

MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the City of Eureka, we offer readers of the City of Eureka's financial statements this narrative overview and analysis of the financial activities of the City of Eureka for the fiscal year ended June 30, 2010. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal found in the introductory section of this annual report.

Overview of the Financial Statements

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

Government-wide financial statements. The government-wide financial statements are designed to provide readers with a broad overview of the City of Eureka's finances, in a manner similar to private-sector business.

The statement of net assets presents information on all of the City of Eureka'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 of Eureka is improving or deteriorating.

The statement of activities presents information showing how the government's net assets changed during the most recent 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 earned but unused vacation leave).

Both of the government-wide financial statements distinguish functions of the City of Eureka 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 of Eureka include general government, public safety, community development, culture-recreation, public works, interest on long-term debt and unallocated depreciation. The business-type activities of the City of Eureka include water, wastewater, transit, harbor, building, and golf operations.

The government-wide financial statements include not only the City of Eureka itself (known as the primary government), but also a legally separate redevelopment agency for which the City of Eureka is financially accountable. The redevelopment agency, although legally separate, functions for all practical purposes as a department of the City of Eureka, and therefore has been included as an integral part of the primary government.

The government-wide financial statements can be found beginning on page 17 of this report.

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 of Eureka, 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 of Eureka 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 short-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 short-term financing requirements.

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 short-term financing decisions. Both the governmental funds 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 of Eureka maintains fifteen 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 and the redevelopment funds, which are considered to be major funds. Data from the other eleven governmental funds are combined into a single, aggregated presentation. Individual fund data for these non-major governmental funds is provided in the form of combining statements found in the supplemental statements and schedules section of this report.

The City of Eureka adopts an annual appropriated budget for its general fund. A budgetary comparison schedule has been provided for the general fund to demonstrate compliance with this budget and is found on page 92 in the basic financial statements section of this report. The basic governmental fund financial statements can be found on pages 26-33 of this report.

Proprietary funds. The City of Eureka 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 of Eureka uses enterprise funds to account for its water, wastewater, transit, harbor, building, and golf operations. Internal service funds are an accounting device used to accumulate and allocate costs internally among the City of Eureka's various functions. The City of Eureka uses internal service funds to account for its equipment operation, risk management, information technology, and redevelopment 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.

Proprietary fund financial statements provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the water, wastewater, transit, harbor, building, and golf operations, all of which are considered to be major funds of the City of Eureka. Conversely, all internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements. Individual fund data for the internal service funds is provided in the form of combining statements found in the supplemental statements and schedules section of this report.

The basic proprietary fund financial statements can be found on pages 36-40 of this report.

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 statements because the resources of those funds are not available to support the City of Eureka's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds.

The basic fiduciary fund financial statements can be found on pages 43-44 of this report.

Notes to the 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. The notes to the financial statements can be found on pages 34-75 of this report.

Other information. In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information concerning the City of Eureka's progress in funding its obligation to provide pension benefits to its employees. Required supplementary information can be found on pages 45-90 of this report.

The combining statements and schedules referred to earlier in connection with non-major governmental funds and internal service funds are presented immediately following the required supplementary information. Combining and individual fund statements and schedules can be found on pages 101-105 of this report.

Government-wide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City of Eureka, assets exceeded liabilities by \$146,724,703 at the close of the most recent fiscal year.

A large portion of the City of Eureka's net assets (75 percent) reflects its investment in capital assets (e.g., land, easements, buildings, machinery, and infrastructure); less any related debt used to acquire those assets that is still outstanding. The City of Eureka uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City of Eureka'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.

