

2014

Regional Wastewater Reclamation Enterprise Fund



Pima County, Arizona
For the Fiscal Year Ended June 30, 2014

PIMA COUNTY, ARIZONA
Regional Wastewater Reclamation Enterprise Fund
June 30, 2014

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Independent Auditors' Report

Board of Supervisors
Pima County, Arizona

We have audited the accompanying financial statements of the Regional Wastewater Reclamation Enterprise Fund of Pima County, Arizona, as of and for the year ended June 30, 2014, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Regional Wastewater Reclamation Enterprise Fund of Pima County, Arizona as of June 30, 2014, and the changes in financial position and cash flows thereof for the year then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

As discussed in Note 1, the financial statements present only the Regional Wastewater Reclamation Enterprise Fund and do not purport to, and do not, present fairly the financial position of Pima County, Arizona as of June 30, 2014, the changes in its financial position or, where applicable, its cash flows for the year then ended in accordance with U.S. generally accepted accounting principles. Our report is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 30, 2014 on our consideration of the Regional Wastewater Reclamation Enterprise Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Regional Wastewater Reclamation Enterprise Fund's internal control over financial reporting and compliance.

Beach Fleischman PC

Tucson, Arizona
October 30, 2014

PIMA COUNTY, ARIZONA
Regional Wastewater Reclamation Enterprise Fund
Statement of Net Position
June 30, 2014

Assets

Current assets:

Cash and cash equivalents	\$	121,426,425
Restricted cash and cash equivalents		55,458,043
Interest receivable		194,203
Accounts receivable, net		18,039,057
Due from other Pima County funds		6,587
Due from other governments		3,000
Inventory of materials and supplies		1,877,227
Prepaid expenses		53,807
		197,058,349
Total current assets		197,058,349

Noncurrent assets:

Restricted cash and cash equivalents:

Restricted for debt service		29,087,695
Emergency reserve fund		20,000,000
		49,087,695
Total restricted assets		49,087,695

Capital assets, net of accumulated depreciation where applicable:

Land and other improvements		8,494,939
Intangibles - Easements		2,366,925
Sewage conveyance system, net		439,753,600
Treatment facilities, net		648,088,398
Equipment, net		88,616,699
Construction in progress		60,000,343
		1,247,320,904
Total capital assets, net		1,247,320,904

Total noncurrent assets		1,296,408,599
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Total assets	\$	1,493,466,948
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(continued)

See accompanying notes to financial statements

PIMA COUNTY, ARIZONA
Regional Wastewater Reclamation Enterprise Fund
Statement of Net Position
June 30, 2014

(continued)

Liabilities

Current liabilities:

Accounts payable	\$	18,960,508
Accrued payroll and employee benefits		4,312,901
Interest payable		299,704
Due to other Pima County funds		11,986
Due to other governments		3,389
Current portion of sewer obligations payable		21,890,000
Current portion of sewer revenue bonds payable		17,555,000
Current portion of wastewater loans payable		1,534,678
Unearned revenue - effluent and connection fee credits		2,506,005
Total current liabilities		67,074,171

Noncurrent liabilities:

Construction contract retentions payable		7,942,420
Sewer obligations payable, less current portion		472,240,000
Sewer revenue bonds payable, less current portion		120,095,000
Wastewater loans payable, less current portion		18,145,019
Sewer obligations and revenue bonds premium		46,938,773
Total noncurrent liabilities		665,361,212
Total liabilities		732,435,383

Net Position

Net investment in capital assets		577,779,481
Restricted for:		
Debt service		31,615,145
Capital projects		22,720,033
Operation and maintenance		18,820,307
Unrestricted		110,096,599
Total net position	\$	761,031,565

See accompanying notes to financial statements

PIMA COUNTY, ARIZONA
Regional Wastewater Reclamation Enterprise Fund
Statement of Revenues, Expenses and Changes in Net Position
Year Ended June 30, 2014

Operating revenues:

Sewer utility service	\$ 160,017,699
Engineering review and inspection fees	164,475
Permits and fines	47,051
Other income	1,447,279
Total operating revenues	161,676,504

Operating expenses:

