SANTA CRUZ METROPOLITAN TRANSIT DISTRICT

FINANCIAL STATEMENTS
WITH
INDEPENDENT AUDITOR'S REPORT

JUNE 30, 2008 AND 2007

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
JUNE 30, 2008 AND 2007

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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 (METRO), as of June 30, 2008 and 2007, 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, 2008 and 2007, 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 10, 2008 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 THORNBURGH & KEETER
ACCOUNTANCY CORPORATION

Bakersfield, California
November 10, 2008

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2008 AND 2007

Introduction

This report provides a narrative and analytical overview of the financial activities of the Santa Cruz Metropolitan Transit District (METRO) with selected comparative information for the years ended June 30, 2008 and 2007. 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.

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. 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

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. 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 Statements of Net Assets present information on METRO's assets and liabilities, with the difference between the two reported as net assets.

The Statements of Revenue, Expenses and Changes in Fund Net Assets report the *operating* revenues and expenses, *non-operating* revenues and expenses and *capital grant* revenues. *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 Statements of Cash Flows report 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* financing activities (acquisitions and disposal) and *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

METRO has completed the MetroBase Service and Fueling Facility located at 1200 B River Street, Santa Cruz, and is continuing site work on the Maintenance Building at 120 Golf Club Drive, Santa Cruz. In August 2007, METRO acquired the building located at 110 Vernon Street, Santa Cruz that is strategically located across from the new Maintenance Building at 120 Golf Club Drive. This property was acquired as a replacement facility for the leased Administration facility located at 370 Encinal, Santa Cruz. The MetroBase project will ultimately bring operations, maintenance, and administration into one cluster of buildings to provide the needed infrastructure to achieve service expansion goals. The MetroBase project is funded with local, state, and federal funds. Capital additions to the MetroBase project for the year totaled $9,421,190.

The MetroBase project is also a necessary component for providing Compressed Natural Gas (CNG) to METRO's fleet. In January 2007 Caltrans executed a grant agreement with METRO to convert up to forty (40) buses from diesel to CNG fuel engines. By June 2008 thirty-one (31) of the diesel to CNG conversions had been completed and installed. Fueling 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 $4,765,644.

Condensed Statement of Net Assets:

	2008	2007	Increase/(Decrease) Amount	%
Total Assets	$ 105,036,300	$ 85,616,653	$ 19,419,647	23%
Total Liabilities	$ 24,760,587	$ 22,262,083	$ 2,498,504	11%
Total Net Assets	$ 80,275,713	$ 63,354,570	$ 16,921,143	27%

Total Assets increased this year due to real estate acquisitions and construction in progress. Total Liabilities increased due to the addition of restricted capital funds (Proposition 1B PTMISEA).

An increase or decrease in net assets is an indicator of the financial health of METRO. For the fiscal year ended June 30, 2008, METRO's net assets increased by $16,921,143 due to capital and real estate additions related to on-going construction of the Consolidated Metrobase Project, and the conversion of thirty-one (31) diesel bus engines to Compressed Natual Gas (CNG).

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

	2008	2007	Increase/(Decrease) Amount	%
Operating Revenues	$ 8,272,058	$ 7,730,499	$ 541,559	7%
Operating Expenses	(38,683,643)	(31,952,451)	(6,731,192)	21%
Operating Loss	(30,411,585)	(24,221,952)	(6,189,633)	26%
Non-operating Revenues	28,164,895	33,133,407	(4,968,512)	-15%
Capital Contributions	19,167,833	6,659,395	12,508,438	188%
Increase (Decrease) in Net Assets	$ 16,921,143	$ 15,570,850	$ 1,350,293	9%

Operating Revenues increased slightly by 7% due to increased ridership for UC Santa Cruz and Cabrillo College.

Operating Expenses increased by 21% primarily due to the effect of a significant reduction made last fiscal year to the Workers' Compensation incurred but not reported (IBNR) account, increased medical insurance premiums, and significantly increased fuel costs.

Non-operating Revenues decreased by 15% primarily due to lower than anticipated sales tax revenue, less favorable interest income, and one time revenue.

Capital Contributions are capital grant funds received for purchases of revenue vehicles and facilities improvement. Capital acquisitions were significantly increased by 188% from the prior year due to capital and real estate additions related to construction of the Consolidated MetroBase Project, and the conversion of thirty-one (31) diesel bus engines to Compressed Natual Gas (CNG).

