

**SANTA CRUZ COUNTY  
SANITATION DISTRICT**

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

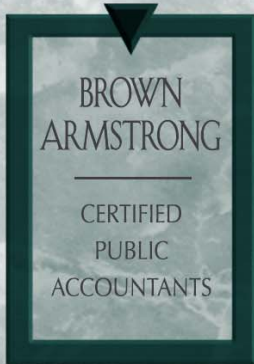
**BASIC FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORTS**

**JUNE 30, 2014**

**SANTA CRUZ COUNTY  
SANITATION DISTRICT  
JUNE 30, 2014**

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# BROWN ARMSTRONG

*Certified Public Accountants*

## INDEPENDENT AUDITOR'S 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 statement of net position of the Santa Cruz Sanitation District (the District) a component Unit of the County of Santa Cruz (the County), as of and for the year ended June 30, 2014, and the related statements of revenues, expenses, and changes in net position and cash flows for the year then ended, and the related notes to the 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 these financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's 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 these 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 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 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 financial statements.

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

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## Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the District, as of June 30, 2014, and the changes in its financial position and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

## Emphasis of Matters

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 as of June 30, 2014, and the changes in its financial position, or, where applicable, its cash flows for the year then ended, in conformity 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 information on pages 3-6 be presented to supplement the 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 12, 2014, on our consideration of the County's internal control over financial reporting relating to the District and on our tests of its 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.

This report is intended for the information and use of the audit committee, management, and Board of Directors of the District. However, this report is a matter of public record and its distribution is not limited.

BROWN ARMSTRONG  
ACCOUNTANCY CORPORATION

A handwritten signature in blue ink that reads "Brown Armstrong Accountancy Corporation". The signature is written in a cursive style.

Bakersfield, California  
November 12, 2014

**SANTA CRUZ COUNTY  
SANITATION DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
JUNE 30, 2014**

## **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, 2014. 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 2013/2014 fiscal year by \$121,390,042 (net position). Of this amount, \$25,013,225 (unrestricted) may be used to meet ongoing obligations to citizens and creditors; \$1,133,798 is restricted for specific purpose (restricted for debt service); and \$95,243,019 is net invested in capital assets.
- The District's total net position decreased by \$133,593. This decrease is primarily attributable to an increase of \$650,684 in revenues from the customers offset by an increase of \$2,685,574 in services and supplies expenses, and an increase of \$667,379 in the District's depreciation expense.

## **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 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*). 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 position may serve as a useful indicator of a government's financial position. In the case of the District, assets exceeded liabilities by \$121,390,042 at the close of the most recent fiscal year. Further detail is provided in the following table.

	2014	2013	Increase (Decrease) %
<b>Assets</b>			
Current assets	\$ 27,662,757	\$ 22,737,175	21.7%
Capital assets, net	118,455,757	119,210,261	-0.6%
Noncurrent assets	1,286,719	1,677,942	-23.3%
<b>Total Assets</b>	<b>147,405,233</b>	<b>143,625,378</b>	<b>2.6%</b>
<b>Liabilities</b>			
Current liabilities	5,664,602	3,230,957	75.3%
Long-term liabilities	20,350,589	18,870,786	7.8%
<b>Total Liabilities</b>	<b>26,015,191</b>	<b>22,101,743</b>	<b>17.7%</b>
<b>Net Position</b>			
Net invested in capital assets	95,243,019	97,726,226	-2.5%
Restricted	1,133,798	1,255,964	-9.7%
Unrestricted	25,013,225	22,541,445	11.0%
<b>Total Net Position</b>	<b>\$ 121,390,042</b>	<b>\$ 121,523,635</b>	<b>-0.1%</b>

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

- Capital assets, net have decreased by \$754,504. Further information is presented under the Capital Asset and Long-Term Debt section of this Management's Discussion and Analysis.
- Long-term liabilities have increased by \$1,479,803. The substantial increase is the result of a loan increase of \$4,494,316 offset by bond & loans payments of \$2,763,378. 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 (\$95,243,019 (78.5%)) reflects its net investment in capital assets (e.g., pumping stations, transmission systems, mobile equipment, other equipment, sewage treatment plant, and construction in progress), 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 (\$1,133,798 (0.9%)) represents resources that are subject to external restrictions on how they may be used. The remaining balance of the District's net position (\$25,013,225 (20.6%)) is unrestricted and may be used to meet the District's ongoing obligations to citizens and creditors.

