Occidental County Sanitation District

Basic Financial Statements

Year Ended June 30, 2006

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PISENTI & BRINKER LLP
Certified Public Accountants and Advisors
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Independent Auditors' Report

Board of Supervisors
County of Sonoma
Occidental County Sanitation District
Santa Rosa, California

We have audited the accompanying basic financial statements of the Occidental County Sanitation District ("the District"), a component unit of the County of Sonoma, as of and for the year ended June 30, 2006. These basic financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

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

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the District as of June 30, 2006, and the results of its operations and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 15, 2006, on our consideration of the District'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 result 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* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis ("MD&A") on pages 2 - 8 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the MD&A. However, we did not audit the information and express no opinion on it.

Pisenti & Brinker LLP

Santa Rosa, California
September 15, 2006

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Management's Discussion and Analysis

As management of the Occidental County Sanitation District (the District), we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the fiscal year ended June 30, 2006. We encourage readers to consider the information presented here in conjunction with the District's financial statements (pages 9 - 12) and the accompanying notes to the financial statements (pages 13 - 25).

Reporting Entity

The Occidental County Sanitation District is managed by the Sonoma County Water Agency (the "Water Agency"), which provides administration, engineering, operational and maintenance services. The District is governed by a Board of Directors, which is the County of Sonoma Board of Supervisors. The District is considered an integral part of the County of Sonoma's reporting entity, resulting in the District's financial statements being included in the County's annual financial statements.

Please refer to the reporting entity definition within the notes to the financial statements for additional detail.

Financial Highlights

Net Assets

The assets of the District exceeded its liabilities at the close of the most recent fiscal year by $954,997 (*net assets*). Of this amount, $77,316 (*unrestricted net assets*) may be used to meet the District's ongoing obligations to citizens and creditors.

Revenues

The District recognized total revenues of $736,061 during fiscal year 2005/06. Of this amount, $255,996 consists of charges for services (operating revenues), and $480,065 of non-operating revenues consisting of investment earnings, connection fees, and intergovernmental revenue.

Expenses

The District incurred expenses totaling $454,820 during fiscal year 2005/06. This amount represents operating expenses related to the collection, treatment, disposal, and reclamation of effluent, as well as administrative and general expenses.

Increase in Net Assets

The District recorded an operating loss of $198,824 for fiscal year 2005/06. Due to non-operating revenues of $480,065, the District recognized an overall increase in net assets of $281,241.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the District's financial statements. The District's financial statements are comprised of three components: 1) Management's Discussion and Analysis, 2) financial statements, and 3) notes to the financial statements.

Management's Discussion and Analysis

The *Management's Discussion and Analysis* is intended to provide the narrative overview that users need to interpret the financial statements. Management's Discussion and Analysis also provides analysis of some key data presented in the financial statements.

Financial Statements

The District is engaged only in business-type activities. The District accounts for its financial activity utilizing fund accounting, specifically enterprise fund accounting, to ensure and demonstrate compliance with finance-related legal requirements. An enterprise fund is a proprietary fund type used to report activities for which a fee is charged to external customers for goods or services provided. The focus of an enterprise fund is the determination of operating income, changes in net assets (or cost recovery), financial position, and cash flow. The financial statements presented are the *statement of net assets; the statement of revenues, expenses, and changes in net assets; and the statement of cash flows.*

Notes to the Financial Statements

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements can be found on pages 13- 25.

Financial Analysis

Net assets may serve over time as a useful indicator of a District's financial position. In the case of the District, assets exceeded liabilities by $954,997 at the close of the most recent fiscal year compared to net assets of $673,756 at June 30, 2005.

A significant portion of the District's net assets (91.6% for fiscal year 2006 compared to 87.1% for 2005) reflects its investment in capital assets (e.g., land and buildings), less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the District's investment in it's 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.

Financial Analysis (continued)

Net Assets	June 30, 2005	June 30, 2006	Percentage Change
Current and other assets	$ 91,007	$ 82,246	(9.6) %
Capital assets	840,793	878,040	4.4 %
Total assets	931,800	960,286	3.1 %
Current liabilities	255,044	3,289	(98.7) %
Non-current liabilities	3,000	2,000	(33.3)%
Total liabilities	258,044	5,289	(98.0) %
Invested in capital assets net of related debt	586,793	875,040	49.1 %
Restricted for debt service	3,648	2,641	(27.6) %
Unrestricted	83,315	77,316	(7.2) %
Total net assets	$ 673,756	$ 954,997	41.7 %

A portion of the District's net assets $2,641 (0.3% for fiscal year 2006) and $3,648 (0.5% for fiscal year 2005) represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets of $77,316 for fiscal year 2006 and $83,315 for fiscal year 2005 may be used to meet the District's ongoing obligations to citizens and creditors.