Employee compensation	34,878,050
Operating supplies	8,069,868
Utilities	7,663,853
Sludge and refuse disposal	1,512,336
Repairs and maintenance	6,266,954
General and administrative	10,809,821
Consultants and professional services	7,366,757
Depreciation	48,592,852
Total operating expenses	125,160,491
Operating income	36,516,013

Nonoperating revenues (expenses):

Interest income	1,197,185
Sewer connection revenues	11,397,156
Loss on disposal of equipment	(3,905,245)
Interest expense	(15,528,690)
Debt issuance cost	(523,366)
Total nonoperating revenues (expenses)	(7,362,960)
Income before capital contributions and transfers	29,153,053

Capital contributions	6,807,670
Transfers in	51,403,860
Transfers out	(36,986,457)
Increase in net position	50,378,126

Net position - July 1, 2013	710,653,439
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Net position - June 30, 2014	\$ 761,031,565
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See accompanying notes to financial statements

PIMA COUNTY, ARIZONA
Regional Wastewater Reclamation Enterprise Fund
Statement of Cash Flows
Year Ended June 30, 2014

Cash flows from operating activities:

Receipts from customers	\$ 160,202,496
Miscellaneous receipts	1,447,279
Payments to suppliers for goods and services	(26,695,161)
Payments to other Pima County funds for goods and services	(11,809,843)
Payments to employees	(34,738,300)
Net cash provided by operating activities	88,406,471

Cash flows from noncapital financing activities:

Repayment of interfund borrowings	22,946,555
Net cash provided by noncapital financing activities	22,946,555

Cash flows from capital and related financing activities:

Sewer connection receipts from customers	10,990,587
Purchase and construction of capital assets	(102,825,352)
Proceeds from issuance of sewer revenue obligations	48,500,000
Proceeds from premium	7,032,675
Principal payments on revenue bonds, obligations and loans	(36,979,449)
Interest payments on revenue bonds, obligations and loans	(23,364,590)
Debt issuance costs of new debt	(523,366)
Net cash used for capital and related financing activities	(97,169,495)

Cash flows from investing activities:

Interest received on investments	1,068,263
Net cash provided by investing activities	1,068,263

Net increase in cash and cash equivalents 15,251,794

Cash and cash equivalents, July 1, 2013 210,720,369

Cash and cash equivalents, June 30, 2014 **\$ 225,972,163**
(continued)

See accompanying notes to financial statements

PIMA COUNTY, ARIZONA
Regional Wastewater Reclamation Enterprise Fund
Statement of Cash Flows
Year Ended June 30, 2014

(continued)

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

Operating income	\$	36,516,013
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation		48,592,852
Changes in assets and liabilities:		
Decrease (increase) in assets:		
Accounts receivable		(25,789)
Due from other governments		(940)
Inventory of materials and supplies		1,220,084
Prepaid expenses		(36,129)
Increase (decrease) in liabilities:		
Accounts payable		2,005,346
Due to other governments		(4,716)
Accrued payroll and employee benefits		139,750
Net cash provided by operating activities	\$	88,406,471

Noncash investing, capital, and noncapital financing activities during the year ended June 30, 2014:

Developers conveyed capital assets with an estimated fair value of \$6,541,122 and received other capital asset totaling \$75,638. These transactions were recorded as capital contributions.

The Fund disposed of capital assets with a net book value of \$3,905,245.

The Fund received capital assets from the County's general government in the amount of \$278,147. This transaction was recorded as capital contributions.

Pima County Board of Supervisors approved Connection Flow-Through Sewer Credit Agreements in the amount of \$94,869. This transaction was recorded as an increase to unearned revenue and a decrease in capital contributions.

The Fund retired expired Sewer Credit Agreements totaling \$7,632. This transaction was recorded as a decrease to unearned revenue and an increase in capital contributions.

See accompanying notes to financial statements

PIMA COUNTY, ARIZONA
Regional Wastewater Reclamation Enterprise Fund
Notes to Financial Statements
June 30, 2014

Note 1 – Summary of Significant Accounting Policies

The accounting policies of Pima County (County) and its Regional Wastewater Reclamation Enterprise Fund (Fund), formerly known as the Wastewater Management Enterprise Fund, conform to U.S. generally accepted accounting principles (GAAP) applicable to governmental units as promulgated by the Governmental Accounting Standards Board (GASB) and the regulatory requirements of the State of Arizona. A summary of the County's significant accounting policies affecting the Fund follows.

