



Midpeninsula Regional  
Open Space District

R-14-110  
Meeting 14-23  
August 28, 2014

## **AGENDA ITEM 5**

### **AGENDA ITEM**

Response to the 2013-14 Management Letter from the Auditor

### **DISTRICT CONTROLLER'S RECOMMENDATION**

Accept the response to the Management Letter from the District Auditor, Chavan & Associates, received July 30, 2014.

### **SUMMARY**

The Management Letter from the Auditor has been received for the completed audit of Fiscal Year 2013-14. Although the Auditor did not identify any material deficiencies, six areas have been identified with recommended changes to strengthen the District's internal controls, which the District intends to adopt, as further described in this report.

### **DISCUSSION**

On February 12, 2014, the Board approved the appointment of Chavan & Associates (Chavan) as the Auditor for the Midpeninsula Regional Open Space District (District) to complete the Fiscal Year (FY) 2013-14 audit. Chavan completed its audit of the District's FY2013-14 financial statements in June, published the audited financial statements with a clean opinion on July 1, and submitted the final version of its Management Letter on July 30, 2014 (see attachment). As stated in the third paragraph of the letter, Chavan did not identify any deficiencies in District internal controls that they consider to be a material weakness. However, Chavan has identified six areas for which they recommend changes that could strengthen the District's internal controls. Several of these items were already planned for 2015 and Chavan's detailed recommendations are very helpful in implementing the accounting improvements needed to accommodate the future Measure AA bonds, comply with GASB requirements, and make financial operations more efficient. The District is pleased that Chavan took the time to prepare a thoughtful and comprehensive management letter, which is the first the District has received from its auditors in many years. The District plans to adopt all six of the recommendations.

Listed below, for each of the six recommendations, is a summary of the Auditor's suggestions and the District response and plan for implementation.

1. General Ledger and Fund Accounting. Chavan recommends that the District establish five accounting funds in its general ledger. Staff agrees and plans to implement this recommendation over the remainder of the fiscal year such that implementation is complete

in time for the next year's audit. Since inception, the District has accounted for its finances in one General Fund, similar to a small business. At the end of each fiscal year, the external auditors reconfigure the numbers into the variety of fund statements shown in our official annual financial statements needed to satisfy GASB reporting requirements. There are currently only two funds within our accounting system — the General Fund and the Hawthorn Fund. Fixed assets are accounted for in the General Fund and detailed on a spreadsheet, a growing headache for accounting. The advantage of this legacy approach was its simplicity for financial planning, clarity, and focus on total consolidated revenue, expenses, capital expenditures, debt service, and cash. A good contrast can be seen by comparison to the comprehensive and very complicated financial statements of the East Bay Regional Park District. Chavan recommends that it is now time for the District to establish the foundation needed to account for future general obligation bonds and become able to generate GASB-compliant financial statements on an interim basis, while increasing the efficiency of the accounting staff. The District's New World System accounting software is designed to operate exactly as Chavan recommends. New World's consultant has already trained District staff to implement the auditor's recommendation to establish the five suggested funds. Once the funds are established in the system and spreadsheet asset data is transferred, depreciation and other entries will be automatically calculated by the accounting software. The Hawthorn Fund will continue as a separate sub-fund within the General Fund.

2. Project Accounting. Chavan recommends that the District eliminate the excessive use of one-off project numbers to segregate costs by effectively utilizing the project codes built into the New World System software and modify the District's chart of accounts to accommodate more object codes. Staff agrees and is in the process of implementation. Henceforth, all project numbers will be authorized by Accounting and will be assigned in logical groups by fund, source of funding (e.g. Measure AA bond, grant, general fund, etc.), function, department, project name, and general ledger account code. Roll-ups (e.g. by Top 25 projects) will be relatively easy and automatic.
3. Grant Billing and Reconciliation. Chavan recommends that Accounting prepare, following completion of all federal or state-funded grant projects, a reconciliation of grant awards, expenditures, claims and cash receipts. Staff agrees and will implement this for all future federal and state grants.
4. New Employee Checklists. Chavan recommends that the new employee checklist, completed for all new employees, be kept in the employee's file. The auditors suggested this when they interviewed Human Resources staff. This recommendation was accepted and implemented immediately by Human Resources.
5. Fund Balance Policy. Chavan recommends that the District adopt a fund balance policy that meets the requirements of GASB 54. Staff agrees. Presentation of a proposal for a more detailed reserve policy was already on the agenda for the mid-year financial review. A proposal, aligned with the auditor recommendation, will be presented at the Action Plan and Budget Committee (ABC) meeting on November 18. It is currently anticipated that the proposal will include Restricted funds for Hawthorn and OPEB, Committed Funds for (non-Measure AA-funded) infrastructure, emergency (fire, earthquake and flood) response, and equipment replacement, and minimum balance requirements for the General Fund for working capital liquidity and land acquisitions prior to general obligation bond reimbursement. The proposal will include the purpose of each fund, authority for