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

	2008	2007	% Change
Revenues			
Passenger Fares	$ 8,272,058	$ 7,730,499	7.0%
Sales and Use Tax	17,054,735	17,652,773	-3.4%
Non-Operating Revenues (1)	1,558,759	2,032,515	-23.3%
TDA (2)	6,313,334	6,165,834	2.4%
Federal Operating Assistance	3,375,281	3,338,212	1.1%
Total Operating Revenue	$ 36,574,167	$ 36,919,833	-0.9%
Expenses			
Route Operation	$ 20,834,142	$ 19,872,415	4.8%
Vehicle Maintenance	4,998,255	4,811,254	3.9%
Facilities Maintenance	1,333,439	1,281,359	4.1%
General Administration (3)	7,763,787	6,592,585	17.8%
Total Operating Expense (excluding depreciation)	$ 34,929,623	$ 32,557,613	7.3%
Performance Indicators			
Total Passengers	5,888,213	5,695,910	3.4%
Revenue Hours	257,705	260,099	-0.9%
Revenue Miles	3,709,152	3,685,802	0.6%
Farebox Recovery Ratio (4)	23.7%	23.7%	-0.1%
Cost/Passenger	$ 5.93	$ 5.72	3.7%
Cost/Hour	$ 135.54	$ 125.17	8.3%
Cost/Mile	$ 9.41	$ 8.83	6.6%
Full Time Equivalent Employees	323	318	1.6%
Active Fleet - Fixed Route	112	115	-2.6%
Active Fleet - Paratransit	38	34	11.8%

(1) Non-Operating Revenues decreased primarily from less than anticipated sales tax receipts due to less consumer discretionary spending and current economic conditions.

(2) Transportation Development Act (TDA) funding constitutes a significant percentage of METRO's operating revenues. The TDA revenue METRO receives fluctuates 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.

(3) General Administration expenses increased this year due to the effect of a reduction made to the Worker's Compensation incurred but not reported (IBNR) account last year.

(4) Farebox Recovery Ratio is a standard transit performance indicator that is calculated by dividing passenger fares by operating expenses and does not include depreciation or current year incurred but not reported (IBNR) Worker's Compensation adjustments.

Condensed Statement of Cash Flows:

	2008	2007	Change
Net Cash (Used) in Operating Activities	$ (25,145,487)	$ (24,793,543)	$ (351,944)
Net Cash Provided by Non-Capital Financing Activities	27,045,524	32,400,938	(5,355,414)
Net Cash Provided by (Used) in Capital and Related Financing Activities	(5,206,123)	(4,919,921)	(286,202)
Net Cash Provided by Non-Transportation Activities	1,090,834	1,469,308	(378,474)
Net Increase (Decrease) in Cash and Cash Equivalents	(2,215,252)	4,156,782	(6,372,034)
Cash and Cash Equivalents, Beginning of Year	36,045,562	31,888,780	4,156,782
Cash and Cash Equivalents, End of Year	$ 33,830,310	$ 36,045,562	$ (2,215,252)

Cash and cash equivalents held by METRO decreased by $2,215,252 or 6% during the year.

Contacting METRO's Financial Management

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

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF NET ASSETS
JUNE 30, 2008 AND 2007

	2008	2007
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents	$ 19,660,767	$ 23,924,509
Sales Tax and Other Receivables	12,290,177	5,861,817
Inventory	946,561	994,550
Prepaids	389,232	401,478
Total Current Assets	33,286,737	31,182,354
RESTRICTED ASSETS		
Cash and Cash Equivalents	14,169,543	12,121,053
PROPERTY AND EQUIPMENT		
Building and Improvements	13,467,177	10,486,491
Revenue Vehicles	40,194,340	35,609,181
Operations Equipment	2,203,998	2,818,470
Other Equipment	1,489,053	1,285,123
Other Vehicles	1,217,023	1,153,348
Office Equipment	1,199,716	1,143,615
	59,771,307	52,496,228
Less Accumulated Depreciation	(34,516,865)	(32,084,205)
	25,254,442	20,412,023
Construction in Progress	23,160,708	15,952,697
Land	9,164,870	5,948,526
Total Property and Equipment	57,580,020	42,313,246
TOTAL ASSETS	$ 105,036,300	$ 85,616,653

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

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF NET ASSETS (Continued)
JUNE 30, 2008 AND 2007

