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March 11, 2011

Mr. Rudy Jenkins, Executive Director  
Butte County Employees Association, Local 1  
Email: [bcea-gcea@onemain.com](mailto:bcea-gcea@onemain.com)

Re: Financial Analysis of the County of Butte

Dear Rudy:

Pursuant to your request, we have analyzed the Basic Financial Statement (BFS) for the year ended June 30, 2005 and the Comprehensive Annual Financial Reports (CAFR) of the County of Butte (County) for the years ended June 30, 2006 through June 30, 2010 for the purpose of rendering our basic report on the financial status of the County. Our basic report concentrates on the government wide financial statements, revenues, and the General Fund. Per your request, we also analyzed two of the County's internal service funds as follow:

- The Self Insurance Fund, and
- The Worker's Compensation Fund.

The BFS and the CAFRs are presented using Generally Accepted Accounting Principles (GAAP); rules, standards, reporting requirements and definitions that govern accounting and financial reporting. GAAP allows readers of the government's financial statements to determine the availability of the government's resources to finance and pay for its ongoing expenses and debt payments. It gives taxpayers, rating agencies and other end users the ability to assess how the government is using its resources and compare it to other governments. GAAP is promulgated by the Governmental Accounting Standards Board (GASB) and codified for the users of financial statements in the Codification of Governmental Accounting and Financial Reporting Standards (Code).

Our overall conclusion from analyzing the Comprehensive Annual Financial Reports is that the County of Butte financial position is healthy, but declining. It has accumulated reserves in the General Fund and in two insurance funds, but current trends indicate flat or declining revenues. We have prepared Exhibit I through Exhibit VII to highlight our findings.

#### EXHIBIT I

**Exhibit I** is an analysis of selected information from the County of Butte's **Government-wide Financial Statements** for the years ended June 30, 2005 through June 30, 2010. We have only presented the governmental activities of the County as that is the funding source for the most



government employees. The governmental activities include not only the General Fund, but also the Special Revenue Funds, the Capital Project Funds, the Debt Service Funds and the Internal Service Funds. It does not include the Enterprise Funds, which are the business activities portion of the government-wide financial statements. **Not all of the resources in this exhibit are available for compensation purposes due to restriction of their use at the fund level.**

The purpose of this exhibit is not to show all of the County's resources that are available for wage and benefit increases. Instead, the purpose of this exhibit is three fold:

- To determine the financial health of the government as a whole, and not the individual funds,
- To determine if the government's financial health is growing stronger or is declining, and
- How the government finances and acquires its infrastructure and capital assets.

**Exhibit I-A** summarizes the components of the governmental activities portion of the Statement of Activities, which shows how the County's net assets changed during the fiscal year. In the six years since July 1, 2004, the County's net assets are \$38.7 million lower as of June 30, 2010 falling from \$393.2 million to \$354.5 million despite restatements and prior period adjustments that increased net assets by \$18 million.

### **General**

- All of the decrease in net assets is due to program expenses exceeding revenues, special items, and transfers during the past six years by \$56.6 million.
- Expenses, net of program revenues exceeded tax revenues, all years presented.
- Net assets decreased all years presented.

### **Expenses and Program Revenues**

There are significant differences between expenses as reported in the government-wide financial statements and expenditures as reported in the governmental fund statement. Expenditures represent the expenditure of cash and include the acquisition cost of capital assets and debt principle. Expenditures do not include depreciation expense. Expenses represent the use of an asset and include depreciation and amortization expenses, but do not include the acquisition of assets or the payment of principle on long-term debt.

The County allocates its government-wide expenses between eight functions, seven of which receive program revenues. The five largest expense functions are material, as each exceeded 5% of 2010 total expenses and accounted for over 95% of expenses. The three smallest expense functions, education, culture and recreation, and interest on long-term, are immaterial and their related program revenues are insignificant. The County does not explain why large increases occur in expenses or revenues in its Management's Discussion and Analysis (MDA).

Revenues generated by a program or function are program revenues. Restrictions on the use of these revenues vary between the three types of program revenues.

- Revenues from charges for services generally are not restricted to finance future program services. There are exceptions.
  - These revenues usually can be used to finance wages and benefits.



- Charges for services received by the General Fund usually can be used to finance all General Fund programs.
- After declining in 2006, charges for services revenues grew each year from \$29.7 million in 2006 to \$41.2 million in 2010.
- Operating grants and contributions grew from \$184.5 million in 2005 to \$222.9 million in 2009, than declined slightly in 2010 to \$222.6 million.
  - Operating grants and contributions for specific programs can only be spent for those specific purposes and may be available to finance only those wages that provide the specific services.
    - Unspent operating grants for specific grants should be reported as restricted net assets if unspent at year end.
- Capital grants and contributions either represent infrastructure contributed by developers or moneys that can only be spent for specific capital projects.
  - The County received relatively small amounts of capital contributions, ranging from a low of \$12 million in 2006 to \$20.9 million in 2010.
  - These moneys cannot be spent on wages and benefits.
  - Unspent capital grants should be reported as restricted net assets if unspent at year end.

Total governmental activities expenses grew each year from \$322.4 million at June 30, 2005 to \$379.6 million at June 30, 2008 before declining the next two years to \$365.9 million in 2010.

