



A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Financial Statement Audit

Pima County

Department of Wastewater
Management
June 30, 2003



Debra K. Davenport
Auditor General

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Pima County
Department of Wastewater Management
Report on Audit of Financial Statements
June 30, 2003

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**STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL**

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

Independent Auditors' Report

Members of the Arizona State Legislature

The Board of Supervisors of Pima County, Arizona

We have audited the accompanying financial statements of the Pima County Department of Wastewater Management as of and for the year ended June 30, 2003, as listed in the table of contents. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the Pima County Department of Wastewater Management's financial statements are intended to present the financial position, and the changes in financial position and cash flows, of only that portion of the business-type activities and major funds of Pima County that is attributable to the Pima County Department of Wastewater Management Fund. They do not purport to, and do not, present fairly the financial position of Pima County as of June 30, 2003, and the changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Pima County Department of Wastewater Management as of June 30, 2003, and the changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Pima County Department of Wastewater Management. The accompanying financial information listed as supplementary schedules in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

Debbie Davenport
Auditor General

November 7, 2003

Pima County
 Department of Wastewater Management
 Statement of Net Assets—Enterprise Fund
 June 30, 2003

Assets

Current assets:

Cash and cash equivalents	\$ 966,267
Interest receivable	7,021
Accounts receivable, net	6,859,763
Due from other Pima County funds	1,675
Due from other governments	287,517
Inventory of materials and supplies	2,610,951
Prepaid expenses	<u>128,877</u>
Total current assets	<u>10,862,071</u>

Noncurrent assets:

Restricted assets:

Cash and cash equivalents:

Restricted for debt service	1,245,429
Restricted for operation and maintenance	3,669,003
Held in escrow as construction contract retentions	2,987,679
Interest receivable	<u>19,952</u>
Total restricted assets	<u>7,922,063</u>

Capital assets, net of accumulated depreciation where applicable:

Land and other improvements	11,958,225
Solid waste transfer stations, net	1,595,764
Conveyance systems, net	264,664,983
Treatment facilities, net	130,640,733
Equipment, net	6,952,999
Construction in progress	<u>136,170,979</u>
Total capital assets, net	<u>551,983,683</u>

Deferred financing costs	<u>848,259</u>
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Total noncurrent assets	<u>560,754,005</u>
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Total assets	<u>\$571,616,076</u>
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(Continued)

See accompanying notes to financial statements.

Pima County
 Department of Wastewater Management
 Statement of Net Assets—Enterprise Fund
 June 30, 2003
 (Continued)

Liabilities

Current liabilities:

Accounts payable	\$ 8,371,812
Accrued payroll and employee benefits	3,146,908
Due to other Pima County funds	10,967,672
Interest payable	11,714
Current portion of sewer revenue bonds payable	4,965,000
Current portion of wastewater loans payable	4,269,721
Deferred sewer connection revenue	1,346,678
Deferred sludge hauling revenue	<u>500</u>
Total current liabilities	<u>33,080,005</u>

Noncurrent liabilities:

Construction contract retentions payable	6,848,853
Landfill closure and postclosure care costs payable	15,644,952
Sewer revenue bonds payable, less current portion	63,275,000
Wastewater loans payable, less current portion	59,609,308
Deferred interest expense and bond discount	<u>(5,469,829)</u>
Total noncurrent liabilities	<u>139,908,284</u>

Total liabilities	<u>172,988,289</u>
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Net Assets

Invested in capital assets, net of related debt	426,182,741
Restricted for:	
Debt service	1,245,429
Capital projects	3,007,631
Wastewater management	3,669,003
Unrestricted deficit	<u>(35,477,017)</u>
Total net assets	<u>\$398,627,787</u>

See accompanying notes to financial statements.

Pima County
Department of Wastewater Management
Statement of Revenues, Expenses, and
Changes in Fund Net Assets—Enterprise Fund
Year Ended June 30, 2003

Operating revenues:	
Sewer utility service	\$ 45,318,741
Solid waste fees	5,690,740
Engineering review and inspection fees	245,820
Permits and fines	91,024
Other income	<u>870,785</u>
Total operating revenues	<u>52,217,110</u>
Operating expenses:	
Employee compensation	25,377,959
Operating supplies	5,227,812
Utilities	1,976,584
Sludge and refuse disposal	2,241,854
Repairs and maintenance	5,105,339
Landfill closure and postclosure care costs	1,078,282
General and administrative	8,025,785
Consultants and professional services	3,646,323
Depreciation	<u>16,670,498</u>
Total operating expenses	<u>69,350,436</u>
Operating loss	<u>(17,133,326)</u>
Nonoperating revenues (expenses):	
Grant revenue	303,934
Interest income	1,014,349
Sewer connection revenue	20,279,607
State-shared tax revenue	958,603
Loss on disposal of equipment	(213,135)
Interest expense	(5,271,134)
Amortization of deferred charges	<u>(88,645)</u>
Total nonoperating revenues (expenses)	<u>16,983,579</u>
Loss before capital contributions and extraordinary item	<u>(149,747)</u>
Capital contributions	13,702,141
Extraordinary item—loss from State Treasurer’s Local Government Investment Pool	<u>(1,263,168)</u>
Increase in net assets	12,289,226
Net assets—July 1, 2002	<u>386,338,561</u>
Net assets—June 30, 2003	<u>\$ 398,627,787</u>

See accompanying notes to financial statements.

