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February 10, 2004

Board of Supervisors
County of El Dorado
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I have audited the financial statements of the County of El Dorado for the year ended June 30, 2003, and have issued my report dated February 10, 2004. Professional standards require that I provide you with the following information related to my audit.

My Responsibility under Generally Accepted Auditing Standards and OMB Circular A-133

As stated in my engagement letter dated May 02, 2003, my responsibility, as described by professional standards, is to plan and perform my audit to obtain reasonable, but not absolute assurance about whether the financial statements are free of material misstatement. Because an audit is designed to provide reasonable, but not absolute assurance, and because I did not perform a detailed examination of all transactions, there is a risk that material errors, fraud, or other illegal acts may exist and may not be detected by me.

In planning and performing my audit, I considered the County of El Dorado's internal control over financial reporting in order to determine my auditing procedures for the purpose of expressing my opinion on the financial statements and not to provide assurance on the internal control over financial reporting. I also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine my auditing procedures for the purpose of expressing my opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

As part of obtaining reasonable assurance about whether the County of El Dorado's financial statements are free of material misstatement, I 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 my audit. Also, in accordance with OMB circular A-133, I examined, on a test basis, evidence about the County of El Dorado's compliance with types of compliance requirements described in the U.S. Office of Management and Budget Circular A-133 Compliance Supplement applicable to each of its major federal programs for the purpose of expressing an opinion on the County of El Dorado's compliance with those requirements. While my audit provides a reasonable basis for my opinion, it does not provide a legal determination of the County of El Dorado's compliance with those requirements.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, I will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the County of El Dorado are described in Note Two (2) to the financial statements. I noted no transactions entered into by the County of El Dorado during the year that were both significant and unusual, and of which, under professional

standards, I am required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the general purpose 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 general purpose financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

Managements' estimate of accrued compensated absences is based on current employee wage rates. I evaluated the key factors and assumptions used to develop the accrued compensated absences in determining that it is reasonable in relation to the financial statements taken as a whole.

Managements' estimate of delinquent assessments receivable is based on County of El Dorado abstracts. I evaluated the key factors and assumptions used to develop the delinquent assessments receivable in determining that it is reasonable in relation to the financial statements taken as a whole.

Managements' estimate of the Risk Management Fund's liability claims for self insurance is based on actuarial assumptions. I evaluated the key factors and assumptions used to develop the Risk Management Fund's liability claim for self insurance in determining that it is reasonable in relation to the financial statements taken as a whole.

Managements' estimate of the liability for closure and postclosure costs for the Union Mine Landfill is based on engineering studies. I evaluated the key factors and assumptions used to develop the closure and postclosure costs of the Union Mine Landfill in determining that it is reasonable in relation to the financial statement taken as a whole.

Significant Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the general purpose financial statements that, in my judgement, may not have been detected except through my auditing procedures. The adjustments may include those proposed by me, but not recorded by the County of El Dorado that could potentially cause future financial statements to be materially misstated. All audit adjustments proposed have been accepted.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to my satisfaction, concerning financial accounting, reporting, or auditing that could be significant to the general purpose financial statements or the auditor's report. I am pleased to report that no such disagreements arose during the course of my audit.

Consultations with Other Independent Accountants

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 general purpose financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require that the consulting accountant check with me to determine that the consultant has all the relevant facts. To

my knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditor

I generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the County of El Dorado's auditor. However, this discussion occurred in the normal course of my professional relationship and my responses were not a condition to my retention.

Difficulties Encountered in Performing the Audit

The completion of my audit was delayed because the Schedule of Federal Awards was not completed in a timely manner.

Findings and Recommendations

In the following section I will discuss certain observations that I believe warrant attention and/or future monitoring by the County management.

PRIOR YEAR MANAGEMENT COMMUNICATION

Finding:

Responses to findings in my management communication letter dated January 31, 2003, have not been addressed by management.

Recommendations:

Finding and recommendations from the previous years should be addressed in conjunction with the current year's findings.

SOCIAL SERVICES DEPARTMENT

Finding:

The auditor encountered limited cooperation from the Department. Upon inquiry no one person knew the system completely, and no one would take responsibility. There are gaps in various controls over receipts, collections, and disbursements. What controls are in place are not always being utilized. There also appears to be a different and vaguely defined merit system in place than that of the rest of the County. The Department, because of not being responsive to client inquiries, has a less than desirable reputation in the community. Based upon the above factors, the auditor has designated this department as a high risk area.

