

NAPA SANITATION DISTRICT
AUDIT REPORT
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

NAPA SANITATION DISTRICT

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Napa Sanitation District
Napa, California

We have audited the accompanying basic financial statements of Napa Sanitation District (the District) as of and for the year ended June 30, 2006, 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 our audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, based on our audit, the financial statements referred to above present fairly, in all material respects, the financial position of the Napa Sanitation District, as of June 30, 2006, and the changes in financial position 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 December 7, 2006, 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. 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.

Board of Directors
Napa Sanitation District
Napa, California

The management's discussion and analysis and the schedule of funding progress are not a required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and do not express an opinion on it.

BARTIG, BASLER & RAY, LLP
a Gallina LLP Company

A handwritten signature in black ink that reads "Bartig Basler & Ray, LLP". The signature is written in a cursive, flowing style.

December 7, 2006
Roseville, California

MANAGEMENT'S DISCUSSION AND ANALYSIS

NAPA SANITATION DISTRICT

Management's Discussion and Analysis (Unaudited) June 30, 2006

This section of the District's Annual Financial Statements presents our discussion and analysis of the District's financial performance during the fiscal year ended June 30, 2006. Please read it in conjunction with the District's Financial Statements, which follow this section.

FINANCIAL HIGHLIGHTS

- The District's assets exceeded liabilities at the close of the 2005-2006 fiscal year by \$126,105,794 (*net assets*). Of this amount, \$19,957,976 (*unrestricted net assets*) may be used to meet ongoing obligations to citizens and creditors, \$5,429,049 is restricted for debt service and capital projects and \$100,718,769 is invested in capital assets, net of related debt.
- Current year results reflect an operating loss of \$1,568,345, a decrease of \$1,960,125 from prior year. Operating expenses increased by \$510,579 while operations revenue decreased by \$1,449,546.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the District's Basic Financial Statements. The Statement of Net Assets (pages 8-9), the Statement of Revenues, Expenses, and Changes in Net Assets (page 10), and the Statement of Cash Flows (pages 11-12) provide information about the activities of the District. The financial statements also include various footnote disclosures, which further describe the District activities.

Napa Sanitation District Condensed Statement of Net Assets

	2006	2005
Assets		
Current and other assets	\$ 32,022,234	\$ 32,646,804
Capital assets	137,938,747	136,829,975
Total Assets	<u>169,960,981</u>	<u>169,476,779</u>
Liabilities		
Current and other liabilities	4,462,017	2,793,108
Long term liabilities	39,427,495	40,510,733
Total Liabilities	<u>43,889,512</u>	<u>43,303,841</u>
Net Assets		
Invested in capital assets, net	100,718,769	98,662,708
Restricted	5,429,049	14,987,782
Unrestricted	19,957,976	12,522,448
Total Net Assets	<u>\$ 126,105,794</u>	<u>\$ 126,172,938</u>

NAPA SANITATION DISTRICT

Management's Discussion and Analysis (Unaudited) June 30, 2006

During the fiscal year ended June 30, 2006, net assets decreased by \$67,144 with capital assets, net of related debt increasing by \$2,056,061, restricted net assets decreasing by \$9,558,733, and unrestricted net assets increasing by \$7,435,528.

The District reports positive balances in all three components of net assets. Net assets invested in capital assets, net of related debt continues to increase as a result of further additions to the utility plant. Restricted net assets increased due to excess connection fees collected over amounts used for utility plant expansion.

	2006	2005	Change	% Change
Operating revenues				
Sewer Charges	\$ 10,421,825	\$ 10,192,156	\$ 229,669	2.25%
Connection fees	1,773,245	3,396,692	(1,623,447)	-47.79%
Other charges for services	296,963	352,731	(55,768)	-15.81%
Total operating revenues	<u>12,492,033</u>	<u>13,941,579</u>	<u>(1,449,546)</u>	<u>-10.40%</u>
Operating expenses				
Sewage processing	2,667,383	2,321,318	346,065	14.91%
Depreciation	4,915,339	4,763,296	152,043	3.19%
Administration and general	6,477,656	6,465,185	12,471	0.19%
Total operating expenses	<u>14,060,378</u>	<u>13,549,799</u>	<u>510,579</u>	<u>3.77%</u>
Operating Income (Loss)	<u>(1,568,345)</u>	<u>391,780</u>	<u>(1,960,125)</u>	<u>-500.31%</u>
Non-Operating Revenue (Expense)				
Interest income	1,011,271	756,353	254,918	33.70%
Intergovernmental revenue	867,240	--	867,240	100.00%
Interest expense	(1,886,210)	(1,746,458)	(139,752)	8.00%
Gain (loss) on asset disposal	5,373	4,376,280	(4,370,907)	-99.88%
Other revenues (expenses)	462,677	423,147	39,530	9.34%
Total non-operating revenue (expense)	<u>460,351</u>	<u>3,809,322</u>	<u>(3,348,971)</u>	<u>-87.92%</u>
Net income (loss) before capital contributions	(1,107,994)	4,201,102	(5,309,096)	-126.37%
Capital contributions	<u>1,040,850</u>	<u>745,660</u>	<u>295,190</u>	<u>39.59%</u>
Change in net assets	(67,144)	4,946,762	(5,013,906)	-101.36%
Total Net Assets - Beginning of Year	<u>126,172,938</u>	<u>121,226,176</u>	<u>4,946,762</u>	<u>4.08%</u>
Total Net Assets - End of Year	<u>\$ 126,105,794</u>	<u>\$ 126,172,938</u>	<u>\$ (67,144)</u>	<u>-0.05%</u>

For the fiscal year ended June 30, 2006, operating revenue decreased by \$1,449,546 while operating expenses increased by \$510,579 due to increased depreciation and sewage processing expenses.

