



MEMO

To: NCRA Board of Directors

From: Executive Director Mitch Stogner

Date: June 10, 2009

Subject: Agenda Item F-1 Discussion and Possible Approval of Fiscal Year 2007-08 Final Financial and Compliance Audit Report performed by Aycock & Edgmon CPA's

Attached for your consideration is the Final Financial and Compliance Audit Report for Fiscal Year 2007-08 performed by NCRA's contract audit firm, Aycock & Edgmon of Ferndale, Ca.

The Board was presented with the Draft Financial Audit on May 13, 2009 and requested the following changes or additions:

1. Disclosure of the costs associated with the Novato Consent Decree;
2. Disclosure of the costs associated with the Environmental Consent Decree;
3. Reclassification of the Advance Lease Payments from Operator to Deferred Revenue;

The Board also requested additional information on the Schedule of Findings. The Board directed staff to prepare a Management Discussion and Analysis (MD&A), as well as a Corrective Action Plan that outlines the steps staff will take to ensure that Conditions outlined in the Schedule of Findings are resolved. Both of these issues have been addressed and are included in the Final Financial Audit for Fiscal Year 2007-08 that you have before you.

Staff Recommendation:

Approve the Final Financial and Compliance Audit for Fiscal Year 2007-08.

NORTH COAST RAILROAD AUTHORITY

FINANCIAL STATEMENTS

For the Year Ended June 30, 2008

TABLE OF CONTENTS

June 30, 2008

INDEPENDENT AUDITORS' REPORT	1
MANAGEMENT'S DISCUSSION AND ANALYSIS	3
FINANCIAL STATEMENTS	
Statement of Net Assets	8
Statement of Revenues, Expenses, and Changes in Net Assets	9
Statement of Cash Flows	10
Notes to Financial Statements	12
REPORTS REQUIRED BY <i>GOVERNMENT AUDITING STANDARDS</i>	
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	22
Schedule of Findings and Responses	24



INDEPENDENT AUDITORS' REPORT

To the Board of Directors
North Coast Railroad Authority
Ukiah, California

We have audited the accompanying basic financial statements of North Coast Railroad Authority as of and for the year ended June 30, 2008, as listed in the table of contents. These financial statements are the responsibility of North Coast Railroad Authority's management. Our responsibility is to express an opinion 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 opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of North Coast Railroad Authority as of June 30, 2008, and the changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 15, North Coast Railroad is economically dependent on federal and state funds for rail line rehabilitation projects that are necessary to upgrade the rail line to meet Federal Railroad Administration standards. Continued funding by federal and state agencies is subject to approval by those agencies. The financial statements do not include any adjustment relating to the amounts and classification of liabilities that might be necessary if North Coast Railroad is not able to fund the rehabilitation projects.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 5, 2009, on our consideration of North Coast Railroad Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

The management's discussion and analysis, presented on pages 3 through 6, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Aycock & Edgmon

Aycock and Edgmon
May 5, 2009

MANAGEMENT'S DISCUSSION AND ANALYSIS

MANAGEMENT'S DISCUSSION AND ANALYSIS

Year Ended June 30, 2008

Management of the North Coast Railroad Authority (NCRA) provides this narrative overview and analysis of the financial activities of the NCRA for the fiscal year ended June 30, 2008. We encourage readers to consider the information presented here in conjunction with NCRA's basic financial statements and related notes, which follow this section.

REPORTING ENTITY

The North Coast Railroad Authority was formed in 1989 by the California Legislature to ensure the continuation of railroad service in Northwestern California. The NCRA provides a unified and revitalized rail infrastructure, meeting the freight and passenger service needs in Humboldt and Mendocino Counties. With the formation of the NCRA the state also created the Northwestern Pacific Railroad Authority (NWPRA) to own the right of way (ROW) in Sonoma County. The ROW owned by NWPRA was transferred to Sonoma Marin Area Rail Transit District (SMART) in March 2004, with the NCRA holding the exclusive rights for freight service through Sonoma County to a feeder track in Schellville, which runs through Napa County to the Union Pacific mainline in Fairfield-Suisun City.

Please refer to the reporting entity definition within the notes to the financial statements for additional detail.

FINANCIAL HIGHLIGHTS

- The NCRA's financial status increased overall during the fiscal year, as total net assets increased by \$4,923,738 or by more than 50%. Unrestricted net assets increased by \$4,586,798 as a result of revenue recognition for project costs of \$7,138,721 that were appropriately capitalized. The NCRA incurred Traffic Congestion Relief Project (TCRP) costs of \$13,922,233 that were reimbursable by \$18.026 million in TCRP funds allocated in fiscal year 2007/08 by the California Transportation Commission (CTC) and \$1,752,467 in project costs funded by the Department of Fish and Game.
- Operating revenues from property and equipment leases, permits and fees, and other revenue totaled \$505,464.
- Operating expenses increased to \$10,636,453 which was due primarily to the contractual services for project costs for work performed under the Traffic Congestion Relief Projects and Department of Fish and Game project.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the NCRA's basic financial statements and provide analysis of some key data presented in the financial statements. The NCRA's basic financial statements consist of two components: financial statements and the notes to financial statements.

