
CUPERTINO SANITARY DISTRICT

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

JUNE 30, 2016

 **Patel &
Associates, LLP**
Certified Public Accountants

**CUPERTINO SANITARY DISTRICT
JUNE 30, 2016**

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INDEPENDENT AUDITOR'S REPORT

The Board of Directors of
Cupertino Sanitary District
Cupertino, California

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of Cupertino Sanitary District, (the "District") as of and for the year ended June 30, 2016 and the related notes to the financial statements, which collectively comprise Cupertino Sanitary District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our 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 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 opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of Cupertino Sanitary District as of June 30, 2016, and the respective changes in financial position and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Prior Period Financial Statements

The financial statements as of June 30, 2016, were audited by Vargas and Company, who merged with Patel and Associates, LLP as of August 31, 2016, and whose report dated October 1, 2015, expressed an unmodified opinion on those statements.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Government Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 18, 2016 on our consideration of Cupertino Sanitary District'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 Cupertino Sanitary District's internal control over financial reporting and compliance.

Patel & Associates, LLP

Oakland, California
November 18, 2016

**CUPERTINO SANITARY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
YEAR ENDED JUNE 30, 2016**

The following discussion and analysis of the Cupertino Sanitary District's (the "District") financial performance provides an overview of the District's financial activities for the fiscal year ended June 30, 2016. Please read it in conjunction with the District's basic financial statements following this section.

FINANCIAL HIGHLIGHTS

- Change in Net Position at the end of FY2015-16 is \$2,831,131 which comprised of \$2,688,665 in net operating income (\$14,397,251 revenue less \$11,708,586 operating expenses) plus \$142,466 in interest income and unrealized gain/(loss) on investments fair value. This compares to last fiscal year's change amount of \$1,532,710 or increase of \$1,298,421 over last fiscal year. A major difference between 2015 and 2016 was that in 2016, District decided to receive cash payment for prior year unspent capital and O&M expenses for the San Jose-Santa Clara Wastewater Facility. This amount of revenue was \$2,235,489. If this revenue from City of San Jose was removed, the net increase in operating revenue is 25.63% as compared to previous year, which resulted from 8% rate increase and reduced by less revenue from development fees in 2016.
- Current Assets increased by \$44,993 (0.20%) to \$22,733,316 from \$22,688,323. This is due primarily to increase in cash of \$113,867. Moreover, the unrestricted investment is being tracked separately for the future needs to fund City of San Jose treatment plant improvement cost with an annual transfer of cash into the unrestricted capital investment fund of \$300,000, now totaling \$1,800,000.
- The actual cash balance is \$20,880,142 as compared to previous fiscal year of \$21,066,275 or decrease of \$(186,133) although the cash balance includes \$2,235,489 cash payment from City of San Jose which was offset by a larger payment made to City of San Jose for the wastewater facility capital projects.
- Net investment in capital assets are \$23,425,793 which reflects an increase of \$2,949,640 due to acquisitions of \$3,448,145 in sub-sewer infrastructures (Prospect Pump Stations, Manhole Rehabilitation, Apple Campus 2, Cherryland and Timequare developments) and \$90,419 in equipment and annual depreciation of \$(498,505).
- Total revenues (operating and non-operating) are \$14,539,717 as compared to last fiscal year of \$11,548,353 or an increase of 25.9% due to primarily due to cash receipt from City of San Jose for the unspent capital and O&M and an 8% rate increase in sewer service charges.
- Operating expenses are \$11,708,586 as compared to last fiscal year of \$9,994,108 or an increase of 17.2%. The main difference is due to treatment plant capital outlay expenditure of \$- and increased repair and maintenance expenses of District's infrastructure due to CCTV findings (\$2,328,803 as compared to \$1,371,244 for previous fiscal year).
- Current liabilities increased by \$163,502 or 41.8% due to advance deposits by developers for plan check and inspection services.