NAPA SANITATION DISTRICT

Management's Discussion and Analysis (Unaudited)
June 30, 2006

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The District has a five-year capital improvement program and publishes a capital budget annually in conjunction with the District's budget process. The capital program is reviewed and updated on an annual basis.

As of June 30, 2006, the District's investment in capital assets amounted to \$137,938,747 (net of accumulated depreciation), an increase of \$1,108,772. This investment in capital assets includes land, building and improvements, equipment, construction in progress, donated sewer lines and other contributed assets.

The table below provides a comparison of the District's capital assets for the current and prior years.

Napa Sanitation District Capital Assets, Net of Accumulated Depreciation

	<u>2006</u>	<u>2005</u>	<u>\$ Change</u>
Land	\$ 7,436,649	\$ 7,436,649	\$ --
Buildings and improvements	89,616,512	90,772,133	(1,155,621)
Equipment	3,999,598	4,305,004	(305,406)
Construction in progress	12,592,521	10,027,403	2,565,118
Donated sewer lines and other contributed assets	24,293,467	24,288,786	4,681
	<u>\$ 137,938,747</u>	<u>\$ 136,829,975</u>	<u>\$ 1,108,772</u>

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

- North Napa Bypass Siphon
- Soscol Pond Embankment Repair
- Collection System Master Plan
- Winter Biosolids Removal Project

NAPA SANITATION DISTRICT

Management's Discussion and Analysis (Unaudited) June 30, 2006

For additional information on capital assets, see Note 3 on page 20.

Long Term Obligations

At June 30, 2006, the District's total long-term debt outstanding was \$40,788,699, compared to \$41,786,412 in the prior year. This amount was comprised of \$336,429 of compensated absences, \$29,782,771 of certificates of participation, \$9,740,000 of variable rate Series 1998 demand bonds and \$929,499 in notes payable.

For additional information on long-term debt, see Note 4 on pages 20 and 21.

ECONOMIC FACTORS

The District's fiscal year 2006-2007 Operations & Maintenance (O&M) budget is \$10.9 million. The 2006-2007 O&M budget reflects a balanced budget which includes a transfer from the O&M Fund to the Rehabilitation Fund.

Projected Revenues in FY 06/07

The District receives a variety of revenues from many sources, most of which must be accounted for separately and their identity kept intact. Revenue projections illustrated in the FY 06/07 budget are estimated using historical information, data collected from the Office of the Governor, the League of California Cities, the Napa County Auditor-Controller, the State Controller, the State Department of Finance and numerous financial advisors. Trends in regional development, environmental factors, and interest rates are examined. We utilize historical data, economic indicators, and in-house plans for service delivery to help predict future revenues. When combined with County, State and other information as noted above, we can produce a reasonably good but financially conservative picture of the near future.

Overall, revenues for the entire District are expected to be \$17,427,313. When compared to prior year budget, overall revenues for the entire District are projected higher by \$1,917,185. More specifically, Operating Fund revenue is projected higher by \$1,824,777, Expansion Fund revenue is projected lower by \$1,078,627, and Rehabilitation Fund revenue is projected higher by \$1,171,035.

Projected Expenditures in FY 06/07

Overall, expenditures for the entire District are expected to be \$30,869,437. The emphasis is on capital project with the Rehabilitation Fund proposed to spend \$6,136,780 more than prior year budget, the Expansion fund proposed to spend \$4,496,175 more than prior year budget, while the Operating Fund is proposed to spend \$159,146 less than prior year budget.

NAPA SANITATION DISTRICT

Management's Discussion and Analysis (Unaudited)
June 30, 2006

REQUESTS FOR INFORMATION

The financial report is designed to provide a general overview of the District's finances for all those with interest in them. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Napa Sanitation District, 935 Hartle Court, P.O. Box 2480, Napa, California 94558.

