

**OCCIDENTAL COUNTY SANITATION
DISTRICT**

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

For the Year Ended June 30, 2007

**OCCIDENTAL COUNTY SANITATION DISTRICT
FOR THE YEAR ENDED JUNE 30, 2007**

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Board of Directors
Occidental County
Sanitation District
Santa Rosa, California

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying basic financial statements of the Occidental County Sanitation District (District), a component unit of the County of Sonoma, California, as of and for the year ended June 30, 2007, 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 the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide 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, 2007, and the changes in its financial position and its 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 issued our report dated October 26, 2007 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 (MD&A) on pages 3 through 9 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 required supplementary information. However, we did not audit the information and express no opinion on it.

Macias Gini & O'Connell CP

Certified Public Accountants

Sacramento, California

October 26, 2007

Management's Discussion and Analysis

**OCCIDENTAL COUNTY SANITATION DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2007**

As management of the Occidental County Sanitation District (the District), we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the year ended June 30, 2007. We encourage readers to consider the information presented here in conjunction with the District's financial statements (pages 10 - 13) and the accompanying notes to the financial statements (pages 14 - 23).

Reporting Entity

The Occidental 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 \$1,138,269 (*net assets*). Of this amount, \$30,244 (*unrestricted net assets*) may be used to meet the District's ongoing obligations to citizens and creditors.

Revenues

The District recognized total revenues of \$686,664 during fiscal year 2006/07. Of this amount, \$313,173 consists of charges for services (operating revenues), and \$373,491 of nonoperating revenues consisting of investment earnings, intergovernmental revenue and property taxes.

Expenses

The District incurred expenses totaling \$537,392 for the year ended June 30, 2007. This amount represents operating expenses related to the collection, treatment, disposal, and reclamation of effluent, as well as administrative and general expenses.

Increase in Net Assets

The District recorded an operating loss of (\$224,219) for fiscal year 2006/07.

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.

**OCCIDENTAL COUNTY SANITATION DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2007**

Management's Discussion and Analysis

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 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 – 23.

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 \$1,138,269 at the close of the most recent fiscal year compared to net assets of \$954,997 as of June 30, 2006.

A significant portion of the District's net assets (97.2% for fiscal year 2007 compared to 91.6% for 2006) 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 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.

**OCCIDENTAL COUNTY SANITATION DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2007**

Net Assets

	June 30, 2006	June 30, 2007	Percentage Change
Current and other assets	\$ 82,246	\$ 47,902	(41.8)%
Capital assets	878,040	1,108,370	26.2%
Total Assets	960,286	1,156,272	20.4%
Current liabilities	3,286	17,003	417.4%
Noncurrent liabilities	2,000	1,000	(50.0)%
Total Liabilities	5,286	18,003	240.6%
Invested in capital assets net of related debt	875,040	1,106,370	26.4%
Restricted for debt service	2,641	1,655	(37.3)%
Unrestricted	77,316	30,244	(60.9)%
Total Net Assets	\$ 954,997	\$ 1,138,269	19.2%

A portion of the District's net assets \$1,655 (0.1% for fiscal year 2007) and \$2,641 (0.3% for 2006) represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets of \$30,244 for 2007 and \$77,316 for 2006 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.