Pima County
 Department of Wastewater Management
 Statement of Cash Flows—Enterprise Fund
 Year Ended June 30, 2003

Cash flows from operating activities:	
Receipts from customers	\$ 51,598,819
Miscellaneous receipts	2,449,039
Payments to suppliers for goods and services	(19,752,290)
Payments to other Pima County funds	(8,814,623)
Payments to employees	<u>(24,872,770)</u>
Net cash provided by operating activities	<u>608,175</u>
Cash flows from noncapital financing activities:	
Noncapital grant receipts	303,934
State-shared tax receipts	958,603
Net interfund borrowings	<u>10,982,193</u>
Net cash provided by noncapital financing activities	<u>12,244,730</u>
Cash flows from capital and related financing activities:	
Proceeds from loans	9,745,533
Sewer connection receipts from customers	19,701,257
Purchase and construction of capital assets	(59,227,759)
Principal payments on revenue bonds and loans	(8,886,774)
Interest payments on revenue bonds and loans	<u>(4,742,206)</u>
Net cash used for capital and related financing activities	<u>(43,409,949)</u>
Cash flows from investing activities:	
Loss from State Treasurer's Local Government Investment Pool	(1,263,168)
Interest received on investments	<u>1,124,948</u>
Net cash used for investing activities	<u>(138,220)</u>
Net decrease in cash and cash equivalents	(30,695,264)
Cash and cash equivalents, July 1, 2002	<u>39,563,642</u>
Cash and cash equivalents, June 30, 2003	<u>\$ 8,868,378</u>

(Continued)

See accompanying notes to financial statements.

Pima County
 Department of Wastewater Management
 Statement of Cash Flows—Enterprise Fund
 Year Ended June 30, 2003
 (Continued)

Reconciliation of operating loss to net cash
 provided by operating activities:

Operating loss	\$(17,133,326)
Adjustments to reconcile operating loss to net cash provided by operating activities:	
Depreciation	16,670,498
Landfill closure and postclosure care costs	1,078,282
Changes in assets and liabilities:	
Decrease (increase) in assets:	
Accounts receivable	1,497,046
Due from other governments	333,702
Inventory of materials and supplies	(54,092)
Prepaid expenses	(47,448)
Increase (decrease) in liabilities:	
Accounts payable	(2,236,910)
Accrued payroll and employee benefits	505,189
Due to other Pima County funds	<u>(4,766)</u>
Net cash provided by operating activities	<u>\$ 608,175</u>

Noncash investing, capital, and noncapital financing activities:

During the year ended June 30, 2003, Pima County transferred capital assets with a net book value of \$1,228,477 to the Department. This transaction was recorded as a capital contribution.

During the year ended June 30, 2003, the Department retired capital assets with a net book value of \$213,135, resulting in a loss on disposal of equipment.

During the year ended June 30, 2003, developers conveyed capital assets with an estimated fair value of \$12,473,664 to the Department. This transaction was recorded as a capital contribution.

See accompanying notes to financial statements.

Pima County
Department of Wastewater Management
Notes to Financial Statements
June 30, 2003

Note 1 - Summary of Significant Accounting Policies

The accounting policies of the Department of Wastewater Management conform to generally accepted accounting principles applicable to governmental units adopted by the Governmental Accounting Standards Board (GASB). A summary of the Department's more significant accounting policies follows.

A. Reporting Entity

The Department is accounted for as an enterprise fund of Pima County, Arizona, and is responsible for managing and operating all liquid and solid waste programs in Pima County. The Department's management is directed by an administrator appointed by the Pima County Board of Supervisors. However, ultimate financial accountability for the Department remains with Pima County.

B. Fund Accounting

The Department's accounts are maintained in accordance with the principles of fund accounting to ensure that limitations and restrictions on the Department's available resources are observed. The principles of fund accounting require that resources be classified for accounting and reporting purposes into funds in accordance with the activities or objectives specified for those resources. A fund is considered a separate accounting entity, and its operations are accounted for in a separate set of self-balancing accounts that comprise its assets, liabilities, net assets, revenues, and expenses.

The Department's financial transactions are recorded and reported as an enterprise fund because its operations are financed and operated in a manner similar to private business enterprises, in which the intent of the Board of Supervisors is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

C. Basis of Accounting

Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied, and determines when revenues and expenses are recognized in the accounts and reported in the financial statements. The Department's financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recognized when they are earned, and expenses are recognized at the time liabilities are incurred, regardless of when the related cash flows take place. When both restricted and unrestricted net assets are available to finance departmental expenses, restricted resources are used before unrestricted resources. Interfund transactions

Pima County
Department of Wastewater Management
Notes to Financial Statements
June 30, 2003

that would be treated as revenues or expenses if they involved parties external to Pima County are recorded in the appropriate revenue or expense accounts. Intrafund transactions within the Department are eliminated for the consolidated financial statement presentation.

The Department follows those Financial Accounting Standards Board Statements and Interpretations issued on or before November 30, 1989; Accounting Principles Board Opinions; and Accounting Research bulletins, unless those pronouncements conflict with GASB pronouncements.

D. Basis of Presentation

The financial statements include a statement of net assets; a statement of revenues, expenses, and changes in fund net assets; and a statement of cash flows.

A statement of net assets provides information about the assets, liabilities, and net assets of the Department at the end of the year. Assets and liabilities are classified as either current or noncurrent. Net assets are classified according to external restrictions or availability of assets to satisfy the Department's obligations. Invested in capital assets net of related debt represents the value of capital assets, net of accumulated depreciation, less any outstanding debt incurred to acquire or construct the assets. Restricted net assets represent grants, contracts, and other resources that have been externally restricted for specific purposes. Unrestricted net assets include all other net assets, including those that have been designated by management to be used for other than general operating purposes.

A statement of revenues, expenses, and changes in fund net assets provides information about the Department's financial activities during the year. Revenues and expenses are classified as either operating or nonoperating, and all changes in net assets are reported, including capital contributions and extraordinary items. Generally, operating revenues, such as sewer utility service and solid waste fees, result from transactions associated with the Department's principal activities. Other revenues, such as sewer connection revenues and interest earnings, are not generated from operations and are considered to be nonoperating revenues.