A. Reporting Entity

The Fund is accounted for as an enterprise fund of Pima County, Arizona, however, the ultimate financial accountability for the Fund remains with Pima County. The Fund's management is responsible for operating all wastewater conveyance and treatment systems and water pollution control programs throughout Pima County.

The financial statements present only the Regional Wastewater Reclamation Enterprise Fund as one of the enterprise funds of Pima County and are not intended to present the balances and activities of Pima County in its entirety.

B. Fund Accounting

The Fund's accounts are maintained in accordance with the principles of fund accounting to ensure that limitations and restrictions on the Fund'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. Each 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 position, revenues, and expenses.

The Fund'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. It is the intent of the Board of Supervisors that the costs (expenses, including depreciation) of goods or services provided by the Fund 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 and determines when revenues and expenses are recognized in the accounts and reported in the financial statements. The financial statements of the Fund are reported using the economic resources measurement focus and are presented on the accrual basis of accounting. Revenues are recognized when earned, and expenses are recognized when a liability is incurred, regardless of the timing of the related cash flows. When both restricted and unrestricted net position are available to finance Fund expenses, restricted resources are used before unrestricted resources. Interfund transactions that would be treated as revenues or expenses if they involved parties external to the County are recorded in the appropriate revenue or expense accounts. Intrafund transactions within the fund are eliminated for the consolidated financial statement presentation.

D. Basis of Presentation

The financial statements include a statement of net position, a statement of revenues, expenses, and changes in fund net position, and a statement of cash flows. A statement of net position provides information about the assets, liabilities, and net position of the Fund at the end of the year. Assets and liabilities are classified as either current or noncurrent. Net position is classified according to external restrictions or availability of assets to satisfy the Fund's obligations. Net investment in capital assets represents the cost of capital assets, net of accumulated depreciation, less any outstanding debt incurred to acquire or construct the assets. Restricted net position represents grants, contracts, and other resources that have been externally restricted for specific purposes. Unrestricted net position includes all other net position,

PIMA COUNTY, ARIZONA
Regional Wastewater Reclamation Enterprise Fund
Notes to Financial Statements
June 30, 2014

Note 1 – Summary of Significant Accounting Policies (continued)

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 position provides information about the Fund's financial activities during the year. Revenues and expenses are classified as either operating or nonoperating, and all changes in net position are reported, including capital contributions and transfers. Generally, charges for services and fees generated from providing wastewater treatment services and sewer utility service fees are considered to be operating. Other revenues, such as sewer connection revenues and interest income, are not generated from operations and are considered to be nonoperating revenues. Operating expenses include the costs of providing sewer services, administrative expenses, and depreciation on capital assets. Other expenses, such as interest expense on debt, are considered to be nonoperating expenses.

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

E. Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, cash and investments held by the Pima County Treasurer, investments with the State Treasurer, deposits with fiscal agent 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, deposit with fiscal agent and deposits held in escrow accounts.

For purposes of its statement of cash flows, the County considers cash on hand, demand deposits, cash on deposit with the County Treasurer, and only those highly liquid investments with a maturity of 3 months or less when purchased to be cash equivalents.

Nonparticipating interest-earning investment contracts are stated at cost. Money market investments and participating interest-earning investment contracts with a remaining maturity of 1 year or less at the time of purchase are stated at amortized cost. All (other) investments are stated at fair value.

F. Accounts Receivable

Accounts receivable consist primarily of amounts due from customers for services provided. These balances are stated at the amount management expects to collect. Management provides for probable uncollectible amounts through charge to earnings and credit to a valuation allowance based on its assessment of the current status of individual balances. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable.

G. Inventory

Inventories consist of operating supplies and are recorded as assets when purchased and expensed when consumed. These inventories are stated at the lower of cost or market. Cost is determined using the moving average method.

