South Park County Sanitation District

Basic Financial Statements

Year Ended June 30, 2006

Table of Contents

	Page
Independent Auditors' Report	
Management's Discussion and Analysis	2
Basic Financial Statements	
Statement of Net Assets	9
Statement of Revenues, Expenses and Changes in Net Assets	11
Statement of Cash Flows	12
Notes to Basic Financial Statements	14
Compliance	
Independent Auditors' Report on Internal Control and on Compliance and Other Matters Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*	
Schedule of Findings and Questioned Costs	29

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

Independent Auditors' Report

Board of Supervisors
County of Sonoma
South Park County Sanitation District
Santa Rosa, California

We have audited the accompanying basic financial statements of the South Park 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 South Park 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 - 13) and the accompanying notes to the financial statements (pages 14 - 27).

Reporting Entity

The South Park County Sanitation District is managed by the Sonoma County 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 $10,889,865 (*net assets*). Of this amount, $5,192,314 (*unrestricted net assets*) may be used to meet the District's ongoing obligations to citizens and creditors.

Revenues

The District recognized total revenues of $3,737,023 during fiscal year 2005/06. Of this amount, $2,796,038 consists of charges for services (operating revenues), and $940,985 of non-operating revenues consisting of investment earnings, connection fees, capital grants and intergovernmental revenue.

Expenses

The District incurred expenses totaling $1,943,085 during fiscal year 2005/06. Of this amount $1,861,250 represents operating expenses related to the collection, treatment, disposal, and reclamation of effluent, as well as administrative and general expenses. The non-operating expenses total $81,835 which is comprised of interest expense related to debt obligation.

Increase in Net Assets

The District recorded operating income of $934,788 for fiscal year 2005/06. The District recognized an overall increase in net assets of $1,793,938.

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 14 – 27.

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 $10,889,865 at the close of the most recent fiscal year compared to net assets of $9,095,927 at June 30, 2005.

A portion of the District's net assets (44.7% for fiscal year 2006 compared to 25.5% 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 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.

Financial Analysis (continued)

Net Assets

	June 30, 2005	June 30, 2006	Percentage Change
Current and other assets	$ 6,949,197	$ 6,735,689	(0.3)%
Capital assets	5,445,338	7,788,787	43.0%
Total Assets	12,394,535	14,524,476	19.6%
Current liabilities	148,112	717,406	384.4%
Non-current liabilities	3,150,496	2,917,205	7.4%
Total Liabilities	3,298,608	3,634,611	10.2%
Invested in capital assets net of related debt	2,318,804	4,863,477	109.7%
Restricted for debt service	87,257	57,600	(34.0)%
Restricted for capital projects	748,647	776,574	3.7%
Unrestricted	5,941,219	5,192,214	(12.6)%
Total Net Assets	$ 9,095,927	$10,889,865	19.7%

A portion of the District's net assets $834,174 (7.7% for fiscal year 2006) and $835,904 (9.2% for 2005) represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets of $5,192,214 for June 30, 2006 and $5,941,219 for June 30, 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	$ 2,758,690	$ 2,796,038	1.4 %
General revenues			
Investment earnings	151,825	254,552	67.7 %
Intergovernmental	-	412,413	NA
Capital grants	83,410	146,020	75.1 %
Contributions - connection fees	5,060	128,000	2,429.6 %
Total revenues	$ 2,998,985	$3,737,023	24.6 %

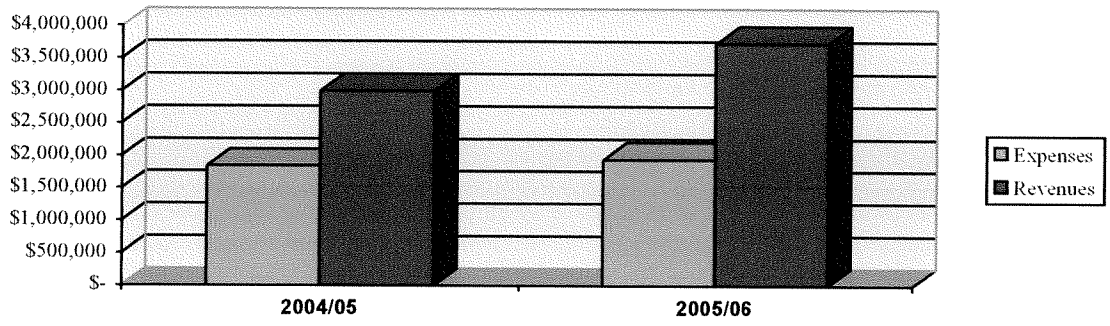
Financial Analysis (continued)

