

CITY OF McFARLAND, CALIFORNIA

FINANCIAL STATEMENTS

Fiscal Year Ended June 30, 2011

City of McFarland
401 West Kern Avenue
McFarland, CA 93250
(661) 792-3091

Manuel Cantu Jr., Mayor
Dennis Martin, Mayor Pro-Tem
Stephen McFarland, Council Member
Russell Coker, Council Member
Vidal Santillano, Council Member

John Wooner, City Manager

CITY OF McFARLAND

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Independent Auditor's Report

To the Members of the City Council of the
City of McFarland, California:

We have audited the accompanying financial statements of the governmental activities, the business-type activities, and each major fund of the City of McFarland, California (City), as of and for the year ended June 30, 2011, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Governmental Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated January 12, 2012, on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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Accounting principles generally accepted in the United States of America require that the budgetary comparison information on pages 34 through 42 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance. The City has not presented the management's discussion and analysis that accounting principles generally accepted in the United States has determined is necessary to supplement, although not required to be part of, the basic financial statements.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the financial statements. The schedule of expenditures of federal awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Albert & Associates, LLP

Wasco, California
January 12, 2012

City of McFarland
STATEMENT OF NET ASSETS
June 30, 2011

	Governmental Activities	Business-Type Activities	Total
Assets:			
Current Assets:			
Cash and Investments	\$ 1,405,220	\$ 4,658,962	\$ 6,064,182
Restricted Cash:			
With Fiscal Agents	-	6,792,923	6,792,923
Receivables, net	1,425,800	471,799	1,897,599
Internal Balances	59,602	(59,602)	-
Inventory	129,720	-	129,720
Supplies on Hand	-	10,115	10,115
	3,020,342	11,874,197	14,894,539
Total Current Assets			
Noncurrent Assets:			
Capital Assets:			
Land	493,248	1,166,042	1,659,290
Construction in Progress	940,351	-	940,351
Depreciable Buildings, Property, Equipment and Infrastructure, net of accumulated depreciation	8,211,023	7,956,046	16,167,069
Advances to Other Funds	210,000	-	210,000
Notes Receivable	578,858	-	578,858
Deferred Charges	-	354,825	354,825
	10,433,480	9,476,913	19,910,393
Total Noncurrent Assets			
Total Assets	13,453,822	21,351,110	34,804,932
Liabilities:			
Current Liabilities:			
Accounts Payable	285,610	839,795	1,125,405
Accrued Liabilities	25,422	81,432	106,854
Deposits Received	-	7,794	7,794
Unearned Revenue	-	22,313	22,313
Bonds and Notes Payable Due Within One Year	123,603	204,409	328,012
	434,635	1,155,743	1,590,378
Total Current Liabilities			
Noncurrent Liabilities:			
Bonds and Notes Payable Due in More Than One Year	1,704,331	7,350,000	9,054,331
Compensated Absences	24,293	17,040	41,333
Advance from Other Funds	210,000	-	210,000
	1,938,624	7,367,040	9,305,664
Total Noncurrent Liabilities			
Total Liabilities	2,373,259	8,522,783	10,896,042
Net Assets:			
Invested in Capital Assets, net of related debt	9,612,164	8,360,602	17,972,766
Restricted For:			
Streets and Roads	50,365	-	50,365
Community Development	554,834	-	554,834
Capital Projects	2,488,764	1,763,881	4,252,645
Unrestricted	(1,625,564)	2,703,844	1,078,280
	11,080,563	12,828,327	23,908,890
Net Assets	\$ 11,080,563	\$ 12,828,327	\$ 23,908,890

The accompanying notes are an integral part of these financial statements.

City of McFarland
STATEMENT OF ACTIVITIES
Year ended June 30, 2011

Functions / Programs	Program Revenues				Net (Expenses) Revenues and Changes in Net Assets		
	Expenses	Charges for Services	Operating Contributions and Grants	Capital Contributions and Grants	Governmental Activities	Business-Type Activities	Total
Governmental Activities:							
General Government	\$ 672,582	\$ 200,669			\$ (471,913)	\$ -	\$ (471,913)
Public Safety	1,746,805	64,853	100,000		(1,581,952)	-	(1,581,952)
Public Works	990,517	858,996		847,121	715,600	-	715,600
Community Development	531,392	192,621		803,188	464,417	-	464,417
Total Governmental Activities	3,941,296	1,317,139	100,000	1,650,309	(873,848)	-	(873,848)
Business-Type Activities:							
Sewer	1,197,084	2,209,506	-	-	-	1,012,422	1,012,422
Refuse	958,326	1,051,122	-	5,000	-	97,796	97,796
Water	1,121,330	1,226,305	-	56,787	-	161,762	161,762
Public Transportation	107,063	10,049	109,080	-	-	12,066	12,066
Total Business-Type Activities	3,383,803	4,496,982	109,080	61,787	-	1,284,046	1,284,046
Total	\$ 7,325,099	\$ 5,814,121	\$ 209,080	\$ 1,712,096	(873,848)	1,284,046	410,198
General Revenues:							
Taxes:							
Property Tax					355,166	-	355,166
Sales Tax					281,241	-	281,241
Franchise Tax					154,512	-	154,512
State Allocation of Gas Tax					355,303	-	355,303
Transient Occupancy Tax					-	-	-
Intergovernmental, Unrestricted:							
Motor Vehicle In-lieu Tax					979,023	-	979,023
Total Taxes					2,125,245	-	2,125,245
Unrestricted investment earnings					117,205	-	117,205
Transfers					-	-	-
Total General Revenues and Transfers					2,242,450	-	2,242,450
Change in Net Assets					1,368,602	1,284,046	2,652,648
Net Assets - Beginning					9,711,961	11,544,281	21,256,242
Net Assets - Ending					\$ 11,080,563	\$ 12,828,327	\$ 23,908,890

The accompanying notes are an integral part of these financial statements.

City of McFarland
BALANCE SHEET – GOVERNMENTAL FUNDS
June 30, 2011

	General	TDA - LTF	Gas Tax	CDBG	HOME	Development Impact	RDA Debt Service	RDA Capital Projects	RDA Low & Moderate Income Housing	Total Governmental Funds
Assets:										
Cash and Investments	\$ 333,368	\$ -	\$ 28,687	\$ -	\$ -	\$ 1,018,428	\$ 13,339	\$ 280	\$ 11,118	\$ 1,405,220
Receivables, net	224,403	465,000	41,380	46,750	648,267	-	-	-	-	1,425,800
Due from Other Funds	-	-	-	-	-	1,130,336	-	-	-	1,130,336
Notes Receivable	-	-	-	-	578,858	-	-	-	-	578,858
Land Held for Resale	-	-	-	-	-	-	-	129,720	-	129,720
Advance to Other Funds	-	-	-	-	-	210,000	-	-	-	210,000
Total Assets	\$ 557,771	\$ 465,000	\$ 70,067	\$ 46,750	\$ 1,227,125	\$ 2,358,764	\$ 13,339	\$ 130,000	\$ 11,118	\$ 4,879,934
Liabilities:										
Accounts Payable	\$ 141,494	\$ 58,527	\$ -	\$ 18,274	\$ 67,315	\$ -	\$ -	\$ -	\$ -	\$ 285,610
Accrued Liabilities	25,411	-	-	11	-	-	-	-	-	25,422
Deposits Received	-	-	-	-	-	-	-	-	-	-
Due to Other Funds	-	426,175	-	28,465	616,094	-	-	-	-	1,070,734
Deferred Revenue	-	-	-	-	578,858	-	-	-	-	578,858
Advances from Other Funds	-	-	-	-	-	-	210,000	-	-	210,000
Total Liabilities	166,905	484,702	-	46,750	1,282,267	-	210,000	-	-	2,170,624
Fund Balances:										
Nonspendable:										
Land Held for Resale	-	-	-	-	-	-	-	129,720	-	129,720
Restricted:										
Streets and Transportation	-	-	70,067	-	-	-	-	-	-	70,067
Low and Moderate Income Housing	-	-	-	-	-	-	-	-	11,118	11,118
Impact Fees	-	-	-	-	-	2,358,764	-	-	-	2,358,764
Assigned:										
Redevelopment Capital Projects	-	-	-	-	-	-	-	280	-	280
Unassigned	390,866	(19,702)	-	-	(35,142)	-	(196,661)	-	-	139,361
Total Fund Balances	390,866	(19,702)	70,067	-	(35,142)	2,358,764	(196,661)	130,000	11,118	2,709,310
Total Liabilities & Fund Balances	\$ 557,771	\$ 465,000	\$ 70,067	\$ 46,750	\$ 1,227,125	\$ 2,358,764	\$ 13,339	\$ 130,000	\$ 11,118	\$ 4,879,934

The accompanying notes are an integral part of these financial statements.

City of McFarland

RECONCILIATION OF THE FUND BALANCES OF GOVERNMENTAL FUNDS TO THE NET ASSETS OF GOVERNMENTAL ACTIVITIES IN THE STATEMENT OF NET ASSETS June 30, 2011

Fund balances of governmental funds \$ 2,709,310

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not current financial resources, and therefore, are not reported in the Governmental Funds Balance Sheet. However, the Statement of Net Assets includes those capital assets among the assets of the City as a whole.

Beginning Balance, net of depreciation	\$ 8,384,634	
Current Year Additions	1,598,585	
Current Year Depreciation	<u>(338,597)</u>	
Ending Balance, net of depreciation		9,644,622

Long-term assets that are not available to pay for current-period expenditures are considered deferred revenue for the Government Funds Balance Sheet. However, these assets are included in the Statement of Net Assets. 578,858

Accrued interest payable for the period between the final interest payment date and the end of the fiscal year is not reported as a liability in the governmental funds balance sheet. -

Long-term liabilities are not due and payable in the current period, and therefore, are not reported as liabilities in the Governmental Funds Balance Sheet. All liabilities, both current and long-term, are reported in the Statement of Net Assets.

Compensated Absences	(24,293)	
Long-Term Debt	<u>(1,827,934)</u>	
Total Long-Term Liabilities		<u>(1,852,227)</u>

Net assets of governmental activities \$ 11,080,563

City of McFarland
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES (DEFICITS) – GOVERNMENTAL FUNDS
Year ended June 30, 2011

	General	TDA - LTF	Gas Tax	CDBG	HOME	Development Impact	RDA Debt Service	RDA Capital Projects	RDA Low & Moderate Income Housing	Total Governmental Funds
Revenues:										
Taxes	\$ 1,744,383	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 42,031	\$ -	\$ -	\$ 1,786,414
Licenses & Permits	112,073	-	-	-	-	1,054,832	-	-	-	1,166,905
Fines, Forfeitures & Assessments	62,841	-	-	-	-	-	-	-	-	62,841
Use of Money or Property	107,992	-	-	-	-	-	-	-	-	107,992
Intergovernmental	261,223	608,869	355,303	144,921	658,267	9,213	-	-	-	1,177,516
Charges for Services	52,686	-	-	-	-	-	-	-	-	52,686
Contributions and Donations	77,029	-	-	-	-	-	-	-	-	77,029
Other Income	27,476	-	-	-	-	-	-	-	-	27,476
Total Revenues	2,445,503	608,869	355,303	144,921	658,267	1,064,045	42,031	-	-	5,318,939
Expenditures:										
Current:										
General Government	683,274	-	-	-	-	-	-	-	-	683,274
Public Safety	1,708,059	-	-	-	-	-	-	-	-	1,708,059
Public Works	611,793	5,998	8,552	-	-	72,385	-	-	-	698,728
Community Development	318,896	-	-	56,700	691,414	-	-	-	-	1,110,250
Capital Outlay	87,590	412,057	225,200	668,877	-	203,466	3,827	-	39,413	1,597,190
Debt Service:										
Principal Retirement	208,635	-	-	-	-	-	-	-	-	208,635
Tax Increment Pass-Through Payments	-	-	-	-	-	-	-	-	-	-
Interest and Finance Charges	1,958	-	-	-	-	-	8,508	-	-	8,508
County Administrative Fee	-	-	-	-	-	-	-	-	-	1,958
							533			533
Total Expenditures	3,600,203	418,055	233,752	725,577	691,414	275,831	12,868	-	39,413	5,997,113
Excess of Revenues Over (Under) Expenditures	(1,154,700)	190,814	121,551	(580,656)	(33,147)	788,214	29,163	-	(39,413)	(678,174)
Other Financing Sources (Uses):										
Transfers In	443,561	3,062	-	632,448	-	-	-	-	-	1,217,477
Transfers Out	(3,062)	-	(238,399)	(12,162)	(1,995)	(825,453)	(138,406)	130,000	8,406	(1,217,477)
Loan Proceeds	-	-	-	-	-	-	-	-	-	-
Total Other Financing Sources (Uses)	440,499	3,062	(238,399)	620,286	(1,995)	(825,453)	(138,406)	130,000	8,406	-
Net Change in Fund Balances	(714,201)	193,876	(114,848)	39,630	(35,142)	(37,236)	(109,243)	130,000	(31,007)	(678,174)
Fund Balances - Beginning	1,105,067	(213,578)	184,915	(39,630)	-	2,396,003	(87,418)	-	42,125	3,387,484
Fund Balances - Ending	\$ 390,866	\$ (19,702)	\$ 70,067	\$ -	\$ (35,142)	\$ 2,358,764	\$ (196,661)	\$ 130,000	\$ 11,118	\$ 2,709,310

The accompanying notes are an integral part of these financial statements.

