

**Date: February 9, 2021**

**To: Audit Committee**

**From: Paul Navazio,  
Director of Finance**

**Subject: Comments on Annual Audit Committee Report (dated 2/1/21)**

The purpose of this memorandum is to provide the Audit Committee with staff comments regarding selected issues of concerns and recommendations included in the draft Annual Report of the Audit Committee, appearing on your agenda for the Audit Committee meeting of February 10<sup>th</sup>, and also provided to the Board of Trustees via their agenda for the Board meeting of February 10<sup>th</sup>:

General Comments:

- *Recommendations: Among the recommendations included in the draft Annual Audit Committee Report to the Board of Trustees are several items that suggest that the 2020 CAFR be modified, updated or corrected to address several concerns. This appears to be in conflict with the direction provided by the Audit Committee at their meeting of January 27, 2021, where upon presentation of the 2020 CAFR and related Audit Reports, the committee requested that the Board of Trustees direct staff to seek an extension for the filing of the CAFR in order to allow time for the Audit Committee Report to be presented to the Board (on February 10<sup>th</sup>).*

At their meeting of January 28<sup>th</sup>, the Board of Trustees opted to hear the presentation of the CAFR and Audit Report; however, consistent with the recommendation from the Audit Committee, the Board directed staff to hold off filing of the CAFR and, instead, seek an extension from the Department of Taxation in order to allow time for the Audit Committee to prepare and present their Annual Report, and for the filing of the CAFR to be delayed until such time.

Staff requested a two-week extension on the time for filing the CAFR on February 1<sup>st</sup>, and received formal approval from the Department of Taxation for a second extension, until February 15, 2021. This two-week extension was granted, as requested, to allow time for the Annual Audit Committee Report to be presented to the Board of Trustees at their meeting of February 10<sup>th</sup>, as directed by the Board of Trustees, upon recommendation of the Audit Committee.

- *Process and expectations inferred by Board Policy 15.1.0 would benefit from review and update to better align with the standard process established for independent audits, and the proper role of the Audit Committee as oversight body for the annual audit.*

The Annual Audit Committee Report includes a section (III. History) that summarizes the multiple updates provided by staff to the Audit Committee over the course of the independent audit of the District's financial statements.

The Audit Committee is correct to note that the CAFR and the Auditor's reports should have, ideally, been presented in a timely fashion to provide ample time for the Committee to prepare and discuss their Annual Report to the Board of Trustees; however, given that the final CAFR and Audit Report were delayed, in part, to allow for the report from Moss Adams to be finalized (received in Final form on January 15, 2021), it should be noted that the final CAFR and audit report, issued by Eide Bailly on January 22, 2021, was presented to the Audit Committee at its first meeting following its issuance. This schedule also conforms to the timeline implied by the District's first request for a 30-day extension of the time to file the CAFR and audit report, which per NRS 364 is December 31, 2020.

The Annual Audit Committee Report also notes the Audit Committee had requested copies of draft documents provided to the external auditor to expedite the Committee's review process, and stated that the process needs to be improved as part of the 2021 external audit "to comply with Board Policy 15.1.0. Staff concurs with this comment, and would add that 1) draft documents were, in fact, provided to the Audit Committee at their meetings in September, October, November and January, and b) it is impractical and, arguably, outside the "oversight" role of the Audit Committee to review every document provided by staff to the auditors, OR, for the Audit Committee to conduct prior review and oversight of these documents. This includes items such as the Transmittal Letter, Management Discussion and Analysis, Basic Financial Statements, Management Representation Letter, etc.

- *Concerns and Comments Regarding Compliance with Generally-Accepted Accounting Principles (GAAP) – Application of Moss Adams report recommendations in the 2020 CAFR.*

Staff concurs with the comments in the Annual Audit Committee Report that Moss Adams was engaged to specifically review accounting and reporting treatment on four major items, and the resulting Moss Adams recommendations would provide (final) clarification on accounting and reporting issues raised by members of the community over prior CAFR's.

Staff believes that the 2020 CAFR appropriately incorporates recommendations from the Moss Adams report related to each of the four areas identified for review in the Moss Adams Engagement:

- 1) Central Service Cost Allocations to Special Revenue Funds were determined to be in accordance with GAAP; however, Moss Adams recommended that the presentation of Central Services Overhead Allocations be presented as "netted" against administrative expenditures instead of revenues to the General Fund. This was reviewed with Eide Bailly, agreed to, and corrected in the 2020 CAFR.
- 2) Punch Card Accounting / Use of Contra-Revenue Accounts were determined by Moss Adams to NOT conflict with GAAP/GASB. However, in recognition that this is a confusing and complicated accounting issue, Moss Adams has recommended that the District cease the accounting treatment of contra-revenue accounts for punch cards. In process.
- 3) Enterprise Fund vs. Special Revenue Fund Accounting was reviewed by Moss Adams and concluded that GASB does NOT require the District to use Enterprise Fund Accounting for reporting its Community Services and Beach Activities. However, in their review, Moss Adams concluded that Enterprise Fund accounting is preferable when an entity wishes to

ensure that its fees and charged cover the full cost of operating, capital and debt. Staff concurs and, in fact, has already initiated the transition back to Enterprise Fund accounting for Community Services and Beach activities.