- General government expenses include the administrative, financial, human resources and similar departments.
  - After falling from \$28.1 million in 2005 to \$16.6 million in 2006, general government expenditures grew slowly the next three years to \$20.7 million.
  - In 2010, general government expenses increased \$4.4 million, from \$20.7 million to \$25.1 million.
  - As a percentage of total expenditures, general government ranged from a low of 5.07% in 2006 to a high of 8.72% in 2005.
    - In 2010, general government expenditures were 6.86% of total expenditures.
  - As shown in the following table, general government received significant program revenues, predominantly revenues from charges for services.

### General Government Program Revenues

Fiscal Year Ended June 30,	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Total Program Revenues
2005	16,760,879	1,481,494	4,130,428	22,372,801
2006	16,779,891	4,788,087	45,780	21,613,758
2007	19,903,572	3,248,354	19,427	23,171,353
2008	20,463,697	3,103,818	150,514	23,718,029
2009	16,567,360	18,612,704	0	35,180,064
2010	21,694,710	16,852,886	0	38,547,596



- As shown, program revenues exceeded expenses each year presented.
  - The most important program revenue, charges for services, increased significantly, offsetting the impact of expense increases.
  - In 2009 and 2010, operating grants increased significantly.
- Public protection includes the grand jury, district attorney’s office, the public defender, the probation department, and the sheriff’s department and is the County’s second largest expense function.
  - After a small decline in 2006, public protection expenses grew \$16.7 million to \$96.7 million in 2008, it high during the period covered by our report.
  - Expenses declined the next two years to \$88.8 million at June 30, 2010.
  - The percentage of public protection expenses ranged from its low of 24.26% in 2010 to 25.73% in 2009.
  - As shown in the following table, public protection also received program revenues, the largest being operating grants.
    - However, operating grants declined from their high in 2006, dropping \$12.5 million to its low in 2009 before recovering slightly in 2010.
    - Since 2007, charges for services has increased, but has not covered the decline in operating grants and contributions.

**Public Protection Program Revenues**

Fiscal Year Ended June 30,	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Total Program Revenues
2005	6,461,794	25,152,733	26,010	31,640,537
2006	5,581,142	26,005,043	82,899	31,669,084
2007	5,285,862	25,559,284	7,527	30,852,673
2008	6,000,509	23,229,633	821,116	30,051,258
2009	9,180,534	13,460,159	491,824	23,132,517
2010	10,708,534	15,324,214	0	26,032,748

- Public ways and facilities primary function is the maintenance of the County’s roads and is financed by the Road fund.
  - Its primary revenue source, as shown in the following table, is capital grants and contributions from the State consisting of gas tax revenues.



### Public Ways and Facilities

Fiscal Year Ended June 30,	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Total Program Revenues
2005	2,680,446	182,551	10,782,889	13,645,886
2006	2,932,837	1,482,058	11,853,516	16,268,411
2007	3,439,296	1,493,055	13,109,947	18,042,298
2008	3,547,975	3,289,072	12,009,834	18,846,881
2009	4,082,071	2,842,797	15,808,169	22,733,037
2010	2,225,165	1,836,542	20,924,224	24,985,931

- Health and sanitation expenses grew in four of the five years since 2005 from \$56.4 million to \$72.5 million in 2010, an increase of 28.5%.
  - This function’s expenses are not financed by the General Fund, but by the Public Health Fund and the Behavior Health Fund.
    - The *Public Health Fund* was established to account for the activities of the Butte County Department of Public Health.
  - As shown in the following table, by far the most important revenues are operating grants and contributions from the state.
  - Program revenues have financed a substantial portion of the County’s health and sanitation expenses the last six years.

### Health and Sanitation Program Revenues

Fiscal Year Ended June 30,	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Total Program Revenues
2005	4,109,596	28,366,282	0	32,475,878
2006	4,041,916	25,882,716	0	29,924,632
2007	5,011,027	34,793,685	0	39,804,712
2008	5,176,893	38,385,293	0	43,562,186
2009	5,676,115	46,537,615	0	52,213,730
2010	5,756,094	46,543,314	0	52,299,408

- Public assistance expenses are by far the County’s largest expense function, and grew each year covered by our report from \$130.9 million to \$143.7 million.
  - The vast majority of these expenses are financed by the Welfare Fund.
    - The *Welfare Fund* accounts for the activities of the Butte County Department of Employment and Social Services. The department administers the CalWorks program, Adult and Children’s Protection Services and various other State, Federal and local assistance programs.
  - This function’s program revenues were stagnant from 2004 through 2006 before experiencing strong growth through the next three years through 2009.



- As shown in the following table, this fund’s program revenues have covered most if not all of the function’s expenses over the years.

**Public Assistance Program Revenues**

Fiscal Year Ended June 30,	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Total Program Revenues
2005	393,023	128,263,959	0	128,656,982
2006	205,520	135,926,051	0	136,131,571
2007	354,261	140,649,146	0	141,003,407
2008	543,906	145,318,884	0	145,862,790
2009	711,842	141,115,257	0	141,827,099
2010	676,610	141,750,799	0	142,427,409

- This fund’s program revenues can only be spent on public assistance and not for general government purposes.

**General Revenues**

General revenues grew from 2005 through 2010.

- The County’s tax revenues never exceeded the governmental activities’ expenses net of program revenues in all years presented.
- Property tax revenues are the most important revenue source and grew each year from \$34.3 million to \$49.8 million.
- The second largest general revenue is unrestricted grants and other contributions.
  - These revenues have fluctuated only in the six years ranging from \$15.5 million in 2010 to \$25.1 million in 2006.
- We will discuss the growth of general revenues in greater detail in our **Exhibit II**.

