RUSSIAN RIVER COUNTY
SANITATION DISTRICT
(A Component Unit of the
County of Sonoma, California)

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

For the Year Ended June 30, 2008

RUSSIAN RIVER COUNTY SANITATION DISTRICT
FOR THE YEAR ENDED JUNE 30, 2008

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Russian River County
Sanitation District
Santa Rosa, California

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying basic financial statements of the Russian River County Sanitation District (District), a component unit of the County of Sonoma, California, as of and for the year ended June 30, 2008, 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 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, 2008, 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 November 5, 2008 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 on pages 3 through 10 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 LLP

Certified Public Accountants

Sacramento, California
November 17, 2008

Management's Discussion and Analysis

RUSSIAN RIVER COUNTY SANITATION DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2008
(UNAUDITED)

As management of the Russian River 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, 2008. We encourage readers to consider the information presented here in conjunction with the District's financial statements (pages 11 – 15) and the accompanying notes to the financial statements (pages 16 – 27).

Reporting Entity

The District is managed by the Sonoma County Water Agency (Water Agency) which provides administration, engineering, operational and maintenance services. The District is governed by a Board of Directors (Board) which is the County of Sonoma Board of Supervisors. The District is considered an integral part of the County of Sonoma's (County) 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 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 $26,357,840 (*net assets*). Of this amount, $4,120,972 (*unrestricted net assets*) may be used to meet the District's ongoing obligations to citizens and creditors.

Revenues

The District recognized total revenues of $3,375,618 during fiscal year 2007/08. Of this amount, $2,966,686 consists of charges for services (operating revenues), and $373,534 of nonoperating revenues consisting of investment earnings, property taxes, and intergovernmental revenue. The District recognized capital contributions in the amount of $35,398 for connection fees.

Expenses

The District incurred expenses totaling $3,221,298 during fiscal year 2007/08. Of this amount $3,078,972 represents operating expenses related to the collection, treatment, disposal, and reclamation of effluent, as well as administrative and general expenses. Nonoperating expenses consisted of interest expense related to the District's long-term debt obligations of $142,326.

Increase in Net Assets

The District recorded an operating loss of $112,286 for fiscal year 2007/08, while recognizing an overall increase in net assets of $154,320.

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 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 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 16 – 27.

Financial Analysis

Net assets may serve over time as a useful indicator of the District's financial position. In the case of the District, assets exceeded liabilities by $26,357,840 at the close of the most recent fiscal year compared to net assets of $26,203,520 as of June 30, 2007.

The largest portion of the District's net assets (82.1% for fiscal year 2007/08 compared to 83.1% for 2006/07) reflects its investment in capital assets (e.g., land and buildings), less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the District's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

Condensed Statement of Net Assets

	June 30, 2007	June 30, 2008	Percentage Change
Current and other assets	$ 4,621,014	$ 4,848,913	4.9%
Capital assets	27,910,132	27,377,706	(1.9)%
Total Assets	32,531,146	32,226,619	(0.9)%
Current liabilities	477,324	363,956	(23.8)%
Noncurrent liabilities	5,850,302	5,504,823	(5.9)%
Total Liabilities	6,327,626	5,868,779	(7.3)%
Invested in capital assets net of related debt	21,772,415	21,627,404	(0.7)%
Restricted for debt service	574,552	609,464	6.1%
Unrestricted	3,856,553	4,120,972	6.9%
Total Net Assets	$ 26,203,520	$26,357,840	0.6%

A portion of the District's net assets $609,464 (2.3% for 2007/08) and $574,552 (2.2% for 2006/07) represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets of $4,120,972 for 2008 and $3,856,553 for 2007 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.

