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August 15, 2019

READ AND CONSIDERED
DATE 9/4/19 BY M

Honorable Gary Nadler
Hall of Justice
600 Administration Drive
Santa Rosa, CA 95403

Dear Judge Nadler:

Below, please find the response of the County of Sonoma Auditor-Controller-Treasurer-Tax Collector (ACTTC) to the Grand Jury's findings published in the 2018-2019 Grand Jury Report: Managing Public Properties in Sonoma County.

FINDINGS ADDRESSED TO ACTTC:

F2. Sonoma County Capital Assets Policy FA-1 fails to provide sufficient reporting for management to determine the extent to which normal maintenance and repairs of buildings and other County facilities are being deferred.

Agree, however the purpose of Fiscal Policy FA-1, *Accounting for Capital Assets*, is to present a uniform method of maintaining capital asset records and to apply a consistent method of accounting for capital assets. The focus of this policy is to ensure accurate, complete and timely physical and financial records needed for financial reporting in accordance with Generally Accepted Accounting Principles (GAAP). The policy addresses asset impairment, which is required for GAAP reporting, and to the extent deferred maintenance results in a financial impairment, it is covered in policy FA-1 (although there is no specific mention of impairment due to deferred maintenance in Fiscal Policy FA-1, and it could be made more clear that deferred maintenance could result in impairment). The policy is not intended to address areas outside of the authority/responsibility of the ACTTC, such as planning and budgeting for capital asset purchases and disposals, asset maintenance activities, the appropriate use of County-owned assets, etc. If the County is lacking a policy specifically related to the tracking and reporting of required/deferred maintenance of County-owned assets, that policy should be created by the department(s) with oversight/authority of that activity (County Administrator, General Services, etc.)

F8. Deferred maintenance costs are continuing to accumulate to an extent that they constitute a major reduction in asset value not reported in the County's financial statements.

Disagree, the ACTTC is not aware of any assets that qualify for impairment at this time. The Sonoma County Comprehensive Annual Financial Report (CAFR) is prepared in accordance with generally accepted accounting principles applicable to state and local governmental entities. As such, the County is required to comply with Governmental Accounting Standards Board (GASB) Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. In order to record an impairment loss, GASB 42 requires that the impairment be significant, unexpected and permanent, and also result in a decline in service utility. If an impairment meets these tests, the asset value must be accounted for at the lower of fair market value or carrying value (i.e. historical cost less accumulated depreciation/amortization). Following the provisions of GASB 42, an outdated/decrepit office building that is still used as an office is not impaired, because there has been no decline in service utility. Conversely an outdated/decrepit office building that cannot be used as an office without major repairs may be impaired if the fair market value is less than the carrying value of the asset, however very old buildings/improvements are likely to be at or near full depreciation already.

F13. Capital assets that suffer from significant accumulations of deferred maintenance may be impaired assets for accounting purposes.

Agree, assets are impaired for accounting purposes when there is a decline in service utility that is significant, unexpected and permanent. Significant deferred maintenance could result in an impairment. Impaired assets that will no longer be used in operations should be accounted for at the lower of fair market value or carrying value (i.e. historical cost less accumulated depreciation/ amortization). Impaired assets that continue to be used in operations should be accounted for at the carrying value reduced by an amount proportionate to the loss in service utility.

RECOMMENDATIONS ADDRESSED TO ACTTC:

R1. The ACTTC (Auditor-Controller-Treasurer-Tax Collector) establish a procedure by October 1, 2019, to supplement Capital Assets Policy FA-I with deferred maintenance reporting comparable to that in Federal Accounting Standards SFFAS 6, 40 & 42. [F2, F8]

This recommendation will not be implemented because the tracking and reporting of planned, actual and deferred maintenance activities is not the responsibility of the Auditor-Controller-Treasurer-Tax Collector, and because it is not appropriate to apply Federal Accounting Standards in the preparation of the County's Comprehensive Annual Financial Report (CAFR). Our office agrees with the Grand Jury that accurate information about deferred maintenance should be provided to the Board of Supervisors in a consistent and timely manner, however we do not agree that the CAFR is the appropriate mechanism for this reporting. As a local governmental entity, Sonoma County is required to prepare the CAFR in conformity with generally accepted accounting principles established by the Governmental Accounting Standards Board (GASB). The GASB does not require or recommend reporting of deferred maintenance by local governments, and therefore does not provide a standard or guideline for such reporting. We surveyed peer counties and our external auditor and found no examples of non-federal governmental entities that include deferred maintenance information in their CAFR. While GAAP does allow financial statement preparers some discretion in the preparation of financial reports in the absence of official guidance, it directs preparers to apply 'widely recognized and prevalent practice' in that situation. Reporting of deferred maintenance does not meet this standard, and including it would make our CAFR less comparable to other county and local government CAFRs and potentially confuse readers. A report created for internal management use can be designed to meet the County's unique needs without the restrictions placed on reports designed for external users, such as the CAFR.

