

NOVATO SANITARY DISTRICT
SINGLE AUDIT REPORT
FOR THE YEAR ENDED JUNE 30, 2009

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VAVRINEK, TRINE, DAY
& COMPANY, LLP
Certified Public Accountants

VALUE THE DIFFERENCE

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF GENERAL PURPOSE
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENTAL AUDITING STANDARDS

Board of Directors
Novato Sanitary District
Novato, California

We have audited the financial statements of Novato Sanitary District; (the District) as of and for the year ended June 30, 2009, and have issued our report thereon, dated March 24, 2010. 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 Novato Sanitary District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Novato Sanitary District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Novato Sanitary District's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Novato Sanitary District's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of Novato Sanitary District's financial statements that is more than inconsequential will not be prevented or detected by Novato Sanitary District's internal control. We consider the deficiency 2009-1 described in the accompanying schedule of findings and questioned costs to be a significant deficiency in internal control over financial reporting.

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

for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the financial statements of the District 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*.

Novato Sanitary District's response to the findings identified in our audit is described in the accompanying schedule of findings and recommendations. We did not audit Novato Sanitary District's response and, accordingly, we express no opinion on it.

This report is intended for the information of the Board of Directors, management, and the State Controller's office and is not intended to be and should not be used by anyone other than these specified parties.

Varrinek, Trine, Day & Co., LLP.

Pleasanton, California
March 24, 2010



INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH UNITED STATES OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133

Board of Directors
Novato Sanitary District
Novato, California

Compliance

We have audited the compliance of the Novato Sanitary District, (the District) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2009. The District's major federal programs are identified in the accompanying Schedule of Expenditures of Federal Awards. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major Federal programs is the responsibility of the District's management. Our responsibility is to express an opinion on the District's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major Federal program occurred. An audit includes examining, on a test basis, evidence about the District's compliance with those requirements and performing such other procedures, as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the District's compliance with those requirements.

In our opinion, the Novato Sanitary District complied, in all material respects, with the requirements referred to above that are applicable to each of its major Federal programs for the year ended June 30, 2009. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as item 2009-2.

Internal Control over Compliance

The management of the District is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to Federal programs. In planning and performing our audit, we considered the District's internal control over compliance with requirements that could have a direct and material effect on a major Federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal

control over compliance in accordance with OMB Circular A-133. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over compliance.

A control deficiency in a District's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a Federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the District's ability to administer a Federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a Federal program that is more than inconsequential will not be prevented or detected by the District's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material noncompliance with a type of compliance requirement of a Federal program will not be prevented or detected by the District's internal control.

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

Novato Sanitary District's response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit Novato Sanitary District's response and, accordingly, we express no opinion on it.

Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of the Novato Sanitary District as of and for the year ended June 30, 2009, and have issued our report thereon, dated March 24, 2010. Our audit was performed for the purpose of forming opinions on the basic financial statements of the Novato Sanitary District taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended for the information and use of the Board of Directors, management, federal granting agencies, pass-through entities and the Controller of the State of California, and is not intended to be and should not be used by anyone other than these specified parties.

Varrinek, Trine, Day & Co., LLP.

Pleasanton, California
March 24, 2010

NOVATO SANITARY DISTRICT

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2009**

Federal Grantor / Pass-through Grantor / Program Title	Grant Identifying Number	Federal Catalog Number	Federal Expenditures
<u>Environmental Protection Agency</u>			
Passed through State Water Resources Control Board			
Capitalization Grants for Clean Water State Revolving Funds ⁽¹⁾	C-06-4903-110	66.458	\$ 28,370,478 ⁽²⁾
Total Expenditures of Federal Awards			<u>\$ 28,370,478</u>

(1) Tested as a major program.

(2) The federal expenditures are different from awarded amount because the capital project has not been completed as of June 30, 2009.

NOVATO SANITARY DISTRICT

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS FOR THE YEAR ENDED JUNE 30, 2009

NOTE #1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. General

The accompanying Schedule of Expenditures of Federal Awards presents the activity of all federal awards programs of the Novato Sanitary District (District). The District's reporting entity is defined in Note #1 of the District's basic financial statements. All federal awards received directly from federal agencies, as well as federal awards passed through other governmental agencies to the District are included in the accompanying schedule.

B. Basis of Accounting

The accompanying Schedule of Expenditures of Federal Awards is presented using the accrual basis of accounting, which is described in Note #1 of the District's basic financial statements.

C. Relationship to Basic Financial Statements

The loan associated with federal award funds is reported within the District's basic financial statements under the financial statement caption current portion of long-term debt and long-term debt, net of current portion.

