

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT

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

JUNE 30, 2010 AND 2009

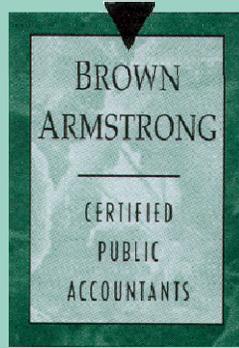
**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
JUNE 30, 2010 AND 2009**

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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying basic financial statements of the Santa Cruz Metropolitan Transit District (Santa Cruz METRO), as of and for the years ended June 30, 2010 and 2009, as listed in the table of contents. These basic financial statements are the responsibility of Santa Cruz METRO's management. Our responsibility is to express an opinion on these basic financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of Santa Cruz METRO, as of June 30, 2010 and 2009, and the results of its operations and the cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 21, 2010, 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 7 and the schedule of funding progress for Santa Cruz METRO's Other Postemployment Benefit (OPEB) Plan on page 28 in the required supplementary information section be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements. The accompanying statements of operating expenses and schedule of expenditures of federal awards are 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 are not a required part of the basic financial statements. The statements of operating expenses and 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. The 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 information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION



Bakersfield, California
December 21, 2010

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2010 AND 2009**

Introduction

This report provides a narrative and analytical overview of the financial activities of the Santa Cruz Metropolitan Transit District (Santa Cruz METRO) with selected comparative information for the years ended June 30, 2010 and 2009. This discussion has been prepared by management and should be read in conjunction with the basic financial statements and the notes thereto, which follow this section.

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

The Financial Statements

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

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

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

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

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

Financial Highlights

The management of Santa Cruz METRO is pleased to present the following discussion that 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, 2010.

Although the recession officially ended in June 2009, economic recovery continues to stall. Operating revenues have decreased by almost \$5 million, since June 2007, while operating expenses have increased by \$2.5 million. We have seen decreases in passenger fares, interest income, sales tax revenue, and Transportation Development Act (TDA) revenues, while labor expense, retirement expense, and medical premiums, to name a few, continue to increase. This loss in revenues, coupled with the increase in expenses has been devastating to Santa Cruz METRO's budget. In response to the dramatic and unprecedented decline in revenues over the past three (3) years, it was necessary to utilize transfers from cash flow reserves and one-time capital revenues to balance the budget this year.

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
JUNE 30, 2010 AND 2009**

Significant capital contributions reported in prior years have contributed to the success of many of the projects that are summarized here. In December 2009, Santa Cruz METRO successfully took occupancy of its Administrative Building at 110 Vernon Street in Santa Cruz after interior and exterior tenant improvements were completed. This facility replaces the leased facility at 370 Encinal Street, and all Administrative, Finance and Human Resources staff have been relocated to Vernon Street. In addition, substantial occupancy has been taken at the Maintenance Facility and Garage, located at 138 Golf Club Drive. The building is now being used to service fleet vehicles and final work is almost completed. Santa Cruz METRO is still pursuing a fully consolidated MetroBase, with the final two pieces—construction of a new Operations Building and the installation of a second compressed natural gas (CNG) 15,000-gallon storage tank at the current Fueling station—still in process.

The biggest challenge to the completion of the consolidated MetroBase project is the drying up of State of California capital funding streams, as noted in last year's report. During the year 7/1/09 – 6/30/10, Santa Cruz METRO worked closely with the California Transit Association (CTA) in an attempt to recoup both the estimated \$31 million in misappropriated funds owed to Santa Cruz METRO, and also to protect transit funding in general from budget raids by promoting a ballot initiative proposing a constitutional amendment protecting transit and other funding. Proposition 22, passed by 63% on November 2, 2010 and its effects will be discussed more in-depth in next year's audit report. Of note is that it is anticipated that, dependent on November 2010 California state bond sales, Santa Cruz METRO will receive the funding necessary to both complete the natural gas storage tank and Operations Building projects (up to ~ \$16 million, still being negotiated). In addition, Santa Cruz METRO also anticipates an installment of \$440,505 from the November bond sale to continue to implement its closed-circuit-TV and land-mobile-radio security projects through the California Emergency Management Agency (formerly Office of Homeland Security).

Santa Cruz METRO continued to implement its three Recovery Act funded projects—replacement of 113 fareboxes on buses; installation of a new bus dispatching system (Hastus/Giro); and, the purchase of 27 replacement vans for paratransit services. As of June 30, 2010, \$382,330 of stimulus funds had been expended, with most project expenditures expected by 12/31/10. Total available funds for these projects is \$5,632,403, including two Recovery Act grants (\$4,909,939 and \$267,464), one earmark (\$475,000) and required local matching funds (\$118,750). The Recovery Act funds were received in the previous fiscal year, and the \$475,000 awarded on 4/16/10.

During this fiscal year, Santa Cruz METRO also implemented approximately \$258,000 worth of investment in infrastructure through Information Technology projects, including the installation and implementation of a new Purchasing and Procurement software, Puridium, and new Fleet and Facilities Maintenance software, Maintstar. In addition, new Human Resources software, Spectrum, was also installed and is expected to be implemented by December 31, 2010.

Finally, in June 2010, Santa Cruz METRO submitted over \$6.5 million in grant proposals for new natural gas buses to round-out the CNG fleet and get more diesel buses off the road; to complete the natural gas storage tank project; and, to fund a staff intern and a transit planning study. Of note is that in October 2010, Santa Cruz METRO received notice that \$5.1 million in capital discretionary grant funding had been awarded for buses (\$4.8 million), the storage tank (\$200K), an intern and the planning study (\$100K). These grants will be discussed in-depth in next year's audit report.

Statement of Net Assets:

	2010	2009	2008	2010 to 2009		2009 to 2008	
				Increase/(Decrease) Amount	%	Increase/(Decrease) Amount	%
Total Assets	\$ 105,530,289	\$ 112,044,106	\$ 105,036,300	\$ (6,513,817)	-6%	\$ 7,007,806	7%
Total Liabilities	\$ 22,352,299	\$ 25,853,950	\$ 24,760,587	\$ (3,501,651)	-14%	\$ 1,093,363	4%
Total Net Assets	\$ 83,177,990	\$ 86,190,156	\$ 80,275,713	\$ (3,012,166)	-3%	\$ 5,914,443	7%

Total Assets decreased this year due to a reduction in cash flow reserves, and prior year carryover funds; reduced restricted capital grant funds on hand, and a reduction in grants receivable. The use of cash flow reserves, and prior year carryover reserves was required to balance the fiscal year 09/10 budget. As the Consolidated MetroBase Project (Maintenance Building and 110 Vernon Renovation and Remodel) neared completion, capital grant funds received in prior periods were disbursed as project expenditures were paid out.