**CUPERTINO SANITARY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
YEAR ENDED JUNE 30, 2016**

USING THIS ANNUAL REPORT

This annual report consists of two parts: Management's Discussion and Analysis and Financial Statements. The Financial Statements also include notes that explain in more detail some of the information contained in those statements.

Required Financial Statements

District's financial statements report financial information about the District using accounting methods similar to those used by private sector companies. The Statement of Net Position includes all District's assets and liabilities, and provides information about the nature and amounts of investments in resources (assets) and obligations to creditors (liabilities). It also provides the basis for computing rate of return, evaluating the capital structure of the District, and assessing the liquidity and financial flexibility of the District.

All of the current year's revenues and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Position. This statement measures the success of the District's operations over the past year and can be used to determine whether the District has successfully recovered all its costs through its user fees and other charges.

The final required financial statement is the Statement of Cash Flows. The primary purpose of this statement is to provide information about the District's cash receipts, cash disbursements and net changes in cash resulting from operating, investing, and capital and noncapital financing activities. It provides answers to questions such as, "Where did the cash come from?" "Cash was used for what purpose?" and "What was the change in cash balance during the reporting period?"

FINANCIAL ANALYSIS OF THE DISTRICT

One of the most important questions asked about the District finances is whether or not the District's overall financial position has improved or deteriorated. The Statement of Net Position and the Statement of Revenues, Expenses, and Changes in Net Position report information about the District's activities in a way that will help answer this question. These two statements report the net position of the District and changes in them. You can think of District's net position - the difference between assets and liabilities - as one way to measure financial health or financial position. Over time, increases or decreases in District's net position are one indicator of whether its financial health is improving or deteriorating. Other factors to consider include changes in economic conditions, population growth, and new or changed legislation.

**CUPERTINO SANITARY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
YEAR ENDED JUNE 30, 2016**

Changes in Net Position

District's total net position increased from the previous year by \$2,831,131. The following condensed financial statements include summary figures from the statement of net position and the statement of revenue, expenses and changes in net position.

Condensed Statements of Net Position

	<u>2016</u>	<u>2015</u>	<u>Change</u>	<u>%</u>
Current assets	\$ 22,733,316	\$ 22,688,323	\$ 44,993	0.20 %
Capital assets, net	<u>23,425,793</u>	<u>20,476,153</u>	<u>2,949,640</u>	14.41 %
Total assets	<u>46,159,109</u>	<u>43,164,476</u>	<u>2,994,633</u>	6.94 %
Current liabilities	<u>554,294</u>	<u>390,792</u>	<u>163,502</u>	41.84 %
Total liabilities	<u>554,294</u>	<u>390,792</u>	<u>163,502</u>	41.84 %
Net investment in capital assets	23,425,793	20,476,153	2,949,640	14.41 %
Unrestricted net position	<u>22,179,022</u>	<u>22,297,531</u>	<u>(118,509)</u>	(0.53)%
Total net position	<u>\$ 45,604,815</u>	<u>\$ 42,773,684</u>	<u>\$ 2,831,131</u>	6.62 %

In part, changes in District's net position can be determined by reviewing the following condensed Statement of Revenue, Expenses, and Changes in Net Position.

Condensed Statements of Revenues, Expenses and Changes in Net Position

	<u>2016</u>	<u>2015</u>	<u>Change</u>	<u>%</u>
Operating revenue	\$ 14,397,251	\$ 11,459,833	\$ 2,937,418	25.63 %
Non-operating revenue	<u>142,466</u>	<u>88,520</u>	<u>53,946</u>	60.94 %
Total revenues	<u>14,539,717</u>	<u>11,548,353</u>	<u>2,991,364</u>	25.90 %
Operating expenses	11,708,586	9,994,108	1,714,478	17.15 %
Non-operating expenses	<u>11,708,586</u>	<u>21,535</u>	<u>(21,535)</u>	(100.00)%
Total expenses	<u>11,708,586</u>	<u>10,015,643</u>	<u>1,692,943</u>	16.90 %
Changes in net position	2,831,131	1,532,710	1,298,421	84.71 %
Net position, beginning	<u>42,773,684</u>	<u>41,240,974</u>	<u>1,532,710</u>	3.72 %
Net position, ending	<u>\$ 45,604,815</u>	<u>\$ 42,773,684</u>	<u>\$ 2,831,131</u>	6.62 %

