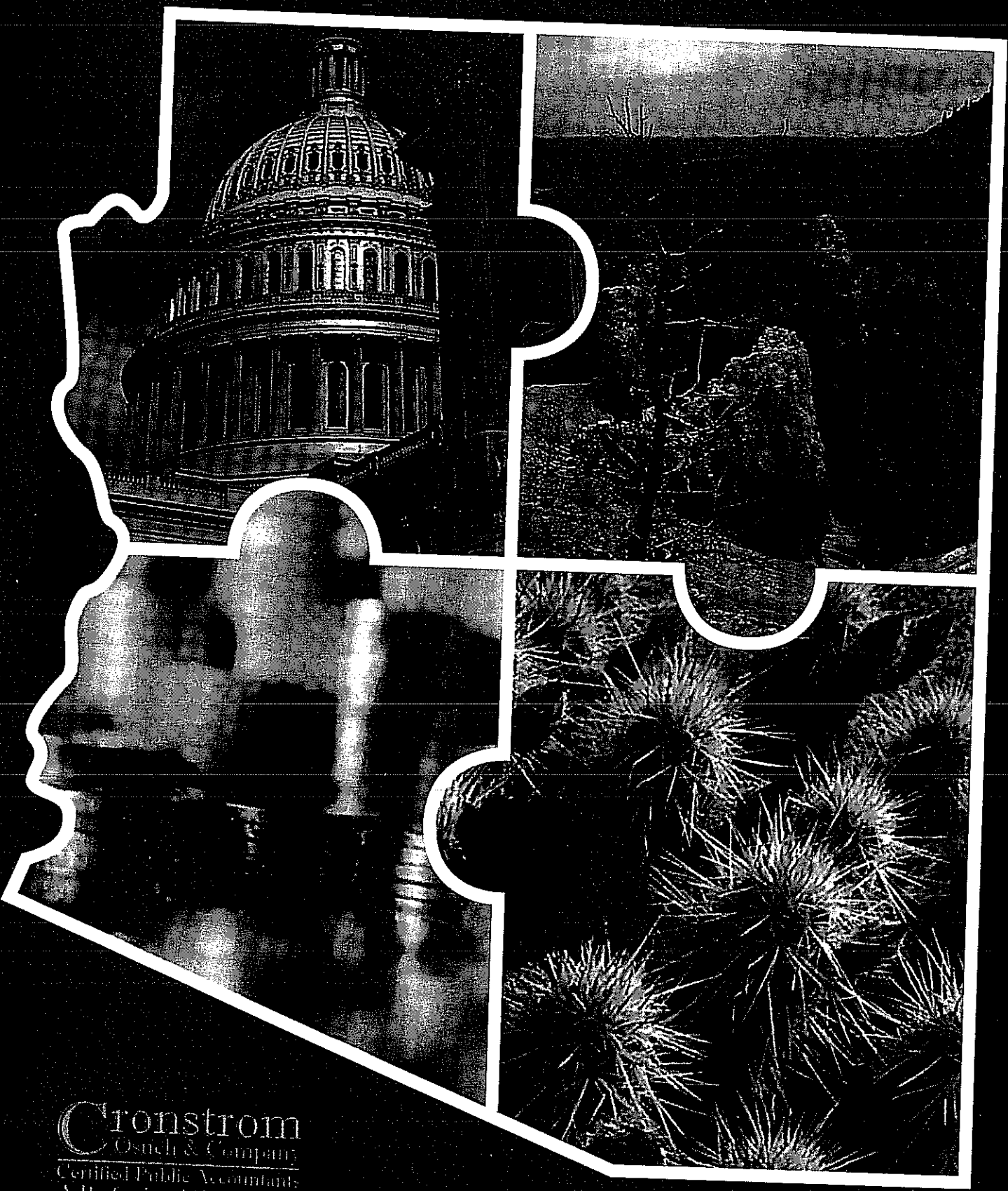
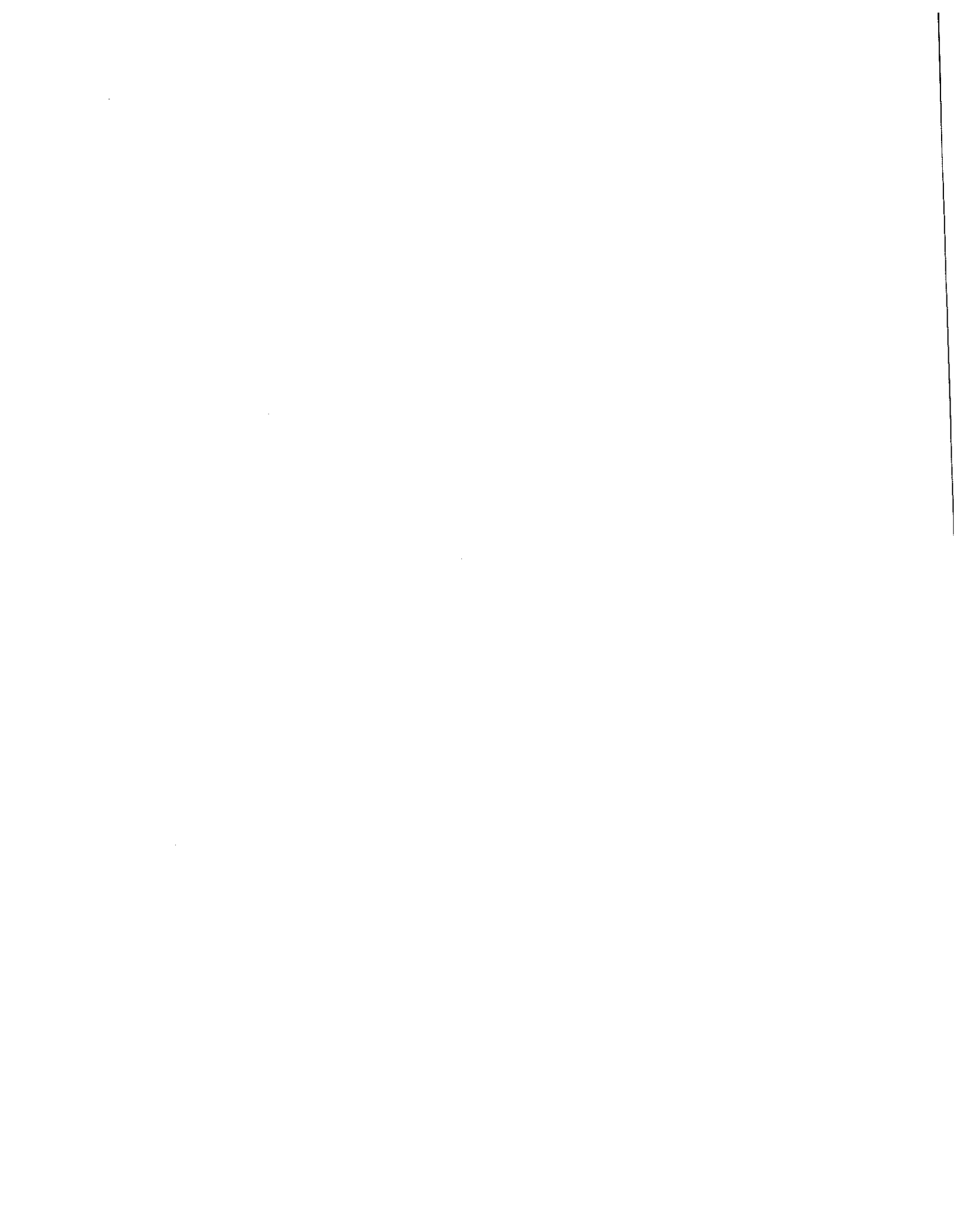


CITY OF SOUTH TUCSON, ARIZONA

Annual Financial Report • Fiscal Year Ended June 30, 2007



Cronstrom
Osuch & Company
Certified Public Accountants
A Professional Corporation



CITY OF SOUTH TUCSON, ARIZONA

ANNUAL FINANCIAL REPORT

FISCAL YEAR ENDED JUNE 30, 2007

CITY OF SOUTH TUCSON, ARIZONA
ANNUAL FINANCIAL REPORT
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

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FINANCIAL SECTION

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INDEPENDENT AUDITOR'S REPORT

The Honorable Mayor and the City Council of the
City of South Tucson, Arizona

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the City of South Tucson, Arizona (City), as of and for the year ended June 30, 2007, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. 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 reports 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 the 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the City of South Tucson, Arizona, as of June 30, 2007, and the respective budgetary comparison for the General and Housing Funds for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 3 - 10 and the Public Safety Personnel Retirement System Schedule of Funding Progress on page 44 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated January 25, 2008 on our consideration of the City's internal control over financial reporting and 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.

Cronstrom, Osuch + Company, P.C.

Cronstrom, Osuch & Company, P.C.

January 25, 2008

Management's Discussion and Analysis

We (the City of South Tucson, Arizona (City)) are pleased to provide an overview of our financial activities for the fiscal year ended June 30, 2007. The intended purpose of Management's Discussion and Analysis (MD&A) is to provide an introduction to the basic financial statements, that provides an objective and easy to read analysis of our financial activities based on currently known facts, decisions, and conditions, by providing an easily readable summary of operating results and reasons for changes, which will help to determine if the City's financial position improved or deteriorated over the past year. This report addresses current operational activities, the sources, uses, and changes in resources, adherence to budget, service levels, limitations, significant economic factors, and the status of infrastructure and its impacts on the City's debt and operation. When referring to prior year data in this analysis we will be drawing upon information from last year's audited financial reports.