H. Capital Assets

Purchased capital assets are reported at actual cost. Donated assets are reported at estimated fair market value at the

PIMA COUNTY, ARIZONA
Regional Wastewater Reclamation Enterprise Fund
Notes to Financial Statements
June 30, 2014

Note 1 – Summary of Significant Accounting Policies (continued)

time received. The Fund capitalizes all land and developer contributions regardless of cost; sewage conveyance systems, buildings and improvements, infrastructure and intangibles costing \$100,000 or more, and equipment costing \$5,000 or more. 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. All assets other than land and construction in progress are depreciated over their estimated useful lives using the straight-line method. The estimated useful lives are as follows:

Treatment facilities and equipment	4 to 30 years
Conveyance systems	50 years

I. Compensated Absences

Compensated absences consist of vacation leave and a calculated amount of sick leave earned by employees based on services already rendered.

Employees may accumulate up to 240 hours of vacation depending upon years of service, but any vacation hours in excess of the maximum amount that are unused at year-end are forfeited. Upon termination of employment, all unused and unforfeited vacation benefits are paid to employees. Accordingly, vacation benefits are accrued as a liability in the financial statements.

Employees may accumulate a limited number of sick leave (1,920) hours. Generally, sick leave benefits provide for ordinary sick pay and are cumulative but are forfeited upon termination of employment. Sick leave benefits do not vest with employees; however employees who are eligible to retire from County service into the Arizona State Retirement system, Public Safety Personnel Retirement System, or Corrections Officer Retirement Plan may request sick leave be converted to annual leave, on a predetermined conversion basis. An estimate of those retirement payouts is accrued as a liability.

J. Construction Contract Retentions

The Fund has numerous construction projects in process. The Fund 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.

K. Revenues

Sewer utility billings are based on the content and volume of wastewater discharged and a minimum service charge.

Land developers contribute capital and aid in the construction of certain portions of the conveyance systems. Contributions are recorded as contributed capital at their estimated fair value. In those instances when a developer makes enhancements that exceed the requirements for the conveyance systems, the Fund 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 Fund's operating expenses that are not recovered by the sewer utility service fees. Accordingly, fees collected are classified as nonoperating revenues.

PIMA COUNTY, ARIZONA
Regional Wastewater Reclamation Enterprise Fund
Notes to Financial Statements
June 30, 2014

Note 2 – Cash and Investments

Cash and cash equivalents consisted of the following amounts:

Current	
Cash on hand	\$ 2,450
Cash and cash equivalents	121,423,975
Restricted cash and cash equivalents:	
Construction	28,857,046
Debt service	7,780,690
Operation and maintenance	<u>18,820,307</u>
Total restricted cash	55,458,043
Noncurrent	
Restricted cash and cash equivalents:	
Debt service	29,087,695
Emergency reserve fund	<u>20,000,000</u>
Total restricted cash	<u>49,087,695</u>
Total cash and cash equivalents	<u><u>\$ 225,972,163</u></u>

Current restricted cash and cash equivalents represents cash received for capital projects, anticipated debt service payments, and an estimated one-fourth of annual operating expenses. In prior years, only one-twelfth of the annual debt principal and interest was restricted. However, because the Water Infrastructure Finance Authority debt payment is paid July 1, the entire amount of the payment is now included as restricted cash for debt service.

Noncurrent restricted cash and cash equivalents consisted of deposits with fiscal agent for the reserve requirement which is equal to one-half of maximum annual debt service on the 2010, 2011B, 2012A and 2014 Obligations, emergency reserve funds to cover potential emergency and unplanned projects.

The Fund's cash and investments in the Pima County Treasurer's investment pool represent a portion of the County Treasurer's investment pool portfolio. There is no oversight provided for the County Treasurer's investment pool, and the pool's structure does not provide for shares. The Fund's portion in the pool is not identified with specific investments and is not subject to custodial credit risk.

Credit Risk – Credit risk is the risk that an issuer or counterparty to an investment will not fulfill its obligations. The County does not have a formal investment policy with respect to credit risk. The Pima County Treasurer's investment pool is unrated.

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect an investment's fair value. The County does not have a formal investment policy with respect to interest rate risk. The Pima County Treasurer's investment had a weighted average maturity of 525 days at June 30, 2014.

