M E M O R A N D U M

TO: Audit Committee

FROM: Paul Navazio
Director of Finance

Martin Williams
Controller

SUBJECT: Review and discuss possible next steps on outstanding accounting and financial reporting issues identified by the former Audit Committee and through past Correspondence. (Requesting Trustee: Audit Committee Chair Michaela Tonking)

DATE: February 7, 2023

I. BACKGROUND

This agenda serves to provide the Audit Committee with a summary of issues identified by the former Audit Committee as well as selected issues from Correspondence received by the Committee.

A number of the issues have been previously addressed, or deemed, by either the Audit Committee or, in some cases, the Board of Trustees to not warrant further action. Nonetheless, they are presented herein for background information purposes as a number of these same issues are recurring matters brought to the attention of the Audit Committee. As such, the Audit Committee may wish to recommend follow-up action, as deemed appropriate.

Attachment A to this memorandum provides a summary of topics and issues raised by the former Audit Committee as well as through correspondence that has appeared on prior Committee agendas, as well as recent correspondence received by the current Audit Committee.

The summary is presented in (roughly) chronological order, with issues identified as pertaining to one or more of the following categories:

- Moss Adams Recommendations – stemming from recommendations provided through three separate consulting engagements, most notably an Evaluation of Certain Accounting and Financial Reporting Matters.

- Capitalization of Fixed Assets – includes issues related to application of generally-accepted accounting principles, applicable Board policy, and Moss Adams recommendations.

- Financial Reporting / Annual Comprehensive Financial Report (ACFR) – include issues raised related to the information provided in the District's Annual Comprehensive Financial Report. May include questions about financial statement, Notes, or Supplemental Information contained in the report(s).

For each issue identified, the summary table provided in Attachment A also identifies, where applicable, a stated dollar impact (or estimate), whether the dollar impact is deemed "material", and comments to include status and references.

Several attachment are provided as reference to selected issues identified in this report. These include excerpts to previous management responses provided to the Audit Committee and/or Board of Trustees.

II. ATTACHMENTS

A. Summary Table of Issues Identified by Former Audit Committee and ongoing Correspondence.
B. Summary of Moss Adams Recommendations with Management Responses (BOT memorandum, meeting of 6/29/22).
C. Management Responses to Audit Committee Report on 2021 ACFR, dated 4/13/22
D. History of District's reporting of Facility Fee revenues (excerpt from report to Audit Committee dated 6/16/22.

SUMMARY OF ISSUES IDENTIFIED BY AUDIT COMMITTEE AND CORRESPONDENCE

	Moss Adams Recommendations	Capitalization of Fixed Assets	Financial Reporting ACFR	Stated Impact on Financial Statements	Material (Y/N)	Notes
• **Moss Adams Report Recommendations**						
○ AC Meeting 4/13/22 - Item D.2 – Moss Adams Recommendations						
1 Account and report on central services cost allocations using an Internal Services Fund with a detailed schedule of individual expenditure line times to be allocated.	X		X	None - Methodolgy	N	Central Services Overhead Methodology under review
2 Cease using contra-accounting (punch card accounting) within Community Services effective July 1, 2022.	X		X	Minor	N	Implemented change related to Contra-Revenues across Community Services and Beach Funds; maintain contra-revenue WITHIN each fund.
3 Reflect revenues from the Facility Fee within each activity/fund/cost center at the time of budget adoption.	X		X	Presentation; Impacts Sub-Funds	N	Implemented
4 Report the Facility Fees as nonoperating revenue in the statement of revenues and expenses, as non-capital related financing activities section in the statement of cash flows and as program revenue in the statement of activities.	X		X	Presentation	N	Response included in 6/16 memo to AC and 6/29 Memo to Board of Trustees (excerpt attached); Controller, Indepenendent Auditor and State Dept. of Taxation DO NOT concur with Moss Adams recommendation
5 Modify the newly updated capitalization policy to include the following:						
a. The different stages of a project and the types of costs incurred in the different stages.	X	X			N	Issues addressed with adoption of new Capitalization Policy (8.1.0), approved by the BOT eff. 1/1/22. Moss Adams engagement #3 assisted with and reviewed drafts of updated policy.
b. The accounting treatment of costs incurred in the different stages.	X	X			N	
c. What elements or criteria need to be met for expenditures associated with a repair project to be eligible for capitalization based on the concept of service capacity in addition to the extension of useful life of an asset.	X	X			POSSIBLY	
○ Board Meeting of 6/29/22 – Item H.5. - Status Report on Moss Adams						
• **AC Meeting agenda items**:						
○ Meeting Date: 4/13/22						
▪ D.3 – Effluent Pipeline (Dobler)		X		$ 182,022	N	Capital and Construction in Process were reviewed by the District's Independent Auditor as part of the financial audit for FYE 6/30/21; an number of items were expensed, as a result of this review. Items remaiing in capital or CIP were not expensed with concurrence from the auditors.
▪ D.4 – Golf Courses (Dobler)		X		Avg. $103,666 per year over past 6 yrs		
▪ D.5 – Claims Payable (Dobler)			X	Presentation / Disclosure	N	
▪ D.6. – Expensing Net Costs (Dobler)			X	$ 169,230		
▪ D.7. – Note 22 (Dobler)		X		$105,433 (net)	N	Requested restatement of 2021 ACFR; issue is moot given transition back to Enterprise Fund accounting for Community Services.
▪ D.8 - Burnt Cedar Pool (Dobler)						Memo claims violation of NRS policy; reviewed with State Dept of Taxation which had no issues - in fact, DOT feedback informed BOT action. That said, past practice has been modified to avoid occurrence.