**CUPERTINO SANITARY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
YEAR ENDED JUNE 30, 2016**

CAPITAL ASSETS

At the end of fiscal year 2016 the District had \$23,425,793 (net of accumulated depreciation) net investment in capital assets. The assets included: land, sewage treatment plant capacity right, collection system consisting of subsurface lines and pumps, and equipment. Acquisitions for the fiscal year totaled \$3,448,145, while annual depreciation expense is \$498,505 or a net increase of \$2,949,640. The following table summarizes District capital assets at historical costs for fiscal year ended June 30, 2016.

Land	\$ 16,897
Equipment	958,000
Sub Sewer System	28,829,752
Intangible Assets - Capacity Rights	<u>8,947,170</u>
Total Historical Cost of Capital Assets	38,751,819
Accumulated depreciation	(15,326,026)
Total capital assets	<u>\$ 23,425,793</u>

Additional information on capital assets can be found in the Note 3 to the financial statements.

RATES AND OTHER ECONOMIC FACTORS

The District's elected officials consider many factors when setting the fiscal budget including the economy, increased salary and benefit costs for both District operations and the City of San Jose Treatment Plant operations, as well as increased capital improvement programs. In addition, the District's operation is governed in part by the requirements and provisions of the State Water Resources Control Board (SWRCB) that require adequate funding to cover the costs of operation, maintenance, and recurring capital replacement (OM&R) to be in compliance with Sewer System Management Plant (SSMP).

The District is not subject to general economic conditions such as increase or decrease in property tax values or other types of revenues that vary with economic conditions such as sales taxes.

Accordingly, the District sets its rates to its users to cover the costs of OM&R plus any requirements in program costs. Increases in operating costs have been kept at or below inflationary levels in recent years for the District's portion of expenses. However, the San Jose-Santa Clara Treatment Plant expenses have increased at higher rates due to rehabilitation or replacement of the plant's older infrastructure.

REQUESTS FOR INFORMATION

This financial report is designed to provide our customers and creditors with a general overview of District's finances, and demonstrate accountability for the money it receives. If you have any questions about this report, or need additional financial information, contact the District at 20863 Stevens Creek Blvd., Suite #100, Cupertino, California, 95014 or by calling (408) 253-7071.

CUPERTINO SANITARY DISTRICT
STATEMENT OF NET POSITION - PROPRIETARY FUND
JUNE 30, 2016
(With comparative totals for June 30, 2015)

	<u>2016</u>	<u>2015</u>
ASSETS		
Current assets		
Cash	\$ 20,880,142	\$ 21,066,275
Capital unrestricted investment	1,800,000	1,500,000
Accounts receivable	1,035	42,433
Interest receivable		26,545
Prepaid expenses	<u>52,139</u>	<u>53,070</u>
Total Current Assets	22,733,316	22,688,323
Noncurrent assets		
Capital assets, net	<u>23,425,793</u>	<u>20,476,153</u>
Total Assets	<u>46,159,109</u>	<u>43,164,476</u>
LIABILITIES AND NET POSITION		
Current liabilities		
Accounts payable	360,427	303,620
Other liabilities	<u>193,867</u>	<u>87,172</u>
Total Liabilities	<u>554,294</u>	<u>390,792</u>
NET POSITION		
Net investment in capital assets	23,425,793	20,476,153
Unrestricted net position	<u>22,179,022</u>	<u>22,297,531</u>
Total Net Position	<u>45,604,815</u>	<u>42,773,684</u>
Total Liabilities and Net Position	<u>\$ 46,159,109</u>	<u>\$ 43,164,476</u>