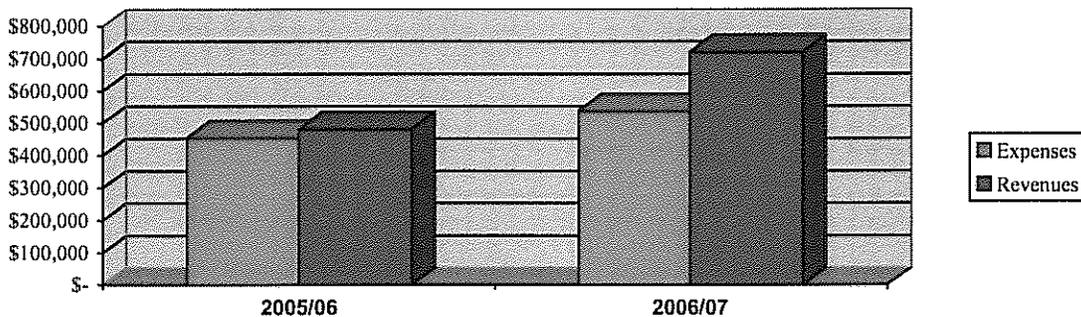
Changes in Net Assets

	June 30, 2006	June 30, 2007	Percentage Change
Revenues:			
Operating revenues	\$ 255,996	\$ 313,173	22.3%
Nonoperating revenues	226,065	373,491	65.2%
Total revenues	482,061	686,664	42.4%
Expenses			
Services and supplies	408,631	481,535	17.8%
Fiscal agent fees and legal services	642	10,060	1,467.0%
Depreciation and amortization	45,547	45,797	0.5%
Total expenses	454,820	537,392	18.2%
Income before contributions and transfers	27,241	149,272	448.0%
Capital contributions – connection fees	4,000	34,000	750.0%
Transfers	250,000	-	(100.0)%
Increase in net assets	281,241	183,272	(34.8)%
Net assets at beginning of year	673,756	954,997	41.7%
Net assets at end of year	\$ 954,997	\$ 1,138,269	19.2%

**OCCIDENTAL COUNTY SANITATION DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2007**

The District's net assets increased by \$183,272 during 2007 compared to an increase of \$281,241 during 2006. The 2007 increase is due primarily to intergovernmental revenues of \$372,170. This amount is primarily comprised of funding received from the Sonoma County Water Agency totaling \$367,000 in order to allow the District to meet its ongoing operating expenses.

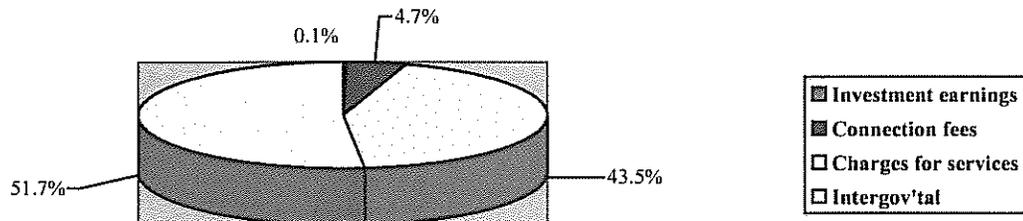
Expenses and Revenues



Total expenses for the District increased by \$82,572 to \$537,392 for the year ended June 30, 2007 due primarily to increased maintenance and capital project activity.

Total revenues of the District for fiscal year 2006/07 totaled \$720,664 representing an increase of \$234,603 from the preceding fiscal year revenues of \$486,061. The rate based charges for services, representing 43.5% of the District's 2006/07 total revenue, increased by \$57,177 (22.3%); connection fees, representing 4.7% of the District's total revenue, increased by \$30,000. Investment earnings decreased from the preceding year by \$282. Intergovernmental revenues totaling \$372,170 (51.7%) were received from the Sonoma County Water Agency (\$367,000) and from the State and FEMA (\$5,170) for disaster related assistance. The combined effect of these occurrences is an overall increase in revenues of 48.3%.

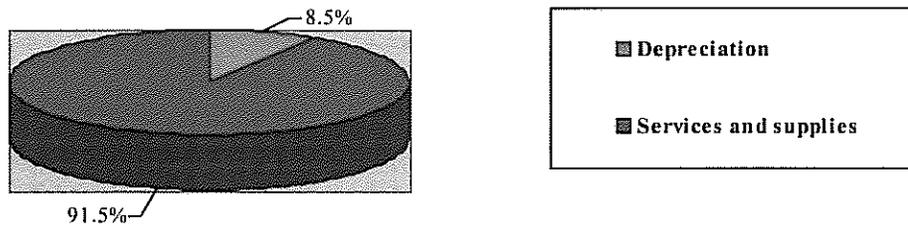
Revenues by Source



**OCCIDENTAL COUNTY SANITATION DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2007**

As previously mentioned, revenues collected by the District for 2006/07 totaled \$720,664. Of this amount \$313,173 or 43.5%, 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 4.7% of the annual revenue, are also collected through the permitting process. Investment earnings represent 0.1% of revenues and consist of earnings on pooled cash held with the Sonoma County Treasurer. Intergovernmental revenues, representing financing from the Sonoma County Water Agency totaled 51.7% of the District's revenues for the year ended June 30, 2007.

Expenses by Function



Total expenses for the District for fiscal year 2006/07 totaled \$537,392. Costs associated with the collection, treatment, and disposal of effluent represent 91.5% of the District's costs. Annual depreciation expense on capital assets represents \$45,797 (8.5%) of total expenses.

