

**SANTA CRUZ COUNTY
SANITATION DISTRICT
A Component Unit of Santa Cruz County**

AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2007

SANTA CRUZ COUNTY SANITATION DISTRICT
A Component Unit of Santa Cruz County
June 30, 2007

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BARTIG, BASLER & RAY, LLP

A GALLINA LLP COMPANY

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying basic financial statements of the Santa Cruz County Sanitation District, a component unit of the County of Santa Cruz, California, as of and for the year ended June 30, 2007, as listed in the table of contents. These basic financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Santa Cruz County Sanitation District as of June 30, 2007, and the changes in its financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

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

In accordance with *Government Auditing Standards*, we have also issued our report dated December 26, 2007, on our consideration of the Santa Cruz County Sanitation District internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants, agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*, and should be considered in assessing the results of our audit.

BARTIG, BASLER & RAY, LLP
A Gallina LLP Company

Bartig, Basler & Ray, LLP

December 26, 2007
Roseville, California

MANAGEMENT'S DISCUSSION AND ANALYSIS

SANTA CRUZ SANITATION DISTRICT
A Component Unit of Santa Cruz County
Management's Discussion and Analysis
June 30, 2007

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, 2007. 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 2006-2007 fiscal year by \$99,608,856 (net assets). Of this amount, \$32,535,156 (unrestricted net assets) may be used to meet ongoing obligations to citizens and creditors, \$971,080 is restricted for specific purpose (restricted net assets), and \$66,102,620 is invested in capital assets, net of related debt.
- The District's total net assets increased by \$3,466,121. This increase is primarily attributable to revenues from the customer service rates that included \$2,475,000 for the capital improvement program and \$1,650,316 for principal payments on long-term debt. The District's total long-term debt decreased by \$1,652,521 in comparison with the prior year. The decrease resulted primarily from scheduled principal retirements of bonds and loans payable.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

Government-wide Financial Statements

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

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

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

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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 \$99,608,856 at the close of the most recent fiscal year. Further detail is provided in Table 1.

Table 1 - District's Net Assets

	<u>Business-type Activities</u>		Increase (Decrease) %
	<u>2007</u>	<u>2006</u>	
Assets			
Current and other assets	\$ 34,929,052	\$ 33,234,401	5%
Capital assets, net	91,589,665	90,795,660	1%
Noncurrent assets	620,047	727,451	-15%
Total Assets	<u>127,138,764</u>	<u>124,757,512</u>	<u>2%</u>
Liabilities			
Current liabilities	3,739,548	3,125,497	20%
Long-term liabilities, net	23,790,360	25,489,280	-7%
Total Liabilities	<u>27,529,908</u>	<u>28,614,777</u>	<u>-4%</u>
Net Assets			
Invested in capital assets, net of related debt	66,102,620	63,656,064	4%
Restricted net assets	971,080	1,716,711	-43%
Unrestricted net assets	32,535,156	30,769,960	6%
Total Net Assets	<u>\$ 99,608,856</u>	<u>\$ 96,142,735</u>	<u>4%</u>

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

- Capital assets, net have increased by \$794,005. Further information is presented under the Capital Asset and Debt Administration section of this Management's Discussion and Analysis.
- Long-term liabilities, net have decreased by \$1,652,551. Further information is presented under the Capital Asset and Debt Administration section of this Management's Discussion and Analysis.

Analysis of Net Assets

The largest portion of the District's net assets \$66,102,620 (66%) reflects its investment in capital assets (e.g. pumping stations, transmission systems, mobile equipment, other equipment, sewage treatment plant, and construction in progress), less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the District's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the District's net assets, \$971,080 (1%) represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets, \$32,535,156 (33%) may be used to meet the government's ongoing obligations to citizens and creditors.