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

CUPERTINO SANITARY DISTRICT
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
PROPRIETARY FUND
YEAR ENDED JUNE 30, 2016
(With comparative totals for year ended June 30, 2015)

	2016	2015
OPERATING REVENUES		
Sewer service charges	\$ 11,894,557	\$ 11,201,089
Permits, inspection, and other fees	<u>2,502,694</u>	<u>258,744</u>
Total Operating Revenues	<u>14,397,251</u>	<u>11,459,833</u>
OPERATING EXPENSES		
Sewage treatment	7,575,354	6,856,406
Management services	329,169	250,688
Engineering	548,812	511,971
Supplies	7,369	17,702
Repairs & maintenance	2,328,803	1,371,244
Outfall maintenance	64,351	123,787
Utilities	57,436	61,608
Membership fees	22,607	8,673
Insurance	121,316	120,104
Emergency funds	102,271	147,351
Depreciation	498,505	438,840
Miscellaneous	<u>52,593</u>	<u>85,734</u>
Total Operating Expenses	<u>11,708,586</u>	<u>9,994,108</u>
Net Operating Income	<u>2,688,665</u>	<u>1,465,725</u>
NON-OPERATING REVENUES (EXPENSES)		
Interest income	101,634	88,520
Unrealized gain/(loss) on investments fair value	40,832	
Loss on disposal of asset		<u>(21,535)</u>
Total Non-Operating Revenues (Expenses)	<u>142,466</u>	<u>66,985</u>
Change in Net Position	2,831,131	1,532,710
Net Position, Beginning	<u>42,773,684</u>	<u>41,240,974</u>
Net Position, Ending	<u>\$ 45,604,815</u>	<u>\$ 42,773,684</u>

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

CUPERTINO SANITARY DISTRICT
STATEMENT OF CASH FLOWS - PROPRIETARY FUND
YEAR ENDED JUNE 30, 2016
(With comparative totals for year ended June 30, 2015)

	2016	2015
CASH FLOWS PROVIDED BY OPERATING ACTIVITIES:		
Cash received from customers and other sources	\$ 14,397,251	\$ 11,459,833
Cash paid to suppliers and service providers	<u>(11,277,705)</u>	<u>9,852,421</u>
Net Cash Provided by Operating Activities	<u>3,119,546</u>	<u>1,607,412</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest received	101,634	88,520
Unrealized gain/(loss) on investments fair value	40,832	
Loss on disposal of asset		<u>(21,535)</u>
Net Cash Provided by Investing Activities	<u>142,466</u>	<u>66,985</u>
CASH FLOWS USED FROM FINANCING ACTIVITIES:		
Change in capital assets, net	<u>(3,448,145)</u>	<u>(1,310,637)</u>
Net Cash Used from Financing Activities	<u>(3,448,145)</u>	<u>(1,310,637)</u>
Net Change in Cash	(186,133)	363,760
Cash, Beginning	<u>21,066,275</u>	<u>20,702,515</u>
Cash, Ending	<u>\$ 20,880,142</u>	<u>\$ 21,066,275</u>
 Reconciliation of Operating Income to Net Cash Provided (Used)		
by Operating Activities:		
Operating Income	\$ 2,688,665	\$ 1,465,725
Adjustments to reconcile change in net position to cash flows from operating activities:		
Depreciation	498,505	438,840
(Increase) decrease in operating assets:		
Capital unrestricted investment	(300,000)	(300,000)
Interest receivable	26,545	(8,556)
Accounts receivable	41,398	(42,433)
Prepaid expenses	931	(3,907)
Increase (decrease) in operating liabilities:		
Accounts payable	56,807	34,307
Accrued liabilities	<u>106,695</u>	<u>23,436</u>
Net Cash Provided by Operating Activities	<u>\$ 3,119,546</u>	<u>\$ 1,607,412</u>

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

**CUPERTINO SANITARY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2016**

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

The Cupertino Sanitary District (the "District") is a separate governmental unit established as a special district of the State of California. The District was organized on December 28, 1953 as County Sanitation District No. 7; and reorganized April 30, 1956 as the Cupertino Sanitary District. Through an agreement with the City of San Jose for treatment and disposal services, the District provides sewage collection services to the area in and around the Cities of Cupertino and Saratoga in Santa Clara County. Revenues are derived principally from sewer service charges collected from commercial and residential users within the District.