Financial Highlights

- ◆ The assets of the City of South Tucson, Arizona exceeded its liabilities at the close of the most recent fiscal year by \$22,338,437 (net assets). Of this amount a deficit of \$698,543 was recorded as unrestricted net assets.
- ◆ As of the close of the current fiscal year, the City of South Tucson, Arizona's governmental funds reported combined ending fund balances of \$2,035,170, an increase of \$157,098 in comparison with the prior year.
- ◆ At the end of the current fiscal year, unreserved fund balance for the General Fund was a deficit of \$209,905.
- ◆ General Fund revenues (on a budgetary basis) exceeded budgeted revenues by \$572,409 for fiscal year 2007. Additionally, budgetary basis expenditures exceeded the final budget in the General Fund.
- ◆ General Fund revenues exceeded expenditures by \$636,552; a positive variance of \$464,939 from the original budget.

Overview of the Financial Statements

The financial section of the Annual Financial Report (AFR) for the City of South Tucson, Arizona consists of this discussion and analysis, the basic financial statements and the required supplementary schedule presented after the basic financial statements. The basic financial statements include the government-wide financial statements, fund financial statements, including the budgetary statements for the General Fund and major special revenue funds, and notes to the basic financial statements.

Government-wide financial statements. The government-wide financial statements are designed to provide readers with a broad overview of the City of South Tucson, Arizona's finances, in a manner similar to private-sector business.

The statement of net assets presents information on all of the City of South Tucson, Arizona's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as useful indicators of whether the financial position of the City of South Tucson, Arizona is improving or deteriorating.

The statement of activities presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

The government-wide financial statements distinguish functions of the City of South Tucson, Arizona that are principally supported by taxes and intergovernmental revenues from other functions that are intended to recover all or a significant portion of their costs through user fees and charges. The governmental activities of the City of South Tucson, Arizona include general government, public safety, highways and streets, culture and recreation, redevelopment and housing, economic development, and health and welfare.

The government-wide financial statements can be found immediately following the MD&A.

Fund financial statements. Also presented are the traditional fund financial statements for governmental funds. The fund financial statements focus on major funds of the City. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City of South Tucson, Arizona, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City of South Tucson, Arizona can be divided into two categories: governmental funds and fiduciary funds.

Governmental funds. Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements. Since the governmental fund financial statements focus on near-term spendable resources, while the governmental activities on the government-wide financial statements have a longer term focus, a reconciliation of the differences between the two is provided with the fund financial statements.

The basic governmental fund financial statements can be found on pages 14 - 20 of this report.

Fiduciary funds. Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statement because the resources of those funds are not available to support the City of South Tucson, Arizona's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds.

The basic fiduciary fund financial statements can be found on pages 21 - 22 of this report.

Notes to the basic financial statements. The notes to the basic financial statements (pages 23 - 42) provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements and should be read with the basic financial statements.

Required supplementary information other than MD&A. Governments have an option of including the budgetary comparison statements for the General Fund and major special revenue funds as either part of the fund financial statements within the basic financial statements, or as required supplementary information after the footnotes. The City has chosen to present these budgetary statements as part of the basic financial statements. Additionally, governments are required to disclose certain information about employee pension funds. The City has disclosed this information in Note 4 to the basic financial statements.

Government-Wide Financial Analysis

Net assets may serve over time as useful indicators of a government's financial position. The following table reflects the condensed Statement of Net Assets of the City for June 30, 2007 showing that assets exceeded liabilities by \$22,338,437.

**City of South Tucson, Arizona
Condensed Statement of Net Assets
June 30, 2007 and 2006**

	Governmental Activities		
	2007	2006	% Change
ASSETS			
Current and other assets	\$ 3,913,825	\$ 3,991,293	(1.9)%
Capital assets			
Non-depreciable	4,508,966	3,421,681	31.8
Depreciable (net)	<u>24,050,489</u>	<u>24,838,515</u>	(3.2)
Total assets	<u>32,473,280</u>	<u>32,251,489</u>	0.7
LIABILITIES			
Other liabilities	969,252	1,255,480	(22.8)
Non-current liabilities			
Due within one year	490,806	205,099	139.3
Due in more than one year	<u>8,674,785</u>	<u>8,600,917</u>	0.9
Total liabilities	<u>10,134,843</u>	<u>10,061,496</u>	0.7
NET ASSETS			
Invested in capital assets, net of related debt	21,482,299	21,144,661	1.6
Restricted	1,554,681	1,392,443	11.7
Unrestricted	<u>(698,543)</u>	<u>(347,111)</u>	101.2
Total net assets	<u>\$ 22,338,437</u>	<u>\$ 22,189,993</u>	0.7

The City does not currently have any proprietary or enterprise funds that would otherwise be classified as business-type activities. All City funds are considered governmental activities.

Net assets consist of three components. The largest portion of the City of South Tucson, Arizona's net assets (96%) reflects its investment in capital assets (e.g., land, buildings, machinery and equipment), less any related debt used to acquire those assets that is still outstanding. The City of South Tucson, Arizona uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City of South Tucson, Arizona's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the City of South Tucson, Arizona's net assets (7%) represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets is a deficit \$698,543. The City's unrestricted net assets are currently in a deficit position largely due to the utilization of resources for interest payments on long-term debt and various City revitalization projects.

City of South Tucson, Arizona
Changes in Net Assets
Fiscal Years Ended June 30, 2007 and 2006

	<u>Governmental Activities</u>		
	<u>2007</u>	<u>2006</u>	<u>% Change</u>
Revenues			
Program revenues			
Fees, fines and charges for services	\$ 1,702,391	\$ 1,160,045	46.8 %
Operating grants and contributions	2,610,725	2,425,269	7.6
Capital grants and contributions	2,018,778	2,487,577	(18.8)
General revenues			
Property taxes	2,542,399	2,307,367	10.2
State shared revenues	1,421,070	1,416,957	0.3
Investment earnings	56,981	33,571	69.7
Total revenues	<u>10,352,344</u>	<u>9,830,786</u>	5.3
Expenses			
Current			
General government	2,630,909	2,445,683	7.6
Public safety	3,287,644	3,249,609	1.2
Highways and streets	1,571,257	1,638,333	(4.1)
Culture and recreation	130,298	118,894	9.6
Redevelopment and housing	2,147,149	2,122,183	1.2
Economic development	47,812	45,340	5.5
Health and welfare	14,796	129,571	(88.6)
Interest on long-term debt	374,035	364,984	2.5
Total expenses	<u>10,203,900</u>	<u>10,114,597</u>	0.9
Change in net assets	148,444	(283,811)	(152.3)
Net assets, beginning of year	<u>22,189,993</u>	<u>22,473,804</u>	(1.3)
Net assets, end of year	<u>\$ 22,338,437</u>	<u>\$ 22,189,993</u>	0.7

Governmental activities. Governmental activities increased the City's net assets by \$148,444. Key factors of this decrease were due to the following:

- ◆ A slight increase in most functional expenses due to increased costs of current programs and salary increases. Highways and streets decreased due to fewer street maintenance projects and health and welfare expenses decreased due to the completion of two grant projects in the prior year.
- ◆ General revenues did not significantly change over the prior year. Property taxes slightly increased as a result of increased assessed valuation; however, the increase did not affect the overall financial activity.
- ◆ Capital grants and contributions decreased due to a reduction in current year funding from Pima County for various revitalization projects. The reduction was due to nearing completion on several projects.
- ◆ Fees, fines and charges for services increased due to revenue received as part of an agreement on the Rio Nuevo project.

Financial Analysis of the City's Funds

The focus of the City's governmental funds is to provide information on near-term inflows, outflows, and balances of resources that are available for spending. Such information is useful in assessing the City's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. Types of Governmental funds reported by the City include the General Fund, Special Revenue Funds, Debt Service Fund and Capital Project Funds.

As of the end of the current fiscal year the City's governmental funds reported combined ending fund balances of \$2,035,170, an increase of \$157,098 in comparison with the prior year. The General Fund reported a negative fund balance of \$209,905. The deficit is due to the prior year's use of resources to pay off a capital lease. At fiscal year-end 2006-07 fund balances were as follows:

Fund	Balance	Increase (Decrease) From 2005-06
General Fund	\$ (209,905)	\$ 418,848
Housing Fund	123,477	(122,579)
Debt Service Fund	695,458	29,611
Nonmajor Governmental Funds	1,426,140	(168,782)

The fund balance of the City of South Tucson, Arizona's General Fund increased by \$418,848. The increase was due to \$200,000 in contributions received from the Tohono O'dam Indian Tribe. The contribution was used to offset the acquisition of a sanitation vehicle through a lease-purchase in the prior year. Additionally, the City has a contract with Rio Nuevo, in which the City received \$500,000 in the current fiscal year.

The Housing Fund decreased due to the use of prior year carryovers for housing operations.

The Debt Service and Revitalization Projects Funds did not significantly change from the prior year.

Nonmajor Governmental Funds of the City are combined into one column on the governmental fund statements and the net decrease was mainly due to projects related to flood control. The City receives funding from Pima County to subsidize the costs of these projects. The City had carried over funds from the prior year that were used in 2006-07 for flood control. The City also had a significant increase in funding for various housing revitalization projects and youth operations through a community development block grant (CDBG). However, the increase in these projects did not have an effect on fund balance as the projects are reimbursable through CDBG.

Budgetary Highlights

The City's annual budget is the legally adopted expenditure control document of the City. Budgetary comparison statements are required for the General Fund and all major special revenue funds and may be found on pages 18 - 20. These statements compare the original adopted budget, the budget if amended throughout the fiscal year, and the actual expenditures prepared on a budgetary basis.

The City did not amend its original budget during the year.

General Fund revenues of \$5,606,773, on a budgetary basis, were less than budgeted revenues of \$5,034,364 by \$572,409 while budgetary basis expenditures of \$4,970,221 were in excess of budgeted expenditures. The excess of budgeted revenues over actual revenues received is primarily due to the City receiving an unbudgeted contribution from the Tohono O'dam Indian Tribe and \$500,000 received from the Rio Nuevo agreement, which was not budgeted.