**Change in Net Assets**

The County’s governmental activities net assets declined year each covered by our report.

- Net assets declined from \$393.2 million at July 1, 2004, after a restatement, to \$354.5 million at June 30, 2010, a decline of \$38.7 million.
  - This decline occurred due to cumulative annual net asset declines of \$56.6 million.
  - Since 2005, restatements and prior period adjustments that increased net assets partially offset the annual declines by \$17.9 million.
  - Net assets increased in 2009 and 2010 due to restatements of the beginning net asset balance for corrections.
- Depreciation expense, a non-cash expense contributed to this decline.
  - The cumulative depreciation expenses for the six year period totaled \$148 million, \$91.4 million more than the decline in net assets.
  - Annual depreciation expense exceeded the annual decreases in net assets each presented.

**EXHIBIT I-A**  
**COUNTY OF BUTTE**  
**ANALYSIS OF GOVERNMENTAL ACTIVITIES' STATEMENT OF ACTIVITIES**

	<i>For the Years Ended June 30,</i>					
	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
<b>Expenses</b>						
General government	28,108,571	16,617,793	19,086,836	20,865,771	20,710,290	25,115,218
Public protection	82,634,178	81,999,331	87,500,747	96,664,267	94,362,185	88,790,678
Public ways and facilities	17,520,672	31,531,708	34,623,721	39,999,631	34,975,071	30,009,178
Health and sanitation	56,395,525	58,593,884	64,268,283	72,458,490	67,582,300	72,502,065
Public assistance	130,935,568	130,966,814	135,871,668	142,125,227	142,615,875	143,688,838
Education	2,723,315	2,905,270	3,117,432	3,394,070	3,291,233	2,805,328
Culture and recreation services	499,967	658,741	604,386	374,615	524,852	512,353
Interest on long-term debt	3,608,601	4,183,940	4,315,185	3,696,005	2,659,630	2,499,474
Total governmental activities expenses	<u>322,426,397</u>	<u>327,457,481</u>	<u>349,388,258</u>	<u>379,578,076</u>	<u>366,721,436</u>	<u>365,923,132</u>
<b>Program revenues</b>						
Charges for services	30,478,270	29,761,189	34,211,094	35,942,551	36,328,606	41,207,325
Operating grants and contributions	184,501,125	194,629,899	206,381,946	214,119,802	222,937,925	222,575,034
Capital grants and contributions	14,939,327	11,982,196	13,136,901	12,981,464	16,299,993	20,924,224
Total Program Revenues	<u>229,918,722</u>	<u>236,373,284</u>	<u>253,729,941</u>	<u>263,043,817</u>	<u>275,566,524</u>	<u>284,706,583</u>
<b>Net (expense) revenues and change in net assets - Governmental Activities</b>	<u>(92,507,675)</u>	<u>(91,084,197)</u>	<u>(95,658,317)</u>	<u>(116,534,259)</u>	<u>(91,154,912)</u>	<u>(81,216,549)</u>

**EXHIBIT I-A**  
**COUNTY OF BUTTE**  
**ANALYSIS OF GOVERNMENTAL ACTIVITIES' STATEMENT OF ACTIVITIES**

	<i>For the Years Ended June 30,</i>					
	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
<b>Net (expense) revenues and change in net assets - Governmental Activities</b>	<u>(92,507,675)</u>	<u>(91,084,197)</u>	<u>(95,658,317)</u>	<u>(116,534,259)</u>	<u>(91,154,912)</u>	<u>(81,216,549)</u>
<b>General revenues, special items and transfers</b>						
Taxes						
Property taxes	34,260,317	41,656,548	45,641,947	47,928,940	49,534,039	49,822,100
Sales taxes	4,952,509	3,371,227	4,551,967	4,006,588	3,525,252	3,502,003
Other taxes	<u>1,935,715</u>	<u>1,624,332</u>	<u>1,356,479</u>	<u>989,470</u>	<u>1,031,960</u>	<u>1,010,109</u>
Total taxes	41,148,541	46,652,107	51,550,393	52,924,998	54,091,251	54,334,212
Grants and other contributions	18,526,669	25,122,030	21,030,134	21,299,136	17,253,122	15,503,952
Unrestricted investment earnings	3,291,173	1,474,933	5,558,955	5,367,056	4,832,431	3,218,361
Gain (loss) on disposal of capital assets	(66,147)	19,610	0	0	0	0
Miscellaneous	<u>19,507,815</u>	<u>8,327,670</u>	<u>11,430,359</u>	<u>12,932,121</u>	<u>11,688,662</u>	<u>4,521,606</u>
Total general revenues and special items	<u>82,408,051</u>	<u>81,596,350</u>	<u>89,569,841</u>	<u>92,523,311</u>	<u>87,865,466</u>	<u>77,578,131</u>
Transfers	<u>0</u>	<u>0</u>	<u>(8,770)</u>	<u>0</u>	<u>0</u>	<u>14,369</u>
Total General Revenues, special items and transfers	<u>82,408,051</u>	<u>81,596,350</u>	<u>89,561,071</u>	<u>92,523,311</u>	<u>87,865,466</u>	<u>77,592,500</u>
<b>Change in Net Assets - increase (decrease)</b>	<u>(10,099,624)</u>	<u>(9,487,847)</u>	<u>(6,097,246)</u>	<u>(24,010,948)</u>	<u>(3,289,446)</u>	<u>(3,624,049)</u>
<b>Net Assets - beginning of year</b>	344,523,998	383,092,273	375,799,541	369,702,295	345,691,347	350,484,621
<b>Restatements</b>	0	0	0	0	8,082,720	7,677,891
<b>Prior year adjustments</b>	<u>48,667,899</u>	<u>2,195,115</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
<b>Net Assets - beginning of year, restated</b>	<u>393,191,897</u>	<u>385,287,388</u>	<u>375,799,541</u>	<u>369,702,295</u>	<u>353,774,067</u>	<u>358,162,512</u>
 <b>Net Assets - end of year</b>	 <u>383,092,273</u>	 <u>375,799,541</u>	 <u>369,702,295</u>	 <u>345,691,347</u>	 <u>350,484,621</u>	 <u>354,538,463</u>
 Depreciation Expense	 <u>23,673,634</u>	 <u>23,630,598</u>	 <u>24,030,029</u>	 <u>28,245,541</u>	 <u>24,280,543</u>	 <u>24,169,629</u>



