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LANE COUNTY
Eugene, Oregon

AUDITOR'S REPORT TO THE BOARD OF COMMISSIONERS AND MANAGEMENT

For the Year Ended June 30, 2003

JONES&ROTH
CPAs and Business Consultants

LANE COUNTY
Eugene, Oregon

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For the Year Ended June 30, 2003

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For the Year Ended June 30, 2003

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JONES & ROTH
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To the Board of County Commissioners and Management
Lane County, Oregon
Eugene, Oregon

In planning and performing our audit of the financial statements of Lane County for the year ended June 30, 2003, we considered the County's internal control structure to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control structure.

However, during our audit we became aware of several matters that are opportunities for strengthening internal controls or operating efficiency. The memorandum that accompanies this letter summarizes our comments and recommendations. This letter does not affect our report dated December 11, 2003 on the financial statements of Lane County.

We will review the status of these comments during our next audit engagement. We have already discussed many of these comments and recommendations with County personnel and we would be pleased to discuss them in further detail, to perform any additional study of these matters, or to assist you in implementation.

Jones & Roth, P.C.

JONES & ROTH, P.C.

January 8, 2004

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AUDITOR'S REPORT TO THE
BOARD OF COMMISSIONERS AND MANAGEMENT
For the Year Ended June 30, 2003

Introduction

The prior year management letter included recommendations to improve internal and external financial reporting and to improve audit efficiency and timeliness. Implementation of these recommendations is important for several reasons:

- Responsible fiscal management requires accurate and timely financial information. Otherwise, critical decisions may be based on incorrect or incomplete information.
- External financial reporting is a requirement of Oregon law and the results affect the County's reputation with taxpayers and the business community.
- Bonding agencies rely on financial statement information to develop their bond ratings. These agencies also give more credibility to governmental entities that publish a Comprehensive Annual Financial Report (CAFR). A CAFR provides assurance that the financial statements are appropriately prepared and the information is consistent with information provided by other comparable governments. This directly translates to a better bond rating for the County, which results in significant savings in financing costs to Lane County taxpayers. This is of special concern because a recent interim review by one of the bond rating agencies indicated they were concerned about an apparent deterioration in the County's fiscal situation and a downgrading of the County's rating was likely.
- The financial statements are the responsibility of the County; the auditor's responsibility is to give their opinion on the financial statements. Using internal staff to prepare the County's financial statements is a significant way to demonstrate the County's commitment to fiscal accountability. It also enables the audit firm to more easily maintain its independence.
- The personnel in your Financial Services Division gain technical expertise; this expertise enables them to provide more valuable assistance to management.
- The audit firm can allocate more of its resources to critical issues identified by the Board of County Commissioners and management.

Many of our recommendations in these areas were implemented during the last year. Changes or accomplishments by the Financial Services Division team during the year included:

- Preparation of a more complete and organized workingpaper package for the external auditors.
- A careful examination of accounting policies and account balances resulting in better formatted financial statements and a clearer, more consistent presentation of information.
- Preparation and posting of closing journal entries for the budgetary basis general ledger (modified accrual basis) at an earlier date, thus streamlining the audit process.
- Creation of separate ledgers for the fund financial statements (GAAP basis) and the government-wide financial statements (accrual basis). This bridged the County's accounting system to the financial reporting process and helped automate drafting of the different parts of the external financial statements.
- Internal preparation and publishing of the County's first financial report.
- Preparation and publishing of the County's first CAFR.
- Submission of the CAFR to the Government Finance Officers Association (GFOA) for consideration for a Certificate of Excellence in Financial Reporting.

- Completion of the audit and submission of the financial report by the state-mandated deadline.
- A significant increase in the accounting and financial reporting expertise of County personnel. This was accomplished by a reorganization of duties, appropriate staff changes, internal training, and an emphasis on improving the quality of the County's financial reporting.

We commend these much-needed advances and encourage the County to continue to support the Financial Services Division. During times of financial stress, it would be tempting to reduce the human resources committed to this area, however this would be detrimental to the overall financial health of the County. As discussed above, good financial management is essential to the efficient use of the County's existing resources. Also, any cut-back in internal accounting services increases the County's reliance on outside providers and would not necessarily decrease overall costs in the Financial Services Division.

Office of Management and Budget (OMB) Circular A-133 requires that certain federal programs be selected for testing each year. These programs are selected based on a risk assessment; as a result, there is some variation in which programs are tested year-to-year. Each of the previous four audits have resulted in findings related to reportable conditions, although usually in different programs each year. While the findings generally have not been considered to be material weaknesses in the system of controls over the programs, they nevertheless have resulted in audit findings and related reporting to the federal government as part of the compliance section in the County's financial statements. During the year ended June 30, 2003 we reported no findings or reportable conditions. In addition, the County's timeliness and completeness of preparing the information for the Schedule of Federal Awards has consistently improved over the past four years.

We have reviewed our recommendations from last year and have included two comments that deal partially with subjects that have been previously discussed. Comments #2 and #5 include additional information because of the importance of the subject or the need for additional emphasis. Comments #1, #3, and #4 are new subjects which have arisen in conjunction with the most recent audit.

1. <u>Lane County Fair</u>

The Lane County Fair (the Fair) relies on the fair event, rental receipts, and ice arena income to fund its operations. Additionally, the Fair is the recipient of excess Transient Room Tax (TRT) receipts pursuant to Lane Code 4.175(5). The use of the TRT receipts is restricted to capital improvements by the Fairgrounds Capital Improvements Plan (Order No. 02-1-9-4 dated January 2002), reimbursement of the special projects fund related to Planetarium operations ($50,000, Order No. 03-06-18-1 dated June 2003), and creation of a "Rainy Day" cash reserve ($125,000, Order No. 03-06-18-1 dated June 2003).

Attachments A and B summarize certain aspects of the Fair's financial condition and operations over the last seven years. They represent a combination of Fair Board operations (the Fair Board Fund, which is an enterprise fund) and the Fair Board Debt Service Fund (created to pay the debt service related to the issuance of $7,615,000 of debt for fairgrounds capital improvements). Both of these funds are necessary to understand the overall cost of operating and supporting Fair operations.

