

Santa Cruz County Sanitation District

A Component Unit of Santa Cruz County

Santa Cruz, California

*Basic Financial Statements
and Independent Auditors' Report*

For the year ended June 30, 2009

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Basic Financial Statements
For the year ended June 30, 2009

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
the Santa Cruz County Sanitation District
Santa Cruz, California

We have audited the accompanying basic financial statements of the Santa Cruz County Sanitation District (District), a component unit of Santa Cruz County, as of and for the year ended June 30, 2009, as listed in the table of contents. These basic financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in the United States 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 basic financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the District at June 30, 2009, and results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles in the United States.

The accompanying Required Supplementary Information, such as Management's Discussion and Analysis as listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. 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.

In accordance with *Government Auditing Standards*, we have also issued our report, dated December 22, 2009, on our consideration of the District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grants, 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 read in conjunction with this report in considering the results of our audit.

Caporicci & Larson

Irvine, California
December 22, 2009

Toll Free Ph: (877) 862-2200

Toll Free Fax: (866) 436-0927

Oakland
180 Grand Ave., Suite 1365
Oakland, California 94612

Orange County
9 Corporate Park, Suite 100
Irvine, California 92606

Sacramento
777 Campus Commons Rd., Suite 200
Sacramento, California 95825

San Diego
4858 Mercury, Suite 106
San Diego, California 92111

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SANTA CRUZ COUNTY SANITATION DISTRICT

A Component Unit of Santa Cruz County

Management's Discussion and Analysis

June 30, 2009

This section of the Santa Cruz County Sanitation District (the "District") annual financial report presents a discussion and analysis of the District's financial performance during the fiscal year that ended June 30, 2009. Please read it in conjunction with the District's basic financial statements following this section.

FINANCIAL HIGHLIGHTS

- The assets of the District exceeded liabilities at the close of the 2008/2009 fiscal year by \$105,363,286 (net assets). Of this amount, \$28,087,764 (unrestricted net assets) may be used to meet ongoing obligations to citizens and creditors, \$1,520,933 is restricted for specific purpose (restricted net assets), and \$75,754,589 is invested in capital assets, net of related debt.
- The District's total net assets increased by \$1,964,864. This increase is primarily attributable to revenues from the customer service rates that included \$2,775,000 for the capital improvement program and \$1,758,932 for principal payments on long-term debt. The District's total long-term debt decreased by \$1,761,168 in comparison with the prior year. The decrease resulted primarily from scheduled principal retirements of bonds and loans payable.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the District's basic financial statements. The District's basic financial statements comprise two components: (1) **Government-wide** financial statements, and (2) **Notes** to the basic financial statements. Fund financial statements are not included in the basic financial statements because all activities of the District are accounted for within a single enterprise fund. Enterprise funds are accounted for using the accrual method of accounting. Required Supplementary Information is included in addition to the basic financial statements.

Government-wide Financial Statements

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

The *statement of net assets* presents information on all District assets and liabilities, with the difference between the two reported as net assets. Over time, increases and decreases in net assets may serve as a useful indicator of whether or not the financial position of the District is improving or deteriorating.

The *statement of revenues, expenses and changes in net assets* presents information showing how the District's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods.

SANTA CRUZ COUNTY SANITATION DISTRICT

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Management's Discussion and Analysis

June 30, 2009

Both of these government-wide financial statements would distinguish functions of the District that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). There are no governmental activities in the District.

Notes to the Financial Statements

The notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide financial statements.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

As noted earlier, net assets may serve as useful indicator of a government's financial position. In the case of the District, assets exceeded liabilities by \$105,363,286 at the close of the most recent fiscal year. Further detail is provided in Table 1.