**Exhibit I-B** is an analysis of the ending balances of the governmental activities assets, liabilities and net assets from the Statement of Net Assets.

The rise or decline in cash and investments is influenced by other factors besides the annual increases to net assets. The collection of receivables, the payment of liabilities, the purchase of inventory, and the acquisition of capital assets affect cash and investments ending balance.

- The County's unrestricted cash and investments increased from \$73.3 million at June 30, 2005 to \$96.8 million at June 30, 2010.
  - The primary reason for the increase in cash and investments is that the annual declines in net assets did not affect cash and investments.
    - Depreciation expense, a non-monetary expense, was an important factor in the annual declines in net assets, and does not affect cash and investments, but instead reduced capital assets.
  - Cash and investments are very healthy.

### **Current Asset to Current Liability Ratio**

The asset to liability ratio is used to predict the ability of an entity to pay its current liabilities timely and is considered an indicator of financial health. Usually the higher the asset to liability ratio is, the healthier the entity. While the change in net assets will have an effect on these ratios, the largest influence on the growth or decline in these ratios are changes in liabilities. To offset an increase or decrease in liabilities, the change in assets must be proportionately greater to maintain these ratios **Furthermore non-cash expenses such as depreciation, while it affects the change in net assets, has no effect on current assets and liabilities.**

- The County of Butte has maintained a very healthy current asset to current liability ratio between 4.32 and 5.76.
- The movement of this ratio, in most years, is due to the increase or decrease in current liabilities.

### **Net Assets Invested in Capital Assets, Net of Related Debt**

The governmental activities' net assets invested in capital assets net of related debt reflects the County's governmental activities investment in capital assets such as building and streets, and as such is not available for future spending. Since June 30, 2005, this component of net assets declined \$65.4 million after depreciation, \$8.8 million more than the annual change in net assets.

- The annual decline in net assets due to the large annual depreciation expenses, has affected this component of net assets more than the other components of net assets.

### **Restricted Net Assets**

The governmental activities' restricted net assets reflect those **resources whose uses are restricted by external agencies or by enabling legislation.** Again, these assets are not available for general day to day use.

- Since June 30, 2005 this component of the governmental activities' net assets grew from \$15 million to \$55.9 million at June 30, 2010.
- The rise in restricted net assets is due to the increase in "general restrictions" net assets.



### **Unrestricted Net Assets**

**The third component of net assets is the unrestricted portion that can be used for any purpose. The only restriction is at the fund level.**

- As shown, throughout the period covered by our report, the governmental activities unrestricted net assets have fluctuated.
- The decline of unrestricted net assets from its high of \$45.1 million in 2006 to its low of \$19.6 million in 2008 is due to the increase of restricted net assets, not the annual declines in net assets.
  - Unrestricted net assets increased in three of the five years since 2005, despite the annual declines in net assets.
  - Unrestricted net assets grew in 2009 and 2010.