Reporting Entity

Although the nucleus of financial reporting entity usually is a primary government, an organization other than a primary government, such as a stand-alone government, may serve as the nucleus for its financial reporting entity when the stand-alone government provides separately issued financial statements. A stand-alone government is a legally separate government organization that has a separately elected governing body and does not meet the definition of a component unit. Cupertino Sanitary District meets the criteria as a stand-alone government, and accordingly, is accounted for and reported on as though it were a primary government.

For financial reporting purposes and in conformity with the Governmental Accounting Standards Board ("GASB") Codification Section 2100 which defines the governmental reporting entity, the District includes all funds that are controlled by, or are dependent on the Board of Directors of the District. Since no other entities are controlled by, or rely upon the District, the reporting entity consists solely of the District.

Fund Accounting Classification

The financial statements of the District are presented as those of an enterprise fund under the broad category of funds called proprietary funds, which also include internal service funds.

Enterprise funds account for operations that are financed and operated in a manner similar to private business enterprise, where the intent is that the costs (expenses, including depreciation) of providing goods and services to the general public on a continuing basis be financed or recovered primarily through user charges. The acquisition and capital improvement of the physical plant facilities required to provide these goods and services can be financed from existing cash resources, cash flow from operations, the issuance of bonds, and contributed capital.

**CUPERTINO SANITARY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2016**

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

Basis of Accounting

Enterprise funds are accounted for using the accrual basis of accounting. Revenues are recognized when they are earned, and expenses are recognized when they are incurred. The District follows Alternative 1 of GASB 20 regarding the use of the pronouncements of the Governmental Accounting Standards Board ("GASB") and Financial Accounting Standards Board ("FASB") in its accounting. That is, the District follows: (1) all GASB pronouncements and (2) FASB pronouncements, Accounting Principles Board ("APB") Opinions, and Accounting Research Bulletins ("ARB"), that do not conflict with GASB pronouncements.

The District distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the District's principal ongoing operations. The principal operating revenues of the District are charges to customers for sales and services. Operating expenses for the District include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Net position are reported as restricted when there are limitations imposed on their use either through the enabling legislation adopted by the District or through external restrictions imposed by creditors, grantors, or laws and regulations of other governments. The District first applies restricted revenues when an expense is incurred for purposes for which both restricted and unrestricted net position are available.

Capital Assets and Depreciation

Property, plant, and equipment purchased are stated at cost. Subsurface sewer lines, equipment, and land and improvements contributed to the District are stated at estimated value at time of contribution.

Depreciation is provided using the straight-line method over estimated useful lives, which are 7 years for equipment; 15 years for pump stations; and 50 years for sewer collection facilities. The District's threshold for capitalization is \$5,000. Intangible assets with indefinite useful lives (capacity rights) are not depreciated.

Statements of Cash Flows

For purposes of the statement of cash flows, all highly liquid investments with maturities of three months or less, when purchased, are considered cash equivalents.

**CUPERTINO SANITARY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2016**

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 2. CASH AND INVESTMENTS

The cash balance of the District is pooled and invested by the County's Treasurer in the pooled cash investment program ("Pool") for the purpose of increasing earnings through investment activities. The County's pooled deposits and investments are regulated by California Government Code and by a County investment policy approved annually by the County Treasury Oversight Committee and the Board. At fiscal year end, the County provides the participants' the pooled investments' fair value, based on quoted market prices. The County allocates interest to the District based on the District's average daily cash balance relative to the entire Pool. The value of the participants' pool shares that may be withdrawn is determined on an amortized basis, which is different than the fair value of the participants' positions in the pool. In addition, the County's investment pool is not rated by any of the credit rating agencies. The County's comingled pool consists of cash in bank, U.S. government and agency securities, corporate bonds, negotiable certificates of deposit, commercial paper, securities lending collateral, and deposits in the State's Local Agency Investment Fund. Additional information regarding the County's investment policy and cash and investments, including interest rate risk, credit risk, custodial credit risk categories, securities lending transactions, and maturities of the different categories of investments, can be found in the County's notes to the basic financial statements.

