

**COUNTY OF HUMBOLDT**

**Management Report  
with Required Communications**

**For the Year Ended June 30, 2010**

**COUNTY OF HUMBOLDT**

Management Report  
For the Year Ended June 30, 2010

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To the Honorable Members of the  
Board of Supervisors of the County of Humboldt  
Eureka, California

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the County of Humboldt (County) for the year ended June 30, 2010. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, *Government Auditing Standards* and OMB Circular A-133, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our engagement letter dated November 8, 2011. Professional standards also require that we communicate to you the following information related to our audit as discussed in the Required Communications section of this report.

In planning and performing our audit of the basic financial statements of the County of Humboldt (County) for the fiscal year ended June 30, 2010, in accordance with auditing standards generally accepted in the United States of America, we considered its internal control over financial reporting as a basis for designing our audit procedures for the purpose of expressing an 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.

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.

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.

Honorable Members of the Board of Supervisors  
County of Humboldt

We previously reported on the County's internal control in our Single Audit report dated December 29, 2011, which contains our report on significant deficiencies and material weaknesses in the County's internal control. This letter does not affect our report dated December 29, 2011, on the basic financial statements of the County of Humboldt.

During our audit we also 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 regarding those matters.

This report is intended for the use of management, the Board of Supervisors, and officials of the federal and state grantor agencies.

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

*Gallina LLP*

Roseville, California  
December 29, 2011

# COUNTY OF HUMBOLDT

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

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

As stated in our engagement letter dated November 8, 2011, 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 and to express opinions based on the assurance obtained. 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. Our audit of the financial statements does not relieve you or management of your responsibilities.

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 U.S. Office of Management and Budget (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 OMB Circular A-133 Compliance Supplement that could have a direct and material effect on each of the County's 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 of Audit**

We performed the audit according to the planned scope and timing previously communicated to you in our engagement letter dated November 8, 2011.

# COUNTY OF HUMBOLDT

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

### **Significant Accounting Policies**

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the County are described in Note 1 to the financial statements. The application of existing policies was not changed during the year. We noted no transactions entered into by the County during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

### **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 are discussed below:

- Management believes receivables are fully collectible based on historical experience. Accordingly, no allowance for doubtful accounts is included in the financial statements.
- Management's estimate of risk liabilities and liabilities related to other postemployment benefits (OPEB) is based on either actuarially-determined projections prepared by outside specialists using experiential data gathered over the last several years.

We evaluated the key factors and assumptions used to develop these estimates in determining that they were reasonable in relation to the financial statements taken as a whole.

### **Difficulties Encountered in Performing the Audit**

We encountered no significant difficulties in dealing with management in performing and completing our audit with the exception of trying to reconcile some of the beginning account balances reported in the previous audit to the County's accounting records. Examples include identifying which trust funds were rolled up into the General Fund, capital assets, and receivables.

## COUNTY OF HUMBOLDT

### 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 adjustments detected as a result of audit procedures were corrected by management:

- Report other postemployment benefits (OPEB) obligation balance (\$2.5 million) at beginning of year not reported in the prior audit.
- Adjust receivables by \$6.5 million for subsequent receipts not properly accrued by County
- Various significant adjustments to correct prior year audited balances, including capital assets (\$2.8 million), interest receivable (\$975 thousand), accrued salaries (\$1.89 million), and capital lease obligations (\$685 thousand)
- Various reclassifications to properly report interfund loans and transfers involving the Headwaters Funds.
- Adjust accrued salaries to properly account for all working days within the accounting period (\$1.05 million).
- Various significant adjustments to proprietary fund capital asset balances and related activity to accounting records.

The County agreed to record all of these adjustments to the June 30, 2010 audit report.

#### **Immaterial Misstatements Not Corrected by Management**

Management passed on the following adjustments:

- Adjustment to total pooled cash to account for the fair value of the County's investments at June 30, 2010.
- Adjustment to interest earnings accounts due to the County posting the 4<sup>th</sup> quarter interest apportionment in the subsequent year.

#### **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 HUMBOLDT

## 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 December 29, 2011.

### **Management Consultations with Other Independent Auditors**

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 governmental unit’s auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

### **Other Supplementary Information Accompanying the Audited Financial Statements**

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or the financial statements themselves.

## COUNTY OF HUMBOLDT

Management Report – New Accounting Standard  
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.