At the end of the current fiscal year, the District is able to report positive balances in all categories of net assets.

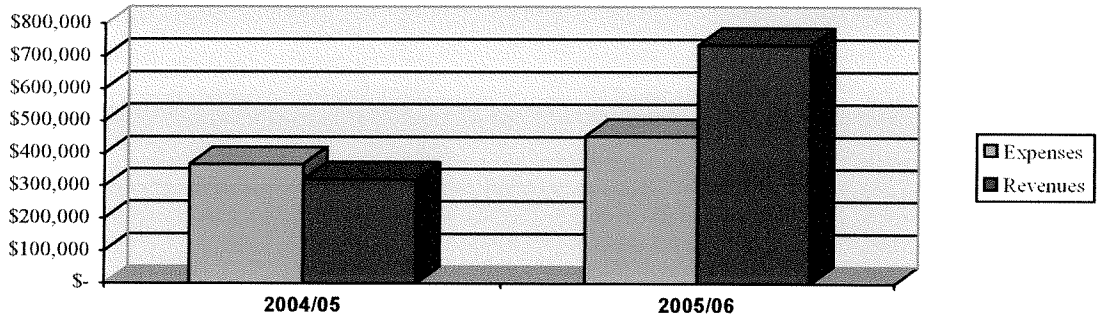
Changes in Net Assets	For the Years Ended		
	June 30, 2005	June 30, 2006	Percentage Change
Revenues:			
Program revenues			
Operating revenues	$ 236,647	$ 255,996	8.2 %
General revenues			
Investment earnings	1,756	1,521	(13.4) %
Property tax	159	99	(37.7) %
Intergovernmental	77,812	474,445	509.7 %
Contributions - connection fees	4,540	4,000	(11.9) %
Total revenues	320,914	736,061	129.4 %
Expenses			
Services and supplies	325,022	408,631	25.7 %
Fiscal agent/legal services	10,216	642	(93.7) %
Depreciation/amortization	32,997	45,547	38.0 %
Total expenses	368,235	454,820	23.5 %
Increase (decrease) in net assets	(47,321)	281,241	694.3 %
Net assets at beginning of year	721,077	673,756	(6.6) %
Net assets at end of year	$ 673,756	$ 954,997	41.7 %

Financial Analysis (continued)

Changes in Net Assets (continued)

The District's net assets increased by $281,241 during fiscal year 2006 compared to a decrease of $47,321 during fiscal year 2005. The fiscal year 2006 increase is due primarily to intergovernmental revenues of $474,445. This amount represents funding received from the Water Agency. The Water Agency forgave an advance to the District in the amount of $250,000 during 2005/06. The District received this advance in August of 1998. In addition, the Water Agency also provided an additional $224,445 in financing in order to allow the District to meet its ongoing operating expenses.

Expenses and Revenues

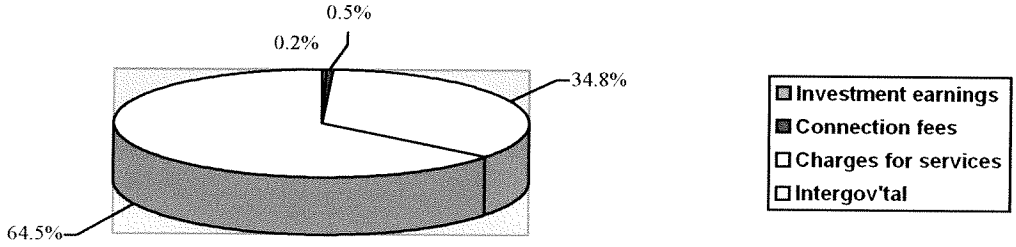


Total revenues of the District for fiscal year 2005/06 totaled $736,061 representing an increase of $415,147 from the preceding fiscal year revenues of $320,914. The rate based charges for services, representing 34.8% of the District's 2005/06 total revenue, increased by $19,349 (8.2%); connection fees, representing 0.5% of the District's total revenue in the current fiscal year, decreased by $540. Investment earnings decreased from the preceding fiscal year by $235. Intergovernmental revenues totaling $474,445 (64.5% of current year revenues) were received from the Water Agency. The combined effect of these occurrences is an overall increase in revenues of 129.4%.

Total expenses for the District increased by $86,585 to $454,820 for fiscal year 2005/06. Utilities expenses decreased significantly for the District during 2005-06 due to the Power and Water Resource Pooling Authority, which provided the District power during the year. These savings were offset by additional costs related to the New Year's floods resulting in an overall increase in expenses of 23.5%.

