MERCED COMMUNITY
COLLEGE DISTRICT

Merced, California

FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION WITH
INDEPENDENT AUDITORS' REPORTS

June 30, 2010

Matson and Isom

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INDEPENDENT AUDITORS’ REPORT

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INDEPENDENT AUDITORS' REPORT

Board of Trustees
Merced Community College District
Merced, California

We have audited the accompanying financial statements of the business-type activities and the discretely presented component unit of Merced Community College District (the District) as of and for the year ended June 30, 2010, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District'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 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 business-type activities and the discretely presented component unit of the District as of June 30, 2010, and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 22, 2010, on our consideration of the District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance, and the results of the testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 5 through 15 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.

INDEPENDENT AUDITORS' REPORT
Continued

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

Matson and Isom

November 22, 2010

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Required Supplementary Information)

ACCOUNTING STANDARDS

In June 1999, the Governmental Accounting Standards Board (GASB) released Statement No. 34, *Basic Financial Statements–and Management's Discussion and Analysis–for State and Local Governments,* which established a reporting format for annual financial statements. In November 1999, GASB released Statement No. 35, *Basic Financial Statements–and Management's Discussion and Analysis–for Public Colleges and Universities*, which applies the reporting standards to public colleges and universities.

The California Community College Chancellor's Office recommended that all State community college districts follow the new standards under the business-type activity (BTA) model. The purpose of selecting the BTA reporting model statewide is to be able to report financial information to the Legislature whereby community college districts can be compared to other community college districts within the State. Merced Community College District (the District) adopted these new standards in the 2002-03 fiscal year.

Adoption of the BTA reporting model by the District resulted in changes in the annual report to the Board of Trustees. The annual report consists of three basic financial statements that provide information on the District as a whole: the statement of net assets; the statement of revenues, expenses, and changes in net assets; and the statement of cash flows. The information provided on the statements that follow includes all funds, including the Associated Students of Merced College, but excluding the Merced College Foundation. Each statement will be discussed separately.

Under the BTA model of financial reporting, a single entity-wide statement is required to report financial activity for all funds of the District. As this is a variance from previous fund-type presentations, the following information is provided to help with the understanding of the financial statements.

The following discussion and analysis provides an overview of the District's financial activities.

FINANCIAL AND ATTENDANCE HIGHLIGHTS

The 2009-10 State Budget is the culmination of California's effort to restore balance to a state budget that has been decimated by the worst budget crisis in the state's history. With the economy continuing to deteriorate by December 2008, the Governor was advocating for an 18-month budget through June 30, 2010, with a proposed $41.7 billion in budget solutions. On February 19, 2009, the Legislature sent the 18-month budget to the Governor for signature.

A special election was called for by the Governor to be held on May 19, 2009. Voter approval of the initiatives became more significant as economic news was worsening. Almost immediately after the passage of the 18-month budget, the state was reporting additional revenue shortfalls. Governor Schwarzenegger sent a letter to the Legislature stating that for the first time since 1938, California faces a decline in personal income. He further stated although the budget, as adopted by the Legislature in late February, closed an unprecedented budget shortfall of $41.7 billion through June 30, 2010; the severe economic downturn in California, like the rest of the nation, has been facing has worsened substantially. These changes in the state's economic and revenue pictures have caused a significant new budget problem to emerge. If the May 19 special election initiatives fail, the deficit will grow to $21.3 billion.

On May 14, 2009, the Governor released the "May Revise" which provided for $15.4 billion in budget cuts should the initiatives pass and $21.3 billion in budget cuts should the initiatives fail. Included in his proposal were budget reductions and revenue deferrals for the 2008-09 fiscal year. On

May 19, 2009, the California voters overwhelmingly defeated the Governor's initiatives thus moving the Governor and the Legislature to begin budget negotiations.

On July 28, 2009, Governor Schwarzenegger signed into law a budget package with the latest round of budget reductions. The impact to community colleges is as follows:

- Elimination of growth funding
- No Cost-of-Living Adjustment (COLA)
- A permanent reduction of $333 million in categorical programs
- Defers an additional $163 million of community college revenues from 2009-10 to 2010-11 bringing a total inter-year deferral from $540 million in 2008-09 to $703 million in 2009-10
- Increase student enrollment fee from $20 per credit unit to $26 per credit unit
- A one-time allocation of $35 million in Federal (General Purpose) American Recovery and Reinvestment Act (ARRA) funds
- Provides augmentation of $10 million to SB70 Career Technical Education (CTE) Programs
- Reduction of $120 million in general apportionment funds
- Includes language authorizing the Chancellor to reduce base workload measures in proportion to cuts in general apportionment funding
- Includes flexibility language authorizing community college District's to transfer funds out of certain categorical programs and into other selected programs

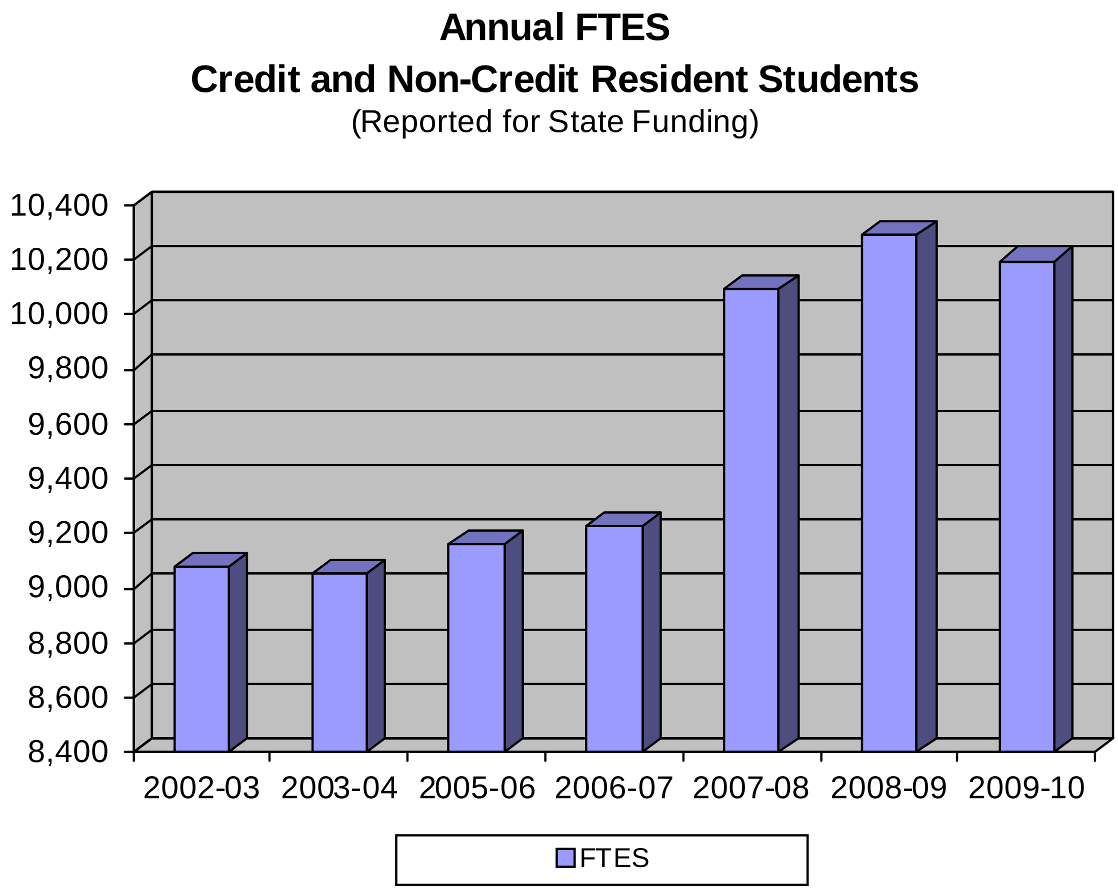
On October 6, 2009, the District presented to the Board of Trustees its annual budget with permanent general apportionment reductions of 3.39% or $1.7 million. This apportionment reduction was tied to statewide reductions in general apportionment of $120 million, projected shortfall in property tax of $53.4 million, base shortfall of $41.2 million, and student fees shortfall of $21.2 million. A further impact to the District was the reduction in categorical programs. The 2009-10 District awards of $6.8 million were reduced by $2.7 million to $4.1 million. To help offset this loss in categorical revenue, the ARRA dollars amounted to $371 thousand which reduced the current-year revenue reduction to $2.4 million.

One of the components of the revenue reductions in 2009-10 was the elimination of growth funding. Assembly Bill X4 1, was enacted as a revision to the 2009-10 Budget Act and includes a provision authorizing the Chancellor to adjust District's base workload measures commensurate with reductions in general apportionment revenues. The purpose of this workload adjustment is to align full-time equivalent student (FTES) workload with the reduced revenues provided to District's by the state in the 2009-10 fiscal year. Simply put, the workload adjustment provision acknowledges that significant budget cuts will reduce the capacity of community colleges to offer courses and serve students and reduces workload expectations accordingly. Therefore, Merced College's FTES workload measure was rebenched from the 2008-09 base workloads of 10,290 FTES to 9,853 FTES. The District's 2009-10 unfunded FTES (437) totaled $1.9 million in lost income.

As previously discussed, the State budget did not contain a statutory Cost of Living Adjustment (COLA) which has been calculated to be 4.25% for 2009-10. It is important to note that the District received a COLA of 4.53% in 2007-08 which amounted to $1,945,254 and a 5.92% COLA in 2006-07 which amounted to $2,294,044. When community colleges do not receive a COLA as per statue, as in 2008-09 and now in the 2009-10 fiscal year, it negatively impacts their ability to deliver instructional programs and services.

The District, using the Community College's League of California 2009-10 Tax and Revenue Anticipation Notes (TRANs) Program, issued a TRANs in July 2009, and a mid-year TRANs in April 2010 for the purpose of providing sufficient cash to address the latest cash deferrals from the state.

For fiscal year 2009-10, the District reported on the 2009-10 Apportionment Attendance Report (CCFS 320) its total FTES at 10,196. This decrease of 94 FTES over the prior year is still above the now required rebenched base workload measures as prescribed in Assembly Bill X4 1. It is important to note the District generated approximately 343 FTES above the expected base workload measures at a cost of $1.6 million.



STATEMENT OF NET ASSETS

The statement of net assets includes all assets and liabilities using the accrual basis of accounting, which is similar to the accounting method used by most private sector organizations. Net assets, the difference between assets and liabilities, are an indicator of the financial health of a district.