City of McFarland
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF ACTIVITIES
Year ended June 30, 2011

Net change in fund balance - total governmental funds	\$	(678,174)
Amounts reported for governmental activities in the statement of activities are different because:		
Government funds report capital outlay as expenditures. However, in the Statement of Activities, the costs of those assets is allocated over their estimated useful lives, and reported as depreciation expense. This is the amount by which capital expenditures (\$1,598,585) exceeded depreciation (\$338,597) in the current period.		1,259,988
Repayment of long-term debt principal is an expenditure in the government funds, but the repayment reduces long-term liabilities in the Statement of Net Assets.		208,637
Accrued interest payable for the period between the final interest payment date and the end of the fiscal year is not reported as an expense in the governmental fund statements. This difference between the prior year's accrued interest expense and the current year's accrued interest expense is reported in the Statement of Activities.		-
Long-term compensated absence expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in government funds.		(707)
Earned long-term assets not available to pay for current-period expenditures are not recognized as revenue in the government funds. Revenue in the Statement of Activities is not limited by availability. This adjustment is the amount by which unavailable deferred revenue at the beginning of the year (\$0) is exceeded by unavailable deferred revenue at the end of the year (\$578,858)		<u>578,858</u>
Change in net assets of governmental activities	\$	<u><u>1,368,602</u></u>

The accompanying notes are an integral part of these financial statements.

City of McFarland
STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
June 30, 2011

	Sewer	Refuse	Water	Public Transit	Total Proprietary
Assets:					
Current Assets:					
Cash and Investments	\$ 1,430,686	\$ 358,332	\$ 2,869,944	\$ -	\$ 4,658,962
Investments With Fiscal Agents - Restricted	4,317,374	-	2,475,549	-	6,792,923
Receivables	187,428	145,234	92,867	46,270	471,799
Supplies	-	-	10,115	-	10,115
Total Current Assets	5,935,488	503,566	5,448,475	46,270	11,933,799
Noncurrent Assets:					
Deferred Charges	269,050	-	85,775	-	354,825
Capital Assets:					
Land	1,120,000	-	46,042	-	1,166,042
Depreciable Buildings, Property, Equipment and Infrastructure, net of accumulated depreciation	4,191,985	20,867	3,608,410	134,784	7,956,046
Total Noncurrent Assets	5,581,035	20,867	3,740,227	134,784	9,476,913
Total Assets	\$ 11,516,523	\$ 524,433	\$ 9,188,702	\$ 181,054	\$ 21,410,712
Liabilities:					
Current Liabilities:					
Accounts Payable	\$ 60,422	\$ 84,940	\$ 691,020	\$ 3,413	\$ 839,795
Accrued Interest Payable	54,850	-	26,582	-	81,432
Customer Deposits	-	-	7,794	-	7,794
Due to Other Funds	-	-	-	59,602	59,602
Deferred Revenue	-	-	22,313	-	22,313
Current Portion of Long-Term Debt	154,409	-	50,000	-	204,409
Total Current Liabilities	269,681	84,940	797,709	63,015	1,215,345
Noncurrent Liabilities:					
Compensated Absences Payable	5,340	4,360	6,725	615	17,040
Bonds Payable	4,900,000	-	2,450,000	-	7,350,000
Total Noncurrent Liabilities	4,905,340	4,360	2,456,725	615	7,367,040
Total Liabilities	5,175,021	89,300	3,254,434	63,630	8,582,385
Net Assets:					
Invested In Capital Assets, net of related debt	4,574,950	20,867	3,630,001	134,784	8,360,602
Restricted For:					
Capital Projects (expendable)	559,037	-	1,204,844	-	1,763,881
Unrestricted	1,207,515	414,266	1,099,423	(17,360)	2,703,844
Net Assets	\$ 6,341,502	\$ 435,133	\$ 5,934,268	\$ 117,424	\$ 12,828,327

The accompanying notes are an integral part of these financial statements.

City of McFarland
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS
PROPRIETARY FUNDS
Year ended June 30, 2011

	Sewer	Refuse	Water	Public Transit	Total Proprietary
Operating Revenues:					
Charges for Services	\$ 1,618,763	\$ 1,047,684	\$ 895,513	\$ 10,049	\$ 3,572,009
Total Operating Revenues	1,618,763	1,047,684	895,513	10,049	3,572,009
Operating Expenses:					
Wages and Benefits	228,759	116,012	255,882	59,737	660,390
Administration	142,524	785,515	220,991	4,560	1,153,590
Materials and Supplies	48,084	35,798	46,012	21,751	151,645
Maintenance and Repair	92,386	1,410	116,860	3,569	214,225
Utilities	251,361	12,400	222,866	49	486,676
Depreciation	236,208	7,191	178,550	17,397	439,346
Total Operating Expenses	999,322	958,326	1,041,161	107,063	3,105,872
Operating Income (Loss)	619,441	89,358	(145,648)	(97,014)	466,137
Nonoperating Revenues (Expenses):					
Interest Income	4,521	3,438	7,050	-	15,009
Rent Income	58,632	-	-	-	58,632
Connection Fees	527,590	-	323,742	-	851,332
Intergovernmental	-	5,000	56,787	109,080	170,867
Interest Expense	(197,762)	-	(80,169)	-	(277,931)
Total Nonoperating Revenues (Expenses)	392,981	8,438	307,410	109,080	817,909
Income (Loss) Before Contributions and Transfers	1,012,422	97,796	161,762	12,066	1,284,046
Capital Contributions	-	-	-	-	-
Transfers In	-	-	-	-	-
Change in Net Assets	1,012,422	97,796	161,762	12,066	1,284,046
Net Assets - Beginning	5,329,080	337,337	5,772,506	105,358	11,544,281
Net Assets - Ending	\$ 6,341,502	\$ 435,133	\$ 5,934,268	\$ 117,424	\$ 12,828,327

The accompanying notes are an integral part of these financial statements.

City of McFarland
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
Year ended June 30, 2011

	Sewer	Refuse	Water	Public Transportation	Total Proprietary
Cash flows from operating activities:					
Cash received from:					
Customers, including cash deposits	\$ 1,598,426	\$ 1,085,278	\$ 908,318	\$ 10,049	\$ 3,602,071
Cash paid to:					
Suppliers	(598,204)	(752,426)	(568,435)	(28,805)	(1,947,870)
Employees	(228,332)	(115,109)	(254,674)	(61,009)	(659,124)
Net cash provided (used) by operating activities	771,890	217,743	85,209	(79,765)	995,077
Net cash provided from noncapital financing activities:					
Cash transferred from other funds	-	-	-	59,602	59,602
Cash transferred to other funds	-	-	-	(42,647)	(42,647)
Connection fees	527,590	-	323,742	-	851,332
Intergovernmental revenue	-	5,000	52,249	62,810	120,059
Net cash provided (used) by noncapital financing activities	527,590	5,000	375,991	79,765	988,346
Cash flows from capital and related financing activities:					
Principal payments:					
Bonds	-	-	-	-	-
Certificates of Participation	(738,935)	-	-	-	(738,935)
Notes	(52,266)	-	-	-	(52,266)
Advances from other funds	(500,000)	-	-	-	(500,000)
Interest paid	(153,140)	-	(53,587)	-	(206,727)
Debt Issuance Costs	(269,050)	-	(85,775)	-	(354,825)
Purchase of capital assets	(162,365)	-	(10,815)	-	(173,180)
Proceeds from capital debt	5,000,000	-	2,500,000	-	7,500,000
Net cash provided (used) by capital and related financing activities	3,124,244	-	2,349,823	-	5,474,067
Cash flows from investing activities:					
Interest received	4,521	3,438	7,050	-	15,009
Rents Received	58,632	-	-	-	58,632
Net cash provided by investing activities	63,153	3,438	7,050	-	73,641
Net increase (decrease) in cash	4,486,877	226,181	2,818,073	-	7,531,131
Cash and cash equivalents - Beginning of year	1,261,183	132,151	2,527,420	-	3,920,754
Cash and cash equivalents - End of year	\$ 5,748,060	\$ 358,332	\$ 5,345,493	\$ -	\$ 11,451,885
Reconciliation of Operating Income to Net Cash Provided (Used) by Operating Activities:					
Operating income (loss)	\$ 619,441	\$ 89,358	\$ (145,648)	\$ (97,014)	\$ 466,137
Adjustments to reconcile operating income to net cash provided (used) by operating activities:					
Depreciation expense	236,208	7,191	178,550	17,397	439,346
(Increase) decrease in accounts receivable	(20,337)	37,594	12,805	-	30,062
Increase (decrease) in accounts payable	(63,849)	82,697	38,294	1,124	58,266
Increase (decrease) in compensated absences	427	903	1,208	(1,272)	1,266
Net cash provided (used) by operating activities	\$ 771,890	\$ 217,743	\$ 85,209	\$ (79,765)	\$ 995,077

The accompanying notes are an integral part of these financial statements.

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 1 – Summary of Significant Accounting Policies

The accompanying financial statements of the City of McFarland (the "City") have been prepared in conformity with U.S. generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The following summary of the City's more significant accounting policies is presented to assist the reader in interpreting the basic financial statements and other data in this report. These policies should be viewed as an integral part of the accompanying basic financial statements.

A - Reporting Entity

The City of McFarland, California was incorporated on July 18, 1957. The City is a full-service city and operates under a Council – City Administrator form of government, providing the following services: general government; public safety; public works; and development and conservation. The City is located in Kern County approximately 25 miles north of Bakersfield, the County government seat.

The City has defined its reporting entity in accordance with accounting principles generally accepted in the United States of America which provide guidance for determining which governmental activities, organizations, and functions should be included in the reporting entity. The Basic Financial Statements present information on the activities of the reporting entity, including all of the fund types and account groups of the City.

Accounting principles generally accepted in the United States of America require that the component units be separated into blended or discretely presented units for reporting purposes. Although legally separate entities, blended component units are, in substance, part of the City's operations. Therefore, they are reported as part of the primary government. Discretely presented component units are reported in a separate column in the basic financial statements to emphasize that they are legally separate from the City. The City has no component units.

Blended Component Units

The McFarland Redevelopment Agency (the "Agency") was formed by the City of McFarland in 2007 by Ordinance No. 318-2007. The Agency is the legislative body of the City of McFarland, which is undertaking the implementation of the McFarland Redevelopment Project, as adopted by the McFarland City Council. The fundamental aim of the Agency is to create and maintain an urban environment that meets the needs of all the City's people through a balanced pattern of residential, commercial, industrial and recreational areas. In working toward this objective, the Agency is concerned with better housing, job creation and social economic and racial integration. The funds of this component unit are reported in the Special Revenue Funds and the Capital Projects Funds. The Agency issues separate component unit financial statements. Upon completion, the Agency's financial statements can be obtained at City Hall.

On July 31, 2001, the City and the Agency entered into a Joint Exercise of Powers Agreement establishing the McFarland Public Financing Corporation (the "Corporation") for the purpose of issuing its bonds to be used to provide financial assistance to the City, the Agency or any other public entity of the State of California. The funds of the component unit are reported in the Special Revenue Funds and the Agency Fund. Separate financial statements are not available for the Corporation.

The City Council of McFarland is the governing body for the Agency and Corporation.

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 1 – Summary of Significant Accounting Policies, (continued)

B - Basis of Presentation

Government-Wide Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the primary government and its component units. 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. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable.

For the most part, the effect of interfund activity has been removed from the government-wide financial statements. Exceptions to this general rule are payments-in-lieu of taxes where the amounts are reasonably equivalent in value to the interfund services provided and other charges between the City's sewer, water and refuse function and various other functions of the government. Eliminations of these charges would distort the direct costs and program revenues reported for the various functions concerned.

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. Indirect expenses have been allocated to major functions in order to present a more accurate and complete picture of the cost of services. 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, proprietary funds and fiduciary funds, even though the fiduciary funds are excluded from the government-wide financial statements. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

Fund Financial Statements

The accounting system of the City is organized and operated on the basis of separate funds, each of which is considered to be a separate accounting entity. Each fund is accounted for by providing a separate set of self-balancing accounts that constitute its assets, liabilities, fund equity, revenues, and expenditures/expenses. Funds are organized into three major categories: governmental, proprietary, and fiduciary. An emphasis is placed on major funds within the governmental and proprietary categories. A fund is considered major if it is the primary operation fund of the City or meets the following criteria:

- a. Total assets, liabilities, revenues, or expenditures/expenses of that individual governmental or enterprise fund are at least 10 percent of the corresponding total for all funds of that category or type; and

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 1 – Summary of Significant Accounting Policies, (continued)

- b. Total assets, liabilities, revenues, or expenditures/expenses of the individual governmental fund or enterprise fund are at least 5 percent of the corresponding total for all governmental and enterprise funds combined.
- c. The government has determined that a fund is important to the financial statement user.

