

**REDEVELOPMENT AGENCY OF THE
CITY OF CAPITOLA**

FINANCIAL STATEMENTS

Year Ended June 30, 2011

Redevelopment Agency of the City of Capitola
Financial Statements
Year Ended June 30, 2011

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Independent Auditors' Report

Board Members
Redevelopment Agency of the City of Capitola
Capitola, California

We have audited the accompanying financial statements of the governmental activities and each major fund of the Redevelopment Agency of the City of Capitola (the "Agency"), a component unit of the City of Capitola, California (City), as of and for the year ended June 30, 2011, which collectively comprise the Agency's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Agency'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 financial position of the governmental activities and each major fund of the Agency, as of June 30, 2011, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the financial statements, the Agency adopted the provisions of GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, as of June 30, 2011.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 19, 2011 on our consideration of the Agency's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and on compliance and the results of that testing, and to provide an opinion on compliance but not on internal control over financial reporting. 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.

Management has omitted the *Management's Discussion and Analysis* that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.

Accounting principles generally accepted in the United States of America require that the Budget and Actual Comparison, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a required 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.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Agency's financial statements as a whole. The "Supplementary Information" listed in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements. The supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statement 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 the financial statements as a whole.

Teaman Ramirez & Smith, L.L.C.

December 19, 2011

BASIC FINANCIAL STATEMENTS

Redevelopment Agency of the City of Capitola
Statement of Net Assets
June 30, 2011

	<u>Governmental Activities</u>
ASSETS	
Current Assets:	
Cash and Investments	\$ 3,188,461
Due From Other Governments	51,325
Interest Receivable	17,046
Loans Receivable	2,167,879
Prepays	<u>108,700</u>
Total Assets	<u>5,533,411</u>
LIABILITIES	
Current Liabilities:	
Accounts Payable and Accrued Liabilities	68,789
Unearned Revenue	1,395,586
Noncurrent Liabilities:	
Due Within One Year	245,528
Due in More Than One Year	<u>4,351,760</u>
Total Liabilities	<u>6,061,663</u>
NET ASSETS	
Restricted for Low/Moderate Income Housing	3,053,716
Restricted for Debt Service	2,410,906
Unrestricted	<u>(5,992,874)</u>
Total Net Assets	<u><u>\$ (528,252)</u></u>

The accompanying notes are an integral part of this statement.

Redevelopment Agency of the City of Capitola
Statement of Activities
Year Ended June 30, 2011

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	
Governmental Activities:					
General Government	\$ 2,620,313	\$	\$	\$	\$ (2,620,313)
Community Development	1,185,550				(1,185,550)
Interest on Long-Term Debt	200,020				(200,020)
Total Governmental Activities	\$ 4,005,883	\$ -	\$ -	\$ -	(4,005,883)
		General Revenues:			
					2,451,649
					13,343
					2,464,992
					(1,540,891)
					1,012,639
					\$ (528,252)

The accompanying notes are an integral part of this statement.

Redevelopment Agency of the City of Capitola
Balance Sheet
Governmental Funds
June 30, 2011

	Low and Moderate Income Housing	Debt Service	Capital Projects	Total Govern- mental Funds
ASSETS				
Cash and Investments	\$ 890,796	\$ 2,297,665	\$	\$ 3,188,461
Due From Other Governments		51,325		51,325
Interest Receivable	2,448	14,598		17,046
Loans Receivable	2,167,879			2,167,879
Prepays		108,700		108,700
	<u>3,061,123</u>	<u>2,472,288</u>	<u>-</u>	<u>5,533,411</u>
Total Assets	<u>\$ 3,061,123</u>	<u>\$ 2,472,288</u>	<u>\$ -</u>	<u>\$ 5,533,411</u>
LIABILITIES AND FUND BALANCES				
Liabilities:				
Accounts Payable and Accrued Liabilities	\$ 7,407	\$ 61,382	\$	\$ 68,789
Deferred Revenue	2,167,879			2,167,879
	<u>2,175,286</u>	<u>61,382</u>	<u>-</u>	<u>2,236,668</u>
Total Liabilities	<u>2,175,286</u>	<u>61,382</u>	<u>-</u>	<u>2,236,668</u>
Fund Balances:				
Nonspendable:				
Prepays		108,700		108,700
Restricted for:				
Low and Moderate Income Housing	885,837			885,837
Debt Service		2,302,206		2,302,206
	<u>885,837</u>	<u>2,410,906</u>	<u>-</u>	<u>3,296,743</u>
Total Fund Balances	<u>885,837</u>	<u>2,410,906</u>	<u>-</u>	<u>3,296,743</u>
Total Liabilities and Fund Balances	<u>\$ 3,061,123</u>	<u>\$ 2,472,288</u>	<u>\$ -</u>	<u>\$ 5,533,411</u>

The accompanying notes are an integral part of this statement.

Redevelopment Agency of the City of Capitola
Reconciliation of the Balance Sheet of Governmental Funds
to the Statement of Net Assets

June 30, 2011

Fund balances of governmental funds	\$ 3,296,743
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Amounts reported for governmental activities in the Statement of Net Assets are different because:

Long-term liabilities are not due and payable in the current period. Therefore, they are not reported in the Governmental Funds Balance Sheet. The long-term liabilities were adjusted as follows:

Advances payable	(1,968,028)
Note payable	(1,000,000)
RDA obligations	(1,629,260)

In governmental funds, other long-term assets are not available to pay for current period expenditures and, therefore, are deferred in the funds.