SUMMARY OF ISSUES IDENTIFIED BY AUDIT COMMITTEE AND CORRESPONDENCE

○ Meeting Date: 6/1/22					
▪ D.1 – Water and Sewer Pump Station Improvements (Dobler)	X		Water - $306,670 est. Sewer - $238,563 est.	Y	Capital and Construction in Process were reviewed by the District's Independent Auditor as part of the financial audit for FYE 6/30/21; an number of items were expensed, as a result of this review. Items remaiing in capital or CIP were not expensed with concurrence from the auditors.
▪ D.2. – Wetlands Effluent Disposal Facility (Dobler)	X		$ 174,332	N	
▪ D.3. – Management Response to ACFR (Management)		X			Provides management responses to AC Recommendations from 2020/21 ACFR
▪ D.4 – Note 22 - Prior Period Adjustment (Dobler)		X			Same Memo as D.5 from 4/13/22 Mtg.
▪ D.5 – Accounting and reporting of Facility Fees (Dobler)		x			See Response to AC 6/16/22 and BOT 6/29/22
○ Meeting Date: 6/16/22					
▪ D.2 – Wastewater Treatment Plant Improvements (dobler)	X		Undetermined	N	See response above
▪ D.3. - Burnt Cedar Water Disinfection Plant (Dobler)	X		Undetermined	N	See response above
○ Meeting Date: 9/28/22					
▪ D.6 – Correspondence Wastewater Treatment Plant Improvements (Dobler, 7/10/22)	X		$ 167,118	N	
• **Correspondence from Mr. Cliff Dobler**					
○ Date: July 10, 2022 - Wastewater Treatment Plant Improvements	X			N	See Response to AC 6/16/22 and BOT 6/29/22
○ Date: August 15, 2022 - Charge off: Capital asset costs 2021 ACFR	X	X	Undermined	Y	See Response to AC 6/16/22 and BOT 6/29/22
• **Correspondence re FY2021/22 ACFR**					
○ Dobler Correspondence:		X			
▪ Date: 1/9/23 – Observations and Potential Corrections 2022 ACFR		X		N	
▪ Date: 1/14/23 - Lack of Full Disclosure in Note 18 of ACFR		X		N	
▪ Date: 1/21/23 – Unauthorized Change in Reporting		X		N	
▪ Date: 1/30/23 – Investment Earnings		X		N	See discussion of Investment Earinings (Mgmt response provided to AC at 6/1/22 mtg.)
▪ Date: 1/30/23 – Internal Service Funds				N	

EXHIBIT 2

Moss Adams #2 0 – Evaluation of Certain Accounting and Financial Reporting Matters

Subject: Review of selected District Accounting and financial reporting issues:
GAASB Compliance related to:

Contract Executed:	September 21, 2020 (Audit Committee) Not-to-Exceed: $28,410
Start of Engagement	June 8, 2021
Final Report Completed:	January 14, 2021
Presented to BOT:	January 28, 2021
Progress Report on Recommendations:	October 26, 2021 (Audit Committee)

Scope: Review District policies and practices related to the following areas for consistency with GAAP/GASB:

1) Enterprise vs Special Revenue Fund Accounting for Community Services and Beach activities.
2) Central Services Cost Allocation Plan (charged to Special Revenue Funds)
3) Punch Card Accounting
4) Evaluate the District's capitalization practices for compliance with GAAP/GASB

Summary of Recommendations – See Attachment 3

- *Special Revenue Fund Accounting – Moss Adams concluded that the GAAP/GASB does not require Enterprise Fund Accounting for Community Services and Beach Activities; however the report recommended that this is a policy decision and recommended that the District would be well-served by transitioning back to Enterprise Fund accounting*

  The District transitioned back to Enterprise Fund accounting for Community Services and Beach Activities for fiscal year 2021/22.

- *Central Services Cost Allocations Plan – Moss Adams concluded that the application of Central Services Cost Allocations to Enterprise Funds is consistent with GAAP/GASB and is not prohibited by the NRS. The report recommended that the District review its Central Services Cost Allocation Plan and provide additional explanations for the methodology and basis for the cost allocations.*

  The District has incorporated a discussion of the methodology used to develop and administer its Central Services Cost Allocation Plan, and this information was included in the materials provided to the Board of Trustees in approving the Central Services Cost Allocation for the FY2022/23 budget (see Board packet of May 26, 2022).

- *Punch Card Accounting - Moss Adams concluded that the Districts accounting for Punch Cards does not violate GAAP/GASB; however, the report noted that the accounting practice is confusing and recommended ceasing contra-revenue accounting (related to adjustments between Community Services and Beach Funds*

The District ceased the practice of adjusting contra-revenue accounting entries related to use of Punch Cards <u>between</u> the Community Services and Beach Funds. Additionally, as the District continues to evaluate the existing use of Punch Cards as part of the broader policy discussion related to Ordinance 7, management will continue to review and update the accounting treatment related to Punch Cards, accordingly..