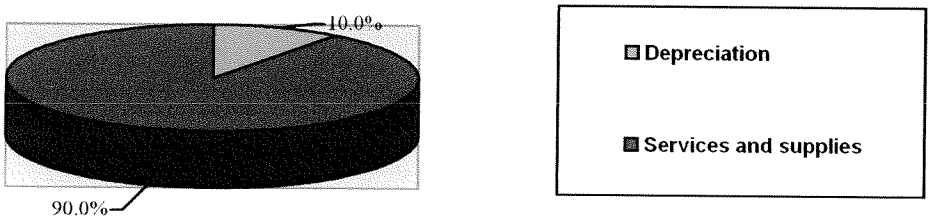
Financial Analysis (continued)

Revenues by Source



As previously mentioned, revenues collected by the District for 2005/06 totaled $736,061. Of this amount $255,996 or 34.8%, was generated through charges for services. Charges for services represent sewer services charges to cover operations and maintenance costs, which are initially collected through the permitting process, then subsequently through the tax rolls. Connection fees, which accounted for 0.5% of the annual revenue, are also collected through the permitting process. Investment earnings represent 0.2% of revenues and consist of earnings on pooled cash held with the Sonoma County Treasurer. Intergovernmental revenues, representing financing from the Water Agency totaled 64.5% of the District's revenues in 2005/06.

Expenses by Function



Total expenses for the District for fiscal year 2005/06 totaled $454,820. Costs associated with the collection, treatment, and disposal of effluent represent 90.0% of the District's costs. Annual depreciation expense on capital assets represents $45,547 (10.0%) of total expenses.

Capital Asset and Debt Administration

Capital assets

The District's investment in capital assets as of June 30, 2006, amounts to $878,040 (net of accumulated depreciation). This investment in capital assets includes buildings and improvements, and construction in progress.

Occidental County Sanitation District's Capital Assets

	June 30, 2005	June 30, 2006	Percentage Change
Buildings and improvements	$1,394,588	$ 1,395,500	0.1 %
Construction in progress	902	82,782	9,077.6 %
Accumulated depreciation	(554,695)	(600,242)	8.2 %
Total	$ 840,795	$ 878,040	4.4 %

Additional information on the District's capital assets can be found in Note D on page 20 of the financial statement footnotes.

Long-term Debt

At the end of the current fiscal year, the District had a total of $3,000 in outstanding debt consisting of general obligation bonds. This amount comprises debt backed by the full faith and credit of the District.

Occidental Sanitation District's Outstanding Current and Long Term Debt

	June 30, 2005	June 30, 2006	Percentage Change
General obligation bonds	$ 4,000	$ 3,000	(25.0) %
Advances from other governments	250,000	-	(100.0) %
Total	$ 254,000	$ 3,000	(98.8) %

The District's total debt decreased by $251,000 during the current fiscal year.

The decrease in advances ($250,000) is a result of the forgiveness of the $250,000 advance the District received from the Water Agency in August of 1998.

Additional information on the District's current and long-term debt can be found in Notes E and F on page 21 of this report.

Next Year's Budget and Rates

Budgeted gross expenditures for the District for fiscal year 2006/07 have decreased by $2,297,027 (50.8%) for a total of $2,233,070. The major component of the decrease in budgeted expenditures is related to capital projects that have been delayed / cancelled in the District's construction fund due to financial constraints.

Following is a comparison of final 2005/06 and proposed 2006/07 budgeted expenditures for the District:

	2005/06	2006/07	Increase (Decrease)	Percentage Change
Occidental				
Operations	$ 529,855	$ 338,673	$ (191,182)	(36.1) %
General obligation bonds	242	195	(47)	(19.4) %
Construction	4,000,000	1,894,202	(2,105,798)	(52.6) %
	$ 4,530,097	$ 2,233,070	$ (2,297,027)	(50.8) %

NOTE: Budgeted expenditures for fiscal year 2005/06 differ in several instances from the budgeted expenditures presented in the Management's Discussion and Analysis for the period ending June 30, 2005. These variances are due to Board approved budgetary adjustments made subsequent to the publication of the 2004/05 audited financial statements.

The sewer service fees were increased for the 2006 - 2007 budget year. The rates were increased by 7.0 %.