D. Relationship to Federal Financial Reports

Amounts reported in the accompanying Schedule of Expenditures of Federal Awards agree with the amounts reported in the related federal financial reports. However, certain federal financial reports are filed based on cash expenditures. As such, certain timing differences may exist in the recognition of revenues and expenditures between the Schedule of Expenditures of Federal Awards and the federal financial reports.

NOVATO SANITARY DISTRICT

FINANCIAL STATEMENT FINDINGS AND RECOMMENDATIONS FOR THE YEAR ENDED JUNE 30, 2009

2009-1 Infrastructure Capital Assets

Condition

During our audit of capital assets, we found an instance where land was being depreciated, which is not permitted under accounting principles generally accepted in the United States of America (GAAP). We also observed that the District has historically not depreciated certain infrastructure assets (i.e. sewer collection and outfall system), which is also a departure from GAAP.

Criteria

GAAP allows government an option of either depreciating all capital assets over their estimated useful lives, or not reporting depreciation on one or more networks or subsystems of their infrastructure assets, provided that the government has made a commitment to maintain those particular networks or subsystems at a predetermined condition level of its own choosing and has established an asset management system that is adequate for that purpose. Governments that use this “modified approach” for networks or subsystems of infrastructure assets are required to present certain data as required supplementary information to demonstrate that they are, in fact, maintaining those assets at an appropriate condition level.

Depreciation is not appropriate for land and other assets that are considered to be inexhaustible.

Cause of Condition

This observation was brought to management’s attention during prior audits. At that time the effect of this error was immaterial to the financial statements on the whole, however, because no action was taken during past 3 fiscal years, the error created a significant cumulative effect on the financial statements.

Effect of Condition

Net capital assets were overstated and not accounted for in accordance with accounting principles generally accepted in the United States of America (GAAP). An audit adjustment was needed to correct the misstatement.

Recommendation

We recommend the District choose one of the options of accounting for infrastructure assets acceptable under accounting principles generally accepted in the United States of America (GAAP) and records the appropriate accounting entries to all related accounts. If the District chooses the modified approach, management should become familiar with all aspects of this method, including the disclosures that are required in the notes to the annual financial statements.

District Response

The District will amend their current fixed asset policy to include the depreciation of their infrastructure assets (i.e. sewer collection and outfall system) to be in compliance with GASB 34. In the past the District has depreciated land, however this error was corrected in fiscal year 08/09 and land was not depreciated.

NOVATO SANITARY DISTRICT

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2009

2009-2 Reporting

Federal Agency: Environmental Protection Agency
Passed through State Water Resources Control Board
Federal Program: Capitalization Grants for Clean Water State Revolving Funds
CFDA Number: 66.458

Condition

The Installment Sales Agreement between the Novato Sanitary District and the State Water Resources Control Board (SWRCB) requires the District to report minority business enterprises (MBE)/woman business enterprises (WBE) utilization to the Division of Financial Assistance of the SWRCB.

The District failed to submit the required MBE/WBE utilization reports to the State Water Resources Control Board as required.

Criteria or Specific Requirements

Section 6. Federal MBE/WBE Reporting, of Exhibit M – SWRCB Special Terms and Conditions of the Installment Sales Agreement No. C-06-4903-110, Agreement No. 07-824-550-0 between the Novato Sanitary District and the State Water Resources Control Board (SWRCB) requires the District to report MBE/WBE utilization to the Division of Financial Assistance of the SWRCB on the MBE/WBE Utilization Report, SWRCB Form MBE/WBE UR334. Reports must be submitted to the Division within ten (10) calendar days following the end of each fiscal year quarter until such time as the Notice of Completion is issued.

Effect

Lack of timely submittal of required reports, in accordance with State and Federal guidelines, leads to non-compliance with federal and state reporting requirements.

Questioned Costs

None.

Cause

The District was unable to ensure compliance with requirements over reporting due to failure of submittal of the MBE/WBE utilization reports to the State Water Resources Control Board.

Recommendation

We recommend Novato Sanitary District identify all compliance requirements outlined in the agreements with the granting agencies and as required by OMB Circular A-133. We further recommend that the District develop and adhere to policies and procedures to ensure that all required reports are submitted by their respective due dates in order to ensure compliance.

District Response

MBE/WBE reports were filed at the beginning of the project but the District was unaware there were continuing reporting requirements once the project started. We plan to file the delinquent reports and submit quarterly MBE/WBE Utilization Reports as required on an ongoing basis until the project “Notice of Completion” is filed.

NOVATO SANITARY DISTRICT

**SUMMARY SCHEDULE OF PRIOR YEAR FINDINGS
FOR THE YEAR ENDED JUNE 30, 2009**

None reported.