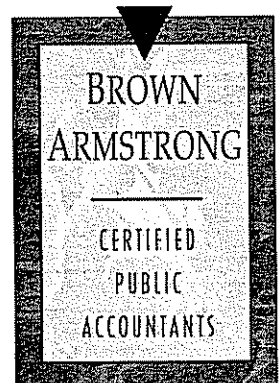


SANTA CRUZ METROPOLITAN TRANSIT DISTRICT

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

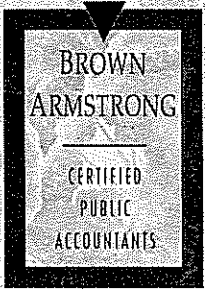
JUNE 30, 2003 AND 2002



**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
JUNE 30, 2003 AND 2002**

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**BROWN ARMSTRONG
PAULDEN McCOWN STARBUCK & KEETER**
CERTIFIED PUBLIC ACCOUNTANTS

■ Main Office
4200 Truxtun Ave., Suite 300
Bakersfield, California 93309
Tel 661-324-4971 Fax 661-324-4997
e-mail: barrinfo@barrcpa.com

■ Shafter Office
560 Central Avenue
Shafter, California 93263
Tel 661-746-2145 Fax 661-746-1218

Peter C Brown, CPA

Burton H Armstrong, CPA, MST

Andrew J Paulden, CPA

Harvey J McCown, CPA

Steven R Starbuck, CPA

Aileen K Keeter, CPA

Chris M Thornburgh, CPA

Lynn R Krausse, CPA, MST

Bradley M Hankins, CPA

Eric H Xin, CPA

Melinda A McDaniels, CPA

Thomas M Young, CPA

Amanda E Wilson, CPA

Sharon Jones, CPA, MST

Rosalva Flores, CPA

Debbie A Rapp, CPA

Julie A Auvil, CPA

Connie M Perez, CPA

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 (the District), as of June 30, 2003 and 2002, 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 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 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 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 financial position of the Santa Cruz Metropolitan Transit District, as of June 30, 2003 and 2002, 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.

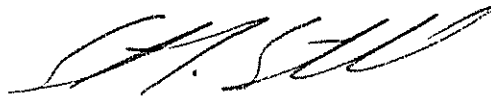
As described in Note 1, the District implemented Governmental Accounting Standard's Board Statement 34, Basic Financial Statements – and Management's Discussion and Analysis for State and Local Governments, Statement 36, Recipient Reporting for Certain Shared Nonexchange Revenues (an amendment of GASB Statement 33); Statement 37, Basic Financial Statements – and Management's Discussion and Analysis for State and Local Governments, Omnibus; and Statement 38, Certain Financial Statement Note Disclosures.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 13, 2003 on our consideration of the Santa Cruz Metropolitan Transit District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. 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 considering the results of our audit.

The Management's Discussion and Analysis on pages 3 through 6 is not a required part of the basic financial statements but is 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 supplementary information. However, we did not audit the information and express no opinion on it.

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 PAULDEN
McCOWN STARBUCK & KEETER
ACCOUNTANCY CORPORATION



Bakersfield, California
August 13, 2003

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS (Unaudited)
JUNE 30, 2003 AND 2002**

Introduction

The following discussion and analysis of the financial performance and activity of the Santa Cruz Metropolitan Transit District (the District) provide an introduction and understanding of the basic financial statements of the District's for the year ended June 30, 2003 with selected comparative information for the year ended June 30, 2002. 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.

The District 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. The District 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

For the fiscal year ended June 30, 2003, the District adopted Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – Management's Discussion & Analysis – for State and Local Governments* as amended by GASB Statement No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus* and GASB Statement No. 38, *Certain Financial Statements Note Disclosures* and has applied those statements on a retroactive basis. GASB Statement No. 34 establishes the accounting and financial reporting standards for state and local governments, including special-purpose governments such as the District. GASB Statement No. 38 modifies, establishes, and rescinds certain financial statement disclosure requirements.

The District's basic financial statements include (1) the *Statements of Net Assets*, (2) the *Statements of Revenues, Expenses and Changes in Fund Net Assets*, and (3) the *Statements of Cash Flows*. The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

Significant Changes to the Financial Statements

The Statement of Net Assets replaces the Balance Sheet. The Statement of Net Assets reports assets, liabilities and the difference as net assets. The entire equity section is combined to report total net assets and is displayed in three components - invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets.

The net asset component *invested in capital assets, net of related debt*, consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any borrowings attributable to the acquisition, construction or improvements of those assets.

Restricted net assets consist of assets where constraints on their use are either (a) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or (b) imposed by law through constitutional provisions or enabling legislation.

Unrestricted net assets consist of net assets that do not meet the definition of restricted or invested in capital assets, net of related debt. This net asset component includes net assets that have been designated by management for specific purposes which in the case of the District include assets allocated to fund capital projects, reserves for self-insurance and other liabilities, and reserves for cash flow, which indicate that management does not consider them to be available for general operations (See Note 5).

Statement of Revenues, Expenses and Changes in Fund Net Assets replaces the Statement of Revenues and Expenses. Revenues and expenses are now categorized as either operating or nonoperating based upon the definitions provided by GASB Statements No. 33 and No. 34. Significant recurring sources of the District's revenues, such as capital contributions, are reported as nonoperating revenues.

Statements of Cash Flows is presented using the direct method and includes a reconciliation of operating cash flows to operating income.

