

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, 2013

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Basic Financial Statements
For the year ended June 30, 2013

Table of Contents

	<u>Page</u>
<u>FINANCIAL SECTION</u>	
Independent Auditors' Report	1
Management's Discussion and Analysis	3
Basic Financial Statements:	
Statement of Net Position	11
Statement of Revenues, Expenses and Changes in Net Position	12
Statement of Cash Flows	13
Notes to the Basic Financial Statements	14
Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	25

INDEPENDENT AUDITORS' REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of the Santa Cruz County Sanitation District (District) as of and for the year ended June 30, 2013, 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 Financial Statements

Management is responsible for the preparation and fair presentation of these 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' 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 entity's preparation and fair presentation of the 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 entity'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 financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the District as of June 30, 2013, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements present only the District and do not purport to, and do not, present fairly the financial position of the County of Santa Cruz as of June 30, 2013, the changes in its financial position, or, where applicable, its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, on pages 3 through 8 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 December 18, 2013 on our consideration of the District's internal control over financial reporting and on 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 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 District's internal control over financial reporting and compliance.

Marcum LLP

Irvine, California
December 18, 2013

SANTA CRUZ COUNTY SANITATION DISTRICT
A Component Unit of Santa Cruz County
Management's Discussion and Analysis
June 30, 2013

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, 2013. 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 2012/2013 fiscal year by \$121,523,635 (net position). Of this amount, \$22,541,445 (unrestricted) may be used to meet ongoing obligations to citizens and creditors; \$1,255,964 is restricted for specific purpose (restricted for debt service); and \$97,726,226 is invested in capital, net investment in capital assets.
- The District's total net position increased by \$2,460,713. This increase is primarily attributable to an increase of \$715,791 in revenues from the customers, an increase of \$347,000 in donated sewer lines, and a decrease of \$2,420,816 in the District's total long-term debt.

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 assets. Over time, increases and decreases in net assets may serve as a useful indicator of whether or not the financial position of the District is improving or deteriorating.

The *statement of revenues, expenses, and changes in net 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 future fiscal period

SANTA CRUZ COUNTY SANITATION DISTRICT
A Component Unit of Santa Cruz County
Management's Discussion and Analysis
June 30, 2013

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

Notes to the Financial Statements

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

GOVERNMENT-WIDE FINANCIAL ANALYSIS

As noted earlier, net assets may serve as a useful indicator of a government's financial position. In the case of the District, assets exceeded liabilities by \$121,615,778 at the close of the most recent fiscal year. Further detail is provided in Table 1.

Table 1 – District's Net Position

	2013	2012	Increase (Decrease) %
Assets			
Current assets	22,737,175	27,922,190	-19%
Capital assets, net	119,210,261	114,699,782	4%
Noncurrent assets	1,677,942	1,498,699	12%
Total Assets	<u>143,625,378</u>	<u>144,120,671</u>	<u>-0.3%</u>
Deferred Outflows of Resources			
Deferred bond issuance costs	72,275	83,218	-13%
Total deferred outflows of resources	<u>72,275</u>	<u>83,218</u>	<u>-13%</u>
Liabilities			
Current liabilities	3,230,957	3,777,090	-14%
Long-term Liabilities	18,943,061	21,363,877	-11%
Total Liabilities	<u>22,174,018</u>	<u>25,140,967</u>	<u>-12%</u>
Fund Net Position			
Invested in capital assets, net of related debt	97,726,226	90,957,192	7%
Restricted	1,255,964	1,443,622	-13%
Unrestricted	22,541,445	26,662,108	-15%
Total Fund Net Position	<u>121,523,635</u>	<u>119,062,922</u>	<u>2%</u>

SANTA CRUZ COUNTY SANITATION DISTRICT
A Component Unit of Santa Cruz County
Management's Discussion and Analysis
June 30, 2013

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

- Capital, net have increased by \$4,510,479. Further information is presented under the Capital Asset and Long-Term Debt section of this Management's Discussion and Analysis.
- Long-term liabilities have decreased by \$2,420,816. The substantial decrease is the result of bond & loans payments of \$2,459,822. Further information is presented under the Capital Asset and Long-Term Debt section of this Management's Discussion and Analysis.

