# COUNTY OF SUTTER

## Management Report
## with Required Communication

## FOR THE YEAR ENDED JUNE 30, 2015

GALLINA LLP
CERTIFIED PUBLIC ACCOUNTANTS

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**COUNTY OF SUTTER**

Management Report
For the Year Ended June 30, 2015

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GALLINA LLP
CERTIFIED PUBLIC ACCOUNTANTS

The Honorable Board of Supervisors and Grand Jury
County of Sutter
Yuba City, California

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, 2015. 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 January 8, 2016. 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 financial statements of the County of Sutter for the year ended June 30, 2015, 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.

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.

We previously reported on the County's internal control in our Single Audit report dated March 31, 2016, which contains our report on significant deficiencies and material weaknesses in the County's internal control. This letter does not affect our report dated March 31, 2016, on the basic financial statements of the County of Sutter.

During our audit we also became aware of 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, the Grand Jury 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
[DATE]



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**COUNTY OF SUTTER**

Management Report
Required Communications
For the Year Ended June 30, 2015

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

As communicated in our engagement letter dated January 8, 2016, our responsibility, as described by professional standards, is to form and express opinions about whether the financial statements that have been prepared by management with your oversight are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your respective responsibilities.

Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. Accordingly, as part of our audit, we considered the internal control of the County of Sutter solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

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.

We are also responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.

### Planned Scope and Timing of the Audit

We conducted our audit consistent with the planned scope and timing we previously communicated to you.

### Compliance with All Ethics Requirements Regarding Independence

The engagement team, others in our firm, and as appropriate, our firm, and our network firms have complied with all relevant ethical requirements regarding independence.

### Qualitative Aspects of the Entity's Significant Accounting Practices

*Significant Accounting Policies*

Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the County of Sutter is included in Note 1 to the financial statements.

As described in the Note 1 to the financial statements, the County adopted new accounting guidance, GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68*, during the fiscal year 2015.

No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas 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 current judgments. Those judgments are normally based on 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 markedly from management's current judgments.

The most sensitive accounting estimates affecting the financial statements are:

- Management's estimate of the allowance for uncollectible accounts is based on past experience and subsequent collections.
- Management's estimate of the claims liabilities is based on actuarial valuation reports obtained from experts.
- Management's estimate of the other post-employment benefits (OPEB) liability is based on actuarial valuation reports obtained from experts.
- Management's estimate of the net pension liability and related deferred inflows/outflows is based on actuarial valuation reports obtained from GovInvest.

We evaluated the key factors and assumptions used to develop the estimates described above and determined that they are reasonable in relation to the basic financial statements taken as a whole and in relation to the applicable opinion units.

**Significant Difficulties Encountered during the Audit**

We encountered no significant difficulties in dealing with management relating to the performance of the audit.

**Uncorrected and Corrected Misstatements**

For purposes of this communication, professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that we believe are trivial, and communicate them to the appropriate level of management. Further, professional standards require us to also communicate the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole and each applicable opinion unit. No material misstatements were noted as a result of our audit.

**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, which could be significant to the County of Sutter's financial statements or the auditor's report. No such disagreements arose during the course of the audit.

### Representations Requested from Management

We have requested certain written representations from management, which are included in the management representation letters dated March 31, 2016.

### Management's Consultations with Other Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters. Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

### Other Significant Matters, Findings, or Issues

In the normal course of our professional association with the County of Sutter, we generally discuss a variety of matters, including the application of accounting principles and auditing standards, operating and regulatory conditions affecting the entity, and operational plans and strategies that may affect the risks of material misstatement. None of the matters discussed resulted in a condition to our retention as the County of Sutter's auditors.

This report is intended solely for the information and use of the Board of Supervisors, and management of the County of Sutter and is not intended to be and should not be used by anyone other than these specified parties.

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## Miscoding of Interfund Transfers

Criteria

According to the Statements of the National Council on Governmental Accounting (NCGAS) 1 — Governmental Accounting and Financial Reporting Principles, issued by the Governmental Accounting Standards Board (GASB), paragraphs 100-106, the following interfund transactions (excluding receivables and payables) should be reported in the financial statements as follows:

(1) *Quasi-External Transactions*. Transactions that would be treated as revenues, expenditures, or expenses if they involved organizations external to the governmental unit should be accounted for as revenues, expenditures, or expenses in the funds involved.