Statement of Changes in Net Assets

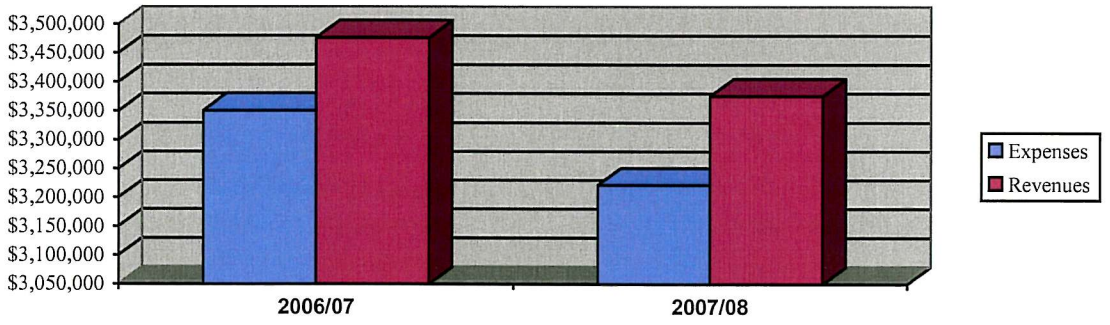
	June 30, 2007	June 30, 2008	Percentage Change
Revenues:			
Operating revenues	$ 2,891,641	$ 2,966,686	2.6%
Nonoperating revenues:			
Investment earnings	220,792	191,562	(13.2)%
Intergovernmental	130,959	8	(99.9)%
Property taxes	177,805	181,964	2.3%
Total revenues	3,421,197	3,340,220	(2.4)%
Expenses:			
Services and supplies	2,116,680	2,048,112	(3.2)%
Fiscal agent fees and legal services	14,887	3,878	(74.0)%
Depreciation and amortization	1,026,680	1,026,982	0.0%
Interest expense	190,101	142,326	(25.1)%
Loss on disposal of capital assets	2,244	--	--
Total expenses	3,350,592	3,221,298	(3.9)%

Statement of Changes in Net Assets (Continued)

	June 30, 2007	June 30, 2008	Percentage Change
Income before capital contributions	70,605	118,922	68.4%
Capital contribution – connection fees	55,093	35,398	(35.7)%
Increase in net assets	125,698	154,320	22.8%
Net assets – beginning of year	26,077,822	26,203,520	0.5%
Net assets – end of year	$ 26,203,520	$ 26,357,840	0.6%

The District's net assets increased by $154,320 during 2007/08 compared to an increase of $125,698 during 2006/07.

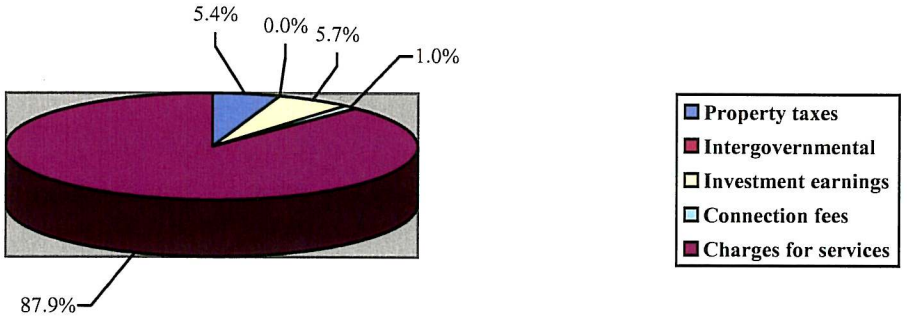
Expenses and Revenues



Total revenues of the District for fiscal year 2007/08 totaled $3,340,220 representing a decrease of $80,977 from the preceding fiscal year revenues of $3,421,197. The rate based charges for services, representing 88.8% of the District's total revenue, increased by $75,045 (2.6%); property taxes, representing 5.4% of the District's total revenue, increased by $4,159. Investment earnings decreased from the preceding year by $29,230. The combined effect of these occurrences is an overall decrease in revenues of 2.4%.

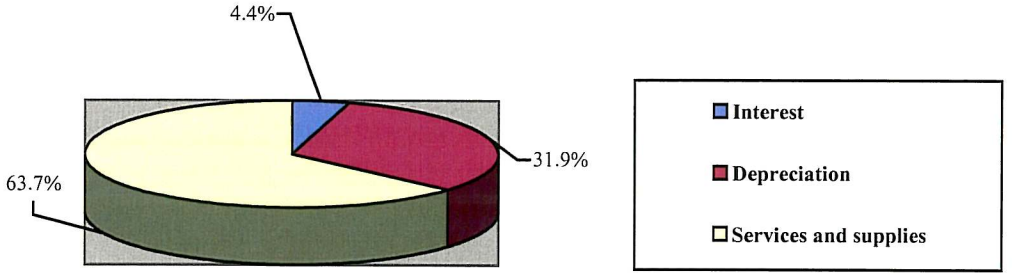
Total expenses for the District decreased by $129,294 to $3,221,298 for fiscal year 2007/08. Interest expense decreased $47,775 (25.1%) due to interest payments on the Third Unit Processes loan with the State Water Resources Control Board. Additional decreases in maintenance project expenses of $49,265 (24.8%), utilities expense of $11,644 (7.7%) were also realized by the District in 2007/08. The effect of these occurrences is an overall decrease in expenses of 3.9%.