**EXHIBIT I-B**  
**COUNTY OF BUTTE**  
**ANALYSIS OF GOVERNMENTAL ACTIVITIES' STATEMENT OF NET ASSETS**

	<i>For the Years Ended June 30,</i>					
	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
<b>Assets</b>						
Unrestricted cash and investments	73,317,703	76,971,137	76,855,872	80,532,993	91,848,254	96,778,785
Restricted cash and investments with fiscal agents	24,715,279	9,007,543	14,193,493	3,771,864	5,545,168	6,448,463
Imprest Cash	86,360	86,260	89,689	85,845	85,945	87,045
Other current assets	12,821,095	13,657,126	16,189,105	25,531,435	28,238,505	34,943,511
Total current assets	<u>110,940,437</u>	<u>99,722,066</u>	<u>107,328,159</u>	<u>109,922,137</u>	<u>125,717,872</u>	<u>138,257,804</u>
Non-current assets	52,852,304	53,710,690	54,744,484	53,636,936	54,615,341	53,481,334
Capital assets	338,130,113	323,360,842	306,376,555	286,612,527	275,395,020	268,350,417
Total assets	<u><u>501,922,854</u></u>	<u><u>476,793,598</u></u>	<u><u>468,449,198</u></u>	<u><u>450,171,600</u></u>	<u><u>455,728,233</u></u>	<u><u>460,089,555</u></u>
<b>Liabilities</b>						
Current liabilities	19,331,908	17,304,746	20,000,427	21,868,234	29,116,048	26,448,932
Non-current liabilities	99,498,673	83,689,311	78,746,476	77,086,019	76,127,564	79,102,151
Total liabilities	<u><u>118,830,581</u></u>	<u><u>100,994,057</u></u>	<u><u>98,746,903</u></u>	<u><u>98,954,253</u></u>	<u><u>105,243,612</u></u>	<u><u>105,551,083</u></u>
<b>Current Asset to Current Liability Ratio</b>	<u>5.74</u>	<u>5.76</u>	<u>5.37</u>	<u>5.03</u>	<u>4.32</u>	<u>5.23</u>
<b>Net Assets</b>						
Invested in capital assets, net of related debt	328,573,058	313,955,354	299,087,057	280,126,245	269,571,545	263,205,333
Restricted						
General restrictions	N/A	N/A	7,548,579	32,574,438	33,984,846	39,777,184
Grants and special revenue	N/A	N/A	8,993,522	0	0	0
County service areas	N/A	N/A	0	5,694,483	6,322,209	6,677,241
Other purposes	N/A	N/A	0	1,407,021	1,711,665	0
Debt service	N/A	N/A	9,779,607	6,323,784	9,070,659	9,448,490
Total restricted	<u>14,971,692</u>	<u>16,696,959</u>	<u>26,321,708</u>	<u>45,999,726</u>	<u>51,089,379</u>	<u>55,902,915</u>
Unrestricted	<u>39,547,523</u>	<u>45,147,228</u>	<u>44,293,530</u>	<u>19,565,376</u>	<u>29,823,697</u>	<u>35,430,215</u>
<b>Net Assets - end of year</b>	<u><u>383,092,273</u></u>	<u><u>375,799,541</u></u>	<u><u>369,702,295</u></u>	<u><u>345,691,347</u></u>	<u><u>350,484,621</u></u>	<u><u>354,538,463</u></u>



**Exhibit I-C** shows how the County's long-term debt affects the governmental activities unrestricted net assets. Long-term liabilities that are not related to the acquisition or construction of the County's capital assets are allocated to unrestricted net assets, hiding resources that are available to finance current operations. This exhibit calculates the long-term debt that was not allocated to the capital assets and instead applied to the unrestricted net assets in order to determine the unrestricted net resources.

- In order to determine the current resources available to finance governmental activities expenses, we have to remove non-current/non-monetary assets.
- As shown in this exhibit, the current unrestricted net resources are much larger than the unrestricted net assets in all years covered by our report.
  - The County's net resources ranged from a low of \$36.5 million in 2008 to a high of \$76.6 million in 2005.
  - As of June 30, 2010, the County's net resources were \$55.9 million.

The County's financial health is reflected in the strong positive ratios of the governmental activities of unrestricted resources to revenues and unrestricted resources to expenses.

- The unrestricted resources to revenue ratio declined from 24.54% in 2005 to 10.27% in 2008 due to the increases in governmental activities' restricted net assets.
  - As of June 30, 2010, the revenue ratio grew to 15.43%.
- The expense ratio has been slightly smaller each year falling from 23.77% in 2005 to a low of 9.62% in 2008, again due to the increase in restricted net assets.
  - As of June 30, 2010, the expense ratio was 15.28%.
- These are healthy ratios.

Exhibit I-D is a graphic representation of the County's net assets.

### **Findings**

- Despite annual decreases in net assets, governmental activities' cash and investments grew \$23.5 million from 2005's balance of \$73.3 million to \$96.8 million at June 30, 2010.
- The County's governmental activities net assets declined \$38.7 million since July 1, 2004, due to expenses exceeding revenues and transfers by \$56.6 million.
  - Restatements and prior period adjustments increasing net assets by \$17.9 million since 2005 offset part of the annual decline in net assets.
  - The annual declines are due to the large annual depreciation expenses that exceeded \$23 million per year and cumulatively totaled \$148 million during the years covered by our report.
- The affects of the depreciation expense on net assets is highlighted by the increase and decrease in the components of net assets.
  - Since June 30, 2005, the entire decline in net assets due to expenses exceeding revenues and transfers affected net assets invested in capital assets net of related debt, which declined \$65.4 million.
- The decline in the governmental activities unrestricted net assets from 2006 through 2008 is not due to the annual declines in net assets, but is due to the increase in restricted assets.