- *Capitalization Practices – the Moss Adams report concluded that, while "there is relatively little material in the accounting standards to provide guidance on when it is appropriate an expenditure as capital," the District's past practices related to capitalization of feasibility studies and certain maintenance and repairs activities did not conform to accounting practices. The report recommended that the District update its capitalization policy to provided clearer direction on capitalization criteria.*

  As a result of this recommendation, the District entered into a follow-up engagement with Moss Adams (see Moss Adams #3) to include consultation on the update of the District's capitalization policies. A new capitalization policy was approved by the Board of Trustees in January, 2022.

  As it relates to questions and concerns related to specific items that were capitalized in prior years, management reviewed a number of items that were written-off as expense items during the preparation of both the FY2019/20 and FY2020/21 ACFR. Consistent with recommendations included in the Moss Adams report, management's review of capitalized items was conducted in consultation with the District's independent auditors.

  Most recently, the Board authorized the Audit Committee to execute a supplemental engagement with Davis Farr, the District's current independent auditor, to review compliance of capitalization practices with applicable Board policies.

Enterprise Fund Accounting

Executive Summary:

While governmental fund reporting can be supported with the District's current circumstances, the District should report these activities through the use of Enterprise Funds to achieve the benefits of the full accrual basis of accounting. These activities generally meet the GAAP definition of 'business-type' activities and are better suited for reporting within enterprise funds that use the full accrual basis of accounting to provide stakeholders with a better understanding of the sufficiency of the rates charged to users in covering all costs incurred including the use of capital assets and debt service. See additional observations and recommendations in the body of this report.

Additional Recommendations:

1 The District should use the full accrual basis of accounting through the use of enterprise funds for the recreational activities reported within Community Services and Beach. The full accrual basis of accounting will allow the District to determine what portion of its operating costs, including the use of capital assets and interest incurred on debt, are recovered from the rates it charges for these activities.

2 Should the District decide to continue the use of governmental funds for the reporting its recreational activities within Community Services and Beach, the District should consider adopting a separate resolution with wording that clearly establishes its intent to commit the Factility Fees to the activities within Community Services and Beach as provided by the applicable accounting standards. Further, the District would need to commit additional resources reported within Community Services and Beach in order to meet the spirit and intent of GAAP to use special revenue funds. In the absence of a substantial portion of resources
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either restricted or committed as defined in GAAP, the Community Services and Beach funds would need to be combined with the General Fund for external financial reporting purposes.

3 Should the decision be made to report Community Services and Beach as enterprise funds, the District could consider the use of separate budgetary funds for purposes of tracking and monitoring resources designated for specific purposes like acquisition of capital assets or repayment of debt that are combined with the enterprise funds for external financial reporting purposes, or otherwise tracking resources within the enterprise funds with constraints separately through the chart of accounts and related separate line items in the budgetary forms used for State budget compliance purposes.

Overhead Cost Allocations

Executive Summary:

If the current method of reporting expenditures initially within the General Fund is maintained, the expenditures and reporting of the related income as a negative expenditure should be removed from the General Fund and only reported as expenses or expenditures in the reimbursing funds. See additional observations and recommendations in the body of this report.

Additional Recommendations:

1 Costs initially incurred and paid by the General Fund that ultimately benefit activities reported within, and reimbursed by, the other District funds, should not be reported in the General Fund's financial statements. They should be reported as transactions within the fund benefitting from the services provided.

2 While the allocation of costs incurred by the General Fund and charged to other funds is in conformance with GAAP, it is more common to report costs that benefit multiple funds within Internal Service Funds similar to how the District accounts for and reports for its fleet, engineering, and building maintenance services. The District should consider the accounting for administrative costs that benefit multiple activities and funds within Internal Service Funds and charge the activities and funds that benefit from the underlying services.

3 The District could improve the transparency of its central service cost allocations by providing the detail of line items included in the budget that make up the total central service costs that ultimately are allocated to the District's various activities.

4 The District should consider revising Policies and Practices to include the methodology to be used to allocate central service costs. The methodology should allow for different bases for different types of costs incurred to better match amounts allocated with the drivers of those costs to the activities responsible for paying for them.

5 The District should consider adjusting amounts charged to the various activities at year-end to match actual costs incurred, or alternatively, revise ensuing year allocations by prior year over or under charges compared to actual costs incurred so that reimbursements over time approximate the actual costs incurred.

Punch Card Accounting

Executive Summary:

We find the contra revenue accounting associated with the value of punch card usage to be consistent with annual budgets adopted by the Board and approved by the State, and in compliance with governmental accounting standards. That said, we recommend the District discontinue the use of contrarevenue accounting for the utilization of punch cards for the reasons noted above. See additional observations and recommendations in the body of this report.

Additional Recommendations:

1 While we find there is a reasonable purpose behind the contra revenue methodology that is not inconsistent with GAAP and the budget requirements of the State, we recommend ceasing the use of the current accounting methodology. This methodology complicates revenue estimates to use for budget purposes, is confusing to stakeholders, and requires a significant amount of staff time during the year to administer. The time, cost, and complexity involved appears to outweigh the benefits perceived to be achieved.

