

**SONOMA VALLEY COUNTY
SANITATION DISTRICT**

Independent Auditor's Reports, Management's
Discussion and Analysis and Basic
Financial Statements

For the Fiscal Year Ended June 30, 2010

**SONOMA VALLEY COUNTY SANITATION DISTRICT
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

TABLE OF CONTENTS

	<u>Page(s)</u>
Independent Auditor’s Report	1-2
Management’s Discussion and Analysis (Required Supplementary Information)	3-10
Basic Financial Statements:	
Statement of Net Assets	11
Statement of Revenues, Expenses and Changes in Net Assets	12
Statement of Cash Flows	13-14
Notes to the Basic Financial Statements	15-30
Other Report:	
Independent Auditor’s Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	31-32



Board of Directors
Sonoma Valley County Sanitation District
Santa Rosa, California

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying basic financial statements of Sonoma Valley County Sanitation District (District), a component unit of the County of Sonoma, California, as of and for the fiscal year ended June 30, 2010, as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 financial statements referred to above present fairly, in all material respects, the financial position of the District as of June 30, 2010, and the changes in its financial position and its cash flows for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America

As described in Note C to the basic financial statements, effective July 1, 2009, the District implemented Governmental Accounting Standards Board (GASB) Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*.

In accordance with *Government Auditing Standards*, we have issued our report dated November 4, 2010 on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit

The management's discussion and analysis as listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Macinnis Gini & O'Connell LLP

Certified Public Accountants

Sacramento, California

November 4, 2010

Management's Discussion and Analysis

**SONOMA VALLEY COUNTY SANITATION DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

As management of the Sonoma Valley 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, 2010. We encourage readers to consider the information presented here in conjunction with the District's financial statements (pages 11 - 14) and the accompanying notes to the basic financial statements (pages 15 - 30).

Reporting Entity

The 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 three member board, including two members of the Sonoma County Board of Supervisors (Board) of the County of Sonoma (the County). The District is considered an integral part of the County of Sonoma's (the County) reporting entity, resulting in the District's financial statements being included in the County's Comprehensive Annual Financial Report.

Please refer to the definition of the reporting entity within the notes to the basic 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 \$57,647,986 (*net assets*). Of this amount, \$11,653,370 (*unrestricted net assets*) may be used to meet the District's ongoing obligations to citizens and creditors.

Revenues and Capital Contributions

The District recognized total revenues of \$12,413,847 during the fiscal year ended June 30, 2010. Of this amount, \$11,764,557 consists of operating revenues including charges for services, a refund from the Water Agency, and \$649,290 of nonoperating revenues consisting of investment earnings, property taxes, conservation program, and intergovernmental revenue. The District also recognized capital contributions of \$86,817 from connection fees, and the donation of a dedicated sewer easement valued at \$56,700.

Expenses

The District incurred expenses totaling \$13,295,208 during the fiscal year ended June 30, 2010. \$11,164,768 represents operating expenses related to the collection, treatment, disposal, and reclamation of effluent, as well as administrative and general expenses. Nonoperating expenses total \$2,130,440 which is comprised of conservation program expenses of \$1,478,266 and interest expense of \$652,174 related to the District's long-term debt obligations.

Increase in Net Assets

The District recorded operating income of \$599,789 for the fiscal year ended June 30, 2010. The District recognized an overall decrease in net assets of \$737,844.

**SONOMA VALLEY COUNTY SANITATION DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

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 basic financial statements.

Management's Discussion and Analysis

Management's discussion and analysis, this section, is intended to provide a narrative overview that users need to interpret the financial statements. Management's discussion and analysis also provides analysis of 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 Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the basic financial statements can be found on pages 15-30

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 \$57,647,986 at the close of the most recent fiscal year compared to net assets of \$58,385,830 as of June 30, 2009. The decrease in net assets of \$737,844 is due primarily to an increase in conservation program expenses.

The largest portion of the District's net assets (76.2% as of June 30, 2010 compared to 74.0% for June 30, 2009) reflects its investment in capital assets (e.g., land and buildings and improvements), net of 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.

**SONOMA VALLEY COUNTY SANITATION DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Condensed Statements of Net Assets

	June 30, 2009	June 30, 2010	Percentage Change
Current and other assets	\$ 15,723,615	\$ 14,676,620	-6.7%
Capital assets	64,375,889	64,104,657	-0.4%
Total Assets	80,099,504	78,781,277	-1.6%
Current liabilities	1,498,154	1,933,843	29.1%
Noncurrent liabilities	20,215,520	19,199,448	-5.0%
Total Liabilities	21,713,674	21,133,291	-2.7%
Invested in capital assets net of related debt	43,184,180	43,900,286	1.7%
Restricted for conservation	1,532,873	107,613	-93.0%
Restricted for debt service	1,850,103	1,986,717	7.4%
Unrestricted	11,818,674	11,653,370	-1.4%
Total Net Assets	\$ 58,385,830	\$ 57,647,986	-1.3%

A portion of the District's net assets \$2,094,330 (3.6% as of June 30, 2010) represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets of \$11,653,370 as of June 30, 2010 may be used to meet the District's ongoing obligations to citizens and creditors. As of June 30, 2010, the District reports positive balances in all categories of net assets.

