

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT

**FINANCIAL STATEMENTS
WITH
INDEPENDENT AUDITOR'S REPORT**

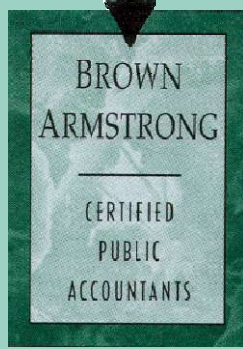
JUNE 30, 2009 AND 2008

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
JUNE 30, 2009 AND 2008**

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Santa Cruz Metropolitan Transit District
Santa Cruz, California

We have audited the accompanying basic financial statements of the Santa Cruz Metropolitan Transit District (Santa Cruz METRO), as of June 30, 2009 and 2008, as listed in the table of contents. These basic financial statements are the responsibility of the Santa Cruz Metropolitan Transit District's management. Our responsibility is to express an opinion on these basic financial statements based on our audits.

We conducted our audits 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in the notes to the financial statements, Santa Cruz METRO adopted the provisions of GASB Statements No. 45, *Accounting and Financial Reporting by Employers for Post Employment Benefits Other Than Pensions*, No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, and No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Santa Cruz Metropolitan Transit District, as of June 30, 2009 and 2008, and the results of its operations and the cash flows for the years 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 November 9, 2009, on our consideration of the Santa Cruz Metropolitan Transit District's internal control over financial reporting 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis (MD&A) and Required Supplementary Information (RSI), as listed in the Table of Contents, are not required parts of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the MD&A. However, we did not audit the MD&A and express no opinion on it. The RSI has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Our audit was performed for the purpose of forming an opinion on the basic financial statements of Santa Cruz Metropolitan Transit District, taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," and is not a required part of the financial statements. The accompanying statements of operating expenses by function are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION



Bakersfield, California
November 9, 2009

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2009 AND 2008**

Introduction

This report provides a narrative and analytical overview of the financial activities of the Santa Cruz Metropolitan Transit District (Santa Cruz METRO) with selected comparative information for the years ended June 30, 2009 and 2008. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

Santa Cruz METRO is an independent agency formed in 1969 by the legislature of the State of California for the purpose of providing transit service to the general public in Santa Cruz County. Santa Cruz METRO is governed by a Board of Directors composed of eleven members, and one ex-officio member as described in Note 1.A.

The Financial Statements

Santa Cruz METRO's basic financial statements are prepared using proprietary fund (enterprise fund) accounting that uses the same basis of accounting as private-sector business enterprises. Santa Cruz METRO reports its financial results using one enterprise fund under the accrual method of accounting which records revenue when earned and expenses when incurred.

The Condensed Statement of Net Assets present information on Santa Cruz METRO's assets and liabilities, with the difference between the two reported as net assets.

The Condensed Statement of Revenues, Expenses and Change in Fund Net Assets reports the *operating* revenues and expenses, *non-operating* revenues and expenses and *capital grant* contributions. *Capital grant* expenses are listed in the Schedule of Expenditures of Federal Awards and are included in the current year increase in fixed assets.

The Condensed Statement of Cash Flows reports the sources and uses of cash for the fiscal years resulting from *operating* activities, *non-capital* financing activities (operating grants and sales tax revenue), *capital* acquisitions and disposals, and related *financing* activities (non-transportation revenues). The net result of these activities, added to the cash balances at the beginning of the year reconciles to the cash balances (current plus restricted) at the end of the current fiscal year on the Statement of Net Assets.

The Statements of Operating Expenses, located in the Supplementary Information section of the financial statements, reports expenditures in greater detail.

Financial Highlights

In February 2008 Santa Cruz METRO completed construction on the MetroBase Service and Fueling Facility located at 1200 B River Street, and continues with site work on the second half of the new Maintenance Building located at 138 Golf Club Drive, both in Santa Cruz. In August 2007 Santa Cruz METRO purchased the property at 110 Vernon as a replacement facility for the current leased Administration facility at 370 Encinal Street. Interior and exterior tenant improvements continue at 110 Vernon with final occupancy expected in December 2009. This is in alignment with Santa Cruz METRO's long-term strategy to replace leased facilities with owned facilities. The Consolidated MetroBase project will ultimately bring operations, maintenance, and administration into one cluster of close proximity buildings to provide the needed infrastructure to achieve service expansion goals. The MetroBase project is funded with local, state, and federal funds. Unfortunately, state capital funding sources (specifically PTMISEA and STA) are on hold due to a variety of issues, including poor bond sales (PTMISEA) and the illegal "re-allocation or diversion" of STA transit funding by the Governor, which isn't expected to be restored until 2013 at the earliest. Capital additions to the MetroBase project for the year totaled \$6,844,016.

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
JUNE 30, 2009 AND 2008**

The MetroBase project is also a necessary component for providing Compressed Natural Gas (CNG) to Santa Cruz METRO's fleet. In January 2007 Caltrans executed a grant agreement with Santa Cruz METRO to convert up to forty (40) buses from diesel to CNG fuel engines. By June 2008, thirty-one (31) of the conversions had been completed and, by June 2009, all forty (40) buses had been converted. Fueling Santa Cruz METRO's fleet with CNG, a cleaner fuel source, will comply with the California Air Resource Board (CARB) requirements. Capital additions to the CNG Bus Conversion project for the year totaled \$1,382,989.

In October 2003 Culver CityBus entered into a contract with New Flyer of America for the manufacture, purchase and delivery of an indefinite quantity of 40-foot, low- and standard-floor CNG buses. The contract specifically authorized other public agencies to have the right to "piggy-back" onto the contract for CNG buses. Utilizing the "piggy-back" feature allowed by the Culver CityBus contract, Santa Cruz METRO executed an agreement with New Flyer of America for the purchase of thirteen (13) replacement buses. Santa Cruz METRO then entered into a grant agreement with Caltrans in February 2007 to replace eight (8) local fixed-route buses and five (5) buses for the Highway 17 Express service. The thirteen (13) replacement buses were funded with Federal, State and Local funds totaling \$5,925,254.

Condensed Statement of Net Assets:

	2009	2008	2007	2009 to 2008		2008 to 2007	
				Increase/(Decrease) Amount	%	Increase/(Decrease) Amount	%
Total Assets	\$ 112,044,106	\$ 105,036,300	\$ 85,616,653	\$ 7,007,806	7%	\$ 19,419,647	23%
Total Liabilities	\$ 25,853,950	\$ 24,760,587	\$ 22,262,083	\$ 1,093,363	4%	\$ 2,498,504	11%
Total Net Assets	\$ 86,190,156	\$ 80,275,713	\$ 63,354,570	\$ 5,914,443	7%	\$ 16,921,143	27%

Total Assets increased this year due to construction in progress and capital additions. Total Liabilities increased primarily due to the implementation of Governmental Accounting Standards Board (GASB) accounting standards 43 and 45 related to "other post employment benefits" (OPEB's) and the addition of restricted capital grant funds (Proposition 1B PTMISEA).

An increase or decrease in net assets is an indicator of the financial health of Santa Cruz METRO. For the fiscal year ended June 30, 2009, Santa Cruz METRO's net assets increased by \$5,914,443 due to capital additions related to on-going construction of the Consolidated MetroBase Project, and the purchase of thirteen (13) fixed route buses.

Condensed Statement of Revenues, Expenses and Change in Fund Net Assets:

	2009	2008	2007	2009 to 2008		2008 to 2007	
				Increase/(Decrease) Amount	%	Increase/(Decrease) Amount	%
Operating Revenues	\$ 8,769,185	\$ 8,272,058	\$ 7,730,499	\$ 497,127	6%	\$ 541,559	7%
Operating Expenses	(41,975,092)	(38,683,643)	(31,952,451)	(3,291,449)	9%	(6,731,192)	21%
Operating Loss	(33,205,907)	(30,411,585)	(24,221,952)	(2,794,322)	9%	(6,189,633)	26%
Non-operating Revenues(Expenses)	24,877,839	28,164,895	33,133,407	(3,287,056)	-12%	(4,968,512)	-15%
Capital Grant Contributions	14,242,511	19,167,833	6,659,395	(4,925,322)	-26%	12,508,438	188%
Increase (Decrease) in Net Assets	\$ 5,914,443	\$ 16,921,143	\$ 15,570,850	\$ (11,006,700)	-65%	\$ 1,350,293	9%

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
JUNE 30, 2009 AND 2008**

Operating Revenues increased by 6% due to increased ridership for UC Santa Cruz, Cabrillo College, and the Highway 17 Express.

Operating Expenses increased by 9% primarily due to the implementation of GASB accounting standards 43 and 45 related to "other post employment benefits" (OPEB's).

Non-operating Revenues decreased by 12% due to lower than anticipated sales tax revenue, Transportation Development Act (TDA) revenue, and a significant reduction in interest income.