The major funds are as follows:

Governmental Funds

The General Fund is the general operating fund of the City. It is used to account for all financial resources except those required to be accounted for in another fund. The revenues of the General Fund consist mostly of property tax, sales tax, motor vehicle tax, and franchise fees.

The TDA - LTF accounts for the City's share of the Transportation Development Allocation which is legally restricted for specific purposes, primarily street construction and maintenance and related street expenses. This fund also accounts for other State and Federal grant revenues related to street maintenance or construction.

The State Gas Tax Fund is used to account for the City's share, based on population, of state gasoline taxes. State law requires these gasoline taxes to be used to maintain streets or for major street construction. This fund also accounts for other State and Federal grant revenues related to street maintenance or construction.

The CDBG Fund is used to account for CDBG grant funds.

The HOME Fund is used to account for HOME grant funds.

The Development Impact Fund accounts for developer fees received for future government impact, police impact, park impact, traffic impact and storm drain costs.

The RDA Debt Service Fund accounts for the accumulation of resources for, and the payment of, general long-term debt principal, interest, and related costs of the McFarland Redevelopment Agency.

The RDA Capital Projects Fund accounts for all revenues and costs of funding the McFarland Redevelopment Agency's redevelopment activities such as land acquisition, public improvements, and other project costs in compliance with the California redevelopment law.

The RDA Low & Moderate Income Housing fund is a special revenue fund type that accounts for the required 20% set-aside of tax revenues specifically to be used toward low and moderate income housing projects as required by State law.

Proprietary Funds

The Sewer Fund is used to account for the provisions of sewer service to the residents of the City. All activities necessary to provide such service are accounted for in this fund.

The Refuse Fund is used to account for the collection and disposal of refuse within the City. All activities necessary to provide such service are accounted for in this fund.

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 1 – Summary of Significant Accounting Policies, (continued)

The Water Fund is used to account for the provisions of water service to residents of the City. All activities necessary to provide such service are accounted for in this fund.

The Public Transit Fund is used to account for the operations of a Dial-A-Ride system for general transportation of all citizens and a Social Services System which transports seniors and handicapped. The City received funds under the Transportation Development Act.

C - Measurement Focus and Basis of Accounting

Measurement focus is a term used to describe “which” transactions are recorded within the various financial statements. Basis of accounting refers to “when” transactions are recorded regardless of the measurement focus applied.

Measurement Focus

On the government-wide Statement of Net Assets and the Statement of Activities, both governmental and business-like activities are presented using the economic resources measurement focus. The accounting objectives of the economic measurement focus are the determination of operating income, changes in net assets (or cost recovery), financial position, and cash flows. All assets and liabilities (whether current or noncurrent) associated with their activities are reported.

In the fund financial statements, the “current financial resources” measurement focus or the “economic resources” measurement focus is used as appropriate:

- a. All governmental funds utilize a “current financial resources” measurement focus. Only current financial assets and liabilities are generally included on their balance sheets. Their operating statements present sources and uses of available spendable financial resources during a given period. These funds use fund balance as their measure of available spendable financial resources at the end of the period.
- b. The proprietary fund utilizes an “economic resources” measurement focus. Proprietary fund equity is classified as net assets.
- c. Agency funds are not involved in the measurement of results of operations; therefore, measurement focus is not applicable to them.

Basis of Accounting

In the government-wide Statement of Net Assets and Statement of Activities, both governmental and business-like activities are presented using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place.

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 1 – Summary of Significant Accounting Policies, (continued)

In the fund financial statements, governmental funds are presented on the modified accrual basis of accounting. Under this modified accrual basis of accounting, revenues are recognized when "measurable and available". Measurable means knowing or being able to reasonably estimate the amount. Available means collectible within the current period or soon enough thereafter to pay current liabilities. Revenues which are susceptible to accrual include property taxes and special assessments that are levied for and due for the fiscal year and collected within 60 days after year-end. Licenses, permits, fines, forfeits, charges for services and miscellaneous revenues are recorded as governmental fund type revenues when received in cash because they are not generally measurable until actually received. Revenue from taxpayer assessed taxes, such as sales taxes, are recognized in the accounting period in which they became both measurable and available to finance expenditures of the fiscal period. Grant funds and reimbursements of expenses under contractual agreements are reported in governmental fund types and are recorded as a receivable when earned rather than when susceptible to accrual. Generally, this occurs when authorized expenditures are made under the grant program or contractual agreement. Expenditures are recognized when the fund liability is incurred, if measurable, except for unmatured interest on long-term debt, which is recognized when due.

The accrual basis of accounting is followed by the proprietary fund and fiduciary funds. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing goods and services in connection with a proprietary fund's principal ongoing operations. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Private-sector standards of accounting and financial reporting issued prior to December 1989, generally are followed in both 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.

D - Assets, Liabilities, Net Assets or Equity, and Other Financial Statement Items

Cash and Investments

Cash and investment balances of each of the City's funds, except for funds required to be held by outside fiscal agents under the provisions of bond indentures, are pooled in order to take advantage of an effective investment strategy. Income earned from pooled investments is allocated to each of the funds based on average pooled cash balances during the year. Deficit cash balances are classified as due to other funds and funded by the General Fund or related operating fund.

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 1 – Summary of Significant Accounting Policies, (continued)

<u>Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Specified % Of Portfolio</u>	<u>Minimum Quality Requirements</u>
Local Agency Bonds	5 Years	None	None
U.S. Treasury Obligations	5 Years	None	None
State Obligations	5 Years	None	None
CA Local Agency Obligations	5 Years	None	None
U.S. Agency Obligations	5 Years	None	None
Bankers' Acceptance	180 Days	40%	None
Commercial Paper - Select Agencies	270 Days	25%	A-1
Commercial Paper - Other Agencies	270 Days	40%	A-1
Negotiable Certificates of Deposit	5 Years	30%	None
CD Placement Service	5 Years	30%	None
Repurchase Agreements	1 Year	None	None
Reverse Repurchase Agreements	92 Days	20%	None
Medium-Term Notes	5 Years	30%	A
Mutual and Money Market Fund	N/A	20%	Multiple
Collateralized Bank Deposits	5 Years	None	None
Mortgage Pass-Through Securities	5 Years	20%	AA
Bank/Time Deposits	5 Years	None	None
County Pooled Investment Funds	N/A	None	None
Joint Powers Authority Pool	N/A	None	Multiple
Local Agency Investment Fund (LAIF)	N/A	None	None

Investment of debt proceeds held by bond trustees are governed by the provisions of the Agency's debt agreement rather than the general provisions of the California Government Code.

For purposes of the Combined Statement of Cash Flows for the Proprietary fund types, cash and cash equivalents includes all pooled cash investments, non-pooled restricted cash and restricted investments with an original maturity of three months or less. The City considers the investments held in LAIF to be a demand deposit account where funds may be withdrawn and deposited at any time without prior notice or penalty.

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 interfund receivables/interfund payables (i.e., the current portion of interfund loans) or advances to/from other funds (the noncurrent portion) of interfund loans. All other outstanding balances between funds are reported as interfund receivables/interfund payables. Any residual balances outstanding between the governmental activities and the 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 governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

All trade and tax receivables are shown net of an allowance for uncollectible accounts and estimated refunds due.

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 1 – Summary of Significant Accounting Policies, (continued)

Assessed values are determined on an annual basis by the Kern County Assessor as of January 1. Taxes are levied annually and become a lien on real property at July 1. Taxes are due November 1 and February 1, and are delinquent if not paid by December 10 and April 10, respectively. In 1978, a state constitutional amendment (Proposition 13) provided that the tax rate be limited to 1% of market value, levied only by the County and shared with all other jurisdictions. Such limitation on the rate may only be increased through voter approval. The County collects property taxes and distributes them to taxing jurisdictions on the basis of the taxing jurisdiction's assessed valuations and on the tax rate for voter-approved debt.

Capital Assets and Depreciation

Capital assets, which include property, plant, equipment and infrastructure assets (e.g., roads, traffic signals, drainage systems and similar items), are reported in the applicable governmental or business-type activities column in the government-wide financial statements. Capital assets are defined by the City as assets with an initial cost of more than \$1,000 (\$25,000 for infrastructure) and an estimated 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.

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

The City elected not to retroactively report all of its major general infrastructure assets prior to July 1 2003, as permitted to phase 3 governments under GASB 34, Paragraph 148.

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

<u>Assets</u>	<u>Years</u>
Buildings	15 - 40
Improvements other than buildings	20
Machinery and Equipment	5 - 20
Infrastructure	20 - 50
Vineyard	20

Compensated Absences

It is the City's policy to permit employees to accumulate earned but unused vacation and sick pay benefits up to certain limits. All vacation pay is accrued when incurred in the government-wide financial statements and the proprietary fund type financial statements. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements. There is no liability for unpaid accumulated sick leave since the City does not pay such amounts when employees separate from service with the City.

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 1 – Summary of Significant Accounting Policies, (continued)

Long-Term Obligations

In the government-wide financial statements and 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. Initial-issue bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line method. The difference between the reacquisition price of refunding bonds and the net carrying amount of refunded debt (deferred amount on refunding) is amortized over the shorter of the lives of the refunding debt or remaining life of the refunded debt. Bonds payable are reported net of the unamortized portion of applicable premium, discount or deferred amount on refunding. Bond issuance costs, including underwriters' discount, are reported as deferred bond issuance costs. Amortization of bond premiums or discounts, issuance costs and deferred amounts on refunding are included in interest expense.

In the fund financial statements, governmental fund types recognize bond premiums, discounts and issuance costs during the period issued. The face amount of debt issued is reported as other financing sources. Premiums received are reported as other financing sources, while discounts are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

Net Assets

The government-wide and business-type activities fund financial statements utilize a net assets presentation. Net assets are categorized as invested capital assets (net of related debt), restricted and unrestricted.

Invested In Capital Assets, Net of Related Debt – This category groups all capital assets, including infrastructure, into one component of net assets. Accumulated depreciation and the outstanding balances of debt that are attributable to the acquisition, construction or improvement of these assets reduce the balance in this category.

Restricted Net Assets – This category presents external restrictions imposed by creditors, grantors, contributors or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation. The government-wide statement of net assets reports \$4,857,844 of restricted net assets, all of which is restricted externally by grantors, creditors, or laws or regulations of other governments.

Unrestricted Net Assets – This category represents net assets of the City, not restricted for any project or other purpose.

When both restricted and unrestricted net assets are available for use, it is the City's policy to use restricted net assets first, and then unrestricted net assets as they are needed.

Fund Balance – Government Funds

As of these financial statements, the City has adopted GASB Statement No. 54, which redefined how fund balances of the governmental funds are presented in the financial statements based on classifications that comprise a hierarchy that is based primarily on the extent to which the City is bound to honor constraints on the specific purposes for which amounts in the respective governmental funds can be spent. Fund balances are classified as follows:

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 1 – Summary of Significant Accounting Policies, (continued)

Nonspendable – Amounts that cannot be spent either because they are not in a spendable form or because they are legally or contractually required to be maintained intact.

Restricted – Amounts restricted by external sources (creditors, laws of other governments, etc.) or by constitutional provision or enabling legislation.

Committed – Amounts that can be used only for specific purposes determined by a formal action by Board of Director resolution. This includes the budget reserve account.

Assigned – Amounts the City intends to use for a specific purpose, but do not meet the definition of restricted or committed fund balance. Amounts may be assigned by the City Manager.

Unassigned – All other spendable amounts.

When an expenditure is incurred for purposes for which both restricted and unrestricted fund balance is available, the City considers restricted funds to have been spent first. When an expenditure is incurred for which committed, assigned, or unassigned fund balances are available, the City considers amounts to have been spent first out of committed funds, then assigned funds, and finally unassigned funds, as needed, unless the board has provided otherwise in its commitment or assignment actions.

Appropriated Budget and Budgetary Control

The City Council is required to adopt an annual budget resolution by July 1 of each fiscal year for the General, Special Revenue, Debt Service and Capital Projects funds. The budgets are presented for reporting purposes on a budgetary basis consistent with accounting principles generally accepted in the United States of America.

The appropriated budget is prepared by fund, function, and department. The City Manager may make transfers of appropriations within a department. Transfers of appropriations between departments requires the approval of the council. The legal level of budgetary control (i.e., the level at which expenditures may not legally exceed appropriations) is the department level. Unexpended or unencumbered appropriations lapse at the end of the fiscal year. Encumbered appropriations are reappropriated in the ensuing year's budget.