Legal Provisions – Arizona Revised Statutes authorize counties to invest public monies in the State Treasurer's investment pool: obligations issued or guaranteed by the United States or any of the senior debt of its agencies, sponsored agencies, corporations, sponsored corporations, or instrumentalities; specified state and local government bonds; interest earning investments such as savings accounts, certificates of deposit, and repurchase agreements in eligible depositories; and specified commercial paper, bonds, debentures, and notes issued by corporations organized

PIMA COUNTY, ARIZONA
Regional Wastewater Reclamation Enterprise Fund
Notes to Financial Statements
June 30, 2014

Note 2 – Cash and Investments (continued)

and doing business in the United States. In addition, the County Treasurer may invest trust funds in fixed income securities of corporations doing business in the United States or District of Columbia.

Credit risk - Statutes have the following requirements for credit risk:

1. Commercial paper must be rated P1 by Moody's Investors Service or A1 or better by Standard and Poor's rating service.
2. Corporate bonds, debentures, and notes must be rated A or better by Moody's investors' service or Standard and Poor's rating service.
3. Fixed income securities must carry one of the two highest ratings by Moody's investors' service and Standard and Poor's rating service. If only one of the above-mentioned services rates the security, it must carry the highest rating of that service.

Custodial credit risk - Statutes require collateral for demand deposits, certificates of deposit, and repurchase agreements at 101 percent of all deposits not covered by federal depository insurance.

Concentration of credit risk - Statutes do not include any requirements for concentration of credit risk.

Interest rate risk - Statutes require that public monies invested in securities and deposits have a maximum maturity of 5 years and that public operating fund monies invested in securities and deposits have a maximum maturity of 3 years. Investments in repurchase agreements must have a maximum maturity of 180 days.

Foreign currency risk - Statutes do not allow foreign investments.

PIMA COUNTY, ARIZONA
Regional Wastewater Reclamation Enterprise Fund
Notes to Financial Statements
June 30, 2014

Note 3– Capital Asset Activity

Capital asset activity for the year ended June 30, 2014, is presented in the following schedule:

	Balance <u>June 30, 2013</u>	<u>Increases</u>	<u>Decreases</u>	Balance <u>June 30, 2014</u>
Capital assets not being depreciated:				
Land and other improvements	\$ 8,419,301	\$ 75,638		\$ 8,494,939
Intangibles - easements	2,366,925			2,366,925
Construction in progress	<u>500,964,060</u>	<u>88,671,731</u>	<u>\$ (529,635,448)</u>	<u>60,000,343</u>
Total capital assets not being depreciated	<u>511,750,286</u>	<u>88,747,369</u>	<u>(529,635,448)</u>	<u>70,862,207</u>
Capital assets being depreciated:				
Sewage conveyance systems	693,048,077	30,902,366	(2,435,810)	721,514,633
Treatment facilities	382,320,031	473,802,344	(17,261,832)	838,860,543
Equipment	<u>105,889,837</u>	<u>32,024,105</u>	<u>(6,327,697)</u>	<u>131,586,245</u>
Total capital assets being depreciated	<u>1,181,257,945</u>	<u>536,728,815</u>	<u>(26,025,339)</u>	<u>1,691,961,421</u>
Less accumulated depreciation for:				
Sewage conveyance systems	269,767,865	13,538,729	(1,545,561)	281,761,033
Treatment facilities	181,136,644	25,723,287	(16,087,786)	190,772,145
Equipment	<u>38,125,456</u>	<u>9,330,836</u>	<u>(4,486,746)</u>	<u>42,969,546</u>
Total accumulated depreciation	<u>489,029,965</u>	<u>48,592,852</u>	<u>(22,120,093)</u>	<u>515,502,724</u>
Total capital assets being depreciated, net	<u>692,227,980</u>	<u>488,135,963</u>	<u>(3,905,246)</u>	<u>1,176,458,697</u>
Capital assets, net	<u>\$ 1,203,978,266</u>	<u>\$ 576,883,332</u>	<u>\$ (533,540,694)</u>	<u>\$ 1,247,320,904</u>

Note 4 – Claims, Judgments, and Risk Management

The Fund is a participant in Pima County’s self-insurance program. The County’s self-insurance program covers the Fund 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 Fund’s management, any unfavorable outcomes from these types of risks would be covered by that self-insurance program. Accordingly, the Fund has no risk of loss beyond adjustments to future years’ premium payments to Pima County’s self-insurance program. All estimated losses for 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 Fund’s management does not believe that these types of losses would be material to the financial statements; therefore, no accrual of losses has been reported in the financial statements. At June 30, 2014, there were no material lawsuits related to contractual breaches.

