PLUMAS EUREKA COMMUNITY SERVICES DISTRICT

MANAGEMENT REPORT

FOR THE YEAR ENDED
JUNE 30, 2021

PLUMAS EUREKA COMMUNITY SERVICES DISTRICT

Management Report
For the Year Ended June 30, 2021

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FECHTER
& COMPANY
Certified Public Accountants

Craig R. Fechter, CPA, MST
(1976 – 2022)

Board of Directors of the
Plumas Eureka Community Services District
Blairsden, California

In planning and performing our audit of the financial statements of the Plumas Eureka Community Services District for the year ended June 30, 2021, we considered the District'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.

Our consideration of the internal control would not necessarily disclose all matters in the internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce, to a relatively low level, the risk that errors or irregularities in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We will review the status of these comments during our next audit engagement. We will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations. We thank the District's staff for its cooperation on this audit.

Fechter & Company
Certified Public Accountants

Fechter + Company

December 28, 2022
Sacramento, California

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The Auditor's Responsibility under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated June 13, 2022, 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. 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.

In planning and performing our audit, we considered the District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

As part of obtaining reasonable assurance about whether the District 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.

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 District are described in Note 2 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. We noted no transactions entered into by the District 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.

Internal Control Related Matters

In any smaller entity, whether private enterprise or a governmental agency, the lack of segregation of duties can present potential issues in regards to the perpetuation and concealment of fraud. Even with a perfect segregation of duties frauds can be perpetuated and concealed. The District can perform some specific control procedures to help reduce the risk of fraud, however. Some of the controls would include:

- Having someone independent of the bank reconciliation function review the bank statements on a monthly basis. At this District it would mean someone independent of the accounting function reviewing the county reports and bank reconciliations.
- Examining a budget to actual report on a frequent basis.
- Comparing the financial statements on a detailed level to the prior year on a frequent basis.
- Requiring someone independent of the payroll process review payroll each pay period, checking for accuracy of pay rates, paid time off recorded, etc.

- Verifying that a second person is approving all disbursement activity and that an individual independent of the accounting function is signing checks and asking questions about invoices presented for payment.
- Frequently displaying "professional skepticism" when considering staff responses on District finances.

California Government Code Section 12422.5 requires the State Controller's office to develop internal control guidelines applicable to each local agency by January 1, 2015. The intent of the legislation is to assist local agencies in establishing a system of internal control to safeguard assets and prevent and detect financial errors and fraud. To this end, the State Controller's Office has produced a draft of control guidelines for local Agencies. As the District contemplates changes to its system of internal control, we advise in utilizing these guidelines when developing internal procedures to assist with your internal control processes.

The State Controller's office has defined internal controls into five components that work together in an integrated framework. Their guidelines were adopted from the definitions and descriptions contained in *Internal Control – Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The components are:

- Control Environment
- Risk Assessment
- Control Activities
- Information and Communication
- Monitoring Activities

The objective of *control environment* is the set of standards, processes, and structures that provided the basis for carrying out internal control across the entity. The governing board and management establish the "tone at the top" regarding the importance of internal control, including expected standards of conduct which then cascade down through the various levels of the organization and have a strong effect on the overall system of internal control.

A District's *Risk Assessment* process includes how management identifies risks (including fraud risk) relevant to the preparation and fair presentation of the financial statements in accordance with the District's applicable financial reporting framework. In addition, this would also involve areas of business and operational risk which could potentially affect the District's finances on a go-forward basis.

The District's risk assessment process is an extremely important activity the board and management should undertake. Every organization, public or private, faces business risks on a day to day basis. Identifying those risks and then acting on them in a timely manner may prevent future problems from becoming completely unmanageable.

Management should consistently attempt to identify risks that exist and then present those risks to the board for action. It is impossible for us to identify every potential risk that exists but either way, management and the board should proactively attempt to identify risks that could adversely affect the District's operations.

Control Activities are in reference to establishing policies and procedures that achieve management directives and respond to identified risks in the internal control system. These are specific procedures designed to perform a secondary review of internal processes that will allow for segregation of duties and a management level review of processed transactions.

Information and Communication are the District's methods of identifying what information is relevant to present to management and the board to assist the District in making the correct decisions. It also is in reference to the District's internal processes of gathering and summarizing that information.

Monitoring involves evaluating the effectiveness of controls on an on-going basis and taking remedial actions when necessary when identified by the other control procedures in place. On-going monitoring activities often are built into the normal recurring activities of a local government and include regular management and supervisory activities.

There is no catch-all for finding all instances of fraud within any entity, whether public or private. One of the key factors in helping prevent fraud is to encourage ethical behavior at all levels of the organization, i.e., "tone at the top". Another key would be to note instances of abnormal behavior of finance or accounting staff when questioned about District financial matters.