The City Council adopts budgets for the Enterprise funds. However, all Proprietary fund types are accounted for on a cost of service (net income), or "capital maintenance" measurement focus. As a result, budget comparisons are impractical. Additionally, the City is not legally mandated to report the results of operations for these Proprietary fund types on a budget comparison basis; therefore, budgetary data related to these funds has not been presented.

Note 1 – Summary of Significant Accounting Policies, (continued)

Use of Estimates

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

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 2 – Cash and Investments

The City pools all of its cash and investments except those funds required to be held by outside fiscal agents under the provisions of bond indentures.

The following is a summary of the City's cash and investments as classified in the accompanying financial statements:

Pooled Cash and Investments - Government Funds	\$	1,405,220
Pooled Cash and Investments - Business-Type Funds		4,658,962
Restricted Investments with Fiscal Agents - Business-Type Funds		<u>6,792,923</u>
Total	\$	<u><u>12,857,105</u></u>

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

Cash on Hand	\$	2,600
Demand Deposits		4,690,364
Investments		<u>8,164,141</u>
Total	\$	<u><u>12,857,105</u></u>

Deposits:

Custodial credit risk – In the case of deposits, this is the risk that in the event of a bank failure, the City's deposits may not be returned to it. The City has no deposit policy for custodial credit risk.

The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure public agency deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits. As of June 30, 2011, all of the City's deposits with financial institutions in excess of federal depository insurance limits were held in fully collateralized accounts, as permitted by the California Government Code.

Under Government Code Section 53655, the placement of securities by a bank or savings and loan association with an Agent of Depository has the effect of perfecting the security interest in the name of the local governmental agency. Accordingly, all collateral held by California Agents of Depository is considered to be held for, and in the name of, the local governmental agency.

As of June 30, 2011, all of the City's deposits with financial institutions in excess of federal depository insurance limits were held in fully collateralized accounts, as permitted by the California Government Code.

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 2 – Cash and Investments, (continued)

Investments:

The City had the following investments at June 30, 2011:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Maturity Date</u>
State Treasurer's Investment Pool (LAIF) Held by Trustees:	\$ 1,371,218	N/A
Cash and Short Term Investments	<u>6,792,923</u>	N/A
Total Investments	<u>\$ 8,164,141</u>	

LAIF is a special fund of the California State Treasury through which local governments may pool investments. Investments in LAIF are highly liquid, as deposits can be converted to cash within 24 hours without loss of interest. Included in LAIF's investment portfolio are certain derivative securities or similar products, such as structured notes and asset backed securities. LAIF's and the City's exposure to credit, market, or legal risk is not available. The fair value of the City's position in the pool is the same as the value of the pool shares. LAIF is regulated by the California Government Code.

Interest rate risk – The City's exposure to interest rate risk is identified by the above weighted average maturities. The City has no investment policy for interest rate risk.

Credit rating risk – The City is required to disclose the credit quality ratings of investments in debt securities as issued by nationally recognized statistical rating organizations (NRSROs). At June 30, 2011, the Credit ratings for the money market funds and investment in LAIF was unavailable. The City has no investment policy for credit risk.

Concentration of credit risk – The City is required to disclose any investment in any one issuer that represents 5% or more of total investments. Investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are excluded from this requirement. As such, the City has no concentration of credit risk that exceeds 5%. The City has no investment policy for concentration of credit risk.

Custodial credit risk – For an investment, this is the risk that, in the event of the failure of the counterparty, the City will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. With respect to investments, custodial credit risk generally applies only to direct investments in marketable securities. Custodial credit risk does not apply to a local government's indirect investment in securities through the use of mutual funds or government investment pools (such as LAIF). The City has no investment policy for custodial credit risk.

Restricted Investments with Fiscal Agents

Business-Type Activities:

Revenue Bonds – The trustee is required to hold, in a reserve account, funds necessary to secure bonds until 2020 and to hold unexpended funds for future construction projects.

\$ 6,792,923

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 3 – Receivables

Receivables at June 30, 2011 consist of the following:

	General Fund	TDA - LTF	State Gas Tax	CDBG	HOME	Total
Governmental Activities:						
Accounts receivable, net	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Due from Governments	224,403	465,000	41,380	46,750	648,267	1,425,800
Less Allowance for Doubtfull Accounts	-	-	-	-	-	-
Total	\$ 224,403	\$ 465,000	\$ 41,380	\$ 46,750	\$ 648,267	\$ 1,425,800

	Sewer	Refuse	Water	Public Transit	Total
Business-Type Activities:					
Accounts receivable, net	\$ 187,428	\$ 140,234	\$ 87,178	\$ -	\$ 414,840
Due from Governments	-	5,000	5,689	46,270	56,959
Less Allowance for Doubtfull Accounts	-	-	-	-	-
Total	\$ 187,428	\$ 145,234	\$ 92,867	\$ 46,270	\$ 471,799

Note 4 – Interfund Receivables, Payables, Advances and Transfers

The composition of interfund balances as of June 30, 2011 is as follows:

Fund	Due From Other Funds	Due To Other Funds
Government Funds:		
TDA-LTF	\$ -	\$ 426,175
CDBG	-	28,465
HOME	-	616,094
Development Impact	1,130,336	-
Total Governmental Funds	1,130,336	1,070,734
Proprietary Funds:		
Public Transit	-	59,602
Total Proprietary Funds	-	59,602
Total Due From/To	\$ 1,130,336	\$ 1,130,336

Composition and purpose of interfund receivables and payables is as follows:

The above balances represent money advanced for cash shortages or expenditures to be reimbursed.

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 4 – Interfund Receivables, Payables, Advances and Transfers, (continued)

Advances between funds are as follows:

Included in the Development Impact Fund is an advance to the Redevelopment Agency Debt Service Fund in the amount of \$210,000. This represents funds expended in prior years for the formation of the Redevelopment Agency and is not expected to be paid back within the next 12 months.

Interfund transfers at June 30, 2011 consisted of the following:

	<u>Transfers In</u>	<u>Transfers Out</u>
Governmental Funds:		
General	\$ 443,561	\$ 3,062
TDA-LTF	3,062	-
Gas Tax	-	236,399
CDBG	632,448	12,162
HOME	-	1,995
Development Impact	-	825,453
RDA Debt Service	-	138,406
RDA Capital Projects	130,000	-
RDA Low & Moderate Income Housing	8,406	-
Proprietary Funds:		
None	-	-
	<u> </u>	<u> </u>
Total Transfers	<u>\$ 1,217,477</u>	<u>\$ 1,217,477</u>

Composition and purpose of interfund transfers is as follows:

General fund transfers in of \$443,561 consist of \$236,399 from Gas Tax fund to reimburse for street maintenance, \$195,000 of public safety impact fees from the Development Impact fund for police department startup costs, and \$12,162 from CDBG fund to reimburse community center construction costs.

TDA-LTF fund transfers in of \$3,062 from the General fund for operational expenditures.

CDBG fund transfers in of \$632,448 consist of \$630,453 from the Development Impact fund for community center construction costs and \$1,995 from the HOME fund form reimbursement of labor costs.

RDA Capital Projects fund transfers in of \$130,000 from the RDA Debt Service fund was to cover the cost of land purchased for resale.

RDA Low & Moderate Income Housing fund transfers in of \$8,406 from the RDA Debt Service fund represent the required 20% set-aside of tax revenues as required by State law.

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 5 – Land Held for Resale

At June 30, 2011, inventory consisted of one commercial lot in the RDA Capital Projects fund valued at \$129,720. All values are stated at original cost.

Note 6 – Deferred Charges

Deferred charges represent the capitalized costs of issuing debt. The deferred charges are being amortized over the term of the debt on the straight line basis. Deferred charges at June 30, 2010, net of amortization, are as follows:

	Sewer	Water	Total
Revenue Bonds	\$ 269,050	\$ 85,775	\$ 354,825

Note 7 – Capital Assets

Capital asset activity for the year ended June 30, 2011 is as follows:

Governmental Activities	Balance June 30, 2010	Additions	Deletions	Transfers	Balance June 30, 2011
Capital Assets Not Being Depreciated:					
Land	\$ 493,248	\$ -	\$ -	\$ -	\$ 493,248
Construction in Progress	390,129	668,877	-	(118,655)	940,351
Total Capital Assets Not Being Depreciated	883,377	668,877	-	(118,655)	1,433,599
Capital Assets Being Depreciated:					
Infrastructure	8,092,617	837,903	-	69,355	8,999,875
Machinery and Equipment	330,885	91,805	-	49,300	471,990
Total Capital Assets Being Depreciated	8,423,502	929,708	-	118,655	9,471,865
Less Accumulated Depreciation For:					
Infrastructure	842,033	288,989	-	-	1,131,022
Machinery and Equipment	80,212	49,608	-	-	129,820
Total Accumulated Depreciation	922,245	338,597	-	-	1,260,842
Total Capital Assets Being Depreciated, net	7,501,257	591,111	-	118,655	8,211,023
Governmental Activities Capital Assets, net	\$ 8,384,634	\$ 1,259,988	\$ -	\$ -	\$ 9,644,622

Depreciation charged to governmental functions on the Statement of Activities during the year is as follows: \$6,647 to General Government, \$42,961 to Public Safety and \$288,989 to Public Works.

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 7 – Capital Assets, (continued)

Proprietary fund type property, plant and equipment are as follows:

<u>Business-Type Activities</u>	Balance June 30, 2010	Additions	Deletions	Transfers	Balance June 30, 2011
Capital Assets Not Being Depreciated:					
Land	\$ 1,166,042	\$ -	\$ -	\$ -	\$ 1,166,042
Construction in Progress	-	-	-	-	-
Total Capital Assets Not Being Depreciated	1,166,042	-	-	-	1,166,042
Capital Assets Being Depreciated:					
Building and Improvements	2,647,511	729,218	-	-	3,376,729
Infrastructure	559,361	-	-	-	559,361
Machinery and Other	9,628,689	35,000	-	-	9,663,689
Vehicles	249,198	22,680	-	-	271,878
Vineyards	611,398	-	-	-	611,398
Total Capital Assets Being Depreciated	13,696,157	786,898	-	-	14,483,055
Less Accumulated Depreciation For:					
Building and Improvements	1,084,698	100,105	-	-	1,184,803
Infrastructure	83,904	13,984	-	-	97,888
Machinery and Other	4,503,527	312,234	-	-	4,815,761
Vehicles	201,544	13,025	-	-	214,569
Vineyards	213,990	-	-	-	213,990
Total Accumulated Depreciation	6,087,663	439,348	-	-	6,527,011
Total Capital Assets Being Depreciated, net	7,608,494	347,550	-	-	7,956,044
Business-Type Activities Capital Assets, net	\$ 8,774,536	\$ 347,550	\$ -	\$ -	\$ 9,122,086

Depreciation charged to business-type activities on the Statement of Activities during the year is as follows: \$236,208 to Sewer, \$178,550 to Water, \$7,191 to Refuse, and \$17,397 to Public Transit.

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 8 – Long-Term Liabilities

	Balance June 30, 2010	Additions	Reductions	Balance June 30, 2011	Due Within One Year
Governmental Activities:					
Note Payable	\$ 1,972,934	\$ -	\$ (177,458)	\$ 1,795,476	\$ 91,145
Capital Lease	63,637	-	(31,179)	32,458	32,458
Compensated Absences	23,586	707	-	24,293	-
Total Governmental Activities	2,060,157	707	(208,637)	1,852,227	123,603
Business-Type Activities:					
Revenue Bonds	-	7,500,000	-	7,500,000	150,000
Certificates of Participation	750,000	-	(750,000)	-	-
Capital Lease	106,675	-	(52,266)	54,409	54,409
Compensated Absences	15,774	1,266	-	17,040	-
Total Business-Type Activities	872,449	7,501,266	(802,266)	7,571,449	204,409
Total Long-Term Liabilities	\$ 2,932,606	\$ 7,501,973	\$ (1,010,903)	\$ 9,423,676	\$ 328,012

The compensated absences for governmental and business-type activities will be paid by the respective funds in which the expense was accrued. Compensated absences for governmental activities are typically paid from the General Fund.

Governmental Activities:

Note Payable:

Settlement agreement payable to the County of Kern dated November 17, 2009, in the amount of \$2,059,303; principal and interest at 3.62% due each July 1 and December 1 through 2019.

\$ 1,795,476

Capital Lease:

Lease/Purchase obligation payable to Zions First National Bank dated August 8, 2006, in the amount of \$150,000; principal payments due each August 8 through 2011 and accrued interest at 4.1% payable semi-annually. Secured by a street sweeper.