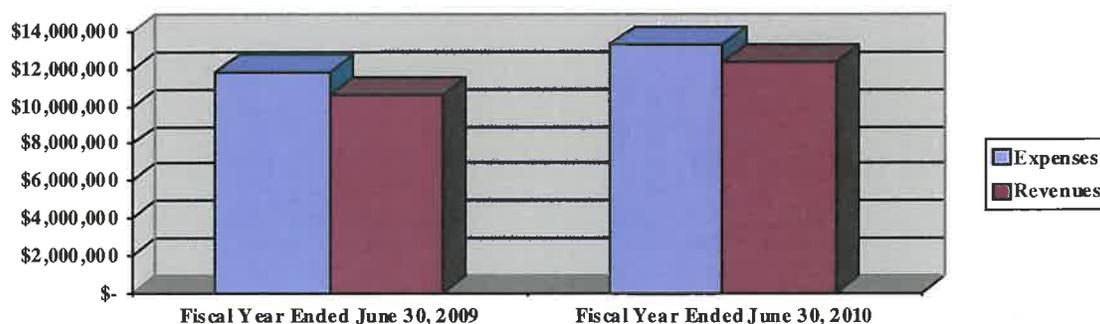
**SONOMA VALLEY COUNTY SANITATION DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Condensed Statements of Changes in Net Assets

	Fiscal Year Ended		Percentage Change
	June 30, 2009	June 30, 2010	
Revenues			
Operating revenues	\$ 10,199,024	\$ 11,764,557	15.3%
Nonoperating revenues	471,777	649,290	37.6%
Total revenues	10,670,801	12,413,847	16.3%
Expenses			
Services and supplies	7,571,521	8,044,480	6.2%
Fiscal agent fees and legal services	39,527	28,683	-27.4%
Depreciation and amortization	3,038,639	3,091,605	1.7%
Conservation program	437,124	1,478,266	238.2%
Interest expense	707,818	652,174	-7.9%
Loss on disposal of capital assets	14,417	-	-100.0%
Total expenses	11,809,046	13,295,208	12.6%
Loss before contributions	(1,138,245)	(881,361)	-22.6%
Capital contributions:			
Donations	-	56,700	-
Connection fees	59,757	86,817	45.3%
Decrease in net assets	(1,078,488)	(737,844)	-31.6%
Net assets, beginning of year	59,464,318	58,385,830	-1.8%
Net assets, end of year	\$ 58,385,830	\$ 57,647,986	-1.3%

The District's net assets decreased by \$737,844 during the fiscal year ended June 30, 2010 compared to a decrease of \$1,078,488 for the fiscal year ended June 30, 2009.

Expenses and Revenues

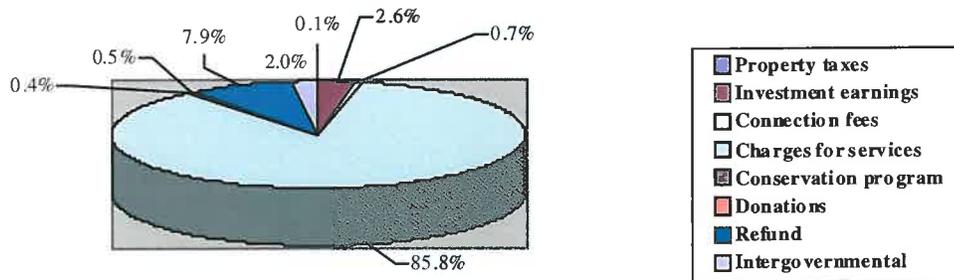


**SONOMA VALLEY COUNTY SANITATION DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Revenues of the District for the fiscal year ended June 30, 2010 totaled \$12,413,847 representing an increase of \$1,743,046 from the preceding fiscal year revenues of \$10,670,801. The rate based charges for services, representing 85.8% of the District's total revenue, increased by \$574,129 (5.6%) due primarily to a 6.0% rate increase from the previous year. Investment earnings decreased by \$114,696 (25.8%) due to a lower rate of return on pooled cash earned during the year. Conservation program revenue increased by \$42,927 (425.9%) due to an increase in sewer permits issued during the fiscal year ended June 30, 2010. The District also received a refund of \$991,403 for prior year overhead and equipment charges from the Water Agency. In addition, the District received \$86,817 in capital contributions from connection fees, compared to \$59,757 received during the fiscal year ended June 30, 2009, and also received a donation of a dedicated sewer easement valued at \$56,700.

Total expenses for the District increased by \$1,486,162 to \$13,295,208 for the fiscal year ended June 30, 2010, due primarily to a large increase in conservation program expenses of \$1,041,142, along with the recognition of a \$350,000 fine imposed by the San Francisco Bay Regional Water Quality Control Board for a series of spills that occurred over the past 3 years. The overall effect was an increase in expenses of 12.6%.

