



# 2006

Pima County  
Wastewater Management  
Enterprise Fund

**PIMA COUNTY ARIZONA**

*For the Fiscal Year Ended June 30, 2006*

Pima County  
Department of Wastewater Management  
Report on Audit of Financial Statements  
Year Ended June 30, 2006

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## INDEPENDENT AUDITORS' REPORT

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, 2006, as listed in the table of contents. These financial statements are the responsibility of the management of Pima County Department of Wastewater Management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

As discussed in Note 1, the financial statements of the Pima County Department of Wastewater Management 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, Arizona that is attributable to the Pima County Department of Wastewater Management. They do not purport to, and do not, present fairly the financial position of Pima County, Arizona, as of June 30, 2006, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pima County Department of Wastewater Management, as of June 30, 2006, and the respective changes in its financial position and its cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 21, 2006 on our consideration of the Pima County Department of Wastewater Management's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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 are 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.

Heinfeld, Meech & Co., P.C.

HEINFELD, MEECH & CO., P.C.  
Certified Public Accountants

September 21, 2006

Pima County  
 Department of Wastewater Management  
 Statement of Net Assets - Enterprise Fund  
 June 30, 2006

**Assets**

Current assets:

Cash and cash equivalents	\$	42,260,533
Restricted cash and cash equivalents		14,672,299
Accounts receivable, net		8,317,829
Due from other Pima County funds		1,502
Due from other governments		293,053
Inventory of materials and supplies		3,031,674
Prepaid expenses		92,889
Total current assets		68,669,779

Noncurrent assets:

Restricted cash and cash equivalents		492,372
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Capital assets, net of accumulated depreciation where applicable:

Land and other improvements		6,844,999
Conveyance systems, net		327,334,713
Treatment facilities, net		233,899,359
Equipment, net		5,032,936
Construction in progress		14,841,706
Total capital assets, net		587,953,713

Deferred financing costs		750,701
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Total noncurrent assets		589,196,786
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Total assets	\$	657,866,565
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(Continued)

Pima County  
 Department of Wastewater Management  
 Statement of Net Assets - Enterprise Fund  
 June 30, 2006  
 (Continued)

**Liabilities**

Current liabilities:

Accounts payable	\$ 8,330,318
Accrued payroll and employee benefits	2,990,674
Due to other Pima County funds	177,284
Due to other governments	24,297
Interest payable	1,431,501
Current portion of sewer revenue bonds payable	5,570,000
Current portion of wastewater loans payable	5,502,956
Deferred revenue	2,828,758
Total current liabilities	26,855,788

Noncurrent liabilities:

Construction contract retentions payable	4,562,235
Sewer revenue bonds payable, less current portion	49,955,000
Wastewater loans payable, less current portion	74,864,281
Deferred interest expense and bond discount	(4,034,071)
Total noncurrent liabilities	125,347,445

Total liabilities	152,203,233
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**Net Assets**

Invested in capital assets, net of related debt	456,846,248
Restricted for:	
Debt service	438,569
Operation and maintenance	4,355,797
Unrestricted	44,022,718
Total net assets	\$ 505,663,332

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, 2006

**Operating revenues:**

Sewer utility service	\$ 61,735,147
Engineering review and inspection fees	29,005
Permits and fines	58,906
Other income	451,046
Total operating revenues	62,274,104

**Operating expenses:**

Employee compensation	27,625,536
Operating supplies	6,321,867
Utilities	5,314,030
Sludge and refuse disposal	1,297,758
Repairs and maintenance	4,296,842
General and administrative	6,435,640
Consultants and professional services	5,610,305
Depreciation	20,416,294
Total operating expenses	77,318,272
Operating loss	(15,044,168)

**Nonoperating revenues (expenses):**

Intergovernmental revenue	1,435,703
Interest income	1,783,906
Sewer connection revenue	42,219,962
Loss on disposal of equipment	(20,354)
Interest expense	(4,623,759)
Amortization of deferred charges	(97,087)
Total nonoperating revenues (expenses)	40,698,371
Income before capital contributions and transfers	25,654,203
Capital contributions	14,607,737
Transfers in	156,156
Transfers out	(21,710)
Increase in net assets	40,396,386
Net assets—July 1, 2005	465,266,946
<b>Net assets—June 30, 2006</b>	<b>\$ 505,663,332</b>

