



CITY OF MERCED, CALIFORNIA

**BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

City of Merced

Merced, California

Annual Financial Report

For the year ended June 30, 2012

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City of Merced
Annual Financial Report
For the year ended June 30, 2012

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GALLINA LLP
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITOR'S REPORT

To the Honorable Mayor and Members
of the City Council of the City of Merced
Merced, California

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Merced, California (the "City"), as of and for the year ended June 30, 2012, 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 *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of Merced, as of June 30, 2012, and the respective changes in financial positions 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 under separate cover our report dated February 6, 2013, on our consideration of the City of Merced's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements. 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.

To the Honorable Mayor and Members
of the City Council of the City of Merced
Merced, California
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Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, the Schedules of Revenue, Expenditures, and Changes in Fund Balances - Budget and Actual and the Schedules of Funding Progress, as listed in the table of contents, 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.



Roseville, California
February 6, 2013

MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the City of Merced (City), we offer readers of the City's financial statements this narrative overview and analysis of the financial activities of the City for the fiscal year ended June 30, 2012. We encourage readers to consider the information presented here in conjunction with additional information that is furnished in the letter of transmittal, which can be found in the introductory section of this report, and the City's Financial Statements, which follows this discussion.

IMPACT OF STATE LEGISLATION

- Pursuant to Assembly Bill 1X 26, the Redevelopment Agency of the City of Merced was dissolved on February 1, 2012. The dissolution of the Redevelopment Agency created an extraordinary item of \$31.3 million on the Statement of Activities and a negative \$1.8 million on the Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balance. Additional information about the dissolution of the Redevelopment Agency can be found in Note 18. Extraordinary Item - Redevelopment Agency Dissolution.

FINANCIAL HIGHLIGHTS

- The City's net assets as shown on the Statement of Activities increased by \$29.4 million. The governmental net assets increased by \$17.6 million and the business-type net assets increased by \$11.8 million.
- As shown on the Statement of Net Assets, the assets of the City exceeded its liabilities at the close of the fiscal year by \$614.5 million.
- At the end of the current fiscal year, the unassigned fund balance for the General Fund was \$7.4 million, or 51% percent of the General Fund fund balance.
- The net decrease to governmental activity long-term debt was \$38.2 million which was due to scheduled principal payments and termination of the related debt due to the dissolution of the Redevelopment Agency. Additional information about the dissolution of the Redevelopment Agency can be found in Note 18. Extraordinary Item - Redevelopment Agency Dissolution.
- The net decrease to the business-type activity long-term debt was \$7.4 million. The decrease was due to scheduled principal payments and the principal forgiveness of \$2 million on the California State Water Resources Control Board loan from the American Recovery and Reinvestment Act (ARRA), which was triggered by the completion of construction on the Wastewater Treatment Plant expansion project. The 2012 Series Water and Wastewater System Refunding Revenue Bonds were issued for \$17.9 million to refund the California Statewide Communities Development Authority (CACDA) Water and Wastewater Revenue Bonds Series 2005A.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the City of Merced's basic financial statements. The City of Merced's basic financial statements are comprised of three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the basic financial statements. This report also contains other required supplementary information.

Government-Wide Financial Statements-Government-wide Financial Statements are designed to provide readers with a broad overview of the City of Merced's finances, in a manner similar to a private-sector business.

OVERVIEW OF THE FINANCIAL STATEMENTS, Continued

The focus is on both the City as a whole and the fund financial statements, including the major individual funds of the governmental and business-type categories, as well as the fiduciary funds, (by fund type) and the component units. Both the government-wide and fund financial statements (within the basic financial statements) categorize primary activities as either governmental or business type. In the government-wide statement of net assets, both the governmental and business-type activities columns are presented on a consolidated basis by column, and are reflected, on a full accrual, economic resource basis, which incorporates long-term assets and receivables as well as long-term debt and obligations. Each presentation provides valuable information that can be analyzed and compared (between years and between governments) to enhance the usefulness of the information.

The Statement of Net Assets presents information on all of the City's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The Statement of Activities presents information showing how the government's net assets changed during the fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g. uncollected taxes and compensated absence).

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the City include general government, public safety, parks, and capital outlay. The business-type activities of the City include an airport, water, wastewater and refuse services.

The government-wide financial statements include not only the City itself (known as the primary government), but also the following legally separate entities for which the City is financially accountable:

- The City of Merced Redevelopment Agency (Agency)
- The City of Merced Public Financing and Economic Development Authority (Authority)
- The Parking Authority of the City of Merced (Parking Authority)

The financial information for these component units is blended with the City and reported in the governmental activities of the Government-wide Financial Statements and the Fund Financial Statements.

Fund Financial Statements- A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental Funds- Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

OVERVIEW OF THE FINANCIAL STATEMENTS, Continued

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City maintains forty individual governmental funds. Information is presented separately in the Governmental Funds Balance Sheet and in the Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances for the General Fund, Housing Special Revenue Fund, Low and Moderate Income Housing Fund, Streets and Signals Capital Projects Fund, and Public Financing Economic Development Authority Capital Project Fund, which are considered to be major funds. Data from the other thirty-six governmental funds are combined into a single, aggregated presentation.

The City adopts an annual appropriated budget for all its governmental funds. A budgetary comparison has been provided for the General Fund, Housing Special Revenue Fund and the Low and Moderate Income Housing in the Required Supplementary Information to demonstrate compliance with the budget.

Proprietary Funds- The City maintains two different types of proprietary funds. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City maintains five individual enterprise funds. Information is presented separately in the Proprietary Statement of Net Assets and the Proprietary Statement of Revenues, Expense and Changes in Fund Net Assets for the Wastewater System, Water System and Refuse Collection, which are considered major funds. Data from the other two proprietary funds are combined into a single, aggregated presentation. Internal service funds are an accounting device used to accumulate and allocate costs internally among the City's various functions. The City uses internal service funds to account for Worker's Compensation, Liability Insurance, Unemployment, Employee Benefits, Fleet Management, Fleet Replacement, Facility Maintenance, Support Services, Personal Computer Replacement and Public Works Administration. Because these services predominantly benefit governmental rather than business-type functions, they have been included within governmental activities in the Government-wide Financial Statements.

Fiduciary Funds- Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statement because the resources of those funds are not available to support the City's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds.

Notes to the Basic Financial Statements- The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Other Information- In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information concerning the City's progress in funding its obligation to provide pension and postemployment health care benefits to its employees and budgetary comparison schedules for the General Fund and major special revenue funds.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

As noted earlier, net assets may serve over time as a useful indicator of a governments' financial position. In the case of the City, assets exceeded liabilities by \$614.5 million at the close of the most recent fiscal year.

Summary of Net Assets

	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
Current and other assets	\$ 107,782,434	\$ 133,520,858	\$ 108,274,059	\$ 126,356,826	\$ 216,056,493	\$ 259,877,684
Capital assets	343,344,519	343,204,822	166,041,929	146,808,640	509,386,448	490,013,462
Total assets	451,126,953	476,725,680	274,315,988	273,165,466	725,442,941	749,891,146
Current liabilities	10,662,473	23,862,977	8,698,087	11,647,600	19,360,560	35,510,577
Noncurrent liabilities	32,052,697	62,046,082	59,481,467	67,243,491	91,534,164	129,289,573
Total liabilities	42,715,170	85,909,059	68,179,554	78,891,091	110,894,724	164,800,150
Net assets:						
Invested in capital assets, net of debt	340,674,993	300,226,422	114,734,369	80,020,736	455,409,362	380,247,158
Restricted	29,088,347	47,515,076	12,032,422	34,622,726	41,120,769	82,137,802
Unrestricted	38,648,443	43,075,123	79,369,643	79,630,913	118,018,086	122,706,036
Total net assets	\$ 408,411,783	\$ 390,816,621	\$ 206,136,434	\$ 194,274,375	\$ 614,548,217	\$ 585,090,996

The largest portion of the City's net assets, 74%, reflects its investment in capital assets (e.g., land and improvements, construction in progress, buildings and structures, machinery and equipment, and improvements other than buildings, structures and land improvements), less any related debt used to acquire those assets that is still outstanding. The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

Seven percent of the City's net assets represent resources that are subject to external restrictions on how they may be used. The remaining balance of \$118.0 million is the unrestricted net assets. The Governmental Activities unrestricted net assets of \$38.6 million include only \$4.3 million of funds that are unassigned. The Business-Type Activities restricted net assets of \$12 million include \$2.1 million of funds that are for specific projects and programs.

At the end of the current fiscal year, the City is able to report positive balances in all three categories of net assets, both for the government as a whole, as well as for its separate governmental and business-type activities.

GOVERNMENT-WIDE FINANCIAL ANALYSIS, Continued

Analysis of the City's Operations-The following table provides a summary of the changes in net assets for governmental and business-type activities.

	Statement of Activities					
	Governmental Activities		Business-type Activities		Total Government	
	2012	2011	2012	2011	2012	2011
Revenues						
Program revenues:						
Charges for services	\$ 10,456,569	\$ 14,335,029	\$ 46,104,253	\$ 43,566,056	\$ 56,560,822	\$ 57,901,085
Operating grants and contributions	14,212,898	8,473,837	1,295,142	1,772,760	15,508,040	10,246,597
Capital grants and contributions	8,939,200	10,256,032	2,550,000		11,489,200	10,256,032
General revenues and transfers:						
Property taxes	15,499,462	19,760,688	33,879	44,174	15,533,341	19,804,862
Sales taxes	12,173,010	11,442,904			12,173,010	11,442,904
Franchise taxes	1,541,714	1,555,272			1,541,714	1,555,272
Transient occupancy tax	894,418	717,508			894,418	717,508
Business license tax	1,091,483	1,067,420			1,091,483	1,067,420
Cost recovery impact study	73,707	14,487			73,707	14,487
Business improvement area	73,123	79,029			73,123	79,029
Other	1,926,299	430,086	1,559,143	855,953	3,485,442	1,286,039
Total revenues	66,881,883	68,132,292	51,542,417	46,238,943	118,424,300	114,371,235
Expenses						
Governmental activities:						
General government	27,533,277	22,593,791			27,533,277	22,593,791
Public Safety	31,047,015	27,605,798			31,047,015	27,605,798
Public Works	19,506,108	41,546,045			19,506,108	41,546,045
Parks	609,543	1,721,922			609,543	1,721,922
Other	2,003,185	2,000,680			2,003,185	2,000,680
Business-type activities:						
Wastewater system			12,903,776	12,304,995	12,903,776	12,304,995
Water system			12,573,036	10,895,212	12,573,036	10,895,212
Refuse collection			11,906,585	10,885,926	11,906,585	10,885,926
Merced municipal airport			1,011,166	877,123	1,011,166	877,123
Parks and Community Services			1,216,788	1,696,868	1,216,788	1,696,868
Total expenses	80,699,128	95,468,236	39,611,351	36,660,124	120,310,479	132,128,360
Increase in net assets before transfers and Extraordinary item	(13,817,245)	(27,335,944)	11,931,066	9,578,819	(1,886,179)	(17,757,125)
Transfers	69,007	1,205,374	(69,007)	(1,205,374)		
Extraordinary item-RDA Dissolution	31,343,400				31,343,400	
Increase in net assets	17,595,162	(26,130,570)	11,862,059	8,373,445	29,457,221	(17,757,125)
Net assets beginning of year	390,816,621	416,947,191	194,274,375	185,900,930	585,090,996	602,848,121
Net assets ending of year, as restated (Note 19)	\$ 408,411,783	\$ 390,816,621	\$ 206,136,434	\$ 194,274,375	\$ 614,548,217	\$ 585,090,996

Governmental Activities- Governmental Activities increased the City's net assets by \$17.5 million. Taxes provided 47% of the revenue and charges for services provided 16% of the revenue, and operating and capital grants and contributions provided 35% of the revenue received during the year. Pursuant to Assembly Bill 1X 26 (AB 1X 26) on February 1, 2012, the Redevelopment Agency was dissolved creating an extraordinary item of \$31.3 million. Additional information about the Redevelopment Agency dissolution can be found in Note 18. Extraordinary Item - Redevelopment Agency Dissolution.

GOVERNMENT-WIDE FINANCIAL ANALYSIS, Continued

The following table shows the cost of each of the City's major programs and the net cost of the programs. Net cost is the total cost less fees and other direct revenue generated by the activities. The net cost reflects the financial burden that was placed on the City's taxpayers by each of the programs.

**Net Cost of Governmental Activities
For the Fiscal Year Ended June 30, 2012**

	Total Cost of Services	Net Cost of Services
General Government	\$ 27,533,277	\$ (16,007,510)
Public Safety	31,047,015	(26,706,269)
Public Works	19,506,108	(3,049,516)
Parks	609,543	675,019
Interest on long-term debt	2,003,185	(2,003,185)
Total	\$ 80,699,128	\$ (47,091,461)

The costs for all governmental activities during the year were \$80.6 million, which is 67% of total expenses. The costs were paid for by \$33.6 million of program revenues, \$31.3 million of taxes and the balance was covered by interest and investment earnings, transfers and other revenues.

Business-type Activities-Business-type activities increased the City's net assets by \$11.8 million. This increase consists of fees collected for future capital projects. The revenues from the business-type activities total \$51.5 million. Program revenues of the City's business-type activities total \$49.9 million. Expenses of business-type activities were \$39.6 million. Transfers from the City's business-type activities were \$69,007.

FINANCIAL ANALYSIS OF THE GOVERNMENT'S FUNDS

As noted earlier, the City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds -The focus of the City's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the City's financing requirements. In particular, the unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

The City's governmental funds reported a combined fund balance at June 30, 2012 of \$45.3 million, a decrease of \$16.5 million. The net decrease was due to use of reserves or accumulated funds to maintain operations, finance capital projects and the extraordinary item caused by the dissolution of the Redevelopment Agency.

The General Fund is the chief operating fund of the City. The General Fund is used to account for all financial resources except those required to be accounted for in another fund. At the end of the current fiscal year, the fund balance of the General Fund was \$14.6 million and the unassigned fund balance was \$7.4 million. As a measure of the General Fund's liquidity, it may be useful to compare unassigned fund balance to total expenditures. The unassigned fund balance represents 19% of total General Fund expenditures.

FINANCIAL ANALYSIS OF THE GOVERNMENT'S FUNDS, Continued

The General Fund balance decreased by \$931,402 during the fiscal year. Sales tax and property tax are the primary revenues of the General Fund. Property tax decreased 2% while Sales tax increased by 6%. Due to the downturn in the economy, the City continues to follow a five year financial plan which was implemented in fiscal year 2009-10 that reduced expenditures and utilized General Fund reserves in order to maintain core services.

Other changes in fund balances include the following:

Housing Special Revenue Fund-

- This major fund increased by \$121,132 due to program income from the repayment on loans.

Low and Moderate Income Housing Special Revenue Fund-

- This major fund increased by \$2.8 million due to the transfer in and retention of the Housing assets and liabilities of the former Redevelopment Agency.

Streets & Signals Capital Projects Fund-

- This major fund increased by \$1.4 million due to developer revenue, grant funds and transfers in exceeding the capital outlay.

Public Financing and Economic Development Authority Capital Projects Fund-

- This major fund decreased by \$13.7 million due to the use of accumulated funds primarily for capital outlay.

Proprietary Funds - The City's proprietary funds provide the same type of information found in the Government-wide Financial Statements, but in more detail.

The unrestricted net assets of the Governmental Activities Internal Service Funds were \$8.6 million. The unrestricted net assets of the enterprise funds were \$79.3 million. The total change in net assets for the Governmental Activities Internal Service Funds and the Enterprise Funds were (\$4.5) million and \$11.8 million, respectively. Other factors concerning the finances of the Proprietary funds have been addressed in the discussion of the City's business-type activities.

GENERAL FUND BUDGETARY HIGHLIGHTS

During the fiscal year, the City Council approved budgetary revisions for supplemental appropriations, which increased appropriations in individual funds and transfers between funds.

The difference between the General Fund original budget and the final budget was an increase of \$2.1 million, which includes machinery and equipment, professional services, utilities and personnel related expenditures. The actual expenditures were under budget by \$2.4 million.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets - The City of Merced's investment in capital assets for its governmental and business-type activities as of June 30, 2012, amounted to \$509.3 million. This investment in capital assets includes land and improvements, construction in progress, buildings and structures, machinery and equipment, improvements other than buildings, structures, and land improvement. Additional information on the City of Merced's capital assets can be found in Note 6. Capital Assets.

CAPITAL ASSET AND DEBT ADMINISTRATION, Continued

Capital Assets

	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
	Non-depreciable Assets:					
Land and improvements	\$ 87,121,374	\$ 70,604,091	\$ 1,899,420	\$ 258,681	\$ 89,020,794	\$ 70,862,772
Construction in progress	28,677,098	32,775,969	43,117,688	59,200,465	71,794,786	91,976,434
Total non-depreciable assets	115,798,472	103,380,060	45,017,108	59,459,146	160,815,580	162,839,206
Depreciable Assets:						
Building and structures	22,926,121	20,848,739	4,287,506	4,287,506	27,213,627	25,136,245
Machinery and equipment	37,862,996	39,092,958	4,005,739	3,946,444	41,868,735	43,039,402
Improvements other than buildings, structures and land improvements	90,383,268	91,118,560	133,209,672	94,788,581	223,592,940	185,907,141
Infrastructure	371,510,054	371,570,534	37,499,142	36,878,107	409,009,196	408,448,641
Accumulated depreciation	(295,136,392)	(282,806,029)	(57,977,238)	(52,551,144)	(353,113,630)	(335,357,173)
Total depreciable assets, net	227,546,047	239,824,762	121,024,821	87,349,494	348,570,868	327,174,256
Total capital assets	\$ 343,344,519	\$ 343,204,822	\$ 166,041,929	\$ 146,808,640	\$ 509,386,448	\$ 490,013,462

The change to capital assets during the current fiscal year included the following costs:

- G Grade BNSF Railroad Separation of \$4.9 million.
- Wastewater Treatment Plant Phase 5 solids handling of \$19.6 million.
- Central Merced Street Reconstruction on 16th and 18th Streets of \$1.0 million.
- Relocation and Replacement of utilities on 16th street and Highway 99 of \$1.5 million.
- Yosemite Avenue Widening of \$1.8 million.
- Energy upgrades to heating and air conditioning, lighting, and irrigation of \$2.3 million.

Long-term debt - At the end of the current fiscal year, the City had \$73.5 million in outstanding debt consisting of pension obligation bonds, revenue bonds, capital lease, improvement bonds, participation and development agreements, loans payable and loan guarantees payable. All of the debt was secured or earmarked by specific revenue sources.

