

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT

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

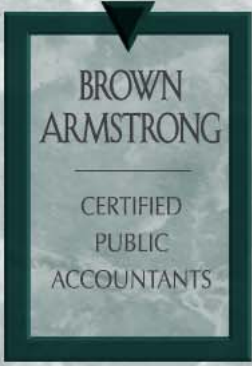
JUNE 30, 2015

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
JUNE 30, 2015**

TABLE OF CONTENTS

	<u>Page</u>
<u>Financial Section</u>	
Independent Auditor's Report	1
Management's Discussion and Analysis.....	3
 <u>Basic Financial Statements</u>	
Statement of Net Position	11
Statement of Revenues, Expenses, and Changes in Fund Net Position	13
Statement of Cash Flows.....	14
Notes to Basic Financial Statements	15
 <u>Required Supplementary Information</u>	
Schedule of Changes in the Net Pension Liability and Related Ratios	35
Schedule of Contributions	36
Schedule of Funding Progress – Other Postemployment Benefits	37
 <u>Supplementary Information</u>	
Statements of Operating Expenses	38
 <u>Other Schedules and Reports</u>	
Schedule of Expenditures of Federal Awards.....	39
Notes to Schedule of Expenditures of Federal Awards	40
Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Basic Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	41
Independent Auditor's Report on Compliance for Each Major Program and on Internal Control over Compliance Required by OMB Circular A-133	43
Independent Auditor's Report on Compliance Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with the Statutes, Rules, and Regulations of the California Transportation Development Act and the Allocation Instructions and Resolutions of the Transportation Commission.....	45
 <u>Findings and Questioned Costs Section</u>	
Schedule of Findings and Questioned Costs.....	47

FINANCIAL SECTION



BROWN ARMSTRONG

Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of the Santa Cruz Metropolitan Transit District (Santa Cruz METRO), as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprises the Santa Cruz METRO's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to Santa Cruz METRO's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Santa Cruz METRO's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

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Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Santa Cruz METRO as of June 30, 2015 and the respective changes in financial position, and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, Schedule of Changes in the Net Pension Liability and Related Ratios, and Schedule of Contributions on page 35 and 36, as well as the schedule of funding progress for Santa Cruz METRO's other postemployment benefit (OPEB) plan on page 37, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board (GASB), who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the basic financial statements. The statements of operating expenses are presented for purposes of additional analysis and are not a required part of the basic financial statements. The 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 also not a required part of the basic financial statements.

The statements of operating expenses and the schedule of expenditures of federal awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the statements of operating expenses and the schedule of expenditures of federal awards are fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 22, 2015, on our consideration of Santa Cruz METRO's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Santa Cruz METRO's internal control over financial reporting and compliance.

Bakersfield, California
December 22, 2015

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Brown Armstrong
Accountancy Corporation

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2015**

Introduction

The following Management's Discussion and Analysis (MD&A) of activities and financial performance of Santa Cruz Metropolitan Transit District (Santa Cruz METRO) provides a narrative and analytical overview of the financial activities of Santa Cruz METRO with selected comparative information for the years ended June 30, 2015 and 2014. Following the MD&A are the basic financial statements of Santa Cruz METRO together with the notes thereto, which are essential for a full understanding of the data contained in the financial statements.

Activities and Highlights

Santa Cruz METRO is an independent agency formed in 1969 by the legislature of the State of California for the purpose of providing Fixed Route bus service to the general public in Santa Cruz County (County). Santa Cruz METRO assumed direct operation of federally mandated Americans with Disabilities Act (ADA) complementary paratransit (Paracruz) services in November 2004. Prior to 2004, the paratransit service was delivered under contract. Santa Cruz METRO also operates the Highway 17 (Commuter) Express bus service to Santa Clara County in cooperation with the Santa Clara Valley Transportation Authority (VTA), AMTRAK, San Joaquin Joint Powers Authority (SJJPA), and the Capitol Corridor Joint Powers Authority (CCJPA). Overseeing the employees who work in the public interest, the Chief Executive Officer/General Manager coordinates the operation of Santa Cruz METRO according to the policy and direction of the governing Board of Directors, composed of eleven directors and one ex-officio director as described in Note 1.A.

The Financial Statements

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

The Statement of Net Position presents complete information on Santa Cruz METRO's assets and deferred outflows of resources, as well as liabilities and deferred inflows of resources, with the difference reported as net position. Changes in net position that occur over time may serve as an indicator of the Santa Cruz METRO's financial position.

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

The Statement of Cash Flows reports the sources and uses of cash for the fiscal year resulting from *operating* activities, *non-capital financing* activities (operating grants and sales tax receipts), *capital and related financing* activities (capital acquisitions and disposals), and *investing* activities (interest and rental receipts). 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 Position.

The Notes to the Financial Statements are an integral component of the report, as they provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes describe the nature of Santa Cruz METRO's operations and significant accounting policies as well as clarify financial information unique to Santa Cruz METRO.

Following the basic financial statements and footnotes is the Required Supplementary Information, which provides a schedule of changes in the net pension liability, schedule of contributions to Santa Cruz METRO's defined benefit pension plan and a schedule of funding progress for other postemployment benefits (OPEB) obligations.

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
JUNE 30, 2015**

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

Financial Highlights

The following discussion provides an overview of the financial activities related to operations (operating revenue and expense) and capital funding (contributions) received for facilities improvements and the purchase of capital equipment for the year ended June 30, 2015.

Operating Revenue and Expense

Santa Cruz METRO utilizes five primary sources of revenue to operate its public transit services: passenger fares, sales tax, local transportation funds (TDA), federal funds, and other non-transportation related revenues (including advertising income, investment income, and rental income). After the economic recession of 2008, and in an effort to bridge the resulting operating budget gap, two sources of revenue that were used historically to fund the capital program were re-directed from the capital budget to the operating budget. These funding sources, Federal Transit Administration – Small Transit Intensive Cities (FTA-STIC) and State Transit Assistance (STA) have allowed Santa Cruz METRO to continue to provide and maintain a consistent level of service to the public, despite operating budgetary shortfalls. It was anticipated that the temporary waiver that allowed Santa Cruz METRO to use STA in the operating budget would expire in 2016. Senate Bill (SB) 508 (Beall) – commencing on July 1, 2016 provides transit properties the flexibility to use STA for operations or capital and limits the penalties for non-compliance with the efficiency standards, allowing Santa Cruz METRO to continue to use STA to partially meet future operating budgetary shortfalls.

Operating expenses are classified into ten basic categories: labor and fringe benefits, services, mobile materials and supplies, other materials and supplies, utilities, insurance costs (casualty and liability), taxes, purchased transportations costs, miscellaneous expense, and leases and rental expenses. These categories are consistent with the Uniform System of Accounts (USOA) and National Transit Database (NTD) reporting.

As with many transit and public agencies across the region and throughout the state, Santa Cruz METRO continues to face financial challenges due to significant increases in operating and capital costs with no significant increases in operating or capital contributions. The fiscal year 2015 operating budget is a balanced budget using operating revenues, STIC, STA and Cash Reserves to fill the budget gap. However, the fiscal year 2015 operating budget is not a structurally balanced budget, as recurring expenses exceed recurring revenues. In fiscal year 2015, Santa Cruz METRO staff conducted a series of workshops and Board of Directors' presentations in studying and identifying the systemic causes of the structural deficit that has occurred in recent years. A major contributing factor to the structural deficit has been identified as the reduction in sales tax revenue since the economic downturn of 2008. Operating costs have continued to rise and outpace any sales tax revenue recovery experienced since then. Resolving the ongoing budgetary funding issues will require a multi-year approach.

Capital Program

In fiscal year 2015, Santa Cruz METRO spent over \$9.5 million in capital contributions on new and ongoing capital projects. These capital projects were funded by a variety of sources including the Federal Transportation Administration (FTA), California Proposition 1B Transportation Bonds (Public Transportation Modernization, Improvement, and Service Enhancement Account (PTMISEA) and the Transit System Safety, Security, and Disaster Response Account (TSSSDRA)), State Transit Assistance (STA), the State-Local Partnership Program (SLPP), the State Transportation Improvement Program (STIP), FTA construction settlement funds, and local cash reserves.

Operating buses and owning/maintaining transit facilities is a capital intensive business. Funding Santa Cruz METRO's overall operation is a delicate balance between identifying the resources to operate the

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
JUNE 30, 2015**

service and identifying the resources to purchase and maintain the vehicles and facilities with which to operate the service. Santa Cruz METRO needs to reduce its dependence on using capital-eligible funds and cash reserves in the operating budget, and concentrate on restoring these funding sources to the capital program in order to achieve a "state-of-good-repair" and ensure that new capital grant opportunities that require matching funds from reserves can be pursued. To that end, the Santa Cruz METRO Board has recently adopted a Reserve Fund Policy that provides for the gradual restoration of STIC and STA funding to the capital program.

