

**SANTA CRUZ COUNTY
SANITATION DISTRICT**

**A COMPONENT UNIT OF
THE COUNTY OF SANTA CRUZ**

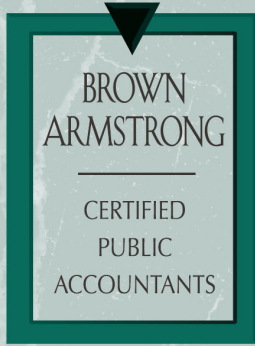
**BASIC FINANCIAL STATEMENTS AND
INDEPENDENT AUDITOR'S REPORTS**

**FOR THE FISCAL YEAR ENDED
JUNE 30, 2019**

**SANTA CRUZ COUNTY SANITATION DISTRICT
JUNE 30, 2019**

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BROWN ARMSTRONG

Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

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

Report on the Basic Financial Statements

We have audited the accompanying basic financial statements of the Santa Cruz County Sanitation District (the District), a component unit of the County of Santa Cruz (the County) as of and for the fiscal year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Basic Financial Statements

Management is responsible for the preparation and fair presentation of these basic financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of basic financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions 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 *Government Auditing Standards* issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the basic financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the District's preparation and fair presentation of the basic financial statements in order to design 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the basic financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

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Opinions

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the respective financial position of the District, as of June 30, 2019, and the respective changes in financial position and, cash flows thereof for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3-6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 26, 2019, on our consideration of the County's internal control over financial reporting relating to the District and on our tests of the County's compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the County's internal control over financial reporting and compliance relating to the District.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Brown Armstrong
Accountancy Corporation

Bakersfield, California
November 26, 2019

**SANTA CRUZ COUNTY SANITATION DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2019**

INTRODUCTION

This section of the Santa Cruz County Sanitation District's (the District) annual financial report presents a discussion and analysis of the District's financial performance during the fiscal year that ended June 30, 2019. Please read it in conjunction with the District's basic financial statements following this section.

THE FINANCIAL HIGHLIGHTS

- The assets of the District exceeded liabilities at the close of the 2018/2019 fiscal year by \$135,574,234 (net position). Of this amount, \$10,853,422 (unrestricted) may be used to meet ongoing obligations to citizens and creditors, and \$124,720,812 is the net investment in capital assets.
- The District's total net position increased by \$1,837,175. This is a decrease of \$832,406 from the prior year's change in net position. This increase is primarily attributable to a \$906,828 increase in charges for services, offset by a \$965,497 decrease in aid from other government agencies, a \$336,814 increase in general and administrative expense, and an increase in services and supplies expense of \$425,855.

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 position* presents information on all District assets and liabilities, with the difference between the two reported as net position. Over time, increases and decreases in net position 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 position* presents information showing how the District's net position changed during the most recent fiscal year. All changes in net position 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 a future fiscal period.

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*). However, there are no governmental activities in the District.

Notes to the Basic 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 position may serve as a useful indicator of a government's financial position. In the case of the District, assets exceeded liabilities by \$135,574,234 at the close of the most recent fiscal year. Further detail is provided in the following table:

Condensed Statements of Net Position

	2019	2018	Increase (Decrease) \$	Increase (Decrease) %
Assets				
Current assets	\$ 22,557,010	\$ 13,649,854	\$ 8,907,156	65.3%
Capital assets, net	133,402,476	133,815,265	(412,789)	-0.3%
Other noncurrent assets	55,077	55,077	-	0.0%
Total Assets	156,014,563	147,520,196	8,494,367	5.8%
Liabilities				
Current liabilities	5,333,168	5,101,472	231,696	4.5%
Long-term liabilities	15,107,161	8,681,665	6,425,496	74.0%
Total Liabilities	20,440,329	13,783,137	6,657,192	48.3%
Net Position				
Net investment in capital assets	124,720,812	122,919,862	1,800,950	1.5%
Unrestricted	10,853,422	10,817,197	36,225	0.3%
Total Net Position	\$ 135,574,234	\$ 133,737,059	\$ 1,837,175	1.4%

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

- Capital assets, net decreased by \$412,789 from the prior year. Further information is presented under the Capital Assets and Debt Administration section of this Management's Discussion and Analysis.
- Long-term liabilities have increased by \$6,425,496. The substantial increase is the result of the initiation of a \$7,000,000 loan payable offset by bond and loan payments on the existing bond and loans. Further information is presented under the Capital Assets and Debt Administration section of this Management's Discussion and Analysis.