	Outstanding Debt June 30, 2012					
	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
Pension obligation bonds	\$ 6,485,000	\$ 6,690,000	\$	\$	\$ 6,485,000	\$ 6,690,000
Tax allocation bonds payable		32,372,825				32,372,825
Loan payable	250,000	5,350,000			250,000	5,350,000
Loan guarantee		554,869				554,869
Capital Lease	7,157,493	7,157,493			7,157,493	7,157,493
Revenue bonds payable			19,803,425	23,748,115	19,803,425	23,748,115
Water Well Development Agreement			24,016	47,086	24,016	47,086
Loan payable			39,818,179	42,632,841	39,818,179	42,632,841
Improvement bonds payable				645,000		645,000
Lease agreement						
Total	\$ 13,892,493	\$ 52,125,187	\$ 59,645,620	\$ 67,073,042	\$ 73,538,113	\$ 119,198,229

During the current fiscal year, the City's net debt decreased by \$45.6 million or 38% which includes the scheduled principal payments, the principal forgiveness of \$2 million on the California State Water Resources Control Board loan from the American Recovery and Reinvestment Act (ARRA), which was triggered by the completion of construction on the Wastewater Treatment Plant expansion project, and elimination of debt of \$32.7 million due to the dissolution of the Redevelopment Agency. Additional information on the City of Merced's debt can be found in Note 9. Long-Term Debt.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

- Positive local economic factors for fiscal year 2012-13 include increasing enrollment at the University of California, Merced, expansion of Mercy Hospital operations, increase in automobile sales and decline in the supply of single family housing stock.
- The City used General Fund reserves in an attempt to maintain City services. The General Fund original budget for fiscal year 2012-13 includes the use of \$1.6 million of reserves. After the City and four employee bargaining units agreed, in July and August of 2012, on employee concessions in the areas of health and welfare benefits and retirement contributions, the adjusted budget reduced the use of General Fund reserves to \$306,729.
- The Enterprise Funds have maintained a healthy financial position through the economic downturn and recovery period. The practice is to conduct periodic rate studies to validate the revenues are sufficient. A rate study for the sewer fees was prepared in 2011 and rate studies for the water and refuse fees are planned for fiscal year 2012-13. The Enterprise Funds will add three new positions in fiscal year 2012-13 to comply with State mandates on Clean Water and Refuse Recycling.

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the City of Merced's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Finance Officer, City of Merced, 678 West 18th Street, Merced, CA, 9534

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BASIC FINANCIAL STATEMENTS

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GOVERNMENT-WIDE FINANCIAL STATEMENTS

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CITY OF MERCED
Statement of Net Assets
June 30, 2012

	Governmental Activities	Business-Type Activities	Totals
ASSETS			
Current assets:			
Cash, cash equivalents and investments	\$ 51,614,834	\$ 92,934,118	\$ 144,548,952
Restricted cash held by fiscal agents	190,441		190,441
Receivables	14,785,976	13,142,169	27,928,145
Internal balances	(156,395)	156,395	
Prepaid items	4,230		4,230
Inventory	151,034	171,545	322,579
Total current assets	66,590,120	106,404,227	172,994,347
Noncurrent assets:			
Land held for resale	3,960,723		3,960,723
Notes receivable	31,756,928	11,796	31,768,724
Deferred charges		1,858,036	1,858,036
Prepaid pension asset	5,474,663		5,474,663
Capital assets:			
Non-depreciable	115,798,472	45,017,108	160,815,580
Depreciable, net of accumulated depreciation	227,546,047	121,024,821	348,570,868
Total noncurrent assets	384,536,833	167,911,761	552,448,594
Total assets	451,126,953	274,315,988	725,442,941
LIABILITIES			
Current liabilities:			
Accounts payable	2,039,266	3,713,676	5,752,942
Payroll liabilities	691,000	169,014	860,014
Deposits and other liabilities	5,116,890	1,117,395	6,234,285
Unearned revenue	132,485	249,030	381,515
Accrued interest payable	195,540	166,302	361,842
Claims liability, due within one year	1,297,729		1,297,729
Compensated absences, due within one year	572,146	56,707	628,853
Long-term debt, due within one year	617,417	3,225,963	3,843,380
Total current liabilities	10,662,473	8,698,087	19,360,560
Noncurrent liabilities:			
Claims liability, due in more than one year	2,666,960		2,666,960
Compensated absences, due in more than one year	2,812,243	575,227	3,387,470
Long-term debt, due in more than one year	13,275,076	56,419,658	69,694,734
Net other postemployment benefits obligation	13,298,418	2,486,582	15,785,000
Total noncurrent liabilities	32,052,697	59,481,467	91,534,164
Total liabilities	42,715,170	68,179,554	110,894,724
NET ASSETS			
Invested in capital assets, net of related debt	340,674,993	114,734,369	455,409,362
Restricted for:			
Streets and street lights	1,742,329		1,742,329
Community development	11,186,117		11,186,117
Housing	597,670		597,670
Public safety	5,567,799		5,567,799
Special districts	2,155,020		2,155,020
Other special projects and programs	328,423	2,156,329	2,484,752
Debt service	134,887	53,944	188,831
Capital projects	7,362,818	9,822,149	17,184,967
Unrestricted	38,661,727	79,369,643	118,031,370
Total net assets	\$ 408,411,783	\$ 206,136,434	\$ 614,548,217

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

CITY OF MERCED

Statement of Activities and Changes in Net Assets

For the Year Ended June 30, 2012

Functions/Programs	Expenses	Program Revenues			Total
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	
Governmental activities:					
General government	\$ 27,533,277	\$ 2,222,342	\$ 8,127,249	\$ 1,176,176	\$ 11,525,767
Public safety	31,047,015	2,606,551	1,735,195		4,341,746
Public works	19,506,108	5,612,181	4,165,454	6,678,957	16,456,592
Parks	609,543	15,495	185,000	1,084,067	1,284,562
Interest on long-term debt	2,003,185				
Total governmental activities	80,699,128	10,456,569	14,212,898	8,939,200	33,608,667
Business-Type activities:					
Wastewater system	12,903,776	20,033,662	460,753	2,550,000	23,044,415
Water system	12,573,036	13,582,154	14,989		13,597,143
Refuse collection system	11,906,585	11,662,877	680,097		12,342,974
Merced municipal airport	1,011,166	448,073	139,303		587,376
Recreation and parks	1,216,788	377,487			377,487
Total business-type activities	39,611,351	46,104,253	1,295,142	2,550,000	49,949,395
Total government	\$ 120,310,479	\$ 56,560,822	\$ 15,508,040	\$ 11,489,200	\$ 83,558,062

General Revenues:

Taxes:

Property

Sales

Franchise taxes

Transient occupancy taxes

Business license tax

Business improvement tax

Cost recovery impact study

Total taxes

Interest and investment earnings

Other

Transfers

Extraordinary item - RDA dissolution

Total general revenues and transfers

Change in net assets

Net Assets:

Beginning of year, as restated (note 19)

End of year

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

Net (Expense) Revenue and
Changes in Net Assets

Governmental Activities	Business-Type Activities	Total
\$ (16,007,510)	\$	\$ (16,007,510)
(26,705,269)		(26,705,269)
(3,049,516)		(3,049,516)
675,019		675,019
(2,003,185)		(2,003,185)
<u>(47,090,461)</u>		<u>(47,090,461)</u>
	10,140,639	10,140,639
	1,024,107	1,024,107
	436,389	436,389
	(423,790)	(423,790)
	<u>(839,301)</u>	<u>(839,301)</u>
	<u>10,338,044</u>	<u>10,338,044</u>
<u>(47,090,461)</u>	<u>10,338,044</u>	<u>(36,752,417)</u>
15,499,462	33,879	15,533,341
12,173,010		12,173,010
1,541,714		1,541,714
894,418		894,418
1,091,483		1,091,483
73,123		73,123
73,707		73,707
<u>31,346,917</u>	<u>33,879</u>	<u>31,380,796</u>
1,222,658	1,546,082	2,768,740
703,641	13,061	716,702
69,007	(69,007)	
<u>31,343,400</u>		<u>31,343,400</u>
<u>64,685,623</u>	<u>1,524,015</u>	<u>66,209,638</u>
17,595,162	11,862,059	29,457,221
390,816,621	194,274,375	585,090,996
<u>\$ 408,411,783</u>	<u>\$ 206,136,434</u>	<u>\$ 614,548,217</u>

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GOVERNMENTAL FUND FINANCIAL STATEMENTS

General Fund - This fund is used to account for financial resources applicable to the General Governmental Operations of the City of Merced which are not required to be accounted for in another fund.

Housing Special Revenue Fund - This fund is used to account for programs and activities aimed at benefiting low and moderate income persons. The Block Grant is used for providing loans to low and moderate income persons for rehabilitation of dwelling units, and support to other funds which provide grant-eligible services such as Community Police.

Low and Moderate Income Housing Special Revenue Fund - This fund is used to account for the housing activities. On January 12, 2012, the City Council adopted Resolution 2012-5 electing the City of Merced to assume all rights, powers, assets, liabilities, duties, and obligations associated with the housing activities of the Redevelopment Agency.

Streets and Signals Capital Projects Fund - This fund is used to account for projects which are funded by State and Federal sources and Public Facilities Impact Fees.

Public Financing and Economic Development Authority Capital Projects Fund - This fund is used to account for the financial resources used in the acquisition and construction of major capital facilities.

CITY OF MERCED
Balance Sheet
Governmental Funds
June 30, 2012

	General Fund	Housing Special Revenue	Low and Moderate Income Housing Special Revenue
ASSETS			
Cash, cash equivalents and investments	\$ 10,569,305	\$ 705,561	\$ 17,569
Restricted cash held by fiscal agents	47		
Receivables:			
Accounts	512,823	485	
Due from other governments	2,446,309	1,499,823	
Interest	20,390	358,571	120,943
Due from other funds	27,833		
Inventory	41,781		
Land held for resale		1,208,593	1,603,665
Notes receivable		19,615,635	10,190,153
Advances to other funds	1,710,992		
Total assets	\$ 15,329,480	\$ 23,388,668	\$ 11,932,330
LIABILITIES AND FUND BALANCES			
Liabilities:			
Accounts payable	\$ 107,631	\$ 51,571	\$
Payroll liabilities	441,682	10,115	
Deferred revenue	124,942	20,149,137	9,051,172
Due to other funds		1,300,000	
Advances from other funds			
Other liabilities	16,267	2,959	
Total liabilities	690,522	21,513,782	9,051,172
Fund balances:			
Nonspendable	1,752,772	1,208,593	1,603,664
Restricted	4,000,000	666,293	1,277,494
Committed			
Assigned	1,432,911		
Unassigned	7,453,275		
Total fund balances	14,638,958	1,874,886	2,881,158
Total liabilities and fund balances	\$ 15,329,480	\$ 23,388,668	\$ 11,932,330

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

Streets & Signals Capital Projects	Public Financing and Economic Development Authority Capital Projects	Non-Major Governmental Funds	Total
\$	\$ 551,998	\$ 20,349,147	\$ 32,193,580
			47
1,817,068	166,597	1,225,232	3,722,205
3,180,466	530,433	2,712,943	10,369,974
	7,694	49,410	557,008
	1,300,000	1,743,356	3,071,189
			41,781
		1,148,465	3,960,723
		1,951,140	31,756,928
	237,500		1,948,492
<u>\$ 4,997,534</u>	<u>\$ 2,794,222</u>	<u>\$ 29,179,693</u>	<u>\$ 87,621,927</u>
\$ 1,141,823	\$ 64,745	\$ 184,108	\$ 1,549,878
		163,848	615,645
		454,876	29,780,127
528,770	1,066,606	340,590	3,235,966
		1,948,492	1,948,492
		5,077,151	5,096,377
<u>1,670,593</u>	<u>1,131,351</u>	<u>8,169,065</u>	<u>42,226,485</u>
		1,148,465	5,713,494
3,326,941	1,662,871	21,769,552	32,703,151
		1,199,097	1,199,097
			1,432,911
		(3,106,486)	4,346,789
<u>3,326,941</u>	<u>1,662,871</u>	<u>21,010,628</u>	<u>45,395,442</u>
<u>\$ 4,997,534</u>	<u>\$ 2,794,222</u>	<u>\$ 29,179,693</u>	<u>\$ 87,621,927</u>

CITY OF MERCED
Reconciliation of the Governmental Funds Balance Sheet
to the Government-Wide Statement of Net Assets
June 30, 2012

Total Fund Balances - Total Governmental Funds **\$ 45,395,442**

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

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the governmental funds.

Non-depreciable, net of Internal Service Fund assets of \$22,618	115,775,854	
Depreciable, net of accumulated depreciation and net of Internal Service Fund assets of \$7,127,390	<u>220,418,657</u>	336,194,511

The prepaid pension asset resulting from contributions in excess of the annual required contribution are not financial resources and therefore not reported in the funds.	5,474,663
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Long-term liabilities are not due and payable in the current period, and therefore are not reported in the governmental funds.

Long-term debt due within one year	(495,000)	
Long-term debt due in more than one year	(6,240,000)	
Net other postemployment health care benefits obligation, net of Internal Service Fund obligation of \$1,243,834	(12,054,584)	
Compensated absences, net of Internal Service Fund liability of \$372,109	<u>(3,012,280)</u>	(21,801,864)

Deferred revenues recorded in the governmental funds resulting from activities in which revenues were earned but funds were not available are reclassified as revenues in the Government-Wide Financial Statements.	29,647,642
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Interest payable on long-term debt does not require current financial resources. Therefore, interest payable is not reported as a liability in the governmental funds.	(87,271)
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Internal service funds are used by management to charge the costs of certain activities to individual funds. This amount represents the net assets of the Internal Service Funds.	<u>13,588,660</u>
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Net assets of governmental activities	<u><u>\$ 408,411,783</u></u>
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CITY OF MERCED
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2012

	General Fund	Housing Special Revenue	Low and Moderate Income Housing Special Revenue
REVENUES:			
Taxes	\$ 22,715,567	\$	\$
Intergovernmental	1,298,970	3,765,532	25,866
Licenses and permits	25,335		
Use of money and property	302,829	12,181	5,816
Service charges	6,015,742	274,850	
Fines, forfeitures and penalties	543,510		
Other	256,943	81,724	
Total revenues	<u>31,158,896</u>	<u>4,134,287</u>	<u>31,682</u>
EXPENDITURES:			
Current operating:			
General government	4,982,519	1,558,808	2,967
Public safety	24,159,207		
Public works	1,751,927		
Parks			
Total current operating	<u>30,893,653</u>	<u>1,558,808</u>	<u>2,967</u>
Capital outlay		898,131	(201,582)
Debt Service:			
Principal	205,000		
Interest	387,781		
Total expenditures	<u>31,486,434</u>	<u>2,456,939</u>	<u>(198,615)</u>
REVENUES OVER (UNDER) EXPENDITURES	<u>(327,538)</u>	<u>1,677,348</u>	<u>230,297</u>
OTHER FINANCING SOURCES (USES):			
Sale of capital assets	15,206	889,591	
Transfers in	831,078		2,650,861
Transfers out	(1,450,148)	(2,445,807)	
Total other financing sources (uses)	<u>(603,864)</u>	<u>(1,556,216)</u>	<u>2,650,861</u>
EXTRAORDINARY ITEM:			
RDA dissolution			
NET CHANGE IN FUND BALANCES	(931,402)	121,132	2,881,158
FUND BALANCES:			
Beginning of year	15,570,360	1,753,754	
End of year	<u>\$ 14,638,958</u>	<u>\$ 1,874,886</u>	<u>\$ 2,881,158</u>

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

Streets & Signals Capital Projects	Public Financing and Economic Development Authority Capital Projects	Non-Major Governmental Funds	Total
\$ 6,678,957	\$ 157,496	\$ 8,631,350	\$ 31,346,917
		4,928,387	16,855,208
		550,728	576,063
162	62,640	768,774	1,152,402
		6,786,287	13,076,879
		68,827	612,337
1,009,338	1,157,382	597,482	3,102,869
<u>7,688,457</u>	<u>1,377,518</u>	<u>22,331,835</u>	<u>66,722,675</u>
	3,956,232	5,877,985	16,378,511
		5,868,035	30,027,242
		5,822,451	7,574,378
		62,938	62,938
	3,956,232	17,631,409	54,043,069
11,281,725	5,957,509	4,525,980	22,461,763
		4,821,071	5,026,071
		1,679,630	2,067,411
<u>11,281,725</u>	<u>9,913,741</u>	<u>28,658,090</u>	<u>83,598,314</u>
<u>(3,593,268)</u>	<u>(8,536,223)</u>	<u>(6,326,255)</u>	<u>(16,875,639)</u>
	875,000	91,378	1,871,175
5,347,139	1,670,236	14,014,828	24,514,142
(295,850)	(7,789,834)	(12,303,427)	(24,285,066)
<u>5,051,289</u>	<u>(5,244,598)</u>	<u>1,802,779</u>	<u>2,100,251</u>
		(1,818,650)	(1,818,650)
1,458,021	(13,780,821)	(6,342,126)	(16,594,038)
1,868,920	15,443,692	27,352,754	61,989,480
<u>\$ 3,326,941</u>	<u>\$ 1,662,871</u>	<u>\$ 21,010,628</u>	<u>\$ 45,395,442</u>

CITY OF MERCED

Reconciliation of the Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balance to the Government-Wide Statement of Activities and Changes in Net Assets For the Year Ended June 30, 2012

Net Change in Fund Balances - Total Governmental Funds	\$ (16,594,038)
Amounts reported for governmental activities in the Statement of Activities are different because:	
Governmental funds report acquisition of capital assets as part of capital outlay expenditures. However in the Government-Wide Statement of Activities and Changes in Net Assets, the cost of those assets is allocated over their estimated useful lives as depreciation expense.	12,726,204
Depreciation expense on capital assets was reported in the Government-Wide Statement of Activities and Changes in Net Assets, but it did not require the use of current financial resources. Therefore, depreciation expense was not reported as expenditures in the governmental funds. This amount is net of internal service fund depreciation expense of \$2,121,324.	(12,299,272)
Loss on disposal of capital assets was reported in the Government-Wide Statement of Activities and Changes in Net Assets, but it did not require the use of current financial resources. Therefore, the loss was not reported as expenditures in the governmental funds.	(1,169,089)
Revenue in the Government-Wide Statement of Activities and Changes in Net Assets which do not require the use of current financial resources are not reported as revenue in the governmental funds. These revenues are reported as loans receivable and deferred revenues in the governmental funds.	3,908,052
Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Government-Wide Statement of Net Assets. The issuance of long-term debt provides current financial resources to governmental funds but does not have any effect on the Government-Wide Statement of Activities and Changes in Net Assets.	
Principal payment	5,070,014
Extraordinary item from dissolution of Redevelopment Agency	33,162,680
The liability for compensated absences does not require the use of current financial resources. As a result, these costs were not recorded in the governmental funds. This amount represents the current year's costs which were recorded in the Government-Wide Statement of Activities and Changes in Net Assets.	(111,538)
Some expenses reported in the Government-Wide Statement of Activities and Changes in Net Assets do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.	
Change in net other postemployment health care benefits obligation, net of Internal Service Fund obligation expense of \$345,717	(2,651,328)
Change in prepaid pension asset	(271,733)
Interest expense on long-term debt is reported in the Government-Wide Statement of Activities and Changes in Net Assets, but it does not require the use of current financial resources. Therefore, accrued interest expense is not reported as expenditures in the governmental funds. The following amount represents the change in accrued interest from the prior year.	352,792
Internal service funds are used by management to charge the costs of certain activities to individual funds. The change in Net Assets of the internal service funds is reported with governmental activities.	(4,527,582)
Change in Net Assets of Governmental Activities	\$ 17,595,162

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

PROPRIETARY FUND FINANCIAL STATEMENTS

Wastewater System - This fund is used to account for the City's wastewater utility, which provides wastewater collection and treatment services to the residents of the City and some residents of the County.