Significant capital asset activity includes:

- Construction nears completion on the Judy K. Souza Operations Facility, which began in spring 2013. This operations building and bus parking structure is another phase of the transit Santa Cruz METRO's MetroBase consolidated operations in the Harvey West area of Santa Cruz. The project budget is approximately \$26 million, with the majority of funding provided by the PTMISEA program, which was established through Proposition 1B. The current estimated completion date is January, 2016. This project is in progress.
- Purchase and installation of Land Mobile Radio (LMR) Equipment, Fiber Optic Cable at Watsonville Transit Center, and Video Surveillance Room Air Conditioning System at Pacific Station – funding provided by Cal-OES TSSSDRA (Proposition 1B) funds over 10 consecutive years starting in fiscal year 2009 – The LMR portion of the project is a fully functioning fleet mobile radio system for the fixed route, paratransit and non-revenue (service) vehicles that meets the Federal Communication Commission (FCC) mandated requirement for narrowband migration by January 1, 2013. Additionally, this system will be compliant for the future narrowband migration that is required tentatively by the year 2018. The LMR portion of this comprehensive transit security project should be complete by 2016. Santa Cruz METRO collaborated with the City of Watsonville to find solutions to reduce crime in the area in which the Watsonville Transit Center is located. A fiber optic cable connection was installed that allows the Watsonville Police Department (WPD) access to the Watsonville Transit Center (WTC) video surveillance camera system. It will also allow the WPD access to their network while working out of the WTC lobby police substation office; another project that was funded with proceeds from this grant. This portion of the transit security project was completed in October 2014. In August 2015, an air conditioning system was installed as a follow-up to the video surveillance project at the Pacific Station (downtown) transit center.
- Bus Stop Improvements – funded with local cash reserves - The Bus Stop Improvements Project provided for professional engineering services required on several bus stop projects throughout the county, including the San Lorenzo Valley High School bus stop, the Highway 236 at Ridge Drive, Boulder Creek bus stop, the Felton Faire bus stop, and execution of a contract to finish construction on the Green Valley at Airport Boulevard bus stop in Watsonville. These bus stop projects should be completed in 2016.
- Purchase and replacement of two (2) new Paratransit Vans funded by a STIP grant. This grant provides funding for four (4) replacement alternatively-fueled vehicles. These two (2) vehicles are powered by gasoline; Santa Cruz METRO's intention is to replace gasoline-fueled vehicles with CNG-fueled vehicles whenever the alternative CNG-fueled model is available. Project partially complete.
- Replace three (3) Transit Supervisor Vehicles: Three replacement Ford Focus' were received in August 2014, with funding provided by STA funds. These vehicles are used by the transit supervisors for monitoring transit service and responding to incidents and accidents throughout a 365 square mile service area within the County. Vehicle reliability is critical due to severe weather conditions, emergencies and disasters that occur in the county.

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
JUNE 30, 2015**

- Ticket Vending Machine – San Lorenzo Valley – An additional ticket vending machine (TVM) was purchased to provide after-hours ticket and pass purchasing and Smart Card value loading options, for riders in the San Lorenzo Valley area. Santa Cruz METRO is currently working towards locating a site to install this TVM. It will be the sixth TVM placed in service since 2011. Other TVM locations include, Santa Cruz Metro Center, 920 Pacific Avenue, Santa Cruz, Cabrillo College, 6500 Soquel Drive, Aptos, Capitola Mall, 1855 - 41st Avenue, Capitola Mall, Bart Cavallaro Transit Center, 246 Kings Village Road, Scotts Valley, and the Watsonville Transit Center, 475 Rodriguez Street, Watsonville. Funding was provided by STA and local cash reserves. Project will be complete when the site is finalized.

Ridership

Santa Cruz METRO provided 5,802,094 rides through both its fixed-route and paratransit services in fiscal year 2015, an increase of 191,046 rides from the prior year.

Future Outlook

Looking ahead, Santa Cruz METRO will be addressing the structural deficit over the next few years by taking steps to increase revenues and decrease expenses. Fare increases, service reductions, personnel cost containment, as well as administrative and operational efficiency measures are ways that will enhance operating revenue, minimize costs and bring the budget back into structural balance.

Fare Increases: In an effort to increase operating revenue, reduce operating costs and increase efficiency, the Board approved a fare restructuring of the Highway 17 (Commuter) Express, as well as service realignments and fare modifications for ParaCruz service effective September 10, 2015.

Personnel Cost Containment: Labor and fringe benefit costs accounted for 75% of total operating expenses in the current year; measures to control personnel costs will have a significant effect on Santa Cruz METRO's fiscal imbalance. In August 2015, Santa Cruz METRO drivers and management stepped up to help solve Santa Cruz METRO's budgetary challenge and worked with the Board of Directors to defer a previously negotiated cost of living salary and wage increase. Staff is working efficiently at full capacity as several funded positions have been put on hold and left unfilled in order to keep personnel costs down. In August 2015, the Board of Directors approved an early retirement incentive for qualified employees upon their retirement prior to December 31, 2015.

System-Wide Restructuring: In August 2015, Santa Cruz METRO began efforts on a Comprehensive Operational Analysis (COA). The study will take a fresh look at Santa Cruz METRO's current service offering to ensure that it properly serves the needs of the community, and analyze how best to provide service within budgetary limitations. The COA will identify system-wide and chronic problems, as well as new service opportunities through an in-depth qualitative and quantitative analysis that can be used to recommend immediate, short and long-term service changes to the existing fixed route service. As a way to align fixed route service levels with recurring operating revenues, the COA will be a critical next step towards solving the structural deficit and providing efficient, sustainable transit service to the County.

Future Funding: The financial challenges facing Santa Cruz METRO are not unique. The Federal government's inability to agree on a long-term surface transportation funding program has resulted in numerous short-term Continuing Resolutions and provided relatively flat Federal operating assistance since fiscal year 2010, which has placed public transit funding on perilous footing nationwide. In December 2015, President Obama signed the Fixing America's Surface Transportation (FAST) Act into law. This long-awaited successor to the Moving Ahead for Progress in the 21st Century Act (MAP-21) increases annual spending authority for transit programs from its current level of \$8.6 billion to \$9.35 billion in fiscal year 2016 and up to \$10.15 billion in fiscal year 2020, an increase of 18% over the life of the bill. As a result, California public transit agencies will receive \$1.32 billion in 2016, growing to over \$1.43 billion in 2020. The bill includes important policy and structural changes to federal surface transportation programs that are intended to improve mobility, streamline capital project construction and

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
JUNE 30, 2015**

acquisition, and increase the safety of public transportation systems across the country. Santa Cruz METRO will continue to work with state and federal funding partners to pursue new grant opportunities that will help Santa Cruz METRO with capital and operations funding challenges as well as bring new initiatives to fruition.

Future Operational Improvements:

Automatic Vehicle Locators (AVL) – Santa Cruz METRO is seeking state and federal grants to purchase AVL. This technology will provide data that will be used to improve on-time performance. AVL uses global positioning satellite information that allows for electronic signs at bus stops and a smart phone application that will predict when the next bus will arrive. AVL will significantly enhance customer real-time information on bus arrival times, system disruptions and provide better system performance from better ridership data.

Wi-Fi – Currently, free Wi-Fi service is available to riders on the Highway 17 (Commuter) Express. Santa Cruz METRO is investigating new grant opportunities that might result in the addition of Wi-Fi to other commuter-like service corridors and to the transit centers.

Zero Emission Vehicles (ZEVs) – Santa Cruz METRO is studying the possibility of augmenting their fleet with zero emission electric buses. In December 2015, the Board of Directors approved the submittal of a \$6 million grant application to the FTA for the purchase of five (5) electric buses. The addition of electric buses will help with the unfunded and ongoing need for replacement buses. Santa Cruz County residents will applaud a renewed commitment by METRO to air quality and sustainability.

Future Capital Projects:

Re-design and remodel of Pacific Station in Santa Cruz - Located in the heart of downtown, Pacific Station is the City of Santa Cruz's primary multi-modal public transit center. Constructed in 1984, the existing building has endured over three decades of heavy use. Santa Cruz METRO and the City of Santa Cruz are partnering to redesign the downtown Pacific Station mixed use transit center. A redesigned transit center presents an opportunity to improve the experiences of both commuters and Santa Cruz METRO employees. Three rounds of community engagement have been completed to gather input on needs and opportunities, collect feedback on site and use options, and to present the design alternatives. Design consultants presented the Conceptual Development Strategy Report to the Board of Directors and the Santa Cruz City Council in the spring of 2015. Santa Cruz METRO and City staff are in the process of determining the next steps for the Pacific Station project in regards to both funding sources and project schedule.

Watsonville Transit Center Renovations – The Watsonville Transit Center (WTC) serves intermodal passenger connections among Santa Cruz METRO, Monterey Salinas Transit (MST), and Greyhound buses, as well as ParaCruz vehicles, taxis and bicycles. The WTC has been serving riders in South Santa Cruz County for 20 years; these aging facilities require renovation. In winter 2012, staff conducted a series of public outreach efforts which included one-on-one surveys, focus groups and public outreach meetings. With the information generated from the public outreach, Santa Cruz METRO staff was able to narrow down design options and in 2013 began working with conceptual design consultants for the WTC renovations. The final conceptual design plans were presented to the Board of Directors in the fall of 2015. Santa Cruz METRO is now in the process of determining the next steps for the project in regards to funding sources and environmental and construction documentation.

Financial Analysis

Following are the condensed comparative financial statements, which highlight key financial data. Certain significant year-to-year variances are discussed following the statements.