City of Eureka
Net Assets

	Governmental Activities		Business-type Activities		Total	
	2010	2009	2010	2009	2010	2009
Current and other assets	\$ 30,429,126	\$ 23,000,533	\$ 15,243,318	\$ 16,756,119	\$ 45,672,444	\$ 39,756,652
Capital assets	77,344,668	75,487,075	76,117,214	77,244,531	153,461,882	152,731,606
Total assets	<u>107,773,794</u>	<u>98,487,608</u>	<u>91,360,532</u>	<u>94,000,650</u>	<u>199,134,326</u>	<u>192,488,258</u>
Non-current liabilities	26,935,540	17,086,816	18,193,130	19,184,058	45,128,670	36,270,874
Other liabilities	3,951,785	3,520,696	3,329,168	2,933,443	7,280,953	6,454,139
Total liabilities	<u>30,887,325</u>	<u>20,607,512</u>	<u>21,522,298</u>	<u>22,117,501</u>	<u>52,409,623</u>	<u>42,725,013</u>
Net assets:						
Invested in capital assets, net of related debt	51,063,708	58,614,367	59,594,461	58,603,096	110,658,169	117,217,463
Restricted	28,243,074	18,420,342	6,384,634	10,355,814	34,627,708	28,776,156
Unrestricted	(2,420,313)	845,387	3,859,139	2,924,239	1,438,826	3,769,626
Total Net Assets	<u>\$ 76,886,469</u>	<u>\$ 77,880,096</u>	<u>\$ 69,838,234</u>	<u>\$ 71,883,149</u>	<u>\$ 146,724,703</u>	<u>\$ 149,763,245</u>

An additional portion of the City of Eureka's net assets (24 percent) represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets \$1,438,826 may be used to meet the government's ongoing obligations to citizens and creditors.

At the end of the current fiscal year, the City of Eureka 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. The same situation held true for the prior fiscal year. Overall, total net assets decreased by \$3,038,542.

Changes in net assets. The statement of net assets provides a snapshot at a given point in time of the assets and liabilities of the City. The other government-wide statement provided is the Statement of Activities. This statement provides the reader with information regarding the revenues, expenses, and changes in net assets over the fiscal year. Generally, all changes to the City's net assets from one fiscal year to the next flows through the statement of activities.

The City of Eureka's net assets decreased by \$3,038,542, including prior period adjustments totaling \$2,315,109. The change in net assets is the result of a decrease of \$1,205,887 in governmental activities, while the change in net assets as a result of business-type activities increased by \$482,454.

Details of the City's changes in net assets are as follows:

City of Eureka Changes in Net Assets						
	Governmental		Business-type		Total	
	Activities		Activities			
	2010	2009	2010	2009	2010	2009
Revenues:						
Program Revenues:						
Charges for services	\$ 4,503,984	\$ 3,366,328	\$ 13,794,848	\$ 12,497,436	\$ 18,298,832	\$ 15,863,764
Operating grants and contributions	335,636	2,126,731			335,636	2,126,731
Capital grants and contributions	2,208,338	3,441,840	542,493		2,750,831	3,441,840
General Revenues:						
Taxes:						
Property taxes	6,489,434	6,767,867			6,489,434	6,767,867
Sales taxes	9,448,968	8,411,860			9,448,968	8,411,860
Other taxes	5,848,288	4,539,269			5,848,288	4,539,269
Investment income	362,666	1,130,512	333,083	622,839	695,749	1,753,351
Other	624,645	2,722,514	438	460,824	625,083	3,183,338
Total revenues	29,821,959	32,506,921	14,670,862	13,581,099	44,492,821	46,088,020
Expenses:						
General government	3,948,020	4,783,555			3,948,020	4,783,555
Public safety	13,954,934	13,984,279			13,954,934	13,984,279
Community development	2,787,902	4,105,920			2,787,902	4,105,920
Culture - recreation	2,115,173	2,384,666			2,115,173	2,384,666
Public works	6,358,368	3,219,875			6,358,368	3,219,875
Interest on long-term debt	1,385,114	1,235,223	917,111	983,668	2,302,225	2,218,891
Unallocated depreciation	-	2,236,926			-	2,236,926
Water			4,544,152	3,940,290	4,544,152	3,940,290
Wastewater			5,808,213	5,303,530	5,808,213	5,303,530
Transit			1,825,016	1,748,801	1,825,016	1,748,801
Harbor			991,312	984,311	991,312	984,311
Building			567,019	613,222	567,019	613,222
Golf			13,920	21,887	13,920	21,887
Total expenses	30,549,511	31,950,444	14,666,743	13,595,709	45,216,254	45,546,153
Change in net assets before transfers	(727,552)	556,477	4,119	(14,610)	(723,433)	541,867
Transfers	(478,335)	(466,675)	478,335	466,675		
Change in net assets	<u>(1,205,887)</u>	<u>89,802</u>	<u>482,454</u>	<u>452,065</u>	<u>(723,433)</u>	<u>541,867</u>
Net assets - beginning	77,880,096	78,002,752	71,883,149	71,399,897	149,763,245	149,402,649
Prior period adjustments	212,260	(212,458)	(2,527,369)	31,187	(2,315,109)	(181,271)
Net assets - beginning, (restated)	<u>78,092,356</u>	<u>77,790,294</u>	<u>69,355,780</u>	<u>71,431,084</u>	<u>147,448,136</u>	<u>149,221,378</u>
Net assets - ending	<u>\$ 76,886,469</u>	<u>\$ 77,880,096</u>	<u>\$ 69,838,234</u>	<u>\$ 71,883,149</u>	<u>\$ 146,724,703</u>	<u>\$ 149,763,245</u>