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

	2014	2013	Increase (Decrease) %
<b>Revenues</b>			
Program Revenues			
Charges for services	\$ 21,977,224	\$ 21,326,540	3.1%
General Revenues			
Special assessments	93,064	92,170	1.0%
Aid from other governmental agencies	21,898	(17,440)	-225.6%
Investment income	229,497	34,891	557.8%
Contributions and donations	238,396	347,000	-31.3%
Gain on sale of capital assets	4,655	31,819	-85.4%
<b>Total Revenues</b>	<b>22,564,734</b>	<b>21,814,980</b>	<b>3.4%</b>
<b>Expenses</b>			
Sanitation District	22,698,327	19,354,267	17.3%
<b>Total Expenses</b>	<b>22,698,327</b>	<b>19,354,267</b>	<b>17.3%</b>
<b>Change in Net Position</b>	<b>(133,593)</b>	<b>2,460,713</b>	<b>-105.4%</b>
<b>Net Position, Beginning</b>	<b>121,523,635</b>	<b>119,062,922</b>	<b>2.1%</b>
<b>Net Position, Ending</b>	<b>\$ 121,390,042</b>	<b>\$ 121,523,635</b>	<b>-0.1%</b>

#### Analysis of Changes in Net Position

The District's Change in Net Position is \$(133,593) for the current fiscal year. This is a decrease of \$2,594,306 over the prior year. This decrease is primarily attributable to an increase of \$650,684 in revenues from the customers offset by an increase of \$2,685,574 in services and supplies expenses, and an increase of \$667,379 in the District's depreciation expense.

#### **CAPITAL ASSET AND DEBT ADMINISTRATION**

##### Capital Assets

The District's, net investment in capital assets as of June 30, 2014, amounted to \$95,243,019. This investment in capital assets includes 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 \$754,504 or 0.6%.

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

- Completed construction in progress reduced construction in progress by \$5,894,475 and increased pumping stations by \$881,229 and transmission systems by \$5,013,246. The remaining changes in capital assets were additions of \$4,516,622, deletions of \$1,209,619, and depreciation expense of \$4,432,512.

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

	2014	2013	Increase (Decrease) %
Pumping station	\$ 42,086,148	\$ 41,131,129	2.3%
Transmission systems	101,772,327	95,510,615	6.6%
Sewage treatment plant	35,148,509	35,148,509	0.0%
Construction in progress	7,029,417	10,779,667	-34.8%
Mobile equipment	3,666,097	3,587,296	2.2%
Other equipment	2,394,817	2,633,096	-9.0%
<b>Total cost</b>	<b>192,097,315</b>	<b>188,790,312</b>	<b>1.8%</b>
<b>Less accumulated depreciation</b>	<b>(73,641,558)</b>	<b>(69,580,051)</b>	<b>5.8%</b>
<b>Capital assets, net</b>	<b>\$ 118,455,757</b>	<b>\$ 119,210,261</b>	<b>-0.6%</b>

#### Long-Term Debt

At June 30, 2014, the District had total long-term debt outstanding of \$23,212,738 (including current portion of \$2,868,614) as compared to \$21,484,035 (including current portion of \$2,545,822) in the prior year. This current year amount was comprised of \$3,910,000 of revenue bonds (including current portion of \$840,000); \$405,000 of special assessments bonds (including current portion of \$75,000); and \$18,876,603 of loans payable (including current portion of \$1,951,379). The majority of the increase relates to increases to the loans payable for the State Water Resources Control Board of \$4,350,138 and the City of Santa Cruz of \$144,178 offset by bond and loan payments of \$2,763,378.