Changes in Net Assets (continued)

	For the Years Ended		
	June 30, 2005	June 30, 2006	Percentage Change
Expenses			
Services and supplies	$ 1,657,413	$ 1,679,394	1.3 %
Fiscal agent/legal services	17,859	10,676	(40.2)%
Depreciation/amortization	145,855	151,691	4.0 %
Environmental investigation	22,469	19,489	(13.3)%
Interest expense	129,937	81,835	(37.0) %
Total expenses	1,973,533	1,943,085	(1.5) %
Increase in net assets	1,025,452	1,793,938	74.9 %
Net assets at beginning of year	8,070,475	9,095,927	12.7 %
Net assets at end of year	$ 9,095,927	$ 10,889,865	19.7 %

The District's net assets increased by $1,793,938 during 2006 compared to an increase of $1,025,452 during 2005. The 2006 increase is due primarily to increases in charges for services ($37,348), investment earnings ($102,727), intergovernmental revenues ($412,413), capital grants ($62,610), and connection fees ($122,940). In addition, total expenses incurred by the District decreased ($30,338) compared to the previous fiscal year due primarily to decreased interest expense ($48,102) incurred by the District in 2005/06.

Expenses and Revenues



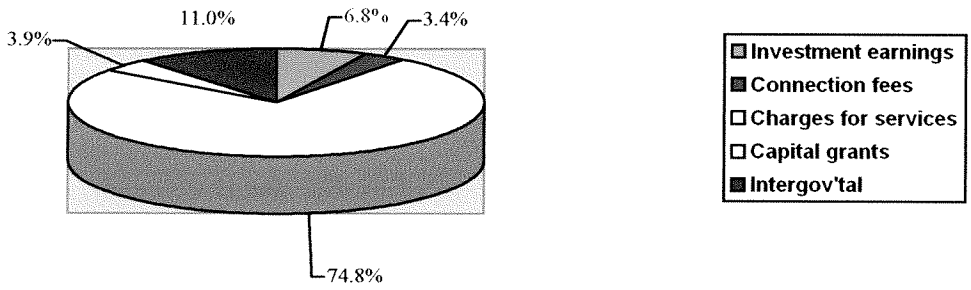
Total revenues of the District for fiscal year 2005/06 totaled $3,737,023 representing an increase of $738,038 from the preceding fiscal year revenues of $2,998,995. The rate based charges for services, representing 74.8% of the District's total revenue, increased by $37,348 (1.4% increase); connection fees, representing 3.4% of the District's total revenue, increased by $122,940. Investment earnings improved from the prior fiscal year by $102,727. Intergovernmental revenues totaling $412,413 (11.0% of total revenues) were received from the City of Santa Rosa towards funding of capital projects. Capital grants, representing 3.9% of the District's total revenue in the current fiscal year increased by $62,610. The combined effect of these occurrences is an overall increase in revenues of 24.6%.

Financial Analysis (continued)

Expenses and Revenues (continued)

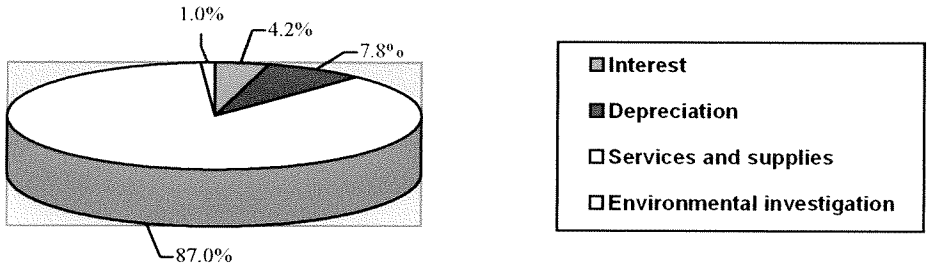
Total expenses for the District decreased by $30,448 to $1,943,085 for fiscal year 2005/06. Interest expense decreased $48,102, and depreciation/amortization expenses increased $5,836 over the prior fiscal year. Costs related to collection and administration increased $21,981 over the prior fiscal year. Overall, the District's expenses decreased 1.5% over the prior fiscal year.

