

COUNTY OF SUTTER
MANAGEMENT REPORT
FOR THE YEAR ENDED JUNE 30, 2010

COUNTY OF SUTTER

Management Report
For the Year Ended June 30, 2010

Table of Contents

	<u>Page</u>
Introduction.....	1-2
Required Communications.....	3-6
Comments Pertaining to Officials and Departments – Current Year	7-20
New Accounting Pronouncement	21-22
Status of Prior Year Management Comments	23-24



Sutter County Board of Supervisors
Yuba City, California

In planning and performing our audit of the financial statements of the County of Sutter for the year ended June 30, 2010, in accordance with auditing standards generally accepted in the United States of America, we considered the County's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the County's internal control. Accordingly, we do not express an opinion on the effectiveness of the County's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all such deficiencies have been identified. However, as discussed below, we did identify a deficiency in internal control that we consider to be a material weakness.

A deficiency in internal control 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the following deficiency in the County's internal control to be a material weakness:

Finding FS-10-1: Deferred Revenue Availability Period - Material Weakness

This finding is presented in the Schedule of Findings and Questioned Costs of the Single Audit Report.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

During our audit we also became aware of a few matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions regarding those matters. This letter does not affect our report dated March 30, 2011 on the financial statements of the County of Sutter.

Sutter County Board of Supervisors
Yuba City, California

This communication is intended solely for the information and use of management, the Board of Supervisors, and federal and state grantor agencies, and is not intended to be and should not be used by anyone other than these specified parties.

We thank the County's staff for its cooperation during our audit.

Gallina LLP

Roseville, California
March 30, 2011

COUNTY OF SUTTER

Management Report Required Communication For the Year Ended June 30, 2010

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the County of Sutter (County) for the year ended June 30, 2010, and have issued our report thereon dated March 30, 2011. Professional standards require that we provide you with the following information related to our audit.

Our Responsibilities under U.S. Generally Accepted Auditing Standards and OMB Circular A-133

As stated in our engagement letter dated May 10, 2010, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute assurance that the financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting principles. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

In planning and performing our audit, we considered the County's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting. We also considered 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.

As part of obtaining reasonable assurance about whether the County's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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. Also, in accordance with OMB Circular A-133, we examined, on a test basis, evidence about the County's compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement applicable to each of its major federal programs for the purpose of expressing an opinion on the County's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the County's compliance with those requirements.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our engagement letter dated May 10, 2010.

COUNTY OF SUTTER

Management Report Required Communication For the Year Ended June 30, 2010

Qualitative Aspects of Accounting Practices

Significant Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the County are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended June 30, 2010. We noted no transactions entered into by the County during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Significant Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate(s) affecting the financial statements were:

- Liability for self-insurance claims: Management's estimate is derived from actuarial valuations obtained from experts. We agreed the claims liability reported in the financial statements to those reported in actuarial reports prepared and issued during the year being audited.
- OPEB liability: Management's estimate is derived from actuarial valuations obtained from experts. We agreed the claims liability reported in the financial statements to those reported in actuarial reports prepared and issued during the year being audited.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

COUNTY OF SUTTER

Management Report Required Communication For the Year Ended June 30, 2010

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements.

The following material misstatements detected as a result of audit procedures were corrected by management:

- Recognize revenue for receipts received between August 20 and August 31 in the fund statements that was deferred and should have been earned.

Management passed on the following adjustments:

- Increase receivables and unavailable revenue for amounts due to the County at June 30, 2010, and not accrued by the County at year-end.
- Adjust total pooled cash to account for the fair value of the County's investments at June 30, 2010.

Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole, with which we concur.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

COUNTY OF SUTTER

Management Report Required Communication For the Year Ended June 30, 2010

Management Representations

We have requested certain representations from management that are included in the management representation letter dated March 30, 2011.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a “second opinion” on certain situations. If a consultation involves application of an accounting principle to the governmental unit’s financial statements or a determination of the type of auditor’s opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the County’s auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

COUNTY OF SUTTER

Management Report Current Year Recommendations For the Year Ended June 30, 2010

CAPITALIZATION POLICY

Criteria

Generally accepted accounting principles require that capital assets, that generally constitute the single largest asset of the County, be accurately recorded.