772,293

Net assets of governmental activities

\$ (528,252)

Redevelopment Agency of the City of Capitola
Statement of Revenues, Expenditures, and Changes in Fund Balances
Governmental Funds
Year Ended June 30, 2011

	Low and Moderate Income Housing	Debt Service	Capital Projects	Total Govern- mental Funds
Revenues				
Taxes	\$	\$ 2,451,649	\$	\$ 2,451,649
Use of Money and Property	2,347	10,996		13,343
Total Revenues	<u>2,347</u>	<u>2,462,645</u>	-	<u>2,464,992</u>
Expenditures				
Current:				
General Government		1,436,681		1,436,681
Community Development	527,410	618,000		1,145,410
Debt Service:				
Principal		228,926		228,926
Interest and Fiscal Charges		200,020		200,020
SERAF Payment		144,752		144,752
Total Expenditures	<u>527,410</u>	<u>2,628,379</u>	-	<u>3,155,789</u>
Excess (Deficiency) of Revenues over Expenditures	<u>(525,063)</u>	<u>(165,734)</u>	-	<u>(690,797)</u>
Other Financing Sources (Uses)				
Transfers In	490,330			490,330
Transfers Out		(490,330)		(490,330)
Total Other Financing Sources (Uses)	<u>490,330</u>	<u>(490,330)</u>	-	<u>-</u>
Net Change in Fund Balances	(34,733)	(656,064)	-	(690,797)
Fund Balances, Beginning of Year	<u>920,570</u>	<u>3,066,970</u>	-	<u>3,987,540</u>
Fund Balances, End of Year	<u>\$ 885,837</u>	<u>\$ 2,410,906</u>	<u>\$ -</u>	<u>\$ 3,296,743</u>

The accompanying notes are an integral part of this statement.

Redevelopment Agency of the City of Capitola
Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances
of Governmental Funds to the Statement of Activities
Year Ended June 30, 2011

Net change in fund balances - total governmental funds	\$ (690,797)
Amounts reported for governmental activities in the Statement of Activities are different because:	
The statement of activities reports losses arising from the disposal of capital assets. However, governmental funds do not report any losses on disposal of capital assets.	(1,038,880)
In governmental funds, repayment of long-term debt is reported as an expenditure.	228,926
The Agency's long-term obligation relating to the County Library Building is increased by 5% each year according to the agreement. This is the amount reported as an expense in the Statement of Activities, due to the increase in long-term debt.	(89,340)
In governmental funds, notes receivable are offset by deferred revenue as they are not available to pay for current period expenditures. This represents the change in deferred revenue for the fiscal year.	<u>49,200</u>
Change in Net Assets of Governmental Activities	<u><u>\$ (1,540,891)</u></u>

The accompanying notes are an integral part of this statement.

Redevelopment Agency of the City of Capitola
Notes to Financial Statements
Year Ended June 30, 2011

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Redevelopment Agency of the City of Capitola
Notes to Financial Statements
Year Ended June 30, 2011

1) REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A) Reporting Entity

The Agency is a blended component unit of the City. The Agency was created by the City of Capitola City Council (City Council) in 1980. The City Manager acts as the Agency's Executive Director and the City Council acts as the governing commission, which exerts significant influence over its operations. The primary purpose of the Agency is to eliminate blighted areas by encouraging the development of residential, commercial, industrial, recreational, and public facilities.

Funds for redevelopment projects are provided from various sources, including incremental property tax revenues, tax allocation bonds, and advances from the City.

B) Basis of Presentation

The Agency's basic financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. The Governmental Accounting Standards Board is the acknowledged standard setting body for establishing accounting and financial reporting standards followed by governmental entities in the United States of America.

Government-Wide Financial Statements

The Government-wide financial statements (i.e., the Statement of Net Assets and the Statement of Activities) report information on all of the nonfiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. All Agency activities are governmental; no business-type activities are reported in these financial statements.

The Statement of Activities demonstrates the degree to which the direct expenses of given functions or segments are offset by program revenues. Direct expenses are expenses that are clearly identifiable with a specific program, project, function or segment. Program revenues of the Agency include: 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment.

Taxes and other items that are properly not included among program revenues are reported instead as general revenues.

Fund Financial Statements

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

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

The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which

Redevelopment Agency of the City of Capitola
Notes to Financial Statements
Year Ended June 30, 2011

1) REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

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

they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the providers have been met.

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Agency considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures are recorded only when payment is due.

Interest associated with the current fiscal period is considered to be susceptible to accrual, and is therefore recognized as revenues of the current fiscal period.

The Agency reports the following major governmental funds:

The Low/Moderate Income Housing Fund is used to reflect Low and Moderate Income Housing Activities.

The Debt Service Fund is used to account for the accumulation of resources for, and the payment of, long-term debt principal, interest and related costs.

The Capital Projects Fund is used to account for financial resources to be used for the acquisition or construction of redevelopment projects and administrative expenses.

As a general rule, the effect of inter-fund activity has been eliminated from the government-wide financial statements. Direct expenses have not been eliminated from the functional categories; indirect expenses and internal payments have been eliminated, if any.

