

Santa Cruz County Sanitation District

A Component Unit of Santa Cruz County

Santa Cruz, California

*Basic Financial Statements
and Independent Auditors' Report*

For the year ended June 30, 2012

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Basic Financial Statements
For the year ended June 30, 2012

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INDEPENDENT AUDITORS' REPORT

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

We have audited the basic financial statements of the Santa Cruz County Sanitation District (District), a component unit of Santa Cruz County (County), as of and for the year ended June 30, 2012, as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the respective financial position of the District at June 30, 2012, and the respective changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report, dated December 21, 2012, on our consideration of the District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*, and should be read in conjunction with this report in assessing the results of our audit.



To the Board of Directors of
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Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, on pages 3 through 8, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Management decided to omit the fiscal 2010 financial information within its management discussion and analysis, on pages 3 through 8, that accounting principles generally accepted in the United States of America require to be presented when comparative fiscal year financial statements are presented. Such missing 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. Our opinion on the basic financial statements is not affected by this omission of the fiscal 2010 financial information for purposes of the management discussion and analysis.



Marcum LLP
Certified Public Accountants
Irvine, California
December 21, 2012

SANTA CRUZ COUNTY SANITATION DISTRICT
A Component Unit of Santa Cruz County
Management's Discussion and Analysis
June 30, 2012

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, 2012. 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 2011/2012 fiscal year by \$119,062,922 (net assets). Of this amount, \$26,662,108 (unrestricted net assets) may be used to meet ongoing obligations to citizens and creditors; \$1,443,622 is restricted for specific purpose (restricted for debt service); and \$90,957,192 is invested in capital assets, net of related debt.
- The District's total net assets increased by \$5,322,733. This increase is primarily attributable to an increase of \$953,948 in revenues from the customers, an increase of \$915,733 in aid from other governmental agencies, an increase of \$352,750 in donated sewer lines and a decrease of \$2,911,827 in the District's total long-term debt.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

Government-wide Financial Statements

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

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

The *statement of 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 \$119,062,922 at the close of the most recent fiscal year. Further detail is provided in Table 1.

Table 1 – District's Net Assets

	2012	2011	Increase (Decrease) %
Assets			
Current assets	27,922,190	28,762,513	-3%
Capital assets, net	114,699,782	111,177,200	3%
Noncurrent assets	1,581,917	1,667,712	-5%
Total Assets	<u>144,203,889</u>	<u>141,607,425</u>	<u>2%</u>
Liabilities			
Current liabilities	3,774,856	3,589,298	5%
Long-term Liabilities	21,366,111	24,277,938	-12%
Total Liabilities	<u>25,140,967</u>	<u>27,867,236</u>	<u>-10%</u>
Net Assets			
Invested in capital assets, net of related debt	90,957,192	84,866,835	7%
Restricted net assets	1,443,622	1,517,334	-5%
Unrestricted net assets	26,662,108	27,356,020	-3%
Total Net Assets	<u>119,062,922</u>	<u>113,740,189</u>	<u>5%</u>

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

- Capital assets, net have increased by \$3,522,582. Further information is presented under the Capital Asset and Long-Term Debt section of this Management's Discussion and Analysis.
- Long-term liabilities have decreased by \$2,911,827. The decrease is substantially the result of pay downs of bonds and loans payable of \$2,081,193. Further information is presented under the Capital Asset and Long-Term Debt section of this Management's Discussion and Analysis.

Analysis of Net Assets

The largest portion of the District's net assets (\$90,957,192 (76%)) reflects its investment in capital assets (e.g., pumping stations, transmission systems, mobile equipment, other equipment, sewage treatment plant, and construction in progress), less any related debts used to acquire those assets that are still outstanding. The District uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the District's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay these debts must be provided from other sources, since the capital assets themselves cannot be used to liquidate these debts.

An additional portion of the District's net assets (\$1,443,622 (1%)) represents resources that are subject to external restrictions on how they may be used. The remaining balance of the District's net assets (\$26,662,108 (23%)) is unrestricted and may be used to meet the District's ongoing obligations to citizens and creditors.