Financial Highlights

Statement of Revenues, Expenses and Change in Fund Net Assets

A summary of the District's Statements of Revenues, Expenses and Changes in Fund Net Assets for fiscal years 2003 and 2002 is as follows:

	2003	2002	Increase/(Decrease)	
			Amount	%
Operating revenues	\$ 5,898,305	\$ 5,969,670	\$ (71,365)	(1%)
Operating expenses	<u>(33,673,928)</u>	<u>(31,611,764)</u>	<u>(2,062,164)</u>	7%
Operating loss	(27,775,623)	(25,642,094)	(2,133,529)	9%
Nonoperating revenues (expenses)	22,395,493	22,992,315	(596,822)	(3%)
Capital contributions	<u>12,761,993</u>	<u>1,975,508</u>	<u>10,786,485</u>	546%
Increase (decrease) in net assets	<u>\$ 7,381,863</u>	<u>\$ (674,271)</u>	<u>\$ 8,056,134</u>	1194%

The combined operating and non-operating revenues for fiscal year 2003 and 2002 decreased by approximately \$668,187 and \$1.9 million, respectively. The failure of the economy to recover quickly in 2003 and 2002 had a negative impact on the District's two main sources of operating revenues - passenger revenue and sales tax/TDA as well as on our main source of non-operating revenue - interest income. The decrease in passenger revenues are due to a decline in system ridership; the decreases in sales tax/TDA are due to a decline in consumer spending; and the decreases in interest income are due to a combination of the decline in interest rates during 2003 and 2002 and the reduction in the District's general fund balance (the source of interest income) since reserves were expended for acquisition of capital assets and to cover operating revenue shortfalls.

Selected revenue decreases, change from prior year:

	2003	2002
Passenger revenue	\$ (71,365)	\$ (58,698)
Sales tax/TDA revenue	\$ (734,208)	\$ (1,260,654)
Interest income	\$ (336,879)	\$ (514,069)

Operating expenses, net of depreciation, for fiscal year 2003 were approximately \$29.3 million, a net increase over 2002 of \$210,379 or 1%. The increase results primarily from a \$310,000 net increase in employees' salaries, wages and benefits. The increase in salaries is due to contractual pay increases in 2003 in compliance with the labor agreements.

The depreciation expense increased by \$1.8 million from \$2.5 million in 2002 to \$4.3 million in 2003 due to depreciation on new equipment, vehicles and buses purchased during the year.

An increase or decrease in net assets is an indicator of whether the District's financial health is improving or deteriorating. For the fiscal years ended June 30, 2003 and 2002, the District's net assets changed by \$7.3 million in 2003 and (\$674,271) in 2002, respectively. The increase in 2003 is due to federal, state and local capital contributions for acquisition of assets.

Statement of Net Assets

A comparison of the District's Statements of Net Assets as of June 30, 2003 and 2002 is as follows:

	2003	2002	Increase/(Decrease)	
			Amount	%
Current assets	\$ 23,256,699	\$ 26,229,745	\$ (2,973,046)	(11%)
Noncurrent assets - capital assets, net	30,922,252	20,636,417	10,285,835	50%
Noncurrent assets - restricted	8,025,961	6,860,597	1,165,364	17%
Total assets	\$ 62,204,912	\$ 53,726,759	\$ 8,478,153	16%
Current liabilities	\$ 6,678,488	\$ 6,747,562	\$ (69,074)	(1%)
Noncurrent liabilities	10,895,801	9,730,437	1,165,364	12%
Total liabilities	\$ 17,574,289	\$ 16,477,999	\$ 1,096,290	7%
Net assets:				
Invested in capital assets, net of debt	\$ 30,922,252	\$ 20,636,417	\$ 10,285,835	50%
Unrestricted net assets	13,708,371	16,612,343	(2,903,972)	(17%)
Total net assets	\$ 44,630,623	\$ 37,248,760	\$ 7,381,863	20%

Capital Assets

As of the end of fiscal year 2003, the District's capital assets, before accumulated depreciation, increased by \$13 million. The major additions during the year included purchases of new revenue vehicles; support vehicles; equipment; construction of a CNG fueling station; and CNG maintenance facility improvements.

Details of the capital assets, net of accumulated depreciation, as of June 30, 2003 and 2002 are as follows:

	2003	2002	Increase/(Decrease)	
			Amount	%
Buildings and improvements	\$ 10,419,320	\$ 10,083,303	\$ 336,017	3%
Transportation Vehicles	32,275,993	20,193,225	12,082,768	60%
Operations Equipment	2,685,368	2,035,645	649,723	32%
Other Equipment	2,574,306	2,544,367	29,939	1%
Other Vehicles	892,920	793,543	99,377	13%
Land	3,763,502	3,763,502	-	
Construction in progress	83,883	175,648	(91,765)	(52%)
Total	52,695,292	39,589,233	13,106,059	33%
Less Accumulated Depreciation	(21,773,040)	(18,952,816)	(2,820,224)	15%
Net Total	\$ 30,922,252	\$ 20,636,417	\$ 10,285,835	50%

Statement of Cash Flows/Cash Investments

Overall, the total cash and investments held by the District at the end of the year decreased by \$1.37 million from \$28.3 million in 2002 to \$26.9 million in 2003. The decrease in cash and investments is primarily due to the acquisition of capital assets including revenue and support vehicles and facility construction, which required use of District reserves for the District share of the grant-funded projects.