Capital Contributions are capital grant funds received for facilities improvements and the purchase of capital equipment including revenue vehicles. Capital contributions decreased by 26% from the prior year due to the receipt of a non-recurring State funded grant (AB3090) received last year related to construction of the Consolidated MetroBase Project, and the continued diversion of State Transit Assistance Program (STA) funds this fiscal year.

**Supplemental Revenue, Expense and Performance Report:
(based on FTA account grouping guidelines)**

	2009	2008	2007	2009 to 2008 % Change	2008 to 2007 % Change
Revenues					
Passenger Fares	\$ 8,769,185	\$ 8,272,058	\$ 7,730,499	6.0%	7.0%
Sales and Use Tax ⁽¹⁾	14,923,139	17,054,735	17,652,773	-12.5%	-3.4%
Non-Operating Revenues ⁽²⁾	731,908	1,558,759	2,032,515	-53.0%	-23.3%
TDA ⁽³⁾	5,696,249	6,313,334	6,165,834	-9.8%	2.4%
Federal Operating Assistance	3,615,707	3,375,281	3,338,212	7.1%	1.1%
Total Operating Revenue	\$ 33,736,188	\$ 36,574,167	\$ 36,919,833	-7.8%	-0.9%
Expenses					
Route Operation	\$ 21,752,897	\$ 20,834,142	\$ 19,872,415	4.4%	4.8%
Vehicle Maintenance	4,982,067	4,998,255	4,811,254	-0.3%	3.9%
Facilities Maintenance	1,667,389	1,333,439	1,281,359	25.0%	4.1%
General Administration ⁽⁴⁾	8,515,251	7,763,787	6,592,585	9.7%	17.8%
Total Operating Expense (excluding depreciation)	\$ 36,917,604	\$ 34,929,623	\$ 32,557,613	5.7%	7.3%
Performance Indicators					
Total Passengers	5,987,518	5,888,213	5,695,910	1.7%	3.4%
Revenue Hours	243,241	257,705	260,099	-5.6%	-0.9%
Revenue Miles	3,766,435	3,709,152	3,685,802	1.5%	0.6%
Farebox Recovery Ratio ⁽⁵⁾	23.8%	23.7%	23.7%	0.2%	0.0%
Cost/Passenger	\$ 6.17	\$ 5.93	\$ 5.72	4.0%	3.7%
Cost/Hour ⁽⁶⁾	\$ 151.77	\$ 135.54	\$ 125.17	12.0%	8.3%
Cost/Mile	\$ 9.80	\$ 9.41	\$ 8.83	4.2%	6.6%
Full Time Equivalent Employees	314	323	318	-2.8%	1.6%
Active Fleet - Fixed Route	112	112	115	0.0%	-2.6%
Active Fleet - Paratransit	38	38	34	0.0%	11.8%

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
JUNE 30, 2009 AND 2008**

- (1) Sales Tax Revenues continue to decline as a result of the current economic recession and no job growth.
- (2) Non-Operating Revenues have decreased from last year due to a significant reduction in the interest rate paid on Santa Cruz METRO's deposits in the Santa Cruz County Pooled Investment Fund. In an effort to protect the safety of the principal of the pool, increase credit quality and liquidity, the County Treasurer increased the portion of the portfolio invested in US Treasuries and Government Sponsored Enterprises bonds (GSE's) which resulted in lower overall market rates and a lower yield on the portfolio.
- (3) Transportation Development Act (TDA) funding revenues fluctuate annually based on retail sales in the County and by the amount retained by the Santa Cruz County Regional Transportation Commission (SCCRTC) for other county-wide projects and overhead. Receipts continue to decline due to the current economic recession and the "no job growth" economy.
- (4) Total Operating Expenses increased this year due to the implementation and first time recognition of the accrued liability related to GASB accounting standards 43 and 45 as they pertain to "other post employment benefits" (OPEB's).
- (5) Farebox Recovery Ratio is a standard transit performance indicator that is calculated by dividing passenger fares by operating expenses and does not include depreciation.
- (6) Cost / Hour is calculated by dividing Total Operating Expenses by Revenue Hours. Cost / Hour increased as a result of the increase in total operating expenses this fiscal year.

Condensed Statement of Cash Flows:

	2009	2008	2007	2009 to 2008 Change	2008 to 2007 Change
Net Cash (Used) in Operating Activities	\$ (27,984,781)	\$ (25,145,487)	\$ (24,793,543)	\$ (2,839,294)	\$ (351,944)
Net Cash Provided by Non-Capital Financing Activities	25,012,481	27,045,524	32,400,938	(2,033,043)	(5,355,414)
Net Cash Provided by (Used) in Capital and Related Financing Activities	5,044,102	(5,206,123)	(4,919,921)	10,250,225	(286,202)
Net Cash Provided by Non-Transportation Activities	531,567	1,090,834	1,469,308	(559,267)	(378,474)
Net Increase (Decrease) in Cash and Cash Equivalents	2,603,369	(2,215,252)	4,156,782	4,818,621	(6,372,034)
Cash and Cash Equivalents, Beginning of Year	33,830,310	36,045,562	31,888,780	(2,215,252)	4,156,782
Cash and Cash Equivalents, End of Year	<u>\$ 36,433,679</u>	<u>\$ 33,830,310</u>	<u>\$ 36,045,562</u>	<u>\$ 2,603,369</u>	<u>\$ (2,215,252)</u>

Cash and cash equivalents held by Santa Cruz METRO increased by \$2,603,369 or 8% during the year.

Contacting Santa Cruz METRO's Financial Management

Santa Cruz METRO's financial report is designed to provide Santa Cruz METRO's Board of Directors, management, and the public with an overview of Santa Cruz METRO's finances. For additional information about this report, please contact Angela Aitken, Finance Manager and Acting Assistant General Manager, at 110 Vernon Street, Santa Cruz, CA 95060.

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF NET ASSETS
JUNE 30, 2009 AND 2008**

<u>ASSETS</u>	<u>2009</u>	<u>2008</u>
CURRENT ASSETS		
Cash and Cash Equivalents	\$ 24,072,345	\$ 20,709,070
Sales Tax and Other Receivables	7,211,566	12,290,177
Inventory	806,099	946,561
Prepays	<u>481,547</u>	<u>389,232</u>
Total Current Assets	<u>32,571,557</u>	<u>34,335,040</u>
RESTRICTED ASSETS		
Cash and Cash Equivalents	<u>12,361,334</u>	<u>13,121,240</u>
CAPITAL ASSETS		
Building and Improvements	12,427,094	13,467,177
Revenue Vehicles	44,656,992	40,194,340
Operations Equipment	2,154,389	2,203,998
Other Equipment	1,500,624	1,489,053
Other Vehicles	1,218,674	1,217,023
Office Equipment	<u>1,293,076</u>	<u>1,199,716</u>
	63,250,849	59,771,307
Less Accumulated Depreciation	<u>(35,479,687)</u>	<u>(34,516,865)</u>
	27,771,162	25,254,442
Construction-in-Progress	30,175,183	23,160,708
Land	<u>9,164,870</u>	<u>9,164,870</u>
Total Property and Equipment	<u>67,111,215</u>	<u>57,580,020</u>
TOTAL ASSETS	<u><u>\$ 112,044,106</u></u>	<u><u>\$ 105,036,300</u></u>

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

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF NET ASSETS (Continued)
JUNE 30, 2009 AND 2008

	2009	2008
<u>LIABILITIES AND NET ASSETS</u>		
CURRENT LIABILITIES		
Accounts Payable and Accrued Liabilities	\$ 2,185,549	\$ 2,804,010
Accrued Payroll and Employee Benefits	3,799,326	3,726,070
Workers' Compensation Liabilities	972,231	1,022,608
Other Accrued Liabilities	419,585	417,684
Security Deposit	15,684	17,684
Total Current Liabilities	7,392,375	7,988,056
LIABILITIES PAYABLE FROM RESTRICTED ASSETS		
Deferred Revenue - Settlement Agreement	3,092,552	6,612,064
Deferred Revenue - STA Grant	1,836,010	2,066,267
Deferred Revenue - PTMISEA	7,003,247	4,442,909
Deferred Revenue - OHS 1B	429,525	-
Other Post-Employment Benefit Liabilities	2,561,254	-
LONG-TERM LIABILITIES		
Workers' Compensation Liabilities	3,538,987	3,651,291
Total Liabilities	25,853,950	24,760,587
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	67,111,215	57,580,020
Unrestricted Net Assets	19,078,941	22,695,693
Total Net Assets	86,190,156	80,275,713
TOTAL LIABILITIES AND NET ASSETS	\$ 112,044,106	\$ 105,036,300

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

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF REVENUES, EXPENSES, AND
CHANGES IN FUND NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2009 AND 2008**