Revenues and Capital Contributions by Source



Revenues and capital contributions earned by the District for the fiscal year ended June 30, 2010 totaled \$12,557,364. Of this amount \$10,755,719 or 85.7%, 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. The District's charges for services increased as a result of rate increases effective during the fiscal year ended June 30, 2010. Property tax revenues accounted for 0.1% of annual revenues, and are collected through the tax rolls to satisfy debt service requirements. Investment earnings represent 2.6% of revenues and consist of earnings on pooled cash held with the Sonoma County Treasurer. Conservation program revenues accounted for 0.4% of the District's revenues for the fiscal year ended June 30, 2010. The District also recognized \$86,817 or 0.7% of revenues and capital contributions, in capital contributions related to connection fees, which are collected through the permitting process. The District received \$991,403 (7.9%) in refunds from the Water Agency and received a donation of a dedicated sewer easement valued at \$56,700 (0.5%).

**SONOMA VALLEY COUNTY SANITATION DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Expenses by Function



Expenses for the District for the fiscal year ended June 30, 2010 totaled \$13,295,208. Costs associated with the collection, treatment, and disposal of effluent represent 60.6% of the District's costs. Annual depreciation and amortization expense on capital assets which was \$3,091,605 (23.3%) of total expenses. Interest expense totaling \$652,174 (4.9%) represents the cost of meeting current debt service obligations. Conservation program expenses totaled \$1,478,266 (11.2%) for the fiscal year ended June 30, 2010.

Capital Asset and Debt Administration

Capital Assets

The District's investment in capital assets as of June 30, 2010, amounts to \$64,104,657 (net of accumulated depreciation). In addition to reporting the District's investment in capital assets including land, buildings and systems, improvements and construction in progress, the District is now reporting its investment in intangible assets as required by Governmental Accounting Standards Board (GASB) Statement No. 51 – *Accounting and Financial Reporting for Intangible Assets*. Intangible assets for the District include easements (both temporary and permanent). Major capital asset activity during the fiscal year included an Underground Tank Replacement project, the Napa Salt Marsh pipeline and trunk replacement from West 6th Street to Aqua Creek.

Sonoma Valley County Sanitation District's Capital Assets

	June 30, 2009	June 30, 2010	Percentage Change
Land	\$ 3,119,077	\$ 3,568,116	14.4%
Construction in progress	3,348,454	3,848,817	14.9%
Intangible assets			
Permanent easements	276,117	815,772	195.4%
Temporary easements	-	10,656	-
Buildings and improvements	92,696,659	93,861,853	1.3%
Machinery and equipment	165,940	301,523	81.7%
Accumulated depreciation/amortization	(35,230,358)	(38,302,080)	8.7%
Total	\$ 64,375,889	\$ 64,104,657	-0.4%

**SONOMA VALLEY COUNTY SANITATION DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Capital Asset and Debt Administration (Continued)

Capital Assets (Continued)

Additional information on the District's capital assets can be found in Note E on page 23 of the financial statement footnotes.

Long-term Obligations

At June 30, 2010, the District had a total of \$20,204,371 in outstanding debt consisting of general obligation bonds, revenue bonds, and advances from other governments. Of this amount, \$89,000 comprises debt backed by the full faith and credit of the District, \$13,416,614 in special obligations of the District payable solely from net revenues of the District's operations, and \$6,698,757 is related to advances from the State Water Resources Control Board.

Sonoma Valley County Sanitation District's Long-Term Debt

	June 30, 2009	June 30, 2010	Percentage Change
General obligations bonds	\$ 101,000	\$ 89,000	-11.9%
Revenue bonds	14,058,845	13,416,614	-4.6%
Advances from other governments	7,031,865	6,698,757	-4.7%
Total long-term debt	\$ 21,191,710	\$ 20,204,371	-4.7%

The District's total debt decreased by \$987,339 during the fiscal year ended June 30, 2010.

Advances from other governments decreased \$333,108 as a result of scheduled principal payments for the existing outfall line advance received from the State Water Resources Control Board (SWRCB) in the amount of \$42,367, along with a principal payment to the SWRCB on the Treatment Plant Upgrade loan of \$290,741.

Decreases in both general obligation bonds and revenue bonds are also due to annual principal payments on the outstanding debt.

Additional information on the District's current and long-term obligations can be found in Notes F and G on pages 24 - 27 of this report.

Next Year's Budget and Rates

Budgeted gross expenses for the District for fiscal year ending June 30, 2011 have decreased by \$14,171,473 (41.0%) for a total of \$20,433,717. The major component of the decrease in budgeted expenses is related to decreases in capital projects and operations. The decreases in operations and construction is due to the budgeted receipt in the operations fund of \$7.2 million in bond proceeds in 2009/10 and the budgeted transfer of these proceeds to the construction fund towards the Napa/Sonoma Salt Marsh Project. The District subsequently decided to not issue bonds for the project and are currently exploring alternate financing options.

**SONOMA VALLEY COUNTY SANITATION DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Following is a comparison of final 2009/10 and proposed 2010/11 budgeted expenses for the District:

	Fiscal Year Ended June 30, 2010	Fiscal Year Ending June 30, 2011	Decrease	Percentage Change
Operations	\$ 24,478,514	\$ 15,866,947	\$ (8,611,567)	-35.2%
Debt service - general obligation bonds	5,102	4,502	(600)	-11.8%
Debt service - Revenue bonds	683,041	608,928	(74,113)	-10.9%
Debt service - outfall line	7,345	6,200	(1,145)	-15.6%
Construction	9,279,598	3,798,349	(5,481,249)	-59.1%
State revolving fund loan	151,590	148,791	(2,799)	-1.8%
Total	\$ 34,605,190	\$ 20,433,717	\$ (14,171,473)	-41.0%

Budgeted expenses for fiscal year ended June 30, 2010 differ in several instances from the budgeted expenses presented in the management's discussion and analysis for the period ended June 30, 2009. These variances are due to Board approved budgetary adjustments made subsequent to the publication of the audited basic financial statements for the fiscal year ended June 30, 2010.