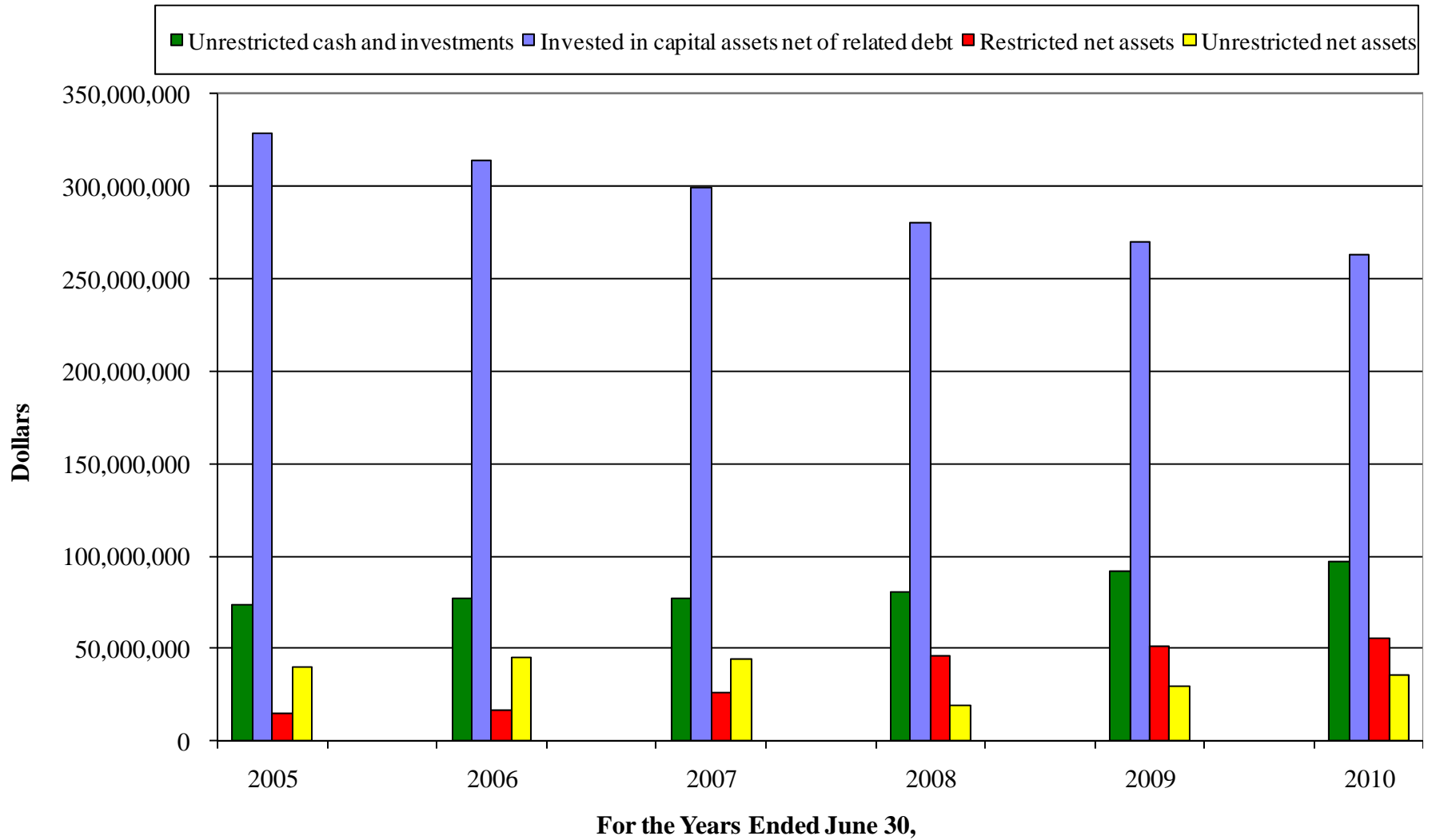


- Despite the annual declines in net assets, both restricted and unrestricted net assets increased in 2009 and 2010.
- The governmental activities as presented in the government-wide financial statements are healthy.
  - This growth has increased the County's options and its ability to respond to economic downturns.

**EXHIBIT I-C**  
**COUNTY OF BUTTE**  
**COMPUTATION OF NET RESOURCES AND RATIO ANALYSIS OF GOVERNMENT ACTIVITIES**

	<i>For the Years Ended June 30,</i>					
	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
<b>Computation of Governmental Activities Net Resources Available</b>						
1 Long-term debt - non-current portion	99,498,673	83,689,311	78,746,476	77,086,019	76,127,564	79,102,151
2 Capital assets	338,130,113	323,360,842	306,376,555	286,612,527	275,395,020	268,350,417
3 Less: net assets invested in capital assets, net of related debt	(328,573,058)	(313,955,354)	(299,087,057)	(280,126,245)	(269,571,545)	(263,205,333)
4 Related debt invested in capital assets (line 2 minus line 3)	9,557,055	9,405,488	7,289,498	6,486,282	5,823,475	5,145,084
5 Debt unrelated to capital assets applied to unrestricted net assets (line 1 minus line 4)	89,941,618	74,283,823	71,456,978	70,599,737	70,304,089	73,957,067
6 Non-current assets	(52,852,304)	(53,710,690)	(54,744,484)	(53,636,936)	(54,615,341)	(53,481,334)
7 Unrestricted net assets	39,547,523	45,147,228	44,293,530	19,565,376	29,823,697	35,430,215
<b>8 Governmental Activities Unrestricted Resources (line 5 plus line 6)</b>	<u>76,636,837</u>	<u>65,720,361</u>	<u>61,006,024</u>	<u>36,528,177</u>	<u>45,512,445</u>	<u>55,905,948</u>
<b>Ratio Analysis - Unrestricted Resources to Revenues and Expenses</b>						
<b>Total Revenues</b>						
Program revenues - from Exhibit I-A	229,918,722	236,373,284	253,729,941	263,043,817	275,566,524	284,706,583
Total General Revenues, special items and transfers - from Exhibit I-A	82,408,051	81,596,350	89,569,841	92,523,311	87,865,466	77,578,131
	<u>312,326,773</u>	<u>317,969,634</u>	<u>343,299,782</u>	<u>355,567,128</u>	<u>363,431,990</u>	<u>362,284,714</u>
% of unrestricted resources to total revenues	24.54%	20.67%	17.77%	10.27%	12.52%	15.43%
<b>Program expenses - from Exhibit 1-A</b>	<u>322,426,397</u>	<u>327,457,481</u>	<u>349,388,258</u>	<u>379,578,076</u>	<u>366,721,436</u>	<u>365,923,132</u>
% of unrestricted resources to total expenses	23.77%	20.07%	17.46%	9.62%	12.41%	15.28%