Total Liabilities also decreased this year due to reductions in restricted capital grant funds. Proposition 1B PTMISEA grant funding is allocated according to an approved expenditure plan, and funds are received in a lump sum annually, and then disbursed as project expenditures are paid out.

For the fiscal year ended June 30, 2010, Santa Cruz METRO's net assets decreased by \$3,012,166 due to decreased cash on hand and reduced grants receivable.

Statement of Revenues, Expenses, and Changes in Fund Net Assets:

	2010	2009	2008	2010 to 2009		2009 to 2008	
				Increase/(Decrease) Amount	%	Increase/(Decrease) Amount	%
Operating Revenues	\$ 8,427,944	\$ 8,769,185	\$ 8,272,058	\$ (341,241)	-4%	\$ 497,127	6%
Operating Expenses	(42,218,182)	(41,975,092)	(38,683,643)	243,090	1%	(3,291,449)	-9%
Operating Loss	(33,790,238)	(33,205,907)	(30,411,585)	584,331	2%	(2,794,322)	-9%
Non-Operating Revenues	23,916,825	24,877,839	28,164,895	(961,014)	-4%	(3,287,056)	-12%
Capital Grant Contributions	6,861,247	14,242,511	19,167,833	(7,381,264)	-52%	(4,925,322)	-26%
Increase (Decrease) in Net Assets	\$ (3,012,166)	\$ 5,914,443	\$ 16,921,143	\$ (7,757,947)	-131%	\$ (11,006,700)	-65%

Operating Revenues decreased by 4% this year due to an overall decrease in ridership of -4.7%.

Operating Expenses only increased by 1% overall when compared to last year. Due to the severe economic downturn and the resulting declines in revenue, significant cost-cutting measures have been implemented to achieve savings at all levels in all departments.

Non-operating Revenues decreased by 4% primarily due to lower than anticipated sales tax revenue, Transportation Development Act (TDA) revenue, and reduced interest income.

Capital Contributions are capital grant funds received for facilities improvements and the purchase of capital equipment including revenue vehicles. Capital contributions decreased by 52% from the prior year as the Consolidated MetroBase Project (Maintenance Building and 110 Vernon Renovation and Remodel) neared completion.

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
JUNE 30, 2010 AND 2009**

**Supplemental Revenue, Expenses, and Performance Report:
(based on Federal Transit Authority (FTA) account grouping guidelines)**

	2010	2009	2008	2010 to 2009 % Change	2009 to 2008 % Change
Revenues					
Passenger Fares	\$ 8,427,944	\$ 8,769,185	\$ 8,272,058	-3.9%	6.0%
Sales and Use Tax	14,320,288	14,923,139	17,054,735	-4.0%	-12.5%
Non-Operating Revenues ⁽¹⁾	569,113	731,908	1,558,759	-22.2%	-53.0%
TDA ⁽²⁾	5,001,737	5,696,249	6,313,334	-12.2%	-9.8%
Federal Operating Assistance ⁽³⁾	4,025,687	3,615,707	3,375,281	11.3%	7.1%
Total Revenues	\$ 32,344,769	\$ 33,736,188	\$ 36,574,167	-4.1%	-7.8%
Expenses					
Route Operation	\$ 22,746,197	\$ 21,752,897	\$ 20,834,142	4.6%	4.4%
Vehicle Maintenance	4,772,212	4,982,067	4,998,255	-4.2%	-0.3%
Facilities Maintenance	1,734,676	1,667,389	1,333,439	4.0%	25.0%
General Administration	8,080,210	8,515,251	7,763,787	-5.1%	9.7%
Total Expenses (excluding depreciation)	\$ 37,333,295	\$ 36,917,604	\$ 34,929,623	1.1%	5.7%
Performance Indicators					
Total Passengers	5,839,990	5,987,518	5,888,213	-2.5%	1.7%
Revenue Hours	243,691	243,241	257,705	0.2%	-5.6%
Revenue Miles	3,781,170	3,766,435	3,709,152	0.4%	1.5%
Farebox Recovery Ratio ⁽⁴⁾	22.6%	23.8%	23.7%	-4.9%	0.2%
Cost/Passenger ⁽⁵⁾	\$ 6.39	\$ 6.17	\$ 5.93	3.6%	4.0%
Cost/Hour ⁽⁶⁾	\$ 153.20	\$ 151.77	\$ 135.54	0.9%	12.0%
Cost/Mile ⁽⁷⁾	\$ 9.87	\$ 9.80	\$ 9.41	0.7%	4.2%
Full Time Equivalent Employees	303	314	323	-3.5%	-2.8%
Active Fleet - Fixed Route	112	112	112	0.0%	0.0%
Active Fleet - Paratransit	37	38	38	-2.6%	0.0%

⁽¹⁾ Non-Operating Revenues have decreased from last year due to a significant reduction in the interest rate paid on Santa Cruz METRO's deposits in the Santa Cruz County Pooled Investment Fund. In an effort to protect the safety of the principal of the pool, increase credit quality and liquidity, the County Treasurer increased the portion of the portfolio invested in US Treasuries and Government Sponsored Enterprises bonds (GSE's) which resulted in lower overall market rates and a lower yield on the portfolio.

⁽²⁾ Transportation Development Act (TDA) funding revenues fluctuate annually based on retail sales in the County and by the amount retained by the Santa Cruz County Regional Transportation Commission (SCCRTC) for other county-wide projects and overhead. Receipts continue to decline due to the current economic recession and the "no job growth" economy.

⁽³⁾ Federal Operating Assistance increased this year due to the receipt of a portion of the one-time American Reinvestment and Recovery Act (ARRA) operating grant; and recognition of the full amount of the FTA Section 5307 operating funds available, due to no further payments due on the five (5) year ParaCruz FTA start-up loan, that was repaid in full last fiscal year.

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
JUNE 30, 2010 AND 2009**

- (4) Farebox Recovery Ratio is a standard transit performance indicator that is calculated by dividing passenger fares by total operating expenses and does not include depreciation.
- (5) Cost / Passenger is calculated by dividing total passengers by total operating expenses.
- (6) Cost / Hour is calculated by dividing total operating expenses by revenue hours.
- (7) Cost / Mile is calculated by dividing total operating expenses by revenue miles.