Analysis of Net Position

The largest portion of the District's net position (\$97,726,226 (80%)) 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 position (\$1,255,964 (1%)) represents resources that are subject to external restrictions on how they may be used. The remaining balance of the District's net position (\$22,541,445 (19%)) is unrestricted and may be used to meet the District's ongoing obligations to citizens and creditors.

SANTA CRUZ COUNTY SANITATION DISTRICT
A Component Unit of Santa Cruz County
Management's Discussion and Analysis
June 30, 2013

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

Table 2 – Districts' Changes in Net Position

	2013	2012	Increase (Decrease) %
Revenues			
Program Revenues			
Charges for services	21,326,540	20,610,749	3%
General Revenues			
Taxes - special assessments	92,170	89,946	2%
Aid from other governmental agencies	(17,440)	1,774,213	-101%
Investment income	34,891	169,058	-79%
Contributions and donations	347,000	352,750	-2%
Gain on sale of capital assets	31,819	13,088	143%
Total Revenue	<u>21,814,980</u>	<u>23,009,804</u>	<u>-5%</u>
Expenses			
Sanitation District	<u>19,354,267</u>	<u>17,687,071</u>	<u>9%</u>
Total Expenses	<u>19,354,267</u>	<u>17,687,071</u>	<u>9%</u>
Change in Net Position	2,460,713	5,322,733	-54%
Net Position, Beginning, as restated	<u>119,062,922</u>	<u>113,740,189</u>	<u>5%</u>
Net Position, Ending	<u><u>121,523,635</u></u>	<u><u>119,062,922</u></u>	<u><u>2%</u></u>

Analysis of Changes in Net Position

The District's Change in Net Position is \$2,460,713 for the current fiscal year. This is a decrease of \$2,862,020 over the prior year. This decrease is primarily attributable to a decrease in aid from other government agencies during the 2012/2013 fiscal year.

SANTA CRUZ COUNTY SANITATION DISTRICT
A Component Unit of Santa Cruz County
 Management's Discussion and Analysis
 June 30, 2013

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The District's Capital, net investment in capital assets as of June 30, 2013, amounted to \$97,726,226. 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 \$4,510,479 or 4%.

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

- Transmission Systems increase of \$22,495,426 is due mainly to the completion of the Aptos Transmission Main Relocation project totaling \$21,204,882

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

	2013	2012	Increase (Decrease) %
Pumping station	\$ 41,131,129	\$ 39,484,678	4%
Transmission systems	95,510,615	73,015,189	31%
Sewage treatment plant	35,148,509	35,038,480	0.3%
Construction in progress	10,779,667	26,868,373	-60%
Mobile equipment	3,587,296	3,690,964	-3%
Other equipment	2,633,096	2,520,682	4%
Total cost	188,790,312	180,618,366	5%
Less accumulated depreciation	(69,580,051)	(65,918,584)	6%
Capital assets, net	\$ 119,210,261	\$ 114,699,782	4%

SANTA CRUZ COUNTY SANITATION DISTRICT
A Component Unit of Santa Cruz County
Management's Discussion and Analysis
June 30, 2013

Long-Term Debt

At June 30, 2013, the District had total long-term debt outstanding of \$21,484,035 (including current portion of \$2,545,822) as compared to \$23,742,592 (including current portion of \$2,453,203) in the prior year. This current year amount was comprised of \$4,710,000 of revenue bonds (including current portion of \$800,000); \$475,000 of special assessments bonds (including current portion of \$70,000); \$16,275,665 of loans payable (including current portion of \$1,673,587); and \$23,370 of unamortized bond charges.

Pollution Remediation Obligations

The District is responsible for pollution clean-up costs for the Rio Del Mar Pump Station Storage Tank Site. The District has contracted with a consultant to develop a corrective action plan for the Rio Del Mar Pump Station Storage Tank Site. 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.

