

COUNTY OF SUTTER
MANAGEMENT REPORT
FOR THE YEAR ENDED JUNE 30, 2008

COUNTY OF SUTTER

Management Report
For the Year Ended June 30, 2008

Table of Contents

	<u>Page</u>
Introduction.....	1-2
Required Communications.....	3-6
Comments Pertaining to Officials and Departments – Current Year	7-11
Status of Prior Year Management Comments	12-14



Sutter County Board of Supervisors
Yuba City, California

In planning and performing our audit of the basic financial statements of the County of Sutter (County) as of and for the year ended June 30, 2008, 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 opinions 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.

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 a combination of control deficiencies, that adversely affects the entity'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 the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or a 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 the entity's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. We reported on the County's significant deficiencies or material weaknesses in internal controls within the Schedule of Findings and Questioned Costs of the Single Audit report:

We previously reported on the County's internal control in our report dated June 17, 2009. A separate report dated June 17, 2009, contains our report on the significant deficiencies and material weaknesses in the County's internal control and identified above. This letter does not affect our report dated June 17, 2009, on the financial statements of the County of Sutter.

Sutter County Board of Supervisors
Yuba City, California

However, during our audit we became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions concerning those matters.

This report is intended for the use of management, the Board of Supervisors, management and officials of the 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
June 17, 2009

COUNTY OF SUTTER

Management Report Required Communication For the Year Ended June 30, 2008

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, 2008, and have issued our report thereon dated June 17, 2009. 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 February 12, 2009, 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 February 12, 2009.

COUNTY OF SUTTER

Management Report Required Communication For the Year Ended June 30, 2008

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, 2008. 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:

- Accrual and disclosure of compensated absences: Management's estimate is based on information collected in the County's payroll system using current pay rates and past experience on employee use of compensating time-off. Our audit agreed balances reported in the financial statements to those in the County's payroll system.
- Capital asset lives and depreciation expense: Management's estimate is based on past experience. We scanned depreciation listings for reasonable compliance to this approach.
- 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.

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, 2008

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:

- Record unavailable revenue (deferred revenue) with a corresponding increase to accounts receivable on the fund financial statements.
- Reclassify interfund reimbursements from transfers to expenditures.

Management passed on the following adjustments:

- Reduce cash on hand in agency fund at June 30th to properly account for cash that was not received until the following month.
- Adjust accounts payable and public work expenditures in the Road Fund for work performed in June 2008 and not recorded by the County.
- Adjust retention payable to account for retention amount owed to outside contractors for the Tisdale bridge project at June 30th.
- Adjust total pooled cash to account for the fair value of the County's investments at June 30th.

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.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated June 17, 2009.

COUNTY OF SUTTER

Management Report
Required Communication
For the Year Ended June 30, 2008

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, 2008

POLICIES AND PROCEDURES

Criteria

Good internal control requires that procedures be documented and performed in a consistent manner in accordance with approved County policy.

Condition

We noted that the County does not have an updated written procedures guide for performing many of the current financial processes. Lack of organized written procedures has contributed to significant operating difficulties with the County.

Cause

The County does not have adequate written policies and procedures.

Effect of Condition

Without written procedures, tasks may not be performed in a consistent manner among employees and or departments which can result in significant operating difficulties.

Recommendation

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.

Management Response

Auditor-Controller's Office Response

The Auditor-Controller's Office has an ongoing program to update written policies and procedures. In 2008-09 these included:

- A-87 Cost Plan Procedure
- Capital Asset Procedure
- Encumbrance Procedure
- Journal Entry Procedure
- Year End Expenditures and Revenue Accruals Procedure
- Travel and Business Expense Accounting Form Procedure
- Claims Procedure
- SDI and Worker's Comp Payment Procedures
- Cash Handling Procedures

COUNTY OF SUTTER

Management Report Current Year Recommendations For the Year Ended June 30, 2008

POLICIES AND PROCEDURES (continued)

Management Response (continued)

Auditor-Controller's Office Response (continued)

We will be looking at this as we continue to update our payroll and financial system.