Statement of Cash Flows:

	2010	2009	2008	2010 to 2009 Change	2009 to 2008 Change
Net Cash Used in Operating Activities	\$ (30,577,635)	\$ (27,984,781)	\$ (25,145,487)	\$ (2,592,854)	\$ (2,839,294)
Net Cash Provided by Non-Capital Financing Activities	23,663,797	25,012,481	27,045,524	(1,348,684)	(2,033,043)
Net Cash Provided by (Used in) Capital and Related Financing Activities	(637,360)	5,044,102	(5,206,123)	(5,681,462)	10,250,225
Net Cash Provided by Non-Transportation Activities	318,624	531,567	1,090,834	(212,943)	(559,267)
Net Increase (Decrease) in Cash and Cash Equivalents	(7,232,574)	2,603,369	(2,215,252)	(9,835,943)	4,818,621
Cash and Cash Equivalents, Beginning of Year	36,433,679	33,830,310	36,045,562	2,603,369	(2,215,252)
Cash and Cash Equivalents, End of Year	\$ 29,201,105	\$ 36,433,679	\$ 33,830,310	\$ (7,232,574)	\$ 2,603,369

Cash and cash equivalents held by Santa Cruz METRO decreased by \$7,232,574 or 19.9% during the current year.

Contacting Santa Cruz METRO's Financial Management

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

BASIC FINANCIAL STATEMENTS

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF NET ASSETS
JUNE 30, 2010 AND 2009**

<u>ASSETS</u>	<u>2010</u>	<u>2009</u>
CURRENT ASSETS		
Cash and Cash Equivalents	\$ 21,335,939	\$ 24,072,345
Sales Tax, Grants, and Other Receivables	6,020,712	7,211,566
Inventory	741,896	806,099
Prepays	474,877	481,547
	<u>28,573,424</u>	<u>32,571,557</u>
RESTRICTED ASSETS		
Cash and Cash Equivalents	<u>7,865,166</u>	<u>12,361,334</u>
CAPITAL ASSETS		
Building and Improvements	12,483,953	12,427,094
Revenue Vehicles	44,599,626	44,656,992
Operations Equipment	1,810,861	2,154,389
Other Equipment	1,500,624	1,500,624
Other Vehicles	1,169,471	1,218,674
Office Equipment	1,453,135	1,293,076
	<u>63,017,670</u>	<u>63,250,849</u>
Less Accumulated Depreciation	<u>(39,771,947)</u>	<u>(35,479,687)</u>
	23,245,723	27,771,162
Construction-in-Progress	36,681,106	30,175,183
Land	<u>9,164,870</u>	<u>9,164,870</u>
Total Capital Assets	<u>69,091,699</u>	<u>67,111,215</u>
TOTAL ASSETS	<u><u>\$ 105,530,289</u></u>	<u><u>\$ 112,044,106</u></u>

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

SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF NET ASSETS (Continued)
JUNE 30, 2010 AND 2009

<u>LIABILITIES AND NET ASSETS</u>	<u>2010</u>	<u>2009</u>
CURRENT LIABILITIES		
Accounts Payable and Accrued Liabilities	\$ 775,270	\$ 2,185,549
Accrued Payroll and Employee Benefits	3,896,434	3,799,326
Workers' Compensation Liabilities	888,730	972,231
Other Accrued Liabilities	564,560	419,585
Security Deposit	<u>15,684</u>	<u>15,684</u>
Total Current Liabilities	6,140,678	7,392,375
NON-CURRENT LIABILITIES		
Deferred Revenue - Settlement Agreement	1,322,636	3,092,552
Deferred Revenue - STA Grant	4,232,523	1,836,010
Deferred Revenue - PTMISEA Grant	1,475,663	7,003,247
Deferred Revenue - Proposition 1B OHS CTS GP Grant	834,344	429,525
Deferred Revenue - Other	34,034	-
OTHER LONG-TERM LIABILITIES		
Workers' Compensation Liabilities	3,194,347	3,538,987
Other Postemployment Benefit Liabilities	<u>5,118,074</u>	<u>2,561,254</u>
Total Liabilities	<u>22,352,299</u>	<u>25,853,950</u>
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	69,091,699	67,111,215
Unrestricted Net Assets	<u>14,086,291</u>	<u>19,078,941</u>
Total Net Assets	<u>83,177,990</u>	<u>86,190,156</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 105,530,289</u>	<u>\$ 112,044,106</u>

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

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF REVENUES, EXPENSES, AND
CHANGES IN FUND NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
OPERATING REVENUES		
Passenger Fare	\$ 4,551,560	\$ 4,742,581
Special Transit Fare	3,876,384	4,026,604
	<u>8,427,944</u>	<u>8,769,185</u>
OPERATING EXPENSES		
Wages, Salaries, and Employee Benefits	30,315,865	30,373,279
Purchased Transportation Services	294,183	176,002
Material and Supplies	2,658,384	2,389,907
Other Expenses	4,064,863	3,978,416
Depreciation	4,884,887	5,057,488
	<u>42,218,182</u>	<u>41,975,092</u>
Net Operating Loss	<u>(33,790,238)</u>	<u>(33,205,907)</u>
NON-OPERATING REVENUES (EXPENSES)		
Sales and Use Tax	14,320,288	14,923,139
Transportation Development Act Assistance	5,001,737	5,696,249
Section 8/5303 Planning Fund	4,351	27,799
Section 9/5307 Operating Assistance	3,645,442	3,426,293
Section 18/5307 Operating Assistance	375,894	161,615
Interest Income	192,546	391,808
Rental Income	126,078	139,759
Other Revenue	250,010	200,341
Gain (Loss) on Sale and Disposal of Property, Equipment, and Inventory	479	(89,164)
	<u>23,916,825</u>	<u>24,877,839</u>
Total Non-Operating Revenues	<u>23,916,825</u>	<u>24,877,839</u>
Net Loss Before Capital Contributions	<u>(9,873,413)</u>	<u>(8,328,068)</u>
CAPITAL CONTRIBUTIONS		
Grants Restricted for Capital Expenditures	<u>6,861,247</u>	<u>14,242,511</u>
NET ASSETS		
Increase (Decrease) in Net Assets	(3,012,166)	5,914,443
Total Net Assets, Beginning of Year	<u>86,190,156</u>	<u>80,275,713</u>
Total Net Assets, End of Year	<u>\$ 83,177,990</u>	<u>\$ 86,190,156</u>

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

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from Customers	\$ 8,426,099	\$ 9,594,562
Payments to Employees	(30,646,898)	(30,462,704)
Payments to Suppliers	(8,356,836)	(7,116,639)
	<u>(30,577,635)</u>	<u>(27,984,781)</u>
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:		
Operating Grants Received, Including Sales and Use Tax	23,663,797	25,000,666
Other Non-Operating Revenue	-	11,815
	<u>23,663,797</u>	<u>25,012,481</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Proceeds from Sale of Property and Equipment	512	-
Capital Grants Received	6,227,532	19,632,785
Capital Expenditures	(6,865,404)	(14,588,683)
	<u>(637,360)</u>	<u>5,044,102</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment and Rental Income Received	<u>318,624</u>	<u>531,567</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(7,232,574)	2,603,369
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>36,433,679</u>	<u>33,830,310</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 29,201,105</u>	<u>\$ 36,433,679</u>
RECONCILIATION OF NET OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES		
Net Operating Loss	\$ (33,790,238)	\$ (33,205,907)
Adjustments to Reconcile Net Operating Loss to Net Cash Used in Operating Activities:		
Depreciation	4,884,887	5,057,488
Changes in Assets and Liabilities:		
(Increase) Decrease in Receivables	(1,845)	825,377
Decrease in Inventory	64,203	140,462
(Increase) Decrease in Prepaid Expenses	6,670	(92,315)
Decrease in Accounts Payable	(1,410,279)	(618,461)
Decrease in Other Liabilities	(331,033)	(91,425)
	<u>(331,033)</u>	<u>(91,425)</u>
Net Cash Used in Operating Activities	<u>\$ (30,577,635)</u>	<u>\$ (27,984,781)</u>