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

Deferred revenues arise when potential revenues do not meet both the "measurable" and "available" criteria for recognition in the current period. Deferred revenues also arise when the government receives resources before it has a legal claim to them, as when grant monies are received prior to incurring qualifying expenditures. In subsequent periods, when both revenue recognition criteria are met or when the government has a legal claim to the resources, the deferred revenue is recognized as revenue.

D) Assets, Liabilities and Net Assets or Equity

1) Receivables

Incremental property tax revenues represent property taxes in the project area arising from increased assessed valuations over base valuations established at the inception of the project area. Incremental property taxes from the

Redevelopment Agency of the City of Capitola
Notes to Financial Statements
Year Ended June 30, 2011

1) REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

D) Assets, Liabilities and Net Assets or Equity - Continued

1) Receivables - Continued

project area accrue to the Agency until all liabilities and commitments of the project area have been repaid (including cumulative funds provided or committed by the Agency). After all such indebtedness has been repaid, all property taxes from the project area revert back to the various taxing authorities.

Property taxes are assessed and collected each fiscal year according to the following property tax calendar:

Lien Date	March 1	
Levy Year	July 1 to June 30	
Due Dates	November 1	1 st Installment
	February 1	2 nd Installment
Delinquent Dates	December 10	1 st Installment
	April 10	2 nd Installment

Under the California law, property taxes are assessed and collected by counties up to 1% of assessed value, plus other increases approved by voters. Property tax revenues are pooled and then allocated to agencies based on complex formulas prescribed by state statutes.

2) Capital Assets

The Agency's assets are capitalized at historical cost or estimated historical cost. Agency policy has set the capitalization threshold for reporting capital assets at \$5,000. Gifts or contributions of capital assets are recorded at fair value when received. Depreciation is recorded on a straight-line basis over the useful lives of these assets, as follows:

Infrastructure	15 - 50 years
Structures and Improvements	50 years
Equipment	5 years

E) Use of Estimates

The financial statements have been prepared in accordance with generally accepted accounting principles and necessarily include amounts based on estimates and assumptions by Management. Actual results could differ from those amounts.

F) Relationship to the City of Capitola

The Agency is an integral part of the reporting entity of the City of Capitola. The funds of the Agency have been blended within the financial statements of the City because the City Council of the City of Capitola is the governing board of the Agency and exercises control over the operations of the Agency. Only the funds of the Agency are included herein; therefore, these financial statements do not purport to represent the financial position or results of operations of the City of Capitola.

Redevelopment Agency of the City of Capitola
Notes to Financial Statements
Year Ended June 30, 2011

1) REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

G) Low/Moderate Income Housing

The California Health and Safety Code requires the Agency project area to deposit 20% of allocated incremental property tax revenues (or 20% of net bond proceeds plus 20% of incremental revenues in excess of debt service payments on the bonds) into a Low/Moderate Income Housing Fund. This money is restricted for the purpose of increasing and improving the community's supply of low and moderate income housing. The Agency accounts for these revenues in a special revenue fund.

H) Net Assets and Fund Balances

Government-wide Financial Statements

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

Restricted Net Assets - This amount represents net assets restricted by external creditors, grantors, contributors, or laws or regulations.

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

Fund Financial Statements

The Agency implemented GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* as of June 30, 2011. Fund balances in governmental funds are reported in classifications that comprise a hierarchy based primarily on the extent to which the Agency is bound to honor constraints on the specific purposes for which amounts in those funds can be spent. The Agency considers restricted fund balance to have been spent first when an expenditure is incurred for purposes for which both restricted and unrestricted fund balance is available. Similarly, when an expenditure is incurred for purposes for which amounts in any of the unrestricted classifications of fund balance could be used, the Agency considers committed amounts to be reduced first, followed by assigned amounts and then unassigned amounts.

The following classifications describe the relative strength of the spending constraints placed on the purposes for which resources can be used:

Nonspendable Fund Balance - Amounts that cannot be spent either because they are in nonspendable form or are required to be maintained intact.

Restricted Fund Balance - Amounts that are constrained to specific purposes by state or federal laws, or externally imposed conditions by grantors or creditors.

Committed Fund Balance - Amounts constrained for a specific purpose by Board of Directors action. It would require the same action by the Board to remove the constraint.

Redevelopment Agency of the City of Capitola
Notes to Financial Statements
Year Ended June 30, 2011

1) REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

H) Net Assets and Fund Balances - Continued

Fund Financial Statements - Continued

Assigned Fund Balance - Amounts that are constrained by the Board of Director's intent to use specified financial resources for specific purposes, but are neither restricted nor committed.

Unassigned Fund Balance - Amounts expended in excess of resources that are nonspendable, restricted, committed, or assigned.

2) CASH AND INVESTMENTS

Cash and Investments as of June 30, 2011 consisted of the following:

Statement of Net Assets:	
Cash and Investments Pooled with the City	\$ 3,188,461
Total Cash and Investments	\$ 3,188,461

See the City's Comprehensive Annual Financial Report for disclosures related to cash and investments and the related custodial risk categorization.

3) INTERFUND TRANSACTIONS

Interfund Operating Transfers

	Transfers In	Transfers Out
Low/Moderate Income Housing Fund	\$ 490,330	\$ -
Debt Service Fund	-	490,330
	\$ 490,330	\$ 490,330

This transfer was made in order to deposit 20% of the tax increment in the Low/Moderate Income Housing Fund.