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
JUNE 30, 2015**

Statements of Net Position:

	2015	2014	2015 to 2014	
			Increase/(Decrease) Amount	%
Assets				
Current assets	\$ 25,709,446	\$ 28,667,981	\$ (2,958,535)	-10%
Capital assets - net	82,753,490	78,497,841	4,255,649	5%
Restricted assets	14,463,480	12,433,687	2,029,793	16%
Total assets	\$ 122,926,416	\$ 119,599,509	\$ 3,326,907	3%
Deferred Outflows of Resources				
Pension Contributions	3,903,126	N/A		
Total deferred outflows of resources	\$ 3,903,126	N/A		
Liabilities				
Current liabilities	\$ 7,315,473	\$ 6,936,367	\$ 379,106	5%
Non-current liabilities	15,304,383	15,774,448	(470,065)	-3%
Other Long-term liabilities	69,040,678	21,854,235	47,186,443	216%
Total liabilities	\$ 91,660,534	\$ 44,565,050	\$ 47,095,484	106%
Deferred Inflows of Resources				
Pension Investment Earnings	7,432,943	N/A		
Total deferred inflows of resources	\$ 7,432,943	N/A		
Net Position				
Net investment in capital assets	\$ 82,753,490	\$ 78,497,841	\$ 4,255,649	5%
Unrestricted net position	(55,017,425)	(3,463,382)	(51,554,043)	1489%
Total net position	\$ 27,736,065	\$ 75,034,459	\$ (47,298,394)	-63%

2015 vs 2014 Analysis

Key changes include:

- *Current assets* decreased by \$2.9 million or (10%) to \$25.7 million, primarily due to decreases in cash and cash equivalents. Unrestricted cash was used to bridge the fiscal year 2015 budget gap and fund operations, as well as purchase capital assets.
- *Capital assets – net* increased by \$4.3 million or 5% to \$82.8 million, primarily due to increases in capital construction in progress related to the progress payments made for the construction of the new Judy K. Souza Operations Facility.
- *Restricted assets* increased by \$2.0 million or 16% to \$14.5 million. While unearned grant funds previously received from PTMISEA were spent down on Metrobase construction during the year, receipt of \$5.9 million of restricted PTMISEA funding was received in fiscal year 2015.

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
JUNE 30, 2015**

- *Deferred Outflows of Resources* of \$3.9 million in pension contributions was recognized in the current year due to the implementation of Governmental Accounting Standards Board (GASB) Statement No. 68 in fiscal year 2015.
- *Current liabilities* increased by \$379 thousand or 5% to \$7.3 million in total, primarily due to increases in accrued payroll and employee benefits.
- *Non-current liabilities* decreased by \$470 thousand or (3%) to \$15.3 million due to the spending down of unearned grant funds on construction and capital acquisition during the year. Grant funds received are restricted and reported as liabilities until spent on the specific purpose for which they were awarded.
- *Other Long-term liabilities* increased by \$47.2 million or 216% to \$69.0 million primarily due to the first year implementation of GASB Statement No. 68 in fiscal year 2015, resulting in recognition of a net pension liability of \$42.3 million in the financial statements.
- *Deferred Inflows of Resources* of \$7.4 million in pension investment earnings was recognized in the current year due to the implementation of GASB Statement No. 68 in fiscal year 2015.

Statements of Revenues, Expenses, and Changes in Fund Net Position:

	2015	2014	2015 to 2014 Increase/(Decrease)	
			Amount	%
Operating Revenues	\$ 9,796,024	\$ 9,511,613	\$ 284,411	3%
Operating Expenses	(54,939,475)	(55,356,660)	417,185	-1%
Operating Loss	(45,143,451)	(45,845,047)	701,596	-2%
Non-Operating Revenues	34,812,002	34,188,736	623,266	2%
Capital Grant Contributions	9,270,417	11,503,229	(2,232,812)	-19%
Decrease in Net Position	\$ (1,061,032)	\$ (153,082)	\$ (907,950)	593%

2015 vs 2014 Analysis

Operating Revenues (Passenger Fares) increased by \$284 thousand or 3% this year primarily due to increased revenue from ridership contracts with public agencies and University of California, Santa Cruz.

Operating Expenses decreased by \$417 thousand or (1%) overall when compared to last year due to a decrease in depreciation expense as certain capital assets became fully depreciated in the prior year.

Non-Operating Revenues increased by \$623 thousand, or 2% over last year primarily due to an increase in sales tax revenue generated by increased consumer spending in fiscal year 2015, along with an increase in alternative fuel tax credits received. The alternative fuel incentives were retroactively extended by the Tax Increase Prevention Act of 2014, enacted in fiscal year 2015.

Capital Contributions are capital grant funds received for facilities improvements and the purchase of capital equipment including revenue vehicles. The receipt of capital grant funds can fluctuate year over year based on a variety of factors including project eligibility requirements, formula-based funding criteria, the economy, etc. Capital contributions decreased by 19% over last year primarily due to the purchase of six (6) new CNG buses in fiscal year 2014.

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
JUNE 30, 2015**

Statement of Cash Flows:

	2015	2014	2015 to 2014 Change
Net Cash Used in Operating Activities	\$ (39,649,655)	\$ (39,178,568)	\$ (471,087)
Net Cash Provided by Non-Capital Financing Activities	34,501,675	34,117,855	383,820
Net Cash Provided by (Used in) Capital and Related Financing Activities	3,724,925	(2,152,710)	5,877,635
Net Cash Provided by Non-Transportation Activities	<u>245,062</u>	<u>233,780</u>	<u>11,282</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(1,177,993)	(6,979,643)	5,801,650
Cash and Cash Equivalents, Beginning of Year	<u>33,161,856</u>	<u>40,141,499</u>	<u>(6,979,643)</u>
Cash and Cash Equivalents, End of Year	<u>\$ 31,983,863</u>	<u>\$ 33,161,856</u>	<u>\$ (1,177,993)</u>

Contacting Santa Cruz METRO's Financial Management

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

BASIC FINANCIAL STATEMENTS

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENT OF NET POSITION
JUNE 30, 2015**

	<u>2015</u>
ASSETS	
CURRENT ASSETS	
Cash and Cash Equivalents	\$ 17,520,383
Sales Tax, Grants, and Other Receivables	6,993,415
Inventory	660,859
Prepays	<u>534,789</u>
Total Current Assets	<u>25,709,446</u>
RESTRICTED ASSETS	
Cash and Cash Equivalents	<u>14,463,480</u>
CAPITAL ASSETS	
Building and Improvements	47,505,460
Revenue Vehicles	50,605,014
Operations Equipment	6,433,325
Other Equipment	2,061,303
Other Vehicles	1,178,619
Office Equipment	<u>3,904,539</u>
Total Depreciated Capital Assets	111,688,260
Less Accumulated Depreciation	<u>(61,136,862)</u>
Total Depreciated Capital Assets Net of Accumulated Depreciation	50,551,398
Construction-in-Progress	20,605,781
Land	<u>11,596,311</u>
Total Capital Assets	<u>82,753,490</u>
Total Assets	<u>122,926,416</u>
DEFERRED OUTFLOWS OF RESOURCES	
Pension Contributions	<u>3,903,126</u>

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

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENT OF NET POSITION (Continued)
JUNE 30, 2015**

	2015
LIABILITIES	
CURRENT LIABILITIES	
Accounts Payable and Accrued Liabilities	\$ 1,987,300
Accrued Payroll and Employee Benefits	3,975,145
Deferred Rent	2,885
Workers' Compensation Liabilities, Current	919,137
Other Accrued Liabilities	415,622
Security Deposit	15,384
Total Current Liabilities	7,315,473
NON-CURRENT LIABILITIES	
Unearned Revenue - Settlement Agreement	780,861
Unearned Revenue - State Transit Assistance	1,304,185
Unearned Revenue - PTMISEA Grant	12,847,226
Unearned Revenue - Proposition 1B Grant	372,111
OTHER LONG-TERM LIABILITIES	
Workers' Compensation Liabilities, Net of Current	3,484,177
Other Post Employment Benefit Liabilities	23,244,745
Net Pension Liability	42,311,756
Total Liabilities	91,660,534
DEFERRED INFLOWS OF RESOURCES	
Pension Investment Earnings	7,432,943
NET POSITION	
Net Investment in Capital Assets	82,753,490
Unrestricted Net Position	(55,017,425)
Total Net Position	\$ 27,736,065

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

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND
CHANGES IN FUND NET POSITION
FOR THE YEAR ENDED JUNE 30, 2015**

	2015
OPERATING REVENUES	
Passenger Fares	\$ 5,636,565
Special Transit Fares	4,159,459
Total Operating Revenues	9,796,024
OPERATING EXPENSES	
Wages, Salaries, and Employee Benefits	41,465,990
Purchased Transportation Services	170,746
Materials and Supplies	3,878,833
Other Expenses	4,098,558
Depreciation	5,325,348
Total Operating Expenses	54,939,475
Net Operating Loss	(45,143,451)
NON-OPERATING REVENUES (EXPENSES)	
Sales and Use Taxes	16,405,582
Transportation Development Act Assistance (TDA)	6,444,515
State Transit Assistance (STA)	5,075,779
Federal Transit Administration (FTA) Section 5307 Operating Assistance	5,478,097
FTA Section 5311 Rural Operating Assistance	212,267
Alternative Fuel Tax Credit	638,208
Planning Grants	29,488
Interest Income	85,908
Rental Income	159,154
Other Revenue	289,389
Loss on Sale and Disposal of Property, Equipment, and Inventory	(6,385)
Total Non-Operating Revenues	34,812,002
Net Loss Before Capital Contributions	(10,331,449)
CAPITAL CONTRIBUTIONS	
Grants Restricted for Capital Expenditures	9,270,417
NET POSITION	
Change in Net Position	(1,061,032)
Total Net Position, Beginning of Year	75,034,459
Prior Period Adjustment	(46,237,362)
Total Net Position, End of Year	\$ 27,736,065

