

**PRELIMINARY DRAFT
FOR DISCUSSION PURPOSES ONLY
SUBJECT TO CHANGE**

Sonoma Valley County Sanitation District

Basic Financial Statements

Year Ended June 30, 2006

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Independent Auditors' Report

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

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

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

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

In accordance with *Government Auditing Standards*, we have also issued our report dated September 15, 2006, on our consideration of the District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the result of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis ("MD&A") on pages 3 – 11 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the MD&A. However, we did not audit the information and express no opinion on it.

Santa Rosa, California
September 15, 2006

**PRELIMINARY DRAFT
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Management's Discussion and Analysis

As management of the Sonoma Valley County Sanitation District (the District), we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the fiscal year ended June 30, 2006. We encourage readers to consider the information presented here in conjunction with the District's financial statements (pages 12 - 16) and the accompanying notes to the financial statements (pages 17 - 32).

Reporting Entity

The Sonoma Valley 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 three-member Board of Directors. 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 \$57,614,684 (net assets). Of this amount, \$13,343,984 (*unrestricted net assets*) may be used to meet the District's ongoing obligations to citizens and creditors.

Revenues

The District recognized total revenues of \$10,600,361 during fiscal year 2005/06. Of this amount, \$8,931,953 consists of charges for services (operating revenues), and \$1,688,408 of non-operating revenues consisting of investment earnings, property taxes, conservation program, connection fees, and intergovernmental revenue.

Expenses

The District incurred expenses totaling \$7,798,020 during fiscal year 2005/06. Of this amount \$7,435,482 represents operating expenses related to the collection, treatment, disposal, and reclamation of effluent, as well as administrative and general expenses. The non-operating expenses total \$362,538 which is comprised of conservation program expenses and interest expense related to debt obligation.

Increase in Net Assets

The District recorded operating income of \$1,496,471 for fiscal year 2005/06. The District recognized an overall increase in net assets of \$2,802,341.

Overview of the Financial Statements

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

Management's Discussion and Analysis

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

Financial Statements

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

Notes to the Financial Statements

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements can be found on pages 17 - 32.

Financial Analysis

Net assets may serve over time as a useful indicator of a District's financial position. In the case of the District, assets exceeded liabilities by \$57,614,684 at the close of the most recent fiscal year compared to net assets of \$54,812,343 at June 30, 2005.

The largest portion of the District's net assets (71.6% for fiscal year 2006 compared to 72.1% for 2005) reflects its investment in capital assets (e.g., land and buildings), less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the District's investment in 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.

Year Ended June 30, 2006

Financial Analysis (continued)

<i>Net Assets</i>	June 30, 2005	June 30, 2006	Percentage Change
Current and other assets	\$ 16,248,026	\$ 17,270,685	6.3 %
Capital assets	57,679,198	57,345,514	(0.6) %
Total Assets	73,927,224	74,616,199	.9 %
Current liabilities	1,325,531	1,282,570	(3.2) %
Non-current liabilities	17,789,350	15,718,945	(11.6) %
Total Liabilities	19,114,881	17,001,515	(11.1) %
Invested in capital assets net of related debt	39,507,235	41,245,865	4.4 %
Restricted for conservation program	2,000,814	2,065,459	3.2 %
Restricted for debt service	1,127,917	940,318	(16.6) %
Restricted for capital projects	62,684	19,058	(69.6) %
Unrestricted	12,113,693	13,343,984	10.2 %
Total Net Assets	\$ 54,812,343	\$ 57,614,684	5.1 %

A portion of the District's net assets \$3,024,835 (5.3% for fiscal year 2006) and \$3,191,415 (5.8% for 2005) represents resources that are subject to external restrictions on how they may be used. Unrestricted net assets of \$13,343,984 for fiscal year 2006 and \$12,113,693 for fiscal year 2005 may be used to meet the District's ongoing obligations to citizens and creditors.