Revenues by Source



Total revenues and capital contributions collected by the District for 2007/08 totaled $3,375,618. Of this amount $2,966,686 or 87.9%, was generated through flat charges and 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 1.0% of the annual revenue, are also collected through the permitting process. Property tax revenues accounted for 5.4% of the annual revenues, and are collected through the tax rolls to satisfy debt service requirements. Investment earnings represent 5.7% of revenues and consist of earnings on pooled cash held with the Sonoma County Treasurer.

Expenses by Function



Total expenses for the District for fiscal year 2007/08 totaled $3,221,298. Costs associated with the collection, treatment, and disposal of effluent represent 63.7% of the District's costs. The next largest functional area is the annual depreciation expense on capital assets and represents $1,026,982 (31.9%) of total expenses. Interest expense totaling $142,326 (4.4%) represents the cost of meeting current debt service obligations.

Capital Asset and Debt Administration

Capital Assets

The District's investment in capital assets as of June 30, 2008, amounts to $27,377,706 (net of accumulated depreciation). This investment in capital assets includes land, buildings and systems, improvements, and construction in progress. The increase in construction in progress is due to initial design and engineering costs incurred ($260,986) for the upcoming Disinfection Treatment Upgrade as well as design and environmental impact costs of $176,986 associated with the Irrigation Expansion project.

Russian River County Sanitation District's Capital Assets

	June 30, 2007	June 30, 2008	Percentage Change
Land	$ 223,833	$ 223,833	0.0%
Construction in progress	1,107,025	1,601,581	44.7%
Buildings and improvements	43,868,042	43,868,042	0.0%
Accumulated depreciation	(17,288,768)	(18,315,750)	5.9%
Total capital assets	$ 27,910,132	$ 27,377,706	(1.9)%

Additional information on the District's capital assets can be found in Note D on page 22 of the financial statement footnotes.

Long-term Debt

At the end of the current fiscal year, the District had a total of $5,730,149 in outstanding debt consisting of general obligation bonds, revenue bonds, and advances from other governments. Of this amount, $1,325,000 comprises debt backed by the full faith and credit of the District, $1,060,000 which are special obligations of the District payable solely from net revenues of District operations, and $3,345,149 is related to advances from the State Water Resources Control Board.

Russian River County Sanitation District's Outstanding Current and Long-Term Debt

	June 30, 2007	June 30, 2008	Percentage Change
General obligation bonds	$ 1,425,000	$ 1,325,000	(7.0)%
Revenue bonds	1,125,000	1,060,000	(5.8)%
Advances from other governments	3,501,564	3,345,149	(4.5)%
Total long-term debt	$ 6,051,564	$ 5,730,149	(5.3)%

The District's total debt decreased by $321,415 during the current fiscal year.

Long-term Debt (Continued)

Advances from other governments decreased by $156,415 (4.5%) due to annual repayments of existing advances to the State Water Resources Control Board.

The general obligation and revenue bonds decrease is due to the scheduled annual repayments on the outstanding debt.

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

Next Year's Budget and Rates

Budgeted gross expenditures for the District for fiscal year 2008/09 have increased by $533,639 (6.7%) for a total of $8,525,267. The major component of the increase in budgeted expenditures is related to an increase in anticipated planned capital projects.

Following is a comparison of final 2007/08 and proposed 2008/09 budgeted expenditures for the District:

	2007/08	2008/09	Increase (Decrease)	Percentage Change
Operations	$3,717,852	$ 3,904,569	$186,717	5.0%
Debt service - general obligation bonds	71,302	66,250	(5,052)	(7.1)%
Debt service - revenue bonds	56,250	53,000	(3,250)	(5.8)%
Construction	4,146,224	4,501,448	355,224	8.6%
	$7,991,628	$ 8,525,267	$ 533,639	6.7%

Budgeted expenditures for fiscal year 2007/08 differ in several instances from the budgeted expenditures presented in management's discussion and analysis for the period ended June 30, 2007. These variances are due to Board approved budgetary adjustments made subsequent to the publication of the 2006/07 audited basic financial statements.

The sewer service fees were increased for the 2008/09 budget year. The rates were increased by 5.0%.

Following are tables showing the sanitation services rates and equivalent single dwellings for the District.