2 The District should record revenues from charges for services and Facility Fees within the different activities and funds according to the net cash collected from rates charged and the allocaiton of Facility Fees determined by the Board at the time of the budget adoption

3 Whether the District continues to report its recreational activities within governmental funds or switches to enterprise funds, its policy on the Incline Village General Improvement District | 21 classification of the Facility Fee revenue should be disclosed in the notes to the financial statements. We recommend the District stick to the non-exchange classification of the Facility fees, and if the decision is to switch to enterprise fund reporting, to report the fees within the nonoperating section in the statement of revenues and expenses and the non-capital related financing activities section in the statement of cash flows.

Accounting for Capital Expenditures

Executive Summary:

The District is in need of developing more robust capitalization policies that provide for the different stages of a capital project, how to handle costs incurred in each stage, clarification on the nature of expenditures that increase the service capacity and therefore appropriate to capitalize, and the nature of expenditures that are repairs and maintenance and therefore should be expensed as incurred. See additional observations and recommendations in the body of this report.

Additional Recommendations:

1 The District's practices and policies should be revised to acknowledge different stages to a project, definition of costs incurred in each stage, and how to account for the expenditures incurred in each stage, consistent with established and accepted governmental accounting practices.

2 In most cases, the District should expense expenditures for feasibility studies and master plans. Policies should be revised to address the few circumstances where preliminary engineering, architectural, or design costs are actually utilized in a capital project and eligible for capitalization.

3 Board policies and practices should be revised to provide for capitalization of expenditures that truly increase service capacity, and further, that provide the criteria to be followed in making the increased service capacity decision on expenditures by nature or function of the different asset types versus expenditures that should be expensed.

Incline Village General Improvement District
Classification of accounting/reporting issues raised

		Suggested for expanded SOW	To be addressed in future CAFRs with the District's future audit firm	Issue is immaterial to the financial statements	Addressed in MA consulting report	Comments	Management Comments - FY 2020/21 CAFR Preparation
1	Improper switch from enterprise funds to use of special revenue funds for Community Services and Beach				X	Our recommendation is to switch back to enterprise fund reporting, and we understand the District is planning to make this change.	Does not apply to 2020/21 financial statements. (Transition back to Enterprise Funds for Community Services and Beach funds for FY2021/22 Budget)
2	Improper capitalization of effluent pipe repairs and condition assessments		X			We understand the projects in question have some elements of extension of useful life and likely some elements that would not meet capitalization criteria. We understand management already has plans to perform a more detailed analysis, and we believe the project will require more evaluation and judgement. Further, the evaluation necessary will be enhanced by development of more robust capitalization policies yet to be developed as we recommended in our report. **We believe this to be better addressed in the District's work with its external auditor and once the dollar amount of any necessary adjustments is determined the reporting implications can be determined at that time.**	Under review by District's external auditor; recommended expensing of assets previously capitalized are being done in accordance to auditor recommendations.
3	Improper capitalization of feasibility studies and master plans				X	We understand management has already identified amounts capitalized incorrectly and has made adjustments to the 19/20 financial statements.	Substantially addressed in 19/20 financials; additional items being expensed in 20/21 based on review by external auditor.
4	Improper use of punch card contra-revenue accounting				X	This issue was addressed in our report with a recommendation to cease the use of punch card accounting. We understand management is already making plans to cease use of this methodology.	Partially implemented; Punch Card contra-revenues are no longer adjusted based on ration of Recreation / Beach Facility Fee; Punch card utilization was changed in 20/21 to remain within Community Services or Beach funds, based on venue.
5	Improper allocation of administrative and overhead costs from the GF		X		X	This issue was addressed in our report. Changes were noted as necessary in the financial statement for both reimbursements between funds and how internal service fund activity is reported in the government-wide financial statements that can be revised in future CAFRs since neither issue has a bearing on total net position or fund balance of any individual fund.	Issue addressed in 19/20 financials
6	Incorrect revenue recognition for utility base rate charges in periods prior to delivery of service		X	X		The amount in question is immaterial to the utility fund financial statements. **This issue would best be discussed with the District's external audit firm with any revisions made in future CAFRs.**	Under review by District's external auditor.
7	Indadequate disclosure of construction commitments and lack of classifying related amounts of fund balance as committed for capital projects		X			There is adequate accounting guidance for disclosure requirements of construction and other commitments as well as classifying fund balance among the different levels of constraints. **This can be worked out with the District's external audit firm with any revisions made in future CAFRs.**	Note to Financial Statement is being updated for 20/21 to reflect complete list of (material) construction contract commitments.
8	Improper classification/reporting of Facility Fees and GF admin and overhead charges in the Statement of Activities		X			This has to do with the placement of Facility Fee revenues in the Statement of Activities, and the 'netting' vs. 'gross' reporting of expenditures and reimbursement revenues within the Statement of Revenues and Expenditures for the General Fund, and does not impact net position or fund balances of individual funds. **Therefore, this can best be addressed in future CAFRs.**	Under revierw by District's external auditor. (See document request list)

Incline Village General Improvement District
Classification of accounting/reporting issues raised