Financial Statements

The NCRA is engaged only in the business activities related to maintenance and capital repairs of a rail system. The NCRA uses the accrual method of accounting in accordance with accounting principles generally accepted in the United States of America, and applies Governmental Accounting Standards Board (GASB) statements as well as Financial Accounting Standards Board (FASB) statements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB statements. The focus of an enterprise fund is the determination of operating income, changes in net assets (or cost recovery), financial position, and cash flow. The financial statements presented are the statement of net assets; the statement of revenues, expenses, and changes in net assets; and the statement of cash flows.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Year Ended June 30, 2008

OVERVIEW OF THE FINANCIAL STATEMENTS - CONTINUED**Notes to Financial Statements**

The notes provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements can be found on pages 12 to 20.

Financial Analysis

Net assets may serve over time as a useful indicator of the NCRA's financial position. However, other factors may need to be considered such as changes in economic conditions and state and federal legislation.

The largest portion of NCRA's assets (74%) reflects its investment in capital assets (e.g., land, buildings, machinery, and equipment), less any related debt used to acquire those assets that is still outstanding. NCRA uses these capital assets to contract with a private operator to provide rail services to its customers; consequently, these assets are not available for future spending.

Condensed Statement of Net Assets

	June 30, 2007	June 30, 2008	Change
Current and Other Assets	\$ 3,682,657	\$ 6,910,100	\$ 3,227,443
Capital Assets	13,473,691	19,967,909	6,494,218
Other Assets	6,157,278	-	(6,157,278)
Total Assets	<u>23,313,626</u>	<u>26,878,009</u>	<u>3,564,383</u>
Current Liabilities	13,356,296	11,799,294	(1,557,002)
Non-Current Liabilities	380,705	578,352	197,647
Total Liabilities	<u>13,737,001</u>	<u>12,377,646</u>	<u>(1,359,355)</u>
Invested in Capital Assets Net of Related Debt	13,473,691	19,967,909	6,494,218
Restricted	6,157,278	-	(6,157,278)
Unrestricted	(10,054,344)	(5,467,546)	4,586,798
Total Net Assets	<u>\$ 9,576,625</u>	<u>\$ 14,500,363</u>	<u>\$ 4,923,738</u>

The deficit balance of *unrestricted net assets* (\$5,467,546) results primarily from accumulated losses incurred beginning with the fiscal year ended June 30, 1996. The June 30, 2007 portion of the NCRA's net assets of \$6,157,278 represented resources that were subject to external restrictions on how they could be used and were repaid to the funding agency during the fiscal year ended June 30, 2008.

Condensed Statement of Activities and Changes in Net Assets

	June 30, 2007	June 30, 2008	Change
Revenues			
Operating revenues	\$ 739,999	\$ 505,464	(234,535)
Nonoperating revenues	4,741,356	16,091,345	11,349,989
Total Revenues	<u>5,481,355</u>	<u>16,596,809</u>	<u>11,115,454</u>
Expenses			
Operating expenses	5,536,482	10,098,545	4,562,063
Depreciation expense	553,521	537,908	(15,613)
Nonoperating expenses	245,239	231,938	(13,301)
Total Expenses	<u>6,335,242</u>	<u>10,868,391</u>	<u>4,533,149</u>
Special Items	967,906	-	(967,906)
Change in Net Assets	114,019	5,728,418	5,614,399
Net Assets - Beginning of Year	9,586,112	9,576,625	(9,487)
Prior Period Adjustment	(123,506)	(804,680)	(681,174)
Net Assets - End of Year	<u>\$ 9,576,625</u>	<u>\$ 14,500,363</u>	<u>\$ 4,923,738</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS

Year Ended June 30, 2008

Financial Analysis (Continued)*Revenues and Expenses*

Total revenues for NCRA for fiscal year ended June 30, 2008 totaled \$16,596,809 representing an increase of \$11,115,454 from the preceding fiscal year of \$5,481,355. Intergovernmental revenues increased \$11,613,384 from the fiscal year ended June 30, 2007, which is primarily due to the Traffic Congestion Relief Projects (TCRP) funded by the State of California, Department of Transportation. The operating revenue that consists primarily of charges for property leases and equipment leases, representing 3% of the NCRA's total revenue, decreased by \$234,535. The decrease in operating revenue is primarily due to the reclassification of the operator advance lease payments as deferred revenue. Interest income decreased by \$263,395, as a result of the repayment of the TCRP funds of \$5,500,000 along with accrued interest previously held in LAIF. The combined effect of these occurrences is an overall increase in revenues of over 300%.

Total expenses for NCRA increased by \$4,533,149 to \$10,868,391 for the fiscal year 2007/08. The consultant and contractor costs incurred in conjunction with the TCRP projects comprise 82% of the increase in expenses.