Capital Asset and Debt Administration

Capital assets

The District's investment in capital assets as of June 30, 2007, amounts to \$1,108,370 (net of accumulated depreciation). This investment in capital assets includes buildings and improvements, and construction in progress.

Occidental County Sanitation District's Capital Assets

	June 30, 2006	June 30, 2007	Percentage Change
Buildings and improvements	\$1,395,500	\$1,395,500	0.0%
Construction in progress	82,782	358,909	333.6%
Accumulated depreciation	(600,242)	(646,039)	7.6%
Total	\$ 878,040	\$1,108,370	26.2%

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

**OCCIDENTAL COUNTY SANITATION DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2007**

Long-term debt

At the end of the current fiscal year, the District had a total of \$2,000 in outstanding debt consisting of general obligation bonds. This amount comprises debt backed by the full faith and credit of the District.

Occidental Sanitation District's Outstanding Current and Long Term Debt

	June 30, 2006	June 30, 2007	Percentage Change
General obligation bonds	\$3,000	\$2,000	(33.3)%

Additional information on the District's current and long-term debt can be found in Note E on pages 20-21 of this report.

Next Year's Budget and Rates

Budgeted gross expenses for the District for fiscal year 2007/08 have decreased by \$1,989,828 (76.5%) for a total of \$610,242. The major component of the decrease in budgeted expenses is related to capital projects that have been delayed and/or cancelled in the District's construction fund due to financial constraints.

Following is a comparison of the final 2006/07 and proposed 2007/08 budgeted expenses for the District:

	2006/07	2007/08	Increase (Decrease)	Percentage Change
Occidental				
Operations	\$ 532,673	\$401,200	\$ (131,473)	(24.7)%
General obligation bonds	195	147	(48)	(24.6)%
Construction	2,067,202	208,895	(1,858,307)	(89.9)%
	\$2,600,070	\$ 610,242	\$ (1,989,828)	(76.5)%

Budgeted expenses for fiscal year 2006/07 differ in several instances from the budgeted expenses presented in the management's discussion and analysis for the period ending June 30, 2006. These variances are due to Board approved budgetary adjustments made subsequent to the publication of the 2006/07 audited financial statements.

**OCCIDENTAL COUNTY SANITATION DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2007**

The sewer service fees were increased for the 2007 - 2008 budget year. The rates were increased by 6.5%. Following are tables showing the sanitation services rates and equivalent single dwellings for the District.

Rate per Equivalent Single-Family Dwelling

	2006/07	2007/08	Percentage Change
	\$1,116	\$1,189	6.5%

Number of Equivalent Single-Family Dwellings by District

	2006/07	2007/08	Percentage Change
	266	266	0.0%

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 101F, Santa Rosa, CA 95403.

**OCCIDENTAL COUNTY SANITATION DISTRICT
STATEMENT OF NET ASSETS
JUNE 30, 2007**

Assets

Current assets:

Cash and investments	\$ 43,577
Accounts receivable	1,531
Prepaid expense	1,139
Total current assets	46,247

Noncurrent assets:

Restricted cash and investments:	
General obligation bond fund	1,655
Total noncurrent assets	1,655

Capital assets:

Buildings and improvements	1,395,500
Construction in progress	358,909
Less accumulated depreciation	(646,039)
Total capital assets (net of (accumulated depreciation))	1,108,370
Total noncurrent assets	1,110,025

Total assets	1,156,272
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Liabilities

Current liabilities payable from unrestricted assets:

Accounts payable and accrued expenses	16,003
Current liabilities payable from restricted assets:	
General obligation bonds payable	1,000

Total current liabilities	17,003
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Noncurrent liabilities

General obligation bonds payable	1,000
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Total liabilities	18,003
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Net Assets

Invested in capital assets, net of related debt	1,106,370
Restricted for debt service	1,655
Unrestricted	30,244
Total net assets	\$ 1,138,269

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

**OCCIDENTAL COUNTY SANITATION DISTRICT
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2007**

Operating revenues		
Flat charges	\$	286,065
Charges for services		27,108
Total operating revenues		313,173
Operating expenses		
Services and supplies		481,535
Fiscal agent fees and legal services		10,060
Depreciation and amortization		45,797
Total operating expenses		537,392
Operating loss		(224,219)
Nonoperating revenues		
Investment earnings		1,239
Intergovernmental		372,170
Property taxes		82
Total nonoperating revenues		373,491
Income before capital contributions		149,272
Capital contribution:		
Connection fees		34,000
Increase in net assets		183,272
Net assets - beginning of year		954,997
Net assets - end of year		\$ 1,138,269