PIMA COUNTY, ARIZONA
Regional Wastewater Reclamation Enterprise Fund
Notes to Financial Statements
June 30, 2014

Note 5 – Long-Term Liabilities

The following schedule details the Fund’s long-term liability and obligation activity for the year ended June 30, 2014:

	Balance <u>June 30, 2013</u>	<u>Additions</u>	<u>Reductions</u>	Balance <u>June 30, 2014</u>	Due Within <u>1 year</u>
Sewer revenue bonds	\$ 154,415,000		\$ (16,765,000)	\$ 137,650,000	\$ 17,555,000
Unamortized premium/discount	1,099,536		(318,195)	781,341	
Total sewer revenue bonds	<u>155,514,536</u>		<u>(17,083,195)</u>	<u>138,431,341</u>	<u>17,555,000</u>
Sewer revenue obligations	464,355,000	\$ 48,500,000	(18,725,000)	494,130,000	21,890,000
Unamortized premium/discount	46,619,848	7,032,675	(7,495,091)	46,157,432	
Total sewer obligations payable	<u>510,974,848</u>	<u>55,532,675</u>	<u>(26,220,091)</u>	<u>540,287,432</u>	<u>21,890,000</u>
Wastewater loans payable	21,169,146		(1,489,449)	19,679,697	1,534,678
Total wastewater loans payable	<u>21,169,146</u>		<u>(1,489,449)</u>	<u>19,679,697</u>	<u>1,534,678</u>
Construction contract retention payable	12,645,549	1,610,396	(6,313,525)	7,942,420	
Total long-term liabilities	<u>\$ 700,304,079</u>	<u>\$ 57,143,071</u>	<u>\$ (51,106,260)</u>	<u>\$ 706,340,890</u>	<u>\$ 40,979,678</u>

Sewer Revenue Bonds Payable—The Fund has issued several series of sewer revenue bonds (Refunding 2004, Series 2007, Series 2008, Series 2009, and Refunding 2011A) to provide funds for the defeasance of prior sewer revenue bonds, the construction of a sewage treatment plant, and the construction of 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. The entire authorized amounts from the May 20, 1997 and May 18, 2004 bond elections have been issued in full by the end of fiscal year 2010.

Sewer Revenue Obligations Payable—The Fund issued 2010, 2011B, 2012A, and 2014 Series of the Sewer System Revenue Obligations for the purpose of financing capital improvement programs constituting improvements and extensions to the entire sewer system of the County. These are subordinated debts secured solely by pledged revenues and require no voter authorization.

Wastewater Loans Payable—The Fund has entered into two loan agreements/amendments with the Water Infrastructure Financing Authority of Arizona (2004 and 2009 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.

In February 2014, the County issued for the Fund \$48,500,000 in Sewer Revenue Obligations Series 2014. The net proceeds of the issuance were used to primarily to pay a portion of the costs of the construction, expansion and improvement of sewer treatment facilities and conveyance systems for the System, including Wastewater Reclamation Facilities Tres Rios, formerly Ina Road and Agua Nueva, formerly Roger Road.

Debt Covenants—All revenue bonds were issued and the loan agreements were executed with a first lien on the pledge of the Fund’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 Fund 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, 2014, the Fund had a surety bond to meet the requirements of the debt covenants. The County is also authorized to issue for the Fund 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.