Condition

At the time of our audit, we noted that the County did not have a formal capitalization policy that addressed infrastructure assets or estimated useful asset lives. In fiscal year 2006, the County issued a memorandum revising the estimated life of a road from 15 to 30 years. However, this information, along with the details of a complete infrastructure accounting system, has never been formalized into a comprehensive infrastructure capitalization policy.

Cause

The County has not yet written a formal policy for the capitalization of infrastructure.

Effect of Condition

Without a written capitalization policy which addresses infrastructure and estimated useful asset lives, inconsistencies and misunderstandings regarding proper policy are likely to occur. In addition, misstatement of net capital assets as well as a lack of comparability between years can result when policies and procedures regarding capital assets are unclear.

Recommendation

We recommend that the County adopt a comprehensive updated capitalization policy which includes all required capital asset accounting elements including infrastructure and estimated useful asset life. This project will likely involve the combined efforts of the Auditor-Controller, County Administrative Officer and Public Works departments. This is a repeat of a prior year recommendation.

Management Response

Auditor-Controller's Office Response

The Auditor-Controller, with the exception of infrastructure, has a detailed capitalization policy posted on the County website. In general, infrastructure is capitalized in accordance with the guidelines of the State Controller's *Accounting Standards and Procedures for Counties* and in consultation with Public Works engineers until such time as a more complete listing can be

COUNTY OF SUTTER

Management Report Current Year Recommendations For the Year Ended June 30, 2010

Management Response (continued)

Auditor-Controller's Office Response (continued)

incorporated in the formal policy. Because of the infrequent construction of infrastructure this has been adequate for the County. We agree that a formalized policy should be developed with the collaboration of the County Administrative Officer and Public Works, and adopted by the Board of Supervisors.

County Administrator's Office Response

The County agrees with the Independent Auditor's recommendation.

COUNTY OF SUTTER

Management Report Current Year Recommendations For the Year Ended June 30, 2010

PERSONNEL BENEFITS TRUSTS

Criteria

Good internal control requires reconciliation of all trust funds.

Condition

We noted that the Personnel Benefits Revolving Trust fund (Fund 5226) had not been reconciled.

Cause

The staff assigned to reconcile the accounts does not have the appropriate training or expertise for such a task.

Effect of Condition

Without monthly trust account reconciliations of all payroll trusts, errors and irregularities could occur and not be detected in a timely manner.

Recommendation

We recommend that the unresolved differences be resolved and any inactive accounts be closed. This is a repeat of a prior year recommendation.

Management Response

Auditor-Controller's Office Response

Only the Personnel Department has the detailed information needed to reconcile Personnel Benefits Revolving Trust. It is not reasonable to separate the accounting function of Fund #5226 from the management of Personnel Benefits as recommend by the County Administrator in previous years. Therefore, the Auditor-Controller's office recommends assigning the responsibility for the accounting of Fund #5226 along with the management of personnel benefits to the Auditor-Controller's office with the addition of one staff member with adequate training to perform the tasks.

COUNTY OF SUTTER

Management Report Current Year Recommendations For the Year Ended June 30, 2010

PERSONNEL BENEFITS TRUSTS (continued)

Management Response (continued)

County Administrator's Office Response

The County agrees with the Independent Auditor's recommendation; however, we believe that the reconciliation of the Benefits Trust Fund #5226 should be a function of the Auditor-Controller's office and not of the Human Resources Department.

In FY 1996-97 response to this same recommendation the Auditor-Controller stated "We agree with the recommendation. The payroll accountant recognized this problem and set up a meeting in March 1997 with the data processing analyst assigned to this office to work on programming to accomplish this reconciliation." The Auditor-Controller then stated that "We agree with the independent auditor that the accounts should be reconciled and will do so when we are assigned the necessary technical staff." Since then, an Accountant II was added to the Auditor-Controller's staff in FY 2000-01 and an Account Clerk III in FY 2001-02. The next year the Auditor-Controller responded that "The accounts of the payroll trust fund should be reconciled. This will have to be a joint project with the Personnel Department" also stating that "the Personnel Department administers four of the accounts." Personnel staff does administer some of the accounting functions within the Personnel Benefits Revolving Trust fund #5226, but they do not have an accountant on staff. The Auditor-Controller's office also administers portions of the accounting function, such as payroll withholdings, employee deposits, and assigning account numbers for the Human Resources department to use. The reconciliation of funds is a function of the Auditor-Controller. The Auditor-Controller has stated that the Payroll Revolving Trust Fund #5225 has been reconciled by his department but that the Personnel Revolving Benefits Trust Fund #5226 is not his responsibility.