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

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009**

NOTE 1 – OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of Organization

The Santa Cruz Metropolitan Transit District (Santa Cruz METRO) was formed February 9, 1969, following a favorable election in conformity with Section 9800 et. seq. of the Public Utilities Code. The transit system serves the general public in the cities of Santa Cruz, Watsonville, Scotts Valley, 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, 2010, the directors were as follows:

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

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

B. Reporting Entity

Santa Cruz METRO and the Santa Cruz Civic Improvement Corporation (the Corporation) have a financial and operational relationship, which meets the reporting entity definition criteria of 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 years ending June 30, 2010 and 2009, 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 assets; and unrestricted net assets.

Contributed Capital/Reserved Retained Earnings:

Santa Cruz METRO receives grants from the Federal Transit Administration (FTA) and other agencies of the U.S. Department of Transportation, state, and local transportation funds for the acquisition of transit-related equipment and improvements. Prior to July 1, 2001, capital grants were recognized as donated capital to the extent that project costs under the grant 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 resulting in an increase in net revenue of \$6,861,247 and \$14,242,511 for the fiscal years 2010 and 2009, respectively.

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

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

C. Basis of Accounting and Presentation (Continued)

Proprietary Accounting and Financial Reporting:

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

Net Assets:

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

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

D. Cash and Cash Equivalents

Santa Cruz METRO considers all highly liquid investments with a maturity date within three months of the date acquired to be cash equivalents. Santa Cruz METRO deposits funds into an external investment pool maintained by the 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, banker's acceptances, repurchase agreements, and the State Treasurer's investment pool. Cash and cash equivalents are stated at fair value. For purposes of the 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 assets because their use is subject to externally imposed stipulations, either by laws or regulations.

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

F. Restricted Assets (Continued)

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

	<u>2010</u>	<u>2009</u>
Cash and Cash Equivalents		
Federal Transit Administration Grant	\$ 1,322,636	\$ 3,092,552
Proposition 1B PTMISEA Grant	1,475,663	7,003,247
Proposition 1B OHS CTSGP Grant	834,344	429,525
State Transit Assistance Grant	<u>4,232,523</u>	<u>1,836,010</u>
Total Restricted Assets	<u>\$ 7,865,166</u>	<u>\$ 12,361,334</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	20-30 years
Revenue vehicles	12 years
Other vehicles and equipment	3-10 years

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

Major improvements and betterments to existing facilities and equipment are capitalized. Costs for maintenance and repairs, which do not extend the useful 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 Scotts Valley Redevelopment Agency (the Agency), a political subdivision of the State of California, was one of Santa Cruz METRO's funding sources for this project and has retained an interest in the property. The title to the property is retained by both Santa Cruz METRO and the Agency as tenants in common with each party holding an individual interest in proportion to each party's financial participation in the project. The Agency's portion of the property is 13.87%. The Agency's portion is not recorded in Santa Cruz METRO's basic financial statements.

H. Sales and Use Tax

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

I. Operating Assistance Grants

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

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

J. Self-Insurance

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

K. Employee Benefits

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

L. Payroll

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

M. Pension Costs

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

N. Use of Estimates

The preparation of 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. Implementation of New Accounting Pronouncements

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. This statement requires that an intangible asset be recognized in the statement of net assets only if it is considered identifiable. This statement also establishes guidance specific to intangible assets related to amortization. This statement provides guidance on determining the useful lives of intangible assets when the length of their lives is limited by contractual or legal provisions. The statement did not have an effect on the financial position of Santa Cruz METRO.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. This statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. This statement is not effective until June 30, 2010. The statement did not have an effect on the financial position of Santa Cruz METRO.

NOTE 2 – CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following at June 30, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Cash on Hand	\$ 30,843	\$ 48,577
Demand Deposits	330,770	310,114
Deposits in Santa Cruz County Pooled Investment Fund	<u>28,839,492</u>	<u>36,074,988</u>
	<u>\$ 29,201,105</u>	<u>\$ 36,433,679</u>

Cash on Hand and Cash in Banks

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

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

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

Disclosures Relating to Interest Rate Risk

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

NOTE 2 – CASH AND 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
County Pooled Investment Fund	\$ 28,839,492	\$ 28,839,492	\$ -	\$ -	\$ -

Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations

Santa Cruz METRO's investments were not considered to be highly sensitive to interest rate fluctuations as of June 30, 2010 or 2009.

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
County Pooled Investment Fund	\$ 28,839,492	N/A	\$ -	\$ -	\$ -	\$ 28,839,492

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, 2010 or 2009.

Custodial Credit Risk

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

NOTE 2 – CASH AND CASH EQUIVALENTS (Continued)

Cash on Hand and Cash in Banks (Continued)

Custodial Credit Risk

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

Investment in 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>2010</u>	<u>2009</u>
Federal Grants	\$ 18,232	\$ 1,793,004
State Grants	3,338,305	2,835,132
Sales Tax Revenue	2,262,400	2,181,400
Other	401,775	402,030
	<u>\$ 6,020,712</u>	<u>\$ 7,211,566</u>

NOTE 4 – CHANGES IN CAPITAL ASSETS

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

<u>June 30, 2010</u>	<u>Balance July 1, 2009</u>	<u>Additions and Transfers</u>	<u>Retirements and Transfers</u>	<u>Balance June 30, 2010</u>
Non-Depreciated Assets				
Land	\$ 9,164,870	\$ -	\$ -	\$ 9,164,870
Construction-in-Progress	30,175,183	6,657,767	(151,844)	36,681,106
Total Non-Depreciated Assets	39,340,053	6,657,767	(151,844)	45,845,976
Depreciated Assets				
Building and Improvements	12,427,094	57,524	(665)	12,483,953
Revenue Vehicles	44,656,992	-	(57,366)	44,599,626
Operations Equipment	2,154,389	-	(343,528)	1,810,861
Other Equipment	1,500,624	-	-	1,500,624
Other Vehicles	1,218,674	-	(49,203)	1,169,471
Office Equipment	1,293,076	301,958	(141,899)	1,453,135
Total Depreciated Assets	63,250,849	359,482	(592,661)	63,017,670
Less Accumulated Depreciation	<u>(35,479,687)</u>	<u>(4,884,887)</u>	<u>592,627</u>	<u>(39,771,947)</u>
Depreciated Assets Net of Accumulated Depreciation	<u>27,771,162</u>	<u>(4,525,405)</u>	<u>(34)</u>	<u>23,245,723</u>
Total Capital Assets	<u>\$ 67,111,215</u>	<u>\$ 2,132,362</u>	<u>\$ (151,878)</u>	<u>\$ 69,091,699</u>

Depreciation expense at June 30, 2010, was \$4,884,887.