Rate per Equivalent Single-Family Dwelling

2007/08	2008/09	Percentage Change
$940	$987	5.0%

Number of Equivalent Single-Family Dwellings by District

2007/08	2008/09	Percentage Change
3,182	3,184	0.1%

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. 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.

Basic Financial Statements

RUSSIAN RIVER COUNTY SANITATION DISTRICT
STATEMENT OF NET ASSETS
JUNE 30, 2008

ASSETS	
Current assets	
Cash and investments	$ 3,850,817
Accounts receivable	375,382
Restricted cash and investments	
General obligation bond fund	152,921
Revenue bond fund	348,543
Total current assets	4,727,663
Noncurrent assets	
Restricted cash and investments	
Revenue bond reserve fund	121,250
Capital assets	
Land	223,833
Construction in progress	1,601,581
Buildings and improvements	43,868,042
Less accumulated depreciation	(18,315,750)
Total capital assets (net of (accumulated depreciation)	27,377,706
Total noncurrent assets	27,498,956
Total assets	$ 32,226,619

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

RUSSIAN RIVER COUNTY SANITATION DISTRICT
STATEMENT OF NET ASSETS (CONTINUED)
JUNE 30, 2008

LIABILITIES		
Current liabilities		
Accounts payable and accrued expenses	$	56,444
Due to other County funds		20,153
Due to other governments		160,326
Accrued interest payable		48,783
Total current liabilities		285,706
Current liabilities payable from restricted assets		
Revenue bonds payable		65,000
Accrued interest payable		13,250
Total current liabilities payable from restricted assets		78,250
Noncurrent liabilities		
General obligation bonds payable		1,325,000
Revenue bonds payable		995,000
Advances from other governments		3,184,823
Total noncurrent liabilities		5,504,823
Total liabilities		5,868,779
NET ASSETS		
Invested in capital assets, net of related debt		21,627,404
Restricted for debt service		108,000
Unrestricted		4,622,436
Total net assets		26,357,840
Total liabilities and net assets	$	32,226,619

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

RUSSIAN RIVER COUNTY SANITATION DISTRICT
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2008

Operating revenues		
Flat charges	$	2,934,611
Charges for services		32,075
Total operating revenues		2,966,686
Operating expenses		
Services and supplies		2,048,112
Fiscal agent fees and legal services		3,878
Depreciation and amortization		1,026,982
Total operating expenses		3,078,972
Operating loss		(112,286)
Nonoperating revenues (expenses)		
Investment earnings		191,562
Interest expense		(142,326)
Intergovernmental		8
Property taxes		181,964
Total nonoperating revenues, net		231,208
Income before capital contributions		118,922
Capital contribution - connection fees		35,398
Increase in net assets		154,320
Net assets - beginning of year		26,203,520
Net assets - end of year	$	26,357,840

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

RUSSIAN RIVER COUNTY SANITATION DISTRICT
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2008

CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	$	2,899,690
Payments to Sonoma County Water Agency		(1,525,806)
Payments to suppliers		(496,189)
Net cash provided by operating activities		877,695
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Taxes		181,964
Intergovernmental revenue		8
Net cash provided by noncapital financing activities		181,972
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchases of capital assets		(477,545)
Principal payments - advances from other governments		(156,415)
Principal payments - bonds		(165,000)
Principal payments - advances from the County		(66,000)
Interest paid on capital debt		(215,040)
Connection fees		51,801
Net cash used by capital and related financing activities		(1,028,199)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received on pooled cash and investments		191,562
Net increase in cash and cash equivalents		223,030
Cash and cash equivalents - beginning of year		4,250,501
Cash and cash equivalents - end of year	$	4,473,531
Reconciliation to the statement of net assets:		
Cash and investments	$	3,850,817
Restricted cash and investments		121,250
Total cash and cash equivalents	$	3,972,067

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

RUSSIAN RIVER COUNTY SANITATION DISTRICT
STATEMENT OF CASH FLOWS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2008

Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	$	(112,286)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation and amortization		1,026,982
Change in assets and liabilities:		
Increase in accounts receivable		(66,996)
Decrease in prepaid expenses		45,724
Decrease in accounts payable and accrued expenses		(15,729)
Net cash provided by operating activities	$	877,695

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

Notes to the Basic Financial Statements

Note A. Defining the Financial Reporting Entity

The Russian River 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 financial statements should be combined and presented with the District's 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.