Capital Asset and Debt Administration

The City's capital assets for its governmental activities as of June 30, 2007 amounted to \$28,559,455 (net of accumulated depreciation), a net increase of 1.1%. For government-wide financial statement presentation, all depreciable capital assets were depreciated from acquisition date to the end of the current fiscal year. Fund financial statements record capital asset purchases as expenditures.

Capital assets include land, land and improvements, buildings and improvements, furniture, equipment, and vehicles, construction in progress and infrastructure. During fiscal year 2006-2007 the annual depreciation expense was \$1,137,152. Additions to capital assets during the fiscal year for totaled \$1,436,411.

Major capital asset events during the current fiscal year included the following:

- ◆ \$622,811 of construction on the 2nd avenue and 5th avenue parks currently in progress.
- ◆ Various street improvements currently in progress. During the current fiscal year, the City spent \$292,153 on these projects.
- ◆ \$349,126 in vehicles and equipment.

The following table provides a breakdown of the capital assets of the City at June 30, 2007 and 2006.

**City of South Tucson, Arizona
Capital Assets (net)
June 30, 2007 and 2006**

	Governmental Activities	
	2007	2006
Land	\$ 479,136	\$ 479,136
Land improvements	566,961	627,535
Buildings and improvements	7,358,843	7,584,897
Infrastructure	14,664,740	15,192,364
Furniture, equipment and vehicles	1,459,945	1,433,719
Construction in progress	4,029,830	2,942,545
	<u>\$ 28,559,455</u>	<u>\$ 28,260,196</u>

Long-term Debt

At the end of the current fiscal year, the City of South Tucson, Arizona had total long-term debt outstanding of \$6,860,000. The City issued no new bonds during the fiscal year.

The following schedule shows the outstanding bonds of the City as of June 30, 2007 and 2006. Further detail on the City's outstanding debt may be found in Note 3.D. beginning on page 37.

**City of South Tucson, Arizona
Outstanding Debt
June 30, 2007 and 2006**

	Governmental Activities	
	2007	2006
MPC Excise Tax Revenue Bonds	<u>\$ 6,860,000</u>	<u>\$ 6,860,000</u>

Economic Factors and Next Year's Budgets and Rates

The City occupies one square mile and is composed largely of small business and low income housing. The City continues to seek sources of revenues through grants and taxes to support many of its operations.

Financial Contact

This financial report is designed to provide a general overview of the City's finances for all of those with an interest in the government's finances and to demonstrate accountability for the use of public funds. Questions about any of the information provided in this report, or requests for additional financial information should be addressed to:

City of South Tucson, Arizona
Accounting Department
P.O. Box 7307
South Tucson, AZ 85725
(520) 792-2424

Basic Financial Statements

CITY OF SOUTH TUCSON, ARIZONA
STATEMENT OF NET ASSETS
JUNE 30, 2007

	<u>Governmental Activities</u>
Assets	
Cash and cash equivalents	\$ 819,198
Receivables, net	
Accounts receivable	1,524,973
Taxes receivable	350,107
Intergovernmental receivable	333,310
Interest receivable	15,371
Prepaid items	51,847
Restricted assets	819,019
Capital assets	
Non-depreciable	4,508,966
Depreciable (net)	<u>24,050,489</u>
Total assets	<u><u>32,473,280</u></u>
Liabilities	
Accounts payable	825,692
Accrued wages and benefits	60,521
Customer deposits payable	48,161
Unearned revenue	34,878
Noncurrent liabilities	
Due within one year	490,806
Due in more than one year	<u>8,674,785</u>
Total liabilities	<u><u>10,134,843</u></u>
Net assets	
Invested in capital assets, net of related debt	21,482,299
Restricted for	
Highways and streets	533,823
Capital outlay	695,458
Other	325,400
Unrestricted	<u>(698,543)</u>
Total net assets	<u><u>\$ 22,338,437</u></u>

The notes to the basic financial statements are an integral part of this statement.

CITY OF SOUTH TUCSON, ARIZONA
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	Program Revenues			Net (Expenses) Revenue and Changes in Net Assets
	Expenses	Fees, Fines and Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
	Governmental Activities	Governmental Activities	Governmental Activities	Governmental Activities
Functions/Programs				
Governmental activities				
Current				
General government	\$ 2,630,909	\$ 1,419,648	\$ 533,678	\$ 517,240
Public safety	3,287,644	-	264,855	181,612
Highways and streets	1,571,257	1,384	461,841	927,182
Culture and recreation	130,298	-	113,000	83,708
Redevelopment and housing	2,147,149	275,959	1,190,055	309,036
Economic development	47,812	5,400	32,500	-
Health and welfare	14,796	-	14,796	-
Interest on long-term debt	374,035	-	-	-
	\$ 10,203,900	\$ 1,702,391	\$ 2,610,725	\$ 2,018,778
Totals				(3,872,006)
General revenues				
Taxes				
Property taxes				2,542,399
State revenue sharing				639,206
State sales tax revenue sharing				535,117
Auto licu tax revenue sharing				246,747
Investment earnings				56,981
Total general revenues				4,020,450
Change in net assets				148,444
Net assets, beginning of year				22,189,993
Net assets, end of year				\$ 22,338,437

The notes to the basic financial statements are an integral part of this statement.

CITY OF SOUTH TUCSON, ARIZONA
BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2007

	General	Housing	Debt Service	Nonmajor Governmental Funds	Totals
Assets					
Cash and cash equivalents	\$ -	\$ 202,300	\$ -	\$ 616,898	\$ 819,198
Restricted assets	123,561	-	695,458	-	819,019
Receivables, net					
Accounts receivable	1,235,175	13,382	-	276,416	1,524,973
Taxes receivable	350,107	-	-	-	350,107
Intergovernmental receivable	28,612	48,129	-	256,569	333,310
Interest receivable	15,371	-	-	-	15,371
Due from other funds	182,600	-	-	912,470	1,095,070
Prepaid items	31,437	20,410	-	-	51,847
Total assets	<u>\$ 1,966,863</u>	<u>\$ 284,221</u>	<u>\$ 695,458</u>	<u>\$ 2,062,353</u>	<u>\$ 5,008,895</u>
Liabilities and Fund Balances					
Liabilities					
Accounts payable	\$ 569,575	\$ 112,583	\$ -	\$ 143,534	\$ 825,692
Accrued wages and benefits	60,521	-	-	-	60,521
Due to other funds	756,917	-	-	338,153	1,095,070
Deferred revenue	789,755	-	-	154,526	944,281
Customer deposits payable	-	48,161	-	-	48,161
Total liabilities	<u>2,176,768</u>	<u>160,744</u>	<u>-</u>	<u>636,213</u>	<u>2,973,725</u>
Fund balances					
Unreserved	(209,905)	123,477	695,458	-	609,030
Unreserved, reported in nonmajor					
Special revenue funds	-	-	-	1,011,620	1,011,620
Capital projects funds	-	-	-	414,520	414,520
Total fund balances	<u>(209,905)</u>	<u>123,477</u>	<u>695,458</u>	<u>1,426,140</u>	<u>2,035,170</u>
Total liabilities and fund balances	<u>\$ 1,966,863</u>	<u>\$ 284,221</u>	<u>\$ 695,458</u>	<u>\$ 2,062,353</u>	<u>\$ 5,008,895</u>

The notes to the basic financial statements are an integral part of this statement.

CITY OF SOUTH TUCSON, ARIZONA
 RECONCILIATION OF THE BALANCE SHEET TO THE STATEMENT OF NET ASSETS
 GOVERNMENTAL FUNDS
 JUNE 30, 2007

Fund balances - total governmental funds	\$	2,035,170
Amounts reported for governmental activities in the statement of net assets are different because:		
Court fines not collected within 60 days subsequent to fiscal year-end are deferred in the governmental funds.		789,755
CDBG loans recognized as revenues in previous years, but deferred in the governmental funds.		119,648
Capital assets used in governmental activities are not financial resources and therefore are not reported in the governmental funds.		
Governmental capital assets		40,755,671
Less accumulated depreciation		<u>(12,196,216)</u>
Capital assets used in governmental activities		<u>28,559,455</u>
Long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the governmental funds.		
Revenue bonds		(6,860,000)
Capital leases		(217,156)
Compensated absences		(249,923)
Long-term liabilities not due and payable in the current period		<u>(1,838,512)</u>
Net assets of governmental activities	\$	<u>22,338,437</u>

The notes to the basic financial statements are an integral part of this statement.