BASIC FINANCIAL STATEMENTS

This page intentionally left blank

SANTA CRUZ COUNTY SANITATION DISTRICT
A COMPONENT UNIT OF SANTA CRUZ COUNTY

Statement of Net Position
June 30, 2013

ASSETS

Current Assets:

Cash and investments with County Treasurer, unrestricted	\$ 22,722,985	
Inventories	14,190	
Total Current Assets		22,737,175

Noncurrent assets:

Cash and investments with County Treasurer, restricted	652,928	
Cash and investments with fiscal agents	969,937	
Capital asset, net	119,210,261	
Promissory note receivable	55,077	
Total Non-current Assets		120,888,203

Total Assets

143,625,378

DEFERRED OUTFLOWS OF RESOURCES

Deferred bond issuance costs		72,275
Total deferred outflows of resources		72,275

LIABILITIES

Current Liabilities:

Accounts payable and accrued liabilities	333,931	
Accrued bond interest	351,204	
Bonds and loans payable, current portion	2,545,822	
Total Current Liabilities		3,230,957

Noncurrent Liabilities:

Bonds and loans payable, net	18,938,213	
Pollution remediation liability	4,848	
Total Non-current Liabilities		18,943,061

Total Liabilities

22,174,018

NET POSITION

Net investment in capital assets	97,726,226	
Restricted for Debt Service	1,255,964	
Unrestricted	22,541,445	
Total Net Position		\$ 121,523,635

See accompanying Notes to Basic Financial Statements

SANTA CRUZ COUNTY SANITATION DISTRICT
A COMPONENT UNIT OF SANTA CRUZ COUNTY

Statement of Revenues, Expenses and
Changes In Net Position
For The Year Ended June 30, 2013

OPERATING REVENUES	
Charges for services	\$ 21,326,540
OPERATING EXPENSES	
General and administrative	4,603,651
Services and supplies	10,286,303
Depreciation	3,765,132
Total Operating Expenses	18,655,086
Operating Income	2,671,454
<u>NON-OPERATING REVENUES (EXPENSES)</u>	
Special assessments	92,170
Aid from other government agencies	(17,440)
Investment income	34,891
Contributions and donations	347,000
Bond interest and related fees	(699,181)
Gain on sale of fixed assets	31,819
Total Non-operating Revenues (Expenses)	(210,741)
Change in Net Position	2,460,713
Net Position - Beginning	119,062,922
Net Position - Ending	\$ 121,523,635

See accompanying Notes to Basic Financial Statements

SANTA CRUZ COUNTY SANITATION DISTRICT
A COMPONENT UNIT OF SANTA CRUZ COUNTY

Statement of Cash Flows
Year Ended June 30, 2013

Cash Flows from Operating Activities:	
Cash receipts from customers	\$ 21,326,540
Cash paid to suppliers for goods and services	(7,484,984)
Cash paid for interfund services used	(7,419,979)
Net Cash Provided By Operating Activities	<u>6,421,577</u>
Cash Flows from Noncapital Financing Activities:	
Subsidy from other government agencies	186,063
Net Cash Provided by Noncapital Financing Activities	<u>186,063</u>
Cash Flows From Capital and Related Financing Activities:	
Special Assessments	92,171
Acquisition and construction of capital assets	(8,573,612)
Principal paid on capital debt	(2,459,822)
Interest paid on capital debt	(731,161)
Other receipts (payments)	31,819
Net Cash Used by Capital and Related Financing Activities	<u>(11,640,605)</u>
Cash Flows from Investing Activities:	
Interest and investment income received	34,891
Net Cash Provided by Investing Activities	<u>34,891</u>
Net Decrease in Cash and Investments	(4,998,074)
Cash and Investments, Beginning	<u>29,343,924</u>
Cash and Investments, Ending	<u><u>\$ 24,345,850</u></u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:	
Operating income	\$ 2,671,454
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	3,765,132
Changes in assets and liabilities:	
Accounts receivable	8,200
Inventories	
Pollution remediation liability	(21,729)
Accounts payable	(1,480)
Net Cash Provided by Operating Activities	<u><u>\$ 6,421,577</u></u>
Supplemental Data	
Cash and investments with County Treasurer, unrestricted	\$ 22,722,985
Cash and investments with fiscal agents	\$ 969,937
Cash and investments with County Treasurer, restricted	<u>\$ 652,928</u>
Cash and Investments, Ending	<u><u>\$ 24,345,850</u></u>

See accompanying Notes to Basic Financial Statements

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Notes to the Basic Financial Statements
For the year ended June 30, 2013

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% 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 financial statements are presented as an enterprise fund and as a discretely presented component unit in the County's financial statements, pursuant to Governmental Accounting Standards Board Statement (GASB) No. 14.