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

Changes in Net Assets

	For the Years Ended		
	June 30, 2005	June 30, 2006	Percentage Change
Revenues:			
Program revenues			
Operating revenues	\$ 8,066,370	\$ 8,931,953	10.7 %
General revenues			
Property taxes	17,745	17,978	1.3 %
Investment earnings	401,520	541,694	34.9 %
Intergovernmental	204	180	(11.8) %
Conservation program	228,870	175,170	(23.5) %
Capital grants	37,500	-	(100.0) %
Contributions - connection fees	1,151,902	933,386	(19.0) %
Total revenues	9,904,111	10,600,361	7.0 %

Year Ended June 30, 2006

Financial Analysis (continued)

Changes in Net Assets (continued)

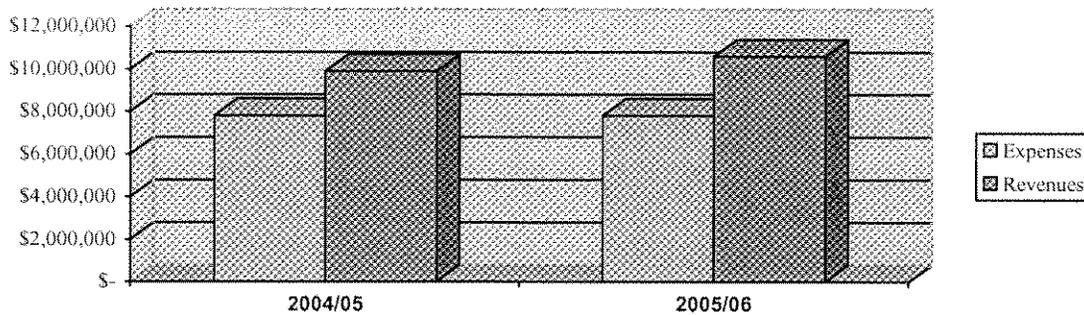
	For the Years Ended		
	June 30, 2005	June 30, 2006	Percentage Change
<hr/>			
Expenses			
Services and supplies	5,026,718	5,246,508	4.4 %
Fiscal agent/legal services	6,211	14,940	140.5 %
Depreciation/amortization	2,178,130	2,174,034	(0.2)%
Conservation program	44,411	110,525	148.9 %
Interest expense	521,957	252,013	(51.7)%
Other	26,706	-	(100.0)%
<hr/>			
Total expenses	7,804,133	7,798,020	(0.1)%
<hr/>			
Increase in net assets	2,099,978	2,802,341	33.4 %
Net assets at beginning of year	52,712,365	54,812,343	4.0 %
<hr/>			
Net assets at end of year	\$ 54,812,343	\$ 57,614,684	5.1 %

The District's net assets increased by \$2,802,341 during fiscal year 2006 compared to an increase of \$2,099,978 during fiscal year 2005. The fiscal year 2006 increase is due primarily to increases in charges for services (\$865,583), and investment earnings (\$140,174). These increases were offset by decreases in conservation program revenues (\$53,700), capital grants (\$37,500) and connection fees (\$218,516). In addition, total expenses incurred by the District decreased (\$6,113) compared to the previous fiscal year due primarily to significant reductions in utilities expenses incurred by the District as the result of its participation in the Power and Water Resource Pooling Authority during 2005/06. These savings were offset by expenses incurred by the District related to the New Year's floods.

Year Ended June 30, 2006

Financial Analysis (continued)

Expenses and Revenues



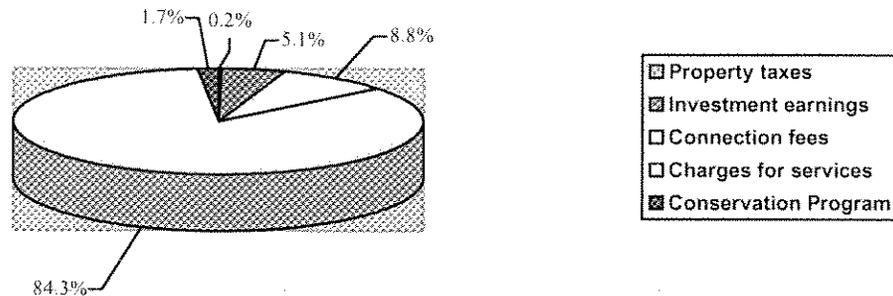
Total revenues of the District for fiscal year 2005/06 totaled \$10,600,361 representing an increase of \$696,250 from the preceding fiscal year revenues of \$9,904,111. The rate based charges for services, representing 84.3% of the District's total revenue, increased by \$865,583 (10.7%); property taxes, representing 0.2% of the District's total revenue, increased by \$233; connection fees, representing 8.8% of the District's total revenue, decreased by \$218,516. Investment earnings improved from the preceding year by \$140,174. Conservation program revenues, representing 1.7% of the District's total revenue decreased \$53,700 from the previous year. The combined effect of these changes is an overall increase in revenues of 7.0%.