CITY OF SOUTH TUCSON, ARIZONA
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	General	Housing	Debt Service	Nonmajor Governmental Funds	Totals
Revenues					
Taxes					
Property taxes	\$ 2,542,399	\$ -	\$ -	\$ -	\$ 2,542,399
Intergovernmental	1,455,828	1,439,069	-	2,876,957	5,771,854
Fines and forfeitures	113,195	-	-	-	113,195
Licenses and permits	295,187	-	-	-	295,187
Charges for services	205,133	-	-	1,534	206,667
Rents and royalties	98,848	255,709	-	-	354,557
Contributions and donations	200,000	-	-	411	200,411
Investment earnings	40,485	5,555	3,070	7,871	56,981
Other	<u>655,698</u>	<u>14,625</u>	<u>-</u>	<u>5,400</u>	<u>675,723</u>
Total Revenues	<u>5,606,773</u>	<u>1,714,958</u>	<u>3,070</u>	<u>2,892,173</u>	<u>10,216,974</u>
Expenditures					
Current					
General government	1,450,467	-	-	556,187	2,006,654
Public safety	2,961,263	-	-	284,877	3,246,140
Highways and streets	504,346	-	-	926,919	1,431,265
Culture and recreation	-	-	-	669,401	669,401
Redevelopment and housing	-	1,837,537	-	102,067	1,939,604
Economic development	-	-	-	47,812	47,812
Health and welfare	-	-	-	14,796	14,796
Debt Service					
Principal retirement	38,379	-	-	-	38,379
Interest on long-term debt	15,766	-	358,269	-	374,035
Capital outlay	-	-	-	291,790	291,790
Total Expenditures	<u>4,970,221</u>	<u>1,837,537</u>	<u>358,269</u>	<u>2,893,849</u>	<u>10,059,876</u>
Excess (deficiency) of revenues over expenditures	<u>636,552</u>	<u>(122,579)</u>	<u>(355,199)</u>	<u>(1,676)</u>	<u>157,098</u>
Other financing sources (uses)					
Transfers in	182,600	-	384,810	15,494	582,904
Transfers out	<u>(400,304)</u>	<u>-</u>	<u>-</u>	<u>(182,600)</u>	<u>(582,904)</u>
Total other financing sources (uses)	<u>(217,704)</u>	<u>-</u>	<u>384,810</u>	<u>(167,106)</u>	<u>-</u>
Net change in fund balances	418,848	(122,579)	29,611	(168,782)	157,098
Fund balances, beginning of year	<u>(628,753)</u>	<u>246,056</u>	<u>665,847</u>	<u>1,594,922</u>	<u>1,878,072</u>
Fund balances, end of year	<u>\$ (209,905)</u>	<u>\$ 123,477</u>	<u>\$ 695,458</u>	<u>\$ 1,426,140</u>	<u>\$ 2,035,170</u>

The notes to the basic financial statements are an integral part of this statement.

CITY OF SOUTH TUCSON, ARIZONA
 RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND
 CHANGES IN FUND BALANCES TO THE STATEMENT OF ACTIVITIES
 GOVERNMENTAL FUNDS
 FOR THE FISCAL YEAR ENDED JUNE 30, 2007

Net change in fund balances - total governmental funds \$ 157,098

Amounts reported for governmental activities in the statement of activities are different because:

Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.

Expenditures for capital assets	1,436,411
Less current year depreciation	<u>(1,137,152)</u>
Excess capital expenditures over depreciation	<u>299,259</u>

Some revenues reported in the statement of activities do not provide current financial resources and therefore are not reported as revenues in governmental funds.

Court fines	57,062
CDBG loan proceeds	<u>(5,400)</u>

The issuance of long-term debt (e.g. bonds, leases) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets. The issuance of long-term debt increases long-term liabilities on the statement of net assets and the repayment of principal on long-term debt reduces long-term debt on the statement of net assets.

Principal payments on long-term debt	38,379
Increase in other commitments	<u>(386,202)</u>

Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds.

Net decrease in compensated absences	<u>(11,752)</u>
--------------------------------------	-----------------

Change in net assets of governmental activities \$ 148,444

The notes to the basic financial statements are an integral part of this statement.

CITY OF SOUTH TUCSON, ARIZONA
GENERAL FUND
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND
BALANCES - BUDGET AND ACTUAL
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	Original and Final Budget	Actual	Variance with Final Budget
Revenues			
Taxes	\$ 2,554,036	\$ 2,542,399	\$ (11,637)
Intergovernmental	1,600,639	1,455,828	(144,811)
Fines and forfeitures	165,200	113,195	(52,005)
Licenses and permits	301,700	295,187	(6,513)
Charges for services	189,000	205,133	16,133
Rents and royalties	98,789	98,848	59
Contributions and donations	-	200,000	200,000
Investment earnings	8,000	40,485	32,485
Other	117,000	655,698	538,698
Total Revenues	<u>5,034,364</u>	<u>5,606,773</u>	<u>572,409</u>
Expenditures			
Current			
General government			
Operating administration	7,950	12,876	(4,926)
City manager administration	516,339	416,235	100,104
Mayor and council	54,519	42,654	11,865
Magistrate court	234,792	209,458	25,334
City clerk	83,908	90,505	(6,597)
Finance	198,468	199,610	(1,142)
Information technology	123,037	121,385	1,652
Personnel	48,295	46,698	1,597
Development services	41,835	34,379	7,456
Public buildings	62,224	63,760	(1,536)
Non-departmental	186,500	212,907	(26,407)
Total general government	<u>1,557,867</u>	<u>1,450,467</u>	<u>107,400</u>
Public safety			
Fire department	861,901	863,564	(1,663)
Voluntary fire department	44,298	18,113	26,185
Police department	1,500,814	1,746,830	(246,016)
Civilian police department	378,112	332,756	45,356
Total public safety	<u>2,785,125</u>	<u>2,961,263</u>	<u>(176,138)</u>
Highways and streets			
Public works	29,325	26,510	2,815
Sanitation	207,236	207,632	(396)
Streets	100,000	130,747	(30,747)
Fleet service	65,782	58,388	7,394
Planning and zoning	53,716	81,069	(27,353)
Total highways and streets	<u>456,059</u>	<u>504,346</u>	<u>(48,287)</u>
Debt Service			
Principal retirement	46,200	38,379	7,821
Interest on long-term debt	17,500	15,766	1,734
Total Expenditures	<u>4,862,751</u>	<u>4,970,221</u>	<u>(107,470)</u>
Excess (deficiency) of revenues over expenditures	<u>171,613</u>	<u>636,552</u>	<u>464,939</u>

(continued)

The notes to the basic financial statements are an integral part of this statement.

CITY OF SOUTH TUCSON, ARIZONA
GENERAL FUND
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND
BALANCES - BUDGET AND ACTUAL
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	<u>Original and Final Budget</u>	<u>Actual</u>	<u>Variance with Final Budget</u>
<i>(concluded)</i>			
Other financing sources (uses)			
Transfers in	182,600	182,600	-
Transfers out	<u>(354,213)</u>	<u>(400,304)</u>	<u>(46,091)</u>
Total other financing sources (uses)	<u>(171,613)</u>	<u>(217,704)</u>	<u>(46,091)</u>
Net change in fund balances	-	418,848	418,848
Fund balances, beginning of year (deficit)	<u>-</u>	<u>(628,753)</u>	<u>(628,753)</u>
Fund balances, end of year (deficit)	<u>\$ -</u>	<u>\$ (209,905)</u>	<u>\$ (209,905)</u>

The notes to the basic financial statements are an integral part of this statement.

CITY OF SOUTH TUCSON, ARIZONA
HOUSING FUND
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND
BALANCES - BUDGET AND ACTUAL
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	Original and Final Budget	Actual	Variance with Final Budget
Revenues			
Intergovernmental	\$ 1,353,537	\$ 1,439,069	\$ 85,532
Rents and royalties	267,470	255,709	(11,761)
Investment earnings	-	5,555	5,555
Other	<u>14,546</u>	<u>14,625</u>	<u>79</u>
Total Revenues	<u>1,635,553</u>	<u>1,714,958</u>	<u>79,405</u>
Expenditures			
Current			
Redevelopment and housing	<u>1,635,553</u>	<u>1,837,537</u>	<u>(201,984)</u>
Total Expenditures	<u>1,635,553</u>	<u>1,837,537</u>	<u>(201,984)</u>
Excess (deficiency) of revenues over expenditures	-	(122,579)	(122,579)
Fund balances, beginning of year	<u>-</u>	<u>246,056</u>	<u>246,056</u>
Fund balances, end of year	<u>\$ -</u>	<u>\$ 123,477</u>	<u>\$ 123,477</u>

The notes to the basic financial statements are an integral part of this statement.

CITY OF SOUTH TUCSON, ARIZONA
STATEMENT OF FIDUCIARY NET ASSETS
FIDUCIARY FUNDS
JUNE 30, 2007

	<u>Pension Trust</u>
Assets	
Cash and cash equivalents	\$ <u>205.839</u>
Total assets	\$ <u><u>205.839</u></u>
 Net Assets	
Held in trust	\$ <u><u>205.839</u></u>

The notes to the basic financial statements are an integral part of this statement.

CITY OF SOUTH TUCSON, ARIZONA
 STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
 FIDUCIARY FUNDS
 FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	<u>Pension Trust</u>
Additions	
Contributions	
State insurance contribution	\$ <u>2.029</u>
Total additions	<u>2.029</u>
Deductions	
Benefits	<u>9.850</u>
Total deductions	<u>9.850</u>
Change in net assets	(7,821)
Net assets, beginning of year	<u>213.660</u>
Net assets, end of year	<u>\$ <u>205.839</u></u>

The notes to the basic financial statements are an integral part of this statement.

CITY OF SOUTH TUCSON, ARIZONA
NOTES TO THE BASIC FINANCIAL STATEMENTS
FISCAL YEAR ENDED JUNE 30, 2007

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying basic financial statements of the City of South Tucson, Arizona (City) have been prepared in conformity with accounting principles generally accepted in the United States of America applicable to governmental units adopted by the Governmental Accounting Standards Board (GASB). A summary of the City's more significant accounting policies follows.

A. Reporting entity

The City is a municipal government that is governed by a separately elected governing body. It is legally separate from and fiscally independent of other state and local governments. The accompanying basic financial statements present the City and its component units, entities for which the City is considered to be financially accountable. Blended component units, although legally separate entities, are, in substance, part of the City's operations.

Included within the reporting entity:

South Tucson Industrial Development Authority. The South Tucson Industrial Development Authority's governing board is appointed by the City Council. The bond issuance authorizations are also approved by the City Council. The Industrial Development Authority has been inactive in recent years.