Analysis of Net Position

The largest portion of the District's net position (\$124,720,812 (91.99%)) reflects its net investment in capital assets (e.g., pumping stations, transmission systems, mobile equipment, other equipment, sewage treatment plant, and construction in progress), less related debt 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.

The remaining balance of the District's net position (\$10,853,422 (8.01%)) is unrestricted and may be used to meet the District's ongoing obligations to citizens and creditors.

Condensed Statements of Revenues, Expenses, and Changes in Net Position

	2019	2018	Increase (Decrease) \$	Increase (Decrease) %
Revenues				
Program Revenues				
Charges for services	\$ 25,664,972	\$ 24,758,144	\$ 906,828	3.7%
General Revenues				
Special assessments	-	91,348	(91,348)	-100.0%
Aid from other government agencies	-	965,497	(965,497)	-100.0%
Investment income	263,233	220,886	42,347	19.2%
Total Revenues	25,928,205	26,035,875	(107,670)	-0.4%
Expenses				
Sanitation District	24,091,030	23,366,294	724,736	3.1%
Total Expenses	24,091,030	23,366,294	724,736	3.1%
Change in Net Position	1,837,175	2,669,581	(832,406)	-31.2%
Net Position, Beginning as Restated	133,737,059	131,067,478	2,669,581	2.0%
Net Position, Ending	\$ 135,574,234	\$ 133,737,059	\$ 1,837,175	1.4%

Analysis of Changes in Net Position

The District's change in net position was \$1,837,175 for the current fiscal year. This is a decrease of \$832,406 from the prior year's change in net position. This increase is primarily attributable to a \$906,828 increase in charges for services, offset by a \$965,497 decrease in aid from other government agencies, a \$336,814 increase in general and administrative expense, and an increase in services and supplies expense of \$425,855.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The District's net capital assets as of June 30, 2019, amounted to \$133,402,476. These net capital assets include pumping stations, transmission systems, mobile equipment, other equipment, sewage treatment plant, and construction in progress.

The net decrease in the District's capital assets (net book value) for the current period was \$412,789, or 0.31%.

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

- Additions to construction in progress amounted to \$2,694,024.
- Transmission systems increased by \$1,534,768 and mobile equipment increased by \$396,259. The remaining changes in capital assets were additions of \$50,233 and depreciation expense of \$5,088,073.

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

	2019	2018	Increase (Decrease) \$	Increase (Decrease) %
Pumping station	\$ 52,269,123	\$ 52,226,265	\$ 42,858	0.1%
Transmission systems	129,543,724	128,008,956	1,534,768	1.2%
Sewage treatment plant	35,148,509	35,148,509	-	0.0%
Construction in progress	7,054,029	4,360,005	2,694,024	61.8%
Mobile equipment	3,597,040	3,200,781	396,259	12.4%
Other equipment	1,710,815	1,703,440	7,375	0.4%
Total cost	229,323,240	224,647,956	4,675,284	2.1%
Less accumulated depreciation	(95,920,764)	(90,832,691)	(5,088,073)	5.6%
Capital assets, net	<u>\$ 133,402,476</u>	<u>\$ 133,815,265</u>	<u>\$ (412,789)</u>	<u>-0.3%</u>

Long-Term Debt – Bonds and Loans Payable

At June 30, 2019, the District had total bonds and loans payable outstanding of \$15,680,151 (including current portion of \$573,309) as compared to \$10,892,817 (including current portion of \$2,212,666) at the prior year-end. This current fiscal year amount remaining was comprised of \$15,680,151 of loans payable. The increase is due to the issuance of a \$7,000,000 loan offset by bond and loan payments of \$2,212,666.