Following are table shows the sanitation services rates and equivalent single dwellings for the District:

	2005/06	2006/07	Percentage Change
Rate per Equivalent Single-Family Dwelling	$ 1,043	$ 1,116	7.0 %
Number of Equivalent Single-Family Dwellings by District	263	266	1.14 %

Request for Additional Information:

This financial report is designed to provide a general overview of the District's finances for all those with an interest in the District's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Sonoma County Auditor-Controller's Office, ATTN. Fiscal Division, 585 Fiscal Drive, Room 101F, Santa Rosa, CA. 95403

Basic Financial Statements

Occidental County Sanitation District

Statement of Net Assets

	June 30, 2006
Assets	
Current assets	
Cash and equivalents	$ 74,734
Accounts receivable	2,574
Prepaid expenses	2,297
Total current assets	79,605
Noncurrent assets	
Restricted cash, cash equivalents, and investments:	
Cash - general obligation bond fund	2,641
Total restricted assets	2,641
Capital assets:	
Buildings and improvements	1,395,500
Construction in progress	82,782
Less: accumulated depreciation	(600,242)
Total capital assets (net of accumulated depreciation)	878,040
Total noncurrent assets	880,681
Total assets	960,286
Liabilities	
Current liabilities payable from unrestricted assets	
Accounts payable and accrued expenses	2,289
Current liabilities payable from restricted assets	
General obligation bonds payable	1,000
Total current liabilities	3,289
Noncurrent liabilities	
General obligation bonds payable	2,000
Total liabilities	5,289
Net assets	
Invested in capital assets, net of related debt	875,040
Restricted for debt service	2,641
Unrestricted	77,316
Total net assets	$ 954,997

See accompanying Notes to Basic Financial Statements

Occidental County Sanitation District

Statement of Revenues, Expenses and Changes in Net Assets

	For the Year Ended June 30, 2006
Operating revenues	
Flat charges	$ 247,263
Charges for services	8,733
Total operating revenues	255,996
Operating expenses	
Services and supplies	408,631
Fiscal agent fees and legal services	642
Depreciation and amortization	45,547
Total operating expenses	454,820
Operating loss	(198,824)
Nonoperating revenues	
Investment income	1,521
Intergovernmental	224,445
Property taxes	99
Net nonoperating revenues	226,065
Net income before contributions and transfers	27,241
Capital contribution:	
Connection fees	4,000
Transfer in	250,000
Increase in net assets	281,241
Net assets at beginning of year	673,756
Net assets at end of year	$ 954,997

See accompanying Notes to Basic Financial Statements

Occidental County Sanitation District

Statement of Cash Flows

		For the Year Ended June 30, 2006
Cash flows from operating activities		
Receipts from customers	$	255,862
Payments for interfund services used		(332,999)
Payments to suppliers		(80,326)
Net cash used in operating activities		(157,463)
Cash flows from noncapital financing activities		
Taxes		99
Cash flows from capital and related financing activities		
Purchase of capital assets		(82,626)
Principal payments - bonds		(1,000)
Interest paid on capital debt		(166)
Advances from other related governments		224,445
Connection fees		4,000
Net cash provided by capital and related financing activities		144,653
Cash flows from investing activities		
Interest received on pooled cash and investments		1,520
Net decrease in cash and cash equivalents		(11,191)
Cash and cash equivalents at beginning of year		88,566
Cash and cash equivalents at end of year	$	77,375
Cash and cash equivalents includes the following:		
Cash and cash equivalents	$	74,734
Restricted cash and cash equivalents		2,641
	$	77,375

See accompanying Notes to Basic Financial Statements

		For the Year Ended June 30, 2006
Reconciliation of operating income to net cash used in operating activities:		
Operating loss	$	(198,824)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization expense		45,547
Change in assets and liabilities:		
Increase in accounts receivable		(133)
Increase in prepaid expenses		(2,297)
Increase in accounts payable and accrued expenses		(1,756)
Net cash used in operating activities	$	(157,463)

Noncash investing, capital and financing activities:		
Net increase in fair value of investment in County Treasurer's Pooled cash	$	25
Decrease in due to other related governments for debt forgiven by the Sonoma County Water Agency	$	250,000

The notes to the basic financial statements include a summary of significant accounting policies and other notes considered essential to fully disclose and fairly present the transactions and financial position of Occidental County Sanitation District as follows:

Note A. Defining the Financial Reporting Entity

Note B. Summary of Significant Accounting Policies

Note C. Cash and Investments

Note D. Capital Assets

Note E. Intergovernmental Activity

Note F. Long-Term Obligations

Note G. Related Party Transactions

Note H. Commitments and Contingencies

Note I. Recent Governmental Accounting Standards

Note A. Defining the Financial Reporting Entity

The Occidental County Sanitation District (the "District") is managed by the Sonoma County Water Agency (the "Water Agency"), which provides engineering, administration, operational, and maintenance services. The District is responsible for maintaining and operating the local sanitation collection systems, pump stations, and treatment plants. The District has an ordinance defining policies, including user fees.

Component Unit Reporting

The District is governed by the Board of Supervisors ("Board of Supervisors") of the County of Sonoma (the "County"). The exercise of this oversight responsibility causes the District to be an integral part of the County's reporting entity. Therefore, the District's financial statements have also been included in the County's annual financial statements.

