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Management Letter

January 28, 2011

To the Honorable County Judge and
Members of Commissioners' Court of
Polk County, Texas:

The American Institute of Certified Public Accountants issued a new auditing standard that must be followed when communicating certain internal control related matters as part of an audit of financial statements effective for audit periods ending on or after December 15, 2009. The new standard (Statement on Auditing Standards No. 115, *Communicating Internal Control Related Matters Identified in an Audit,* "SAS 115") provides guidance to auditors on communicating internal control matters to management and the governing body, board of directors, or equivalent body. Although it replaces a similar standard, it revises certain terminology, as defined below. Auditors are also required to report on issues identified in previous years even if it is not feasible to cost effectively address the matter.

It is important to note when reviewing findings reported within this letter that classification of the findings is based on the definitions required by SAS 115 as further discussed below. Please note that these classifications are based on the potential impact to the financial statements, not necessarily the likelihood of actual loss to the County. Accordingly, the County's assessment of the "significance" or ranking of severity will likely be substantially different based on a number of factors including, but not limited to, its assessment of risk and the cost benefit of making the change.

In planning and performing our audit of the financial statements of Polk County, Texas (the "County") as of and for the year ended September 30, 2010, in accordance with auditing standards generally accepted in the United States of America, we considered the County's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the County's internal control. Accordingly, we do not express an opinion on the effectiveness of the County's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and, therefore, there can be no assurances that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the County's financial statements will not be prevented, or detected, and corrected on a timely basis.

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A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our findings and additional comments are as follows:

MATTERS PREVIOUSLY REPORTED

Other Matters:

2009-2. ESCHEAT PAYABLE

Background

Under Texas State Property Code Chapter 72, Subchapter B. § 72.101, property is presumed abandoned if the owner of the property does not claim the property within three years. Under Texas State Property Code Chapter 74, *Subchapter D. § 74.301* , each holder who, on June 30, holds property that is presumed abandoned under Chapter 72 shall deliver the property to the comptroller on or before the following November 1 accompanied by the report required to be filed under Section 74.101. Under Texas State Property Code Chapter 74, Subchapter B. § 74.101 , each holder who, on June 30, holds property that is presumed abandoned under Chapter 72 of this code shall file a report of that property on or before the following November 1.

Finding

The County has a significant number of checks outstanding at year end, some of which are up to eight years old.

Recommendation

All escheat payable amounts that are older than three years from June 1 of the current year should be reported and delivered to the State no later than November 1. The County should monitor all outstanding checks and record escheat payable in accordance with the Texas State Property Code noted above.

Management's Response

We concur with the recommendation.

This communication is intended solely for the information and use of management, Commissioners' Court, the County Judge, and others within the County, and is not intended to be and should not be used by anyone other than these specified parties.

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January 28, 2011

Fact Sheet about Fund Balance Reporting and Governmental Fund Type Definitions

1. Why has the GASB issued new standards for reporting fund balance?

The GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions,* to address issues related to how fund balance was being reported. The GASB's original intention was to clear up confusion regarding the relationship between reserved fund balance and restricted net assets. However, the GASB's research revealed that the existing standards guiding fund balance reporting were being interpreted inconsistently by different governments. Consequently, the fund balance information reported by many governments also was inconsistent. It also became clear that the understandability of fund balance information was affected and that financial statement users were unable to readily interpret reported fund balance information.

2. Why did the GASB decide not to just clarify the existing fund balance classifications (reserved, designated, unreserved)?

The GASB considered pursuing a solely educational approach to these issues. However, it became apparent based on interviews and survey results that, even if all governments interpreted the requirements consistently, the resulting information would not meet the needs of people who use fund balance information to identify available resources and assess liquidity and financial flexibility.

3. How will governments report fund balance in the future?

Fund balance will be displayed in the following classifications depicting the relative strength of the spending constraints placed on the purposes for which resources can be used:

- *Nonspendable fund balance*—amounts that are not in a spendable form (such as inventory) or are required to be maintained intact (such as the corpus of an endowment fund)
- *Restricted fund balance*—amounts constrained to specific purposes by their providers (such as grantors, bondholders, and higher levels of government), through constitutional provisions, or by enabling legislation
- *Committed fund balance*—amounts constrained to specific purposes by a government itself, using its highest level of decision-making authority; to be reported as committed, amounts cannot be used for any other purpose unless the government takes the same highest-level action to remove or change the constraint
- *Assigned fund balance*—amounts a government *intends* to use for a specific purpose; intent can be expressed by the governing body or by an official or body to which the governing body delegates the authority

- *Unassigned fund balance*—amounts that are available for any purpose; these amounts are reported only in the general fund.

4. Why is unassigned fund balance reported only in the general fund?

When a government transfers resources from the general fund to another governmental fund, it is communicating that, at a minimum, it intends to use those resources for the purpose of the fund receiving them. This expression of intent meets the requirements for classification as assigned fund balance. Because unassigned fund balance represents amounts that are not constrained in any way, not even by an intention to use them for a specific purpose, the general fund is the only appropriate place to report this classification of fund balance.