Fair operations has relied on its working capital (current assets less current liabilities) as an additional resource, particularly in those years when the fair event was not as successful as anticipated. As demonstrated in the attachments, the Fair's financial condition has deteriorated significantly in the last three years. Net income has decreased each year (Attachment A), as has working capital (Attachment B). At June 30, 2003, working capital was negative by approximately $669,000 (Attachment B). In addition, interfund loans and lines of credit have been necessary to maintain cash flow (Attachment B).

The County has prepared an estimate of future TRT receipts. Assuming the same level of TRT receipts in the future, beginning in 2006 the amount of excess TRT receipts will decrease by $240,000 due to an increase in the debt service requirement for outstanding bonded debt related to Fair capital improvements.

Recommendations:

We understand that a feasibility analysis was prepared in conjunction with the Fair Board limited tax revenue bonds issued during the fiscal year ended June 30, 2002. This analysis should be updated.

In addition, a plan for stabilizing the Fair financial situation is needed. Consideration should be given to current economic conditions, recent Fair revenues, and anticipated excess TRT receipts. Besides the steps that have already been proposed or undertaken, the following may need to be considered:

- Granting Fair management more discretion in the use of the excess TRT receipts;
- Additional privatization of Fair operations.

Response:

The Fair Board concurs with the assessment of the Auditor that the financial situation is problematic. Despite numerous initiatives to generate additional revenue with facility condition and market competition constraints and reduce expenses including elimination of positions, outsourcing, compensation restrictions and energy conservation projects, the inability to increase revenue sufficiently to cover the increasing expenses causes the current and projected negative financial environment. The Fair Board's 2004 work plan includes discussion of the two options listed of expanded use of Transient Room Taxes for operations and privatization. The Board believes these are the two viable approaches available to ensure financial stability and continuance of the services provided by the Lane County Fair Board. There are many related issues associated with these two options such as an on-going commitment of the Transient Room Tax monies if the option is an operating budget infusion or the production or viability of the County and 4H/FFA Fairs if the option is privatization. The Fair Board hopes to have a recommendation to the County Commission by late Spring; and, the Board believes policy direction from the Commission is required expeditiously to rectify the negative financial situation.

2. Decentralized Structure

Historically, the County has had a very decentralized structure, with many accounting functions delegated to individual departments. While this gives a significant amount of control at the level where services are being provided, it has some inherent limitations. Some examples:

- Invoicing and collections are generally done at the department level. Billing and collection procedures are not standardized throughout the County. At any given time, central management does not know how much is due to the County in terms of permits, services, and grants. At year-end, the Financial Services Division determines what is owed to the County by inquiry of individual departments and by observation of what is actually collected after year-end. No proactive control of this process is possible. It is difficult to ascertain whether all receivables are being properly billed and whether collections are prompt and complete.
- The cost accounting for Public Works improvements is done at the department level; financial reporting of infrastructure assets, including cost and depreciation, is the responsibility of the Financial Services Division. Actual expenditures (which are centrally processed) are not reconciled between the PeopleSoft accounting system and the cost accounting system used by Public Works.
- Grant applications, administration, reporting, and collections are predominantly the responsibility of individual departments. Procedures may vary between departments. Individuals at the department level may not have adequate training in grant administration.

Recommendations:

- Consider centralizing billing and collections (or standardize procedures to the extent duties are still delegated to individual departments).
- Utilize PeopleSoft or other software to integrate systems which are now independent.
- In last year's letter, we noted that the County would benefit from a position with oversight responsibility for federal and state grant administration. We understand that current fiscal constraints preclude adding such a position, however strong effort should be made to reallocate existing resources to accommodate these duties.
- Increase training of individuals in the departments; improve consistency of communication between departments and central management.
- Require yearly representation letters from all department heads to County administration outlining areas of significant control or knowledge which are vested in their departments.

Response:

Management Services would strongly support, and be willing to take a lead role in, a County-wide analysis of the billing and collection needs of the organization as part of an exploration of the need for a centralized billing and collection function. We concur with the auditor's observation that there is a lack of standardized procedures and controls in the area of billing and collections at the County.

Management Services also concurs with the suggestion that the County should evaluate opportunities to develop better integration between the County's primary PeopleSoft financial systems and the stand-alone departmental financial applications. As part of the "fit-gap" process for the upgrade to PeopleSoft Financials version 8.8, we intend to identify all such stand-alone systems and evaluate existing functionality in the new version of the system which may better meet department needs. We will also evaluate options for uploading data from nonintegrated systems in order to avoid duplicate data entry, which creates both opportunity for errors and the need for on-going reconciliations.

Management Services also continues to strongly support the recommendation for a position charged with the County-wide oversight responsibility for grant administration. As a recipient of significant grant dollars, it is important that the County develop standardized, timely and accurate grant accounting, monitoring and reporting systems in order to assure continued grant awards and allotments. Direction could be given to reprioritize existing services and resources in order to create at least some capacity in the form of a partial position to begin addressing this important organizational need for more training, coordination, and monitoring in the area of grants administration. We in Management Services would value being part of an effort to explore options for reprioritizing and reallocating existing resources to this end.

The department directors have recently been provided with information on the strengthened reporting requirements resulting from the Sarbanes-Oxley Act and have been advised that representation letters will be requested in the future. Current financial policies hold department directors responsible for financial transactions within their respective departments.

3. Lane Workforce Partnership

Lane Workforce Partnership (LWP) is a separate legal entity (both a council of governments and a not-for-profit organization) with a separate board of directors. It is fairly autonomous (receives no Lane County funds), but almost all of its employees are from Lane County. The administrative agreement that governs its relationship with Lane County has expired. Based on these, and other factors, financial reporting and other issues are very complex. For the year ended June 30, 2003, the financial reporting for LWP was changed from a department of Lane County to a discretely presented component unit.

Recommendation:

The relationship between the County and LWP should be clarified. At a minimum, a new administrative agreement should be negotiated (no current agreement exists). Based on the autonomous nature of LWP, the County should consider whether the separation should be formalized. The following are some of the more significant issues which would need to be resolved:

- Employee status (currently the employees are Lane County employees).
- PERS status (the employees participate in PERS as part of Lane County).