There are no other organizations or agencies whose basic financial statements should be combined and presented with these basic financial statements.

Note B. Summary of Significant Accounting Policies

The District conforms to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units. A summary of significant accounting policies is included below:

Government-wide and Fund Financial statements

The government-wide financial statements (i.e., the statement of net assets and the statement of revenues, expenses and changes in net assets) display information on the District as a whole. These financial statements include the financial activities of the District's nonfiduciary activities. The District does not have any activities that are considered government-type or fiduciary activities. The statement of net assets presents the financial condition of the business activities of the District at year end.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The District uses a proprietary (enterprise) fund to account for its activities. Proprietary funds are used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

Note B. Summary of Significant Accounting Policies (continued)

Measurement Focus, Basis of Accounting, and Financial Statement Presentation (continued)

The District's financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. All assets and liabilities associated with the operation of the District are included on the statement of net assets. 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.

The District has elected under Governmental Accounting Standards Board ("GASB") Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting,* to apply all applicable GASB pronouncements as well as any applicable pronouncement of the Financial Accounting Standards Board or any Accounting Research Bulletins issued on or before November 20, 1989 unless those pronouncements conflict with or contradict GASB pronouncement. The GASB periodically updates its codification of the existing Governmental Accounting and Financial Reporting Standards which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes GAAP for governmental units.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the District are charges for services. Operating expenses for the District include expenses relating to the collection, treatment, disposal, and reclamation of effluent as well as administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Cash and Investments

The District's cash and investments are pooled with the Sonoma County Treasurer. The Sonoma County Treasurer also acts as a disbursing agent for the District. The fair value of the investments in the pool is determined quarterly. Realized and unrealized gains or losses and interest earned on pooled investments are allocated quarterly to the District based on its respective average daily balance for that quarter in the County Treasury Investment Pool (the "Treasury Pool"), an external investment pool.

The District applies the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools,* which requires governmental entities to report certain investments at fair value in the statement of net assets and recognize the corresponding change in the fair value of investments in the year in which the change occurred. In accordance with GASB Statement No. 31, the District has stated certain Treasury Pool investments at fair value.

Note B. Summary of Significant Accounting Policies (continued)

Cash and Investments (continued)

The District applies the provisions of GASB Statement No. 40, *Deposit and Investment Risk Disclosures* – an amendment to GASB Statement No. 3, which requires governmental entities to provide proper disclosures on common deposit and investment risk related to credit risk, interest rate risk and foreign currency risk. In accordance with GASB Statement No. 40, the District has made such disclosure.

For purposes of the statement of cash flows, the District considers all pooled cash and investments as cash and cash equivalents because the Treasury Pool is used as a demand deposit account. Restricted cash and investments with a maturity of three months or less when purchased are also treated as cash and cash equivalents.

Accounts Receivable

Accounts receivable consists of uncollected fees for sanitation services and flat charges at June 30, 2006. These flat charges are established annually by the Board of Supervisors and billed through the County's property tax system.

Prepaid Expenses

Prepaid expenses represent payments made to vendors for services that will benefit periods beyond June 30, 2006.

Restricted Assets

Restricted assets represent cash, investments and receivables maintained in accordance with bond resolutions and formal actions of the Board of Supervisors or by agreement, for the purpose of funding certain debt service payments.

Capital Assets

Capital assets are stated at cost or estimated historical cost. Capital assets are defined by the District as assets with an initial, individual cost of more than $5,000 and an estimated useful life in excess of one year. Depreciation has been provided, excluding land, using the straight-line method over estimated lives ranging from 3 to 50 years. Useful lives of machinery and equipment are generally estimated to be 3 to 15 years. Buildings and improvements are generally estimated to have useful lives ranging from 30 to 50 years.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed.

Note B. Summary of Significant Accounting Policies (continued)

Net Assets

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowings used for the acquisition, construction or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use, either through enabling legislation adopted or through external restrictions imposed by creditors, grantors or laws or regulation of other governments. The District applies restricted resources first when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

Budget and Budgetary Accounting

The Board of Supervisors adopts a budget annually to be effective July 1st for the ensuing fiscal year for all governmental and proprietary fund types within the jurisdiction of Sonoma County. The general manager of the Water Agency is authorized to transfer budgeted amounts of the District except for transfers between the major expenditure classes or transfers between capital assets and operating expenses. Such transfers require approval by the County Administrator and/or the Board of Supervisors.

Property Tax Revenue

Property taxes, including tax rates, are regulated by the State and are administered locally by the County. The County is responsible for assessing, collecting and distributing property taxes in accordance with state law. The County is responsible for the allocation of property taxes to the District.

