

**REDEVELOPMENT AGENCY
OF THE
COUNTY OF MENDOCINO
(A Component Unit of the
County of Mendocino, California)**

**Management Report
For the Year Ended June 30, 2007**

**REDEVELOPMENT AGENCY
OF THE
COUNTY OF MENDOCINO**

Management Report
For the Fiscal Year Ended June 30, 2007

Table of Contents

	<u>Page</u>
Introduction.....	1
Required Communication	2-3
Accounting for Future Tax Increment Revenues.....	4-6
Use of Redevelopment Agency Indebtedness.....	7
Accounting for Land Held for Resale.....	8-9
Accounting for Loans Receivable.....	10-11
Status of Prior Year Recommendations.....	12-14



BARTIG, BASLER & RAY, LLP
A GALLINA LLP COMPANY

CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors of
The Redevelopment Agency
of the County of Mendocino, California

In planning and performing our audit of the basic financial statements of the Redevelopment Agency of the County of Mendocino (Agency), a component unit of the County of Mendocino, California, for the year ended June 30, 2007, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing an opinion on the basic financial statements and not to provide assurance on the internal control structure.

Our consideration of the internal control would not necessarily disclose all matters in the internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A *material weakness* is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving the internal control and its operation that we consider to be material weaknesses as defined above.

However, during our audit we became aware of matters that are opportunities for strengthening internal controls and operating efficiency, as well as compliance with California Redevelopment law which affects financial reporting. The memorandum that accompanies this letter summarizes our comments and suggestions concerning those matters. We previously reported on the Agency's internal control in our report dated January 9, 2008. This letter does not affect our report dated January 9, 2008 on the financial statements of the Redevelopment Agency of the County of Mendocino.

This report is intended for the use of management, the Board of Supervisors and officials of the federal and state grantor agencies.

We thank the Agency's staff for its cooperation during our audit.

BARTIG, BASLER & RAY, LLP
A Gallina LLP Company

Roseville, California
January 9, 2008

**REDEVELOPMENT AGENCY
OF THE
COUNTY OF MENDOCINO**

Required Communication
For the Fiscal Year Ended June 30, 2007

The Auditor's Responsibility under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated July 13, 2007, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute assurance that the financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting principles. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered the internal control of the Agency. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

As part of obtaining reasonable assurance about whether the Agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

Significant Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Agency are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. We noted no transactions entered into by the Agency during the year that were both significant and unusual, and of which, under professional standards, we are 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 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 financial statements and because of the possibility that future events affecting them may differ significantly from those expected. We are not aware of any significant estimates affecting the financial statements.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Agency's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the Agency, either individually or in the aggregate, indicate matters that could have a significant effect on the Agency's financial reporting process.

Disagreements with Management

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

Consultations with Other Independent Auditors

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 financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Agency's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

**REDEVELOPMENT AGENCY
OF THE
COUNTY OF MENDOCINO**

Management Report
For the Fiscal Year Ended June 30, 2007

**ACCOUNTING FOR FUTURE TAX INCREMENT REVENUES
(Informational Only)**

The Agency began receiving tax increment revenues during the fiscal year ended June 30, 2005. In accordance with last year's recommendation, the Agency has set up its accounting structure to ensure that it is prepared to properly track and report the activity related to tax increment revenue.

California Redevelopment law provides:

1. Health & Safety Code section 33334.2 requires that 20 percent of all taxes allocated to an agency are to be used by the agency to increase, improve or preserve the community's supply of low and moderate income housing.
2. Health & Safety Code section 33607.5 requires automatic payments to other pass-through taxing agencies based on statutory pass-through formulas. In general, the Agency is required to distribute 25 percent of the total tax increments it receives each year, after deducting the amount required to be deposited for low and moderate income housing (see above), to each taxing entity levying property taxes in the Redevelopment's project area.
3. Health & Safety Code section 33670(b) requires that the remainder of tax increment revenues can only be used to pay principal of and interest on loans and other forms of indebtedness obtained to finance or refinance redevelopment projects, including the following:
 1. Loans and advances from the County's General Fund
 2. Lease-purchase agreements
 3. Reimbursement agreements with the County
 4. Disposition and Development Agreements (DDAs) between the Agency and outside developers
 5. Owner Participation Agreements
 6. Bank loans
 7. Any contract which, if breached, could subject the Agency to damages or other liabilities