Note B. Summary of Significant Accounting Policies (Continued)

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

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting,* the District applies all applicable GASB pronouncements as well as any applicable pronouncement of the Financial Accounting Standards Board or any Accounting Principles Board Opinions or 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. The District has elected not to apply private-sector standards issued after 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 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 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.

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 disclosures on 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. 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, 2008. These flat charges are established annually by the Board of Supervisors and billed through the County's property tax system. Accounts receivable also include amounts to be collected for connection fees related to Russian River Ordinance #39. Ordinance #39 receivables have fifteen year lives with an interest rate of 5%. The District does not expect to collect $53,435 of accounts receivable related to Ordinance #39 within the next year.

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, using the straight-line method over estimated lives ranging from 3 to 50 years. Useful lives of machinery and equipment are generally estimated to be 3 to 15 years. Buildings and improvements are generally estimated to have useful lives ranging from 30 to 50 years.

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

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

Note B. Summary of Significant Accounting Policies (Continued)

Net Assets

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowings used for the acquisition, construction or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use, either through enabling legislation adopted or through external restrictions imposed by creditors, grantors or laws or regulation of other governments. Unrestricted net assets represent amounts that are not restricted for any project or other purposes and can be used for ongoing operations and to fund current obligations.

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 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 annual 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 revenues and expenses by the District.

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 balances 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 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
- Joint power agreements

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

As of June 30, 2008, the District's investments consisted of $4,473,531 in the Treasury Pool managed by the County Treasurer, which is not rated by credit rating agencies, and had a weighted average maturity of 394 days. The credit rating and other information regarding specific investments maintained in the Treasury Pool as of June 30, 2008 are disclosed in the County's 2007-08 Comprehensive Annual Financial Report.

Note C. Cash and Investments (Continued)

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the District manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments, and by timing cash flows from maturities so that a portion of the portfolio is maturing, or coming close to maturity, evenly over time, as necessary, to provide the cash flow and liquidity needed for operations.

Custodial Credit Risk

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

Investments in external investment pools and in open-end mutual funds are not exposed to custodial credit risk. As of June 30, 2008, 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 2007-08 are disclosed in the County's 2007-08 Comprehensive Annual Financial Report.

Note D. Capital Assets

Capital asset activity for the year ended June 30, 2008 was as follows:

	July 1, 2007	Additions	Retirements	June 30, 2008
Capital assets, not being depreciated:				
Land	$ 223,833	$ -	$ -	$ 223,833
Construction in progress	1,107,025	494,556	-	1,601,581
Total capital assets, not being depreciated	1,330,858	494,556	-	1,825,414
Capital assets, being depreciated:				
Buildings and improvements	43,868,042	-	-	43,868,042
Less accumulated depreciation for:				
Buildings and improvements	(17,288,768)	(1,026,982)	-	(18,315,750)
Total capital assets, being depreciated, net	26,579,274	(1,026,982)	-	25,552,292
Total capital assets, net	$ 27,910,132	$ (531,426)	-	$27,377,706

Depreciation expense amounted to $1,026,982 for the year ended June 30, 2008.

The total amount of interest capitalized in connection with wastewater treatment facilities construction projects during the year ended June 30, 2008 was $69,620.

Note E. Intergovernmental Payable

Activity between related governments that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other governments" (i.e., the current portion of intergovernmental loans) or "advances to/from other governments" (i.e., the noncurrent portion of intergovernmental loans).

As of June 30, 2008, the District owed the County's general fund $20,153, representing the final payment on the District's long-term loan for treatment plant capital improvements.

Note F. Long-Term Obligations

Advances from other governments:

During fiscal year 2004-05, the District received a loan of $3,352,796 from the State Water Resources Control Board to aid in funding the Third Unit Processes project. The District received an additional $448,173 during fiscal year 2006-07. The loan agreement requires repayment to begin within one year of the project's completion, which occurred during March 2006. As of June 30, 2008, the outstanding balance is $3,345,149. The loan is a State Revolving Loan with current payments of $243,954, including interest, payable annually in November. The expected term is 20 years at an annual interest rate of 2.5% with the last payment scheduled for November 2024.

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

Year ending June 30,	Principal	Interest
2009	$ 160,326	$ 83,628
2010	164,334	79,620
2011	168,442	75,512
2012	172,653	71,301
2013	176,969	66,985
2014 – 2018	953,464	266,307
2019 – 2023	1,078,757	141,014
2024 – 2025	470,204	17,704
Total	$ 3,345,149	$ 802,071

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 $2,900,000. General obligation bonds are direct obligations and pledge the full faith and credit of the District. General obligation bonds outstanding as of June 30, 2008 were $1,325,000 with interest rates ranging from 4% to 5%.

