

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, 2010

C&L
Caporicci & Larson, Inc.
A Subsidiary of Marcum LLP
Certified Public Accountants

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Basic Financial Statements
For the year ended June 30, 2010

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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, 2010, 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 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 respective financial position of the District at June 30, 2010, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report, dated March 23, 2011, on our consideration of the District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements. 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.

To the Board of Directors of
the Santa Cruz County Sanitation District
Santa Cruz, California
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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 the Required Supplementary Information.

Caporicci & Larson, Inc.

Caporicci & Larson, Inc.
A Subsidiary of Marcum LLP
Certified Public Accountants
Irvine, California
March 23, 2011

SANTA CRUZ COUNTY SANITATION DISTRICT
A Component Unit of Santa Cruz County
Management's Discussion and Analysis
June 30, 2010

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, 2010. 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 2009/2010 fiscal year by \$109,943,251 (net assets). Of this amount, \$24,267,407 (unrestricted net assets) may be used to meet ongoing obligations to citizens and creditors; \$1,524,139 is restricted for specific purpose (restricted for debt service); and \$84,151,705 is invested in capital assets, net of related debt.
- The District's total net assets increased by \$4,579,965. This increase is primarily attributable to an increase of \$870,818 in revenues from the customers, and \$1,868,296 received by the District pursuant to the American Recovery and Reinvestment Act of 2009. The District's total long-term debt decreased by \$2,103,429 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 activities 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.

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.

SANTA CRUZ COUNTY SANITATION DISTRICT
A Component Unit of Santa Cruz County
 Management's Discussion and Analysis
 June 30, 2010

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 a useful indicator of a government's financial position. In the case of the District, assets exceeded liabilities by \$109,943,251 at the close of the most recent fiscal year. Further detail is provided in Table 1.

Table 1 - District's Net Assets

| | 2010 | 2009 | Increase (Decrease) % |
|---|------------------------------|------------------------------|--------------------------|
| Assets | | | |
| Current assets | \$ 27,989,503 | \$ 31,532,789 | -11% |
| Capital assets, net | 105,334,283 | 97,781,547 | 8% |
| Noncurrent assets | 714,383 | 722,120 | -1% |
| Total Assets | <u>134,038,169</u> | <u>130,036,456</u> | <u>3%</u> |
| Liabilities | | | |
| Current liabilities | 5,238,706 | 3,713,529 | 41% |
| Long-term Liabilities | <u>18,856,212</u> | <u>20,959,641</u> | <u>-10%</u> |
| Total Liabilities | <u>24,094,918</u> | <u>24,673,170</u> | <u>-2%</u> |
| Net Assets | | | |
| Invested in capital assets, net of related debt | 84,151,705 | 75,754,589 | 11% |
| Restricted net assets | 1,524,139 | 1,520,933 | 0% |
| Unrestricted net assets | <u>24,267,407</u> | <u>28,087,764</u> | <u>-14%</u> |
| Total Net Assets | <u><u>\$ 109,943,251</u></u> | <u><u>\$ 105,363,286</u></u> | <u><u>4%</u></u> |

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

- Capital assets, net have increased by \$6,582,799. Further information is presented under the Capital Asset and Long-Term Debt section of this Management's Discussion and Analysis.
- The Current liabilities have increased by \$1,525,177. This increase is substantially the result of an increase of \$1,358,354 in Accounts payable and accrued liabilities. The District was invoiced after the end of the fiscal year for services performed for a large construction project (Aptos Transmission Main Relocation) before the end of the fiscal year. These invoices have subsequently been paid.
- Long-term liabilities have decreased by \$2,103,429. This decrease is the result of a decrease of \$2,018,395 in Bonds and loans payable and a decrease of \$85,034 in Pollution remediation. Further information is presented under the Capital Asset and Long-Term Debt section of this Management's Discussion and Analysis.

SANTA CRUZ COUNTY SANITATION DISTRICT
A Component Unit of Santa Cruz County
 Management's Discussion and Analysis
 June 30, 2010

Analysis of Net Assets

The largest portion of the District's net assets (\$84,151,705 (77%)) 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 debts used to acquire those assets that are 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 needed to repay these debts must be provided from other sources, since the capital assets themselves cannot be used to liquidate these debts.