See accompanying notes to financial statements

Pima County  
 Department of Wastewater Management  
 Statement of Cash Flows - Enterprise Fund  
 Year Ended June 30, 2006

**Cash flows from operating activities:**

Receipts from customers	\$ 61,819,344
Miscellaneous receipts	451,046
Payments to suppliers for goods and services	(21,805,603)
Payments to other Pima County funds for goods and services	(7,477,555)
Payments to employees	(28,215,923)
Net cash provided by operating activities	4,771,309

**Cash flows from noncapital financing activities:**

Intergovernmental receipts	528,751
Repayment of interfund borrowings	126,968
Cash transfers to other Pima County funds	(4,311,153)
Net cash used for noncapital financing activities	(3,655,434)

**Cash flows from capital and related financing activities:**

Sewer connection receipts from customers	42,141,638
Proceeds from the sale of capital assets	2,000
Intergovernmental contract receipts	191,418
Purchase and construction of capital assets	(14,339,450)
Proceeds from issuance of sewer loans	1,085,658
Principal payments on revenue bonds and loans	(9,500,734)
Interest payments on revenue bonds and loans	(4,224,328)
Net cash provided by capital and related financing activities	15,356,202

**Cash flows from investing activities:**

Interest received on investments	1,870,914
Net cash provided by investing activities	1,870,914

Net increase in cash and cash equivalents	18,342,991
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Cash and cash equivalents, July 1, 2005	39,082,213
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<b>Cash and cash equivalents, June 30, 2006</b>	<b>\$ 57,425,204</b>
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(Continued)

See accompanying notes to financial statements

Pima County  
 Department of Wastewater Management  
 Statement of Cash Flows - Enterprise Fund  
 Year Ended June 30, 2006  
 (Continued)

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

Operating loss	\$ (15,044,168)
Adjustments to reconcile operating loss to net cash provided by operating activities:	
Depreciation	20,416,294
Changes in assets and liabilities:	
Decrease (increase) in assets:	
Accounts receivable	(240,818)
Due from other governments	237,104
Inventory of materials and supplies	(216,781)
Prepaid expenses	(66,646)
Increase (decrease) in liabilities:	
Accounts payable	265,062
Due to other governments	11,649
Accrued payroll and employee benefits	(590,387)
Net cash provided by operating activities	\$ 4,771,309

Noncash investing, capital, and noncapital financing activities:

During the year ended June 30, 2006, developers conveyed capital assets with an estimated fair value of \$14,407,846 and the County's Internal Service Fund conveyed capital assets with a net book value of \$26,050 to the Department. These transactions were recorded as capital contributions.

During the year ended June 30, 2006, the Pima County Board of Supervisors approved Connection Fee Flow-Through Sewer Credit Agreements totaling \$16,697. This transaction was recorded as an increase to deferred revenue and a decrease in capital contributions.

During the year ended June 30, 2006, the Department retired expired Sewer Credit Agreements totaling \$190,538. This transaction was recorded as a decrease to deferred revenue and an increase in capital contributions.

During the year ended June 30, 2006, the Department retired assets with a net book value of \$22,354.

During the year ended June 30, 2006, the Department transferred to the County's general government the assets of the Solid Waste Management division with a net book value of \$11,334,107.

During the year ended June 30, 2006, the Department conveyed the long-term liabilities of the Solid Waste Management division in the amount of \$15,779,706 to the County's general government.

Pima County  
Department of Wastewater Management  
Notes to Financial Statements  
June 30, 2006

**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 wastewater treatment and water pollution control programs throughout Pima County. The Department segregated the operation of the Solid Waste from the Liquid Waste division effective July 2005, and Solid Waste activities are now reported in a special revenue fund.