4) LOANS RECEIVABLE

The Agency loans the low and moderate tax increment set-aside taxes to low and moderate income families. The loans are collateralized by the property and generally mature upon the sale of the property. The loan's principal and interest amounts are deferred and due at maturity. At June 30, 2011, these outstanding loans totaled \$2,167,879 and bear interest at 3%.

Redevelopment Agency of the City of Capitola
Notes to Financial Statements
Year Ended June 30, 2011

5) CAPITAL ASSETS

Capital assets activity for the fiscal year ended June 30, 2011, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Non Depreciable Capital Assets:				
Land	\$ 1,038,880	\$ -	\$ 1,038,880	\$ -
Construction in Progress	-	-	-	-
Total Non Depreciable Capital Assets	<u>1,038,880</u>	<u>-</u>	<u>1,038,880</u>	<u>-</u>
Depreciable Capital Assets:				
Equipment	-	-	-	-
Infrastructure	-	-	-	-
Building and Improvements	-	-	-	-
Total Depreciable Capital Assets	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total Capital Assets	1,038,880	-	1,038,880	-
Less Accumulated Depreciation	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net Capital Assets	<u>\$ 1,038,880</u>	<u>\$ -</u>	<u>\$ 1,038,880</u>	<u>\$ -</u>

6) LONG-TERM DEBT

Advances from City

The Redevelopment Agency has incurred substantial costs for a proposed expansion of the redevelopment area and amendment of the redevelopment plan. The City has been providing staff and administrative services without compensation to the Agency since the fiscal year 1997/1998. The City and the Agency entered into an agreement to identify the staff and administrative costs due to the City since the fiscal year 1997/1998. The parties agreed that the Agency will pay the City for its past administrative services, plus interest calculated at the Local Agency Investment Fund (LAIF) rate published for the quarter ending March. In June 2006, the City and Agency agreed to amend the interest rate to the greater of the following: a) the interest rate charged by the Public Employees Retirement System for the City's unfunded liability, b) the true interest cost of any obligation bond sold by the City, c) the State of California LAIF rate, or d) 5%. The parties further agreed that the amount owed has been calculated at an overhead rate of fifteen percent of net tax increment, with simple interest. The principal amount of this reimbursement shall be paid as Agency funds become available, but in no event later than twenty-five years. As of June 30, 2011, the Agency owes the City \$618,028.

In July 2003, the City of Capitola sold the Rispin Mansion property to the Redevelopment Agency of Capitola in exchange for a \$1,350,000 note. In the 2010-11 fiscal year, the Agency transferred title to the City for the City to use the land in accordance with redevelopment purposes. The parties agreed to calculate interest on the advance at 5% per annum. In June 2006, the City and Agency agreed to amend the interest rate to the greater of the following: a) the interest rate charged by the Public Employees Retirement System for the City's unfunded liability; b) the true interest cost of any pension obligation bond sold by the City; c) the State of California LAIF rate; or d) 5%. The outstanding principal sum of this Note shall be due and payable in full on June 24, 2017 ("Maturity Date"), provided, however, that

Redevelopment Agency of the City of Capitola
Notes to Financial Statements
Year Ended June 30, 2011

6) **LONG-TERM DEBT - Continued**

Advances from City - Continued

if the Redevelopment Plan for the Capitola Redevelopment Project is amended to extend the time limit on receipt of tax increment revenues, then the Maturity Date shall automatically be extended until the last date on which the Agency may receive tax increment under the Redevelopment Plan, as amended. Payment of interest is due on a quarterly basis. As of June 30, 2011, the Agency owes the City \$1,350,000. In April 2007, the RDA Board of Directors passed a resolution which credited the RDA cap with \$629,059 as a result of state legislation regarding previous Educational Relief Augmentation Fund (ERAF) payments made by the Capitola Redevelopment Agency.

Redevelopment Agency Pass-Through Agreements

Previous California redevelopment law permitted redevelopment agencies to negotiate agreements with overlapping taxing jurisdictions, whereby the agency pays a portion of its tax increment revenues to other jurisdictions whose revenues and function(s) may be adversely impacted by the Agency. The terms of such agreements were negotiable in accordance with the needs of the Agency and the jurisdictions. Accordingly, the Agency negotiated agreements with certain overlapping jurisdictions, which call for deferred payment of portions of the Agency's tax increment revenues. A summary of these deferred liabilities is as follows:

County Library Fund and County Special District Funds

The Agency entered into an agreement in 1984 with the County of Santa Cruz which provided that the Agency would not be required to pass through to the County Library Fund or Special District Funds any tax increments during years one through twenty of the Capitola Redevelopment Project. Instead, the Agency is required to pay these funds over a ten-year period beginning in year twenty-one (fiscal year ended June 30, 2002). The deferred pass-through payments are \$45,910/year for the County Library Fund and \$20,116/year for the County Special District Funds, for ten years ending June 30, 2012. There is no provision for interest in the agreement.

Principal balance at June 30, 2011	\$ 66,026
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County Library Building Fund

In August 2004, the Agency entered into an Implementation Agreement with the County of Santa Cruz to clarify and confirm provisions in the original Pass-Through Agreement, and First and Second Library Agreements. The Implementation Agreement requires that the Agency design and commence construction of a library building and related on-site improvements no later than June 30, 2018. The Agency's maximum obligation for this project, beginning with the 2004-05 fiscal year, is \$1,400,000, which is increased 5% per annum (compounded annually) until the fiscal year in which the library construction is completed or the full amount of the Agency assistance has been paid to the County.