An additional portion of the District's net assets (\$1,524,139 (1%)) represents resources that are subject to external restrictions on how they may be used. The remaining balance of the District's net assets (\$24,267,407 (22%)) is unrestricted and may be used to meet the District'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

| | 2010 | 2009 | Increase (Decrease) % |
|--------------------------------------|------------------------------|------------------------------|--------------------------|
| Revenues | | | |
| Program Revenues | | | |
| Charges for services | \$ 19,298,779 | \$ 18,427,961 | 5% |
| General Revenues | | | |
| Taxes - special assessments | 90,139 | 95,533 | -6% |
| Aid from other governmental agencies | 2,261,175 | 226,344 | 899% |
| Investment income | 268,414 | 568,839 | -53% |
| Gain on sale of capital assets | - | 14,042 | -100% |
| Total Revenue | <u>21,918,507</u> | <u>19,332,719</u> | <u>13%</u> |
| Expenses | | | |
| Sanitation District | <u>17,338,542</u> | <u>17,367,855</u> | <u>0%</u> |
| Total Expenses | <u>17,338,542</u> | <u>17,367,855</u> | <u>0%</u> |
| Change in Net Assets | 4,579,965 | 1,964,864 | 133% |
| Net Assets, Beginning | <u>105,363,286</u> | <u>103,398,422</u> | <u>2%</u> |
| Net Assets, Ending | <u><u>\$ 109,943,251</u></u> | <u><u>\$ 105,363,286</u></u> | <u><u>4%</u></u> |

Analysis of Changes Net Assets

The District's Change in Net Assets is \$4,579,965 for the current fiscal year. This is an increase of \$2,615,101 over the prior year. This increase is primarily attributable to an increase in revenues received from customers, and revenues received by the District pursuant to the American Recovery and Reinvestment Act of 2009 (ARRA) during the current fiscal year. The customer revenues increased by \$870,818. The District received \$1,868,296 of ARRA funds during the 2009/2010 fiscal year.

SANTA CRUZ COUNTY SANITATION DISTRICT
A Component Unit of Santa Cruz County
Management's Discussion and Analysis
June 30, 2010

CAPITAL ASSET AND LONG TERM DEBT

Capital Assets

The District's investment in capital assets, net of related debt as of June 30, 2010, amounted to \$84,151,705. 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 \$6,582,799 or 7%.

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

- Construction in progress' net increase of \$3,349,019 is due mainly to costs incurred for the Aptos Transmission Main Relocation project totaling \$4,935,232; netted against the total costs of \$1,444,847 for the El Dorado Sewer Replacement project, which was completed during the current fiscal year;
- The Other equipment increase of \$329,149 is due mainly to the purchase of four new emergency diesel generators totaling \$294,486.

The District's capital assets are presented below by type to illustrate changes from the prior year:

| | 2010 | 2009 | Increase (Decrease) % |
|-------------------------------|-----------------------|----------------------|--------------------------|
| Pumping station | \$ 39,058,837 | \$ 38,062,424 | 3% |
| Transmission systems | 71,060,184 | 65,667,020 | 8% |
| Sewage treatment plant | 34,955,020 | 34,865,583 | 0% |
| Construction in progress | 12,905,339 | 9,556,320 | 35% |
| Mobile equipment | 3,074,211 | 3,056,415 | 1% |
| Other equipment | 2,993,168 | 2,664,019 | 12% |
| Total cost | 164,046,759 | 153,871,781 | 7% |
| Less accumulated depreciation | (59,682,413) | (56,090,234) | 6% |
| Capital assets, net | <u>\$ 104,364,346</u> | <u>\$ 97,781,547</u> | <u>7%</u> |

Long-Term Debt

At June 30, 2010, the District had total long-term debt outstanding of \$20,212,641 (including current portion of \$2,018,395) as compared to \$22,026,958 (including current portion of \$1,814,317) in the prior year. This current year amount was comprised of \$6,910,000 of revenue bonds (including current portion of \$705,000); \$665,000 of special assessments bonds (including current portion of \$60,000); \$12,607,565 of loans payable (including current portion of \$1,251,160); and \$30,076 of unamortized bond charges.