The increase in budgeted sewer service fees revenue is 6.0% for the fiscal year ending June 30, 2011.

The following tables indicate the sanitation sewer service rates and equivalent single dwellings for the District.

	Fiscal Year Ended June 30, 2010	Fiscal Year Ending June 30, 2011	Percentage Change
Rate per Equivalent Single-Family Dwelling	\$ 655	\$ 694	6.0%
Number of Equivalent Single-Family Dwellings	17,279	17,250	-0.2%

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 Treasurer Tax Collector's Office, ATTN: Fiscal Division, 585 Fiscal Drive, Room 100, Santa Rosa, CA, 95403.

SONOMA VALLEY COUNTY SANITATION DISTRICT
STATEMENT OF NET ASSETS
JUNE 30, 2010

ASSETS

Current assets:

Cash and investments	\$	6,703,183
Accounts receivable		642,650
Due from Sonoma County Water Agency		405,168
Due from other governments		250,457
Restricted cash and investments:		
Conservation program		107,613
General obligation bond fund		7,085
Revenue bond fund		1,583,740
Debt service		591,334
Loan reserve fund		106,523
Total current assets		10,397,753

Noncurrent assets

Advances to Sonoma County Water Agency		3,917,587
Deposits with others		157,400
Other assets		203,880
Capital assets:		
Land		3,568,116
Construction in progress		3,848,817
Intangible assets		826,428
Buildings and improvements		93,861,853
Machinery and equipment		301,523
Less accumulated depreciation and amortization		(38,302,080)
Total capital assets, net		64,104,657
Total noncurrent assets		68,383,524
Total assets		78,781,277

LIABILITIES

Current liabilities:

Accounts payable and accrued expenses		626,955
Due to other governments		337,692
Accrued interest payable		105,393
Total current liabilities		1,070,040

Current liabilities payable from restricted assets:

Revenue bonds payable		667,231
Accrued interest payable		196,572
Total current liabilities payable from restricted assets		863,803

Noncurrent liabilities:

General obligation bonds payable		89,000
Revenue bonds payable		12,749,383
Advances from other governments		6,361,065
Total noncurrent liabilities		19,199,448

Total liabilities		21,133,291
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NET ASSETS

Invested in capital assets, net of related debt		43,900,286
Restricted for conservation		107,613
Restricted for debt service		1,986,717
Unrestricted		11,653,370
Total net assets	\$	57,647,986

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

SONOMA VALLEY COUNTY SANITATION DISTRICT
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

Operating revenues	
Flat charges	\$ 9,841,204
Charges for services	914,515
Refund from Sonoma County Water Agency	991,403
Other	17,435
Total operating revenues	11,764,557
 Operating expenses	
Services and supplies	8,044,480
Fiscal agent fees and legal services	28,683
Depreciation and amortization	3,091,605
Total operating expenses	11,164,768
Operating income	599,789
 Nonoperating revenues (expenses)	
Investment earnings	329,311
Interest expense	(652,174)
Intergovernmental	250,590
Property taxes	16,382
Conservation program revenue	53,007
Conservation program expense	(1,478,266)
Total nonoperating expenses, net	(1,481,150)
Loss before capital contributions	(881,361)
 Capital contributions:	
Donations - dedicated easement	56,700
Connection fees	86,817
Decrease in net assets	(737,844)
Net assets - beginning of year	58,385,830
Net assets - end of year	\$ 57,647,986

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

**SONOMA VALLEY COUNTY SANITATION DISTRICT
STATEMENT OF CASH FLOWS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

CASH FLOWS FROM OPERATING ACTIVITIES

Receipts from customers	\$	10,770,425
Refund from Sonoma County Water Agency		991,403
Payments to Sonoma County Water Agency		(6,021,320)
Payments to suppliers		(1,708,879)
Conservation program outlays		(1,478,266)
Net cash provided by operating activities		2,553,363

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

Taxes received		16,382
Intergovernmental revenue received		133
Conservation program receipts		42,997
Net cash provided by noncapital financing activities		59,512

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

Purchase of capital assets		(2,512,329)
Refund of eminent domain deposits		71,500
Loan principal payments - advances from other governments		(333,108)
Principal payments - bonds		(717,000)
Interest paid on capital debt		(756,875)
Connection fees received		86,817
Net cash used by capital and related financing activities		(4,160,995)

CASH FLOWS FROM INVESTING ACTIVITIES

Loan repayment from Sonoma County Water Agency - principal		388,845
Loan repayment from Sonoma County Water Agency - interest		199,011
Interest received on pooled cash and investments		130,300
Net cash provided by investing activities		718,156

Net decrease in cash and cash equivalents (829,964)

Cash and cash equivalents - beginning of year		9,929,442
Cash and cash equivalents - end of year	\$	9,099,478