## COUNTY OF HUMBOLDT

### Management Report – New Accounting Standard For the Year Ended June 30, 2010

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.

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.
- The public safety special revenue fund does not appear to receive a substantial portion of its resources from restricted and committed resources. The most significant resource in the public safety special revenue fund is the general fund's annual contribution, a funding source that arises only to the level of assigned.

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 HUMBOLDT

### Management Report – Current Year Comments and Recommendations For the Year Ended June 30, 2010

#### **DISAGGREGATION OF RECEIVABLES**

##### Criteria

Governmental Accounting Standards Board Statement No. 38, *Certain Financial Statement Disclosures*, requires components of significant receivables to be disclosed in the financial statements. Components of receivables include accounts receivable (due from citizens), taxes (property, sales taxes, transient occupancy) receivable, interest receivable, amounts due from other governments and notes receivable.

##### Condition

Currently, the County records accounts receivable, taxes receivable and due from other governments within the same receivable account within its general ledger. The County's chart of accounts does not currently have separate accounts for the various types of receivables.

##### Cause

The County's chart of accounts does not currently have separate accounts for the various types of receivables.

##### Effect of Condition

By not properly classifying receivables in its general ledger, the County is relying on external spreadsheets to ensure receivables are properly disclosed for financial reporting.

##### Recommendation

We recommend the County modify its chart of accounts to include separate accounts for accounts receivable, loans receivable, interfund advances (and payables) and amounts due from other governments. Year-end closing procedures should be modified to capture receivable balances into each of these accounts according to their nature.

##### Management Response

We agree that disaggregation of receivables will aid in accounting for these assets and will establish new accounts and accounting procedures to accomplish that.

## COUNTY OF HUMBOLDT

### Management Report – Current Year Comments and Recommendations For the Year Ended June 30, 2010

#### **GOVERNMENTAL TRUST FUNDS**

##### Criteria

Under Governmental Accounting Standards Board Statement No. 34 (GASB 34), amounts formally held in trust but used to support the County's own programs should be reported as funds within the County's reporting entity so as to ensure all economic resources that can be used by the County are reported in their financial statements. Activity in these accounts is required to be included in the County's reporting entity, either as additional funds or transactions in existing county funds.

Use of the agency fund type is limited to resources the County holds purely in a custodial capacity for individuals or other organizations, such as school districts and special districts not governed by the County Board of Supervisors.

##### Condition

The County is currently maintaining more than 150 governmental trust funds to track activity benefitting the General Fund and other primary operating funds of the County.

##### Cause

Before GASB 34 took effect, the County's current treatment was permitted. Although reporting requirements have changed, the County still has a need to account for these resources separately from other general fund resources.

##### Effect of Condition

By excluding transaction activity in these funds, balances for revenues and expenses in the County's own financial reports (including budgetary reports) are not complete.

There is the potential to double-report revenues when resources are transferred into operating funds. Using multiple funds within the accounting system to control the flow of revenues increases the potential for reporting revenues twice.

As the County does not budget for any activity occurring in these governmental trust funds, any deviations from the adopted budget are not apparent until well after the end of the fiscal year and thus cannot be addressed when they occur.

## COUNTY OF HUMBOLDT

### Management Report – Current Year Comments and Recommendations For the Year Ended June 30, 2010

#### **GOVERNMENTAL TRUST FUNDS** (continued)

##### Recommendation

We recommend the County analyze each of its governmental trust funds to determine if there is a particular need to account for resources separately from the primary operating funds of the County. We further recommend the County implement controls to minimize the double reporting of revenues and expenditures when utilizing these trust funds for controlling the flow of resources.

##### Management Response

Generally accepted accounting principles hold that the ideal number of trust funds a government should have is the smallest number that enables that government to achieve its purposes. The number of trust funds established by the County of Humboldt over the past several decades has proliferated with adverse effect on accounting controls, especially in light of the reduced number of accounting staff overseeing the general ledger in recent years.

We agree that many currently active trust funds should be closed and those funds moved into budgeted accounts in the main County operating trusts. The Auditor-Controller and County Administrative Office will work with departments to identify trust funds that should be closed in order to simplify our account structure.