SANTA CRUZ COUNTY SANITATION DISTRICT
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Management's Discussion and Analysis
June 30, 2010

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 7 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, 2010

ASSETS

Current Assets:

| | |
|--|-------------------|
| Cash and investments with County Treasurer | \$ 27,955,346 |
| Receivables | 18,654 |
| Inventories | 15,503 |
| Total current assets | <u>27,989,503</u> |

Noncurrent Assets:

| | |
|--|--------------------|
| Cash and investments with fiscal agents | 969,937 |
| Cash and investments with County Treasurer, restricted | 554,202 |
| Deferred charges | 105,104 |
| Promissory note receivable | 55,077 |
| Capital assets, net | 104,364,346 |
| Total noncurrent assets | <u>106,048,666</u> |
| Total assets | <u>134,038,169</u> |

LIABILITIES

Current Liabilities:

| | |
|---|------------------|
| Accounts payable and accrued liabilities | 2,790,559 |
| Accrued bond interest | 429,752 |
| Bonds and loans payable - due within one year | 2,018,395 |
| Total current liabilities | <u>5,238,706</u> |

Noncurrent Liabilities:

| | |
|---|-------------------|
| Bonds and loans payable - due in more than one year | 18,194,246 |
| Pollution remediation liability | 661,966 |
| Total noncurrent liabilities | <u>18,856,212</u> |
| Total liabilities | <u>24,094,918</u> |

NET ASSETS

| | |
|---|-----------------------|
| Invested in capital assets, net of related debt | 84,151,705 |
| Restricted for debt service | 1,524,139 |
| Unrestricted | 24,267,407 |
| Total net assets | <u>\$ 109,943,251</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, 2010

OPERATING REVENUES

| | |
|----------------------|---------------|
| Charges for services | \$ 19,298,779 |
|----------------------|---------------|

OPERATING EXPENSES

| | |
|---------------------------------|-------------------|
| General and administrative | 4,226,649 |
| Service and supplies | 8,658,522 |
| Depreciation | 3,763,469 |
| Total operating expenses | <u>16,648,640</u> |
| Operating income | <u>2,650,139</u> |

NONOPERATING REVENUES/(EXPENSES)

| | |
|---|------------------|
| Special assessments | 90,139 |
| Aid from other governmental agencies | 2,261,175 |
| Investment income | 268,414 |
| Bond interest and related fees | (689,902) |
| Total nonoperating revenues/(expenses) | <u>1,929,826</u> |
| Change in net assets | <u>4,579,965</u> |

NET ASSETS:

| | |
|-------------------|-----------------------|
| Beginning of year | <u>105,363,286</u> |
| End of year | <u>\$ 109,943,251</u> |

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Statement of Cash Flows
For the year ended June 30, 2010

CASH FLOWS FROM OPERATING ACTIVITIES:

| | |
|---|------------------|
| Cash received from customers | \$ 19,290,634 |
| Cash payments to employees | (4,226,649) |
| Cash payments to suppliers for goods and services | (7,358,393) |
| Net cash provided by operating activities | 7,705,592 |

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:

| | |
|---|------------------|
| Subsidy from other governmental agencies | 2,261,175 |
| Net cash provided by noncapital financing activities | 2,261,175 |

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:

| | |
|--|---------------------|
| Special assessments | 90,139 |
| Acquisition and construction of capital assets | (10,346,268) |
| Principal paid on capital debt | (1,803,374) |
| Interest paid on capital debt | (727,157) |
| Net cash used in capital and related financing activities | (12,786,660) |

CASH FLOWS FROM INVESTING ACTIVITIES:

| | |
|--|--------------------|
| Interest and investment income received | 268,414 |
| Net cash provided by investing activities | 268,414 |
| Net decrease in cash and investments | (2,551,479) |

CASH AND INVESTMENTS:

| | |
|-------------------|----------------------|
| Beginning of year | 32,030,964 |
| End of year | \$ 29,479,485 |

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

| | |
|---|---------------------|
| Operating income/(loss) | \$ 2,650,139 |
| Adjustments to reconcile operating income/(loss) to net cash provided/(used) by operating activities: | |
| Depreciation | 3,763,469 |
| Changes in assets and liabilities: | |
| Receivables | (8,145) |
| Inventories | 26,809 |
| Pollution remediation liability | (85,034) |
| Accounts payable | 1,358,354 |
| Net cash provided by operating activities | \$ 7,705,592 |

Supplemental Data

| | |
|--|----------------------|
| Cash and investments with County Treasurer | \$ 27,955,346 |
| Cash and investments with fiscal agents | 969,937 |
| Cash and investments with County Treasurer, restricted | 554,202 |
| Cash and investments, ending | \$ 29,479,485 |

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, 2010

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. Other charges related to construction and acquisitions of sewage processing facilities have been capitalized in the accompanying financial statements once the improvements or acquisitions have been completed.

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 include the Statement of Net Assets, the Statement of Activities and Changes in Net Assets, and the Statement of Cash Flows.

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 while expenses are recognized in the period in which the liability is incurred.