Revenues by Source

As previously mentioned, total revenues recognized by NCRA for the 2007/08 fiscal year totaled \$16,596,809. Of this amount \$232,081, or 1%, was generated through property leases, and \$251,620 or 2% was generated through rental of NCRA owned equipment. Permits and fees and other revenues of \$21,763, comprise less than 1% of the total revenues. Interest income of \$49,573 represents less than 1% of the total revenues. NCRA also recognized \$16,041,772, or 97%, in intergovernmental revenues that consist of revenues earned on TCRP projects.

Expenses by Function

Total expenses for NCRA for the fiscal year ended June 30, 2008 totaled \$10,868,391. Costs associated with the administration of the tracks represent 14% of the NCRA's operating costs. Of the remaining 86% of operating costs, 84% are related to the rail infrastructure rehabilitation projects.

CAPITAL ASSET AND DEBT ADMINISTRATIONCapital Assets

The NCRA's investment in capital assets as of June 30, 2008, amounts to \$19,967,909 (net of accumulated depreciation). This investment in capital assets includes land and land rights, buildings, track structures, heavy equipment, rolling stock, and furniture and equipment.

	June 30, 2007	June 30, 2008	Percentage Change
Land	\$ 1,879,260	\$ 1,879,260	N/A
Work-in-process	695,484	360,093	(48.2)
Buildings and track structures	9,510,514	16,924,165	79.8
Machinery and equipment	4,905,785	4,728,598	(3.6)
Accumulated depreciation	<u>(3,517,352)</u>	<u>(3,924,207)</u>	11.6
Total	<u>\$ 13,473,691</u>	<u>\$ 19,967,909</u>	<u>48.2</u>

Additional information on NCRA's capital assets can be found in Note 4 of the financial statement footnotes.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Year Ended June 30, 2008

Long-term Debt

At the end of the current fiscal year, NCRA had a total of \$545,295 in outstanding long-term debt consisting of loans from private companies, and loan agreements with other government agencies. This amount consists of: \$126,000 - two separate loan agreements with Humboldt Redwood Company (formerly Pacific Lumber Company) that is secured by gravel rights; \$124,000 - a loan agreement with TransDynamics Corporation for the purchase of 4 passenger cars and 1 power car that is secured by said equipment; \$128,490 - an advance from the Sonoma Marin Area Rail Transit District (SMART) for repairs to the Haystack Landing Swing Bridge that is secured by the deed of trust on the Ukiah Property; and \$166,805 - a loan agreement with the Humboldt Bay Harbor Recreation and Conservation District that is secured with 10 property leases.

	June 30, 2007	June 30, 2008	Percentage Change
Humboldt Redwood Company	72,000	72,000	N/A
Humboldt Redwood Company	54,000	54,000	N/A
TransDynamics Corporation	124,000	124,000	N/A
SMART	128,490	128,490	N/A
Humboldt Bay Harbor Recreation and Conservation District	<u>166,805</u>	<u>166,805</u>	<u>N/A</u>
Total	<u>\$ 545,295</u>	<u>\$ 545,295</u>	<u>N/A</u>

Additional information on NCRA's current and long-term debt can be found in Note 8 of this report.

REQUEST FOR ADDITIONAL INFORMATION

This financial report is designed to provide a general overview of NCRA's financial status. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the North Coast Railroad Authority, 419 Talmage Avenue, Suite M, Ukiah, California 95482.

FINANCIAL STATEMENTS

STATEMENT OF NET ASSETS

June 30, 2008

ASSETS**Current Assets**

Cash and cash equivalents	\$ 120,807	
Accounts receivable - Net	65,623	
Intergovernmental receivable	6,713,418	
Prepaid expenses	<u>10,252</u>	
Total Current Assets		\$ 6,910,100

Noncurrent Assets

Capital assets, not depreciated	2,239,353	
Capital assets, depreciated	<u>17,728,556</u>	
Total Net Capital Assets		<u>19,967,909</u>

TOTAL ASSETS**\$ 26,878,009****LIABILITIES****Current Liabilities**

Current portion of capital lease payable	\$ 1,454	
Loans payable	3,348,176	
Accounts payable	4,033,895	
Accrued expenses	3,384,917	
Deferred revenue	641,625	
Due to other governments	134,737	
Matured notes payable	<u>254,490</u>	
Total Current Liabilities		\$ 11,799,294

Noncurrent Liabilities

Notes payable	290,805	
Capital lease payable	2,082	
Accrued interest payable	<u>285,465</u>	
Total Noncurrent Liabilities		<u>578,352</u>

TOTAL LIABILITIES**12,377,646****NET ASSETS**

Invested in capital assets, net of related debt	19,967,909	
Restricted	-	
Unrestricted	<u>(5,467,546)</u>	

TOTAL NET ASSETS**\$ 14,500,363**

The accompanying notes to financial statements are an integral part of this statement.