County Administrative Office Response

The County agrees with the Independent Auditor's recommendation. The County initiated a serious effort to develop policies and procedures in 2006. On December 14, 2006, the Board of Supervisors hired Harvey M. Rose Associates, LLC (HMR) to work with the Auditor-Controller to develop and implement comprehensive policies and procedures for all current financial processes. The Board of Supervisors had directed that this be completed in FY 2006-07.

HMR completed Phase I of the work plan by preparing written policies and procedures for internal Auditor-Controller processes and developing measures for monitoring performance. The second phase of the project was designed to prepare written policies and procedures for countywide accounting processes, a project that required the active participation of the Auditor-Controller and his staff. On March 8, 2007, the Assistant Auditor-Controller canceled pending meetings, citing a staffing shortage, and did not reschedule the pending meetings.

HMR presented their final report to the Board of Supervisors on June 12, 2007, stating that:

We were unable to sufficiently progress on the Phase II project, since to do so would have required active cooperation and assistance from the Auditor-Controller and his staff that was not forthcoming. Such cooperation and assistance is particularly important, since only limited countywide accounting policies and procedures exist.

We are therefore recommending that, rather than moving forward with Phase II at this time, the project be postponed to a later date.

To date, the Auditor's Office has not contacted HMR or the County Administrative Office to recommence the project. The Board of Supervisors agrees that the Auditor-Controller should develop comprehensive policies and procedures for current financial processes, but as he is an independent elected official, the Board cannot compel him to complete the project nor discipline him for his failure to do so. On September 30, 2008, in response to a finding by the 2007-08 Grand Jury that "the Grand Jury is incredulous that this condition has taken so long to be addressed by the Auditor-Controller," the Board of Supervisors stated that it "continues to be

COUNTY OF SUTTER

Management Report
Current Year Recommendations
For the Year Ended June 30, 2008

POLICIES AND PROCEDURES (continued)

Management Response (continued)

County Administrative Office Response (continued):

willing to fund the firm of Harvey M. Rose and Associates to assist the Auditor-Controller in writing the manual.”

Finally, it should be noted that the Auditor-Controller’s above-mentioned list of policies developed in FY 2008-09 appears to be inaccurate. Items 1-4 are posted on the Auditor-Controller’s website and were presented to County departments during year-end closing meetings held by the Auditor-Controller’s Office on May 19 and 21, 2009. The Auditor-Controller’s Office did not consult with other County departments in the development of these policies (as recommended by HMR), nor have the policies been submitted to the Board of Supervisors for formal adoption. If Items 5 and 6 exist, they have not yet been shared with any County department. Item 7 as posted on the website is simply a claim form, not a procedure. Item 8 is dated September 20, 2004. It may be adequate, but it was not developed during FY 2008-09. Similarly, Item 9 is dated January 2001. As stated in the previous paragraph, the Board of Supervisors is willing to contract again with HMR to help the Auditor-Controller complete the project.

COUNTY OF SUTTER

Management Report Current Year Recommendations For the Year Ended June 30, 2008

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.

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 Administrator 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 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 OF SUTTER

Management Report
Current Year Recommendations
For the Year Ended June 30, 2008

CAPITALIZATION POLICY (continued)

Management Response (continued)

County Administrative 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, 2008

PAYROLL TRUSTS

Criteria

Good internal control requires reconciliation of all trust funds.

Condition

We noted that the Personnel Benefits Revolving Trust fund (5226), had not been reconciled. The fund had individual account balances ranging from Regular Health (2002-03) with a credit balance of \$467,508 to Regular Health (2000-2001) with a debt balance of \$138,978. We also noted that accounts in the Payroll Revolving Trust fund (5225) had not been reconciled and contained errors at the time of our fieldwork.

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. The Auditor-Controller's Office requested reports to reconcile the Payroll Revolving Trust fund from Information Technology and I.T. failed to provide the reports. The reports were requested several times to no avail. We agree the fund needs to be reconciled and will redouble our efforts to get the IT support we need to do it.