		Suggested for expanded SOW	To be addressed in future CAFRs with the District's future audit firm	Issue is immaterial to the financial statements	Addressed in MA consulting report	Comments	Management Comments - FY 2020/21 CAFR Preparation
9	Potential for error in the period of recognition of a grant obtained for the Incline Park ball fields		X			We understand a grant was obtained and as of 6/30/20, was completely or nearly completely received and expended. We understand the budget contained estimated resources and expenditures in the year(s) cash was expected to be received and expenditures made. **If the grant is an 'expenditure-driven' grant, it is likely the timing of revenue recognition in past CAFRs have been correct**. If the grant is not an expenditure-driven grant - there is a chance revenue should have been recognized sooner and in the year all eligibility requirements were met securing the District's right to the grant resources. Given this is a timing issue in the year(s) grant revenues are to be recognized, we would not recommend restating prior year financial statements for this item absent a request by the grantor, federal or state regulator, or some other reason for which the District would deem the benefit of the restatement effort to be greater than people and financial resources required.	Under revierw by District's external auditor. (See document request list)
10	Improper capitalization of $150,751 of repairs to Mountain Golf Course Clubhouse addressing fire damage		X	X		An evaluation of all costs incurred in the year of the fire and in future years, incurred specifically to address the fire damage and bring the facility back to its condition prior to the fire, should have been compared to any insurance proceeds received with a resulting gain or loss recognized in the year of the fire. **The amount noted is immaterial to the Community Service financial statements and any expenditures incurred for the renovation of the Clubhouse can best be evaluated annually as they occur and discussed with the District's external auditor.**	Under revierw by District's external auditor.
11	Indadequate disclosure of lease commitments with US Dept of Agriculture and Parasol Foundation		X			Current accounting standards issued require footnote disclosure of signifcant lease commitments, and GASB 87 which can be implemented by the District at any time now and no later than its fiscal year beginning July 1, 2021 will significantly change how leases are reported within the financial statements. **We suggest the evaluation of the signifcance of these leases and related disclosures and the implementation of GASB 87 be discussed with the District's external audit firm and any revisions to the accounting and disclosures be made in future CAFRs.**	Under revierw by District's external auditor. (See document request list)

Incline Village General Improvement District
Classification of accounting/reporting issues raised

		Suggested for expanded SOW	To be addressed in future CAFRs with the District's future audit firm	Issue is immaterial to the financial statements	Addressed in MA consulting report	Comments	Management Comments - FY 2020/21 CAFR Preparation
12	Inaccurate disclosure of who has authority to create assigned fund balance		X			Any remaining positive fund balance amounts in governmental funds outside of the General Fund are appropriately reported as 'assigned' as specified in GASB 54. In essence, the fact the Board is accounting for certain resources in governmental funds, GASB deems the resource to be 'assigned' if it is not otherwise non-spendable, restricted, or committed - by definition. Local governments can establish who has the authority to establish assigned resources in the General Fund and it is common for that authority to be given to certain members of management. It is a best practice to memorialize who has the authority and what action and documentation is required to establish an assignment. This is something that can be addressed in a review and enhancements to Board policies in the future to memorialize the Board's decision on who can create an assignment and how, and the reporting in the financial statements can be discussed with the District's external auditor and any revisions made to future CAFRs.	
13	Lack of classification of certain amounts as 'fund balance committed for capital projects' for commitments on executed construction contracts		X			The mere fact the Board and management have remaining commitments for capital projects at any year-end does not result in a requirement for a portion of fund balance in governmental funds to be reported as 'restricted' or 'committed', or net position in any enterprise fund to be reported as 'restricted'. Such a classification would only be required for an externally created restriction on a resource for any fund or an interally created commitment by the Board for governmental funds related to unspent resources at year-end. **We suggest this issue is best addressed with the District's external auditor and if any revisions are found to be necessary, that they are made to future CAFRs.**	Under revierw by District's external auditor. (See document request list)
14	Inconsistent references to note titles		X			We find it to be a best practice to use consistent titles throughout the financial statements. This is something best addressed in future CAFRs.	Notes reviewed for consistency (ongoing).
15	Incorrect reporting in the notes of 'segment information' for Community Services and Beach funds that is not applicable only to enterprise funds		X			Segment information is only required in certain circumstances for enterprise funds that include multiple activities. It is not appropriate for governmental funds. This is something that can be revised in future CAFRs.	Under review - applies to Supplemental information

Incline Village General Improvement District
Classification of accounting/reporting issues raised