South Tucson Municipal Property Corporation. The City of South Tucson, Arizona, Arizona Municipal Property Corporation's (MPC) board of directors are appointed by the City of South Tucson, Arizona's City Council. The MPC, which is a nonprofit corporation incorporated under the laws of the State of Arizona, was formed for the sole purpose of assisting the City in obtaining financing for various projects of the City. The City has a "moral obligation" for the repayment of the MPC's bonds. For financial reporting purposes, transactions of the MPC are combined together and included as if they were part of the City's operations.

B. Government-wide and fund financial statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the primary government and its component units. The effect of interfund activity has been removed from these statements. *Governmental activities*, which are normally supported by taxes and intergovernmental revenues are reported separately from *business-type activities*, which rely to a significant extent on fees and charges for support. The City did not have any business-type activities during the year.

CITY OF SOUTH TUCSON, ARIZONA
NOTES TO THE BASIC FINANCIAL STATEMENTS
FISCAL YEAR ENDED JUNE 30, 2007

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as *general revenues*.

Separate financial statements are provided for governmental funds and fiduciary funds even though the latter are excluded from the government-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements.

C. Measurement focus, basis of accounting, and financial statement presentation

The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting, except expenditures related to compensated absences and claims and judgments, which are recorded only when payment is due. However, since debt service resources are provided during the current year for payment of long-term principal and interest due early in the following year, the expenditures and related liabilities have been recognized in the Debt Service Fund.

Intergovernmental grants and aid, franchise taxes, licenses charges for services and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the government.

CITY OF SOUTH TUCSON, ARIZONA
NOTES TO THE BASIC FINANCIAL STATEMENTS
FISCAL YEAR ENDED JUNE 30, 2007

The City reports the following major governmental funds:

The *General Fund* is the City's primary operating fund. It accounts for all financial resources of the City, except those required to be accounted for in another fund.

The *Housing Fund* is used to account for the operations of the City's public housing program.

The *Debt Service Fund* accounts for the accumulation of resources for and the payment of, long-term principal, interest and related costs.

Additionally, the Town reports the following fund types:

The *Pension Trust Fund* accounts for the activities of the Firefighters' Relief and Pension Trust Fund (Fireman Pension Trust Fund), which accumulates funds for the defined contribution pension plan administered by the City and a board of trustees for the City's volunteer firefighters.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements.

Amounts reported as program revenues include 1) charges for services, 2) operating grants and contributions, and 3) capital grants and contributions. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

When both restricted and unrestricted resources are available for use, for governmental activities it is the City's policy to use restricted resources first, then unrestricted resources as they are needed.

D. Assets, liabilities, and net assets or equity

1. Deposits and investments

The City's cash and cash equivalents are considered to be cash on hand, demand deposits, cash and investments held by the State Treasurer, and highly liquid investments with maturities of three months or less from the date of acquisition.

CITY OF SOUTH TUCSON, ARIZONA
NOTES TO THE BASIC FINANCIAL STATEMENTS
FISCAL YEAR ENDED JUNE 30, 2007

Cash and investments are pooled except for funds required to be held by fiscal agents or restricted under provisions of bond indentures. Interest earned from investments purchased with such pooled monies is allocated to each of the funds based on the average daily cash balances. State statutes authorize the City to invest in obligations of the U.S. Treasury and U.S. agencies, certificates of deposit in eligible depositories, repurchase agreements, obligations of the State of Arizona or any of its counties or incorporated cities, Cities or duly organized school districts, improvement districts in this state and the State Treasurer's Local Government Investment Pool. Investments are stated at fair value.

2. Receivables

Court fines receivable are shown net of an allowance for uncollectibles.

Pima County levies real property taxes on or before the third Monday in August that become due and payable in two equal installments. The first installment is due on the first day of October and becomes delinquent after the first business day of November. The second installment is due on the first day of March of the next year and becomes delinquent after the first business day of May. However, a lien against real and personal property assessed attaches on the first day of January preceding assessment and levy thereof.

3. Short-term interfund receivables/payables

During the course of operations, individual funds within the City's pooled cash accounts may borrow money from the other funds within the pool on a short-term basis. These receivables and payables are classified as "due from other funds" or "due to other funds" on the balance sheet of the fund financial statements and are eliminated in the preparation of the government-wide financial statements.

4. Inventories and prepaid items

Inventories consist of expendable supplies held for consumption. Inventories are valued at cost using the first-in/first-out (FIFO) method. Inventories of governmental funds are recorded as expenditures when consumed rather than when purchased.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

CITY OF SOUTH TUCSON, ARIZONA
NOTES TO THE BASIC FINANCIAL STATEMENTS
FISCAL YEAR ENDED JUNE 30, 2007

5. Capital assets

Capital assets, which include land and improvements, buildings and improvements, infrastructure, furniture, equipment and vehicles, are reported in the governmental activities column in the government-wide financial statements. Capital assets are defined by the City as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of one year.

Capital assets purchased or acquired are carried at historical cost or estimated historical cost. Contributed assets are recorded at fair market value as of the date received. Additions, improvements and other capital outlays that significantly extend the useful life of an asset are capitalized. Other costs incurred for repairs and maintenance are expensed as incurred.

Depreciation on all assets is provided on a straight-line basis over the following estimated useful lives:

Land improvements	20 years
Buildings and improvements	50 years
Infrastructure	75 years
Furniture, equipment and vehicles	5-15 years

6. Compensated absences

The liability for compensated absences reported in the government-wide statements consists of unpaid, accumulated leave balances. The liability has been calculated using the vesting method, in which leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included.

7. Long-term obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities.

CITY OF SOUTH TUCSON, ARIZONA
NOTES TO THE BASIC FINANCIAL STATEMENTS
FISCAL YEAR ENDED JUNE 30, 2007

8. Net assets

In the government-wide financial statements, net assets are reported in three categories: net assets invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets. Net assets invested in capital assets, net of related debt is separately reported because the City reports all assets which make up a significant portion of total net assets. Restricted net assets account for the portion of net assets restricted by parties outside the City. Unrestricted net assets are the remaining net assets not included in the previous two categories.

9. Fund equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

NOTE 2 - STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

A. Budgetary information

The City Council follows these procedures in establishing the budgetary data reflected in the financial statements:

1. In accordance with Arizona Revised Statutes, the City Manager submits a proposed budget for the fiscal year commencing the following July 1 to the City Council. The operating budget includes proposed expenditures and the means of financing them for the upcoming year.
2. Public hearings are conducted to obtain taxpayer comment.
3. Prior to the third Monday in August, the expenditure limitation for the City is legally enacted through passage of an ordinance. To ensure compliance with the expenditure limitation, a uniform expenditure report must be filed with the State each year. This report, issued under a separate cover, reconciles total City expenditures from the audited basic financial statements to total expenditures for reporting in accordance with the State's uniform expenditure reporting system (A.R.S. §41-1279.07).

CITY OF SOUTH TUCSON, ARIZONA
NOTES TO THE BASIC FINANCIAL STATEMENTS
 FISCAL YEAR ENDED JUNE 30, 2007

4. Expenditures may not legally exceed the expenditure limitation described below of all fund types as a whole. For management purposes, the City adopts a budget by department for the General Fund and in total by fund for other funds. The City Manager, subject to City Council approval, may at any time transfer any unencumbered appropriation balance or portion thereof between a department. The adopted budget cannot be amended in any way without City Council approval.

5. Formal budgetary integration is employed as a management control device during the year for the General, Special Revenue, Debt Service and Capital Projects Funds on essentially the same modified accrual basis of accounting used to record actual revenues and expenditures.

The City is subject to the State of Arizona's Spending Limitation Law for Towns and Cities. This law does not permit the City to spend more than budgeted revenues plus the carryover unrestricted cash balance from the prior fiscal year. The limitation is applied to the total of the combined funds. The City complied with this law during the year.

No supplementary budgetary appropriations were necessary during the year.

B. Excess of expenditures over appropriations

Expenditures exceeded appropriations in the following funds:

	Amount of Overexpenditure
General Fund:	
Operating administration	\$ 4,926
City clerk	6,597
Finance	1,142
Public buildings	1,536
Non-departmental	26,407
Fire department	1,663
Police department	246,016
Sanitation	396
Streets	30,747
Planning and zoning	27,353

Cash was available to meet all the overexpenditures above.

CITY OF SOUTH TUCSON, ARIZONA
NOTES TO THE BASIC FINANCIAL STATEMENTS
 FISCAL YEAR ENDED JUNE 30, 2007

C. Deficit fund equity

A deficit fund balance in the amount of \$209,905 was reported in the General Fund. The deficit was the result of a carryover from prior years, plus current year debt service requirements. The City plans to recover this deficit over the next three years as the money from the New River agreement with the City of Tucson, Arizona is received.

NOTE 3 - DETAILED NOTES ON ALL FUNDS

A. Assets

1. Deposits and investments

Deposits and investments at June 30, 2007 consist of the following:

Deposits	
Cash on hand	\$ 2,284
Cash in bank	255,017
Cash on deposit with Pima County	285,994
Investments	
State Treasurer's Investment Pool	481,742
Cash on deposit with trustee	<u>819,019</u>
Total deposits and investments	1,844,056
Less: Restricted assets	(819,019)
Fiduciary funds cash	<u>(205,839)</u>
Total cash and cash equivalents	<u>\$ 819,198</u>

Deposits - The carrying value of the City's deposits at June 30, 2007 was \$255,017 and the bank balance was \$934,255. Of the bank balance \$300,000 was covered by federal depository insurance and \$634,255 was covered by collateral held by the City's custodial bank in the City's name. The cash on deposit with Pima County was collateralized by Pima County in the City's name.