The District distinguishes operating revenues and expenses from nonoperating 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. Nonoperating revenues, such as property taxes and investment income, result from nonexchange 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, 2010

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 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. Investments in the investment pool are highly liquid, as deposits and withdrawals can be made at anytime without penalty. The County does not impose any maximum investment limit. The fair value of the District's investment in this pool is reported in the accompanying financial statements at amounts based upon the District's prorated share of the fair value provided by the County for the entire investment pool. The balance available for withdrawal is based on the accounting records maintained by the County, which are recorded on an amortized cost basis.

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 using the FIFO method (first-in, first-out).

F. Capital Assets

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

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

Public Domain ("Infrastructure") capital 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, 2010

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 consists of 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.

2. CASH AND INVESTMENTS

A. Pooled Cash

Cash and investments are presented on the Statement of Net Assets as follows at June 30, 2010:

| | |
|--|----------------------|
| Cash and Investments with County Treasury | \$ 27,955,346 |
| Cash and Investments with County Treasury - Restricted | 554,202 |
| Cash and Investments with fiscal agents | 969,937 |
| Total | \$ 29,479,485 |

B. Cash Held with the Santa Cruz County Treasurer

The District pools cash from all sources and all funds except Cash and Investments with fiscal agents with the County Treasurer so that it can be invested at the maximum yield, consistent with safety and liquidity, while individual funds can make expenditures at any time. The Santa Cruz County Treasury Oversight Committee oversees the Treasurer's investments and policies.

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, 2010

2. CASH AND INVESTMENTS, Continued

B. Cash Held with the Santa Cruz County Treasurer, Continued

The California Government Code requires California banks and savings and loan associations to secure the County's cash deposits by pledging securities as collateral. This Code states that collateral pledged in this manner shall have the effect of perfecting a security interest in such collateral superior to those of a general creditor. Thus, collateral for cash deposits is considered to be held in the County's name.

The market value of pledged securities must equal at least 110% of the County's cash deposits. California law also allows institutions to secure County deposits by pledging first trust deed mortgage notes having a value of 150% of the County's total cash deposits. The County may waive collateral requirements for cash deposits, which are fully insured up to \$250,000 by the Federal Deposit Insurance Corporation. The County, however, has not waived the collateralization requirements.

C. Investments

The table below identifies the investment types that are authorized for the County by the California Government Code or the County's investment policy, where more restrictive. The table also identifies certain provisions of the County's investment policy that address interest rate risk, credit risk, and concentration risk.

| Authorized Investment Types | Maximum Maturity | Maximum Percentage of Portfolio | Maximum Investment in One Issuer |
|---|---------------------|---------------------------------------|--|
| Local agency bonds | 5 years | 100% | None |
| U.S. Treasury obligations | 5 years | 100% | None |
| U.S. Government Agency obligations | None | 100% | None |
| State of California obligations | 5 years | 100% | None |
| Banker's acceptances | 180 days | 40% | 30% |
| Commercial paper | 270 days | 40% | 10% |
| Negotiable certificates of deposit | 5 years | 30% | None |
| Nonnegotiable certificates of deposit | 180 days | 10% | 10% |
| Repurchase agreements | 1 year | 100% | None |
| Medium term notes | 5 years | 30% | None |
| Mutual funds/money market mutual funds | N/A | 20% | 10% |
| Local Agency Investment Fund (LAIF) | N/A | \$50 million | None |
| Joint Powers Authority investment funds | None | 25% | None |

In accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, investments were stated at cost, as the fair market value adjustment at the year end was immaterial.

Investments of debt proceeds held by the bond trustee are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the County's investment policy.

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, 2010

2. CASH AND INVESTMENTS, Continued

D. Interest Rate Risk

The County manages its exposure to declines in fair values by limiting the weighted average maturity of its investment portfolio to five years or less in accordance with its investment policy.

E. Concentration of Credit Risk

At June 30, 2010, in accordance with State law and the County's Investment Policy, the County did not have 5% or more of its net investment in commercial paper, corporate bonds or medium term notes of a single organization, nor did it have 10% or more of its net investment in any one money market mutual fund. Investments in obligations of the U.S. government, U.S. government agencies, or government-sponsored enterprises are exempt from these limitations.

F. Custodial Credit Risk

For investments and deposits held with fiscal agents, custodial credit risk is the risk that, in the event of the failure of the counterparty, the County will not be able to recover the value of its investments or deposits that are in the possession of an outside party. At year end, the County's investment pool and cash with fiscal agents had no securities exposed to custodial credit risk.