	2010	2009	Change
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents	$ 12,939,706	$ 7,846,450	65%
Receivables - net	15,848,962	16,417,247	-3%
Inventory, prepaid, and other assets	915,103	799,028	15%
Total Current Assets	29,703,771	25,062,725	19%
NONCURRENT ASSETS			
Restricted cash and cash equivalents	12,784,941	11,629,372	10%
Deferred charges	1,126,783	1,219,912	-8%
Net other postemployment benefits (OPEB) deferred charge	-	169,897	-100%
Capital assets - net	111,145,602	115,596,789	-4%
Total Noncurrent Assets	125,057,326	128,615,970	-3%
Total Assets	$ 154,761,097	$ 153,678,695	1%
LIABILITIES AND NET ASSETS			
CURRENT LIABILITIES			
Cash overdraft	$ 779,954	$ -	100%
Accounts payable and accrued liabilities	2,474,144	3,203,429	-23%
Tax revenue anticipation notes (TRANs)	3,193,537	-	100%
Deferred revenue	3,911,286	3,879,492	1%
Other current liabilities	1,725,613	2,140,319	-19%
Total Current Liabilities	12,084,534	9,223,240	31%
NONCURRENT LIABILITIES			
Other postemployment benefits (OPEB)	255,035	-	100%
Long-term liabilities	51,704,805	53,271,731	-3%
Total Noncurrent Liabilities	51,959,840	53,271,731	-2%
Total Liabilities	$ 64,044,374	$ 62,494,971	2%
NET ASSETS			
Invested in capital assets - net of related debt	$ 72,693,646	$ 74,074,369	-2%
Restricted	6,045,060	7,388,646	-18%
Unrestricted:			
Reserve for noncash assets	3,255,276	2,426,836	34%
Contractual obligations	100,459	198,360	-49%
General reserve	3,306,445	3,525,983	-6%
Contingency reserve and other designations	880,318	702,071	25%
Undesignated	4,435,519	2,867,459	55%
Total Unrestricted	11,978,017	9,720,709	23%
Total Net Assets	90,716,723	91,183,724	-1%
Total Liabilities and Net Assets	$ 154,761,097	$ 153,678,695	1%

Current cash and cash equivalents consist mainly of cash in the Merced County Treasury.

Receivables of $15.8 million are dollars owed to the District from local, State, and federal grants, state apportionment, and tuition and fees. The decrease in receivables is directly attributable to the State fully reimbursing all outstanding construction claims. State construction receivables declined from $3.5 million in 2008-09 to $0 in 2009-10.

Inventory, prepaid, and other assets consist entirely of bookstore inventory of $734 thousand and prepayments to vendors of $180 thousand.

Restricted cash and cash equivalents of $12.8 million consists mainly of $6.2 million invested in the California Asset Management Program and $3.5 million in the Merced County Treasury relating to the bond construction funds, and $3.1 million deposited with the Merced County Treasury for the retirement of the District's general obligation bonds sold in 2003, 2005, and 2006.

Net capital assets are the historical value of land, buildings, and equipment (with an itemized cost of $5,000 or more) less accumulated depreciation. In fiscal year 2009-10, the District continued construction projects associated with the remodel of the Student Union and Administration buildings. The decrease of $4.5 million in net capital assets indicates the total capital asset disposals exceeded the amount of new construction and capital equipment, net of depreciation. This decrease was primarily due to the sale of the Los Banos Wetlands property in December 2009.

Accounts payable and accrued liabilities of $5.7 million includes accrued payroll expenses, load banking of $477 thousand, and payables due to vendors of $1.6 million. However, the major source of the increase in accounts payable and accrued liabilities is attributable to the pending repayment of the mid-year TRANs of $3.2 million.

Deferred revenue relates to federal, State, and local program funds received but not yet earned as of the end of the fiscal year. Most grant funds are earned when expended (up to the grant amount awarded). Also included are deferred enrollment fees for the 2010-11 fiscal year of $2.3 million.

Long-term liabilities (noncurrent portion) are long-term debt to be paid in one year or later. Compensated absences payable of $900 thousand and the outstanding portion of $48.5 million in general obligation bonds are the major components of the noncurrent portion.

Unrestricted net assets include amounts reserved for noncash assets, prepayments, bookstore inventory, and amounts reserved for capital and other projects. Board policy states that in accordance with fiscal policies and guidelines recommended by the Chancellor's Office, the District maintains a contingency reserve of approximately 6% of the unrestricted General Fund. Reserves are also maintained in other funds at a prudent level.

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

The statement of revenues, expenses, and changes in net assets presents the operating finances of the District, as well as the nonoperating revenues and expenses. State general apportionment funds, while budgeted for operations, are considered nonoperating revenues according to generally accepted accounting principles.

	2010	2009	Change
REVENUES			
Operating revenues:			
Net tuition and fees	$ 3,374,319	$ 3,216,880	5%
Grants, contracts, and other designated revenues - noncapital	7,861,704	11,377,949	-31%
Auxiliary enterprise - net	3,155,558	3,332,002	-5%
Other operating income	717,393	1,013,626	-29%
Total Operating Revenue	15,108,974	18,940,457	-20%
Total Operating Expenses	64,953,107	69,296,499	-6%
Operating Loss	(49,844,133)	(50,356,042)	-1%
Nonoperating revenues (expenses):			
State apportionments - noncapital	40,151,573	38,620,929	4%
Local property taxes - noncapital	7,687,815	8,680,883	-11%
Lottery and other revenues - noncapital	1,431,316	1,391,290	3%
Investment income - noncapital	241,722	641,351	-62%
Amortization expense	(93,129)	(99,404)	-6%
Other nonoperating revenues (expenses) - net	31,468	(437,813)	-107%
Total Nonoperating Revenues	49,450,765	48,797,236	1%
Income Before Other Revenues, Expenses, Gains, or Losses	(393,368)	(1,558,806)	-75%
Apportionment and property taxes - capital	-	4,176,175	-100%
Local property taxes and revenues - capital	2,047,074	2,055,676	0%
Investment income - capital	85,139	252,232	-66%
Interest expense - capital	(2,116,810)	(2,160,691)	-2%
Loss - disposal of capital assets	(600,527)	-	100%
Increase (Decrease) in Net Assets	(978,492)	2,764,586	-135%
Net Assets - as Previously Reported	91,183,724	88,419,138	3%
Prior-Period Adjustment	511,491	-	100%
Net Assets - as Restated	91,695,215	88,419,138	4%
Net Assets - End of Year	$ 90,716,723	$ 91,183,724	-1%

Net tuition and fees of $3.4 million consist of enrollment fees of $1.8 million; nonresident tuition, noncapital portion, of $691 thousand; and all other fees of $843 thousand. The regular enrollment fees of $26 per unit remained for the 2009-10 fiscal year. Enrollment fees are set by the State for all community colleges. Regular enrollment fees are included in the revenue calculation of the District's general apportionment.

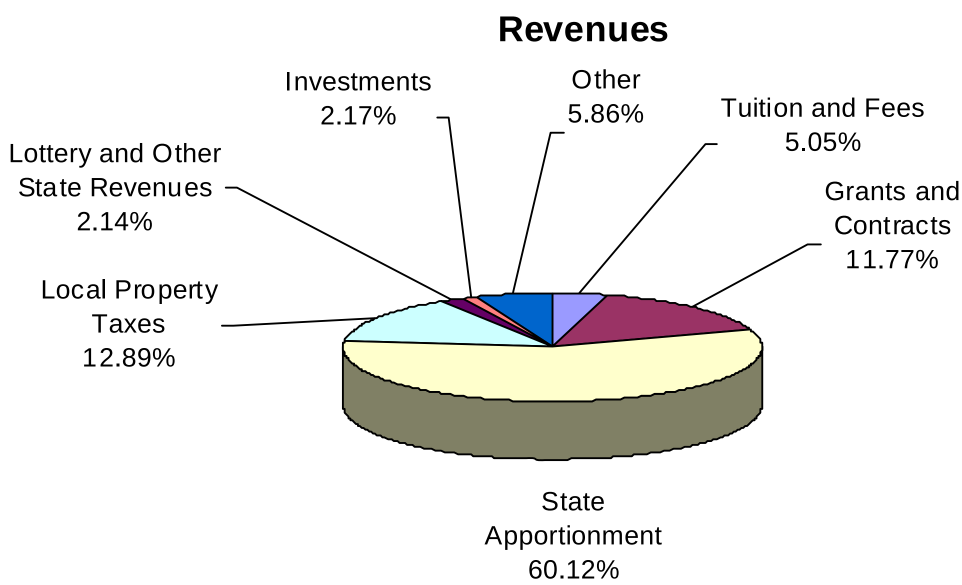
Auxiliary enterprise, net, is primarily bookstore sales less allowances.

Other operating income (payments) consists primarily of rentals of District facilities and non-instructional fees.

State apportionment (noncapital) of $40.2 million represents total general apportionment earned less regular enrollment fees and property taxes.

Lottery and other revenues consist primarily of the restricted and unrestricted State lottery revenue of $1.3 million.

Local property taxes and revenues (capital) consist of ad valorem taxes associated with redemption of the general obligation bonds. As a result of an agreement in the Legislature in 2004-05, the District no longer receives Educational Relief Act Funds (ERAF). The State did replace the loss in ERAF revenue with general apportionment. However, it is important to note that counties are negatively charging ERAF accounts to make up for projected shortfalls based on an interpretation of the legislation. The impact for 2009-10 was that Merced and Fresno counties reduced the District's secured taxes by $1.4 million. Community colleges do not have backfill guarantees afforded to K-12 education and must rely on the State Legislature for backfill funding.



OPERATING EXPENSES (BY NATURAL CLASSIFICATION)

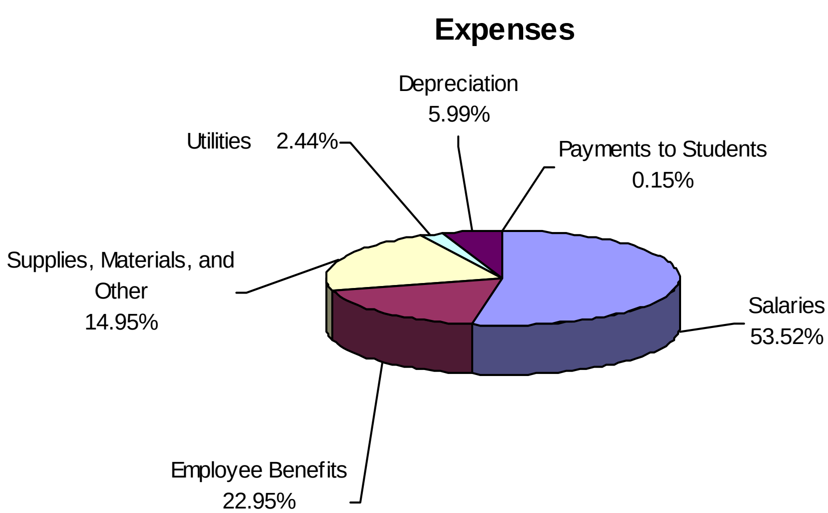
	2010	2009	Change
Salaries	$ 34,761,334	$ 36,511,450	-5%
Employee benefits	14,906,080	12,300,650	21%
Supplies, materials, and other operating expenses and services	9,712,231	15,126,003	-36%
Utilities	1,586,266	1,586,264	0%
Depreciation	3,892,196	3,684,132	6%
Payments to students	95,000	88,000	8%
Total Operating Expenses	$ 64,953,107	$ 69,296,499	-6%

Compensation slightly decreased in 2009-10 as a result of the District not filling all vacant positions. The District is currently in negotiations with both the classified and faculty bargaining groups.