A statement of cash flows provides information about the Department's sources and uses of cash and cash equivalents during the year. Increases and decreases in cash and cash equivalents are classified as either, operating, noncapital financing, capital financing, or investing.

Pima County
Department of Wastewater Management
Notes to Financial Statements
June 30, 2003

E. Cash and Cash Equivalents

For purposes of the statement of cash flows, cash and cash equivalents consist of cash on hand, cash and investments held by the Pima County Treasurer, investments with the State Treasurer, and deposits held in escrow accounts from both restricted and unrestricted sources. Unrestricted cash and cash equivalents consist of cash on hand, cash and investments held by the Pima County Treasurer in an investment pool, and investments with the State Treasurer. Restricted cash and cash equivalents consist of cash and investments held by the Pima County Treasurer in an investment pool, and deposits held in escrow accounts. All investments are stated at fair value.

F. Deferred Charges

Deferred charges (primarily bond and loan issuance costs) are being amortized over the life of the related debt using the straight-line method.

G. Capital Assets

Capital assets are reported at actual cost. Donated assets are reported at estimated fair value at the time received. The Department capitalizes all land and buildings regardless of cost and all other property, plant and equipment valued at \$5,000 and above. Costs for internally constructed capital assets include material, direct labor, engineering, interest, and allocated portions of other indirect costs related to the construction projects. Depreciation of such assets is charged as an expense against operations. These assets are depreciated over their estimated useful lives using the straight-line method. The estimated useful lives are as follows:

Treatment facilities and equipment	3 to 50 years
Conveyance systems	50 years
Solid waste transfer stations	50 years

H. Compensated Absences

Compensated absences consist of annual leave and a calculated amount of sick leave earned by employees based on services already rendered. Employees may accumulate up to 240 hours of annual leave, but must forfeit any annual leave hours in excess of the maximum that are unused at the end of the payroll period in which the employee's anniversary date falls. Upon termination, all unused and unforfeited annual leave benefits are paid to employees. Accordingly, annual leave benefits are accrued as a liability in the financial statements. Employees may accumulate an unlimited number of sick leave hours.

Pima County
Department of Wastewater Management
Notes to Financial Statements
June 30, 2003

Generally, sick leave benefits provide for ordinary sick pay and are cumulative, but do not vest with employees and therefore, are not accrued in the financial statements. However, for employees who retire with 20 years or more of continuous service or who have a combined total of age and years of service equal to 80 points, and who retire from service into the Arizona State Retirement System, sick leave benefits do vest and, therefore, are accrued.

I. Construction Contract Retentions

The Department has numerous construction projects in process. The Department retains a percentage of each progress payment until the project's successful completion. In some instances, contract retentions are deposited in escrow accounts so contractors may earn interest during the construction period.

J. Deferred Interest Expense

For advance refundings resulting in defeasance of debt, the difference between the reacquisition price and net carrying amount of the old debt is deferred and amortized as a component of interest expense over the life of the refunded debt or the refunding debt, whichever is shorter. This deferred amount is reported as a deduction from the new debt liability on the statement of net assets.

K. Revenues

Sewer utility billings are based on the content and volume of wastewater discharged and a minimum charge for service. Solid waste fees are based on landfill location, weight of disposed material, and material type.

Land developers contribute capital and aid in the construction of certain portions of the conveyance systems. Contributions are recorded as an increase in net assets at their estimated fair value. In those instances where a developer makes enhancements that exceed the requirements for the conveyance systems, the Department establishes reduced fees and credits that can be used to offset future fees charged to developers for each new connection to the conveyance systems. These credits are recorded as deferred sewer connection revenue and recognized as income when connection permits are issued.

Sewer connection fees are assessed to land developers based on the type and number of fixtures attached to the conveyance systems. Fees are established at a level to provide for the recovery of the Department's operating expenses that are not recovered by the sewer utility service fees. Accordingly, fees collected are classified as nonoperating revenues.

Pima County
 Department of Wastewater Management
 Notes to Financial Statements
 June 30, 2003

Note 2 - Cash and Cash Equivalents

Cash and cash equivalents consisted of the following amounts:

Current assets:	
Cash on hand	\$ 3,850
Cash and investments held by the Pima County Treasurer	864,313
Investments with State Treasurer	<u>98,104</u>
Total current cash and cash equivalents	<u>966,267</u>
Restricted assets:	
Cash and investments held by the Pima County Treasurer	4,914,432
Deposits held in escrow accounts	<u>2,987,679</u>
Total restricted cash and cash equivalents	<u>7,902,111</u>
 Total cash and cash equivalents	 <u>\$8,868,378</u>

The Department's cash and investments held by the Pima County Treasurer represent a proportionate interest in the County Treasurer's investment pool portfolios. This portion is not identified with specific investments and is not subject to custodial credit risk.

In addition, the investments with the State Treasurer represent investments in the State Treasurer's Local Government Investment Pool. The State Board of Investment provides oversight for the State Treasurer's pools, and the Local Government Investment Pool Advisory Committee provides consultation and advice to the Treasurer. The fair value of a participant's position in the pool approximates the value of that participant's pool shares. Those shares are not identified with specific investments and are not subject to custodial credit risk.

Of the deposits held in escrow by financial institutions, \$100,000 was covered by federal depository insurance and \$2,887,679 was uninsured and uncollateralized.