#### 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**

**SANTA CRUZ COUNTY  
SANITATION DISTRICT  
STATEMENT OF NET POSITION  
JUNE 30, 2014**

	2014
<b>ASSETS</b>	
Current Assets:	
Cash and investments with County Treasurer, unrestricted	\$ 27,648,822
Inventories	13,935
Total Current Assets	27,662,757
Noncurrent assets:	
Cash and investments with County Treasurer, restricted	261,705
Cash and investments with fiscal agents	969,937
Capital asset, net	118,455,757
Promissory note receivable	55,077
Total Noncurrent Assets	119,742,476
<b>Total Assets</b>	<b>147,405,233</b>
<b>LIABILITIES</b>	
Current Liabilities:	
Accounts payable and accrued liabilities	2,593,103
Accrued bond interest	202,885
Bonds and loans payable, current portion	2,868,614
Total Current Liabilities	5,664,602
Noncurrent Liabilities:	
Bonds and loans payable, net	20,344,124
Pollution remediation liability	6,465
Total Noncurrent Liabilities	20,350,589
<b>Total Liabilities</b>	<b>26,015,191</b>
<b>NET POSITION</b>	
Net investment in capital assets	95,243,019
Restricted for debt service	1,133,798
Unrestricted	25,013,225
<b>Total Net Position</b>	<b>\$ 121,390,042</b>

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, 2014**

	2014
<b>OPERATING REVENUES</b>	
Charges for services	\$ 21,977,224
<b>OPERATING EXPENSES</b>	
General and administrative	4,438,926
Services and supplies	12,971,877
Depreciation	4,432,511
<b>Total Operating Expenses</b>	21,843,314
Operating Income	133,910
<b><u>NON-OPERATING REVENUES (EXPENSES)</u></b>	
Special assessments	93,064
Aid from other government agencies	21,898
Investment income	229,497
Contributions and donations	238,396
Bond interest and related fees	(855,013)
Gain on sale of fixed assets	4,655
<b>Total Non-operating Revenues (Expenses)</b>	(267,503)
<b>Change in Net Position</b>	(133,593)
<b>Net Position - Beginning</b>	121,523,635
<b>Net Position - Ending</b>	\$ 121,390,042

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, 2014**

	2014
<b>Cash Flows from Operating Activities:</b>	
Cash receipts from customers	\$ 21,977,224
Cash paid to suppliers for goods and services	(8,684,654)
Cash paid for interfund services used	(7,317,291)
<b>Net Cash Provided by Operating Activities</b>	<b>5,975,279</b>
<b>Cash Flows from Noncapital Financing Activities:</b>	
Subsidy from other government agencies	191,076
<b>Net Cash Provided by Noncapital Financing Activities</b>	<b>191,076</b>
<b>Cash Flows From Capital and Related Financing Activities:</b>	
Special assessments	93,064
Acquisition and construction of capital assets	(2,825,823)
Principal paid on capital debt	(2,763,378)
Interest paid on capital debt	(719,896)
Other receipts (payments)	4,354,795
<b>Net Cash Used in Capital and Related Financing Activities</b>	<b>(1,861,238)</b>
<b>Cash Flows from Investing Activities:</b>	
Interest and investment income received	229,497
<b>Net Cash Provided by Investing Activities</b>	<b>229,497</b>
<b>Net Increase in Cash and Investments</b>	4,534,614
<b>Cash and Investments, Beginning</b>	<b>24,345,850</b>
<b>Cash and Investments, Ending</b>	<b>\$ 28,880,464</b>

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

**SANTA CRUZ COUNTY  
SANITATION DISTRICT  
STATEMENT OF CASH FLOWS (Continued)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

**Reconciliation of Operating Income to Net Cash**

**Provided by Operating Activities:**

Operating income	\$ 133,910
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	4,432,511
Changes in assets and liabilities:	
Accounts receivable	255
Accounts payable	1,408,603
	1,408,603
<b>Net Cash Provided by Operating Activities</b>	<b>\$ 5,975,279</b>

**Supplemental Data**

Cash and investments with County Treasurer, unrestricted	\$ 27,648,822
Cash and investments with fiscal agents	969,937
Cash and investments with County Treasurer, restricted	261,705
	261,705
<b>Cash and Investments, Ending</b>	<b>\$ 28,880,464</b>

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

**SANTA CRUZ COUNTY  
SANITATION DISTRICT  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
JUNE 30, 2014**

**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. Descriptions of 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 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'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 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.