Governmental activities: The City's largest governmental revenue source, sales tax, accounts for 32% of total governmental revenues equaling \$9,448,968 this fiscal year, which is an increase of \$1,037,108 from last year. Property tax is the next largest governmental revenue source making up 22% of total governmental revenues equaling \$6,489,434, a decrease of \$278,433 from last year.

All City programs have charges for services including general government, public safety, public works, and culture and recreation. The increase of \$1,137,656 comes primarily from a change in how operating cost recovery from public works is reported, as well as an increase in redevelopment administration charges.

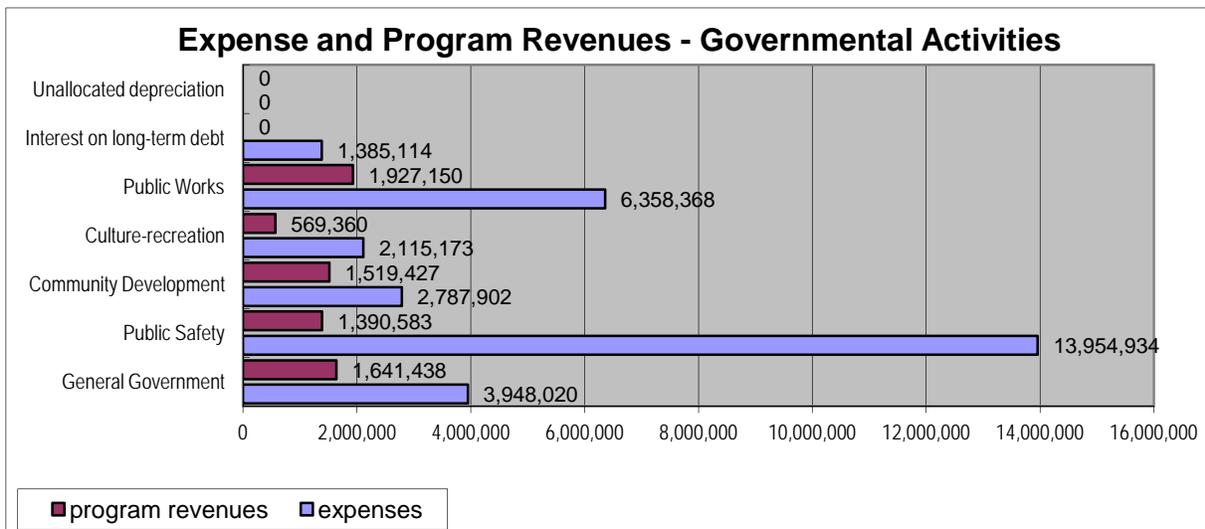
Operating grants for governmental activities furnished resources to support three of the City of Eureka’s functions: general government, community development, and public safety, with the greatest portion, 64% supporting public safety.