Pima County
Department of Wastewater Management
Notes to Financial Statements
June 30, 2003

Note 3 - Capital Asset Activity

Capital asset activity for the year ended June 30, 2003, is presented in the following schedule:

	<u>Balance July 1, 2002</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2003</u>
Capital assets not being depreciated:				
Land and other improvements	\$ 11,858,947	\$ 99,278		\$ 11,958,225
Construction in progress	<u>73,886,991</u>	<u>62,685,801</u>	<u>\$(401,813)</u>	<u>136,170,979</u>
Total capital assets not being depreciated	<u>85,745,938</u>	<u>62,785,079</u>	<u>(401,813)</u>	<u>148,129,204</u>
Capital assets being depreciated:				
Transfer stations	2,168,380			2,168,380
Conveyance systems	386,816,567	12,929,925		399,746,492
Treatment facilities	214,237,033	18,923		214,255,956
Equipment	<u>14,835,405</u>	<u>2,792,193</u>	<u>(645,017)</u>	<u>16,982,581</u>
Total capital assets being depreciated	<u>618,057,385</u>	<u>15,741,041</u>	<u>(645,017)</u>	<u>633,153,409</u>
Less accumulated depreciation for:				
Transfer stations	(530,141)	(42,475)		(572,616)
Conveyance systems	(126,621,930)	(8,459,579)		(135,081,509)
Treatment facilities	(76,509,958)	(7,105,265)		(83,615,223)
Equipment	<u>(9,117,814)</u>	<u>(1,343,650)</u>	<u>431,882</u>	<u>(10,029,582)</u>
Total accumulated depreciation	<u>(212,779,843)</u>	<u>(16,950,969)</u>	<u>431,882</u>	<u>(229,298,930)</u>
Total capital assets being depreciated, net	<u>405,277,542</u>	<u>(1,209,928)</u>	<u>(213,135)</u>	<u>403,854,479</u>
Total capital assets, net	<u>\$ 491,023,480</u>	<u>\$ 61,575,151</u>	<u>\$(614,948)</u>	<u>\$ 551,983,683</u>

Pima County
Department of Wastewater Management
Notes to Financial Statements
June 30, 2003

Note 4 - Long-Term Liabilities

The following schedule details the Department's long-term liability and obligation activity for the year ended June 30, 2003:

	<u>Balance</u> <u>July 1, 2002</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2003</u>	<u>Due Within</u> <u>1 year</u>
Sewer revenue bonds	\$ 73,440,000		\$5,200,000	\$ 68,240,000	\$4,965,000
Less unamortized deferred amounts	<u>5,628,968</u>		<u>487,030</u>	<u>5,141,938</u>	<u> </u>
Total revenue bonds payable	<u>67,811,032</u>		<u>4,712,970</u>	<u>63,098,062</u>	<u>4,965,000</u>
Wastewater loans payable	57,820,270	\$ 9,745,533	3,686,774	63,879,029	4,269,721
Less unamortized deferred amounts	<u>364,323</u>		<u>36,432</u>	<u>327,891</u>	<u> </u>
Total loans payable	<u>57,455,947</u>	<u>9,745,533</u>	<u>3,650,342</u>	<u>63,551,138</u>	<u>4,269,721</u>
Landfill closure and postclosure care costs	14,566,670	1,078,282		15,644,952	
Construction contract retentions payable	<u>3,684,792</u>	<u>4,156,410</u>	<u>992,349</u>	<u>6,848,853</u>	<u> </u>
Total long-term liabilities	<u>\$143,518,441</u>	<u>\$14,980,225</u>	<u>\$9,355,661</u>	<u>\$149,143,005</u>	<u>\$9,234,721</u>

Sewer Revenue Bonds—The Department has issued several series of sewer revenue bonds (Series 1993, Refunding 1994A, Series 1994B, Series 1998, and Series 2001) to provide funds for the defeasance of prior sewer revenue bonds, the construction of a utility plant, and improvements to the sewer system. The bonds are callable at various prices depending on the date of call. Interest on the bonds is payable semiannually. Of the total amount originally authorized, \$23,910,000 from the May 20, 1997, bond election remains unissued.

Loans Payable—The Department has entered into three loan agreements with the Water Infrastructure Financing Authority of Arizona (1996, 1997, and 2000 loans payable) to provide funds for the defeasance of prior sewer revenue bonds and the construction and improvement of wastewater treatment facilities. Interest is payable semiannually and is calculated based on the principal amount of the loan outstanding during such period.

At June 30, 2003, the Department has drawn down only \$54,009,932 of the \$61,180,286 authorized loan amount for the 2000 Water Infrastructure Financing Authority of Arizona loan. Payments of principal, which are subject to change, are based upon the total amounts drawn.

Pima County
 Department of Wastewater Management
 Notes to Financial Statements
 June 30, 2003

Debt Covenants—All revenue bonds were issued and the loan agreements were executed with a first lien on the first pledge of the Department's net revenues and have restrictive covenants, primarily related to minimum utility rates and limitations on future bond issues. The bond covenants also require the Department to either maintain a surety bond guaranteeing the payment of annual debt service or to maintain in the Bond Reserve Account monies equal to the average annual debt service payment. At June 30, 2003, the Department had a surety bond in place to meet the requirements of the debt covenants. The Department is also authorized to issue additional parity bonds if certain conditions are met (primarily that net revenues for the fiscal year immediately preceding issuance of the parity bonds exceed 120 percent of the maximum annual debt service requirements immediately after such issuance).