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 prorated share of the fair value provided by the County for the entire investment pool. The balance available for withdrawal is based on the accounting records maintained by the County, which are recorded on an amortized cost basis.

**D. Restricted Cash and Investments**

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

**E. Inventories**

Inventories consist of materials and supplies which are valued using the FIFO method (first-in, first-out).

**F. Capital Assets**

Capital assets, 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 & 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 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. Deferred Outflows and Inflows of Resources

Deferred outflows of resources 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. 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 does not meet the definition of “net investment in capital assets” or “restricted net position.”

### I. 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.

### J. Effect of New Governmental Accounting Standards Board Pronouncements

During the fiscal year ending June 30, 2014, the District implemented the following standards:

GASB Statement No. 66 – *Technical Corrections—2012—an Amendment of GASB Statements No. 10 and No. 62*. There was no effect on the District’s accounting or financial reporting as a result of implementing this standard.

GASB Statement No. 67 – *Financial Reporting for Pension Plans—an Amendment of GASB Statement No. 25*. There was no effect on the District’s accounting or financial reporting as a result of implementing this standard.



**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

J. Effect of New Governmental Accounting Standards Board Pronouncements (Continued)

GASB Statement No. 70 – *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. There was no effect on the District’s accounting or financial reporting as a result of implementing this standard.

K. Future Governmental Accounting Standards Board Pronouncements

GASB Statement No. 68 – *Accounting and financial Reporting for Pensions—an Amendment of GASB Statement No. 27* will improve the decision-usefulness of information in employer and governmental nonemployer contributing entity financial reports and will enhance its value for assessing accountability and interperiod equity by requiring recognition of the entire net pension liability and a more comprehensive measure of pension expense. Decision-usefulness and accountability also will be enhanced through new note disclosures and required supplementary information. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2014. The District is assessing, but has not yet determined the effects of the implementation of this statement on its financial statements.

GASB Statement No. 69 – *Government Combinations and Disposals of Government Operations* provides specific accounting and financial reporting guidance for combinations in the governmental environment. This statement also improves the decision usefulness of financial reporting by requiring that disclosures be made by governments about combination arrangements in which they engage and for disposals of government operations. The requirements of this statement are effective for financial statements for periods beginning after December 15, 2013. The District is assessing, but has not yet determined the effects of the implementation of this statement on its financial statements.

GASB Statement No. 71 – *Pension Transition for Contributions Made Subsequent to the Measurement Date* amends paragraph 137 of GASB Statement No. 68 to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability. This Statement will eliminate the source of a potential significant understatement of restated beginning net position and expense in the first year of implementation of GASB Statement No. 68 in the accrual basis financial statements of employers and nonemployer contributing entities. The provisions of this Statement should be applied simultaneously with the provisions of GASB Statement No. 68 and therefore are effective for financial periods beginning after June 15, 2014. The District is assessing, but has not yet determined the effects of the implementation of this statement on its financial statements.

**NOTE 2 – CASH AND INVESTMENTS**

A. Pooled Cash

Cash and investments are presented on the Statement of Net Position as follows at June 30, 2014:

Cash and investments with County Treasurer	\$ 27,648,822
Cash and investments with County Treasurer, restricted	261,705
Cash and investments with fiscal agents	<u>969,937</u>
Total	<u>\$ 28,880,464</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.

**NOTE 2 – CASH AND INVESTMENTS** (Continued)

**B. Cash Held with the Santa Cruz County Treasurer** (Continued)

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

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

**C. Investments**

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

<u>Authorized Investment Types</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage of Portfolio</u>	<u>Maximum Investment in One Issuer</u>
Local agency bonds	5 Years	10%	None
U.S. Treasury obligations	5 Years	100%	None
U.S. Government Agency obligations	5 Years	100%	25%
Banker's 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%	10%
Local Agency Investment Fund (LAIF)	N/A	\$50 million	None
Joint Powers Authority investment fund	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 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 the fiscal year 2013/2014 period resulting in no meaningful change in fair value of pooled investments as of June 30, 2014.