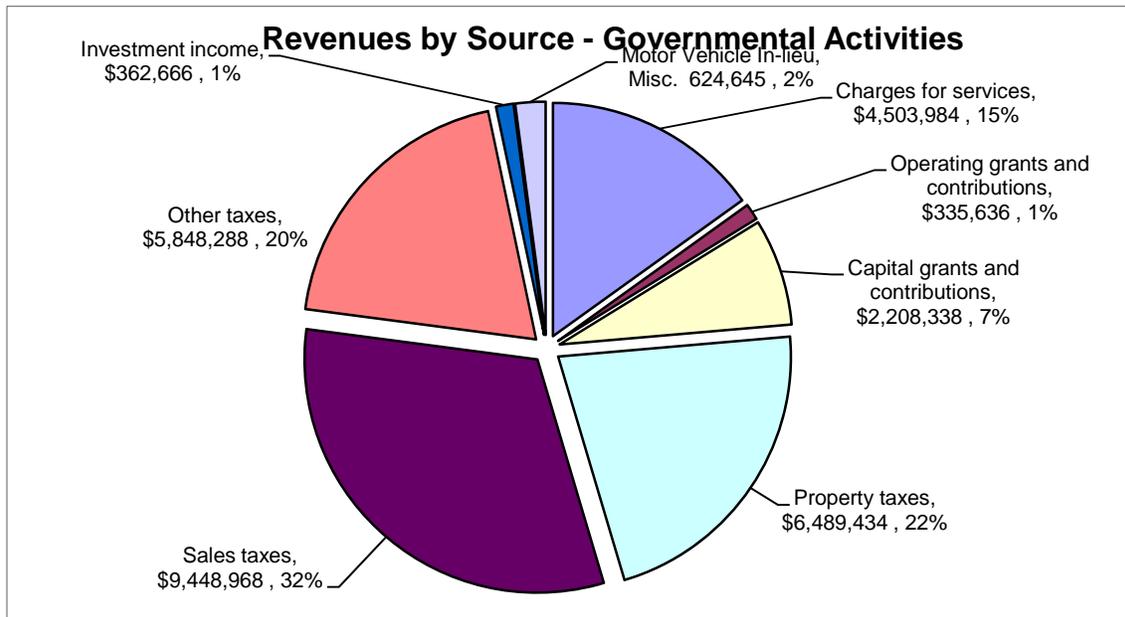
Capital grants for governmental activities decreased by \$1,233,502 providing resources for community development, public safety and public works, with 53% supporting public works.

The reduction of \$767,846 in investment income is the result of decreasing invested balances along with declining rates of return.

The increase in Public Works is mostly attributable to depreciation expense, which was unallocated amongst departments in FY08-09.

Public safety expenses account for 46% of the total governmental activity expenses, compared to 44% in the prior fiscal year. The increase can be attributed to the higher salaries public safety employees received compared to other government employees and reflect the City Council’s desire to highly prioritize spending on public safety programs.



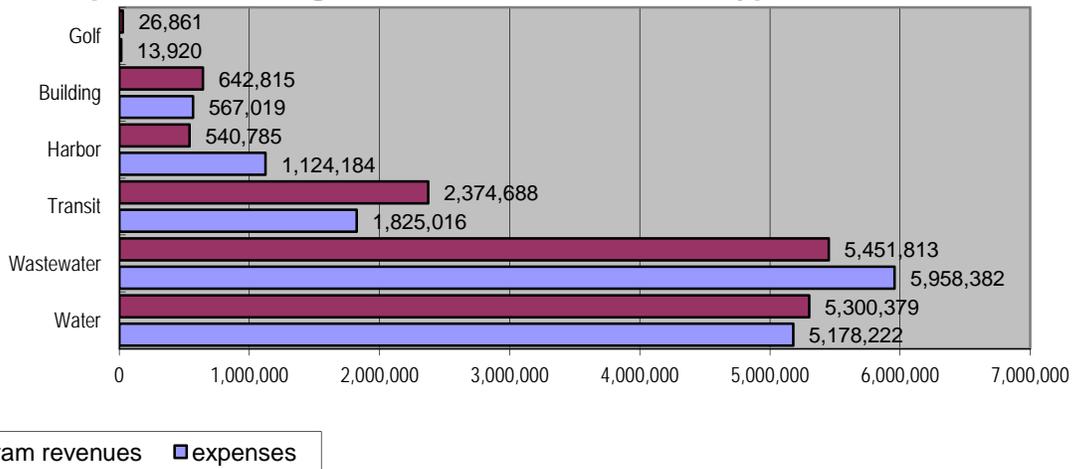


Business-type activities. Business-type activities decreased the City of Eureka’s net assets by \$2,044,915. This is the net of a current year increase in business-type net assets of \$482,454 and a prior period adjustment decreasing net assets by \$2,527,369.