	2008	2007
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts Payable and Accrued Liabilities	$ 2,804,010	$ 1,284,299
Accrued Payroll and Employee Benefits	3,726,070	3,732,012
Workers' Compensation Liabilities	1,022,608	1,022,608
Other Accrued Liabilities	417,684	428,619
Security Deposit	17,684	17,884
Deferred Revenue	-	4,317
Total Current Liabilities	7,988,056	6,489,739
LIABILITIES PAYABLE FROM RESTRICTED ASSETS		
Deferred Revenue - Settlement Agreement	6,612,064	7,304,339
Deferred Revenue - STA Grant	2,066,267	4,816,714
Deferred Revenue - PTMISEA	4,442,909	-
LONG-TERM LIABILITIES		
Workers' Compensation Liabilities	3,651,291	3,651,291
Total Liabilities	24,760,587	22,262,083
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	57,580,020	42,313,246
Unrestricted Net Assets	22,695,693	21,041,324
Total Net Assets	80,275,713	63,354,570
TOTAL LIABILITIES AND NET ASSETS	$ 105,036,300	$ 85,616,653

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, 2008 AND 2007

	2008	2007
OPERATING REVENUES		
Passenger Fare	$ 4,671,177	$ 4,463,020
Special Transit Fare	3,600,881	3,267,479
Total Operating Revenues	8,272,058	7,730,499
OPERATING EXPENSES		
Wages, Salaries and Employee Benefits	26,900,557	22,978,995
Purchased Transportation Services	288,787	200,482
Material and Supplies	4,068,119	3,455,571
Other Expenses	3,672,161	3,547,649
Depreciation	3,754,019	1,769,754
Total Operating Expenses	38,683,643	31,952,451
Net Operating Loss	(30,411,585)	(24,221,952)
NON-OPERATING REVENUES (EXPENSES)		
Sales and Use Tax	17,054,735	17,652,773
Transportation Development Act Assistance	6,313,334	6,165,834
Section 8/5303 Planning Fund	54,609	39,404
Section 9/5307 Operating Assistance	3,153,552	3,130,226
Section 18/5307 Operating Assistance	167,120	168,582
Other State Operating Assistance	-	3,989,033
Interest Income	942,456	1,327,929
Rental Income	148,378	141,379
Other Revenue	467,925	563,207
Loss on Sale and Disposal of Property, Equipment, and Inventory	(137,214)	(44,960)
Total Non-Operating Revenues	28,164,895	33,133,407
Net Gain (Loss) Before Capital Contributions	(2,246,690)	8,911,455
CAPITAL CONTRIBUTIONS		
Grants Restricted for Capital Expenditures	19,167,833	6,659,395
NET ASSETS		
Increase in Net Assets	16,921,143	15,570,850
Total Net Assets, Beginning of Year	63,354,570	47,783,720
Total Net Assets, End of Year	$ 80,275,713	$ 63,354,570

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, 2008 AND 2007

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts From Customers	$ 8,210,333	$ 7,459,799
Payments to Employees	(26,906,499)	(24,972,990)
Payments to Suppliers	(6,449,321)	(7,280,352)
Net Cash Used in Operating Activities	(25,145,487)	(24,793,543)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Operating Grants Received, Including Sales and Use Tax	27,039,733	32,400,067
Other Nonoperating	5,791	871
Net Cash Provided by Noncapital Financing Activities	27,045,524	32,400,938
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Proceeds From Sale of Property and Equipment	1,265	1,027,896
Capital Grants Received	13,814,670	6,626,541
Capital Expenditures	(19,022,058)	(12,574,358)
Net Cash Used in Capital and Related Financing Activities	(5,206,123)	(4,919,921)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment and Rental Income Received	1,090,834	1,469,308
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(2,215,252)	4,156,782
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	36,045,562	31,888,780
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 33,830,310	$ 36,045,562
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES		
Operating Loss	$ (30,411,585)	$ (24,221,952)
Adjustments to Reconcile Net Operating Loss to Net Cash Used in Operating Activities:		
Depreciation	3,754,019	1,769,754
Changes in Assets and Liabilities:		
(Increase) Decrease in Receivables	(61,725)	(270,700)
(Increase) in Inventory	47,989	(66,524)
(Increase) Decrease in Prepaid Expenses	12,246	153,875
Increase (Decrease) in Accounts Payable	1,519,711	(165,201)
Increase (Decrease) in Other Liabilities	(6,142)	(1,992,795)
Net Cash Used in Operating Activities	$ (25,145,487)	$ (24,793,543)