Beginning February 1, 2005, and February 1st of each fiscal year thereafter through February 1, 2018, or until the total amount of the Agency assistance is funded or the Library construction is completed, the Agency is required to pay minimum scheduled payments into a County trust account, which earns interest at a rate equivalent to the County's pooled investment fund rate.

Redevelopment Agency of the City of Capitola
Notes to Financial Statements
Year Ended June 30, 2011

6) LONG-TERM DEBT - Continued

Redevelopment Agency Pass-Through Agreements - Continued

The Agency may prefund any portion of the obligation at any time. "Prefund" means providing the total amount of funding needed in a particular year to achieve the total Agency obligation as of that fiscal year. The maximum obligation of the Agency through the fiscal year ending June 30, 2018 is \$2,640,000. The Agency has recorded the initial debt of \$1,400,000 as of the 2004-05 fiscal year, which is increased by 5% each year and reduced by the minimum scheduled payment each year. The principal balance at June 30, 2011 is \$1,563,234. A schedule of the Agency assistance obligation (increased by 5% per year) and the minimum scheduled payments is as follows:

Fiscal Year	Total Amount of Agency Assistance Obligation	Minimum Scheduled Payment Amount
2004-05	\$ 1,400,000	\$ 25,000
2005-06	1,470,000	25,000
2006-07	1,543,500	25,000
2007-08	1,620,675	25,000
2008-09	1,701,709	25,000
2009-10	1,786,794	25,000
2010-11	1,876,134	162,900
2011-12	1,969,941	179,502
2012-13	2,068,438	211,720
2013-14	2,171,860	250,243
2014-15	2,280,452	287,116
2015-16	2,394,475	325,579
2016-17	2,514,199	366,577
2017-18	2,639,909	417,640
		\$ 2,351,277

Note Payable

On September 29, 2000, the Agency borrowed \$1,000,000 to provide temporary, short-term financing for various capital projects included in the five year plan. The loan allowed for the principle to be fully prepaid without premium by the Agency upon 30 day written notice to the lender at any time after September 29, 2001. On March 30, 2006, Chase NYC took over the WestAmerica note and established a new expiration of September 29, 2014. Interest is a 4.75% (\$47,500/year) payable semiannually on March 29, and September 29.

Redevelopment Agency of the City of Capitola
Notes to Financial Statements
Year Ended June 30, 2011

6) LONG-TERM DEBT - Continued

Changes in Long-Term Debt

Following is a summary of long-term debt for the 2010-2011 fiscal year:

	Balance Beginning of Year	Additions	Deletions	Balance End of Year	Current Portion
Advances Payable	\$ 1,968,028	\$ -	\$ -	\$ 1,968,028	\$ -
Note Payable	1,000,000	-	-	1,000,000	-
RDA Pass-Throughs	1,768,846	89,340	228,926	1,629,260	245,528
Totals	\$ 4,736,874	\$ 89,340	228,926	4,597,288	\$ 245,528

7) LOW AND MODERATE INCOME HOUSING FUND

California Redevelopment Law requires that each year, 20% of the Agency's gross tax increment revenue be set aside to enhance the City's supply of housing available to low and moderate income persons. During fiscal year 2010/2011, the Agency set-side for this purpose was \$490,330.

The Redevelopment Agency expended \$527,410 during fiscal year 2010/2011, for low and moderate income housing programs, and administration thereof.

8) RISK MANAGEMENT

The City (and Agency) participates in the Monterey Bay Area Self-Insurance Agency (Authority), a joint powers agency comprising the City and nine other local jurisdictions, created pursuant to California law for liability and workers compensation insurance services. The Monterey Bay Area Self-Insurance Authority's Board of Directors is elected from representatives of the member governments, and controls operations of the fund, including selection of management and approval of operating budgets. It is independent of the individual member influence, except for their representation on the board, and is therefore not a component unit of the City for reporting purposes.

The City is exposed to various risks including worker injuries, tort liability, theft, damage or destruction of assets, errors and omissions, and natural disasters. With respect to risks other than workers' compensation, the City and other pool participants pay an annual premium estimated by the pool administrator to be sufficient to cover all liability claims for which the pool is obligated. If a covered entity's losses exceed its premiums, there is no individual supplemental assessment, and if a covered entity's losses are lower than its assessment, it does not receive a refund. However, annual budget appropriations are experience-based. The pool views its activities in the aggregate and makes overall adjustments to the premiums charged, and is therefore intended to be self-sustaining through member contributions (premiums). Risk of loss is retained by the City for general liability claims up to \$10,000 per occurrence. The fund carries excess loss coverage for general liability claims between \$90,000 and \$20,000,000 per insured event, and is uninsured for losses in excess of \$20,000,000 per event. Unpaid claims at fiscal year end, as reported by the fund, were not material. There was no reduction in the City's insurance coverage as compared to the previous fiscal year, nor have there been any losses exceeding coverage during any of the three previous years.

Redevelopment Agency of the City of Capitola
Notes to Financial Statements
Year Ended June 30, 2011

8) RISK MANAGEMENT - Continued

Premium payment amounts are determined by the funds Board, and are charged to the City's general fund as expenditures when paid.