The County has adopted the Teeter Alternative Method of Property Tax Allocation known as the "Teeter Plan". The State Revenue and Taxation Code allows counties to distribute secured real property and supplemental property taxes on an accrual basis resulting in full payment to the District each fiscal year. Any subsequent delinquent payments and related penalties and interest will revert to Sonoma County.

Property taxes are recognized as revenue when they are levied. Liens on real property are established January 1 for the ensuing fiscal year. The property tax is levied as of July 1 on all taxable property located in the County. Secured property taxes are due in two equal installments on November 1 and February 1, and are delinquent after December 10 and April 10, respectively. Additionally, supplemental property taxes are levied on a pro rata basis when changes in assessed valuation occur due to sales transactions or the completion of construction. Property tax collection and valuation information is disclosed in the County of Sonoma's financial statements.

Note B. Summary of Significant Accounting Policies (continued)

Intergovernmental Transactions

Intergovernmental transactions made during the year are primarily charges for current services rendered or facilities provided. These transactions are recorded as revenue and expenses by the District.

Use of Estimates

The preparation of financial statements 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 expenditures/expenses during the reporting period. Actual results could differ from those estimates.

Note C. Cash and Investments

The District follows the practice of pooling cash and investments with the County Treasurer except for funds required to be held by outside fiscal agents or trustees under the provisions of bond indentures and lease agreements. The Treasury Oversight Committee has regulatory oversight for all monies deposited into the Treasury Pool.

Interest income earned on pooled cash and investments is allocated quarterly based on the average daily balance of the District during the quarter. Interest income from cash and investments with fiscal agents or trustees is credited directly to the District.

Investment Guidelines

The District's pooled cash and investments are invested pursuant to investment policy guidelines established by the County Treasurer and approved by the Board of Supervisors. The objectives of the policy are, in order of priority: safety of capital, liquidity and maximum rate of return. The policy addresses the soundness of financial institutions in which the County will deposit funds, types of investment instruments as permitted by the California Government Code, and the percentage of the portfolio that may be invested in certain instruments with longer terms to maturity.

Permitted investments include the following:

- U.S. Treasury and Federal Agency securities
- Bonds issued by local agencies
- Registered State Warrants and Municipal Notes
- Negotiable certificates of deposit
- Bankers' acceptances
- Commercial paper
- Medium-term corporate notes
- Local Agency Investment Fund (State Pool) demand deposits
- Repurchase agreements
- Reverse repurchase agreements
- Shares of a mutual fund average life
- Collateralized mortgage obligations
- Joint power agreements

Note C. **Cash and Investments** (continued)

Investment Guidelines (continued)

A copy of the County Investment Policy is available upon request from the County Treasurer at 585 Fiscal Drive, Room 100F, Santa Rosa, California, 95403.

Balance Sheet

As of June 30, 2006, the District's cash and investments consisted of $77,375 in the Treasury Pool managed by the County Treasurer, which has a weighted average maturity of less than two years. The credit rating and other information regarding the Treasury pool for the fiscal year 2005-06 are disclosed in the County of Sonoma's 2005-06 Comprehensive Annual Financial Report.

The net increase in the fair value of the District's investments during fiscal year 2005-06 was $25 and is included in revenue. This amount takes into account all changes in fair value (including purchases and sales) that occurred during the year. The unrealized loss on investments held at year end amounted to $182. The realized gain and loss from securities matured during the current fiscal year are recognized through the net change in the fair value of the investment held in the Treasury Pool.

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the District manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments, and by timing cash flows from maturities so that a portion of the portfolio is maturing, or coming close to maturity, evenly over time, as necessary, to provide the cash flow and liquidity needed for operations. As of June 30, 2006 all of the District's cash and investments are held by the Treasury Pool, which has a weighted average maturity of less than two years.

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party.

Investments in external investment pools and in open-end mutual funds are not exposed to custodial credit risk. At June 30, 2006, all of the District's investments are in an external investment pool and are therefore not exposed to custodial credit risk.

Note C. **Cash and Investments** (continued)

Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The District follows the County's policy to purchase investments with the minimum ratings required by the California Government Code. The credit rating and other information regarding the Treasury pool for the fiscal year 2005-06 are disclosed in the County of Sonoma's 2005-2006 Comprehensive Annual Financial Report.

Note D. **Capital Assets**

Capital asset activity for the year ended June 30, 2006 was as follows:

	Beginning Balance July 1, 2005	Additions	Retirements	Transfers and Adjustments	Ending Balance June 30, 2006
Capital assets, not being depreciated:					
Construction in progress	$ 902	$ 82,792	$ -	$ (912)	$ 82,782
Capital assets, being depreciated:					
Buildings and improvements	1,394,588	-	-	912	1,395,500
Less accumulated depreciation for:					
Buildings and improvements	(554,695)	(45,547)	-	-	(600,242)
Total capital assets, being depreciated, net	839,893	(45,547)	-	912	795,258
Total capital assets, net	$ 840,795	$ 37,245	$ -	$ -	$ 878,040

Depreciation expense amounted to $45,547 for the year ended June 30, 2006.

