:

Demand deposits and cash on hand	\$ 174,985
Investments with Humboldt County Treasurer	6,685,554
Investments with Local Agency Investment Fund	126,442
Investments with US Bank	<u>159,230</u>
Total deposits and investments	<u>\$ 7,146,211</u>

*Custodial Credit Risk - Deposits.* Custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned to it. 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, 2010, none of the District's bank balances of \$ 199,374 was exposed to credit risk.

Investments - At June 30, 2010, the District had the following investments.

<i>Investment</i>	<i>Maturities</i>	<i>Fair Value</i>
Humboldt County Treasurer's Investment Fund	Average 830 days	\$ 6,685,554
U.S.Bank Money Market Funds	NA	159,230
Local Agency Investment Fund (LAIF)	Average 203 days	<u>126,442</u>
Totals		<u>\$ 6,971,226</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 as regards securities ratings. The Local Agency Investment Fund (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.

**MCKINLEYVILLE COMMUNITY SERVICES DISTRICT**

**Notes to the Basic Financial Statements  
June 30, 2010**

**4. Detailed Notes on All Funds (Continued)**

**A. Deposits and Investments(Continued)**

**Custodial Credit Risk** - For an investment, custodial credit risk is the risk that, in the event of the failure of a counterparty, 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's only investments are in the LAIF, the Humboldt County Treasurer's Investment Fund and in money Markey funds; and these investments are not evidenced by specific securities in the name of the District and are therefore not subject to custodial credit risk.

**B. Receivables**

Receivables as of year-end for the government's individual major and nonmajor funds in the aggregate, net of the applicable allowances for uncollectible accounts, are as follows:

	<u>General Fund</u>	<u>Street Lighting Fund</u>	<u>Total Governmental</u>	<u>Water</u>	<u>Wastewater</u>	<u>Total Business- Type</u>
Interest	\$ 5,380	\$ -	\$ 5,380	\$ 9,160	\$ 10,215	\$ 19,375
Accounts	1,736	3,021	4,757	33,779	41,180	74,959
Proposition 1A	39,325		39,325			
<b>Totals</b>	<u>\$ 46,441</u>	<u>\$ 3,021</u>	<u>\$ 49,462</u>	<u>\$ 42,939</u>	<u>\$ 51,395</u>	<u>\$ 94,334</u>

**C. Interfund Transfers**

1. The composition of interfund balances was:

<u>Receiving Fund</u>	<u>Transferring Fund</u>	<u>Amount</u>
General fund for debt service	Wastewater enterprise	\$ 42,551
	<b>Total</b>	<u>\$ 42,551</u>

# MCKINLEYVILLE COMMUNITY SERVICES DISTRICT

## Notes to the Basic Financial Statements June 30, 2010

### 4. Detailed Notes on All Funds (Continued)

#### D. Capital Assets

Capital asset activity relating to governmental activities for the year ended June 30, 2010 was as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
<b>Governmental activities:</b>				
Capital assets, not being depreciated				
Land	\$ 1,214,858	\$ 125,742	\$ -	\$ 1,340,600
Total capital assets, not being depreciated	<u>1,214,858</u>	<u>125,742</u>	<u>-</u>	<u>1,340,600</u>
Capital assets, being depreciated:				
Buildings	2,221,291	16,464	-	2,237,755
Street lighting	331,520	11,500	-	343,020
Tools and equipment	244,090	9,185	-	253,275
Vehicles	54,664	-	-	54,664
Improvements	<u>1,172,876</u>	<u>35,147</u>	<u>-</u>	<u>1,208,023</u>
Total capital assets being depreciated	<u>4,024,441</u>	<u>72,296</u>	<u>-</u>	<u>4,096,737</u>
Less accumulated depreciation for:				
Buildings	(997,522)	(76,120)	-	(1,073,642)
Street lighting	(109,424)	(11,051)	-	(120,475)
Tools and equipment	(180,950)	(15,378)	-	(196,328)
Vehicles	(41,526)	(4,662)	-	(46,188)
Improvements	<u>(565,262)</u>	<u>(66,938)</u>	<u>-</u>	<u>(632,200)</u>
Total accumulated depreciation	<u>(1,894,684)</u>	<u>(174,149)</u>	<u>-</u>	<u>(2,068,833)</u>
Total capital assets, being depreciated, net	<u>2,129,757</u>	<u>(101,853)</u>	<u>-</u>	<u>2,027,904</u>
Governmental activities capital assets, net	<u>\$ 3,344,615</u>	<u>\$ 23,889</u>	<u>\$ -</u>	<u>\$ 3,368,504</u>