BASIC FINANCIAL STATEMENTS

NAPA SANITATION DISTRICT

Statement of Net Assets June 30, 2006

ASSETS

Current Assets:

Cash in County treasury	\$ 10,506,680
Imprest cash	300
Assessments receivable	93,460
Accounts receivable (net)	206,054
Interest receivable	53,580
Other receivable	10,883
Due from other governmental agencies	1,967,240
Inventory	150,015

Total Current Assets 12,988,212

Restricted or Designated Assets:

Toilet retrofit program	40,055
Cash with fiscal agent	3,232,292
Plant expansion account	2,196,757
Capital projects account	13,170,248

Total Restricted Assets 18,639,352

Other Assets:

Deferred charges	<u>428,995</u>
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Capital Assets:

Nondepreciable	20,029,170
Depreciable, net	<u>117,909,577</u>

Total Capital Assets 137,938,747

Total Assets \$ 169,995,306

(continued)

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

NAPA SANITATION DISTRICT

Statement of Net Assets (continued)

June 30, 2006

LIABILITIES

Current Liabilities:

Accounts payable	\$ 2,277,782
Salaries and benefits payable	206,463
Current portion of compensated absences	184,633
Current portion of long-term debt	<u>1,176,571</u>

Total Current Liabilities 3,845,449

Current Liabilities Payable from Restricted Assets:

Interest payable	<u>616,568</u>
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Non-Current Liabilities:

Liability for compensated absences	151,796
Long-term debt, net of unamortized original issue discount	<u>39,275,699</u>

Total Non-Current Liabilities 39,427,495

Total Liabilities 43,889,512

NET ASSETS

Invested in capital assets, net of related debt	100,718,769
Restricted for debt service and construction projects	5,429,049
Unrestricted	<u>19,957,976</u>

Total Net Assets 126,105,794

Total Liabilities and Net Assets \$ 169,995,306

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

NAPA SANITATION DISTRICT

Statement of Revenues, Expenses and Changes in Net Assets For the Year Ended June 30, 2006

Operating Revenues:

Sewer charges	\$ 10,421,825
Connection fees	1,773,245
Other charges for services	296,963
Total Operating Revenues	<u>12,492,033</u>

Operating Expenses:

Insurance	214,493
Salaries and benefits	4,717,262
Materials, supplies and repairs	1,391,538
General and administrative	354,265
Contractual services	1,457,884
Utilities	995,006
Depreciation	4,915,339
Amortization	14,591
Total Operating Expenses	<u>14,060,378</u>

Operating Loss	<u>(1,568,345)</u>
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Non-Operating Revenue (Expense):

Lease income	227,725
Taxes	(28,404)
Gain (loss) on disposal of assets	5,373
Interest income	1,011,271
Intergovernmental revenue	867,240
Interest expense	(1,886,210)
Other revenue (expense)	263,356

Total Non-Operating Revenues (Expenses)	<u>460,351</u>
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Income (Loss) Before Capital Contributions	(1,107,994)
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Capital contributions	<u>1,040,850</u>
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Change in Net Assets	(67,144)
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Total Net Assets - Beginning of Year	<u>126,172,938</u>
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Total Net Assets - End of Year	<u>\$ 126,105,794</u>
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The accompanying notes are an integral part of these financial statements.

NAPA SANITATION DISTRICT

Statement of Cash Flows For the Year Ended June 30, 2006

Cash Flows from Operating Activities:

Receipts from customers	\$ 12,158,611
Payments to suppliers	(2,936,434)
Payments to employees	(4,603,444)
Net cash flows provided (used) for operating activities	<u>4,618,733</u>

Cash Flows from Noncapital Financing Activities:

Tax expense	(28,404)
Other revenue	263,356
Lease income	227,725
Net cash flows provided (used) for noncapital financing activities	<u>462,677</u>

Cash Flows from Capital and Related Financing Activities:

Payments of principal on long-term debt	(1,130,409)
Proceeds from sale of capital assets	5,373
Proceeds from debt	90,138
Purchase of capital assets	(4,983,260)
Capital contributions	867,240
Interest paid	(1,888,288)
Net cash provided (used) for capital and related financing activities	<u>(7,039,206)</u>

Cash Flows from Investing Activities:

Interest Income	<u>1,011,271</u>
Net cash flows provided (used) for investing activities	<u>1,011,271</u>

Net increase (decrease) in cash and cash equivalents (946,525)

Cash and cash equivalents, beginning of the year 30,092,857

Cash and cash equivalents, end of the year \$ 29,146,332

Reconciliation of Cash and Cash Equivalents to the Statement of Net Assets:

Cash and cash equivalents in current assets	\$ 10,506,980
Cash and cash equivalents in restricted assets	<u>18,639,352</u>

Total Cash and Cash Equivalents \$ 29,146,332

(continued)

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

NAPA SANITATION DISTRICT

Statement of Cash Flows (continued)
For the Year Ended June 30, 2006

Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities:

Operating income (loss)	<u>\$ (1,568,345)</u>
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	4,915,339
Amortization	14,591
Changes in Assets and Liabilities:	
(Increase) decrease in accounts receivable	8,994
(Increase) decrease in assessments receivable	15,097
(Increase) decrease in inventory	(34,185)
(Increase) decrease in other receivable	1,601,008
(Increase) decrease in due from other governments	(1,967,240)
(Increase) decrease in deferred charges	8,718
Increase (decrease) in accounts payable	1,510,938
Increase (decrease) in salaries and benefits payable	85,851
Increase (decrease) in compensated absences payable	<u>27,967</u>
 Total Adjustments to Operating Income	 <u>6,187,078</u>
 Net cash provided (used) by operating activities	 <u><u>\$ 4,618,733</u></u>
 Noncash, investing, capital and financing activities:	
Contribution of capital assets	<u><u>\$ 1,040,850</u></u>

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

NOTES TO BASIC FINANCIAL STATEMENTS

The notes provided in the financial section of this report are considered an integral and essential part of adequate disclosure and fair presentation of this report. The notes include a summary of significant accounting policies for the District, and other necessary disclosure of pertinent matters relating to the financial position of the District. The notes express significant insight to the financial statements and are conjunctive to understanding the rationale for presentation of the financial statements and information contained in this document.