On May 1, 2008 the County Administrative Office contracted with an independent CPA firm, Tenney and Company, to reconcile the Personnel Benefits Revolving Trust fund #5226. The CPA firm required assistance from the Auditor-Controller and Personnel Departments. The Auditor-Controller's office stated that they did not have the staff to assist with the reconciliation. The Personnel Department attempted to provide assistance, but does not have a staff accountant and therefore lacks the technical expertise to provide the assistance necessary for the reconciliation. In 2009, the consulting firm informed the County Administrative Office that they were unable to complete the reconciliation of the fund due to the lack of accounting knowledge and expertise in the Human Resources Department and the lack of cooperation from the Auditor-Controller's office. The two departments have been unable to work together to establish procedures to ensure timely reconciliation of this fund.

COUNTY OF SUTTER

Management Report Current Year Recommendations For the Year Ended June 30, 2010

PERSONNEL BENEFITS TRUSTS (continued)

Management Response (continued)

County Administrator's Office Response (continued)

Currently, the County Administrative Office is reconciling this Fund. The inactive accounts have been closed and the unresolved differences in each of the five accounts, Health, Dental Vision, Life Insurance and Supplemental Life Insurance, will be addressed to the Board of Supervisors during fiscal year 2010-11.

We agree with the Auditor-Controller that it is not reasonable to separate the accounting function of Fund #5226 from the management of the Personnel Revolving Benefits Trust fund #5226 and recommend assigning the responsibility for the accounting of Fund #5226 along with the management of personnel benefits to the Auditor-Controller's office. In response to the June 30, 2007 Management Comment, the County Administrative Office stated, "The Auditor-Controller may also want to assume the entire accounting function of Fund #5226 and thereby have complete control of this Fund." In response to the June 30, 2008 comment, the County Administrative Office stated, "We strongly recommend that the Auditor-Controller's Office assume the ongoing responsibility for the accounting function of Fund #5226, as Personnel staff do not have the appropriate training or expertise for such a task." In response to the June 30, 2009 comment, the County Administrative Office again stated, "We strongly recommend that the Auditor-Controller's Office assume the ongoing responsibility for the accounting function of Fund #5226, as Personnel staff do not have the appropriate training or expertise for such a task."

We recommend that procedures be established to provide for the proper tracking of activity within this fund and to ensure the timely reconciliation of this fund on an annual basis.

COUNTY OF SUTTER

Management Report Current Year Recommendations For the Year Ended June 30, 2010

USE OF MISCELLANEOUS REVENUE ACCOUNTS

Criteria

The miscellaneous revenue accounts should be used to record revenues that fall outside of the other revenue categories, such as intergovernmental revenues and charges for services, and that are considered to be infrequent in nature.

Condition

We noted that the County's miscellaneous revenue accounts included court reimbursements for postage and copier rentals of \$69,639 and Sheriff bailiff services of \$499,301 which we reclassified to charges for services. Miscellaneous revenue was reported as \$2,724,962 before these adjustments.

Cause

Departments have initial responsibility for classifying cash receipts for financial reporting and may not have adequate knowledge or guidance to properly classify certain revenues. In the absence of other guidance, departments likely record revenues they are unsure of in the miscellaneous revenue account.

Effect of Condition

When revenues are improperly classified as miscellaneous revenues the true condition of the fund may be misleading. The level of detail for classifying transactions should be sufficiently categorized so as to be meaningful to management in making decisions.

Recommendation

We recommend that the County consider restricting the use of its miscellaneous revenue account for revenue sources that cannot be categorized under the existing revenue types, including charges for services, fines, intergovernmental revenues, and licenses and permits. This is a repeat of a prior year recommendation.