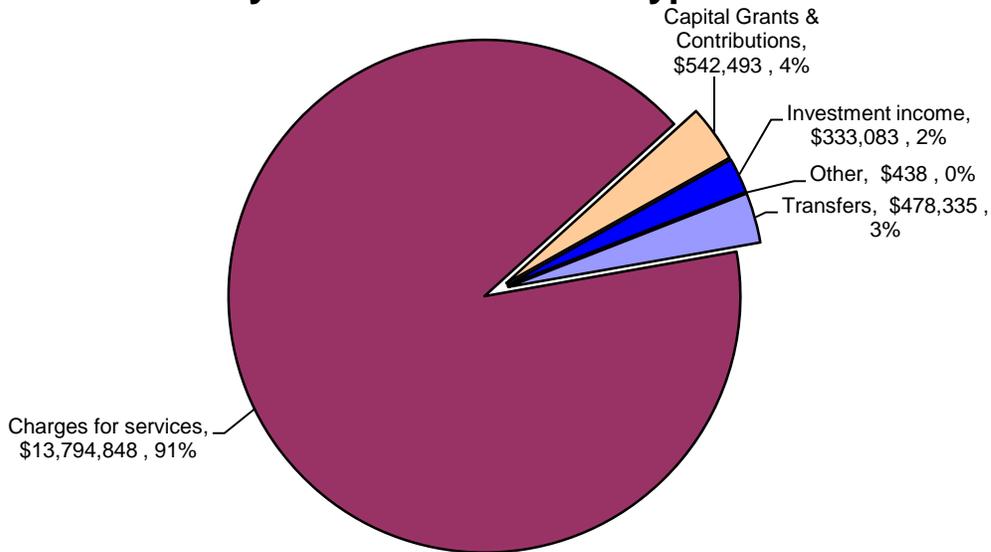
Key elements of the change in net assets are:

- \$283,491 increase in the Water fund is primarily due to the regularly scheduled rate increases designed to achieve bond coverage and create reserves for future capital.
- \$349,023 loss in the Wastewater Fund. These rates were also designed to achieve bond coverage and create reserves for future capital but experience is showing the rates are insufficient. A rate study is currently in progress to study this and produce new rate recommendations before the end of FY2010-11.
- \$ 2,739,878 prior period adjustment in the Wastewater Fund correcting an overstatement of Construction in Progress which previously recorded the portion of CIP costs belonging to Humboldt Community Services District as belonging to the City.
- \$150,029 loss in the Harbor Fund. In the current economic climate, the operating costs and debt service continue to outpace operating revenues in this fund requiring an ongoing, growing subsidy from the City.
- \$134,027 increase in the Building Fund. The City’s new rates, as well as increased code enforcement enabled this increase in net assets.
- \$763,556 increase in the Transit Fund. Intergovernmental revenues increased by \$699,328, while prior period adjustments increased net assets by recognizing revenues reportable in fiscal year 6/30/2010.

Expense and Program Revenues - Business-type Activities



Revenue by Source - Business-type Activities



Financial Analysis of the Government's Funds

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

Governmental funds. The focus of the City of Eureka's governmental funds is to provide information on short-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the City of Eureka's financing requirements. In particular, 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.

As of the end of the current fiscal year, the City of Eureka's governmental funds reported combined ending fund balances of \$11,348,053, an increase of \$4,997,287 in comparison with the prior year. The majority of this fund balance is reserved to indicate that it is not available for new spending because it has already been committed for the following purposes: 1) parking enforcement; 2) encumbrances; 3) prepaid items; 4) fire tower project; 5) debt service; 6) capital projects; 7) Low/moderate housing; 8) advances; and 9) land held for resale. The current year increase in net assets stems primarily from the issuance of \$9,195,000 in debt to fund Redevelopment projects.