Table 1 - District's Net Assets

	<u>Business-type Activities</u>		
	<u>2009</u>	<u>2008</u>	<u>Increase (Decrease) %</u>
Assets			
Current and other assets	\$ 31,532,789	\$ 31,260,822	1%
Capital assets, net	97,781,547	97,114,506	1%
Noncurrent assets	722,120	678,865	6%
Total Assets	<u>130,036,456</u>	<u>129,054,193</u>	<u>1%</u>
Liabilities			
Current liabilities	3,713,529	3,628,812	2%
Long-term Liabilities	20,959,641	22,026,959	-5%
Total Liabilities	<u>24,673,170</u>	<u>25,655,771</u>	<u>-4%</u>
Net Assets			
Invested in capital assets, net of related debt	75,754,589	73,326,380	3%
Restricted net assets	1,520,933	969,940	57%
Unrestricted net assets	28,087,764	29,102,102	-3%
Total Net Assets	<u>\$ 105,363,286</u>	<u>\$ 103,398,422</u>	<u>2%</u>

The significant changes in the District's net assets are summarized as follows:

- Capital assets, net have increased by \$667,041. Further information is presented under the Capital Asset and Debt Administration section of this Management's Discussion and Analysis.
- Non-current long-term liabilities have decreased by \$1,814,317. Further information is presented under the Capital Asset and Debt Administration section of this Management's Discussion and Analysis.

SANTA CRUZ COUNTY SANITATION DISTRICT

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Management's Discussion and Analysis

June 30, 2009

Analysis of Net Assets

The largest portion of the District's net assets \$75,754,589 (72%) reflects its investment in capital assets (e.g. pumping stations, transmission systems, mobile equipment, other equipment, sewage treatment plant, and construction in progress), less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the District's investment in its capital assets is reported net of related debt, it should be noted that the resources need to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the District's net assets \$1,520,933 (1%) represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets, \$28,087,764 (27%) may be used to meet the government's ongoing obligations to citizens and creditors.

At the end of the current fiscal year, the District reported positive balances in all three categories of net assets.

Table 2 - Districts' Changes in Net Assets

	<u>Business-type Activities</u>		Increase (Decrease) %
	2009	2008	
Revenues			
Program Revenues			
Charges for services	\$ 18,427,961	\$ 18,329,876	1%
General Revenues			
Taxes - special assessments	95,533	102,835	-7%
Investment income	568,839	1,346,887	-58%
Gain on sale of capital assets	14,042	3,735	276%
Aid from other governmental agencies	226,344	2,580	8673%
Total Revenue	19,332,719	19,785,913	-2%
Expenses			
Sanitation District	17,367,855	15,996,347	9%
Total Expenses	17,367,855	15,996,347	9%
Change in Net Assets	1,964,864	3,789,566	-48%
Net Assets, Beginning	103,398,422	99,608,856	4%
Net Assets, Ending	\$ 105,363,286	\$ 103,398,422	2%

Analysis of Changes Net Assets

The District's net assets increased by \$1,964,864 during the current fiscal year. This increase is primarily attributable to revenues from the customer service rates that included \$2,775,000 for the capital improvement program and \$1,758,932 for principal payments on long-term debt.

SANTA CRUZ COUNTY SANITATION DISTRICT

A Component Unit of Santa Cruz County

Management's Discussion and Analysis

June 30, 2009

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The District's investment in capital assets, net of depreciation as of June 30, 2009, amounted to \$97,781,547. This investment in capital assets includes pumping stations, transmission systems, mobile equipment, other equipment, sewage treatment plant, and construction in progress. The net increase in the District's capital assets (net book value) for the current period was \$667,041 or 1%.

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

- Transmission systems increased by \$299,948 due mainly to the Capitola Esplanade Sewer replacement totaling \$239,793.
- Pumping stations increased by \$2,076,878 due mainly to the Electric Panel Upgrade totaling 1,234,837, and New Brighton grinders totaling \$193,744.
- Construction in progress' net increase of \$442,654 is due mainly to costs incurred for the Aptos Esplanade Replacement Sewer totaling \$468,723.