#	Issue	Suggested for expanded SOW	To be addressed in future CAFRs with the District's future audit firm	Issue is immaterial to the financial statements	Addressed in MA consulting report	Comments	Management Comments - FY 2020/21 CAFR Preparation
16	FYE 6/30/19 CAFR under-reporting of Facility Fees and Beach Fees the Board intended for capital projects and debt service		X			To the extent the Board is in agreement with the findings in our report that Facility Fees in general and portions assessed for capital projects and debt service specifically meet the criteria for 'commited' resources, to the extent any Facility Fees committed to capital projects or debt services remain unspent at the end of the year, the calculated amount should be reported as 'committed for capital projects' or 'committed for debt service' within the governmental funds to which they relate. In discussing this with management and review of prior CAFRs, it appeared greater amounts have been spent on capital projects than the allocation of the Facility Fees to capital projects. So it is not clear if any change would need to be made to the classifications of ending fund balance at this time. **Since this relates to a reclassification of existing fund balance amounts, if a revision is necessary, this could be addressed in future CAFRs.**	Facility Fee revenues are budgeted and reported within Special Revenue, Capital and Debt funds in FY20/21 financials.
17	Improper reporting of fund balance classifications in Community Services and Beach funds between committed, assigned, and unassigned		X			This appears to be the same issue noted in #12 and #16 above which we suggest can be addressed in future CAFRs.	Under revierw by District's external auditor. (See document request list)
18	Inadequate capital asset policy disclosure in the notes to the financial statements		X			**This is a disclosure issue we believe can be addressed with the District's external auditor and any revisions made in future CAFRs.**	Note disclosure to be updated
19	Lack of disclosure of minimum fund balance policies		X			**This is a disclosure issue we believe can be addressed with the District's external auditor and any revisions made in future CAFRs.**	Note disclosure to be updated
20	$198,135 of proceeds from land sales between 2016 to 2019 were innappropriately recorded in Community Services special revenue fund instead of the related capital project fund.			X		The amount involved is immaterial to the financial statements.	No action needed.
21	Missallocation of Facilities Fees the Board allocated to Capital Projects and Debt Service of Community Services and Beach to the CS and Beach special revenue funds.		X			This appears to be the same issue noted in #16 above.	
22	Innappropriate classification of effluent pipe special assessments in the Statement of Revenues and Expenses as operating revenues		X			The issue noted here addresses the location/classification of the special assessment amounts for the effluent pipe replacement project within the Statement of Revenues and Expenses for the Utility fund. The proper classification is dependent on how the special assessment is calculated, how it is assessed, and how it relates to what was represented to the community at the time of its assessment. **Given it does not impact the total net position of the Utility fund, we suggest this can be addressed with the District's external auditor in future CAFRs.**	The amounts being collected from customers for the Effluent Pipeline project are not, technically, a special assessementl rather, it is included in the Capital Project charge in both the Sewer Rate ordinance and on the utility bills. The Board has designated a portion of the capital charge for a specific project, but it is being collected and accounted conistent with the other rate revenues collected by the uitlity.

Incline Village General Improvement District
Classification of accounting/reporting issues raised

		Suggested for expanded SOW	To be addressed in future CAFRs with the District's future audit firm	Issue is immaterial to the financial statements	Addressed in MA consulting report	Comments	Management Comments - FY 2020/21 CAFR Preparation
23	Interest earned on unspent effluent pipe replacement special assessments should be limited in use to the effluent pipe replacement project to comply with Board Policy 13.1.0 and Board Practice 13.2.0		X	X		The amount involved is immaterial to the Utility fund. That said, the amount could be significant and involves the application of a written Board practice. We believe a calculation can easily be performed of interest deemed to be associated with average actual unspent special assessments annually and cumulatively and a balance of unspent special assessment amounts plus unspent interest earnings can be disclosed in the footnotes for Board designations in future CAFRs.	Note has been updated to include interest earnings applied to Effluent Export Pipeline set-aside
24	$119,497 of costs incurred to assess underground piping, potential leaks, and other pool related issues were capitalized that should have been expensed			X		Amounts are immaterial fo the financial statements.	No action needed.

M E M O R A N D U M

TO: Board of Trustees

THROUGH: Paul Navazio
Director of Finance

FROM: Indra Winquest
District General Manager

SUBJECT: Management Comments Related to Audit Committee Annual Report (dated March 9, 2022)

DATE: April 13, 2022

I. RECOMMENDATION

Staff recommends that the Board of Trustees consider management's response(s) to the recommendations included in the Annual Report of the Audit Committee, presented to the Board of Trustees on March 9, 2022, prior to consideration of formal Board action related to the Audit Committee's recommendations.

II. BACKGROUND

The purpose of this memorandum serves to provide management's response to the recommendations presented to the Board of Trustees via the Audit Committee's annual report on the FY2020/21 audit, which was transmitted to the Board on March 9, 2022.

Upon receipt of the Audit Committee's Annual Report, the Board of Trustees deferred action on the specific recommendations being advanced by the Audit Committee, pending review and comment from management (and, where appropriate, the District's external auditor).

This agenda item has been prepared in response to the request from the Board of Trustees.

The Audit Committee's Annual Report, presented to the Board of Trustees at their meeting of March 9, 2022 contained a series of specific recommendations within five general topics, for consideration by the Board.

Staff concurs with recommendations of the Audit Committee related to:

> *Recommendation #1 - Expanding the scope of audit work for FY21/22 to include enhanced review of internal controls.*

Staff has largely implement the recommendation of the Audit Committee related to items to be included in the District's Capital Budget:

> *Recommendation #5 - the Audit Committee recommends the Capital Improvement budget contain only project costs that are to be capitalized. The Audit Committee recommends that projects or project elements related to preliminary stage activities, repair and maintenance items are separated and included in operating expenses.*

In addition, related to Recommendation #4, staff concurs with updating the historical methodology for allocating interest earnings; however, staff wishes to clarify that a change in methodology for allocating investment earnings was implemented for FY2021/22. This revised approach is consistent with best management practices. Staff feels that the Audit Committee's recommendation, as presented in their Annual Report, is based on a misunderstanding of the how investment earnings were allocated in the past, as well as the change in methodology that has been implemented in the current fiscal year.