The cash in bank is insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000.

Cash and investments at June 30, 2016 consists of the following:

	<u>Amount</u>
Cash and investments:	
Cash with County Treasury common pool	\$ 22,420,032
Cash in bank	<u>260,110</u>
Total cash and investments	<u>\$ 22,680,142</u>

**CUPERTINO SANITARY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2016**

NOTE 2. CASH AND INVESTMENTS (CONT'D)

Governmental Accounting Standards Board, Statement No. 31, "Accounting and Financial Reporting for Certain Investment and for External Investment Pools" establishes accounting and financial reporting standards for all investments held by governmental external investment pools. The statement requires governmental entities to report investments at fair value.

The original cost of cash with County Treasury common pool as of June 30, 2016 is \$22,379,200.

NOTE 3. CAPITAL ASSETS

The capital asset activity for the year ended June 30, 2016 is as follows:

	<u>Balance 6/30/15</u>	<u>Additions/ Adjustment</u>	<u>Disposals/ Adjustment</u>	<u>Balance 6/30/16</u>
Capital assets, not being depreciated:				
Intangible assets - capacity rights	\$ 8,947,170	\$	\$	\$ 8,947,170
Land	<u>16,897</u>	<u> </u>	<u> </u>	<u>16,897</u>
Total capital assets, not being depreciated	<u>8,964,067</u>	<u> </u>	<u> </u>	<u>8,964,067</u>
Capital assets, being depreciated:				
Equipment	867,580	90,419		957,999
Sub Sewer System	<u>25,472,027</u>	<u>3,357,726</u>	<u> </u>	<u>28,829,753</u>
Total capital assets, being depreciated	26,339,607	3,448,145		29,787,752
Less accumulated Depreciation	<u>(14,827,521)</u>	<u>(498,505)</u>	<u> </u>	<u>(15,326,026)</u>
Total capital assets, being depreciated, net	<u>11,512,086</u>	<u>2,949,640</u>	<u> </u>	<u>14,461,726</u>
Capital assets, net	<u>\$ 20,476,153</u>	<u>\$ 2,949,640</u>	<u>\$</u>	<u>\$ 23,425,793</u>

Depreciation expense for the year ended June 30, 2016 is \$498,505.

**CUPERTINO SANITARY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2016**

NOTE 4. COMMITMENTS AND CONTINGENT LIABILITIES

The District has various agreements with the cities of San Jose and Santa Clara relating to the discharge of sewage into the San Jose-Santa Clara Water Pollution Control Plant (Plant). Total charges under these agreements for the year ended June 30, 2016 were \$10,509,931. These charges are calculated based on the District's share of budgeted Plant operating expenditures, estimated capital improvements to the Plant, and related debt financing charges incurred by the Plant. The City of San Jose invoices the District for these charges throughout the year and then reconciles the payments made by the District to the actual expenses incurred by the wastewater plant subsequent to each fiscal year end. Prior year under or over payment made by the District versus actual expenses incurred by the treatment plant are credited to the District in the third quarter of the subsequent year. Therefore, due to the fact that the actual over/under payment is not known at year end, there are no residual amounts reflected in these financial statements at year end. Historically, any over or under payment has been immaterial for financial reporting purposes. However, the City of San Jose is currently updating the Treatment Plant and developing a capital improvement program over the next five years with estimated costs in the range of \$1,200,000,000, of which the District will be responsible for 5% of the total costs. In anticipation of this the District will set aside funds to meet these obligations under a cash investment fund that currently has \$1,800,000.