**REDEVELOPMENT AGENCY
OF THE
COUNTY OF MENDOCINO**

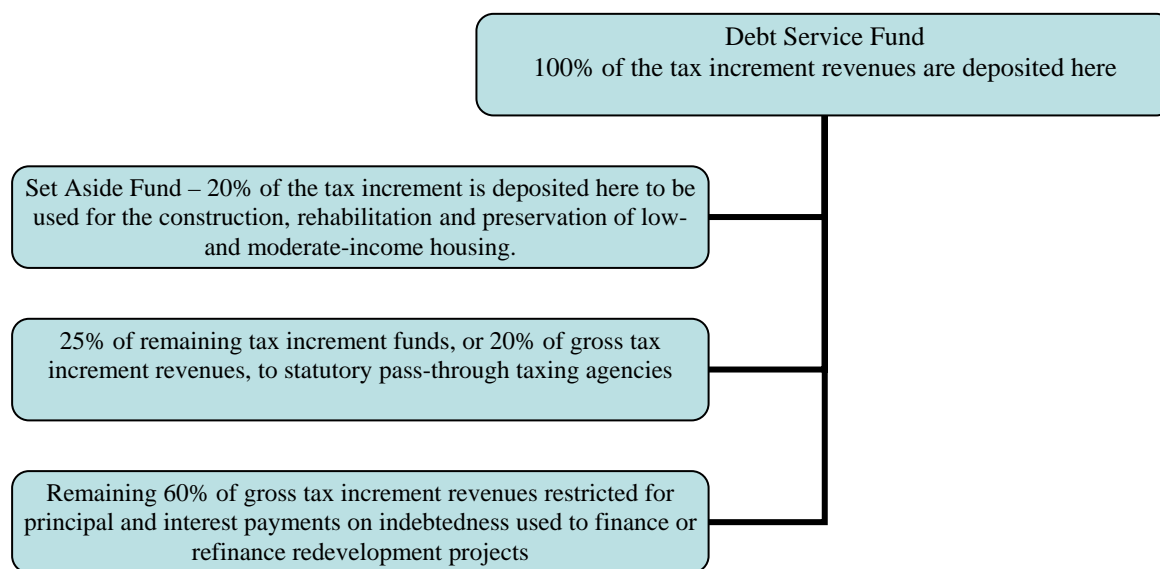
Management Report
For the Fiscal Year Ended June 30, 2007

ACCOUNTING FOR FUTURE TAX INCREMENT REVENUES (continued)

For informational purposes, we have included the following steps for depositing gross tax increment revenues:

1. Deposit the gross tax increment less administrative fees charged by the County into the RDA Debt Service Fund. The Debt Service Fund should account for 100% of the Agency's tax increment revenues.
2. Distribute 20% of the gross tax increment deposit to the RDA Set-Aside Fund. This should be recorded as a transfer.
3. Distribute 25% of the remaining gross tax increment deposit in the RDA Debt Service Fund to statutory pass-through taxing agencies. This should be recorded as an expense of the Debt Service Fund.

An illustration of the flow of tax increment funds is shown below.



**REDEVELOPMENT AGENCY
OF THE
COUNTY OF MENDOCINO**

Management Report
For the Fiscal Year Ended June 30, 2007

ACCOUNTING FOR FUTURE TAX INCREMENT REVENUES (continued)