Bonds and loans outstanding at June 30, 2003, were as follows:

<u>Description</u>	<u>Interest Rates</u>	<u>Maturity Dates</u>	<u>Outstanding Principal June 30, 2003</u>
Series 1993	5.6-6.5%	2004 -2005	\$ 615,000
Refunding 1994A	4.5-5.0%	2004 -2015	25,520,000
Series 1994B	5.5%	2004	580,000
Series 1998	4.0-5.5%	2004 -2015	23,395,000
Refunding 2001	4.0-5.4%	2004 -2015	<u>18,130,000</u>
Total bonds payable			<u>\$68,240,000</u>
1996 loan payable	3.19%	2004 -2012	11,313,350
1997 loan payable	2.95%	2004 -2011	4,757,899
2000 loan payable	2.02%	2004 -2016	<u>47,807,780</u>
Total loans payable			<u>\$63,879,029</u>

Pima County
 Department of Wastewater Management
 Notes to Financial Statements
 June 30, 2003

Revenue bond debt service and loan payment requirements to maturity, are as follows:

Year ending June 30,	<u>Revenue Bond Debt Service</u>		<u>Revenue Loan Debt Service</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2004	\$ 4,965,000	\$ 3,315,426	\$ 4,269,721	\$ 2,350,906
2005	4,595,000	3,067,341	4,950,734	2,194,315
2006	4,470,000	2,841,886	5,502,957	2,012,687
2007	5,525,000	2,622,699	4,892,394	1,810,721
2008	5,800,000	2,340,529	5,098,403	1,631,275
2009-2013	28,990,000	7,580,549	30,053,570	4,955,200
2014-2016	<u>13,895,000</u>	<u>1,064,456</u>	<u>9,111,250</u>	<u>480,949</u>
Total	<u>\$68,240,000</u>	<u>\$22,832,886</u>	<u>\$63,879,029</u>	<u>\$15,436,053</u>

Refunded Sewer Revenue Bonds Outstanding—The Department used the proceeds of the 1996 loan payable to refund certain sewer revenue bonds. The proceeds were used to purchase U.S. government securities, which were placed in irrevocable trusts with the escrow agents to provide for future debt service payments on the refunded bonds. Accordingly, the trust account assets of \$2,952,256 and the liability for the defeased bonds listed below are not included in the Department’s financial statements:

<u>Description</u>	<u>Interest Rates</u>	<u>Maturity Dates</u>	<u>Outstanding Principal June 30, 2003</u>
Series 1993	5.0-5.9%	2006-2012	\$2,845,000

Landfill Closure and Postclosure Care Costs—State and federal laws and regulations require the Department to place a final cover on its solid waste landfill sites when these sites stop accepting waste and to perform certain maintenance and monitoring functions at the sites for 30 years after closure. Although closure and postclosure care costs will not be paid until near or after the date that the landfill stops accepting waste, the Department reports a portion of these closure and postclosure care costs in each operating period even though actual payouts will not occur until the landfill is closed. The amount recognized each year is based on landfill capacity used at the end of each fiscal year. The \$15,644,952 reported as landfill closure and postclosure care liability at June 30, 2003, represents the cumulative amount reported to date based on the use of 90, 99, and 78 percent of the estimated capacity of the Ajo, Sahuarita, and Tangerine landfills, respectively. The Department will recognize the remaining estimated cost of closure and postclosure care of \$3,309,607 as the remaining estimated capacity of each landfill is filled. These amounts are based on what it would cost to perform all closure and postclosure care in fiscal year 2003. The Department expects to close the Ajo, Sahuarita, and Tangerine, landfills in the years 2007, 2003, and 2008, respectively, and actual costs may be higher due to inflation, changes in technology, or changes in regulations.

Pima County
Department of Wastewater Management
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June 30, 2003

According to state and federal laws and regulations, the County must comply with the local government financial test requirements that assure the County can meet the costs of landfill closure, postclosure and corrective action when needed. The County is in compliance with these requirements.

El Camino del Cerro Landfill stopped accepting waste during 1978 and is not subject to the state and federal regulations referred to above. However, the Arizona Department of Environmental Quality (ADEQ) has filed a complaint pursuant to other state and federal laws alleging that hazardous substances have been released at the landfill. The County has entered into settlement negotiations with the ADEQ to resolve the cleanup litigation. The County has also voluntarily incurred cleanup expenses for a soil vapor extraction system, a series of drainage improvements, a re-grade of the landfill cap, and groundwater remediation. No liability has been recognized in the financial statements because the outcome of the litigation is uncertain. The County's cleanup costs could total \$3.6 million, and county management plans to finance any required cleanup costs through future bond issues.

Construction Contract Retentions Payable—State laws and regulations require the Department to withhold a portion of progress payments made on construction contracts until the successful completion of the construction project.

Note 5 - Due To Other Pima County Funds

Amounts due to other Pima County funds at June 30, 2003, include \$10,843,386 due to the General Fund, \$68,305 due to the Special Revenue Funds, and \$55,981 due to the Capital Projects Fund. Of the amount due to the General Fund, \$10,823,837 represented a short-term loan to eliminate a negative cash balance within the Department. This cash deficit can be eliminated in the future through normal operations or by operating transfers from the General Fund.

Note 6 - Related Party Transactions

Administrative and Fiscal Services—The Department incurred expenses from Pima County for a variety of administrative and fiscal services, including \$1,676,352 for the allocation of overhead; \$763,916 for self-insurance premiums; \$2,735,128 for interdepartmental supplies and services charges; \$1,834,037 for motor pool charges; \$410,511 for professional charges; \$400,357 for repair and maintenance charges; \$94,867 for printing charges; and \$445,082 for miscellaneous other charges.

Pima County
Department of Wastewater Management
Notes to Financial Statements
June 30, 2003

Public Works Center—The Department occupies a portion of the Public Works Center and pays rent based on a pro rata share of the building expenses incurred by the Pima County Facilities Management department. The Department's rent expense totaled \$449,607 for the year ended June 30, 2003.

Note 7 - Significant Commitments

Commitments under construction contracts at June 30, 2003, totaled \$40,370,425.

Note 8 - Risk Management

The Department is a participant in Pima County's self-insurance program. The County's self-insurance program covers the Department for risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. In the opinion of the Department's management, any unfavorable outcomes from these types of risks would be covered by that self-insurance program. Accordingly, the Department has no risk of loss beyond adjustments to future years' premium payments to Pima County's self-insurance program. All estimated losses for these unsettled claims and actions of Pima County are determined on an actuarial basis and are included in the *Pima County Comprehensive Annual Financial Report*.