RECONCILIATION TO THE STATEMENT OF NET ASSETS

Cash and investments	\$	6,703,183
Restricted cash and investments		2,396,295
Cash and cash equivalents	\$	9,099,478

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

**SONOMA VALLEY COUNTY SANITATION DISTRICT
STATEMENT OF CASH FLOWS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

**RECONCILIATION OF OPERATING INCOME TO NET
CASH PROVIDED BY OPERATING ACTIVITIES:**

Operating income	\$	599,789
Adjustments to reconcile operating income to net cash provided by operating activities:		
Conservation program outlays		(1,478,266)
Depreciation and amortization		3,091,605
Change in assets and liabilities:		
Increase in accounts receivable		(2,729)
Increase in accounts payable and accrued expenses		342,964
Net cash provided by operating activities	\$	2,553,363

NONCASH CAPITAL AND RELATED FINANCING ACTIVITIES:

Acquisition of capital assets in accounts payable	\$	103,508
Donations - dedicated easements		56,700
Capitalized interest		159,173
Capitalized costs in retention payable		33,460

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

**SONOMA VALLEY COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Note A. Defining the Financial Reporting Entity

The Sonoma Valley 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 a three member board, including two members of the Board of Supervisors (Board) 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 Comprehensive Annual Financial Report.

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.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The District uses a proprietary (enterprise) fund to account for its activities. An enterprise fund may be used to report any activity for which a fee is charged to external users for goods or services. Enterprise funds are required for any activity whose principal external revenue sources meet any of the following criteria: (1) issued debt is backed solely by fees and charges, (2) the cost of providing services for any activity (including capital costs such as depreciation or debt service) must be legally recovered through fees or charges, or (3) if the government's policy is to establish activity fees or charges designed to recover the cost of providing services.

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.

**SONOMA VALLEY COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Note B. Summary of Significant Accounting Policies (continued)

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

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 30, 1989 unless those pronouncements conflict with or contradict GASB pronouncements. The GASB periodically updates its codification of existing Governmental Accounting and Financial Reporting Standards which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes GAAP for governmental units. Governments have the option of following private-sector guidance issued subsequent to November 30, 1989, as such, the District has elected not to follow private-sector guidance subsequent to November 30, 1989.

Proprietary funds distinguish operating from nonoperating revenues and expenses. 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 flat charges and 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.

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

Cash and Investments

The District's cash and investments are pooled with the Sonoma County Treasurer (Treasurer) except for restricted funds held by an outside trustee. The 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 reported its investment in the Treasury Pool at estimated fair value.

**SONOMA VALLEY COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

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 risks related to credit risk, interest rate risk and custodial credit risk.

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 considered cash and cash equivalents.

Accounts Receivable

Accounts receivable primarily consists of uncollected fees for sanitation services and flat charges as of June 30, 2010. Flat charges are established annually by the Board and billed through the County's property tax system. The District does not record an allowance for uncollectible receivables as it deems all receivables as fully collectible.

Other Assets

Other assets represent unamortized bond issuance costs of \$203,880 as of June 30, 2010. These costs are amortized using the straight-line method over the term of the outstanding bonds. Amortization expense for the year ended June 30, 2010 related to the bond issuance costs was \$19,883.

Deposits with Others

Deposits with others represents cash on deposit with the Sonoma County Superior Court towards eminent domain proceedings related to the District's Sewer Trunk Main replacement project.

Restricted Assets

Restricted assets represent cash and investments maintained in accordance with bond resolutions or by agreement, for the purpose of funding certain debt service payments, rebate programs and improvements and extensions to the wastewater treatment systems.

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 and construction in progress, using the straight-line method over estimated useful 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.

**SONOMA VALLEY COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Note B. Summary of Significant Accounting Policies (continued)

Capital Assets (continued)

The costs of normal maintenance and repairs that do not add to the value or materially extend the useful life of the assets, 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, offset by interest earned on unspent debt proceeds, is included as part of the capitalized value of the assets constructed.

Intangible Assets

Intangible assets are stated at cost or estimated historical cost. Intangible assets for the District consist of temporary and permanent easements. Temporary easements are defined by the District as any easement acquired during the course of a project that, by agreement, will expire after a certain period of time after the completion of a project, and has an estimated useful life in excess of 1 year. Temporary easements are amortized using the straight line method over the duration of the easement. Permanent easements, including dedicated easements, are stated at cost, estimated historical cost, or fair value and are not amortized.

Bond Issuance Discount and Deferred Amount on Refunding

Revenue bond discounts (discounts) are deferred and amortized using the straight-line method over the term of the outstanding bonds. Discounts reduce the carrying value of the related long-term debt. The deferred amount on refunding of revenue bonds, results from the difference between the carrying amount of defeased/refunded debt and its reacquisition price. Deferred amounts on refunding are amortized over the remaining life of the refunded debt or the remaining life of the newly issued debt, whichever is shorter. The unamortized portion of the deferred amount on refunding is reported as a direct reduction to the carrying amount of the refunding 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 are reported as restricted when there are limitations imposed on their use, either through enabling legislation or through external restrictions imposed by creditors, grantors or laws or regulation of other governments. At June 30, 2010, the District has \$107,613 restricted for the District's conservation program and \$1,986,717 restricted for future debt service.