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

Year ending June 30,	Principal	Interest
2009	$ -	$ 68,750
2010	105,000	63,625
2011	110,000	58,250
2012	115,000	52,625
2013	120,000	46,750
2014 – 2018	710,000	133,250
2019	165,000	4,125
Total	$ 1,325,000	$ 427,375

Note F. Long-Term Obligations (Continued)

Revenue Bonds

The District also issued revenue bonds where the District pledges income derived from charges for services to pay debt service. The original amount of revenue bonds issued to finance construction projects to both expand existing wastewater treatment facilities and construct additional facilities was $2,000,000, of which $1,060,000 with an interest rate of 5% remains outstanding as of June 30, 2008.

Revenue bond debt service requirements to maturity are as follows:

Year ending June 30,	Principal	Interest
2009	$ 65,000	$ 53,000
2010	70,000	49,750
2011	75,000	46,250
2012	75,000	42,500
2013	80,000	38,750
2014 – 2018	470,000	128,750
2019 – 2020	225,000	17,000
Total	$ 1,060,000	$376,000

Long-term obligation activity for the year ended June 30, 2008 was as follows:

	July 1, 2007	Additions	Reductions	June 30, 2008	Due Within One Year
Advances from other governments	$ 3,501,564	$ -	$ (156,415)	$3,345,149	$ 160,326
General obligation bonds	1,425,000	-	(100,000)	1,325,000	-
Revenue bonds	1,125,000	-	(65,000)	1,060,000	65,000
Total	$ 6,051,564	$ -	$ (321,415)	$5,730,149	$225,326

Note G. Accrued Interest Payable

Interest payable as of June 30, 2008 consists of interest accrued on the State Water Resources Control Board loan of $48,783 and the revenue bonds of $13,250.

Note H. 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 $1,285,821 to the Water Agency for administrative support during the year ended June 30, 2008.

Note I. Commitments and Contingencies

Commitments

The District has active construction projects as of June 30, 2008. The projects include expansion and/or improvements of several wastewater treatment facilities. At year-end, the District's commitments to construction projects included $1,601,581 spent to date with remaining commitments of $111,448 for expansion.

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 June 2005, the North Coast Regional Water Quality Control Board (NC Regional Board) issued an Administrative Civil Liability (ACL) order to the District and Water Agency for violations of effluent limitations that occurred during periods of discharge to receiving waters from January 2000 through August 2004. The District and the Water Agency were assessed a mandatory penalty of $63,000 pursuant to the ACL. The majority of this penalty ($60,400) is eligible to be permanently suspended if the executive officer of the NC Regional Board determines that reasonable progress is being made (and reported) toward completion of a compliance project and the suspended amount is spent toward completion of the compliance project within five years from the date of the ACL. Annual reports are submitted to the NC Regional Board to report progress on the selected compliance project, which is already underway.

Note I. Commitments and Contingencies (Continued)

In June 2008, the NC Regional Board issued an ACL order to the District and the Water Agency which formalized a settlement for water discharge violations, as noted above. The District and the Water Agency were assessed a mandatory penalty of $99,000. The majority of the penalty ($68,000) is eligible to be permanently suspended if the executive officer of the NC Regional Board determines that reasonable progress is being made (and reported) toward completion of a compliance project and the suspended amount is spent toward completion of the compliance project by July 2011.

Other Regulatory Matters

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

Note J. Risk Management

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

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

The County also maintains public employee faithful performance/employee dishonesty coverage through a joint-purchase program provided by National Union Fire Insurance Company and administered by CSAC-EIA with limits of $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 $575,000,000 per occurrence including flood and $60,000,000 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 its pro-rata share of annual premiums for insurance coverage through the Water Agency's allocation of overhead costs (see Note H). Settled claims have not exceeded this coverage for any of the past four fiscal years.

Note K. Recent Governmental Accounting Standards

The Governmental Accounting Standards Board (GASB) has released the following new standard which may have an impact on 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 not yet been adopted, is unknown at this time.

Other Report

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Board of Directors
Russian River 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 Russian River County Sanitation District (District), as of and for the year ended June 30, 2008, and have issued our report thereon dated November 5, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the 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 entity'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 entity's financial statements that is more than inconsequential will not be prevented or detected by the entity'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 entity'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
November 17, 2008