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Management's Discussion and Analysis
June 30, 2007

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

Table 2 - District's Changes in Net Assets

	Business-type Activities		Increase (Decrease) %
	2007	2006	
Revenues			
Program Revenues			
Charges for services	\$ 17,913,947	\$ 18,074,773	-1%
Contributions and donations	--	27,500	-100%
General Revenues			
Taxes - special assessments	92,253	97,653	-6%
Investment income	1,718,683	1,433,061	20%
Gain on sale of capital assets	16,893	1,475	1045%
Aid from other governmental agencies	78,338	95,899	-18%
Total Revenue	19,820,114	19,730,361	0%
Expenses			
Sanitation District	16,353,993	14,978,025	9%
Total Expenses	16,353,993	14,978,025	9%
Change in Net Assets	3,466,121	4,752,336	-27%
Net Assets, Beginning	96,142,735	91,390,399	5%
Net Assets, Ending	\$ 99,608,856	\$ 96,142,735	4%

Analysis of Changes Net Assets

The District's net assets increased by \$3,466,121 during the current fiscal year. This increase is primarily attributable to revenues from the customer service rates that included \$2,475,000 for the capital improvement program and \$1,650,316 for principal payments on long-term debt.

SANTA CRUZ SANITATION DISTRICT
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June 30, 2007

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The District's investment in capital assets, net for depreciation as of June 30, 2007, amounted to \$91,589,665. 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 \$794,005 or 1%.

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

- Pumping station increased by \$1,678,580 due mainly to the Rodeo Pump Station Project totaling \$1,413,000.
- Transmission systems increased by \$4,530,682 due mainly to the Soquel Avenue Rehabilitation, Riverview and the 16th and 4th Avenue projects.
- Construction in progress' net decrease of \$2,314,759 due mainly to the completion of Soquel Avenue Rehabilitation Project.

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

	<u>Business-type Activities</u>		Increase (Decrease) %
	<u>2007</u>	<u>2006</u>	
Pumping Station	\$ 34,610,256	\$ 32,931,676	5%
Transmission systems	62,256,942	57,726,260	8%
Sewage treatment plant	33,225,001	33,225,000	0%
Construction in progress	6,090,050	8,404,809	-28%
Mobile equipment	2,795,986	2,775,571	1%
Other equipment	2,141,436	2,006,883	7%
Total cost	<u>141,119,671</u>	<u>137,070,199</u>	3%
Less accumulated depreciation	<u>(49,530,006)</u>	<u>(46,274,539)</u>	7%
Capital assets, net	<u><u>\$ 91,589,665</u></u>	<u><u>\$ 90,795,660</u></u>	<u>1%</u>

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Management's Discussion and Analysis
June 30, 2007

Long-Term Debt

At June 30, 2007, the District had total long-term debt outstanding of \$25,487,045 (including current portion of \$1,696,685) as compared to \$27,139,596 (including current portion of \$1,650,316) in the prior year. This current year amount was comprised of \$8,450,000 of revenue bonds (including current portion of \$490,000), \$840,000 of special assessments bonds (including current portion of \$55,000), \$16,160,263 of loans payable (including current portion of \$1,151,685), and \$36,782 of unamortized bond charges.

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 –
FUND FINANCIAL STATEMENTS**

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

Statement of Net Assets
June 30, 2007

ASSETS

Current Assets:

Cash and investments with County Treasurer, unrestricted	\$ 33,869,882
Cash and investments with fiscal agents	993,080
Due from primary government	1,288
Inventories	64,802
Total Current Assets	<u>34,929,052</u>

Noncurrent Assets:

Cash and investments with County Treasurer, restricted	427,037
Capital assets, net	91,589,665
Deferred charges	137,933
Promissory note receivable	55,077
Total Noncurrent Assets	<u>92,209,712</u>

Total Assets	<u><u>\$ 127,138,764</u></u>
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LIABILITIES

Current Liabilities:

Accounts payable and accrued liabilities	\$ 1,504,786
Accrued bond interest	538,077
Bonds and loans payable, current portion	<u>1,696,685</u>
Total Current Liabilities	3,739,548

Noncurrent Liabilities:

Bonds and loans payable, net	<u>23,790,360</u>
Total Liabilities	<u>27,529,908</u>

NET ASSETS

Invested in capital assets, net of related debt	66,102,620
Restricted for debt service	971,080
Unrestricted	<u>32,535,156</u>
Total Net Assets	<u>99,608,856</u>

Total Liabilities and Net Assets	<u><u>\$ 127,138,764</u></u>
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The accompanying notes are an integral part of these financial statements.