Illustrative Journal Entries to Account for Tax Increment Revenues

<u>Account Classification</u>	<u>Account Description</u>	<u>Fund</u>	<u>Debit</u>	<u>Credit</u>
Asset Revenue	Cash Gross tax increment <i>to record the receipt of gross tax increment revenues.</i>	Debt Service Fund Debt Service Fund	\$ 1,000,000	\$ 1,000,000
Other Financing Use Asset Asset Other Financing Source	Transfers out Cash Cash Transfers in <i>to record the transfer of 20% gross tax increment to the Set-Aside Fund.</i>	Debt Service Fund Debt Service Fund Special Revenue Set-Aside Special Revenue Set-Aside	\$ 200,000 \$ 200,000	\$ 200,000 \$ 200,000
Expense Asset	Payments to other agencies Cash <i>to record the payment of 25% net tax increment to statutory pass-thru taxing agencies.</i>	Debt Service Fund Debt Service Fund	\$ 200,000	\$ 200,000
Asset Other Financing Source	Cash Proceeds from Advances <i>to record advance from County General fund.</i>	Capital Projects Fund Capital Projects Fund	\$ 600,000	\$ 600,000
Expense Asset	Project costs Cash <i>to record project expenditures.</i>	Capital Projects Fund Capital Projects Fund	\$ 600,000	\$ 600,000
Expense Other Financing Source	Interest expenditures Proceeds from Advances <i>to accrue interest on County advance.</i>	Capital Projects Fund Capital Projects Fund	\$ 200,000	\$ 200,000
Expense Asset	Principal payments Cash <i>to record repayment of County advance using tax increment revenues.</i>	Debt Service Fund Debt Service Fund	\$ 800,000	\$ 800,000

**REDEVELOPMENT AGENCY
OF THE
COUNTY OF MENDOCINO**

Management Report
For the Fiscal Year Ended June 30, 2007

**USE OF REDEVELOPMENT AGENCY INDEBTEDNESS
(Informational Only)**

Health & Safety Code section 33670(b) provides that tax increment revenue can only be used to pay principal of and interest on loans and other forms of indebtedness obtained to finance or refinance redevelopment projects.

Redevelopment agency indebtedness includes all of the following:

1. Loans and advances from the County's General fund.
2. Lease-purchase agreements.
3. Reimbursement agreements with the County.
4. Disposition and Development Agreements (DDAs) between the Agency and outside developers.
5. Owner Participation Agreements.
6. Bank loans.
7. Any contract which, if breached, could subject the Agency to damages or other liabilities, including contracts with other governmental agencies and contracts with professionals such as architects, engineers, attorneys, accountants, financial consultants, etc.

Recommendation

We recommend the Agency maximize the use of the types of indebtedness listed above to fund redevelopment project costs. Future advances from the County's General Fund should be facilitated through an active transfer of cash and not through the use of deficit accounts. The effect of these types of indebtedness should be reflected in the Agency's Capital Project Fund so that it offsets the project costs and administrative costs which also should be recorded in the Capital Project Fund. Excess tax increment revenues should be used to make repayments of the type of indebtedness utilized.

**REDEVELOPMENT AGENCY
OF THE
COUNTY OF MENDOCINO**

Management Report
For the Fiscal Year Ended June 30, 2007

**ACCOUNTING FOR LAND HELD FOR RESALE
(Informational Only)**

Redevelopment activities may call for the Agency to purchase property with the intent to rehabilitate and/or resell the property at a later date. The Agency may convey the property to a developer, who with the Agency's assistance may incur rehabilitation and/or construction activities that contribute to the project area's redevelopment plans. The Agency may execute a Disposition and Development Agreement (DDA) which is used to convey agency-owned land to the developer, and provide all the terms and conditions relating to the development of the property.

In August 1987, the California Committee on Municipal Accounting issued a position paper related to the proper accounting and reporting of land held for resale as inventory of the Agency.

Recommendation

With regard to property that will be acquired with the intent to redevelop and/or resell, we recommend the following:

1. Land purchased for resale and/or development should be capitalized as an investment in the Agency's Capital Project fund.
2. If the cost of the land exceeds net realizable value (market value), the cost should be written down through the use of an allowance for decline in value.
3. If the land purchased for resale will not be sold within sixty days after the close of the fiscal year, a reserve in fund balance should be set up to indicate that a portion of fund balance equal to the amount recorded as land held for resale is not available to finance expenditures of the current period.

Example journal entries to account for transactions related to land held for resale are illustrated on the next page.