	<u>2009</u>	<u>2008</u>
OPERATING REVENUES		
Passenger Fare	\$ 4,742,581	\$ 4,671,177
Special Transit Fare	4,026,604	3,600,881
	<u>8,769,185</u>	<u>8,272,058</u>
Total Operating Revenues		
OPERATING EXPENSES		
Wages, Salaries and Employee Benefits	30,373,279	26,900,557
Purchased Transportation Services	176,002	288,787
Material and Supplies	2,389,907	4,068,119
Other Expenses	3,978,416	3,672,161
Depreciation	5,057,488	3,754,019
	<u>41,975,092</u>	<u>38,683,643</u>
Total Operating Expenses		
Net Operating Loss	<u>(33,205,907)</u>	<u>(30,411,585)</u>
NON-OPERATING REVENUES (EXPENSES)		
Sales and Use Tax	14,923,139	17,054,735
Transportation Development Act Assistance	5,696,249	6,313,334
Section 8/5303 Planning Fund	27,799	54,609
Section 9/5307 Operating Assistance	3,426,293	3,153,552
Section 18/5307 Operating Assistance	161,615	167,120
Interest Income	391,808	942,456
Rental Income	139,759	148,378
Other Revenue	200,341	467,925
Loss on Sale and Disposal of Property, Equipment, and Inventory	<u>(89,164)</u>	<u>(137,214)</u>
Total Non-Operating Revenues	<u>24,877,839</u>	<u>28,164,895</u>
Net Gain (Loss) Before Capital Contributions	<u>(8,328,068)</u>	<u>(2,246,690)</u>
CAPITAL CONTRIBUTIONS		
Grants Restricted for Capital Expenditures	<u>14,242,511</u>	<u>19,167,833</u>
NET ASSETS		
Increase in Net Assets	5,914,443	16,921,143
Total Net Assets, Beginning of Year	<u>80,275,713</u>	<u>63,354,570</u>
Total Net Assets, End of Year	<u>\$ 86,190,156</u>	<u>\$ 80,275,713</u>

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

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2009 AND 2008**

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts From Customers	\$ 9,594,562	\$ 8,210,333
Payments to Employees	(30,462,704)	(26,906,499)
Payments to Suppliers	(7,116,639)	(6,449,321)
	<u>(27,984,781)</u>	<u>(6,449,321)</u>
Net Cash Used in Operating Activities	<u>(27,984,781)</u>	<u>(25,145,487)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Operating Grants Received, Including Sales and Use Tax	25,000,666	27,039,733
Other Nonoperating	11,815	5,791
	<u>25,012,481</u>	<u>27,045,524</u>
Net Cash Provided by Noncapital Financing Activities	<u>25,012,481</u>	<u>27,045,524</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Proceeds From Sale of Property and Equipment	-	1,265
Capital Grants Received	19,632,785	13,814,670
Capital Expenditures	(14,588,683)	(19,022,058)
	<u>5,044,102</u>	<u>(5,206,123)</u>
Net Cash Used in Capital and Related Financing Activities	<u>5,044,102</u>	<u>(5,206,123)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment and Rental Income Received	531,567	1,090,834
	<u>531,567</u>	<u>1,090,834</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>2,603,369</u>	<u>(2,215,252)</u>
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>33,830,310</u>	<u>36,045,562</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 36,433,679</u>	<u>\$ 33,830,310</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES		
Operating Loss	\$ (33,205,907)	\$ (30,411,585)
Adjustments to Reconcile Net Operating Loss to Net Cash Used in Operating Activities:		
Depreciation	5,057,488	3,754,019
Changes in Assets and Liabilities:		
(Increase) Decrease in Receivables	825,377	(61,725)
(Increase) in Inventory	140,462	47,989
(Increase) Decrease in Prepaid Expenses	(92,315)	12,246
Increase (Decrease) in Accounts Payable	(618,461)	1,519,711
Increase (Decrease) in Other Liabilities	(91,425)	(6,142)
	<u>(91,425)</u>	<u>(6,142)</u>
Net Cash Used in Operating Activities	<u>\$ (27,984,781)</u>	<u>\$ (25,145,487)</u>

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

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2009 AND 2008**

NOTE 1 – OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of Organization

The Santa Cruz Metropolitan Transit District (Santa Cruz METRO) was formed February 9, 1969, following a favorable election in conformity with Section 9800 *et. seq.* of the Public Utilities Code. The transit system serves the general public in the cities of Santa Cruz, Watsonville, Scotts Valley, Capitola and the unincorporated areas of Santa Cruz County. A Board of eleven directors, and one Ex-Officio director representing the University of California, Santa Cruz governs Santa Cruz METRO. At June 30, 2009, the directors were as follows:

Chairperson:	Dene Bustichi		
Vice Chair:	Ellen Pirie		
Members:	Ron Graves	Michelle Hinkle	Mark Stone
	Mike Rotkin	Pat Spence	Donald Hagen
	Lynn Robinson	Marcela Tavantzis	Emilio Martinez
Ex-Officio:	Donna Blitzer		

Santa Cruz METRO also serves the Highway 17 corridor into Santa Clara County to provide commuter express service through a memorandum of understanding with the California Department of Transportation, the Capitol Corridor Joint Powers Authority and the Santa Clara Valley County Transit District (VTA). Amtrak Thruway bus service is also provided by Santa Cruz METRO on the same corridor.

B. Reporting Entity

Santa Cruz METRO and the Santa Cruz Civic Improvement Corporation (the Corporation) have a financial and operational relationship, which meets the reporting entity definition criteria of GASB Statement No. 14, as amended by GASB Statement No. 39, *The Financial Reporting Entity*, for inclusion of the Corporation as a component unit of Santa Cruz METRO. Accordingly, the financial activities of the Corporation have been included in the financial statements of Santa Cruz METRO. For the years ending June 30, 2009 and 2008, this activity was minimal.

Scope of Public Service:

The Corporation is a nonprofit, public benefit corporation incorporated under the laws of the State of California and recorded by the Secretary of State in July 1986. The Corporation was formed for the sole purpose of providing financial assistance to Santa Cruz METRO for the construction and acquisition of major capital facilities.

The following are those aspects of the relationship between Santa Cruz METRO and the Corporation, which satisfy GASB Statement No. 14/39 criteria.

Accountability:

1. Santa Cruz METRO's Board of Directors appointed the Corporation's Board of Directors.

NOTE 1 – OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

B. Reporting Entity (Continued)

2. Santa Cruz METRO is able to impose its will upon the Corporation, based on the following:
 - All major financing arrangements, contracts, and other transactions of the Corporation must have the consent of Santa Cruz METRO.
 - Santa Cruz METRO exercises significant influence over operations of the Corporation as it is anticipated that Santa Cruz METRO will be the sole lessee of all facilities owned by the Corporation. Likewise, it is anticipated that Santa Cruz METRO's lease payments will be the sole revenue source of the Corporation.
3. The Corporation provides specific financial benefits or imposes specific financial burdens on Santa Cruz METRO based upon the following:
 - Santa Cruz METRO has assumed a "moral obligation", and potentially a legal obligation, for any debt incurred by the Corporation.

C. Basis of Accounting and Presentation

Santa Cruz METRO is accounted for as a Business Type Activity, as defined by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – Management's Discussion & Analysis – for State and Local Governments* and its financial statements are presented on the accrual basis of accounting. Under this method, revenues are recognized when they are earned, and expenses are recognized when they are incurred.

Santa Cruz METRO adopted GASB Statement No. 34 as amended by GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, as of and for the year ended June 30, 2003, and applied those standards on a retroactive basis. GASB Statement No. 34 establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into three net asset categories; namely, those invested in capital assets, net of related debt, restricted net assets and unrestricted net assets.

Contributed Capital/Reserved Retained Earnings:

Santa Cruz METRO receives grants from the Federal Transit Administration (FTA) and other agencies of the U.S. Department of Transportation, state, and local transportation funds for the acquisition of transit-related equipment and improvements. Prior to July 1, 2001, capital grants were recognized as donated capital to the extent that project costs under the grant have been incurred. Capital grant funds earned, less amortization equal to accumulated depreciation of the related assets, were included in contributed capital. As required by GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, Santa Cruz METRO changed its method of accounting for capital grants from capital contributions to reserved nonoperating revenues. In accordance with GASB No. 33, capital grants are required to be included in the determination of net income resulting in an increase in net revenue of \$14,242,511 and \$19,167,833 for the fiscal years 2009 and 2008, respectively.

Under GASB Statement No. 34, contributed capital and reserved retained earnings are presented in the net asset section as invested in capital assets, net of related debt.

Retained Earnings:

Retained earnings which represented the residual value of operations and capital assets constructed with funds other than grants, were restated to reclassify the capital assets to invested in capital assets, net of related debt and the remaining assets resulting from operations as either restricted or unrestricted net assets.