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 District'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.

BASIC FINANCIAL STATEMENTS

**SANTA CRUZ COUNTY SANITATION DISTRICT
STATEMENT OF NET POSITION
JUNE 30, 2019**

	2019
ASSETS	
Current Assets:	
Cash and investments with County Treasurer, unrestricted	\$ 15,542,639
Restricted cash with fiscal agent	7,000,000
Account receivables	1,072
Inventories	13,299
Total Current Assets	22,557,010
Noncurrent Assets:	
Capital assets, net	133,402,476
Promissory note receivable	55,077
Total Noncurrent Assets	133,457,553
Total Assets	156,014,563
LIABILITIES	
Current Liabilities:	
Accounts payable and accrued liabilities	4,703,968
Accrued bond interest	54,697
Capital leases	1,194
Bonds and loans payable, current portion	573,309
Total Current Liabilities	5,333,168
Noncurrent Liabilities:	
Bonds and loans payable, net	15,106,842
Capital leases	319
Total Noncurrent Liabilities	15,107,161
Total Liabilities	20,440,329
NET POSITION	
Net investment in capital assets	124,720,812
Unrestricted	10,853,422
Total Net Position	\$ 135,574,234

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

**SANTA CRUZ COUNTY SANITATION DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND
CHANGES IN NET POSITION
FOR THE FISCAL YEAR ENDED JUNE 30, 2019**

	2019
OPERATING REVENUES	
Charges for services	\$ 25,664,972
OPERATING EXPENSES	
General and administrative	5,771,734
Services and supplies	12,869,924
Depreciation	5,088,073
Total Operating Expenses	23,729,731
Operating Income	1,935,241
NONOPERATING REVENUES (EXPENSES)	
Special assessments	(129,567)
Investment income	263,233
Bond interest and related fees	(231,732)
Total Nonoperating Revenues (Expenses)	(98,066)
Change in Net Position	1,837,175
Net Position - Beginning	133,737,059
Net Position - Ending	\$ 135,574,234

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

**SANTA CRUZ COUNTY SANITATION DISTRICT
STATEMENT OF CASH FLOWS
FOR THE FISCAL YEAR ENDED JUNE 30, 2019**

	2019
Cash Flows from Operating Activities:	
Cash receipts from customers	\$ 25,694,600
Cash paid to suppliers for goods and services	(7,454,911)
Cash paid for interfund services used	(9,301,419)
	8,938,270
Cash Flows from Capital and Related Financing Activities:	
Special assessments	(129,567)
Acquisition and construction of capital assets	(4,675,284)
Issuance of loans payable	7,000,000
Principal paid on capital debt	(2,213,738)
Interest paid on capital debt	(246,227)
	(264,816)
Cash Flows from Investing Activities:	
Interest and investment income received	263,233
	263,233
Net Cash Provided by Investing Activities	263,233
Net Increase in Cash and Investments	8,936,687
Cash and Investments, Beginning	13,605,952
Cash and Investments, Ending	\$ 22,542,639
Reconciliation of cash and cash equivalents to the Statement of Net Position	
Cash and investments with County Treasurer, unrestricted	\$ 15,542,639
Restricted cash with fiscal agent	7,000,000
	\$ 22,542,639
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:	
Operating income	\$ 1,935,241
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	5,088,073
Changes in assets and liabilities:	
Accounts receivable	29,628
Inventories	(98)
Accounts payable	1,885,426
	8,938,270
Net Cash Provided by Operating Activities	\$ 8,938,270

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

**SANTA CRUZ COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2019**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Santa Cruz County Sanitation District (the District) have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the District's accounting policies are described below.