Water System - This fund is used to account for the City's water utility, which provides water delivery services to the residents of the City and some residents of the County.

Refuse Collection System - This fund is used to account for the collection and disposal of municipal solid waste for industrial, commercial and residential customers.

Internal Service Funds - These funds were used to account for the financing of goods or services provided by one department or agency to other departments or agencies of the City and to other governmental units, on a cost reimbursement basis.

CITY OF MERCED
Statement of Net Assets
Proprietary Funds
June 30, 2012

	Business-type Activities Major Enterprise Funds		
	Wastewater System	Water System	Refuse Collection System
ASSETS			
Current assets:			
Cash, cash equivalents and investments	\$ 38,501,809	\$ 48,425,505	\$ 5,871,076
Cash held by fiscal agents			
Accounts receivable, net	1,817,507	1,001,537	84,212
Due from other governments	5,523,194	3,749,806	642,274
Interest receivable	64,746	81,105	9,903
Prepaid items			
Due from other funds			
Inventory		171,545	
Total current assets	<u>45,907,256</u>	<u>53,429,498</u>	<u>6,607,465</u>
Noncurrent assets:			
Notes receivable-private parties	11,796		
Advances to other funds		395,888	
Deferred charges	1,470,944	387,092	
Capital assets:			
Non-depreciable	40,258,171	3,368,788	860,608
Depreciable, net of accumulated depreciation	65,681,942	34,326,156	14,537,533
Total noncurrent assets	<u>107,422,853</u>	<u>38,477,924</u>	<u>15,398,141</u>
Total assets	<u>153,330,109</u>	<u>91,907,422</u>	<u>22,005,606</u>
LIABILITIES			
Current liabilities:			
Accounts payable	2,671,768	418,007	585,900
Payroll payable	53,483	43,376	54,459
Unearned revenue	106,690	71,170	71,170
Accrued interest payable	91,187	75,115	
Deposits and other liabilities	393,521	464,083	222,907
Compensated absences, due within one year	26,918	13,490	15,386
Claims payable, due within one year			
Long-term debt, due within one year	2,760,344	465,619	
Total current liabilities	<u>6,103,911</u>	<u>1,550,860</u>	<u>949,822</u>
Noncurrent liabilities:			
Advances from other funds			
Compensated absences, due in more than one year	165,946	209,928	187,668
Claims payable, due in more than one year			
Long-term debt, due in more than one year	47,197,994	9,221,664	
Net other postemployment benefits obligation	843,510	717,070	804,409
Total noncurrent liabilities	<u>48,207,450</u>	<u>10,148,662</u>	<u>992,077</u>
Total liabilities	<u>54,311,361</u>	<u>11,699,522</u>	<u>1,941,899</u>
NET ASSETS			
Invested in capital assets, net of related debt	60,643,753	31,683,743	15,398,142
Restricted:			
Other special projects and programs	1,283,674	583,965	153,633
Debt service			
Capital projects	9,490,591	117,563	192,116
Unrestricted	27,600,730	47,822,629	4,319,816
Total net assets	<u>\$ 99,018,748</u>	<u>\$ 80,207,900</u>	<u>\$ 20,063,707</u>

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

Business-type Activities	Total	Governmental
Nonmajor Enterprise Funds	Enterprise Funds	Activities Internal Service Funds
\$ 135,728	\$ 92,934,118	\$ 19,421,254
		190,394
46,500	2,949,756	104,231
121,223	10,036,497	
162	155,916	32,558
		4,230
156,395	156,395	8,382
	171,545	109,253
460,008	106,404,227	19,870,302
	11,796	
	395,888	
	1,858,036	
529,541	45,017,108	22,618
6,479,190	121,024,821	7,127,390
7,008,731	168,307,649	7,150,008
7,468,739	274,711,876	27,020,310
38,001	3,713,676	489,388
17,696	169,014	75,355
	249,030	
	166,302	108,269
36,884	1,117,395	20,513
913	56,707	9,027
		1,297,729
	3,225,963	122,417
93,494	8,698,087	2,122,698
395,888	395,888	
11,685	575,227	363,082
		2,666,960
	56,419,658	7,035,076
121,593	2,486,582	1,243,834
529,166	59,877,355	11,308,952
622,660	68,575,442	13,431,650
7,008,731	114,734,369	4,786,321
135,057	2,156,329	127,248
53,944	53,944	
21,879	9,822,149	
(373,532)	79,369,643	8,675,091
\$ 6,846,079	\$ 206,136,434	\$ 13,588,660

CITY OF MERCED

Statement of Revenues, Expenses and Changes in Net Assets

Proprietary Funds

For the Year Ended June 30, 2012

	Business-type Activities Major Enterprise Funds		
	Wastewater System	Water System	Refuse Collection System
OPERATING REVENUES			
Charges for services	\$ 19,488,901	\$ 12,566,815	\$ 11,583,789
Other revenues	544,761	1,015,339	79,088
Total operating revenues	<u>20,033,662</u>	<u>13,582,154</u>	<u>11,662,877</u>
OPERATING EXPENSES			
Personnel services	3,953,729	3,034,560	3,872,417
Materials, supplies and other services	6,656,635	6,823,712	7,176,354
Depreciation	1,990,307	2,208,029	857,814
Total operating expenses	<u>12,600,671</u>	<u>12,066,301</u>	<u>11,906,585</u>
OPERATING INCOME (LOSS)	<u>7,432,991</u>	<u>1,515,853</u>	<u>(243,708)</u>
NONOPERATING REVENUES (EXPENSES):			
Property taxes			
Intergovernmental revenues	460,753	14,989	680,097
Interest and investment earnings	627,642	822,878	88,333
Gain (loss) on disposition of capital assets	757	11,895	61
Interest and related expenses	(303,105)	(506,735)	
Total nonoperating revenues (expenses)	<u>786,047</u>	<u>343,027</u>	<u>768,491</u>
INCOME (LOSS) BEFORE TRANSFERS AND CAPITAL CONTRIBUTIONS	<u>8,219,038</u>	<u>1,858,880</u>	<u>524,783</u>
TRANSFERS AND CAPITAL CONTRIBUTIONS			
Capital contributions	2,550,000		
Transfers in	38,543	250,000	
Transfers out	(272,402)	(465,357)	(634,162)
Total transfers and capital contributions	<u>2,316,141</u>	<u>(215,357)</u>	<u>(634,162)</u>
CHANGE IN NET ASSETS	10,535,179	1,643,523	(109,379)
NET ASSETS:			
Beginning of year	88,483,569	78,564,377	20,173,086
End of year	<u>\$ 99,018,748</u>	<u>\$ 80,207,900</u>	<u>\$ 20,063,707</u>

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

Business-type Activities	Total Enterprise Funds	Governmental Activities Internal Service Funds
\$ 695,486	\$ 44,334,991	\$ 24,203,038
135,685	1,774,873	226,613
<u>831,171</u>	<u>46,109,864</u>	<u>24,429,651</u>
1,080,525	11,941,231	5,158,037
724,772	21,381,473	21,854,822
403,415	5,459,565	2,121,324
<u>2,208,712</u>	<u>38,782,269</u>	<u>29,134,183</u>
<u>(1,377,541)</u>	<u>7,327,595</u>	<u>(4,704,532)</u>
33,879	33,879	
139,303	1,295,142	170,912
1,618	1,540,471	385,652
348	13,061	112,964
(19,242)	(829,082)	(332,509)
<u>155,906</u>	<u>2,053,471</u>	<u>337,019</u>
<u>(1,221,635)</u>	<u>9,381,066</u>	<u>(4,367,513)</u>
	2,550,000	
1,024,823	1,313,366	191,000
(10,452)	(1,382,373)	(351,069)
<u>1,014,371</u>	<u>2,480,993</u>	<u>(160,069)</u>
(207,264)	11,862,059	(4,527,582)
7,053,343	194,274,375	18,116,242
<u>\$ 6,846,079</u>	<u>\$ 206,136,434</u>	<u>\$ 13,588,660</u>

CITY OF MERCED
Statement of Cash Flows
Proprietary Funds
For the Year Ended June 30, 2012

	Business-type Activities Major Enterprise Funds		
	Wastewater System	Water System	Refuse Collection System
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash received from customers, including cash deposits	\$ 23,657,127	\$ 12,957,842	\$ 11,052,575
Cash paid to suppliers	(8,418,532)	(6,612,512)	(6,769,613)
Cash paid to employees	(3,655,415)	(2,760,453)	(3,560,246)
Net cash provided (used) by operating activities	11,583,180	3,584,877	722,716
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:			
Advances to other funds		1,129,701	
Advances from other funds			
Due from other funds			
Tax proceeds not attributable to capital			
Transfers from other funds	38,543	250,000	
Transfers to other funds	(272,402)	(465,357)	(634,162)
Net cash provided (used) by noncapital financing activities	(233,859)	914,344	(634,162)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:			
Acquisition and construction of capital assets	(22,964,719)	(686,372)	(826,232)
Proceeds of capital contributions	460,753	14,989	680,097
Payment of long-term debt	(3,667,187)	(1,210,234)	
Interest payments	(1,727,398)	(855,055)	
Proceeds from disposal of equipment	757	11,895	61
Net cash provided (used) by capital and related financing activities	(27,897,794)	(2,724,777)	(146,074)
CASH FLOWS FROM INVESTING ACTIVITIES			
INVESTING ACTIVITIES:			
Investment earnings	593,621	767,739	81,741
Net cash provided (used) by investing activities	593,621	767,739	81,741
Net Increase (decrease) in Cash and Cash Equivalents	(15,954,852)	2,542,183	24,221
Cash and cash equivalents at beginning of year	54,456,661	45,883,322	5,846,855
Cash and cash equivalents at end of year	<u>\$ 38,501,809</u>	<u>\$ 48,425,505</u>	<u>\$ 5,871,076</u>
<u>Noncash Investing, Capital and Financing Activities:</u>			
Contribution from State to modify note payable	<u>\$ 2,550,000</u>	<u>\$</u>	<u>\$</u>

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

Business-type Activities	Total Enterprise Funds	Governmental Activities Internal Service Funds
\$ 711,609	\$ 48,379,153	\$ 24,532,564
(733,602)	(22,534,259)	(22,383,244)
<u>(1,077,379)</u>	<u>(11,053,493)</u>	<u>(4,925,006)</u>
<u>(1,099,372)</u>	<u>14,791,401</u>	<u>(2,775,686)</u>
	1,129,701	
70,299	70,299	
(156,395)	(156,395)	(3,134)
33,879	33,879	
1,024,823	1,313,366	191,000
<u>(10,452)</u>	<u>(1,382,373)</u>	<u>(351,069)</u>
<u>962,154</u>	<u>1,008,477</u>	<u>(163,203)</u>
(215,531)	(24,692,854)	(2,947,743)
139,303	1,295,142	170,912
	(4,877,421)	
(19,242)	(2,601,695)	(324,807)
348	13,061	112,964
<u>(95,122)</u>	<u>(30,863,767)</u>	<u>(2,988,674)</u>
<u>1,544</u>	<u>1,444,645</u>	<u>364,149</u>
<u>1,544</u>	<u>1,444,645</u>	<u>364,149</u>
<u>(230,796)</u>	<u>(13,619,244)</u>	<u>(5,563,414)</u>
<u>366,524</u>	<u>106,553,362</u>	<u>25,175,062</u>
<u>\$ 135,728</u>	<u>\$ 92,934,118</u>	<u>\$ 19,611,648</u>
<u>\$</u>	<u>\$ 2,550,000</u>	<u>\$</u>

Continued

CITY OF MERCED
Statement of Cash Flows (continued)
Proprietary Funds
For the Year Ended June 30, 2012

	Business-type Activities Major Enterprise Funds		
	Wastewater System	Water System	Refuse Collection System
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:			
Operating income (loss)	\$ 7,432,991	\$ 1,515,853	\$ (243,708)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:			
Depreciation	1,990,307	2,208,029	857,814
Receivables	4,736,427	210,317	224,327
Inventory		(12,724)	
Accounts payable	(1,782,028)	143,393	386,537
Payroll liabilities	(109,292)	(80,140)	(103,950)
Deposits	25,017	80,531	20,204
Unearned revenues	(1,112,962)	(834,629)	(834,629)
Other liabilities	(4,886)		
Insurance claims			
Compensated absences	(10,807)	24,554	17,526
Net other postemployment benefits obligation	418,413	329,693	398,595
Total adjustments	4,150,189	2,069,024	966,424
Net Cash Provided (used) by operating activities	\$ 11,583,180	\$ 3,584,877	\$ 722,716

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

Business-type Activities	Total	Governmental
Nonmajor Enterprise Funds	Enterprise Funds	Activities Internal Service Funds
\$ (1,377,541)	\$ 7,327,595	\$ (4,704,532)
403,415	5,459,565	2,121,324
(119,562)	5,051,509	257,293
	(12,724)	(48,202)
(10,580)	(1,262,678)	(539,964)
(39,905)	(333,287)	(142,140)
1,762	127,514	(37,152)
	(2,782,220)	(154,380)
(12)	(4,898)	20,513
		76,383
2,797	34,070	29,454
<u>40,254</u>	<u>1,186,955</u>	<u>345,717</u>
<u>278,169</u>	<u>7,463,806</u>	<u>1,928,846</u>
<u>\$ (1,099,372)</u>	<u>\$ 14,791,401</u>	<u>\$ (2,775,686)</u>

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FIDUCIARY FUND FINANCIAL STATEMENTS

Private Purpose Trust Funds - These funds are used to account for assets held by the government in a trustee capacity.

Agency Funds - These funds are used to account for assets held by the government as an agent for individuals, private organizations, other governments and/or other funds.

CITY OF MERCED
Statement of Fiduciary Net Assets
Fiduciary Funds
June 30, 2012

	Private Purpose Trust Funds	Agency Funds
ASSETS		
Cash, cash equivalents and investments	\$ 236,154	\$ 8,430,041
Restricted cash held by fiscal agent		2,249,432
Receivables	133,966	808,830
Deposits		104,398
Total assets	370,120	11,592,701
LIABILITIES		
Accounts payable		5,634,827
Deferred revenue	21,390	
Deposits		1,485,759
Other liabilities		387,288
Due to bondholders		4,084,827
Total liabilities	21,390	\$ 11,592,701
NET ASSETS		
Held in trust for other purposes	348,730	
Total net assets	\$ 348,730	

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

CITY OF MERCED

**Statement of Changes in Fiduciary Net Assets
Fiduciary Funds - Private Purpose Trust Funds
For the Year Ended June 30, 2012**

	<u>Private Purpose Trust Funds</u>
ADDITIONS:	
Investment earnings	\$ 21,870
Miscellaneous	<u>184,612</u>
Total Additions	206,482
DEDUCTIONS:	
General government	<u>366,929</u>
Net Change	(160,447)
NET ASSETS HELD IN TRUST FOR OTHER PURPOSES:	
Beginning of year	<u>509,177</u>
End of year	<u><u>\$ 348,730</u></u>

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

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City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basic financial statements of the City of Merced, California, (City) have been prepared in conformity with Generally Accepted Accounting Principles (GAAP) as applied to governmental agencies. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The more significant of the City's accounting policies are described below.

A. Reporting Entity

The City was incorporated April 1, 1889. The current Charter for the City's government was ratified by electors on April 12, 1949, and approved by the legislature of the State of California on May 11 and May 12, 1949. The City operates under a Council-Manager form of government and provides the following services: safety (police and fire), highways and streets, wastewater, water, refuse, parks and recreation, planning and zoning, airport and general administrative services.

The financial reporting entity, as defined by GASB, consists of the primary government, the City, organizations for which the primary government is financially accountable and any other organization for which the nature and significance of their relationship with the primary government are such that exclusion would cause the City's financial statements to be misleading or incomplete.

The City Council acts as the governing body and is able to impose its will on the following organizations, establishing financial accountability:

- The City of Merced Redevelopment Agency (Agency)
- The City of Merced Public Financing and Economic Development Authority (Authority)
- The Parking Authority of the City of Merced (Parking Authority)

As a result, these organizations are considered component units of the City and are included within the financial statements of the City using the blended method.

The Agency of the City was originally established pursuant to the State of California Health and Safety Code Section 33000, entitled Community Redevelopment Law. Its purpose was to prepare and carry out plans for the improvement, rehabilitation and redevelopment of project areas within the territorial limits of the City. As discussed in Note 18. Extraordinary Item - Redevelopment Agency Dissolution, the Agency was dissolved on January 31, 2012 and its funds closed. The activities of the Agency through January 31, 2012 are included in the basic financial statements.

The Authority was originally created in August 1987 but had expired by its terms. The Authority was re-created on January 1, 2003, by a City and Redevelopment Resolution. The Parking Authority became a member of the Authority on April 18, 2011. On January 30, 2012, the Agency was removed as a member from the Authority. The Authority is a separate public entity and is to provide for the financing of costs and expenses of acquisition, construction and installation of authorized public capital improvements for the members through any financing procedures legally available to the members. All powers are vested in the governing board.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

A. Reporting Entity, Continued

The Parking Authority was created on April 18, 2011, by City and Parking Authority Resolutions. The Authority is a separate public entity and is a specialized governmental agency focusing on parking issues and how to alleviate parking problems. All powers are vested in the governing board.

All entities included in this financial statement maintain June 30 as their fiscal year-end.

The City provides accounting and investing services for the Merced Mariposa Narcotics Task Force and Merced Somoto Sister City, whose funds are included in the City's pooled cash for investing purposes only. The City does not have the ability to exercise influence over them, therefore these entities are reported in the accompanying financial statements as Agency Funds in the Fiduciary Fund Financial Statements.

B. Government-Wide Fund Financial Statements

The basic financial statements include both Government-Wide (based on the City as a whole) and Fund Financial Statements. While the previous reporting model emphasized fund types (the total of all funds of a particular type), in the new reporting model the focus is on either the City as a whole or major individual funds (within the Fund Financial Statements). Major Funds are funds whose revenues, expenditures or expenses, assets, or liabilities are at least ten percent of the corresponding totals for all Governmental or Enterprise Funds and at least five percent of the aggregate amount for all Governmental and Enterprise Funds for the same type. The General Fund is always a Major Fund and any other governmental or enterprise fund may be reported as a Major Fund if the City believes that fund is particularly important to financial statement users.

The Government-Wide Financial Statements (i.e., the Statement of Net Assets and the Statement of Activities and Changes in Net Assets) report information on all of the nonfiduciary activities of the government. For the most part, the effect of interfund activity has been removed from these statements. Governmental Activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from Business-Type Activities, which rely to a significant extent on fees and charges for support.