**EXHIBIT I-D  
COUNTY OF BUTTE  
ANALYSIS OF NET ASSETS**





## EXHIBIT II

The amounts for **Exhibit II** were obtained from the statistical section of the 2009 and the 2010 CAFRs. This exhibit is an analysis of the **all revenues** for all of the County's governmental type funds, which includes the General Fund, Special Revenue Funds, Capital Project Funds and the Debt Service Funds from 2002 through 2010. The various revenues are shown as they were originally reported in the governmental fund financial statements in the year they occurred. **As such, these revenues are reported using the modified accrual method of accounting. Since the government-wide financial statements use the accrual method of accounting, there will be differences between the revenues as shown in Exhibit I and the revenues shown in this exhibit.**

We have calculated both the annual increase from the prior year and the internal rate of return (IRR) for both the ten year period since 2002 and the four year period since 2006. The IRR is the implied annual rate of change for an amount to increase/decrease from the beginning of a period to the end of a period.

**Exhibit II-A** is analysis of the **tax revenues for the County's governmental type funds**. As shown in this Exhibit, the County reports three tax revenue sources, property taxes, sales taxes and other taxes.

- Total tax revenues have experienced strong growth since 2002, with annual revenue increases each year presented.
  - Since 2002, the IRR was a strong 12.46%, principally due to very strong annual revenue increases from 2003 through 2007.
    - The driving force in the in the increases has been property tax revenues, especially in 2005, which caused total tax revenues to increase 62.43%.
  - The IRR since 2006 declined significantly to 3.88% due to drastic declines in the annual rate of growth from 2008 through 2010.
    - Declines in the rate increase for property tax revenues and decreasing sales tax caused the decline in total revenues.
- The reallocation of the sales tax revenues, property tax revenues and vehicle license fees (VLF) due to the State's budget crisis in 2004, the passage of SB 1096 in July 2004, and the ERAF III had a lasting impact on the County's tax revenues.
  - The "triple flip" revenue shift began in the 2004-2005 fiscal year with the State replacing sales taxes and VLF revenues taken from local governments with property taxes. The exchange of revenues include:
    - The State receiving 25% of the Bradley Burns local governments' 1% sales tax rate to the State to guarantee the repayment of 2004's \$15 billion voter approved bonds to refinance existing State debt for property taxes to local government.
      - This revenue shift will continue until the deficit bonds issued by the State are repaid.
    - The replacement of local governments' Vehicle License Fees (VLF) revenues with property taxes due to the permanent reduction of the local government VLF rate from 2% to 0.65% of market value.



- The changes also included temporary loans and shifts of revenues to the State from local government.
  - Cities and counties loaned the June 2004 VLF revenues to the State with repayment originally rescheduled in the fiscal year ended June 30, 2006.
  - A temporary shift of certain property taxes from local government to the state in 2004-2005 and the 2005-2006 fiscal years.
- This reallocation of revenues increased local governments' reliance on property taxes.
- A review of the tax revenue components shows that the strongest IRR for the eight years since 2002 and the four years since 2006 occurred in property tax revenues, which grew at an IRR of 16.92% and 4.58% respectively.
  - Property tax revenues grew each year since 2002.
  - Property tax revenues experienced strong growth through 2007, but the strong growth rates began to decline in 2008.
  - The growth of property tax revenues is due to increased assessed values, discussed below, and the reallocation of sales and property tax revenues between the state and local government due to the "triple flip" discussed above.
- Sales tax revenues experienced minimum growth during the period covered by our report experiencing an IRR of 0.83% since 2002 and an IRR of 0.96% since 2006.
  - Strong growth in sales tax revenues from 2003 through 2006 were nullified by sales tax revenue declines in four of the five years since 2005.
    - The 31.93% decline in 2006 was due to the exchange of Bradley/Burns sales tax revenue discussed above.
    - The declines in sales tax revenues beginning in 2008 and continuing through 2010 is due to the recession.
  - Due to their size, sales tax revenues are not an important revenue source for the County, but they are an indicator to the County's economy.
    - The declines in sales tax revenues indicate a weak local economy
- The other component of tax revenues is immaterial.

### **Assessed Values and Property Taxes**

We obtained the information in the following table for the years ended June 30, 2000 through June 30, 2011 from the County's 2009 and 2010 CAFRs and the 2008, 2009 and 2010 assessed values from the Auditor Certified Values by Tax Base from the County of Butte's Auditor's office.