A comparative presentation of the major sources and uses of cash for 2003 and 2002 follows:

	<u>2003</u>	<u>2002</u>
Net cash used in operating activities	\$ (23,340,749)	\$ (23,681,897)
Net cash provided by noncapital financing activities	22,177,595	22,982,698
Net cash used in capital and related financing activities	(751,254)	(1,624,388)
Net cash provided by investing activities	<u>544,669</u>	<u>881,961</u>
Net increase (decrease) in cash and cash equivalents	(1,369,739)	(1,441,626)
Cash and cash equivalents, beginning of year	<u>28,262,303</u>	<u>29,703,929</u>
Cash and cash equivalents, end of year	<u>\$ 26,892,564</u>	<u>\$ 28,262,303</u>

Contacting the District's Financial Management

The District's financial report is designed to provide the District's Board of Directors, management, and public with an overview of the District's finances. For additional information about this report, please contact Elisabeth Ross, Finance Manager, at 370 Encinal Street, Suite 100, Santa Cruz, CA 95060.

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF NET ASSETS
JUNE 30, 2003 AND 2002**

	2003	2002
<u>ASSETS</u>		
CURRENT ASSETS		
Cash and Cash Equivalents	\$ 18,866,603	\$ 21,401,706
Sales Tax and Other Receivables	3,499,002	3,927,938
Inventory	814,045	862,599
Prepays	77,049	37,502
	23,256,699	26,229,745
TOTAL CURRENT ASSETS		
RESTRICTED ASSETS		
Cash and Cash Equivalents	8,025,961	6,860,597
	8,025,961	6,860,597
PROPERTY AND EQUIPMENT		
Building and Improvements	10,419,320	10,083,303
Transportation Vehicles	32,275,993	20,193,225
Operations Equipment	2,685,368	2,035,645
Other Equipment	1,279,607	1,243,396
Other Vehicles	892,920	793,543
Office Equipment	1,294,699	1,300,971
	48,847,907	35,650,083
Less Accumulated Depreciation	(21,773,040)	(18,952,816)
	27,074,867	16,697,267
Construction in Progress	83,883	175,648
Land	3,763,502	3,763,502
	30,922,252	20,636,417
TOTAL PROPERTY AND EQUIPMENT		
	30,922,252	20,636,417
TOTAL ASSETS	\$ 62,204,912	\$ 53,726,759

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

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF NET ASSETS (Continued)
JUNE 30, 2003 AND 2002

	2003	2002
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts Payable and Accrued Liabilities	\$ 879,522	\$ 706,378
Accrued Payroll and Employee Benefits	2,682,972	2,616,256
Other Accrued Liabilities	3,078,408	3,072,181
Security Deposit	15,714	14,514
Deferred Revenue	21,872	338,233
Total Current Liabilities	6,678,488	6,747,562
LIABILITIES PAYABLE FROM RESTRICTED ASSETS		
Deferred Revenue - Settlement Agreement	6,758,106	6,625,124
Deferred Revenue - STA Grant	1,267,855	235,473
LONG-TERM LIABILITIES		
Workers' Compensation Liabilities	2,869,840	2,869,840
Total Liabilities	17,574,289	16,477,999
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	30,922,252	20,636,417
Unrestricted Net Assets	13,708,371	16,612,343
Total Net Assets	44,630,623	37,248,760
TOTAL LIABILITIES AND NET ASSETS	\$ 62,204,912	\$ 53,726,759

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, 2003 AND 2002**

	<u>2003</u>	<u>2002</u>
OPERATING REVENUES		
Passenger Fare	\$ 3,623,650	\$ 3,756,299
Special Transit Fare	<u>2,274,655</u>	<u>2,213,371</u>
Total Operating Revenues	<u>5,898,305</u>	<u>5,969,670</u>
OPERATING EXPENSES		
Wages, Salaries and Employee Benefits	21,026,370	20,716,236
Purchased Transportation Services	2,565,373	2,723,353
Material and Supplies	2,020,621	2,268,603
Other Expenses	3,723,202	3,416,995
Depreciation	<u>4,338,362</u>	<u>2,486,577</u>
Total Operating Expenses	<u>33,673,928</u>	<u>31,611,764</u>
Net Operating Loss	<u>(27,775,623)</u>	<u>(25,642,094)</u>
NON-OPERATING REVENUES (EXPENSES)		
Sales and Use Tax	15,263,828 ✓	15,095,441 ✓
Transportation Development Act Assistance	5,134,522	6,037,117
Section 9/5307 Operating Assistance	1,229,934	505,614
Section 18/5307 Operating Assistance	46,701	42,448
Other Federal Assistance	183,609	194,905
Other State Assistance	113,856	-
Interest Income	400,059	735,838
Rental Income	144,610	146,123
Other Revenue	139,847	227,950
Gain (Loss) on Sale of Property, Equipment, and Inventory	<u>(261,473)</u>	<u>6,879</u>
Total Non-Operating Revenues and (Expenses)	<u>22,395,493</u>	<u>22,992,315</u>
Net Loss Before Capital Contributions	<u>(5,380,130)</u>	<u>(2,649,779)</u>
CAPITAL CONTRIBUTIONS		
Grants Restricted for Capital Expenditures	<u>12,761,993</u>	<u>1,975,508</u>
NET ASSETS		
Increase (Decrease) in Net Assets	7,381,863	(674,271)
Total Net Assets, Beginning of Year	<u>37,248,760</u>	<u>37,923,031</u>
Total Net Assets, End of Year	<u>\$ 44,630,623</u>	<u>\$ 37,248,760</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, 2003 AND 2002**