Staff does not concur with the Audit Committee's recommendations related to the need for additional prior period adjustments. Each of these items were reviewed by the District's external auditors (past and/or present), and the most recent audit of the District's financial statements were determined by the independent auditor to be "fairly represented in all material respects." Therefore, a review and revision of items already audited and deemed appropriate by both management and the District's independent auditor is unwarranted and unnecessary. These Audit Committee recommendations include:

> *Recommendation #2 - The Audit Committee recommends a prior period adjustment to expense items 2a & 2b for consistency and accuracy of our financial statements. (Related to maintenance and repair activities).*
>
> *Recommendation #3 - The Audit Committee recommends a prior year adjustment to expense these items for compliance with Board Practice and consistency and accuracy of our financial statements. (Application of capitalization threshold criteria).*
>
> *Recommendation #4 - The Audit Committee recommends a prior period adjustment removing investment income credited to the General Fund and included in the fund balances for the fund(s) which had cash invested at LGIP, as it had historically been done, prior to FY 2018-2019.*

III. DISCUSSION

This discussion sections provides more specific responses to each of the recommendations included in the Audit Committee's Annual Report to the Board of Trustees, dated March 9, 2022. The Audit Committee's recommendations are presented herein, verbatim, and *management's responses are presented in italics.*

1. The Audit Committee notes actions are being taken by management to address the identified issues in the Auditors Compliance Report related to Internal Controls and Construction Projects.

   The Audit Committee recommends that the FY 21-22 audit be expanded in scope to include enhanced review of internal controls.

   Management Response:

   Management concurs that the scope of the independent audit engagement did not constitute a "comprehensive forensic audit," nor is this typically the scope of an annual audit of financial statements.

   Should the Board choose to undertake an audit that goes beyond the standard audit procedures for review of financial statements for compliance with GAAP/GAASB and Generally-Accepted Audit Standards, this should be discussed with the external auditor. Additional audit scope would likely require a separate engagement (and cost) from the specific scope of the annual financial statement audit, for which the District has entered into a multi-year, fixed-price contract.

2. Management corrected prior years of capitalization for items considered to be maintenance and repairs. However, the FY 2019-2020 and 2020-21 ACFRs are inconsistent.
   a. For the Utility Fund, this is estimated to be $181,882 (see Comments and Concerns #2 and Section 3.1)
   b. For Community Services the amount is estimated to be $1,171,606 (see Concern 11, Section 3.3, and Appendix D). These were for preliminary stage activities which include conceptual formulation and evaluation of alternatives, determination of future needs, feasibility studies and development of financing alternatives, temporary repairs for the Burnt Cedar pool and temporary repairs at the Mountain Golf Course Clubhouse.
   c. Similar costs were expensed for 2019-2020 (as a prior period adjustment - Note 22 of CAFR) for the Parks Master Plan ($212,044) and the Incline Village Ballfield ($77,216). In FY 2020-2021 similar costs of $3,100,110 for the Effluent Pipeline were charged off as a prior period adjustment. This highlights the inconsistency of the financial statements.

The Audit Committee recommends a prior period adjustment to expense items 2a & 2b for consistency and accuracy of our financial statements.

Management Response:

All FY2020/21 capital and construction-in-process items were reviewed by management and the auditor and concluded that capitalization was appropriate.

3. Contained in the initial draft of the ACFR, the Auditor had identified an additional $866,503.70 of charge off to expenses items for items capitalized in past CAFRs. After review by Management, some items were removed including levee and roadway repairs at the wetlands, spot paving at various recreational venues, sewer line repairs and roof repairs which, as noted in #2 above, had been determined to be expense items rather than capital.

   Additionally, equipment items were grouped together to meet the capitalization threshold while Board Practice 2.9 states "**In no case will the District establish a capitalization threshold of less than $5,000 for any individual item.**". The Audit Committee Chair reviewed this with the Auditor, after the financial report was complete, and she concurred that the Board Practice is clear and not open to interpretation. In addition, an Audit Committee member reviewed with Melissa Crosthwaite, District Legal Counsel, who also concurred the statement is clear. (see Concern 8 and Section 3.2)

   The Audit Committee recommends a prior year adjustment to expense these items for compliance with Board Practice and consistency and accuracy of our financial statements.

   Management Response:

   As discussed with the Audit Committee, and supported by the Auditor, at issue are items that the Auditor had identified as potential write-offs, based on their review of Board Policy and GAAP/GASB guidelines. The reversals of items initially written-off were all reviewed with the Auditor <u>and were only reversed upon concurrence of the Auditor</u>.

   Moreover, management believes that the review of capital assets and subsequent write-offs to be consistent with Board Policy 9.1 and Board Practice 9.2. At the same time, given the identified need to clarify aspects of the capitalization policy, these have been largely addressed in the updated capitalization policy approved by the Board in January.

   Staff notes that in following up with both the external auditor and the District's legal counsel, the comments attributed to both in this Audit Committee recommendation *are taken out of context and should not be viewed as concurrence with the Audit Committee's position.*

4. Beginning in FY 2018-2019 investment income was credited to the General Fund instead of other funds which had cash deposits at LGIP. This caused the General Fund's opening balance in the FY 2020-21 ACFR to be overstated by approximately $492K (over a 10% overstatement). This has not been corrected.

   The new process management has chosen to implement is allocating investment income not by the fund with cash invested at LGIP, but based on total cash equivalents by fund.

   The Audit Committee recommends a prior period adjustment removing investment income credited to the General Fund and included in the fund balances for the fund(s) which had cash invested at LGIP, as it had historically been done, prior to FY 2018-2019.