establishment and change, amount of each fund, trigger for usage, procedure for replenishment, and frequency of review. The objective is for the Board to adopt the new policy in December or January.

6. Grant Documentation and Organization. In completing the Single Audit of the federally-funded Mount Umunhum Project, Chavan found that the Project financial files contained too much documentation and it was unnecessarily difficult to conform the general ledger numbers to the source documents. Upon review, Chaven confirmed that the District was fully in compliance with federal regulations. However, Chaven recommends that Accounting establish a simple standard procedure for documenting grant claims and reimbursements. Staff agrees and will establish such a procedure.

**FISCAL IMPACT**

No additional fiscal impact is anticipated. The Auditor’s recommendations can be implemented by the District within the current annual budget for FY2014-15.

**BOARD COMMITTEE REVIEW**

Acceptance of the Management Letter does not require committee review, however certain recommendations, particularly the Fund Balance Policy, will be brought before the Action Plan and Budget Committee for consideration prior to implementation.

**PUBLIC NOTICE**

Notice was provided pursuant to the Brown Act. No additional notice is necessary.

**CEQA COMPLIANCE**

No compliance is required as this action is not a project under CEQA.

**NEXT STEPS**

Following Board acceptance of this report and the proposed response, staff will proceed with implementing the recommendations as described above.

Attachment:

1. Management Letter from Chavan & Associates

Prepared by:

Michael Foster, Controller  
Andrew Taylor, Accountant

Contact persons:

Michael Foster, Controller  
Andrew Taylor, Accountant



Midpeninsula Regional Open Space District  
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In planning and performing our audit of the basic financial statements of Midpeninsula Regional Open Space District as of and for the year ended March 31, 2014, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered Midpeninsula Regional Open Space District'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 District's internal control. Accordingly, we do not express an opinion on the effectiveness of Midpeninsula Regional Open Space District's internal control over financial reporting.

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 a 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 was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations, during our audit **we did not** identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

As a result of the procedures performed during our audit, we identified the following areas that could strengthen internal controls:

1. General Ledger and Fund Accounting

As discussed with management during the audit, the District would benefit from a reorganization of the number and type of funds in its general ledger. This will establish the foundation needed to account for future bond issuances, reduce the risk of reporting errors and improve transparency.

We recommend that the District include the following funds:

- **General Fund** – The purpose of this fund is to handle the day to day operations of the District. No capital assets or long-term debt should be reported in this fund. Currently the District accounts for the restricted cash and activity from the Hawthorne property in a separate fund that is included in the general fund for reporting purposes. We recommend that the District continue this practice.
- **Capital Projects Fund(s)** – The District can have one or multiple capital projects funds in its general ledger. However, we recommend that the District present one capital projects fund in its audited financial statements. The purpose of the capital projects fund is to account for resources used to purchase and construct capital related items. Typically a local government would report revenues from bond issuances and expenditures on construction projects in a



capital projects fund. Note that cash restricted for debt service requirements in a bond issuance should be reported as revenue and cash in a debt service fund and not in a capital projects fund.