NAPA SANITATION DISTRICT

Notes to Basic Financial Statements
June 30, 2006

Note 1: **Summary of Significant Accounting Policies**

The financial statements of the Napa Sanitation District (The District) are prepared in accordance with Generally Accepted Accounting Principles (GAAP). The District applies all relevant Government Accounting Standards Board (GASB) pronouncements. Proprietary funds apply Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which case, GASB prevails.

A. Reporting Entity

The Napa Sanitation District (the District) was organized as a County Sanitation District under the California Health and Safety Code in November 1945 to provide the necessary sewerage service to the City of Napa as well as adjacent areas of Napa County. The District is responsible for wastewater collection, treatment and disposal/reuse within the city limits of the City of Napa as well as adjacent areas of Napa County.

The District is not a component unit of the County of Napa. The District is legally separate and fiscally independent of the County of Napa. The District includes all activities (operations of its administrative staff and District officers) considered to be a part of the District. The District reviewed the criteria developed by the Governmental Accounting Standards Board (GASB) in its issuance of Statement No. 14, relating to the financial reporting entity to determine whether the District is financially accountable for other entities. The District has determined that no other outside entity meets the above criteria, and therefore, no agency has been included as a component unit in the financial statements. In addition, the District is not aware of any entity that would be financially accountable for the District that would result in the District being considered a component unit of that entity.

B. Basis of Presentation and Method of Accounting

The District accounts for its activities as a single enterprise fund, and the financial statements are accounted for on a flow of economic resources measurement focus, using the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when the related liability is incurred, regardless of the timing of related cash flows.

Operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. *Nonoperating* revenues, such as subsidies and investment earnings, result from nonexchange transactions or ancillary activities.

NAPA SANITATION DISTRICT

Notes to Basic Financial Statements
June 30, 2006

Note 1: **Summary of Significant Accounting Policies** (continued)

B. Basis of Presentation and Method of Accounting (continued)

Nonexchange transactions, in which the District gives (or receives) value without directly receiving (or giving) equal value in exchange, include property and sales taxes, grants, entitlements and donations. In accordance with GASB No. 33, *Accounting and Reporting for Nonexchange Transactions*, revenue from property taxes are recognized in the fiscal year for which the taxes are levied. Revenues from sales tax are recognized when the underlying transactions take place. Revenues from grants, entitlements and donations are recognized in the fiscal year in which all eligible requirements have been satisfied.

C. Cash, Investments and Equivalents

The District has adopted Governmental Accounting Standards Board (GASB) Statement No. 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools*. The District's cash is pooled with the County of Napa's cash for investment purposes. It has been determined that the fair value of the County's cash in total compared to cost is not materially different, so that no adjustment has been reported on these financial statements.

Cash, short-term investments and restricted investments are stated at cost, which approximates current fair value.

For purposes of the statement of cash flows, the District considers all cash and investments with original maturities of three months or less when purchased and their equity in the County Treasurer's Investment Pool, which is payable on demand, as cash and cash equivalents.

D. Receivables

Receivables consist mostly of fees charged for sewer services and reclaimed water sales. Management believes its receivables to be fully collectible, and accordingly, no allowance for doubtful accounts is required.

E. Inventory

Inventories consist of operating materials and supplies held for consumption, and are recognized as an expense at the time inventory is used. The District carries inventory at the lower of cost or market, on a first in, first out (FIFO) basis.

NAPA SANITATION DISTRICT

Notes to Basic Financial Statements
June 30, 2006

Note 1: **Summary of Significant Accounting Policies** (continued)

F. Deferred Charges

Deferred charges represent the cost of issuance of the 1998 certificates of participation payable, and of the installment purchase contract entered into on June 1, 2001 with the WasteReuse Finance Authority.

G. Restricted Assets

Amounts shown as restricted assets have been restricted by either bonds, by law or contractual obligations to be used for specified purposes, such as servicing bonded debt and construction of capital assets.

Restricted assets include water and sewer connection fees. The resolution establishing the authority for water and sewer connection fees restricts the use of these fees to the construction, acquisition, or financing of capital assets.

H. Capital Assets

All purchased capital assets are valued at cost where historical records are available and at an estimated historical cost where no historical records exist. Donated capital assets are valued at their estimated fair market value on the date received. The District's policy is to include in construction-in-progress capitalized interest costs of related borrowings, net of interest earned on unspent proceeds of the related borrowings, as well as capitalized amortization of deferred charges and original issue discount. No interest costs or amortization were capitalized for the year ended June 30, 2006.