Total expenses for the District decreased by \$6,113 to \$7,798,020 for fiscal year 2005/06. Interest expense decreased \$269,944 (51.7%) as a result of increased capital project expenses combined with savings as a result of the refunding of a portion of the 1998 Special Revenue bonds. Depreciation/amortization expenses decreased \$4,096 (0.2%). Utilities expenses decreased significantly for the District during 2005-06 due to the Power and Water Resource Pooling Authority which provided the District power during the year. These savings were offset by additional costs related to the New Year's floods resulting in an overall decrease in expenses of 0.1%.

Year Ended June 30, 2006

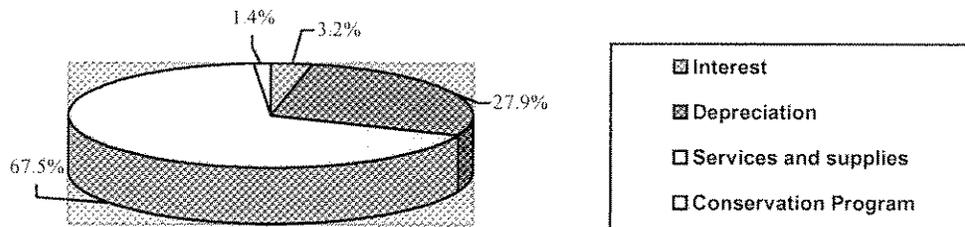
Financial Analysis (continued)

Revenues by Source



As previously mentioned, revenues collected by the District for 2005/06 totaled \$10,600,361. Of this amount \$8,931,953 or 84.3%, 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 8.8% of the annual revenue, are also collected through the permitting process. Property tax revenues accounted for 0.2% of the annual revenues, and are collected through the tax rolls to satisfy debt service requirements. Investment earnings represent 5.1% of revenues and consist of earnings on pooled cash held with the Sonoma County Treasurer. Conservation program revenues accounted for 1.7% of the District's 2005/06 revenues.

Expenses by Function



Total expenses for the District for fiscal year 2005/06 totaled \$7,798,020. Costs associated with the collection, treatment, and disposal of effluent represent 67.5% of the District's costs. The next largest functional area is the annual depreciation expense on capital assets and represents \$2,174,034 (27.9%) of total expenses. Interest expense totaling \$252,013 (3.2%) represents the cost of meeting current debt service obligations. Conservation program expenses totaled \$110,525 (1.4%) for fiscal year 2005/06.

Year Ended June 30, 2006

Capital Asset and Debt Administration

Capital assets

The District's investment in capital assets as of June 30, 2006, amounts to \$57,345,514 (net of accumulated depreciation). This investment in capital assets includes land, buildings and systems, improvements, and construction in progress.

Major capital asset acquisitions during the current fiscal year consisted primarily of an electrical service upgrade.

Sonoma Valley County Sanitation District's Capital Assets

	June 30, 2005	June 30, 2006	Percentage Change
Land	\$ 3,062,558	\$ 3,072,311	0.3 %
Buildings and improvements	71,266,196	73,643,892	3.3 %
Machinery & Equipment	227,179	227,179	0.0 %
Construction in progress	8,588,568	8,010,668	(6.7) %
Accumulated depreciation	(25,465,303)	(27,608,536)	8.4 %
Total	\$ 57,679,198	\$ 57,345,514	(0.6) %

Additional information on the District's capital assets can be found in Note D on page 25 of the notes to the financial statements.

Long-term Debt

At the end of the current fiscal year, the District had a total of \$17,105,132 in outstanding debt consisting of general obligation bonds, revenue bonds, and advances from other governments. Of this amount, \$135,000 comprises debt backed by the full faith and credit of the District, \$16,529,614 which are special obligations of the District payable solely from net revenues of District operations, and \$392,518 is related to advances from the State Water Resources Control Board.

Sonoma Valley County Sanitation District's Outstanding Current and Long Term Debt

	June 30, 2005	June 30, 2006	Percentage Change
General obligation bonds	\$ 145,000	\$ 135,000	(6.9) %
Revenue bonds	17,861,832	15,855,539	(12.0) %
Advances/due to	430,602	392,518	(8.8) %
Total	\$18,437,434	\$16,383,057	(11.1) %

The District's total debt decreased by \$2,054,377 during the current fiscal year.