In the other governmental funds, however, if a government spends more on a specific purpose than the resources available for that purpose in the fund, then it may need to report a negative amount as unassigned fund balance. If a government cannot cover the deficit with amounts assigned to other purposes in that fund, then the remaining deficit should be reported on the unassigned fund balance line.

5. How will rainy-day amounts be reported under Statement 54?

Statement 54 treats stabilization arrangements as a specific purpose, allowing governments to report these amounts in the general fund as restricted or committed, if they meet the applicable definitions and criteria. Stabilization amounts that do not qualify to be reported as restricted or committed should be included in unassigned fund balance. Governments may report stabilization amounts in a special revenue fund only if they derive from specific revenue sources that are restricted or committed to stabilization.

Regardless of where stabilization amounts are reported, governments also will disclose key information about their stabilization arrangements in the notes to the financial statements, including the authority by which the arrangements were established, the conditions under which additions to the stabilization amounts are required, and the circumstances under which amounts may be used.

6. How has Statement 54 changed the way encumbrances are reported?

The new standards clarify that an encumbrance is not a specific purpose and therefore should not be reported as a separate line on the face of the balance sheet. Encumbering amounts that are restricted or committed does not further limit the purposes for which they can be used. If the encumbering process meets the definition and criteria for committed fund balance, then encumbering an assigned or unassigned amount could result in the amount being reported as committed; however, it would be reported with other amounts committed to the same or similar purposes, *not* as "committed for encumbrances." If a government has significant encumbrances, it should disclose them under the standards for significant commitments.

7. What did the GASB find out about the reporting of governmental funds?

In practice, many governments have interpreted in different ways the prior standards on reporting governmental funds contained in National Council on Governmental Accounting (NCGA) Statement 1, *Governmental Accounting and Financial Reporting Principles.* This is particularly true for special revenue funds.

8. How does Statement 54 clarify the special revenue fund type definition?

Statement 54 makes clear that, for financial reporting purposes, a special revenue fund may only be established around one or more revenue sources that are restricted or committed to purposes other than capital projects or debt service. For example, a school district might report state and federal aid for elementary and secondary education in a special fund if those revenue sources represent a substantial portion of the fund's total inflows.

9. How does Statement 54 clarify the definitions of debt service and capital projects fund types?

Statement 54 revises the definitions of the debt service and capital projects fund types so that consistent language and structure are used across all of the governmental fund type definitions. Although the existing definition of a capital project fund specifies that they should be used to account for "the acquisition or construction of major capital facilities," many governments have used them to report on capital assets that are not facilities or major or either. Based on constituent feedback, the GASB broadened the definition to encompass capital outlays in general.

10. How will Statement 54 impact the reporting of governmental funds?

The most significant changes are likely to occur in the reporting of special revenue funds, because that is where there has been the most variation in how the prior standards were interpreted. Some governments may not be able to continue to report some of their special revenue funds under the clarified definition. The Statement 54 definition is considered by some to be more permissive that the NCGA Statement 1 definition. However, practice has varied so much that the Statement 54 definition may appear more restrictive to some governments.

11. Does Statement 54 affect how governments use funds for internal accounting purposes or for special reporting?

No. Statement 54 affects only the *reporting* of governmental funds in general purpose external financial reports in conformity with generally accepted accounting principles (GAAP). Governments may continue to use any funds they choose or are required to for their internal accounting or for special purpose reporting.

12. What if a state law requires local governments to report a particular type of fund or to report using the current classifications of fund balance?

For general purpose external financial reporting under GAAP, governments are required to follow Statement 54. If a law conflicts with Statement 54 or any other part of GAAP, the legal requirements can be met by presenting supplemental schedules. Governments will still be able to comply with such state laws in their general purpose external financial report, but outside of the basic financial statements, notes to the basic financial statements, and required supplementary information.

13. What other note disclosures does Statement 54 require?

In addition to the disclosures already mentioned, Statement 54 requires governments to disclose:

- Additional detail regarding the purposes of restrictions, commitments, and assignments, if the required level of detail is not met through display on the face of the balance sheet
- The decision-making authority and formal action, if any, that results in commitments of fund balance
- The bodies or persons with the authority to express intended uses of resources that result in assigned fund balance
- The order in which a government assumes restricted, committed, assigned, and unassigned amounts are spent when amounts in more than one classification are available for a particular purpose
- Information about minimum fund balance policies, if a government has one
- The purpose for each major special revenue fund, identifying which revenues and other resources are reported in each of those funds.

14. When should Statement 54 be implemented?

Governments should implement Statement 54 no later than the first fiscal year beginning after June 15, 2010 (for example, the fiscal year starting on July 1, 2010 and ending on June 30, 2011). Governments are encouraged to implement the standards earlier.