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

Statement of Revenues, Expenses and
Changes in Net Assets
For the Year Ended June 30, 2007

OPERATING REVENUES	
Charges for services	\$ 17,913,947
OPERATING EXPENSES	
Operating expenses other than depreciation	12,125,747
Depreciation	3,387,328
Total Operating Expenses	<u>15,513,075</u>
Operating Income (Loss)	<u>2,400,872</u>
NON-OPERATING REVENUES (EXPENSES)	
Special assessments	92,253
Aid from other government agencies	78,338
Investment income	1,718,683
Bond interest and related fees	(840,918)
Gain on sale of capital assets	16,893
Total Nonoperating Revenues (Expenses)	<u>1,065,249</u>
Change in Net Assets	3,466,121
Net Assets - Beginning	<u>96,142,735</u>
Net Assets - Ending	<u>\$ 99,608,856</u>

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

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

Statement of Cash Flows
For the Year Ended June 30, 2007

Cash Flows from Operating Activities:	
Cash receipts from customers	\$ 18,001,447
Cash paid to suppliers for goods and services	(4,973,006)
Cash paid for interfund services used	<u>(6,237,820)</u>
Net Cash Provided (Used) by Operating Activities	<u>6,790,621</u>
Cash Flows from Non-Capital Financing Activities:	
Subsidy from other government agencies	<u>79,638</u>
Net Cash Provided (Used) by Non-Capital Financing Activities	<u>79,638</u>
Cash Flows from Capital and Related Financing Activities:	
Special assessments	92,253
Acquisition and construction of capital assets	(4,495,948)
Principal paid on capital debt	(1,650,316)
Interest paid on capital debt	(866,091)
Other receipts (payments)	<u>16,893</u>
Net Cash Provided (Used) by Capital and Related Financing Activities	<u>(6,903,209)</u>
Cash Flows From Investing Activities:	
Interest and investment income received	<u>1,718,683</u>
Net Cash Provided (Used) by Investing Activities	<u>1,718,683</u>
Net Increase (Decrease) in Cash and Investments	1,685,733
Cash and Investments, Beginning	<u>33,604,266</u>
Cash and Investments, Ending	<u><u>\$ 35,289,999</u></u>
Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities:	
Operating income (loss)	\$ 2,400,872
Adjustments to reconcile net operating income to net cash provided (used) by operating activities:	
Depreciation expense	3,387,328
Changes in assets and liabilities:	
Accounts receivable	87,500
Inventories	(1,257)
Accounts payable	<u>916,178</u>
Net Cash Provided (Used) by Operating Activities	<u><u>\$ 6,790,621</u></u>
Supplemental Data	
Cash and investments with County Treasurer, unrestricted	\$ 33,869,882
Cash and investments with fiscal agents	993,080
Cash and investments with County Treasurer, restricted	<u>427,037</u>
Cash and Investments, Ending	<u><u>\$ 35,289,999</u></u>

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

SANTA CRUZ SANITATION DISTRICT
A Component Unit of Santa Cruz County

Notes to the Basic Financial Statements
For the Year Ended June 30, 2007

Note 1: **Summary of Significant Accounting Policies**

A. Reporting Entity

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

1. Collection, by the Treasurer-Tax Collector, of approximately 100% of sewer charges included on the customers' tax bill by the Auditor-Controller's Office.
2. Collection of connection fees by the Planning Department.
3. Provision of investment services by the Treasurer.
4. Provision of legal services by the County Counsel.

The County Department of Public Works recovers its administrative costs from a 1% to 7% surcharge on all services performed. Surcharges related to construction and acquisition of sewage processing facilities have been capitalized in the accompanying financial statements.