Management Response

Auditor-Controller's Office Response

Last year's recommendation was based on the condition "the County's use of the miscellaneous revenue account includes various types of revenue, including intergovernmental revenues and revenue generated from charges for services." During the year our office made a significant

COUNTY OF SUTTER

Management Report
Current Year Recommendations
For the Year Ended June 30, 2010

USE OF MISCELLANEOUS REVENUE ACCOUNTS (continued)

Management Response (continued)

Auditor-Controller's Office Response (continued)

effort to clean up all miscellaneous revenue accounts. The Auditor-Controller's office provided specific guidance to all departments at their annual presentation in May, on an ongoing basis throughout the year as revenue came in, and again provided specific instruction to each department needing adjustments at the year-end close meetings. The court reimbursement revenue account will be adjusted to charges for services in the next fiscal year.

County Administrator's Office Response

The County agrees with the Independent Auditor's recommendation. We note that the classification of revenues within the chart of accounts is the responsibility of the Auditor-Controller's office, as that office has sole responsibility for creating account numbers and assigning account names. Departments generally record revenues as advised by the Auditor-Controller's office.

COUNTY OF SUTTER

Management Report Current Year Recommendations For the Year Ended June 30, 2010

ACCOUNTS RECEIVABLE

Criteria

During its year-end closing process, the County should establish and enforce policies and procedures to ensure that year-end accruals are properly identified and recorded for all account balances, including revenues and receivables.

Condition

During the audit, we noted a receipt for services provided during the fiscal year ended June 30, 2010, that was not properly accrued at year-end. The total amount of the related passed audit adjustment which was immaterial to the financial statements was \$212,826.

Cause

Subsequent to year-end, the County did not identify significant revenues that should have been accrued during the year-end closing process.

Effect of Condition

By not properly accounting for the revenue received subsequent to year-end, the County is significantly understating its accounts receivable at the end of the year.

Recommendation

We recommend that the County enforce its policy that all significant deposits made subsequent to year-end be reviewed to determine the correct period for revenue recognition. By enforcing its policy, the County will improve its year-end closing process for identifying the appropriate year-end accruals and reduce the risk of material misstatement in their annual financial statements.

Management Response

Auditor-Controller's Office Response

For both accounting and budgeting purposes the county is required to follow *State of California Accounting Standards and Procedures for Counties* which is available to all departments in hard copy and on line. In an effort to help the departments understand the proper accounting of all revenues (including accounts receivable and deferred revenue) the Auditor-Controller's office included in their year end presentation in May 2010 training specific to identifying revenue, accounts receivable, and deferred revenue. In addition, our office provided ongoing one-on-one

COUNTY OF SUTTER

Management Report Current Year Recommendations For the Year Ended June 30, 2010

ACCOUNTS RECEIVABLE (continued)

Management Response (continued)

Auditor-Controller's Office Response (continued)

training to the departments throughout the year as revenue and accounts receivable were received. We also sent a Year-End Closing Memo that outlined all of the necessary steps to assure proper posting of accounts receivable, and finally, we provided specific instruction to each department at the annual year end closing meetings to correct their accounts. A significant factor in many cases is the personnel in the departments do not appear to have the minimum knowledge and skills (high level analytical skills and knowledge of generally accepted accounting principles) needed to understand and comply with the accounting standards as required by law.

County Administrator's Office Response

The County agrees with the Independent Auditor's recommendation.

COUNTY OF SUTTER

Management Report Current Year Recommendations For the Year Ended June 30, 2010

MISCLASSIFICATION OF INTERFUND ADVANCE IN BUDGET

Criteria

The *County Budget Guide* issued by the State of California states that counties should refer to its *Accounting Standards and Procedures for Counties Manual* for proper budgetary treatment of each type of transaction. The *Accounting Standards and Procedures for Counties Manual* states that interfund loans should be accounted for as interfund receivables in the lender funds and interfund payables in the borrower funds. The activity should not be reported as other financing sources or uses in the fund financial statements.

Condition

During the audit, we noted that an advance from the General Fund to the Special Aviation Fund of \$67,811 had been incorrectly included as long term debt proceeds in the Special Aviation Fund's budget.

Cause

Departments responsible for preparing budgets may not have adequate knowledge or guidance to properly classify certain items.

Effect of Condition

By not properly classifying interfund loans, budgetary revenues were overstated.

Recommendation

We recommend that the County carefully review the budget prior to its adoption to ensure that all items are classified properly.