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

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2015**

	2015
CASH FLOWS FROM OPERATING ACTIVITIES:	
Receipts from Customers	\$ 9,738,456
Payments to Employees	(41,074,101)
Payments to Suppliers	(7,918,221)
Payments to Other	(395,789)
	<u>(39,649,655)</u>
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:	
Operating Grants Received, Including Sales and Use Taxes	34,501,675
	<u>34,501,675</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:	
Proceeds from Sale of Property and Equipment	5,370
Capital Grants Received	13,312,307
Capital Expenditures	(9,592,752)
	<u>(3,275,075)</u>
Net Cash Provided by Capital and Related Financing Activities	<u>3,724,925</u>
CASH FLOWS FROM INVESTING ACTIVITIES:	
Investment and Rental Income Received	245,062
	<u>245,062</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,177,993)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>33,161,856</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 31,983,863</u>
RECONCILIATION OF NET OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES	
Net Operating Loss	\$ (45,143,451)
Adjustments to Reconcile Net Operating Loss to Net Cash Used in Operating Activities:	
Depreciation	5,325,348
Changes in Assets and Liabilities:	
Increase in Receivables	(57,568)
Decrease in Inventory	69,634
Increase in Prepaid Expenses	(21,010)
Increase in Accounts Payable and Accrued Liabilities	182,492
Decrease in Net Pension Liability	(395,789)
Increase in Other Liabilities	390,689
	<u>390,689</u>
Net Cash Used in Operating Activities	<u>\$ (39,649,655)</u>

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

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE 1 – OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of Organization

The Santa Cruz Metropolitan Transit District (Santa Cruz METRO) was formed February 9, 1969, following a favorable election in conformity with Section 9800 et. seq. of the Public Utilities Code (PUC). The transit system serves the general public in the cities of Santa Cruz, Watsonville, Scotts Valley, and Capitola and the unincorporated areas of Santa Cruz County. A Board of eleven directors and one Ex-Officio director representing the University of California, Santa Cruz governs Santa Cruz METRO. At June 30, 2015, the directors were as follows:

Chairperson:	Dene Bustichi		
Vice Chair:	Mike Rotkin		
Members:	Cynthia Chase	Zach Friend	Donald Norm Hagen
	Karina Cervantez	Don Lane	John Leopold
	Jimmy Dutra	Ed Botorff	Bruce McPherson
Ex-Officio:	Donna Blitzer		

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

B. Reporting Entity

Santa Cruz METRO and the Santa Cruz Civic Improvement Corporation (the Corporation) have a financial and operational relationship, which meets the reporting entity definition criteria of Governmental Accounting Standards Board (GASB) Statement No. 14, as amended by GASB Statement No. 39, *The Financial Reporting Entity*, for inclusion of the Corporation as a blended component unit of Santa Cruz METRO. Accordingly, the financial activities of the Corporation have been included in the basic financial statements of Santa Cruz METRO. For the year ending June 30, 2015, these activities were minimal.

Scope of Public Service:

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

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

Accountability:

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

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

B. Reporting Entity (Continued)

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

C. Basis of Accounting and Presentation

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

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

Contributed Capital/Reserved Retained Earnings:

Santa Cruz METRO receives grants from the Federal Transit Authority (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 had been incurred. Capital grant funds earned, less amortization equal to accumulated depreciation of the related assets, were included in contributed capital. As required by GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, Santa Cruz METRO changed its method of accounting for capital grants from capital contributions to reserved non-operating revenues. In accordance with GASB Statement No. 33, capital grants are required to be included in the determination of net income (loss) resulting in an increase in net revenue of \$9,270,417 for the fiscal year 2015.

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

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

C. Basis of Accounting and Presentation (Continued)

Proprietary Accounting and Financial Reporting:

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of Santa Cruz METRO are passenger fares and special transit fares. Operating expenses for Santa Cruz METRO include the wages, purchased transportation, materials and supplies, depreciation/amortization on capital assets, and other expenses. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Net Position:

Net position represents the residual interest in Santa Cruz METRO's assets after liabilities are deducted. In accordance with GASB Statement No. 34, the fund equity section on the statements of net position was combined to report total net position and present it in three broad components: net investment in capital assets, restricted, and unrestricted. Net position invested in capital assets includes capital assets net of accumulated depreciation. Net position is restricted when constraints are imposed by third parties or by law through constitutional provisions or enabling legislation. All other net position is unrestricted.

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

D. Cash and Cash Equivalents

Santa Cruz METRO considers all highly liquid investments with a maturity date within three months of the date acquired to be cash equivalents. Santa Cruz METRO deposits funds into an external investment pool maintained by Santa Cruz County. These deposits are considered cash equivalents. The Santa Cruz County 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, bankers' acceptances, repurchase agreements, and the State Treasurer's investment pool. Cash and cash equivalents are stated at fair value. For purposes of the statements of cash flows, Santa Cruz METRO considers all highly liquid investments (including restricted assets) to be cash equivalents.

E. Inventory

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

F. Restricted Assets

Certain assets are classified as restricted assets on the statements of net position 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 8, represents proceeds restricted by the FTA. The State Transit Assistance (STA) Grant, Proposition 1B Public Transportation Modernization, Improvement, and Service Enhancement Account (PTMISEA) Grant, and the Proposition 1B Office of Homeland Security (OHS) California Transit Security Grant Program (CTSGP) Grant are restricted for capital expenditures. Restricted assets at June 30 are as follows:

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

F. Restricted Assets (Continued)

	<u>2015</u>
Cash and Cash Equivalents	
FTA Grant	\$ 780,861
Proposition 1B PTMISEA Grant	12,847,226
Proposition 1B OHS CTSGP Grant	372,111
STA Grant	<u>463,282</u>
Total Restricted Assets	<u>\$ 14,463,480</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 improvements	20-39 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 position, 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 lives of the applicable assets, are charged to expense as incurred. Upon disposition, costs and accumulated depreciation are removed from the accounts and resulting gains or losses are included in operations.

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

H. Sales and Use Tax

Santa Cruz METRO receives a 0.5% 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. During the fiscal year ended June 30, 2015, sales tax revenue of \$2,358,336 was used as the local match for capital projects funded by the State-Local Partnership Program (SLPP), as required by this formula program. Actual receipts of sales tax for the fiscal year ended June 30, 2015, were \$18,763,918.

Additionally, Santa Cruz METRO is allocated, through the Santa Cruz County Regional Transportation Commission, a portion of the 0.25% sales and use tax levied by the Transportation Development Act (TDA).

I. Operating Assistance Grants

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

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

J. Self-Insurance

Santa Cruz METRO is self-insured for the first \$250,000 of general and vehicular liability. For settlements in excess of \$250,000, Santa Cruz METRO has total coverage up to \$25,000,000 per occurrence. Additionally, Santa Cruz METRO is self-insured up to \$350,000 for workers' compensation claims. Santa Cruz METRO has recorded a liability for estimated claims to be paid, including incurred but not reported claims.

K. Employee Benefits

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

L. Payroll

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

M. Pension Costs

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

N. Use of Estimates

The preparation of basic 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 basic financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

O. Reclassifications

Certain reclassifications have been made to prior period amounts to conform to the classifications used in the current period. Such reclassifications had no effect on Santa Cruz METRO's financial positions or results of operations for the periods presented.

P. Implementation of Governmental Accounting Standards Board Statement

GASB Statement No. 68 – *Accounting and Financial Reporting for Pensions—an Amendment of GASB Statement No. 27*. The provisions of GASB Statement No. 68 are effective for fiscal years beginning after June 15, 2014. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions by establishing standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, and expenses. Note disclosures and required supplementary information requirements about pensions are also addressed. The requirements of this Statement will improve the decision-usefulness of information in employer financial reports and will enhance its value for assessing accountability and inter-period equity by requiring recognition of the entire net pension liability and a more comprehensive measure of pension expense. Santa Cruz METRO has implemented the provisions of GASB Statement No. 68 in the current year. As a result of this implementation, Santa Cruz METRO reported a prior period adjustment to net position in the amount of \$46,237,362 and recognized a net pension liability, deferred outflow of resources and deferred inflow of resources associated with the pension liability as of June 30, 2015. See Note 10 for detailed discussion of the effects on the Santa Cruz METRO's current and prior period financial statements as a result of the adoption of this standard.

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

P. Implementation of Governmental Accounting Standards Board Statement (Continued)

GASB Statement No. 69 – *Government Combinations and Disposals of Government Operations*. The provisions of GASB Statement No. 69 are effective for fiscal years beginning after December 15, 2013. There was no effect on the Santa Cruz METRO's accounting or financial reporting as a result of implementing this standard.

GASB Statement No. 71 – *Pension Transition for Contributions Made Subsequent to the Measurement Date* amends paragraph 137 of GASB Statement No. 68. The provisions of this statement were applied simultaneously with the provisions of GASB Statement No. 68. There was no effect on the Santa Cruz METRO's accounting or financial reporting as a result of implementing this standard.

Q. Future Governmental Accounting Standards Board Statements

GASB Statement No. 72 – *Fair Value Measurement and Application*. The provisions of this statement are effective for financial statements for reporting periods beginning after June 15, 2015. The Santa Cruz METRO has not fully judged the effect of the implementation of GASB Statement No. 72 as of the date of the basic financial statements.

GASB Statement No. 73 – *Accounting and Financial Reporting for Pensions and Related Assets that are not within the Scope of GASB Statement No. 68, and Amendments to Certain Provisions of GASB Statements No. 67 and No. 68*. The provisions of this statement are effective for fiscal years beginning after June 15, 2015 – except those provisions that address employers and governmental nonemployer contributing entities for pensions that are not within the scope of GASB Statement No. 68, which are effective for fiscal years beginning after June 15, 2016. The Santa Cruz METRO has not fully judged the effect of the implementation of GASB Statement No. 73 as of the date of the basic financial statements. The Santa Cruz METRO does not expect a material effect on accounting or financial reporting as a result of implementing this standard.