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

**OCCIDENTAL COUNTY SANITATION DISTRICT
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2007**

CASH FLOWS FROM OPERATING ACTIVITIES	
Receipts from customers	\$ 314,216
Payments for interfund services used	(418,892)
Payments to suppliers	(59,328)
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Net cash used by operating activities	(164,004)
<hr/>	
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Taxes	82
Intergovernmental revenue	372,170
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Net cash provided by noncapital financing activities	372,252
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CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Purchase of capital assets	(274,512)
Principal payments - bonds	(1,000)
Interest paid on capital debt	(118)
Connection fees	34,000
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Net cash provided by capital and related financing activities	(241,630)
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CASH FLOWS FROM INVESTING ACTIVITIES	
Interest received on pooled cash and investments	1,239
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Net decrease in cash and cash equivalents	(32,143)
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Cash and cash equivalents - beginning of year	77,375
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Cash and cash equivalents - end of year	\$ 45,232
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Reconciliation to the statement of net assets:	
Cash and cash equivalents	\$ 43,577
Restricted cash and cash equivalents	1,655
<hr/>	
Cash and cash equivalents	\$ 45,232
<hr/>	

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

**OCCIDENTAL COUNTY SANITATION DISTRICT
STATEMENT OF CASH FLOWS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2007**

Reconciliation of operating loss to net cash	
used by operating activities:	
Operating loss	\$ (224,219)
Adjustments to reconcile operating loss to net cash	
used by operating activities:	
Depreciation and amortization	45,797
Change in assets and liabilities:	
Decrease in accounts receivable	1,043
Decrease in prepaid expenses	1,157
Increase in accounts payable and accrued expenses	12,218
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Net cash used by operating activities	\$ (164,004)
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The accompanying notes are an integral part of these financial statements.

**OCCIDENTAL COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2007**

Note A. Defining the Financial Reporting Entity

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

Component Unit Reporting

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

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

Note B. Summary of Significant Accounting Policies

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

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.

**OCCIDENTAL COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2007**

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 20, 1989 unless those pronouncements conflict with or contradict GASB pronouncements. 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 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 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 Treasurer of Sonoma County. 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 stated its investment in the Treasury Pool 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.

**OCCIDENTAL COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2007**

Note B. Summary of Significant Accounting Policies (continued)

Cash and Investments (continued)

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

Accounts Receivable

Accounts receivable consists of uncollected fees for sanitation services and flat charges as of June 30, 2007. These flat charges are established annually by the Board and are billed through the County's property tax system.

Prepaid Expenses

Prepaid expenses represent payments made to vendors for services that will benefit periods beyond June 30, 2007.

Restricted Assets

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

Capital Assets

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

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

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

**OCCIDENTAL COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2007**

Note B. Summary of Significant Accounting Policies (continued)

Net Assets

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

Budget and Budgetary Accounting

The Board 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 of the District except for transfers between the major expense classes or transfers between capital assets and operating expenses. Such transfers require approval by the County Administrator and/or the Board.

Property Tax Revenue

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

The County has adopted the Teeter Alternative Method of Property Tax Allocation known as the "Teeter Plan". The State Revenue and Taxation Code allows counties to distribute secured real property and supplemental property taxes on an accrual basis resulting in full payment to the District each fiscal year. Any subsequent delinquent payments and related penalties and interest will revert to 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 assessed valuation occur due to sales transactions or the completion of construction. Property tax collection and valuation information is disclosed in the County's financial statements.

Intergovernmental Transactions

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

**OCCIDENTAL COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2007**

Note B. Summary of Significant Accounting Policies (continued)

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.

Note C. Cash and Investments

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

Interest income earned on pooled cash and investments is allocated quarterly based on the average daily balance of the District during the quarter.

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. The objectives of the policy are, in order of priority: safety of capital, liquidity and maximum rate of return. The policy addresses the soundness of financial institutions in which the County will deposit funds, types of investment instruments as permitted by the California Government Code, and the percentage of the portfolio that may be invested in certain instruments with longer terms to maturity.

Permitted investments include the following:

- U.S. Treasury and Federal Agency securities
- Bonds and notes 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) deposits
- Repurchase agreements
- Reverse repurchase agreements
- Money market mutual funds
- Collateralized mortgage obligations
- Collateralized time deposits
- Joint powers agreement

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.