The total amount of interest capitalized in connection with wastewater treatment facilities construction projects during the year ended June 30, 2006 amounted to $166.

Note E. Intergovernmental Activity

Activity between related governments that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other related governments" (i.e., the current portion of interfund loans) or "advances to/from other related governments" (i.e., the non-current portion of interfund loans). At June 30, 2006 there were no amounts due to or owed from other related governments.

In August 1998, the District received a loan of $250,000 from the Water Agency in order to finance continued planning for a treatment plant upgrade project. The agreement required repayment no later than June 30, 2006. The loan was forgiven through the adoption of a resolution of the board of directors of the Water Agency and the District in June 2006 and is referred to as a transfer in.

Note F. Long-Term Obligations

General Obligation Bonds

The District issued general obligation bonds to provide funds for the acquisition and construction of major capital facilities. The original amount of general obligation bonds issued in prior years was $32,000. No new general obligation bonds were issued during the current fiscal year.

General obligation bonds are direct obligations and pledge the full faith and credit of the government. General obligation bonds outstanding at June 30, 2006 are $3,000 with an interest rate of 5%.

Annual debt service requirements to maturity for general obligation bonds are as follows:

Year ending June 30,	Principal	Interest
2007	$ 1,000	$ 143
2008	1,000	95
2009	1,000	47
Total	$ 3,000	$ 285

Changes in Long-Term Obligations

Long-term obligation activity for the year ended June 30, 2006 was as follows:

	Beginning Balance July 1, 2005	Additions	Reductions	Ending Balance June 30, 2006	Due Within One Year
General obligation bonds	$ 4,000	$ -	$ (1,000)	$ 3,000	$ 1,000

Note G. Related Party Transactions

The District is a special district under the Board of Supervisors, and as such, has the same board members as the County of Sonoma.

The District is managed by the Water Agency, which provides administration, engineering, operational, and maintenance services. The District does not incur any payroll expenses. The Water Agency allocates overhead costs to the District via the use of a 65% overhead rate charged on labor applicable to the District. The overhead rate is reviewed annually by management to determine its effectiveness. The District paid $325,441 to the Water Agency for administrative support during the year ended June 30, 2006

During the year ended June 30, 2006, the District received funding from Water Agency to allow the District to meet operating expenses. The total funding received by the District amounted to $228,000 for the year ended June 30, 2006.

Note H. Commitments and Contingencies

Commitments

The District's Board approved an agreement for a wastewater collection system replacement project. In connection with this project, the District entered into a contract with consulting engineers in the amount of $75,000. The District anticipates the construction cost of the project to be approximately $1.6 million.

On June 29, 2004, the District entered into an agreement with a consulting company for engineering and design services for the Occidental County Sanitation District and Camp Meeker Wastewater Reclamation Project. Phase 1 of this project is in the amount of $535,500, and began in the 2004-05 fiscal year.

Risk Management

The District is covered by the County's self-insurance program, which is accounted for in the County's Risk Management Internal Service Fund. The District is covered under this program for general liability, auto liability, public employees' performance/dishonesty and property insurance.

The County maintains a self-insured retention of $1,000,000 per occurrence for general and automobile liability. Excess liability coverage is maintained through participation in the California State Association of Counties, Excess Insurance Authority ("CSAC-EIA") and Excess Liability Program. Limits of this coverage are $15,000,000.

Note H. Commitments and Contingencies (continued)

The County also maintains public employee faithful performance/employee dishonesty coverage through a joint-purchase program provided by National Union Fire Insurance Company and administered by CSAC-EIA with limits of $5,000,000 and a $25,000 deductible.

The County maintains "All Risk" property insurance including flood and earthquake through participation in the CSAC-EIA property insurance program. Limits of coverage are $200,000,000 per occurrence including flood and $50,000,000 per occurrence for earthquake. Deductibles for most perils are $50,000 per occurrence, with flood at $200,000 per county per occurrence and earthquake at 5% of total insured values per unit, per occurrence, subject to a $500,000 minimum per occurrence. For losses within the deductible, the County maintains a deductible self-insured pool for losses in excess of $5,000.

The District pays an annual premium to the County for this insurance coverage. Settled claims have not exceeded this coverage for any of the past four fiscal years.