The Statement of Activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. 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 and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not properly included in program revenues are reported as general revenues.

Separate financial statements are provided for Governmental Funds, Proprietary Funds, and Fiduciary Funds, even though the latter 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.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

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

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

Governmental Fund Financial Statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded in the accounting period in which the related liability is incurred.

Property taxes, special assessments, sales taxes, licenses, intergovernmental revenues, investment earnings, charges for services and fines and penalties associated with the current fiscal year are all considered to be susceptible to accrual and have been recognized as revenues of the current fiscal year. Property taxes attach as an enforceable lien on property. Secured and unsecured property taxes are levied on July 1. The unsecured and secured property tax lien date is January 1. Unsecured property taxes become delinquent on August 31. Secured property taxes are payable in two installments, on November 1 and February 1 of each year, and become delinquent on December 10 and April 10, respectively. The County of Merced, California (County) bills and collects the property taxes and remits them to the City according to a payment schedule established by the County. City property tax revenues are recognized when received in cash except at year-end when they are accrued pursuant to the modified accrual basis of accounting. The County is permitted by State law to levy property taxes at 1% of properties assessed value and can increase property assessed value no more than 2% per year.

The City reports the following major governmental funds:

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

The Housing Special Revenue Fund is used to account for programs and activities aimed at benefiting low and moderate income persons.

The Low and Moderate Income Housing Fund is used to account for the housing activities. On January 12, 2012, City Council adopted Resolution 2012-5 electing the City of Merced to assume all rights, powers, assets, liabilities, duties, and obligations associated with the housing activities of the Redevelopment Agency.

The Streets & Signals Capital Projects Fund is used to account for projects which are funded by State and Federal sources and Public Facilities Impact fees. These funds are accounted for in Special Revenue Funds and then transferred to the Street and Signals CIP fund when the project expenditures have been incurred.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

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

The Public Financing and Economic Development Authority Capital Improvement Projects Fund accounts for the financial resources used in the acquisition and construction of major capital facilities, and construction of major capital facilities.

The City reports the following proprietary funds as major:

The Wastewater System Fund is used to account for treatment of industrial and domestic wastewater. The fund collects user fees and disburses all expenditures for this purpose. The fund also collects fees resulting from new growth. These funds will be used in the future to expand capacity of the wastewater treatment plant due to growth. The Wastewater System Fund consists of the Wastewater Operation Fund, Wastewater Improvement Fund, Wastewater Revolving Fund and University Capital Charge Wastewater Fund.

The Water System Fund is used to account for operation and maintenance of a water system consisting of well sites, deep well pumps, fluoridation facilities, a distribution pipeline and elevated storage tanks. The Water System Fund consists of the Water Operation Fund, Restricted Water Wells Fund, Restricted Water Mains Fund and University Capital Charge Water Fund.

The Refuse Collection System Fund is used to account for collection and disposal of municipal solid waste from industrial, commercial and residential customers. In addition, the fund provides for a green waste and recycling program which were created to divert waste from the landfill. The Refuse Collection Fund consists of the Refuse Collection Fund and Refuse Capital Equipment Fund.

Additionally, the government reports the following fund types:

Internal Service Funds are used to account for services provided to other departments of the City, or to other governments, on a cost reimbursement basis. The City has Internal Service Funds for Workers' Compensation Insurance, Liability Insurance, Unemployment Insurance, Employee Benefits, Fleet Management, Fleet Replacement, Facility Maintenance, Support Services, Personal Computer Replacement, and Public Works Administration.

The Private Purpose Trust Funds are used to account for resources legally held in trust for the Task Force Trust, Youth Programs Endowment, Wahneta Hall Trust, Missing Children Trust and Regional Transportation Trust.

The Agency Funds are used to account for resources held by the City in a purely custodial capacity. Included in the agency funds are deposits from external organizations, the handling of assessment district activity and special purpose accounts for City community groups.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

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

Certain eliminations have been made as prescribed by GASB Statement No. 34 for interfund activities, payables and receivables. All internal balances in the Statement of Net Assets have been eliminated except those representing balances between governmental activities and business-type activities, which are presented as internal balances and eliminated in the total governmental column. In the Statement of Activities, internal service fund transactions have been eliminated. However, transactions between governmental and business-type activities have not been eliminated.

Amounts reported as program revenues include 1) charges to customers for services, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

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

The City applies all applicable GASB pronouncements (including all NCGA Statements and Interpretations currently in effect) as well as the following pronouncements issued on or before November 30, 1989, to the business type activities, unless those pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARB) of the committee on Accounting Procedure. The City applies all applicable FASB Statements and Interpretations issued after November 30, 1989, except those that conflict with or contradict GASB pronouncements.

D. Use of Restricted and Unrestricted Net Assets

When an expense is incurred for purposes for which both restricted and unrestricted net assets are available, the City's policy is to apply restricted net assets first.

E. Cash, Cash Equivalents, and Investments

The City pools cash resources from all funds in order to facilitate the management of cash. The balance in the pooled cash account is available to meet current operating requirements. Cash in excess of current requirements is invested in various interest-bearing accounts and other investments for varying terms.

For purposes of the statement of cash flows of the proprietary fund types, cash and cash equivalents include all investments, as the City operates an internal cash management pool which maintains the general characteristics of a demand deposit account.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

E. *Cash, Cash Equivalents, and Investments, Continued*

In accordance with GASB Statement No. 40, *Deposit and Investment Disclosures (Amendment of GASB No. 3)*, certain disclosure requirements for Deposits and Investment Risks were made in the following areas:

- Interest Rate Risk
- Credit Risk
 - Overall
 - Custodial Credit Risk
 - Concentrations of Credit Risk

In accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, highly liquid market investments with maturities of one year or less at time of purchase are stated at amortized cost. All other investments are stated at fair value. Market value is used as fair value for those securities for which market quotations are readily available.

The City participates in an investment pool managed by the State of California titled Local Agency Investment Fund (LAIF) which has invested a portion of the pooled funds in Structured Notes and Asset-Backed Securities. LAIF's investments are subject to credit risk with the full faith and credit of the State of California collateralizing these investments. In addition, these Structured Notes and Asset-Backed Securities are subject to market risk as to change in interest rates.

F. *Receivables*

All receivables are shown net of an allowance for doubtful accounts. Service charge revenues (water, sewer and refuse collection) are recorded as billed to customers on a cyclical basis. All utility customers are billed monthly. Amounts unbilled at June 30 are recorded as a receivable and recognized as revenue.

G. *Interfund Balances/Internal Balances*

Advances to and advances from other funds represent interfund loans in the fund financial statements. Advances between funds are offset by a non-spendable fund balance classification in the applicable governmental funds to indicate that they are not available financial resources.

All other outstanding balances between funds are reported as due to and due from other funds. These are generally repaid within the following fiscal year.

Any residual balances outstanding between the governmental activities and business-type activities are reported in the Government-Wide Financial Statements as "internal balances."

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

H. Inventory

Inventory is valued at average cost, which approximates cost as determined on a first-in-first-out basis. Inventory in the General Fund consists of expendable supplies held for consumption by all departments of the City. The cost is recorded as an expenditure or expense in the appropriate fund at the time individual inventory items are withdrawn for use (consumption method). The General Fund inventory amount is offset by a non-spendable fund balance classification, which indicates that it does not constitute available financial resources. Inventories in the proprietary funds are recorded at cost, which approximates market.

I. Land Held for Resale

Land held for resale consists of land and project costs relating to property acquired or constructed which will be sold under terms of disposition and development agreements between the City (or its component units) and developers. The land held for resale is recorded at the lower of cost or estimated net realizable value. Reported amounts are offset by a non-spendable fund balance classification, which indicates that they do not constitute available resources.

J. Capital Assets

Capital assets, which include land and improvements, buildings and structures, improvements other than buildings, structures, and land improvements, machinery and equipment, construction in progress and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities in the Government-Wide Financial Statements. Capital assets are recorded at historical cost or estimated historical cost if actual cost is not available. Donated assets are valued at their estimated fair value on the date donated. City policy has set the capitalization thresholds for reporting capital assets at the following:

General capital assets	\$	5,000
Infrastructure capital assets	\$	5,000

Depreciation has been provided on a straight-line basis over the following useful lives:

	Years
Infrastructure	10-40
Buildings and structures	15-20
Improvements other than buildings	15
Machinery and equipment	5

The City defines infrastructure as the basic physical assets that allow the City to function. The assets include: streets, water and sewer systems, park land, and other similar items. Each major infrastructure system can be divided into subsystems. For example, the street system can be subdivided into pavement, curb and gutters, sidewalks, medians, streetlights, landscaping and land. These subsystems were not delineated in the basic financial statements.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

J. Capital Assets, Continued

Interest accrued during capital assets construction, if any, is capitalized as part of the asset cost for the business-type and proprietary funds.

The City elected to use the Basic Approach as defined by GASB Statement No. 34 for infrastructure reporting. The City commissioned an appraisal of City owned infrastructure and property as of June 30, 2002. This appraisal determined the original cost, which is defined as historical cost or estimated historical cost if actual cost was not available. The accumulated depreciation was calculated from the date of construction/acquisition to the current date on a straight-line basis. The book value can be computed by deducting the accumulated depreciation from the original cost.

K. Compensated Absences

The City accounts for compensated absences in accordance with GAAP. In the Government-Wide Financial Statements and Proprietary Fund Financial Statements, which use the accrual basis of accounting, accrued compensated absences benefits are recorded as liabilities as vested and earned.

L. Deferred Revenue/Unearned Revenue

In the Government-Wide Financial Statements, unearned revenue is recorded for transactions for which revenues have not been earned.

In the Fund Financial Statements, deferred revenue is recorded when transactions have not yet met the revenue recognition criteria based on the modified accrual basis of accounting. The City records deferred revenue for transactions for which revenues have not been earned, or for which funds are not available to meet current financial obligations.

M. Long-Term Liabilities

In the Government-Wide Financial Statements and Proprietary Fund Financial Statements long-term debt and other financed obligations are reported as liabilities in the appropriate activities. Bond premiums and discounts are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable premium or discount.

In the Fund Financial Statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of the debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs are reported as expenditures.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

N. Net Assets and Fund Equity

Government-Wide Financial Statements

In the Government-Wide Financial Statements, net assets are classified in the following categories:

Invested in Capital Assets, Net of Related Debt - This amount consists of capital assets net of accumulated depreciation and reduced by outstanding debt that is attributed to the acquisition, construction, or improvement of the assets.

Restricted Net Assets - This amount is restricted by external creditors, grantors, contributors, or laws or regulations of other governments.

Unrestricted Net Assets - This amount is all net assets that do not meet the definition of "invested in capital assets, net of related debt" or "restricted net assets."

Fund Financial Statements

In the Fund Financial Statements, the following classifications describe the relative strength of the spending constraints placed on the purposes for which resources can be used:

Non-spendable fund balance - This includes amounts that cannot be spent because they are either not spendable in form or legally or contractually required to remain intact.

Restricted fund balance - This includes amounts with constraints placed on their use by those external to the City, including creditors, grantors, contributors or laws and regulations of other governments. It also includes constraints imposed by law through constitutional provisions or enabling legislation.

Committed fund balance - This includes amounts that can only be used for specific purposes determined by formal action of the City Council and that remain binding unless removed in the same manner. The underlying action that imposed the limitation needs to occur no later than the close of the reporting period.

Assigned fund balance - This includes amounts that are constrained by the City's intent to be used for specific purposes. The intent can be established at either the highest level of decision making or by a body or an official designated for that purpose.

Unassigned fund balance - This is the residual classification that includes amounts not contained in the other classifications.

The City Council establishes, modifies or rescinds fund balance restrictions, commitments and assignments by Council action, which includes passage of a resolution adopting the budget and appropriating revenue for the fiscal year. Detailed classifications of the City's fund balances are presented in Note 11.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

O. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates and assumptions.

2. CASH AND INVESTMENTS

The City maintains a cash and investment pool, which includes cash balances and authorized investments of all funds, which the Finance Officer invests to enhance interest earnings. The pooled interest earned is allocated to the funds based on daily cash and investment balances in these funds.

A. Cash Deposits

At June 30, 2012, the carrying amount of the City's cash and cash equivalents were comprised of the general checking account which had a balance of (\$450,208) and petty cash of \$4,173. Bank balances in the City's general checking accounts were \$45,685 and were fully insured and collateralized with securities held by the pledging financial institutions in the City's name as discussed below. The difference between the bank balance and the carrying amount represents outstanding checks and deposits in transit.

The California Government Code requires California banks and savings and loan associations to secure the City's cash deposits by pledging securities as collateral. This Code states that collateral pledged in this manner shall have the effect of perfecting a security interest in such collateral superior to those of a general creditor. Thus, collateral for cash deposits is considered to be held in the City's name. The fair value of pledged securities must equal at least 110% of the City's cash deposits. California law also allows institutions to secure City deposits by pledging first trust deed mortgage notes having a value of 150% of the City's total cash deposits. The City waived collateral requirements for cash deposits, because it is fully insured up to \$250,000 by the Federal Deposit Insurance Corporation.

B. Investments

The City is authorized by State statutes and in accordance with the City's Investment Policy (the Policy) to invest in the following:

- U.S. Treasury and U.S. Agency Issues
- Non-Negotiable Certificates of Deposit
- California Local Agency Investment Fund (LAIF)
- Government Bonds and Notes
- Passbook Savings
- Bankers Acceptances
- Commercial Paper (Corporations)
- Medium-Term Corporate Notes
- Repurchase Agreements
- Mutual Funds

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

2. CASH AND INVESTMENTS, Continued

C. Summary of Cash and Investments

The following is a summary of pooled cash and investments, including restricted cash and investments at June 30, 2012:

	Government-Wide Statement of Net Assets			Fund Financials	Total
	Governmental Activities	Business-Type Activities	Total	Fiduciary Funds Statement of Net Assets	
Cash and Investments	<u>\$ 51,614,834</u>	<u>\$ 92,934,118</u>	<u>\$ 144,548,952</u>	<u>\$ 8,666,195</u>	<u>\$ 153,215,147</u>
Restricted Cash held by fiscal agent	<u>\$ 190,441</u>	<u>\$</u>	<u>\$ 190,441</u>	<u>\$ 2,249,432</u>	<u>\$ 2,439,873</u>

D. Risks

Interest Rate Risk: Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, an investment with a longer maturity date has a greater sensitivity of its fair value to be subject to changes in market interest rates. In accordance with the City's investment policy, exposure to interest rate risk is mitigated by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

2. CASH AND INVESTMENTS, Continued

D. Risks, Continued

Pooled cash and investments, including cash with fiscal agents, held in the City by maturity date at June 30, 2012 are shown below:

Investment Type	Fair Value	Investment Maturities (in years)	
		Less than 1 year	5 years or less
Cash:			
Cash Deposits	\$ (450,208)	\$ (450,208)	\$
Petty Cash	4,173	4,173	
Total cash:	(446,035)	(446,035)	
Investments:			
Money Market Fund	3,609,769	3,609,769	
U.S. Government Agency Securities	109,791,558		109,791,558
Local Agency Investment Fund (LAIF)	40,259,855	40,259,855	
Total investments	153,661,182	43,869,624	109,791,558
Total cash and investments	\$ 153,215,147	\$ 43,423,589	\$ 109,791,558
Restricted Cash with Fiscal Agents:			
Commercial Paper	\$ 1,085,456	\$ 1,085,456	\$
Public Investment Money Market Fund	190,394	190,394	
Local Agency Investment Fund	1,163,976	1,163,976	
Money Market Funds	47	47	
Total restricted cash with fiscal agents	\$ 2,439,873	\$ 2,439,873	\$

Credit Risk: Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the June 30, 2012 rating which meets the minimum rating required by (where applicable) the California Government Code, the City's Investment Policy, or debt agreements:

<u>Credit Quality Ratings</u>	
Investments:	
Money Market Fund	AAA
U.S. Government Agency Securities	AA+
Local Agency Investment Fund	Not rated
Fiscal Agents:	
Commercial Paper	AA-
Public Investment Money Market Fund	A+
Local Agency Investment Fund	Not rated
Money Market Funds	AAA

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

2. CASH AND INVESTMENTS, Continued

D. Risks, Continued

Custodial Credit Risk: Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of failure of the counter party (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the City's Investment Policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: 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 City). 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 City deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

E. Fair Value of Investments

GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, requires that the City's investments be carried at fair market value instead of cost. Accordingly, the City adjusts the carrying value of its investments to reflect their fair value at each fiscal year-end and the effects of these adjustments are included in income for that fiscal year. Changes in value in the fiscal year ended June 30, 2012 from June 30, 2011 amounted to an unrealized gain of \$1,031,514.

F. Investments in Local Agency Investment Fund

The City's investments with LAIF at June 30, 2012, included a portion of the pooled funds invested in Structured Notes and Asset-Backed Securities. These investments included the following:

Structured Notes are debt securities (other than asset-backed securities) whose cash-flow characteristics (coupon rate, redemption amount, or stated maturity) depend upon one or more indices and/or have embedded forwards or options.

Asset-Backed Securities, the bulk of which are mortgage-backed securities, entitle their purchasers to receive a share of the cash flows from a pool of assets such as principal and interest repayments from a pool of mortgages (such as Collateralized Mortgage Obligations) or credit card receivables.

As of June 30, 2012, the City had \$41,423,831 invested in LAIF, which had invested 3.47% of the pooled investment funds in Structured Notes and Asset-Backed Securities as compared to 5.01% in the previous year. The LAIF fair value factor of 1.001219643 was used to calculate the fair value of the investments in LAIF.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

2. CASH AND INVESTMENTS, Continued

G. Cash and Investments with Fiscal Agents

Funds deposited with fiscal agents can be held in cash or invested in various securities. The fiscal agents can invest in securities as outlined in trust agreements, provided the investments are within the limits imposed by state statutes. These investments include federal securities, investment agreements, interest-bearing demand or time deposits, commercial paper rated "A" or better by Moody's, and money market mutual funds which are rated in the highest category by Moody's. At June 30, 2012, cash and investments with fiscal agents totaling \$2,439,873 were recorded at fair value.