Employee benefits increased as a result of additional retirees and the rate increases in health insurance premiums experienced by the District during fiscal year 2009-10.

Supplies, materials, other operating expenses and services decreased as the District took steps to reduce discretionary spending resulting from the uncertainty of the State budget and continuing economic downturn. In addition, the District reduced the allocation of one-time resources from the District's reserves from $4 million in 2008-09 to approximately $1 million in 2009-10. These one-time funds are used for improving instruction and services programs as well as generating additional FTES growth.

Utilities remained essentially unchanged as the District continues to institute energy, water, and other natural resource saving measures. One such measure is the co-generation (co-gen) system installed at the pool in 2006-07. The co-gen system is used to heat the pool as well as to produce electricity to be used on campus.



STATEMENT OF CASH FLOWS

The statement of cash flows provides information about cash receipts and cash payments during the fiscal year. This statement also helps readers assess the District's ability to generate net cash flows, its ability to meet its obligations as they come due, and the need for external financing.

	2010	2009
Net cash provided (used) by:		
Operating activities	$ (44,347,020)	$ (53,493,081)
Noncapital financing activities	48,884,621	43,254,724
Capital and related financing activities	1,469,502	(5,057,290)
Investing activities	241,722	641,351
Net Increase (Decrease) in Cash	6,248,825	(14,654,296)
Cash - Beginning of Fiscal Year	19,475,822	34,130,118
Cash - End of Fiscal Year	$ 25,724,647	$ 19,475,822

Cash receipts from operating activities consist primarily of state grants and contracts. Cash outlays were payments to, or on behalf of, our employees.

In comparing the 2009 and 2010 fiscal years, the increase in overall cash is primarily the result of the District obtaining a mid-year TRAN over $3.2 million. Additionally, the state fully reimbursed the District in 2009-10 for construction-related expenditures made in 2008-09

Payment on capital debt is the main use of cash for capital and related financing activities.

ECONOMIC FACTORS THAT MAY AFFECT THE FUTURE

On October 8, 2010, Governor Schwarzenegger signed into law the 2010-11 State Budget. One hundred days late, it was the most overdue state budget in California history. The budget package comprised of 26 separate pieces of legislation was also one of the most complex California has ever seen. Having exhausted all the easy and straightforward solutions in recent years, state leaders used a combination of cuts, rosy assumptions, borrowing, and temporary revenues to bridge an estimated $19.3 billion budget gap.

On October 20, 2010, the Governor finalized action on the educational trailer bill (Assembly Bill 1610). In doing so, he vetoed $60 million from the community college budget package. The vetoes centered on how the funds would be provided. Specifically, the $60 million would have been disbursed to community college District's in July 2011, in effect borrowing from next year's budget in order to support programs in the current year. The Governor's vetoes included $35 million to partially restore categorical programs and an additional $25 million for the Economic and Workforce development program. The District budget did not include income estimates from these sources.

On November 9, 2010, the Legislative Analyst Office (LAO), the Legislature's nonpartisan budget and policy advisor, released its annual Fiscal Outlook which provides an assessment of the state's current fiscal condition as well as five-year economic and budget forecast. In the report, LAO projects that, absent corrective action, California will face a two-year budget shortfall of $25.4 billion. Of this amount, $6.1 billion is attributed to 2010-11 and $19.2 billion is attributed to 2011-12. In reaction to this news Governor Schwarzenegger announced that he will call for a special session of the Legislature to address the current-year shortfall.

The cause for the major deterioration in the current year includes a variety of unrealistic revenue and expenditure assumptions that were included in the budget package adopted just a month ago. Major items include:

- Federal revenues overstated by $3.5 billion
- State General Fund revenues overstated (combined total of $447 million over two years)
- Underestimated prison cost of $965 million
- Loss of $800 million due to passage of proposition 22 which prevents the state from borrowing from local governments
- Overestimated local property tax revenues (combined total of $400 million over two years)
- Underestimated Medi-Cal costs of $400 million
- Underestimated In-Home Supportive Services costs of $195 million

For 2011-12, LAO projects the current year liabilities will roll forward and be compounded by the expiration of a number of temporary budget solutions used in 2010-11. These include:

- Expiration of $8 billion in temporary tax increases agreed to as part of the 2009-10 state budget
- Phase out $4.5 billion in one-time federal funds used to balance the current year budget

LAO advises the Legislature to take a multi-year approach to tackling this budget gap. Specifically, they recommend using a combination of ongoing and one-time solutions to balance the budget in 2011-12, then adding more ongoing solutions in 2012-13, and so on over several years until the state budget has been brought into full alignment. In addition, the LAO urges that added revenues be included as part of the overall package. Among revenue solutions, they recommend that the legislature consider limiting tax breaks, extending temporary taxes, charging additional user fees, and making changes to corporate tax structure.

Governor Schwarzenegger announced that he would call a special session of the Legislature to begin on December 6, the day that newly elected legislators are sworn in. This will be the eighth special session on the budget that the Governor has called in the past seven years. While the Governor has not yet released any specific budget proposals, his press releases on the special session indicate that he will be proposing budget cuts to bridge the $6.1 billion current year shortfall.

The Department of Finance, which is working closely with both the outgoing and incoming Administrations, will play a key role in shaping the special session budget proposals. In particular, the Chancellor's Office is seeking additional information on the downgraded local property tax revenue estimates which could have a material impact on the community colleges.

IMPLICATIONS FOR THE COMMUNITY COLLEGES

While it is too early to know how the Legislature and the incoming Brown Administration will react to these developments, it is safe to say that the information included in the LAO report increases the probability of cuts in both the current year and budget year.

A realistic scenario is that the Legislature would take back the $126 million in enrollment funding provided as part of the recently enacted 2010-11 State Budget. If this were to occur, it would not have a direct impact on the 2010-11 budget adopted by the Board on October 5, 2010 as this income was not factored into the expected revenue stream. However, the college over the past two years continues to serve students well beyond available state funding. If continued, this pattern could have a direct negative impact on future programs, services and access to students.

The LAO reports hints at the possibility of mid-year cuts and District's are asked to prepare for budget reductions in the current and budget year 2011-12. As the budget challenges are tackled in the LAO's report, actions by the Legislature may further reduce general apportionment to the District in 2010-11 had additional resources it used to assist the categorical programs with may or may not be there in 2011-12. Unexpectedly, the District received a small allocation of American Recovery and Reinvestment Act ARRA funds ($42 thousand) that were utilized to backfill a staff position in the Financial Aid department.

As the biggest budget challenges still seem ahead of us, the District has gained acceptance of the 2011-12 budget development calendars, which guides the institution through the budget development process and involves the entire campus community.

FINANCIAL SECTION

June 30, 2010	Primary Institution	Foundation
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 12,939,706	$ 2,188,255
Accounts receivable - net	15,848,962	1,304,944
Inventory	734,732	-
Prepaid expenses	180,371	-
Total Current Assets	29,703,771	3,493,199
NONCURRENT ASSETS		
Restricted cash and cash equivalents	12,784,941	-
Long-term investments	-	1,640,280
Deferred charges	1,126,783	-
Capital assets - net	111,145,602	-
Total Noncurrent Assets	125,057,326	1,640,280
Total Assets	$ 154,761,097	$ 5,133,479
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Cash overdraft	$ 779,954	$ -
Accounts payable	1,992,559	36,733
Tax revenue anticipation notes (TRANs)	3,193,537	-
Accrued salaries and related benefits	481,585	-
Deferred revenue	3,911,286	-
Amounts held in trust for others	166,178	-
Current portion of long-term liabilities	1,559,435	-
Total Current Liabilities	12,084,534	37,706
NONCURRENT LIABILITIES		
Other postemployment benefits (OPEB)	255,035	-
Long-term liabilities	51,704,805	-
Total Noncurrent Liabilities	51,959,840	-
Total Liabilities	64,044,374	37,706
NET ASSETS		
Invested in capital assets - net of related debt	72,693,646	-
Restricted:		
Nonexpendable	-	1,890,144
Expendable	6,045,060	3,130,470
Unrestricted	11,978,017	75,159
Total Net Assets	90,716,723	5,095,773
Total Liabilities and Net Assets	$ 154,761,097	$ 5,133,479

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

Year Ended June 30, 2010	Primary Institution	Foundation
OPERATING REVENUES		
Tuition and fees (gross)	$ 7,190,248	$ -
Scholarship discounts and allowances	(3,815,929)	-
Net Tuition and Fees	3,374,319	-
Grants and contracts - noncapital:		
Federal	1,908,496	-
State	5,124,429	-
Local	828,779	-
Other operating receipts	717,393	-
Auxiliary enterprise sales and charges	3,155,558	-
Total Operating Revenues	15,108,974	-
OPERATING EXPENSES		
Salaries	34,761,334	-
Employee benefits	14,906,080	-
Supplies, materials, and other operating expenses and services	9,712,231	935,490
Utilities	1,586,266	-
Depreciation	3,892,196	-
Payments to students	95,000	307,533
Total Operating Expenses	64,953,107	1,243,023
Operating Loss	(49,844,133)	(1,243,023)
NONOPERATING REVENUES (EXPENSES)		
State apportionment - noncapital	40,151,573	-
Local property taxes - noncapital	7,687,815	-
State taxes and other revenues - noncapital	1,431,316	-
Investment income - noncapital	241,722	197,443
Interest expense - noncapital	(70,813)	-
Financial aid revenues - federal	20,549,149	-
Financial aid revenues - State	1,537,251	-
Financial aid expenses	(22,359,596)	-
Amortization expense	(93,129)	-
Other nonoperating revenues-grants/gifts - noncapital	375,477	1,358,613
Total Nonoperating Revenues (Expenses)	49,450,765	1,556,056
Income (Loss) Before Other Revenues, Expenses, Gains, or Losses	(393,368)	313,033
OTHER REVENUES, EXPENSES, GAINS, OR LOSSES		
Local property taxes and revenues - capital	2,047,074	-
Investment income - capital	85,139	-
Interest expense - capital	(2,116,810)	-
Loss - disposal of capital assets	(600,527)	-
Total Other Revenues, Expenses, Gains, or Losses	(585,124)	-
Increase (Decrease) in Net Assets	(978,492)	313,033
Net Assets - as Previously Reported	91,183,724	4,782,734
Prior-Period Adjustment	511,491	-
Net Assets - as Restated	91,695,215	4,782,734
Net Assets - End of Year	$ 90,716,723	$ 5,095,767