**MCKINLEYVILLE COMMUNITY SERVICES DISTRICT**

**Notes to the Basic Financial Statements  
June 30, 2010**

**4. Detailed Notes on All Funds (Continued)**

**D. Capital Assets**

Capital asset activity relating to business-type activities for the year ended June 30, 2010 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
<b>Business-type activities:</b>				
Capital assets, not being depreciated				
Land and rights of way	\$ 3,577,387	\$ -	\$ -	\$ 3,577,387
Construction in progress	137,011	412,434	139,608	409,837
Total capital assets, not being depreciated	3,714,398	412,434	139,608	3,987,224
Capital assets, being depreciated:				
Buildings and shops	296,794	135,183	-	431,977
Water treatment plant	2,623,688	-	-	2,623,688
Water lines and pumping stations	6,557,923	160,122	-	6,718,045
Wastewater lines and collection system	9,719,023	142,824	-	9,861,847
Wastewater pumping stations and facilities	6,772,120	3,728	-	6,775,848
Vehicles	701,972	-	-	701,972
Equipment and other capital items	976,196	15,950	65,240	926,906
Total capital assets being depreciated	27,647,716	457,807	65,240	28,040,283
Less accumulated depreciation for:				
Buildings and shops	(134,219)	(10,092)	-	(144,311)
Water treatment plant	(1,209,539)	(55,422)	-	(1,264,961)
Water lines and pumping stations	(3,380,464)	(132,074)	-	(3,512,538)
Wastewater lines, stations and facilities	(8,040,463)	(347,715)	-	(8,388,178)
Vehicles, equipment and other items	(1,342,980)	(80,520)	59,969	(1,363,531)
Total accumulated depreciation	(14,107,665)	(625,823)	59,969	(14,673,519)
Total capital assets, being depreciated, net	13,540,051	(168,016)	(5,271)	13,366,764
Business-type activities capital assets, net	\$ <u>\$17,254,449</u>	\$ <u>244,418</u>	\$ <u>(144,879)</u>	\$ <u>17,353,988</u>

# MCKINLEYVILLE COMMUNITY SERVICES DISTRICT

## Notes to the Basic Financial Statements June 30, 2010

### 4. Detailed Notes on All Funds (Continued)

#### D. Capital Assets (Continued)

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

**Governmental activities:**

Street lighting	\$ 11,051
Parks and recreation	163,098
Total depreciation expense-governmental activities	<u>\$ 174,149</u>

**Business-type activities:**

Water	\$ 224,098
Wastewater	401,725
Total depreciation expense-business type activities	<u>\$ 625,823</u>

#### E. Long-Term Debt

##### *Capital Lease Obligation – Governmental Activities*

The District, in 2003, entered into a refunding lease agreement with Delta Financing Corporation for the purpose of advance refunding a previous refunding lease entered into in 1998 related to obtaining financing for the acquisition by the District of real property. The 2003 lease had an original principal amount of \$1,956,768 with interest at 3.50 percent per annum. The lease is secured by the related real property and the District has not pledged any specific revenue for its repayment. The District has agreed to make the lease payments from any source of legally available revenues. Future debt service on the lease is as follows:

<u>Fiscal Year Ending June 30</u>	<u>Totals</u>
2011	\$ 167,824
2012	167,824
Total minimum lease payments	335,648
Less amount representing interest	<u>(11,447)</u>
Present value net minimum lease payments	<u>\$ 324,201</u>