GASB Statement No. 74 – *Financial Reporting for Postemployment Benefits Other than Pension Plans*. The provisions of this statement are effective for fiscal years beginning after June 15, 2016. The Santa Cruz METRO has not fully judged the effect of the implementation of GASB Statement No. 74 as of the date of the basic financial statements.

GASB Statement No. 75 – *Accounting and Financial Reporting for Postemployment Benefits Other than Pension Plans*. The provisions of this statement are effective for fiscal years beginning after June 15, 2017. The Santa Cruz METRO has not fully judged the effect of the implementation of GASB Statement No. 75 as of the date of the basic financial statements.

GASB Statement No. 76 – *Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The provisions of this statement are effective for fiscal years beginning after June 15, 2015. The Santa Cruz METRO has not fully judged the effect of the implementation of GASB Statement No. 76 as of the date of the basic financial statements. The Santa Cruz METRO does not expect a material effect on accounting or financial reporting as a result of implementing this standard.

GASB Statement No. 77 – *Tax Abatement Disclosures*. The requirements of this statement are effective for reporting periods beginning after December 15, 2015. The Santa Cruz METRO has not fully judged the effect of the implementation of GASB Statement No. 77 as of the date of the basic financial statements. The Santa Cruz METRO does not expect a material effect on accounting or financial reporting as a result of implementing this standard.

GASB Statement No. 79 – *Certain External Investment Pools and Pool Participant*. The requirements of this statement are effective for fiscal years beginning after June 15, 2015, except for the provisions in paragraphs 18, 19, 23–26, and 40, which are effective for reporting periods beginning after December 15, 2015. The Santa Cruz METRO has not fully judged the effect of the implementation of GASB Statement No. 79 as of the date of the basic financial statements.

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

Q. Future Governmental Accounting Standards Board Statements (Continued)

GASB Statement No. 78 – *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*. The requirements of this statement are effective for fiscal years beginning after December 15, 2015. The Santa Cruz METRO has not fully judged the effect of the implementation of GASB Statement No. 78 as of the date of the basic financial statements.

NOTE 2 – CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following at June 30, 2015:

	<u>2015</u>
Cash on Hand	\$ 15,792
Demand Deposits	315,823
Certificate of Deposit (CD)	40,611
Deposits in Santa Cruz County Pooled Investment Fund	<u>31,611,637</u>
	<u>\$ 31,983,863</u>

Cash on Hand and Cash in Banks

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

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

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage of Portfolio</u>	<u>Maximum Investment in One Issuer</u>
Local Agency Bonds	5 years	None	None
U.S. Treasury Obligations	5 years	None	None
U.S. Agency Securities	5 years	None	None
Bankers’ Acceptances	180 days	None	None
Commercial Paper	270 days	None	None
Negotiable CDs	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
Santa Cruz County Pooled Investment Funds	N/A	100%	None
Local Agency Investment Fund (LAIF)	N/A	None	None

Disclosures Relating to Interest Rate Risk

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

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

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

Investment Type	Amount	Remaining Maturity (in Months)			
		12 Months or Less	13 to 24 Months	25 to 60 Months	More Than 60 Months
Santa Cruz County Pooled Investment Fund	\$ 31,611,637	\$ 31,611,637	\$ -	\$ -	\$ -

Disclosures Relating to Credit Risk

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

Investment Type	Amount	Minimum Legal Rating	Exempt From Disclosure	Rating as of Year-End		
				AAA	Aa	Not Rated
Santa Cruz County Pooled Investment Fund	\$ 31,611,637	N/A	\$ -	\$ -	\$ -	\$ 31,611,637

Concentration of Credit Risk

The investment policy of Santa Cruz METRO contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. Santa Cruz METRO did not have any investments in any one issuer (other than external investment pools) that represent 5% or more of total Santa Cruz METRO's investments at June 30, 2015.

Custodial Credit Risk

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

Custodial Credit Risk

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

NOTE 2 – CASH AND CASH EQUIVALENTS (Continued)Cash on Hand and Cash in Banks (Continued)**Investment in Santa Cruz County Pooled Investment Fund**

Santa Cruz METRO is a voluntary participant in the Santa Cruz County Pooled Investment Fund. The fair value of Santa Cruz METRO's investment in this pool is reported in the accompanying basic financial statements at amounts based upon Santa Cruz METRO's pro-rata share of the fair value provided by the Santa Cruz County for the entire Santa Cruz 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 Santa Cruz County, which are recorded on an amortized cost basis.

NOTE 3 – RECEIVABLES

Receivables at June 30 are as follows:

	<u>2015</u>
Federal Grants	\$ 413,449
State Grants	2,712,069
Sales Tax Revenue	3,021,200
Other	<u>846,697</u>
	<u>\$ 6,993,415</u>

NOTE 4 – CHANGES IN CAPITAL ASSETS

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

	<u>Balance July 1, 2014</u>	<u>Additions and Transfers</u>	<u>Retirements and Transfers</u>	<u>Balance June 30, 2015</u>
Non-Depreciated Assets				
Land	\$ 11,596,311	\$ -	\$ -	\$ 11,596,311
Construction-in-Progress	<u>11,744,657</u>	<u>9,592,751</u>	<u>(731,627)</u>	<u>20,605,781</u>
Total Non-Depreciated Assets	23,340,968	9,592,751	(731,627)	32,202,092
Depreciated Assets				
Building and Improvements	47,449,888	65,559	(9,987)	47,505,460
Revenue Vehicles	51,920,525	106,514	(1,422,025)	50,605,014
Operations Equipment	6,387,675	49,324	(3,674)	6,433,325
Other Equipment	2,061,303	-		2,061,303
Other Vehicles	1,197,180	56,430	(74,991)	1,178,619
Office Equipment	<u>3,492,756</u>	<u>453,800</u>	<u>(42,017)</u>	<u>3,904,539</u>
Total Depreciated Assets	112,509,327	731,627	(1,552,694)	111,688,260
Less Accumulated Depreciation	<u>(57,352,454)</u>	<u>(5,325,348)</u>	<u>1,540,940</u>	<u>(61,136,862)</u>
Depreciated Assets Net of Accumulated Depreciation	<u>55,156,873</u>	<u>(4,593,721)</u>	<u>(11,754)</u>	<u>50,551,398</u>
Total Capital Assets	<u>\$ 78,497,841</u>	<u>\$ 4,999,030</u>	<u>\$ (743,381)</u>	<u>\$ 82,753,490</u>

Depreciation expense at June 30, 2015, was \$5,325,348.

NOTE 5 – CAPITAL GRANTS

Santa Cruz METRO receives grants from the FTA, which provides financing for the acquisition of rolling stock and construction of facilities. Santa Cruz METRO also receives grants under the State TDA primarily for the acquisition of rolling stock and support equipment, and purchase of furniture and fixtures.

A summary of federal and state grant activity for the year ended June 30 is as follows:

	<u>2015</u>
Federal Grants	\$ 393,306
State Grants	8,629,132
Other - Settlement Agreement Proceeds	<u>247,979</u>
Total Capital Grants	<u>\$ 9,270,417</u>

NOTE 6 – COMMITMENTS

Santa Cruz METRO leases a number of its facilities under operating leases through 2020. For the year ended June 30, 2015, rental costs relating to the leases were \$396,409. In addition, Santa Cruz METRO receives rent income from retail space in their transit centers. Minimum net lease payments for existing operating leases are as follows:

<u>Year Ending June 30</u>	<u>Lease Commitments</u>	<u>Rental Income</u>	<u>Net</u>
2016	\$ 312,339	\$ 121,581	\$ 190,758
2017	50,986	50,746	240
2018	23,786	34,468	(10,682)
2019	24,261	14,700	9,561
2020	<u>24,747</u>	<u>12,000</u>	<u>12,747</u>
	<u>\$ 436,119</u>	<u>\$ 233,495</u>	<u>\$ 202,624</u>

NOTE 7 – JOINT VENTURES (JOINT POWERS AUTHORITY WITH CalTIP)

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

CalTIP arranges for and provides property and liability insurance for its 34 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 7 – JOINT VENTURES (JOINT POWERS AUTHORITY WITH CalTIP) (Continued)

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

	<u>2015</u>	<u>2014</u>
Total Assets	\$ 25,819,506	\$ 24,998,709
Total Liabilities	<u>16,342,076</u>	<u>13,647,614</u>
Fund Balance	<u>\$ 9,477,430</u>	<u>\$ 11,351,095</u>
Total Revenues	\$ 8,447,347	\$ 7,776,176
Total Expenditures	<u>10,321,012</u>	<u>9,744,461</u>
Net Decrease in Fund Balance	<u>\$ (1,873,665)</u>	<u>\$ (1,968,285)</u>

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

NOTE 8 – WATSONVILLE FLEET MAINTENANCE FACILITY SETTLEMENT RECEIPT

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

In addition, due to design and construction deficiencies by the design and building contractors involved in the original project, Santa Cruz METRO initiated litigation against the contractors and came to a settlement agreement with said contractors on May 30, 1995. In accordance with this agreement, the contractors remitted \$4,776,858 (including \$171,538 in costs) to Santa Cruz METRO during fiscal year 1996, representing damages less attorney fees. FTA Section 3/5309 restricts the use of these proceeds, and the interest earned thereon. Accordingly, the net restricted amount of \$780,861 is reflected on the statement of net position as unearned revenue at June 30, 2015.