In the proper course of operation, the Authority issued debt in the aggregate principal amount of \$5,150,000 on October 1, 2004. The Authority is required to collect and disburse the loan premiums in accordance with the loan agreement, Article VI, Section 6.03. The Member agencies are required by the Amended and Restated Joint Powers Agreement Relating to the Monterey Bay Area Self-Insurance Authority, Article 20 to pay to the Authority their individual debt service amount and associated expenses, as determined by the Authority. Furthermore, the Member Agencies contribution will be payable from any source of available funds of the Member, including amounts on deposit in the general fund of the Member.

9) COMMITMENTS AND CONTINGENCIES

During the 2010-11 fiscal year, the Redevelopment Agency entered into an agreement with a developer committing \$1.0 million to help fund various improvements as part of the redevelopment of the Capitola Mall. As of June 30, 2011, no funds had been expended on this project.

Recent Changes in Legislation Affecting California Redevelopment Agencies

On June 29, 2011, the Governor of the State of California signed Assembly Bills X1 26 and 27 as part of the State's budget package. Assembly Bill X1 26 requires each California redevelopment agency to suspend (effective July 1, 2011) nearly all activities except to implement existing contracts, meet already-incurred obligations, preserve its assets and prepare for the impending dissolution of the agency. Assembly Bill X1 27 provides a means for redevelopment agencies to continue to exist and operate by means of a Voluntary Alternative Redevelopment Program. Under this program, each local government would adopt an ordinance agreeing to make certain payments to the County Auditor Controller in fiscal year 2011-12 and annual payments each fiscal year thereafter. Assembly Bill X1 26 indicates that the city, special district or county "may use any available funds not otherwise obligated for other uses" to make this payment. The City of Capitola intends to use available monies of its redevelopment agency for this purpose and the City and Agency have approved a reimbursement agreement to accomplish that. The amounts to be paid after fiscal year 2012-13 have yet to be determined by the state legislature.

Assembly Bill X1 26 directs the State Controller of the State of California to review the propriety of any transfers of assets between redevelopment agencies and other public bodies that occurred after January 1, 2011. If the public body that received such transfers is not contractually committed to a third party for the expenditure or encumbrance of those assets, the State Controller is required to order the available assets to be transferred to the public body designated as the successor agency by Assembly Bill X1 26.

In the event that Assembly Bill X1 26 is upheld, the receivable recognized by funds of the City that had previously loaned or advanced funds to the redevelopment agency would become uncollectible with a loss recognized to the City. Additionally, the City would be impacted by the elimination of reimbursements previously paid to the City by the redevelopment agency for shared administrative services.

The League of California Cities and the California Redevelopment Association (CRA) filed a lawsuit on July 18, 2011 on behalf of cities, counties and redevelopment agencies petitioning the California Supreme Court to overturn Assembly

Redevelopment Agency of the City of Capitola
Notes to Financial Statements
Year Ended June 30, 2011

9) COMMITMENTS AND CONTINGENCIES - Continued

Recent Changes in Legislation Affecting California Redevelopment Agencies - Continued

Bills X1 26 and 27 on the grounds that they violate the California Constitution. On August 11, 2011, the California Supreme Court issued a stay of all of Assembly Bill X1 27 and most of Assembly Bill X1 26. The California Supreme Court stated in its order that “the briefing schedule is designed to facilitate oral argument as early as possible in 2011, and a decision before January 15, 2012.” A second order issued by the California Supreme Court on August 17, 2011 indicated that certain provisions of Assembly Bills X1 26 and 27 were still in effect and not affected by its previous stay, including requirements to file an appeal of the determination of the community remittance payment by August 15, the requirement to adopt an Enforceable Obligations Payment Schedule (“EOPS”) by August 29, 2011, and the requirement to prepare a preliminary draft of the initial Recognized Obligation Payment Schedule (“ROPS”) by September 30, 2011.

Because the stay provided by Assembly Bill X1 26 only affects enforcement, each agency must adopt an Enforceable Obligation Payment Schedule and draft Recognized Obligation Payment Schedule prior to September 30, as required by the statute. Enforceable obligations include bonds, loans and payments required by the federal or State government; legally enforceable payments required in connection with agency employees such as pension payments and unemployment payments, judgments or settlements; legally binding and enforceable agreements or contracts; and contracts or agreements necessary for the continued administration or operation of the agency that are permitted for purposes set forth in AB1X 26.

On September 22, 2011, City of Capitola Ordinance No. 962 was adopted indicating that the City will comply with the Voluntary Alternative Redevelopment Program in order to permit the continued existence and operation of the agency, in the event Assembly Bills X1 26 and/or 27 are upheld as constitutional. The initial payment by the City is estimated to be \$798,547 with one half due on January 15, 2012 and the other half due May 15, 2012. The amounts to be paid after fiscal year 2012-13 have yet to be determined by the State Legislature. The semi-annual payments will be due on January 15 and May 15 of each year and would increase or decrease with changes in tax increment. Additionally, an increased amount would be due to schools if any "new debt" is incurred. Assembly Bill X1 27 allows a one-year reprieve on the agency’s obligation to contribute 20% of tax increment to the low-and-moderate-income housing fund so as to permit the Agency to assemble sufficient funds to make its initial payments. Failure to make these payments would require agencies to be terminated under the provisions of ABX1 26.