These Sanitation District financial statements are accounted for as a component unit in the County of Santa Cruz's financial statements, pursuant to Governmental Accounting Standards Board Statement No. 14.

B. Basis of Presentation and Accounting

The financial statements of the Santa Cruz County Sanitation District (District) are prepared in accordance with Generally Accepted Accounting Principles (GAAP). The Fund applies all relevant Government Accounting Standards Board (GASB) pronouncements. Proprietary funds apply Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which case, GASB prevails.

The accompanying financial statements of the District are prepared on the accrual basis method of accounting in accordance with generally accepted accounting principles as applicable to governmental units.

SANTA CRUZ SANITATION DISTRICT
A Component Unit of Santa Cruz County

Notes to the Basic Financial Statements
For the Year Ended June 30, 2007

Note 1: **Summary of Significant Accounting Policies** (continued)

B. Basis of Presentation and Accounting (continued)

Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred or economic asset used. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place. Nonexchange transactions, in which the District gives (or receives) value without directly receiving (or giving) equal value in exchange, include property taxes. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied.

All activities of the District are accounted for within a single enterprise fund. Enterprise funds are used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

Operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. *Nonoperating* revenues, such as subsidies and investment earnings, result from nonexchange transactions or ancillary activities.

Nonexchange transactions, in which the District gives (or receives) value without directly receiving (or giving) equal value in exchange, include property and sales taxes, grants, entitlements and donations. In accordance with GASB No. 33, *Accounting and Reporting for Nonexchange Transactions*, revenue from property taxes is recognized in the fiscal year for which the taxes are levied and resources are available. Revenues from sales tax are recognized when the underlying transactions take place and the resources are available. Revenues from grants, entitlements and donations are recognized in the fiscal year in which all eligible requirements have been satisfied and the resources are available.

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

SANTA CRUZ SANITATION DISTRICT
A Component Unit of Santa Cruz County

Notes to the Basic Financial Statements
For the Year Ended June 30, 2007

Note 1: **Summary of Significant Accounting Policies** (continued)

C. Cash and Investments with County Treasurer

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

Required disclosures for the District's deposit and investment risks at June 30, 2007, were as follows:

Credit risk	Not rated
Custodial risk	N/A
Concentration of credit risk	N/A
Interest rate risk	Not available

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

D. Restricted Cash and Investments

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

E. Inventories

Inventories are recorded at estimated or actual cost, which approximates market, using the first-in/first-out (FIFO) method.

F. Capital Assets

Capital assets are stated at cost or estimated historical cost, if purchased, or fair market value, if donated. Depreciation has been provided over estimated useful lives, ranging from five to forty years, using the straight-line method. Depreciation related to certain property purchased with externally restricted resources or donated is closed to the contributed capital account on an annual basis.

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

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

SANTA CRUZ SANITATION DISTRICT
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Notes to the Basic Financial Statements
For the Year Ended June 30, 2007

Note 1: **Summary of Significant Accounting Policies** (continued)

G. Bond Discount and Issuance Costs

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

H. Equity Classifications

In the proprietary fund financial statements, equity is classified as net assets and divided into three components:

- *Invested In Capital Assets, Net of Related Debt* – This category groups all capital assets into one component of net assets. Accumulated depreciation and the outstanding balances of debt that are attributable to the acquisition, construction or improvement of these assets reduce the balance in this category.
- *Restricted Net Assets* – This category presents external restrictions imposed by creditors, grantors, contributors or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation.
- *Unrestricted Net Assets* – This category represents net assets of the District, not restricted for any project or other purpose.

When both restricted and unrestricted net assets are available, restricted resources are used for unrestricted purposes only after the unrestricted resources are depleted.

I. Estimates

The preparation of basic 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.

SANTA CRUZ SANITATION DISTRICT
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Notes to the Basic Financial Statements
For the Year Ended June 30, 2007

Note 2: **Pooled Cash and Investments**

Pooled Cash

The County maintains a cash and investment pool that is available for use by all funds with various financial institutions and a safekeeping agent, Bank of the West.