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

Year Ended June 30, 2010		Primary Institution		Foundation
CASH FLOWS FROM OPERATING ACTIVITIES				
Tuition and fees	$	3,340,138	$	-
Federal grants and contracts		1,032,303		-
State grants and contracts		4,541,794		-
Local grants and contracts		835,428		-
Payments to suppliers		(8,516,377)		(932,221)
Payments to/on behalf of employees		(49,160,624)		-
Payments to/on behalf of students		(95,000)		(307,533)
Auxiliary enterprise sales and charges		3,156,560		-
Other receipts (payments)		518,758		-
Net Cash Used by Operating Activities		(44,347,020)		(1,239,754)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES				
State apportionment and receipts		38,471,025		-
Property taxes		7,763,628		-
State taxes and other revenues		1,830,962		-
Gifts and grants for other than capital purposes		375,477		-
Financial aid, scholarship, and loan trust receipts - federal		20,549,149		-
Financial aid, scholarship, and loan trust receipts - state		1,537,251		-
Financial aid, scholarship, and loan trust disbursements		(21,579,642)		-
Student organization agency receipts		37,618		-
Student organization agency disbursements		(30,034)		-
Interest on noncapital investments		(70,813)		-
Other receipts		-		1,600,570
Net Cash Provided by Noncapital Financing Activities		48,884,621		1,600,570
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES				
State apportionment for capital purposes		3,489,152		-
Purchases of capital assets		(537,200)		-
Proceeds from sale of capital assets		495,665		-
Principal paid on capital debt and capital leases		(1,868,805)		-
Interest paid on capital debt		(2,241,523)		-
Interest on capital investments		85,139		-
Local property taxes and other revenues for capital		2,047,074		-
Net Cash Provided by Capital and Related Financing Activities		1,469,502		-
CASH FLOWS FROM INVESTING ACTIVITIES				
Investment income on noncapital investments				
Proceeds from sales and maturities of investments		241,722		361,000
Interest on investments		-		(9,913)
Purchases of investments		-		(434,500)
Cash Provided (Used) by Investing Activities		241,722		(83,413)
Net Decrease in Cash and Cash Equivalents		6,248,825		277,403
Cash and Cash Equivalents Balance - Beginning of Year		19,475,822		1,910,852
Cash and Cash Equivalents Balance - End of Year	$	25,724,647	$	2,188,255

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

Year Ended June 30, 2010	Primary Institution	Foundation
RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES		
Operating loss	$ (49,844,133)	$ (1,243,023)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense	3,892,196	-
Changes in assets and liabilities:		
Accounts receivables - net	(1,944,688)	-
Inventory	46,411	-
Prepaid expenses	(159,908)	-
Accounts payable	2,900,358	2,895
Accrued salaries and benefits	487,717	374
Deferred revenue	260,704	-
Compensated absences	19,073	-
Other liabilities	(4,750)	-
Net Cash Used by Operating Activities	$ (44,347,020)	$ (1,239,754)

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

1. ORGANIZATION AND NATURE OF ACTIVITIES

Definition of the Reporting Entity Merced Community College District (the District) is a political subdivision of the State of California and provides higher education in portions of three counties. The District consists of one community college with two branches located throughout the service area (the Primary Institution).

For financial reporting purposes, the District includes all funds, agencies, and authorities that are controlled by or dependent on the District's executive and legislative branches. Control by or dependence on the District was determined on the basis of budget adoption, taxing authority, outstanding debt secured by revenues or general obligations of the District, obligations of the District to finance any deficits that may occur, or receipt of significant subsidies from the District.

The financial statements of the District include the financial activities of the District and the combined totals of the trust and agency funds, which represent pass-through accounts and the student organizations' activities within the District.

The District and the Merced College Foundation (the Foundation) have financial and operational relationships that meet the reporting entity definition criteria of the Governmental Accounting Standards Board (GASB) for inclusion of the Foundation as a component unit of the District. Accordingly, the financial activities of the Foundation as a component unit have been included in the financial statements of the District.

The following are those aspects of the relationship between the District and the Foundation as the component unit that satisfies the GASB:

Accountability The Foundation operates under a master agreement with the District in accordance with the *California Education Code* requirements. The District is able to impose its will upon the Foundation. The Foundation provides specific financial benefits or imposes specific financial burdens on the District.

Scope of Public Service The Foundation is a nonprofit public benefit corporation incorporated under the laws of the State of California. The Foundation was formed to promote and assist the educational services of the District.

Discrete Presentation For financial presentation purposes, the Foundation's financial activities have been discretely presented with the financial activities of the District.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting For financial reporting purposes, the District is considered a special-purpose government engaged only in business-type activities (BTA). Accordingly, the District's financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred. All significant interfund transactions have been eliminated.

The District has elected to apply all Financial Accounting Standards Board (FASB) pronouncements issued before November 30, 1989, unless FASB conflicts with GASB. The District has not elected to apply FASB pronouncements issued after that date. The budgetary and financial accounts of the District are recorded and maintained in accordance with the *Budget and Accounting Manual* issued by the Chancellor's Office of the California Community Colleges.

Cash and Cash Equivalents The District's cash and cash equivalents are considered to be cash on hand, demand deposits, and all highly liquid investments purchased with an original maturity of three months or less.

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.

In accordance with *California Education Code*, Section 41001, the District maintains substantially all of its cash in the Merced County Treasury as part of the common investment pool. The county is restricted by *California Education Code*, Section 53635 pursuant to Section 53601 to invest in time deposits, U.S. government securities, state registered warrants, notes, bonds, State Treasurer's investment pool, bankers' acceptances, commercial paper, negotiable certificates of deposit, and repurchase or reverse repurchase agreements. Investments in the county pool are valued using the amortized cost method (which approximates fair value) and include accrued interest. The pool has deposits and investments with a weighted-average maturity of less than one year. As of June 30, 2010, the fair value of the county pool is 100.486% of the carrying value and is deemed to not represent a material difference. Information regarding the amount of dollars invested in derivatives with the county was not available. The county investment pool is subject to regulatory oversight by the Treasury Oversight Committee, as required by *California Education Code,* Section 27130. The District is considered to be an involuntary participant in the external investment pool.

Accounts Receivable Accounts receivable consist of tuition and fee charges to students and auxiliary enterprise services provided to students, faculty, and staff, the majority of each residing in California. Accounts receivable also include amounts due from federal, state, and local governments, or private sources in connection with reimbursement of allowable expenditures made pursuant to the District's grants and contracts. The District utilizes the allowance method with respect to its accounts receivable. The allowance was $-0- at June 30, 2010.

Inventory Inventory, primarily bookstore merchandise, is carried at the lower of cost or market using the first-in, first-out (FIFO) method.

Restricted Cash and Cash Equivalents Cash that is externally restricted for contractual obligations such as debt service payments, sinking or reserve funds, or to purchase or construct capital or other noncurrent assets, is classified as a noncurrent asset in the statement of net assets.

In accordance with *California Education Code,* Section 81965, the District maintains the bond capital project funds in the California Asset Management Program, a California common law trust. The District participates in the California Asset Management Program (CAMP) as described further in note 16. The value of the District's investment in CAMP is the fair value of the pool shares. As of June 30, 2010, the fair value of CAMP is 100.021% of the carrying value and is deemed to not represent a material difference. There are no CAMP funds invested in derivatives as of June 30, 2010. Oversight of CAMP is provided by the Board of Trustees, which consists of seven trustees. The trustees are appointed to the Board of Trustees from members of the governing body, officers, or full-time employees of a public agency that is a participant in the trust and approved annually by the participants. The District is considered to be a voluntary participant in the CAMP investment pool.

Long-Term Investments Long-term investments are reported at fair value. Fair value is determined from quoted market prices. The Foundation's investment policy established safety of principal as the primary investment objective. The Foundation's investment strategy is to realize a reasonable interest yield, and investment decisions are executed with the intent that they will be held to maturity.

The calculation of realized gains is independent of the calculation of the net increase in the fair value of investments. Realized gains and losses on investments that had been held in more than one fiscal year and sold in the current year may have been recognized as an increase or decrease in the fair value of investments reported in the prior year. The net increase in the fair value of investments during the year ended June 30, 2010, was $280,861. This amount takes into account all changes in fair value (including purchases and sales) that occurred during the year. The unrealized gain on investments held at June 30, 2010, was $161,997.

Deferred Charges Deferred charges are bond issuance costs and are deferred and amortized over the term of the bonds using the straight-line method since the results are not significantly different from the effective interest method.

Capital Assets Capital assets are recorded at cost on the date of acquisition or fair value at the date of donation. For equipment, the District's capitalization policy includes all items with a unit cost of $5,000 or more and an estimated useful life of greater than one year. Renovations to buildings and land improvements that significantly increase the value or extend the useful life of the structure are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense is incurred.

Depreciation is computed on a straight-line basis using the half-year convention over the estimated useful life of the assets: generally 50 years for buildings, 10 years for land improvements, 8 years for vehicles, 10 years for equipment, 5 years for library books, and 5 years for technology equipment. Land and construction in progress are considered nondepreciable capital assets; therefore, no depreciation is computed.

Deferred Revenue Deferred revenues include amounts received for tuition, fees, and certain auxiliary activities prior to the end of the fiscal year but related to the subsequent accounting period. Deferred revenues also include amounts received from grant and contract sponsors that have not yet been earned.

Amounts Held in Trust for Others The District administers funds for certain college related organizations. The liability represents the amount of funds held for these organizations.

Compensated Absences Compensated absence costs are accrued when earned by employees. Accumulated unpaid employee vacation benefits are recognized at year end as liabilities of the District. The District has a load banking program for eligible faculty employees whereby the employee may accrue overload service toward a paid leave.

Bond Premium Bond premiums are deferred and amortized over the term of the bonds using the effective interest method. Bond premiums are recorded as long-term liabilities.