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

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

NOTE 5 – AVAILABLE NET ASSETS

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

	<u>2010</u>	<u>2009</u>
Current Assets	\$ 28,573,424	\$ 32,571,557
Current Liabilities	<u>(6,140,678)</u>	<u>(7,392,375)</u>
Working Capital	22,432,746	25,179,182
Less:		
Inventory	(741,896)	(806,099)
Prepaid Expenses	<u>(474,877)</u>	<u>(481,547)</u>
Total Available Net Assets	<u>21,215,973</u>	<u>23,891,536</u>
Net Assets Designated for the Following:		
Cash Flow	(2,511,102)	(5,059,022)
Workers' Compensation Reserve	(2,091,581)	(2,091,581)
110 Vernon Purchase - Renovation		(2,400,000)
Insurance Reserve	(700,757)	(700,757)
Alternative Fuel Conversion Fund	-	-
Bus Stop Improvements Reserve	-	-
Carryover from Fiscal Year 2008-2009 Operating Budget	(1,989,862)	(2,155,738)
Net Assets Required to Offset Projected Operating Budget Shortfall for Fiscal Year 2011	(4,272,159)	(3,154,251)
Net Assets Required to Fund Transportation Improvement Programs for the Fiscal Years 2011-2012	<u>(14,025,636)</u>	<u>(14,025,636)</u>
Available Undesignated Net Assets (Deficits)	<u>\$ (4,375,124)</u>	<u>\$ (5,695,449)</u>

NOTE 6 – CAPITAL GRANTS

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

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

	<u>2010</u>	<u>2009</u>
Federal Grants	\$ 6,629,512	\$ 6,194,664
State Grants	<u>231,735</u>	<u>8,047,847</u>
Total Capital Grants	<u>\$ 6,861,247</u>	<u>\$ 14,242,511</u>

NOTE 7 – COMMITMENTS

Santa Cruz METRO leases a number of its facilities under operating leases extending through 2015. For the years ended June 30, 2010 and 2009, rental expense relating to the leases was \$544,474 and \$728,350, respectively. Santa Cruz METRO also leases to others retail space in its transit facilities under noncancelable agreements. Minimum lease payments and receipts for existing operating leases are as follows:

Year Ending June 30	Lease Commitments	Rental Income	Net
2011	\$ 207,866	\$ 110,768	\$ 97,098
2012	214,726	84,917	129,809
2013	222,474	81,804	140,670
2014	182,954	80,696	102,258
2015	22,771	89,103	(66,332)
	<u>\$ 850,791</u>	<u>\$ 447,288</u>	<u>\$ 403,503</u>

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

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

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

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

	2010	2009
Total Assets	\$ 26,681,312	\$ 25,860,459
Total Liabilities	<u>10,133,289</u>	<u>9,782,422</u>
Fund Balance	<u>\$ 16,548,023</u>	<u>\$ 16,078,037</u>
Total Revenues	\$ 6,386,315	\$ 7,915,686
Total Expenditures	<u>5,916,329</u>	<u>6,485,801</u>
Net Increase in Fund Balance	<u>\$ 469,986</u>	<u>\$ 1,429,885</u>

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

NOTE 9 – 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.

NOTE 9 – WATSONVILLE FLEET MAINTENANCE FACILITY SETTLEMENT RECEIPT (Continued)

In addition, due to design and construction deficiencies by the design and building contractors involved in the original project, Santa Cruz METRO initiated litigation against the contractors and came to a settlement agreement with said contractors on May 30, 1995. In accordance with this agreement, the contractors remitted \$4,776,858 (including \$171,538 in costs) to Santa Cruz METRO during fiscal year 1996, representing damages less attorney fees. FTA Section 3/5309 restricts the use of these proceeds, and the interest earned thereon. Accordingly, the net restricted amount of \$1,322,636 and \$3,092,552 is reflected on the statements of net assets as deferred revenue at June 30, 2010 and 2009, respectively.

NOTE 10 – CONTINGENCIES

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

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

NOTE 11 – DEFINED BENEFIT PENSION PLAN

Plan Description

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

Funding Policy

There are 303 active plan members in the Plan as of June 30, 2010, which are required to contribute a percent of their annual covered salary. In lieu of salary increases and for employees who agreed to salary reductions in certain prior years, Santa Cruz METRO agreed to pay a portion of the employee contribution, based on formulas negotiated in their labor agreements. Santa Cruz METRO is also required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the CalPERS Board of Administration. The required employer contribution rate for the fiscal year ended June 30, 2010, was 13.383%. The contribution requirements of the plan members are established by State statute and the employer contribution rate is established and may be amended by CalPERS.

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

For fiscal year ended June 30, 2010, Santa Cruz METRO's annual pension cost of \$2,151,927 was equal to Santa Cruz METRO's required and actual contributions. This includes Santa Cruz METRO's contribution to the employee contribution requirement. The required contribution for fiscal year ended June 30, 2010, was determined as part of the June 30, 2007, actuarial valuation using the entry age normal actuarial cost method with the contributions determined as a percent of pay. The actuarial assumptions included (a) 7.75% investment rate of return (net of administration expenses), (b) projected salary increases that vary by duration of service ranging from 3.25% to 14.45% for miscellaneous members, and (c) 3.25% cost-of-living adjustment. Both (a) and (b) include an inflation component of 3.0%. The actuarial value of the Plan's assets was determined using a technique that smoothes the effect of short-term volatility in the market value of investments over a three-year period. The Plan's unfunded actuarial accrued liability (UAAL) is being amortized as a level percentage of projected payroll on a closed basis.