- Payroll reporting (currently reported under the Lane County EIN).
- Cash custodianship (some cash transactions are handled through Lane County's Financial Services Division).
- Budgeting (Lane County provides budgetary services and adopts LWP's legal budget).

Response:

Staff will discuss the Auditor's recommendation with the Lane Workforce Partnership Board of Directors and the LWP attorney, other member governments – Cities of Eugene and Springfield, and our grantor agencies. Upon concurrence of all parties involved and in cooperation with the County Administrator, a detailed plan will be drafted with dates and actions regarding resolution of this issue.

4. Level of Reserves in Internal Service Funds

As demonstrated in the following table, the level of reserves in the County's internal service funds has considerable variation in both absolute magnitude and as a percentage of yearly operating expenses within each fund. We have defined reserves to be the equivalent of working capital (current assets less current liabilities). This definition is more meaningful than cash or equity, because it takes into account all short-term assets and liabilities, but excludes long-term assets and liabilities (such as equipment or debt used to finance equipment purchases).

	Working Capital	Operating Expenses	Working Capital as a % of Operating Expenses
Self-insurance	797,421	1,317,971	61%
Employee Benefits	3,713,830	25,811,173	14%
Motor Pool	13,563,383	5,305,021	256%
Intergovernmental Services	339,072	823,252	41%
PC Replacement	444,037	1,070,210	41%
	18,857,743	34,327,627	

See Attachment C and following for more detail.

By definition, internal service funds are cost-reimbursement devices. That is, they are used to accumulate costs related to a given activity on the accrual basis so that costs can by allocated to the funds receiving the benefit in the form of fees or charges. Depending on the purpose and type of the fund, charges to other funds (which include depreciation) may lead to a surplus if that is necessary to meet future requirements for replacement of equipment.

Recommendations:

The County may wish to review the purpose of the listed funds and the amount of reserves that are necessary to accomplish each fund's objectives. Based on that review, the County should consider establishing policies for the amount of reserves in each fund. Internal service funds without any future unfunded obligations or the need to replace equipment may need only minimal reserves. Funds with extensive amounts of equipment may need larger reserves based on a specific schedule of future equipment purchases.

Because the cost allocation rules for federal grants prohibit charges to grants which are in excess of actual costs, the County should do at least an annual evaluation of charges to other funds to ensure that they are not in excess of the allowable costs incurred by the internal service funds.

Response:

The County's existing financial policies documented in Lane Manual 4.010 include policies addressing the level of reserves to be maintained in all funds. Staff is currently in the process of updating the reserve policy to clarify specific levels to be maintained and approved uses of reserves.

Rates charged by internal services funds are determined using cost recovery methods and are reviewed annually during the budget development process. In addition to cost recovery, the Self-Insurance Fund includes a reserve for actuarially determined liabilities and both the Motor Pool and PC Replacement Funds include reserves for replacement costs of existing equipment. To ensure that the rates and the current surplus levels are appropriate, County staff will analyze each of the internal service fund levels and make recommendations for changes if any are deemed necessary.

5. <u>New Accounting and Auditing Standards</u>

Last year's report to management included a comment on a new General Accounting Office (GAO) governmental auditing standard. This new standard affects not only the auditors, but also the County's Finance and Audit Committee. This new standard is important because it will affect the audit period ending June 30, 2004. It requires County management to specify, in its representation letter to its auditors, the audit firm's role in providing non-audit services.

The new GAO standard also significantly changes the auditor independence rules by restricting the type of non-audit services that may be performed:

- The audit firm cannot perform management functions or make management decisions.
- Auditors are prohibited from auditing their own work or providing non-audit services when the services are material or significant to the subject matter of the audit.

If the non-audit service does not conflict with the above principles, the audit firm may perform the service as long as:

- The audit and non-audit work is performed by separate engagement teams;
- The scope of the audit work is not reduced beyond the level that would be appropriate if the non-audit work were performed by an unrelated party; and
- The audit firm establishes and documents an understanding with the County on the non-audit service.

The rule does include a de minimis exception – if the audit firm provides no more than 40 hours of non-audit services relating to a specific audit engagement, the requirement of separate engagement teams is waived. Also, routine services such as establishing internal controls, help in implementation of audit recommendations, and related training are permitted.

Recommendation:

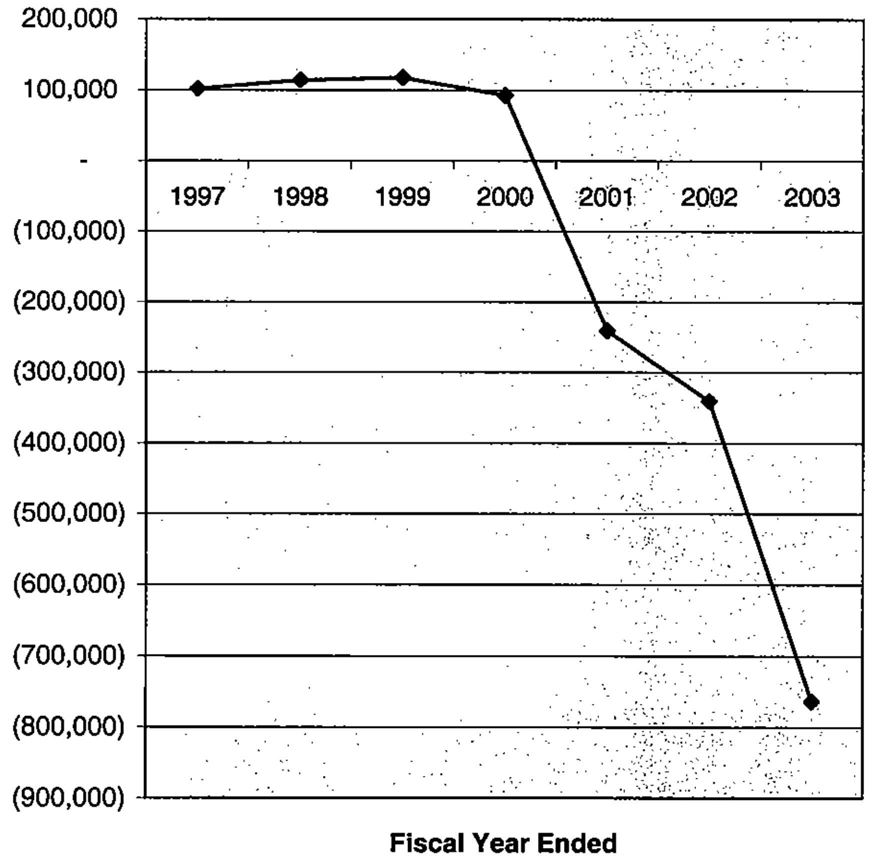
The Finance and Audit Committee and management will need to evaluate the effect of this new standard on their responsibilities when asking audit firms to provide non-audit services. Additionally the Board will need to adopt policies to ensure that all departmental requests for outside accounting services are brought to the attention of the Finance and Audit Committee to ensure that the services provided are not in violation of the new GAO rule on independence.