Year Ended June 30, 2006

Capital Asset and Debt Administration (continued)

Long-term Debt (continued)

Advances from other governments/funds decreased by \$38,084 due to the annual repayment of the existing Outfall line advance to the State Water Resources Control Board.

The decreases in general obligation bonds are due to annual principal payments on the debt.

The decrease in revenue bonds is due to both the annual principal repayments of the debt along with the partial refunding of the 1998 Special Revenue bonds. The refunding resulted in the retirement of \$11,095,000 of principal and was financed via the issuance of \$10,240,000 in 2005C Revenue Bonds. Prior to the partial refunding, a principal payment of \$610,000 was made on the 1998 Revenue Bonds.

Additional information on the District's current and long-term debt can be found in Notes F, G and H on pages 26 - 28 of this report.

Next Year's Budget and Rates

Budgeted gross expenditures for the District for fiscal year 2006/07 have decreased by \$8,142,744 (24.3%) for a total of \$25,352,573. The major component of the reduction in budget expenditures is related to significantly lower anticipated capital expenditures due to the completion of capital projects during the current year.

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

	2005/06	2006/07	Increase (Decrease)	Percentage Change
Operations	\$13,825,756	\$12,365,538	\$(1,460,218)	(10.6)%
Debt service - General Obligation Bonds	7,302	6,802	(500)	(6.8)%
Debt service - Revenue Bonds	887,734	721,647	(166,087)	(18.7)%
Debt service - Outfall Line	10,637	10,598	(39)	(0.4)%
Construction	18,763,888	12,247,988	(6,515,900)	(34.7)%
	\$33,495,317	\$25,352,573	\$ (8,142,744)	(24.3)%

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

The sewer service fees were increased for the 2006 - 2007 budget year. The rates were increased by 6.0 %.

Year Ended June 30, 2006

Next Year's Budgets and Rates (continued)

The following table shows the sanitation services rates and equivalent single dwellings for the District:

	2005/06	2006/07	Percentage Change
Rate per Equivalent Single-Family Dwelling	\$ 518	\$ 549	6.0 %
Number of Equivalent Single-Family Dwellings by District	16,870	17,097	1.35 %

Request for Additional Information:

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

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Basic Financial Statements

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Sonoma Valley County Sanitation District

Statement of Net Assets

June 30, 2006

Assets

Current assets

Cash and equivalents	\$	13,054,944
Accounts receivable (net of allowance for uncollectibles of \$25,000)		485,202
Prepaid expenses		206,937

Total current assets		13,747,083
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Noncurrent assets

Restricted cash, cash equivalents, and investments:

Cash - conservation program		2,065,459
Cash - general obligation bond fund		5,287
Cash - revenue bond fund		1,150,390
Cash with trustee restricted for capital projects		19,058

Total restricted assets		3,240,194
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Other assets 283,408

Capital assets:

Land		3,072,311
Buildings and improvements		73,643,892
Machinery and equipment		227,179
Construction in progress		8,010,668
Less: accumulated depreciation		(27,608,536)

Total capital assets (net of accumulated depreciation)		57,345,514
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Total noncurrent assets		60,869,116
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Total assets	\$	74,616,199
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Sonoma Valley County Sanitation District

Statement of Net Assets (continued)

June 30, 2006

	<u>Total</u>
Liabilities	
Current liabilities payable from unrestricted assets	
Accounts payable and accrued expenses	\$ 392,501
Due to other governments	39,112
Accrued interest payable	10,598
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Total current liabilities payable from unrestricted assets	442,211
Current liabilities payable from restricted assets	
Revenue bonds payable	625,000
Accrued interest payable	215,359
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Total current liabilities payable from restricted assets	840,359
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Total current liabilities	1,282,570
Noncurrent liabilities	
General obligation bonds payable	135,000
Revenue bonds payable	15,230,539
Advances from other governments	353,406
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Total noncurrent liabilities	15,718,945
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Total liabilities	17,001,515
Net assets	
Invested in capital assets, net of related debt	41,245,865
Restricted for conservation program	2,065,459
Restricted for debt service	940,318
Restricted for capital projects	19,058
Unrestricted	13,343,984
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Total net assets	\$ 57,614,684