As of June 30, 2007, the District's cash and investments consisted of \$45,232 in the Treasury Pool managed by the County Treasurer, which is not rated by credit rating agencies, and had a weighted average maturity of 414 days. The credit rating and other information regarding specific investments maintained in the Treasury Pool as of June 30, 2007 are disclosed in the County's 2006-07 Comprehensive Annual Financial Report.

**OCCIDENTAL COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2007**

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 is to changes in market interest rates. One of the ways that the County Treasurer manages the District's 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.

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.

Investments in external investment pools and in open-end mutual funds are not exposed to custodial credit risk. As of June 30, 2007, all of the District's investments were in the County Treasury Pool and, are therefore, not exposed to custodial credit risk.

Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The District follows the County's policy to purchase investments with the minimum ratings required by the California Government Code. The credit rating and other information regarding the Treasury pool for the fiscal year 2006-07 are disclosed in the County's 2006-2007 Comprehensive Annual Financial Report.

**OCCIDENTAL COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2007**

Note D. Capital Assets

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

	July 1, 2006	Additions	Retirements	June 30, 2007
Capital assets, not being depreciated:				
Construction in progress	\$ 82,782	\$ 276,127	\$ -	\$ 358,909
Capital assets, being depreciated:				
Buildings and improvements	1,395,500	-	-	1,395,500
Less accumulated depreciation for:				
Buildings and improvements	(600,242)	(45,797)	-	(646,039)
Total capital assets, being depreciated, net	795,258	(45,797)	-	749,461
Total capital assets, net	\$ 878,040	\$ 230,330	\$ -	\$ 1,108,370

Depreciation expense was \$45,797 for the year ended June 30, 2007.

Note E. Long-Term Obligations

General Obligation Bonds

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

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, 2007 are \$2,000 with an interest rate of 5%.

Long-term obligation activity for the year ended June 30, 2007 was as follows:

	July 1, 2006	Additions	Reductions	June 30, 2007	Due Within One Year
General obligation bonds	\$ 3,000	\$ -	\$ (1,000)	\$ 2,000	\$ 1,000

**OCCIDENTAL COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2007**

Note E. Long-Term Obligations (continued)

General Obligation Bonds (continued)

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

Year ending June 30.	Principal	Interest
2008	\$ 1,000	\$ 95
2009	1,000	47
	<u>\$ 2,000</u>	<u>\$ 142</u>

Note F. Related Party Transactions

The District is a special district under the Board of Supervisors, and as such, has the same board members as the County. 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 \$396,242 to the Water Agency for administrative support during the year ended June 30, 2007.

During the year ended June 30, 2007, the District received funding from the Water Agency to allow the District to meet operating and construction expenses. The total funding received by the District amounted to \$367,000 for the year ended June 30, 2007.

Note G. Commitments and Contingencies

Commitments

The District has active projects as of June 30, 2007. The projects include preliminary engineering work and environmental studies towards expansion and/or improvements of wastewater collection and treatment facilities. As of June 30, 2007, the District's commitments to projects included \$358,909 of amounts spent to date with current commitments of \$48,895. The District anticipates the total construction cost of the project to be approximately \$1.6 million.

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.

**OCCIDENTAL COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2007**

Note G. Commitments and Contingencies (continued)

Risk Management (continued)

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.

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

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

Pending Litigation, Claims, and Assessments

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

**OCCIDENTAL COUNTY SANITATION DISTRICT
NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2007**

Note G. Commitments and Contingencies (continued)

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 H. Recent Governmental Accounting Standards

The Governmental Accounting Standards Board (GASB) has released the following new standard that will be applicable to the District:

Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, issued in November 2006. This Statement establishes accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. The Statement establishes once any of five specified obligating events occurs, that a government is required to estimate the components of the expected pollution remediation outlays and determine whether the outlays for those components should be recorded as a liability or, if appropriate, capitalized when goods and services are acquired. GASB Statement No. 49 is effective for financial statements for years beginning after December 15, 2007.

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



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Board of Directors
Occidental 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 financial statements of the Occidental County Sanitation District (District), as of and for the year ended June 30, 2007, and have issued our report thereon dated October 26, 2007. 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 control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the District's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the District's financial statements that is more than inconsequential will not be prevented or detected by the District's internal control.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies 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 solely for the information and use 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.

Macias Gini & O'Connell LLP

Certified Public Accountants

Sacramento, California
October 26, 2007