Management believes that the Agency will have sufficient funds to pay its obligations as they become due during the fiscal year ending June 30, 2012 and for a period shortly thereafter. The nature and extent of the operation of redevelopment agencies in the State of California beyond that time frame are dependent upon the outcome of litigation surrounding the actions of the state. In the event that Assembly Bills X1 26 and/or 27 are specifically found by the courts to be unconstitutional, there is a possibility that future legislative acts may create new challenges to redevelopment agencies ability to continue in view of the California State Legislature’s declared intent to eliminate redevelopment agencies and to reduce their funding.

10) SUBSEQUENT EVENT

Subsequent to June 30, 2011, the Redevelopment Agency loaned \$1.0 million to a non-profit agency to acquire a mobile home park. The agreement with the non-profit agency provides for additional funding of \$100,000/year for a ten-year period to provide rental assistance and infrastructure rehabilitation.

REQUIRED SUPPLEMENTARY INFORMATION

Redevelopment Agency of the City of Capitola
Schedule of Revenues, Expenditures, and Changes in Fund Balances
Low and Moderate Income Housing Fund
Budget and Actual
Year Ended June 30, 2011

	Budgeted Amounts		Actual Amounts	Variances with Final Budget Positive (Negative)
	Original	Final		
Revenues				
Use of Money and Property	\$	\$	\$ 2,347	\$ 2,347
Total Revenues	-	-	2,347	2,347
Expenditures				
Community Development	465,852	465,852	527,410	(61,558)
Total Expenditures	465,852	465,852	527,410	(61,558)
Excess (Deficiency) of Revenues over Expenditures	(465,852)	(465,852)	(525,063)	(59,211)
Other Financing Sources (Uses)				
Transfers In	463,400	463,400	490,330	26,930
Transfers Out		(730,000)		730,000
Total Other Financing Sources (Uses)	463,400	(266,600)	490,330	756,930
Net Change in Fund Balance	(2,452)	(732,452)	(34,733)	697,719
Fund Balance - Beginning of Year	920,570	920,570	920,570	-
Fund Balance - End of Year	\$ 918,118	\$ 188,118	\$ 885,837	\$ 697,719

SUPPLEMENTARY INFORMATION

Capitola Redevelopment Agency
Computation of Low and Moderate Housing Excess Surplus Funds

	<u>Low and Moderate Income Housing Funds July 1, 2010</u>	<u>Low and Moderate Income Housing Funds July 1, 2011</u>
Opening Fund Balance	<u>\$ 920,570</u>	<u>\$ 885,837</u>
Less Unavailable Amounts:		
Unspent Bond Proceeds	\$ -	\$ -
Encumbrances [Section 33334.12 (g)(2)]	-	-
Loans Receivable	-	-
Land Held for Resale	-	-
	<u>-</u>	<u>-</u>
Available Low and Moderate Income Housing Funds	\$ 920,570	\$ 885,837
Limitation (greater of \$1,000,000 or four years set-aside)		
Set-Aside for last four years:		
2010-11	\$ -	\$ 490,330
2009-10	485,113	485,113
2008-09	499,274	499,274
2007-08	466,900	466,900
2006-07	448,997	-
	<u>\$ 1,900,284</u>	<u>\$ 1,941,617</u>
Base Limitation	\$ 1,000,000	\$ 1,000,000
Greater amount	<u>\$ 1,900,284</u>	<u>\$ 1,941,617</u>
Computed Excess Surplus	<u><u>NONE</u></u>	<u><u>NONE</u></u>

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

Board Members
Redevelopment Agency of the City of Capitola
Capitola, California

Compliance

We have audited the Redevelopment Agency of the City of Capitola's (the "Agency") compliance with the types of compliance described in the *Guidelines for Compliance Audits of California Redevelopment Agencies, June 2011*, issued by the State Controller, applicable to the Agency's activities for the year ended June 30, 2011. Compliance with the requirements referred to above is the responsibility of the Agency's management. Our responsibility is to express an opinion on the Agency'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 the *Guidelines for Compliance Audits of California Redevelopment Agencies, June 2011*, issued by the State Controller, and as interpreted in the *Auditing Procedures for Accomplishing Compliance Audits of California Redevelopment Agencies, August 2011*, issued by the Governmental Accounting and Auditing Committee of the California Society of Certified Public Accountants.

Those standards and the State's *Guidelines for Compliance Audits of California Redevelopment Agencies* require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the compliance requirements referred to above that could have a material effect on the Agency occurred. An audit includes examining, on a test basis, evidence about the Agency'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 Agency's compliance with those requirements.

In our opinion, the Agency complied, in all material respects, with the compliance requirements referred to above that are applicable for the year ended June 30, 2011. However, the results of our auditing procedures disclosed an instance of noncompliance with those requirements, which is required to be reported in accordance with the *Guidelines for Compliance Audits of California Redevelopment Agencies, June 2011*, and which is described in the accompanying Schedule of Findings and Responses, as item 2011-1.

Internal Control Over Compliance

Management of the Agency is responsible for establishing and maintaining effective internal control over compliance with the compliance requirements referred to above. In planning and performing our audit, we considered the Agency's internal control over compliance to determine the auditing procedures for the purpose of expressing our opinion on compliance, 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 Agency's internal control over compliance.

A deficiency in internal control over compliance 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, noncompliance 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 compliance requirement 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 over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified a certain deficiency in internal control over compliance, described in the accompanying Schedule of Findings and Responses as item 2011-1, that we consider to be a significant deficiency. A *significant deficiency* in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

The Agency's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. We did not audit the Agency's responses, and accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of management, the Board of Directors, others within the Agency, and the State Controller's Office, Division of Accounting and Reporting and is not intended to be and should not be used by anyone other than these specified parties.