32,458

Compensated Absences Payable

24,293

Total Governmental Activities

\$ 1,852,227

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 8 – Long-Term Liabilities, (continued)

Business-Type Activities:

Revenue Bonds:

Revenue Bonds dated September 21, 2010, in the original amount of \$7,500,000 at .65% to 5% interest; payable semi-annually commencing April 1, 2011. Principal is due annually commencing October 1, 2011, with final payment due October 1, 2040. Secured by a pledge of water and wastewater net revenues.

\$ 7,500,000

Capital Lease:

Lease/Purchase obligation payable to Zions First National Bank dated August 8, 2006, in the amount of \$350,000; principal payments due each August 8 through 2011 and accrued interest at 4.1% payable semi-annually. Secured by a fine bubble diffuser aeration system.

54,409

Compensated Absences Payable

17,040

Total Business-Type Activities

\$ 7,571,449

The annual requirements to amortize all indebtedness and other long-term liabilities outstanding at June 30, 2011, are as follows:

Year Ending June 30	Governmental Activities			
	Note Payable County of Kern		Capital Lease Zions Bank	
	Principal	Interest	Principal	Interest
2012	\$ 91,145	\$ 32,498	\$ 32,458	\$ 665
2013	187,269	60,017	-	-
2014	194,109	53,177	-	-
2015	201,199	46,086	-	-
2016	208,549	38,737	-	-
2017-2020	913,205	75,937	-	-
Total	<u>\$ 1,795,476</u>	<u>\$ 306,452</u>	<u>\$ 32,458</u>	<u>\$ 665</u>

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 8 – Long-Term Liabilities, (continued)

Year Ending June 30	Business-Type Activities			
	Revenue Bonds		Capital Lease	
	Principal	Interest	Principal	Interest
2012	\$ 150,000	\$ 316,798	\$ 54,409	\$ 1,115
2013	150,000	321,293	-	-
2014	150,000	319,468	-	-
2015	155,000	317,443	-	-
2016	155,000	314,885	-	-
2017-2021	840,000	1,516,425	-	-
2022-2026	1,000,000	1,362,668	-	-
2027-2031	1,250,000	1,106,000	-	-
2032-2036	1,600,000	760,000	-	-
2037-2041	2,050,000	317,500	-	-
Total	\$ 7,500,000	\$ 6,652,480	\$ 54,409	\$ 1,115

Note 9 – Deferred Revenue

Deferred Revenue at June 30, 2011 is detailed as follows:

	Governmental Activities		
	Unearned	Unavailable	Total Deferred Revenue
HOME Grants	\$ -	\$ 578,858	\$ 578,858

Business-Type Activities

	Unearned
Water - State of California Grant	\$ 22,313

Note 10 – Public Entity Risk Pools

The City maintains self-insurance programs for workers' compensation, general liability and auto liability.

For general liability and workers' compensation programs, the City is a member of the Central San Joaquin Valley Risk Management Authority (the RMA). The RMA is comprised of 55 member cities and special districts and is organized under a Joint Powers Agreement pursuant to the California Government Code. The purpose of the RMA is to arrange and administer programs of insurance for the pooling of self-insured losses and to purchase excess insurance coverage. Each member has a representative on the Board of Directors with officers of the RMA being elected annually by the Board Members.

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 10 – Public Entity Risk Pools, (continued)

General Liability – Annual deposits are paid by members and are adjusted retrospectively to cover costs. Each member has a specific self insured retention (SIR) level. The City of McFarland's SIR is \$25,000. The city is responsible for the first \$25,000 of each occurrence. The City does not share or pay for losses of other members with SIRs under \$25,000. Specific coverage includes general and automobile liability, personal injury, errors and omissions, and certain other coverage. Claims from \$25,000 to \$1,000,000 are covered by a special pre-funded self-insurance pool maintained by the RMA. Claims from \$1,000,000 to \$13,000,000 are self-insured by the California Affiliated Risk Management Authorities (CARMA), a joint powers authority providing excess coverage to a membership consisting of six underlying joint powers authorities, representing approximately 175 cities and special districts. Claims from \$14,000,000 to \$29,000,000 are covered by an Excess Comprehensive General Liability Policy.

Workers' Compensation – Annual deposits are paid by members and are adjusted retrospectively to cover costs. Each member has a specific self insured retention (SIR) level. The City of McFarland's SIR is \$25,000 per occurrence. The City is responsible for the first \$25,000 of each occurrence. The City does not share or pay for losses of other members with SIRs under \$25,000. Losses between \$25,000 and \$500,000 are covered by a special pre-funded self-insurance pool maintained by the RMA. Claims from \$500,000 to \$5,000,000 are self-insured by the Local Agency Workers' Compensation Excess Joint Powers Authority which is a joint powers authority providing excess coverage to 36 members including cities, special districts, and joint powers authorities. Claims in excess of \$5,000,000 are self-insured by the California State Association of Counties Excess Insurance Authority, another joint powers authority.

The latest audited financial information available from CSJVRMA is for the year ended June 30, 2010 as follows:

Total Assets	\$ 67,337,173
Total Liabilities	55,453,249
 Total Members' Equity	 \$ 11,883,924
 Total Revenue	 \$ 32,727,775
Total Expenses	30,147,304
 Net Increase in Members' Equity	 \$ 2,580,471

Note 11 – Retirement Plan

Plan Description – The City's defined contribution plan provides for retirement benefits to plan members and beneficiaries. The Plan is administrated by John Hancock Life Insurance Company.

Funding Policy – The City contributes 10% of permanent employees' salaries who have at least one year of service. City policy requires employees to contribute 3% under the same conditions; however, these contributions were not made. In the event an employee terminates service prior to retirement, the employee is entitled to a refund of the employee's contributions plus interest plus the vested portion of the City's contributions. During the current year, the City was required to make contributions to the plan in the amount of \$123,315.

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 12 – Other Disclosures

Pledged Revenues

The City has pledged certain sewer and water revenues for the repayment of long-term debt obligations.

Economic Dependency

The City is dependent upon taxes and user fees received from the residents of the McFarland area.

Fund Deficits

The City had accumulated fund deficits in the following individual funds:

Governmental Funds:		
TDA - LTF	\$	(19,702)
HOME		(35,142)
RDA Debt Service		<u>(196,661)</u>
Total Governmental Funds	\$	<u>(251,505)</u>

The TDA-LTF and HOME deficits are a result of expenditures prior to grant reimbursement. The RDA Debt Service deficit resulted from initial funding of the Redevelopment Agency and will be satisfied with future tax revenues.

Date of Management Evaluation

Management has evaluated subsequent events through January 12, 2012, the date on which the financial statements were available to be issued.

Excess of Expenditures over Appropriations

For the year ended June 30, 2011, some expenditures exceeded appropriations. The over expenditures were funded from current tax revenue and charges for services. All City expenditures were approved by the City Council.

Contingencies

Property Tax Liability – The City has a contingent property tax liability for its share of tax refund claims pending against the County of Kern attributable to taxes paid by property owners but disputed. Because both the amount of the contingency and the expected outcome cannot be determined, the liability has not been provided for in the financial statements. At June 30, 2010, the latest date reported by the County, the contingent liability was \$23,658.

Federal and State Government Programs – The City participates in several federal and state grant programs. These programs have been audited, as needed, in accordance with the provisions of OMB Circular A-133 and applicable state requirements. Various Findings and Questioned Costs were noted and these programs are still subject to further examination by the grantors. Expenditures that may be disallowed by the granting agencies cannot be determined at this time. The City expects such amounts, if any, to be immaterial.

City of McFarland
NOTES TO THE BASIC FINANCIAL STATEMENTS
Year ended June 30, 2011

Note 13 – Subsequent Events

As a result of a June 29, 2011 state law, the McFarland Redevelopment Agency suspended activities and was subsequently dissolved. On January 12, 2012 the City Council passed a resolution to serve as successor to the Agency.

REQUIRED SUPPLEMENTARY INFORMATION

City of McFarland
SUPPLEMENTAL SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES (DEFICITS), BUDGET AND ACTUAL
GENERAL FUND
Year ended June 30, 2011

	Original Budget	Final Budget	Actual Amounts	Variance with Final Budget
Revenues:				
Taxes	\$ 1,652,000	\$ 1,652,000	\$ 1,744,383	\$ 92,383
Licenses & Permits	215,000	215,000	112,073	(102,927)
Fines, Forfeitures & Assessment	33,000	33,000	62,641	29,641
Use of Money or Property	55,000	55,000	107,992	52,992
Intergovernmental	117,500	117,500	261,223	143,723
Loan Repayments	140,000	140,000	-	(140,000)
Charges for Services	24,500	24,500	52,686	28,186
Contributions and Donations	75,000	75,000	77,029	2,029
Other Income	5,000	5,000	27,476	22,476
Total Revenues	2,317,000	2,317,000	2,445,503	128,503
Expenditures:				
Current:				
General Government	\$ 512,600	\$ 512,600	\$ 663,274	\$ 150,674
Public Safety	1,377,650	1,377,650	1,708,059	330,409
Public Works	414,040	414,040	611,793	197,753
Community Development	259,000	259,000	318,896	59,896
Capital Outlay	-	-	87,590	87,590
Debt Service:				
Principal Retirement	174,302	174,302	208,635	34,333
Interest and Finance Charges	72,984	72,984	1,956	(71,028)
Total Expenditures	2,810,576	2,810,576	3,600,203	789,627
Excess of Revenues Over (Under) Expenditures	(493,576)	(493,576)	(1,154,700)	(661,124)
Other Financing Sources (Uses):				
Transfers In	200,000	200,000	443,561	243,561
Transfers Out	(2,500)	(2,500)	(3,062)	(562)
Loan Proceeds	-	-	-	-
Total Other Financing Sources (Uses)	197,500	197,500	440,499	242,999
Net Change in Fund Balances	(296,076)	(296,076)	(714,201)	(418,125)
Fund Balances - Beginning	1,105,067	1,105,067	1,105,067	-
Total Liabilities & Fund Balances	\$ 808,991	\$ 808,991	\$ 390,866	\$ (418,125)

City of McFarland
SUPPLEMENTAL SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES (DEFICITS), BUDGET AND ACTUAL
TDA - LTF
Year ended June 30, 2011

	Original Budget	Final Budget	Actual Amounts	Variance with Final Budget
Revenues:				
Intergovernmental	\$ 470,790	\$ 470,790	\$ 608,869	\$ 138,079
Total Revenues	470,790	470,790	608,869	138,079
Expenditures:				
Current:				
Public Works	\$ 410,000	\$ 410,000	\$ 5,998	\$ (404,002)
Capital Outlay	-	-	412,057	412,057
Total Expenditures	410,000	410,000	418,055	8,055
Excess of Revenues Over (Under) Expenditures	60,790	60,790	190,814	130,024
Other Financing Sources (Uses):				
Transfers In	-	-	3,062	3,062
Transfers Out	(60,790)	(60,790)	-	60,790
Total Other Financing Sources (Uses)	(60,790)	(60,790)	3,062	63,852
Net Change in Fund Balances	-	-	193,876	193,876
Fund Balances - Beginning	(213,578)	(213,578)	(213,578)	-
Total Liabilities & Fund Balances	\$ (213,578)	\$ (213,578)	\$ (19,702)	\$ 193,876

City of McFarland
SUPPLEMENTAL SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES (DEFICITS), BUDGET AND ACTUAL
GAS TAX FUND
Year ended June 30, 2011

	Original Budget	Final Budget	Actual Amounts	Variance with Final Budget
Revenues:				
Intergovernmental	\$ 210,000	\$ 210,000	\$ 355,303	\$ 145,303
Total Revenues	210,000	210,000	355,303	145,303
Expenditures:				
Current:				
Public Works	\$ -	\$ -	\$ 8,552	\$ 8,552
Capital Outlay	-	-	225,200	225,200
Total Expenditures	-	-	233,752	233,752
Excess of Revenues Over (Under) Expenditures	210,000	210,000	121,551	(88,449)
Other Financing Sources (Uses):				
Transfers In	-	-	-	-
Transfers Out	(200,000)	(200,000)	(236,399)	(36,399)
Total Other Financing Sources (Uses)	(200,000)	(200,000)	(236,399)	(36,399)
Net Change in Fund Balances	10,000	10,000	(114,848)	(124,848)
Fund Balances - Beginning	184,915	184,915	184,915	-
Total Liabilities & Fund Balances	\$ 194,915	\$ 194,915	\$ 70,067	\$ (124,848)

City of McFarland
SUPPLEMENTAL SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES (DEFICITS), BUDGET AND ACTUAL
CDBG FUND
Year ended June 30, 2011