Net Assets The District's net assets are classified as follows:

Invested in capital assets - net of related debt represents the District's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred for capital assets but not yet expended, such amounts are not included as a component of invested in capital assets, net of related debt.

Restricted net assets - nonexpendable consist of endowment and similar type funds in which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may be expended or added to principal depending on donor stipulations.

Restricted net assets - expendable include resources in which the District is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.

When an expense is incurred that can be paid using either restricted or unrestricted resources, the District's policy is to first apply the expense towards restricted resources and then towards unrestricted resources.

Classification of Revenues The District has classified its revenues as either operating or nonoperating revenues according to the following criteria:

Operating revenues include activities that have the characteristics of exchange transactions, such as: (1) student tuition and fees, net of scholarship discounts and allowances; (2) sales and services of auxiliary enterprises; and (3) most federal, state, and local grants and contracts, and federal appropriations.

Nonoperating revenues include activities that have the characteristics of nonexchange transactions, such as gifts and contributions; and other revenue sources that are defined as nonoperating revenues, such as state appropriations and investment income, according to GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities that Use Proprietary Fund Accounting,* and GASB Statement No. 34, *Basic Financial Statements–and Management's Discussion and Analysis–for State and Local Governments*.

Scholarship Discounts and Allowances and Financial Aid Student tuition and fee revenues are reported net of scholarship discounts and allowances in the statement of activities. The District offers Board of Governors' Waivers (BOGW) to qualified students, and these tuition waivers are reported as scholarship discounts and allowances.

Risk Management The District retains risk for property damage on the first $100,000 of each claim. The District retains no risk for liability or workers' compensation claims, and coverage is provided by pooled insurance as a member of a joint powers authority.

Certain liability coverage in excess of $350,000 and up to $20,000,000 is provided by pooled insurance as a member of a joint powers authority of California community colleges and school districts. Property damage in excess of $5,000 and up to $100,000,000 is provided by pooled insurance as a member of a joint powers authority.

Estimates Used in Financial Reporting In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements as well as revenues and expenses during the reporting period. Actual results could differ from those estimates. The District's largest sources of revenues are property taxes, enrollment fees, and state revenues. Each of these revenue types is subject to some estimation at the date of the financial statements.

Budgets and Budgetary Accounting By state law, the District's governing board must approve a tentative budget no later than July 1 and adopt a final budget no later than September 15 of each year. A hearing must be conducted for public comments prior to adoption. The District's governing board satisfied these requirements.

The budget is revised during the year to incorporate categorical funds that are awarded during the year and for miscellaneous changes to the spending plans. The District's governing board approves revisions to the budget.

General Apportionment and Property Tax The District's general apportionment is received from a combination of local property taxes, state apportionments, and other local sources.

The county is responsible for assessing, collecting, and apportioning property taxes. Taxes are levied for each fiscal year on taxable real and personal property in the county. Secured property taxes attach as an enforceable lien on property as of March 1. Property taxes on the secured roll are due on November 1 and February 1 and become delinquent after December 10 and April 10, respectfully.

Secured property taxes are recorded as revenue when apportioned in the fiscal year of the levy. The county apportions secured property tax revenue in accordance with the alternate method of distribution prescribed by Section 4705 of the *California Revenue and Taxation Code*. This alternate method provides for crediting each applicable fund with its total secured taxes upon completion of the secured tax roll, approximately October 1 of each year.

Property taxes are recorded as local revenue sources by the District. The California Community Colleges Chancellor's Office reduces the District's entitlement by the District's local property tax revenue and student fees. The balance is paid from the State's General Fund and is referred to as state apportionment. The District's base revenue is the amount of general purpose tax revenue, per full-time equivalent student (FTES), that the District is entitled to by law.

3. CASH AND CASH EQUIVALENTS AND INVESTMENTS

The following is a summary of cash and investments at June 30, 2010:

	Primary Institution	Foundation
PETTY CASH/CASH AWAITING DEPOSIT	$ 148,543	$ -
DEPOSITS (1)	(697,230)	2,170,290
INVESTMENTS THAT ARE NOT SECURITIES (2)		
County treasurer's investment pool	19,229,863	-
California Asset Management Program	6,263,517	-
Money market mutual fund	-	17,965
Subtotal	25,493,380	17,965
INVESTMENT SECURITIES		
Bond mutual funds	-	850,891
Equity mutual funds	-	789,389
Subtotal	-	1,640,280
Total Cash and Cash Equivalents and Investments	$ 24,944,693	$ 3,828,535

(1) ***Deposits*** The carrying amount of deposits includes checking accounts, savings accounts, nonnegotiable certificates of deposits, and money market accounts at financial institutions, if any.

(2) ***Investments That are Not Securities*** A "security" is a transferable financial instrument that evidences ownership or creditorship, whether in physical or book-entry form. Investments that are not securities do not have custodial credit risk because they do not involve a transferable financial instrument. Thus, they are not categorized into custodial credit risk categories.

Custodial Credit Risk – Deposits

For deposits, custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned. The District and Foundation do not have policies for custodial credit risk. As of June 30, 2010, the District's and the Foundation's bank balances were exposed to custodial credit risk as follows:

	Primary Institution	Foundation
Uninsured and uncollateralized	$ -	$ 1,929,732
Uninsured and collateral held by pledging bank's trust department not in the District's name	165,451	-
Total	$ 165,451	$ 1,929,732

Primary Institution – Investment Credit Risk

California Government Code, Section 53601, limits investments in commercial paper to "prime" quality of the highest ranking or of the highest letter and numerical rating as provided by nationally recognized statistical rating organizations (NRSRO), and limits investments in medium-term notes to a rating of A or better. Individual securities must be backed by the federal government or rated AAA, AA, or A by Standard & Poor's or Aaa, Aa, or A by Moody's indices. The District's and the Foundation's investment policies do not further limit their investment choices.

Investment Type	Fair Value	AAA	Not Rated
County treasurer's investment pool	$ 19,229,863	$ -	$ 19,229,863
California Asset Management Program	6,263,517	6,263,517	-
Totals	$ 25,493,380	$ 6,263,517	$ 19,229,863

Foundation – Investment Credit Risk

		S & P's Ratings as of Year End		
Investment Type	**Fair Value**	**AAA**	**BBB**	**Unrated**
Bond mutual funds	$ 850,891	$ 415,379	$ 406,479	$ 29,033

Concentration of Credit Risk – Investments

The proportion of investment in each of the permissible investment categories is restricted as defined in *California Government Code*, Sections 53601 and 53635. The District had no investment greater than 5% of the District's total investments. The Foundation had one investment greater than 5% of the Foundation's total investments, which consisted of $2,170,290 in WestAmerica Bank.

Primary Institution – Investment Interest Rate Risk

California Government Code, Section 53601, limits the District's investments to maturities of five years. The District's investment policy is to hold investments to call or maturity to further mitigate interest rate risk. The Foundation's investment policy does not further limit investment choices. The schedule of maturities at June 30, 2010, is as follows:

Investment Type	Fair Value	Maturity in Less Than 1 Year
County treasurer's investment pool	$ 19,229,863	$ 19,229,863
California Asset Management Program	6,263,517	6,263,517
Totals	$ 25,493,380	$ 25,493,380

Foundation - Investment Interest Rate Risk

		Maturity (in Years)			
Investment Type	**Fair Value**	**Less Than 1**	**1-5**	**6-10**	**More Than 10**
Bond mutual funds	$ 850,891	-	$ 224,252	$ 415,379	$ 211,260

4. ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following at June 30, 2010:

	Primary Institution	Foundation
Federal grants and contracts	$ 1,492,981	$ -
State grants and contracts	1,530,766	-
Local grants and contracts	38,435	-
State apportionment - noncapital	8,672,077	-
State apportionment - capital	74,581	-
State taxes and other revenue	370,815	-
Auxiliaries	23,322	-
Tuition and fees	3,154,396	-
Other	491,589	1,304,944
Total	$ 15,848,962	$ 1,304,944

5. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2010, is as follows:

	Balance July 1, 2009	Additions	Deductions	Balance June 30, 2010
NONDEPRECIATED CAPITAL ASSETS				
Land	$ 2,763,558	$ -	$ 1,093,300	$ 1,670,258
Construction in progress	2,314,172	210,179	72,228	2,452,123
DEPRECIATED CAPITAL ASSETS				
Site improvements	12,977,042	-	-	12,977,042
Buildings and improvements	120,590,250	72,228	-	120,662,478
Equipment	9,292,848	214,569	21,247	9,486,170
Vehicles	987,661	46,998	-	1,034,659
Library books and film	1,279,896	65,454	-	1,345,350
Total Capital Assets	150,205,427	609,428	1,186,775	149,628,080
Less: Accumulated depreciation	34,608,638	3,892,196	18,356	38,482,478
Total Capital Assets - Net	$ 115,596,789	$ (3,282,768)	$ 1,168,419	$ 111,145,602

6. TAX AND REVENUE ANTICIPATION NOTES

On July 7, 2009, the District issued $5,000,000 of tax revenue anticipation notes (TRANs) at an interest rate of 2% due on June 30, 2010. These TRANs were issued under the authority of the *California Government Code.* Proceeds from the issuance of TRANs were used to meet fiscal 2009-10 expenditures, including operating expenditures, capital expenditures, and the discharge of other obligations or indebtedness of the District. TRANs are general obligations of the District but are payable only from taxes, revenues, cash receipts, and other monies received by the District. On June 30, 2010, the TRANs were repaid in accordance with the above terms.

On April 22, 2010, the District issued $3,200,000 of tax revenue anticipation notes (TRANs) at an interest rate of 2.0% due March 1, 2011. These TRANs were issued under the authority of the *California Government Code*. Proceeds from the issuance of TRANs were used to meet fiscal 2010-11 expenditures, including operating expenditures, capital expenditures, and the discharge of other obligations or indebtedness of the District. TRANs are general obligations of the District but are payable only from taxes, revenues, cash receipts, and other monies received by the District.

7. LONG-TERM LIABILITIES

The long-term liability activity for the year ended June 30, 2010, is as follows:

	Beginning Balance	Additions	Payments and Reductions	Ending Balance	Current Portion
Compensated absences	$ 881,489	$ 19,070	$ -	$ 900,559	$ -
Capital leases	3,329,367	-	598,805	2,730,562	549,435
General obligation bonds	49,755,000	-	1,270,000	48,485,000	1,010,000
Bond issuance premium	1,287,602	-	139,483	1,148,119	-
Total	$ 55,253,458	$ 19,070	$ 2,008,288	$ 53,264,240	$ 1,559,435

8. CAPITAL LEASES

The District leases equipment at a cost of $4,400,093, with related accumulated depreciation of $1,642,617, under agreements which provide for title to pass upon expiration of the lease period. The amount of interest cost incurred during the year ended June 30, 2010, was $119,135, all of which was charged to expenses. Future minimum lease payments are as follows:

Year Ending June 30	Lease Payments
2011	$ 647,115
2012	647,115
2013	647,115
2014	250,961
2015	239,012
2016-2019	637,365
Total	3,068,683
Less: Amount representing interest	338,121
Present Value of Net Minimum Lease Payments	$ 2,730,562

Amortization of leased equipment under capital assets is included with depreciation expense.