(2) *Reimbursements*. Transactions which constitute reimbursements of a fund for expenditures or expenses initially made from it which are properly applicable to another fund should be recorded as expenditures or expenses (as appropriate) in the reimbursing fund and as reductions of the expenditure, or expense in the fund that is reimbursed.

(3) *Operating Transfers.* Flows of assets between funds without equivalent flows of assets in return and without a requirement for repayment, such as legally authorized transfers from a fund receiving revenue to the fund through which the resources are to be expended, transfers of tax revenues from a Special Revenue Fund to a Debt Service Fund, transfers from the General Fund to a Special Revenue or Capital Projects Fund, operating subsidy transfers from the General or a Special Revenue Fund to an Enterprise Fund, and transfers from an Enterprise Fund other than payments in lieu of taxes to finance General Fund expenditures. Operating transfers should be in the "Other Financing Sources (Uses)" section of the financial statements

Condition

While reviewing the transfers schedule that was provided by the County, we noted that in several instances, the County used the same account to record two or more types of interfund transactions. For example, accounts 53619 and 53623 included operating transfers, reimbursements, and quasi-external transactions.

Cause

The individual(s) who recorded the interfund transactions were not aware of the GASB reporting requirements.

Effect of Condition

By not properly recording interfund transactions, revenues, expenditures, and transfers, may be misstated.

Recommendation

We recommend the County use separate accounts to record the quasi-external transactions, reimbursements, and operating transfers.

Management's Response

The auditor-controller's office agrees with the finding. Interfund transfers are generally recorded in the accounting books and records pursuant to the approved budget. The chart of accounts will easily accommodate these separate accounts to properly budget and record quasi-external transactions, reimbursements, and operating transfers. We recommend that the County administrator's office work with the auditor-controller's office to ensure interfund transfers are properly identified, budgeted, and recorded in the accounting records.

## Information Technology Internal Controls

Criteria

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) identifies five essential components of internal control including the “Control Environment” and “Information and Communication.” Of these two, subset principles indicate that “Management, with Board oversight, establishes structure, authority and responsibility” and “Communicates internally” the roles and responsibilities for initiating, authorizing, recording, processing, and reporting transactions.

Condition

During the FY 2014 audit, an IT matter relevant to financial reporting came to our attention. An IT person in the Department of General Services allegedly made a recent unauthorized change to a journal entry in the County’s financial accounting system resulting in a negative account balance.

Cause

It does not appear that sufficient safeguards exist to control changes to the accounting system, used by the Auditor Controller’s Office and other County Departments, by IT staff such as passwords, access permissions, logs of changes made, and documented authorization protocol. Nor does it appear that the IT personnel’s roles and responsibilities related to the financial accounting internal control process have been defined.

Effect of Condition

Unauthorized changes to the accounting system and records can result in misstatements due to fraud and error in the account balances reported.

Recommendation

We recommend the County assess, possibly with the use of IT consultants, the IT controls and environment at the General Services Department, IT Division. Based on such an assessment, the County’s administration could consider making informed decisions related to the IT Internal Controls.

Management’s Response

1. Management agrees that access permissions, logs of changes made and documented authorization protocols are necessary safeguards to secure any County system, including the financial system. Many of these safeguards are already in place.
2. Management agrees with the recommendation to assess the controls, roles, and responsibilities related to the financial accounting internal controls. Steps will be taken to begin this assessment process.

## Miscoding of Interfund Transfers

Recommendation

We recommend the County use separate accounts to record the quasi-external transactions, reimbursements, and operating transfers.

Status

Not implemented

## Information Technology Internal Controls

Recommendation

We recommend the County assess, possibly with the use of IT consultants, the IT controls and environment at the General Services Department, IT Division. Based on such an assessment, the County's administration could consider making informed decisions related to the IT Internal Controls.

Status

Not implemented

## Completeness of Construction in Progress (CIP) and Classification of Capital Assets

Recommendation

We recommend that the Roads Department assign accounting or fiscal personnel to track construction progress regularly and implement an annual reconciliation process to the County's accounting books and records. In addition, we advise that the Auditor-Controller's Office and the Road Department review all projects being tracked in CAMS at year-end to identify which projects qualify as capital assets. To reduce unidentified costs, we suggest that Road Department managers be required to capture their rates and hours by project.

Status

Implemented