Statutes authorize the County to invest in obligations of the U.S. Treasury, agencies, and instrumentalities, commercial paper rated A-1 by Standard & Poor's Corporation or P-1 by Moody's Commercial Paper Record, banker's acceptances, repurchase agreements, and the State Treasurer's investment pool. The County is also authorized to enter into reverse repurchase agreements.

In accordance with the Governmental Accounting Standards Board Statement No, 3, *Deposits with Financial Institutions, Investments and Reverse Repurchase Agreements*, the District's deposits are categorized by the level of risk assumed by the County at year end. Category 1 includes deposits insured or collateralized with securities held by the District or its agent in the District's name. Category 2 includes deposits collateralized with securities held by the pledging financial institution's trust department or agent in the District's name. Category 3 includes uncollateralized deposits. The District had no deposits in Category 2 or 3.

District cash and investments by category as of June 30, 2007 are as follows:

<u>Description</u>	<u>Category 1</u>	<u>Carrying Value</u>	<u>Fair Value</u>
Cash in treasury	\$ 34,296,919	\$ 34,296,919	\$ 34,296,919
Cash with fiscal agent			
U.S. agency obligations	<u>993,080</u>	<u>993,080</u>	<u>993,080</u>
Total Cash and Investments	<u>\$ 35,289,999</u>	<u>\$ 35,289,999</u>	<u>\$ 35,289,999</u>

Cash with Fiscal Agent

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

SANTA CRUZ SANITATION DISTRICT
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Notes to the Basic Financial Statements
For the Year Ended June 30, 2007

Note 2: **Pooled Cash and Investments** (continued)

Governmental Accounting Standards Board Statement No. 31

The Governmental Accounting Standards Board (GASB) issued a statement effective for all years beginning after June 15, 1997 which requires that cash and investments be reported on a fair value basis with the related change in fair value being reflected in income of the period in which it occurs.

As of June 30, 2007, fair value represents 100.00% of the carrying value. The beginning value differences were immaterial and, therefore, no prior period adjustment was required.

Note 3: **Capital Assets**

Capital assets as of June 30, 2007 may be summarized as follows:

	Balance July 1, 2006	Additions	Retirements	Transfers & Adjustments	Balance June 30, 2007
<i>Capital assets, not being depreciated:</i>					
Construction in progress	\$ 8,404,809	\$ 3,894,504	\$ --	\$ (6,209,263)	\$ 6,090,050
Total capital assets, not being depreciated	8,404,809	3,894,504	--	(6,209,263)	6,090,050
<i>Capital assets, being depreciated:</i>					
Pumping stations	32,931,676	--	--	1,678,580	34,610,256
Transmission systems	57,726,260	--	--	4,530,682	62,256,942
Sewage treatment plants	33,225,000	--	--	1	33,225,001
Mobile equipment	2,775,570	152,276	(131,860)	--	2,795,986
Other equipment	2,006,883	134,553	--	--	2,141,436
Total capital assets, being depreciated	128,665,389	286,829	(131,860)	6,209,263	135,029,621
Less accumulated depreciation for:					
Pumping stations	(14,426,341)	(716,310)	--	--	(15,142,651)
Transmission systems	(22,930,952)	(1,413,589)	--	--	(24,344,541)
Sewage treatment plants	(5,912,664)	(862,987)	--	--	(6,775,651)
Mobile equipment	(1,566,026)	(238,650)	131,860	--	(1,672,816)
Other equipment	(1,438,555)	(155,792)	--	--	(1,594,347)
Total accumulated depreciation	(46,274,538)	(3,387,328)	131,860	--	(49,530,006)
Total capital assets, being depreciated, net	82,390,851	(3,100,499)	--	6,209,263	85,499,615
Total Capital Assets, net	<u>\$ 90,795,660</u>	<u>\$ 794,005</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ 91,589,665</u>

SANTA CRUZ SANITATION DISTRICT
A Component Unit of Santa Cruz County

Notes to the Basic Financial Statements
For the Year Ended June 30, 2007

Note 3: **Capital Assets** (continued)

The District owns 47% of capacity rights of the City of Santa Cruz Treatment Plant. Operation and maintenance of these treatment and outfall facilities are the responsibility of the City, with the Sanitation 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.