Revenues by Source



As previously mentioned, revenues collected by the District for 2005/06 totaled $3,737,023. Of this amount $2,796,038 or 74.8%, 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 3.4% of the annual revenue, are also collected through the permitting process. Investment earnings represent 6.8% of revenues and consist of earnings on pooled cash held with the Sonoma County Treasurer. Intergovernmental revenues and capital grants, representing financing from external governmental entities towards capital projects combined for 14.9% of the District's revenues in 2005/06.

Expenses by Function



Expenses for the District for fiscal year 2005/06 totaled $1,943,085. Costs associated with the collection, treatment, and disposal of effluent represent 87.0% of the District's costs. The next largest functional area is the annual depreciation expense on capital assets and represents $151,691 (7.8%) of total expenses. Interest expense totaling $81,835 (4.2%) represents the cost of meeting current debt service obligations. Environmental investigation expenses totaled $19,489 (1.0%) for fiscal year 2005/06.

Capital Asset and Debt Administration

Capital assets

The District's investment in capital assets as of June 30, 2006, amounts to $7,788,787 (net of accumulated depreciation). This investment in capital assets includes buildings and improvements, and construction in progress.

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

- Victoria Drive / Corby Avenue - collection system replacement

South Park Sanitation District's Capital Assets

	June 30, 2005	June 30, 2006	Percentage Change
Buildings and improvements	$ 7,343,854	$ 9,241,099	25.8%
Construction in progress	774,053	1,367,573	76.7%
Accumulated depreciation	(2,672,569)	(2,819,885)	5.5%
Total	$ 5,445,338	$ 7,788,787	43.0%

Additional information on the District's capital assets can be found in Note D on pages 22 and 23 of the notes to the financial statements.

Long-term Debt

At the end of the current fiscal year, the District had a total of $3,017,205 in outstanding revenue bonds.

South Park County Sanitation District's Outstanding Current and Long Term Debt

	June 30, 2005	June 30, 2006	Percentage Change
Revenue bonds	$ 3,235,497	$ 3,017,205	(6.7)%

The District's total debt decreased by $218,292 during the current fiscal year.

The decrease in revenue bonds is due to both the annual principal repayments of the debt along with the refunding of the 2000B Special Revenue bonds during 2005/06. The refunding resulted in the retirement of $3,255,000 of principal and was financed via the issuance of $3,250,000 in 2005C Revenue Bonds.

Additional information on the District's current and long-term debt can be found in Notes E, F and G on pages 23 and 24 of this report.

Next Year's Budget and Rates

Budgeted gross expenditures for the District for fiscal year 2006/07 have decreased by $138,163 (19.4%) for a total of $6,617,379. The major component of the decrease in budgeted expenditures is related to capital projects in the District's construction fund.

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
South Park				
Operations	$ 2,496,553	$ 2,550,430	$ 53,877	2.2 %
Debt Service - Revenue Bonds	184,178	160,580	(23,598)	(12.8)%
Construction	4,074,811	3,906,369	(168,442)	(4.1)%
	$ 6,755,542	$ 6,617,379	$(138,163)	(2.0)%

NOTE: Budgeted expenditures for fiscal year 2005/06 differ in several instances from the budgeted expenditures presented in the management discussion and analysis issued 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 basic financial statements.

The sewer service fees were increased for the 2006 - 2007 budget year. The rates were increased by 3.0 %.

The following 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	$ 684	$ 705	3.0 %
Number of Equivalent Single-Family Dwellings by District	3,905	3,926	0.5 %

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

South Park County Sanitation District

Statement of Net Assets

	June 30, 2006
Assets	
Current assets	
Cash and equivalents	$ 5,621,273
Accounts receivable	154,727
Total current assets	5,776,000
Noncurrent assets	
Restricted cash, cash equivalents, and investments:	
Cash - revenue bond fund	91,220
Cash with trustee restricted for capital projects	776,574
Total restricted assets	867,794
Other assets	91,895
Capital assets:	
Buildings and improvements	9,241,099
Construction in progress	1,367,573
Less: accumulated depreciation	(2,819,885)
Total capital assets (net of accumulated depreciation)	7,788,787
Total noncurrent assets	8,748,476
Total assets	$ 14,524,476