9. GENERAL OBLIGATION BONDS

The general obligation bonds payable at June 30, 2010, with their outstanding balances, are comprised of the following issuances:

Series 2003 general obligation bond for School Facilities Improvement District No. 1, due in annual installments of $310,000 to $1,500,000 beginning August 1, 2004, through August 1, 2027, at interest from 2.50% to 5.00%.	$ 14,420,000
Series 2003 general obligation bond for School Facilities Improvement District No. 2, due in annual installments of $45,000 to $440,000 beginning August 1, 2004, through August 1, 2027, at interest from 2.50% to 4.50%.	285,000
Series 2005 general obligation bond for School Facilities Improvement District No. 2, due in annual installments of $25,000 to $135,000 beginning August 1, 2007, through August 1, 2015, at interest from 3.63% to 5.00%.	575,000
Series 2006 general obligation bond for School Facilities Improvement District No. 1, due in annual installments of $70,000 to $3,210,000 beginning August 1, 2007, through August 1, 2031, at interest from 4.50% to 5.00%.	22,785,000
Series 2006 general obligation refunding bonds for School Facilities Improvement District No. 2, due in annual installments of $60,000 to $1,390,000 beginning August 1, 2007, through August 1, 2025, at interest from 3.50% to 5.00%.	10,420,000
Total	$ 48,485,000

The amount of interest cost incurred during the year ended June 30, 2010, was $2,256,294, all of which was charged to expenses. The annual requirements to amortize the general obligation bonds are as follows:

Year Ending June 30	**Principal**	**Interest**	**Total**
2011	$ 1,010,000	$ 2,223,551	$ 3,233,551
2012	1,890,000	2,186,697	4,076,697
2013	8,350,000	1,922,986	10,272,986
2014	585,000	1,706,689	2,291,689
2015	1,160,000	1,668,590	2,828,590
2016-2020	6,520,000	7,602,584	14,122,584
2021-2025	12,255,000	5,384,907	17,639,907
2026-2030	10,560,000	2,706,602	13,266,602
2031-2032	6,155,000	186,143	6,341,143
Totals	$ 48,485,000	$ 25,588,749	$ 74,073,749

10. LEASE REVENUE BONDS

The District and the State of California have entered into a financing arrangement under which the State provides funds for the construction of the Interdisciplinary Academic Center (IAC). The funds are proceeds of lease revenue bonds issued by the State of California, Public Works Board (the Board). The bonds are a special obligation of the Board payable from the State General Fund revenues appropriated to the Board of Governors' of the California Community College who therein make adequate provision in the annual budget of the State for the servicing of such bonds. However, in the unlikely event that the State could not pay the semiannual installment payment, the District would be responsible for the payments attributable to the District's facilities. Approximately $9,028,000 of the project costs were appropriated in the 2001-02 year. No amounts had been accrued for any contingent payments at June 30, 2010.

The IAC is included in the District's statement of net assets. The Board leases to the District the facilities constructed with these bonds. Annual installments on the lease range from $195,890 to $617,100 beginning March 15, 2006, through September 15, 2031. Upon full repayment of the associated bonds, title to the facilities shall transfer to the District.

11. OPERATING LEASES

The District has entered into various operating leases with lease terms in excess of one year. None of these agreements contains purchase options. All agreements contain a termination clause providing for cancellation after a specified number of days' written notice to lessors, but it is unlikely that the District will cancel any of the agreements prior to the expiration date. Future minimum lease payments are as follows:

Year Ending June 30	**Lease Payments**
2011	$ 87,434
2012	87,434
2013	84,922
2014	70,837
2015	52,689
Total	$ 383,316

12. EMPLOYEE RETIREMENT SYSTEMS

California State Teachers' Retirement System

Plan Description

The District contributes to the California State Teachers' Retirement System (CalSTRS), a cost-sharing multiple-employer public employee retirement system defined benefit pension plan administered by CalSTRS. The plan provides retirement, disability, and survivor benefits to beneficiaries. Benefit provisions are established by state statutes, as legislatively amended, within the State Teachers' Retirement Law. CalSTRS issues a separate comprehensive annual financial report that includes financial statements and required supplementary information. Copies of the CalSTRS annual financial report may be obtained from the CalSTRS office, 100 Waterfront Place, Sacramento, California 95605.

Funding Policy

Active plan members are required to contribute 8.00% of their salary and the District is required to contribute an actuarially determined rate. The actuarial methods and assumptions used for determining the rate are those adopted by the CalSTRS Board. The required employer contribution rate for fiscal year 2009-10 was 8.25% of annual payroll. The contribution requirements of the plan members are established by state statute. The District's contributions to CalSTRS for the fiscal years ended June 30, 2010, 2009, and 2008 were $1,624,723, $1,699,124, and $1,674,517, respectively, and equaled 100% of the required contributions for each year.

Other Information

Under CalSTRS law, certain early retirement incentives require the employer to pay the present value of the additional benefit, which may be paid on either a current or deferred basis. The District has no obligations to CalSTRS for early retirement incentives granted to retired employees at June 30, 2010.

California Public Employees Retirement System

Plan Description

The District contributes to the School Employer Pool under the California Public Employees' Retirement System (CalPERS), a cost-sharing multiple-employer public employee retirement system defined benefit pension plan administered by CalPERS. The plan provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Benefit provisions are established by state statutes, as legislatively amended, within the Public Employees' Retirement Law. CalPERS issues a separate comprehensive annual financial report that includes financial statements and required supplementary information. Copies of the CalPERS annual financial report may be obtained from the CalPERS Executive Office, 400 Q Street, Sacramento, California 95811.

Funding Policy

Active plan members are required to contribute 7.00% of their salary and the District is required to contribute an actuarially determined rate. The actuarial methods and assumptions used for determining the rate are those adopted by the CalPERS Board of Administration. The required employer contribution rate for fiscal year 2009-10 was 9.709% of annual payroll. The contribution requirements of the plan members are established by state statute. The District's contributions to CalPERS for the fiscal years ended June 30, 2010, 2009, and 2008 were \$1,084,038, \$1,047,452, and \$1,006,177, respectively, and equaled 100% of the required contributions for each year.

13. DEFERRED COMPENSATION PLANS

The District offers its employees deferred compensation plans in accordance with *Internal Revenue Code*, Section 457 (457 plans). The plans, available to eligible District employees, permit employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or qualifying event. The assets of the 457 plans were held in trust as described in the *Internal Revenue Code*, Section 457 for the exclusive benefit of the employees and their beneficiaries. The plan administrators are agents of the employer for purposes of providing directions for the investment of funds held in the employers account. In accordance with GASB Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*, plan balances and activities are not reflected in the District's financial statements.

14. OTHER POSTEMPLOYMENT BENEFITS PLAN

Plan Description

In addition to the pension benefits described above, the District provides certain health care benefits for retired salaried employees after an annual retiree contribution of \$120 (\$150 for classified retirees) for eligible employees who have retired from service with the District. Classified and management eligible employees hired before February 1, 1989, receive lifetime benefits. Classified and management employees hired after February 1, 1989, and faculty members hired after January 1, 1991, can receive retiree health benefits until age 65. The District's salaried employees may become eligible for those benefits if they reach normal retirement age while working for the District. At June 30, 2010, the District has 233 retirees receiving benefits and has a total of 416 active participants, of which 183 are not yet eligible to receive benefits.

The District provides these benefits through the Community College League of California (CCLC) Retiree Health Benefit Program (RHBP), an agent multiple-employer defined benefit other postemployment (OPEB) plan. RHBP is administered by an elected board.

Funding Policy

The District's agreement with retired employees is for monthly contributions for members who meet the eligibility criteria of their collective agreement and who retire during the term of the contract. The contribution requirements of the District and plan members are established and may be amended by the District. The District has the right to modify, alter, or amend the plan in whole or in part.

GASB Statement No. 45 requires the actuarial amounts to be calculated using claims cost or age-adjusted premiums that approximate costs for retirees separately from those for active employees. However, the District's contributions to the RHBP are based on actuarial valuations prepared using the actuarial cost method.

Annual OPEB Cost and Net Other Postemployment Benefit Obligation

For fiscal year 2010, the District's OPEB cost for the RHBP was $3,515,417. The District's OPEB cost, the percentage of OPEB cost contributed to the plan, and the net OPEB obligation for the year ended June 30, 2010, were as follows:

Annual required contribution	$ 3,517,600
Interest on net OPEB obligation	(11,893)
Adjustment to annual required contribution	9,710
Subtotal	3,515,417
Contributions	3,090,485
Change in Net OBEP Obligation	424,932
Net OPEB Obligation (Deferred Charge) - Beginning of Year	(169,897)
Net OPEB Obligation - End of Year	$ 255,035

Year Ended	**Annual OPEB Cost**	**Actual Employer Contributions**	**Percentage Contributed**	**Net Ending OPEB Obligation (Deferred Charge)**
June 30, 2008	$ 3,292,339	$ 1,146,521	35%	$ 2,145,818
June 30, 2009	$ 3,538,670	$ 5,854,385	165%	$ (169,897)
June 30, 2010	$ 3,515,417	$ 3,090,485	88%	$ 255,035

Funded Status and Funding Progress

The funded status of the Plan as of the actuarial valuation dates below, was as follows:

	January 1, 2007	August 1, 2009
Actuarial accrued liability (AAL)	$ 62,863,161	$ 52,359,974
Actuarial value of plan assets	1,146,521	1,001,490
Unfunded Actuarial Accrued Liability (UAAL)	$ 61,716,640	$ 51,358,484
Funded ratio (actuarial value of plan assets/AAL)	1.82%	1.91%
Covered payroll (active members)	$ 25,414,461	$ 23,182,198
UAAL as a Percentage of Covered Payroll	242.84%	221.54%

Actuarial valuations for an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Actuarially determined amounts are subject to continuous revision as actual results are compared to past expectations and new estimates about the future are formulated. Although the valuation results are based on values which the District's actuarial consultant believes are reasonable assumptions, the valuation results reflect a long-term perspective and, as such, are merely an estimate of future costs. Deviations in any of several factors, such as future interest rates, medical cost inflation, Medicare coverage, and changes in marital status could result in actual costs being less or greater than estimated.