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

For the Year Ended June 30, 2008

OPERATING REVENUES	
Property and operator leases	\$ 483,701
Permits and fees	21,706
Other revenue	<u>57</u>
Total Operating Revenues	505,464
OPERATING EXPENSES	
Salaries, wages, and benefits	191,653
Directors' fees	6,100
Accounting and auditing	65,121
Bad debt expense	7,500
Car hire expense	200,484
Communications	7,560
Contractual and other professional services	153,094
Depreciation	537,908
Insurance	35,538
Legal services	209,530
Office expense	21,185
Other operating expenses	22,830
Permits and licenses	12,022
Private car expense	8,758
Project costs	8,962,729
Property tax assessments	13,589
Rents and leases	11,973
Repairs and maintenance	143,567
Travel	3,760
Utilities	<u>21,552</u>
Total Operating Expenses	<u>10,636,453</u>
OPERATING LOSS	(10,130,989)
NONOPERATING REVENUES (EXPENSES)	
Investment earnings	49,573
Intergovernmental revenues	16,041,772
Interest expense	(208,054)
Loss on asset disposal	<u>(23,884)</u>
Total Nonoperating Revenues (Expenses)	<u>15,859,407</u>
CHANGE IN NET ASSETS	5,728,418
NET ASSETS - BEGINNING OF YEAR	9,576,625
PRIOR PERIOD ADJUSTMENT	<u>(804,680)</u>
NET ASSETS - BEGINNING OF YEAR AS RESTATED	<u>8,771,945</u>
NET ASSETS - END OF YEAR	<u>\$ 14,500,363</u>

The accompanying notes to financial statements are an integral part of this statement.

STATEMENT OF CASH FLOWS

For the Year Ended June 30, 2008

CASH FLOWS FROM OPERATING ACTIVITIES	
Cash received from customers	\$ 516,789
Cash paid to suppliers for goods and services	(10,330,749)
Cash paid to employees for services	<u>(259,847)</u>
Net Cash Provided (Used) by Operating Activities	(10,073,807)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Cash paid on amounts due to other governments	(6,147,975)
Cash paid on amounts due to claimants	<u>(7,075)</u>
Net Cash Flows Provided (Used) by Noncapital Financing Activities	(6,155,050)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Cash received from other governments under grants and contracts	12,100,896
Cash advances received on bridge loan and other advances	3,418,967
Cash paid on bridge loan	(1,487,750)
Cash paid to acquire capital assets	(4,746,464)
Cash received from sale of assets	22,250
Cash paid to reduce debt on capital leases and on notes and loan payable	(1,204)
Cash paid to reduce debt due other creditors	(8,673)
Cash paid on interest due	<u>(12,403)</u>
Net Cash Flows Provided (Used) by Capital and Related Financing Activities	9,285,619
CASH FLOWS FROM INVESTING ACTIVITIES	
Interest received	<u>133,201</u>
Net Cash Flows Provided (Used) by Investing Activities	<u>133,201</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(6,810,037)
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	<u>6,930,844</u>
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$ 120,807</u>
FINANCIAL STATEMENT PRESENTATION	
Current Assets	
Cash and cash equivalents	<u>\$ 120,807</u>

The accompanying notes to financial statements are an integral part of this statement.

STATEMENT OF CASH FLOWS

For the Year Ended June 30, 2008

RECONCILIATION OF OPERATING INCOME (LOSS) TO	
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	
Operating income (loss)	\$ (10,130,989)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:	
Depreciation	537,908
Changes in operating assets and liabilities:	
(Increase) decrease in accounts receivable	(23,152)
(Increase) decrease in prepaid expenses	199
Increase (decrease) in accounts payable	(682,126)
Increase (decrease) in deferred revenue	38,003
Increase (decrease) in accrued expenses	186,350
Net Cash Provided (Used) by Operating Activities	<u>\$ (10,073,807)</u>

The accompanying notes to financial statements are an integral part of this statement.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**A. Financial Reporting Entity**

The North Coast Railroad Authority (NCRA) is a political subdivision of the State of California, created in 1989 under the North Coast Railroad Authority Act, Government Code Sections 93000, et seq. The NCRA is governed by a seven-member Board of Directors appointed by the Board of Supervisors from Humboldt, Mendocino, Sonoma, and Marin Counties. The mission of the North Coast Railroad Authority is to provide a unified and revitalized rail infrastructure, meeting the freight and passenger needs of the region; a first class service working in partnership with others to build and sustain the economy of the region.

The accompanying financial statements include all organizations, activities, and functions that comprise the North Coast Railroad Authority. There are no component units (entities that are legally separate for which the NCRA is financially accountable) included within the reporting entity.

B. Basic Financial Statements

The basic financial statements (Statement of Net Assets, Statement of Activities and Changes in Net Assets, and Statement of Cash Flows) report information on all of the enterprise activities of the NCRA. GASB Statement No. 34 requires the classification of net assets into three components - invested in capital assets, net of related debt; restricted, and unrestricted.

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

The basic financial statements are prepared using the economic resource measurement focus and the accrual basis of accounting. Accordingly, all assets and liabilities (whether current or noncurrent) are included on the Statement of Net Assets. The Statement of Activities and Changes in Net Assets presents increases (revenues) and decreases (expenses) in total net assets. Under the accrual basis of accounting, revenues are recognized in the period in which they are earned and expenses are recognized in the period in which the related liability is incurred.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, are generally followed to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments have the option of following subsequent private-sector guidance for their business-type activities, subject to this same limitation. The NCRA has elected not to follow subsequent private-sector guidance.