3. RECEIVABLES

A. Government Wide Financial Statements

At June 30, 2012, the Government-Wide Financial Statements reported the following receivables net of allowances for uncollectible amounts:

	Governmental Activities	Business-Type Activities	Total
Accounts receivable	\$ 3,826,436	\$ 2,949,756	\$ 6,776,192
Due from other governments	10,369,974	10,036,497	20,406,471
Interest receivable	589,566	155,916	745,482
Total	<u>\$ 14,785,976</u>	<u>\$ 13,142,169</u>	<u>\$ 27,928,145</u>

B. Fund Financial Statements

At June 30, 2012, the fund financial statements show the following receivables:

	Governmental Funds	Enterprise Fund	Internal Service Funds	Total
Accounts receivable	\$ 3,722,205	\$ 2,949,756	\$ 104,231	\$ 6,776,192
Due from other governments	10,369,974	10,036,497		20,406,471
Interest receivable	557,008	155,916	32,558	745,482
Total	<u>\$ 14,649,187</u>	<u>\$ 13,142,169</u>	<u>\$ 136,789</u>	<u>\$ 27,928,145</u>

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

3. RECEIVABLES, Continued

B. Fund Financial Statements, Continued

Accounts Receivable

Accounts receivable consists of amounts accrued in the ordinary course of operations. The accounts receivable as of June 30, 2012, was as follows:

	Accounts Receivable	Allowance for Doubtful Accounts	Net Accounts Receivable
<i>Governmental Funds:</i>			
General Fund	\$ 2,830,192	\$ (2,317,369)	\$ 512,823
Housing Special Revenue Fund	3,878	(3,393)	485
Streets & Signals Capital Project Fund	1,817,068		1,817,068
Public Financing and Economic Development Authority Capital Project Fund			166,597
Non-major Funds	1,235,855	(10,623)	1,225,232
Total governmental funds	<u>5,886,993</u>	<u>(2,331,385)</u>	<u>3,722,205</u>
<i>Enterprise Funds:</i>			
Wastewater System	1,923,972	(106,465)	1,817,507
Water System	1,114,775	(113,238)	1,001,537
Refuse Collection System	169,981	(85,769)	84,212
Non-major Funds	48,158	(1,658)	46,500
Total enterprise funds	<u>3,256,886</u>	<u>(307,130)</u>	<u>2,949,756</u>
<i>Internal Service Funds</i>	<u>231,627</u>	<u>(127,396)</u>	<u>104,231</u>
Total Accounts Receivable	<u><u>\$ 9,375,506</u></u>	<u><u>\$ (2,765,911)</u></u>	<u><u>\$ 6,776,192</u></u>

Notes Receivable

On December, 10, 2010, the City through a long-term lease transferred the Merced Theatre to the Merced Theatre Landlord, a limited liability company. At the same time, the Agency entered into a development agreement with the Merced Theatre Landlord which included a loan of \$11,024,911 to the Merced Investment Fund, LLC, an entity related to Merced Theatre Landlord, for the purpose of funding reconstruction and rehabilitation costs of the theatre. Merced Theatre Landlord has the option but is not obligated to provide for repayment of the loan described above by the transfer of all or a portion of promissory notes evidencing the Merced Theatre improvements. Because repayment of the loan is uncertain as of June 30, 2012, an allowance equal to the face amount of the loan was recorded at June 30, 2012.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

3. RECEIVABLES, Continued

B. Fund Financial Statements, Continued

Due from other Governments

Due from other governments consists of amounts due from other governmental entities. The due from other governments as of June 30, 2012, was as follows:

<i>Governmental Funds:</i>	
General Fund	\$ 2,446,309
Housing - Special Revenue Fund	1,499,823
Streets & Signals Capital Project Fund	3,180,466
Public Financing and Economic Development Authority Capital Project Fund	530,433
Non-major Funds	<u>2,712,943</u>
Total governmental funds	<u>10,369,974</u>
<i>Enterprise Funds:</i>	
Wastewater System	5,523,194
Water System	3,749,806
Refuse Collection System	642,274
Non-major Funds	<u>121,223</u>
Total enterprise funds	<u>10,036,497</u>
Total Accounts Receivable	<u><u>\$ 20,406,471</u></u>

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

3. RECEIVABLES, Continued

B. Fund Financial Statements, Continued

Interest Receivable

Interest receivable consisted of interest income from notes and investments pooled by the City as well as interest income to be received by fiscal agents from investments in their possession. Interest income is allocated to the funds at the end of the accounting period. The interest receivable as of June 30, 2012, was as follows:

	City Pooled Investments	Fiscal Agent Investments	Total
<i>Governmental Funds:</i>			
General Fund	\$ 20,390	\$	\$ 20,390
Housing Special Revenue Fund	358,571		358,571
Low and Moderate Income Housing Special Revenue Fund	120,943		120,943
Public Financing and Economic Development Authority Capital Project Fund	7,694		7,694
Non-major Funds	47,685	1,725	49,410
	<hr/>	<hr/>	<hr/>
Total governmental funds	555,283	1,725	557,008
<i>Enterprise Funds:</i>			
Wastewater System	64,746		64,746
Water System	81,105		81,105
Refuse Collection System	9,903		9,903
Non-major Funds	162		162
	<hr/>	<hr/>	<hr/>
Total enterprise funds	155,916		155,916
<i>Internal Service Funds:</i>			
	32,558		32,558
	<hr/>	<hr/>	<hr/>
Total interest receivable	\$ 743,757	\$ 1,725	\$ 745,482

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

4. DEFERRED REVENUE/UNEARNED REVENUE

A. Government-Wide Financial Statements

Unearned revenues in the Government-Wide Financial Statements represent amounts for which revenues have not been earned. At June 30, 2012, unearned revenues in the Government-Wide Financial Statements were as follows:

	Governmental Activities	Business-Type Activities	Total
Prepaid business license fees	\$ 132,485	\$	\$ 132,485
Service charges received in advance		249,030	249,030
	<u>\$ 132,485</u>	<u>\$ 249,030</u>	<u>\$ 381,515</u>

B. Fund Financial Statements

At June 30, 2012, the following deferred revenues were recorded in the Fund Financial Statements because either the revenues had not been earned or the funds were not available to finance expenditures of the current period:

Governmental Funds:

	General	Housing Special	Low and Moderate Income Housing	Non-major	Total
Prepaid business license fees	\$ 124,942	\$	\$	\$ 7,543	\$ 132,485
Grants		135,933		184,709	320,642
Long-term loans receivable		20,013,204	9,051,172	262,624	29,327,000
Total	<u>\$ 124,942</u>	<u>\$ 20,149,137</u>	<u>\$ 9,051,172</u>	<u>\$ 454,876</u>	<u>\$ 29,780,127</u>

Proprietary Funds:

	Wastewater System	Water System	Refuse Collection System	Internal Service Funds	Total
Service charges received in advance	\$ 106,690	\$ 71,170	\$ 71,170	\$	\$ 249,030
Total	<u>\$ 106,690</u>	<u>\$ 71,170</u>	<u>\$ 71,170</u>	<u>\$</u>	<u>\$ 249,030</u>

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

5. INTERFUND TRANSACTIONS

A. Fund Financial Statements

Due To, Due From

At June 30, 2012, the City had the following short-term interfund receivables and payables:

		Due From					Total
		Governmental Activities		Business-type Activities			
		Public and Economic Development Authority Capital Project		Non-Major Funds	Non-Major Funds	Internal Service Funds	
		General	Capital Project				
Due To	<i>Governmental Activities:</i>						
		Housing Special Revenue	\$ 1,300,000	\$	\$	\$	\$ 1,300,000
		Streets & Signals Capital Project		528,770			528,770
		Public Financing and Economic Development Authority Capital Project		1,066,606			1,066,606
		Non-Major Funds	27,833	147,980	156,395	8,382	340,590
	Totals	\$27,833	\$ 1,300,000	\$1,743,356	\$ 156,395	\$ 8,382	\$ 3,235,966

Amounts shown as due to and from other funds represent interfund balances that arise in the normal course of operation and are expected to be repaid shortly after the end of the fiscal year.

Long-Term Advances

At June 30, 2012, the City had the following interfund long-term advances:

		Advances to Other Funds				
		Governmental Activities		Business-Type Activities		
		General	Public Financing and Economic Development Authority Capital Project	Water System	Total	
						Advances from Other Funds
	Non-Major funds	\$ 1,710,992	\$ 237,500	\$	\$ 1,948,492	
<i>Business-type Activities:</i>						
	Non-Major funds			395,888	395,888	
	Total	\$ 1,710,992	\$ 237,500	\$ 395,888	\$ 2,344,380	

Advance to the Community Facility Districts Fund (a non-major fund) represents an advance from the General Fund. Interest rate is equal to the rate earned on the City's investment portfolio from the date of disbursements. Advance is to be repaid from funds received by annual special tax apportioned among the parcels within the district. Advance balance as of June 30, 2012 is \$1,710,992.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

5. INTERFUND TRANSACTIONS, Continued

A. Fund Financial Statements, Continued

Long-Term Advances, Continued

Advance to the Merced Theatre Restoration Capital Project Fund (a non-major fund) represents an advance from the City of Merced Public Finance and Economic Development Authority for \$237,500. Advance to be repaid from grant funding related to the Merced Theatre reconstruction.

Advance to the Merced Municipal Airport Capital Improvement Project Fund (a non-major fund) represents advances from the Restricted Water Mains Enterprise Fund of \$400,000 per City Council action November 17, 2008. The advance of \$400,000 is to provide funding for general aviation hangars purchase. Advance to be repaid back over ten years at a rate of 6.210% with monthly payments of \$4,495. Advance balance as of June 30, 2012 is \$290,888. The advance of \$105,000 is to cash flow loan to tenant for land improvements per City Council action on December 19, 2011. The advance is to be repaid back over 3 years.

Transfers

At June 30, 2012, the City had the following transfers:

		Governmental Activities					
		Transfers In					
		General	Low and Moderate Income Housing	Streets & Signals Capital Projects	Public Financing and Economic Development Authority Capital Project	Nonmajor Funds	Total Governmental Funds
Transfers Out	<i>Governmental Activities:</i>						
	General	\$		\$		\$ 536,079	\$ 536,079
	Housing Special Revenue		177,100		1,600,000	668,707	2,445,807
	Streets and Signals Capital Project					295,850	295,850
	Public Financing and Economic Development Authority Capital Project			84,303		7,705,531	7,789,834
	Non-major Funds	413,186	2,650,861	5,025,174	70,236	4,069,039	12,228,496
	<i>Business-type Activities:</i>						
	Wastewater System	100,060		22,342			122,402
	Water System			215,320		37	215,357
	Refuse					634,162	634,162
	Non-major Funds					10,452	10,452
	<i>Internal Service Funds</i>		140,732			94,971	235,703
	Total	\$	831,078	\$ 2,650,861	\$ 5,347,139	\$ 1,670,236	\$ 14,014,828

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

5. INTERFUND TRANSACTIONS, Continued

A. Fund Financial Statements, Continued

Transfers, Continued

		Business Activities							
		Transfers In							
		Total							
		Wastewater	Water	Non-Major	Business	Internal	Total	Total	
		System	System	Funds	Activities	Services	Governmental	All Funds	
		Funds	Funds	Funds	Funds	Funds	Funds	Funds	
Transfers Out	<i>Governmental Activities:</i>								
	General	\$	\$	\$ 914,069	\$ 914,069		\$ 536,079	\$ 1,450,148	
	Housing Special Revenue						2,445,807	2,445,807	
	Streets and Signals Capital Project						295,850	295,850	
	Public Financing and Economic Development Authority Capital Project						7,789,834	7,789,834	
	Nonmajor Funds			74,931	74,931		12,228,496	12,303,427	
	<i>Business-type Activities:</i>								
	Wastewater System					150,000	122,402	272,402	
	Water System		250,000		250,000		215,357	465,357	
	Refuse						634,162	634,162	
	Non-Major Funds						10,452	10,452	
	<i>Internal Service Funds</i>		38,543		35,823	74,366	41,000	235,703	351,069
	Total	\$	\$ 38,543	\$ 250,000	\$ 1,024,823	\$ 1,313,366	\$ 191,000	\$ 24,514,142	\$ 26,018,508

Transfers represent funding of various City operations, funding for capital projects, lease payments or debt service, and the closing of specific funds.

The following are explanations for the transfers in and out for the major funds:

- I. Transfers from the Housing Special Revenue Fund to the General Fund were for police officers and community aides.
- II. Transfers from the Housing Special Revenue Fund to the Public Financing and Economic Development Authority Capital Projects Fund were for Highway 59 multi-family housing project.
- III. Transfers from the Public Financing and Economic Development Authority Capital Projects Funds to the Streets and Signals Capital Projects Fund were for Highway 59 multi-family housing project.
- IV. Transfers from the Wastewater System to the General Fund were for 20% match to the Fire Fighters Grant to replace and upgrade the public safety communication system at the Wastewater Treatment Plant.
- V. Transfers from the Water System to the Streets and Signals Capital Projects Fund were for capital outlay projects.
- VI. Transfers from the Water System to Water Capital Project Fund were for capital outlay projects.
- VII. Transfers from the Employee Benefits Internal Services Fund to the Wastewater System funds were for unemployment benefits.
- VIII. Transfers from the Wastewater System to the Streets and Signals Capital Projects Fund were for capital outlay projects.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

6. CAPITAL ASSETS

A. Government-Wide Financial Statements

At June 30, 2012, the City's capital assets consisted of the following:

	Governmental Activities	Business-Type Activities	Total
<i>Non-depreciable Assets:</i>			
Land and improvements	\$ 87,121,374	\$ 1,899,420	\$ 89,020,794
Construction in process	28,677,098	43,117,688	71,794,786
Total non-depreciable assets	115,798,472	45,017,108	160,815,580
<i>Depreciable Assets:</i>			
Buildings and structures	22,926,121	4,287,506	27,213,627
Machinery and equipment	37,862,996	4,005,739	41,868,735
Improvements other than buildings, structures, and land improvements	90,383,268	133,209,672	223,592,940
Infrastructure	371,510,054	37,499,142	409,009,196
Total depreciable Assets:	522,682,439	179,002,059	701,684,498
Less accumulated depreciation	(295,136,392)	(57,977,238)	(353,113,630)
Total depreciable assets, net	227,546,047	121,024,821	348,570,868
Total Capital Assets	\$ 343,344,519	\$ 166,041,929	\$ 509,386,448

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

6. CAPITAL ASSETS, Continued

A. Government-Wide Financial Statements, Continued

The following is a summary of capital assets for governmental activities:

	Balance July 1, 2011	Additions	Deletions	Dissolution of Redevelopment Agency	Reclassification	Balance June 30, 2012
<i>Non-depreciable Assets:</i>						
Land and improvements	\$ 70,604,091	\$ 847,365	\$	\$	\$ 15,669,918	\$ 87,121,374
Construction in progress	32,775,969	11,718,612	(1,131,898)		(14,685,585)	28,677,098
Total non-depreciable assets	103,380,060	12,565,977	(1,131,898)		984,333	115,798,472
<i>Depreciable Assets:</i>						
Buildings and structures	20,848,739				2,077,382	22,926,121
Machinery and equipment	39,092,958	651,218	(1,881,180)			37,862,996
Improvements other than buildings, structures, and land improvements	91,118,560	2,544,720		(278,777)	(3,001,235)	90,383,268
Infrastructure	371,570,534				(60,480)	371,510,054
Total depreciable assets	522,630,791	3,195,938	(1,881,180)	(278,777)	(984,333)	522,682,439
<i>Accumulated depreciation:</i>						
Buildings and structures	(6,635,979)	(366,282)				(7,002,261)
Machinery and equipment	(33,044,906)	(2,472,320)	1,812,084			(33,705,142)
Improvements other buildings, than buildings, structures, and land improvements	(46,545,863)	(2,163,488)		278,149		(48,431,202)
Infrastructure	(196,579,281)	(9,418,506)				(205,997,787)
Total accumulated depreciation	(282,806,029)	(14,420,596)	1,812,084	278,149		(295,136,392)
Total depreciable assets, net	239,824,762	(11,224,658)	(69,096)	(628)	(984,333)	227,546,047
Total governmental activities, net	\$ 343,204,822	\$ 1,341,319	\$ (1,200,994)	\$ (628)	\$	\$ 343,344,519

With the dissolution of the Redevelopment Agency as discussed in Note 18, Extraordinary Item - Redevelopment Agency Dissolution, the capital assets have been removed from the basic financial statements.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

6. CAPITAL ASSETS, Continued

A. Government-Wide Financial Statements, Continued

Governmental activities depreciation expense for capital assets for the year ended June 30, 2012 was as follows:

General Government	\$ 1,591,306
Public Safety	767,479
Public Works	11,865,035
Parks	196,776
	<u>14,420,596</u>
Total depreciation expense	<u>\$ 14,420,596</u>

The following is a summary of capital assets for business-type activities:

	Balance July 1, 2011	Additions	Deletions	Reclassification	Balance June 30, 2012
<i>Non-depreciable Assets:</i>					
Land and improvements	\$ 258,681	\$ 550,000	\$	\$ 1,090,739	\$ 1,899,420
Construction in progress	59,200,465	23,144,263	(177,313)	(39,049,727)	43,117,688
	<u>59,459,146</u>	<u>23,694,263</u>	<u>(177,313)</u>	<u>(37,958,988)</u>	<u>45,017,108</u>
Total non-depreciable assets					
<i>Depreciable Assets:</i>					
Buildings and structures	4,287,506				4,287,506
Machinery and equipment	3,946,444	101,398	(42,103)		4,005,739
Improvements other than buildings, structures, and land improvements	94,788,581	1,083,138		37,337,953	133,209,672
Infrastructure	36,878,107			621,035	37,499,142
	<u>139,900,638</u>	<u>1,184,536</u>	<u>(42,103)</u>	<u>37,958,988</u>	<u>179,002,059</u>
Total depreciable assets					
<i>Accumulated depreciation:</i>					
Buildings and structures	(2,449,877)	(100,408)			(2,550,285)
Machinery and equipment	(3,629,286)	(172,258)	33,471		(3,768,073)
Improvements other than buildings, structures, and land improvements	(39,478,738)	(4,107,235)			(43,585,973)
Infrastructure	(6,993,243)	(1,079,664)			(8,072,907)
	<u>(52,551,144)</u>	<u>(5,459,565)</u>	<u>33,471</u>		<u>(57,977,238)</u>
Total accumulated depreciation					
Total depreciable assets, net	<u>87,349,494</u>	<u>(4,275,029)</u>	<u>(8,632)</u>	<u>37,958,988</u>	<u>121,024,821</u>
Total business-type activities	<u>\$ 146,808,640</u>	<u>\$ 19,419,234</u>	<u>\$ (185,945)</u>	<u>\$</u>	<u>\$ 166,041,929</u>

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

6. CAPITAL ASSETS, Continued

A. Government-Wide Financial Statements, Continued

Business-type activities depreciation expense for capital assets for the year ended June 30, 2012 was as follows:

Wastewater System Fund	\$	1,990,307
Water System Fund		2,208,029
Refuse Collection System		857,814
Non-Major Funds		<u>403,415</u>
Total depreciation expense	\$	<u>5,459,565</u>

B. Fund Financial Statements

The Fund Financial Statements do not present general government capital assets. Consequently, capital assets are shown as a reconciling item in the Reconciliation of the Governmental Funds Balance Sheet to the Government-Wide Statement of Net Assets.

The capital assets of the enterprise funds in the Proprietary Fund Financial Statements are the same as those shown in the business-type activities of the Government-Wide Financial Statements. Internal Service Funds' capital assets are combined with governmental activities.