Response:

The Finance and Audit committee is receiving regular updates on the status of new legislation and standards and has requested that department directors be similarly apprised. Management will provide periodic updates and reminders to department finance personnel on the requirements for non-audit services.

	1997	1998	1999	2000	2001	2002	2003
Net income (loss)	101,582	113,855	117,274	92,143	(241,406)	(341,115)	(763,690)

Net Income (Loss)

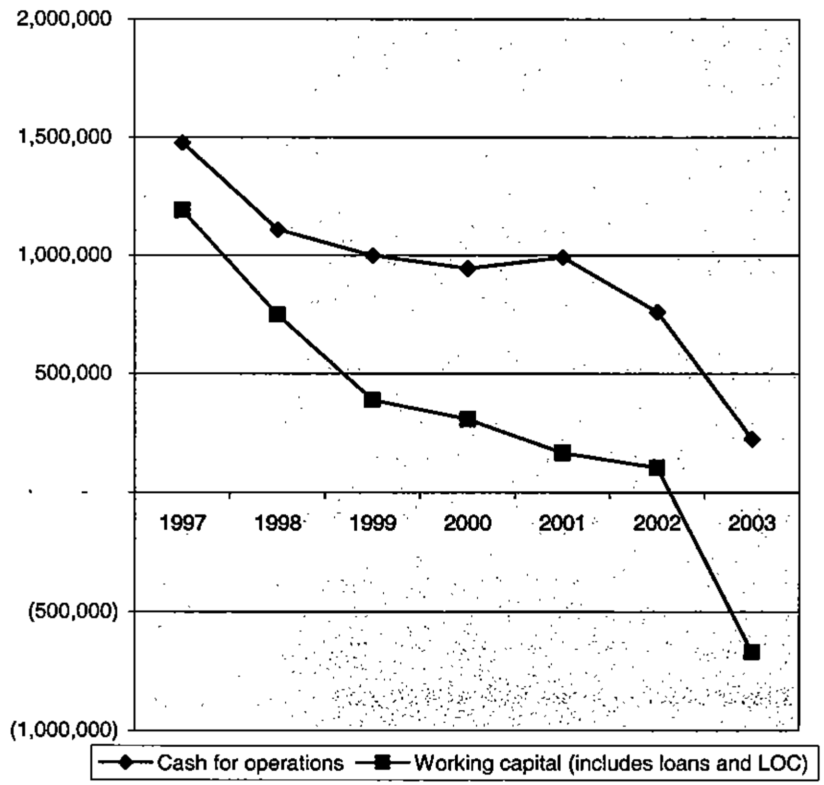


This is net income (loss) for the combined Fair Board Fund and the Fair Board Debt Service Fund.

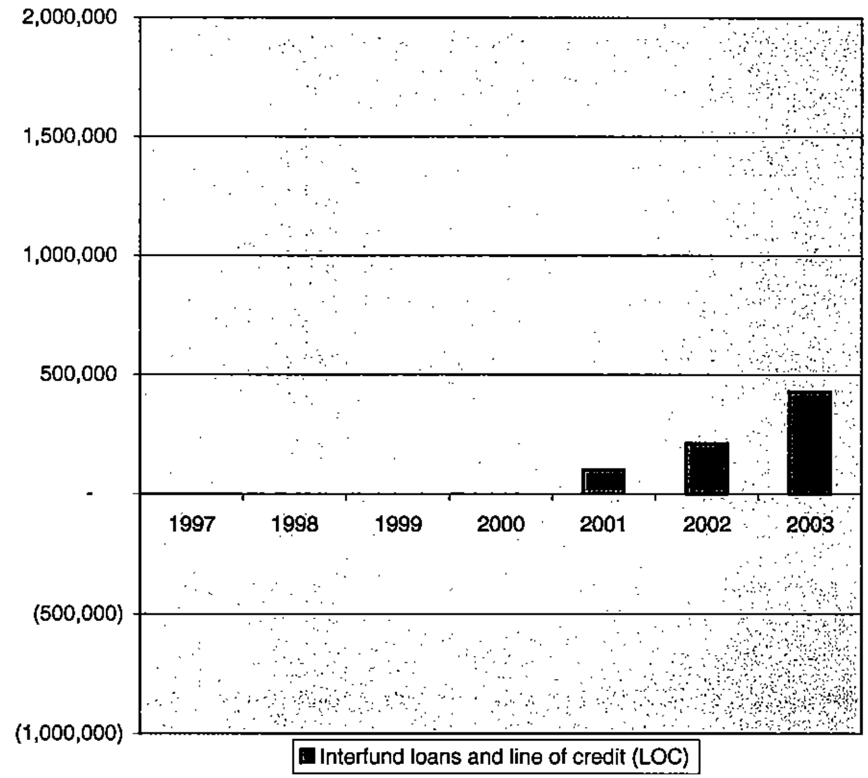
It is accrual basis, and includes all income, including TRT, any non-operating revenues and expenses, depreciation, and interest on debt.