	<u>2003</u>	<u>2002</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts From Customers	\$ 5,872,743	\$ 5,841,322
Payments to Employees	(20,959,654)	(20,383,961)
Payments to Suppliers	<u>(8,253,838)</u>	<u>(9,139,258)</u>
Net Cash Used in Operating Activities	<u>(23,340,749)</u>	<u>(23,681,897)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Operating Grants Received, Including Sales and Use Tax	22,029,773	22,757,981
Other Nonoperating	<u>147,822</u>	<u>224,717</u>
Net Cash Provided by Noncapital Financing Activities	<u>22,177,595</u>	<u>22,982,698</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Proceeds From Sale of Property and Equipment	25,110	6,879
Capital Grants Received	14,001,424	1,237,295
Capital Expenditures	<u>(14,777,788)</u>	<u>(2,868,562)</u>
Net Cash Used in Capital and Related Financing Activities	<u>(751,254)</u>	<u>(1,624,388)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment and Rental Income Received	<u>544,669</u>	<u>881,961</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,369,739)	(1,441,626)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>28,262,303</u>	<u>29,703,929</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 26,892,564</u>	<u>\$ 28,262,303</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES		
Operating Loss	\$ (27,908,615)	\$ (25,642,094)
Adjustments to Reconcile Net Operating Loss to Net Cash Used in Operating Activities:		
Depreciation	4,338,362	2,486,577
Changes in Assets and Liabilities:		
(Increase) Decrease in Receivables	(25,562)	(128,348)
(Increase) Decrease in Inventory	48,554	(128,201)
(Increase) Decrease in Prepaid Expenses	(39,547)	(19,050)
Increase (Decrease) in Accounts Payable	173,143	(582,806)
Increase (Decrease) in Other Liabilities	<u>72,916</u>	<u>332,025</u>
Net Cash Used in Operating Activities	<u>\$ (23,340,749)</u>	<u>\$ (23,681,897)</u>

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

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2003 AND 2002**

NOTE 1 - OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of Organization

The Santa Cruz Metropolitan Transit District (the District) 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. The District is governed by a Board of eleven directors, and one Ex-Officio director representing the University of California, Santa Cruz. At June 30, 2003, the directors were as follows:

Chairperson:	Emily Reilly		
Vice Chair:	Mike Keogh		
Members:	Jeff Almquist	Michelle Hinkle	Ana Ventura Phares
	Jan Beautz	Sheryl Ainsworth	Pat Spence
	Mike Rotkin	Dennis Norton	Marcela Tavantzis
Ex-Officio:	Wes Scott		

B. Reporting Entity

The District 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, *The Financial Reporting Entity*, for inclusion of the Corporation as a component unit of the District. Accordingly, the financial activities of the Corporation have been included in the financial statements of the District. For the years ending June 30, 2003 and 2002, 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 the District for the construction and acquisition of major capital facilities.

The following are those aspects of the relationship between the District and the Corporation, which satisfy GASB Statement No. 14 criteria.

Accountability:

1. The Corporation's Board of Directors were appointed by the District's Board of Directors.
2. The District 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 the District.
 - The District exercises significant influence over operations of the Corporation as it is anticipated that the District will be the sole lessee of all facilities owned by the Corporation. Likewise, it is anticipated that the District'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 the District based upon the following:
 - The District has assumed a "moral obligation", and potentially a legal obligation, for any debt incurred by the Corporation.

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

C. Basis of Accounting and Presentation

The District 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.

The District 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.

The District adopted GASB Statement No. 38, *Certain Financial Statement Note Disclosures* for the year ended June 30, 2003, and applied the standard on a retroactive basis. GASB 38 modifies, establishes, and rescinds certain financial statement disclosure requirements.

The following shows the reconciliation of the components of total equity for June 30, 2002, as previously reported to net asset balances for the same period.

Fund Equity	
Contributed Capital:	
Federal Grants	\$ 8,098,484
State Grants	7,125,462
Local Grants	984,995
Other Grants	<u>6,836</u>
Total Contributed Capital	16,215,777
Retained Earnings	<u>21,032,983</u>
	<u>\$ 37,248,760</u>
Fund Net Assets:	
Invested in Capital Assets, Net of Related Debt	\$ 20,636,417
Unrestricted Net Assets	<u>16,612,343</u>
	<u>\$ 37,248,760</u>

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

C. Basis of Accounting (Continued)

Contributed Capital/Reserved Retained Earnings:

The District 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*, the District 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 \$12,761,993 and \$1,975,508 for the fiscal years 2003 and 2002, 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.

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*, the District 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. The District 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 the District's operations.

Net Assets:

Net assets represent the residual interest in the District'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.

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

D. Cash and Cash Equivalents

The District considers all highly liquid investments with a maturity date within three months of the date acquired to be cash equivalents. The District 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, the District considers all highly liquid investments (including restricted assets) to be cash equivalents.

E. Inventory

Inventory is carried at cost. Inventory held by the District consists of spare bus parts that are consumed by the District 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.

The cash resulting from a settlement agreement as described in Note 9, represents proceeds restricted by the Federal Transit Administration. The STA Grant is restricted until authorized expenditures occur. Restricted assets at June 30, are as follows:

	<u>2003</u>	<u>2002</u>
Cash and cash equivalents		
Settlement agreement with contractor	\$ 6,758,106	\$ 6,625,124
STA Grant	<u>1,267,855</u>	<u>235,473</u>
Total Restricted Assets	<u>\$ 8,025,961</u>	<u>\$ 6,860,597</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.