A. Description of the Reporting Entity

The 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 bills.
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 3.0% to 10.0% overhead 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's financial statements are presented as an enterprise fund and as a discretely presented component unit in the County's financial statements, pursuant to GASB Statement No. 61.

The District does not have employees. All employees are employees of the Department. The County charges the District a weighted labor rate for work performed on behalf of the District.

B. Measurement Focus, Basis of Accounting, and Basis of Presentation

The basic financial statements include the Statement of Net Position; the Statement of Revenues, Expenses, and Changes in Net Position; and the Statement of Cash Flows.

The basic financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Accordingly, all assets, deferred outflows of resources, liabilities, and deferred inflows of resources (whether current or noncurrent) are included on the Statement of Net Position. The Statement of Revenues, Expenses, and Changes in Net Position presents increases (revenues) and decreases (expenses) in total net position. 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.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

B. Measurement Focus, Basis of Accounting, and Basis of Presentation (Continued)

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.

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 unless they contradict or conflict with GASB Statement No. 61.

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 pro-rata 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 of accounting.

D. Restricted Cash with Fiscal Agents

Restricted cash with fiscal agents is comprised of funds reserved for capital projects and 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, which include land, construction in progress, buildings and improvements, improvements other than buildings, machinery and equipment, autos and trucks, equipment under capitalized leases, and infrastructure assets (e.g., roads, bridges, traffic signals, and similar items), are reported in the Government-Wide Financial Statements. County policy has set the capitalization threshold for reporting capital assets at \$5,000 for equipment and vehicles and \$25,000 for infrastructure, buildings, and structures. Capital assets are valued at historical cost or estimated historical cost if actual historical cost was not available. Donated assets are valued at their estimated market value on the date donated.

Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets as follows:

Infrastructure	4-65 years
Buildings and structures	10-50 years
Equipment and vehicles	3-15 years

For infrastructure systems, the County elected to use the "Basic Approach" as defined by GASB Statement No. 34 for infrastructure reporting.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

F. Capital Assets (Continued)

The County defines infrastructure as the basic physical assets that allow the County to function. The assets include streets, bridges, sidewalks, drainage systems, etc. Each major infrastructure system can be divided into subsystems. For example, the street system can be subdivided into pavement, curb and gutters, sidewalks, medians, streetlights, landscaping, and land. These subsystems were not delineated in the basic financial statements. The appropriate operating department maintains information regarding the subsystems.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest on construction-related debt incurred during the period of construction is capitalized as a cost of the constructed assets.

Maintenance and repairs are charged to operations when incurred. Betterments and major improvements which significantly increase values, change capacities, or extend useful lives are capitalized. Upon sale or retirement of capital assets, the cost and related accumulated depreciation are removed from the respective accounts and any resulting gain or loss is included in the results of the operations.

G. Net Position

In the Statement of Net Position, net position is classified in the following categories:

Net Investment in Capital Assets – 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.

Unrestricted Net Position – This amount consists of all net position that does not meet the definition of “net investment in capital assets” or “restricted net position.”

H. Use of Estimates

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

I. Effect of New Governmental Accounting Standards Board Pronouncements

During the fiscal year ended June 30, 2019, the District implemented the following standards:

GASB Statement No. 83 – *Certain Asset Retirement Obligations*. The requirements of this statement are effective for reporting periods beginning after June 15, 2018. The District has not fully judged the effect of the implementation of GASB Statement No. 83 as of the date of the basic financial statements. There was no impact on the basic financial statements due to the implementation of this statement.

GASB Statement No. 88 – *Certain Disclosures Related to Debt, including Direct Borrowing and Direct Placements*. The requirements of this statement are effective for reporting periods beginning after June 15, 2018. There was no impact on the basic financial statements due to the implementation of this statement.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

J. Future Governmental Accounting Standards Board Pronouncements

Recently released standards by GASB affecting future fiscal years are as follows:

GASB Statement No. 84 – *Fiduciary Activities*. The requirements of this statement are effective for reporting periods beginning after December 15, 2018. The District has not fully judged the effect of the implementation of GASB Statement No. 84 as of the date of the basic financial statements.