##### *Davis Grunsky Act Loan – Water Enterprise*

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 percent per annum. Under the 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 has pledged to make the loan principal and interest repayments; and it has not pledged any specific revenue for 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:

**MCKINLEYVILLE COMMUNITY SERVICES DISTRICT**

**Notes to the Basic Financial Statements  
June 30, 2010**

**4. Detailed Notes on All Funds (Continued)**

**E. Long-Term Debt (Continued)**

*Davis Grunsky Act Loan- Water Enterprise (Continued)*

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 87,443	\$ 53,835	\$ 141,278
2012	89,203	52,075	141,278
2013	91,008	50,270	141,278
2014	92,857	48,421	141,278
2015	94,753	46,625	141,278
2016-2020	503,896	202,494	706,390
2021-2025	558,920	147,470	706,390
2026-2030	621,174	85,216	706,390
2031-2034	405,944	17,889	423,833
<b>Totals</b>	<b>\$ 2,545,198</b>	<b>\$ 704,195</b>	<b>\$ 3,249,393</b>

*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 obtaining financing to expend the District's wastewater treatment plant. The District as an entity is obligated to make the loan repayments 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 this obligation. Future debt service is:

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 40,920	\$ -	\$ 40,920
2012	40,920	-	40,920
2013	40,920	-	40,920
2014	40,920	-	40,920
2015	40,920	-	40,920
2016	40,920	-	40,920
<b>Totals</b>	<b>\$ 245,520</b>	<b>\$ -</b>	<b>\$ 245,520</b>

The District in 1998 obtained a \$430,293 loan from the State Water Resources Control Board bearing interest at 2.6 percent per annum for the purpose of obtaining financing for Phase 2 of its sewer capacity expansion project. The District as an entity is obligated to fund the loan repayments. The District is obligated to levy taxes or assessments should it not have other revenues available for repayment of the obligation. Future debt service is:

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 22,727	\$ 5,179	\$ 27,906
2012	23,330	4,576	27,906
2013	23,924	3,982	27,906
2014	24,546	3,360	27,906
2015	25,184	2,722	27,906
2016-2018	79,512	4,162	83,674
<b>Totals</b>	<b>\$ 199,223</b>	<b>\$ 23,981</b>	<b>\$ 223,204</b>

**MCKINLEYVILLE COMMUNITY SERVICES DISTRICT**

**Notes to the Basic Financial Statements**  
**June 30, 2010**

**4. Detailed Notes on All Funds (Continued)**

**E. Long-Term Debt (Continued)**

*Sewer Revenue Bonds*

The District in 1982 sold \$1,575,000 in its 1982 Sewer Revenue Bonds which bonds 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 District is obligated to make semiannual payments of principal and interest in amounts sufficient to pay the principal and interest on the bonds. The District's repayment obligation is secured by a pledge of the net revenues of its wastewater enterprise. The bonds bear interest at 5.0 percent and mature each August 1 through August 1, 2022. The District's debt service on the bonds is as follows:

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 50,000	\$ 41,500	\$ 91,500
2012	50,000	39,000	89,000
2013	60,000	36,250	96,250
2014	60,000	33,250	93,250
2015	60,000	30,250	90,250
2016-2020	350,000	102,000	452,000
2021-2023	225,000	16,125	241,725
Totals	<u>\$ 855,000</u>	<u>\$ 298,375</u>	<u>\$ 1,153,975</u>

Annual principal and interest payments on the bonds are expected to require less than 17 percent of system net revenues. Total principal and interest remaining to be paid on the bonds is \$1,153,975. Principal and interest paid for the current fiscal year and total system net revenues as defined were, \$94,000 and \$613,272, respectively.

*Bank Loan*

The District in fiscal year 1998 obtained a \$675,000 Loan from Umpqua for the purpose of financing wastewater system improvements. The loan bears interest at 5.50 percent per annum and is repayable in monthly payments of \$4,644 interest and principal taken together and matures on December 4, 2017.