The District has 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 the District's funding sources for this project and has retained an interest in the property. The title to the property is retained by both the District 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 the District's financial statements.

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

H. Fare Operating Revenues

Fare operating revenues are earned as passengers utilize the District's transit services. Deferred revenue includes prepaid rent and a local operating grant.

I. Sales and Use Tax

The District 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, the District 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.

J. Operating Assistance Grants

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

K. Self-Insurance

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

L. 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 District service.

M. Payroll

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

N. Pension Costs

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

O. 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.

P. Reclassifications

Certain reclassifications have been made to the prior year financial statements to comply with the retroactive application of GASB Statement No. 34.

NOTE 2 - CASH AND CASH EQUIVALENTS

Cash and cash equivalents consists of the following at June 30, 2003:

	<u>2003</u>	<u>2002</u>
Cash on hand	\$ 45,521	\$ 29,464
Demand deposits	328,154	413,269
Deposits in Santa Cruz County Pooled Investment Fund	<u>26,518,889</u>	<u>27,819,570</u>
	<u>\$ 26,892,564</u>	<u>\$ 28,262,303</u>

Cash on Hand and Cash in Banks

Cash is maintained in a financial institution, which provides deposit protection on the bank balance from the Federal Deposit Insurance Corporation. Additionally, the California Government Code requires all financial institutions to maintain an investment pool equal to 110% of all government deposits held by the institution as collateral for such deposits.

Cash is categorized below to give an indication of the level of risk assumed by the District. Category 1 includes cash balances that are insured in the District's name. Category 2 includes cash balances for which the collateral securities are held by the financial institution in the District's name. Category 3 includes uninsured cash balance for which the collateral securities are held by the financial institution but not in the District's name.

Cash on Hand and Cash in Banks

Cash at June 30, 2003 consists of the following:

	Balance per SCMTD	Balance per Bank	<u>Categories</u>		
			<u>1</u>	<u>2</u>	<u>3</u>
Cash in banks	\$ 328,154	<u>\$ 503,684</u>	<u>\$ 100,000</u>	<u>\$ 403,684</u>	<u>\$ -</u>
Cash on hand	<u>45,521</u>				
	<u>\$ 373,675</u>				

Cash at June 30, 2002 consists of the following:

	Balance per SCMTD	Balance per Bank	<u>Categories</u>		
			<u>1</u>	<u>2</u>	<u>3</u>
Cash in banks	\$ 413,269	<u>\$ 698,034</u>	<u>\$ 100,000</u>	<u>\$ 598,034</u>	<u>\$ -</u>
Cash on hand	<u>29,464</u>				
	<u>\$ 442,733</u>				

Investments

At June 30, 2003 and 2002, the District had \$26,518,889 and \$27,819,570, respectively, invested in the Santa Cruz County Pooled Investment Fund. Pooled cash held in the County Investment Fund is considered uncategorized. In accordance with GASB guidelines, the District has marked all investments to their market value.

NOTE 3 - RECEIVABLES

Receivables at June 30, are as follows:

	<u>2003</u>	<u>2002</u>
Federal grants	\$ 96,764	\$ 184,662
State grants	358,360	703,825
Local grants	20,000	33,159
Sales tax revenue	2,504,500	2,428,400
Other	519,378	577,892
	<u>\$ 3,499,002</u>	<u>\$ 3,927,938</u>

NOTE 4 - CHANGES IN CAPITAL ASSETS

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

June 30, 2003

	<u>Balance July 1, 2002</u>	<u>Additions and Transfers</u>	<u>Retirements and Transfers</u>	<u>Balance June 30, 2003</u>
Non Depreciated Assets				
Land	\$ 3,763,502	\$ -	\$ -	\$ 3,763,502
Construction-in-progress	175,648	83,883	(175,648)	83,883
Total Non Depreciated Assets	3,939,150	83,883	(175,648)	3,847,385
Depreciated Assets				
Building and Improvements	10,083,303	338,433	(2,416)	10,419,320
Revenue Vehicles	20,193,225	13,634,322	(1,551,554)	32,275,993
Operations Equipment	2,035,645	667,194	(17,471)	2,685,368
Other Equipment	1,243,396	36,211	-	1,279,607
Other Vehicles	793,543	104,836	(5,459)	892,920
Office Equipment	1,300,970	67,530	(73,801)	1,294,699
Total Depreciated Assets	35,650,082	14,848,526	(1,650,701)	48,847,907
Less Accumulated Depreciation	<u>(18,952,815)</u>	<u>(4,338,363)</u>	<u>1,518,138</u>	<u>(21,773,040)</u>
Depreciated Assets Net of Accumulated	<u>16,697,267</u>	<u>10,510,163</u>	<u>(132,563)</u>	<u>27,074,867</u>
Total	<u>\$ 20,636,417</u>	<u>\$ 10,594,046</u>	<u>\$ (308,211)</u>	<u>\$ 30,922,252</u>

NOTE 4 - CHANGES IN CAPITAL ASSETS (Continued)