**REDEVELOPMENT AGENCY
OF THE
COUNTY OF MENDOCINO**

Management Report
For the Fiscal Year Ended June 30, 2007

ACCOUNTING FOR LAND HELD FOR RESALE (continued)

Illustrative Journal Entries to Account for Land Held for Resale

<u>Account Classification</u>	<u>Account Description</u>	<u>Fund</u>	<u>Debit</u>	<u>Credit</u>
Asset	Land held for resale	Capital Projects Fund	\$ 200,000	
Asset	Cash	Capital Projects Fund		\$ 200,000
	<i>to record the purchase of land held for resale.</i>			
Expense	Decline in value of land held for resale	Capital Projects Fund	\$ 10,000	
	Allowance for decline in value of land held for			
Asset	resale	Capital Projects Fund		\$ 10,000
	<i>to record the estimated decline in market value of land held for resale.</i>			
Fund Equity	Fund balance, unreserved	Capital Projects Fund	\$ 190,000	
Fund Equity	Fund balance, reserved for land held for resale	Capital Projects Fund		\$ 190,000
	<i>to reserve a portion of fund balance for land that is held for resale.</i>			
Asset	Cash	Capital Projects Fund	\$ 150,000	
Asset	Allowance for decline in value of land held for resale	Capital Projects Fund	\$ 10,000	
Revenue	Loss on land held for resale	Capital Projects Fund	\$ 40,000	
Asset	Land held for resale	Capital Projects Fund		\$ 200,000
	<i>to record the sale of land held for resale.</i>			
Fund Equity	Fund balance, reserved for land held for resale	Capital Projects Fund	\$ 190,000	
Fund Equity	Fund balance, unreserved	Capital Projects Fund		\$ 190,000
	<i>to reverse the reservation of fund balance for land that was held for resale.</i>			

**REDEVELOPMENT AGENCY
OF THE
COUNTY OF MENDOCINO**

Management Report
For the Fiscal Year Ended June 30, 2007

**ACCOUNTING FOR LOANS RECEIVABLE
(Informational Only)**

California Redevelopment law allows the Agency to use various incentive programs that contribute to a valid public purpose for redevelopment projects. One such purpose commonly employed is the issuance of long-term loans to businesses, individuals and/or developers. Often these loans carry little or no interest with principal repayments deferred for several years.

These loans are considered long-term revenues and require special treatment for financial reporting purposes. Because receipts are not readily available, the entire balance of loans receivable at the end of the year should be recorded in the governmental fund statements with an offset to deferred revenues.

Recommendation

We recommend that the Agency account for long-term loans receivable as an asset in the fund where the loan originated. If the loan is project related, the loan should be made from the Capital Projects fund. We also recommend that the Agency adopt a method of accounting that treats all principal repayments as deferred revenue until collected. This effectively means that fund balance, a measure of the Agency's financial stability, will not be overstated by the amount of loans that have been made for which resources are not available to finance future expenditures. An expense should be recognized when loans are issued and revenue should be recorded when principal repayments are received.

Example journal entries to account for transactions related to loans to owners or developers are illustrated on the next page.

**REDEVELOPMENT AGENCY
OF THE
COUNTY OF MENDOCINO**

Management Report
For the Fiscal Year Ended June 30, 2007

ACCOUNTING FOR LOANS RECEIVABLE (continued)

Illustrative Journal Entries to Account for Loans to Owners or Developers

<u>Account Classification</u>	<u>Account Description</u>	<u>Fund</u>	<u>Debit</u>	<u>Credit</u>
Expense	Project costs	Capital Projects Fund	\$ 200,000	
Asset	Cash	Capital Projects Fund		\$ 200,000
	<i>to record the loan of funds to a developer</i>			
Asset	Loan receivable	Capital Projects Fund	\$ 200,000	
Liability	Deferred revenue	Capital Projects Fund		\$ 200,000
	<i>to record the corresponding loan receivable and associated deferred revenue for the loan made to a developer</i>			
Asset	Cash	Capital Projects Fund	\$ 10,000	
Revenue	Interest revenue	Capital Projects Fund		\$ 10,000
	<i>to record the collection of interest revenue on a loan made to a developer</i>			
Asset	Cash	Capital Projects Fund	\$ 100,000	
Revenue	Other revenue	Capital Projects Fund		\$ 100,000
	<i>to record the collection of principal repayments on a loan to a developer</i>			
Liability	Deferred revenue	Capital Projects Fund	\$ 100,000	
Asset	Loan receivable	Capital Projects Fund		\$ 100,000
	<i>to record the effect of principal repayments on a loan made to a developer</i>			