The NCRA distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the principal ongoing operations. The principal operating revenues of the NCRA are charges to customers for rents and leases. Operating expenses include the cost of maintaining the railroad property, car hire expense, general and administrative expenses, and depreciation of capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, the NCRA uses restricted resources first, then unrestricted resources as they are needed.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

D. Budget and Budgetary Accounting

The Board of Directors adopt a budget annually to be effective July 1st of the ensuing fiscal year. Budgets are adopted on a basis consistent with generally accepted accounting principles.

E. Cash and Cash Equivalents

For purposes of the Statement of Cash Flows, the NCRA considers all pooled cash and investments as cash and cash equivalents. Restricted cash and investments are also treated as cash and cash equivalents.

F. Capital Assets

Capital assets are recorded at cost. The capitalization threshold for all capital assets is \$5,000. Depreciation is based on the estimated useful lives of the assets, which range from five to fifteen years for equipment and rolling stock, and twenty-five to fifty years for buildings and improvements, using the straight-line method.

G. Compensated Absences

All vested vacation and compensatory leave time is recognized as an expense and as a liability at the time the benefit vests. The liability for compensated absences is included as part of the accrued expenses payable from unrestricted current assets.

The Executive Director's contract provides payment upon termination of one-half of accumulated sick leave benefits subject to a maximum of thirty days at the current salary. A provision for this contingent liability has not been recognized in the accompanying financial statements.

H. Net Assets

In the Statement of Net Assets, net assets are classified in the following categories:

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

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

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

I. Use of Estimates

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

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE 2 - CASH AND INVESTMENTS

The cash and cash equivalents as of June 30, 2008 are classified in the accompanying financial statements as follows:

Cash and Cash Equivalents	
Unrestricted	\$ <u>120,807</u>

The carrying amounts of the NCRA's cash and investments as of June 30, 2008 consisted of the following:

Investments in External	
Investment Pool	\$ <u>120,807</u>

Investments in External Investment Pool

The NCRA participates in an external cash and investment pool sponsored by the County of Sonoma (County). The County pools these funds with those of other entities in the County and invests the cash. The County is restricted by Government Code Section 53635 pursuant to Section 53601 to invest in time deposits, U.S. Government securities, state registered warrants, notes or bonds, State Treasurer's investment pool, bankers' acceptance, commercial paper, negotiable certificates of deposit, and repurchase to reverse repurchase agreements. These pooled funds are carried at cost which approximates market value. Interest earned is deposited quarterly into participating funds. Any investment losses are shared proportionately by all funds in the pool.

Custodial Credit Risk

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. Custodial credit risk does not apply to a local government's indirect investment in securities through the use of government investment pools.

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. The NCRA does not have a specific policy which relates to interest rate risk.

Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization; however, the external investment pool with the County Treasury is not rated.

NOTE 3 - RECEIVABLES

Receivables were comprised of the following as of June 30, 2008:

Accounts Receivable		
Rents and leases	\$ 74,828	
Allowance for doubtful accounts	(15,000)	
Disallowed costs due from contractors	5,608	
Other	<u>187</u>	\$ 65,623
Intergovernmental Receivables		
Traffic Congestion Relief Projects		<u>6,713,418</u>
		<u>\$ 6,779,041</u>

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE 4 - CAPITAL ASSETS

A summary of the changes in capital assets for the year ended June 30, 2008 is as follows:

	<u>Balance July 1, 2007</u>	<u>Additions</u>	<u>Retirements and Transfers</u>	<u>Balance June 30, 2008</u>
Capital assets, not being depreciated				
Land and land rights	\$ 1,879,260	\$ -	\$ -	\$ 1,879,260
Work-in-process inventory	<u>695,484</u>	<u>-</u>	<u>(335,391)</u>	<u>360,093</u>
Total capital assets, not being depreciated	2,574,744	-	(335,391)	2,239,353
Capital assets, being depreciated				
Buildings and track structures	9,510,514	7,413,651	-	16,924,165
Machinery and equipment	<u>4,905,785</u>	<u>-</u>	<u>(177,187)</u>	<u>4,728,598</u>
Total capital assets, being depreciated	14,416,299	7,413,651	(177,187)	21,652,763
Less accumulated depreciation	<u>(3,517,352)</u>	<u>(537,908)</u>	<u>131,053</u>	<u>(3,924,207)</u>
Total capital assets, being depreciated, net	<u>10,898,947</u>	<u>6,875,743</u>	<u>(46,134)</u>	<u>17,728,556</u>
Total capital assets, net	<u>\$13,473,691</u>	<u>\$ 6,875,743</u>	<u>\$ (381,525)</u>	<u>\$19,967,909</u>

NOTE 5 - ACCRUED LIABILITIES

Accrued liabilities were comprised of the following as of June 30, 2008:

Car hire expense	\$ 2,679,692
Contingent liabilities	104,280
CRC Termination agreement	134,937
Interest payable within	
one year and in arrears	169,075
Judgments	238,853
Other accrued expenses	1,261
Past legal services	40,701
Salaries and benefits payable	<u>16,118</u>
	<u>\$ 3,384,917</u>

Car Hire Expense

Railcars that are owned by or leased by the Union Pacific Railroad Company (UP) are still stranded north of Willits. Car hire, the process where railroads pay each other for the use of their railcars, continues to accrue for the stranded railcars. The accrued car hire presented in the financial statements consists of accrued car hire for the period beginning January 1, 2000 through June 30, 2008 and includes a current provision of \$200,484.