County Administrative 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, 2008

PAYROLL TRUSTS (continued)

Management Response (continued)

County Administrative Office Response (continued)

The County Administrative Office contracted with an independent CPA firm, Tenney and Company, on May 1, 2008, 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 reconciliation. The CPA firm was able to complete only a partial reconciliation of Fund #5226 due to lack of assistance from the Auditor-Controller's Office. The County Administrative Office will present a staff report to the Board of Supervisors in the near future requesting the Board's guidance and direction regarding the next step to take to reconcile the fund.

Although the Auditor-Controller agreed with this same recommendation in FY 1996-97, and two positions have been added to his department since then* to provide him with the technical staff to do so, he still cited lack of staff as a reason for not assisting Tenney and Company.

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.

*An Accountant II was added in FY 2000-01 and an Account Clerk III in FY 2001-02

COUNTY OF SUTTER

Management Report Current Year Recommendations For the Year Ended June 30, 2008

MONITORING OF DEPARTMENTS

Criteria

According to the government code section 26883, “the Board (of Supervisors) shall have the power to require that the County Auditor-Controller shall audit the accounts and records of any department, office, board or institution under its control and of any district whose funds are kept in the County Treasury.”

Condition

Although the Auditor-Controller Office staff does a good job of training departmental personnel on how to accurately record transactions as well as the year-end closing procedures, the Auditor-Controller’s Office does not conduct audits of departments.

Cause

Due to inadequate staffing levels, the Auditor-Controller’s Office does not have the resources to devote to internal audits of departments.

Effect of Condition

By not performing internal audits of departments, the likelihood of a material misstatement due to error or fraud is heightened.

Recommendation

We recommend that the Auditor-Controller Office perform departmental audits on a regular basis. We feel that this would enhance the internal controls that the County already has in place to prevent and detect errors and fraud that are material to the financial statements.

Management Response

Auditor-Controller’s Office Response

The Auditor-Controller’s Office has requested the restoration of the internal auditor position several times since the position was eliminated by the Board of Supervisors and the person was laid off in 1991. This position is requested again in the 2009-2010 budget. We agree that an internal auditor is necessary and agree that this is a material weakness.

COUNTY OF SUTTER

Management Report
Current Year Recommendations
For the Year Ended June 30, 2008

MONITORING OF DEPARTMENTS (continued)

Management Response (continued)

County Administrative Office Response:

County Administrative Office staff has reviewed Auditor-Controller budget requests dating back to FY 1992-93. The Auditor-Controller did not submit any written requests for an Internal Auditor position until the current budget year, FY 2009-10.

Nevertheless, the County agrees with the Independent Auditor's recommendation. Due to the increasing requirements being placed on local governments as a result of the issuance of SAS-112, the County Administrative Office is reviewing procedures for an Internal Auditor to perform the recommended departmental audits on a regular basis.

COUNTY OF SUTTER

Management Report Current Year Recommendations For the Year Ended June 30, 2008

MATCHING REVENUES WITH EXPENDITURES

Criteria

Generally accepted accounting principles require that revenues be matched with expenditures.

Condition

For several of its nonmajor funds, the County records revenues while transferring the associated costs to other funds so that functional costs are not recorded in the fund that earned the revenue.

For example:

- *Criminal Justice & Law Fund*: The County reported \$8.5 million in revenues and \$369 thousand in expenditures with \$8.1 million being reported as transfers to other funds for the year ended June 30, 2008.
- *Local Health & Welfare Fund*: The County reported \$8.7 million in revenues and \$0 in expenditures with \$7.2 million being reported as transfers to other funds for the year ended June 30, 2008.

This accounting approach is reflective of the way these funds are budgeted each year.

Effect of Condition

By not recording the functional expenditures in the same fund as the revenue, the true operating cost of the fund is not reflected on the financial statements.

Recommendation

We recommend that the County record functional expenditures in the same fund that earns the revenue.

Management Response

Auditor-Controller's Office Response

The Auditor-Controller's Office agrees that functional expenditures should be recorded in the same fund that earns the revenue. It is necessary for the Board of Supervisors to budget in accordance with this recommendation to implement it.