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.

## NOTE 2 – CASH AND INVESTMENTS (Continued)

### E. Concentration of Credit Risk

At June 30, 2014, 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.

### 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 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, 2014, 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, 2014, the County had \$40,023,755 invested in LAIF, which had invested 0.21% of the pool investment funds in Structured Notes and Asset-Backed Securities as compared to 0.33% in the previous year. LAIF provided a fair value factor of 1.00029875 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.

### NOTE 3 – CAPITAL ASSETS

Capital assets at June 30, 2014, are as follows:

	Balance July 1, 2013	Additions	Deletions	Reclassification	Balance June 30, 2014
Nondepreciable assets:					
Construction in progress	\$ 10,779,667	\$ 2,604,140	\$ (459,915)	\$ (5,894,475)	\$ 7,029,417
Total nondepreciable assets	10,779,667	2,604,140	(459,915)	(5,894,475)	7,029,417
Depreciable assets:					
Pumping stations	41,131,129	129,096	(55,306)	881,229	42,086,148
Transmission systems	95,510,615	1,627,165	(378,699)	5,013,246	101,772,327
Sewage treatment capacity rights	35,148,509	-	-	-	35,148,509
Mobile equipment	3,587,296	111,628	(32,827)	-	3,666,097
Other equipment	2,633,096	44,593	(282,872)	-	2,394,817
Total depreciable assets	178,010,645	1,912,482	(749,704)	5,894,475	185,067,898
Accumulated depreciation:					
Pumping stations	(20,113,867)	(914,326)	55,306	-	(20,972,887)
Transmission systems	(32,846,186)	(2,241,145)	-	-	(35,087,331)
Sewage treatment capacity rights	(12,138,973)	(949,587)	-	-	(13,088,560)
Mobile equipment	(2,644,059)	(191,497)	32,827	-	(2,802,729)
Other equipment	(1,836,966)	(135,956)	282,871	-	(1,690,051)
Total accumulated depreciation	(69,580,051)	(4,432,511)	371,004	-	(73,641,558)
Depreciable assets, net	108,430,594	(2,520,029)	(378,700)	5,894,475	111,426,340
Total capital assets, net	\$ 119,210,261	\$ 84,111	\$ (838,615)	\$ -	\$ 118,455,757

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, 2014, was \$4,432,511.

### NOTE 4 – BONDS AND LOANS PAYABLE

The following is a summary of long-term liabilities transactions for the year ended June 30, 2014:

Description	Beginning Balance July 1, 2013	Additions	Deletions	Ending Balance June 30, 2014	Amounts Due Within One Year	Amounts Due More Than One Year
Revenue bond:						
2005 Wastewater Revenue Refunding Bonds	\$ 4,710,000	\$ -	\$ (800,000)	\$ 3,910,000	\$ 840,000	\$ 3,070,000
Special assesment bond:						
Limited Obligation Refunding Improvement Bonds	475,000	-	(70,000)	405,000	75,000	330,000
Loans payable:						
City of Santa Cruz	8,748,007	144,178	(1,359,228)	7,532,957	1,444,657	6,088,300
State Water Resources Control Board	7,527,658	4,350,138	(534,150)	11,343,646	506,722	10,836,924
Unamortized bond charges	23,370	-	(2,235)	21,135	2,235	18,900
Total bonds and loans payable, net	\$ 21,484,035	\$ 4,494,316	\$ (2,765,613)	\$ 23,212,738	\$ 2,868,614	\$ 20,344,124

**NOTE 4 – BONDS AND LOANS PAYABLE** (Continued)

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, 2014 is \$3,910,000.