7. DEFERRED CHARGES

At June 30, 2012, the City had the following deferred charges:

	Balance July 1, 2011	Additions	Deletions	Balance June 30, 2012
Wastewater Revenue Bonds	\$ 223,724	\$ 1,470,944	\$ (223,724)	\$ 1,470,944
Water Revenue Bonds	103,841	387,092	(103,841)	387,092
Improvement Bonds Payable	7,430		(7,430)	
Total	<u>\$ 334,995</u>	<u>\$ 1,858,036</u>	<u>\$ (334,995)</u>	<u>\$ 1,858,036</u>

These deferred charges represent bond issuance costs, which are being amortized over the life of the related bonds using the straight-line method. Amortization expense for the year ended June 30, 2012 was \$334,995.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

8. DEPOSITS AND OTHER LIABILITIES

Deposit and other liabilities consist of amounts accrued in the ordinary course of operations. The other liabilities as of June 30, 2012, were as follows:

A. Government-Wide Financial Statements

	Governmental Funds	Business-Type Funds	Total
Developers Credits	\$ 5,076,301	\$	\$ 5,076,301
Deposits	850	971,868	972,718
Miscellaneous Liabilities	39,739	145,527	185,266
Total	<u>\$ 5,116,890</u>	<u>\$ 1,117,395</u>	<u>\$ 6,234,285</u>

B. Fund Financial Statements

	Developers Credits	Deposits	Miscellaneous Liabilities	Total Other Liabilities
<i>Governmental Funds</i>				
General Fund	\$	\$	\$ 16,267	\$ 16,267
Housing Special Revenue Fund			2,959	2,959
Non-Major Funds	5,076,301	850		5,077,151
Total governmental funds	<u>5,076,301</u>	<u>850</u>	<u>19,226</u>	<u>5,096,377</u>
<i>Business Type Funds</i>				
Wastewater System		271,738	121,783	393,521
Water System		452,735	11,348	464,083
Refuse Collection		222,907		222,907
Non-Major Funds		24,488	12,396	36,884
Total business type funds		<u>971,868</u>	<u>145,527</u>	<u>1,117,395</u>
<i>Internal Services Funds</i>			20,513	20,513
Total	<u>\$ 5,076,301</u>	<u>\$ 972,718</u>	<u>\$ 185,266</u>	<u>\$ 6,234,285</u>

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

9. LONG-TERM DEBT

A. Government-Wide Financial Statements

Governmental Activities

Following is a summary of governmental activity long-term debt transactions during the fiscal year ended June 30, 2012:

	Balance July 1, 2011	Additions	Retirements	Dissolution of Redevelopment Agency	Balance June 30, 2012	Due Within One Year	Due in More than One Year
Tax Allocation Bonds	\$ 32,372,825	\$	\$ (2,030,000)	\$ (30,342,825)	\$	\$	\$
Pension Obligation Bonds	6,690,000		(205,000)		6,485,000	245,000	6,240,000
Loans Payable	5,350,000		(2,700,000)	(2,400,000)	250,000	250,000	
Loan Guarantees	554,869		(135,273)	(419,596)			
Capital Lease	7,157,493				7,157,493	122,417	7,035,076
Total	\$ 52,125,187	\$	\$ (5,070,273)	\$ (33,162,421)	\$ 13,892,493	\$ 617,417	\$ 13,275,076

Dissolution of the Redevelopment Agency

With the dissolution of the Redevelopment Agency as discussed in Note 18 Extraordinary Item - Redevelopment Agency Dissolution, the February 1, 2012 balance of the following tax allocation bonds, loans payable and loan guarantees have been removed from the basic financial statements.

Tax Allocation Bonds	
1999 \$25,000,000 Tax Allocation Bonds, Series A	\$ 7,400,000
2001 \$2,400,000 Tax Allocation Bonds, Series A	2,000,000
2003 \$9,007,825 Tax Allocation Bonds, Series A	8,167,825
2009 \$13,120,000 Tax Allocation Bonds, Series A	12,775,000
Total Tax Allocation Bonds	30,342,825
Loan Payable:	
2003 \$4,000,000 Loan Payable	2,400,000
Loan guarantees:	
2001 Debt Service Agreement	121,496
2005 Debt Service Agreement	298,100
	419,596
Total Dissolution of Redevelopment Agency Debt	\$ 33,162,421

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

9. LONG-TERM DEBT, Continued

A. Government-Wide Financial Statements, Continued

Pension Obligation Bonds

California Statewide Communities Development Authority Taxable Pension Obligation Bonds

On June 29, 2004, the California Statewide Communities Development Authority (CSCDA) issued bonds pursuant to the terms of a Trust Agreement dated June 29, 2004, by and between the CSCDA and Wells Fargo Bank (Trustee) as trustee for the purpose of purchasing taxable pension obligation bonds of participating counties and cities (Local Agencies). The obligations of each Local Agency are imposed by law. The total amount of the bonds issued was \$197,084,195. The City's obligation amounted to \$7,355,000.

The bond proceeds in the amount of \$7,138,378 were used by the City to prepay a portion of the unfunded actuarial accrued liability to the California Public Employees' Retirement System. The bonds are an unconditional obligation of the City payable from legally available funds. The prepayment created a net pension asset. At June 30, 2012, the net pension asset was \$5,474,663. Additional information about the net pension asset can be found in Note 14. Retirement Plans.

Principal payments are due on June 1 of each year and interest payments ranging from 2.65% to 5.58% are due on June 1 and December 1 of each year. Local Agencies are obligated to deposit with the Trustee an amount equal to the annual debt service by August 1 of each year.

The annual debt service requirements for the Pension Obligation Bonds are as follows:

For the Years Ending June 30,	Principal	Interest	Total
2013	\$ 245,000	\$ 377,162	\$ 622,162
2014	285,000	364,104	649,104
2015	325,000	348,691	673,691
2016	375,000	330,790	705,790
2017	425,000	309,835	734,835
2018-2022	3,065,000	1,103,141	4,168,141
2023-2024	1,765,000	158,602	1,923,602
Total	\$ 6,485,000	\$ 2,992,325	\$ 9,477,325

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

9. LONG-TERM DEBT, Continued

A. Government-Wide Financial Statements, Continued

Loans Payable

Loans payable at June 30, 2012 consisted of the following:

2008 \$250,000 Property Acquisition Loan Payable	\$ 250,000
Total	\$ 250,000

2008 \$250,000 Real Estate Purchase Agreement

2008 \$250,000 Real Estate Purchase Agreement for the purchase of park land in Fahrens Park. Payments are \$15,000 interest only for 4 years. A balloon payment of \$250,000 principal and \$15,000 interest will be paid in 2013. The annual debt service requirements for the 2008 \$250,000 Real Estate Purchase Agreement are as follows:

For the Years Ending June 30,	Principal	Interest	Total
2013	\$ 250,000	\$ 15,000	\$ 265,000
Total	\$ 250,000	\$ 15,000	\$ 265,000

Capital Lease

The City entered into a capital lease agreement to fund certain energy cost saving facility improvement measures and facility upgrades under which the related facility will become the property of the City when all terms of the lease agreement are met.

The following is a summary of property leased under capital lease agreements by the City as of June 30, 2012:

	Stated Interest Rate	Present Value of Remaining Payments as of June 30, 2012
Governmental Activities: Facilities	4.50%	\$ 7,157,493

The equipment is currently under construction.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

9. LONG-TERM DEBT, Continued

A. Government-Wide Financial Statements, Continued

Capital Lease, Continued

As of June 30, 2012, future minimum lease payments under capital leases are as follows:

Year Ending June 30:	Governmental Activities
2013	\$ 569,641
2014	590,122
2015	611,321
2016	633,262
2017	655,970
2018-2022	3,649,290
2023-2027	3,336,454
Total Future Minimum Lease Payments	10,046,060
Less: Interest	(2,888,567)
Present Value of Minimal Lease Payments	<u>\$ 7,157,493</u>

Business-Type Activities

Following is a summary of business-type activity long-term debt transactions during the fiscal year ended June 30, 2012:

	Balance June 30, 2011	Additions	Retirements	Balance June 30, 2012	Due Within One Year	Due in More than One Year
Revenue bonds payable	\$ 23,748,115	\$ 19,803,425	\$ (23,748,115)	\$ 19,803,425	\$ 1,212,580	\$ 18,590,845
Loans payable	42,632,841		(2,814,662)	39,818,179	1,989,367	\$ 37,828,812
Water well development agreement	47,086		(23,070)	24,016	24,016	
Improvement bonds payable	645,000		(645,000)			
Total	<u>\$ 67,073,042</u>	<u>\$ 19,803,425</u>	<u>\$ (27,230,847)</u>	<u>\$ 59,645,620</u>	<u>\$ 3,225,963</u>	<u>\$ 56,419,657</u>

Revenue Bonds Payable

Revenue bonds payable at June 30, 2012, consisted of the following:

Water Revenue Bonds Payable	\$ 5,987,185
Wastewater Revenue Bonds Payable	13,816,240
Total	<u>\$ 19,803,425</u>

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

9. LONG-TERM DEBT, Continued

A. Government-Wide Financial Statements, Continued

Revenue Bonds Payable, Continued

2005 CSCDA Water and Wastewater Revenue Bonds, Series A

On June 2, 2004, the California Statewide Communities Development Authority (CSCDA) issued Water and Wastewater Revenue Bonds (Pooled Financing Program) in the amount of \$56,880,000 pursuant to an Indenture by and between the CSCDA and Union Bank of California (Trustee) as trustee. The pooled financing program was available to California cities and special districts that operate water and wastewater enterprises. The bonds were authorized by law and were used to finance and refinance certain public capital improvements of the four project participants.

Principal payments were due on October 1 of each year and interest payments ranging from 3% to 5.25% were due on April 1 and October 1 of each year.

The 2005 CSCDA Water and Wastewater Revenue Bonds were refunded by the 2012 Series Water and Wastewater Revenue Bonds. Additional information on the refunding of the 2005 CSCDA Water and Wastewater Revenue Bonds can be found in the following discussion.

2012 Series Water and Wastewater Revenue Bonds

On June 19, 2012, the City issued 2012 series in the amount of \$17,995,000 with an average interest rate of 3.665 percent to advance refund \$22,270,000 of outstanding 2005 CSCDA Water and Wastewater Bonds, \$6,555,000 and \$15,715,000 respectively, with an average interest rate of 5.223 percent. The net proceeds of \$19,853,035, after payment of \$305,711 in underwriting fees, insurance, and other issuance costs, plus an additional \$4,225,388 of city funds were used to purchase State and Local Government Securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the 2005A Series bonds. As a result, the 2005 CSCDA Water and Wastewater Bonds are considered to be defeased and the liability for those bonds has been removed from the long term debt.

The City completed the advance refunding to reduce debt service payments over the next 14 years which achieved an economic gain of \$2,339,835. The advance refunding resulted in a difference between the reacquisition price and net carrying amount of the old debt of \$1,808,425 and is reported as unamortized premium. It will be charged to operations through the year 2022 using the effective-interest method. The amount issued of \$17,995,000 plus amortized premium of \$1,808,425 equals the total revenue bonds payable of \$19,803,425.

The bonds were secured by pledges of the Water Enterprise Fund and Wastewater Enterprise Fund net revenues under the respective installment purchase agreements for each individual program participant. The City's obligation is \$5,455,000 for its Water Enterprise Fund and \$12,540,000 for its Wastewater Enterprise Fund.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

9. LONG-TERM DEBT, Continued

A. Government-Wide Financial Statements, Continued

Revenue Bonds Payable, Continued

2012 Series Water and Wastewater Revenue Bonds, Continued

Principal payments are due on October 1 of each year and interest payments ranging from 2.0% to 5.0% are due on April 1 and October 1 of each year.

The annual debt service requirements for the CSCDA Water Revenue Bonds are as follows:

For the Years Ending June 30,	Principal	Interest	Total
2013	\$ 335,000	\$ 143,515	\$ 478,515
2014	355,000	175,463	530,463
2015	365,000	164,663	529,663
2016	375,000	154,125	529,125
2017	385,000	144,731	529,731
2017-2021	2,140,000	494,600	2,634,600
2022-2025	1,500,000	78,599	1,578,599
	5,455,000	1,355,696	6,810,696
Add unamortized premium	532,185		532,185
Total	\$ 5,987,185	\$ 1,355,696	\$ 7,342,881

The annual debt service requirements for the CSCDA Wastewater Revenue Bonds are as follows:

For the Years Ending June 30,	Principal	Interest	Total
2013	\$ 810,000	\$ 376,654	\$ 1,186,654
2014	805,000	466,925	1,271,925
2015	825,000	446,500	1,271,500
2016	850,000	422,438	1,272,438
2017	870,000	395,725	1,265,725
2018-2022	5,995,000	1,572,125	9,139,250
2023-2025	2,385,000	120,624	2,505,624
	12,540,000	3,800,991	16,340,991
Add unamortized premium	1,276,240		1,276,240
Total	\$ 13,816,240	\$ 3,800,991	\$ 17,617,231

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

9. LONG-TERM DEBT, Continued

A. Government-Wide Financial Statements, Continued

Loans Payable

Loans payable at June 30, 2012 consisted of the following:

California Infrastructure Bank and Economic Development Bank (CIEDB)		
Enterprise Fund Installment Sales Agreement		\$ 7,502,209
California State Water Resources Control Board		
Clean Water State Revolving Fund		32,315,970
	<i>Total</i>	<u>39,818,179</u>
Water Well Development Agreement		24,016
Total		<u><u>\$ 39,842,195</u></u>

California Infrastructure and Economic Development Bank Enterprise Fund Installment Sales Agreement

On October 1, 2003, the City entered into an Enterprise Fund Installment Sales Agreement with California Infrastructure and Economic Development Bank for the purchase of water and sewer improvements for the University of California Merced Campus. The promissory note is not to exceed \$9 million and bears interest of 3.17%.

Principal payments are due on August 1 of each year and interest payments are due on February 1 and August 1 of each year.

The annual debt service requirements for the Enterprise Fund Installment Sales Agreement are as follows:

For the Years Ending June 30,	Principal	Interest	Total
2013	\$ 175,000	\$ 235,046	\$ 410,046
2014	175,000	229,499	404,499
2015	200,000	223,555	423,555
2016	200,000	217,214	417,214
2017	225,000	201,479	426,479
2018-2022	1,375,000	933,519	2,308,519
2023-2027	1,850,000	667,938	2,517,938
2028-2032	2,275,000	347,067	2,622,067
2033-2034	1,027,209	32,991	1,060,200
Total	<u><u>\$ 7,502,209</u></u>	<u><u>\$ 3,088,308</u></u>	<u><u>\$ 10,590,517</u></u>

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

9. LONG-TERM DEBT, Continued

A. Government-Wide Financial Statements, Continued

Loans Payable, Continued

California State Water Resources Control Board Clean Water State Revolving Fund Loan

On October 1, 2008, the City entered into an agreement with California State Water Resources Control Board for a Wastewater Treatment Plant Expansion Project funded by Clean Water State Revolving Fund (CWSRF) loan. The project consists of upgrading and expanding existing facilities. The loan amount was originally \$34,980,632 with an interest rate of 1.0% per annum. The City received the American Recovery and Reinvestment Act (ARRA) principal forgiveness grant of \$2,000,000, which was contingent on the City's completion of the project by December 31, 2011, and other American Recovery and Reinvestment Act (ARRA) requirements. In addition, the costs of the improvements required fewer funds from the loan.

The loan principal has been adjusted as follows:

Loan Balance at June 30, 2011	\$ 34,980,632
Less ARRA Principal Forgiveness	(2,000,000)
Less unspent loan funds	<u>(664,662)</u>
Loan Balance at June 30, 2012	<u><u>\$ 32,315,970</u></u>

Principal and interest payments are due on September 30 of each year beginning September 2012 and ending September 30, 2031.

The annual debt service requirements for the Clean Water State Revolving Fund Loan are as follows:

For the Years Ending June 30,	Principal	Interest	Total
2013	\$ 1,484,522	\$ 305,298	\$ 1,789,820
2014	1,481,505	308,314	1,789,819
2015	1,496,320	293,499	1,789,819
2016	1,511,284	278,536	1,789,820
2017	1,526,396	263,423	1,789,819
2018-2022	7,864,016	1,085,082	8,949,098
2023-2027	8,265,160	683,938	8,949,098
2028-2031	8,686,767	262,332	8,949,099
Total	<u><u>\$ 32,315,970</u></u>	<u><u>\$ 3,480,422</u></u>	<u><u>\$ 35,796,392</u></u>

Water Well Development Agreement

During fiscal year 2002, the City entered into a Development Agreement with Zelman Retail Partners, Inc. (Developer) which contained a provision for the construction of a water well site. The City determined that the fair value of the well site was \$250,000 which the City agreed to pay to the Developer in ten equal annual installments. The accreted interest was calculated at a rate of 4.1% resulting in a principal amount of \$201,767.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

9. LONG-TERM DEBT, Continued

A. Government-Wide Financial Statements, Continued

Loans Payable, Continued

Water Well Development Agreement, Continued

The annual debt service requirements of the Development are as follows:

For the Years Ending June 30,	Principal	Interest	Total
2013	\$ 24,016	\$ 984	\$ 25,000
Total	\$ 24,016	\$ 984	\$ 25,000

Improvement Bonds Payable

1999 \$4,024,381 Improvement Bonds, North Merced Sewer Improvement Refunding Reassessment City, \$264,381 to \$430,000 principal payable annually, interest at 4.35% to 5.55% payable semi-annually, matures in fiscal year 2013, secured by assessments. The bond was paid in full in fiscal year 2012.

B. Fund Financial Statements

The Governmental Fund Financial Statements do not present General Government long-term debt. Consequently, long term debt is shown as a reconciling item in the Reconciliation of the Governmental Funds Balance Sheet to the Government-Wide Statement of Net Assets.

The long-term debt of the enterprise funds in the Proprietary Fund Financial Statements are the same as those shown in the business-type activities of the Government-Wide Financial Statements. Internal Service Funds' long-term debt is combined with governmental activities.

C. Debt with No City Commitment

The following bond issues are not reported in the City's financial statements, because the City acts solely as an agent for the bond holders in collecting and forwarding the special assessments. Accordingly, no liability for these bonds has been recorded in the City's general purpose financial statements.

The City has issued bonds under the "Mello-Roos Community Facilities Act of 1982." These bonds are secured by real property within the district boundaries. Special taxes levied on these properties are used to pay the bonds.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

9. LONG-TERM DEBT, Continued

C. Debt with No City Commitment, Continued

	Outstanding June 30, 2012
1998 Liberty Park Refunding Assessment District	\$ 296,000
16th Street Refunding Assessment District	192,000
Fahrens Park Refunding Assessment District	3,480,000
Bellevue Ranch East CFD	9,800,000
Bellevue Ranch West CFD	6,820,000
Moraga CFD	5,405,000
Total	<u>\$ 25,993,000</u>

10. COMPENSATED ABSENCES

The City's compensated absences consist of accrued vacation pay and floating holiday pay for all permanent full-time employees. Some employees also accrue compensatory time. The total amount of the accrued liability is recorded in the Government-Wide Financial Statements and charges for compensated absences expense is charged to the General Fund, Development Services Fund, Housing Fund, Street Trees Fund, Streets and Street Light Maintenance Fund, Recreation & Parks Fund, Public Works Administration Fund, Measure "C" Fund, Maintenance Districts Fund, and the Community Facilities Districts Services Fund.