Recommendations:

In addition to developing policies and procedures to document controls and the flow of documents through the system, the Department also needs to develop performance measures. This is important for effective management. Performance measures are indices developed by function or position that management can use to properly understand the results of operations and gauge the improvement in performance over time. Performance measures are developed by reviewing the time, quality, and quantity of a function. Outside consultants should be retained to review the system and develop controls and performance measures for each

major function.

FLEET MANAGEMENT-PRIOR YEAR FINDING

Finding:

In the current year, employees continue to record their fuel usage in a hand-written log maintained at the pump site. Fuel usage could be abused. Since everything is done by hand and re-entered into the system, errors have occurred. There is no numerical control over the hand-prepared logs, which could be lost, especially on a windy or rainy day.

Entering the data from the logs is also labor intensive.

This area is not considered high risk since each transaction is small amounts. It would take a large volume of errors or misuse to have a material effect on the financial position of the County.

Recommendations:

The underlying factor in this observation is that the present system is subject to abuse. Repairing the system to be fully automatic should be reviewed by management.

FLEET MANAGEMENT

Finding:

The Department has an accumulative unreserved fund balance in excess of \$2.6 million which is in excess of one quarter or three months worth of operating costs. Also the reserve for replacement, which is based upon incremental charges added to each billing, has not been recalculated for the past few years. This has resulted in finding from the State Controller's Office Division of Accounting and Reporting. A corrective action plan has been submitted to the State whereby the reserve for replacement has been recalculated and increased and \$2,700,000 will be rebated of the unreserved fund balance to each department to decrease Fleet's's unreserved fund balance.

Recommendations:

To ensure that rates are not excessive in the future, annually exclude Fleet's reported income and unreserved fund balance to allow for the timely adjustment of rates if deemed applicable. As for the reserve for replacements the amounts should be reevaluated each fiscal year.

Finding:

There is apathy by the departments in reporting the correct mileage on the odometers at the end of each month. This has resulted in incorrect cost allocation to the departments. Errors may work out over a period of time but data on a monthly basis is not accurate.

Recommendations:

Department heads should be notified that the policy is there to be followed. If it is to inconvenient then the present County policy should be reviewed.

COUNTY WATER AGENCY

Finding:

On February 6, 1996, the County, represented by the Water Agency, sold to the El Dorado Irrigation District property known as Texas Hill. The installment purchase agreement called for five annual payments of \$500,000 commencing September 1, 1996. An additional payment \$3,378,360 is due when the District obtains construction financing for and commences construction on the Texas Hill Reservoir. In the event that the property is sold or used for any purpose that is inconsistent with the development of the Texas Hill Reservoir, any funds received must be used to fund the development of increased water supplies or increased waste water capacity for the benefit of customers or potential customers of the District.

The County has recorded the full \$3,378,360 as a receivable. The District has included an unamortized discount of \$1,845,360, based on an imputed interest rate of 5%. The balance of \$1,533,000 is recorded as a payable to the County. There is no stipulation in the agreement between the two entities for this interpretation.

Recommendations:

Management should clarify the issues surrounding this note receivable from El Dorado Irrigation District.

RISK MANAGEMENT

Finding:

As of the year end the self-insurance fund maintained by risk management had a deficit fund balance of over \$1.4 million.

Recommendations:

Management needs to develop a strategy to eliminate the deficit and to maintain a reasonable balance in subsequent years.

TRUST FUND-WILLIAMSON AGRICULTURE ACT

Finding:

As mentioned in the previous communication, there is presently a balance of \$457,204.25 in this account with no activity since 1986. These funds were collected from landowners upon the cancellation of Williamson contracts for agricultural preserves.

The fees mentioned are provided for in Government Code Sections 51283 and 51283.1. Section 51283 contains a formula for determining "cancellation fees" for immediate cancellation of a Williamson Act contract. Section 51283.1 provides a scheme for determining additional "deferred taxes" to be paid upon cancellation. The distinction between the two payments is significant in that the cancellation fees are to be paid to the State upon collection as set forth in Section 51283(d). This section states as follows:

"When deferred taxes required by this section are collected, they shall be transmitted by the County Treasurer to the Controller and be deposited in the General Fund. The funds collected by the County Treasurer with respect to each cancellation of a contract shall be transmitted to the Controller within

thirty days of the Board's or Council's execution of a certificate of cancellation of a contract, as specified in subdivision (b) of Section 51283.4."