The general fund, which is the chief operating fund of the City of Eureka, ended the current fiscal year with an unreserved fund balance of \$2,227,128, an increase of \$1,869,791 in comparison with the prior year. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance at the end of the fiscal year represented 10% of total general fund expenditures, while total fund balance represents 10.4% of total general fund expenditures.

During the current fiscal year, the fund balance of the City of Eureka's general fund decreased by \$1,635,692. A portion of the decrease was planned and represents Council's determination to maintain services in spite of shrinking reserves, while sales tax and other general fund revenues remain low in these difficult economic times.

The Low and Moderate Income Housing fund has a fund balance of \$843,469, all of which will be used for specific housing activities.

The fund balances of the Eureka Redevelopment Agency Funds total \$2,995,416, which is the combined total of a deficit of (\$5,041,261) in the Debt Service Fund that represents long term advances due to the City of Eureka; to be paid from future Tax Increment revenues and \$8,036,677 in the Capital Projects fund.

Proprietary funds

The City of Eureka's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

Unrestricted net assets of the proprietary funds at the end of the year amounted to \$3,859,139, of this amount the Harbor fund is the only one with a deficit balance totaling \$3,933,572. The deficit unrestricted net assets in the Harbor fund, reflects the continuing struggle to generate revenues sufficient to cover costs. One irksome component of operating costs is an obligation to pay the State of California 15% of gross fund revenues in perpetuity. This obligation was created in 1978 as a loan covenant.

Capital Asset and Debt Administration

Capital assets. The capital assets of the City are those assets that are used in the performance of the City's functions, including infrastructure. As of June 30, 2010, the City of Eureka's net capital assets for its governmental and business-type activities amounts to \$153,461,884 (net of accumulated depreciation). The investment in capital assets includes land, easements, buildings, improvements other than buildings, machinery and equipment, infrastructure, artwork, and construction in progress. Net change to capital assets of the City in comparison to the prior year, is an increase of \$730,276.

Major capital asset events during the current fiscal year included the following:

In the governmental funds, construction in progress increased \$4,569,150 due primarily to project expenditures for the Fisherman’s Terminal Building, C Street Improvements, Palco Marsh Enhancements, and the Flake Ice Plant. \$491,285 of construction in progress was reclassified as Building improvements and infrastructure for the completion of the Englund Marine Fuel Terminal and street improvement projects. Machinery and equipment increased \$251,956 due primarily to the purchase of five new police cars. Infrastructure additions of \$114,613 consisted of new Zoo exhibits donated to the city by the Sequoia Zoo Foundation.

In the proprietary funds, additions of construction in progress of \$1,933,090 consisted primarily of costs for the Martin Slough, Mad River pipeline, and wastewater outflow stabilization projects. \$1,056,276 of construction in progress was reclassified as improvements primarily for the completion of a Biosolids Dewatering project. Adjustments to construction in progress consisted of a decrease of \$1,642,334 for Humboldt Community Service District’s portion of project costs which had been included in construction in progress in prior years. Machinery and equipment additions totaled \$1,233,033 and consisted primarily of capitalization of 3 new buses in the transit fund. A decrease of \$427,467 was due to the retirement of two old Gillig buses.

City of Eureka
Capital Assets (net of depreciation)

	Governmental		Business-type		Total	
	Activities		Activities			
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
Land	\$ 3,692,899	\$ 3,692,899	\$ 11,348,689	\$ 11,348,689	\$ 15,041,588	\$ 15,041,588
Easements	23,922,864	23,922,864			23,922,864	23,922,864
Buildings	10,624,544	10,711,707	5,811,121	6,065,383	16,435,665	16,777,090
Improvements other than buildings	10,291,511	10,502,511	16,957,614	16,541,141	27,249,125	27,043,652
Machinery and equipment	3,251,773	3,713,933	21,158,626	21,274,050	24,410,399	24,987,983
Infrastructure	16,885,460	18,345,405	13,179,858	13,537,307	30,065,318	31,882,712
Artwork	150,000	150,000			150,000	150,000
Construction in progress	8,525,619	4,447,754	\$ 7,661,306	6,784,492	16,186,925	11,232,246
Total capital assets	<u>\$ 77,344,670</u>	<u>\$ 75,487,073</u>	<u>\$ 76,117,214</u>	<u>\$ 75,551,062</u>	<u>\$ 153,461,884</u>	<u>\$ 151,038,135</u>

Additional information on the City of Eureka’s capital assets can be found in note 5 on pages 66-68 of this report.