Three-Year Trend Information for the Plan

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

<u>Year Ending</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
6/30/2008	\$ 1,997,214	100%	\$ -
6/30/2009	\$ 2,215,058	100%	\$ -
6/30/2010	\$ 2,151,927	100%	\$ -

Required Supplementary Information

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

<u>Valuation Date</u>	<u>Entry Age Actuarial Accrued Liability</u>	<u>Actuarial Value of Assets</u>	<u>Unfunded/ (Overfunded) Liability</u>	<u>Funded Ratio</u>	<u>Annual Covered Payroll</u>	<u>UAAL as a % of Payroll</u>
6/30/2006	\$ 82,885,847	\$71,312,490	\$ 11,573,357	86.0%	\$15,022,920	77.0%
6/30/2007	\$ 90,009,906	\$78,752,158	\$ 11,257,748	87.5%	\$15,491,039	72.7%
6/30/2008	\$ 97,329,553	\$85,056,437	\$ 12,273,116	87.4%	\$16,065,532	76.4%
6/30/2009	\$ 109,418,745	\$89,621,182	\$ 19,797,563	81.9%	\$16,397,024	120.7%

NOTE 12 – DEFERRED COMPENSATION PLAN

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

At June 30, 2010, all amounts held under the Great-West plan and the CalPERS plan are held in trust and are not reflected on the accompanying statement of net assets as required under GASB Statement No. 27, *Accounting Standards for Pensions by State and Local Governmental Employers*.

NOTE 12 – DEFERRED COMPENSATION PLAN (Continued)

Complete financial statements for Great-West can be obtained from Great-West at 8515 E. Orchard Road, Greenwood Village, CO 80111. Complete financial statements for CalPERS can be obtained from CalPERS at Lincoln Plaza North, 400 Q Street, Sacramento, CA 94229.

NOTE 13 – RISK MANAGEMENT

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

Liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported (IBNR). The IBNR for workers' compensation was based on an actuarial study dated May 2010. 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>2010</u>	<u>2009</u>
Unpaid Claims, Beginning of Fiscal Year	\$ 4,511,218	\$ 4,673,899
Incurred Claims (Including IBNR's)	(984,735)	(903,021)
Claim Payments	<u>556,594</u>	<u>740,340</u>
Unpaid Claims, End of Fiscal Year	<u>\$ 4,083,077</u>	<u>\$ 4,511,218</u>

NOTE 14 – 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 Public Utilities Code.

Section 6634

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

Section 6637

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

Sections 99267, 99268.1, and 99314.6

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

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

In November 2006, California voters passed a bond measure enacting the Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006, 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 the Public Transportation Modernization, Improvement, and Service Enhancement Account (PTMISEA). These funds are available to the California Department of Transportation for intercity rail projects and to transit operators in California for rehabilitation, safety, or modernization improvements; capital service enhancements or expansions; new capital projects; bus rapid transit improvements; or for rolling stock procurement, rehabilitation, or replacement.

The audit of public transportation operator finances, pursuant to Section 99245 of the Public Utilities Code (PUC) and required under the 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, 2010, Santa Cruz METRO earned interest of \$45,581 from the State's PTMISEA account for construction funding for the Consolidated MetroBase Project. As of June 30, 2010, qualifying expenditures of \$5,573,165 were incurred and the remaining balance of \$1,475,663 including accrued interest was deferred. Qualifying expenditures must be encumbered within three years from the date of the allocation and expended within three years from the date of the encumbrance.

**Schedule of PTMISEA Bond 1B Grants
For the Year Ended June 30, 2010**

	<u>2010</u>
Balance - beginning of the year	\$ 7,003,247
Receipts:	
Interest accrued 7/1/2009 through 6/30/2010	45,581
Expenses:	
MetroBase Construction	<u>(5,573,165)</u>
Balance - end of year	<u>\$ 1,475,663</u>

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

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

NOTE 16 – POSTEMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS

Plan Description

Santa Cruz METRO provides post-retirement CalPERS medical benefits to qualified retired employees age 50 and older (including eligible dependents) who have completed at least five years of CalPERS eligible service. Santa Cruz METRO pays medical premiums depending on bargaining union contract requirements. If the retiree has ten years of Santa Cruz METRO eligible service, Santa Cruz METRO provides post-retirement dental and vision benefits for qualified retirees (including eligible dependents), and life insurance for the retiree only, until the retiree reaches age 65. Bus operators who retired and reached the age of 65 prior to June 30, 1994, will continue to receive dental and vision coverage beyond age 65. Life insurance is not provided to management retirees who retired prior to July 1, 2005. The costs of providing these benefits are recognized when paid. Santa Cruz METRO has recognized approximately \$1,597,810 and \$1,557,326 of expense for these benefits for the years ending June 30, 2010 and 2009, respectively.

Annual OPEB Cost and Net OPEB Obligation

Santa Cruz METRO's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45, *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 2009-10, Santa Cruz METRO's annual OPEB cost was \$2,556,820. 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, 2010, were as follows:

Annual required contribution	\$ 4,140,013
Interest on net OPEB obligation	128,063
Adjustments to annual required contribution	<u>(113,446)</u>
Annual OPEB cost	4,154,630
Contributions made	<u>1,597,810</u>
Change in net OPEB obligation (asset)	2,556,820
Net OPEB obligation (asset) - beginning of year	<u>2,561,254</u>
Net OPEB obligation (asset) - end of year	<u><u>\$ 5,118,074</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 (Asset)</u>
2009	\$ 3,980,818	\$ 1,419,564	35.66%	\$ 2,561,254
2010	\$ 4,154,630	\$ 1,597,810	38.46%	\$ 5,118,074

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 2009-10, Santa Cruz METRO contributed \$1,597,810 to the plan.

As of April 1, 2010, the most recent actuarial valuation date, the actuarial accrued liability for benefits was \$43,442,791, all of which was unfunded.

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

Funding Policy, Funded Status, and Funding Progress (Continued)

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and probability about the occurrence of future events far into the future. Amounts determined regarding the funded status of a plan and the annual required contributions of 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, will present multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

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 rates were taken from CalPERS actuarial table for miscellaneous employees, which closely matches Santa Cruz METRO turnover experience. Retirement rates were also based on Santa Cruz METRO experience. Healthcare inflation rates are based on actuarial analysis of recent Santa Cruz METRO experience and actuarial knowledge of the general healthcare environment. The actuarial assumption to determine the cost of covering early retirees (those under the age of 65) was an age-specific claims cost matrix fitted to the average estimated equivalent one-party premium for the current retiree group. Healthcare costs were assumed to increase by 3% per year of age for ages under 65. The unfunded actuarial accrued liability is being amortized as a level percentage of payroll on a closed basis over 30 years. The remaining amortization period as of June 30, 2010, was 29 years.