NOTE 1 – OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

C. Basis of Accounting and Presentation (Continued)

Proprietary Accounting and Financial Reporting:

As required under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, Santa Cruz METRO will continue to apply all applicable GASB pronouncements as well as Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARBs) of the Committee on Accounting Procedure issued on or before November 30, 1989, unless those pronouncements conflict or contradict GASB pronouncements. Santa Cruz METRO has elected under GASB Statement No. 20 to not apply all FASB Statements and Interpretations issued after November 30, 1989, due to the governmental nature of Santa Cruz METRO's operations.

Net Assets:

Net assets represent the residual interest in Santa Cruz METRO's assets after liabilities are deducted. In accordance with GASB Statement No. 34, the Fund Equity section on the Statement of Net Assets was combined to report total net assets and present it in three broad components: invested in capital assets, net of related debt; restricted; and unrestricted. Net assets invested in capital assets, net of related debt include capital assets net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets. Net assets are restricted when constraints are imposed by third parties or by law through constitutional provisions or enabling legislation. All other net assets are unrestricted.

When both restricted and unrestricted resources are available for use, generally it is Santa Cruz METRO's policy to use restricted resources first, and then unrestricted resources as they are needed.

D. Cash and Cash Equivalents

Santa Cruz METRO considers all highly liquid investments with a maturity date within three months of the date acquired to be cash equivalents. Santa Cruz METRO deposits funds into an external investment pool maintained by the County of Santa Cruz. These deposits are considered cash equivalents. The County of Santa Cruz Pooled Investment Fund is authorized to invest in obligations of the U.S. Treasury agencies and instrumentalities, commercial paper rated A-1 by Standard and Poor's Corporation or P-1 by Moody's Commercial Paper Record, banker's acceptances, repurchase agreements, and the State Treasurer's investment pool. Cash and cash equivalents are stated at fair value. For purposes of the statement of cash flows, Santa Cruz METRO considers all highly liquid investments (including restricted assets) to be cash equivalents.

E. Inventory

Inventory is carried at cost using the first-in/first-out (FIFO) method. Inventory held by Santa Cruz METRO consists of spare bus parts and operating supplies that are consumed by Santa Cruz METRO and are not for resale purposes.

F. Restricted Assets

Certain assets are classified as restricted assets on the Statement of Net Assets because their use is subject to externally imposed stipulations, either by laws or regulations.

NOTE 1 – OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

F. Restricted Assets (Continued)

The cash resulting from a settlement agreement, as described in Note 9, represents proceeds restricted by the Federal Transit Administration. The State Transit Assistance Grant, Proposition 1B PTMISEA Grant, and the Proposition 1B OHS CTSGP Grant are restricted for capital expenditures. Restricted assets at June 30, are as follows:

	<u>2009</u>	<u>2008</u>
Cash and Cash Equivalents		
Federal Transit Administration Grant	\$ 3,092,552	\$ 6,612,064
Proposition 1B PTMISEA Grant	7,003,247	4,442,909
Proposition 1B OHS CTSGP Grant	429,525	-
State Transit Assistance Grant	<u>1,836,010</u>	<u>2,066,267</u>
Total Restricted Assets	<u>\$ 12,361,334</u>	<u>\$ 13,121,240</u>

G. Property and Equipment

Property and equipment are recorded at cost. Depreciation for all such assets is computed on a straight-line basis. Estimated useful lives of assets are as follows:

Buildings and structures	20-30 years
Revenue vehicles	12 years
Other vehicles and equipment	3-10 years

Depreciation expense on assets acquired with capital grant funds are transferred to net assets - invested in capital assets, net of related debt after being charged to operations.

Major improvements and betterments to existing facilities and equipment are capitalized. Costs for maintenance and repairs, which do not extend the useful life of the applicable assets, are charged to expense as incurred. Upon disposition, costs and accumulated depreciation are removed from the accounts and resulting gains or losses are included in operations.

Santa Cruz METRO completed and capitalized the Scotts Valley Transit Center in fiscal 1999. The cost of this facility totaled \$4,063,634, which was funded by federal, state and local funds. The Scotts Valley Redevelopment Agency (the Agency), a political subdivision of the state of California, was one of Santa Cruz METRO's funding sources for this project and has retained an interest in the property. The title to the property is retained by both Santa Cruz METRO and the Agency as tenants in common with each party holding an individual interest in proportion to each party's financial participation in the project. The Agency's portion of the property is 13.87%. The Agency's portion is not recorded in Santa Cruz METRO's financial statements.

H. Sales and Use Tax

Santa Cruz METRO receives a .5% sales and use tax levied on all taxable sales in Santa Cruz County, which is collected and administered by the California State Board of Equalization. Additionally, Santa Cruz METRO is allocated, through the Santa Cruz County Regional Transportation Commission, a portion of the .25% sales and use tax levied by the Transportation Development Act (TDA).

I. Operating Assistance Grants

Operating assistance grants are recognized as revenue in the grant period earned.

NOTE 1 – OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

J. Self-Insurance

Santa Cruz METRO is self-insured for the first \$250,000 of general and vehicular liability. For settlements in excess of \$250,000, Santa Cruz METRO has total coverage up to \$20,000,000 per occurrence. Additionally, Santa Cruz METRO is self insured up to \$350,000 for workers' compensation claims. Santa Cruz METRO has recorded a liability for estimated claims to be paid including incurred but not reported claims.

K. Employee Benefits

Vacation and medical leave benefits are accrued when earned and reduced when used. Any paid medical leave accrued beyond 96 hours may, at the employee's option be converted to annual leave and credited to the employee's annual leave schedule or paid in cash, depending on the bargaining unit, at 100% of the earned rate. Employees are paid accrued and unused annual leave at the time of separation from Santa Cruz METRO service.

L. Payroll

Santa Cruz METRO contracts with the Santa Cruz County Auditor-Controller to provide payroll processing services.

M. Pension Costs

Pension costs are expensed as incurred. These costs equal the actuarially determined annual contribution amount.

N. 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 the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

O. Implementation of New Accounting Pronouncements

Santa Cruz METRO implemented GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions (OPEB)* effective for the year ended June 30, 2009. This statement improves the relevance and usefulness of financial reporting by (a) requiring systematic, accrual-basis measurement and recognition of OPEB cost (expense) over a period that approximates employees' years of service and (b) providing information about actuarial accrued liabilities associated with OPEB and whether and to what extent progress is being made in funding the plan. Note 16 shows the disclosures as required by GASB Statement No. 45.

In addition, Santa Cruz METRO also implemented the provisions of GASB Statements No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, and No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in AICPA Statements on Auditing Standards*. Statement No. 55 incorporates the hierarchy of generally accepted accounting principles (GAAP) for state and local governments into the Governmental Accounting Standards Board's (GASB) authoritative literature. Implementation of this statement did not cause any real changes to the preparation process of the financial statements and did not have a significant impact on the financial statements, thus the Board does not expect this statement will result in a change in current practice. Statement No. 56, incorporated into the Governmental Accounting Standards Board's (GASB) authoritative literature certain accounting and financial reporting guidance presented in the American Institute of Certified Public Accountants' *Statements on Auditing Standards*, did not establish new accounting standards but rather incorporates the existing guidance (to the extent appropriate in a governmental environment) into the GASB standards. Thus, this provision did not cause any real changes to the preparation process of the financial statements and did not have a significant impact on the financial statements.

NOTE 2 – CASH AND INVESTMENTS

Cash and cash equivalents consists of the following at June 30, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Cash on Hand	\$ 48,577	\$ 40,311
Demand Deposits	310,114	357,298
Deposits in Santa Cruz County Pooled Investment Fund	<u>36,074,988</u>	<u>33,432,701</u>
	<u>\$ 36,433,679</u>	<u>\$ 33,830,310</u>

Cash on Hand and Cash in Banks

Investments Authorized by the California Government Code and Santa Cruz METRO's Investment Policy

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

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Of Portfolio</u>	<u>Maximum Investment in One Issuer</u>
Local Agency Bonds	5 years	None	None
U.S. Treasury Obligations	5 years	None	None
U.S. Agency Securities	5 years	None	None
Banker's Acceptances	180 days	None	None
Commercial Paper	270 days	None	None
Negotiable Certificates of Deposit	5 years	None	None
Repurchase Agreements	1 year	None	None
Reverse Repurchase Agreements	92 days	None	None
Medium-Term Notes	5 years	None	None
Mutual Funds	N/A	None	None
Money Market Mutual Funds	N/A	None	None
Mortgage Pass-Through Securities	5 years	None	None
County Pooled Investment Funds	N/A	100%	None
Local Agency Investment Fund (LAIF)	N/A	None	None

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates.