Pending Litigation, Claims, and Investigation

In September 2004, the Water Agency received a revised 60-day notice letter from Northern California River Watch ("River Watch") providing notification that River Watch intended to file a citizen's suit action against the Water Agency and the County for violation of Clean Water Act permit requirements at treatment facilities including the District, the Russian River County Sanitation District, and the Sonoma Valley County Sanitation District. The District is operated by the Water Agency under contract. In fall 2005, River Watch amended its 60-day notice letter to address only the Sonoma Valley County Sanitation District facility and filed suit in late 2005. In spring 2006, River Watch issued a 60-day notice addressing the Russian River County Sanitation District facility and filed suit shortly thereafter. Legal challenges to the Sonoma Valley case have been made. The parties are attempting to resolve the litigation and reach settlement. Substantial costs may be incurred by the Water Agency or the various sanitation districts in connection with future proceedings based on the claims of violations of the Clean Water Act alleged by River Watch, or in connection with a settlement of any such claims. Costs may include penalties, attorneys' fees, court costs and costs associated with physical improvements determined to be necessary to comply with the Clean Water Act. Although settlement of the claims may be close at hand, it is too early as this time to determine the amount of these costs or the source of funds.

Note H. Commitments and Contingencies (continued)

Pending Litigation, Claims, and Investigation (continued)

In March, 2003, two enforcement orders issued by the North Coast Regional Quality Control Board ("NC Regional Board") against the District and the Water Agency remain outstanding pending completion of capital improvements for the District facility. These enforcement orders require the District to construct compliance projects to address historical discharge permit violations. One of the projects planned to comply with the enforcement orders is to replace the District's collection system. A second project would consist of constructing a new pipeline from the District to the Russian River County Sanitation District ("Russian River") treatment plant in Guerneville to treat wastewater generated by the District and the closure of the District's existing treatment plant. CEQA review is necessary for the pipeline/treatment plant closure project. Estimated costs for these projects are still being developed, but are anticipated to be on the order of $8,000,000. It is too early to predict the cost for the District to participate in construction of this project as the level of cost will depend on the amount of grants and loans obtained from outside funding agencies. The District is authorized to spend approximately $150,000 of previously assessed mandatory minimum penalty fines toward one or possibly both of these compliance projects. In addition, although payment of a $50,000 fine for previous violations at the District facility has been postponed by the NC Regional Board and may be waived, payment will be required if system improvements are not completed by the District in the next several years.

Other Regulatory Matters

The District is subject to Section VII of the Endangered Species Act. Section VII requires that all affected agencies, including the District, consult with fish and wildlife officials before performing any work which might disrupt or harm any endangered or threatened species or their habitat. This Act increases the possibility of threatened litigation from various environmental groups and individuals. The District is also subject to Section X of the Endangered Species Act which deals with habitat conservation planning.

Note I. Recent Governmental Accounting Standards

The Governmental Accounting Standard Board ("GASB") has released the following new standards:

Statement No. 43, *Financial Reporting for Postemployment Benefit (OPEB) Plans Other than Pension Plans* issued in April 2004. This Statement establishes uniform financial reporting standards for OPEB plans focusing on reporting current financial information about plan net assets held in trust for OPEB and financial activities related to the administration of the trust. GASB No. 43 is effective for financial statements for years beginning after December 15, 2006.

Note I. **Recent Governmental Accounting Standards** (continued)

Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefit Other than Pension* issued in June 2004. This Statement establishes standards for the measurement, recognition, and display of Postemployment Benefits expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of state and local governmental employers. GASB No. 45 is effective for financial statements for years beginning after December 15, 2007.

The impact on the financial statements of the District of these pronouncements which have been issued, but not yet adopted, is unknown at this time.

Compliance

PISENTI & BRINKER LLP
Certified Public Accountants and Advisors
An Independently Owned Member of the RSM McGladrey Network

Independent Auditors' Report on Internal Control and on Compliance and Other Matters Over Financial Reporting Based on Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

County of Sonoma Board of Supervisors
Occidental County Sanitation District
Santa Rosa, California

We have audited the basic financial statements of the Occidental County Sanitation District ("the District"), a component unit of the County of Sonoma, as of and for the year ended June 30, 2006, and have issued our report thereon dated September 15, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

Compliance

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

This report is intended for the information of the management of the District, the Sonoma County Board of Supervisors, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than those specified parties.

Pisenti & Brinker LLP

Santa Rosa, California
September 15, 2006

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Section I. Summary of Auditors' Results

Financial Statements

Type of auditors' report issued:	*unqualified*			
Internal control over financial reporting:				
Material weaknesses identified	_____	yes	__X__	no
Reportable conditions identified not considered to be material weaknesses			none reported	
Noncompliance material to financial statements noted	_____	yes	__X__	no

Section II. Financial Statement Findings

There were no observations noted in last year's report that require current year resolution.

There were no observations noted in the current year's audit.