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

NOTE 1 – OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of Organization

The Santa Cruz Metropolitan Transit District (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. METRO is governed by a Board of eleven directors, and one Ex-Officio director representing the University of California, Santa Cruz. At June 30, 2008, the directors were as follows:

Chairperson:	Marcela Tavantzis		
Vice Chair:	Jan Beautz		
Members:	Dale Skillicorn	Michelle Hinkle	Mark Stone
	Mike Rotkin	Emily Reilly	Pat Spence
	Dene Bustichi	Donald Hagen	Kirby Nicol
Ex-Officio:	Donna Blitzer		

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

B. Reporting Entity

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 METRO. Accordingly, the financial activities of the Corporation have been included in the financial statements of METRO. For the years ending June 30, 2008 and 2007, 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 METRO for the construction and acquisition of major capital facilities.

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

Accountability:

1. The Corporation's Board of Directors was appointed by METRO's Board of Directors.

NOTE 1 – <u>OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES</u> (Continued)

B. <u>Reporting Entity</u> (Continued)

2. 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 METRO.
   - METRO exercises significant influence over operations of the Corporation as it is anticipated that METRO will be the sole lessee of all facilities owned by the Corporation. Likewise, it is anticipated that 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 METRO based upon the following:

   - METRO has assumed a "moral obligation", and potentially a legal obligation, for any debt incurred by the Corporation.

C. <u>Basis of Accounting and Presentation</u>

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.

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:

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*, 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 $19,167,833 and $6,659,395 for the fiscal years 2008 and 2007, 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*, 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. 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 METRO's operations.

Net Assets:

Net assets represent the residual interest in 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 METRO's policy to use restricted resources first, then unrestricted resources as they are needed.

D. Cash and Cash Equivalents

METRO considers all highly liquid investments with a maturity date within three months of the date acquired to be cash equivalents. 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, 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 METRO consists of spare bus parts that are consumed by 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 and the Proposition 1B PTMISEA Grant are restricted for capital expenditures. Restricted assets at June 30, are as follows:

	2008	2007
Cash and Cash Equivalents		
Federal Transit Administration Grant	$ 7,660,367	$ 7,304,339
Proposition 1B PTMISEA Grant	4,442,909	-
State Transit Assistance Grant	2,066,267	4,816,714
Total Restricted Assets	$ 14,169,543	$ 12,121,053

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.

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

H. Sales and Use Tax

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, 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.

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

METRO is self-insured for the first $250,000 of general and vehicular liability. For settlements in excess of $250,000, METRO has total coverage up to $20,000,000 per occurrence. Additionally, METRO is self insured up to $350,000 for workers' compensation claims. 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 lease 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.

L. Payroll

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.

NOTE 2 – CASH AND INVESTMENTS

Cash and cash equivalents consists of the following at June 30, 2008 and 2007:

	2008	2007
Cash on Hand	$ 40,311	$ 29,121
Demand Deposits	357,298	289,542
Deposits in Santa Cruz County Pooled Investment Fund	33,432,701	35,726,899
	$ 33,830,310	$ 36,045,562

NOTE 2 – CASH AND INVESTMENTS (Continued)

Cash on Hand and Cash in Banks

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

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

Authorized Investment Type	Maximum Maturity	Maximum Percentage Of Portfolio	Maximum Investment in One Issuer
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.

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

		Remaining Maturity (in Months)			
Investment Type	Amount	12 Months Or Less	13 to 24 Months	25 to 60 Months	More Than 60 Months
County Investment Pool	$ 33,432,701	$ 33,432,701	$ -	$ -	$ -

Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations

METRO's investments were not considered to be highly sensitive to interest rate fluctuations as of June 30, 2008 or 2007.

NOTE 2 – CASH AND INVESTMENTS (Continued)

Cash on Hand and Cash in Banks (Continued)

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, 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:

				Rating as of Year End		
Investment Type	Amount	Minimum Legal Rating	Exempt From Disclosure	AAA	Aa	Not Rated
County Investment Pool	$ 33,432,701	N/A	$ -	$ -	$ -	$ 33,432,701

Concentration of Credit Risk

The investment policy of METRO contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. METRO did not have any Investments in any one issuer (other than external investment pools) that represent 5% or more of total METRO's investments at June 30, 2008 or 2007.