Management Response

Auditor-Controller's Office Response

We agree with the recommendation. The Auditor-Controller's office has repeatedly recommended to the County Administrator's Office (responsible for preparing the recommended budget) and the Board of Supervisor's (prior to filing the adopted budget) that interfund loans should be accounted for as interfund receivables in the lender funds and interfund payables in the borrower funds and the activity should not be reported as other financing sources or uses in the fund financial statements. The Auditor-Controller's office has informed them also, that to have a lawful budget it must conform to generally accepted accounting principles as required by the

COUNTY OF SUTTER

Management Report Current Year Recommendations For the Year Ended June 30, 2010

MISCLASSIFICATION OF INTERFUND ADVANCE IN BUDGET (continued)

Management Response (continued)

Auditor-Controller's Office Response (continued)

county budget act, Government Code sections 29002 and 30200. Therefore, the effect of this condition properly stated is that the county has not complied with the law in filing its budget. This has been especially apparent in the airport fund which has been operating at a loss for many years.

County Administrator's Office Response

The County agrees with the Independent Auditor's assessment that interfund loan activity should not be reported as other financing sources or uses in the fund financial statements, and offers the following clarification as it pertains to budget law.

The County is required to follow the County Budget Act, beginning with Government Code Sections 29001, in the preparation of the County's annual budget. The basic budget formula, as represented in the County Budget Guide (produced by the State Controller's Office) requires that Fund Balance Unreserved/Undesignated, plus Decreases to Prior Year's Reserves/Designations, plus Estimated Additional Financing Sources must equal Estimated Financing Uses plus Increases to Reserves/Designation (New or Increased). Government Code Section 29009 states: "In the recommended, adopted and final budgets the funding sources shall equal the financing uses." Therefore, to have a lawful budget, the County budget must conform to Government Code Section 29009, which, in essence, requires that the budget be in balance.

When a Board of Supervisors approves to loan money between funds within the County as a means of supporting financing uses (expenditures) within the budget year, it is necessary to show the loaned funds as a financing source within the recipient budget in order to make financing sources equal the financing uses within that budget.

The Auditor-Controller indicates that the County should not use the account "Long Term Debt Proceeds," for reflecting General Fund loan funding as a financing source to a non-General Fund budget. As has been stated previously, absent any further advice or direction from the Auditor-Controller on which account number to use to reflect the "financing" that is proposed to be used to cover appropriations, the County has continued to use the "Long Term Debt Proceeds" account. The account is in use in the FY 2010-11 budget for the Airport, and, as is noted in this comment, was used in the Airport budget in FY 2009-10. The account was used for the same purpose in 2003 when the General Fund loaned money to CSA-F for the Sutter Fire Station. The Auditor-Controller presented no disagreement with the use of this type of account for the purposes described here until November 23, 2010.

COUNTY OF SUTTER

Management Report
Current Year Recommendations
For the Year Ended June 30, 2010

MISCLASSIFICATION OF INTERFUND ADVANCE IN BUDGET (continued)

Management Response (continued)

County Administrator's Office Response (continued)

Our research has shown no clear guidance on how to treat such loans for budgeting purposes, nor does there exist a clear pattern of treatment by other counties. Instances have been found where counties have shown loans between County funds as interfund transfers for budgeting purposes, yet the actual amounts were recorded as an advance receivable in the contributing fund and as an advance payable in the recipient fund for the purposes of the financial statements. This treatment allows the budget to present the public with an accounting of the funding to be used to finance expenditures, and would be consistent with the Independent Auditor's statement that interfund loan activity should not be reported as other financing sources or uses in the fund financial statements.

The County is willing to use an account recommended by the Auditor-Controller for the purposes for presenting the transfer of funds as a financing source for budgeting purposes, as long as the treatment recommended by the Auditor-Controller allows the County to continue to meet the requirements of the County Budget Act, which requires that the County submit a balanced budget.

COUNTY OF SUTTER

Management Report Current Year Recommendations For the Year Ended June 30, 2010

ENTERPRISE FUND BUDGET

Criteria

The *County Budget Act* Section 29141 issued by the State of California requires that the adopted budget includes a schedule showing the managerial budget of each service activity financed by a proprietary fund established pursuant to Section 25260 and 25261. The schedule should set forth expected operations of the activity in such detail for revenues, expenses, and reserves as to adequately display the nature and the approximate size of its operations.

Condition

During the audit, we noted that Waterworks District No. 1, an enterprise fund of the County, had not been included in the County's budget.

Cause

Those responsible for preparing the County's budget may not be aware that a budget is required for all enterprise funds.