See accompanying Notes to Basic Financial Statements

**PRELIMINARY DRAFT
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Sonoma Valley County Sanitation District

Statement of Revenues, Expenses and Changes in Net Assets

For the Year Ended June 30, 2006

Operating revenues	
Flat charges	\$ 7,692,440
Charges for services	1,050,999
Other	188,514
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Total operating revenues	8,931,953
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Operating expenses	
Services and supplies	5,246,508
Fiscal agent fees and legal services	14,940
Depreciation and amortization	2,174,034
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Total operating expenses	7,435,482
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Operating income	1,496,471
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Nonoperating revenues (expenses)	
Investment income	541,694
Interest expense	(252,013)
Intergovernmental	180
Property taxes	17,978
Conservation program revenue	175,170
Conservation program expense	(110,525)
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Net nonoperating revenues	372,484
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Net income before contributions and transfers	1,868,955
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Capital contribution:	
Connection fees	933,386
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Increase in net assets	2,802,341
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Net assets at beginning of year	54,812,343
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Net assets at end of year	\$ 57,614,684

See accompanying Notes to Basic Financial Statements

**PRELIMINARY DRAFT
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Sonoma Valley County Sanitation District

Statement of Cash Flows

For the Year Ended June 30, 2006

Cash flows from operating activities	
Receipts from customers	\$ 8,994,116
Payments for intergovernmental services used	(4,478,201)
Payments to suppliers	(1,016,219)
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Net cash provided by operating activities	3,499,696
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Cash flows from noncapital financing activities	
Taxes	18,158
Conservation program	120,850
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Net cash provided by noncapital financing activities	139,008
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Cash flows from capital and related financing activities	
Purchase of capital assets	(1,350,139)
Principal payments - other governments	(38,084)
Principal payments - bonds	(11,715,000)
Proceeds from revenue bond issuance	9,636,046
Interest paid on capital debt	(841,965)
Connection fees	1,216,581
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Net cash used in capital related financing activities	(3,092,561)
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Cash flows from investing activities	
Interest received on pooled cash and investments	541,694
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Net increase in cash and cash equivalents	1,087,837
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Cash and cash equivalents at beginning of year	15,207,301
<hr/>	
Cash and cash equivalents at end of year	\$ 16,295,138
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Cash and cash equivalent includes the following:	
Cash and cash equivalents	\$ 13,054,944
Restricted cash and cash equivalents	3,240,194
<hr/>	
	\$ 16,295,138
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See accompanying Notes to Basic Financial Statements

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Sonoma Valley County Sanitation District

Statement of Cash Flows (continued)

For the Year Ended June 30, 2006

**Reconciliation of operating income to net cash
provided by operating activities:**

Operating income	\$	1,496,471
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expense		2,174,034
Change in assets and liabilities:		
Increase in accounts receivable		(49,350)
Increase in prepaid expenses		(206,937)
Increase in accounts payable and accrued expenses		85,478
Net cash provided by operating activities	\$	3,499,696

Noncash investing, capital and financing activities:

Project costs included in accounts payable	\$	2,365
Net decrease in fair value of investment in County Treasurer's Pooled cash	\$	5,015

**PRELIMINARY DRAFT
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Sonoma Valley County Sanitation Districts

Notes to Basic Financial Statements

Year Ended June 30, 2006

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

- Note A. Defining the Financial Reporting Entity
- Note B. Summary of Significant Accounting Policies
- Note C. Cash and Investments
- Note D. Capital Assets
- Note E. Due to Other Governments
- Note F. Intergovernmental Accounts
- Note G. Long-Term Obligations
- Note H. Debt Defeasance
- Note I. Accrued Interest Payable
- Note J. Related Party Transactions
- Note K. Commitments and Contingencies
- Note L. Recent Governmental Accounting Standards

Note A. Defining the Financial Reporting Entity

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

Component Unit Reporting

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

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

Note B. Summary of Significant Accounting Policies

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

Government-wide and Fund Financial Statements

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

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

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

Note B. Summary of Significant Accounting Policies (continued)

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

The District's financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. All assets and liabilities associated with the operation of the District are included on the statement of net assets. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

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

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

Cash and Investments

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

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

Note B. Summary of Significant Accounting Policies (continued)

Cash and Investments (continued)

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

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

Accounts Receivable

Accounts receivable consists of uncollected fees for sanitation services and flat charges at June 30, 2006. These flat charges are established annually by the Board of Supervisors and billed through the County's property tax system. All trade and property tax receivables are shown net of an allowance for uncollectibles. Trade accounts receivable in excess of one year comprise the allowance for uncollectibles.