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 presented using the economic resources measurement focus and the accrual basis of accounting. Revenues are recognized when 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 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. The Department has chosen the option not to follow FASB Statements and Interpretations issued after November 30, 1989.

Pima County  
Department of Wastewater Management  
Notes to Financial Statements  
June 30, 2006

**Note 1 - Summary of Significant Accounting Policies (continued)**

**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 transfers. Operating revenues and expenses generally result from providing waste services. Accordingly, operating revenues, such as sewer utility service fee result from transactions associated with the Department's principal activities. 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 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.

**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.

Pima County  
Department of Wastewater Management  
Notes to Financial Statements  
June 30, 2006

**Note 1 - Summary of Significant Accounting Policies (continued)**

**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 developer contributions regardless of cost. Sewage conveyance system, buildings and improvements, and infrastructure are capitalized at \$100,000 or more, as is 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 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

**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.

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, except for the actual amount used during the thirty day period subsequent to fiscal year end. 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 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 Department establishes reduced

Pima County  
 Department of Wastewater Management  
 Notes to Financial Statements  
 June 30, 2006

**Note 1 - Summary of Significant Accounting Policies (continued)**

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.

**Note 2 - Cash and Cash Equivalents**

Cash and cash equivalents consisted of the following amounts:

<u>Current</u>	
Cash on hand	\$ 2,700
Cash and cash equivalents	42,257,833
Restricted cash and cash equivalents:	
Construction	2,002,510
Debt service	8,313,992
Operation and maintenance	<u>4,355,797</u>
Total restricted cash	14,672,299
 Total current cash and cash equivalents	 <u>56,932,832</u>
 <u>Noncurrent</u>	
Restricted cash and cash equivalents:	
Deposits held in escrow accounts	<u>492,372</u>
 Total cash and cash equivalents	 <u>\$ 57,425,204</u>

Current restricted cash and cash equivalents represents cash received for capital projects, anticipated debt service payments, and an estimated one-twelfth 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 are deposits held in escrow pending completion of capital projects.

The Department'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 Department'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 Department does not have a formal investment policy with respect to credit risk. The Pima County Treasurer's investment pool is unrated.

Pima County  
Department of Wastewater Management  
Notes to Financial Statements  
June 30, 2006

**Note 2 - Cash and Cash Equivalents (continued)**

**Interest Rate Risk** – Interest rate risk is the risk that changes in interest rates will adversely affect an investment’s fair value. The Department does not have a formal investment policy with respect to interest rate risk. The Pima County Treasurer’s investment pool had a weighted average maturity of 22 days at June 30, 2006.

**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 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  
Department of Wastewater Management  
Notes to Financial Statements  
June 30, 2006

**Note 3 - Capital Asset Activity**

Capital asset activity for the year ended June 30, 2006, is presented in the following schedule:

	<u>Balance</u> <u>July 1, 2005</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2006</u>
Capital assets not being depreciated:				
Land and other improvements	\$ 12,397,849	\$ 2,287,789	\$ 7,840,639	\$ 6,844,999
Construction in progress	<u>63,324,807</u>	<u>11,017,366</u>	<u>59,500,467</u>	<u>14,841,706</u>
Total capital assets not being depreciated	<u>75,722,656</u>	<u>13,305,155</u>	<u>67,341,106</u>	<u>21,686,705</u>
Capital assets being depreciated:				
Transfer stations	2,168,380		2,168,380	
Conveyance systems	475,148,141	15,451,683		490,599,824
Treatment facilities	278,054,466	62,297,745	92,226	340,259,985
Equipment	<u>18,409,923</u>	<u>929,643</u>	<u>6,365,155</u>	<u>12,974,411</u>
Total capital assets being depreciated	<u>773,780,910</u>	<u>78,679,071</u>	<u>8,625,761</u>	<u>843,834,220</u>
Less accumulated depreciation for:				
Transfer stations	672,829		672,829	
Conveyance systems	153,003,285	10,261,826		163,265,111
Treatment facilities	96,947,504	9,413,122		106,360,626
Equipment	<u>11,545,014</u>	<u>741,345</u>	<u>4,344,884</u>	<u>7,941,475</u>
Total accumulated depreciation	<u>262,168,632</u>	<u>20,416,293</u>	<u>5,017,713</u>	<u>277,567,212</u>
Total capital assets being depreciated, net	<u>511,612,278</u>	<u>58,262,778</u>	<u>3,608,048</u>	<u>566,267,008</u>
Capital assets, net	<u>\$ 587,334,934</u>	<u>\$71,567,933</u>	<u>\$70,949,154</u>	<u>\$ 587,953,713</u>