NOTE 2 – CASH AND INVESTMENTS (Continued)Cash on Hand and Cash in Banks (Continued)**Disclosures Relating to Interest Rate Risk** (Continued)

Information about the sensitivity of the fair values of Santa Cruz METRO's investments to market interest rate fluctuations is provided by the following table that shows the distribution of Santa Cruz METRO's investments by maturity:

Investment Type	Amount	Remaining Maturity (in Months)			
		12 Months Or Less	13 to 24 Months	25 to 60 Months	More Than 60 Months
County Investment Pool	\$ 36,074,988	\$ 36,074,988	\$ -	\$ -	\$ -

Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations

Santa Cruz METRO's investments were not considered to be highly sensitive to interest rate fluctuations as of June 30, 2009 or 2008.

Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by (where applicable) the California Government Code, Santa Cruz METRO's investment policy, and the actual rating as of year-end for each investment type. The column marked "exempt from disclosure" identifies those investment types for which GASB No. 40 does not require disclosure as to credit risk:

Investment Type	Amount	Minimum Legal Rating	Exempt From Disclosure	Rating as of Year End		
				AAA	Aa	Not Rated
County Investment Pool	\$ 36,074,988	N/A	\$ -	\$ -	\$ -	\$ 36,074,988

Concentration of Credit Risk

The investment policy of Santa Cruz METRO contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. Santa Cruz METRO did not have any Investments in any one issuer (other than external investment pools) that represent 5% or more of total Santa Cruz METRO's investments at June 30, 2009 or 2008.

Custodial Credit Risk

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and Santa Cruz METRO's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies.

NOTE 2 – CASH AND INVESTMENTS (Continued)

Cash on Hand and Cash in Banks (Continued)

Custodial Credit Risk

GASB Statement No. 40 requires that the following disclosure be made with respect to custodial credit risks relating to deposits and investments: none of Santa Cruz METRO's deposits with financial institutions in excess of federal depository insurance limits were held in uncollateralized accounts.

Investment in County Investment Pool

Santa Cruz METRO is a voluntary participant in the Santa Cruz County Investment Fund. The fair value of Santa Cruz METRO's investment in this pool is reported in the accompanying financial statements at amounts based upon Santa Cruz METRO's pro-rata share of the fair value provided by the County for the entire County portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by the County, which are recorded on an amortized cost basis.

NOTE 3 – RECEIVABLES

Receivables at June 30, are as follows:

	<u>2009</u>	<u>2008</u>
Federal Grants	\$ 1,793,004	\$ 8,589
State Grants	2,835,132	8,170,973
Sales Tax Revenue	2,181,400	2,818,400
Local Grants	-	37,500
Other	402,030	1,254,715
	<u>\$ 7,211,566</u>	<u>\$ 12,290,177</u>

NOTE 4 – CHANGES IN CAPITAL ASSETS

Facilities, property and equipment at June 30, are summarized as follows:

June 30, 2009

	<u>Balance July 1, 2008</u>	<u>Additions and Transfers</u>	<u>Retirements and Transfers</u>	<u>Balance June 30, 2009</u>
Non Depreciated Assets				
Land	\$ 9,164,870	\$ -	\$ -	\$ 9,164,870
Construction-in-Progress	23,160,708	7,070,170	(55,695)	30,175,183
Total Non Depreciated Assets	32,325,578	7,070,170	(55,695)	39,340,053
Depreciated Assets				
Building and Improvements	13,467,177	17,607	(1,057,690)	12,427,094
Revenue Vehicles	40,194,340	7,463,295	(3,000,643)	44,656,992
Operations Equipment	2,203,998	53,059	(102,668)	2,154,389
Other Equipment	1,489,053	11,671	(100)	1,500,624
Other Vehicles	1,217,023	1,651	-	1,218,674
Office Equipment	1,199,716	138,596	(45,236)	1,293,076
Total Depreciated Assets	59,771,307	7,685,879	(4,206,337)	63,250,849
Less Accumulated Depreciation	(34,516,865)	(5,057,488)	4,094,666	(35,479,687)
Depreciated Assets Net of Accumulated Depreciation	25,254,442	2,628,391	(111,671)	27,771,162
Total	<u>\$ 57,580,020</u>	<u>\$ 9,698,561</u>	<u>\$ (167,366)</u>	<u>\$ 67,111,215</u>

Depreciation expense at June 30, 2009 was \$5,057,488.

June 30, 2008

	<u>Balance July 1, 2007</u>	<u>Additions and Transfers</u>	<u>Retirements and Transfers</u>	<u>Balance June 30, 2008</u>
Non Depreciated Assets				
Land	\$ 5,948,526	\$ 3,216,344	\$ -	\$ 9,164,870
Construction-in-Progress	15,952,697	11,607,432	(4,399,421)	23,160,708
Total Non Depreciated Assets	21,901,223	14,823,776	(4,399,421)	32,325,578
Depreciated Assets				
Building and Improvements	10,486,491	3,101,325	(120,639)	13,467,177
Revenue Vehicles	35,609,181	5,109,897	(524,738)	40,194,340
Operations Equipment	2,818,470	66,489	(680,961)	2,203,998
Other Equipment	1,285,123	203,930	-	1,489,053
Other Vehicles	1,153,348	188,979	(125,304)	1,217,023
Office Equipment	1,143,615	83,541	(27,440)	1,199,716
Total Depreciated Assets	52,496,228	8,754,161	(1,479,082)	59,771,307
Less Accumulated Depreciation	(32,084,205)	(3,754,019)	1,321,359	(34,516,865)
Depreciated Assets Net of Accumulated Depreciation	20,412,023	5,000,142	(157,723)	25,254,442
Total	<u>\$ 42,313,246</u>	<u>\$ 19,823,918</u>	<u>\$ (4,557,144)</u>	<u>\$ 57,580,020</u>

Depreciation expense at June 30, 2008 was \$3,754,019.

NOTE 5 – AVAILABLE NET ASSETS

An analysis of Santa Cruz METRO's available (undesignated) net assets at June 30, follows:

	<u>2009</u>	<u>2008</u>
Current Assets	\$ 32,571,557	\$ 33,286,737
Current Liabilities	<u>(7,392,375)</u>	<u>(7,988,056)</u>
Working Capital	25,179,182	25,298,681
Less:		
Inventory	(806,099)	(946,561)
Prepaid Expenses	<u>(481,547)</u>	<u>(389,232)</u>
Total Available Net Assets	<u>23,891,536</u>	<u>23,962,888</u>
Net Assets Designated for the Following:		
Cash Flow	(5,059,022)	(5,059,022)
Workers' Compensation Reserve	(2,091,581)	(2,091,581)
110 Vernon Purchase - Renovation	(2,400,000)	(2,962,139)
Insurance Reserve	(700,757)	(750,757)
Alternative Fuel Conversion Fund	-	(462,000)
Bus Stop Improvements Reserve	-	(400,000)
Carryover for Fiscal Year 2008-2009 Operating Budget	(2,155,738)	(2,951,178)
Net Assets Required to Offset Projected Operating Budget Shortfall for Fiscal Year 2010	(3,154,251)	-
Net Assets Required to Fund Transportation Improvement Programs for the Fiscal Years 2008-2012	<u>(14,025,636)</u>	<u>(13,625,636)</u>
Available Undesignated Net Assets (Deficits)	<u>\$ (5,695,449)</u>	<u>\$ (4,339,425)</u>

NOTE 6 – CAPITAL GRANTS

Santa Cruz METRO receives grants from the Federal Transit Administration (FTA), which provides financing for the acquisition of rolling stock and construction of facilities. Santa Cruz METRO also receives grants under the State Transportation Development Act primarily for the acquisition of rolling stock and support equipment, and purchase of furniture and fixtures.

A summary of federal, state and local grant activity for the years ended June 30, are as follows:

	<u>2009</u>	<u>2008</u>
Federal Grants	\$ 6,194,664	\$ 2,152,133
State Grants	8,047,847	16,980,757
Local Grants	<u>-</u>	<u>34,943</u>
Total Capital Assistance	<u>\$ 14,242,511</u>	<u>\$ 19,167,833</u>

NOTE 7 – COMMITMENTS

Santa Cruz METRO leases a number of its facilities under operating leases extending through 2012. For the years ended June 30, 2009 and 2008, rental expense relating to the leases was \$728,350 and \$697,925, respectively. Santa Cruz METRO also leases to others retail space in their transit facilities under noncancelable agreements. Minimum lease payments and receipts for existing operating leases are as follows:

<u>Year Ending June 30</u>	<u>Lease Commitments</u>	<u>Rental Income</u>	<u>Net</u>
2010	\$ 241,974	\$ 111,795	\$ 130,179
2011	123,829	30,692	93,137
2012	21,697	-	21,697
	<u>\$ 387,500</u>	<u>\$ 142,487</u>	<u>\$ 245,013</u>

NOTE 8 – JOINT VENTURES (Joint Powers Authority with CalTIP)

Santa Cruz METRO participates in a joint powers authority (JPA), the California Transit Insurance Pool (CalTIP). The relationship between Santa Cruz METRO and the JPA is such that the JPA is not a component unit of Santa Cruz METRO for financial reporting purposes.

