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December 6, 2006

To the Board of County Commissioners and the Citizens of Douglas County:

We are please to submit the Comprehensive Annual Financial Report of Douglas County, Oregon, for the fiscal year ended June 30, 2006, together with the opinion thereon of our independent certified public accounting firm licensed to perform municipal audits in Oregon. This report, required by Oregon Revised Statute 297.425 is prepared by Management and Finance. Also included are the auditor's report on internal controls and compliance in accordance with Government Auditing Standards and Audit Comments and Disclosures required under the Minimum Standards for Audits of Oregon Municipal Corporations Section of the Oregon Administrative Rules.

In addition, the County is required to have a comprehensive single audit of its Federal Assistance Programs in accordance with the provisions of Single Audit Act Amendments of 1996 and U.S. Office of Management and Budget Circular A-133 and the provisions of *Government Auditing Standards* promulgated by the U.S. Comptroller General as they pertain to financial and compliance audits. Information related to this single audit, including the schedule of federal financial assistance, findings and recommendations, and accountants' reports on the internal control and compliance with applicable laws and regulations are included in a separately issued single audit report.

This report consists of management's representations concerning the finances of Douglas County, Oregon. Consequently, management assumes full responsibility for the completeness and reliability of all of the information presented in this report. To provide a reasonable basis for making these representations, management of the county has established a comprehensive internal control framework that is designed both to protect the government's assets from loss, theft, or misuse and to compile sufficient reliable information for the presentation of the county's financial statements in conformity with generally accepted accounting principles. Because the cost of internal controls should not outweigh their benefits, the county's comprehensive framework of internal controls has been designed to provide reasonable rather than absolute assurance that the financial statements will be free from material misstatement. As management, we assert that, to the best of our knowledge and belief, this financial report is complete and reliable in all material respects.

Douglas County's financial statements have been audited by Kenneth Kuhns & Co., Certified Public Accountants. The goal of the independent audit was to provide reasonable assurance that the financial statements of the county for the fiscal year ended June 30, 2006, are free of material misstatement. The independent audit involved 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; and evaluating the overall financial statement presentation. Kenneth Kuhns & Co. has concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that Douglas County's financial statements are fairly presented in conformity with generally accepted accounting principles. The independent auditor's report is presented as the first component of the financial section of this report.

Generally accepted accounting principles require that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement MD&A and should be read in conjunction with it. Douglas County's MD&A can be found immediately following the independent auditors' report.

PROFILE OF DOUGLAS COUNTY, OREGON

The County was incorporated January 7, 1852. It extends from sea level at the Pacific Ocean to Mt. Thielsen (9,182 feet high) in the Cascade Range. The Umpqua River marks the dividing line between northern and southern Oregon, and its entire watershed lies within the County's boundaries. Douglas County contains the largest stand of old growth timber in the world. It has a land area of 5,071 square miles and a population of 102,950. The County is empowered to levy a property tax on both real and personal property.

The County operates under a three member Board of Commissioners. The Board is responsible for passing ordinances and resolutions, adopting the budget, appointing committees, and overseeing the day-to-day operations of the government. Board members serve four-year terms with two members' terms expiring simultaneously and the third member's term being staggered.

As a general purpose government, Douglas County provides a full range of services, including public safety protection; corrections and probation; construction and maintenance of roads, highways, bridges and other infrastructure; health and social services; library and community enhancement; and internal business support.

The annual budget serves as the foundation for the county's financial planning and control. The budget is prepared on the modified accrual basis of accounting. In accordance with state statutes, the County budgets all funds except trust and agency funds. The County Board of Commissioners adopts the budget by department for those funds having more than one department and by major expenditure classification for those funds with only one department. The expenditure appropriations lapse at the end of the fiscal year. Additional resources and corresponding appropriations may be added to the budget during the fiscal year through a supplemental budget process. Original and supplemental budgets may be modified during the fiscal year by the use of appropriation transfers between categories. The Board of Commissioners must approve any supplemental budget and any appropriation transfer in a public meeting. Budget to actual comparisons are provided in this report for each individual governmental fund for which an appropriated annual budget has been adopted.

For financial reporting purposes, Douglas County includes all funds of Douglas County as well as one component unit. A component unit is a legally separate entity for which Douglas County

is financially accountable. Additional information on this legally separate entity can be found in note 1 of the notes to the financial statements.