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Management's Discussion and Analysis
June 30, 2012

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

Table 2 – Districts' Changes in Net Assets

	2012	2011	Increase (Decrease) %
Revenues			
Program Revenues			
Charges for services	20,610,749	19,656,801	5%
General Revenues			
Taxes - special assessments	89,946	92,653	-3%
Aid from other governmental agencies	1,774,213	858,480	107%
Investment income	169,058	189,012	-11%
Contributions and donations	352,750	-	100%
Gain on sale of capital assets	13,088	-	100%
Total Revenue	<u>23,009,804</u>	<u>20,796,946</u>	<u>11%</u>
Expenses			
Sanitation District	<u>17,687,071</u>	<u>15,720,209</u>	<u>13%</u>
Total Expenses	<u>17,687,071</u>	<u>15,720,209</u>	<u>13%</u>
Change in Net Assets	5,322,733	5,076,737	5%
Net Assets, Beginning	<u>113,740,189</u>	<u>108,663,452</u>	<u>5%</u>
Net Assets, Ending	<u><u>119,062,922</u></u>	<u><u>113,740,189</u></u>	<u><u>5%</u></u>

Analysis of Changes Net Assets

The District's Change in Net Assets is \$5,322,733 for the current fiscal year. This is an increase of \$245,996 over the prior year. This increase is due to an increase in Contributions and donations for donated sewer lines associated with property developments during the 2011/12.

SANTA CRUZ COUNTY SANITATION DISTRICT
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Management's Discussion and Analysis
June 30, 2012

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The District's investment in capital assets, net of related debt as of June 30, 2012, amounted to \$90,957,192. 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 \$3,522,582 or 3%.

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

- Construction in progress net increase of \$4,962,277 is due mainly to costs incurred for the Aptos Transmission Main Relocation project totaling \$3,564,850.

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

	<u>2012</u>	<u>2011</u>	<u>Increase (Decrease) %</u>
Pumping station	\$ 39,484,678	\$ 39,153,144	1%
Transmission systems	73,015,189	71,792,589	2%
Sewage treatment plant	35,038,480	35,012,270	0%
Construction in progress	26,868,373	21,906,096	23%
Mobile equipment	3,690,964	3,627,721	2%
Other equipment	<u>2,520,682</u>	<u>3,227,252</u>	-22%
Total cost	180,618,366	174,719,072	3%
Less accumulated depreciation	<u>(65,918,584)</u>	<u>(63,541,872)</u>	4%
Capital assets, net	<u><u>\$ 114,699,782</u></u>	<u><u>\$ 111,177,200</u></u>	3%

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Long-Term Debt

At June 30, 2012, the District had total long-term debt outstanding of \$23,742,590 (including current portion of \$2,450,968) as compared to \$26,310,365 (including current portion of \$2,083,427) in the prior year. This current year amount was comprised of \$5,475,000 of revenue bonds (including current portion of \$765,000); \$540,000 of special assessments bonds (including current portion of \$65,000); \$17,701,985 of loans payable (including current portion of \$1,620,968); and \$25,605 of unamortized bond charges.

Pollution Remediation Obligations

The District is responsible for pollution clean-up costs for the Rio Del Mar Pump Station Storage Tank Site. The District has contracted with a consultant to develop a corrective action plan for the Rio Del Mar Pump Station Storage Tank Site. See Note 7 for further information.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the District's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Santa Cruz County Auditor-Controller, 701 Ocean Street, Room 100, Santa Cruz, CA 95060.

BASIC FINANCIAL STATEMENTS

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

Statement of Net Assets
June 30, 2012 and 2011

	2012	2011
ASSETS		
Current Assets:		
Cash and investments with County Treasurer, unrestricted	27,900,302	\$ 28,746,696
Accounts receivables	-	-
Due from primary government	8,202	-
	13,686	15,817
Total Current Assets	27,922,190	28,762,513
Noncurrent assets:		
Cash and investments with County Treasurer, restricted	473,685	548,537
Cash and investments with fiscal agents	969,937	969,937
Capital asset, net	114,699,782	111,177,200
Deferred charges	83,218	94,161
Promissory note receivable	55,077	55,077
Total Non-current Assets	116,281,699	112,844,912
Total Assets	\$ 144,203,889	\$ 141,607,425
LIABILITIES		
Current Liabilities:		
Accounts payable and accrued liabilities	928,966	1,115,509
Accrued bond interest	394,921	390,362
Bonds and loans payable, current portion	2,453,203	2,083,427
	3,777,090	3,589,298
Total Current Liabilities	3,777,090	3,589,298
Noncurrent Liabilities:		
Bonds and loans payable, net	21,289,389	24,226,938
Pollution remediation liability	74,488	51,000
Total Non-current Liabilities	21,363,877	24,277,938
Total Liabilities	25,140,967	27,867,236
NET ASSETS		
Invested in capital assets, net of related debt	90,957,190	84,866,835
Restricted	1,443,623	1,517,334
Unreserved	26,662,109	27,356,020
	119,062,922	113,740,189
Total Net Assets	119,062,922	113,740,189
Total Liabilities and Nets Assets	\$ 144,203,889	\$ 141,607,425