PIMA COUNTY, ARIZONA
Regional Wastewater Reclamation Enterprise Fund
Notes to Financial Statements
June 30, 2014

Note 5 – Long-Term Liabilities (continued)

Bonds, obligations and loans outstanding at June 30, 2014, were as follows:

<u>Description</u>	<u>Interest Rates</u>	<u>Maturity Dates</u>	<u>Call Dates</u>	<u>Outstanding Principal</u>
*Refunding 2004	4.6%	2015	July 1, 2014	\$ 4,000,000
*Series 2007	4.0-5.0%	2015-26	July 1, 2017	34,715,000
*Series 2008	4.0-5.0%	2015-23	July 1, 2018	70,130,000
Series 2009	3.25-4.25%	2015-24	July 1, 2019	14,540,000
Refunding 2011A	3.0-5.0%	2015-16		14,265,000
Total sewer revenue bonds payable				<u>\$ 137,650,000</u>
Series 2010	2.5-5.0%	2015-25	July 1, 2020	\$ 163,000,000
Series 2011B	5.0%	2015-26	July 1, 2021	164,450,000
Series 2012A	1.75-5.0%	2015-27	July 1, 2022	118,180,000
Series 2014	2.0-5.0%	2015-28	July 1, 2023	48,500,000
Total sewer revenue obligations payable				<u>\$ 494,130,000</u>
2004 loan payable	1.81%	2015-24		\$ 13,534,296
2009 loan payable	0.96%	2015-24		6,145,401
Total wastewater loans payable				<u>\$ 19,679,697</u>

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

Year ending June 30,	<u>Revenue Bond Debt Service</u>		<u>Sewer Obligation Debt Service</u>		<u>Loan Payment Requirements</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2015	\$ 17,555,000	\$ 5,882,481	\$ 21,890,000	\$ 23,870,825	\$ 1,534,678	\$ 576,095
2016	15,950,000	5,057,294	22,740,000	22,967,225	1,581,303	528,749
2017	11,250,000	4,353,644	36,170,000	21,989,125	1,629,369	479,941
2018	11,810,000	3,885,919	37,795,000	20,366,350	1,678,921	429,623
2019	12,405,000	3,413,675	39,615,000	18,548,225	1,730,004	377,749
2020-2024	61,400,000	8,606,181	229,110,000	61,691,100	9,473,357	1,052,662
2025-2028	7,280,000	440,400	106,810,000	9,316,500	2,052,065	31,301
Total	<u>\$ 137,650,000</u>	<u>\$ 31,639,594</u>	<u>\$ 494,130,000</u>	<u>\$ 178,749,350</u>	<u>\$ 19,679,697</u>	<u>\$ 3,476,120</u>

The Fund has pledged future user charges, net of specified operating expenses, to repay \$137,650,000 in sewer revenue bonds and \$494,130,000 in sewer obligations issued between 2004 and 2014, and \$19,679,697 in sewer revenue loans issued between 2004 and 2009. Proceeds from the bonds, obligations and loans provided financing for construction of various treatment facilities and sewer infrastructure within Pima County. The bonds, obligations and loans are payable from net sewer revenues and are payable through 2028. Annual principal and interest payments on the bonds and obligations are expected to require approximately 67 percent of net revenues. The annual principal and interest payments on the loans are expected to require approximately 3 percent of net revenues. Total principal and interest remaining to be paid on the bonds and obligations is \$842,168,944. Total principal and interest to be paid on the loans is

PIMA COUNTY, ARIZONA
Regional Wastewater Reclamation Enterprise Fund
Notes to Financial Statements
June 30, 2014

Note 5 – Long-Term Liabilities (continued)

\$23,155,817. Principal and interest paid for bonds, obligations and loans in the current year and total customer net revenues were \$65,277,093, \$1,793,661 and \$96,133,627, respectively.

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

Note 6 – Due To Other Pima County Funds

Due to other Pima County funds represents payables to other County funds for goods or services. At June 30, 2014, the payables included \$5,573 due to the Capital Projects and \$6,413 due to Other Special Revenue – Grants. At June 30, 2014 the receivables included \$175 due from Environmental Quality and \$6,412 due from Other Special Revenue – Grants.

Note 7 – Related Party Transactions

Administrative and Fiscal Services—The Fund incurred expenses from Pima County for a variety of administrative and fiscal services, including \$4,544,788 for the allocation of overhead; \$1,473,149 for self-insurance premiums; \$2,428,480 for interdepartmental supplies and services charges; \$2,450,760 for motor pool charges; \$600,253 for repair and maintenance charges; and \$10,926 for other miscellaneous charges.