NOTE 9 – CONTINGENCIES

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

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

NOTE 10 – DEFINED BENEFIT PENSION PLAN

A. General Information About the Pension Plans

Plan Description

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

Funding Policy

There are 334 active plan members in the Plan as of June 30, 2015, which are required to contribute a percentage of their annual covered salary. In lieu of salary increases and for employees who agreed to salary reductions in certain prior years, Santa Cruz METRO agreed to pay a portion of the employee contribution, based on formulas negotiated in their labor agreements. Santa Cruz METRO is also required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the CalPERS Board of Administration. The required employer contribution rate for the fiscal year ended June 30, 2015, was 20.651%. 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.

The Plan's provisions and benefits in effect at June 30, 2015, are summarized as follows:

Hire Date	<u>Prior to January 1, 2013</u>	<u>On or after January 1, 2013</u>
Benefit Formula	2.5%@55	2%@62
Benefit Vesting Schedule	5 years service	5 years service
Benefit Payments	monthly for life	monthly for life
Retirement Age	50	52
Monthly Benefits, as a Percentage of Eligible Compensation	2.000% - 2.500%	1.000%-2.500%
Required Employee Contribution Rates	8.000%	6.250%
Required Employer Contribution Rates	20.651%	20.651%

Employees Covered – At June 30, 2015, the following employees were covered by the benefit terms for each Plan:

Inactive Employees or Beneficiaries Currently Receiving Benefits	244
Inactive Employees Entitled to but not yet Receiving Benefits	123
Active Employees	<u>334</u>
Total	<u><u>701</u></u>

NOTE 10 – DEFINED BENEFIT PENSION PLAN (Continued)

B. Net Pension Liability

Santa Cruz METRO's net pension liability for the Plan is measured as the total pension liability, less the pension plan's fiduciary net position. The net pension liability of the Plan is measured as of June 30, 2014, using an annual actuarial valuation as of June 30, 2013, rolled forward to June 30, 2014, using standard update procedures. A summary of principal assumptions and methods used to determine the net pension liability is shown below.

Actuarial Assumptions – The total pension liabilities in the June 30, 2013, actuarial valuations were determined using the following actuarial assumptions:

Valuation Date	June 30, 2013
Measurement Date	June 30, 2014
Actuarial Cost Method	Entry Age Normal
Actuarial Assumptions:	
Discount Rate	7.50%
Inflation	2.75%
Payroll Growth	3.00%
Projected Salary Increase	Varies by Entry Age and Service ⁽¹⁾
Investment Rate of Return	7.5% ⁽²⁾
	Derived using ⁽³⁾
	CalPERS' Membership
Mortality	Data for all Funds

⁽¹⁾ Depending on age, service, and type of employment.

⁽²⁾ Net of pension plan investment expenses, including inflation.

⁽³⁾ The mortality table used was developed based on CalPERS' specific data. The table includes 20 years of mortality improvements using Society of Actuaries Scale BB.

The underlying mortality assumptions and all other actuarial assumptions used in the June 30, 2013 valuation were based on the results of a January 2014 actuarial experience study for the period 1997 to 2011. Further details of the Experience Study can found on the CalPERS website.

Discount Rate – The discount rate used to measure the total pension liability was 7.50%. To determine whether the municipal bond rate should be used in the calculation of a discount rate for the Plan, CalPERS stress tested plans that would most likely result in a discount rate that would be different from the actuarially assumed discount rate. Based on the testing, none of the tested plans run out of assets. Therefore, the current 7.50% discount rate is adequate and the use of the municipal bond rate calculation is not necessary. The long-term expected discount rate of 7.50% will be applied to all plans in the Public Employees Retirement Fund (PERF). The stress test results are presented in a detailed report that can be obtained from the CalPERS website.

According to Paragraph 30 of GASB Statement No. 68, the long-term discount rate should be determined without reduction for pension plan administrative expense. The 7.50% investment return assumption used in this accounting valuation is net of administrative expenses. Administrative expenses are assumed to be 15 basis points. An investment return excluding administrative expenses would have been 7.65%. Using this lower discount rate has resulted in a slightly higher Total Pension Liability and Net Pension Liability. CalPERS checked the materiality threshold for the difference in calculation and did not find it to be a material difference.

NOTE 10 – DEFINED BENEFIT PENSION PLAN (Continued)

B. Net Pension Liability (Continued)

CalPERS is scheduled to review all actuarial assumptions as part of its regular Asset Liability Management (ALM) review cycle that is scheduled to be completed in February 2018. Any changes to the discount rate will require Board action and proper stakeholder outreach. For these reasons, CalPERS expects to continue using a discount rate net of administrative expenses for GASB Statements No. 67 and No. 68 calculations through at least the 2017-18 fiscal year. CalPERS will continue to check the materiality of the difference in calculation until such time as it has changed its methodology.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class.

In determining the long-term expected rate of return, CalPERS took into account both short-term and long-term market return expectations as well as the expected pension fund cash flows. Using historical returns of all the funds' asset classes, expected compound returns were calculated over the short-term (first 10 years) and the long-term (11-60 years) using a building-block approach. Using the expected nominal returns for both short-term and long-term, the present value of benefits was calculated for each fund. The expected rate of return was set by calculating the single equivalent expected return that arrived at the same present value of benefits for cash flows as the one calculated using both short-term and long-term returns. The expected rate of return was then set equivalent to the single equivalent rate calculated above and rounded down to the nearest one quarter of one percent.

The table below reflects the long-term expected real rate of return by asset class. The rate of return was calculated using the capital market assumptions applied to determine the discount rate and asset allocation. These rates of return are net of administrative expenses.

<u>Asset Class</u>	<u>New Strategic Allocation</u>	<u>Real Return Years 1 - 10 ^(a)</u>	<u>Real Return Years 11+ ^(b)</u>
Global Equity	47.00%	5.25%	5.71%
Global Fixed Income	19.00%	0.99	2.43
Inflation Sensitive	6.00%	0.45	3.36
Private Equity	12.00%	6.83	6.95
Real Estate	11.00%	4.50	5.13
Infrastructure and Forestland	3.00%	4.50	5.09
Liquidity	2.00%	(0.55)	(1.05)
Total	<u>100.00%</u>		

^(a) An expected inflation of 2.5% used for this period.

^(b) An expected inflation of 3.0% used for this period.

NOTE 10 – DEFINED BENEFIT PENSION PLAN (Continued)

C. Changes in the Net Pension Liability

The changes in the Net Pension Liability for each Plan follow:

	Increase (Decrease)		
	Total Pension Liability	Plan Fiduciary Net Position	Net Pension Liability/(Asset)
Balance at June 30, 2013 ⁽¹⁾	\$ 144,528,243	\$ 94,622,877	\$ 49,905,366
Changes in the year:			
Service Cost	3,200,114	-	3,200,114
Interest on the Total Pension Liability	10,709,850	-	10,709,850
Differences between Actual and Expected Experience	-	-	-
Changes in Assumptions	-	-	-
Changes in Benefit Terms	-	-	-
Contribution - Employer	-	3,668,004	(3,668,004)
Contribution - Employee (Paid by Employer)	-	-	-
Contribution - Employee	-	1,573,391	(1,573,391)
Net Investment Income ⁽²⁾	-	16,262,179	(16,262,179)
Administrative Expenses	-	-	-
Benefit Payments, Including Refunds of Employee Contributions	(6,660,594)	(6,660,594)	-
Net Changes	7,249,370	14,842,980	(7,593,610)
Balance at June 30, 2014 ⁽¹⁾	\$ 151,777,613	\$ 109,465,857	\$ 42,311,756

⁽¹⁾ The fiduciary net position includes receivables for employee service buybacks, deficiency reserves, fiduciary self-insurance and other postemployment benefits (OPEB) expense. This may differ from the Plan assets reported in the funding actuarial valuation report.

⁽²⁾ Net of administrative expenses.

Sensitivity of the Net Pension Liability to Changes in the Discount Rate – The following presents the net pension liability of the Plan, calculated using the discount rate for the Plan, as well as what the Santa Cruz METRO's net pension liability would be if it were calculated using a discount rate that is one percentage point lower or one percentage point higher than the current rate:

1% Decrease Net Pension Liability	\$ 60,693,573
Current Discount Rate Net Pension Liability	\$ 42,311,756
1% Increase Net Pension Liability	\$ 26,875,334

Pension Plan Fiduciary Net Position – Detailed information about each pension plan's fiduciary net position is available in the separately issued CalPERS financial reports.

NOTE 10 – DEFINED BENEFIT PENSION PLAN (Continued)

D. Pension Expenses and Deferred Outflows/Inflows of Resources Related to Pensions

For the year ended June 30, 2015, the Santa Cruz METRO recognized a pension expense of \$3,507,337. At June 30, 2015, the Santa Cruz METRO reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Pension Contributions Subsequent to Measurement Date	\$ 3,903,126	\$ -
Net Differences between Projected and Actual Earnings on Plan Investments	<u>-</u>	<u>(7,432,943)</u>
Total	<u>\$ 3,903,126</u>	<u>\$ (7,432,943)</u>

\$3,903,126 reported as deferred outflows of resources related to contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2016. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized as pension expense as follows:

<u>Measurement Period Ended June 30</u>	
2015	\$ (1,858,236)
2016	(1,858,236)
2017	(1,858,236)
2018	<u>(1,858,235)</u>
Total	<u>\$ (7,432,943)</u>

E. Payable to the Pension Plan

At June 30, 2015, the Santa Cruz METRO reported a payable of \$0 for the outstanding amount of contributions to the pension plan required for the year ended June 30, 2015.