Capital assets for the business-type activities are presented below to illustrate changes from the prior year:

Business-type Activities

	<u>2009</u>	<u>2008</u>	<u>Increase (Decrease) %</u>
Pumping station	\$ 38,062,424	\$ 35,985,546	6%
Transmission systems	65,667,020	65,367,072	0%
Sewage treatment plant	34,865,583	33,830,970	3%
Construction in progress	9,556,320	9,113,666	5%
Mobile equipment	3,056,415	3,025,647	1%
Other equipment	2,664,019	2,276,968	17%
Total cost	<u>153,871,781</u>	<u>149,599,869</u>	<u>3%</u>
Less accumulated depreciation	<u>(56,090,234)</u>	<u>(52,485,363)</u>	<u>7%</u>
Capital assets, net	<u>\$ 97,781,547</u>	<u>\$ 97,114,506</u>	<u>1%</u>

Long-Term Debt

At June 30, 2009, the District had total long-term debt outstanding of \$22,026,958 (including current portion of \$1,814,317) as compared to \$23,788,126 (including current portion of \$1,761,168) in the prior year. This current year amount was comprised of \$7,445,000 of revenue bonds (including current portion of \$535,000), \$725,000 of special assessments bonds (including current portion of \$60,000), \$13,824,647 of loans payable (including current portion of \$1,217,082), and \$32,311 of unamortized bond charges.

SANTA CRUZ COUNTY SANITATION DISTRICT

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Management's Discussion and Analysis

June 30, 2009

Pollution Remediation Obligations

The District is responsible for pollution clean-up costs for the Lode Street Underground Storage Tank Site and the Rio Del Mar Pump Station Storage Tank Site. The District has contracted with a consultant to develop a corrective action plan. See Note 9 for further information.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the District's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Santa Cruz County Auditor-Controller, 701 Ocean Street, Room 100, Santa Cruz, CA 95060.

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BASIC FINANCIAL STATEMENTS

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Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Statement of Net Assets
June 30, 2009

ASSETS

Current Assets:

Cash and investments with County Treasurer, unrestricted	\$ 30,510,031
Cash and investments with fiscal agents	969,937
Receivables	10,509
Inventories	42,312
Total current assets	<u>31,532,789</u>

Noncurrent Assets:

Cash and investments with County Treasurer, restricted	550,996
Deferred charges	116,047
Promissory note receivable	55,077
Capital assets, net	97,781,547
Total noncurrent assets	<u>98,503,667</u>
Total assets	<u>130,036,456</u>

LIABILITIES

Current Liabilities:

Accounts payable and accrued liabilities	1,432,205
Accrued bond interest	467,007
Bonds and loans payable	1,814,317
Total current liabilities	<u>3,713,529</u>

Noncurrent Liabilities:

Bonds and loans payable	20,212,641
Pollution remediation liability	747,000
Total liabilities	<u>24,673,170</u>

NET ASSETS

Invested in capital assets, net of related debt	75,754,589
Restricted for debt service	1,520,933
Unrestricted	28,087,764
Total net assets	<u>\$ 105,363,286</u>

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Statement of Activities and Changes in Net Assets
For the year ended June 30, 2009

OPERATING REVENUES

Charges for services	\$ 18,427,961
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OPERATING EXPENSES

Operating expenses other than depreciation	13,015,764
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Depreciation	3,604,871
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Total operating expenses	16,620,635
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Operating income	1,807,326
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NONOPERATING REVENUES/(EXPENSES)

Special assessments	95,533
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Aid from other governmental agencies	226,344
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Investment income	568,839
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Bond interest and related fees	(747,220)
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Gain on sale of capital assets	14,042
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Total nonoperating revenues/(expenses)	157,538
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Change in net assets	1,964,864
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NET ASSETS:

Beginning of year	103,398,422
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End of year	\$ 105,363,286
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Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Statement of Cash Flows
For the year ended June 30, 2009

CASH FLOWS FROM OPERATING ACTIVITIES:

Cash received from customers	\$ 18,427,303
Cash payments to suppliers for goods and services	(6,292,450)
Cash payments for interfund services used	(6,720,607)
Net cash provided/(used) by operating activities	5,414,246

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:

Subsidy from other governmental agencies	215,835
Net cash provided/(used) by noncapital financing activities	215,835

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:

Special assessments	95,533
Acquisition and construction of capital assets	(4,188,335)
Principal paid on capital debt	(1,758,932)
Interest paid on capital debt	(769,538)
Other receipts/(payments)	14,040
Net cash provided/(used) by capital and related financing activities	(6,607,232)

CASH FLOWS FROM INVESTING ACTIVITIES:

Interest and investment income received	568,839
Net cash provided/(used) by investing activities	568,839
Net increase/(decrease) in cash and investments	(408,312)

CASH AND INVESTMENTS:

Beginning of year	31,692,276
End of year	<u>\$ 31,283,964</u>

**RECONCILIATION OF OPERATING INCOME/(LOSS) TO NET
CASH PROVIDED/(USED) BY OPERATING ACTIVITIES:**

Operating income/(loss)	\$ 1,807,326
Adjustments to reconcile operating income/(loss) to net cash provided/(used) by operating activities:	
Depreciation	3,604,871
Changes in assets and liabilities:	
Inventories	23,034
Fixed asset write down	1,796
Accounts payable	(22,781)
Net cash provided/(used) by operating activities	\$ 5,414,246

Supplemental Data

Cash and investments with County Treasurer, unrestricted	\$ 30,510,031
Cash and investments with fiscal agents	969,937
Cash and investments with County Treasurer, restricted	550,996
Cash and investments, ending	\$ 32,030,964

See accompanying Notes to the Basic Financial Statements.

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Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Notes to the Basic Financial Statements
For the year ended June 30, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of Reporting Entity

The Santa Cruz County Sanitation District (District) is managed by the Santa Cruz County Department of Public Works (Department) under the direction of the District Board of Directors. Among other assignments, the Department provides management, administration, engineering, maintenance and construction services for the District. In addition, other Santa Cruz County (County) services provided to the District are:

1. Collection, by the Treasurer-Tax Collector, of sewer charges included on the customers' tax bill.
2. Collection of connection fees by the Planning Department.
3. Providing of investment services by the Treasurer.
4. Providing of legal services by the County Counsel.

The Department recovers its administrative costs from a 2.5% to 8.5% surcharge on all services performed. Surcharges related to construction and acquisition of sewage processing facilities have been capitalized in the accompanying financial statements.

The District financial statements are accounted for as a component unit in the County's financial statements, pursuant to Governmental Accounting Standards Board Statement (GASB) No. 14.

B. Basis of Accounting/Measurement Focus

The basic financial statements (the Statement of Net Assets, the Statement of Activities and Changes in Net Assets, and the Statement of Cash Flows) report information on all of the enterprise activities of the District.

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 non-current) 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 while expenses are recognized in the period in which the liability is incurred.

The District distinguishes operating revenues and expenses from non-operating items. Operating revenues, such as charges for services result from exchange transactions associated with the principal activity of the District. Exchange transactions are those in which each party receives and gives up essentially equal values. Non-operating revenues, such as property taxes and investment income, result from non-exchange transactions or ancillary activities in which the District gives (receives) value without directly receiving (giving) equal value in exchange.

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

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Notes to the Basic Financial Statements, Continued
For the year ended June 30, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

B. Basis of Accounting/Measurement Focus, Continued

The District has elected to apply all GASB pronouncements as well as any applicable pronouncements of the Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARB) of the Committee on Accounting Procedure issued on or before November 30, 1989, unless they contradict or conflict with GASB pronouncements.

The Sanitation District's accounting records are a part of the County's centralized accounting system.

C. Cash and Investments

The District maintains all of its cash and investments with the County Treasurer in an investment pool. On a monthly basis the County Treasurer allocates interest to participants based upon their average daily balances. Required disclosure information regarding deposit and investment risk, categorization of investments, and other deposit and investment risk disclosures can be found in the County's financial statements. The County's financial statements may be obtained by contacting the County's Auditor-Controller's office at 701 Ocean Street, Room 100, Santa Cruz, CA 95060.

Investments held in the County's investment pool are available on demand and are stated at cost plus accrued interest.

D. Restricted Cash and Investments

Restricted cash and investments are comprised of funds reserved for debt service.

E. Inventories

Inventories consist of materials and supplies which are valued at average cost method (first-in, first-out).

F. Capital Assets

Capital assets are stated at cost or estimated historical cost, if purchased, or fair market value, if donated. Depreciation has been provided over estimated useful lives ranging from five to forty years, using the straight-line method.

Maintenance and repairs are charged to expense as incurred. Major renewals or betterments are capitalized and depreciated over their estimated useful lives.

Public Domain ("Infrastructure") fixed assets consisting of underground sewer lines are capitalized and depreciated along with other capital assets.