TRUST FUND-WILLIAMSON AGRICULTURE ACT (continued)

The deferred taxes provided for in Section 51283.1, on the other hand, are to be allocated to the various taxing agencies levying property taxes as provided in Section 51283.1(e). As you can see we are substantially past the thirty day limit.

Recommendations:

It is important to determine the nature of the funds received in order that the correct distribution be made.

It appears that the funds currently in the possession of the County should have been either forwarded by the County Treasurer to the State Controller upon collection or allocated to the local taxing agencies having an interest in the property, depending upon the character of the funds collected. I recommend you consult with other affected departments, most notably the Treasurer's and Assessor's offices, to determine the appropriate course of action at this time.

CONSISTENT REVENUE RECOGNITION

Finding:

The County policy is to report revenues using current financial resources, measurement focus, and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. Revenues are accrued when their receipt occurs within sixty days after the end of the accounting period so as to be both measurable and available. Various department are not consistent in following this policy. This is evident in revenue recognition of state and federal grants and awards. One department will record revenues on the cash basis only recognizing the revenues when received. Another department will records as receivable based upon expenditure incurred knowing that these amounts will be forthcoming in a year or two. Amounts received are usually less than the estimate. They are not really measurable and not receivable within the current period.

Recommendation:

The amounts involved are not material to the overall financial position of the County, but it does point to the need for consistency in the recognition of revenue.

RECEIPT/COLLECTION/RECORDING SYSTEM - ANIMAL CONTROL

Finding:

Auditor was unable to track to any type of cash receipt journal. The old computer system crashed and the department lost the data that was maintained on the system. They were in the process of recreating the lost data from their manual receipts. The inadequacy of the system had been mentioned in the previous report.

Recommendation:

The Department needs to develop policies and procedures to document and implement their new CHAMELIAN system.

RECEIPT/COLLECTION/RECORDING SYSTEM - PROBATION

Finding:

During the test of the system it was determined that voided receipts were not being handled properly and that cash handling policies in regard to voided receipts are not being followed. This appears to be a County wide problem since the present guidelines are outdated. The policies address manual systems which are now nearly non-existent.

Recommendation:

The policy and guidelines should be reviewed and updated to include the present technology.

USE OF SICK LEAVE

Finding:

The County allows an employee to accumulate sick leave based upon a pre-determined formula. Each department administrator determines when an individual qualifies to use their sick leave especially when it is for an extended period of time. This has resulted in inconsistent application of requirements for extended sick leave between the departments.

Recommendation:

Management needs to develop policies for use of sick leave that is consistent throughout the County Departments.

LEASEHOLD IMPROVEMENTS

Finding:

It was noted that the County does not have a set policy for capitalization of leasehold improvements. Consequently, the treatment of leasehold expenditures are not consistent. The County's records reflect a number of clearly immaterial items, under \$10,000, that have been capitalized in the past. The items require the same amount of record keeping by the County property system regardless of the size of the transaction.

Recommendation:

It is recommended that management establish a policy whereby all leasehold improvements over \$10,000 and having a useful life of one year or more are capitalized. Leasehold improvements costing less than the established amount or having a useful life of less than one year should be expensed, since the cost of maintaining depreciation records for such items would exceed the benefits. The County should document the capitalization policy and communicate it to those who are responsible to ensure that the policy is consistently followed.

INTER-DEPARTMENT BILLING FORM CEC

Finding:

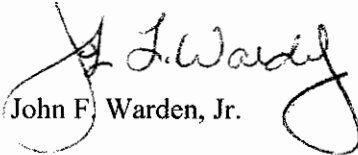
There is a large time lag in reporting expenditures incurred by the Mental Health Department that should be included in the quarterly reimbursement form County Expense Claim filed by the Department of Social Services. The Mental Health expenditures are not reported until the year end of the County. Any unliquidated balances are not reported until a supplement billing is prepared. This supplement billing could have a time lag as much as nine months after the year end. The time lag for any repayment and recognition of the expenditure can be extended over a year and will be reported in subsequent years.

Recommendations:

There should be a system in place in both departments to assure that expenditure-reporting deadlines are met. Social Services should also have a system in place to monitor the cash management activities.

This information is intended solely for the use of the Board of Supervisors, Auditor-Controller and management of the County of El Dorado and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,


John F. Warden, Jr.