SANTA CRUZ COUNTY SANITATION DISTRICT
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Statement of Revenues, Expenses and
Changes In Net Assets
For The Years Ended June 30, 2012 and 2011

	2012	2011
OPERATING REVENUES		
Charges for services	\$ 20,610,749	\$ 19,656,801
OPERATING EXPENSES		
General and administrative	4,706,639	4,243,848
Service and supplies	9,100,833	6,983,450
Depreciation	3,264,266	3,859,459
Total Operating Expenses	17,071,738	15,086,757
Operating Income	3,539,011	4,570,044
<u>NON-OPERATING REVENUES (EXPENSES)</u>		
Special assessments	89,946	92,653
Aid from other government agencies	1,774,213	858,480
Investment income	169,058	189,012
Contributions and donations	352,750	-
Bond interest and related fees	(615,333)	(633,452)
Gain on sale of fixed assets	13,088	-
Total Non-operating Revenues	1,783,722	506,693
Change in Net Assets	5,322,733	5,076,737
Net Assets - Beginning	113,740,189	108,663,452
Net Assets - Ending	\$ 119,062,922	\$ 113,740,189

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

Statement of Cash Flows
Years Ended June 30, 2012 and 2011

	2012	2011
Cash Flows from Operating Activities:		
Cash receipts from customers	\$ 20,610,749	\$ 19,656,801
Cash paid to suppliers for goods and services	(6,445,889)	(5,199,211)
Cash paid for interfund services used	(7,367,427)	(6,605,051)
Net Cash Provided By Operating Activities	6,797,433	7,852,539
Cash Flows from Noncapital Financing Activities:		
Subsidy from other government agencies	986,719	877,134
Net Cash Provided by Noncapital Financing Activities	986,719	877,134
Cash Flows From Capital and Related Financing Activities:		
Special Assessments	89,946	92,653
Acquisition and construction of capital assets	(6,609,320)	(12,381,679)
Principal paid on capital debt	(2,081,193)	(2,016,160)
Interest paid on capital debt	(602,067)	(664,135)
Other receipts (payments)	328,178	6,836,321
Net Cash (Used) by Capital and Related Financing Activities	(8,874,456)	(8,133,000)
Cash Flows from Investing Activities:		
Interest and investment income received	169,058	189,012
Net Cash Provided by Investing Activities	169,058	189,012
Net Increase (Decrease) in Cash and Investments	(921,246)	785,685
Cash and Investments, Beginning	30,265,170	29,479,485
Cash and Investments, Ending	\$ 29,343,924	\$ 30,265,170
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Operating income (loss)	\$ 3,539,011	\$ 4,570,044
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	3,264,266	3,859,459
Changes in assets and liabilities:		
Accounts receivable	(11)	
Inventories	2,131	(313)
Pollution remediation liability	50,461	(529,051)
Accounts payable	(58,425)	(47,600)
Net Cash Provided by Operating Activities	\$ 6,797,433	\$ 7,852,539
Supplemental Data		
Cash and investments with County Treasurer, unrestricted	\$ 27,900,302	\$ 28,746,696
Cash and investments with fiscal agents	969,937	969,937
Cash and investments with County Treasurer, restricted	473,685	548,537
Cash and Investments, Ending	\$ 29,343,924	\$ 30,265,170

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Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Notes to the Basic Financial Statements
For the year ended June 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of Reporting Entity

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

1. Collection, by the Treasurer-Tax Collector, of sewer charges included on the customers' tax bill.
2. Collection of connection fees by the Planning Department.
3. Providing of investment services by the Treasurer.
4. Providing of legal services by the County Counsel.