CalTIP arranges for and provides property and liability insurance for its 25 members. CalTIP is governed by a board that controls the operations of CalTIP, including selection of management and approval of operating budgets, independent of any influence by the member districts. Each member district pays a premium commensurate with the level of coverage requested and shares in surpluses and deficits proportionate to their participation in CalTIP.

Condensed unaudited financial information of CalTIP for the years ended April 30, (most recent information available) is as follows:

	<u>2009</u>	<u>2008</u>
Total Assets	\$ 25,860,459	\$ 22,411,570
Total Liabilities	<u>9,782,422</u>	<u>7,763,419</u>
Fund Balance	<u>\$ 16,078,037</u>	<u>\$ 14,648,151</u>
Total Revenues	\$ 7,915,686	\$ 9,055,989
Total Expenditures	<u>6,485,801</u>	<u>6,490,515</u>
Net Increase in Fund Balance	<u>\$ 1,429,885</u>	<u>\$ 2,565,474</u>

CalTIP has not calculated Santa Cruz METRO's share of year-end assets, liabilities, or fund balance.

NOTE 9 – WATSONVILLE FLEET MAINTENANCE FACILITY

Santa Cruz METRO's fleet maintenance facility in Watsonville was damaged in the Loma Prieta earthquake (the earthquake) in October 1989. An engineering study concluded that the demolition of the existing facility and construction of a new facility was the most practical course of action. Therefore, the net book value of the facility was written off the books in a prior year.

NOTE 9 – WATSONVILLE FLEET MAINTENANCE FACILITY (Continued)

In addition, due to design and construction deficiencies by the design and building contractors involved in the original project, Santa Cruz METRO initiated litigation against the contractors and came to a settlement agreement with said contractors on May 30, 1995. In accordance with this agreement, the contractors remitted \$4,776,858 (including \$171,538 in costs) to Santa Cruz METRO during fiscal year 1996, representing damages less attorney fees. FTA Section 3/5309 restricts the use of these proceeds, and the interest earned thereon. Accordingly, the net restricted amount of \$3,092,552 and \$6,612,064 is reflected on the statements of net assets as deferred revenue at June 30, 2009 and 2008, respectively.

NOTE 10 – CONTINGENCIES

Santa Cruz METRO has received state and federal funds for specific purposes that are subject to review and audit by grantor agencies. Although such audits could generate expenditure disallowances under terms of the grants, Santa Cruz METRO believes that any required reimbursement will not be material.

Additionally, Santa Cruz METRO is party to various claims and litigation in the normal course of business. In the opinion of management and in-house counsel, any ultimate losses have been adequately provided for in the financial statements.

NOTE 11 – DEFINED BENEFIT PENSION PLAN

Plan Description

Santa Cruz METRO's defined benefit pension plan, the Miscellaneous Plan for Santa Cruz Metropolitan Transit District (the Plan), provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. The Plan is part of the Public Agency portion of the California Public Employees' Retirement System (CalPERS), an agent multiple-employer plan administered by CalPERS, which acts as a common investment and administrative agent for participating public employers with the State of California. A menu of benefit provisions as well as other requirements is established by State statutes within the Public Employees' Retirement Law. Santa Cruz METRO selects optional benefit provisions from the benefit menu by contract with CalPERS and adopts those benefits through Board action. CalPERS issues a separate comprehensive annual financial report. Copies of the CalPERS' annual financial report may be obtained from the CalPERS Executive Office, 400 P Street, Sacramento, CA 95814.

Funding Policy

There are 314 active plan members in the Fund as of June 30, 2009, which are required to contribute a percent of their annual covered salary. In lieu of salary increases and for employees who agreed to salary reductions in certain prior years, Santa Cruz METRO agreed to pay a portion of the employee contribution, based on formulas negotiated in their labor agreements. Santa Cruz METRO is also required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the CalPERS Board of Administration. The required employer contribution rate for the fiscal year ended June 30, 2009 was 13.383%. The contribution requirements of the plan members are established by State statute and the employer contribution rate is established and may be amended by CalPERS.

NOTE 11 – DEFINED BENEFIT PENSION PLAN (Continued)Annual Pension Cost

For fiscal year ended June 30, 2009, Santa Cruz METRO's annual pension cost of \$2,215,058 was equal to Santa Cruz METRO's required and actual contributions. This includes Santa Cruz METRO's contribution to the employee contribution requirement. The required contribution for fiscal year ended June 30, 2009 was determined as part of the June 30, 2007 actuarial valuation using the entry age normal actuarial cost method with the contributions determined as a percent of pay. The actuarial assumptions included (a) 7.75% investment rate of return (net of administration expenses); (b) projected salary increases that vary by duration of service ranging from 3.25% to 14.45% for miscellaneous members, and (c) 3.25% cost-of-living adjustment. Both (a) and (b) include an inflation component of 3.0%. The actuarial value of the Plan's assets was determined using a technique that smoothes the effect of short-term volatility in the market value of investments over a three-year period. The Plan's excess assets are being amortized as a level percentage of projected payroll on a closed basis.

Three-Year Trend Information for the Fund

Three-year trend information, with respect to Santa Cruz METRO's participation in CalPERS is as follows:

<u>Ending</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
6/30/2007	\$ 1,791,125	100%	\$ -
6/30/2008	\$ 1,997,214	100%	\$ -
6/30/2009	\$ 2,215,058	100%	\$ -

Required Supplementary Information

Supplementary information is intended to show the progress made towards funding benefit obligations. Required three year supplemental information, available to date, for Santa Cruz METRO is as follows:

<u>Valuation Date</u>	<u>Entry Age Actuarial Accrued Liability</u>	<u>Actuarial Value of Assets</u>	<u>Unfunded/ (Overfunded) Liability</u>	<u>Funded Ratio</u>	<u>Annual Covered Payroll</u>	<u>UAAL as a % of Payroll</u>
6/30/2005	\$ 74,915,137	\$65,041,527	\$ 9,873,610	86.8%	\$14,935,163	66.1%
6/30/2006	\$ 82,885,847	\$71,312,490	\$ 11,573,357	86.0%	\$15,022,920	77.0%
6/30/2007	\$ 90,009,906	\$78,752,158	\$ 11,257,748	87.5%	\$15,491,039	72.7%

NOTE 12 – DEFERRED COMPENSATION PLAN

Santa Cruz METRO offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 and provisions of the Government Code of the State of California. The plan, available to all Santa Cruz METRO employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, or unforeseeable emergency. Santa Cruz METRO employees participate in two such plans, the Great-West Life and Annuity Insurance (Great-West) plan and the other through CalPERS.

At June 30, 2009, all amounts held under the Great-West plan and the CalPERS plan are held in trust and are not reflected on the accompanying balance sheet as required under Statement No. 27 of the Governmental Accounting Standards Board, *Accounting Standards for Pensions by State and Local Governmental Employers*.

NOTE 13 – RISK MANAGEMENT

Santa Cruz METRO is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and natural disasters for which Santa Cruz METRO carries commercial insurance. Santa Cruz METRO has established limited risk management programs for workers' compensation, and general and vehicular liability, as described in Note 1, as well.

Liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported (IBNR). The IBNR for workers' compensation was based on an actuarial study dated June 12, 2007. 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. Changes in the balances of claims liabilities are as follows:

	<u>2009</u>	<u>2008</u>
Unpaid Claims, Beginning of Fiscal Year	\$ 4,673,899	\$ 4,673,900
Incurred Claims (Including IBNR's)	(903,021)	(974,098)
Claim Payments	<u>740,340</u>	<u>974,097</u>
Unpaid Claims, End of Fiscal Year	<u>\$ 4,511,218</u>	<u>\$ 4,673,899</u>

NOTE 14 – TRANSPORTATION DEVELOPMENT ACT/CALIFORNIA ADMINISTRATIVE CODE

Santa Cruz METRO is subject to compliance with the Transportation Development Act provisions, Sections 6634 and 6637 of the California Administrative Code and Sections 99267, 99268.1 and 99314.6 of the Public Utilities Code.

Section 6634

Pursuant to Section 6634, a Transit claimant is precluded from receiving monies from the Local Transportation Fund and the State Transit Assistance Fund in an amount which exceeds the claimant's capital and operating costs, less the required fares, and local support. Santa Cruz METRO did not receive Transportation Development Act or State Transit Assistance revenues in excess of the prescribed formula amounts.

Section 6637

Pursuant to Section 6637, a claimant must maintain its accounts and records in accordance with the Uniform System of Accounts and Records for Transit Operators adopted by the State Controller. Santa Cruz METRO did maintain its accounts and records in accordance with the Uniform System of Accounts and Records for Transit Operators.

Sections 99267 and 99268.1

Pursuant to the Transportation Development Act, Santa Cruz METRO is defined as an older operator and is not required to meet the fare box ratio requirement of the Act. Santa Cruz METRO has met the 50% expenditure limitation requirement.