Risks of loss arising from contractual breaches are not covered by the County's self-insurance program or commercial insurance. The Department's management does not believe that these types of losses would be material to the financial statements; therefore, no accrual of losses has been made within the financial statements. At June 30, 2003, there were no material lawsuits related to contractual breaches.

The Department has received a Notice of Violation from the ADEQ that could result in various penalties, fines or remediation requirements as a result of the Northwest Outfall sewer line failure, which ruptured on September 7, 2002, causing several sink holes and discharging raw sewage into the Santa Cruz River. The Department is currently in a 90-day negotiation period with ADEQ, and is unable to speculate on a possible settlement agreement or the resulting financial impact of any such agreement at this time. Previous Notice of Violations received by the Department have not resulted in financial penalties, however the violations were not of the same magnitude as the most recent sewer line failure. Any loss incurred by the Department for the sewer rupture will not be covered by the County's self insurance program since that program does not cover risks of loss related to maintenance issues.

Pima County
 Department of Wastewater Management
 Notes to Financial Statements
 June 30, 2003

Note 9 - Intergovernmental Agreement

The City of Tucson, Metropolitan Domestic Water Improvement District (MDWID) and Oro Valley Water provide sewer utility billing and collection services, certain computer services, accounting information, and statistical data to the Department. During the year ended June 30, 2003, the Department paid fees totaling \$1,360,443, \$107,111, and \$97,917, respectively, for such services. As part of its agreement, the City of Tucson invests cash collected from utility customers and held for remittance to the Department. Interest earnings on such investments are remitted to the Department. The MDWID and Oro Valley Water submit cash receipts to the Department regularly. However, cash collections are not invested, and therefore, neither MDWID or Oro Valley Water remit interest to the Department.

Note 10 - Segment Information

Liquid Waste, a division of the Department, is reported within the Department's enterprise fund. Liquid Waste operates the sewer system which provides wastewater collection, treatment, and disposal throughout Pima County. All revenues generated by the ownership, use, and operation of Pima County's sewer system are pledged in support of sewer system debt. In addition, debt covenants require sewer system revenues, expenses, gains, losses, assets, and liabilities to be accounted for separately. As a result, condensed financial information for Liquid Waste is presented in the following tables:

Condensed Statement of Net Assets

	<u>Liquid Waste</u>
Assets	
Current assets	\$ 7,286,464
Due from other Pima County funds	1,675
Restricted assets	7,922,063
Capital assets, net of accumulated depreciation	540,657,461
Other noncurrent assets	<u>848,259</u>
Total assets	<u>556,715,922</u>
Liabilities	
Current liabilities	21,594,026
Due to other Pima County funds	10,963,213
Noncurrent liabilities	<u>124,263,332</u>
Total liabilities	<u>156,820,571</u>
Net Assets	
Invested in capital assets, net of related debt	414,856,520
Restricted	7,922,063
Unrestricted deficit	<u>(22,883,232)</u>
Total net assets	<u>\$399,895,351</u>

Pima County
 Department of Wastewater Management
 Notes to Financial Statements
 June 30, 2003

**Condensed Statement of Revenues, Expenses,
 and Changes in Fund Net Assets**

	<u>Liquid Waste</u>
Operating revenues (expenses)	
Sewer utility service	\$ 45,318,741
Other operating revenues	1,157,352
Depreciation expense	(16,364,451)
Other operating expenses	<u>(46,377,358)</u>
Operating loss	(16,265,716)
Nonoperating revenues (expenses)	
Sewer connection revenue	20,279,607
Other nonoperating revenues	1,281,919
Interest expense	(5,271,123)
Other nonoperating expenses	(239,152)
Capital contributions	12,473,664
Extraordinary item—loss from State Treasurer's Local Government Investment Pool	<u>(1,186,975)</u>
Change in net assets	11,072,224
Net assets, July 1, 2002	<u>388,823,127</u>
Net assets, June 30, 2003	<u>\$399,895,351</u>

Condensed Statement of Cash Flows

Net cash provided by (used for)	
Operating activities	\$ (31,576)
Noncapital financing activities	13,240,942
Capital and related financing activities	(43,075,177)
Investment activities	<u>(97,048)</u>
Decrease in cash	(29,962,859)
Cash and cash equivalents, July 1, 2002	<u>37,867,420</u>
Cash and cash equivalents, June 30, 2003	<u>\$ 7,904,561</u>

Pima County
Department of Wastewater Management
Notes to Financial Statements
June 30, 2003

Note 11 - Retirement Plan

Plan Description—The Department contributes to a cost-sharing multiple-employer defined benefit pension plan administered by the Arizona State Retirement System that covers general employees of the Department. Benefits are established by state statute and generally provide retirement, death, long-term disability, survivor, and health insurance premium benefits. The System is governed by the Arizona State Retirement System Board according to the provisions of Arizona Revised Statutes Title 38, Chapter 5, Article 2.

The System issues a publicly available annual financial report that includes its financial statements and required supplementary information. The most recent report may be obtained by writing the System, 3300 North Central Avenue, P.O. Box 33910, Phoenix, Arizona 85067-3910, or by calling (602) 240-2000 or (800) 621-3778.

Funding Policy—The Arizona State Legislature establishes and may amend active plan members' and the Department's contribution rates. For the year ended June 30, 2003, active plan members and the Department were each required by statute to contribute at the actuarially determined rate of 2.49 percent (2.00 percent retirement and 0.49 percent long-term disability) of the members' annual covered payroll. The Department's contributions to the system for the years ended June 30, 2003, 2002, and 2001, were \$495,645, \$449,580, and \$427,785, respectively, which were equal to the required contributions for the year.