Decreases in capital assets include transfers to Pima County as a result of the transfer of the Solid Waste division to a special revenue fund.

Pima County  
 Department of Wastewater Management  
 Notes to Financial Statements  
 June 30, 2006

**Note 4 - Long-Term Liabilities**

The following schedule details the Department's long-term liability and obligation activity for the year ended June 30, 2006. The decrease in the landfill closure and postclosure care costs represents the transfer of the Solid Waste division to a special revenue fund.

	<u>Balance</u> <u>July 1, 2005</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2006</u>	<u>Due Within</u> <u>1 year</u>
Sewer revenue bonds	\$ 60,075,000		\$4,550,000	\$ 55,525,000	\$5,570,000
Less unamortized deferred amounts	<u>4,265,696</u>		<u>450,219</u>	<u>3,815,477</u>	<u>          </u>
Total sewer revenue bonds payable	<u>55,809,304</u>			<u>51,709,523</u>	<u>5,570,000</u>
Wastewater loans payable	84,232,313	1,085,658	4,950,734	80,367,237	5,502,956
Less unamortized deferred amounts	<u>255,027</u>	<u>          </u>	<u>36,433</u>	<u>218,594</u>	<u>          </u>
Total wastewater loans payable	<u>83,977,286</u>			<u>80,148,643</u>	<u>5,502,956</u>
Landfill closure and postclosure care costs	15,635,842		15,635,842		
Construction contract retentions payable	<u>4,851,976</u>	<u>163,086</u>	<u>452,827</u>	<u>4,562,235</u>	<u>          </u>
Total long-term liabilities	<u>\$160,274,408</u>	<u>\$ 1,248,744</u>	<u>\$ 25,102,751</u>	<u>\$136,420,401</u>	<u>\$11,072,956</u>

**Sewer Revenue Bonds Payable**—The Department has issued several series of sewer revenue bonds (Series 1998, Refunding 2001, and Refunding 2004) to provide funds for the defeasance of prior sewer revenue bonds, the construction of a utility 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. Of the total amount originally authorized, \$3,943,000 from the May 20, 1997, bond election, and \$150,000,000 from the May 18, 2004, bond election remain unissued.

**Wastewater Loans Payable**—The Department has entered into four loan agreements with the Water Infrastructure Financing Authority of Arizona (1996, 1997, 2000, and 2004 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.

At June 30, 2006, the Department has drawn down only \$18,538,309 of the \$19,967,331 authorized loan amount for the 2004 Water Infrastructure Financing Authority of Arizona (WIFA) loan. Payments of principal, which are subject to change, are based on the total amounts drawn.

**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, 2006, the Department had a surety bond 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.

Pima County  
 Department of Wastewater Management  
 Notes to Financial Statements  
 June 30, 2006

**Note 4 - Long-Term Liabilities (continued)**

Bonds and loans outstanding at June 30, 2006, were as follows:

<u>Description</u>	<u>Interest Rates</u>	<u>Maturity Dates</u>	<u>Outstanding Principal</u>
Series 1998	4.0-5.5%	2007 – 15	17,655,000
Refunding 2001	4.0-5.4%	2007 – 15	14,980,000
Refunding 2004	2.63-5.5%	2007 – 15	<u>22,890,000</u>
Total sewer revenue bonds payable			<u>\$55,525,000</u>
1996 loan payable	3.19%	2006 – 12	9,069,388
1997 loan payable	2.95%	2006 – 11	3,670,008
2000 loan payable	2.20%	2006 – 16	49,089,532
2004 loan payable	1.81%	2007 – 24	<u>18,538,309</u>
Total wastewater loans payable			<u>\$80,367,237</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>Loan Payment Requirements</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 5,570,000	\$ 2,573,045	\$ 5,502,956	\$ 2,776,392
2008	5,800,000	2,339,501	5,721,589	2,586,339
2009	6,025,000	2,098,076	5,955,046	2,375,205
2010	5,280,000	1,816,076	6,316,650	2,153,157
2011	5,515,000	1,587,777	7,604,514	1,900,764
2012-2016	27,335,000	3,452,414	33,623,000	5,631,015
2017-2021			11,574,417	1,281,937
2022-2025			<u>4,069,065</u>	<u>205,827</u>
Total	<u>\$55,525,000</u>	<u>\$13,866,889</u>	<u>\$ 80,367,237</u>	<u>\$18,910,636</u>

**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**

Due to other Pima County funds represents payables for goods or services. At June 30, 2006, the payables included \$28,820 due to the General Fund, \$1,331 due to the Automotive Services Fund, \$23,053 due to the Environmental Quality Fund, and \$124,080 due to the Capital Projects Fund.

Pima County  
Department of Wastewater Management  
Notes to Financial Statements  
June 30, 2006

**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 \$1,967,662 for the allocation of overhead; \$1,329,338 for self-insurance premiums; \$1,363,679 for interdepartmental supplies and services charges; \$1,169,633 for motor pool charges; \$321,889 for professional charges; \$811,284 for repair and maintenance charges; \$79,083 for printing charges; and \$213,740 for miscellaneous other charges.

**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 totaled \$221,247 for the year ended June 30, 2006.

**Note 7 - Significant Commitments**

Commitments under construction contracts at June 30, 2006 totaled \$8,306,221.

**Note 8 – Claims, Judgments and 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 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 reported in the financial statements. At June 30, 2006, there were no material lawsuits related to contractual breaches.

**Note 9 - Intergovernmental Agreements**

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 Department. During the year ended June 30, 2006, the Department paid fees totaling \$2,125,336, \$93,134, \$17,465, and \$110,226, 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, Town of Marana Water and Oro Valley Water submit cash receipts to the Department regularly. However, cash collections are not invested, and therefore, MDWID, Town of Marana Water, and Oro Valley Water do not remit interest to the Department.

Pima County  
 Department of Wastewater Management  
 Notes to Financial Statements  
 June 30, 2006

**Note 10 - Segment Information**

Liquid Waste operates the sewer system that 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.

**Condensed Statement of Net Assets**

Assets:	
Current assets and restricted assets	\$ 68,668,277
Due from other Pima County funds	1,502
Noncurrent restricted assets	492,372
Capital assets, net of accumulated depreciation	587,953,713
Other noncurrent assets	<u>750,701</u>
Total assets	<u>657,866,565</u>
Liabilities:	
Current liabilities	26,678,504
Due to other Pima County funds	177,284
Noncurrent liabilities	<u>125,347,445</u>
Total liabilities	<u>152,203,233</u>
Net Assets:	
Invested in capital assets, net of related debt	456,846,248
Restricted	4,794,366
Unrestricted	<u>44,022,718</u>
Total net assets	<u>\$505,663,332</u>

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

Operating revenues (expenses):	
Sewer utility service	\$ 61,735,147
Other operating revenues	538,957
Depreciation expense	(20,416,294)
Other operating expenses	<u>(56,901,978)</u>
Operating loss	(15,044,168)
Nonoperating revenues (expenses):	
Sewer connection revenue	42,219,962
Other nonoperating revenues	3,219,609
Interest expense	(4,623,759)
Other nonoperating expenses	(117,441)
Capital contributions	14,607,737
Transfers out to other county funds	<u>(21,710)</u>
Increase in net assets	40,240,230
Net assets, July 1, 2005	<u>465,423,102</u>
Net assets, June 30, 2006	<u>\$505,663,332</u>