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Notes to the Basic Financial Statements, Continued
For the year ended June 30, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

G. Bond Discount and Issuance Costs

Bond issuance costs are amortized using the straight-line method over the life of the bond issue. The original issue bond discount is offset against the related debt and is amortized using the straight-line method.

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

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

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.

J. New Pronouncements

In 2009, the District adopted new accounting standards in order to conform to the following Governmental Accounting Standards Board Statement:

- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* - This Statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups.

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Notes to the Basic Financial Statements, Continued
For the year ended June 30, 2009

2. CASH AND INVESTMENTS

A. Pooled Cash

Cash and investments are presented on the Statement of Net Assets as follows at June 30, 2009:

Cash and Investments with County Treasury - Unrestricted	\$ 30,510,031
Cash and Investments with County Treasury - Restricted	550,996
Cash and Investments with fiscal agents	<u>969,937</u>
Total	<u><u>\$ 32,030,964</u></u>

See the County's Comprehensive Annual Financial Report for disclosures related to cash and investments including those disclosures relating to interest rate risk, credit rate risk, custodial credit risk, and concentration risk

B. Cash and Investments with Fiscal Agent

First Trust California is the fiscal agent and trustee under the Indenture for the 1995 Sanitation District Joint Wastewater Treatment and Disposal Project.

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Notes to the Basic Financial Statements, Continued
For the year ended June 30, 2009

3. CAPITAL ASSETS

Capital assets at June 30, 2009, are as follows:

	Balance July 1, 2008	Additions	Deletions	Transfers	Balance June 30, 2009
Nondepreciable assets:					
Construction in progress	\$ 9,113,666	\$ 3,014,764	\$ -	\$ (2,572,110)	\$ 9,556,320
Total nondepreciable assets	<u>9,113,666</u>	<u>3,014,764</u>	<u>-</u>	<u>(2,572,110)</u>	<u>9,556,320</u>
Depreciable assets:					
Pumping stations	35,985,546	496,548	-	1,580,330	38,062,424
Transmission systems	65,367,072	244,486	-	55,462	65,667,020
Sewage treatment plants	33,830,970	98,295	-	936,318	34,865,583
Mobile equipment	3,025,647	32,565	(1,797)	-	3,056,415
Other equipment	2,276,968	387,051	-	-	2,664,019
Total depreciable assets	<u>140,486,203</u>	<u>1,258,945</u>	<u>(1,797)</u>	<u>2,572,110</u>	<u>144,315,461</u>
Accumulated depreciation:					
Pumping stations	(15,895,752)	(799,018)	-	-	(16,694,770)
Transmission systems	(25,433,717)	(1,465,115)	-	-	(26,898,832)
Sewage treatment plants	(7,603,198)	(935,474)	-	-	(8,538,672)
Mobile equipment	(1,796,526)	(242,105)	-	-	(2,038,631)
Other equipment	(1,756,170)	(163,159)	-	-	(1,919,329)
Total accumulated depreciation	<u>(52,485,363)</u>	<u>(3,604,871)</u>	<u>-</u>	<u>-</u>	<u>(56,090,234)</u>
Depreciable assets, net	<u>88,000,840</u>	<u>(2,345,926)</u>	<u>(1,797)</u>	<u>2,572,110</u>	<u>88,225,227</u>
Total capital assets, net	<u>\$ 97,114,506</u>	<u>\$ 668,838</u>	<u>\$ (1,797)</u>	<u>\$ -</u>	<u>\$ 97,781,547</u>

The District owns 47% of capacity rights of the City of Santa Cruz (City) Treatment Plant. Operation and maintenance of these treatment and outfall facilities are the responsibility of the City, with the District paying its proportionate share based on actual levels of flow. The District's investment in the City Treatment Plant is included in the District's capital assets.

Depreciation expense for the District for the year ended June 30, 2009, was \$3,604,871.