The Department recovers its administrative costs from a 2.5% to 8.5% overhead surcharge on all services performed. Other charges related to construction and acquisitions of sewage processing facilities have been capitalized in the accompanying financial statements once the improvements or acquisitions have been completed.

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

The District does not have employee. All employees are employees of the County's Department of Public Works (PDW) employees. The County charges the District an overhead labor rate for work performed on behalf of the District.

B. Basis of Accounting/M Measurement Focus

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

The basic financial statements are prepared using the economic resource measurement focus and the accrual basis of accounting. Accordingly, all assets and liabilities (whether current or noncurrent) are included on the Statement of Net Assets. The Statement of Revenues, Expenses and Changes in Net Assets presents increases (revenues) and decreases (expenses) in total net assets. Under the accrual basis of accounting, revenues are recognized in the period in which they are earned while expenses are recognized in the period in which the liability is incurred.

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

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

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Notes to the Basic Financial Statements, Continued
For the year ended June 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

B. Basis of Accounting/Measurement Focus, Continued

The District has elected to apply all GASB pronouncements as well as any applicable pronouncements of the Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARB) of the Committee on Accounting Procedure issued on or before November 30, 1989, unless they contradict or conflict with GASB pronouncements.

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

C. Cash and Investments

The District maintains all of its cash and investments with the County Treasurer in an investment pool. On a monthly basis the County Treasurer allocates interest to participants based upon their average daily balances. Investments in the investment pool are highly liquid, as deposits and withdrawals can be made at anytime without penalty. The County does not impose any maximum investment limit. The fair value of the District's investment in this pool is reported in the accompanying financial statements at amounts based upon the District's prorated share of the fair value provided by the County for the entire investment pool. The balance available for withdrawal is based on the accounting records maintained by the County, which are recorded on an amortized cost basis. For purposes of the statement of cash flows, cash and investments include all investments, as noted prior the District operates in an investment pool which maintains the general characteristics of a demand deposit.

D. Restricted Cash and Investments

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

E. Inventories

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

F. Capital Assets

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

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

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

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Notes to the Basic Financial Statements, Continued
For the year ended June 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

G. Bond Discount and Issuance Costs

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

H. Net Assets

In the Statement of Net Assets, net assets are classified in the following categories:

Invested in Capital Assets, Net of Related Debt - This amount consists of capital assets net of accumulated depreciation and reduced by outstanding debt that is attributed to the acquisition, construction, or improvement of the assets.

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

Unrestricted Net Assets - This amount consists of all net assets that do not meet the definition of "invested in capital assets, net of related debt" or "restricted net assets."

I. Use of Estimates

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

2. CASH AND INVESTMENTS

A. Pooled Cash

Cash and investments are presented on the Statement of Net Assets as follows at June 30, 2012:

Cash and investments with County Treasurer	\$ 27,900,302
Cash and investments with County Treasurer, restricted	473,685
Cash and investments with fiscal agents	969,937
Total	\$ 29,343,924

B. Cash Held with the Santa Cruz County Treasurer

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

Santa Cruz County Sanitation District
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Notes to the Basic Financial Statements, Continued
For the year ended June 30, 2012

2. CASH AND INVESTMENTS, Continued

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

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

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

C. Investments

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

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

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

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

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Notes to the Basic Financial Statements, Continued
For the year ended June 30, 2012

2. CASH AND INVESTMENTS, Continued

D. Interest Rate Risk

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

E. Concentration of Credit Risk

At June 30, 2012, in accordance with State law and the County's Investment Policy, the County did not have 5% or more of its net investment in commercial paper, corporate bonds or medium term notes of a single organization, nor did it have 10% or more of its net investment in any one money market mutual fund. Investments in obligations of the U.S. government, U.S. government agencies, or government-sponsored enterprises are exempt from these limitations.

F. Custodial Credit Risk

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

G. Local Agency Investment Fund

The County is a participant in the Local Agency Investment Fund (LAIF) which is regulated by California Government Code Section 16429 under the oversight of the Treasurer of the State of California. The County's investments with LAIF at June 30, 2012, 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, 2012, the County had \$25,032,275 invested in LAIF, which had invested .51% of the pool investment funds in Structured Notes and Asset-Backed Securities as compared to .71% in the previous year. LAIF provided a fair value factor of 1.001219643 to calculate the fair value of the investments in LAIF. However, an adjustment was not made to reflect the fair market value of LAIF, as the fair market value adjustment was considered immaterial.