**SONOMA VALLEY COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Note B. Summary of Significant Accounting Policies (continued)

Budget and Budgetary Accounting

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

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 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 revert to the 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 the assessed valuation occur due to sales transactions or the completion of construction. Property tax collection and valuation information is disclosed in the County's Comprehensive Annual Financial Report.

Intergovernmental Revenues

Intergovernmental revenues primarily consist of grants received from the State of California.

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**SONOMA VALLEY COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Note C. Implementation of New Governmental Accounting Standard

Effective July 1, 2009 the District implemented GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, issued in June 2007. This statement establishes accounting and financial reporting requirements for intangible assets to reduce inconsistencies in the accounting and financial reporting of such assets among state and local governments. This statement also provides authoritative guidance that specifically addresses the nature of the intangible assets including internally generated intangible assets.

The District is reporting intangible assets on its financial statements for the fiscal year ended June 30, 2010. The District's financial statements have not been restated for prior periods as no intangible assets have been identified that would require a restatement, however intangible assets in the amount of \$276,117 were reclassified from Land where they were previously reported.

Note D. Cash and Investments

The District follows the practice of pooling cash and investments of all funds with the Treasurer except for funds required to be held by outside fiscal agents or trustees under the provisions of bond indentures and lease agreements. The Investment Oversight Committee has regulatory oversight for all funds 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 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 Treasurer 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 and notes issued by local agencies
- Registered state warrants and municipal notes and bonds
- Negotiable certificates of deposit
- Bankers' acceptances
- Commercial paper
- Medium-term corporate notes
- Local Agency Investment Fund (State Pool) deposits
- Repurchase agreements
- Reverse repurchase agreements
- Securities lending agreements
- Mutual funds and money market mutual funds
- Collateralized mortgage obligations
- Collateralized time deposits
- Joint power agreements
- Investment Trust of CA. (Caltrust)

**SONOMA VALLEY COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Note D. Cash and Investments (continued)

Investment Guidelines (continued)

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

Cash and investments included the following:

	Fair Value
Cash and investments in Treasurer's Pool	\$ 9,082,205
Cash and investments with trustee	17,273
Total	\$ 9,099,478

As of June 30, 2010, the District's investments in the Treasury Pool managed by the County Treasurer, which is not rated by credit rating agencies, had a weighted average to maturity of 486 days. The credit rating and other information regarding specific investments maintained in the Treasury Pool as of June 30, 2010 are disclosed in the County's Comprehensive Annual Financial Report.

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 its fair value is 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 in the Treasury Pool. As of June 30, 2010, \$17,273 of the District's investments were held by a trustee and invested in a money market mutual fund with a weighted average to maturity of 42 days.

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 June 30, 2010 for each investment type. The credit rating and other information regarding the Treasury Pool as of June 30, 2010 are disclosed in the County's Comprehensive Annual Financial Report.

**SONOMA VALLEY COUNTY SANITATION DISTRICT
 NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
 FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Note D. Cash and Investments (continued)

Credit Risk (continued)

	Fair Value	Minimum Credit Rating	Credit Rating
Held by trustee:			
Money market mutual funds	\$ 17,273	AAA	AAA

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. The California Government Code and the County's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits and securities lending transactions:

- The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by depository regulated under state law. The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.
- The California Government Code limits the total of all securities lending transactions to 20% of the fair value of the investment portfolio.

Investments in external investment pools and in open-end mutual funds are not exposed to custodial credit risk. As of June 30, 2010, none of the District's investments were exposed to custodial credit risk.

**SONOMA VALLEY COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Note E. Capital Assets

Capital asset activity for the fiscal year ended June 30, 2010 was as follows:

	July 1, 2009	Additions	Retirements	Transfers	June 30, 2010
Capital assets, not being depreciated/amortized:					
Land	\$ 3,119,077	\$ 449,039	\$ -	\$ -	\$ 3,568,116
Construction in progress	3,348,454	1,603,270	-	(1,102,907)	3,848,817
Intangibles	276,117	539,655	-	-	815,772
Total capital assets, not being depreciated/amortized	\$ 6,743,648	\$ 2,591,964	\$ -	\$ (1,102,907)	\$ 8,232,705
Capital assets, being depreciated/amortized:					
Buildings and improvements	92,696,659	66,679	-	1,098,515	93,861,853
Intangibles	-	10,656	-	-	10,656
Machinery and equipment	165,940	135,583	-	-	301,523
Total capital assets being depreciated/amortized	92,862,599	212,918	-	1,098,515	94,174,032
Less accumulated depreciation/amortization for:					
Buildings and improvements	(35,108,726)	(3,059,435)	-	-	(38,168,161)
Intangibles	-	-	-	-	-
Machinery and equipment	(121,632)	(12,287)	-	-	(133,919)
Total accumulated depreciation/amortization	(35,230,358)	(3,071,722)	-	-	(38,302,080)
Total capital assets, being depreciated, net	57,632,241	(2,858,804)	-	1,098,515	55,871,952
Total capital assets, net	\$ 64,375,889	\$ (266,840)	\$ -	\$ (4,392)	\$ 64,104,657

Depreciation expense amounted to \$3,071,722 for the fiscal year ended June 30, 2010.