Management is seeking a resolution of this matter with UP that would not require payment by NCRA, but would include forgiveness of UP environmental remediation investigation obligations to NCRA, sale of cars by UP to third parties, and purchase of the remaining cars by NCRA's operator.

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE 5 - ACCRUED LIABILITIES - CONTINUEDJudgments and Claims

The NCRA records a liability for claims when the probability that NCRA's assets will be impaired is likely and it is possible to reasonably estimate the amount of the loss. The liability included in the accompanying financial statements is for four claims to recover damages that have been filed against the NCRA. Management has estimated that the probable loss resulting from these judgments will be \$238,853. See Note 16 regarding a stipulated judgment filed subsequent to the fiscal year end.

The NCRA terminated a passenger operation agreement with California Redwood Coast Company (CRC) and approved a claim to CRC for \$134,937. The settlement calls for payment of \$134,937 to CRC with interest at a rate of 7% beginning July 1, 2005. The accrued interest recognized in the accompanying financial statements as of June 30, 2008 is \$28,337, with a current provision of \$9,446.

Interest Payable

The interest payable consists primarily of accrued interest of \$128,460 on the matured notes that are described in more detail in Note 8, and the current portion of interest payable on other long-term debt obligations.

NOTE 6 - DUE TO OTHER GOVERNMENTS

The NCRA has received Federal and State grants for specific purposes that are subject to review and audit by the grantor agencies. Management has made a provision for amounts due to other governments of \$134,737 that is comprised of the following:

Disallowed Proposition 116 costs	\$ 130,000
Disallowed TCRP Project 32.5 costs	550
Refundable interest earned under Program Supplement 01A0045	<u>4,187</u>
	<u>\$ 134,737</u>

Subsequent audits could generate expenditure disallowance under terms of the agreements, however, management believes that any required reimbursement will not be material.

NOTE 7 - BRIDGE FINANCING

NCRA entered into an agreement on September 12, 2007 with the Northwestern Pacific Railroad Company (NWP) to secure bridge financing for the TCRP projects. The agreement provides for loans as necessary to pay vendors and perform other obligations for work authorized under TCRP, in an amount not to exceed \$5 million outstanding at any one time. The loan proceeds are due at such time as the expenditures for which the loan funds were used are reimbursed by the funding agencies. Interest on any loan funds advanced are at the rate paid by NWP for such funds. All outstanding principal and interest shall be due and payable no later than September 12, 2010. The loan funds advanced are secured by machinery and equipment.

During the year ended June 30, 2008, NCRA received advances of \$3,178,967 and repaid \$1,487,750. The outstanding loan balance as of June 30, 2008 was \$3,348,176. Accrued interest as of June 30, 2008 of \$197,221 includes interest accrued on these funds during the 2008 fiscal year of \$159,550.

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE 8 - LONG-TERM DEBT

The following is a schedule of the changes in the long-term debt for the fiscal year ended June 30, 2008:

	Balance July 1, 2007	Principal Additions	Principal Reductions	Balance June 30, 2008	Classification	
					Current Portion	Long-Term Portion
Humboldt Redwood Co.	\$ 72,000	\$ -	\$ -	\$ 72,000	\$ 72,000	\$ -
Humboldt Redwood Co.	54,000	-	-	54,000	54,000	-
TransDynamics Corporation	124,000	-	-	124,000	-	124,000
Sonoma-Marín Area Rail Transit District (SMART)	128,490	-	-	128,490	128,490	-
Humboldt Bay Harbor Recreation and Conservation District	166,805	-	-	166,805	-	166,805
Total	<u>\$ 545,295</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 545,295</u>	<u>\$ 254,490</u>	<u>\$ 290,805</u>

A. Humboldt Redwood Company

NCRA entered into loan agreements with Pacific Lumber Company (now Humboldt Redwood Company) under two separate agreements. The first loan agreement dated November 7, 1996 for \$80,000 called for the principal and interest at a rate of 6.0% to be paid on the maturity date of November 8, 2006. The accrued interest as of June 30, 2008 of \$51,581 includes a current provision of \$4,320. The loan is secured by gravel rights.

The second loan agreement dated November 8, 1996 for \$60,000 called for the principal and interest at a rate of 6.0% to be paid on the maturity date of November 8, 2006. The accrued interest as of June 30, 2008 of \$41,053 includes a current provision of \$3,240.