The District does not have employees. All employees are employees of the county's Department of Public Works. The county charges the District a weighted labor rate for work performed on behalf of the District.

B. *Basis of Accounting/Measurement Focus*

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 resource 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.

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, 2013

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

B. Basis of Accounting/Measurement Focus, Continued

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

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

The District applies all applicable GASB pronouncements as well as the Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARB) of the American Institute of Certified Public Accountants' Committee on Accounting Procedures issued on or before November 30, 1989, unless those pronouncements conflict with or contradict 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 any time 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 at cost using the FIFO method (first-in, first-out).

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, 2013

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

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.

G. Deferred Outflows and Inflows of Resources

Deferred outflows of resources, consisting of \$72,275 of deferred bond issuance costs at June 30, 2013, and deferred inflows of resources are recognized in accordance with GASB Statement No. 63 and GASB Statement No. 65. Deferred outflows and inflows were items previously reported as assets and liabilities and are defined as "a consumption of net assets by the government that is applicable to a future reporting period, and an acquisition of net assets by the government that is applicable to a future reporting period, respectively."

H. 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.

I. 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.

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

Unrestricted Net Position - This amount consists of all net position that do not meet the definition of "net investment in capital assets" or "restricted net position."

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, 2013

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

J. 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 Position as follows at June 30, 2013:

Cash and investments with County Treasurer	\$ 22,722,985
Cash and investments with County Treasurer, restricted	652,928
Cash and investments with fiscal agents	<u>969,937</u>
Total	<u>\$ 24,345,850</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.

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.

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, 2013

2. CASH AND INVESTMENTS, Continued

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%
State of California obligations	5 years	10%	None
Banker's acceptances	180 days	40%	10%
Commercial paper	270 days	25%	10%
Negotiable certificates of deposit	5 years	30%	None
Nonnegotiable certificates of deposit	180 days	10%	10%
Repurchase agreements	1 year	100%	10%
Medium term notes	5 years	30%	10%
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 fair value. 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.

A rise in interest rates in June 2013 resulted in a material decrease in the fair value of pool investments at June 30, 2013. The District's portion of the decrease was \$92,143, which has been recorded in the financial statements.

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, 2013, 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.

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, 2013

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. *Local Agency Investment Fund*

The County is a participant in the Local Agency Investment Fund (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, 2013, 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, 2013, the County had \$50,024,364 invested in LAIF, which had invested 0.33% of the pool investment funds in Structured Notes and Asset-Backed Securities as compared to 0.51% in the previous year. LAIF provided a fair value factor of 1.000273207 to calculate the fair value of the investments in LAIF. However, an adjustment was not made to reflect the fair market value of LAIF, as the fair market 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.

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, 2013

3. CAPITAL ASSETS

Capital assets at June 30, 2013, are as follows:

	Balance July 1, 2012	Additions	Deletions	Reclassification	Balance June 30, 2013
Nondepreciable assets:					
Construction in progress	\$ 26,868,373	\$ 5,617,457	\$ -	\$ (21,706,163)	\$ 10,779,667
Total nondepreciable assets	26,868,373	5,617,457	-	(21,706,163)	10,779,667
Depreciable assets:					
Pumping stations	39,484,678	1,646,451	-	-	41,131,129
Transmission systems	73,015,189	789,263	-	21,706,163	95,510,615
Sewage treatment capacity rights	35,038,480	110,029	-	-	35,148,509
Mobile equipment	3,690,964	-	(103,668)	-	3,587,296
Other equipment	2,520,682	112,414	-	-	2,633,096
Total depreciable assets	153,749,993	2,658,157	(103,668)	21,706,163	178,010,645
Accumulated depreciation:					
Pumping stations	(19,235,515)	(878,352)	-	-	(20,113,867)
Transmission systems	(31,202,337)	(1,643,849)	-	-	(32,846,186)
Sewage treatment capacity rights	(11,263,847)	(875,126)	-	-	(12,138,973)
Mobile equipment	(2,533,314)	(214,413)	103,668	-	(2,644,059)
Other equipment	(1,683,571)	(153,395)	-	-	(1,836,966)
Total accumulated depreciation	(65,918,584)	(3,765,135)	103,668	-	(69,580,051)
Depreciable assets, net	87,831,409	(1,106,978)	-	21,706,163	108,430,594
Total capital assets, net	\$ 114,699,782	\$ 4,510,479	\$ -	\$ -	\$ 119,210,261

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, 2013, was \$3,765,132.