Beginning balance for Land in the amount of \$276,117 was reclassified to Intangibles to reflect permanent easements previously recorded as Land.

The total amount of interest capitalized in connection with wastewater treatment facilities construction projects during the fiscal year ended June 30, 2010 amounted to \$159,173.

**SONOMA VALLEY COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Note F. Advances to Sonoma County Water Agency

During the fiscal year ended June 30, 2008, the District transferred ownership of its photovoltaic facility to the Water Agency. Terms of the transfer agreement included a contribution to the Water Agency in the amount of \$2,784,354 along with a loan totaling \$5,442,922. The term of the loan is 12 years, with the final payment due in 2019, at an interest rate of 4.198%. The total outstanding amount of the loan as of June 30, 2010 is \$4,322,755. The current portion of the long-term receivable from the Water Agency in the amount of \$405,168 is reported as Due from Sonoma County Water Agency in the statement of net assets.

Note G. Long-Term Obligations

Advances From Other Governments

During the fiscal year ended June 30, 1995, the District received a loan of \$760,992 from the State Water Resources Control Board for an outfall rehabilitation project. As of June 30, 2010, the outstanding balance is \$229,596. The loan is a State Revolving Loan with current payments of \$49,710, payable annually in July. The expected term is 20 years at an annual interest rate of 2.7% with the last payment scheduled for July 2014.

Annual debt service requirements to maturity for this revolving loan is as follows:

Fiscal Year Ending				
June 30,	Principal	Interest	Total	
2011	\$ 43,511	\$ 6,199	\$	49,710
2012	44,686	5,024		49,710
2013	45,902	3,808		49,710
2014	47,131	2,578		49,709
2015	48,366	1,306		49,672
Total	\$ 229,596	\$ 18,915	\$	248,511

The District received funding from the State Water Resources Control Board during the fiscal year ended June 30, 2008 and fiscal year ended June 30, 2009 for the Tertiary Treatment Plant Upgrade project totaling \$6,996,831. The loan is a State Revolving Loan with current annual payments of \$442,972. Payments are secured by a pledge of net revenues earned by the District. The total principal and interest outstanding on the advance from the State Water Resources Control Board secured by net revenues earned by the District as of June 30, 2010 is \$6,469,161 and \$1,504,330, respectively. The District made an initial payment in November 2008. The outstanding balance as of June 30, 2010 is \$6,469,161. The term of the loan is 20 years at an annual interest rate of 2.3% with the final payment currently scheduled for 2027. Annual principal and interest payments are expected to require no more than 16% of net revenues. Principal and interest paid for the year ended June 30, 2010 for the Outfall and Tertiary Loans and total customer net revenues were \$492,880 and \$3,044,205 respectively

**SONOMA VALLEY COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Note G. Long-Term Obligations (continued)

Advances From Other Governments (continued)

Annual debt service requirements to maturity for the revolving loan are as follows:

Fiscal Year Ending June 30,	Principal	Interest	Total
2011	\$ 294,181	\$ 148,791	\$ 442,972
2012	300,947	142,025	442,972
2013	307,869	135,103	442,972
2014	314,950	128,022	442,972
2015	322,194	120,778	442,972
2016-2020	1,725,593	489,265	2,214,858
2021-2025	1,933,377	281,481	2,214,858
2026-2028	1,270,050	58,865	1,328,915
Total	\$ 6,469,161	\$ 1,504,330	\$ 7,973,491

General Obligation Bonds

General obligation bonds are direct obligations and pledged by the full faith and credit of the District. General obligation bonds outstanding as of June 30, 2010 were \$89,000, with interest rates ranging from 4% to 5%.

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

Fiscal Year Ending June 30,	Principal	Interest	Total
2011	\$ -	\$ 2,225	\$ 2,225
2012	13,000	4,125	17,125
2013	14,000	3,450	17,450
2014	14,000	2,750	16,750
2015	15,000	2,025	17,025
2016-2017	33,000	1,675	34,675
Total	\$ 89,000	\$ 16,250	\$ 105,250

The District also issued bonds where the revenue derived from charges for services are pledged to pay for the debt service.

**SONOMA VALLEY COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Note G. Long-Term Obligations (continued)

Revenue Bonds

On September 7, 2005, the District, through the California Statewide Communities Development Authority, issued \$10,240,000 in Water and Wastewater Revenue Bonds (Series 2005C) for the purpose of partially refinancing the outstanding 1998 Special Revenue Bonds, which were initially issued to finance various treatment plant upgrades within the District. The bonds are payable solely from sanitation customer net revenues through 2024. Annual principal and interest payments are expected to require no more than 43% of net revenues. The total principal and interest outstanding on the 1998 Special Revenue Bonds and Series 2005C Revenue Bonds as of June 30, 2010 is \$14,010,000 and \$4,909,507, respectively. Principal and interest paid for the fiscal year ended June 30, 2010 and total customer net revenues were \$1,297,298 and \$3,044,205 respectively. Total amounts outstanding and terms of the 1998 Special Revenue Bonds and Series 2005C Revenue Bonds are as follows:

	Interest Rates	Maturity Date	Amount
1998 Special Revenue Bonds	4.00% - 5.10%	August 1, 2023	\$ 6,460,000
Series 2005C Revenue Bonds	2.7% - 4.05%	October 1, 2018	7,550,000
Total			\$ 14,010,000