The purpose of Fiscal Policy FA-1, *Accounting for Capital Assets*, is to present a uniform method of maintaining capital asset records and to apply a consistent method of accounting for capital assets. The focus of this policy is to ensure accurate, complete and timely physical and financial records needed for financial reporting in accordance with GAAP. The policy addresses asset impairment, which is required for GAAP reporting, and to the extent deferred maintenance results in a financial impairment, it is covered in policy FA-1, although there is no specific mention of impairment due to deferred maintenance. We will update policy FA-1 to make it clear that significant deferred maintenance could cause an asset to be impaired.

Policy FA-1, *Accounting for Capital Assets*, is not intended to address areas outside of the authority/responsibility of the Auditor-Controller-Treasurer-Tax Collector, such as planning and budgeting for capital asset purchases and disposals, asset maintenance activities, the appropriate use of County-owned assets, etc. If the County is lacking a policy specifically related to the tracking and reporting of required/deferred maintenance of County-owned assets, that policy should be created by the department(s) with oversight/authority of that activity (County Administrator, General Services, etc.)

R7. ACTTC review assets with accumulated deferred maintenance and adjust the record of accumulated depreciation if material impairment is found by July 1, 2020. [FI3]

Recommendation R7 has been partially implemented. ACTTC reviews assets annually for impairment as part of the financial close. Prior to year-end, ACTTC sends a Financial Reporting Survey (Survey) to all County departments with assets as reported in the financial system. The Survey asks if the Department has any impaired assets and provides guidance on how to determine impairments per Government Accounting guidance. Responses to the Survey are reviewed by the financial reporting team, and any adjustments for impairment losses are recorded. Impairments could be caused by significant deferred maintenance, but our Survey does not inquire about deferred maintenance specifically.

The ACTTC will expand the annual Financial Reporting Survey beginning with the Survey for June 30, 2020 reporting to specifically include an example of an impairment caused by significant deferred maintenance. Assets that are reported as potentially impaired due to deferred maintenance (or any other reason) will be run through the asset impairment test and reported appropriately in the CAFR.

FINDINGS ADDRESSED TO OTHER DEPARTMENTS:

F4. Real asset records are scattered over an excessive number of record keeping and asset management systems.

All physical/financial asset records are maintained in the EFS Asset Management (AM) module. EFS AM has been implemented county-wide. Some departments use other systems to maintain data not needed for financial reporting of assets, such as maintenance planning for buildings.

F5. General Services, as well as other departments, have yet to take advantage of integrating with the Enterprise Financial System's Asset Management module which provides asset tracking, acquisition, maintenance, inventory, and cost-sharing.

Disagree. This finding is based on inaccurate information about which modules included in the PeopleSoft Asset Lifecycle Management (ALM) solution were purchased and implemented by Sonoma County. The County purchased and implemented PeopleSoft Asset Management to provide a centralized accounting system to track capital assets for the purpose of financial accounting. Since its implementation in July 2014, EFS Asset Management is the centralized sole source and system of record for recording and reporting all asset acquisitions, transfers, cost adjustments, retirements and depreciation. PeopleSoft Asset Management is one of four applications available for controlling and managing assets throughout the asset lifecycle. The applications available within PeopleSoft's (ALM) solution are:

- PeopleSoft **Asset Management (AM):** the foundation product of PeopleSoft ALM, PeopleSoft AM provides a common Asset Repository Manager (ARM), which stores all asset data. Once the PeopleSoft AM product is established, the asset repository is available to all PeopleSoft products that integrate with PeopleSoft AM. PeopleSoft AM includes features, such as asset maintenance, which enable integration with other applications and are dependent upon the purchase and implementation those applications.

- PeopleSoft **IT Asset Management (ITAM)**: represents an entire system of integrated management processes, strategies and technologies implemented to provide control over IT assets throughout the asset life cycle. PeopleSoft AM integrates with PeopleSoft ITAM by sharing assets in the asset repository. Sonoma County did not purchase the ITAM module.

- PeopleSoft **Maintenance Management (MM)**: enables organizations to create work orders, schedule the resources to perform the tasks that are identified on the work orders, and track the costs that are associated with the maintenance and repair of these assets. Sonoma County did not purchase the MM module.

- PeopleSoft **Real Estate Management, renamed Lease Administration (LA)**: ensures that leases are managed according to terms; cost and space utilization are captured for performance management; and divisions comply with companywide financial processes and controls. Sonoma County did not purchase the LA module.

Based on the above, the County has fully implemented the functionality available in the Asset Management module, and that functionality does <u>not</u> include the ability to manage the planned, actual or deferred maintenance of assets. If the County wants to pursue additional functionality in PeopleSoft, it will need to compile the County's requirements, perform a fit-gap analysis of those requirements to functionality available in the other Asset Lifecycle Management solution modules, and analyze the cost and resource needs of implementing additional modules.

Respectfully,

Erick Roeser

Erick Roeser
Auditor-Controller-Treasurer-Tax Collector
County of Sonoma

Cc: Members, Sonoma County Board of Supervisors
Dee Schweitzer, Foreperson, 2018-2019 Sonoma County Civil Grand Jury
Sheryl Bratton, Sonoma County Administrator