The District does not hold title to any plant assets, nor is it directly or legally responsible for any related outstanding long term debt. However, as long as the District continues these agreements, it will be responsible for a predetermined share of the plants annual debt service payments.

Following is a summary of the District's share of scheduled payments related to outstanding Plant Debt issues:

<u>Year ended June 30,</u>	<u>Related to the Plants 1995 Sewer Revenue Bonds</u>	<u>Related to the Plants State Revolving Fund Loans</u>	<u>Total</u>
2017	\$ 634,967	\$ 248,504	\$ 883,471
2018	635,083	241,788	876,871
2019	635,148	21,523	656,671
2020	635,082		635,082
2021	<u>634,806</u>		<u>634,806</u>
Total	<u>\$ 3,175,086</u>	<u>\$ 511,815</u>	<u>\$ 3,686,901</u>

The District is a party to various legal proceedings which normally occur in governmental operations. Management has determined that these legal proceedings are not likely to have a material adverse impact on the affected funds of the District.

**CUPERTINO SANITARY DISTRICT
 NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2016**

NOTE 5. RISK MANAGEMENT

The District is exposed to various risk of loss related to torts; theft of, damage to, and destructions of assets; errors and omissions; injuries to third parties and natural disasters. The District pays annual premiums to purchase commercial insurance through the California Sanitation Risk Management Authority (CSRMA) Primary Insurance Program to protect against these risks.

<u>Insurer</u>	<u>Type of Coverage</u>	<u>Limits</u>
CSRMA with American Alternative Insurance Corporation (AAIC)	General and Auto Liability	\$ 1,000,000
	Public Entity Errors & Omissions Liability	\$ 1,000,000

NOTE 6. SUBSEQUENT EVENTS

The District has evaluated operations for the period of time from its year end June 30, 2016 through November 18, 2016, the date the financial statements were available to be issued and have determined that no adjustments are necessary to the amounts reported in the accompanying financial statements nor have any subsequent events occurred, the nature of which would require disclosure.

**INDEPENDENT AUDITOR'S 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 Directors of
Cupertino Sanitary District
Cupertino, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities of Cupertino Sanitary District (the "District") as of and for the year ended June 30, 2016, and related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated November 18, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the District'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 District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District'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 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 District'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 the testing, and not to provide an opinion on the effectiveness of the entity'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 entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Patel & Associates, LLP

Oakland, California
November 18, 2016

**CUPERTINO SANITARY DISTRICT
SCHEDULE OF FINDINGS AND RESPONSES
YEAR ENDED JUNE 30, 2016**

SECTION I - SUMMARY OF AUDITOR'S RESULTS

Basic Financial Statements

Type of auditor's report issued:	Unmodified
Internal control over financial reporting:	
• Material weaknesses identified?	No
• Significant deficiencies identified?	None reported
Noncompliance material to financial statements noted?	No
<u>Federal Awards</u>	Not applicable

SECTION II - FINANCIAL STATEMENT FINDINGS

Our audit of the accompanying basic financial statements of the Cupertino Sanitary District (the "District") as of and for the year ended June 30, 2016 disclosed no findings nor questioned costs.

Our report on the District's 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* as of and for the year ended June 30, 2016 disclosed no findings nor questioned costs.

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Not applicable.

**CUPERTINO SANITARY DISTRICT
STATUS OF PRIOR AUDIT FINDINGS AND RECOMMENDATIONS
YEAR ENDED JUNE 30, 2016**

SECTION I - FINANCIAL SCHEDULE FINDINGS

The audit of the basic financial statements of the Cupertino Sanitary District (the "District") as of and for the year ended June 30, 2015 disclosed no findings nor questioned costs.

The report on the District's 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* as of and for the year ended June 30, 2015, disclosed no findings nor questioned costs.

SECTION II - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Not applicable.