REQUIRED SUPPLEMENTARY INFORMATION

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF FUNDING PROGRESS
OTHER POSTEMPLOYMENT BENEFITS
JUNE 30, 2010**

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	\$ (1,018,309)	\$ 43,442,791	\$ 44,461,100	-2.34%	\$ 30,646,898	145.08%
4/1/2008	\$ -	\$ 44,208,804	\$ 44,208,804	0.00%	\$ 30,373,279	145.55%

SUPPLEMENTARY INFORMATION

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
STATEMENTS OF OPERATING EXPENSES
FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
Labor		
Operators' salaries and wages	\$ 7,411,965	\$ 7,571,893
Other salaries and wages	6,260,879	6,161,034
Overtime	2,095,294	1,771,761
	<u>15,768,138</u>	<u>15,504,688</u>
Fringe Benefits		
Absence with pay	3,146,948	3,017,547
Pension plans	2,151,927	2,215,059
Vision, medical, and dental plans	5,963,749	5,934,447
Workers' compensation insurance	128,453	577,659
Disability insurance	408,638	388,509
Other fringe benefits	191,192	174,116
Other post employment benefits	2,556,820	2,561,254
	<u>14,547,727</u>	<u>14,868,591</u>
Services		
Accounting	88,407	79,984
Administrative and banking	184,567	185,856
Professional and technical services	600,387	350,007
Security	341,990	358,207
Outside repairs	813,428	790,841
Other services	148,140	163,844
	<u>2,176,919</u>	<u>1,928,739</u>
Materials and Supplies Consumed		
Fuels and lubricants	1,595,353	1,454,579
Tires and tubes	201,950	180,368
Vehicle parts	600,455	460,132
Other materials and supplies	260,626	294,828
	<u>2,658,384</u>	<u>2,389,907</u>
Utilities	453,148	431,353
Casualty and Liability Costs	691,738	685,475
Taxes and Licenses	47,576	43,847
Purchased Transportation Services		
Paratransit	294,183	176,002
Miscellaneous Expenses	139,102	144,675
Equipment and Facility Lease	556,380	744,327
Depreciation		
Property acquired with operator funds	393,121	442,630
Property acquired by federal, state, or TDA funds	4,491,766	4,614,858
	<u>7,067,014</u>	<u>7,283,167</u>
Total Operating Expenses	<u>\$ 42,218,182</u>	<u>\$ 41,975,092</u>

OTHER SCHEDULES AND REPORTS

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010**

<u>Federal Grantor / Program Title</u>	<u>Federal CFDA No.</u>	<u>Pass-Through Grantor's Number</u>	<u>Total Federal Expenditures</u>
U.S. DEPARTMENT OF TRANSPORTATION			
Direct Programs:			
Federal Transit Administration (FTA)			
Section 9/5307			
ARRA - Operating Assistance	20.507*	CA-96-X030	\$ 205,000
Operating Assistance	20.507*	CA-90-Y751	3,645,442
ARRA - PC Vans, Fareboxes, IT Equipment	20.507*	CA-95-X030	<u>177,330</u>
			<u>4,027,772</u>
Section 18/5311			
Operating Assistance	20.509	649170	<u>170,894</u>
New Freedom - Trapeze Pass IVR	20.509	64719	54,406
AMBAG - Transit Planning - Rotational Intern	20.515	WE 670	<u>4,351</u>
			<u>58,757</u>
Total Expenditures of Federal Awards			<u><u>\$ 4,257,423</u></u>

* Major federal financial assistance program.

See accompanying notes to schedule of federal financial assistance.

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010**

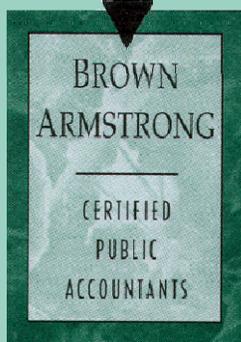
NOTE 1 – GENERAL

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.

Peter C. Brown, CPA
Burton H. Armstrong, CPA, MST
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Chris M. Thornburgh, CPA
Eric H. Xin, CPA, MBA
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**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 AND THE RULES AND REGULATIONS
OF THE CALIFORNIA TRANSPORTATION DEVELOPMENT ACT**

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

We have audited the basic financial statements of the Santa Cruz Metropolitan Transit District, as of and for the year ended June 30, 2010, and have issued our report thereon dated December 21, 2010. We conducted our audit 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 the rules and regulations of the California Transportation Development Act.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

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

We noted certain matters that we reported to management of the Santa Cruz Metropolitan Transit District in a separate letter dated December 21, 2010.

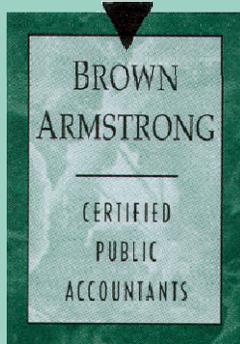
This report is intended solely for the information and use of management, the Board of Directors, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION



Bakersfield, California
December 21, 2010

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**REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE
A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL
CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

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

Compliance

We have audited the Santa Cruz Metropolitan Transit District's 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 the Santa Cruz Metropolitan Transit District's major federal programs for the year ended June 30, 2010. The Santa Cruz Metropolitan Transit District's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Santa Cruz Metropolitan Transit District's management. Our responsibility is to express an opinion on the Santa Cruz Metropolitan Transit District's compliance based on our audit.

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

In our opinion, the Santa Cruz Metropolitan Transit District complied, in all material respects, with the requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2010.

Internal Control Over Compliance

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

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 deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

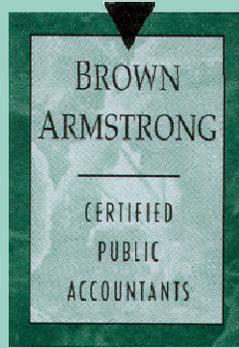
This report is intended for the information of management, the Board of Directors, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION



Bakersfield, California
December 21, 2010

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REPORT ON COMPLIANCE WITH THE CALIFORNIA TRANSPORTATION DEVELOPMENT ACT

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

We have audited the basic financial statements of the Santa Cruz Metropolitan Transit District (Santa Cruz METRO), as of and for the year ended June 30, 2010, and have issued our report thereon dated December 21, 2010.

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

Compliance with laws, regulations, contracts, and grants applicable to Santa Cruz METRO is the responsibility of the management of Santa Cruz METRO. As part of obtaining reasonable assurance about whether Santa Cruz METRO basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of basic 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 Santa Cruz County Regional Transportation Commission and in conformance with the California Transportation Development Act. Specifically, we performed each of the specific tasks identified in the California Code of Regulations Sections 6666 and 6667 that are applicable to 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.