June 30, 2002

	Balance July 1, 2001	Additions and Transfers	Retirements and Transfers	Balance June 30, 2002
Non Depreciated Assets				
Land	\$ 3,763,502	\$ -	\$ -	\$ 3,763,502
Construction-in-progress	1,018,441	127,314	(970,107)	175,648
Total Non Depreciated Assets	4,781,943	127,314	(970,107)	3,939,150
Depreciated Assets				
Building and Improvements	10,081,614	2,203	(514)	10,083,303
Revenue Vehicles	19,288,954	2,500,995	(1,596,724)	20,193,225
Operations Equipment	1,252,569	908,521	(125,445)	2,035,645
Other Equipment	1,195,528	51,518	(3,650)	1,243,396
Other Vehicles	747,229	58,077	(11,763)	793,543
Office Equipment	1,164,113	142,588	(5,731)	1,300,970
Total Depreciated Assets	33,730,007	3,663,902	(1,743,827)	35,650,082
Less Accumulated Depreciation	(18,206,492)	(2,490,080)	1,743,757	(18,952,815)
Depreciated Assets Net of Accumulated	15,523,515	1,173,822	(70)	16,697,267
Total	\$ 20,305,458	\$ 1,301,136	\$ (970,177)	\$ 20,636,417

NOTE 5 - AVAILABLE NET ASSETS

An analysis of the District's available (undesignated) net assets at June 30, are as follows:

	2003	2002
Current assets	\$ 23,256,699	\$ 26,229,745
Current liabilities	(6,678,488)	(6,747,562)
Working capital	16,578,211	19,482,183
Less:		
Inventory	(814,045)	(862,599)
Prepaid expenses	(77,049)	(37,502)
Total available net assets	15,687,117	18,582,082
Net assets designated for the following:		
Cash flow	(2,600,000)	(2,600,000)
Workers' compensation reserve	(1,320,000)	(1,320,000)
Insurance reserve	(770,000)	(900,000)
Alternative fuel conversion fund	(462,000)	(462,000)
Bus stop improvements reserve	(400,000)	(400,000)
Net assets required to fund transportation improvement programs for the fiscal years 2003-2007	(13,350,000)	(14,385,000)
Available undesignated net assets (deficits)	\$ (3,214,883)	\$ (1,484,918)

NOTE 6 - CAPITAL GRANTS

The District receives grants from the Federal Transit Administration (FTA), which provides financing primarily for the acquisition of rolling stock. The District also receives grants under the State Transportation Development Act and State Toll Bridge revenue programs 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>2003</u>	<u>2002</u>
Federal grants	\$ 8,927,343	\$ 452,554
State grants	3,002,988	1,443,634
Transportation Development Act (local transportation grants)	<u>831,662</u>	<u>79,320</u>
Total Capital Assistance	<u>\$ 12,761,993</u>	<u>\$ 1,975,508</u>

NOTE 7 - COMMITMENTS

The District leases a number of its facilities under operation leases extending through 2008. For the years ended June 30, 2003 and 2002, rental expense relating to the leases was \$567,970 and \$545,054, respectively. The District 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>
2004	\$ 602,889	\$ 125,860	\$ 477,029
2005	658,923	92,876	566,047
2006	405,916	26,214	379,702
2007	46,331	16,555	29,776
2008	64,864	16,886	47,978
Thereafter	-	4,305	(4,305)
	<u>\$ 1,778,923</u>	<u>\$ 282,696</u>	<u>\$ 1,496,227</u>

NOTE 8 - JOINT VENTURES (Joint Powers Authority)

The District participates in a joint powers authority (JPA), the California Transit Insurance Pool (CalTIP). The relationship between the District and the JPA is such that the JPA is not a component unit of the District 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.

NOTE 8 - JOINT VENTURES (Joint Powers Authority) (Continued)

Condensed audited financial information of CalTIP for the year ended April 30, 2002 (most recent information available) is as follows:

Total assets	\$ 11,385,304
Total liabilities	<u>8,102,421</u>
Fund Balance	<u>\$ 3,282,883</u>
Total revenues	\$ 3,574,558
Total expenditures and cumulative effect of accounting change	<u>3,005,535</u>
Net Increase in Fund Balance	<u>\$ 569,023</u>

The District's share of year-end assets, liabilities, or fund balance has not been calculated by CalTIP.

NOTE 9 - WATSONVILLE FLEET MAINTENANCE FACILITY

The District'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.

In addition, due to design and construction deficiencies by the design and building contractors involved in the original project, the District 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 the District during fiscal year 1996, representing damages less attorney fees. The use of these proceeds, and the interest earned thereon, is restricted by FTA Section 3/5309. Accordingly, the net restricted amount of \$6,758,106 and \$6,625,124 is reflected on the statements of net assets as deferred revenue at June 30, 2003 and 2002, respectively. The District is currently working towards building or purchasing a new facility in Santa Cruz.

NOTE 10 - CONTINGENCIES

The District 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, the District believes that any required reimbursement will not be material.

Additionally, the District 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

The District'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. The District 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 291 active plan members in the Fund as of June 30, 2003, 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, the District agreed to pay a portion of the employee contribution, based on negotiated formulas. The District 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, 2003 was 0%. 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.

Annual Pension Cost

For fiscal year ended June 30, 2003, the District's annual pension cost of \$845,923 was equal to the District's required and actual contributions. This includes the District's contribution to the employee contribution requirement. The required contribution for fiscal year ended June 30, 2003 was determined as part of the June 30, 2000 actuarial valuation using the entry age normal actuarial cost method with the contributions determined as a percent of pay. The actuarial assumptions included (a) 8.25% investment rate of return (net of administration expenses); (b) projected salary increases that vary by duration of service ranging from 3.75% to 14.20% for miscellaneous members, and (c) 3.75% cost-of-living adjustment. Both (a) and (b) include an inflation component of 3.50%. 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. The remaining amortization period at June 30, 2003 was 16 years.