GASB Statement No. 87 – *Leases*. The requirements of this statement are effective for reporting periods beginning after December 15, 2019. The District has not fully judged the effect of the implementation of GASB Statement No. 87 as of the date of the basic financial statements.

GASB Statement No. 89 – *Accounting for Interest Cost Incurred Before the End of a Construction Period*. The requirements of this statement are effective for reporting periods beginning after December 15, 2019. The District has not fully judged the effect of the implementation of GASB Statement No. 89 as of the date of the basic financial statements.

GASB Statement No. 90 – *Majority Equity Interest*. The requirements of this statement are effective for reporting periods beginning after December 15, 2018. The District has not fully judged the effect of the implementation of GASB Statement No. 90 as of the date of the basic financial statements.

GASB Statement No. 91 – *Conduit Debt Obligations*. The requirements of this statement are effective for reporting periods beginning after December 15, 2020. The District has not fully judged the effect of the implementation of GASB Statement No. 91 as of the date of the basic financial statements.

NOTE 2 – CASH AND INVESTMENTS

A. Cash

Cash and investments are presented on the Statement of Net Position as follows at June 30, 2019:

Cash and investments with County Treasurer, unrestricted	\$ 15,542,639
Restricted cash with fiscal agent	<u>7,000,000</u>
Total	<u><u>\$ 22,542,639</u></u>

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.

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.

NOTE 2 – CASH AND INVESTMENTS (Continued)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	10%	None
U.S. Treasury obligations	5 Years	100%	None
U.S. Government Agency obligations	5 Years	100%	25%
Bankers' acceptances	180 Days	40%	10%
Commercial paper	270 Days	25%	10%
Negotiable certificates of deposit	5 Years	30%	10%
Bank deposit	5 Years	10%	10%
Repurchase agreements	1 Year	100%	10%
Medium-term notes	5 Years	30%	10%
Mutual funds/money market mutual funds	N/A	20%	None
Local Agency Investment Fund (LAIF)	N/A	\$50 million	None
Joint Powers Authority investment fund	None	25%	None
Supranationals	5 Years	30%	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 value adjustment at the year-end was immaterial. The fair value of investments generally changes with fluctuations of interest rates. When interest rates fall, the fair value of investments increases, and conversely when interest rates rise, the fair value of investments could fall below the original cost of the investments.

Market interest rates remained relatively stable in fiscal year 2018/2019 resulting in no meaningful change in fair value of pooled investments as of June 30, 2019.

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.

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, 2019, in accordance with State law and the County's Investment Policy, the County did not have 10% 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.

NOTE 2 – CASH AND INVESTMENTS (Continued)

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. LAIF

The County is a participant in the 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, 2019, 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, 2019, the County had \$65,238,769 invested in LAIF, which had invested 0.02% of the pool investment funds in Structured Notes and Asset-Backed Securities as compared to 0.03% in the previous fiscal year. LAIF provided a fair value factor of 1.001711790 to calculate the fair value of the investments in LAIF. However, an adjustment was not made to reflect the fair value of LAIF, as the fair value adjustment was considered immaterial.

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

H. Investment in County Investment Pool

The District is an involuntary participant in the County Investment Pool that is regulated by California Government Code Section 16429 under the oversight of the Treasurer of the State of California. 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 pro-rata share of the fair value provided by the County for the entire County portfolio. The balance available for withdrawal is based on the accounting records maintained by the County, which are recorded on a fair market value basis.

In accordance with GASB Statement No. 72, investments in the County Treasurer's Investment Pool and restricted cash with fiscal agents are not subject to the three-tiered fair value hierarchy: Level 1, Level 2, and Level 3. The three-tiers are defined as follows:

Level 1 – reflect unadjusted quoted prices in active markets for identical assets.