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

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Notes to the Basic Financial Statements, Continued
For the year ended June 30, 2012

3. CAPITAL ASSETS

Capital assets at June 30, 2012, are as follows:

	Balance July 1, 2011	Additions	Deletions	Reclassification	Balance June 30, 2012
Nondepreciable assets:					
Construction in progress	\$ 21,906,096	\$ 6,097,585	\$ -	\$ (1,135,308)	\$ 26,868,373
Total nondepreciable assets	21,906,096	6,097,585	-	(1,135,308)	26,868,373
Depreciable assets:					
Pumping stations	39,153,144	191	-	331,343	39,484,678
Transmission systems	71,792,589	418,635	-	803,965	73,015,189
Sewage treatment capacity rights	35,012,270	26,210	-	-	35,038,480
Mobile equipment	3,627,721	150,077	(86,834)	-	3,690,964
Other equipment	3,227,252	106,092	(812,662)	-	2,520,682
Total depreciable assets	152,812,976	701,205	(899,496)	1,135,308	153,749,993
Accumulated depreciation:					
Pumping stations	(18,383,272)	(852,243)	-	-	(19,235,515)
Transmission systems	(30,047,958)	(1,154,379)	-	-	(31,202,337)
Sewage treatment capacity rights	(10,440,717)	(823,130)	-	-	(11,263,847)
Mobile equipment	(2,364,109)	(256,041)	86,836	-	(2,533,314)
Other equipment	(2,305,816)	(178,473)	800,718	-	(1,683,571)
Total accumulated depreciation	(63,541,872)	(3,264,266)	887,554	-	(65,918,584)
Depreciable assets, net	89,271,104	(2,563,061)	(11,942)	1,135,308	87,831,409
Total capital assets, net	\$ 111,177,200	\$ 3,534,524	\$ (11,942)	\$ -	\$ 114,699,782

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, 2012, was \$3,264,266.

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Notes to the Basic Financial Statements, Continued
For the year ended June 30, 2012

4. BONDS AND LOANS PAYABLE

The following is a summary of long-term liabilities transactions for the year ended June 30, 2012:

Description	Beginning Balance July 1, 2011	Deletions	Ending Balance June 30, 2012	Amounts Due Within One Year	Amounts Due More Than One Year
Revenue bond:					
2005 Wastewater Revenue Refunding Bonds	\$ 6,205,000	\$ (730,000)	\$ 5,475,000	\$ 765,000	\$ 4,710,000
Special assessment bond:					
Limited Obligation Refunding Improvement Bonds	605,000	(65,000)	540,000	65,000	475,000
Loans payable:					
City of Santa Cruz	11,356,405	(1,286,192)	10,070,213	1,322,206	8,748,007
State Water Resources Control Board	8,116,120	(484,348)	7,631,772	298,762	7,333,010
Unamortized bond charges	27,840	(2,235)	25,605	2,235	23,370
Total bonds and loans payable, net	\$ 26,310,365	\$ (2,567,775)	\$ 23,742,590	\$ 2,453,203	\$ 21,289,387

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, 2012 is \$5,475,000.

The terms of the Revenue Refunding Bonds require the District to, among other things, maintain sewer services charge rates at a level to provide at least 125% of the aggregate revenue bond debt service of the subsequent year plus 100% of the operating expenses, excluding depreciation and amortization, of the current year.

Debt Service Coverage:

Charges for services		<u>\$ 20,610,749</u>
Operating expenses (excluding depreciation)	\$ 13,807,472	
2012 Debt Service - Principal	730,000	
2012 Debt Service - Interest	256,263	<u>\$ 14,793,735</u>
Coverage ratio		<u>139.32%</u>

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Notes to the Basic Financial Statements, Continued
For the year ended June 30, 2012

4. BONDS AND LOANS PAYABLE, Continued

B. Special Assessment Bonds

During 2004, special assessment bonds were issued for the financing of public improvements deemed to benefit the properties against which special assessment bonds were issued pursuant to the Improvement Act of 1911 or the Improvement Act of 1915. Special assessment bonds are collateralized by liens against properties of the assessment districts. Bonds are repaid from assessments levied against the properties that benefited from the improvements. The amount outstanding at June 30, 2012 is \$540,000.