NOTE 15 – PUBLIC TRANSPORTATION, MODERNIZATION, IMPROVEMENT, AND SERVICE ENHANCEMENT ACCOUNT (PTMISEA)

In November 2006, California Voters passed a bond measure enacting the Highway Safety, Traffic Reduction, Air Quality and Port Security Bond Act of 2006. Of the \$19.925 billion of State general obligation bonds authorized, \$4 billion was set aside by the State as instructed by the statute as the Public Transportation Modernization Improvement and Service Enhancement Account (PTMISEA). These funds are available to the California Department of Transportation for intercity rail projects and to transit operators in California for rehabilitation, safety or modernization improvements, capital service enhancements or expansions, new capital projects, bus rapid transit improvements or for rolling stock procurement, rehabilitation or replacement.

The audit of public transportation operator finances, pursuant to Section 99245 of the Public Utilities Code (PUC) and required under the Transportation Development Act (TDA), was expanded to include verification of receipt and appropriate expenditure of PTMISEA bond funds.

The Santa Cruz Regional Transportation Commission (SCCRTC) is responsible for allocating the Proposition 1B PUC Section 99313 funds in Santa Cruz County. In December 2007, the SCCRTC programmed 100% of its share of Section 99313 Proposition 1B PTMISEA funds (approximately \$2.1 million) to Santa Cruz METRO for the Consolidated MetroBase project. Funds audited include the SCCRTC share of PUC Section 99313 Proposition 1B Transit funds that have been passed-through to Santa Cruz METRO.

During the fiscal year ended June 30, 2009, Santa Cruz METRO applied for and received proceeds of \$2,560,338 including interest earned of \$79,428 from the State's PTMISEA account for construction funding for the Consolidated MetroBase Project. As of June 30, 2009, no qualifying expenditures were incurred and the entire proceeds of \$2,560,338 including accrued interest was deferred. Qualifying expenditures must be encumbered within three years from the date of the allocation and expended within three years from the date of the encumbrance.

**Schedule of PTMISEA Bond 1B Funds
For the Year Ended June 30, 2009**

	<u>2009</u>
Balance - beginning of the year	\$ 4,442,909
Receipts:	
Warrant No. 63-181418 - Deposited 7/15/2009	2,480,910
Interest accrued 7/1/2008 through 6/30/2009	79,428
Expenses:	
MetroBase Construction	<u>-</u>
Balance - end of year	<u>\$ 7,003,247</u>

**Schedule of PTMISEA Bond 1B Funds
For the Year Ended June 30, 2008**

	<u>2008</u>
Balance - beginning of the year	\$ -
Receipts:	
Warrant No. 61-495327 - Deposited 3/19/2008	4,404,019
Interest accrued thru 6/30/2008	38,890
Expenses:	
MetroBase Construction	<u>-</u>
Balance - end of year	<u>\$ 4,442,909</u>

NOTE 16 – POSTEMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS

Plan Description

Santa Cruz METRO provides post-retirement CalPERS medical benefits to qualified retired employees age 50 and older (including eligible dependents) who have completed at least five years of CalPERS eligible service. Santa Cruz METRO pays medical premiums depending on bargaining union contract requirements. If the retiree has ten years of Santa Cruz METRO eligible service, Santa Cruz METRO provides post-retirement dental and vision benefits for qualified retirees (including eligible dependents), and life insurance for the retiree only, until the retiree reaches age 65. Bus operators who retired and reached the age of 65 prior to June 30, 1994, will continue to receive dental and vision coverage beyond age 65. Life insurance is not provided to management retirees who retired prior to July 1, 2005. The costs of providing these benefits are recognized when paid. Santa Cruz METRO has recognized approximately \$1,557,326 and \$1,496,061 of expense for these benefits for the years ending June 30, 2009 and 2008, respectively.

Annual OPEB Cost and Net OPEB Obligation

The Santa Cruz METRO's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities (of funding excess) over a period not to exceed thirty years. For fiscal year 2008-09, the Santa Cruz Metropolitan Transit District's annual OPEB cost was \$2,561,254. The Santa Cruz METRO's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the year ended June 30, 2009, were as follows:

Annual required contribution	\$ 3,980,818
Interest on net OPEB obligation	-
Adjustments to annual required contribution	<u>-</u>
Annual OPEB cost	3,980,818
Contributions made	<u>1,419,564</u>
Change in net OPEB obligation (asset)	2,561,254
Net OPEB obligation (asset) - beginning of year	<u>-</u>
Net OPEB obligation (asset) - end of year	<u><u>\$ 2,561,254</u></u>

<u>Year Ended</u> <u>June 30,</u>	<u>Annual</u> <u>OPEB</u> <u>Cost</u>	<u>Actual</u> <u>Employer</u> <u>Contributions</u>	<u>Percentage of</u> <u>Annual OPEB Cost</u> <u>Contributed</u>	<u>Net Ending</u> <u>OPEB</u> <u>Obligation (Asset)</u>
2009	\$ 3,980,818	\$ 1,419,564	35.66%	\$ 2,561,254

Funding Policy, Funded Status and Funding Progress

The Santa Cruz Metropolitan Transit District's required contribution is based on Pay-As-You-Go financing requirements. For fiscal year 2008-09, the Santa Cruz METRO contributed \$1,419,564 to the plan.

As of April 1, 2008, the most recent actuarial valuation date, the actuarial accrued liability for benefits was \$44,208,804, all of which was unfunded.

NOTE 16 – POSTEMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS (Continued)

Funding Policy, Funded Status and Funding Progress (Continued)

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and probability about the occurrence of future events far into the future. Amounts determined regarding the funded status of a plan and the annual required contributions of the Santa Cruz METRO are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

The schedule of funding progress presented as required supplementary information following the notes to the financial statements, will present multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits. Because 2008-09 was the year of implementation of GASB Statement No. 45 and the Santa Cruz METRO elected to apply the statement prospectively, only one year is presented in the schedule at this time. In future years, required trend analysis will be presented.

Actuarial Methods and Assumptions

Calculations of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with long-term perspective of the calculations.

The actuarial assumptions used for rates of employee turnover, retirement, and mortality, as well as economic assumptions regarding healthcare inflation and interest were based on a standard set of actuarial assumptions modified as appropriate for the Santa Cruz METRO. Turnover rates were taken from CalPERS actuarial table for miscellaneous employees, which closely matches Santa Cruz METRO turnover experience. Retirement rates were also based on Santa Cruz METRO experience. Healthcare inflation rates are based on actuarial analysis of recent Santa Cruz METRO experience and actuarial knowledge of the general healthcare environment. The actuarial assumption to determine the cost of covering early retirees (those under the age of 65) was an age-specific claims cost matrix fitted to the average estimated equivalent one-party premium for the current retiree group. Healthcare costs were assumed to increase by 3% per year of age for ages under 65.

REQUIRED SUPPLEMENTARY INFORMATION

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF FUNDING PROGRESS
OTHER POST EMPLOYMENT BENEFITS
JUNE 30, 2009**

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b - a)/c]
4/1/2008	\$ -	\$ 44,208,804	\$ 44,208,804	-	\$ 30,373,279	145.55%

SUPPLEMENTARY INFORMATION

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF OPERATING EXPENSES
FOR THE YEARS ENDED JUNE 30, 2009 AND 2008**

	<u>2009</u>	<u>2008</u>
Labor		
Operators' Salaries and Wages	\$ 7,571,893	\$ 7,430,732
Other Salaries and wages	6,161,034	5,866,496
Overtime	1,771,761	1,736,090
	<u>15,504,688</u>	<u>15,033,318</u>
Fringe Benefits		
Absence with pay	3,017,547	2,839,773
Pension plans	2,215,059	1,997,214
Vision, medical, and dental plans	5,934,447	5,509,822
Workers' compensation insurance	577,659	979,924
Disability insurance	388,509	335,963
Other fringe benefits	174,116	204,543
Other Post Employment Benefits	2,561,254	-
	<u>14,868,591</u>	<u>11,867,239</u>
Services		
Accounting	79,984	84,436
Administrative and banking	185,856	176,719
Professional and technical services	350,007	373,166
Security	358,207	341,087
Outside repairs	790,841	660,244
Other Services	163,844	157,632
	<u>1,928,739</u>	<u>1,793,284</u>
Materials and Supplies Consumed		
Fuels and Lubricants	1,454,579	2,697,309
Tires and Tubes	180,368	185,825
Vehicle parts	460,132	775,902
Other materials and supplies	294,828	409,083
	<u>2,389,907</u>	<u>4,068,119</u>
Utilities	431,353	434,011
Casualty and Liability Costs	685,475	511,863
Taxes and Licenses	43,847	35,364
Purchased Transportation Services		
Para transit	176,002	288,787
Miscellaneous Expenses	144,675	179,802
Equipment and Facility Lease	744,327	717,837
Depreciation		
Property Acquired with operator funds	442,630	471,919
Property acquired by federal, state, or TDA funds	4,614,858	3,282,100
	<u>7,283,167</u>	<u>5,921,683</u>
Total Operating Expenses	<u>\$ 41,975,092</u>	<u>\$ 38,683,643</u>

