COUNTY OF MARIN

Management Report
with Required Communication

For the Year Ended June 30, 2012

GALLINA LLP
CERTIFIED PUBLIC ACCOUNTANTS

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Management Report
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GALLINA LLP
CERTIFIED PUBLIC ACCOUNTANTS

To the Honorable Members of the
Board of Supervisors of the County of Marin
San Rafael, California

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the County of Marin (County) for the year ended June 30, 2012. 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 May 3, 2012. 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 for the fiscal year ended June 30, 2012, 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.

We previously reported on the County's internal control in our Single Audit report dated February 22, 2013. This letter does not affect our report dated February 22, 2013, on the basic financial statements of the County of Marin.

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, 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
February 22, 2013

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The Auditor's Responsibility under U.S. Generally Accepted Auditing Standards and OMB Circular A-133

As stated in our engagement letter dated May 3, 2012, 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 May 3, 2012.

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, 2012. We noted no transactions entered into by the County during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

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:

- *Claims liability*: Management's estimate is derived from actuarial valuations obtained from experts. We compared the claims liability reported in the financial statements to those reported in actuarial reports prepared and issued during the year being audited.
- *Liability for other post-employment benefits (OPEB)*: Management's estimate is derived from actuarial valuations obtained from experts. We compared the liability reported in the financial statements to the actuarial report prepared and issued for the year under audit.

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.

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. No material misstatements were noted as a result of our audit.

However, there was the following immaterial misstatement identified during the audit. Management has determined that its effect is immaterial, both individually and in the aggregate, to the financial statements taken as a whole:

- Record an increase to cash and investments in the amount of $206 thousand which represents the difference between fair market value and the amortized cost of investments reflected on the County's financial statements.

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 February 22, 2013.

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

Extraordinary Item – Redevelopment Agency Dissolution

As a result of the California Supreme Court's December 29, 2011 ruling on Assembly Bill 1X 26, the Redevelopment Agency of the County of Marin (RDA) was dissolved effective February 1, 2012. The final seven months of the activity of the RDA are reported in the governmental funds of the County. In compliance with the *Accounting and Financial Reporting for Dissolution of California Redevelopment Agencies* White Paper issued by the California Committee on Municipal Accounting, the assets and liabilities of the former RDA were transferred to a private-purpose trust fund as of February 1, 2012. The transfer was reported as an extraordinary gain or loss, as appropriate, in the financial statements.

Issues Discussed Prior to Retention of Independent Auditors

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.

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.

USE OF MISCELLANEOUS REVENUE ACCOUNTS

Criteria

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

Condition

We noted that the miscellaneous revenue account in the RDA Low-Income Housing fund included $320 thousand in impact fees that should have been recorded as licenses and permits. In addition, in the General Fund's miscellaneous revenue account, various amounts totaling $415 thousand should have been recorded as charges for services.

Cause

The $320 thousand in impact fees was misclassified due to incorrect coding of the trial balance used to prepare the draft financial statements. The General Fund misclassification of $495 thousand was a result of initial coding by various departments upon receipt of funds for various charges for services. Department staff with initial responsibility for classifying cash receipts may tend to use the miscellaneous revenue account if they lack adequate guidance to ensure proper classification.

Effect of Condition

Reports that include misclassifications cannot be relied upon to present an accurate accounting of the revenue sources for a fund. Proper classification is essential for information 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. A periodic review of the miscellaneous revenue accounts may help to identify and correct misclassifications.

Management Response

To address the condition noted for impact fees that should have been recorded as licenses and permits, the County will perform an extensive review of its chart of accounts, particularly those revenue accounts that are coded to Miscellaneous Revenues for financial reporting purposes, for overall reasonableness based on the nature of the revenue stream to ensure proper classification and presentation.

To address the condition noted for incorrect coding by various departments to miscellaneous revenues, the Department of Finance will transition its year-end miscellaneous classification review from the Department's Accounting Division to the Internal Audit Division. In addition, the Internal Audit Division will perform the miscellaneous revenue throughout the fiscal year, as opposed to at fiscal year-end. Furthermore, as part of the Department of Finance's overall performance plan goals, the Department will implement a training program for County Departments that will provide thorough guidance and instruction to end users on the proper use of the County's miscellaneous revenue account.