FACTORS AFFECTING FINANCIAL CONDITION

Local Economy. Historically, Douglas County's economic base has relied heavily on the lumber and wood products industry. This is not surprising when you consider that slightly over half of the County's total acreage is owned by the federal government and managed by the Bureau of Land Management and the Forest Service.

When the wood products industry went into decline, Douglas County began to diversify. Population increases have been largely from the migration of retirement age people from other states. This has contributed to a growth in the service and retail industries. However, job growth in the County has been slow. The unemployment rate for the month of September 2006 in Douglas County was 6.6%. This is above both the state rate of 4.8% and the national rate of 4.6%.

Financial outlook. Historically, Douglas County's major source of revenue has been derived from timber harvests. In 1992, environmental concerns brought timber sales to a standstill. In 1993 Congress agreed to pay counties 85 percent of the average receipts from fiscal years 1986-87 through 1990-91. Beginning with fiscal 1994-95 counties began receiving a guaranteed payment that reduced by 3 percent a year. In October 2000, HR 2389, Federal Public Law 106-393 "Secure Rural Schools and Community Self-Determination Act of 2000" was enacted. These funds account for approximately 45% of the county's total annual revenues. The County will receive these funds through fiscal year 2006-07. Continuation of this funding beyond fiscal 2006-07 will require congressional action. Douglas County will continue to budget conservatively and manage reserves carefully until county funding can be stabilized.

Cash management policies and practices. The County pools most funds for investment purposes to obtain maximum return on investments while minimizing the risk of loss of principal due to credit and market risk. The County Treasurer, an elected official, is responsible for the investment of all available monies. The County Treasurer complies with state statutes and limits investments primarily to certificates of deposit, obligations of the U.S. Treasury and its agencies, and repurchase agreements. A written Investment Policy, which regulates the County's investment objectives, diversification, limitations and reporting requirements and governs investment transactions, is reviewed with the Board of Commissioners annually.

The maturities of the investments range from one day to two years. The average yield on investments was 3.13% during 2005-06. Investment income includes unrealized gains and losses on investments due to changes in fair market value of investments held at fiscal year end. These reported changes in value are temporary, since the County's policy is to hold investments to maturity. Additional information on the County's cash management activities can be found in note 3A of the notes to the financial statements.

Risk management. The County has established an internal service fund to account for risk management activities and to protect the human, physical and financial assets of the County. As part of the County's plan for risk management, resources are accumulated in the Employee Benefits Trust Fund to meet potential losses. In addition, various control techniques, including loss prevention training and consultation, have been implemented to minimize losses. The County self-insures for general liability, workers' compensation and unemployment. Additional

information on the County's risk management activities can be found in note 4A of the notes to the financial statements.

Pension benefits. Douglas County participates in two employee retirement plans sponsored by the Oregon Public Employees Retirement System (OPERS). These are the Public Employee Retirement System plan (PERS) and the Oregon Public Service Retirement Plan (OPSRP). Those employed prior to August 29, 2003 are members of the PERS plan, while those employed on or after August 29, 2003 are members of the OPSRP plan. Every other year, an independent actuary engaged by OPERS calculates the amount of the annual contribution rate that member employers must make to the pension plans to ensure that the plans will be able to fully meet its obligations to retired employees on a timely basis. Additional information on OPERS can be found on their web site at: <http://oregon.gov/PERS>. Additional information on the County's participation in OPERS can be found in note 4D of the notes to the financial statements.

AWARDS AND ACKNOWLEDGEMENTS

The Government Finance Officers Association (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the County for its comprehensive annual financial report (CAFR) for the year ended June 30, 2005. This was the eighteenth consecutive year that the County has received this prestigious national award. In order to be awarded a Certificate of Achievement, the County published an easily readable and efficiently organized CAFR. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual report continues to meet the Certificate of Achievement Program's requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

The preparation of this report would not have been possible without the services of the employees in the Finance Department who assisted and contributed to the preparation of this report. Appreciation is also extended to the Board of Commissioners for their interest and support in planning and conducting the financial operations of the County.

Respectfully Submitted,



Sandra K. Correll
Chief Financial Officer