OTHER SCHEDULES AND REPORTS

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2009**

<u>Federal Grantor / Program Title</u>	<u>Federal CFDA No.</u>	<u>Pass-Through Grantor's Number</u>	<u>Total Federal Expenditures</u>
U.S. DEPARTMENT OF TRANSPORTATION			
Direct Programs:			
Federal Transit Administration (FTA)			
Section 9/5307			
Metrobase Construction	20.507*	CA-90-Y663	\$ 752,084
Operating Assistance	20.507*	CA-90-Y663	3,426,293
WiFi Equipment	20.507*	CA-95-X066	<u>12,935</u>
			<u>4,191,312</u>
Section 18/5311			
Operating Assistance	20.509	647163	<u>161,615</u>
AMBAG - Short Range Transit Plan (SRTP)	20.505	5303	9,906
AMBAG - Transit Planning - Rotational Intern	20.515	5305	10,545
AMBAG - Transit Professional Development	20.515	5305	<u>7,348</u>
			<u>27,799</u>
Total Expenditures of Federal Awards			<u><u>\$ 4,380,726</u></u>

* Major federal financial assistance program.

See accompanying notes to schedule of federal financial assistance.

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2009**

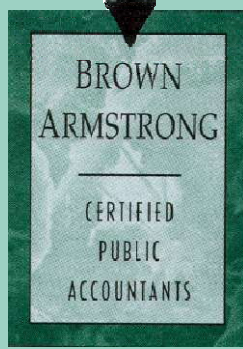
NOTE 1 – GENERAL

The accompanying Schedule of Expenditures of Federal Awards presents the activity of all federal financial assistance programs of the Santa Cruz Metropolitan Transit District (Santa Cruz METRO). Federal financial assistance received directly from federal agencies, as well as federal financial assistance passed through other governmental agents, is included on the schedule.

NOTE 2 – BASIS OF ACCOUNTING

The accompanying Schedule of Expenditures of Federal Awards has been prepared on the accrual basis of accounting. Federal capital grant funds are used to purchase property, plant, and equipment. Federal grants receivable are included in capital and operating grants receivable, which also includes receivables from state and local grant sources.

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**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 AND THE RULES AND REGULATIONS
OF THE CALIFORNIA TRANSPORTATION DEVELOPMENT ACT**

To the Board of Directors
Santa Cruz Metropolitan Transit District
Santa Cruz, California

We have audited the basic financial statements of Santa Cruz Metropolitan Transit District, as of and for the year ended June 30, 2009, which collectively comprise Santa Cruz Metropolitan Transit District's basic financial statements and have issued our report thereon dated November 9, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

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

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

Compliance and Other Matters

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

We noted certain matters that we reported to management of Santa Cruz Metropolitan Transit District in a separate letter dated November 9, 2009.

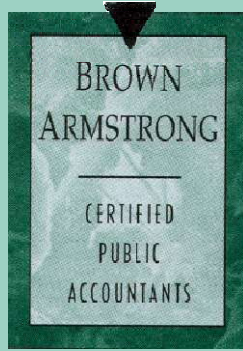
This report is intended solely for the information and use of management, the Board of Directors, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION



Bakersfield, California
November 9, 2009

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REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

To the Board of Directors
Santa Cruz Metropolitan Transit District
Santa Cruz, California

Compliance

We have audited the compliance of Santa Cruz Metropolitan Transit District with the types of compliance requirements described in the U. S. Office of Management and Budget (OMB) Circular A-133 *Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2009. Santa Cruz Metropolitan Transit District's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Santa Cruz Metropolitan Transit District's management. Our responsibility is to express an opinion on Santa Cruz Metropolitan Transit District's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Santa Cruz Metropolitan Transit District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Santa Cruz Metropolitan Transit District's compliance with those requirements.

In our opinion, Santa Cruz Metropolitan Transit District complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2009.

Internal Control Over Compliance

The management of Santa Cruz Metropolitan Transit District is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Santa Cruz Metropolitan Transit District's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Santa Cruz Metropolitan Transit District's internal control over compliance.

A *control deficiency* in an entity's internal control over compliance 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

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

Santa Cruz Metropolitan Transit District's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit Santa Cruz Metropolitan Transit District's response and, accordingly, we express no opinion on it.

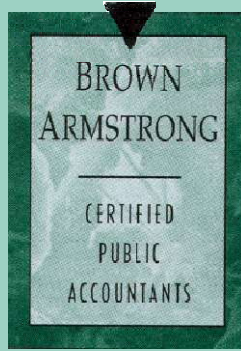
This report is intended for the information of management, the Board of Directors, and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION



Bakersfield, California
November 9, 2009

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REPORT ON COMPLIANCE WITH THE CALIFORNIA TRANSPORTATION DEVELOPMENT ACT

To the Board of Directors
Santa Cruz Metropolitan Transit District
Santa Cruz, California

We have audited the basic financial statements of the Santa Cruz Metropolitan Transit District (Santa Cruz METRO), as of and for the year ended June 30, 2009, and have issued our report thereon dated November 9, 2009.

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.

Compliance with laws, regulations, contracts and grants applicable to Santa Cruz METRO is the responsibility of the management of Santa Cruz METRO. As part of obtaining reasonable assurance about whether the Santa Cruz METRO financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. Additionally, we performed tests to determine that allocations made and expenditures paid by the Santa Cruz METRO were made in accordance with the allocation instructions and resolutions of the Santa Cruz County Regional Transportation Commission and in conformance with the California Transportation Development Act. Specifically, we performed each of the specific tasks identified in the California Code of Regulations Sections 6666 and 6667 that are applicable to the Santa Cruz METRO. In connection with our audit, nothing came to our attention that caused us to believe the Santa Cruz METRO failed to comply with the Statutes, Rules, and Regulations of the California Transportation Development Act and the allocation instructions and resolutions of the Transportation Commission. 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.

In November 2006, California Voters passed a bond measure enacting the Highway Safety, Traffic Reduction, Air Quality and Port Security Bond Act of 2006. Of the \$19.925 billion of state general obligation bonds authorized, \$4 billion was set aside by the State as instructed by statute as the Public Transportation Modernization Improvement and Service Enhancement Account (PTMISEA). These funds are available to the California Department of Transportation for intercity rail projects and to transit operators in California for rehabilitation, safety or modernization improvements, capital service enhancements or expansions, new capital projects, bus rapid transit improvements or for rolling stock procurement, rehabilitation or replacement.

During the fiscal year ended June 30, 2009, Santa Cruz METRO applied for and received \$2,560,338 from the State's PTMISEA account for the purpose of construction of the consolidated MetroBase project. As of June 30, 2009, PTMISEA funds received and expended were verified in the course of our audit as follows:

Schedule of PTMISEA Bond 1B Funds For the Year Ended June 30, 2009	
Description	Amount
Balance – beginning of the year	\$ 4,442,909
Proceeds received:	
PTMISEA	2,480,910
Interest earned	79,428
Expenditures incurred:	
MetroBase Construction	-
Balance – end of year	<u>\$ 7,003,247</u>

The results of our tests indicated that, with respect to the items tested, Santa Cruz METRO complied, in all material respects, with the provisions referred to in the preceding paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that Santa Cruz METRO had not complied, in all material respects, with those provisions.

This report is intended for the information of management, the Board of Directors, the State Controller's Office, the U.S. Department of Transportation, and officials of applicable grantor agencies. However, this report is a matter of public record and its distribution is not limited.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Bakersfield, California
November 9, 2009

FINDINGS AND QUESTIONED COSTS SECTION

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2009**

I. Summary of Auditor's Results

Financial Statements

Type of auditors' report issued: Unqualified

Internal control over financial reporting:
 Material weakness identified? Yes No

Significant deficiencies identified? Yes None reported

Noncompliance material to financial statements noted? Yes No

Federal Awards

Internal control over major federal programs:

Material weakness identified? Yes No

Reportable conditions identified that are not considered
 to be material weaknesses? Yes None reported

Type of auditors' report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in
 accordance with Circular A-133, Section .510(a)? Yes No

Identification of major programs:

CFDA Number(s)

20.500
20.507

Name of Federal Program or Clusters

Federal Transit Administration-Section 3
Federal Transit Administration-Section 9

Dollar threshold used to distinguish Type A & B programs: \$300,000

Auditee qualified as low risk auditee? Yes No

II. Findings Relating to Financial Statements Required Under GAGAS

None.

III. Federal Award Findings and Questioned Costs

None.

IV. State Award Findings and Questioned Costs

None.

V. A Summary of Prior Audit (all June 30, 2008) Findings and Current Year Status Follows

None.