Debt service requirements to maturity for the Revenue Bonds are as follows:

June 30,	Principal	Interest	Total
2011	\$ 730,000	\$ 570,043	\$ 1,300,043
2012	755,000	545,095	1,300,095
2013	775,000	520,273	1,295,273
2014	805,000	493,010	1,298,010
2015	830,000	463,775	1,293,775
2016-2020	4,830,000	1,800,630	6,630,630
2021-2024	5,285,000	516,681	5,801,681
Total	\$ 14,010,000	\$ 4,909,507	\$ 18,919,507

**SONOMA VALLEY COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Note G. Long-Term Obligations (continued)

Changes in Long-Term Obligations

Long-term obligations activity for the fiscal year ended June 30, 2010 was as follows:

	July 1, 2009	Additions	Retirements	June 30, 2010	Due Within One Year
Advances from other Governments	\$ 7,031,865	\$ -	\$ (333,108)	\$ 6,698,757	\$ 337,692
General Obligation Bonds	101,000	-	(12,000)	89,000	-
Revenue Bonds	14,715,000	-	(705,000)	14,010,000	730,000
Less deferred amounts for					
Original issue discount	(137,634)	-	10,917	(126,717)	(10,917)
Deferred amount on refunding	(518,521)	-	51,852	(466,669)	(51,852)
Total revenue bonds	14,058,845	-	(642,231)	13,416,614	667,231
Total	\$ 21,191,710	\$ -	\$ (987,339)	\$ 20,204,371	\$ 1,004,923

Note H. Accrued Interest Payable

Interest payable consists of interest accrued on the following obligations:

	Amount
Advances from other governments	\$ 105,393
General obligations and revenue bonds	196,572
Total	\$ 301,965

**SONOMA VALLEY COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Note I. Related Party Transactions

The District is a special district under the Board of Supervisors, and as such, has similar board members as the County. Both the District and the Water Agency are component units of the County, and therefore, are considered related parties.

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 an overhead rate charged on labor applicable to the District. The overhead rate is reviewed periodically by management to determine its effectiveness. The District paid \$6,021,320 to the Water Agency for administrative support during the fiscal year ended June 30, 2010. The District also received a \$991,403 refund from the Water Agency for overpayment of overhead charges.

Note J. Risk Management

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters. The 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 \$10,000,000 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 \$600,000,000 per occurrence including flood and \$80,000,000 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.

**SONOMA VALLEY COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Note K. Commitments and Contingencies

Commitments

The District has active construction projects as of June 30, 2010. The projects include expansion and/or improvements of wastewater treatment facilities. At June 30, 2010, the District's commitments to construction projects totaling \$66,891.

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 wastewater treatment facilities are being financed by revenue bonds secured by wastewater revenues and by net assets.

Pending Litigation, Claims, and Assessments

In July, 2010, the District received an Administrative Liability Complaint (ALC) from the California Regional Water Quality Control Board, San Francisco Bay Region (SF Bay Regional Board) for alleged discharge violations occurring from 2007 until early 2010. The ALC proposes an administrative penalty of \$348,000. The District has responded stating its desire to enter into a settlement agreement with the SF Bay Regional Board regarding the violations. A Supplemental Environmental Project (SEP) to reduce the penalty in exchange for implementation of an environmentally beneficial project may be included as part of the settlement terms. The final penalty amount and cost of any agreed upon SEP are unknown at this time. The District has accrued a payable for \$350,000 in accounts payable and accrued expenses for the fiscal year ended June 30, 2010 to address this matter.

On July 10, 2010, a sewage leak occurred from a collection system pipe in the District's service area into Sonoma Creek. The leak has been fixed and the District is performing further repair work to protect against possible future collection system failures in the area. The SF Bay Regional Board will likely issue an enforcement action for this leak, or it may be addressed in the ALC enforcement action discussed above. The potential liability for this leak is unknown at this time.

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.

**SONOMA VALLEY COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010**

Note L. Subsequent Event

On July 2, 2010 the District completed the purchase of certain property with the execution of a promissory note in the amount of \$933,000. Terms of the note require semi-annual payments over a 5 year period at an annual interest rate of 4%.

Debt service requirements for the note to maturity are as follows:

Fiscal Year Ending June 30,	Principal	Interest	Total
2011	\$ 171,954	\$ 35,828	\$ 207,782
2012	179,112	28,668	207,780
2013	186,348	21,432	207,780
2014	193,877	13,904	207,781
2015	201,709	6,071	207,780
Total	\$ 933,000	\$ 105,903	\$ 1,038,903



Board of Directors
Sonoma Valley County Sanitation District
Santa Rosa, California

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

We have audited the basic financial statements of Sonoma Valley County Sanitation District (District) as of and for the fiscal year ended June 30, 2010, and have issued our report thereon dated November 4, 2010. Our report contained explanatory language describing the District’s implementation of a new governmental accounting standard, which was effective July 1, 2009. 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 as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District’s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District’s internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

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 Board of Directors and District management and is not intended to be and should not be used by anyone other than these specified parties.

Maciel Meiri & O'Connell LLP

Certified Public Accountants

Sacramento, California
November 4, 2010