Pima County  
Department of Wastewater Management  
Notes to Financial Statements  
June 30, 2006

**Note 10 - Segment Information (continued)**

**Condensed Statement of Cash Flows**

Net cash provided by:	
Operating activities	\$ 4,582,047
Noncapital financing activities	624,664
Capital and related financing activities	15,356,202
Investing activities	<u>1,861,957</u>
Increase in cash and cash equivalents	22,424,870
Cash and cash equivalents, July 1, 2005	<u>35,000,334</u>
Cash and cash equivalents, June 30, 2006	<u>\$ 57,425,204</u>

**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 (ASRS) 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 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 on-line at <http://www.ASRS.state.az.us/web/Aboutus.do>.

**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, 2006, active plan members and the Department were each required by statute to contribute at the actuarially determined rate of 7.4 percent (6.9 percent retirement and 0.5 percent long-term disability) of the members' annual covered payroll. The Department's contributions to the ASRS for the years ended June 30, 2006, 2005, and 2004, were \$1,528,578, \$1,172,625, and \$1,219,545, respectively, which were equal to the required contributions for the year.

## Supplementary Schedules

Pima County  
Department of Wastewater Management  
Combining Statement of Revenues, Expenses,  
and Changes in Fund Net Assets  
Year Ended June 30, 2006

	Liquid Waste	Solid Waste	Total
<b>Operating revenues:</b>			
Sewer utility service	\$ 61,735,147		\$ 61,735,147
Engineering review and inspection fees	29,005		29,005
Permits and fines	58,906		58,906
Other income	451,046		451,046
Total operating revenues	62,274,104		62,274,104
<b>Operating expenses:</b>			
Employee compensation	27,625,536		27,625,536
Operating supplies	6,321,867		6,321,867
Utilities	5,314,030		5,314,030
Sludge and refuse disposal	1,297,758		1,297,758
Repairs and maintenance	4,296,842		4,296,842
General and administrative	6,435,640		6,435,640
Consultants and professional services	5,610,305		5,610,305
Depreciation	20,416,294		20,416,294
Total operating expenses	77,318,272		77,318,272
Operating loss	(15,044,168)		(15,044,168)
<b>Nonoperating revenues (expenses):</b>			
Intergovernmental revenue	1,435,703		1,435,703
Interest income	1,783,906		1,783,906
Sewer connection revenue	42,219,962		42,219,962
Loss on disposal of equipment	(20,354)		(20,354)
Interest expense	(4,623,759)		(4,623,759)
Amortization of deferred charges	(97,087)		(97,087)
Total nonoperating revenues (expenses)	40,698,371		40,698,371
Income before capital contributions and transfers	25,654,203		25,654,203
Capital contributions	14,607,737		14,607,737
Transfers in		\$ 156,156	156,156
Transfers out	(21,710)		(21,710)
Increase in net assets	40,240,230	156,156	40,396,386
Net assets—July 1, 2005	465,423,102	(156,156)	465,266,946
<b>Net assets—June 30, 2006</b>	<b>\$ 505,663,332</b>		<b>\$ 505,663,332</b>

Pima County  
 Department of Wastewater Management  
 Combining Statement of Cash Flows  
 Year Ended June 30, 2006