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 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.

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

Investment in County Investment Pool

METRO is a voluntary participant in the Santa Cruz County Investment Fund. The fair value of METRO's investment in this pool is reported in the accompanying financial statements at amounts based upon 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:

	2008	2007
Federal Grants	$ 8,589	$ 796,879
State Grants	8,170,973	1,071,150
Sales Tax Revenue	2,818,400	2,812,600
Local Grants	37,500	-
Other	1,254,715	1,181,188
	$ 12,290,177	$ 5,861,817

NOTE 4 – CHANGES IN CAPITAL ASSETS

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

June 30, 2008	Balance July 1, 2007	Additions and Transfers	Retirements and Transfers	Balance June 30, 2008
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	$ 42,313,246	$ 19,823,918	$ (4,557,144)	$ 57,580,020

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

NOTE 4 – CHANGES IN CAPITAL ASSETS (Continued)

June 30, 2007

	Balance July 1, 2006	Additions and Transfers	Retirements and Transfers	Balance June 30, 2007
Non Depreciated Assets				
Land	$ 6,976,423	$ -	$ (1,027,897)	$ 5,948,526
Construction-in-Progress	4,816,956	11,135,741	-	15,952,697
Total Non Depreciated Assets	11,793,379	11,135,741	(1,027,897)	21,901,223
Depreciated Assets				
Building and Improvements	10,452,483	34,008	-	10,486,491
Revenue Vehicles	34,649,265	959,916	-	35,609,181
Operations Equipment	2,687,228	132,559	(1,317)	2,818,470
Other Equipment	1,285,123	-	-	1,285,123
Other Vehicles	898,514	254,834	-	1,153,348
Office Equipment	1,094,759	57,299	(8,443)	1,143,615
Total Depreciated Assets	51,067,372	1,438,616	(9,760)	52,496,228
Less Accumulated Depreciation	(30,324,213)	(1,769,752)	9,760	(32,084,205)
Depreciated Assets Net of Accumulated Depreciation	20,743,159	(331,136)	-	20,412,023
Total	$ 32,536,538	$ 10,804,605	$ (1,027,897)	$ 42,313,246

Depreciation expense at June 30, 2007 was $1,769,752.

NOTE 5 – AVAILABLE NET ASSETS

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

	2008	2007
Current Assets	$ 33,286,737	$ 31,182,354
Current Liabilities	(7,988,056)	(6,489,739)
Working Capital	25,298,681	24,692,615
Less:		
Inventory	(946,561)	(994,550)
Prepaid Expenses	(389,232)	(401,478)
Total Available Net Assets	23,962,888	23,296,587
Net Assets Designated for the Following:		
Cash Flow	(5,059,022)	(5,225,000)
Workers' Compensation Reserve	(2,091,581)	(2,142,304)
110 Vernon Purchase - Renovation	(2,962,139)	(1,000,000)
Insurance Reserve	(750,757)	(750,000)
Alternative Fuel Conversion Fund	(462,000)	(462,000)
Bus Stop Improvements Reserve	(400,000)	(400,000)
Carryover for Fiscal Year 2007-2008 Operating Budget	(2,951,178)	(911,228)
Carryover for Sales Tax-Based UTU Wage Adjustment	-	(256,137)
Net Assets Required to Fund Transportation Improvement Programs for the Fiscal Years 2008-2012	(13,625,636)	(13,250,790)
Available Undesignated Net Assets (Deficits)	$ (4,339,425)	$ (1,100,872)

NOTE 6 – CAPITAL GRANTS

METRO receives grants from the Federal Transit Administration (FTA), which provides financing for the acquisition of rolling stock and construction of facilities. 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:

	2008	2007
Federal Grants	$ 2,152,133	$ 4,753,898
State Grants	16,980,757	1,218,835
Local Grants	34,943	686,662
Total Capital Assistance	$ 19,167,833	$ 6,659,395

NOTE 7 – COMMITMENTS

METRO leases a number of its facilities under operating leases extending through 2012. For the years ended June 30, 2008 and 2007, rental expense relating to the leases was $697,925 and $765,219, respectively. 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:

Year Ending June 30	Lease Commitments	Rental Income	Net
2009	$ 540,571	$ 126,156	$ 414,415
2010	241,974	111,795	130,179
2011	123,829	30,692	93,137
2012	21,697	-	21,697
	$ 928,071	$ 268,643	$ 659,428

NOTE 8 – JOINT VENTURES (Joint Powers Authority)

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

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

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

	2008	2007
Total Assets	$ 22,411,570	$ 19,349,480
Total Liabilities	7,763,419	7,390,394
Fund Balance	$ 14,648,151	$ 11,959,086
Total Revenues	$ 9,055,989	$ 8,626,160
Total Expenditures	6,490,515	4,565,456
Net Increase in Fund Balance	$ 2,565,474	$ 4,060,704

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

NOTE 9 – WATSONVILLE FLEET MAINTENANCE FACILITY

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.

In addition, due to design and construction deficiencies by the design and building contractors involved in the original project, 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 METRO 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 $7,669,367 and $7,304,339 is reflected on the statements of net assets as deferred revenue at June 30, 2008 and 2007, respectively.

NOTE 10 – CONTINGENCIES

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, METRO believes that any required reimbursement will not be material.

Additionally, 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

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. 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 323 active plan members in the Fund as of June 30, 2008, 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, METRO agreed to pay a portion of the employee contribution, based on formulas negotiated in their labor agreements. 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, 2008 was 12.86%. 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, 2008, METRO's annual pension cost of $1,997,214 was equal to METRO's required and actual contributions. This includes METRO's contribution to the employee contribution requirement. The required contribution for fiscal year ended June 30, 2008 was determined as part of the June 30, 2006 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 METRO's participation in CalPERS is as follows:

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
6/30/2006	$ 1,800,967	100%	$ -
6/30/2007	$ 1,791,125	100%	$ -
6/30/2008	$ 1,997,214	100%	$ -

NOTE 11 – DEFINED BENEFIT PENSION PLAN (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 METRO is as follows:

Valuation Date	Entry Age Actuarial Accrued Liability	Actuarial Value of Assets	Unfunded/ (Overfunded) Liability	Funded Ratio	Annual Covered Payroll	UAAL as a % of Payroll
6/30/2004	$ 66,923,612	$59,816,757	$ 7,106,855	89.4%	$14,011,732	50.7%
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%

NOTE 12 – POST-RETIREMENT BENEFITS

METRO provides post-retirement benefits to its employees who have completed at least ten years of full-time service with METRO, have reached the age of 50 and have retired under the provisions of CalPERS while an employee of METRO. METRO pays a portion of the premiums for medical insurance for retirees and eligible dependents. METRO 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 who retired prior to July 1, 2005. The costs of providing these benefits are recognized when paid. METRO has recognized approximately $1,496,061 and $1,358,022 of expense for these benefits for the years ending June 30, 2008 and 2007, respectively.

NOTE 13 – DEFERRED COMPENSATION PLAN

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 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. 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, 2008, 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

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 METRO carries commercial insurance. METRO has established limited risk management programs for workers' compensation, and general and vehicular liability, as described in Note 1, as well.

NOTE 14 – RISK MANAGEMENT (Continued)

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 pay-outs and other economic and social factors. Changes in the balances of claims liabilities are as follows:

	2008	2007
Unpaid Claims, Beginning of Fiscal Year	$ 4,673,900	$ 7,048,813
Incurred Claims (Including IBNR's)	(974,098)	(3,204,474)
Claim Payments	974,097	829,560
Unpaid Claims, End of Fiscal Year	$ 4,673,899	$ 4,673,899

NOTE 15 – TRANSPORTATION DEVELOPMENT ACT/CALIFORNIA ADMINISTRATIVE CODE

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

SUPPLEMENTARY INFORMATION

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF OPERATING EXPENSES
FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