The District defines capital assets as assets with an initial individual cost of more than \$3,000 and an estimated useful life in excess of one year. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset life are not capitalized. Depreciation is computed using the straight-line method over the estimated useful lives of the various classes of plant and equipment as follows:

	<u>Useful Life</u> <u>(Years)</u>
Buildings and improvements	5-40
Equipment	5-50
Donated sewer lines and other contributed assets	50

NAPA SANITATION DISTRICT

Notes to Basic Financial Statements
June 30, 2006

Note 1: **Summary of Significant Accounting Policies** (continued)

I. **Compensated Absences**

Earned vacation may be accumulated by all personnel up to a maximum of twice their annual vacation leave on June 30th. Sick leave is accumulated without restriction as to maximum hours. District employees may not receive compensation for accumulated sick leave upon termination of employment, but can convert up to 48 hours of sick leave to personal leave after accumulated sick leave exceeds 500 hours. Any unused personal leave is forfeited on June 30th for non-management employees.

Management employees can accumulate up to a maximum of 96 hours by June 30th. Earned management leave time may be accumulated by management employees up to a maximum of twice their annual management leave time on June 30th.

The total estimated contingent liability for vested compensated absences at June 30, 2006 was \$336,429. The current portion of the liability was determined as 100% of earned compensated time and personal leave, and 50% of earned vacation and management leave.

J. **Net Assets**

The District's financial statements utilize a net assets presentation. Net assets comprise the various net earnings from operating and non-operating revenues, expenses and contributions of capital. Net assets are classified in the following three components: invested capital assets (net of related debt), restricted and unrestricted.

- *Invested in Capital Assets, Net of Related Debt* – This category groups all capital assets, including infrastructure, into one component of net assets. Accumulated depreciation and the outstanding balances of debt that are attributable to the acquisition, construction or improvement of these assets reduce the balance in this category.
- *Restricted Net Assets* – This category presents external restrictions imposed by creditors, grantors, contributors or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation. For the District, this category represents restrictions for debt service and construction projects.

NAPA SANITATION DISTRICT

Notes to Basic Financial Statements
June 30, 2006

Note 1: **Summary of Significant Accounting Policies** (continued)

J. **Net Assets** (continued)

- *Unrestricted Net Assets* – This category represents net assets of the District, not restricted for any project or other purpose.

When both restricted and unrestricted net assets are available, restricted resources are used only after the unrestricted resources are depleted.

K. **Use of Estimates**

Management of the District has made certain estimates and assumptions relating to the reporting of assets and liabilities to prepare these financial statements in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

L. **Amortization**

Deferred charges and original issue discount related to the 1998 certificates of participation are being amortized using the straight-line method over 30 years. Amortization was capitalized until the Wastewater Project was completed on April 17, 2002, and expended thereafter. Deferred charges related to the installment purchase contract entered into on June 1, 2001 with the WateReuse Finance Authority are being amortized using the straight-line method over 27 years.

Note 2: **Cash and Investments**

Cash and investments shown in the statement of net assets represents the District's share of the County of Napa's cash and investment pool and restricted cash held with fiscal agents. The District involuntarily participates in the County's cash and investment pool. Interest earnings from this pool are transferred to the District on a quarterly basis based on the District's average daily balance. The County has an investment committee, which performs regulatory oversight for its pool as required by California Government Code Section 27134.

Required disclosure information regarding categorization of investments and other deposit and investment risk disclosures can be found in the County of Napa's comprehensive annual financial report and may be obtained by contacting the County Auditor-Controller's Office at 1195 Third Street, Room B-10, Napa, California 94559.

NAPA SANITATION DISTRICT

Notes to Basic Financial Statements June 30, 2006

Note 2: **Cash and Investments** (continued)

The District has no deposit or investment policy that addresses a specific type of risk.

At June 30, 2006, the District also had a \$40,055 bank balance on deposit with a financial institution. This amount is fully insured by federal depository insurance.

At June 30, 2006, total cash and investments held by the District were as follows:

	<u>Unrestricted</u>	<u>Restricted</u>	<u>Total</u>
Cash held in County treasury	\$ 10,506,680	\$ 15,367,005	\$ 25,873,685
Cash in bank	--	40,055	40,055
Imprest cash	300	--	300
Cash with fiscal agent	--	3,232,292	3,232,292
Total	<u>\$ 10,506,980</u>	<u>\$ 18,639,352</u>	<u>\$ 29,146,332</u>

Cash with fiscal agent investments were as follows:

	<u>Interest Rates</u>	<u>Maturities</u>	<u>Par Value</u>	<u>Book Value</u>	<u>Fair Value</u>	<u>Weighted Average Maturity (Years)</u>
Cash with Fiscal Agent						
Westdeutsche term deposit	Variable	5/1/2028	\$ 846,062	\$ 846,062	\$ 846,062	22.84
Investment Agreement - AIG						
Matched Funding Corp	5.771	8/1/2008	2,228,250	2,228,250	2,228,250	3.09
Federated Mutual Funds	Variable	On Demand	157,980	157,980	157,980	
Total			<u>\$ 3,232,292</u>	<u>\$ 3,232,292</u>	<u>\$ 3,232,292</u>	<u>8.10</u>