Level 2 – reflect inputs that are based on a similar observable asset either directly or indirectly.

Level 3 – reflect unobservable inputs.

NOTE 3 – CAPITAL ASSETS

Capital assets at June 30, 2019, are as follows:

	Balance July 1, 2018	Additions	Deletions	Transfers	Balance June 30, 2019
Nondepreciable assets:					
Construction in progress	\$ 4,360,005	\$ 3,939,390	\$ (7,019)	\$ (1,238,347)	\$ 7,054,029
Total nondepreciable assets	4,360,005	3,939,390	(7,019)	(1,238,347)	7,054,029
Depreciable assets:					
Pumping stations	52,226,265	42,858	-	-	52,269,123
Transmission systems	128,008,956	296,421	-	1,238,347	129,543,724
Sewage treatment capacity rights	35,148,509	-	-	-	35,148,509
Mobile equipment	3,200,781	396,259	-	-	3,597,040
Other equipment	1,703,440	7,375	-	-	1,710,815
Total depreciable assets	220,287,951	742,913	-	1,238,347	222,269,211
Accumulated depreciation:					
Pumping stations	(24,919,089)	(1,056,618)	-	-	(25,975,707)
Transmission systems	(45,166,946)	(2,845,015)	-	-	(48,011,961)
Sewage treatment capacity rights	(16,740,353)	(912,948)	-	-	(17,653,301)
Mobile equipment	(2,751,657)	(135,775)	-	-	(2,887,432)
Other equipment	(1,254,646)	(137,717)	-	-	(1,392,363)
Total accumulated depreciation	(90,832,691)	(5,088,073)	-	-	(95,920,764)
Depreciable assets, net	129,455,260	(4,345,160)	-	1,238,347	126,348,447
Total capital assets, net	\$ 133,815,265	\$ (405,770)	\$ (7,019)	\$ -	\$ 133,402,476

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 fiscal year ended June 30, 2019, was \$5,088,073.

NOTE 4 – BONDS AND LOANS PAYABLE

The following is a summary of long-term liabilities transactions for the fiscal year ended June 30, 2019:

Description	Beginning Balance July 1, 2018	Additions/ Adjustments	Deletions	Ending Balance June 30, 2019	Amounts Due Within One Year	Amounts Due in More Than One Year
Special Assessment Bond:						
Limited Obligation Refunding Improvement Bonds	\$ 90,000	\$ -	\$ (90,000)	\$ -	\$ -	\$ -
Loans Payable:						
City of Santa Cruz	1,563,340	-	(1,563,340)	-	-	-
State Water Resources Control Board	9,239,477	-	(559,326)	8,680,151	573,309	8,106,842
IBank	-	7,000,000	-	7,000,000	-	7,000,000
Total Bonds and Loans Payable, Net	<u>\$ 10,892,817</u>	<u>\$ 7,000,000</u>	<u>\$ (2,212,666)</u>	<u>\$ 15,680,151</u>	<u>\$ 573,309</u>	<u>\$ 15,106,842</u>

A. 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. These bonds were paid off in the current fiscal year, leaving no amounts outstanding.

B. 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 were approximately \$48 million, of which the District's share was 47% or approximately \$24.4 million of the original principal amount. These funds were used to construct the treatment plant expansion, of which the District has capacity rights. On December 12, 2013, the City refunded the existing \$2.7 million 2005 Wastewater Bonds and \$16.0 million in State Revolving Funds, and issued \$18.7 million in 2013 Wastewater Revenue Refunding Bonds. These bonds were paid off in the current fiscal year, leaving no amounts outstanding.

C. State Water Resources Control Board Loan

During 2009, the District entered into a Project Finance Agreement (Agreement) with the State Water Resources Control Board (SWRCB) to finance the Aptos Transmission Main Relocation Project. Under this Agreement, the SWRCB has agreed to loan the District a total of \$16,725,699. As of June 30, 2019, the District had a balance of \$8,680,151 in loan disbursements pursuant to this Agreement. Pursuant to the Agreement, the interest rate is 2.5% and the District began making payments to repay the loan in the 2013/2014 fiscal year.