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 37,887	\$ 17,847	\$ 55,734
2012	40,024	15,710	55,734
2013	42,282	13,452	55,734
2014	44,667	11,067	55,734
2015	47,187	8,547	55,734
2016-2018	129,628	9,704	139,332
Totals	<u>\$ 341,675</u>	<u>\$ 76,327</u>	<u>\$ 418,002</u>

# MCKINLEYVILLE COMMUNITY SERVICES DISTRICT

## Notes to the Basic Financial Statements June 30, 2010

### 4. Detailed Notes on All Funds (Continued)

#### E. Long-Term Debt (Continued)

##### *Changes in Long-term liabilities*

Long-term debt activity for the 2010 fiscal year was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
<b>Governmental Activities:</b>					
Capital lease obligations	\$ 560,189	\$ -	\$ 235,988	\$ 324,201	\$ 159,264
Compensated absences	15,296	27,035	15,296	27,035	15,107
<b>Total</b>	<b>\$ 575,485</b>	<b>\$ 27,035</b>	<b>\$ 251,284</b>	<b>\$ 351,236</b>	<b>\$ 174,371</b>
<b>Business-Type Activities:</b>					
Davis-Grunsky Act Loan	\$ 2,630,924	\$ -	\$ 85,726	\$ 2,545,198	\$ 87,443
State Revolving Loan	286,441	-	40,921	245,520	40,920
State Revolving Loan	221,373	-	22,150	199,223	22,727
USDA Bonds	905,000	-	50,000	855,000	50,000
Bank loan	377,539	-	35,864	341,675	37,887
Compensated absences	108,701	155,158	108,701	155,158	59,550
<b>Totals</b>	<b>\$ 4,529,978</b>	<b>\$ 155,158</b>	<b>\$ 343,362</b>	<b>\$ 4,341,774</b>	<b>\$ 298,527</b>

### 5. Other Information

#### A. 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 one billion dollars per occurrence.

The SDRMA provides also 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 replacement cost, and comprehensive and collision on selected vehicles. The District's obligations under the arrangement are to pay billed premiums for the specified coverages. The 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.

# MCKINLEYVILLE COMMUNITY SERVICES DISTRICT

## Notes to the Basic Financial Statements June 30, 2010

### 5. Other Information (Continued)

#### A. Risk Management (Continued)

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 (IBNRs). 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 in fiscal 2010 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, 2010 or 2009.

#### B. 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.

*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 permit 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.

#### C. Public Employees Retirement System

*Plan Description.* The District contributes to the California Public Employees Retirement System (PERS), a cost sharing, multiple-employer, public employee, defined benefit pension plan. 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 provisions and all other requirements are established by the State statute and District ordinance. The PERS issues publicly available financial reports that include financial statements and required supplementary information. Copies of PERS annual financial report may be obtained from their executive office, 400 "P" Street, Sacramento, California 95814.

# MCKINLEYVILLE COMMUNITY SERVICES DISTRICT

## Notes to the Basic Financial Statements

June 30, 2010

### 5. Other Information (Continued)

#### C. Public Employees Retirement System (Continued)

*Funding Policy and Annual Pension Cost.* Plan members are required to contribute 7.0 percent of their annual covered salary for regular employees and the District is required to make contributions at actuarially determined rates. The current District rates were 7.841 percent of covered payroll. The contribution requirements of plan members and the District are established by resolutions and contracts and may be amended by PERS. The District's annual pension cost for the most recent three years for each plan is as follows:

#### Three-year Trend of Information

Plan	Year Ending	Annual Pension Cost	Percentage of APC Contributed	Net Pension Obligation
Regular employees	6/30/08	\$ 78,159	100%	\$ -
	6/30/09	\$ 82,753	100%	\$ -
	6/30/10	\$ 87,540	100%	\$ -

#### D. Restricted Net Assets and Designated Fund Balances

The \$751,341 restricted net assets in the business type activities represents assets that can be used only in accordance with restrictions imposed by debt service financing agreements.