Required disclosures for the District's deposit and investment risks for the cash held in the County Treasury at June 30, 2006, were as follows:

Credit risk	Not rated
Custodial risk	Not applicable
Concentration of credit risk	Not applicable
Interest rate risk	1.32 years

NAPA SANITATION DISTRICT

Notes to Basic Financial Statements June 30, 2006

Note 3: Capital Assets

Changes in the District's capital assets and accumulated depreciation for the year ended June 30, 2006 is summarized as follows:

	Balance June 30, 2005	Additions	Retirements and Adjustments	Balance June 30, 2006
Capital assets, not being depreciated:				
Land	\$ 7,436,649	\$ --	\$ --	\$ 7,436,649
Construction in progress	10,027,403	4,186,441	(1,621,323)	12,592,521
Total capital assets, not being depreciated	<u>17,464,052</u>	<u>4,186,441</u>	<u>(1,621,323)</u>	<u>20,029,170</u>
Capital assets, being depreciated:				
Structures and improvements	113,116,632	596,808	1,485,705	115,199,145
Vehicles and equipment	8,036,159	296,820	11,991	8,344,970
Donated assets	46,528,774	1,040,850	--	47,569,624
Total capital assets, being depreciated	<u>167,681,565</u>	<u>1,934,478</u>	<u>1,497,696</u>	<u>171,113,739</u>
Less accumulated depreciation for:				
Structures and improvements	(22,344,499)	(3,238,134)	--	(25,582,633)
Vehicles and equipment	(3,731,155)	(641,035)	26,818	(4,345,372)
Donated assets	(22,239,988)	(1,036,169)	--	(23,276,157)
Total accumulated depreciation	<u>(48,315,642)</u>	<u>(4,915,338)</u>	<u>26,818</u>	<u>(53,204,162)</u>
Total capital assets, being depreciated net	<u>119,365,923</u>	<u>(2,980,860)</u>	<u>1,524,514</u>	<u>117,909,577</u>
Total capital assets, net	<u>\$ 136,829,975</u>	<u>\$ 1,205,581</u>	<u>\$ (96,809)</u>	<u>\$ 137,938,747</u>

Note 4: Long-Term Debt

Individual issues of Bonds, Notes and Certificates of Participation outstanding at June 30, 2006:

	Maturity	Interest Rates	Annual Principal Installments	Original Issue Date	Original Issue	Outstanding June 30, 2006
1998 Certificates of Participation Series A Purpose: Wastewater Project	2028	4.0%-5.0%	\$555,000-\$2,120,000	1/25/1999	\$ 34,520,000	\$ 30,105,000
WaterReuse Installment Purpose: Construction of Water Reservoir Facilities	2028	Not to exceed 12.0%	\$265,000-\$605,000	9/1/1993	\$ 11,165,000	\$ 9,740,000
Note Payable – Somky Purpose: Purchase Land	2007	7.4%	\$7,226	7/16/1986	\$ 925,865	\$ 103,216
State Revolving Fund – SRF Purpose: Summit Avenue/Ora Drive	2022	2.5%	\$34,421-\$58,777	12/13/2003	\$ 901,376	\$ 826,283

NAPA SANITATION DISTRICT

Notes to Basic Financial Statements June 30, 2006

Note 4: **Long-Term Debt** (continued)

The following represents the changes in long-term debt during the year:

	Balance July 1, 2005	Additions	Retirement	Balance June 30, 2006	Amounts Due Within One Year
SRF Loan	\$ 770,566	\$ 90,138	\$ (34,421)	\$ 826,283	\$ 39,765
Somky	179,204	--	(75,988)	103,216	81,806
WateReuse	10,045,000	--	(305,000)	9,740,000	310,000
1998 COP	30,820,000	--	(715,000)	30,105,000	745,000
Less: Unamortized Original Issue Discount	(336,820)	--	14,591	(322,229)	--
Compensated Absences	308,462	--	--	308,462	145,270
	<u>\$ 41,786,412</u>	<u>\$ 90,138</u>	<u>\$ (1,115,818)</u>	<u>\$ 40,760,732</u>	<u>\$ 1,321,841</u>

As of June 30, 2006, annual debt service requirements to maturity are as follows:

Year Ending June 30:	Business-type Activities							
	SRF Loan		Somky		WateReuse		1998 COP	
	Principal	Interest	Principal	Interest	Principal	Interest -a	Principal	Interest
2007	\$ 39,765	\$ 20,482	\$ 81,807	\$ 4,900	\$ 310,000	269,545	\$ 745,000	\$ 1,463,000
2008	40,583	19,663	21,409	267	325,000	260,255	780,000	1,428,687
2009	41,598	18,648	--	--	335,000	250,680	815,000	1,392,800
2010	42,638	17,608	--	--	345,000	240,818	850,000	1,355,338
2011	43,704	16,543	--	--	355,000	230,671	890,000	1,315,075
2012-2016	235,466	65,767	--	--	1,945,000	990,142	5,120,000	5,879,306
2017-2021	266,408	34,825	--	--	2,275,000	684,581	6,520,000	4,443,000
2022-2026	116,121	4,372	--	--	2,660,000	326,855	8,320,000	2,597,000
2027-2028	--	--	--	--	1,190,000	17,293	6,065,000	464,625
	<u>\$ 826,283</u>	<u>\$ 197,908</u>	<u>\$ 103,216</u>	<u>\$ 5,167</u>	<u>\$ 9,740,000</u>	<u>\$ 3,270,840</u>	<u>\$ 30,105,000</u>	<u>\$ 20,338,831</u>

a) Interest was calculated using 2005-2006 rates.