Long-term debt. At the end of the current fiscal year, the City of Eureka had total bonded debt outstanding of \$38,810,412. Of this amount, \$11,198,257 comprises debt backed by revenues within the water fund, another \$3,200,443 comprises debt backed by revenues within the wastewater fund, \$475,002 comprises debt backed by revenues within the harbor fund and \$23,936,710 in tax allocation bonds backed by incremental tax revenues from the redevelopment project areas.

City of Eureka
Outstanding Debt

	Governmental		Business-type		Total	
	Activities		Activities			
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
Revenue bonds payable, net	\$23,936,710	\$14,837,209	\$14,873,702	\$15,505,696	\$38,810,412	\$30,342,905
Capital leases	1,187,101	1,389,559	2,116,180	2,372,060	3,303,281	3,761,619
Loans payable	1,324,900	645,940	2,194,787	2,267,053	3,519,687	2,912,993
Net pension obligation						0
Compensated absences	1,393,732	1,270,087	172,448	136,636	1,566,180	1,406,723
	<u>\$27,842,443</u>	<u>\$18,142,795</u>	<u>\$19,357,117</u>	<u>\$20,281,445</u>	<u>\$47,199,560</u>	<u>\$38,424,240</u>

Changes to the City’s long-term debt included:

- An increase to bonds payables of \$8,467,507 mainly due to an increase from a \$9,195,000 new bond issue and a decrease of \$660,000 from regular semi-annual payments;
- A decrease to capital leases payables of \$458,338 from regular annual payments;
- An increase to loans payables of \$606,694. \$779,520 is from California Infrastructure Bank Loan drawdowns for the C Street Amenities project, -\$100,560 is from a principal payment on this same loan, and -\$72,266 is from a principal payment on the California Department of Boating and Waterways loan.
- A net increase to the liability for compensated absences of \$159,457.

State statutes limit the amount of general obligation debt a governmental entity may issue to 3.75 percent of its total assessed valuation. The current debt limitation for the City of Eureka is \$56,026,687, which is significantly in excess of the City of Eureka’s outstanding general obligation debt, which is currently zero.

Additional information on the City of Eureka’s long-term debt can be found in note 7 on pages 69-78 of this report.

Economic Factors and Next Year's Budgets and Rates

- At the time the budget was prepared, the unemployment rate for the City of Eureka was 10.9 percent. The Humboldt economic index values for employment and manufacturing show decreases of 3.1% and .2%.
- At the time the budget was prepared, home sales had improved, with a 6.2% increase over the prior year. The assessed value of Eureka properties are expected to remain flat with property tax revenues increasing slightly. Property tax revenues represent 7% of budgeted general fund revenues.
- Hospitality and retail sales show very small improvement with increases of 1.1% and .9%.
- Overall, PERS rates show very slight increases and decreases, with the Fiscal Year 2010-11 rates for Police decreasing from to 34.395% to 33.873%; the rates for Fire decreasing from 34.819% to 34.196% and the rates for Miscellaneous (non-safety) employees increasing from 17.064 % to 17.251%.

All of these factors were considered in preparing the City of Eureka's budget for the fiscal year 2010-11.

During the current fiscal year, the unreserved fund balance in the general fund increased to \$2,227,128 which is available in the 2010-11 fiscal year for appropriation.

The City is still working on increasing user fees for Water and Sewer customers in FY 2010-11 in order to meet the ongoing needs for infrastructure improvements and maintenance. If passed, the rate increases will allow the City to secure additional grant funding for badly needed capital projects.

Requests for Information

This financial report is designed to provide a general overview of the City of Eureka's finances for all those with an interest in the government's finances, and to demonstrate the City's accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Office of the Finance Director, City of Eureka, 531 K Street, Eureka, California, 95501.