Supplementary Schedules

Pima County
Department of Wastewater Management
Combining Statement of Net Assets
June 30, 2003

Assets	<u>Liquid Waste</u>	<u>Solid Waste</u>	<u>Total</u>
Current assets:			
Cash and cash equivalents	\$ 2,450	\$ 963,817	\$ 966,267
Interest receivable	3,946	3,075	7,021
Accounts receivable, net	6,413,912	445,851	6,859,763
Due from other Pima County funds	1,675		1,675
Intrafund due from (due to)	(1,955,798)	1,955,798	-
Due from other governments	87,517	200,000	287,517
Inventory of materials and supplies	2,610,951		2,610,951
Prepaid expenses	<u>123,486</u>	<u>5,391</u>	<u>128,877</u>
Total current assets	<u>7,288,139</u>	<u>3,573,932</u>	<u>10,862,071</u>
Noncurrent assets:			
Restricted assets:			
Cash and cash equivalents:			
Restricted for debt service	1,245,429		1,245,429
Restricted for operation and maintenance	3,669,003		3,669,003
Held in escrow as construction contract retentions	2,987,679		2,987,679
Interest receivable	<u>19,952</u>		<u>19,952</u>
Total restricted assets	<u>7,922,063</u>		<u>7,922,063</u>
Capital assets, net of accumulated depreciation where applicable:			
Land and other improvements	4,117,586	7,840,639	11,958,225
Solid waste transfer stations, net		1,595,764	1,595,764
Conveyance systems, net	264,664,983		264,664,983
Treatment facilities, net	130,640,733		130,640,733
Equipment, net	5,063,180	1,889,819	6,952,999
Construction in progress	<u>136,170,979</u>		<u>136,170,979</u>
Total capital assets, net	<u>540,657,461</u>	<u>11,326,222</u>	<u>551,983,683</u>
Deferred financing costs	<u>848,259</u>		<u>848,259</u>
Total noncurrent assets	<u>549,427,783</u>	<u>11,326,222</u>	<u>560,754,005</u>
Total assets	<u>\$556,715,922</u>	<u>\$14,900,154</u>	<u>\$571,616,076</u>

(Continued)

Pima County
Department of Wastewater Management
Combining Statement of Net Assets
June 30, 2003
(Continued)

Liabilities	<u>Liquid Waste</u>	<u>Solid Waste</u>	<u>Total</u>
Current liabilities:			
Accounts payable	\$ 8,066,815	\$ 304,997	\$ 8,371,812
Accrued payroll and employee benefits	2,933,598	213,310	3,146,908
Due to other Pima County funds	10,963,213	4,459	10,967,672
Interest payable	11,714		11,714
Current portion of sewer revenue bonds payable	4,965,000		4,965,000
Current portion of wastewater loans payable	4,269,721		4,269,721
Deferred sewer connection revenue	1,346,678		1,346,678
Deferred sludge hauling revenue	<u>500</u>		<u>500</u>
Total current liabilities	<u>32,557,239</u>	<u>522,766</u>	<u>33,080,005</u>
Noncurrent liabilities:			
Construction contract retentions payable	6,848,853		6,848,853
Landfill closure and postclosure care costs payable		15,644,952	15,644,952
Sewer revenue bonds payable, less current portion	63,275,000		63,275,000
Wastewater loans payable, less current portion	59,609,308		59,609,308
Deferred interest expense and bond discount	<u>(5,469,829)</u>		<u>(5,469,829)</u>
Total noncurrent liabilities	<u>124,263,332</u>	<u>15,644,952</u>	<u>139,908,284</u>
Total liabilities	<u>156,820,571</u>	<u>16,167,718</u>	<u>172,988,289</u>
Net Assets			
Invested in capital assets, net of related debt	414,856,520	11,326,221	426,182,741
Restricted for:			
Debt service	1,245,429		1,245,429
Capital projects	3,007,631		3,007,631
Wastewater management	3,669,003		3,669,003
Unrestricted deficit	<u>(22,883,232)</u>	<u>(12,593,785)</u>	<u>(35,477,017)</u>
Total net assets	<u>\$399,895,351</u>	<u>\$ (1,267,564)</u>	<u>\$398,627,787</u>

Pima County
Department of Wastewater Management
Combining Statement of Revenues, Expenses,
and Changes in Fund Net Assets
Year Ended June 30, 2003

	<u>Liquid Waste</u>	<u>Solid Waste</u>	<u>Total</u>
Operating revenues:			
Sewer utility service	\$ 45,318,741		\$ 45,318,741
Solid waste fees		\$ 5,690,740	5,690,740
Engineering review and inspection fees	245,820		245,820
Permits and fines	91,024		91,024
Other income	<u>820,508</u>	<u>50,277</u>	<u>870,785</u>
Total operating revenues	<u>46,476,093</u>	<u>5,741,017</u>	<u>52,217,110</u>
Operating expenses:			
Employee compensation	23,369,572	2,008,387	25,377,959
Operating supplies	5,226,695	1,117	5,227,812
Utilities	1,921,413	55,171	1,976,584
Sludge and refuse disposal	2,052,083	189,771	2,241,854
Repairs and maintenance	4,700,639	404,700	5,105,339
Landfill closure and postclosure care costs		1,078,282	1,078,282
General and administrative	6,409,429	1,616,356	8,025,785
Consultants and professional services	2,697,527	948,796	3,646,323
Depreciation	<u>16,364,451</u>	<u>306,047</u>	<u>16,670,498</u>
Total operating expenses	<u>62,741,809</u>	<u>6,608,627</u>	<u>69,350,436</u>
Operating loss	<u>(16,265,716)</u>	<u>(867,610)</u>	<u>(17,133,326)</u>
Nonoperating revenues (expenses):			
Grant revenue	303,934		303,934
Interest income	977,985	36,364	1,014,349
Sewer connection revenue	20,279,607		20,279,607
State-shared tax revenue		958,603	958,603
Loss on disposal of equipment	(150,507)	(62,628)	(213,135)
Interest expense	(5,271,123)	(11)	(5,271,134)
Amortization of deferred charges	<u>(88,645)</u>	<u> </u>	<u>(88,645)</u>
Total nonoperating revenues (expenses)	<u>16,051,251</u>	<u>932,328</u>	<u>16,983,579</u>
Income (loss) before capital contributions and extraordinary item	<u>(214,465)</u>	<u>64,718</u>	<u>(149,747)</u>
Capital contributions	12,473,664	1,228,477	13,702,141
Extraordinary item—loss from State Treasurer's Local Government Investment Pool	<u>(1,186,975)</u>	<u>(76,193)</u>	<u>(1,263,168)</u>
Increase in net assets	11,072,224	1,217,002	12,289,226
Net assets—July 1, 2002	<u>388,823,127</u>	<u>(2,484,566)</u>	<u>386,338,561</u>
Net assets—June 30, 2003	<u>\$399,895,351</u>	<u>\$(1,267,564)</u>	<u>\$398,627,787</u>