#### E. Post Employment Benefits Other Than Pensions

*Plan Description.* The District administers the District's 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 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 a projected pay-as-you-go financing requirements, with additional amounts to prefund benefits as determined annually by the Board of Directors. For the fiscal year ended June 30, 2010, the District contributed \$45,223 ( 83%) of the current year premiums and zero to prefund benefits. Plan members receiving benefits contributed \$9,521 (17%) of the total premiums.

*Annual OPEB Costs and the Net OPEB Obligation.* The District's annual other post employment benefit (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 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.

# MCKINLEYVILLE COMMUNITY SERVICES DISTRICT

## Notes to the Basic Financial Statements June 30, 2010

### 5. Other Information (Continued)

#### E. Post Employment Benefits Other Than Pensions (Continued)

Annual required contribution (ARC)	\$ 164,733
Interest on net OPEB Obligation	-
Adjustments to the ARC	-
	<hr/>
Annual OPEB expense	164,733
Contributions made	(45,223)
	<hr/>
Change in net OPEB obligation	119,510
Net OPEB obligation, beginning year	-
	<hr/>
Net OPEB obligation, end of year	<u>\$ 119,510</u>

The District's annual OPEB cost, the percentage of the annual OPEB cost contributed to the plan, and the net OPEB obligation for 2010 (the first year of implementation) was as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage Contributed	Net OPEB Obligation
June 30, 2010	\$164,733	27.5%	\$119,510

**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 liability (UAAL) of the \$1,710,113. The 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 percent.

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 percent 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 percent 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.



# **MCKINLEYVILLE COMMUNITY SERVICES DISTRICT**

## **Notes to the Basic Financial Statements June 30, 2010**

### **5. Other Information (Continued)**

#### **F. Change in Accounting Principle**

The District as required by Governmental Accounting Standards Board Statement 45, titled, Accounting and Financial Reporting by Employers for Post Employment Benefits Other Than Pensions, implemented in fiscal 2010 the provisions of the standard that requires financial reporting about retiree medical benefit plans, the employer's annual required contribution (ARC), contributions made and other information. The implementation of the standard had no effect on the beginning net assets of the District because the District reported a zero net other post employment benefit obligation at the beginning of the 2010 fiscal year.

#### **G. 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).

**Required Supplementary Information**  
**McKinleyville Community Services District**  
**Budgetary Comparison Schedule - General Fund**  
**For the Fiscal Year Ended June 30, 2010**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget Positive (Negative)</u>
	<u>Original</u>	<u>Final</u>		
<b>Fund Balance, July 1</b>	\$ 1,139,546	\$ 1,139,546	\$ 1,139,546	\$ -
<b>Resources (inflows):</b>				
Property taxes	430,000	430,000	460,625	30,625
Assessments Measure B	195,000	195,000	201,114	6,114
Intergovernmental	20,000	20,000	-	(20,000)
Interest	20,000	20,000	18,993	(1,007)
Chages for services	416,491	416,491	409,880	(6,611)
Miscellaneous	76,500	76,500	11,279	(65,221)
Transfers in	-	-	59,856	59,856
<b>Amounts available for charges to appropriations</b>	<u>2,297,537</u>	<u>2,297,537</u>	<u>2,301,293</u>	<u>3,756</u>
<b>Charges to appropriations:</b>				
<b>General government:</b>				
Recreation and cultural services	816,555	856,555	792,328	64,227
<b>Debt service</b>				
Principal	169,947	169,947	235,988	(66,041)
Interest	15,477	15,477	15,477	-
<b>Capital outlay</b>	<u>90,500</u>	<u>220,500</u>	<u>186,355</u>	<u>34,145</u>
<b>Total charges to appropriations</b>	<u>1,092,479</u>	<u>1,262,479</u>	<u>1,230,148</u>	<u>32,331</u>
<b>Fund Balance, June 30</b>	<u>\$ 1,205,058</u>	<u>\$ 1,035,058</u>	<u>\$ 1,071,145</u>	<u>\$ 36,087</u>