CITY OF SOUTH TUCSON, ARIZONA
NOTES TO THE BASIC FINANCIAL STATEMENTS
FISCAL YEAR ENDED JUNE 30, 2007

Investments - The State Board of Deposit provides oversight for the State Treasurer's pools, and the Local Government Investment Pool Advisory Committee provides consultation and advice to the Treasurer. The fair value of a participant's position in the pool approximates the value of that participant's pool shares. The shares are not identified with specific investments and are not subject to custodial credit risk. The cash on deposit with the trustee is held and invested by the City's trustee in U.S. Treasury notes.

Interest rate risk. In accordance with the City's investment policy, the City manages its exposure to declines in fair values by limiting its investments to U.S. government securities with maturities of six months or less.

Credit risk. The City limits its investments to the State Treasurer's Investment Pool and U.S. Government Securities. The cash on deposit with the trustee is invested in U.S. Government Money Market Funds and therefore, has no credit risk.

Custodial credit risk. For an investment, this is the risk that, in the event of the failure of the counterparty, the City will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The City currently does not have a policy in regards to custodial credit. However, because each of the City's investments are secured by the federal government, depository insurance or are collateralized, the City is not exposed to custodial credit risk. The City's investments in the State Treasurer's Investment Pool did not receive a credit quality rating from a national rating agency.

2. Restricted assets

Restricted assets at June 30, 2007 consisted of the following:

Future debt service	\$ 127,560
Reserve fund	<u>691,459</u>
	<u>\$ 819,019</u>

CITY OF SOUTH TUCSON, ARIZONA
NOTES TO THE BASIC FINANCIAL STATEMENTS
 FISCAL YEAR ENDED JUNE 30, 2007

3. Receivables

Court fines are recorded net of uncollectible amounts in the government-wide statements but are not recorded as a receivable in the fund statements because they do not meet the revenue recognition criteria for the modified accrual basis of accounting. The total receivable at June 30, 2007 was \$2,393,196 which was reduced by \$1,603,441 for uncollectible amounts for a net receivable balance at June 30, 2007 of \$789,755.

Governmental funds report deferred revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received, but not yet earned. At the end of the current fiscal year, the various components of deferred revenue and unearned revenue reported in the governmental funds were as follows:

	<u>Unavailable</u>	<u>Unearned</u>
Court fines receivable (General Fund)	\$ 789,755	\$ -
Grants received in advance (Nonmajor Governmental Funds)	-	34,878
CDBG loan receivable (Nonmajor Governmental Funds)	<u>119,648</u>	<u>-</u>
	<u>\$ 909,403</u>	<u>\$ 34,878</u>

CITY OF SOUTH TUCSON, ARIZONA
NOTES TO THE BASIC FINANCIAL STATEMENTS
 FISCAL YEAR ENDED JUNE 30, 2007

4. Capital assets

Capital asset activity for the year ended June 30, 2007 was as follows:

	<u>Beginning Balances</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balances</u>
Governmental Activities:				
Capital assets not being depreciated:				
Land	\$ 479,136	\$ -	\$ -	\$ 479,136
Construction in progress	<u>2,942,545</u>	<u>1,087,285</u>	<u>-</u>	<u>4,029,830</u>
Total capital assets, not being depreciated	<u>3,421,681</u>	<u>1,087,285</u>	<u>-</u>	<u>4,508,966</u>
Capital assets being depreciated:				
Land improvements	1,289,717	-	-	1,289,717
Buildings and improvements	11,302,707	-	-	11,302,707
Infrastructure	19,888,396	-	-	19,888,396
Furniture, equipment and vehicles	<u>3,416,759</u>	<u>349,126</u>	<u>-</u>	<u>3,765,885</u>
Total capital assets being depreciated	<u>35,897,579</u>	<u>349,126</u>	<u>-</u>	<u>36,246,705</u>
Less accumulated depreciation for:				
Land improvements	(662,182)	(60,574)	-	(722,756)
Buildings and improvements	(3,717,810)	(226,054)	-	(3,943,864)
Infrastructure	(4,696,032)	(527,624)	-	(5,223,656)
Furniture, equipment and vehicles	<u>(1,983,040)</u>	<u>(322,900)</u>	<u>-</u>	<u>(2,305,940)</u>
Total accumulated depreciation	<u>(11,059,064)</u>	<u>(1,137,152)</u>	<u>-</u>	<u>(12,196,216)</u>
Total capital assets, being depreciated, net	<u>24,838,515</u>	<u>(788,026)</u>	<u>-</u>	<u>24,050,489</u>
Governmental activities capital assets, net	<u>\$ 28,260,196</u>	<u>\$ 299,259</u>	<u>\$ -</u>	<u>\$ 28,559,455</u>

CITY OF SOUTH TUCSON, ARIZONA
NOTES TO THE BASIC FINANCIAL STATEMENTS
 FISCAL YEAR ENDED JUNE 30, 2007

Depreciation expense was charged to functions/programs as follows:

Governmental activities:	
General government	\$ 306,538
Public safety	205,215
Highways and streets	417,854
Redevelopment and housing	<u>207,545</u>
Total depreciation expense-governmental activities	<u>\$ 1,137,152</u>

5. Construction commitments

The City has an active construction project at June 30, 2007. The project includes the revitalization of the 29th Street Corridor. At fiscal year end the City's commitments with contractors were as follows:

Project	Governmental Activities	
	Spent-to-date	Remaining Commitment
36th street to 4th avenue roadway	\$ 144,339	\$ 88,661
40th street to I-10 roadway	157,394	78,860
6th avenue roadway	169,987	12,509
Drainage project	321,613	609,387
2nd avenue and 5th avenue parks	<u>538,487</u>	<u>14,551</u>
	<u>\$ 1,331,820</u>	<u>\$ 803,968</u>

CITY OF SOUTH TUCSON, ARIZONA
NOTES TO THE BASIC FINANCIAL STATEMENTS
 FISCAL YEAR ENDED JUNE 30, 2007

B. Interfund receivables, payables and transfers

As of June 30, 2007 interfund receivable and payables were as follows:

Due To	Due From		
	General Fund	Nonmajor Governmental Funds	Total
General Fund	\$ -	\$ 182,600	\$ 182,600
Nonmajor Governmental Funds	<u>756,917</u>	<u>155,553</u>	<u>912,470</u>
	<u>\$ 756,917</u>	<u>\$ 338,153</u>	<u>\$ 1,095,070</u>

The above interfund receivables and payables are due to a cash short-fall at fiscal year end in the General Fund and Nonmajor Governmental Funds. The City anticipates receiving funding immediately following the fiscal year end to cover the deficit in the Nonmajor Governmental Funds and anticipates recovering the deficit in the General Fund over the next few years through sales tax revenues. The interfund borrowing between the Nonmajor Governmental Funds and the General Fund was recorded for Pima County funds received subsequent to June 30, 2007.

Interfund transfers for the year ended June 30, 2007 consisted of the following:

Transfers In	Transfers Out		
	General Fund	Nonmajor Governmental Funds	Total
General Fund	\$ -	\$ 182,600	\$ 182,600
Debt Service Fund	384,810	-	384,810
Nonmajor Governmental Funds	<u>15,494</u>	<u>-</u>	<u>15,494</u>
Total	<u>\$ 400,304</u>	<u>\$ 182,600</u>	<u>\$ 582,904</u>

Transfers were made to pay debt service obligations during the fiscal year and to fund capital projects

CITY OF SOUTH TUCSON, ARIZONA
NOTES TO THE BASIC FINANCIAL STATEMENTS
 FISCAL YEAR ENDED JUNE 30, 2007

C. Obligations under leases

Operating lease

The City leases copy machines and a printer under the provisions of long-term lease agreements classified as operating leases for accounting purposes. Rental expenditures under the terms of the operating lease totaled \$16,341 for the year ended June 30, 2007.

The future minimum lease payments for these leases are as follows:

Year Ending June 30,	<u>Amount</u>
2008	\$ 14,983
2009	14,983
2010	14,335
2011	<u>7,213</u>
Total	<u>\$ 51,514</u>

Capital lease

The City entered into a lease agreement as lessee for financing the acquisition of two police vehicles, a staff vehicle and a garbage truck. The lease agreement qualifies as a capital lease for accounting purposes and; therefore, is recorded at the present value of the future minimum lease payments as of the inception date.

The assets acquired through capital leases are as follows:

Asset:	<u>Governmental Activities</u>
Vehicles	\$ 276,837
Less: accumulated depreciation	<u>(41,526)</u>
Total	<u>\$ 235,311</u>

CITY OF SOUTH TUCSON, ARIZONA
NOTES TO THE BASIC FINANCIAL STATEMENTS
 FISCAL YEAR ENDED JUNE 30, 2007

The future minimum lease obligations and the net present value of these minimum lease payments as of June 30, 2007, were as follows:

	Governmental Activities
Year Ending June 30, 2008	\$ 53,334
2009	53,334
2010	53,334
2011	42,854
2012	35,368
2013	14,737
Total minimum lease payments	252,961
Less: amount representing interest	(35,805)
Present value of net minimum lease payments	\$ 217,156

D. Long-term obligations

The City has issued long-term debt to refund earlier obligations with higher interest rates. The debt is being repaid by an irrevocable trust with an escrow agent funded by the proceeds of the refunding. Compensated absences are paid by the applicable fund where each employee is regularly paid, primarily the General Fund.