**REDEVELOPMENT AGENCY
OF THE
COUNTY OF MENDOCINO**

Status of Prior Year Recommendations
As of June 30, 2007

<u>Recommendation</u>	<u>Status/Comment</u>
<p><u>Fund Types, Funds and Budget Units</u></p> <p>We recommend the Agency implement the use of three distinctly separate funds to account for its financial transactions as follows:</p> <ol style="list-style-type: none">1. Special Revenue Set-Aside Fund: Use this fund to report 20% of the gross tax increment revenues that will be dedicated to increasing, improving or preserving the area's supply of low and moderate income housing. Generally, the County's General Plan housing element will determine the scope of these activities.2. RDA Debt Service Fund: Use this fund to receive the deposit of all future gross tax increment revenues and to make future repayments on Agency debt.3. RDA Capital Projects Fund: Use the Agency's existing fund in this capacity. The existing advances as well as future advances from the County's general fund should be accounted for in this fund. All redevelopment project costs which are not chargeable to the Agency's Set-Aside Fund should be accounted for in the Capital Projects Fund generally as expenditures. All Agency administrative and overhead costs should be initially charged to this fund. We recommend using a separate budget unit to account for administrative and overhead costs separately, as shown below.	Implemented
<p><u>Accounting for Future Tax Increment Revenues</u></p> <p>We recommend the Agency continue using the following steps for depositing gross tax increment revenues:</p> <ol style="list-style-type: none">1. Deposit the gross tax increment less administrative fees charged by the County into the RDA Debt Service Fund. The Debt Service Fund should account for 100% of the Agency's tax increment revenues.	Informational

**REDEVELOPMENT AGENCY
OF THE
COUNTY OF MENDOCINO**

Status of Prior Year Recommendations
As of June 30, 2007

<u>Recommendation</u>	<u>Status/Comment</u>
<u>Accounting for Future Tax Increment Revenues</u> (continued)	
<ol style="list-style-type: none">2. Distribute 20% of the gross tax increment deposit to the RDA Set-Aside Fund. This should be recorded as a transfer.3. Distribute 25% of the remaining gross tax increment deposit in the RDA Debt Service Fund to statutory pass-through taxing agencies. This should be recorded as an expense of the Debt Service Fund.	
<u>Use of Redevelopment Agency Indebtedness</u>	Informational
<p>We recommend the Agency maximize the use of the types of indebtedness listed above to fund redevelopment project costs. Future advances from the County's General Fund should be facilitated through an active transfer of cash and not through the use of deficit accounts. The effect of these types of indebtedness should be reflected in the Agency's Capital Project Fund so that it offsets the project costs and administrative costs which also should be recorded in the Capital Project Fund. Excess tax increment revenues should be used to make repayments of the type of indebtedness utilized.</p>	
<u>Accounting for Land Held for Resale</u>	Informational
<p>With regard to property that will be acquired with the intent to redevelop and/or resell, we recommend the following:</p> <ol style="list-style-type: none">1. Land purchased for resale and/or development should be capitalized as an investment in the Agency's Capital Project fund.2. If the cost of the land exceeds net realizable value (market value), the cost should be written down through the use of an allowance for decline in value.	

**REDEVELOPMENT AGENCY
OF THE
COUNTY OF MENDOCINO**

Status of Prior Year Recommendations
As of June 30, 2007

<u>Recommendation</u>	<u>Status/Comment</u>
<u>Accounting for Land Held for Resale</u> (continued)	
3. If the land purchased for resale will not be sold within sixty days after the close of the fiscal year, a reserve in fund balance should be set up to indicate that a portion of fund balance equal to the amount recorded as land held for resale is not available to finance expenditures of the current period.	
<u>Accounting for Loans Receivable</u>	Informational
<p>We recommend that the Agency account for long-term loans receivable as an asset in the fund where the loan originated. If the loan is project related, the loan should be made from the Capital Projects fund. We also recommend that the Agency adopt a method of accounting that treats all principal repayments as deferred revenue until collected. This effectively means that fund balance, a measure of the Agency's financial stability, will not be overstated by the amount of loans that have been made for which resources are not available to finance future expenditures. An expense should be recognized when loans are issued and revenue should be recorded when principal repayments are received.</p>	