B. TransDynamics Corporation and Golden Age Rail Equipment Corporation

On March 15, 1997, NCRA entered into loan agreements with TransDynamics Corporation and Golden Age Rail Equipment Corporation for the purchase of four (4) passenger cars and one (1) power car with a total loan obligation amount of \$405,000. The agreements did not provide for interest. On January 26, 2001, TransDynamics Corporation and Golden Age Rail Equipment Corporation renegotiated these notes which resulted in an acceptance of \$320,000 as debt relief with the stipulation that an additional \$124,000 would be paid with interest at 7% payable from cash proceeds from the sale of the passenger cars and power car. One passenger car, the Golden State, was sold on May 15, 2008 for \$5,250. A payment on this obligation from the proceeds of the sale was not made as of June 30, 2008. The note is secured by the three (3) passenger cars and power car. The accrued interest as of June 30, 2008 of \$64,888 includes a current provision of \$8,680.

C. Sonoma-Marín Area Rail Transit District (SMART)

The Sonoma-Marín Area Rail Transit District (SMART) succeeded in interest to the Northwestern Pacific Railroad Authority (NWPRA) as payee to a note agreement that provided an advance up to \$250,000 for the purpose of developing plans, specifications, and bid documents to repair the Haystack Landing Swing Bridge. An advance of \$175,185 was made to the NCRA on November 29, 2001 for this purpose. The terms of the agreement called for repayment of the loan in \$50,000 annual installments, including interest at a rate of 4.47%, due each April. The note matured on April 30, 2006. The accrued interest as of June 30, 2008 of \$35,825 includes a current provision of \$5,782. The note is secured by a deed of trust on the Ukiah property.

The agreement provides that the NCRA will be given in-kind credit against all amounts owed for the actual out-of-pocket-costs incurred by the NCRA or its contractors in making improvements to the corridor that are of utility to SMART. The in-kind credit to be provided for the repairs made to the Haystack Landing Swing Bridge during the fiscal year ended June 30, 2005 has not been determined.

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE 8 - LONG-TERM DEBT - CONTINUED**D. Humboldt Bay Harbor, Recreation and Conservation District**

On October 13, 2004, the NCRA entered into a loan agreement with the Humboldt Bay Harbor, Recreation and Conservation District to provide operating capital. The promissory note calls for quarterly interest payments at a rate of 8%, commencing on April 1, 2005. The note matures on December 31, 2009, at which time the unpaid principal and interest is due. The accrued interest as of June 30, 2008 is \$3,533. The note is secured by leases held by the NCRA.

E. Option B Interest Payable

Option B interest consists of interest, at a rate of 7%, due to various contractors and vendors on the principal amount stated at the date the final debt was incurred. The agreements call for eleven (11) annual installments payable on July 1 of each year, commencing on July 1, 2001.

Future minimum payments at June 30, 2008 are as follows:

Year Ended June 30,	
2009	\$ 7,255
2010	7,255
2011	7,255
2012	7,256
	<u>\$ 29,021</u>

NOTE 9 - CAPITAL LEASE

The NCRA entered into a lease agreement for financing the acquisition of office equipment. The lease qualifies as a capital lease for accounting purposes and, therefore, has been recorded at the present value of the future minimum lease payments. The following is a detail of the capital lease as of June 30, 2008:

Copier	\$ 6,435
Accumulated depreciation	<u>(3,861)</u>
	<u>\$ 2,574</u>

Future minimum payments under this lease as of June 30, 2008 are as follows:

Year Ended June 30,	
2009	\$ 2,004
2010	2,004
2011	333
Future minimum lease payments	<u>4,341</u>
Less amount representing interest	<u>(805)</u>
Present value of minimum lease payments	<u>\$ 3,536</u>

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE 10 - NET ASSETS

Net assets represent the difference between assets and liabilities. The net asset amounts as of June 30, 2008 are as follows:

Invested in capital assets, net of related debt:	
Capital assets, net of accumulated depreciation	\$ 19,967,909
Restricted	-
Unrestricted	<u>(5,467,546)</u>
Total Net Assets	<u>\$ 14,500,363</u>

NOTE 11 - EMPLOYEE RETIREMENT PLAN**A. Plan Description**

North Coast Railroad Authority contributes to the California Public Employees' Retirement System (CalPERS), an agent multiple-employer, defined benefit public employee retirement system that acts as a common investment and administrative agent for participating entities within the State of California. 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 P Street, Sacramento, California 95814.

B. Funding Policy

Active plan members are required to contribute 7.0% of their salary (7% of monthly salary over \$133.33 if the member participates in social security), and the NCRA 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 contribution requirements of the plan members are established by state statute. The NCRA's contributions to CalPERS for the fiscal years ended June 30, 2008, 2007, and 2006 were \$35,821, \$26,982, and \$27,337, respectively, and equal the total required contributions for each year.

NOTE 12 - RISK MANAGEMENT

The NCRA is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The NCRA maintains commercial coverage covering each of those risks of loss. Management believes such coverage is sufficient to preclude any significant uninsured losses to the NCRA. Settled claims have not exceeded this coverage in any of the past three years.

The NCRA is directly and indirectly involved in various claims, legal actions and complaints relating to environmental remediation and contractual obligations. The amount of ultimate liability, if any, to the NCRA is not determinable at this time. Management believes that the ultimate resolution of these claims and litigations will not have an adverse material effect on the financial condition of the NCRA.