Effect of Condition

The budget is an important control that should be used by counties to monitor its revenues and expenses. For the past several years, expenses have exceeded revenues in Waterworks District No. 1 and the fund has operated with a negative cash balance. This condition may have been prevented had a budget been prepared for the District. In addition, by not preparing a budget for the District, the County is not in compliance with the *County Budget Act*.

Recommendation

We recommend that the County prepare a budget for Waterworks District No. 1 and include it in its annual adopted budget as required by the *County Budget Act*.

Management Response

Auditor-Controller's Office Response

We agree with the recommendation. Since at least 2004 the Auditor-Controller's office has annually advised the County Administrator's Office and the Board of Supervisor's that state law requires a schedule showing the managerial budget of each service activity financed by a proprietary [enterprise] fund. The CAO engaged a consultant, Smith & Newell, CPAs to review the Robbins Water District financial statements and budget report to provide an opinion in

COUNTY OF SUTTER

Management Report Current Year Recommendations For the Year Ended June 30, 2010

ENTERPRISE FUND BUDGET (continued)

Management Response (continued)

Auditor-Controller's Office Response (continued)

writing as to whether the general fund is obligated to make a contribution to the district. Smith & Newell, CPAs' opinion letter of June 7, 2004 stated "And the use of budgetary accounts in proprietary funds is optional." No specific authority was cited to explain the contradiction with GC 29141. Therefore in the absence of any legal authority to explain the contradiction, we have to conclude that Gallina's opinion and recommendation is correct. Had state law been complied with and a balanced budget been prepared for managerial control, it is more likely that the budget imbalance with Robbins Water would have been corrected years ago.

County Administrator's Office Response

The County agrees with the Independent Auditor's recommendation. The Waterworks District Board of Directors adopted a "managerial budget" for the district on February 1, 2011. The "managerial budget" for FY 2011-12 will be adopted by the District and presented to the Board of Supervisors in conjunction with the adoption of the County Recommended Budget, and will be included in the Adopted Budget.

For the Fiscal Years 2006-07, 2007-08, 2008-09, 2009-10, and 2010-11 the County did not include the annual budget for the District in the County's Adopted Budget document. This decision was based on the opinion of an Independent Auditing firm, which indicated that "the use of budgetary accounts in proprietary funds is optional."

The Board of Directors for Waterworks District No. 1 and the Sutter County Board of Supervisors have been aware that the district has been operating with insufficient revenue to cover on-going maintenance and operations costs, and the County and District have been working diligently to address funding of the District. A review of documents will demonstrate that the County has been actively engaged in attempting to balance on-going revenue with on-going expenses, including an unsuccessful attempt through the Proposition 218 process to raise rates in an amount sufficient to balance the fund. The Auditor-Controller is well aware of the efforts, and the complications created by Proposition 218.

COUNTY OF SUTTER

Management Report
New Accounting Pronouncements
For the Year Ended June 30, 2010

GOVERNMENT ACCOUNTING STANDARDS BOARD STATEMENT NO. 54 ***Fund Balance Reporting and Governmental Fund Type Definitions***

This new accounting standard was issued in March 2009 to accomplish the following reporting objectives:

1. Improve the consistency in reporting fund balance components
2. Enhance fund balance presentation
3. Improve the usefulness of fund balance information
4. Clarify the definitions of the governmental fund types

This standard will impact the County's financial statements beginning in the fiscal year ending June 30, 2011.

The new standard requires disclosure of the County's governmental fund balances using the classifications listed below that reflect the level of constraint placed on future spending of fund balance.

1. *Nonspendable*: resources that cannot be spent because they are not in spendable form or are required to be maintained intact. Examples include imprest cash, inventories, prepaid items, long-term receivables, property held for resale and the corpus or principal of a permanent fund.
2. *Restricted*: resources that are constrained by external parties, by constitutional provisions or by enabling legislation (county ordinances) for a specific purpose. Some examples include unspent grant proceeds, property tax increment held by redevelopment agencies, gas taxes and realignment revenues.
3. *Committed*: resources that are constrained for specific purposes imposed by the County's Board of Supervisors using its highest form of decision making authority that remain binding until removed by the same action. The Board of Supervisors must take action before the end of the fiscal year. An example includes the board resolution to use tobacco settlement revenues to fund non-smoking programs.
4. *Assigned*: resources the County sets aside for a specific purpose. Unlike committed resources, assignments can be established by those outside the Board of Supervisors who have been delegated this authority. Assignments may lapse after a period of time or upon the happening of some event; whereas, commitments remain in effect until the Board reverses the decision by taking the same action that initially established the commitment.
5. *Unassigned*: unconstrained resources.