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Notes to the Basic Financial Statements, Continued
For the year ended June 30, 2009

4. BONDS AND LOANS PAYABLE

The following is a summary of long-term liabilities transactions for the year ended June 30, 2009:

Description	Beginning Balance July 1, 2008	Additions	Deletions	Ending Balance June 30, 2009	Amounts Due Within One Year	Amounts Due More Than One Year
Revenue bond:						
2005 Wastewater Revenue Refunding Bonds	\$ 7,960,000	\$ -	\$ (515,000)	\$ 7,445,000	\$ 535,000	\$ 6,910,000
Special assessment bond:						
Limited Obligation Refunding Improvement Bond	785,000	-	(60,000)	725,000	60,000	665,000
Loans payable:						
City of Santa Cruz	15,008,579	-	(1,183,932)	13,824,647	1,217,082	12,607,565
Unamortized bond charges	34,547	-	(2,236)	32,311	2,235	30,076
Total bonds and loans payable, net	\$ 23,788,126	\$ -	\$ (1,761,168)	\$ 22,026,958	\$ 1,814,317	\$ 20,212,641

The terms of the Revenue Refunding Bonds require the District to, among other things, maintain sewer services charge rates at a level to provide at least 125% of the aggregate revenue bond debt service of the subsequent year plus 100% of the operating expenses, excluding depreciation and amortization, of the current year.

Debt Service Coverage:

Charges for services		<u>\$ 18,427,961</u>
Operating expenses (excluding depreciation)	\$ 12,268,764	
2010 Debt Service - Principal	535,000	
2010 Debt Service - Interest	<u>298,628</u>	<u>\$ 13,102,392</u>
Coverage ratio		<u>140.65%</u>

Special assessment bonds were issued for the financing of public improvements deemed to benefit the properties against which special assessment bonds were issued pursuant to the Improvement Act of 1911 or the Improvement Act of 1915. Special assessment bonds are collateralized by liens against properties of the assessment districts. Bonds are repaid from assessments levied against the properties that benefited from the improvements.

The City loan represents 47% of a State Water Resources Control Board loan with the City for which the District has an agreement to participate in the repayment. The total loan proceeds made available in fiscal year 1998/1999 was approximately \$48 million, of which the District's share was 47% or approximately \$24.37 million in original principal amount. These funds were used to construct the treatment plant expansion of which the District has capacity rights. Interest accrued to date of completion has been added to principal.

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Notes to the Basic Financial Statements, Continued
For the year ended June 30, 2009

4. BONDS AND LOANS PAYABLE, Continued

Year Ending June 30,	Revenue Bonds		Special Assessment Bonds		Loan Payable		Total	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2010	\$ 535,000	\$ 298,628	\$ 60,000	\$ 32,730	\$ 1,217,082	\$ 387,090	\$ 1,812,082	\$ 718,448
2011	705,000	280,733	60,000	30,390	1,251,160	353,012	2,016,160	664,135
2012	730,000	256,263	65,000	27,825	1,286,193	317,979	2,081,193	602,067
2013	765,000	229,231	65,000	25,030	1,322,206	281,966	2,152,206	536,227
2014	800,000	196,800	70,000	21,990	1,359,228	244,944	2,229,228	463,734
2015-2019	3,770,000	436,450	405,000	53,978	7,388,778	632,080	11,563,778	1,122,508
2020-2024	140,000	2,800					140,000	2,800
Subtotal	\$ 7,445,000	\$ 1,700,905	\$ 725,000	\$ 191,943	\$ 13,824,647	\$ 2,217,071	21,994,647	\$ 4,109,919
Unamortized bond charges							32,311	
Total							\$ 22,026,958	

5. EMPLOYEES' RETIREMENT SYSTEM

District employees are considered County employees. As such, they participate in the County's Public Employees Retirement System (PERS) which covers substantially all employees of the County. The District contributes moneys to PERS through administrative charges paid to the County. For a complete description of the retirement plan, see the County's financial statements.

6. OTHER POST EMPLOYMENT BENEFITS

District employees are considered County employees. Employees of the County who retire through PERS, their spouse, and eligible dependents may receive health plan coverage through the Public Employees' Medical & Hospital Care Program (PEMHCP) or (Program). The Program is a defined benefit plan which provides the retirees a monthly medical contribution that is not to exceed the cost of the plan selected. The cost of the plan to the County for each bargaining group will be determined through PERS regulations and requirements. For a complete description of the postemployment benefits plan, see the County's financial statements.

7. RISK MANAGEMENT

The District is exposed to various risks of loss related to torts, theft or damage to and destruction of assets, errors and omissions, injuries to employees, and natural disasters.