	1997	1998	1999	2000	2001	2002	2003
Cash	1,475,774	1,107,347	5,999,141	4,993,618	1,740,151	758,093	223,766
Less estimated cash for capital improvements	-	-	(5,000,000)	(4,050,000)	(750,000)	-	-
Cash for operations	1,475,774	1,107,347	999,141	943,618	990,151	758,093	223,766
Other ST assets and liabilities (except debt)	(285,286)	(359,704)	(609,608)	(635,898)	(724,559)	(444,744)	(465,551)
Interfund loans and line of credit (LOC)	-	-	-	-	100,000	210,000	426,898
Working capital (includes loans and LOC)	1,190,488	747,643	389,533	307,720	165,592	103,349	(668,683)

Cash for Operations & Working Capital

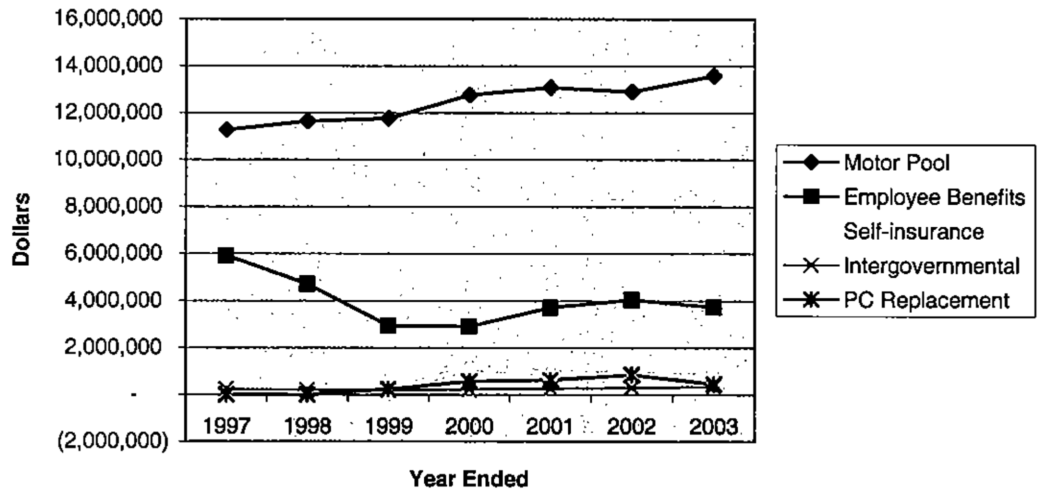


Line of Credit and Interfund Loans Payable



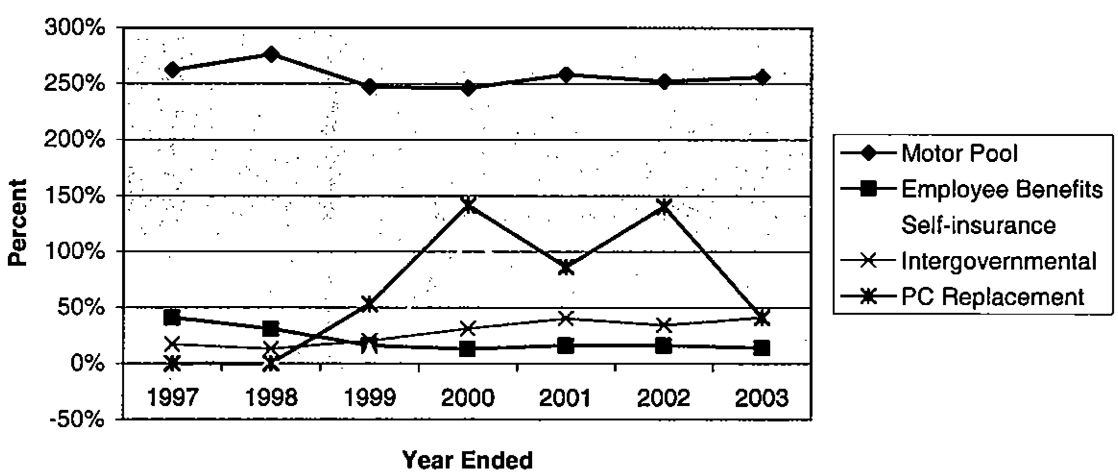
	1997	1998	1999	2000	2001	2002	2003
Motor Pool	11,259,293	11,623,299	11,757,250	12,745,972	13,059,966	12,886,655	13,563,383
Employee Benefits	5,910,700	4,694,697	2,915,843	2,885,659	3,698,014	4,017,765	3,713,830
Self-insurance	(89,685)	75,159	134,275	1,156,801	936,483	831,603	797,421
Intergovernmental	228,059	187,003	186,548	211,762	251,458	284,462	339,072
PC Replacement	-	-	231,810	554,603	625,104	836,800	444,037

Working Capital (Reserves)



	1997	1998	1999	2000	2001	2002	2003
Motor Pool	262%	276%	247%	246%	258%	252%	256%
Employee Benefits	41%	31%	16%	13%	16%	16%	14%
Self-insurance	-5%	5%	11%	109%	65%	82%	61%
Intergovernmental	17%	13%	20%	31%	40%	34%	41%
PC Replacement	0%	0%	53%	141%	86%	140%	41%