	Original Budget	Final Budget	Actual Amounts	Variance with Final Budget
Revenues:				
Intergovernmental	\$ -	\$ -	\$ 144,921	\$ 144,921
Total Revenues	-	-	144,921	144,921
Expenditures:				
Current:				
Community Development	\$ -	\$ -	\$ 56,700	\$ 56,700
Capital Outlay	-	-	668,877	668,877
Total Expenditures	-	-	725,577	725,577
Excess of Revenues Over (Under) Expenditures	-	-	(580,656)	(580,656)
Other Financing Sources (Uses):				
Transfers In	-	-	632,448	632,448
Transfers Out	-	-	(12,162)	(12,162)
Total Other Financing Sources (Uses)	-	-	620,286	620,286
Net Change in Fund Balances	-	-	39,630	39,630
Fund Balances - Beginning	(39,630)	(39,630)	(39,630)	-
Total Liabilities & Fund Balances	\$ (39,630)	\$ (39,630)	\$ -	\$ 39,630

City of McFarland

SUPPLEMENTAL SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES (DEFICITS), BUDGET AND ACTUAL HOME FUND Year ended June 30, 2011

	Original Budget	Final Budget	Actual Amounts	Variance with Final Budget
Revenues:				
Intergovernmental	\$ 800,000	\$ 800,000	\$ 658,267	\$ (141,733)
Total Revenues	800,000	800,000	658,267	(141,733)
Expenditures:				
Current:				
Community Development	\$ 800,000	\$ 800,000	\$ 691,414	\$ (108,586)
Capital Outlay	-	-	-	-
Total Expenditures	800,000	800,000	691,414	(108,586)
Excess of Revenues Over (Under) Expenditures	-	-	(33,147)	(33,147)
Other Financing Sources (Uses):				
Transfers In	-	-	-	-
Transfers Out	-	-	(1,995)	(1,995)
Total Other Financing Sources (Uses)	-	-	(1,995)	(1,995)
Net Change in Fund Balances	-	-	(35,142)	(35,142)
Fund Balances - Beginning	-	-	-	-
Total Liabilities & Fund Balances	\$ -	\$ -	\$ (35,142)	\$ (35,142)

City of McFarland
SUPPLEMENTAL SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES (DEFICITS), BUDGET AND ACTUAL
DEVELOPMENT IMPACT FUND
Year ended June 30, 2011

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
Revenues:				
Licenses & Permits	\$ 332,256	\$ 332,256	\$ 1,054,832	\$ 722,576
Use of Money or Property	11,744	11,744	9,213	(2,531)
Total Revenues	344,000	344,000	1,064,045	720,045
Expenditures:				
Current:				
Public Works	\$ -	\$ -	\$ 72,365	\$ 72,365
Capital Outlay	-	-	203,466	203,466
Total Expenditures	-	-	275,831	275,831
Excess of Revenues Over (Under) Expenditures	344,000	344,000	788,214	444,214
Other Financing Sources (Uses):				
Transfers In	-	-	-	-
Transfers Out	-	-	(825,453)	(825,453)
Total Other Financing Sources (Uses)	-	-	(825,453)	(825,453)
Net Change in Fund Balances	344,000	344,000	(37,239)	(381,239)
Fund Balances - Beginning	2,396,003	2,396,003	2,396,003	-
Total Liabilities & Fund Balances	\$ 2,740,003	\$ 2,740,003	\$ 2,358,764	\$ (381,239)

City of McFarland

SUPPLEMENTAL SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES (DEFICITS), BUDGET AND ACTUAL RDA DEBT SERVICE Year ended June 30, 2011

	Original Budget	Final Budget	Actual Amounts	Variance with Final Budget
Revenues:				
Taxes	\$ 77,150	\$ 77,150	\$ 42,031	\$ (35,119)
Other Income	-	-	-	-
Total Revenues	77,150	77,150	42,031	(35,119)
Expenditures:				
Current:				
Community Development	\$ 2,070	\$ 2,070	\$ 3,827	\$ 1,757
Debt Service:				
Principal Retirement	40,000	40,000	-	(40,000)
Tax Increment Pass-Through Payments	14,896	14,896	8,508	(6,388)
Interest and Finance Charges	3,630	3,630	-	(3,630)
County Administrative Fee	-	-	533	533
Total Expenditures	60,596	60,596	12,868	(47,728)
Excess of Revenues Over (Under) Expenditures	16,554	16,554	29,163	12,609
Other Financing Sources (Uses):				
Transfers In	-	-	-	-
Transfers Out	(15,430)	(15,430)	(138,406)	(122,976)
Total Other Financing Sources (Uses)	(15,430)	(15,430)	(138,406)	(122,976)
Net Change in Fund Balances	1,124	1,124	(109,243)	(110,367)
Fund Balances - Beginning	(87,418)	(87,418)	(87,418)	-
Total Liabilities & Fund Balances	\$ (86,294)	\$ (86,294)	\$ (196,661)	\$ (110,367)

City of McFarland
SUPPLEMENTAL SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES (DEFICITS), BUDGET AND ACTUAL
RDA CAPITAL PROJECTS
Year ended June 30, 2011

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
Revenues:				
Other Income	\$ -	\$ -	\$ -	\$ -
Total Revenues	-	-	-	-
Expenditures:				
Current:				
Community Development	\$ -	\$ -	\$ -	\$ -
Total Expenditures	-	-	-	-
Excess of Revenues Over (Under) Expenditures	-	-	-	-
Other Financing Sources (Uses):				
Transfers In	-	-	130,000	130,000
Transfers Out	-	-	-	-
Total Other Financing Sources (Uses)	-	-	130,000	130,000
Net Change in Fund Balances	-	-	130,000	130,000
Fund Balances - Beginning	-	-	-	-
Total Liabilities & Fund Balances	\$ -	\$ -	\$ 130,000	\$ 130,000

City of McFarland
SUPPLEMENTAL SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES (DEFICITS), BUDGET AND ACTUAL
RDA LOW & MODERATE INCOME HOUSING
Year ended June 30, 2011

	Original Budget	Final Budget	Actual Amounts	Variance with Final Budget
Revenues:				
Other Income	\$ -	\$ -	\$ -	\$ -
Total Revenues	-	-	-	-
Expenditures:				
Current:				
Community Development	\$ -	\$ -	\$ 39,413	\$ 39,413
Total Expenditures	-	-	39,413	39,413
Excess of Revenues Over (Under) Expenditures	-	-	(39,413)	(39,413)
Other Financing Sources (Uses):				
Transfers In	15,430	15,430	8,406	(7,024)
Transfers Out	-	-	-	-
Total Other Financing Sources (Uses)	15,430	15,430	8,406	(7,024)
Net Change in Fund Balances	15,430	15,430	(31,007)	(46,437)
Fund Balances - Beginning	42,125	42,125	42,125	-
Total Liabilities & Fund Balances	\$ 57,555	\$ 57,555	\$ 11,118	\$ (46,437)

**ADDITIONAL REPORTING REQUIRED BY
GOVERNMENT AUDITING STANDARDS**

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

To the Members of the City Council of the
City of McFarland, California:

We have audited the financial statements of the governmental activities, the business type activities and each major fund of the City of McFarland, California (City), as of and for the year ended June 30, 2011, which collectively comprise the City's basic financial statements and have issued our report thereon dated January 12, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings as items 2011-5 to 2011-10, 2011-15 and 2011-16, to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings as items 2011-1 to 2011-4, to be significant deficiencies.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of McFarland's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings as items 2011-9 to 2011-18.

This report is intended solely for the information and use of the management, City Council, others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Albert & Associates, LLP

Wasco, California
January 12, 2012

City of McFarland

SCHEDULE OF FINDINGS

June 30, 2011

2011-1 Segregation of Duties

Criteria and Condition: The City does not have adequate segregation of duties. Systems should be designed so employees do not oversee their own work.

Context: The City has a small staff and resources are limited.

Cause: The City's size and budget limit the number of office accounting employees.

Effect: There is an increased risk that accounting errors could go unnoticed.

Recommendation: The City should design and implement policies and procedures to help mitigate the lack of segregation of duties.

2011-2 Documentation and Monitoring of Internal Controls

Criteria and Condition: Internal controls should be documented and monitored to ensure systems are operating as intended. The City does not have adequate documentation or monitoring of internal controls.

Context: The City does not have a formal process of periodically reviewing internal controls in place and evaluating their effectiveness.

Cause: The City has not allocated sufficient resources to properly monitor and document internal controls.

Effect: There is an increase risk that accounting errors could go unnoticed.

Recommendation: The City should document their internal controls and implement a formal monitoring process.

2011-3 Bank Reconciliation Process

Criteria and Condition: As part of the monthly bank reconciliation process, the City compiles a list of outstanding checks. This list is not kept current.

Context: A review of the outstanding check list indicated old outstanding checks that were either unexplained or related to checks that had been voided but not reversed from the accounting system.

Cause: The monthly list of outstanding checks is not investigated as part of the bank reconciliation process.

Effect: The cash balance and certain expense account balances are misstated on the books.

Recommendation: The monthly bank reconciliation process should include a review of all outstanding checks with any old items investigated and adjusted if necessary.

City of McFarland

SCHEDULE OF FINDINGS

June 30, 2011

2011-4 Accounting for Capital Assets

Criteria and Condition: The City has a policy of only capitalizing capital expenditures over \$1,000. Also, in order to facilitate the budget process, the City expenses enterprise fund capital expenditures throughout the year. This accounting treatment is inconsistent with both policy and accounting method.

Context: The City capitalizes all expenditures irrespective of the capitalization policy and at year end, does not make an analysis to determine the necessary additions to the depreciation schedule. Furthermore, at year end, the City does not transfer enterprise fund capital expenditures out of the expense accounts and to the balance sheet accounts.

Cause: The monthly and year end accounting routines do not include analysis of accounting for capital assets.

Effect: Capital Asset addition information is not available to properly maintain the depreciation schedules and make the accounting entries necessary to record assets in the enterprise funds.

Recommendation: The monthly and annual accounting routines need to segregate capital expenditures above the capitalization policy threshold and at year end capitalize enterprise fund asset acquisitions.

2011-5 Miscoding of Transactions

Criteria and Condition: The normal accounts payable process includes the general ledger coding of expenditures. This is not always done correctly.

Context: The City sometimes miscodes expenditures. This tends to occur in the accounting for activities related to unique projects such as the expenditure of grant funds.

Cause: The miscoding of transactions was primarily caused by a lack of communication between the project administrator and the City's accounts payable department.

Effect: Expense account balances are misstated.

Recommendation: At the beginning of each new project, the project administrator should communicate any unusual reporting requirements to the accounts payable department. The project administrator should become part of the approval and bill paying process for these particular expenditures.

2011-6 City Council Approval of Contracts

Criteria and Condition: The City Council normally approves contracts entered into by the City. This was not always done.

Context: The City entered into three road construction contracts that were not approved in advance by the City Council. Also, in two of these cases, bids were not received.

City of McFarland

SCHEDULE OF FINDINGS

June 30, 2011

Cause: The lack of project management caused the failure to obtain advance City Council approval and caused the failure to obtain bids.

Effect: Construction projects are entered into outside the purview of the City Council.

Recommendation: City management should obtain City Council approval of all substantial construction projects.

2011-7 Bill Paying Documentation

Criteria and Condition: The accounts payable system of the City requires certain documents to substantiate expenditures. Together with various approvals, this process requires the receipt of vendor invoices or statements. Some expenditures were supported by suspicious documentation.

Context: The City paid different vendors' invoices that appeared strikingly similar in appearance to one another. The City also paid invoices that contained superficial information and were non-businesslike in appearance.

Cause: A lack of critical inspection of support documents by the accounts payable department, supported by the highest levels of management, caused the payment of suspicious invoices.

Effect: Fraudulent billings could be paid.

Recommendation: All vendor invoices should be critically inspected with unusual or suspicious documents investigated.

2011-8 Design of Internal Control

Criteria and Condition: The City does not have adequate design of internal control over significant processes.

Context: The City does not perform the following components of Internal Control:

- a. The City did not adjust Accrued income and expense amounts to the actual year end calculated balances for interest income and expense, water department franchise income, accrued vacation, and prepaid rent expense.
- b. The City did not consistently cancel original invoices upon payment to prohibit their reuse as support for duplicate payment. Furthermore, approval documentation on the invoice was often missing.

Cause: The City did not allocate sufficient resources to the accounting function.

Effect: Certain account balances are misstated at year end and improper bills could be paid.

Recommendation: The City should allocate adequate resources to the accounting department.

City of McFarland
SCHEDULE OF FINDINGS
June 30, 2011

2011-9 Use of Ineligible Contractors

Criteria and Condition: A certain grant program allowed for no use of ineligible contractors. The City did not comply with this requirement.

Context: A review of contractors utilized on the project disclosed that the primary contractor did not possess the required state license.

Cause: The lack of project management caused the failure to assure that the contractor possessed the required license.

Effect: Applicable grant costs could be questioned as a result of failing to hire a licensed contractor.

Recommendation: Appropriate management and oversight should be exercised to insure compliance with program requirements.

2011-10 Failure to Pay Prevailing Wage

Criteria and Condition: A certain grant program required the payment of prevailing wage rates required under Federal law. This was not always done.