**Required Supplementary Information**  
**McKinleyville Community Services District**  
**Budgetary Comparison Schedule - General Fund**  
**Note to RSI**  
**For the Fiscal Year Ended June 30, 2010**

**Note A. Explanation of Difference between Budgetary Inflows and Outflows and GAAP**  
**Revenues and expenditures:**

**Sources/inflows resources:**

Actual amounts "available for appropriation" from budgetary  
comparison schedule: \$ 2,301,293

Differences - budget to GAAP:

Interfund transfes in are a budgetary financial inflow but are  
not revenues for financial reporting purposes (59,856)

The fund balance at the beginning of the year is a budgetary  
resource but is not a current year revenue for financial reporting  
purposes (1,139,546)

Total revenues as reported in the statement of revenues, expenditures  
and changes in fund balances - governmental funds

\$ 1,101,891

**Required Supplementary Information**  
**McKinleyville Community Services District**  
**Other Post Employment Benefits (OPEB) Schedule of Funding Progress**  
**June 30, 2010**

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets</u>	<u>Actuarial Accrued Liability (AAL) Entry Age</u>	<u>Unfunded AAL (UAAL)</u>	<u>Funded Ratio</u>	<u>Covered Payroll</u>	<u>UAAL as a Percentage of Covered Payroll</u>
5/1/2010	\$ -	\$ 1,710,113	\$ 1,710,113	0.00%	\$ 1,131,599	151.12%



**Terry E. Krieg, CPA**  
Certified Public Accountant

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Board of Directors  
McKinleyville Community Services District  
McKinleyville, California

I have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the McKinleyville Community Services District, California as of and for the year ended June 30, 2010, which collectively comprise the McKinleyville Community Services District, California's basic financial statements and have issued my report thereon dated January 31, 2011, which report was modified to disclose that the District changed its accounting principles to implement the provisions of Governmental Accounting Standards Board Statement Number 45, titled, Accounting and Financial Reporting for Post Employment Benefits Other Than Pensions. I conducted my 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 my audit, I considered the McKinleyville Community Services District, California's internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the McKinleyville Community Services District, California's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of the McKinleyville Community Services District, California's internal control over financial reporting.

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 combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the District's financial statements will not be prevented, or detected and corrected on a timely basis.

My consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. I did not identify any deficiencies in internal control over financial reporting that I consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the McKinleyville Community Services District, California's financial statements are free of material misstatement, I 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 my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

This report is intended solely for the information of the Board of Directors, Management, and state entities, and is not intended to and should not be used by anyone other than these specified parties.

January 31, 2011

A handwritten signature in dark ink, appearing to read 'Terry E. Krieg', is written over the printed name and title.  
Certified Public Accountant

*Communication to Those Charged With Governance  
McKinleyville Community Services District  
Fiscal Year Ended June 30, 2010*



**Terry E. Krieg, CPA**  
Certified Public Accountant

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January 31, 2011

Honorable President and Members of  
Board of Directors  
McKinleyville Community Services District  
McKinleyville, California

I have audited the basic financial statements of the governmental- type and business-type activities of the McKinleyville Community Services District for the year ended June 30, 2010, and have issued my report thereon dated January 31, 2011. Professional standards require that I provide you with the following information related to my audit.

1. My Responsibility under U.S. Generally Accepted Auditing Standards

As stated in my engagement letter, my responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material aspects, in conformity with U.S. generally accepted accounting principles. My audit of the financial statements does not relieve you or management of your responsibilities.

As part of my audit, I considered the internal control of the McKinleyville Community Services District. Such considerations were solely for the purpose of determining my audit procedures and not to provide assurance concerning such internal control. My responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. I am responsible for communicating significant matters related to the audit that are, in my professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, I am not required to design procedures specifically to identify such matters.