The terms of the Revenue Refunding Bonds require the District to prescribe, revise, and collect rates, fees, and charges for the services and facilities furnished by the Enterprise Fund during each fiscal year that are sufficient, after making allowances for contingencies, to pay for operation and maintenance costs, and the bond principal and interest payments that are due and payable during the fiscal year.

In addition to the gross revenues rate covenant, the District is required to prescribe, revise, and collect rates, fees, and charges for the services and facilities furnished by the District during each fiscal year which, taking into account allowances for contingencies, are sufficient to yield estimated Net Revenues at least equal to 125% of the aggregate amount of principal and interest on the bonds coming due and payable during the fiscal year.

**Calculation for Gross Revenue Rate Covenant:**

Charges for services		\$ 21,977,224
Operating expenses (excluding depreciation)		(17,410,803)
2014 Debt Service - Principal		(800,000)
2014 Debt Service - Interest		<u>(196,800)</u>
	<b>Coverage</b>	<u><u>\$ 3,569,621</u></u>

**Calculation for Net Revenue Rate Covenant:**

Charges for services		\$ 21,977,224
Operating expenses (excluding depreciation)		<u>(17,410,803)</u>
		4,566,421
2014 Debt Service - Principal	\$ 800,000	
2014 Debt Service - Interest	<u>196,800</u>	<u>996,800</u>
	<b>Coverage ratio</b>	458.11%

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, 2014 is \$405,000.

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 \$24.4 million in 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. The amount of the County's portion outstanding as of June 30, 2014 is \$7,532,957.

**NOTE 4 – BONDS AND LOANS PAYABLE** (Continued)**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, 2014, the District has received a total of \$11,981,910 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 2013/2014 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
2015	\$ 840,000	\$ 160,000	\$ 75,000	\$ 18,599	\$ 1,951,379	\$ 414,781	\$ 2,866,379	\$ 593,380
2016	890,000	125,400	75,000	14,980	2,003,738	362,422	2,968,738	502,802
2017	940,000	84,100	80,000	11,123	2,040,566	325,593	3,060,566	420,816
2018	535,000	47,225	85,000	6,913	2,078,103	288,056	2,698,103	342,194
2019	565,000	19,725	90,000	2,363	2,122,666	243,494	2,777,666	265,582
2020-2024	140,000	2,800	-	-	3,013,500	938,063	3,153,500	940,863
2025-2029	-	-	-	-	3,409,499	542,065	3,409,499	542,065
2030-2032	-	-	-	-	2,257,152	113,786	2,257,152	113,786
<b>Sub-total</b>	<b>\$ 3,910,000</b>	<b>\$ 439,250</b>	<b>\$ 405,000</b>	<b>\$ 53,978</b>	<b>\$ 18,876,603</b>	<b>\$ 3,228,260</b>	<b>\$ 23,191,603</b>	<b>\$ 3,721,488</b>

**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 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, 2014, 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.

As of June 30, 2014, the District had a construction contract commitment of \$6,488,000.

The District contract commitment consisted of the following:

Felt Street Sewer Line Replacement	\$ 6,488,000
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As of June 30, 2014, 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 – 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.

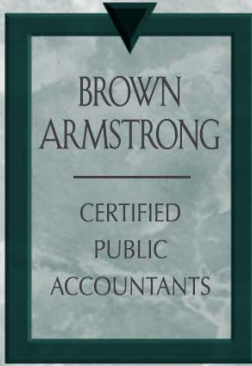
At June 30, 2014, the District identified the following sites which met one of the above obligating events:

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, 2014, is approximately \$6,465.

**NOTE 8 – SUBSEQUENT EVENTS**

Subsequent events have been evaluated through November 12, 2014, 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 financial statements of Santa Cruz County Sanitation District (the District), a component unit of the County of Santa Cruz, as of and for the year ended June 30, 2014, 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 12, 2014.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the County of Santa Cruz's (the County) 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 District'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 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 County's internal control and compliance relating to the District. Accordingly, this report is not suitable for any other purpose.

BROWN ARMSTRONG  
ACCOUNTANCY CORPORATION

*Brown Armstrong  
Accountancy Corporation*

Bakersfield, California  
November 12, 2014