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, 2013

4. BONDS AND LOANS PAYABLE

The following is a summary of long-term liabilities transactions for the year ended June 30, 2013:

Description	Beginning Balance July 1, 2012	Deletions	Ending Balance June 30, 2013	Amounts Due Within One Year	Amounts Due More Than One Year
Revenue bond:					
2005 Wastewater Revenue Refunding Bonds	\$ 5,475,000	\$ (765,000)	\$ 4,710,000	\$ 800,000	\$ 3,910,000
Special assessment bond:					
Limited Obligation Refunding Improvement Bonds	540,000	(65,000)	475,000	70,000	405,000
Loans payable:					
City of Santa Cruz	10,070,213	(1,322,206)	8,748,007	1,359,228	7,388,779
State Water Resources Control Board	7,631,772	(104,114)	7,527,658	314,359	7,213,299
Unamortized bond charges	25,605	(2,235)	23,370	2,235	21,135
Total bonds and loans payable, net	<u>\$ 23,742,590</u>	<u>\$ (2,258,555)</u>	<u>\$ 21,484,035</u>	<u>\$ 2,545,822</u>	<u>\$ 18,938,213</u>

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, 2013 is \$4,710,000.

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		<u>\$ 21,326,540</u>
Operating expenses (excluding depreciation)	\$ 14,889,954	
2012 Debt Service - Principal	765,000	
2012 Debt Service - Interest	<u>229,231</u>	<u>\$ 15,884,185</u>
Coverage ratio		<u>134.26%</u>

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, 2013

4. BONDS AND LOANS PAYABLE, Continued

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, 2013 is \$475,000.

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, 2013 is \$8,748,007.

D. State Water Resources Control Board

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, 2013, the District has received a total of \$7,631,772 in loan disbursements pursuant to this Agreement. Pursuant to the Agreement, the interest rate is 2.5% and the District will begin to make payments to repay the loan in the 2012/2013 fiscal year.

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
2014	800,000	196,800	70,000	21,990	1,673,587	433,135	2,543,587	651,925
2015	840,000	160,000	75,000	18,599	1,719,505	387,219	2,634,505	565,818
2016	890,000	125,400	75,000	14,980	1,766,684	340,039	2,731,684	480,419
2017	940,000	84,100	80,000	11,123	1,815,161	291,562	2,835,161	386,785
2018	535,000	47,225	85,000	6,913	1,864,969	241,754	2,484,969	295,892
2019-2023	705,000	22,525	90,000	2,363	3,429,992	686,935	4,224,992	711,823
2024-2028					2,115,183	397,572	2,115,183	397,572
2029-2032					1,890,584	119,620	1,890,584	119,620
Sub-Total	\$ 4,710,000	\$ 636,050	\$ 475,000	\$ 75,968	\$ 16,275,665	\$ 2,897,836	21,460,665	\$ 3,609,854

Unamortized bond charges

23,370

Total

21,484,035

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, 2013

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 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, 2013, 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.

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, 2013, the District had construction contract commitments \$344,860.

The District contract commitments consisted of the following:

Park Avenue & Wesley Street Sewer	\$	229,868
Aptos Village Sewer Rehab		114,478
Aptos Transmission Line Relocation		514
Total	\$	<u>344,860</u>

As of June 30, 2013, 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.

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, 2013, the District identified the following sites which met one of the above obligating events:

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 District has contracted with a consultant for a corrective action plan, which has been approved. The estimated clean-up cost for the underground contamination and monitoring as of June 30, 2013, is approximately \$4,848.

At June 30, 2013, the District has recorded pollution remediation obligations in the amount of \$4,848.

**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, 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 financial statements of the Santa Cruz County Sanitation District (District), as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise District's basic financial statements, and have issued our report thereon dated December 18, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the District's internal control over financial reporting (internal control) 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 District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

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. 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 financial statements are free from 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*.

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 entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Marcum LLP

Irvine, California
December 18, 2013