Actuarial Methods and Assumptions

Calculations of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) 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 members to that point. The actuarial methods and assumptions used are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the actuarial valuation, the entry age normal cost method was used. The actuarial assumptions included a 7.0% investment rate of return, compounded annually, net of investment expenses, and an annual health care cost trend rate of 4.0% and an annual inflation rate of 3.0%. The actuarial valuation of RHBFP assets was set at the market value of investments as of the measurement date.

The District's initial unfunded actuarial accrued liability (UAAL) as of June 1, 2007, is being amortized over a period of 30 years from July 1, 2007. The remaining amortization period at June 30, 2010, was 27 years. The actuarial valuation of RHBP assets was set at market value of investments as of the measurement date.

15. COMMITMENTS AND CONTINGENCIES

Federal and State Allowances, Awards, and Grants

The District has received state and federal funds for specific purposes that are subject to review and audit by the grantor agencies. Although such audits could generate expenditure disallowances under terms of the grants, it is believed that any required reimbursements will not be material.

16. JOINT POWERS AGREEMENTS

The District participates in joint ventures under joint powers agreements with the following joint powers authorities (JPAs): Valley Insurance Program (VIP), Schools Excess Liability Fund (SELF), and Self-Insured Schools of California (SISC III). The relationship between the District and the JPAs is such that the JPAs are not component units of the District for financial reporting purposes. The JPAs arrange for and provide property, liability, workers' compensation, dental, vision, and excess liability coverage for their members. Each JPA is governed by a board consisting of representatives from the members. The boards control the operations of the JPAs, including selection of management and approval of operating budgets, independent of any influence by the members beyond their representation on the boards. Each member pays a premium commensurate with the level of coverage requested and shares surpluses and deficits proportionate to its participation in the JPA.

The District participates in investment of certain bond proceeds and surplus funds organized by the California Asset Management Program (CAMP). CAMP is a JPA created to provide investment management services for surplus funds and comprehensive investment management, accounting, and arbitrage rebate calculation services for proceeds of tax-exempt financing.

The District participates in the Community College League of California (CCLC) which has established the Retiree Health Benefit Program (RHBP) joint powers agreement. The RHBP is a JPA created to provide funding for postemployment benefits (other than pension benefits) such as medical, dental, vision, life insurance, long-term care, and similar benefits offered by California Community College districts to their employees.

Separately issued financial statements can be requested from each JPA. Condensed audited financial information for each JPA is as follows:

	June 30, 2009	September 30, 2009		December 31, 2009	June 30, 2009
	SELF	**VIP**	**SISC III**	**CAMP**	**CCLC**
Total assets	$ 209,217,000	$ 23,541,821	$ 288,989,243	$ 3,070,925,000	$ 7,505,398
Total liabilities	161,555,000	12,835,314	98,615,380	66,935,000	4,768,210
Net Assets	$ 47,662,000	$ 10,706,507	$ 190,373,863	$ 3,003,990,000	$ 2,737,188
Total operating revenues	$ 18,330,000	$ 6,317,932	$ 958,393,652	$ 19,774,000	$ 5,177,460
Total operating expenditures	27,701,000	5,806,121	945,901,001	3,715,000	4,795,956
Nonoperating income	8,315,000	748,513	8,487,505	81,000	-
Excess Revenues (Expenses)	$ (1,056,000)	$ 1,260,324	$ 20,980,156	$ 16,140,000	$ 381,504

17. PRIOR-PERIOD ADJUSTMENT

Net assets as of July 1, 2009, have been increased by $511,491 as a result of an overstatement of accounts payable as of June 30, 2009. This adjustment has no effect on revenue or expense during the 2009-2010 fiscal year.

SUPPLEMENTARY INFORMATION SECTION

The District, a political subdivision of the State of California, was established on July 1, 1963. Its territories encompass portions of Merced, Madera, and Fresno counties. There were no changes in boundaries during the fiscal year.

The District provides higher education instruction for the first and second years of college education and vocations training at Merced Community College.

GOVERNING BOARD

Lewis S. Braxton	President	2012
Eva deLong	Vice President	2010
Jim Glidden	Clerk	2010
Les McCabe	Member	2010
Eugene J. Vierra	Member	2010
Robert Haden	Member	2012
Jinet Troost	Member	2012

ADMINISTRATION

Dr. Benjamin T. Duran
Superintendent/President

Dr. Anne Newins
Vice President, Student Personnel

Dr. Marianne Tortorici
Vice President, Instruction

Mazie Brewington
Vice President, Administrative Services

Mike Cuchna
Vice President, Technology and Institutional Research

SCHEDULE OF WORKLOAD MEASURES FOR STATE GENERAL APPORTIONMENT ANNUAL ATTENDANCE
June 30, 2010

The full-time equivalent resident students (FTES) eligible for 2009-10 state apportionment reported to the Chancellor's Office as of June 30, 2010, are summarized below:

	Reported Data
SUMMER INTERSESSION (Summer 2009 only)	
Noncredit	255
Credit	155
SUMMER INTERSESSION (Summer 2010 - Prior to July 1, 2010)	
Credit	1
PRIMARY TERMS (Exclusive of Summer Intersession)	
Census Procedure Courses	
Weekly census contact hours	7,958
Daily census contact hours	397
Actual Hours of Attendance Procedure Courses	
Noncredit	1,315
Credit	38
Alternative Attendance Accounting Procedure	
Weekly census procedure courses	65
Daily census procedure courses	12
Total FTES	10,196

SUPPLEMENTAL INFORMATION (Subset of above information)	
In-Service training courses (FTES)	94
BASIC SKILLS COURSES AND IMMIGRANT EDUCATION	
Noncredit	877
Credit	1,042
CDCP Noncredit FTES	748

See the accompanying note to the supplementary information.

June 30, 2010	Pass Through/ Grant Number	Federal CFDA Number	Current Year
FEDERAL DIRECT AWARDS			
U.S. DEPARTMENT OF EDUCATION			
Supplemental Education Opportunity Grants		84.007	$ 264,551
College Work Study		84.033	383,418
ARRA - College Work Study		84.033	81,130
Pell Grants		84.063	20,284,728
Veterans Education		84.064	1,773
MDRC Learning Communities Demo Grant		84.287	24,989
Childcare Access Means Parents in School		84.335	82,824
Academic Competitiveness Grants		84.375	146,477
Total Direct U.S. Department of Education			21,269,890
FEDERAL AWARDS PASSED THROUGH OTHER AGENCIES			
U.S. DEPARTMENT OF EDUCATION			
Passed Through California Department of Education			
Career and Technical Education Act - Block Grant	09-C01-031	84.048	423,018
Career and Technical Education Act - Tech Prep	09-139-530	84.243	67,750
Passed Through CSU Stanislaus			
Undergraduate International Studies and Foreign Language	None	84.016	448
Strengthening Institutions	1840-0745	84.031	7,563
Passed Through Merced County Office of Education			
Charter Schools	None	84.282	3,996
Passed Through California Student Aid Commission			
College Access Challenge Grant Program	P378A100034	84.378A	311,971
Passed Through Chancellor's Office			
ARRA - State Fiscal Stabilization	S394A090005	84.394	371,098
Total U.S. Department of Education			1,185,844
U.S. DEPARTMENT OF AGRICULTURE			
Passed Through California Department of Education			
Child Care Food	None	10.558	74,150
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES			
Passed Through Chancellor's Office			
Temporary Assistance for Needy Families	None	93.558	144,242
Passed Through Yosemite Community College District			
CDC Training Consortium	07-10-3970	93.575	23,404
Passed Through California Department of Education			
CDC Instructional Materials	CIMS-9336	93.575	1,177
CDC School Age Resource	CSCC-8182	93.575	555
CDC PITC Demonstration	5827510-028	93.575	14,972
Merced County Mental Health	ETC 10-021	93.958	12,737
Total California Department of Education			29,441
Passed Through Madera County Office of Education			
CDC MAA	None	93.778	5,056
Total U.S. Department of Health and Human Services			
U.S. DEPARTMENT OF LABOR			
Passed Through Merced County Office of Education			
Workforce Investment Act - Adult Program	200-6194	17.258	196,803
Total Expenditures of Federal Awards			$ 22,928,830

See the accompanying note to the supplementary information.

SCHEDULE OF EXPENDITURES OF STATE AWARDS

Merced Community College District

June 30, 2010	Program Entitlements: Current Year	Program Entitlements: Prior-Year Carryover	Program Entitlements: Total	Program Revenues: Cash Received	Program Revenues: Accounts Receivable	Program Revenues: Deferred Revenue	Program Revenues: Total	Program Expenditures
CATEGORICAL APPORTIONMENTS								
Articulation	$ -	$ 705	$ 705	$ 705	$ -	$ -	$ 705	$ 705
Basic skills	267,517	788,487	1,056,004	1,056,004	-	567,379	488,625	488,625
Board financial assistance	433,144	47,443	480,587	480,587	-	91,682	388,905	388,905
CalWORKS	346,808	1,548	348,356	348,356	-	6,983	341,373	341,373
Disabled students program and services	510,888	33,719	544,607	544,607	-	34,183	510,424	510,424
Economic development	828,217	342,320	1,170,537	917,712	223,724	133,180	1,008,256	1,008,256
Extended opportunity program and services	1,039,507	113,866	1,153,373	1,153,373	-	65,812	1,087,561	1,087,561
Faculty and staff development	-	34,520	34,520	34,520	-	30,690	3,830	3,830
Faculty and staff diversity	6,142	-	6,142	6,142	-	130	6,012	6,012
Matriculation	400,061	121,772	521,833	521,833	-	24,368	497,465	497,465
Nursing faculty grant	-	11,441	11,441	11,441	-	9,361	2,080	2,080
SIE library materials	-	28,130	28,130	28,130	-	-	28,130	28,130
Subtotal	3,832,284	1,523,951	5,356,235	5,103,410	223,724	963,768	4,363,366	4,363,366
CATEGORICAL PROGRAM ALLOWANCES								
Career advancement academy grant	230,000	-	230,000	111,239	92,952	-	204,191	204,191
Career tech community collaborative	39,582	-	39,582	29,521	-	-	29,521	29,521
CDC block grant	394,452	79,583	474,035	457,853	16,182	74,708	399,327	399,327
CDC capacity building grant	-	1,974	1,974	2,680	-	2,680	-	-
CDC family services	106,430	-	106,430	61,976	30,231	-	92,207	92,207
CDC MCOE kids first	3,102	1,564	4,666	4,666	-	2,140	2,526	2,526
CDC preschool program	266,230	-	266,230	199,424	66,806	-	266,230	266,230
Child care food program	4,590	-	4,590	4,112	478	-	4,590	4,590
DSS learning	53,923	-	53,923	53,923	-	-	53,923	53,923
Early child mentors	5,177	-	5,177	-	4,288	1,547	2,741	2,741
Sierra Valley collaborative	80,000	-	80,000	9,895	70,105	44,120	35,880	35,880
SSPIRE program	-	4,805	4,805	4,805	-	-	4,805	4,805
Transfer articulation	-	404	404	404	-	401	3	3
VIP/JPA	-	15,334	15,334	15,334	-	3,703	11,631	11,631
Workforce innovation	10,000	-	10,000	-	10,000	10,000	-	-
Subtotal	1,193,486	103,664	1,297,150	955,832	291,042	139,299	1,107,575	1,107,575
Total State Programs	$ 5,025,770	$ 1,627,615	$ 6,653,385	$ 6,059,242	$ 514,766	$ 1,103,067	$ 5,470,941	$ 5,470,941

See the accompanying note to the supplementary information.