a- variable interest

NAPA SANITATION DISTRICT

Notes to Basic Financial Statements
June 30, 2006

Note 5: **District Employees Retirement Plan (Defined Benefit Pension Plan)**

A. Plan Description

The Napa Sanitation District contributes to the California Public Employees Retirement System (PERS), an agent multiple-employer public employees' retirement system that acts as a common investment and administrative agent for participating public entities with the State of California. Copies of PERS annual financial report may be obtained from their Executive Office – 400 P Street, Sacramento, California 95814.

B. Funding Policy

The District makes the contributions required of District employees on their behalf and for their account. The rates are set by statute and therefore generally remain unchanged from year to year. The present actuarially determined rates of annual covered payment are as follows:

<u>Category</u>	<u>Member Rates as a Percentage of Wages</u>
Local miscellaneous members	8%

State statutes establish the contribution requirements of the plan members and the employer contribution rate is established and may be amended by Cal PERS.

Annual Pension Cost

For the fiscal year ended June 30, 2006, the District's annual pension cost was \$870,470 and the District actually contributed \$870,470. The required contribution for the fiscal year ended June 30, 2006 was determined as part of the June 30, 2003 actuarial valuation using the entry age normal actuarial cost method with the contributions determined as a percent of pay. The actuarial assumptions include (a) 7.75% investment rate of return (net of administrative expenses); (b) projected salary increases that vary by duration of service ranging from 3.25% to 14.45%; and (c) a 3.25% increase overall payroll. Both (a) and (b) included an inflation component of 3.0%.

The actuarial value of the District's assets was determined using a technique that smoothes the effect of short-term volatility in the market value of investments over a two to five year period depending on the size of the investment gains and/or losses. The District's excess assets are being amortized as a level percentage of projected payroll on a closed basis.

NAPA SANITATION DISTRICT

Notes to Basic Financial Statements
June 30, 2006

Note 5: **District Employees Retirement Plan (Defined Benefit Pension Plan)** (continued)

Three-Year Trend Information

<u>Fiscal Year Ending</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
6/30/04	\$ --	100%	\$ --
6/30/05	535,903	100%	--
6/30/06	870,470	100%	--

C. **Deferred Compensation Plan**

All permanent employees of the District are eligible to participate in a District sponsored deferred compensation plan (the Plan) created in accordance with Internal Revenue Code Section 457. The Plan provides for the deferral of a portion of the employees' compensation until retirement, termination, or certain other covered events. The funds are invested on behalf of the employees through an administrator in various instruments including mutual funds, money market funds, and others.

Prior to 1999, all amounts of compensation deferred under the Plan, all property and rights purchased with those amounts and all income attributable to those amounts were (until paid or made available to the employee or other beneficiary) solely the property and rights of the District (without being restricted to the provisions of benefits under the Plan), and subject to the claims of the District's general creditors.

Due to a change in Federal law concerning deferred compensation plans, the Board of Directors amended the Plan. In accordance with the new law, the District set up a trust to hold assets and earnings of the deferred compensation plan for the exclusive benefit of the participants.

Government Accounting Standards Board Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans* requires governments to report Section 457 plans in the financial statements if the assets are held by a government unit in a trustee capacity or as an agent for individuals. Currently, the District has minimal administrative involvement, does not perform the investing function for the plan and, therefore, is not considered to have fiduciary responsibility for the plan or hold the plan in a trustee capacity.

The County of Napa Auditor-Controller's office prepares the District's payroll and remits all required deposits to the third-party administrators.

NAPA SANITATION DISTRICT

Notes to Basic Financial Statements
June 30, 2006

Note 5: **District Employees Retirement Plan (Defined Benefit Pension Plan)** (continued)

D. Post-Employment Benefits

The District provides post-retirement health care benefits to eligible retirees as stipulated by the District's health care provider.

Since the requirement to provide post-retirement health care benefits is contingent upon the District's continuing relationship with its current health care provider, contributions for post-retirement health care benefits are recognized when paid. Post-retirement health care benefits during the year ended June 30, 2006 were provided to 35 former employees at cost of approximately \$221,614 and included health, vision and life insurance premiums.