See accompanying Notes to Basic Financial Statements

	June 30, 2006
Liabilities	
Current liabilities payable from unrestricted assets	
Accounts payable and accrued expenses	$ 583,786
Total current liabilities payable from unrestricted assets	583,786
Current liabilities payable from restricted assets	
Revenue bonds payable	100,000
Accrued interest payable	33,620
Total current liabilities payable from restricted assets	133,620
Total current liabilities	717,406
Noncurrent liabilities	
Revenue bonds payable	2,917,205
Total noncurrent liabilities	2,917,205
Total liabilities	3,634,611
Net assets	
Invested in capital assets, net of related debt	4,863,477
Restricted for debt service	57,600
Restricted for capital projects	776,574
Unrestricted	5,192,214
Total net assets	$ 10,889,865

See accompanying Notes to Basic Financial Statements

South Park County Sanitation District

Statement of Revenues, Expenses and Changes in Net Assets

	For the Year Ended June 30, 2006
Operating revenues	
Flat charges	$ 2,646,798
Charges for services	60,701
Other	88,539
Total operating revenues	2,796,038
Operating expenses	
Services and supplies	1,679,394
Fiscal agent fees and legal services	10,676
Depreciation and amortization	151,691
Environmental investigation	19,489
Total operating expenses	1,861,250
Operating income	934,788
Nonoperating revenues (expenses)	
Investment income	254,552
Interest expense	(81,835)
Intergovernmental	412,413
Net nonoperating revenues	585,130
Net income before contributions and transfers	1,519,918
Capital contribution:	
Connection fees	128,000
Capital grants	146,020
Increase in net assets	1,793,938
Net assets at beginning of year	9,095,927
Net assets at end of year	$ 10,889,865

See accompanying Notes to Basic Financial Statements

South Park County Sanitation District

Statement of Cash Flows

For the Year Ended June 30, 2006

Cash flows from operating activities		
Receipts from customers	$	2,824,326
Payments for intergovenrmental services used		(43,713)
Payments to suppliers		(1,674,319)
Net cash provided by operating activities		1,106,294
Cash flows from noncapital financing activities		
Intergovernmental revenue		49,791
Net cash provided by noncapital financing activities		49,791
Cash flows from capital and related financing activities		
Purchase of capital assets		(1,833,115)
Proceeds from federal and state grants		210,482
Principal payments - bonds		(3,255,000)
Proceeds from revenue bond issuance		3,038,315
Interest paid on capital debt		(162,380)
Contributions from other governments		412,413
Connection fees		130,000
Net cash used in capital related financing activities		(1,459,285)
Cash flows from investing activities		
Interest received on pooled cash and investments		251,300
Net decrease in cash and cash equivalents		(51,900)
Cash and cash equivalents at beginning of year		6,540,967
Cash and cash equivalents at end of year	$	6,489,067
Cash and cash equivalents include the following:		
Cash and cash equivalents	$	5,621,273
Restricted cash and cash equivalents		867,794
	$	6,489,067

See accompanying Notes to Basic Financial Statements

		For the Year Ended June 30, 2006
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$	934,788
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expense		151,691
Change in assets and liabilities:		
Decrease in accounts receivable		28,294
Decrease in accounts payable and accrued expenses		(8,479)
Net cash provided by operating activities	$	1,106,294

Noncash investing, capital and financing activities:		
Project costs included in accounts payable	$	572,236
Net increase in fair value of investment in County Treasurer's Pooled cash	$	366

See accompanying Notes to Basic Financial Statements

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 South Park 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. Long-Term Obligations

Note F. Debt Defeasance

Note G. Accrued Interest Payable

Note H. Related Party Transactions

Note I. Commitments and Contingencies

Note J. Recent Governmental Accounting Standards

Note A. Defining the Financial Reporting Entity

The South Park 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 and pump stations. The District has an ordinance defining policies, including user fees.

An agreement for transfer of responsibility to the City of Santa Rosa of collection system operation and maintenance, and subsequent dissolution of the District, was finalized on February 27, 1996 and amended February 1998, June 2000, and April 1, 2004. Under this agreement, 1) the District will be dissolved no later than June 30, 2011, 2) the City of Santa Rosa shall acquire the unused capacity of the District, and 3) the District will upgrade the collection system to meet City of Santa Rosa standards. The agreement requires the District to replace, slip-line, or repair 41,610 feet of the collection system and upgrade the Todd Road lift station before transfer of the District to the City of Santa Rosa.

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 of Sonoma'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.

Note B. Summary of Significant Accounting Policies (continued)

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.

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.

Note B. Summary of Significant Accounting Policies (continued)

Cash and Investments

The District's cash and investments are pooled with the Sonoma County Treasurer except for restricted funds held by an outside trustee. 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.

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. Cash with trustee and 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.