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

During the fiscal year ended June 30, 2010, Santa Cruz METRO applied for and received \$0 from the State's PTMISEA funds for the purpose of construction of the Consolidated MetroBase Project. As of June 30, 2010, PTMISEA interest received and funds expended were verified in the course of our audit as follows:

Schedule of PTMISEA Bond 1B Funds For the Year Ended June 30, 2010	
Description	Amount
Balance – beginning of the year	\$ 7,003,247
Proceeds received:	
Interest earned	45,581
Expenses incurred:	
MetroBase Construction	(5,573,165)
Balance – end of year	<u>\$ 1,475,663</u>

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

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

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Bakersfield, California
December 21, 2010

FINDINGS AND QUESTIONED COSTS SECTION

**SANTA CRUZ METROPOLITAN TRANSIT DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2010**

I. Summary of Auditor's Results

Financial Statements

Type of auditor's report issued: Unqualified

Internal control over financial reporting:

Material weakness identified? Yes No

Significant deficiencies identified? Yes None reported

Noncompliance material to financial statements noted? Yes No

Federal Awards

Internal control over major federal programs:

Material weakness identified? Yes No

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

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

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

Identification of major programs:

CFDA Number(s)

Name of Federal Program or Clusters

20.507

Federal Transit Administration-Section 9

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

Auditee qualified as low risk auditee? Yes No

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

None.

III. Federal Award Findings and Questioned Costs

None.

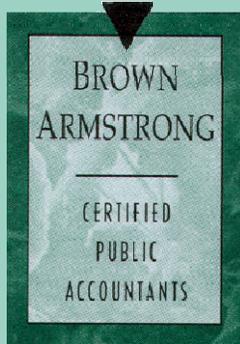
IV. State Award Findings and Questioned Costs

None.

V. A Summary of Prior Audit (all June 30, 2009) Findings and Current Year Status Follows

None.

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AGREED UPON FINDINGS DESIGNED TO INCREASE EFFICIENCY, INTERNAL CONTROLS AND/OR FINANCIAL REPORTING

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

We have audited the basic financial statements of the Santa Cruz Metropolitan Transit District (Santa Cruz METRO) for the year ended June 30, 2010, and have issued our report thereon dated December 21, 2010. In planning and performing our audit of the basic financial statements of Santa Cruz METRO, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

As a result of our audit, we noted two agreed-upon findings. These findings and recommendations, which have been discussed with the appropriate members of management, are intended to improve the internal control structure or result in other efficiencies and are summarized as follows:

Current Year Findings and Recommendations

Finding 1

Santa Cruz METRO does not perform a ticket reconciliation semi-annually that provides assurance that tickets are properly safeguarded and sales are accurately reported.

Recommendation

Santa Cruz METRO should perform ticket-related procedures that determine whether ticket sales are accurately reported and that tickets in inventory are safeguarded. The reconciliation should be performed at least semi-annually until the process results in a tolerable variance level.

Management Response

Management agrees with the recommendation. In December 2010, Santa Cruz METRO installed new GFI Genfare Odyssey Validating Fareboxes on the fixed route bus fleet. This new farebox technology eliminates the requirement of a pre-printed ticket inventory. All tickets are now issued on demand from a farebox, a Printer Encoder Machine (PEM) or from a Ticket Vending Machine (TVM). The tickets are printed on paper that is not negotiable until it is validated by a farebox, PEM or TVM. Finance staff will work with Operations Management and the staff at Metro Center to draft new ticket-related procedures to reconcile all ticket sales to revenue collected, and assure that ticket sales are accurately reported. The reconciliation process will be performed at least semi-annually and monitored until it is determined that the process results in a tolerable variance level. We anticipate the new ticket reconciliation process to be in place by Spring 2011.

Current Year Disposition of Prior Year Finding and Recommendation

Finding 1

Santa Cruz METRO does not perform a ticket reconciliation semi-annually that provides assurance that tickets are properly safeguarded and sales are accurately reported.

Recommendation

Santa Cruz METRO should perform ticket-related procedures that determine whether ticket sales are accurately reported and that tickets in inventory are safeguarded. The reconciliation should be performed at least semi-annually until the process results in a tolerable variance level.

Management Response

Finance Management created reconciliations between tickets received, ticket sales, and revenue collected to assist in accurate reporting of ticket sales. However, the new policy and procedures for ticket reconciliation will not be implemented until late 2009 due to the ticketing manager retiring from Santa Cruz METRO in October. The replacement ticketing manager will be trained on the new reconciliation policies and procedures to ensure the process is accurately adopted.

Current Year Status

See current year Finding 1.

This information is intended solely for the use of the Board of Directors and management of Santa Cruz Metropolitan Transit District should not be used for any other purpose. However, this report is a matter of public record, and its distribution is not limited.

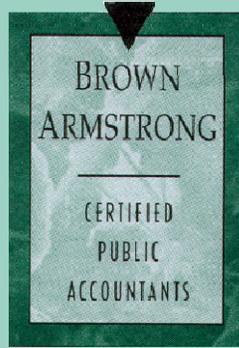
BROWN ARMSTRONG
ACCOUNTANCY CORPORATION



By: Steven R. Starbuck

Bakersfield, California
December 21, 2010

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REQUIRED COMMUNICATION TO THE BOARD OF DIRECTORS IN ACCORDANCE WITH PROFESSIONAL STANDARDS

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

We have audited the basic financial statements of the Santa Cruz Metropolitan Transit District (Santa Cruz METRO) for the year ended June 30, 2010, and have issued our report thereon dated December 21, 2010. Professional standards require that we provide you with the following information related to our audit. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, *Government Auditing Standards*, and OMB Circular A-133, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated April 27, 2010. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by Santa Cruz METRO are described in Note 1 to the financial statements. New accounting policies adopted during the year ended June 30, 2010, are Governmental Accounting Standards Board (GASB) Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, and GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. These statements did not have an effect on the financial position of Santa Cruz METRO. We noted no transactions entered into by Santa Cruz METRO during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the basic financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the basic financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the basic financial statements were:

- Management's estimate of the accrued claims and depreciation expense is based on management's past experience and expected useful life.
- Actuarial Assumptions and Methods Underlying Other Postemployment Benefits (OPEB) Liability – Management's acceptance of various actuarial assumptions and methods underlying the calculation of Santa Cruz METRO's OPEB liability is based on the actuarial valuation prepared by Total Compensation Systems, Inc.

We evaluated the key factors and assumptions used to develop the accrued claims and depreciation expense in determining that it is reasonable in relation to the basic financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the basic financial statements were:

- The disclosure of depreciation expense in Note 4 to the financial statements is based on management's assumption of the asset's expected useful life.
- The disclosure of the Annual OPEB Cost and Net OPEB Obligation in Note 16 to the financial statements is based on actuarial assumptions adopted by management.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material to the basic financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the basic financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated December 21, 2010.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to Santa Cruz METRO's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as Santa Cruz METRO's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of Board of Directors and management of Santa Cruz Metropolitan Transit District and is not intended to be and should not be used by anyone other than these specified parties.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION



By: Steven R. Starbuck

Bakersfield, California
December 21, 2010