C. City of Santa Cruz Loan

The City loan represents 47% of a State Water Resources Control Board loan with the City for which the District has an agreement to participate in the repayment. The total loan proceeds made available in fiscal year 1998/1999 was approximately \$48 million, of which the District's share was 47% or approximately \$24.37 million in original principal amount. These funds were used to construct the treatment plant expansion of which the District has capacity rights. The amount outstanding at June 30, 2012 is \$10,070,213.

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

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

Year Ending June 30,	Revenue Bonds		Special Assessment Bonds		Loans Payable		Total	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2013	765,000	229,231	65,000	25,030	1,620,968	472,760	2,450,968	727,021
2014	800,000	196,800	70,000	21,990	1,665,459	428,269	2,535,459	647,059
2015	840,000	160,000	75,000	18,599	1,711,173	382,555	2,626,173	561,154
2016	890,000	125,400	75,000	14,980	1,758,144	335,584	2,723,144	475,964
2017	940,000	84,100	80,000	11,123	1,806,406	287,321	2,826,406	382,544
2018-2022	1,240,000	69,750	175,000	9,276	4,855,207	671,028	6,270,207	750,054
2023-2027					2,010,233	437,548	2,010,233	437,548
2028-2032					2,274,395	173,387	2,274,395	173,387
Subtotal	\$ 5,475,000	\$ 865,281	\$ 540,000	\$ 100,998	\$ 17,701,985	\$ 3,188,452	23,716,985	\$ 4,154,731
Unamortized bond charges							25,605	
Total							\$ 23,742,590	

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Notes to the Basic Financial Statements, Continued
For the year ended June 30, 2012

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, 2012, the workers' compensation self insured retention is \$500,000.

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

Management is not aware of any claims pending against the District. There have been no reductions in the District's insurance coverage from the prior year and no settlement amounts have exceeded commercial insurance coverage.

6. COMMITMENTS AND CONTINGENCIES

There are various claims and legal actions pending against the District for which no provision has been made in the accompanying basic financial statements. In the opinion of the District management, liabilities arising from these claims and legal actions, if any, will not have an adverse material effect on the financial position of the District.

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

As of June 30, 2012, the District had construction contract commitments \$1,288,099.

The District contract commitments consisted of the following:

Aptos Transmission Line Relocation	\$	962,589
Corey, Carl & Pineknoll Liftstation Upgrade		325,510
	\$	<u>1,288,099</u>

Santa Cruz County Sanitation District
A Component Unit of Santa Cruz County
Notes to the Basic Financial Statements, Continued
For the year ended June 30, 2012

6. COMMITMENTS AND CONTINGENCIES, Continued

As of June 30, 2012, in the opinion of District Management, there were no additional outstanding matters that would have a significant effect on the financial position of the District.

7. POLLUTION REMEDIATION OBLIGATIONS

In accordance with GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, the District is required to estimate the components of expected pollution remediation outlays and determine whether outlays for those components should be accrued as liabilities or, if appropriate, capitalized when goods and services are acquired if one of the following five specified obligating events occurs:

- The District is compelled to take pollution remediation action because of an imminent endangerment;
- The District violates a pollution prevention-related permit or license;
- The District is named, or evidence indicates that it will be named, by a regulator as a responsible party or potentially responsible party for remediation, or as a government responsible for sharing costs;
- The District is named, or evidence indicates that it will be named, in a lawsuit to compel participation in pollution remediation;
- The District commences or legally obligates itself to commence pollution remediation.

At June 30, 2012, the District identified the following site 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, 2012, is approximately \$74,489, which the District has recorded as a pollution remediation obligation.



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

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

We have audited the financial statements of the business-type activities of the Santa Cruz County Sanitation District (District) as of and for the year ended June 30, 2012, and have issued our report thereon dated December 21, 2012. 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

Management of the District is responsible for establishing and maintaining effective internal control over financial reports. In planning and performing our audit, we considered the District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the District's financial statements will not be prevented, or detected and corrected on a timely basis.

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



To the Board of Directors
of the Santa Cruz County Sanitation District
Santa Cruz, California
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Compliance and Other Matters

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

This report is intended solely for the information and use of management, the Board of Directors, others within the entity, 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.

A handwritten signature in black ink that reads "Marcum LLP". The letters are cursive and fluid, with the "M" and "L" being particularly prominent.

Marcum LLP
Certified Public Accountants
Irvine, California
December 21, 2012