D. California Infrastructure and Economic Development Bank (IBank) Loan

In April 2019, the District entered into an Installment Sale Agreement (Agreement) with IBank to reduce the frequency of Sanitary Sewer Overflows (SSO) and, wherever possible, prevent SSO while meeting all applicable regulatory requirements by replacing old and deteriorated sewer lines prior to their failure. Under this Agreement, IBank has agreed to loan the District a total of \$7,000,000. Pursuant to the Agreement, the interest rate is 3.46% with the first principal payment due on August 1, 2020, with a loan maturity date of August 1, 2048. As of June 30, 2019, the District had a balance of \$7,000,000 in loan distributions pursuant to this Agreement.

NOTE 4 – BONDS AND LOANS PAYABLE (Continued)

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

Fiscal Year Ended June 30,	Loans Payable	
	Principal	Interest
2020	\$ 573,309	\$ 217,004
2021	731,667	442,379
2022	751,342	422,619
2023	771,555	402,316
2024	792,324	381,455
2025-2029	4,293,689	1,573,703
2030-2034	3,305,266	978,667
2035-2039	1,242,427	667,206
2040-2044	1,472,765	432,883
2045-2049	1,745,805	155,119
Sub-Total	\$ 15,680,151	\$ 5,673,352

NOTE 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, a joint powers authority whose purpose is to develop and fund programs of excess insurance for its member counties and public entities.

As of June 30, 2019, the workers' compensation self-insured retention is \$500,000.

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, claims exposures, 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.

NOTE 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's 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.

NOTE 6 – COMMITMENTS AND CONTINGENCIES (Continued)

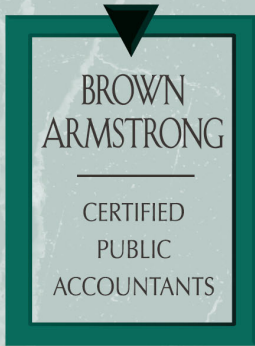
The District has received Federal grants for specific purposes that are subject to review and audit by the Federal government. Although such audits could result in expenditure disallowance under grant terms, the required reimbursements, if any, are not expected to be material.

The District entered into a construction installment sale agreement with the State Water Resources Control Board in October 2018 in the amount of \$5 million for the Soquel pump station force main replacement. Beginning one year after the completion of construction, repayment of the principal of the project funds, together with all interest accrued, shall be repaid annually for 30 years. As of June 30, 2019, the District has not drawn down on the agreement.

As of June 30, 2019, 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.

NOTE 7 – SUBSEQUENT EVENTS

Subsequent events have been evaluated through November 26, 2019, which is the day the financial statements were available to be issued. No events have occurred that would require disclosure.



BROWN ARMSTRONG

Certified Public Accountants

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

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

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We have audited, in accordance with the 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, the basic financial statements of the Santa Cruz County Sanitation District (the District), a component unit of the County of Santa Cruz (the County) as of and for the fiscal year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise the District's basic financial statements and have issued our report thereon dated November 26, 2019.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the County's internal control over financial reporting (internal control) relating to the District to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the County's internal control relating to the District. Accordingly, we do not express an opinion on the effectiveness of the County's internal control relating to the District.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's basic financial statements are free from material misstatement, we performed tests of the County's 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the County's internal control or on compliance relating to the District. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

*Brown Armstrong
Accountancy Corporation*

Bakersfield, California
November 26, 2019

**SANTA CRUZ COUNTY SANITATION DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2019**

CURRENT YEAR SCHEDULE OF FINDINGS AND QUESTIONED COSTS

None noted.

PRIOR YEAR SCHEDULE OF FINDINGS AND QUESTIONED COSTS

None noted.