Three-Year Trend Information for the Fund

Three-year trend information, with respect to the District's participation in CalPERS is as follows:

<u>Fiscal Year Ending</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
6/30/2001	\$ 763,788	100%	\$ -
6/30/2002	\$ 847,843	100%	\$ -
6/30/2003	\$ 845,923	100%	\$ -

NOTE 11 - DEFINED BENEFIT PENSION PLAN (Continued)**Annual Pension Cost (Continued)****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 the District is as follows:

<u>Valuation Date</u>	<u>Entry Age Normal 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>
6/30/1999	\$32,467,163	\$47,476,596	\$(15,009,433)	146.2%	\$10,560,478	(142.128)%
6/30/2000	\$37,219,840	\$53,308,298	\$(16,088,458)	143.2%	\$11,113,415	(144.766)%
6/30/2001	\$44,805,153	\$56,109,004	\$(11,303,851)	125.2%	\$12,209,377	(92.600)%

NOTE 12 - POST-RETIREMENT BENEFITS

The District provides post-retirement benefits to its employees who have completed at least ten years of full-time service with the District, have reached the age of 50 and have retired under the provisions of CalPERS while an employee of the District. The District pays a portion of the premiums for medical insurance for retirees and eligible dependents. The District also provides dental, vision and life insurance plan coverage of retirees and eligible dependents until the retiree attains the age of 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. The costs of providing these benefits are recognized when paid. The District has recognized approximately \$706,924 and \$445,060 of expense for these benefits for the years ending June 30, 2003 and 2002, respectively.

NOTE 13 - DEFERRED COMPENSATION PLAN

The District 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 district 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. The District employees participate in two such plans, the Great-West Life and Annuity Insurance (Great-West) plan and the other through CalPERS.

At June 30, 2003, 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 14 - RISK MANAGEMENT

The District 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 the District carries commercial insurance. The District 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 August 1, 2001. Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amount of pay-outs and other economic and social factors. The IBNR amount based on the actuarial study was determined to be \$2,869,840 at June 30, 2003.

NOTE 15 - TRANSPORTATION DEVELOPMENT ACT/CALIFORNIA ADMINISTRATIVE CODE

The District 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. The District 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. The District 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, the District is defined as an older operator and is not required to meet the fare box ratio requirement of the Act. The District has met the 50% expenditure limitation requirement.

SUPPLEMENTARY INFORMATION

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF OPERATING EXPENSES
JUNE 30, 2003 AND 2002**

	2003	2002
Labor		
Operators' salaries and wages	\$ 5,704,261	\$ 5,896,197
Other salaries and wages	5,210,492	5,301,517
Overtime	1,381,383	1,385,182
Fringe Benefits		
Absence with pay	2,622,853	2,671,447
Pension plans	845,923	847,844
Vision, medical, and dental plans	2,929,449	2,691,670
Workers' compensation insurance	1,801,644	1,252,290
Disability insurance	429,813	564,202
Other fringe benefits	100,552	105,888
Services		
Accounting	77,877	71,559
Administrative and banking	207,606	192,100
Professional and technical services	740,702	528,281
Security	299,589	317,588
Outside repairs	434,962	647,979
Other services	164,107	195,375
Materials and Supplies Consumed		
Fuels and lubricants	1,121,221	910,918
Tires and tubes	136,455	160,518
Vehicle parts	400,291	726,337
Other materials and supplies	362,654	470,830
Utilities	300,212	310,484
Casualty and liability costs	769,663	277,286
Taxes and licenses	37,695	37,342
Purchased Transportation Services		
Paratransit	2,565,373	2,723,353
Miscellaneous Expenses	104,829	275,346
Equipment and Facility Lease	585,960	563,654
Depreciation		
Property acquired with operator funds	762,182	552,806
Property acquired by federal, state, or TDA funds	3,576,180	1,933,771
Total Operating Expenses	\$ 33,673,928	\$ 31,611,764

OTHER SCHEDULES AND REPORTS

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2003**

<u>Federal Grantor / Program Title</u>	<u>Federal CFDA No.</u>	<u>Grantor's Number</u>	<u>Federal Expenditures</u>
U S. DEPARTMENT OF TRANSPORTATION			
Direct Programs:			
Federal Transit Administration (FTA)			
Cluster Defined by the Department of Transportation			
Section 3/5309 Consolidation			
Preliminary Engineering	20.500*	CA-03-0413	\$ 183,609
Paratransit Vans	20.500*	CA-03-0505	<u>6,891</u>
			<u>190,500</u>
Section 9/5307			
MIS Software	20.507*	CA-90-X752	7,948
Buses	20.507*	CA-90-X873	1,627,392
Buses	20.507*	CA-90-X873	700,000
Trolley Bus	20.507*	CA-90-X873	289,786
Buses	20.507*	CA-90-X902	2,130,743
Talking Bus Equipment	20.507*	CA-90-X902	464,649
Farebox Equipment	20.507*	CA-90-X902	43,532
CNG Buses	20.507*	CA-90-X902	572,817
Rebuilt Engines	20.507*	CA-90-Y024	82,330
Buses	20.507*	CA-90-Y024	1,891,554
Buses	20.507*	CA-90-Y024	1,078,000
Paratransit Vans	20.507*	CA-90-Y024	31,702
Operating Assistance	20.507*	CA-90-Y024	<u>1,229,934</u>
			<u>10,150,387</u>
Section 18/5311			
Operating Assistance	20.509	649068	<u>46,701</u>
Total Expenditures of Federal Awards			<u><u>\$ 10,387,588</u></u>

* Major federal financial assistance program.