G. Local Agency Investment Fund

The County is a participant in LAIF which is regulated by California Government Code Section 16429 under the oversight of the Treasurer of the State of California. The County's investments with LAIF at June 30, 2010, included a portion of the pool funds invested in Structured Notes and Asset-Backed Securities:

Structured Notes: debt securities (other than asset-backed securities) whose cash flow characteristics (coupon rate, redemption amount, or stated maturity) depend upon one or more indices and/or have embedded forwards or options.

Asset-Backed Securities: generally mortgage-backed securities that entitle their purchasers to receive a share of the cash flows from a pool of assets such as principal and interest repayments from a pool of mortgages (for example, Collateralized Mortgage Obligations) or credit card receivables.

As of June 30, 2010, the County invested in LAIF, which had invested 5.42% of the pool investment funds in Structured Notes and Asset-Backed Securities. As of June 30, 2010, the LAIF fair value factor of 1.001643776 was used to calculate the fair values of the investments in LAIF.

LAIF is overseen by the Local Agency Investment Advisory Board, which consists of five members, in accordance with State statute.

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, 2010

3. CAPITAL ASSETS

Capital assets at June 30, 2010, are as follows:

| | Balance July 1, 2009 | Additions | Deletions | Reclassification | Balance June 30, 2010 |
|---------------------------------------|-------------------------|---------------------|------------------|--------------------|--------------------------|
| Nondepreciable assets: | | | | | |
| Construction in progress | \$ 9,556,320 | \$ 5,823,273 | \$ - | \$ (2,474,254) | \$ 12,905,339 |
| Total nondepreciable assets | <u>9,556,320</u> | <u>5,823,273</u> | <u>-</u> | <u>(2,474,254)</u> | <u>12,905,339</u> |
| Depreciable assets: | | | | | |
| Pumping stations | 38,062,424 | 838,162 | - | 158,251 | 39,058,837 |
| Transmission systems | 65,667,020 | 3,077,161 | - | 2,316,003 | 71,060,184 |
| Sewage treatment capacity rights | 34,865,583 | 89,437 | - | - | 34,955,020 |
| Mobile equipment | 3,056,415 | 189,086 | (171,290) | - | 3,074,211 |
| Other equipment | 2,664,019 | 329,149 | - | - | 2,993,168 |
| Total depreciable assets | <u>144,315,461</u> | <u>4,522,995</u> | <u>(171,290)</u> | <u>2,474,254</u> | <u>151,141,420</u> |
| Accumulated depreciation: | | | | | |
| Pumping stations | (16,694,770) | (837,434) | - | - | (17,532,204) |
| Transmission systems | (26,898,832) | (1,536,278) | - | - | (28,435,110) |
| Sewage treatment capacity rights | (8,538,672) | (950,071) | - | - | (9,488,743) |
| Mobile equipment | (2,038,631) | (238,537) | 171,290 | - | (2,105,878) |
| Other equipment | (1,919,329) | (201,149) | - | - | (2,120,478) |
| Total accumulated depreciation | <u>(56,090,234)</u> | <u>(3,763,469)</u> | <u>171,290</u> | <u>-</u> | <u>(59,682,413)</u> |
| Depreciable assets, net | <u>88,225,227</u> | <u>759,526</u> | <u>-</u> | <u>2,474,254</u> | <u>91,459,007</u> |
| Total capital assets, net | <u>\$ 97,781,547</u> | <u>\$ 6,582,799</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 104,364,346</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, 2010, was \$3,763,469.

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, 2010

4. BONDS AND LOANS PAYABLE

The following is a summary of long-term liabilities transactions for the year ended June 30, 2010:

| Description | Beginning Balance July 1, 2009 | Deletions | Ending Balance June 30, 2010 | Amounts Due Within One Year | Amounts Due More Than One Year |
|--|--------------------------------------|-----------------------|------------------------------------|--------------------------------------|---|
| Revenue bond: | | | | | |
| 2005 Wastewater Revenue Refunding Bonds | \$ 7,445,000 | \$ (535,000) | \$ 6,910,000 | \$ 705,000 | \$ 6,205,000 |
| Special assessment bond: | | | | | |
| Limited Obligation Refunding Improvement Bonds | 725,000 | (60,000) | 665,000 | 60,000 | 605,000 |
| Loans payable: | | | | | |
| City of Santa Cruz | 13,824,647 | (1,217,082) | 12,607,565 | 1,251,160 | 11,356,405 |
| Unamortized bond charges | 32,311 | (2,235) | 30,076 | 2,235 | 27,841 |
| Total bonds and loans payable, net | \$ 22,026,958 | \$ (1,814,317) | \$ 20,212,641 | \$ 2,018,395 | \$ 18,194,246 |

A. 2005 Wastewater Revenue Refunding Bonds

During 2005, the District issued \$9,335,000 of 2005 Wastewater Revenue Refunding Bonds which refunded the 1977 Sewer Revenue Bonds, Series A, and the 1994 Certificates of Participation issued for the wastewater treatment plant. The bonds are obligations of the District, and are payable from and secured by a pledge of net revenues. The amount outstanding at June 30, 2010 is \$6,910,000.