Other Assets

Other assets are composed of debt issuance costs of \$283,408 for the year ended June 30, 2006, net of accumulated amortization. These costs are amortized using a method which approximates the interest rate method over the terms of the related long-term debt. Amortization expense related to the debt issuance costs amounted to \$30,800 for the year ended June 30, 2006.

Prepaid Expenses

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

Restricted Assets

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

PRELIMINARY DRAFT
FOR DISCUSSION PURPOSES ONLY Sonoma Valley County Sanitation Districts
SUBJECT TO CHANGE

Notes to Basic Financial Statements

Year Ended June 30, 2006

Note B. Summary of Significant Accounting Policies (continued)

Capital Assets

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

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

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

Bond and Certificates of Participation Discounts and Issuance Costs

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

Net Assets

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowings used for the acquisition, construction or improvement of those assets. Net assets invested in capital assets, net of related debt, excludes \$19,058 in unspent debt proceeds for the year ended June 30, 2006. Net assets are reported as restricted when there are limitations imposed on their use, either through enabling legislation adopted or through external restrictions imposed by creditors, grantors or laws or regulation of other governments. The District applies restricted resources first when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

Budget and Budgetary Accounting

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

Year Ended June 30, 2006

Note B. Summary of Significant Accounting Policies (continued)

Property Tax Revenue

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

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

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

Intergovernmental Transactions

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

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. Actual results could differ from those estimates.

Note C. Cash and Investments

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

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

Year Ended June 30, 2006

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

Investment Guidelines

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

Permitted investments include the following:

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

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

Balance Sheet

Cash and investments included the following:

	Fair Value
Cash and investments in Sonoma County	
Treasurer's pooled investment fund	\$ 16,276,080
Cash and investments with trustee	19,058
	<u>\$ 16,295,138</u>

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

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

Balance Sheet (continued)

The net decrease in the fair value of the District's investments during fiscal year 2005-06 was \$5,015 and is included as an offset to revenue. This amount takes into account all changes in fair value (including purchases and sales) that occurred during the year. The unrealized loss on investments held at year end amounted to \$38,304. The realized gain and loss from securities matured during the current fiscal year are recognized through the net change in the fair value of the investment held in the Treasury Pool.

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the District manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments, and by timing cash flows from maturities so that a portion of the portfolio is maturing, or coming close to maturity, evenly over time, as necessary, to provide the cash flow and liquidity needed for operations. The majority of the District's cash and investments is held by the Treasury Pool, which has a weighted average maturity of less than two years. As of June 30, 2006, all of the District's investments held by a trustee of \$19,058 consist of U.S. Treasury obligations with maturities of less than 12 months.

Custodial Credit Risk

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

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

Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The District follows the County's policy to purchase investments with the minimum ratings required by the California Government Code. Presented below is the minimum rating required by (where applicable) the California Government Code, the County's investment policy, or debt agreements, and the actual rating as of year end for each investment type. The credit rating and other information regarding the Treasury pool for the fiscal year 2005-06 are disclosed in the County of Sonoma's 2005-2006 Comprehensive Annual Financial Report. Ratings for amounts the U.S. Treasury obligation held by trustee are exempt from disclosure.

Year Ended June 30, 2006

Note D. Capital Assets

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

	Beginning Balance July 1, 2005	Additions	Retirements	Transfers and Adjustments	Ending Balance June 30, 2006
Capital assets, not being depreciated:					
Land	\$ 3,062,558	\$ 9,753	\$ -	\$ -	\$ 3,072,311
Construction in progress	8,588,568	1,799,796	-	(2,377,696)	8,010,668
Total capital assets, not being depreciated	11,651,126	1,809,549	-	(2,377,696)	11,082,979
Capital assets, being depreciated:					
Buildings and improvements	71,266,196	-	-	2,377,696	73,643,892
Machinery and equipment	227,179	-	-	-	227,179
Total capital assets being depreciated	71,493,375	-	-	2,377,696	73,871,071
Less accumulated depreciation for:					
Buildings and improvements	(25,313,218)	(2,129,107)	-	-	(27,442,325)
Machinery and equipment	(152,084)	(14,127)	-	-	(166,211)
Total accumulated depreciation	(25,465,302)	(2,143,234)	-	-	(27,608,536)
Total capital assets, being depreciated, net	46,028,073	(2,143,234)	-	2,377,696	46,262,535
Total capital assets, net	\$ 57,679,199	\$ (333,685)	\$ -	\$ -	\$ 57,345,514

Depreciation expense amounted to \$2,143,234 for the year ended June 30, 2006.