RECONCILING BEGINNING EQUITY

Criteria

A fund's beginning equity should agree to the ending equity of the prior year. Ending equity or fund balance represents the difference between a fund's assets and liabilities. Journal entries posted during the fiscal year should not include postings to equity, with the exception of reclassifications made between individual fund balance accounts.

Condition

We identified several funds where beginning equity for the current year did not agree to the prior year's ending equity in the trial balances provided to us by the County.

Cause

The reason for the beginning equity differences was due to the County posting entries directly to fund balance or the County not recording prior year audit adjustments.

Effect of Condition

Differences in beginning equity require additional review which results in delays in the preparation of the financial statements.

Recommendation

We recommend that the County reconcile beginning equity to the prior year ending equity prior to the closing of the books each year. Direct postings to fund balance should be kept to a minimum and should reflect error corrections and adjustments relating to the implementation of new standards. To facilitate the reconciliation process we also encourage the County to post all audit adjustments to its financial reporting system.

Management Response

The County does reconcile its current year beginning equity balance to the prior year ending equity balance prior to closing the books each year. However, there are a few blended component units who perform their own independent audits, whose report issuance timing is subsequent to the County's trial balance close. For these cases, we make post-close adjustments to our trial balance in order to mitigate the risk of material variances between our audited financial statements and those of our component units. The issue noted above was merely a timing difference between our trial balance subject to audit and the issuance of our component unit's audited financial statements.

RECORDING OF DEBT ISSUANCE

Criteria

Generally accepted accounting principles (GAAP) requires that debt proceeds in a governmental fund be recorded as an increase in long-term liabilities on the government-wide statement of net assets and be included in the long-term liabilities schedule.

Condition

The County entered into a loan agreement with the California Energy Commission for $1 million during the year and properly recorded the proceeds as an other financing source on its general ledger. However, the new debt was not reported on the long-term liabilities schedule nor was it included on the amortization schedule.

Cause

The County does not have a process in place to ensure all long-term liabilities are properly identified and reported.

Effect of Condition

The omission of a long-term liability from the County's financial statements results in financial statements that are misstated.

Recommendation

We recommend that all debt transactions be carefully reviewed to ensure that all related footnote disclosures are included and that long term obligations are properly reported on the County's financial statements.

Management Response

For the FY 2011-12 financial statement audit, the County engaged GALLINA, LLP to compile its financial statements. As a result, the County did not have a comprehensive set of draft financials until after audit fieldwork, whereby Management discovered a $1M loan had erroneously been omitted from its long-term debt schedule. Upon discovery, Management promptly updated its schedules and corresponding footnote disclosures accordingly. The comment noted above is merely due to timing differences between audit fieldwork and compilation of the financial statements.

OTHER POSTEMPLOYMENT BENEFITS (OPEB)

Criteria

Governmental Accounting Standards Board Statement No. 45 *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (GASB 45) requires that OPEB plans have an actuarial valuation performed at least biennially with the calculated OPEB costs and obligations being recognized in the financial statements. The actuarial report lists out various estimated cost components and assumptions to calculate the overall liability. One of the estimated cost components is the implicit rate subsidy.

Condition

During the audit, we noted the County had not considered the estimated implied subsidy payments in its calculation of the OPEB liability as of June 30, 2012. The calculation in the actuarial valuation included an estimate for the implicit rate subsidy of $957 thousand.

Cause

The error in the estimated OPEB liability was most likely caused by the County not having procedures in place to perform a thorough review of the actuarial report estimates and the amount reported on the financial statements at year-end.

Effect of Condition

An adjustment was recorded at year-end to decrease the OPEB liability by $1.8 million, which included a prior period adjustment of $848 thousand.

Recommendation

We recommend that procedures be established to ensure that the OPEB valuation report be reviewed adequately to ensure that the OPEB liability as calculated by the County includes all required cost components, including the implicit rate subsidy, if applicable.

Management Response

The County will establish and implement procedures to ensure that the OPEB valuation report is reviewed adequately to ensure that the calculated OPEB liability includes all required cost components, including the implicit rate subsidy, if applicable.