The statement includes a number of changes to governmental funds definitions. The most significant change impacts special revenue funds. In some cases, the new statement will require governments to discontinue using the special revenue fund type and combine the fund's remaining resources with the County's general fund.

COUNTY OF SUTTER

Management Report New Accounting Pronouncements For the Year Ended June 30, 2010

Special revenue fund reporting is permitted only if all of the following conditions have been met:

1. The fund receives resources that are restricted or committed to expenditures for a specific purpose.
2. Resources that are restricted or committed comprise a substantial portion of the fund's total resources.
3. The nature of the restriction or commitment is not temporary.

Disclosure in the notes to the financial statements about the County's policies for minimum fund balance levels is required.

Potential challenges the County may encounter in implementing the new standard might include:

- The County has a large number of revenue sources funding a diversity of programs managed by department personnel. Documents identifying the nature of constraints are kept by departments. Obtaining this information may prove challenging.
- The general fund has the most levels of constraints. The accounting system may not provide information to separate its beginning balance into the various levels of constraints.
- Restricted or committed revenues should comprise a substantial portion of the inflows of a fund to meet the definition of a special revenue fund. Transferred-in resources alone do not provide the foundation of restricted or committed revenues required for a special revenue fund.

Our recommended approach for implementation of the new standard includes the following steps:

1. Establish fund balance policies.
2. Identify the highest decision-making level of authority.
3. Establish spending priority as to whether higher constrained resources are used first or last when funding of expenditures is available from multiple funding sources having different levels of constraints.
4. Make and document decisions about minimum fund balance policies.
5. Align formal stabilization arrangements with the more restrictive requirements imposed by the statement.
6. Identify the documents used by the County to evidence the level of constraint placed on resources.
7. Reevaluate existing funding balance types using the new definitions in the standard.
8. Using fund balances of governmental funds in the County's 2010 financial statement, determine fund balance categories using the new statement.

COUNTY OF SUTTER

Management Report Status of Prior Year Management Comments For the Year Ended June 30, 2010

<u>Recommendation</u>	<u>Status</u>
<u>Policies and Procedures</u>	
We recommend that the County initiate a serious effort to develop and implement comprehensive policies and procedures for all current financial processes. This is a repeat of a prior year recommendation.	Implemented
<u>Capitalization Policy</u>	
We recommend that the County adopt a comprehensive updated capitalization policy which includes all required capital asset accounting elements including infrastructure and estimated useful asset life. This is a repeat of a prior year recommendation.	In process
<u>Personnel Benefits Trusts</u>	
We recommend that the unresolved differences be resolved and any inactive accounts be closed. This is a repeat of a prior year recommendation.	In process
<u>Monitoring of Departments</u>	
We recommend that the Auditor-Controller Office perform departmental audits on a regular basis.	Implemented
<u>Construction in Progress</u>	
We recommend that the Auditor-Controller's office and the Public Works department develop better lines of communication to ensure that any changes or adjustments to data by one office is communicated to the other.	Implemented
<u>Reporting of Retention Payable</u>	
The County should implement procedures that initiate the calculation and recording of retention payable.	Implemented
<u>Use of Miscellaneous Revenue Accounts</u>	
We recommend that the County consider restricting the use of its miscellaneous revenue account for revenue sources that cannot be categorized under the existing revenue types, including charges for services, fines, intergovernmental revenues, and licenses and permits.	In process

COUNTY OF SUTTER

Management Report
Status of Prior Year Management Comments
For the Year Ended June 30, 2010

Recommendation	Status
<u>Accounts Payable Cutoff</u>	
<p>We recommend the County review each significant invoice that is processed for payment subsequent to year end to determine which period the expenditure was incurred. For those expenditures that the County identified should be accrued, prior to the closing of the books, the County should continue to account for those expenditures as payables. For those expenditures that should be accrued and are identified after the books are closed, we recommend the County maintain a schedule of these items from which a financial statement adjustment could be made.</p>	Implemented