	<u>Liquid Waste</u>	<u>Solid Waste</u>	<u>Total</u>
<b>Cash flows from operating activities:</b>			
Receipts from customers	\$ 61,216,418	\$ 602,926	\$ 61,819,344
Miscellaneous receipts	451,046		451,046
Payments to suppliers for goods and services	(21,504,915)	(300,688)	(21,805,603)
Payments to other Pima County funds for goods and services	(7,477,555)		(7,477,555)
Payments to employees	(28,102,947)	(112,976)	(28,215,923)
Net cash provided by operating activities	<u>4,582,047</u>	<u>189,262</u>	<u>4,771,309</u>
<b>Cash flows from noncapital financing activities:</b>			
Intergovernmental receipts	528,751		528,751
Repayment of interfund borrowings	117,623	9,345	126,968
Cash transfers to other Pima County funds	(21,710)	(4,289,443)	(4,311,153)
Net cash provided by (used for) noncapital financing activities	<u>624,664</u>	<u>(4,280,098)</u>	<u>(3,655,434)</u>
<b>Cash flows from capital and related financing activities:</b>			
Sewer connection receipts from customers	42,141,638		42,141,638
Proceeds from the sale of capital assets	2,000		2,000
Intergovernmental contract receipts	191,418		191,418
Purchase and construction of capital assets	(14,339,450)		(14,339,450)
Proceeds from issuance of sewer loans	1,085,658		1,085,658
Principal payments on revenue bonds and loans	(9,500,734)		(9,500,734)
Interest payments on revenue bonds and loans	(4,224,328)		(4,224,328)
Net cash provided by capital and related financing activities	<u>15,356,202</u>		<u>15,356,202</u>
<b>Cash flows from investing activities:</b>			
Interest received on investments	1,861,957	8,957	1,870,914
Net cash provided by investing activities	<u>1,861,957</u>	<u>8,957</u>	<u>1,870,914</u>
Net increase (decrease) in cash and cash equivalents	22,424,870	(4,081,879)	18,342,991
Cash and cash equivalents, July 1, 2005	<u>35,000,334</u>	<u>4,081,879</u>	<u>39,082,213</u>
<b>Cash and cash equivalents, June 30, 2006</b>	<u>\$ 57,425,204</u>		<u>\$ 57,425,204</u>

(Continued)

Pima County  
Department of Wastewater Management  
Combining Statement of Cash Flows  
Year Ended June 30, 2006  
(Continued)

	Liquid Waste	Solid Waste	Total
<b>Reconciliation of operating loss to net cash provided by operating activities:</b>			
Operating loss	\$ (15,044,168)		\$ (15,044,168)
Adjustments to reconcile operating loss to net cash provided by operating activities:			
Depreciation	20,416,294		20,416,294
Changes in assets and liabilities:			
Decrease (increase) in assets:			
Accounts receivable	(570,637)	329,819	(240,818)
Due from other governments	(36,003)	273,107	237,104
Inventory of materials and supplies	(216,781)		(216,781)
Prepaid expenses	(68,405)	1,759	(66,646)
Increase (decrease) in liabilities:			
Accounts payable	556,293	(291,231)	265,062
Due to other governments	22,865	(11,216)	11,649
Accrued payroll and employee benefits	(477,411)	(112,976)	(590,387)
Net cash provided by operating activities	\$ 4,582,047	\$ 189,262	\$ 4,771,309

Noncash investing, capital, and noncapital financing activities:

During the year ended June 30, 2006, developers conveyed capital assets with an estimated fair value of \$14,407,846 and the County's Internal Service Fund conveyed capital assets with a net book value of \$26,050 to the Department. These transactions were recorded as capital contributions.

During the year ended June 30, 2006, the Pima County Board of Supervisors approved Connection Fee Flow-Through Sewer Credit Agreements totaling \$16,697. This transaction was recorded as an increase to deferred revenue and a decrease in capital contributions.

During the year ended June 30, 2006, the Department retired expired Sewer Credit Agreements totaling \$190,538. This transaction was recorded as a decrease to deferred revenue and an increase in capital contributions.

During the year ended June 30, 2006, the Department retired assets with a net book value of \$22,354.

During the year ended June 30, 2006, the Department transferred to the County's general government the assets of the Solid Waste Management division with a net book value of \$11,334,107.

During the year ended June 30, 2006, the Department conveyed the long-term liabilities of the Solid Waste Management division in the amount of \$15,779,706 to the County's general government.



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

The Board of Supervisors  
of Pima County, Arizona

Members of the Board:

We have audited the financial statements of Pima County Department of Wastewater Management as of and for the year ended June 30, 2006, and have issued our report thereon dated September 21, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Pima County Department of Wastewater Management's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

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

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

*Heinfeld, Meech & Co., P.C.*

HEINFELD, MEECH & CO., P.C.  
Certified Public Accountants

September 21, 2006