Context: A contractor utilized on the project was paying wages below prevailing wage rates. The City also paid its own employees working on the project at a rate below prevailing wage.

Cause: The lack of project management caused the failure to assure that hired contractors paid prevailing wage and that the City's own employees were paid prevailing wage.

Effect: Applicable labor costs could be questioned as a result of failing to pay required wage rates.

Recommendation: Appropriate management and oversight should be exercised to insure compliance with program requirements.

2011-11 Failure to bid out Contracts

Criteria and Condition: Certain grant programs required that the City bid out contracts and submit invitations for bids to all listed potential bidders. Furthermore, the program required that the City publish a notice soliciting small business participation and obtain prior approval of such notices from the county. Not all contracts were bid out.

Context: The City failed to bid out a number of contracts and failed to publish notices as required.

Cause: The lack of project management caused the failure to follow the contracting provisions of the grant agreement.

City of McFarland

SCHEDULE OF FINDINGS

June 30, 2011

Effect: Applicable costs could be questioned as a result of failing to properly bid contracts.

Recommendation: Appropriate management and oversight should be exercised to insure compliance with program requirements.

2011-12 Failure to maintain Financial Management System

Criteria and Condition: A certain grant program required that the City maintain a financial management system that complies with Federal Standards for Financial Management Systems. The City comingled program expenditures with other activities and failed to comply with this requirement.

Context: A review of project expenditures disclosed a number of payments for non-Federal project activities.

Cause: The failure of project management to communicate expenditure classification to the City's accounting department caused inadequate accounting.

Effect: Due to the failure to segregate expenditures between qualifying and non-qualifying projects, the amount of non-qualifying expenditures is not determinable.

Recommendation: The City's accounts payable system should be modified to require proper project expenditure classification as part of the normal bill paying approval process.

2011-13 Reimbursement of Activity Delivery Costs

Criteria and Condition: A grant program allowed for reimbursement of Activity Delivery Costs up to 24% of construction costs. The City received reimbursements in excess of actual Activity Delivery Costs.

Context: The City submitted project drawdown requests that included an amount for Activity Delivery Costs which were simply calculated to be 24% of the related construction costs. This calculated amount exceeded actual Activity Delivery Costs incurred.

Cause: The lack of timely project management and recordkeeping caused the failure to request claim for reimbursement of Activity Delivery Costs in the proper amount.

Effect: \$49,192 of Activity Delivery Cost reimbursement claims could be questioned as a result of failing to properly prepare project drawdown requests.

Recommendation: Knowledgeable management and oversight should be exercised to insure compliance with program requirements.

City of McFarland

SCHEDULE OF FINDINGS

June 30, 2011

2011-14 Improper Pay off of Existing Deeds of Trust

Criteria and Condition: A grant program only allowed for reimbursement of construction costs plus certain grant amounts. The City paid off existing first deeds of trust which are expenditures outside the scope of allowable expenditures.

Context: The City paid off two existing first deeds of trust and included those payoff amounts in the new loan with the homeowner.

Cause: The lack of knowledgeable project management caused the un-allowed payoff of existing first deeds of trust.

Effect: \$103,914 of costs could be questioned as a result of paying off existing first deeds of trust.

Recommendation: Knowledgeable management and oversight should be exercised to insure compliance with program requirements

2011-15 Loans for amounts other than rehabilitation costs

Criteria and Condition: A grant program provided for loans to homeowners for costs associated with the rehabilitation of their residence. The City made loans for an amount different than the underlying rehabilitation costs.

Context: In one instance, the note receivable from the homeowner exceeded the expenditures made on behalf of the property. In four instances, the loan was less than the amount of home improvements.

Cause: The lack of timely project management and recordkeeping caused the failure to loan and amount corresponding to the rehabilitation costs associated with the property.

Effect: The one note receivable exceeded underlying property expenditures by \$31,856. The four notes receivable that were less than underlying expenditures totaled \$11,080.

Recommendation: Appropriate management and recordkeeping should be exercised to insure compliance with program requirements.

2011-16 Loan/Rehabilitation Compliance

Criteria and Condition: A grant program required the performance of various compliance procedures during the house rehabilitation / lending process. The City did not always follow this process.

Context: A review of the compliance documentation indicated numerous missing documents as well as missing signatures and dates. Furthermore, there were some documents that appeared to be processed either out of order or delayed. The recording of the deeds of trust to secure the underlying note receivable did not occur until months after the date of the promissory note.

City of McFarland

SCHEDULE OF FINDINGS

June 30, 2011

Cause: The lack of timely project management and recordkeeping caused the failure to timely prepare required documents and / or retain them in the files.

Effect: The note receivable from the homeowner may not be secured by a senior lien. Program compliance may not have always been followed.

Recommendation: Appropriate management and oversight should be exercised to insure compliance with program requirements.

2011-17 Reimbursement Claims off from Expenditures

Criteria and Condition: A grant program allowed for reimbursement of construction costs plus possible grants paid to homeowners. The project draw down request amounts did not equal actual qualifying expenditures.

Context: The amount of reimbursement claims exceeded the actual amount of City expenditures (including the payoff of existing first deeds of trust if made - see 2011-14) on all housing projects.

Cause: The lack of timely project management and recordkeeping caused the failure to apply for cost reimbursement corresponding to underlying costs incurred on the property.

Effect: Project drawdown requests could be questioned as a result of failing to properly prepare claim form documents.

Recommendation: Appropriate management and recordkeeping should be exercised to insure compliance with program requirements

2011-18 Bids not Advertised

Criteria and Condition: A grant program required that bidding for home rehabilitation contracts be advertised. Documentation indicated no advertising to solicit bids.

Context: The City failed to document that contracts were bid out.

Cause: The lack of timely project management and recordkeeping caused the failure to document bid advertising.

Effect: The costs charged to the program may be considered unallowable by the awarding agency.

Recommendation: Appropriate management and recordkeeping should be exercised to insure compliance with program requirements

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SINGLE AUDIT REPORTS AND SCHEDULES

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**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH
REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT
ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

The Honorable Mayor and City Council of the
City of McFarland, California:

Compliance

We have audited the City of McFarland's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the City of McFarland's major federal programs for the year ended June 30, 2011. The City of McFarland's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the City of McFarland's management. Our responsibility is to express an opinion on the City of McFarland's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City of McFarland's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the City of McFarland's compliance with those requirements.

As described in items 2011-11 to 2011-14 in the accompanying schedule of findings and questioned costs, the City of McFarland did not comply with grant requirements regarding the hiring of contractors, the payment of prevailing wages and the maintenance of a compliant financial management system applicable to its Community Development Block Grant. Compliance with such requirements is necessary, in our opinion, for the City to comply with requirements applicable to that program. Also, as described in items 2011-17 to 2011-21 in the accompanying schedule of findings and questioned costs, the City of McFarland did not comply with grant requirements regarding the proper claiming of costs for reimbursement that are applicable to its HOME Investment Partnerships Program. Compliance with such requirements is necessary, in our opinion, for the City to comply with requirements applicable to that program.

In our opinion, because of the effects of the noncompliance described in the preceding paragraph, the City of McFarland did not comply, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on the Community Development Block Grant and HOME Investment's Partnership Programs. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as item 2011-22.

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Internal Control Over Compliance

Management of the City of McFarland is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the City of McFarland's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City of McFarland's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2011-5 to 2011-10, 2011-15 and 2011-16 to be material weaknesses.

A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2011-1 to 2011-4 to be significant deficiencies.

This report is intended solely for the information and use of management, City Council, others within the City, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Albert & Associates, LLP

Wasco, California
January 12, 2012

City of McFarland
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year ended June 30, 2011

Federal Grantor/ Pass-through Grantor/ Program Title	Catalog of Federal Domestic Assistance Number	Grant Number / Pass-through Grantor's Number	Federal Expenditures
<u>U.S. Department of Housing and Urban Development</u>			
Pass-through State of California Dept. of Housing & Community Development HOME Investment Partnerships Program	14.239	08-HOME-4703	\$ 693,410
Pass-through County of Kern Community Development Block Grant	14.218	CD#16.04.7	668,877
Pass-through State of California Dept. of Housing & Community Development Pass-through City of Delano Neighborhood Stabilization Program	14.264	No. 2009-40	70,275
Total U.S. Department of Housing and Urban Development			<u>\$ 1,432,562</u>
Total Expenditures of Federal Awards			<u>\$ 1,432,562</u>

See accountant's notes to schedule of expenditures of federal awards

City of McFarland
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year ended June 30, 2011

Note A – Basis of Presentation

The accompanying schedule of expenditures of federal awards (the Schedule) includes the federal grant activity of the City of McFarland, California, under programs of the federal government for the year ended June 30, 2011. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of State, Local Governments, and Non-Profit Organizations*. Because the Schedule presents only a selected portion of the operations of the City of McFarland, it is not intended to and does not present the financial position, changes in net assets, or cash flows of the City of McFarland.

Note B – Summary of Significant Accounting Policies

- 1) Expenditures reported on the Schedule are reported generally using the modified-accrual basis of accounting for program expenditures accounted for in the governmental funds and the accrual basis of accounting for program expenditures accounted for in the proprietary funds, as described in Note 1 of the notes to the City of McFarland's basic financial statements. Such expenditures are recognized following the cost principles contained in OMB Circular A-122, *Cost Principles for Non-profit Organizations*, wherein certain types of expenditures are not allowable or are limited as to reimbursement.
- 2) Pass-through entity identifying numbers are presented where available.

City of McFarland
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
 Year ended June 30, 2011

A. Summary of Auditor's Results:

1. The auditor's report expresses an unqualified opinion on the financial statements of the City of McFarland.
2. Eight significant deficiencies disclosed during the audit of the financial statements are reported in the Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards. Four of the deficiencies are reported as material weaknesses.
3. No instances of noncompliance material to the financial statements of the City of McFarland, which would be required to be reported in accordance with Government Auditing Standards were disclosed during the audit.
4. Four significant deficiencies in internal control over major federal award programs disclosed during the audit are reported in the Independent Auditor's Report on Compliance with Requirements that Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133. The deficiencies are reported as material weaknesses.
5. The auditor's report on compliance for the major federal award programs for the City of McFarland expresses an adverse opinion on all major federal programs.
6. Audit findings that are required to be reported in accordance with Section 510(a) of OMB Circular A-133 are reported in this Schedule.
7. The programs tested as major programs include:

<u>CFDA Numbers</u>	<u>Program Title</u>
14.218	Community Development Block Grant
14.239	HOME Investment Partnerships Program

8. The threshold used for distinguishing between Type A and B programs was \$300,000.
9. The City of McFarland was determined not to be a low-risk auditee.

B. Findings – Financial Statement Audit

SIGNIFICANT DEFICIENCIES

2011-1 Segregation of Duties

Criteria and Condition: The City does not have adequate segregation of duties. Systems should be designed so employees do not oversee their own work.

Context: The City has a small staff and resources are limited.

City of McFarland
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year ended June 30, 2011

Cause: The City's size and budget limit the number of office accounting employees.

Effect: There is an increased risk that accounting errors could go unnoticed.

Recommendation: The City should design and implement policies and procedures to help mitigate the lack of segregation of duties.

2011-2 Documentation and Monitoring of Internal Controls

Criteria and Condition: Internal controls should be documented and monitored to ensure systems are operating as intended. The City does not have adequate documentation or monitoring of internal controls.

Context: The City does not have a formal process of periodically reviewing internal controls in place and evaluating their effectiveness.

Cause: The City has not allocated sufficient resources to properly monitor and document internal controls.

Effect: There is an increase risk that accounting errors could go unnoticed.

Recommendation: The City should document their internal controls and implement a formal monitoring process.

2011-3 Bank Reconciliation Process

Criteria and Condition: As part of the monthly bank reconciliation process, the City compiles a list of outstanding checks. This list is not kept current.

Context: A review of the outstanding check list indicated old outstanding checks that were either unexplained or had been voided but not reversed from the accounting system.

Cause: The monthly list of outstanding checks is not investigated as part of the bank reconciliation process.

Effect: The cash balance and certain expense account balances are misstated on the books.

Recommendation: The monthly bank reconciliation process should include a review of all outstanding checks with any old items investigated and adjusted if necessary.

2011-4 Accounting for Capital Assets

Criteria and Condition: The City has a policy of only capitalizing capital expenditures over \$1,000. Also, in order to facilitate the budget process, the City expenses enterprise fund capital expenditures throughout the year. This accounting treatment is inconsistent with both policy and accounting method.

City of McFarland
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year ended June 30, 2011

Context: The City capitalizes all expenditures irrespective of the capitalization policy and at year end, does not make an analysis to determine the necessary additions to the depreciation schedule. Furthermore, at year end, the City does not transfer enterprise fund capital expenditures out of the expense accounts and to the balance sheet accounts.