The total amount of interest capitalized in connection with wastewater treatment facilities construction projects during the year ended June 30, 2006 amounted to \$457,045.

Year Ended June 30, 2006

Note E. Due to Other Governments

During fiscal year 1994-95, the District received a loan of \$760,992 from the State Water Resources Control Board for an outfall rehabilitation project. As of June 30, 2006, the outstanding balance is \$392,518. The loan is a State Revolving Loan with current payments of \$49,710, payable annually in July. The expected term is 20 years at an annual interest rate of 2.7% with the last payment scheduled for July 2014.

Annual debt service requirements to maturity for these revolving loans are as follows:

Year ending June 30,	Principal	Interest
2007	\$ 39,112	\$ 10,598
2008	40,168	9,542
2009	41,252	8,457
2010	42,366	7,344
2011	43,510	6,200
2012 – 2016	186,110	12,729
	\$ 392,518	\$ 54,870

Note F. Intergovernmental Accounts

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

Note G. Long-Term Obligations

General Obligation Bonds

General obligation bonds are direct obligations and pledge the full faith and credit of the government. General obligation bonds outstanding at June 30, 2006 are \$135,000 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
2007	\$ -	\$ 7,000
2008	11,000	6,475
2009	11,000	5,925
2010	12,000	5,350
2011	12,000	4,750
2012 – 2016	72,000	13,600
2017 – 2019	17,000	425
Total	\$ 135,000	\$ 43,525

Note G. Long-Term Obligations (continued)

Revenue Bonds

The government also issues bonds where the government pledges income derived from charges for services to pay debt service. The original amount of revenue bonds issued in prior years to finance construction projects to both expand existing wastewater treatment facilities and construct additional facilities was \$21,410,000, of which \$11,095,000 was defeased during the year (see Note H).

On September 7, 2005, the Water Agency, through the California Statewide Communities Development Authority, issued Water and Wastewater Revenue Bonds (series 2005C) for the purpose of partially refinancing the outstanding 1998 Revenue. Total amounts and terms of the new bonds are as follows:

Interest Rates	Maturity Date	Amount
2.70% - 4.05%	October 1, 2018	\$ 10,240,000

The total revenue bond balance outstanding at June 30, 2006 is \$16,700,000 with interest rates ranging from 2.7% to 5%.

Revenue bond debt service requirements to maturity are as follows:

Year ending June 30,	Principal	Interest
2007	\$ 625,000	\$ 648,741
2008	670,000	631,405
2009	690,000	612,533
2010	705,000	592,298
2011	730,000	570,042
2012 – 2016	4,025,000	2,455,465
2017 – 2021	5,200,000	1,589,939
2022 – 2026	4,055,000	294,871
Total	\$ 16,700,000	\$ 7,395,294

Year Ended June 30, 2006

Note G. Long-Term Obligations (continued)

Changes in Long-Term Obligations

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

	Beginning Balance July 1, 2005	Additions	Reductions	Ending Balance June 30, 2006	Due Within One Year
Bonds payable:					
General obligation bonds	\$ 145,000	\$ -	\$ (10,000)	\$ 135,000	\$ -
Revenue bonds	18,165,000	10,240,000	(11,705,000)	16,700,000	625,000
Less deferred amounts for:					
Net issuance discounts	(303,168)	(73,101)	205,885	(170,385)	N/A
Deferred charges on Refundings	-	(725,928)	51,852	(674,076)	N/A
Total revenue bonds payable	17,861,832	9,440,971	(11,447,263)	15,855,539	625,000
Total bonds payable	\$18,006,832	\$ 9,440,971	\$ (11,457,263)	\$15,990,539	\$ 625,000

Note H. Debt Defeasance

On September 7, 2005, the District, through the Water Agency and the California Statewide Communities Development Authority, issued Water and Wastewater Revenue Bonds (series 2005C) totaling \$10,240,000. The proceeds of the bonds were used to refund in advance of their maturity dates, the District's 1998 Special Revenue Bonds totaling \$11,095,000 with maturity dates through October 1, 2018. This refunding was done to achieve interest cost savings. The net proceeds from the issuance of the revenue bonds were used to purchase U.S. government securities and those securities were deposited in irrevocable trust accounts with an escrow agent and are structured to pay the principal and interest on the refunded bonds as such payments become due. The advance refunding has met the requirements of an in-substance debt defeasance and the defeased bonds have been removed from the District's financial statements.