Pima County
Department of Wastewater Management
Combining Statement of Cash Flows
Year Ended June 30, 2003

	<u>Liquid Waste</u>	<u>Solid Waste</u>	<u>Total</u>
Cash flows from operating activities:			
Receipts from customers	\$ 45,982,447	\$ 5,616,372	\$ 51,598,819
Miscellaneous receipts	2,398,762	50,277	2,449,039
Payments to suppliers for goods and services	(18,288,106)	(1,464,184)	(19,752,290)
Payments to other Pima County funds	(7,241,725)	(1,572,898)	(8,814,623)
Payments to employees	<u>(22,882,954)</u>	<u>(1,989,816)</u>	<u>(24,872,770)</u>
Net cash provided by (used for) operating activities	<u>(31,576)</u>	<u>639,751</u>	<u>608,175</u>
Cash flows from noncapital financing activities:			
Noncapital grant receipts	303,934		303,934
State-shared tax receipts		958,603	958,603
Net intrafund borrowings	1,955,798	(1,955,798)	-
Net interfund borrowings	<u>10,981,210</u>	<u>983</u>	<u>10,982,193</u>
Net cash provided by (used for) noncapital financing activities	<u>13,240,942</u>	<u>(996,212)</u>	<u>12,244,730</u>
Cash flows from capital and related financing activities:			
Proceeds from issuing sewer bonds and loans	9,745,533		9,745,533
Sewer connection receipts from customers	19,701,257		19,701,257
Purchase and construction of capital assets	(58,892,987)	(334,772)	(59,227,759)
Principal payments on revenue bonds and loans	(8,886,774)		(8,886,774)
Interest payments on revenue bonds and loans	<u>(4,742,206)</u>		<u>(4,742,206)</u>
Net cash used for capital and related financing activities	<u>(43,075,177)</u>	<u>(334,772)</u>	<u>(43,409,949)</u>
Cash flows from investing activities:			
Loss on investments	(1,186,975)	(76,193)	(1,263,168)
Interest received on investments	<u>1,089,927</u>	<u>35,021</u>	<u>1,124,948</u>
Net cash used for investing activities	<u>(97,048)</u>	<u>(41,172)</u>	<u>(138,220)</u>
Net decrease in cash and cash equivalents	(29,962,859)	(732,405)	(30,695,264)
Cash and cash equivalents, July 1, 2002	<u>37,867,420</u>	<u>1,696,222</u>	<u>39,563,642</u>
Cash and cash equivalents, June 30, 2003	<u>\$ 7,904,561</u>	<u>\$ 963,817</u>	<u>\$ 8,868,378</u>

(Continued)

Pima County
 Department of Wastewater Management
 Combining Statement of Cash Flows
 Year Ended June 30, 2003
 (Continued)

	<u>Liquid Waste</u>	<u>Solid Waste</u>	<u>Total</u>
Reconciliation of operating loss to net cash provided by operating activities:			
Operating loss	\$(16,265,716)	\$ (867,610)	\$(17,133,326)
Adjustments to reconcile operating loss to net cash provided by (used for) operating activities:			
Depreciation	16,364,451	306,047	16,670,498
Landfill closure and postclosure care costs		1,078,282	1,078,282
Changes in assets and liabilities:			
Decrease (increase) in assets:			
Accounts receivable	1,578,255	(81,209)	1,497,046
Due from other governments	326,862	6,840	333,702
Inventory of materials and supplies	(54,092)		(54,092)
Prepaid expenses	(44,508)	(2,940)	(47,448)
Increase (decrease) in liabilities:			
Accounts payable	(2,423,446)	186,536	(2,236,910)
Accrued payroll and employee benefits	486,618	18,571	505,189
Due to other Pima County funds	<u> </u>	<u>(4,766)</u>	<u>(4,766)</u>
Net cash provided by (used for) operating activities	<u>\$ (31,576)</u>	<u>\$ 639,751</u>	<u>\$ 608,175</u>

Noncash investing, capital, and noncapital financing activities:

During the year ended June 30, 2003, Pima County transferred capital assets with a net book value of \$1,228,477 to the Solid Waste Division. This transaction was recorded as a capital contribution.

During the year ended June 30, 2003, the Solid Waste Division retired capital assets with a net book value of \$62,628, resulting in a loss on disposal of equipment.

During the year ended June 30, 2003, the Liquid Waste Division retired capital assets with a net book value of \$150,507, resulting in a loss on disposal of equipment.

During the year ended June 30, 2003, developers conveyed capital assets with an estimated fair value of \$12,473,664 to the Liquid Waste Division. This transaction was recorded as a capital contribution.