Working Capital as a % of Operating Expenses



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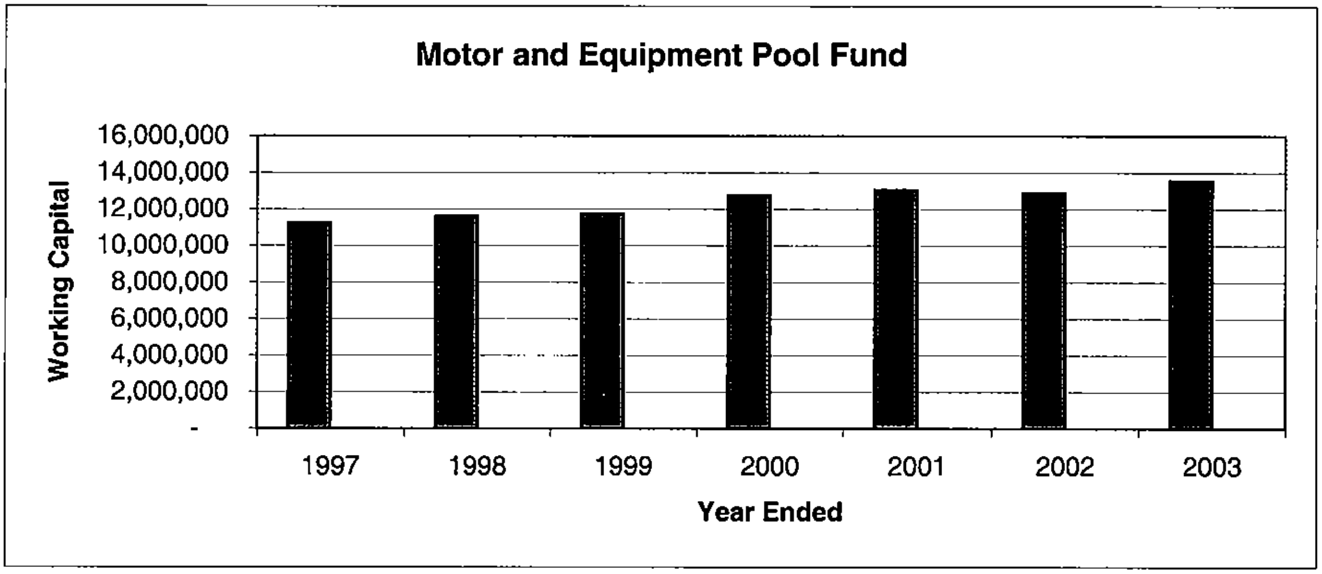

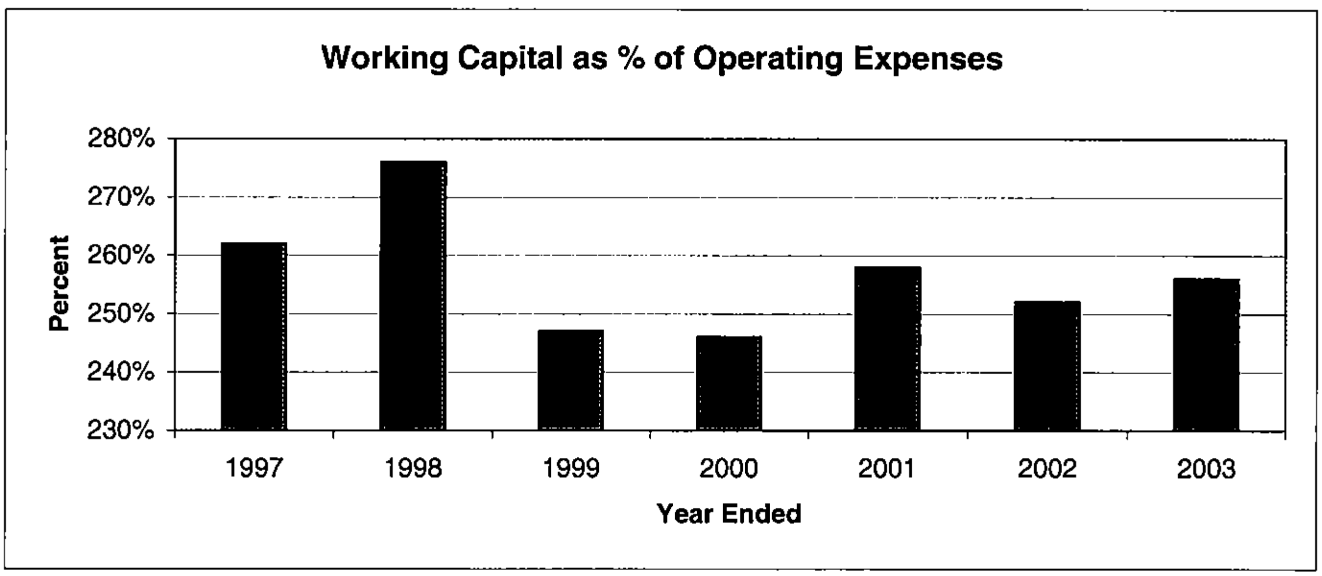

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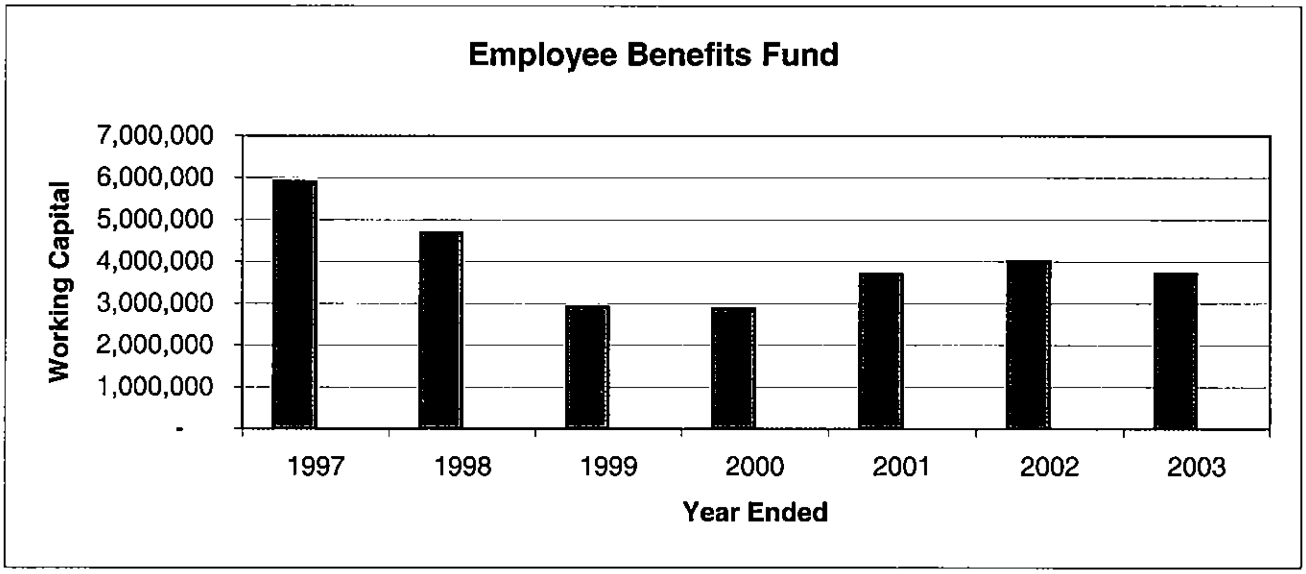