Revenue bonds currently outstanding are as follows:

Purpose	Interest Rates (%)	Maturity	Amount
MPC Excise Tax, Series 2003; original issue \$6,860,000	4.5-5.5	6/1/08-24	\$ <u>6,860,000</u>

CITY OF SOUTH TUCSON, ARIZONA
NOTES TO THE BASIC FINANCIAL STATEMENTS
 FISCAL YEAR ENDED JUNE 30, 2007

Changes in long-term obligations for the year ended June 30, 2007 are as follows:

	<u>July 1, 2006</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2007</u>	<u>Due within one year</u>
Governmental Activities:					
Bonds and loans payable:					
Revenue bonds	\$ 6,860,000	\$ -	\$ -	\$ 6,860,000	\$ 275,000
Other liabilities:					
Capital leases	255,535	-	(38,379)	217,156	40,860
Compensated absences	238,171	155,256	(143,504)	249,923	174,946
Other commitments	<u>1,452,310</u>	<u>386,202</u>	<u>-</u>	<u>1,838,512</u>	<u>-</u>
Governmental activities long-term liabilities	<u>\$ 8,806,016</u>	<u>\$ 541,458</u>	<u>\$ (181,883)</u>	<u>\$ 9,165,591</u>	<u>\$ 490,806</u>

Debt service requirements on long-term debt at June 30, 2007 are as follows:

Year Ending June 30,	<u>Governmental Activities</u>	
	<u>Principal</u>	<u>Interest</u>
2008	\$ 275,000	\$ 354,213
2009	285,000	341,837
2010	295,000	329,012
2011	310,000	315,738
2012	330,000	301,788
2013-17	1,855,000	1,262,186
2018-22	2,370,000	718,864
2023-24	<u>1,140,000</u>	<u>95,700</u>
	<u>\$ 6,860,000</u>	<u>\$ 3,719,338</u>

Other Commitments

The City has an intergovernmental agreement with the City of Tucson, Arizona for transportation services. According to the agreement, the City of Tucson, Arizona will provide transportation to citizens of the City of South Tucson, Arizona at a predetermined rate. As of June 30, 2007, the cities have not come to terms regarding the charges for services. However, the City of Tucson, Arizona has estimated the cost of those charges and is billing the City of South Tucson, Arizona for the related services since the inception of the agreement. The liability is not expected to become due until after the fiscal year ending June 30, 2008, at which time the cities will come to terms regarding the charges for the services and a payment schedule.

CITY OF SOUTH TUCSON, ARIZONA
NOTES TO THE BASIC FINANCIAL STATEMENTS
FISCAL YEAR ENDED JUNE 30, 2007

NOTE 4 - OTHER INFORMATION

A. Risk management

The City of South Tucson, Arizona, is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and natural disasters. The City's insurance protection is provided by the Arizona Municipal Risk Retention Pool, of which the City is a participating member. The limit for basic coverage is for \$2,000,000 per occurrence on a claims made basis. Excess coverage is for an additional \$2,000,000 per occurrence on a follow form, claims made basis. No significant reduction in insurance coverage occurred during the year and no settlements exceeded insurance coverage during any of the past three fiscal years.

The Arizona Municipal Risk Retention Pool is structured such that member premiums are based on an actuarial review that will provide adequate reserves to allow the Pool to meet its expected financial obligations. The Pool has the authority to assess its members additional premiums should reserves and annual premiums be insufficient to meet the Pool's obligations.

The City is also insured by Arizona Municipal Workers Compensation Fund for potential worker related accidents.

B. Contingent liabilities

Accumulated Sick Leave - Sick leave benefits provide for ordinary sick pay and are cumulative but do not vest with employees and, therefore, are not accrued. Unvested accumulated sick leave for City employees at June 30, 2007, totaled \$322,737.

C. Retirement plans

Firefighters' Relief and Pension Fund

The City of South Tucson, Arizona Volunteer Firefighters' Relief and Pension Fund is a defined contribution pension plan administered by the City and a board of trustees for the City's volunteer firefighters.

CITY OF SOUTH TUCSON, ARIZONA
NOTES TO THE BASIC FINANCIAL STATEMENTS
FISCAL YEAR ENDED JUNE 30, 2007

A defined contribution pension plan provides pension benefits in return for services rendered, provides an individual account for each participant, and specifies how contributions to the individual's account are to be determined instead of specifying the amount of benefits the individual is to receive. According to state statute, a volunteer firefighter who has served for 25 years or more or has reached 60 years of age and has served 20 years or more shall be eligible to receive a monthly retirement not to exceed \$150 per month, as determined by the board of trustees. Such pension, if paid, may be increased or decreased in amount, or discontinued at the discretion of the board of trustees. Pension and relief benefits may only be paid from the income of the trust fund. However, a firefighter who leaves the service without being eligible for retirement benefits is entitled to all previous deductions from his salary plus interest at a rate determined by the board of trustees. As established by state statute, in lieu of another acceptable pension plan, all volunteer firefighters must participate in the pension plan from the date they enter service.

State statute requires that both the employee and the City contribute an amount equal to 5% of the employee's salary. However, prior to the year ended June 30, 1992, it was determined the funded status of the plan was sufficient not to require further contributions by the City and has been reviewed on an annual basis since 1992 in which no changes in funding status have occurred.

No pension provision changes occurred during the year that affected the required contributions made by the City or its volunteer firefighters.

The Firefighters' Relief and Pension Fund held no securities of the City or other related parties during the fiscal years or as of the close of the fiscal year.

Arizona State Retirement System

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

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

CITY OF SOUTH TUCSON, ARIZONA
NOTES TO THE BASIC FINANCIAL STATEMENTS
FISCAL YEAR ENDED JUNE 30, 2007

Funding Policy - The Arizona State Legislature establishes and may amend active plan members' and the City's contribution rate. For the year ended June 30, 2007, active plan members and the City were each required by statute to contribute at the actuarially determined rate of 9.10 percent (8.60 percent retirement and .50 percent long-term disability) of the members' annual covered payroll. The City's contributions to the System for the years ended June 30, 2007, 2006, and 2005 were \$152,182, \$118,470, and \$85,613, respectively, which were equal to the required contributions for the year.

Public Safety Personnel Retirement System (PSPRS)

Plan Description - The City contributes to the Public Safety Personnel Retirement System (PSPRS), an agent multiple-employer, public employee retirement system that acts as a common investment and administrative agent to provide retirement and death and disability benefits for public safety personnel who are regularly assigned hazardous duty in the employ of the State of Arizona or a political subdivision thereof. All benefit provisions and other requirements are established by State statute. The Public Safety Personnel Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for PSPRS. That report may be obtained by writing to Public Safety Personnel, 3010 E. Camelback Road, Suite 200, Phoenix, AZ 85016 or by calling (602) 255-5575.

Funding Policy - Covered employees are required to contribute 7.65 percent of their annual salary to the PSPRS. The City is required to contribute the remaining amounts necessary to fund the PSPRS, as determined by the actuarial basis specified by statute. The current rate is 27.90% for police and 11.42% for fire, of annual covered payroll.

Annual Pension Cost - During the year ended June 30, 2007, the City of South Tucson, Arizona's annual pension cost of \$214,911 for police and \$55,042 for fire was equal to the City of South Tucson, Arizona's required and actual contributions.

The required contribution was determined as part of the June 30, 2007 actuarial valuation using an entry age actuarial funding method. Significant actuarial assumptions used in determining the entry age actuarial accrued liability include (a) a rate of return on the investment of present and future assets of 8.50% per year compounded annually, (b) projected salary increases of 6.00% (including inflation at 5.00%) per year compounded annually, and (c) additional projected salary increases of 0.00% to 3.00% per year attributable to seniority/merit.

CITY OF SOUTH TUCSON, ARIZONA
NOTES TO THE BASIC FINANCIAL STATEMENTS
 FISCAL YEAR ENDED JUNE 30, 2007

The actuarial value of the City of South Tucson, Arizona's assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a four-year period. The City of South Tucson, Arizona's unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on a closed basis. The remaining amortization period at June 30, 2007, was 20 years.

The preceding methods comply with the financial reporting standards established by the Governmental Accounting Standards Board.

Three-Year Trend Information

Police

<u>Fiscal Year Ended June 30,</u>	<u>Annual Pension Cost (APC)</u>	<u>Percent Contributed</u>	<u>Net Pension Obligation</u>
2005	\$ 189,015	100.0 %	\$ -
2006	225,849	100.0	-
2007	214,911	100.0	-

Fire

<u>Fiscal Year Ended June 30,</u>	<u>Annual Pension Cost (APC)</u>	<u>Percent Contributed</u>	<u>Net Pension Obligation</u>
2005	\$ 44,324	100.0 %	\$ -
2006	63,483	100.0	-
2007	55,042	100.0	-

Additional historical trend information for the City's PSPRS is disclosed on page 44.

Historical trend information is presented in order for a reader to assess the progress made in accumulating sufficient assets to pay pension benefits as they become payable.