2. Other Information in Documents Containing Audited Financial Statements and Electronic Dissemination of Audited Financial Statements

My responsibility for other information in documents containing the McKinleyville Community Services District financial statements and my auditor's report, such as an official statement for a bond or debt offering, does not extend beyond the financial information identified in the report. I do not have an obligation to perform any procedures to corroborate other information contained in such other documents. To my knowledge, the McKinleyville Community Services District's audited financial statements were not incorporated into other documents.

With regard to the electronic dissemination of audited financial statements, including financial statements published electronically on your website, you understand that electronic sites are a means to distribute information and, therefore, I am not required to read the information in any such sites or to consider the consistency of other information in the electronic site with the original documents.

3. Planned Scope and Timing of the Audit

I performed the audit according to the planned scope and timing previously communicated to the District's General Manager in the audit engagement letter and discussed with the District's Finance Director. My understanding is that the General Manager and Finance Director have the responsibility for coordinating the audit process with my firm and for communicating to you significant audit matters.

#### 4. Significant Audit Findings

##### *A. Qualitative Aspects of Accounting Practices*

Management is responsible for the selection and use of appropriate accounting policies. In accordance with my engagement letter, I will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the McKinleyville Community Services District are described in Note one to the financial statements.

##### *B. Changes in Accounting Policies*

No new accounting policies were adopted and the application of existing policies were not significantly changed in the 2010 fiscal year except for the implementation by the District of Governmental Accounting Standards Board Statement Number 45, titled, Accounting and Financial Reporting by Employers for Post Employment Benefits Other Than Pensions.

As a result of the new standard, the District in fiscal 2010 reported the actuarially determined Annual Required Contribution (ARC) to its retiree medical benefit plan, contributions to the Plan, and then a liability for its Net Other Post Employment Benefit Obligation (the difference between the ARC and contributions made). Also, additional narrative disclosures were added to the notes to the District's financial statements.

##### *C. Significant and Unusual Transactions*

There were no significant and unusual transactions reported in fiscal 2010 in the District's statement of net assets for governmental and business-type activities other than noncash contributions by developers of water and wastewater subdivision improvements dedicated and conveyed to the District

##### *D. Transactions Having a Lack of Authoritative Guidance*

No significant dollar value transactions came to my attention where there was a lack of authoritative guidance regarding the application of accounting principles to the transactions.

##### *E. Accounting Estimates*

Accounting estimates are an integral part of financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most significant estimate affecting the financial statements was management's estimate of depreciation expense which estimates were based upon subsidiary schedules of capital assets and depreciation calculations using the straight-line method of depreciation. I evaluated the key factors and assumptions used to develop the depreciation estimate in determining that it is reasonable in relationship to the financial statements taken as a whole.

##### *F. Sensitive Financial Statement Disclosures*

The disclosures in the financial statements are to be neutral, consistent and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were, in my judgment, the new OPEB Plan disclosures about retiree medical benefits as they were based upon actuarial estimates and not historical costs as are most all other elements of external financial reporting.



5. Difficulties Encountered in Performing the Audit

I experienced no significant difficulties in dealing with management in performing and completing my audit.

6. Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements.

There were only four proposed adjusting entries and they were all implemented by District management. Two adjustments pertained to reporting accounts payable and prepayments, one to reclassification of transfers, and one was conceptual assistance regarding the implementation of the new OPEB retiree medical benefit obligation.

7. Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to my satisfaction, concerning a financial accounting, reporting or auditing matter that could be significant to the financial statements or the auditor's report.

We are pleased to report that no such disagreements arose during the course of the audit.

8. Management Representations

I have requested certain representations from management that are included in the management re-presentation letter.

9. Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves the application of an accounting principle to the District's financial statements or a determination of the type of auditor's opinion that may be expressed on those financial statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts.

To my knowledge, there were no such consultations with other accountants

10. Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to our retention as the District's auditors or prior to commencement of the financial statement audit. However, these discussions occurred in the normal course of my professional relationship and my responses were not a condition to my retention as the District's independent auditor.

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This information is intended solely for the use of the Board of Director of the McKinleyville Community Services District and management of the District, and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely yours

Terry E. Krieb