The District is included within the terms of the County's insurance coverage. The County is self-insured for its general and auto liability, workers' compensation, and property coverage. The County has chosen to establish risk-financing internal service funds, where assets are set aside for claim settlements associated with the above risk of loss up to certain limits. Excess coverage is provided by the California State Association of Counties (CSAC) Excess Insurance Authority (Insurance Authority), a joint powers authority whose purpose is to develop and fund programs of excess insurance for its member counties. Management is not aware of any claims pending against the District. There have been no reductions in the District's insurance coverage from the prior year and no settlement amounts have exceeded commercial insurance coverage. For a complete description of the insurance coverage, see the County's financial statements.

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Notes to the Basic Financial Statements, Continued
For the year ended June 30, 2009

8. COMMITMENTS AND CONTINGENCIES

There are various claims and legal actions pending against the District for which no provision has been made in the accompanying basic financial statements. In the opinion of the District management, liabilities arising from these claims and legal actions, if any, will not have an adverse material effect on the financial position of the District.

The District has received Federal grants for specific purposes that are subject to review and audit by the Federal government. Although such audits could result in expenditure disallowance under grant terms, any required reimbursements are not expected to be material.

As of June 30, 2009, in the opinion of District Management, there were no additional outstanding matters that would have a significant effect on the financial position of the District.

9. POLLUTION REMEDIATION OBLIGATIONS

In accordance with GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, the District is required to estimate the components of expected pollution remediation outlays and determine whether outlays for those components should be accrued as liabilities or, if appropriate, capitalized when goods and services are acquired if one of the following five specified obligating events occurs:

- The District is compelled to take pollution remediation action because of an imminent endangerment;
- The District violates a pollution prevention-related permit or license;
- The District is named, or evidence indicates that it will be named, by a regulator as a responsible party or potentially responsible party for remediation, or as a government responsible for sharing costs;
- The District is named, or evidence indicates that it will be named, in a lawsuit to compel participation in pollution remediation;
- The District commences or legally obligates itself to commence pollution remediation.

At June 30, 2009, the District identified the following sites which met one of the above obligating events:

Lode Street Underground Storage Tank Site

The site was the former location of the District's East Cliff Pump Station underground storage tank (UST). The UST was removed in April 1997. However, levels of hydrocarbons have been detected at the site above acceptable levels. The County has contracted with a consultant for a corrective action plan, which has been approved. The estimated clean-up cost for the underground contamination and monitoring is approximately \$326,000.

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Notes to the Basic Financial Statements, Continued
For the year ended June 30, 2009

9. POLLUTION REMEDIATION OBLIGATIONS, Continued

Rio Del Mar Pump Station

The site was the former location of the District's Rio Del Mar Pump Station underground storage tank (UST). The UST was removed in 1996. However, levels of hydrocarbons have been detected at the site above acceptable levels. The County has contracted with a consultant for a corrective action plan, which has been approved. The estimated clean-up cost for the underground contamination and monitoring is approximately \$421,000.

At June 30, 2009, the District has recorded pollution remediation obligations in the amount of \$747,000.

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

To the Board of Directors
of the Santa Cruz County Sanitation District
Santa Cruz, California

We have audited the basic financial statements of the Santa Cruz County Sanitation District (District) as of and for the year ended June 30, 2009, and have issued our report thereon dated December 22, 2009. We conducted our audit in accordance with generally accepted auditing standards in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

A *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 District'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 District's financial statements that is more than inconsequential will not be prevented or detected by the District's internal control.

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 District's internal control.

Our consideration of internal control over compliance 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 or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

Toll Free Ph: (877) 862-2200

Toll Free Fax: (866) 436-0927

Oakland
180 Grand Ave., Suite 1365
Oakland, California 94612

Orange County
9 Corporate Park, Suite 100
Irvine, California 92606

Sacramento
777 Campus Commons Rd., Suite 200
Sacramento, California 95825

San Diego
4858 Mercury, Suite 106
San Diego, California 92111

To the Board of Directors
of the Santa Cruz County Sanitation District
Santa Cruz, California
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Compliance and Other Matters

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

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



Irvine, California
December 22, 2009