Required Supplementary Information

CITY OF SOUTH TUCSON, ARIZONA
REQUIRED SUPPLEMENTARY INFORMATION
 PUBLIC SAFETY PERSONNEL RETIREMENT SYSTEM
 SCHEDULE OF FUNDING PROGRESS

**Schedule of Funding Progress
 Police**

Valuation Date June 30,	Actuarial Value of Assets	Entry Age Actuarial Accrued Liability (AAL)	Percent Funded	Over(Under) funded AAL	Annual Covered Payroll	Over (Under) funded AAL as a Percentage of Covered Payroll
1998	\$ 1,303,898	\$ 2,513,122	51.9 %	\$ (1,209,224)	\$ 770,733	(156.9)%
1999	1,487,328	2,850,794	52.2	(1,363,466)	750,292	(181.7)
2000	1,576,414	3,007,132	52.4	(1,430,718)	819,162	(174.7)
2001	1,723,865	3,106,082	55.5	(1,382,217)	913,165	(151.4)
2002	1,682,666	3,425,739	49.1	(1,743,073)	960,614	(181.5)
2003	1,669,073	3,804,353	43.9	(2,135,280)	883,890	(241.6)
2004	1,552,207	3,979,057	39.0	(2,426,850)	819,876	(296.0)
2005	1,226,675	4,317,977	28.4	(3,091,302)	818,685	(377.6)
2006	1,268,718	4,597,652	27.6	(3,328,934)	844,928	(394.0)
2007	1,073,458	4,966,457	21.6	(3,892,999)	887,402	(438.7)

**Schedule of Funding Progress
 Fire**

Valuation Date June 30,	Actuarial Value of Assets	Entry Age Actuarial Accrued Liability (AAL)	Percent Funded	Over(Under) funded AAL	Annual Covered Payroll	Over (Under) funded AAL as a Percentage of Covered Payroll
1998	\$ 1,351,103	\$ 1,036,579	130.3 %	\$ 314,524	\$ 326,149	- %
1999	1,566,965	1,248,291	125.5	318,674	377,157	-
2000	1,771,144	1,419,700	124.8	351,444	415,271	-
2001	1,915,267	1,495,662	128.1	419,605	435,068	-
2002	1,930,057	1,641,797	117.6	288,260	533,735	-
2003	1,893,559	1,844,020	102.7	49,539	528,573	-
2004	1,854,087	2,018,322	91.9	(164,235)	482,944	(34.0)
2005	1,663,936	1,933,829	86.0	(269,893)	555,980	(48.5)
2006	1,686,947	2,012,143	83.8	(325,196)	511,977	(63.5)
2007	1,556,028	2,312,999	67.3	(756,971)	564,234	(134.2)

SINGLE AUDIT ACT REPORTS

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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 Honorable Mayor and City Council of the
City of South Tucson, Arizona

We have audited the governmental activities, each major fund, and the aggregate remaining fund information of the City of South Tucson, Arizona (City) as of and for the year ended June 30, 2007, and have issued our report thereon dated January 25, 2008. 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 the City of South Tucson, Arizona's internal control over financial reporting as a basis for designing our auditing procedures 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 City of South Tucson, Arizona's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles, such that there is more than a remote likelihood that a misstatement of the City's financial statements that is more than inconsequential will not be prevented or detected by the City's internal control. We consider the deficiencies described as 07-1 and 07-2 in the accompanying schedule of findings and questioned costs to be a significant deficiencies in internal control over financial reporting.

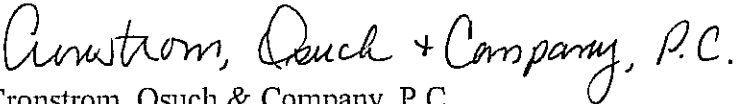
A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the City's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered material weaknesses. However, we believe that the significant deficiencies described above are not material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of South Tucson, Arizona'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 that are required to be reported under *Government Auditing Standards*. However, we noted certain matters that we reported to management of the City in a separate letter dated January 25, 2008.

This report is intended solely for the information and use of the members of the Arizona State Legislature, the Auditor General of the State of Arizona, the City Council, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.


Cronstrom, Osuch & Company, P.C.

January 25, 2008

REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

The Honorable Mayor and City Council of the
City of South Tucson, Arizona

Compliance with Requirements Applicable to Each Major Program

We have audited the compliance of the City of South Tucson, Arizona (City) with the types of compliance requirements described in the U. S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2007. The City of South Tucson, Arizona's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the City of South Tucson, Arizona's management. Our responsibility is to express an opinion on the City of South Tucson, Arizona's compliance based on our audit.

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

In our opinion, the City of South Tucson, Arizona complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the fiscal year ended June 30, 2007.

Internal Control over Compliance in Accordance with OMB Circular A-133

The management of the City of South Tucson, Arizona is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the City of South Tucson, Arizona's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

A control deficiency 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 noncompliance with applicable laws, regulations, contracts and grant agreements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to administer a major federal program being audited in accordance with the applicable laws, regulations, contracts and grant agreements, such that there is more than a remote likelihood that noncompliance that is more than inconsequential will not be prevented or detected by the City's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that noncompliance with the applicable requirements of laws, regulations, contracts and grant agreements that would be material in relation to a major federal program being audited will not be prevented or detected by the City's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the City of South Tucson, Arizona as of and for the year ended June 30, 2007, and have issued our report thereon dated January 25, 2008. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the members of the Arizona State Legislature, the Auditor General of the State of Arizona, the City Council, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Cronstrom, Osuch + Company, P.C.
Cronstrom, Osuch & Company, P.C.

January 25, 2008

CITY OF SOUTH TUCSON, ARIZONA
SCHEDULE OF FEDERAL AWARDS AND FINDINGS AND QUESTIONED COSTS
 FISCAL YEAR ENDED JUNE 30, 2007

SECTION I - SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued: *Unqualified*
 Internal control over financial reporting:

- Material weakness(es) identified? _____ yes X no
- Significant deficiency(ies) identified not considered to be material weakness? X yes _____ none reported

Noncompliance material to financial statements noted? _____ yes X no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? _____ yes X no
- Significant deficiency(ies) identified not considered to be material weaknesses? _____ yes X none reported

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

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

Identification of major programs:

<u>CFDA Numbers</u>	<u>Name of Federal Program or Cluster</u>
14.871	Section 8 Rental Voucher Program
14.856	Low Income Housing Assistance Program
14.218	Community Development Block Grant

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

Auditee qualified as low-risk auditee? X yes _____ no

CITY OF SOUTH TUCSON, ARIZONA
SCHEDULE OF FEDERAL AWARDS AND FINDINGS AND QUESTIONED COSTS
FISCAL YEAR ENDED JUNE 30, 2007

SECTION II - FINANCIAL STATEMENT FINDINGS

FINANCIAL STATEMENTS

07-1 <i>Condition/ Context</i>	The year-end financial statements and related disclosures (statement of cash flows and notes to the financial statements) were not prepared by management.
<i>Criteria</i>	Internal control procedures.
<i>Effect</i>	Internal control weakness and the financial statements and related disclosures were compiled by the auditors and reviewed by management.
<i>Cause</i>	Proper procedures were not established.
<i>Recommendation</i>	In order to strengthen internal controls, the annual financial statements and related disclosures should be prepared by management.
<i>Corrective Action Plan</i>	The City concurs with this recommendation and will consider compiling its own financial statements and related disclosures in the future.
<i>Contact Person</i>	Ruben Villa, Finance Director

CITY OF SOUTH TUCSON, ARIZONA
SCHEDULE OF FEDERAL AWARDS AND FINDINGS AND QUESTIONED COSTS
FISCAL YEAR ENDED JUNE 30, 2007

SECTION II - FINANCIAL STATEMENT FINDINGS (CONCL'D)

HOUSING GRANTS

<i>07-2 Condition</i>	The housing department's revenues, expenditures and cash balances were not reconciled to the City's general ledger.
<i>Context</i>	Section 8, low-rent and the Capital grant.
<i>Criteria</i>	Accounting principles generally accepted in the United States of America (GAAP).
<i>Effect</i>	Noncompliance with GAAP and several audit adjustments were necessary to reconcile the activity.
<i>Cause</i>	The housing department submits checks to the City for funds received and submits check requests for expenditures. Therefore, a timing difference exists between the housing department and the general ledger.
<i>Recommendation</i>	In order to comply with GAAP, the City should assign an employee responsible for reconciling activity of the housing department to the general ledger and any variances should be investigated and resolved.
<i>Corrective Action Plan</i>	The City concurs with this recommendation and will ensure housing department is reconciled to the general ledger in the future.
<i>Contact Person</i>	Ruben Villa, Finance Director

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

None noted.

SECTION IV - SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

None noted.

CITY OF SOUTH TUCSON, ARIZONA
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FISCAL YEAR ENDED JUNE 30, 2007

Grantor Agency	Federal CFDA Number	Pass-through Grantor's Number	Expenditures
U.S. Department of Housing and Urban Development			
Low Income Housing Assistance Program	14.856	N/A	\$ 414,771
Section 8 Rental Voucher Program	14.871	N/A	771,996
Public Housing Capital Fund	14.872	N/A	224,636
Passed through Pima County:			
Community Development Block Grant	14.218	01-70-S-135384-0105	2,989
Community Development Block Grant	14.218	01-39-S-133219-1003	65,422
Community Development Block Grant	14.218	01-70-S-135385-1104	36,645
Community Development Block Grant	14.218	01-70-S137787-0406	111,788
Community Development Block Grant	14.218	01-70-S-138940-1006	185,611
Passed through the Arizona, Housing and Development Home Investment Partnership Program	14.239	164-02	<u>25,000</u>
Total U.S. Department of Housing and Urban Development			<u>1,838,858</u>
U.S. Department of Justice			
Small Communities Methamphetamine Program	16.710	N/A	14,796
Passed through Arizona Governor's Office:			
Juvenile Accountability Incentive Block Grant 1998	16.523	99-43605	<u>13,539</u>
Total U.S. Department of Justice			<u>28,335</u>
Environmental Protection Agency			
Brownfields Assessment and Cleanup Cooperative Agreements	66.818	N/A	<u>118,976</u>
U.S. Department of Health and Human Services			
Drug Free Communities Support Program Grants	93.276	N/A	118,208
Passed through University of Arizona:			
HIV Grant	93.243	H79-SP10318-01	35,540
Centers for Disease Control and Prevention - Investigations and Technical Assistance	93.283	N/A	<u>28,750</u>
Total U.S. Department of Health and Human Services			<u>182,498</u>
U.S. Department of Homeland Security			
Passed through the State of Arizona			
State Domestic Preparedness Equipment Support Program	97.004	N/A	9,429
U.S. Department of Commerce			
Passed through Pima County:			
Economic Development Grant	11.300	07-8705151	<u>32,500</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u><u>\$ 2,210,596</u></u>

Note: This schedule was prepared on the modified accrual basis of accounting.

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