   Additionally, the committee recommends the approach for distribution of investment income be based solely on cash invested by fund or to have separate LGIP accounts by fund, like the Utility Fund, to avoid any confusion.

   Management Response:

   The accounting for investment income has been modified beginning with the 2021/22 (current) fiscal year. This change in methodology is consistent with best management practices and, staff believes, is more closely aligned with the implied goal of the Audit Committee's recommendation.

   Staff does not concur with the Audit Committee's recommendation to record prior period adjustments related to past practice of allocating investment earnings.

   Simply stated, the District's past practice was to record and track investments in LGIP and the District's investment portfolio "by fund." Accordingly, individual funds were credited with investment earnings based on the interest received by investments held by each individual fund. Under this approach, the General Fund was historically credited with interest earnings from pooled cash within the District's governmental funds.

   Beginning July 1, 2021, management modified the methodology for allocating investment earnings. Consistent with best management practices, all available cash on hand is pooled for investment purposes. Individual investments are not recorded, or tracked, by fund, but rather investments are managed under a pooled portfolio, with interest earnings allocated to each of the District's individual funds based on each fund's proportional share of cash balances available for investment.

5. For ease of transparency, and to align with best practices, **the Audit Committee recommends the Capital Improvement budget contain only project costs that are to be capitalized. The Audit Committee recommends that projects or project elements related to preliminary stage activities, repair and maintenance items are separated and included in operating expenses. A separate line item in the Statement of Income, Revenue and Expenses and Change in Net Position for preliminary stage activities, repairs and maintenance is recommended for all funds.** This will allow for cross referencing the expense items budgeted within Services and Supplies.

   Management Response:

   Management does not concur with the full extent of this recommendation, and this issue warrants Board discussion.

   Management concurs, and has implemented, budgeting and accounting practice of reflecting all capital maintenance expenses as operating costs within the District's budget and financial statements. Specifically, items to be capitalized are budgeted as capital outlay within the District's budget, and items that are deemed capital maintenance and repairs (or otherwise do not meet the District's capitalization criteria) are budgeted and accounted for within each fund's operating budget.

   However, the presentation of these items within the District's overall mulit-year capital plan is not only consistent with current Board Policy 13.1/ Practice 13.2, but also assists in identifying individual projects, with varying levels of funding requirements, all related to the maintenance and replacement of the districts, facilities, infrastructure, and assets.

   Notwithstanding, management is developing improved presentation and reporting of the different elements contained in the capital plan for improved transparency and ease of understanding.

   Lastly, management does not concur with the recommendation to reflect all of the maintenance and repair items in a separate line item within the District's financial statements (specifically, Statement of Income, Expense and Change in Net Position). While these items are presently reflected in a single account object code (7505) within the budget and general ledgers, these items are more appropriately reflected in the account codes appropriate for the "type" of expenditure (example: computer equipment, professional services, etc.). Moreover, establishing a separate line item within the District's formal financial statements, as recommended by the Audit Committee, is contrary to GAAP/GASP requirements for these type of expenditures.

(Note: In the context of this discussion, it is important to clarify that, with the transition to Enterprise Fund accounting for the District's Community Services and Beach funds, there is no longer any formal distinction between utility and venue "operating budgets" and "capital budgets." All of the revenues and expenditures for each fund are reflected in a single fund (or sub-fund) budget that includes operating, capital and debt line items).

III. ALTERNATIVES

This report recommends that the Board of Trustees consider management's response to each of the Audit Committee's Annual Report recommendations prior to considering formal Board action.

As an alternative to considering each recommendation individually prior to any Board action, the Board could consider:

1) Accepting all of the recommendations in the Audit Committee's Annual Report, as recommended by the Audit Committee, or
2) Take no action on the recommendations contained within the report, and consider receiving the report and directing the Audit Committee to return to the Board of Trustees with a specific recommendation related to scope and cost of additional audit work to expand the external auditor's review of the District's internal controls.

HISTORY OF REPORTING OF FACILITY FEES IN DISTRICT FINANCIAL STATEMENTS

	Statement of Activities		Statement of Revenues, Expesnes and Change in Net Postion		Statement of Cash Flows				
FYE	Program Revenues	General Revenues	Operating Revenues	Non-Operarting Revenues	Operating Activities	Non-Capital Financing Activities	Capital and Related Financing Activities	Investing Activities	Independent External Auditor
Propietary (Enterprise) Funds									
6/30/2022									
Govrernmental (Special Revenue) Funds									
6/30/2021		X							Davis Farr, LLP
6/30/2020		X							Eide Bailly, LLP
6/30/2019		X							Eide Bailly, LLP
6/30/2018		X							Eide Bailly, LLP
6/30/2017		X							Eide Bailly, LLP
6/30/2016		X							Eide Bailly, LLP
6/30/2015		X							Eide Bailly, LLP
Propietary (Enterprise) Funds									
6/30/2014	X		X		X				Kafoury, Armstron & Co.
6/30/2013	X		X		X				Kafoury, Armstron & Co.
6/30/2012	X		X		X				Kafoury, Armstron & Co.
6/30/2011	X		X		X				Kafoury, Armstron & Co.
6/30/2010	X		X		X				Barnard, Vogler & Co.
6/30/2009	X		X		X				Barnard, Vogler & Co.
6/30/2008	X		X		X				Barnard, Vogler & Co.