The District should remember that they have outside resources available in the case of fraud – they are able to contact the District auditor, their attorney, or county auditor-controller should anyone feel there is a chance of fraud or abuse.

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 were:

- Accrual and disclosure of compensated absences
- Capital asset lives and depreciation expense
- Allocations between water and wastewater funds for shared vs. direct expenditures and revenues billed under the same invoice.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the District's financial reporting process (that is, cause future financial statements to be materially misstated). The following audit adjustments, in our judgment, indicate matters that could have a significant effect on the District's financial reporting process:

- Restating disposition of assets, recording and reclassifying additions, and correcting depreciation expense.
- Accruing expenses recorded subsequent to fiscal year-end for expenses that were incurred during the fiscal year under audit.
- Updating net pension liability and deferred inflows/outflows.

Other Audit Findings or Issues

During the course of performing audit procedures, we identified certain accounting and audit issues that indicate deficiencies in internal controls. The following is a summary of findings for management's review:

<u>Disclaimer of Opinion</u>:

We have disclaimed our opinion in this year's Independent Auditor's Report. We therefore do not provide reasonable assurances over the financial statements, as a result of the scope limitation from needing to stop additional procedures and issue the audit reports before sufficient audit evidence could be obtained for several key balances. Some account balances will need to be revisited to verify opening balances in subsequent reporting periods.

<u>Multiple fund reporting</u>:

This is the first year that the District is reporting water activities separately from wastewater activities, from within what was previously collectively reported as the Enterprise Fund. A major debtholder has maintained certain reporting requirements; and the nature of the District activities also lends to these activities being reported separately. The user of the financial statements would likely find it necessary in order to reasonably understand the operations and performance of wastewater functions and the directly-related debt and user fees charged to the District's customers.

This has proven difficult as the District maintains two sets of accounting records for three funds. As evidenced throughout the Trial Balance, there are assets, revenues, and direct expenses that are specifically attributable to water activities and others for wastewater. However, it appears most liabilities and some assets are being split evenly between the two at year-end by manual adjustment in excel, outside of QuickBooks. This means the accounting records and system cannot be relied upon to support the allocations made between the two funds, and any direct expenses or unique revenues are being ignored and inappropriately applied to both activities during year-end accruals.

Additionally, there are no established or documented policies that can be followed to identify how any indirect or shared amounts should be allocated between water and wastewater. There could be significant bias or error in reporting the performance of water vs. wastewater, of which some users of the financial statement will rely upon.

We recommend the Board adopt a policy that predetermines a consistent application of revenue and/or expense allocation between water and wastewater activities, based upon a time-study, reported hours, or another reasonable metric that can be reperformed or recalculated for ongoing monitoring and reevaluation.

Interfund balances:

On June 30, 2020, there was a reported balance of $59,005 owed from the collective water and sewer (enterprise) fund to the governmental fire fund. It was our understanding that all revenues were billed out of the enterprise (water and sewer) fund, creating a payable to the other fund for those revenues. Certain payroll and other expenses are paid from the enterprise fund to repay this interfund balance. Billing practices have not notably changed, and there was activity in those funds throughout the year.

There should be a matching receivable for every payable entered in both sets of QuickBooks (enterprise and governmental funds) to have a reconciling interfund balance, such that the due-to and due-from amounts net to zero at any given point in time. These balances did not agree with each other throughout the year. Prior to the District's year-end adjusting journal entries, the governmental fund showed a receivable balance of $6,341 and the enterprise fund also showed a balance receivable from the fire fund for $53,446, after some approximate $30,000 interfund payments were made throughout the year.

Additionally, there was an A/R Clearing adjusting journal entry posted at June 30, 2021 to make both balances zero at fiscal year-end. The adjustments resulted in the reclassification of some or all of these balances to other current asset or liability accounts, where there are vendor names such as "various" under the accounts payable listing.

There is lacking documentation, and it is unclear at the time of issuing this report whether all revenues and expenditures had been recorded and in the correct period, and how the interfund balances were resolved.

We recommend a review and reconciliation of this account activity, along with the unwinding of the year-end adjustment to identify the true amounts owed between the funds and clear the false payables or receivables on the Aging Reports that cannot be removed by applying customer/vendor payments.

Capital assets:

The capital asset activity for the fiscal year ended June 30, 2021 does not match the depreciation schedule. There were major additions that had been recorded for different amounts which resulted in differences in our calculated depreciation and amortization expense for the year. When there are major construction additions that have several components, an accurate detail of which items are being added or removed are dependent upon the accuracy of the depreciation schedule. We recommend a regular reconciliation of the depreciation schedule to the District's trial balance in QuickBooks in order to accurately track the significant amount of capital assets that the District is charged with safeguarding and maintaining.

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.

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.

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

Difficulties Encountered in Performing the Audit

While we encountered many delays during the audit, we encountered no significant difficulties in our dealings with management in performing our audit.