Other Assets

Other assets are composed of debt issuance costs of $91,895 for the year ended June 30, 2006, net of accumulated amortization. These costs are amortized using a method which approximates the interest rate method over the terms of the related long-term debt. Amortization expense related to the debt issuance costs amounted to $4,375 for the year ended June 30, 2006.

Note B. Summary of Significant Accounting Policies (continued)

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, rebate programs and improvements and extensions to the collection systems.

Capital Assets

Capital assets are stated at cost or estimated historical cost. Capital assets are defined by the government 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.

Bond and Certificates of Participation Discounts and Issuance Costs

Bond and certificates of participation discounts and issuance costs related to debt of proprietary fund types are deferred and amortized using a method which approximates the interest method over the term of issuance. The discounts are netted against the related debt.

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 invested in capital assets, net of related debt, excludes $776,574 in unspent debt proceeds for the year ended June 30, 2006. 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.

Note B. Summary of Significant Accounting Policies (continued)

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 Sonoma County Water Agency is authorized to transfer budgeted amounts within 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.

Intergovernmental Transactions

Intergovernmental transactions made during the year are primarily Quasi-external (charges for current services) - transactions for services rendered or facilities provided. These transactions are recorded as revenue in the receiving fund and expenditures in the disbursing fund.

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 balances 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.

Note C. Cash and Investments (continued)

Investment Guidelines (continued)

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

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

Cash and investments included the following:

	Fair Value
Cash and investments in Sonoma County Treasurer's pooled investment fund	$ 5,712,493
Cash and investments with trustee	776,574
	$ 6,489,067

At of June 30, 2006, the District' investments consisted of $5,712,493 in the Treasury Pool managed by the County Treasurer, which has 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 $366 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 $13,444. 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.

Note C. Cash and Investments (continued)

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. The majority of the District's cash and investments is held by the Treasury Pool, which has a weighted average maturity of less than two years. As of June 30, 2006, all of the District's investments held by a trustee have a maturity of less than 12 months, as the following schedule presents:

Investment Type	Remaining Maturity 12 Months or Less
Money market funds	$ 774,181
U.S. Treasury obligations	2,393
Total	$ 776,574

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 or open-end mutual funds 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. Presented below is the minimum rating required by (where applicable) the California Government Code, the County's investment policy, or debt agreements, and the actual rating as of year end for each investment type.

Investment Type	Total	Minimum Legal Rating	Exempt From Disclosure	Rating at year end AAA	AA	Not Rated
Held by trustee:						
Money market funds	$ 774,181	A	$ -	$ -	$ -	$ 774,181
U.S. Treasury obligations	2,393	N/A	2,393	-	-	-
Total	$ 776,574		$ 2,393	$ -	$ -	$ 774,181

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	$ 774,053	$ 2,490,765	$ -	$ (1,897,245)	$ 1,367,573
Capital assets, being depreciated:					
Buildings and improvements	7,343,854	-	-	1,897,245	9,241,099
Less accumulated depreciation for:					
Buildings and improvements	(2,672,569)	(147,316)	-	-	(2,819,885)
Total capital assets, being depreciated, net	4,671,285	(147,316)	-	1,897,245	6,421,214
Total capital assets, net	$ 5,445,338	$ 2,343,449	$ -	$ -	$ 7,788,787

Note D. **Capital Assets** (continued)

Depreciation expense amounted to $147,316 for the year ended June 30, 2006.

The total amount of interest capitalized in connection with collection system construction projects during the year ended June 30, 2006 amounted to $85,414.

Note E. **Long-Term Obligations**

Revenue Bonds

The government issues bonds where the government pledges income derived from charges for services to pay debt service. The original amount of revenue bonds issued in prior years to finance construction projects to both expand existing wastewater collection system and construct additional facilities was $3,565,000, of which $3,255,000 was defeased during the year (see Note F).

On September 7, 2005, the Water Agency, through the California Statewide Communities Development Authority, issued Water and Wastewater Revenue Bonds (series 2005C) for the purpose of refinancing the outstanding 2000 Revenue Bonds. Terms of the new bonds and amounts issued and outstanding at June 30, 2006 are as follows:

Interest Rates	Maturity Date	Issued and Outstanding
2.70% - 5.00%	October 1, 2026	$ 3,250,000

Revenue bond debt service requirements to maturity are as follows:

Year ending June 30,	Principal	Interest
2007	$ 100,000	$ 133,179
2008	110,000	130,366
2009	115,000	127,243
2010	115,000	123,909
2011	120,000	120,264
2012 – 2016	660,000	536,616
2017 – 2021	795,000	396,390
2022 – 2026	1,000,000	181,406
2027	235,000	5,141
Total	$ 3,250,000	$ 1,754,514

Note E. **Long-Term Obligations** (continued)

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
Bonds payable:					
Revenue bonds	$ 3,255,000	$ 3,250,000	$ (3,255,000)	$ 3,250,000	$ 100,000
Less deferred amounts for:					
Net issuance discounts	(19,503)	68,283	19,503	68,283	N/A
Deferred charges on refundings	-	(315,415)	14,337	(301,078)	N/A
Total bonds payable	$ 3,235,497	$ 3,002,868	$ (3,221,160)	$ 3,017,205	$ 100,000

Note F. **Debt Defeasance**

On September 7, 2005, the District, through the Water Agency and the California Statewide Communities Development Authority, issued Water and Wastewater Revenue Bonds (series 2005C) for the District totaling $3,250,000. The proceeds of the bonds were used to refund in advance of their maturity dates, the District's Series 2000B Revenue Bonds totaling $3,255,000 with maturity dates through October 1, 2026. This refunding was done to achieve interest cost savings. The net proceeds from the issuance of the revenue bonds were used to purchase U.S. government securities and those securities were deposited in irrevocable trust accounts with an escrow agent and are structured to pay the principal and interest on the refunded bonds as such payments become due. The advance refunding has met the requirements of an in-substance debt defeasance and the defeased bonds have been removed from the District's financial statements.

The advance refunding resulted in differences between the reacquisition price and the net carrying of amount of the old debt of $315,415; these deferred charges are reported as reductions to revenue bonds payable and are charged to operations using a method which approximates the effective interest method over the shorter of the remaining life of the old debt or the life of the new debt. The resulting economic gain (difference between the present value of the debt service payments on the old and new debt) is $96,000.

Note G. **Accrued Interest Payable**

Interest payable at June 30, 2006 is $33,620 for long-term bonds payable.

Note H. Related Party Transactions

The District is 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 Sonoma County 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 $42,524 to the Water Agency for administrative support during the year ended June 30, 2006

Note I. Commitments and Contingencies

Commitments

The District has active construction projects as of June 30, 2006. At year end, the District's commitments to construction projects included $3,179,406 in amounts spent to date with remaining commitments of $1,609,868 for improvements of collection systems.

The balances spent to date include both internal expenses and expenses paid to outside contractors. The remaining commitment balances relate to commitments with outside contractors only.

The commitments for collection systems are being financed by revenue bonds secured by wastewater revenues and by net assets.

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.

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.

Note I. Commitments and Contingencies (continued)

Risk Management (continued)

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 three fiscal years.

Pending Litigation, Claims, and Investigation

The District and the County entered into a Plan of Action with the North Coast Regional Quality Control Board ("NC Regional Board") in 1999 to investigate a groundwater plume of halogenated volatile organic compounds ("HVOC's") believed to have leaked from former dry cleaning operations and possibly using sewer pipes as a conduit. The investigation was completed in February 2002 at a cost of approximately $1,250,000. Currently, the NC Regional Board is focusing on other potentially responsible parties (mainly oil companies) in connection with a petroleum hydrocarbon plume which is co-mingled with the HVOC plume. The District is working with the NC Regional Board to require other potentially responsible parties to conduct investigations of HVOC source areas on their properties. In this regard, the NC Regional Board sent out two information request/source investigation letters in late 2005 to owners of properties in the area which may be a source of HVOCs. The District and the County may be held responsible for conducting remediation of the plume. In such event, substantial additional costs may be incurred in connection with the remedial action. In addition, negotiation of a clean-up strategy will result in costs from technical and legal consultants. It is too early to predict the amount or allocation of these costs.

In 2004, a property owner sued the City of Santa Rosa, the County, and the District, alleging that each public entity owns and operates sewer lines in the vicinity of the plaintiff's property and that the sewer lines have leaked, causing contamination to the plaintiff's property and to the groundwater beneath the plaintiff's property. The complaint was filed in May 2004. The plaintiffs subsequently dismissed their lawsuit in January 2005. However, because the site is still contaminated, there is the possibility that plaintiffs may re-file their action against the County and the District.

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 J. 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.

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.

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.

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
South Park County Sanitation District
Santa Rosa, California

We have audited the basic financial statements of the South Park 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 District's management, Board of Supervisors of the County of Sonoma, 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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