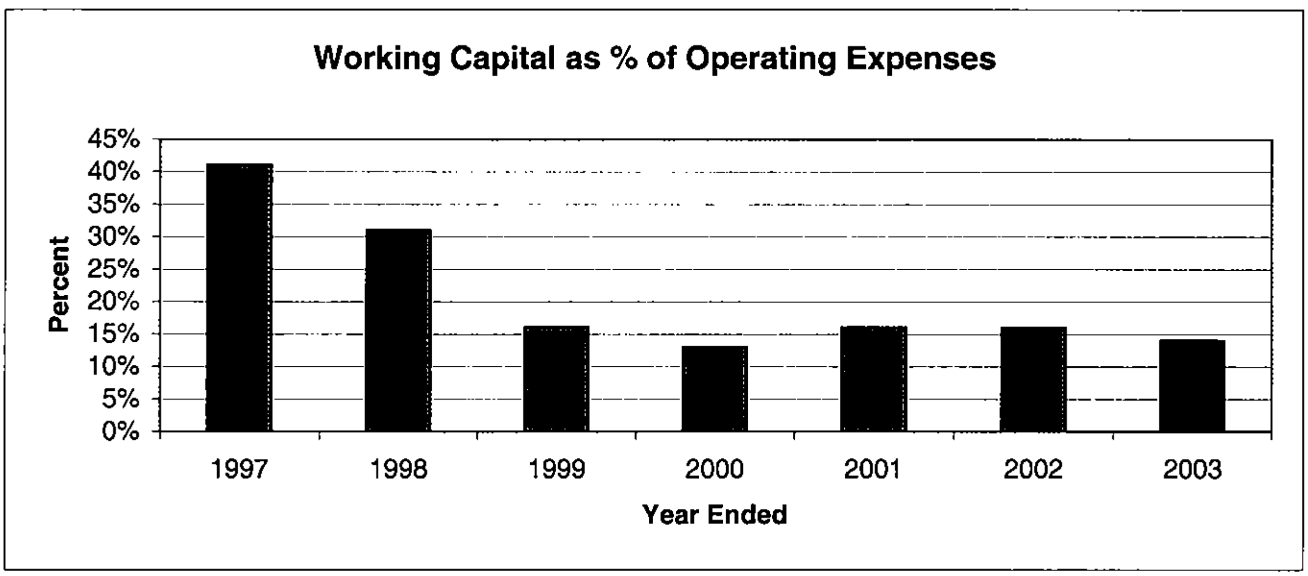

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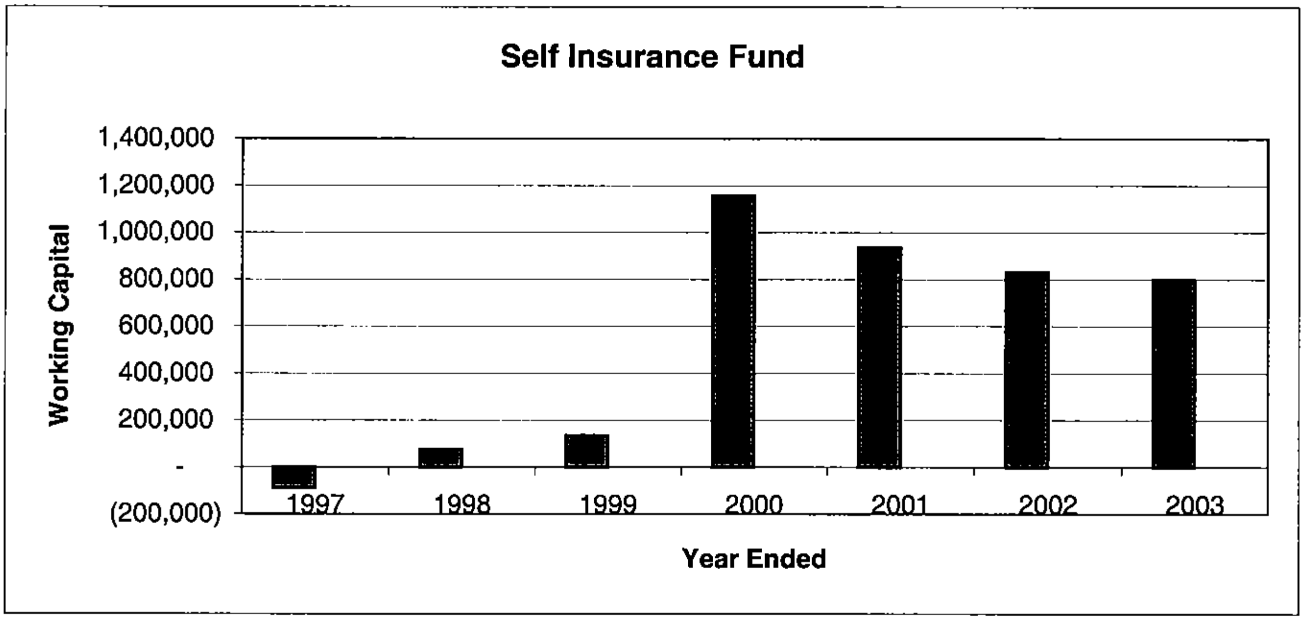