Note 6: **Related Party Transactions**

Pursuant to an agreement between the County of Napa and the District, the County provides Management Information Services to the District. During the year ended June 30, 2006, the District paid the County the following amounts for this service:

Information Technology Services	\$136,008
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Note 7: **Risk Management**

The District is exposed to various risks of loss related to torts; thefts of, damage to and destruction of assets; errors and omissions; injuries to employees and natural disaster. The District joined together with other entities to form the Special District Risk Management Authority (SDRMA), a public risk entity pool currently operating as a common risk management and insurance program for 242 member entities. The purpose of SDRMA is to spread the adverse effects of losses among the member entities and to purchase excess insurance as a group, thereby reducing its cost. A Board composed of one representative from each member agency governs SDRMA. The Board controls the operations of SDRMA including selection of management and approval for operating budgets, independent of any influence by member entities. A copy of the audit report may be obtained from SDRMA at 1481 River Park Drive, Suite 110, Sacramento, California 95815-4501.

The District is also a member of the California Sanitation Risk Management Authority (CSRMA) a public risk sharing pool. The District's workers compensation claims are handled by CSRMA. A Board composed of one representative from each member agency governs CSRMA. The Board controls the operations of CSRMA including selection of management and approval for operating budgets, independent of any influence by member entities. A copy of the audit report may be obtained from CSRMA at the Authority's web site at www.csrma.org.

NAPA SANITATION DISTRICT

Notes to Basic Financial Statements
June 30, 2006

Note 7: **Risk Management (continued)**

In addition to SDRMA, the District also carries commercial insurance coverage for general liability and property damage. Settled claims for SDRMA or commercial insurance have not exceeded coverage in any of the past three fiscal years.

The following is a summary of the insurance policies carried by the District for the fiscal year ended June 30, 2006:

<i>Comprehensive Business Policy</i>		
SDRMA – Specialty National Insurance Co.	General property	\$ 750,000,000
SDRMA	Special property coverage	Various
SDRMA	General liability	2,500,000
SDRMA – Continental Casualty Co.	Boiler and machinery	100,000,000
SDRMA	Auto and personal injury & property damage liability	2,500,000
SDRMA	Errors and omissions liability	2,500,000
SDRMA	Employment practices liability	2,500,000
SDRMA	Employee benefits liability	2,500,000
SDRMA – Fidelity and Deposit of Maryland	Public employees/officials dishonesty blanket coverage	400,000
SDRMA – American Safety Indemnity Co.	Public officials personal liability	500,000
<i>Workers' Compensation Program</i>		
CSRMA – Employers Reinsurance Corp.	Initial workers' compensation	750,000
CSRMA – Employers Reinsurance Corp.	Excess workers' compensation	Statutory
CSRMA – Employers Reinsurance Corp.	Employer's liability	1,000,000
<i>Pollution Legal Liability</i>		
Harbor Insurance Co.		5,000,000

Note 8: **Capital Contributions**

A portion of the construction costs for sewer lines completed by the District were paid for by outside parties. The donated portion of these assets is recorded as capital contributions.

Note 9: **New Accounting Pronouncements**

The Governmental Accounting Standards Board (GASB) recently released new accounting and financial reporting standards. GASB Statement No. 45, *Accounting and Financial Reporting by Employers of Postemployment Benefits Other than Pensions (OPEB)*, and GASB Statement No. 47, *Accounting for Termination Benefits*, may have a significant impact on the District's financial reporting process.

GASB Statement No. 45 establishes standards for the measurement, recognition and display of OPEB expenses/expenditures, related assets and liabilities, note disclosures and, if applicable, required supplementary information in the financial reports of state and

NAPA SANITATION DISTRICT

Notes to Basic Financial Statements June 30, 2006

Note 9: **New Accounting Pronouncements** (continued)

local government employers. GASB Statement No. 45 will be effective for the fiscal year ending June 30, 2009.

GASB Statement No. 47 provides guidance on how employers should account for benefits associated with either voluntary or involuntary terminations. The requirements of this Statement are effective in two parts. For termination benefits provided through an existing defined benefit OPEB plan, the provisions of this Statement should be implemented simultaneously with the requirements of GASB Statement No. 45. For all other termination benefits, this Statement is effective for financial statements for periods beginning after June 15, 2005.

REQUIRED SUPPLEMENTARY INFORMATION

NAPA SANITATION DISTRICT

Required Supplementary Information
For the Year Ended June 30, 2006

FUNDING STATUS – CALPERS

Funded Status of CalPERS Plan

The funded status of the District's plan, including the actuarial value of the plan's assets and the actuarial accrued liability, is no longer available, except on a pooled basis. Additional information can be obtained from CalPERS, 400 Q Street, Sacramento, California 95814.

OTHER REPORT



**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***

Board of Directors
Napa Sanitation District
Napa, California

We have audited the financial statements of the Napa Sanitation District as of and for the year ended June 30, 2006, and have issued our report thereon dated December 7, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and 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 Napa Sanitation District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion 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 operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of the District in a separate letter dated December 7, 2006.

Compliance

As part of obtaining reasonable assurance about whether the Napa Sanitation 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

Board of Directors
Napa Sanitation District
Napa, California

of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States.

This report is intended solely for the information of the Napa Sanitation District, management, and federal and state awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

BARTIG, BASLER & RAY, LLP
A Gallina LLP Company

A handwritten signature in black ink that reads "Bartig Basler & Ray, LLP". The signature is written in a cursive, flowing style.

December 7, 2006
Roseville, California