Moss Adams also concluded that, while District's use of Governmental Fund accounting is consistent with GAAP/GASB, they noted that – while there is no clear standard, and there is variation in practice – as a general rule, best practice has evolved to where a threshold of 20% of revenues collected in a governmental fund must be “committed” by the governing body for specified purpose in order to be properly reported as a Special Revenue fund. Absent this 20% threshold of committed revenues, Moss Adams concludes that the activities should be reported as General Fund revenues. In reviewing this issue, management and Eide Bailly believe that the level of commitment of the District's Facility Fees is sufficient to qualify for use of Special Revenue fund accounting under GASB.

In fact, it should be noted that the original FY2019/20 budget approved by the Board of Trustees effectively eliminated the use of Capital and Debt funds, with all revenues and expenditures budgeted for (and subsequently, accounted for) within the Community Services and Beach Special Revenue funds. When the FY2020/21 budget was approved, to re-establish use of Capital and Debt funds for CS and Beach activities, a resolution was presented to the Board on June 30, 2020 to amend the FY2019/20 budget to retroactively utilize the Capital and Debt funds, for consistency with Resolution 1838, despite the fact that the District was not required to use Capital and Debt funds for tracking of facility fee funded activities.

Notwithstanding the above, report prepared by Moss Adams provides for two options to address their concern over whether the District's Community Services and Beach activities meet GAAP “guidelines” for Special Revenue fund accounting. Specifically, pages 8 and 13 of the Moss Adams report reads, *“Should the District continue to utilize governmental funds for 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 Facility Fees to the activities within Community Services and Beach... Further, the District would need to commit additional resources (i.e. Charges for Services) reported within Community Services and Beach in order to meet the spirit and intent of GAAP to use special revenue funds.”*

In short, management believe that that the District's use of Special Revenue funds is consistent with GAAP/GASB, based on board policy (Resolution 1838) and the practice of restricting use of revenues collected to a specific purpose. Moss Adams suggests that, if this is the Board's intent, the Board should clarify – by resolution – that a) the Facility Fees collected from parcel owners are indeed committed to the purpose for which they are collected, and b) that Charges for Services reported as revenues within the Community Services and Beach Special Revenue funds (per Board Resolution 1838), are also so committed. Moss Adams' concern with use of Special Revenue funds is entirely based on their observation that there appears to be no clear policy language established by the Board that requires that Facility Fees or Charges for Services collected by, and reported within, Community Services and Beach Funds can only be used to support those specific activities.

Rather than directing that Community Services revenues and expenses be treated as General Fund activities in the 2020 CAFR, staff would recommend that the Board first clarify whether it is indeed the intent of the Board for the Facility Fees and Charged for Services charged to property owners and other users of our recreational venues should be committed for that purpose (as implied by Resolution 1838).

- 4) *Accounting for Capital Expenditures was reviewed by Moss Adams and provides – in staff’s opinion – the most important set of recommendations related to the District’s accounting practices.*

The Moss Adams report concludes that District has been capitalizing expenditures in the development of master plans as well as costs that are more appropriately expensed as repair and maintenance costs. The report further states that, “the Board’s capitalization policies and practices are not sufficiently detailed to provide guidance on what types of costs should be considered for capitalization.”

Both the Moss Adams report, and the presentation by its author to the Board (at meeting of January 28<sup>th</sup>) noted that “there is relatively little guidance in the accounting standards to provide specific guidance on when it is appropriate to treat an expenditure as capital. Rather, most of the guidance is based on GASB Concept Statement No. 4 which provides general concepts only...” (page 26). The report goes on to describe elements of existing best practices and provides a series of recommendation to better align the District’s accounting for capital assets with accepted best practices.

Staff concurs with the recommendations included in the Moss Adams report. In fact, a review of existing capital assets reported on the District’s financial statements was undertaken to determine to what extent expenditures may have been capitalized for items that were clearly repairs and maintenance, as defined by Board policy and District’s capitalization procedures, as well as items that appear to have no relation to a planned or proposed future capital project. This review resulted in both current year and prior year adjustments to valuation of capital assets in the District’s financial statements for the year ended June 30, 2020.