RECONCILIATION OF ANNUAL FINANCIAL AND BUDGET REPORT (FORM CCFS-311) WITH AUDITED FINANCIAL STATMENTS
June 30, 2010

There were no adjustments or reclassifications necessary to reconcile the Annual Financial and Budget Report (Form CCFS-311) with the audited statement of net assets and statement of revenues, expenses, and changes in net assets other than those items related to GASB Statements 34 and 35.

PURPOSE OF SCHEDULES

Schedule of Workload Measures for State General Apportionment/Annual Attendance

A full-time equivalent student is a measurement of the number of hours students attend classes. The purpose of attendance accounting from a fiscal standpoint is to provide the basis on which apportionments of state funds are made to community college districts.

Schedule of Expenditures of Federal and State Awards

These schedules are prepared on the modified accrual basis of accounting. OMB Circular A-133 requires disclosure of the financial activities of all federally funded programs. These schedules were prepared to comply with OMB Circular A-133 and state requirements.

Reconciliation of Annual Financial and Budget Report With Audited Financial Statements

This schedule provides the information necessary to reconcile the fund balances of all funds as reported on the Form CCFS-311 to the audited financial statements.

OTHER REPORTS SECTION

Certified Public Accountants

matson and isom

Founded in 1962 by
Robert M. Matson and
W. Howard Isom

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

Board of Trustees
Merced Community College District
Merced, California

We have audited the financial statements of the business-type activities and the discretely presented component unit of Merced Community College District (the District) as of and for the year ended June 30, 2010, which collectively comprise the District's basic financial statements and have issued our report thereon dated November 22, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the District's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying schedule of findings and questioned costs that we consider to be a significant deficiency in internal control over financial reporting (item 10-1). A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

Compliance and Other Matters

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

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

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

Matson and Isom

November 22, 2010

Certified Public Accountants

matson and isom

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Board of Trustees
Merced Community College District
Merced, California

Compliance

We have audited the compliance of Merced Community College District (the District) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2010. The District's major federal programs are identified in the summary of audit results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the District's management. Our responsibility is to express an opinion on the District's compliance based on our audit.

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

In our opinion, the District complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2010.

Internal Control Over Compliance

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

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133
Continued

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

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

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

Matson and Isom

November 22, 2010

Certified Public Accountants

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INDEPENDENT AUDITORS' REPORT ON STATE COMPLIANCE

Board of Trustees
Merced Community College District
Merced, California

We have audited the financial statements of the business-type activities and the discretely presented component unit of Merced Community College District (the District) as of and for the year ended June 30, 2010, which collectively comprise the District's basic financial statements, and have issued our report thereon dated November 22, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; *Government Auditing Standards*, issued by the Comptroller General of the United States; and *California Community Colleges Contracted District Audit Manual*, issued by the California Community Colleges Chancellor's Office. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinion.

The District's management is responsible for the District's compliance with laws and regulations. In connection with the audit referred to above, we selected and tested transactions and records to determine the District's compliance with the state laws and regulations applicable to the following:

SALARIES OF CLASSROOM INSTRUCTORS: 50 PERCENT LAW

APPORTIONMENT FOR INSTRUCTIONAL SERVICE AGREEMENTS

STATE GENERAL APPORTIONMENT FUNDING SYSTEM

RESIDENCY DETERMINATION FOR CREDIT COURSES

STUDENTS ACTIVELY ENROLLED

CONCURRENT ENROLLMENT OF K-12 STUDENTS IN COMMUNITY COLLEGE CREDIT COURSES

USES OF MATRICULATION FUNDS

GANN LIMIT CALCULATION

ENROLLMENT FEE

CALIFORNIA WORK OPPORTUNITY AND RESPONSIBILITY TO KIDS (CALWORKS)

SCHEDULED MAINTENANCE PROGRAM

OPEN ENROLLMENT

STUDENT FEES - INSTRUCTIONAL MATERIALS FEES AND HEALTH FEES

INDEPENDENT AUDITORS' REPORT ON STATE COMPLIANCE
Continued

Based on our audit, for the items tested, we found the District complied with the state laws and regulations referred to above. Further, based on our examination for items not tested, nothing came to our attention to indicate the District had not complied with the state laws and regulations.

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

Matson and Isom

November 22, 2010

SCHEDULE OF FINDINGS AND QUESTIONED COSTS SECTION

SECTION I
SUMMARY OF AUDIT RESULTS

FINANCIAL STATEMENTS

Type of auditors' report issued	Unqualified
Internal control over financial reporting	
Material weaknesses identified?	No
Significant deficiency identified not considered to be a material weakness?	Yes
Noncompliance material to financial statements noted?	No

FEDERAL AWARDS

Internal control over major programs	
Material weaknesses identified?	No
Significant deficiency identified not considered to be a material weakness?	No
Type of auditors' report issued on compliance for major program	Unqualified
Audit findings disclosed relative to major federal award programs?	No
Identification of major programs	
CFDA Nos. 84.007, 84.033, 84.063, 84.375	Student Financial Assistance Cluster and
CFDA No. 84.394	State Fiscal Stabilization Fund
Threshold for distinguishing types A and B programs	$687,865
Determined to be a low-risk auditee?	Yes

STATE AWARDS

Internal control over state programs	
Material weaknesses identified?	No
Significant deficiency identified not considered to be a material weakness?	No
Type of auditors' report issued on compliance for state programs	Unqualified

SECTION II FINDINGS
FINANCIAL STATEMENT AUDIT

INTERNAL CONTROL (Information Technology)
10-1

Significant Deficiency

Condition

No formal procedures or documentation exist for managing the access and security within Datatel.

Criteria

Application controls, such as those programmed in a software application to restrict user access are considered critical to ensure that individual transactions or transaction classes are properly authorized, recorded, and disclosed accurately in the financial statements of an entity.

Effect

Our observation and testing indicated that the user access to Datatel was not appropriately restricted. Management was not performing a periodic review of access controls, which resulted in users with access to modules in which they no longer worked. Additionally, terminated employees were still active in the system.

Recommendation

We recommend that the District design and implement a process in which roles, security, access, and passwords for users are validated on a periodic basis.

Response

The District has developed procedures to ascertain Datatel access per employee using Datatel ODS queries. The Director of ITS is scheduling meetings with managers to review current status per employee. Managers will review and validate screens for users under their supervision. Timeline for implementation: Spring 2011.

The Director of ITS has been working toward an electronic workflow process for employees (new, changed, no longer with the District), in concert with the Human Resources Supervisor. At this time no automated process is in place, therefore a manual process will be used. Timeline for implementation: December 2010.

Password control in Datatel is currently an extremely cumbersome process. Datatel has set forth a roadmap around SharePoint portal resources (web, network, Datatel). Portal resources are tied to active directory (AD). It has been determined that third party software will be necessary to implement strong Datatel passwords with required password change every six months. Timeline for implementation: Spring 2011.

SECTION III FINDINGS
FEDERAL AWARDS AUDIT

None.

SECTION IV FINDINGS
STATE AWARDS AUDIT

None.

Not applicable: There are no current-year findings related to federal awards.

INTERNAL CONTROL (Information Technology)

09-1

Significant Deficiency

Condition

No formal procedures or documentation exist for managing access and security within Datatel.

Criteria

Application controls, such as those programmed in a software application to restrict user access, are considered critical to ensure that individual transactions or transaction classes are properly authorized, recorded, and disclosed in the financial statements of an entity.

Effect

Our observation and testing indicated that the user access to Datatel was not appropriately restricted. Management was not performing a periodic review of access controls, which resulted in users having access to modules in which they no longer worked. Additionally, terminated employees were still active in the system.

Recommendation

We recommend that the District design and implement a process in which security, access, and passwords for users are validated on a periodic basis.

Response

See current year finding at 10-1.

STATE COMPLIANCE (Concurrent Enrollment)

09-2

Significant Deficiency

Condition

In two of the 25 students selected for testing, Merced College did not obtain verification from the K-12 school district that the student could benefit from advanced scholastic or vocational work.

The District does not have a procedure for monitoring or controlling the enrollment of advanced education students.

Criteria

Verify that any special part-time K-12 students present in the course sample are enrolled in no more than 11 units per semester and that the District has obtained verification from the K-12 school district that the student can benefit from advanced scholastic or vocational work. (*California Education Code*, Sections 48800(a), 48800.5, 76300 and 76001(d)).

Effect

There is a potential for non-compliance with State concurrent enrollment regulations due to lack of effective monitoring of advanced education students.

Recommendation

The District should implement procedures to monitor the enrollment of advanced education students to ensure that students who are enrolled received verification from the K-12 school district that the student could benefit from advanced scholastic or vocational work. (*California Education Code*, Sections 48800(a), 48800.5, 76300 and 76001(d)).

Response

Fully implemented.

STATE COMPLIANCE (Student Fees)

09-3

Significant Deficiency

Condition

The District has no method for advising students of the health fee exemption or procedure for claiming the exemption.

Criteria

Districts are permitted to charge a mandatory health fee under the *California Education Code*, Section 76355; however, they must exempt from payment of such fees, students who depend exclusively on prayer for healing and apprenticeship students. The District is required to advise students of the exemptions from payment of the health fees and have a process to ensure that students may claim the exemptions. The District's governing board must have adopted policies or regulations regarding the process through which students may claim the health fee exemption.

Effect

There is a potential for non-compliance with the State instructional materials and health fees regulations due to lack of communicating the exemptions to students and lack of a process for claiming the exemption.

Recommendation

We recommend the District should publish the exemption policies in the catalog and develop a procedure for claiming the exemption.

Response

Fully implemented.