Note 4: **Bonds and Loans Payable**

The following is a summary of long-term liabilities transactions for the year ended June 30, 2007:

	Balance July 1, 2006	Additions	Deletions	Balance June 30, 2007	Amounts Due Within One Year
Revenue Bond:					
2005 Wastewater Revenue Refunding Bonds	\$ 8,925,000	\$ --	\$ 475,000	\$ 8,450,000	\$ 490,000
Special Assessment Bond:					
Limited Obligation Refunding Improvement Bond	895,000	--	55,000	840,000	55,000
Loans Payable:					
City of Santa Cruz	17,280,579	--	1,120,316	16,160,263	1,151,685
Unamortized Bond Charges	39,017	--	2,235	36,782	--
Total Bonds and Loans Payable, net	\$ 27,139,596	\$ --	\$ 1,652,551	\$ 25,487,045	\$ 1,696,685

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.

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

The City of Santa Cruz 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 available in fiscal year 1998/1999 was approximately \$48 million of which the District's share was 47% or approximately \$24.37 million in original principal amount. These funds were used to construct the treatment plant expansion of which the District has capacity rights. Interest accrued to date of completion has been added to principal.

SANTA CRUZ SANITATION DISTRICT
A Component Unit of Santa Cruz County

Notes to the Basic Financial Statements
For the Year Ended June 30, 2007

Note 4: **Bonds and Loans Payable** (continued)

Future maturities of bonds and loans payable are as follows:

Year Ending June 30:	Revenue Bonds		Special Assessment Bonds		Loan Payable		Total	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2008	490,000	329,452	55,000	36,795	1,151,684	452,487	1,696,684	818,734
2009	515,000	314,377	60,000	34,920	1,183,932	420,240	1,758,932	769,537
2010	535,000	298,627	60,000	32,730	1,217,082	387,090	1,812,082	718,447
2011	705,000	280,732	60,000	30,390	1,251,160	353,012	2,016,160	664,134
2012	730,000	256,262	65,000	27,825	1,286,193	317,980	2,081,193	602,067
2013-2017	4,235,000	795,531	365,000	91,721	6,991,759	1,029,100	11,591,759	1,916,352
2018-2022	1,240,000	69,750	175,000	9,276	3,078,453	174,146	4,493,453	253,172
Subtotal	<u>\$ 8,450,000</u>	<u>\$ 2,344,731</u>	<u>\$ 840,000</u>	<u>\$ 263,657</u>	<u>\$ 16,160,263</u>	<u>\$ 3,134,055</u>	<u>\$ 25,450,263</u>	<u>\$ 5,742,443</u>
Unamortized Bond Charges							36,782	
Total							<u>\$ 25,487,045</u>	

Note 5: **Employees' Retirement System**

The District participates in the Public Employees Retirement System (PERS) which covers substantially all employees of the County of Santa Cruz. The District contributes moneys to PERS through administrative charges paid to the County of Santa Cruz. For a complete description of the retirement plan, see the County of Santa Cruz financial statements.

Note 6: **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, medical malpractice, and employees' dental coverage. Management is not aware of any lawsuits or 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. Self-insurance limits per occurrence are presented in the statistical section of the County of Santa Cruz's comprehensive annual financial report.

OTHER REPORTS



BARTIG, BASLER & RAY, LLP

A GALLINA LLP COMPANY

CERTIFIED PUBLIC ACCOUNTANTS

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

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

We have audited the basic financial statements of the Santa Cruz County Sanitation District as of and for the year ended June 30, 2007, and have issued our report thereon dated December 26, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

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

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

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

Compliance and Other Matters

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

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

BARTIG, BASLER & RAY, LLP
A Gallina LLP Company

Bartig, Basler & Ray, LLP

December 26, 2007
Roseville, California