The Annual Audit Committee reports presents an independent analysis, duly and painstakingly performed by a single member of the Audit Committee, and concluded that in excess of \$3.0 million in capital costs associated with the Effluent Pipeline project should have been expensed in the 2020 CAFR. Management, with the concurrence of the Independent Auditor, did not concur with this analysis. At the same time, management is of the opinion that, once Board policy related to accounting for capital assets is reviewed and updated, consistent with the recommendation in the Moss Adams report, this may well result in modifications to how expenditures are classified as either capital or expense on a going forward basis. In addition, some costs that have previously been capitalized under the expectation and assumption that a specific capital asset is to be constructed and/or replaced, may be re-evaluated should the anticipated and planned projects do not come to fruition.

- *Classification of Facility Fees in the Statement of Activities - This issue comes up in the Moss Adams report under their review of Punch Card Accounting (pp. 20-24). In their discussion of this issue (2<sup>nd</sup> paragraph, page 23) and in their recommendation (last paragraph, page 24), Moss Adams notes*

*that “there is diversity of practice in the application of existing guidance with transactions that are not pure exchange or non-exchange transactions. As a result GAAP requires management to set a policy that is consistently applied...” The report goes on to state that, “bases on our review of past CAFR’s we did not find a disclosure specific to the revenue classification of the District’s Facility Fees.*

In the final paragraph on page 24, the report states, “We recommend that the District include its policy on the classification of Facility Fees as either program or general revenue, or either operating or non-operating, in the footnotes to the financial statements.” They also go on to state that “should the district continue to report its recreational activities within the governmental funds, the fees be classified as program revenues and reported in charges for services. If the District reports the recreation activities as enterprise funds, we recommend the fees be recorded as non-operating revenues.”

In response to this Moss Adams recommendation, the FY2019/20 CAFR now includes the recommended disclosure footnote (see below) that speaks directly to the classification of the Facility Fee as a general revenue due to its non-exchange nature (See CAFR page 39). This disclosure was not included in past CAFR’s reviewed by Moss Adams.

#### ***T. Accounting for Facility Fees***

*Each year, the District establishes an annual Recreation Facility Fee and Beach Facility Fee to be collected from property owners within the District through a levy placed on the property tax bill and collected on behalf of the District by the Washoe County Treasurer’s Office. These fees are established based on the revenues required to support debt, capital expenditure and operations for the District’s various recreation and beach facilities. These revenues, combined with service charges collected by the District for facility use and program activities serve to support the operations of the District. These revenues are recorded as general revenues within the government-wide statement of activities as opposed to charges for services. The Facility Fees are recorded as revenues to the Community Services Special Revenue Fund and the Beach Special Revenues fund, with subsequent transfers to Capital and Debt fund, as required, to support actual expenditures.*

Consistent with this, and other recommendations included in the Moss Adams report, especially in the area of Punch Card Accounting, staff intends to implement these recommendations in the CURRENT fiscal year – not reach back and change how the punch card accounting and treatment of facility fees was budgeted, accounted for, and reported in FY2019/20.

- *Remaining 20 accounting and reporting concerns of community members within the 2019 CAFR were reviewed by Moss Adams and, of these, 14 items should be addressed in future CAFRs.*

These additional 20 items were not included in the scope of the Moss Adams review of accounting and reporting issues, nor where they presented to staff as part of the final Moss Adams report. However, as these represent items that had been raised previously by community members, staff and the auditor reviewed these items independent of the Moss Adams report and addressed several of these items in the 2020 CAFR.

In the context of the Audit Committee's Annual Report, any comments or recommendations from Moss Adams related to these items should not be viewed as requiring modifications to the 2020 CAFR. The Moss Adams notes on these issues, provided to staff by members of the Audit Committee (and not Moss Adams) support this position as the items are identified as follows:

*"To be addressed in future CAFRs with the District's future audit firm."*

Management concurs that these items should continue to be reviewed in the context of current fiscal year accounting and reporting, for possible consideration in the 2021 CAFR, following review by management as well as the District's new Independent Auditor.

### **Conclusion**

From staff's perspective, only the four accounting issues reviewed by Moss Adams and referenced in their final report, dated January 14, 2021 were to be considered during the course of the preparation and audit of the District's financial statements for the year ended June 30, 2020. And it is with this understanding that the observations and recommendations from the Moss Adams report were largely, if not entirely, reflected in the 2020 CAFR, to the extent that the Independent Auditor determined these to be relevant and material.