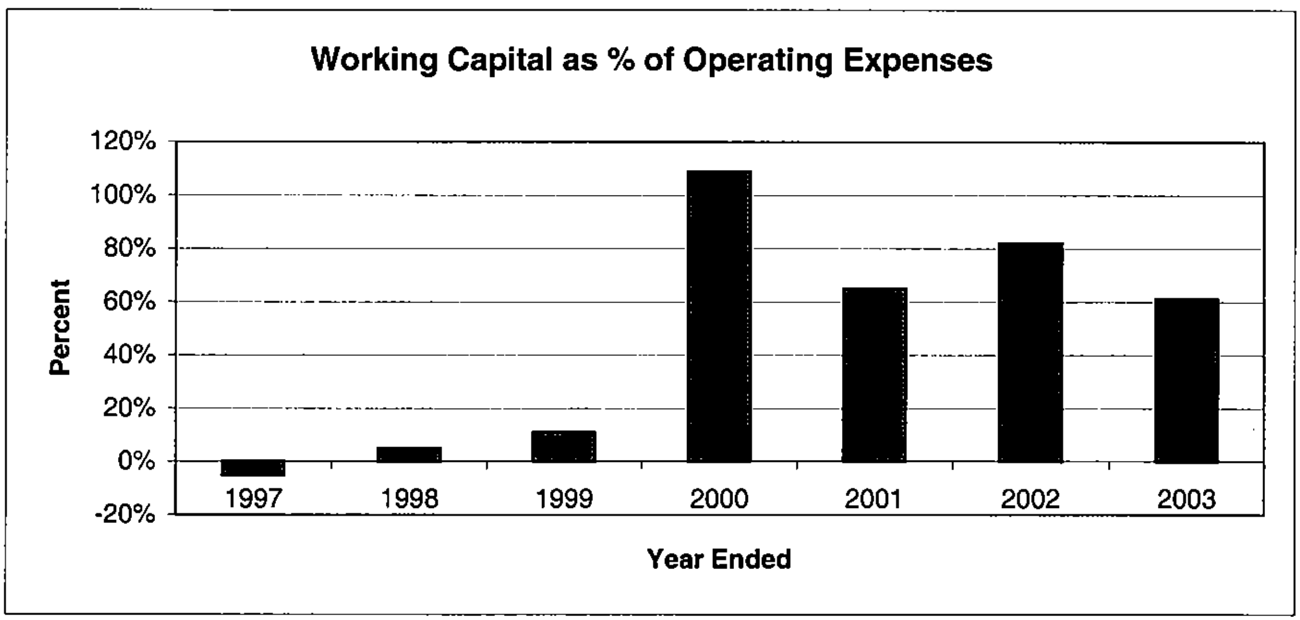

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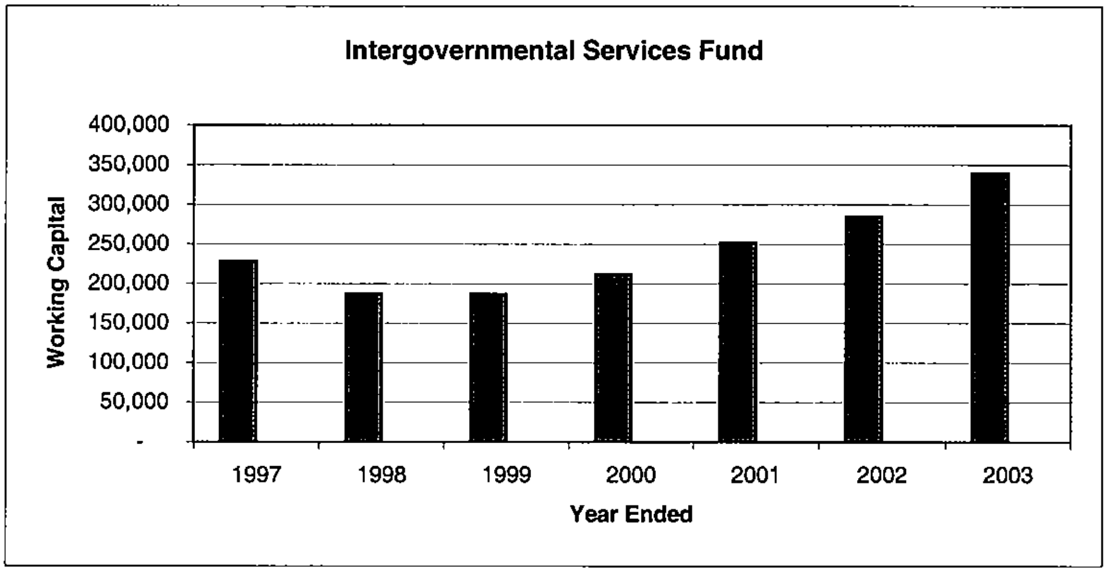

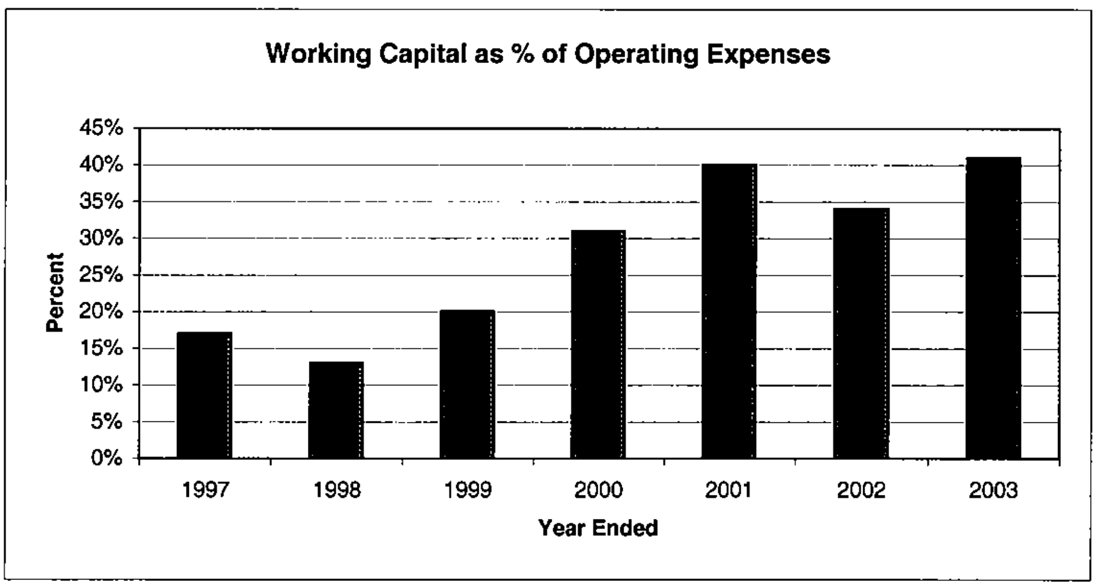

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