A summary of changes in compensated absences for the year ended June 30, 2012, is as follows:

	Balance July 1, 2011	Additions	Retirements	Balance June 30, 2012	Due Within One Year	Due in More than One Year
Governmental Activities	\$ 3,243,397	\$ 738,935	\$ (597,943)	\$ 3,384,389	\$ 572,146	\$ 2,812,243
Business-type Activities	597,864	101,617	(67,547)	631,934	56,707	575,227
Total	<u>\$ 3,841,261</u>	<u>\$ 840,552</u>	<u>\$ (665,490)</u>	<u>\$ 4,016,323</u>	<u>\$ 628,853</u>	<u>\$ 3,387,470</u>

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

11. CLASSIFICATION OF FUND BALANCE

In governmental funds, nonspendable, restricted, committed, assigned and unassigned are presented as components of fund balance as follows:

	General Fund	Housing Special Revenue	Low & Moderate Income Housing Special Revenue	Streets & Signals Capital Projects	Public Financing and Economic Development Authority Capital Projects	Non-Major Funds	Total
Nonspendable:							
Inventory	\$ 41,781	\$	\$	\$	\$	\$	\$ 41,781
Land held for resale		1,208,593	1,603,664			1,148,465	3,960,722
Advances receivable	1,710,991						1,710,991
Total Nonspendable	1,752,772	1,208,593	1,603,664			1,148,465	5,713,494
Restricted for:							
Street and street lights						1,928,556	1,928,556
Community development						11,792,909	11,792,909
Housing		666,293	1,277,494			5,269,324	7,213,111
Public safety						93,136	93,136
Special districts						2,155,020	2,155,020
Capital projects				3,326,941	1,662,871	120,656	5,110,468
Other special projects and programs	4,000,000					409,951	4,409,951
Total Restricted	4,000,000	666,293	1,277,494	3,326,941	1,662,871	21,769,552	32,703,151
Committed to:							
Street and street lights						177,260	177,260
Community development						16,364	16,364
Public safety						1,005,473	1,005,473
Total Committed						1,199,097	1,199,097
Assigned to:							
Appropriations in subsequent year	306,729						306,729
City council	83,101						83,101
City manager	1,622						1,622
City attorney	75,062						75,062
Finance	66,202						66,202
Purchasing	958						958
Police protection	429,835						429,835
Fire protection	397,641						397,641
Public works	11,471						11,471
Economic development	60,220						60,220
Visitor's service	70						70
Total Assigned	1,432,911						1,432,911
Unassigned	7,453,275					(3,106,486)	4,346,789
Total Fund Balances	\$ 14,638,958	\$ 1,874,886	\$ 2,881,158	\$ 3,326,941	\$ 1,662,871	\$ 21,010,628	\$ 45,395,442

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

12. OTHER FUND DISCLOSURES

A. Deficit Fund Balances

At June 30, 2012, the funds below had the following deficit fund balance or net assets:

Capital Project Funds

Park Reserve Fund \$ (3,106,947)

This fund is used to account for all in-lieu fees. As a condition of approval of a final subdivision map or parcel map, a subdivider shall dedicate land, pay a fee in lieu as building permits are pulled, or both, at the option of the City, for neighborhood and community park or recreational purposes. The deficit was caused by the City receiving dedicated park land prior to the Developer pulling building permits which resulted in a developer credit liability. The liability and deficit fund balance will be eliminated as the Developer pulls building permits.

Internal Service Funds

Workers Compensation Insurance Fund \$ (3,627,630)

The deficit net assets was caused by the adoption of Statement No 10 of the Governmental Accounting Standards Board, "Accounting and Financial Reporting for Risk Financing and related Insurance", which established accounting and financial reporting standards for risk financing and insurance-related activities of state and local governmental entities. The Governmental Accounting Standards Board No 10 requires an accrual of claims liabilities based on estimates of the ultimate cost of claims, including future claim adjustment expenditures, that have been reported but not settled, and of claims that have been incurred but not yet reported (IBNR). The recording of these estimated future claims and IBNR has caused the net assets deficit balance.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

12. OTHER FUND DISCLOSURES, Continued

A. Deficit Fund Balances, Continued

Internal Service Funds

Fleet Management \$ (101,009)

This fund is used to account for the daily operation and maintenance of city vehicles. The deficit fund balance was caused by the recording of Other Post Employment Benefits liability. The deficit balance will be eliminated by future fees.

Facility Maintenance \$ (4,005,892)

This fund is used to account for costs of maintaining and operating City facilities. The deficit fund balance was caused by recording of Other Post Employment Benefits liability as well as the recording of the capital lease agreement to fund certain energy cost saving facility improvement measures and facility upgrades. The related facility will become property of the City when all terms of the lease agreement are met. The deficit balance will be eliminated by future fees and debt service payments related to the capital lease agreement.

Support Services Fund \$ (336,019)

This fund is used to account for personnel, Information Systems, Records, and Risk Management Administration divisions which support all other city functions. The deficit fund balance was caused by the recording of Other Post Employment Benefits liability. The deficit balance will be eliminated by future fees.

13. RISK MANAGEMENT

The City maintains internal service funds to account for the City's general liability insurance and workers' compensation insurance. All unpaid claims that were probable liabilities that occurred prior to the year-end and that were estimated based on actuarial studies or historical data were recorded in accordance with GASB Statement No. 10. As of June 30, 2012, claims for general liability and workers' compensation were \$231,266 and \$3,733,424, respectively.

The Liability Insurance Fund is used to account for all general liability claims against the City. The City is a member of the Central San Joaquin Valley Risk Management Authority, with a self-insured retention of \$100,000 for general liability and errors and omissions, and \$100,000 for vehicle liability. Settled claims have not exceeded the commercial claims in any fiscal year. The changes in the general claims liability were as follows:

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

13. RISK MANAGEMENT, Continued

Year Ended June 30,	Claims Payable July 1	Fiscal Year Claims and Changes in Estimates	Claims Payments	Claims Payable June 30	Due Within One Year
2010	\$ 646,999	\$ 2,465,666	\$ (2,215,943)	\$ 896,722	\$ 896,722
2011	896,722	1,796,927	(1,831,740)	861,909	861,909
2012	861,909	2,237,517	(2,868,161)	231,265	231,265

The Workers' Compensation Insurance Fund is used to account for all workers' compensation claims against the City. The fund provides for a maximum of \$350,000 for each claim. The City purchases commercial insurance for claims in excess of the coverage provided in the fund. Settled claims have not exceeded the commercial claims in any fiscal year. The changes in the workers' compensation claims liability were as follows:

Year Ended June 30,	Claims Payable July 1	Fiscal Year Claims and Changes in Estimates	Claims Payments	Claims Payable June 30	Due Within One Year
2010	\$ 2,605,064	\$ 916,778	\$ (975,395)	\$ 2,546,447	\$ 570,512
2011	2,546,447	1,573,763	(1,093,813)	3,026,397	1,057,516
2012	3,026,397	2,669,917	(1,962,890)	3,733,424	1,066,464

14. RETIREMENT PLANS

Pension Plan

Plan Description - The City contributes to the California Public Employees Retirement system (CalPERS), an agent multiple-employer public employee defined benefit pension plan. CalPERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. CalPERS acts as a common investment and administrative agent for participating public entities within the State of California. Benefit provisions and all other requirements are established by State Statute and City Ordinance. Copies of CalPERS' Annual Financial Report may be obtained from their Executive Office located at 400 P Street, Sacramento, California 95814.

Funding Policy - Active plan members are required by State Statute to contribute 8% for miscellaneous and 9% for safety employees of their annual covered salary. The required employee contribution was paid by the City. This amounted to \$2,352,612 for the year ending June 30, 2012. The City employer is required to contribute for fiscal year 2011-2012 at an actuarially determined rate of 12.253% and 21.824% of annual covered payroll for miscellaneous and safety employees, respectively. Of the combined employee and employer miscellaneous rate of 20.253%, miscellaneous employees contributed a range from 2.95% to 6.95% of annual covered payroll. Of the combined employee and employer safety rate of 30.824%, safety employees contributed a range from 0% to 6.243% of annual covered payroll. See the Required Supplementary Information for the Schedule of Funding Progress.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

14. RETIREMENT PLANS, Continued

Pension Plan, Continued

Annual Pension Cost - For fiscal year 2011-2012 the City's annual pension cost of \$4,895,681 is equal to the City's annual required contribution of \$4,623,948, plus the amortization of the net pension asset of \$271,733. The City's contributions paid are equal to the annual required contributions. The annual required contribution was determined as part of the June 30, 2009, actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included (a) 7.75% investment rate of return (net of administrative expenses.), (b) projected annual salary increases that range from 3.55% to 14.45% for miscellaneous and 3.55% to 13.15% for safety employees depending on age, service, and type of employment, and (c) 3.25% per year cost-of-living adjustments. Both (a) and (b) included an inflation component of 3.00%. The actuarial value of CalPERS assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a 15 year period. CalPERS unfunded actuarial accrued liability (or surplus) is being amortized as a level percentage of projected payroll on a closed basis. The remaining amortization period at June 30, 2009, was 29 years for safety employees and 27 years for miscellaneous employees for prior and current service unfunded liability.

Bond proceeds from the 2004 California Statewide Development Authority Taxable Pension Obligation Bonds were used to prepay a portion of the unfunded actuarial accrued liability to the California Public Employees' Retirement System. The prepayment created a net pension asset, which is amortized over a 20 year period. A net pension asset is defined as the cumulative difference between annual pension cost and the employer's annual contributions to a plan.

The City's annual pension cost and net pension asset for the year ended June 30, 2012, were as follows:

Net Pension Asset	
Annual Required contribution	\$ 4,623,948
Interest	(445,346)
Adjustment	717,079
Annual Pension cost	<u>4,895,681</u>
Contributions paid	<u>4,623,948</u>
Decrease in pension asset	(271,733)
Net pension asset, beginning of year restated (Note 19)	<u>5,746,396</u>
Net pension asset, end of year	<u><u>\$ 5,474,663</u></u>

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

14. RETIREMENT PLANS, Continued

Pension Plan, Continued

THREE-YEAR TREND INFORMATION FOR PERS*

Year Ended June 30,	Miscellaneous Employees	Safety Employees	Total Annual Required Contribution (ARC)	Amortization on Pension Asset	Total Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Asset End of Year
	Annual Required Contribution (ARC)	Annual Required Contribution (ARC)	Contribution (ARC)				
2010	\$ 1,652,713	\$ 2,360,359	\$ 4,013,072	\$ 234,049	\$ 4,247,121	94%	\$ 5,998,584
2011	1,644,110	2,384,194	4,028,304	252,188	4,280,492	94%	5,746,396
2012	2,007,337	2,616,611	4,623,948	271,733	4,895,681	94%	5,474,663

* Restated – see Note 19, Prior Period Adjustment for additional information.

A total of \$5,474,663 of unamortized net pension asset is reported on the Government-Wide Financial Statements as Prepaid Pension Asset. Additional information about the bond issue can be found in Note 9. Long-Term Debt.

Funded Status of Plan

The City contributed to the California Public Employees’ Retirement System (CalPERS), as an agent multiple-employer public employee defined benefit pension plan. The amounts reflected herein represent the City’s portion as reported by CalPERS.

The actuarial value of assets for the plan is generally a market related value, while the amount reported as a net pension asset is the unamortized prepaid pension asset created by the issuance of the California Statewide Development Authority Taxable Pension Obligation Bonds.

Miscellaneous Employees

Actuarial Valuation Date	Actuarial Value of Assets	Entry Age Actuarial Accrued Liability	Actuarial Unfunded (Overfunded) Liability	Funded Ratio	Covered Payroll	Liability as Percentage of Covered Payroll
6/30/2011	\$ 84,987,120	\$ 102,743,573	\$ 17,756,453	82.7%	\$ 16,833,042	105.5%

Safety Employees

Actuarial Valuation Date	Actuarial Value of Assets	Entry Age Actuarial Accrued Liability	Actuarial Unfunded (Overfunded) Liability	Funded Ratio	Covered Payroll	Liability as Percentage of Covered Payroll
6/30/2011	\$ 94,119,678	\$ 108,814,708	\$ 14,695,030	86.5%	\$ 12,608,240	116.6%

* Additional information regarding the funded status of the miscellaneous and safety employees’ retirement plan can be found in the Required Supplementary Information section.

City of Merced

Notes to Basic Financial Statements, Continued For the year ended June 30, 2012

15. OTHER POSTEMPLOYMENT HEALTH CARE BENEFITS

Plan Description. The City of Merced Retiree Healthcare Plan ("Plan") is a single-employer defined benefit healthcare plan administered by the City of Merced. Benefit provisions are established and may be amended through agreements and Memorandums of Understanding (MOU) between the City, its management employees, and the unions representing City employees. The City's Retiree Healthcare Plan does not issue a stand-alone financial report.

The City has \$1,294,000 in the California Employers' Retiree Benefit Trust (CERBT) at the beginning of the fiscal year ending June 30, 2012. CERBT is a tax-qualified irrevocable trust administered by the California Public Employees' Retirement System (CalPERS) and organized under Internal Revenue Code Section 115 to pre-fund retiree healthcare and other postemployment benefits. Copies of CalPERS' financial report may be obtained from the CalPERS website at www.calpers.ca.gov or from CalPERS Headquarters at 400 Q Street, Sacramento, California, 95811.

Out of approximately 429 full-time City employees, approximately 242 full-time employees have a current MOU that calls for the City to provide health care insurance upon retirement. Employees hired after December 31, 2002 in the Public Safety Bargaining Unit, December 31, 2003 in the AFSCME Bargaining Unit, December 31, 2004 in the MACE Bargaining Unit, and July 4, 2006 for Unrepresented Management Employees are not eligible for retirement healthcare benefits.

Eligible employees can participate in the City's Retiree Healthcare Plan if they retire directly from the City with at least 10 years of City service. There is no minimum service requirement if retirement is due to a service-connected disability. The City pays the retiree-only premium for medical coverage, up to a capped amount that varies by bargaining unit. Spouse and dependent coverage is available only until the retiree is deceased, and at their own expense. Medical coverage is with Anthem Blue Cross of California. Dental and vision benefits are also available to retirees, but at their own expense. Based on the employee's MOU, employees hired after certain dates are not eligible for the City's Retiree Healthcare Plan.

Since medical premiums are determined for actives and retirees on a combined basis, an implied subsidy must be reflected under GASB 45.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

15. OTHER POSTEMPLOYMENT HEALTH CARE BENEFITS, Continued

Funding Policy. The contribution requirements of the Plan participants and City are established by and may be amended by the City pursuant to agreements with its management employees and the unions representing City employees. The plan is currently funded on a pay-as-you-go basis. No additional pre-funding is currently planned.

For the fiscal year ending June 30, 2012, the City contributed \$1,829,000 to the plan, including \$1,408,000 in medical premium payments for retirees, \$421,000 for implied subsidies. The City allows retirees to participate in the same City medical plan (Anthem Blue Cross of California) as active employees. Because active employees and retirees have pooled premiums, retirees pay less than they would if they were in a stand-alone medical plan. The difference between the expected claims for retirees and the premium charged to retirees is the implied subsidy. The implied subsidy has been included in the actuarial valuation as required under GASB 45, and therefore the corresponding benefit payments are included as an offset to the Annual OPEB Cost accrual.

Annual OPEB Cost and Net OPEB Obligation. The City's annual other postemployment benefit cost (expense) is calculated based on the annual required contribution (ARC) of the employer. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the Normal Cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

The following table shows the components of the City's annual OPEB cost for the year, the amount actually contributed to the Plan, and changes in the City's Net OPEB obligation:

Annual required contribution	\$ 6,717,000
Interest on net OPEB obligation	493,000
Adjustment to annual required contribution	<u>(1,197,000)</u>
Annual OPEB cost (expense)	6,013,000
Contributions made to CERBT	(0)
Benefit payments made outside of CERBT	<u>(1,829,000)</u>
Increase in net OPEB obligation	4,184,000
Net OPEB obligation - beginning of year	<u>11,601,000</u>
Net OPEB obligation - end of year	<u>\$ 15,785,000</u>

The City's annual OPEB cost, the percentage of annual OPEB cost contributed to the Plan, and the net OPEB obligation for fiscal year 2012 and the two preceding fiscal years were as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
6/30/10	\$ 5,951,000	31.7%	\$ 8,435,000
6/30/11	5,929,000	46.6%	11,601,000
6/30/12	6,013,000	30.4%	15,785,000

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

15. OTHER POSTEMPLOYMENT HEALTH CARE BENEFITS, Continued

Funded Status and Funding Progress. The funded status of the Plan as of June 30, 2012, the Plan's most recent actuarial valuation date, was as follows:

Actuarial accrued liability (AAL)	\$ 71,442,000
Actuarial value of Plan assets	<u>(1,261,000)</u>
Unfunded actuarial accrued liability (UAAL)	\$ 70,181,000
Funded ratio (actuarial value of Plan assets/AAL)	1.77%
Covered payroll (eligible active Plan participants)	\$ 16,299,000
UAAL as a percentage of covered payroll	430.6%

Actuarial valuations of an ongoing plan involve estimates of the value of expected benefit payments and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions. Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan participants) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan participants to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the June 30, 2011 actuarial valuation, the entry age normal actuarial cost method was used. The actuarial assumptions included a 4.25% investment rate of return (net of administrative expenses), which is the expected long-term investment return on the City's investments, a 3% general inflation assumption, and an annual pre-Medicare medical cost increase rate of 9.0% for 2013, grading down to 5.0% for 2021 and after. The post-Medicare medical cost increase rate is 9.4% for 2013, grading down to 5.0% for 2021 and after. The caps on the City-paid medical benefits were assumed to increase with the pre-Medicare medical cost trend rate. The initial UAAL as of June 30, 2008 was amortized as a level dollar amount over a fixed 30-year period, plan and assumption changes over a fixed 20-year period, and gains and losses over an open 15-year period. The remaining equivalent single amortization period as of June 30, 2011 was 24 years.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

16. COMMITMENTS AND CONTINGENT LIABILITIES

Project Commitments

As of June 30, 2012, the City had the following outstanding commitments that exceeded \$500,000:

Vendor Name	Outstanding Amount
C. Overaa & Co Inc.	\$ 7,081,757
Merced Pacific Associates	2,688,500
Stantec Consulting Services, Inc.	1,207,274
George Reed, Inc	1,201,874
Carollo Engineers	1,007,324
Taylor Backhoe Service, Inc	988,812
Maxwell Construction, Inc.	793,518
Merced Co Dept of Public Works	679,957
Provost & Pritchard Consulting	565,188
	<u>\$ 16,214,204</u>

17. POLLUTION REMEDIATION OBLIGATIONS

The City of Merced and Agency are aware of various contaminated sites throughout the City, which contain certain gasoline chemicals and other contaminants such as pesticides and solvents. The City is participating on behalf of private responsible parties in pollution remediation activities such as site assessments and cleanups per certain local and state regulations or requirements.