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE 13 - COMMITMENTS

The July 14, 1999 Consent Decree and Stipulated Judgment entered into by the California Department of Fish and Game, California Department of Toxic Substance Control, California Regional Water Quality Control Board, and NCRA called for certain corrective actions, actions to eliminate barriers to fish, site investigation and remediation, compliance monitoring, and payment of administrative and enforcement costs. The administrative and enforcement costs totaled \$163,319 and is included as an accrued liability in the accompanying financial statements. The NCRA was allocated a total of \$4.1 million in Traffic Congestion Relief funds under Program Supplement #32.5, North Coast Railroad, Environmental Remediation Projects, to perform the various actions committed to under the Consent Decree. Approximately \$1.2 million has been expended to date with the remainder committed to site characterization plans and soil and groundwater investigations and remediation. Management does not expect that the costs will exceed the remaining funds available under Program Supplement #32.5.

NOTE 14 - PRIOR PERIOD ADJUSTMENT

The unrestricted net assets were decreased by a \$804,680 to correct the following prior year's misstatements:

Understatement of:

Due to other governments for interest earned on LAIF	\$ 647,975
Accounts payable for weed abatement	23,689
Deferred revenue for advance lease payments	200,000

Overstatement of:

Accrued car hire for railcars sold by UP	(30,791)
Accounts payable for project costs forgiven	(33,468)
Accounts payable for immaterial corrections	<u>(2,725)</u>
	<u>\$ 804,680</u>

NOTE 15 - GOING CONCERN

The North Coast Railroad is economically dependent on federal and state funds for rail line rehabilitation projects. Continued funding by federal and state agencies is subject to approval by those agencies. The rehabilitation projects are necessary to upgrade the rail line to meet Federal Railroad Administration standards before NCRA's operator can begin operations. Revenue generated from the Operator Agreement is expected to provide a source of unrestricted funds that can be used to reduce NCRA's debt obligations. Consequently, continued funding to upgrade the rail lines is necessary for NCRA to meet its debt obligations. The financial statements do not include any adjustment relating to the amounts and classification of liabilities that might be necessary if NCRA is not able to fund the rehabilitation projects.

NOTE 16 - SUBSEQUENT EVENT

On November 3, 2008, the Consent Decree and Stipulated Judgment was agreed to in regards to the City of Novato litigation. The agreement calls for, among other items, the payment of the City of Novato's attorney fees, the completion of 13 quiet zones, landscaping, fencing, purchase of environmentally friendly locomotives, and continuously welded tracks. Management estimates the cost to comply with the Consent Decree to be between \$1.3 to \$1.7 million.

REPORTS REQUIRED BY GOVERNMENT AUDITING STANDARDS



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

To the Board of Directors
North Coast Railroad Authority
Ukiah, California

We have audited the financial statements of the business-type activities of North Coast Railroad Authority as of and for the year ended June 30, 2008, and have issued our report thereon dated May 5, 2009. 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 North Coast Railroad Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of North Coast Railroad's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the North Coast Railroad's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the North Coast Railroad Authority's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the North Coast Railroad's financial statements that is more than inconsequential will not be prevented or detected by the North Coast Railroad's internal control. We consider the deficiencies described in the accompanying Schedule of Findings and Responses to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the North Coast Railroad's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described in the accompanying schedule is a material weakness.

To the Board of Directors
North Coast Railroad Authority
Ukiah, California

Compliance and Other Matters

As part of obtaining reasonable assurance about whether North Coast Railroad Authority'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*.

This report is intended solely for the information and use of management and the Board of Directors, and is not intended to be and should not be used by anyone other than these specified parties.

Aycock & Edgmon

Aycock and Edgmon
May 5, 2009

SCHEDULE OF FINDINGS AND RESPONSES

June 30, 2008

2008-1 Condition and Recommendation

Cut-off procedures were not adequately performed to ensure that the financial statements were complete. Payables should be recorded in the period in which the goods or services are received. At year end, conduct a search for unrecorded invoices.

Corrective Action (Response)

NCRA staff has prepared for Board approval an RFP that will solicit Certified Public Accountant (CPA) firms who will oversell all year-end cut-off procedures.

2008-2 Condition and Recommendation

Effective controls over the preparation and review of account reconciliations of certain general ledger accounts was not maintained during the year. This control deficiency resulted in misstatements in the financial statements that were not detected on a timely basis. Reconcile on a routine basis, general ledger account balances to supporting details such as the aged accounts receivable, aged accounts payable, and contract billing records. Reconcile the cash accounts to Sonoma County's balances monthly.

The accuracy of interim financial reporting and the timeliness of year-end closing would be improved by proving and adjusting, if necessary, general ledger accounts on a monthly or quarterly basis. The process of proving general ledger accounts is vital to ensuring the integrity of the accounting system.

Corrective Action (Response)

NCRA staff has prepared for Board approval an RFP that will solicit Certified Public Accountant (CPA) firms who will, on a quarterly basis, review reconciliations to detect and reconcile errors.