NOTE 11 – DEFERRED COMPENSATION PLAN

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

At June 30, 2015, all amounts held under the Great-West plan and the CalPERS plan are held in trust and are not reflected on the accompanying statements of net position as required under GASB Statement No. 27, *Accounting Standards for Pensions by State and Local Governmental Employers*.

Complete financial statements for Great-West can be obtained from Great-West at P.O. Box 173764, Denver, Colorado 80217-3764. Complete financial statements for CalPERS can be obtained from CalPERS at Lincoln Plaza North, 400 Q Street, Sacramento, California 94229.

NOTE 12 – RISK MANAGEMENT

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

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 May 2013. Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amount of payouts, and other economic and social factors. Changes in the balances of claims liabilities are as follows:

	<u>2015</u>
Workers' Compensation Liabilities:	
Unpaid Claims, Beginning of Fiscal Year	\$ 4,190,177
Other Adjustments (Including IBNRs)	(405,983)
Claim Payments	<u>619,120</u>
Unpaid Claims Liability, End of Fiscal Year	<u>\$ 4,403,314</u>

NOTE 13 – TRANSPORTATION DEVELOPMENT ACT/CALIFORNIA ADMINISTRATIVE CODE

Santa Cruz METRO is subject to compliance with the TDA provisions, Sections 6634 and 6637 of the California Administrative Code and Sections 99267, 99268.1, and 99314.6 of the PUC.

Section 6634

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

Section 6637

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

Sections 99267, 99268.1, and 99314.6

Pursuant to the Transportation Development Act, Santa Cruz METRO meets the 50% Expenditure Limitation required by Public Utilities Code §99268 and does not use the Alternative Revenue Ratio to determine eligibility for TDA funds.

NOTE 14 – PUBLIC TRANSPORTATION MODERNIZATION, IMPROVEMENT, AND SERVICE ENHANCEMENT ACCOUNT (PTMISEA)

In November 2006, California voters passed a bond measure enacting the Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006, Proposition 1B. Of the \$19.925 billion of state general obligation bonds authorized, \$4 billion was set aside by the State, as instructed by the statute, as PTMISEA. These funds are available to the California Department of Transportation for intercity rail projects and to transit operators in California for rehabilitation, safety, or modernization improvements; capital service enhancements or expansions; new capital projects; bus rapid transit improvements; or for rolling stock procurement, rehabilitation, or replacement.

The audit of public transportation operator finances, pursuant to Section 99245 of the PUC and required under the TDA, was expanded to include verification of receipt and appropriate expenditure of PTMISEA bond funds.

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

During the fiscal year ended June 30, 2015, Santa Cruz METRO applied for and received proceeds of \$5,949,126 and earned interest of \$53,188 from the State's PTMISEA account for construction funding for the Consolidated MetroBase Project. During the fiscal year ended June 30, 2015, qualifying expenditures of \$3,061,817 were incurred and the remaining balance of \$12,847,226 including accrued interest was deferred. Qualifying expenditures must be encumbered within three years from the date of the allocation and expended within three years from the date of encumbrance.

**Schedule of PTMISEA Proposition 1B Grants
For the Year Ended June 30, 2015**

	2015
Balance - beginning of the year	\$ 9,906,729
Receipts:	
Grant received	5,949,126
Interest accrued 7/1/2014 through 6/30/2015	53,188
Expenses:	
MetroBase Construction	(3,061,817)
Balance - end of year	\$ 12,847,226

NOTE 15 – POSTEMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS

Plan Description

Santa Cruz METRO provides post-retirement CalPERS medical benefits to qualified retired employees age 50 and older (including eligible dependents) who have completed at least five years of CalPERS eligible service. Santa Cruz METRO pays medical premiums depending on bargaining union and PEMHCA contract requirements. If the retiree has ten years of Santa Cruz METRO eligible service, Santa Cruz METRO provides post-retirement dental and vision benefits for qualified retirees (including eligible dependents), and life insurance for the retiree only, until the retiree reaches age 65. The costs of providing these benefits are recognized when paid. Santa Cruz METRO has recognized approximately \$2,487,455 of expense for these benefits for the year ending June 30, 2015.

NOTE 15 – POSTEMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS (Continued)

Annual OPEB Cost and Net OPEB Obligation

Santa Cruz METRO's annual OPEB cost (expense) is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. For fiscal year 2014-15, Santa Cruz METRO's annual OPEB cost was \$7,201,292. Santa Cruz METRO's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the year ended June 30, 2015, were as follows:

	<u>2015</u>
Annual required contribution	\$ 7,331,665
Interest on net OPEB obligation	741,236
Adjustments to annual required contribution	<u>(871,609)</u>
Annual OPEB cost	7,201,292
Contributions made	<u>2,487,455</u>
Change in net OPEB obligation (asset)	4,713,837
Net OPEB obligation (asset) - beginning of year	<u>18,530,908</u>
Net OPEB obligation (asset) - end of year	<u><u>\$ 23,244,745</u></u>

<u>Year Ended June 30,</u>	<u>Annual OPEB Cost</u>	<u>Actual Employer Contributions</u>	<u>Percentage of Annual OPEB Cost Contributed</u>	<u>Net Ending OPEB Obligation</u>
2015	\$ 7,201,292	\$ 2,487,455	34.54%	\$ 23,244,745

Funding Policy, Funded Status, and Funding Progress

Santa Cruz METRO's required contribution is based on pay-as-you-go financing requirements. For fiscal year 2014-15, Santa Cruz METRO contributed \$2,487,455 to the plan.

As of July 1, 2013, the most recent actuarial valuation date, the projected actuarial accrued liability (AAL) for benefits was \$76,452,944 all of which was unfunded.

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

The schedule of funding progress, presented as required supplementary information following the notes to the basic financial statements, presents multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

NOTE 15 – POSTEMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS (Continued)

Actuarial Methods and Assumptions

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

The actuarial assumptions used for rates of employee turnover, retirement, and mortality, as well as economic assumptions regarding healthcare inflation and interest were based on a standard set of actuarial assumptions modified as appropriate for Santa Cruz METRO. Turnover, mortality, and retirement rates were taken from the CalPERS actuarial table for miscellaneous employees, which closely matches Santa Cruz METRO experience. Healthcare inflation rates are based on the general health care environment. Actual healthcare premiums through 2014 were used and then projected to increase in future years by 8.5% in 2015, with the increases gradually declining until reaching 4.50% in 2024 (4.64% future premiums increases assumed for all years after 2024). The unfunded actuarial accrued liability is being amortized as a level percentage of payroll on a closed basis over 30 years from June 30, 2008, with 23 years remaining as of June 30, 2015.

NOTE 16 – PRIOR PERIOD ADJUSTMENT

A prior period adjustment was made to Net Position as follows:

Net Position June 30, 2014	\$ 75,034,459
Implementation of GASB Statement No. 68	
Net pension liability (measurement date)	(49,905,366)
Deferred outflows of resources - PERS contributions made during the fiscal year ended 2014	<u>3,668,004</u>
Prior period adjustment	<u>(46,237,362)</u>
Restated net position at June 30, 2014	<u><u>\$ 28,797,097</u></u>

NOTE 17 – SUBSEQUENT EVENTS

Subsequent events were evaluated by management through December 22, 2015, which is the date of issuance. There were no subsequent events identified by management which would require disclosure in these financial statements.

REQUIRED SUPPLEMENTARY INFORMATION

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
AN AGENT MULTIPLE-EMPLOYER DEFINED BENEFIT PENSION PLAN
SCHEDULE OF CHANGES IN THE NET PENSION LIABILITY AND RELATED RATIOS
FOR THE YEAR ENDED JUNE 30, 2015
LAST 10 YEARS***

	<u>Measurement Period 2013/14</u>
Total Pension Liability	
Service Cost	\$ 3,200,114
Interest on Total Pension Liability	10,709,850
Benefit Payments, Including Refunds of Employee Contributions	<u>(6,660,594)</u>
Net Change in Total Pension Liability	7,249,370
Total Pension Liability - Beginning	<u>144,528,243</u>
Total Pension Liability - Ending (a)	<u><u>\$ 151,777,613</u></u>
 Plan Fiduciary Net Position	
Contributions - Employer	\$ 3,668,004
Contributions - Employee	1,573,391
Net Investment Income	16,262,179
Benefit Payments	<u>(6,660,594)</u>
Net Change in Plan Fiduciary Net Position	14,842,980
Plan Fiduciary Net Position - Beginning	<u>94,622,877</u>
Plan Fiduciary Net Position - Ending (b)	<u><u>\$ 109,465,857</u></u>
 Net Pension Liability - Ending [(a) - (b)]	<u><u>\$ 42,311,756</u></u>
 Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	72.12%
 Covered-Employee Payroll	\$ 18,385,116
 Net Pension Liability as a Percentage of Covered- Employee Payroll	230.14%

* Fiscal year 2015 was the 1st year of implementation; therefore, only one year is shown.

Notes to Schedule:

Benefit changes. In 2015, there were no benefit changes.

Changes in assumptions. In 2015, there were no changes in assumptions.

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
 AN AGENT MULTIPLE-EMPLOYER DEFINED BENEFIT PENSION PLAN
 SCHEDULE OF CONTRIBUTIONS
 FOR THE YEAR ENDED JUNE 30, 2015
 LAST 10 YEARS***

	Fiscal Year 2013-14
Actuarially Determined Contributions	\$ 3,668,004
Contributions in Relation to the Actuarially Determined Contributions	(3,668,004)
Contribution Deficiency (Excess)	\$ -
Covered-Employee Payroll	\$ 18,385,116
Contributions as a Percentage of Covered- Employee Payroll	19.95%

* Fiscal year 2015 was the 1st year of implementation; therefore, only one year is shown.