COUNTY OF SUTTER

Management Report
Current Year Recommendations
For the Year Ended June 30, 2008

MATCHING REVENUES WITH EXPENDITURES (continued)

Management Response (continued)

County Administrative Office Response

The County Administrative Office agrees with the Independent Auditor's recommendation. We intend to work with the Auditor-Controller's Office to implement the recommendation.

COUNTY OF SUTTER

Status of Prior Year Management Comments For the Year Ended June 30, 2008

<u>Recommendation</u>	<u>Status</u>
<u>Policies and Procedures</u>	
The prior year independent auditors recommended 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.	In process
<u>Fund Balance – County General Reserve</u>	
The prior year independent auditors recommended that the General Reserve be restored back to its original balance of \$1,088,000. This is a repeat of a prior year recommendation.	Implemented
<u>Capitalization Policy</u>	
The prior year independent auditors recommended 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>Payroll Trusts</u>	
The prior year independent auditors recommended that the unresolved differences be resolved and any inactive accounts be closed. This is a repeat of a prior year recommendation.	In process
<u>Budgeting for Changes in Reserves/Designations</u>	
The prior year independent auditors recommended that the County only record provisions for reserves/designations in County Budget Form Schedule 1A. This is a repeat of a prior year recommendation.	Implemented
<u>Fleet Management Unrestricted Net Assets</u>	
The prior year independent auditors recommended that the County analyze this fund and determine whether there are unrecorded reserves/designations for fleet replacement that should be recorded. If there are reserves/designations to be recorded, the entry would be to credit the reserve account within the Fleet Management fund and debit the undesignated retained earnings. If a policy change is to be implemented, it should be	Implemented

COUNTY OF SUTTER

Status of Prior Year Management Comments For the Year Ended June 30, 2008

<u>Recommendation</u>	<u>Status</u>
<u>Fleet Management Unrestricted Net Assets</u> (continued)	
agreed upon between the interested parties and clearly described in a written policy statement. if the new Vehicle Replacement fund 4585 was intended to function as a reserve, fund procedures need to be developed to accomplish that purpose. This is a repeat of a prior year recommendation.	
<u>Flexible Spending Account</u>	
The prior year independent auditors recommended that the County reconcile and record the activity in the flexible spending account. This is a repeat of a prior year recommendation.	Implemented
<u>County Operating Funds</u>	
The prior year independent auditors recommended that County operating funds be numbered in a sequence that is separate from the trust and agency funds and that any funds inappropriately numbered be re-numbered. This is a repeat of a prior year recommendation.	Comment withdrawn
<u>Revenue Recognition</u>	
The prior year independent auditors recommended that this account be analyzed and that the County review their accounting policies and procedures to ensure that all items of revenue are accounted for properly. This is a repeat of a prior year recommendation.	Implemented
<u>Vehicle Replacement Fund</u>	
The prior year independent auditors recommended that the County review fund 4585 to ensure that this fund is being used for the purpose for which it was established. In addition, the prior year independent auditors recommended that the capital assets and accumulated depreciation be transferred to Fleet Management fund 4580. This is a repeat of a prior year recommendation.	Implemented (fund closed and balance transferred to other funds)

COUNTY OF SUTTER

Status of Prior Year Management Comments
For the Year Ended June 30, 2008

<u>Recommendation</u>	<u>Status</u>
<u>Statement on Auditing Standards No. 112</u> The prior year independent auditors recommended that the County take all steps necessary to ensure that staff is in compliance with Statement on Auditing Standards No. 112 requirements.	Implemented
SOCIAL SERVICES	
<u>Adoption Assistance Program – CFDA 93.659</u> The prior year independent auditors recommended that the County require that the AAP-4s be signed by the “Authorized Official of County Welfare Department” (County eligibility staff) and that this person check the appropriate box showing determination of FFP eligibility on the bottom of this form. The prior year independent auditors also recommended that the County incorporate into their review process procedures to ensure that the AAP-4s are properly completed and executed.	Not Implemented (Refer to Single Audit Report Finding 08 SA-1)