Jeannan Ramirez & Smith, Llc.

December 19, 2011

**Redevelopment Agency of the City of Capitola
Schedule of Findings and Responses
For the Year Ended June 30, 2011**

2011-1 Filing of the Fiscal Year 2010 Annual Report

Health and Safety Code Section 33080.1 requires each redevelopment agency to file an annual report with its legislative body within six months of the end of the Agency's fiscal year. The annual report should include the following:

- a) Financial Statement Audit;
- b) Fiscal Statement for the previous fiscal year, which includes the following:
 - i. The amount of outstanding indebtedness of the agency and each project area.
 - ii. The amount of tax increment property tax revenue generated in the agency and in each project area.
 - iii. The amount of tax increment revenues paid to, or spent on behalf of, a taxing agency, other than a school or community college district, pursuant to subdivision (b) of Section 33401 or Section 33676. Moneys expended on behalf of a taxing agency shall be itemized per each individual capital improvement.
 - iv. The financial transactions report required pursuant to Section 53891 of the Government Code.
 - v. The amount allocated to school or community college districts pursuant to each of the following provisions: (1) Section 33401; (2) Section 33445; (3) Section 33445.5; (4) paragraph (2) of subdivision (a) of Section 33676; and (5) Section 33681.
 - vi. The amount of existing indebtedness, as defined in Section 33682, and the total amount of payments required to be paid on existing indebtedness for that fiscal year.
 - vii. Any other financial information which the agency believes useful to describe its programs.
- c) A description of the Agency's activities in the previous fiscal year affecting housing and displacement;
- d) A description of the Agency's progress, including specific actions and expenditures, in alleviating blight in the previous fiscal year;
- e) A list of, and status report on all loans of \$50,000 or more, that in the previous fiscal year were in default or not in compliance with the terms of the loan;
- f) A description of the total number and nature of the properties that the Agency owns and those properties the Agency has acquired in the previous fiscal year;
- g) A list of the fiscal years that the Agency expects specified time limits of the plans to expire;
- h) Any other information that the Agency believes useful to explain its programs, including, but not limited to, the number of jobs created and lost in the previous fiscal year as a result of its activities.

During our audit, except for the items listed at d), e), and f), we found no indication that the Agency submitted the above reports to the Board of Directors, within the required time period, for the year ended June 30, 2010.

**Redevelopment Agency of the City of Capitola
Schedule of Findings and Responses
For the Year Ended June 30, 2011**

Recommendation:

We recommend that the Agency prepare and submit the required annual report, as described above, to the Board of Directors in the required time frame for the 2010-11 fiscal year. In addition, we recommend the Agency establish documented procedures to ensure compliance with Section 33080.1 of the Health and Safety Code.

Response:

The City of Capitola and the Capitola Redevelopment Agency have consistently met the following State Controller RDA reporting requirements:

- online release of State Controller's Redevelopment Agencies' Financial Transactions Report
- submission of the Bureau of Census survey form
- two copies of the City of Capitola Comprehensive Annual Financial Report (independent audit)
- the Capitola Statement of Indebtedness for tax year 2010-11 filed with the Santa Cruz County Auditor-Controller
- two copies of the Capitola Redevelopment Agency Financial Statement for the year ending June 30, 2010
- Housing and Community Development Report on the Status and Use of Low and Moderate Income Housing Fund
- Capitola Redevelopment Agency Plan Limits Summary

In addition, the Agency has consistently met the following Department of Housing and Community Development requirements

- verification of online submittal of the annual report to HCD for the Capitola Redevelopment Agency
- Capitola RDA Plan Limit Summary
- Capitola RDA independent auditor's report and Financial Statement
- Capitola RDA Financial Transactions Report cover page

All reports were reviewed and signed by Redevelopment Agency management and submitted to the State Controller's Office and Department of Housing and Community Development prior to the December 31, 2010 deadline. Capitola Redevelopment Agency standard practice was to submit all required reports by the December 31st deadline and to subsequently file the reports with the Board of Directors at the first available meeting following completion, which occurred on the second Thursday in January.

The State Controller's audit of eighteen redevelopment agencies around the state in March, 2011 highlighted this as a pervasive issue: "None of the 18 reviewed agencies met all of their filing requirements. In some cases, annual financial reports were fed to the RDA governing bodies in pieces, while others simply did not file. Auditors from the Controller's office found that many of the RDAs' department staff were confused by filing requirements, and the report recommends strong training improvements for financial staff."

The State Controller's Office Division of Accounting and Reporting "fiscal alert letter" of August 31, 2011 highlights the reporting requirements and deadlines for SCO and HCD without reference to any state mandated internal agency deadlines. A clarifying letter, dated November 16, 2011, was sent to each Redevelopment Fiscal Officer for the sole purpose of notifying agencies that presenting the State Controller and HCD reports to their legislative bodies is required under Health and Safety Code section 33080.1 and identifying the requirement for a Fiscal Statement.

The Capitola Redevelopment Agency will comply fully with the requirement to present all material required by Health and Safety Code section 33080.1 to the Capitola Redevelopment Agency Board members by the December 31 deadline. In addition, the Agency shall establish documented procedures to ensure compliance with Section 33080.1.