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF FUNDING PROGRESS
OTHER POSTEMPLOYMENT BENEFITS
JUNE 30, 2015**

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

Actuarial Valuation Date*	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b - a)/c]
4/1/2010	\$ -	\$ 43,442,791	\$ 43,442,791	0.00%	\$ 16,109,672	269.67%
6/30/2011	-	59,164,000	59,164,000	0.00%	15,925,000	371.52%
7/1/2013	-	72,397,782	72,397,782	0.00%	18,682,878	387.51%

*Based on the latest actuarial valuation

SUPPLEMENTARY INFORMATION

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENT OF OPERATING EXPENSES
FOR THE YEAR ENDED JUNE 30, 2015**

	2015
Labor	
Operators' salaries and wages	\$ 8,947,861
Other salaries and wages	7,037,245
Overtime	2,897,520
	18,882,626
Fringe Benefits	
Absence with pay	3,690,590
Pension plans	3,507,337
Vision, medical, and dental plans	9,363,094
Workers' compensation insurance	829,705
Disability insurance	337,417
Other fringe benefits	184,402
Other postemployment benefits	4,670,819
	22,583,364
Services	
Accounting	84,494
Administrative and banking	350,240
Professional and technical services	666,954
Security	477,038
Outside repairs	928,346
Other services	142,019
	2,649,091
Materials and Supplies Consumed	
Fuels and lubricants	2,262,328
Tires and tubes	252,890
Vehicle parts	965,831
Other materials and supplies	400,505
	3,881,554
Utilities	501,147
Casualty and Liability Costs	491,907
Taxes and Licenses	42,698
Purchased Transportation Services	
Paratransit	170,746
Miscellaneous Expenses	195,770
Equipment and Facility Lease	215,224
Depreciation	
Property acquired with operator funds	311,386
Property acquired by federal, state, or Transportation Development Act funds	5,013,962
	5,325,348
Total Operating Expenses	\$ 54,939,475

OTHER SCHEDULES AND REPORTS

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2015**

<u>Federal Grantor / Program Title</u>	<u>Federal CFDA No.</u>	<u>Pass-Through Grantor's Number</u>	<u>Total Federal Expenditures</u>
U.S. DEPARTMENT OF TRANSPORTATION			
Direct Programs:			
Federal Transit Administration (FTA)			
Cluster Defined by the Department of Transportation			
Section 3/5309 Consolidation			
Pacific Station Expansion FY2008 (Design/Engineering)	20.500	CA-04-0102	\$ 378,528
State of Good Repair (SGR #2) CNG Bus Purchase	20.500	CA-04-0225	<u>14,779</u>
			<u>393,307</u>
Section 9/5307			
Operating Assistance	20.507	CA-90-Z210	5,478,097
Section 18/5311-5317			
Rural Operating Assistance - 5311	20.509	6414169	212,267
Section 18/5304			
AMBAG Transit Planning Student Internships	20.515	N/A	<u>14,103</u>
Total Expenditures of Federal Awards			<u><u>\$ 6,097,774</u></u>

See accompanying notes to schedule of expenditures of federal awards.

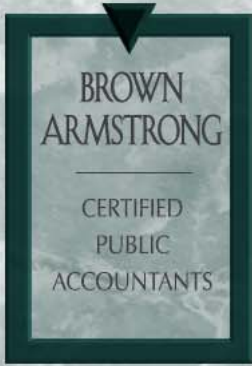
**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2015**

NOTE 1 – GENERAL

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

NOTE 2 – BASIS OF ACCOUNTING

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



BROWN ARMSTRONG
Certified Public Accountants

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

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

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We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Santa Cruz Metropolitan Transit District (Santa Cruz METRO), as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise Santa Cruz METRO's basic financial statements, and have issued our report thereon dated December 22, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Santa Cruz METRO's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Santa Cruz METRO's internal control. Accordingly, we do not express an opinion on the effectiveness of Santa Cruz METRO's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of Santa Cruz METRO's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Santa Cruz METRO'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*.

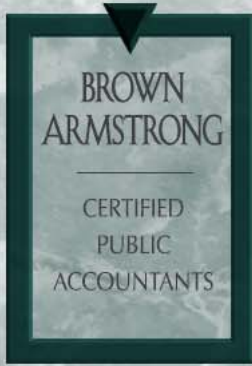
Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Santa Cruz METRO's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Santa Cruz METRO's internal control and compliance. Accordingly, this report is not suitable for any other purpose.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

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

Bakersfield, California
December 22, 2015



BROWN ARMSTRONG
Certified Public Accountants

INDEPENDENT AUDITOR’S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133

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

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Report on Compliance for Each Major Federal Program

We have audited the Santa Cruz Metropolitan Transit District’s (Santa Cruz METRO) compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 *Compliance Supplement* that could have a direct and material effect on each of Santa Cruz METRO’s major federal programs for the year ended June 30, 2015. Santa Cruz METRO’s major federal programs are identified in the summary of auditor’s results section of the accompanying schedule of findings and questioned costs.

Management’s Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor’s Responsibility

Our responsibility is to express an opinion on compliance for each of Santa Cruz METRO’s major federal programs based on our audit of the types of compliance requirements referred to above. 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 METRO’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 on compliance for each major federal program. However, our audit does not provide a legal determination of Santa Cruz METRO’s compliance.

Opinion on Each Major Federal Program

In our opinion, Santa Cruz METRO complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2015.

Report on Internal Control Over Compliance

Management of Santa Cruz METRO is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Santa Cruz METRO's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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 METRO's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

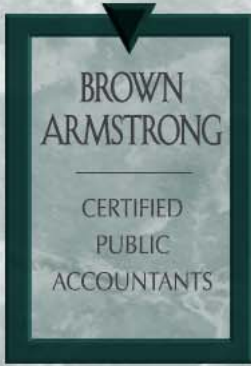
Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Brown Armstrong
Accountancy Corporation

Bakersfield, California
December 22, 2015



BROWN ARMSTRONG
Certified Public Accountants

INDEPENDENT AUDITOR’S REPORT ON COMPLIANCE OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH THE STATUTES, RULES, AND REGULATIONS OF THE CALIFORNIA TRANSPORTATION DEVELOPMENT ACT AND THE ALLOCATION INSTRUCTIONS AND RESOLUTIONS OF THE TRANSPORTATION COMMISSION

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

We have audited, 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, the financial statements of the Santa Cruz Metropolitan Transit District (Santa Cruz METRO) as of and for the year ended June 30, 2015, and have issued our report thereon dated December 22, 2015.

Compliance

As part of obtaining reasonable assurance about whether the Santa Cruz METRO’s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. Additionally, we performed tests to determine that allocations made and expenditures paid by Santa Cruz METRO were made in accordance with the allocation instructions and resolutions of the Transportation Commission and in conformance with the California Transportation Development Act. Specifically, we performed each of the specific tasks identified in the California Code of Regulations Sections 6666 and 6667 that are applicable to Santa Cruz METRO. In connection with our audit, nothing came to our attention that caused us to believe Santa Cruz METRO failed to comply with the Statutes, Rules, and Regulations of the California Transportation Development Act and the allocation instructions and resolutions of the Transportation Commission. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion.

Also as part of our audit, we performed tests of compliance to determine whether certain state funds were received and expended in accordance with the applicable bond act and state accounting requirements.

Other Matters

In November 2006, California voters passed a bond measure enacting the Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006 (Proposition 1B). Of the \$19.925 billion of state general obligation bonds authorized, \$4 billion was set aside by the State as instructed by statute as the Public Transportation Modernization, Improvement, and Service Enhancement Account (PTMISEA). These funds are available to the California Department of

Transportation for intercity rail projects and to transit operators in California for rehabilitation, safety, or modernization improvements; capital service enhancements or expansions; new capital projects; bus rapid transit improvements; or for rolling stock procurement, rehabilitation, or replacement.

During the fiscal year ended June 30, 2015, Santa Cruz METRO received \$5,949,126 from the State's PTMISEA funds for the purpose of construction of the Consolidated MetroBase Project. As of June 30, 2015, PTMISEA interest received and funds expended were verified in the course of our audit as follows:

**Schedule of PTMISEA Proposition 1B Grants
For the Year Ended June 30, 2015**

	2015
Balance - beginning of the year	\$ 9,906,729
Receipts:	
Grant received	5,949,126
Interest accrued 7/1/2014 through 6/30/2015	53,188
Expenses:	
MetroBase Construction	(3,061,817)
Balance - end of year	\$ 12,847,226

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Santa Cruz METRO's internal control or on compliance. Accordingly, this report is not suitable for any other purpose.

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

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Brown Armstrong
Accountancy Corporation

Bakersfield, California
December 22, 2015

FINDINGS AND QUESTIONED COSTS SECTION

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2015**

I. Summary of Auditor's Results

Financial Statements

Type of auditor's report issued: Unmodified

Internal control over financial reporting:

Material weakness identified? Yes No

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

Noncompliance material to financial statements noted? Yes No

Federal Awards

Internal control over major federal programs:

Material weakness identified? Yes No

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

Type of auditor's report issued on compliance for major programs: Unmodified

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

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Clusters</u>
20.500	Federal Transit Capital Investment Grants – Section 3
20.507	Federal Transit Formula Grants – Section 9

Dollar threshold used to distinguish type A and B programs: \$300,000

Auditee qualified as low risk auditee? Yes No

II. Findings Relating to Financial Statements Required Under Generally Accepted Government Auditing Standards

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, 2014) Findings and Current Year Status Follows

None.