The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$725,928 for the District. These deferred charges are reported as reductions to revenue bonds payable and are charged to operations using a method which approximates the effective interest method over the shorter of the remaining life of the old debt or the life of the new debt. The resulting economic gain (difference between the present value of the debt service payments on the old and new debt) is \$333,364.

Note I. Accrued Interest Payable

Interest payable consists of interest accrued on the following obligations:

Payable from unrestricted current assets:	
State Water Resources Control Board	\$ 10,598
Payable from restricted current assets	
Long-term bonds	215,359
<hr/>	
Total accrued interest payable	<u>\$ 225,957</u>

Note J. Related Party Transactions

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

The District is managed by the Water Agency, which provides administration, engineering, operational, and maintenance services. The District does not incur any payroll expenses. The Water Agency allocates overhead costs to the District via the use of a 65% overhead rate charged on labor applicable to the District. The overhead rate is reviewed annually by management to determine its effectiveness. The District paid \$4,212,208 to the Water Agency for administrative support during the year ended June 30, 2006

Note K. Commitments and Contingencies

Commitments

The District has active construction projects as of June 30, 2006. The projects include expansion and/or improvements of wastewater treatment facilities. At year end, the District's commitments to construction projects included \$9,931,320 of amounts spent to date with remaining commitments of \$140,988 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.

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.

Year Ended June 30, 2006

Note K. 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 three fiscal years.

Pending Litigation, Claims, and Investigation

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

Year Ended June 30, 2006

Note K. Commitments and Contingencies (continued)

Pending Litigation, Claims, and Investigation (continued)

In early 2003, the San Francisco Bay Regional Water Control Board (SF Regional Board) adopted a new discharge permit for the District. At that time, the SF Regional Board also adopted a Cease and Desist Order (CDO) that included penalties for zinc violations that occurred from January 2001 through March 2002. The CDO established interim effluent limitations for zinc through March 2005. In April 2005, the District's discharge permit was amended to include new, final effluent limitations for zinc. The County's counsel believes that the new limitations are achievable and that there will not be violations of effluent limitations for zinc in the future. The District's current discharge permit does, however, include several interim effluent limitations that are scheduled to become final effluent limitations from 2007 through 2010. Although a few of these final effluent limitations may become achievable through future permit amendments, site-specific objectives, or basin plan amendments, the District may have difficulty meeting all of the final effluent limitations. It is not possible to predict if this will be a problem for the District in the future.

The District received a Minimum Mandatory Penalty (MMP) for violations occurring from March 2002 through March 2006. The MMP was for \$39,000. The District was given the opportunity to pay \$12,000 to the SF Regional Board and to conduct a Supplementary Environmental Project (SEP) for the balance of \$27,000. The District submitted a SEP proposal for a water education structure adjacent to the District's reclamation facilities. The project will be funded by the District's MMP (remaining balance) and through the Water Agency's Water Education Project (WEP). The WEP at the District reclamation facilities will include a unit focused on wetland ecology, recycled water and sanitation. The District is waiting on approval from the SF Regional Board to begin implementation.

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.

Year Ended June 30, 2006

Note L. Recent Governmental Accounting Standards

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

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

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

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

PRELIMINARY DRAFT
FOR DISCUSSION PURPOSES ONLY
SUBJECT TO CHANGE

Compliance

**PRELIMINARY DRAFT
FOR DISCUSSION PURPOSES ONLY
SUBJECT TO CHANGE**

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

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

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

Internal Control Over Financial Reporting

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

Compliance

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

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

Santa Rosa, California
September 15, 2006

Year Ended June 30, 2006

Section I. Summary of Auditors' Results

Financial Statements

Type of auditors' report issued:

unqualified

Internal control over financial reporting:

Material weaknesses identified

_____ yes

 X no

Reportable conditions identified not considered
to be material weaknesses

none reported

Noncompliance material to financial statements noted

_____ yes

 X no

Section II. Financial Statement Findings

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

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