Cause: The monthly and year end accounting routines do not include analysis of accounting for capital assets.

Effect: Capital Asset addition information is not available to properly maintain the depreciation schedules and make the accounting entries necessary to record assets in the enterprise funds.

Recommendation: The monthly and annual accounting routines need to segregate capital expenditures above the capitalization policy threshold and at year end capitalize enterprise fund asset acquisitions.

MATERIAL WEAKNESSES

2011-5 Miscoding of Transactions

Criteria and Condition: The normal accounts payable process includes the general ledger coding of expenditures. This is not always done correctly.

Context: The City sometimes miscodes expenditures. This tends to occur in the accounting for activities related to unique projects such as the expenditure of grant funds.

Cause: The miscoding of transactions was primarily caused by a lack of communication between the project administrator and the City's accounts payable department.

Effect: Expense account balances are misstated.

Recommendation: At the beginning of each new project, the project administrator should communicate any unusual reporting requirements to the accounts payable department. The project administrator should become part of the approval and bill paying process for these particular expenditures.

2011-6 City Council Approval of Contracts

Criteria and Condition: The City Council normally approves contracts entered into by the City. This was not always done.

Context: The City entered into three road construction contracts that were not approved in advance by the City Council. Also, in two of these cases, bids were not received.

Cause: The lack of project management caused the failure to obtain advance City Council approval and caused the failure to obtain bids.

Effect: Construction projects are entered into outside the purview of the City Council.

City of McFarland
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Recommendation: City management should obtain City Council approval of all substantial construction projects.

2011-7 Bill Paying Documentation

Criteria and Condition: The accounts payable system of the City requires certain documents to substantiate expenditures. Together with various approvals, this process requires the receipt of vendor invoices or statements. Some expenditures were supported by suspicious documentation.

Context: The City paid different vendors' invoices that appeared strikingly similar in appearance to one another. The City also paid invoices that contained superficial information and were non-businesslike in appearance.

Cause: A lack of critical inspection of support documents by the accounts payable department as well as the highest levels of management, allowed the payment of suspicious invoices.

Effect: Fraudulent billings could be paid.

Recommendation: All vendor invoices should be critically inspected with unusual or suspicious documents investigated.

2011-8 Design of Internal Control

Criteria and Condition: The City does not have adequate design of internal control over significant processes.

Context: The City does not perform the following components of Internal Control:

a. The City did not adjust accrued income and expense amounts to the actual year end calculated balances for interest income and expense, water department franchise income, accrued vacation, and prepaid rent expense.

b. The City did not consistently cancel original invoices upon payment to prohibit their reuse as support for duplicate payment. Furthermore, approval documentation on the invoice was often missing.

Cause: The City did not allocate sufficient resources to the accounting function.

Effect: Certain account balances are misstated at year end and improper bills could be paid.

Recommendation: The City should allocate adequate resources to the accounting department.

City of McFarland
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C. Findings and Questioned Costs – Major Federal Award Programs Audit

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

2011-9 Community Development Block Grant – CFDA No. 14.218; Grant No., CD # 16.04.7, Grant period: Year Ended June 30, 2011

Material Deficiency: As discussed at Finding 2011-7, the City paid different vendors' invoices that appeared strikingly similar in appearance to one another. The City also paid invoices that contained superficial information and were non-businesslike in appearance. This indicates a lack of critical inspection of support documents that could give rise to the payment of fraudulent billings. All vendor invoices should be critically inspected with unusual or suspicious documents investigated.

2011-10 Community Development Block Grant – CFDA No. 14.218; Grant No., CD # 16.04.7, Grant period: Year Ended June 30, 2011

Material Deficiency: As discussed at Finding 2011-5, the City miscoded expenditures involving activities related to unique projects such as the expenditure of grant funds. This miscoding was primarily caused by a lack of communication between the project administrator and the City's accounts payable department. This could cause expense accounts to be misstated. At the beginning of each new project, the project administrator should communicate any unusual reporting requirements to the accounts payable department and the project administrator should become part of the approval and bill paying process.

2011-11 Community Development Block Grant – CFDA No. 14.218; Grant No., CD # 16.04.7, Grant period: Year Ended June 30, 2011

Questioned Costs: \$76,460. This questioned cost is included with the questioned costs at finding 2011-12.

Criteria and Condition: The program allows for no use of ineligible contractors. The program has not complied with this requirement.

Context: A review of contractors utilized on the project disclosed that the primary contractor did not possess the required state license.

Cause: The lack of project management caused the failure to verify that the contractor possessed the required license.

Effect: The costs charged to the program may be considered unallowable by the awarding agency.

Recommendation: Appropriate management and oversight should be exercised to insure compliance with program requirements.

City of McFarland
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2011-12 Community Development Block Grant – CFDA No. 14.218; Grant No., CD # 16.04.7, Grant period: Year Ended June 30, 2011

Questioned Costs: \$171,469

Criteria and Condition: The program requires the payment of prevailing wage rates required under Federal law which was not always done.

Context: A contractor utilized on the project paid wages below prevailing wage rates. The City also paid its own employees working on the project at a rate below prevailing wage.

Cause: The lack of project management caused the failure to assure that hired contractors paid prevailing wage and that the City's own employees were paid prevailing wage.

Effect: The costs charged to the program may be considered unallowable by the awarding agency.

Recommendation: Appropriate management and oversight should be exercised to insure compliance with program requirements.

2011-13 Community Development Block Grant – CFDA No. 14.218; Grant No., CD # 16.04.7, Grant period: Year Ended June 30, 2011

Questioned Costs: \$76,460. This questioned costs is included with the questioned costs at finding 2011-12.

Criteria and Condition: The program requires that the City bid out contracts and submit invitations for bids to all listed potential bidders. Furthermore, the program requires that the City publish a notice soliciting small business participation and obtain prior approval of such notices from the county. Not all contacts were bid out.

Context: The City failed to bid out a number of contracts and failed to publish notices as required.

Cause: The lack of project management caused the failure to follow the contracting provisions of the grant agreement.

Effect: The costs charged to the program may be considered unallowable by the awarding agency.

Recommendation: Appropriate management and oversight should be exercised to insure compliance with program requirements.

City of McFarland
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2011-14 Community Development Block Grant – CFDA No. 14.218; Grant No., CD # 16.04.7, Grant period: Year Ended June 30, 2011

Questioned Costs: None

Criteria and Condition: The program requires that the City maintain a financial management system that complies with Federal Standards for Financial Management Systems. The City commingled program expenditures with other activities and failed to comply with this requirement.

Context: A review of project expenditures disclosed a number of payments for non-Federal project activities. The total amount of both qualifying and non-qualifying expenditures was \$674,176.

Cause: The failure of project management to communicate expenditure classification to the City's accounting department caused inadequate accounting.

Effect: Due to the failure to segregate expenditures between qualifying and non-qualifying projects, the amount of non-qualifying expenditures is not determinable.

Recommendation: The City's accounts payable system should be modified to require proper project expenditure classifications as part of the normal bill paying approval process.

Total Questioned Costs – Community Development Block Grant \$171,469

2011-15 HOME Investment Partnerships Program - CFDA No.14.239; Grant No. 08-HOME-4703, Grant period: Year Ended June 30, 2011

Significant Deficiency: As discussed at Finding 2011-7, the City paid different vendors' invoices that appeared strikingly similar in appearance to one another. The City also paid invoices that contained superficial information and were non-businesslike in appearance. This indicates a lack of critical inspection of support documents that could give rise to the payment of fraudulent billings. All vendor invoices should be critically inspected with unusual or suspicious documents investigated.

2011-16 HOME Investment Partnerships Program - CFDA No.14.239; Grant No. 08-HOME-4703, Grant period: Year Ended June 30, 2011

Significant Deficiency: As discussed at Finding 2011-5, the City miscoded expenditures involving activities related to unique projects such as the expenditure of grant funds. This miscoding was primarily caused by a lack of communication between the project administrator and the City's accounts payable department. This could cause expense accounts to be misstated. At the beginning of each new project, the project administrator should communicate any unusual reporting requirements to the accounts payable department and the project administrator should become part of the approval and bill paying process.

City of McFarland
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**2011-17 HOME Investment Partnerships Program – CFDA No.14.239; Grant No. 08-HOME-4703,
Grant period: Year Ended June 30, 2011**

Questioned Costs: \$49,192

Criteria and Condition: The program allows for reimbursement of Activity Delivery Costs up to 24% of construction costs. The City received reimbursements in excess of actual Activity Delivery Costs.

Context: The City submitted Project Drawdown Requests that included an amount for Activity Delivery Costs which were simply calculated to be 24% of the related HOME Funds. This calculated amount exceeded actual Activity Delivery Costs incurred.

Cause: The lack of timely project management and recordkeeping caused the failure to request claim for reimbursement of Activity Delivery Costs in the proper amount.

Effect: The Activity Delivery Costs charged to the program may be considered unallowable by the awarding agency.

Recommendation: Knowledgeable management and oversight should be exercised to insure compliance with program requirements

**2011-18 HOME Investment Partnerships Program - CFDA No.14.239; Grant No. 08-HOME-4703, Grant
period: Year Ended June 30, 2011**

Questioned Costs: \$103,914

Criteria and Condition: The program only allows for reimbursement of construction costs plus certain grants allowed. The City paid off existing first deeds of trust which are expenditures outside the scope of allowable expenditures.

Context: The City paid off two existing first deeds of trust and included those payoff amounts in the new loan with the homeowner.

Cause: The lack of knowledgeable project management caused the un-allowed payoff of existing first deeds of trust.

Effect: The payment of existing first deeds of trust may be considered unallowable by the awarding agency.

Recommendation: Knowledgeable management and oversight should be exercised to insure compliance with program requirements

City of McFarland
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2011-19 HOME Investment Partnerships Program - CFDA No.14.239; Grant No. 08-HOME-4703, Grant period: Year Ended June 30, 2011

Questioned Costs: None

Criteria and Condition: The program provides for loans to homeowners for costs associated with the rehabilitation of their residence. The City made loans for an amount different than the underlying rehabilitation costs.

Context: In one instance, the note receivable from the homeowner exceeded the expenditures made on behalf of the property. In four instances, the loan was less than the amount of home improvements.

Cause: The lack of timely project management and recordkeeping caused the failure to loan an amount corresponding to the rehabilitation costs associated with the property.

Effect: The one note receivable exceeded underlying property expenditures by \$31,856. The four notes receivable that were less than underlying expenditures totaled \$11,080.

Recommendation: Appropriate management and recordkeeping should be exercised to insure compliance with program requirements.

2011-20 HOME Investment Partnerships Program - CFDA No.14.239; Grant No. 08-HOME-4703, Grant period: Year Ended June 30, 2011

Questioned Costs: None

Criteria and Condition: The program requires the performance of various compliance procedures during the house rehabilitation / lending process. The City did not always follow this process.

Context: A review of the compliance documentation indicated numerous missing documents as well as missing signatures and dates. Furthermore, there were some documents that appeared to be processed either out of order or delayed. The recording of the deeds of trust to secure the underlying note receivable did not occur until months after the date of the promissory note.

Cause: The lack of timely project management and recordkeeping caused the failure to timely prepare required documents and / or retain them in the files.

Effect: The note receivable from the homeowner may not be secured by a senior lien. Program compliance may not have always been followed.

Recommendation: Appropriate management and oversight should be exercised to insure compliance with program requirements.

City of McFarland
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**2011-21 HOME Investment Partnerships Program - CFDA No.14.239; Grant No. 08-HOME-4703,
Grant period: Year Ended June 30, 2011**

Questioned Costs: \$54,638

Criteria and Condition: The program allows for reimbursement of construction costs plus possible grants paid to homeowners. The Project draw down request amounts did not equal actual qualifying expenditures.

Context: The amount of HOME reimbursement claims exceeded the actual amount of City expenditures (including the payoff of existing first deeds of trust if made - see 2011-18) on all housing projects.

Cause: The lack of timely project management and recordkeeping caused the failure to apply for cost reimbursement corresponding to underlying costs incurred on the property.

Effect: The costs charged to the program may be considered unallowable by the awarding agency.

Recommendation: Appropriate management and recordkeeping should be exercised to insure compliance with program requirements

**2011-22 HOME Investment Partnerships Program - CFDA No.14.239; Grant No. 08-HOME-4703,
Grant period: Year Ended June 30, 2011**

Questioned Costs: None

Criteria and Condition: The program requires that bidding for the home rehabilitation contracts be advertised. Documentation did not exist to indicate that bids were advertised.

Context: The City failed to document that contracts were bid out.

Cause: The lack of timely project management and recordkeeping caused the failure document bid advertising.

Effect: The costs charged to the program may be considered unallowable by the awarding agency.

Recommendation: Appropriate management and recordkeeping should be exercised to insure compliance with program requirements

Total Questioned Costs – HOME Investment Partnerships Program \$207,744

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No Prior Audit Findings

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