- **Debt Service Fund(s)** – The District can have one or multiple debt service funds in its general ledger. However, we recommend that the District present one debt service fund in its audited financial statements. The purpose of a debt service fund is to account for the restricted cash required to be set-aside from bond issuances, the property taxes collected to pay future debt service requirements, and the actual payment of future debt service requirements. The balance sheet will generally include cash with fiscal agent for both the reserve requirement and the balance of any collections over payments made during the year.
- **General Fixed Assets Fund** – The purpose of this fund is to account for all property, plant, equipment (Capital Assets) and related depreciation owned and maintained by the District. The District should remove all Capital Asset balances from its general fund. The general fixed assets fund is not a true fund for accounting purposes and a separate fund for the fixed assets will not be presented in the audited financial statements. However, having this fund in the general ledger will provide more accountability, improved reporting and allow the District to convert from the governmental fund financial statements to the government-wide financial statements more efficiently. As an alternative, the District may be able to utilize a fixed assets module within its current general ledger software that accomplishes the same goals.
- **General Long-Term Debt Fund** – The purpose of the general long-term debt fund is to account for all of the District’s long-term debt. The items to include in this fund would be promissory notes, revenue bonds, general obligation bonds, compensated absences, net OPEB assets/liabilities, deferred losses on early retirement of debt, premiums on the issuance of debt, discounts on the issuance of debt and any other items that have the potential to be debt and long-term in nature. Note that the net OPEB asset should be included in the GLTDF because it can be an asset or liability depending on how it is funded. The GLTDF is not a legal fund and does not require a board resolution. This fund would be for internal use only and improve the accountability of the District’s long-term debt. The District would use this fund to convert from the governmental fund to the government-wide financial statements.

## 2. Project Accounting

During the audit, we discussed the benefits of tracking expenditures for capital projects by project and resource. In conjunction with our recommendation to expand the use of funds in the District’s general ledger, the District is in the process of restructuring its chart of accounts to improve the accountability over spending of bond proceeds. It appears that the District will accomplish this by utilizing the modules within the District’s current software and by modifying the District’s current chart of accounts. An example of a typical chart of accounts for local governments with multiple resources and projects is Fund-Resource-Function-Department-Project-Object (000-0000-0000-000-0000-0000).

## 3. Grant Billing and Reconciliation

In order to improve the control over grant billings, related receivables and allowable grant expenditures, we recommend that the District have staff in Administrative Services prepare a reconciliation of grant awards, expenditures, claims and receipts by grant. The name of the grant,



grant number, CFDA number (if federal), award date and end date should be included in the master reconciliation. This only applies if the District continues to receive federal and state grants.

#### 4. New Employee Checklists

The District has a procedure where a new employee checklist is completed for all new employees. However, the checklist is not kept in the employee's file. In order to ensure compliance with federal and state requirements, we recommend that the District maintain a copy of the new hire checklist in each new employee's file going forward. This document provides a clear audit trail and reduces the risk of error.

#### 5. Fund Balance Policy

As discussed with management during the audit, we recommend that the District pass a resolution adopting a fund balance policy as required by GASB 54. The policy should identify the required components of fund balance and the level of management authorized to approve balances in each component. The following summarizes the categories of fund balance:

- **Nonspendable** fund balance includes amounts that cannot be spent either because it is not in spendable form or because of legal or contractual constraints. For example, prepaid insurance.
- **Restricted** fund balance includes amounts that are constrained for specific purposes which are externally imposed by providers, such as creditors or amounts constrained due to constitutional provisions or enabling legislation.
- **Committed** fund balance includes amounts that are constrained for specific purposes that are internally imposed by the government through formal action of the highest level of decision making authority and does not lapse at year-end. Committed fund balances are imposed by the District's board of directors.
- **Assigned** fund balance includes amounts that are intended to be used for specific purposes that are neither considered restricted or committed. Fund balance may be assigned by the General Manager or other management as deemed appropriate by the board and identified in the District's policy.
- **Unassigned** fund balance includes positive amounts within the general fund which have not been classified within the above mentioned categories and negative fund balances in other governmental funds.

The District can label amounts within each fund balance type as needed. For example, assigned fund balance can include reserves for contingencies.

#### 6. Grant Documentation and Organization

We recommend that each grant reimbursement claim include support only for the specific claim made and that each claim be printed and directly supported by invoices and general ledger reports



**Chavan & Associates, LLP**  
Certified Public Accountants

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in chronological order behind that claim in the file. Only support for expenditures actually included in the reimbursement claim should be included in the file and directly behind the claim document. We also recommend that the District include a reconciliation in the file directly behind the claim for any differences from a general ledger report and a reimbursement request.

The purpose of this communication, which is an integral part of our audit, is to describe, for management and those charged with governance, the scope of our testing of internal control and the results of that testing. Accordingly, this communication is not intended to be and should not be used for any other purpose.

*C & A LLP*

San Jose, CA  
July 3, 2014