See accompanying notes to schedule of federal financial assistance.

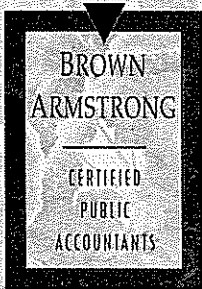
**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2003**

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 (the District). 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.



**BROWN ARMSTRONG
PAULDEN McCOWN STARBUCK & KEETER**
CERTIFIED PUBLIC ACCOUNTANTS

Main Office
4200 Truxtun Ave., Suite 300
Bakersfield, California 93309
Tel 661-324-4971 Fax 661-324-4997
e-mail: barrinfo@barrcpa.com

Shafter Office
560 Central Avenue
Shafter, California 93263
Tel 661-746-2145 Fax 661-746-1218

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Harvey J McCown, CPA
Steven R Starbuck, CPA
Aileen K Keeter, CPA

**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL
OVER FINANCIAL REPORTING BASED ON AN AUDIT OF BASIC
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS AND THE RULES AND
REGULATIONS OF THE TRANSPORTATION DEVELOPMENT ACT**

Chris M Thornburgh, CPA
Lynn R Krausse, CPA, MST
Bradley M Hankins, CPA
Eric H Xin, CPA
Melinda A McDaniels, CPA
Thomas M Young, CPA
Amanda E Wilson, CPA
Sharon Jones, CPA, MST
Rosalva Flores, CPA
Debbie A Rapp, CPA
Julie A Auvil, CPA
Connie M Perez, CPA

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, 2003, and have issued our report thereon dated August 13, 2003. 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.

Compliance

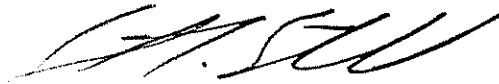
As part of obtaining reasonable assurance about whether the Santa Cruz Metropolitan Transit District's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. 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 that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

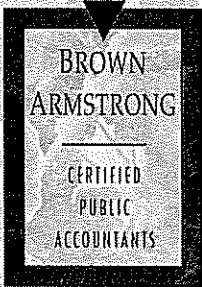
In planning and performing our audit, we considered Santa Cruz Metropolitan Transit District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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 PAULDEN
McCOWN STARBUCK & KEETER
ACCOUNTANCY CORPORATION

A handwritten signature in black ink, appearing to be "G.A. Paulden", written in a cursive style.

Bakersfield, California
August 13, 2003



**BROWN ARMSTRONG
PAULDEN McCOWN STARBUCK & KEETER**
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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**

Chris M Thornburgh, CPA
Lynn R Krausse, CPA, MST
Bradley M Hankins, CPA
Eric H Xin, CPA
Melinda A McDaniels, CPA
Thomas M Young, CPA
Amanda E Wilson, CPA
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Connie M Perez, CPA

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 its major federal program for the year ended June 30, 2003. Santa Cruz Metropolitan Transit District's major federal program is 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 its major federal program 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 on Santa Cruz Metropolitan Transit District's compliance with those requirements.

In our opinion, the Santa Cruz Metropolitan Transit District complied, in all material respects, with the requirements referred to above that are applicable to its major federal programs for the year ended June 30, 2003.

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 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 and to test and report on internal control over compliance in accordance with OMB Circular A-133.

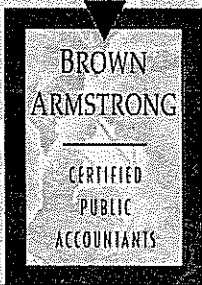
Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

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 PAULDEN
McCOWN STARBUCK & KEETER
ACCOUNTANCY CORPORATION



Bakersfield, California
August 13, 2003



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REPORT ON COMPLIANCE WITH THE
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 (the District), as of and for the year ended June 30, 2003, and have issued our report there on dated August 13, 2003.

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 the District is the responsibility of the management of the District. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the District's compliance with certain provisions of the Transportation Development Act, including Public Utilities Code Section 99245 as enacted and amended by statute through June 30, 2003, and the allocation instructions and resolutions of the Santa Cruz County Regional Transportation Commission as required by Section 6667 of the California Code of Regulations. However, our objective was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests indicated that, with respect to the items tested, the District 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 the District 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 PAULDEN
McCOWN STARBUCK & KEETER
ACCOUNTANCY CORPORATION

Bakersfield, California
August 13, 2003

FINDINGS AND QUESTIONED COSTS SECTION

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2003**

I. Summary of Auditor's Results

Financial Statements

Type of auditors' report issued: Unqualified

Internal control over financial reporting:

Material weakness identified?	Yes	<input checked="" type="checkbox"/>	No
Reportable conditions identified that are not considered to be material weaknesses?	Yes	<input checked="" type="checkbox"/>	None reported
Noncompliance material to financial statements noted?	Yes	<input checked="" type="checkbox"/>	No

Federal Awards

Internal control over major federal programs:

Material weakness identified?	Yes	<input checked="" type="checkbox"/>	No
Reportable conditions identified that are not considered to be material weaknesses?	Yes	<input checked="" type="checkbox"/>	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	<input checked="" type="checkbox"/>	No
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Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Clusters</u>
20.500	Federal Transit Administration-Section 3
20.507	Federal Transit Administration-Section 9

Dollar threshold used to distinguish Type A & B programs:	\$311,600	
Auditee qualified as low risk auditee?	<input checked="" type="checkbox"/>	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, 2002) Findings and Current Year Status Follows

None.