The State of California Regional Water Quality Control Board requires the City to expend \$250,000 annually on perchloroethylene (PCE) remediation efforts at certain dry cleaner sites. Costs for these activities are funded through existing water service fees.

The City and Agency initiated litigation with a variety of entities regarding contamination at specific sites. The liabilities associated with these sites are not reasonably estimable and, as such, are not recorded in the financial statements.

18. EXTRAORDINARY ITEM - REDEVELOPMENT AGENCY DISSOLUTION

On June 28, 2011, the California Legislature adopted Assembly Bill 1X 26 (Dissolution Act), which provided for the elimination of redevelopment agencies. The Bill provides that upon dissolution of a redevelopment agency, either the city or another unit of local government will agree to serve as the "successor agency" to hold the assets until they are distributed to other units of state and local government.

If no local agency elects to serve as a successor agency for a dissolved redevelopment agency, a public body, referred to as a "designated local authority" (DLA) shall be immediately formed. The Governor shall appoint three residents of the county to serve as the governing board of the authority. The designated local authority shall serve as successor agency until a local agency elects to become the successor agency in

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

18. EXTRAORDINARY ITEM - REDEVELOPMENT AGENCY DISSOLUTION, Continued

accordance with the legislation. Because neither the City nor any other local government agreed to serve as the "successor agency", the Governor appointed three residents who met for the first time on August 2, 2012.

After enactment of the law, redevelopment agencies in the State of California cannot enter into new projects, obligations or commitments. Subject to the review of a newly established oversight board, remaining assets of the former redevelopment agency can only be used to pay enforceable obligations in existence at the date of dissolution, including the completion of any unfinished projects that were subject to legally enforceable obligations -- including contracts.

The California Redevelopment Association along with others filed suit challenging the constitutionality of Dissolution Act. On December 29, 2011, the California Supreme Court upheld most of the Dissolution Act which effectively dissolved all Redevelopment Agencies as of February 1, 2012.

On January 12, 2012, the Merced City Council took action to retain the housing assets and functions performed by the Redevelopment Agency, but elected not to serve as the successor agency for the non-housing elements of redevelopment.

Effective February 1, 2012, the Redevelopment Agency of the City of Merced was dissolved and all funds closed. The housing assets and liabilities were transferred to the City's Low and Moderate Income Housing Funds and all remaining non-housing assets and liabilities became the responsibility of the successor agency and therefore are not reflected in the financial statement.

On June 27, 2012, the California Legislature adopted Assembly Bill 1484 (AB 1484), which amended the Dissolution Act. Per Health and Safety Code Section 34183, under AB 1484, the county auditor-controller was to determine the amount, if any, owed by each successor agency to taxing entities and was to provide a demand for payment to the successor agency by July 9, 2012, the "true-up payment".

The true-up payment funds were to be paid to the county by the successor agency no later than July 12, 2012 for deposit into the Redevelopment Property Tax Trust Fund and subsequent distribution by July 16, 2012 to taxing entities.

The County of Merced did not provide such a demand and because no successor agency had been formed, and in order to comply with the legislation, and to avoid both the potential interruption of either sales and use taxes or property taxes or both as well as penalties under AB 1484, the City of Merced remitted all uncommitted funds in the amount of \$5,634,827 from the former Redevelopment Agency to the County of Merced on July 12, 2012.

In order to further prevent the accrual of penalties or the interruption of revenue to the Merced Designated Local Authority or the City, the DLA filed suit on December 24, 2012 against the State Department of Finance, the State Board of Equalization, and the County Auditor-Controller to prevent the immediate application of AB 1484's tax interruption or penalty provisions (*Merced Designated Local Authority V. State Department of Finance et al., Sacramento County Superior Court Case No. 34-2012-80001351-CU-WM-GDS*). A stipulated temporary restraining order was issued by the court on January 2, 2013.

City of Merced
Notes to Basic Financial Statements, Continued
For the year ended June 30, 2012

19. PRIOR PERIOD ADJUSTMENT

During the fiscal year the City identified an accounting correction, and accordingly restated the City's net assets as of July 1, 2011 as follows:

Bond proceeds in the amount of \$7,138,378 from the 2004 California Statement Development Authority Taxable Pension Obligation Bonds were used to prepay a portion of the unfunded actuarial accrued liability to the California Public Employees' Retirement System. The prepayment created a net pension asset, which is amortized over a 20 year period.

The City made an accounting adjustment of \$5,746,396 to Net Assets to record the balance of the unamortized prepaid pension asset. Additional information about the bond issue and prepaid pension asset can be found in Note 9. Long-Term Debt and Note 14. Retirement Plans, respectively.

At June 30, 2012, as a result of the correction, the Government-Wide Financial Statements were restated as follows:

	Net Assets as Previously Reported at June 30, 2011	Accounting Correction to Prepaid Pension Asset	Net Assets, Beginning of Year, as Restated
Governmental Activities	\$ 385,070,225	\$ 5,746,396	\$ 390,816,621

Per GASB 27, net pension assets are reported only in the Government-Wide Financial Statements and not in the Fund Financial Statements.

REQUIRED SUPPLEMENTARY INFORMATION

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City of Merced
Required Supplementary Information
For the year ended June 30, 2012

1. BUDGETARY CONTROL AND ACCOUNTING

The City follows these procedures in establishing the budgetary data reflected in the financial statements:

1. The annual budget adopted by the City Council provides for the general operation of the City. The annual budget is adopted by the City Council in June of each year for all funds. The resolution sets a combined appropriation of the funds for the operation of the City.
2. The City Manager is authorized to transfer budgeted amounts between departments and line items to assure adequate and proper standards of service. Budgetary revisions, including supplemental appropriations which increase appropriations in individual funds and transfers between funds, must be approved by the City Council. The budgetary level of control is at the fund level. The budgeted figures used in the financial statements are the final amended amounts.
3. The budget is formally integrated into the accounting system and employed as a management control device during the year for all funds.
4. Budgets for the governmental fund types are adopted and recorded on the modified basis of accounting on a basis consistent with GAAP. Budget appropriations lapse at the end of the fiscal year. Supplemental appropriations were adopted by the City Council and have been included in the schedules of revenues, expenditures, and changes in fund balance - budget to actual

Under Article XIII B of the California Constitution (the Gann Spending Limitation Initiative), the City is restricted as to the amount of annual appropriations, and if certain proceeds of taxes exceed allowed appropriations, the excess must either be refunded to the State Controller or refunded to the taxpayers through revised tax rates or revised fee schedules. For the fiscal year ended June 30, 2012, proceeds of taxes did not exceed allowable appropriations.

The accompanying Budgetary Comparison Schedule of Revenues, Expenditures and Changes in Fund Balances - Budget and Actual for the Major Funds present comparisons of the legally-adopted budget with actual data on a basis consistent with GAAP.

Encumbrances

Under encumbrance accounting, purchase orders, contracts and other commitments for the expenditures of monies are recorded in order to reserve that portion of the applicable appropriation. Encumbrance accounting is employed as an extension of the formal budgetary process. Encumbrances outstanding at year-end are reported in the various categories of fund balance since they represent commitments, which will be honored during the subsequent year. Encumbrances do not represent expenditures or liabilities.

CITY OF MERCED
Required Supplementary Information, Continued
For the Year Ended June 30, 2012

Budgetary Comparison Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual
General Fund

	Budget		Actual	Variance with Final Budget
	Original	Final		
REVENUES:				
Taxes:				
Property tax:				
Secured	\$ 4,764,710	\$ 4,764,710	\$ 4,630,660	\$ (134,050)
Unsecured	393,205	393,205	366,396	(26,809)
Supplemental roll:				
Prior year - unsecured	5,000	5,000	25,182	20,182
Prior year - supplemental roll	75,000	75,000	50,312	(24,688)
Sales and use	6,899,200	6,899,200	7,182,685	283,485
Transient occupancy tax	785,000	785,000	894,418	109,418
Franchise	1,467,300	1,467,300	1,445,277	(22,023)
Business license	1,175,393	1,175,393	1,091,482	(83,911)
Cost revenue impact study fee	104,195	104,195	73,707	(30,488)
Real property transfer	100,000	100,000	115,346	15,346
Triple flip backfill	1,991,000	1,991,000	2,188,806	197,806
Vehicle in lieu backfill	4,636,400	4,636,400	4,651,296	14,896
Total taxes	<u>22,396,403</u>	<u>22,396,403</u>	<u>22,715,567</u>	<u>319,164</u>
Intergovernmental:				
Motor vehicle in lieu tax	300,454	300,454	40,067	(260,387)
Homeowners property tax relief	75,000	75,000	59,889	(15,111)
Police standards and training	14,000	14,000	40,053	26,053
Other state grants	45,400	152,213	88,816	(63,397)
Other federal grants	512,902	1,494,450	992,533	(501,917)
Office BJA - bulletproof vest grant	5,370	12,439	3,151	(9,288)
State mandated cost reimbursement	38,346	38,346	74,461	36,115
Total intergovernmental	<u>991,472</u>	<u>2,086,902</u>	<u>1,298,970</u>	<u>(787,932)</u>
Licenses and permits:				
Animal licenses	24,220	24,220	17,370	(6,850)
Bicycle licenses	300	300	225	(75)
Other licenses and permits	9,300	9,300	7,740	(1,560)
Total licenses and permits	<u>33,820</u>	<u>33,820</u>	<u>25,335</u>	<u>(8,485)</u>
Use of money and property				
Investment Earnings	75,300	75,300	153,360	78,060
Rents and concessions (other than recreation)	82,319	82,319	67,969	(14,350)
Repayment on loan			81,500	81,500
Total use of money and property	<u>157,619</u>	<u>157,619</u>	<u>302,829</u>	<u>145,210</u>

(continued)

CITY OF MERCED
Required Supplementary Information, Continued
For the Year Ended June 30, 2012

Budgetary Comparison Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual
General Fund

	Budget		Actual	Variance with Final Budget
	Original	Final		
REVENUES, Continued:				
Service Charges:				
Fire department special services	\$ 84,400	\$ 84,400	\$ 33,236	\$ (51,164)
Fire prevention	75,600	75,600	54,417	(21,183)
Accident reports	3,500	3,500	3,840	340
PERS-EE share 2.5% at 55	202,410	202,410	194,134	(8,276)
PERS-EE share 3% at 50	523,435	523,435	384,690	(138,745)
Administrative	2,753,453	2,753,453	2,742,193	(11,260)
Animal control services	6,000	6,000	6,644	644
School police officer	345,027	345,027	361,665	16,638
Valley High School police officer	143,077	143,077	141,793	(1,284)
Interdepartmental charges	1,797,707	1,797,707	1,799,441	1,734
Cost applied	95,900	189,798	235,591	45,793
Other current service charges	128,700	128,700	58,098	(70,602)
Total service charges	6,159,209	6,253,107	6,015,742	(237,365)
Fines, forfeitures and penalties:				
Criminal fines	114,000	114,000	166,922	52,922
Parking fines	369,794	369,794	376,588	6,794
Total fines, forfeitures and penalties	483,794	483,794	543,510	59,716
Other:				
Unclassified revenue	11,500	11,500	43,680	32,180
Snack machine revenue	350	350		(350)
Garnishments handling fees	1,080	1,080	1,130	50
Miscellaneous	71,668	346,435	211,787	(134,648)
Cash overages (shortages)	100	100	46	(54)
Donations/contributions	1,000	1,200	300	(900)
S.M.I.P. fees	500	500		(500)
Total other	86,198	361,165	256,943	(104,222)
Total revenues	30,308,515	31,772,810	31,158,896	(613,914)

(continued)

CITY OF MERCED
Required Supplementary Information, Continued
For the Year Ended June 30, 2012

Budgetary Comparison Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual

General Fund

	Budget		Actual	Variance with Final Budget
	Original	Final		
EXPENDITURES:				
Current operating:				
General government:				
City Council	\$ 210,518	\$ 321,018	\$ 204,988	\$ 116,030
City Manager	661,810	654,310	646,009	8,301
City Attorney	851,221	1,011,466	931,393	80,073
Finance	2,479,123	2,764,584	2,692,183	72,401
Purchasing	206,006	208,123	206,762	1,361
Economic development	183,923	209,984	140,454	69,530
Visitor's services	158,258	160,809	160,730	79
Total general government	<u>4,750,859</u>	<u>5,330,294</u>	<u>4,982,519</u>	<u>347,775</u>
Public safety:				
Police protection	16,354,444	16,936,109	15,442,631	1,493,478
Fire protection and weed abatement	8,374,861	9,284,904	8,716,576	568,328
Total public safety	<u>24,729,305</u>	<u>26,221,013</u>	<u>24,159,207</u>	<u>2,061,806</u>
Public works	<u>1,733,235</u>	<u>1,784,090</u>	<u>1,751,927</u>	<u>32,163</u>
Total current operating	<u>31,213,399</u>	<u>33,335,397</u>	<u>30,893,653</u>	<u>2,441,744</u>
Debt service:				
Principal	205,000	205,000	205,000	
Interest	387,781	387,781	387,781	
Total debt service	<u>592,781</u>	<u>592,781</u>	<u>592,781</u>	
Total expenditures	<u>31,806,180</u>	<u>33,928,178</u>	<u>31,486,434</u>	<u>2,441,744</u>
REVENUES OVER (UNDER) EXPENDITURES	<u>(1,497,665)</u>	<u>(2,155,368)</u>	<u>(327,538)</u>	<u>1,827,830</u>
OTHER FINANCING SOURCES (USES):				
Sale of capital assets	8,900	8,900	15,206	6,306
Transfers in	745,143	890,507	831,078	(59,429)
Transfers out	(1,528,908)	(1,528,908)	(1,450,148)	78,760
Total other financing sources (uses)	<u>(774,865)</u>	<u>(629,501)</u>	<u>(603,864)</u>	<u>25,637</u>
Net change in fund balance	<u>\$ (2,272,530)</u>	<u>\$ (2,784,869)</u>	<u>(931,402)</u>	<u>\$ 1,853,467</u>
FUND BALANCE:				
Beginning of year			15,570,360	
End of year			<u>\$ 14,638,958</u>	

CITY OF MERCED
Required Supplementary Information
For the Year Ended June 30, 2012

Budgetary Comparison Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual
Housing Special Revenue Fund

	Budget		Actual	Variance with Final Budget
	Original	Final		
REVENUES:				
Intergovernmental	\$ 7,046,095	\$ 7,084,082	\$ 3,765,532	\$ (3,318,550)
Use of money and property	1,900	1,900	12,181	10,281
Service charges	339,114	339,114	274,850	(64,264)
Other		81,342	81,724	382
Total revenues	<u>7,387,109</u>	<u>7,506,438</u>	<u>4,134,287</u>	<u>(3,372,151)</u>
EXPENDITURES:				
Current operating:				
General government	5,677,522	5,187,746	1,558,808	3,628,938
Total current operating	<u>5,677,522</u>	<u>5,187,746</u>	<u>1,558,808</u>	<u>3,628,938</u>
Capital outlay	71,482	1,172,681	898,131	274,550
Total expenditures	<u>5,749,004</u>	<u>6,360,427</u>	<u>2,456,939</u>	<u>3,903,488</u>
REVENUES OVER (UNDER) EXPENDITURES	<u>1,638,105</u>	<u>1,146,011</u>	<u>1,677,348</u>	<u>531,337</u>
OTHER FINANCING SOURCES (USES):				
Sale of capital assets	800,000	1,300,000	889,591	(410,409)
Transfers out	<u>(2,618,204)</u>	<u>(2,518,496)</u>	<u>(2,445,807)</u>	<u>72,689</u>
Total other financing sources (uses)	<u>(1,818,204)</u>	<u>(1,218,496)</u>	<u>(1,556,216)</u>	<u>(337,720)</u>
Net change in fund balances	<u>\$ (180,099)</u>	<u>\$ (72,485)</u>	121,132	<u>\$ 193,617</u>
FUND BALANCE:				
Beginning of Year			<u>1,753,754</u>	
End of Year			<u>\$ 1,874,886</u>	

CITY OF MERCED
Required Supplementary Information
For the Year Ended June 30, 2012

Budgetary Comparison Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual
Low and Moderate Income Housing Special Revenue Fund

	Budget		Actual	Variance with Final Budget
	Original	Final		
REVENUES:				
Intergovernmental	\$	\$ 3,105	\$ 25,866	\$ 22,761
Use of money and property			5,816	5,816
Total revenues		3,105	31,682	28,577
EXPENDITURES:				
Current operating:				
General government		2,967	2,967	
Total current operating		2,967	2,967	
Capital outlay			(201,582)	201,582
Total expenditures		2,967	(198,615)	201,582
REVENUES OVER (UNDER) EXPENDITURES		138	230,297	230,159
OTHER FINANCING SOURCES (USES):				
Transfers in		2,650,863	2,650,861	(2)
Total other financing sources (uses)		2,650,863	2,650,861	(2)
Net change in fund balances	\$	\$ 2,651,001	2,881,158	\$ 230,157
FUND BALANCE:				
Beginning of Year				
End of Year			\$ 2,881,158	

City of Merced
Required Supplementary Information, Continued
For the year ended June 30, 2012

2. PUBLIC EMPLOYEE RETIREMENT SYSTEMS SCHEDULE OF FUNDING PROGRESS

Miscellaneous Employees

Actuarial Valuation Date	Actuarial Value of Assets	Entry Age Actuarial Accrued Liability	Actuarial Unfunded (Overfunded) Liability	Funded Ratio	Covered Payroll	Liability as Percentage of Covered Payroll
6/30/2009	\$ 77,071,120	\$ 91,041,038	\$ 13,969,918	84.7%	\$ 18,593,883	75.1%
6/30/2010	80,860,555	96,575,241	15,714,686	83.7%	17,954,782	87.5%
6/30/2011	84,987,120	102,743,573	17,756,453	82.7%	16,833,042	105.5%

Safety Employees

Actuarial Valuation Date	Actuarial Value of Assets	Entry Age Actuarial Accrued Liability	Actuarial Unfunded (Overfunded) Liability	Funded Ratio	Covered Payroll	Liability as Percentage of Covered Payroll
6/30/2009	\$ 84,891,140	\$ 96,887,943	\$ 11,996,803	87.6%	\$ 13,952,127	86.0%
6/30/2010	89,123,527	101,941,129	12,817,602	87.4%	13,411,475	95.6%
6/30/2011	94,119,678	108,814,708	14,695,030	86.5%	12,608,240	116.6%

3. POSTEMPLOYMENT HEALTHCARE PLAN SCHEDULE OF FUNDING PROGRESS

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
6/30/2007	\$	\$ 56,272,000	\$ 56,272,000	0.0%	\$ 20,746,000	271.2%
6/30/2009		60,770,000	60,770,000	0.0%	18,248,000	333.0%
6/30/2011	1,261,000	71,422,000	70,181,000	1.77%	16,299,000	430.6%