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 | | \$ 19,298,779 |
| Operating expenses (excluding depreciation) | \$ 12,885,171 | |
| 2011 Debt Service - Principal | 705,000 | |
| 2011 Debt Service - Interest | 280,733 | \$ 13,870,904 |
| Coverage ratio | | 139.13% |

B. Special Assessment Bonds

During 2004, 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 amount outstanding at June 30, 2010 is \$665,000.

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, 2010

4. BONDS AND LOANS PAYABLE, Continued

C. City of Santa Cruz Loan

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. The amount outstanding at June 30, 2010 is \$12,607,565.

The annual requirements to amortize to maturity all long-term debt outstanding including interest payable are as follows:

| Year Ending June 30, | Revenue Bonds | | Special Assessment Bonds | | Loan Payable | | Total | |
|--------------------------|---------------------|---------------------|--------------------------|-------------------|----------------------|---------------------|----------------------|---------------------|
| | Principal | Interest | Principal | Interest | Principal | Interest | Principal | Interest |
| 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 | 840,000 | 160,000 | 75,000 | 18,599 | 1,397,286 | 206,886 | 2,312,286 | 385,485 |
| 2016-2020 | 3,070,000 | 279,250 | 330,000 | 35,379 | 5,991,492 | 425,194 | 9,391,492 | 739,823 |
| Subtotal | \$ 6,910,000 | \$ 1,402,277 | \$ 665,000 | \$ 159,213 | \$ 12,607,565 | \$ 1,829,981 | 20,182,565 | \$ 3,391,471 |
| Unamortized bond charges | | | | | | | 30,076 | |
| Total | | | | | | | \$ 20,212,641 | |

5. 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.

Amounts in excess of these limits are self-insured. None of the insurance settlements over the past three years has exceeded the amount of insurance coverage. As of June 30, 2010, the workers' compensation liability limit per occurrence was \$500,000.

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, 2010

5. RISK MANAGEMENT, Continued

The unpaid claims liability included in each of the County's Self-Insurance Internal Service Funds are based on the results of actuarial studies and include amounts for claims incurred but not reported. Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends, including frequency and amount of payouts, and other economic and social factors. It is the County's practice to obtain full actuarial studies bi-annually. Annual premiums are charged by each self-insurance fund using various allocation methods which include actual costs, claims experience, and number of participants.

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.

6. 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, the required reimbursements, if any, are not expected to be material.

As of June 30, 2010, the County has construction contract commitments in the Department of Public Works (all fund types) and in Special Revenue and Capital Project Funds in the amount of \$15,274,969 and \$2,746,804, respectively.

The District contract commitments consisted of the following:

| | | |
|--------------------------------|----|-------------------|
| Aptos transmission main | \$ | 10,506,498 |
| Davenport water rehabilitation | | <u>493,423</u> |
| | \$ | <u>10,999,921</u> |

As of June 30, 2010, 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.

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, 2010

7. 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, 2010, 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, as of June 30, 2010, for the underground contamination and monitoring is approximately \$292,146.

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, as of June 30, 2010, for the underground contamination and monitoring is approximately \$369,820.

At June 30, 2010, the District has recorded pollution remediation obligations in the amount of \$661,966.



Caporicci & Larson, Inc.
A Subsidiary of Marcum LLP
Certified Public Accountants

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

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

We have audited the basic financial statements of the business-type activities of the Santa Cruz County Sanitation District (District) as of and for the year ended June 30, 2010, and have issued our report thereon dated March 23, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our 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 *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the District's financial statements will not be prevented, or detected and corrected on a timely basis.

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

To the Board of Directors
of the Santa Cruz County Sanitation District
Santa Cruz, California
Page 2

Compliance and Other Matters

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

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

Caporicci & Larson, Inc.

Caporicci & Larson, Inc.
A Subsidiary of Marcum LLP
Certified Public Accountants
Irvine, California
March 23, 2011