	2008	2007
Labor		
Operators' Salaries and Wages	$ 7,430,732	$ 7,260,939
Other Salaries and wages	5,866,496	5,521,525
Overtime	1,736,090	1,527,481
	15,033,318	14,309,945
Fringe Benefits		
Absence with pay	2,839,773	2,980,676
Pension plans	1,997,214	1,791,125
Vision, medical, and dental plans	5,509,822	4,901,050
Workers' compensation insurance	979,924	(1,554,789)
Disability insurance	335,963	332,785
Other fringe benefits	204,543	218,203
	11,867,239	8,669,050
Services		
Accounting	84,436	71,716
Administrative and banking	176,719	156,778
Professional and technical services	373,166	399,064
Security	341,087	392,183
Outside repairs	660,244	398,714
Other Services	157,632	175,385
	1,793,284	1,593,840
Materials and Supplies Consumed		
Fuels and Lubricants	2,697,309	2,223,764
Tires and Tubes	185,825	187,683
Vehicle parts	775,902	695,062
Other materials and supplies	409,083	349,062
	4,068,119	3,455,571
Utilities	434,011	354,487
Casualty and Liability Costs	511,863	547,738
Taxes and Licenses	35,364	41,039
Purchased Transportation Services		
Para transit	288,787	200,482
Miscellaneous Expenses	179,802	164,830
Equipment and Facility Lease	717,837	845,715
Depreciation		
Property Acquired with operator funds	471,919	311,293
Property acquired by federal, state, or TDA funds	3,282,100	1,458,461
	5,921,683	3,924,045
Total Operating Expenses	$ 38,683,643	$ 31,952,451

OTHER SCHEDULES AND REPORTS

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2008

Federal Grantor / Program Title	Federal CFDA No.	Pass-Through Grantor's Number	Total Federal Expenditures
U.S. DEPARTMENT OF TRANSPORTATION			
Direct Programs:			
Federal Transit Administration (FTA)			
Cluster Defined by the Department of Transportation			
Section 3/5309 Consolidation			
Land Acquisition	20.500*	CA-03-0413	$ 1,226,090
Fixed Route Buses and Vans	20.500*	CA-03-0505-02	71,491
			1,297,581
Section 9/5307			
Metrobase Construction	20.507*	CA-90-Y582	723,645
Operating Assistance	20.507*	CA-90-Y582	3,223,552
			3,947,197
Section 18/5311			
Operating Assistance	20.509	647162	149,335
AMBAG - Short Range Transit Plan	20.509	5303	38,967
AMBAG - Transit Plan	20.509	5313(b)	7,139
AMBAG - Transit Professional Development	20.509	5313(b)	10,572
AMBAG - Coordinated	20.509	5317	1,100
			57,778
Total Expenditures of Federal Awards			$ 5,451,891

* Major federal financial assistance program.

See accompanying notes to schedule of federal financial assistance.

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 (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 TRANSPORTATION DEVELOPMENT ACT

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

We have audited the financial statements of the business-type activities of Santa Cruz Metropolitan Transit District, as of and for the year ended June 30, 2008, which collectively comprise Santa Cruz Metropolitan Transit District's basic financial statements and have issued our report thereon dated November 10, 2008. 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 10, 2008.

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 PAULDEN
McCOWN STARBUCK THORNBURGH & KEETER
ACCOUNTANCY CORPORATION

Bakersfield, California
November 10, 2008

BROWN ARMSTRONG PAULDEN
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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, 2008. 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, 2008.

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 PAULDEN
McCOWN STARBUCK THORNBURGH & KEETER
ACCOUNTANCY CORPORATION

Bakersfield, California
November 10, 2008

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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 (METRO), as of and for the year ended June 30, 2008, and have issued our report thereon dated November 10, 2008.

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 METRO is the responsibility of the management of METRO. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of METRO'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, 2008, 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, 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 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 PAULDEN
McCOWN STARBUCK THORNBURGH & KEETER
ACCOUNTANCY CORPORATION

Bakersfield, California
November 10, 2008

FINDINGS AND QUESTIONED COSTS SECTION

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2008

I. Summary of Auditor's Results

Financial Statements

Type of auditors' report issued:		Unqualified	
Internal control over financial reporting: Material weakness identified?	Yes	X	No
Significant deficiencies identified?	Yes	X	None reported
Noncompliance material to financial statements noted?	Yes	X	No

Federal Awards

Internal control over major federal programs: Material weakness identified?	Yes	X	No
Reportable conditions identified that are not considered to be material weaknesses?	Yes	X	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	X	No

Identification of major programs:

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

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

Auditee qualified as low risk auditee? X Yes No

II. <u>Findings Relating to Financial Statements Required Under GAGAS</u>

None.

III. <u>Federal Award Findings and Questioned Costs</u>

None.

IV. <u>State Award Findings and Questioned Costs</u>

None.

V. <u>A Summary of Prior Audit (all June 30, 2007) Findings and Current Year Status Follows</u>

None.