## COUNTY OF HUMBOLDT

### Management Report – Current Year Comments and Recommendations For the Year Ended June 30, 2010

#### **TAX LOSS RESERVE FUND**

##### Criteria

California Revenue Taxation Code Sections 4703 and 4703.2 requires counties on the teeter plan to establish a tax loss reserve fund maintained at not less than (1) 1 percent of the total of all taxes and assessments levied on the secured roll for the year for participating entities in the county or (2) 25 percent of the total delinquent secured taxes and assessments for participating entities in the county as calculated at the end of the fiscal year. The tax loss reserve fund shall be used exclusively to cover losses that may occur in the amount of tax liens as a result of special sales of tax-defaulted property.

##### Condition

The County was not in compliance with the minimum requirements of the Tax Loss Reserve Fund at June 30, 2010 by approximately \$288 thousand.

##### Cause

The County does not currently have a procedure in place to monitor the minimum cash balance of the tax loss reserve fund.

##### Effect of Condition

The County is not in compliance with the California Revenue Taxation Code Section 4703 and 4703.2.

##### Recommendation

We recommend the County adopt procedures to replenish the tax loss reserve fund when the balance falls below the minimum State requirements.

##### Management Response

We agree that the County has not been in compliance with the Revenue and Taxation Code sections that mandate a minimum balance in the tax loss reserve fund for several years. There are two reasons for this - one is that the Auditor-Controller's office lost the staff accountants who used to monitor this trust due to retirements and downsizing of the department. It is axiomatic that whenever new employees replace retirees, experience and institutional knowledge may be lost. The other reason is that the County has never faced a significant tax loss resulting from auctions of tax-defaulted properties. Thus the issue never became one of urgency but more of pro-forma compliance.

**TAX LOSS RESERVE FUND** (continued)

## COUNTY OF HUMBOLDT

### Management Report – Current Year Comments and Recommendations For the Year Ended June 30, 2010

#### Management Response (continued)

We agree that these legal requirements must be followed even if tax losses do not occur, and balances exist in the tax auction proceeds fund to accomplish this. As current staff has grown in experience we have discovered that this is a necessary task and will add it to our year-end closing procedures. These funds will be transferred annually to meet each year's calculated minimum reserve.

## COUNTY OF HUMBOLDT

### Management Report – Current Year Comments and Recommendations For the Year Ended June 30, 2010

#### **USE OF MISCELLANEOUS REVENUE ACCOUNT**

##### Criteria

The miscellaneous revenue account 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 use of the miscellaneous revenue account (i.e., account 808000) includes various types of revenue, including intergovernmental revenues and revenue generated from charges for services. During the audit, we noted that the miscellaneous revenue accounts aggregated for County funds were in excess of \$5 million.

##### 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.

##### Management Response

The generic revenue object, 808000, is primarily used in fiduciary or agency funds where the name of the fund identifies the revenue stream. For the most part these funds are used to channel a single type of revenue; so further identification of the revenue isn't necessary for staff familiar with that particular program. Using more descriptive revenue objects would however help auditors and others who are less familiar with these programs, so we see the value of creating more revenue objects to convey more specific information about these revenue streams. We will work with the departments and administration to assign more descriptive revenue objects to our various programs.

# COUNTY OF HUMBOLDT

## Management Report – Current Year Comments and Recommendations For the Year Ended June 30, 2010

### **EXPAND CHART OF ACCOUNTS IN CERTAIN FUNDS**

#### Criteria

The County's chart of accounts should be detailed enough as to provide adequate management information.

#### Condition

During our review of the County's debt service fund, we noted that the County recorded its annual net change in the cash with fiscal agent account balance to a single expenditure account.

#### Cause

The County relies on various spreadsheets to track certain accounts at a more detailed level. For example, the County maintains a spreadsheet to track the activity of the debt service fund, including interest earnings and debt service payments.

#### Effect of Condition

In some cases, the chart of accounts is too general to provide the information needed for management to make decisions or for the County to prepare its annual State Controller's report and annual financial statements without having to rely on spreadsheets and other records external to the general ledger.

#### Recommendation

We recommend the County expand its chart of accounts in certain funds where applicable to be used for significant accounts, such major sources of revenues and expenditures. In the debt service fund, for example, the County should report the change in the cash with fiscal agent account as adjustments to debt service principal and interest expenditures and interest earnings rather than as a net change to trust fund expenditures.

#### Management Response

As noted in our previous response, we do have room in our chart of accounts for more descriptive account objects. Especially in dealing with debt service, accounts for principal and interest should be clearly identified and we will make that change.