Public Works Center- The Fund occupies a portion of the Public Works Center and pays rent based on a pro rata share of the building expenses. The Fund's rent totaled \$301,487 for the year ended June 30, 2014.

Note 8 – Construction and Other Significant Commitments

At June 30, 2014, the Fund had construction contractual commitments of \$14,717,803 and other contractual commitments related to service contracts of \$26,039,629. Funding for these expenditures will be primarily from Sewer Revenue Obligations and related fees.

The Fund entered into a service contract agreement with CH2M Hill, Inc. (Service contractor) to operate and maintain the Agua Nueva Wastewater Reclamation Facility (Facility). On May 13, 2014, the Service contractor began operation and maintenance of the Facility on behalf of the County.

Note 9 – Intergovernmental Agreement

The City of Tucson, Metropolitan Domestic Water Improvement District (MDWID), Town of Marana Water, and Oro Valley Water provide sewer utility billing and collection services, certain computer services, accounting information, and statistical data to the Fund. During the year ended June 30, 2014, the Fund paid fees totaling \$2,249,945, \$211,085, \$26,031 and \$201,972, 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 Fund. Interest earnings on such investments are remitted to the Fund. The MDWID, Town of Marana Water and Oro Valley Water submit cash receipts to the Fund regularly. However, cash collections are not invested, therefore, MDWID, Town of Marana Water, and Oro Valley Water do not remit interest to the Fund.

PIMA COUNTY, ARIZONA
Regional Wastewater Reclamation Enterprise Fund
Notes to Financial Statements
June 30, 2014

Note 10 – Retirement Plan

Plan Description—The Fund contributes to a cost-sharing multiple-employer defined benefit pension plan; a cost-sharing multiple-employer defined benefit health insurance premium plan; and a cost-sharing, multiple-employer defined benefit long-term disability plan administered by the Arizona State Retirement System (ASRS) that covers employees of the State of Arizona and employees of participating subdivisions and school districts. Benefits are established by state statute and generally provide retirement, long-term disability, and health insurance premium benefits, including death and survivor benefits. The retirement benefits are generally paid at a percentage, based on years of service of the retiree’s average compensation. Long-term disability benefits vary by circumstance, but generally pay a percentage of the employee’s monthly compensation. Health insurance premium benefits are generally paid as a flat dollar amount per month towards the retiree’s health care insurance premiums, in amounts based on whether the benefit is for the retiree or for the retiree and his or her spouse. The ASRS is governed by the Arizona State Retirement System Board according to the provisions of Arizona Revised Statutes Title 38, Chapter 5, Article 2.

The ASRS issues a comprehensive annual financial report that includes financial statements and required supplementary information. The most recent report may be obtained by writing the Arizona State Retirement System, 3300 North Central Avenue, P.O. Box 33910, Phoenix, Arizona 85067-3910, by calling (602) 240-2000, or 1-800-621-3778, or on-line at www.azasrs.gov.

Funding Policy—The Arizona State Legislature establishes and may amend active plan members’ and the Fund’s contribution rates. For the year ended June 30, 2014, active ASRS members were required by statute to contribute at the actuarially determined rate of 11.54 percent (11.30 percent retirement and health insurance benefit, and 0.24 percent long-term disability) of the members’ annual covered payroll, and the Fund was required by statute to contribute at the actuarially determined rate of 11.54 percent (10.70 percent for retirement, 0.60 percent for health insurance premium, and 0.24 percent for long-term disability) of the members’ annual covered payroll.

Year ended June 30,	Retirement Fund	Health Benefit Supplemental Fund	Long-Term Disability Fund
2014	\$2,545,083	\$142,715	\$57,086
2013	\$2,425,532	\$153,814	\$56,793
2012	\$2,247,002	\$143,426	\$54,638



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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Board of Supervisors
Pima County, Arizona

We have audited, in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Regional Wastewater Reclamation Enterprise Fund of Pima County, Arizona, as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Regional Wastewater Reclamation Enterprise Fund's basic financial statements, and have issued our report thereon dated October 30, 2014.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of this Report

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

Tucson, Arizona
October 30, 2014

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