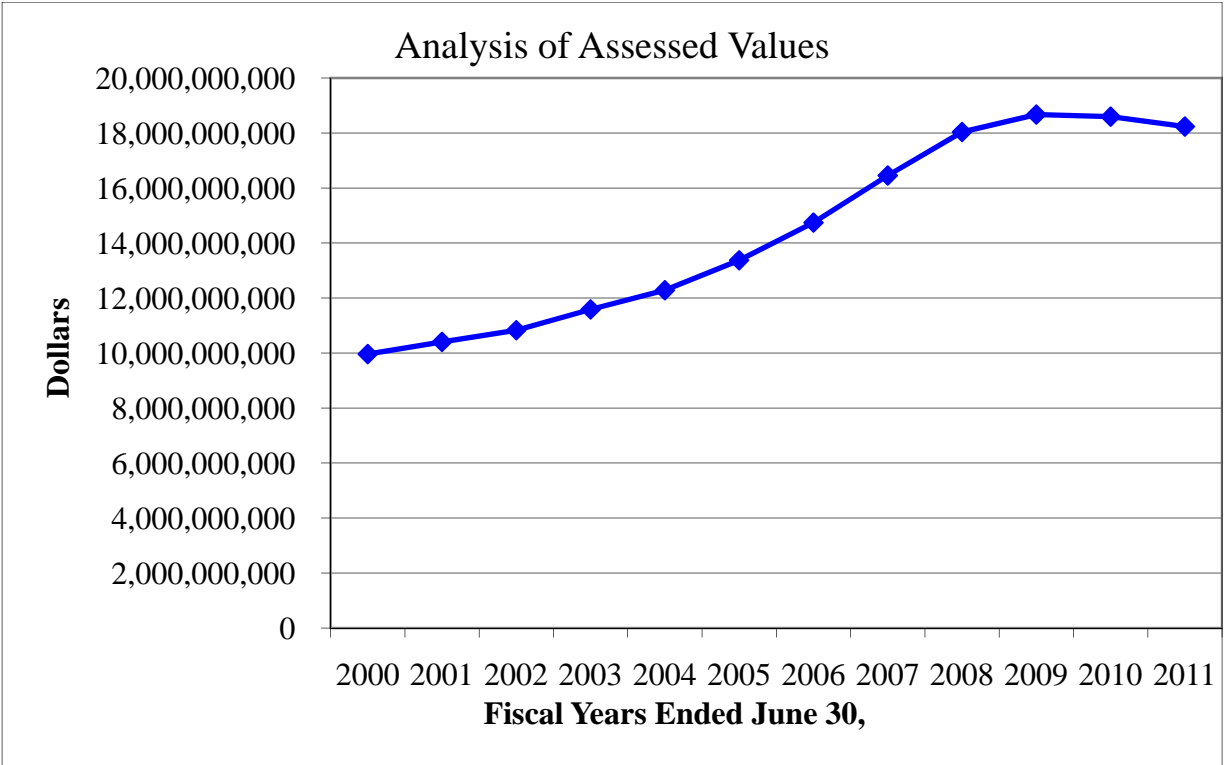
- In reviewing the Auditor Certified Values by Tax Base (Tax Roll) from the County of Butte's Auditor's office for 2009-2010 for the 2010-2011 fiscal year, we noticed that the assessed values for 2011 per the Tax Roll, was the same as the 2010 assessed values per the 2010 CAFR Schedule. We reviewed the two prior years' Tax Rolls and noticed that the County skipped the 2008-2009 tax roll for the 2010 fiscal year. We corrected the error in our table.



### Analysis of Assessed Values

Fiscal Year Ended June 30,	Net Assessed Value	% Change From Prior Year
2000	9,958,248,101	N/A
2001	10,400,691,089	4.44%
2002	10,827,717,650	4.11%
2003	11,582,436,024	6.97%
2004	12,279,362,364	6.02%
2005	13,371,181,722	8.89%
2006	14,740,506,515	10.24%
2007	16,453,060,602	11.62%
2008	18,034,737,948	9.61%
2009	18,671,235,449	3.53%
2010	18,592,445,580	(0.42%)
2011	18,235,074,012	(1.92%)
IRR since 2000		<u>5.65%</u>
IRR since 2005		<u>5.31%</u>

- The strong growth rates from 2000 through 2008, especially in 2005, 2006, 2007, and 2008, provided a cushion for the collapse of the housing market.
- However, the collapse of the housing market in Butte County that began in 2005, as we discuss below, eliminated this cushion in 2010, and assessed values have continued to fall in 2011.
- We have presented the information the assessed value table in the graph below:



We downloaded the information in **following table and Exhibit II-B** from Zillow.com on March 3, 2011 in order to analyze the effects of the decline in market value of residential real estate. Zillow.com obtains its information from various sources including market sales reports and county assessors' offices. The values shown in this table and exhibit are the median prices in a given area.

**County of Butte Median Housing Value Changes**

Median Value April 2003	\$ 189,100
Median Value September 2005	<u>\$ 300,000</u>
Median Value December 2009	<u>\$ 202,300</u>
Median Value December 2010	<u>\$ 189,000</u>
Month to Month Change	(2.00%)
Quarter to Quarter Change	(5.30%)
% Year to Year Change	(6.60%)
Change April 2003 to September 2005	58.65%
\$ Change since September 2005	\$ (111,000)
% Change since September 2005	(37.00%)



As shown in the above table, the median housing market values declined by 6.6% in one year from December 2009 to December 2010, and have had an even greater decline since house values peaked in September 2005 as **shown in Exhibit II-B**. Exhibit II-B is a graphic representation of the annual rate of change for the County's median housing price computed by Zillow.com since 1999. **What is troubling is that housing values, after stabilizing from April 2009 to August 2010, began to decline in September 2010.**

- Due to 1978's Proposition 13 limiting the growth of assessed values on residential and commercial property to 2% per year, declines in current real estate values do not necessarily cause a decrease in the assessed valuation of the total tax base.
  - Property held for periods longer than five years are still below market value.
  - As such, property purchases within the last four years will be assessed downward.
  - Much of the downward pressure on housing market values is due to the large number of foreclosure sales.
    - Banks generally price foreclosed property low so they can be sold quickly, thus lowering the market price for all property in the area.
    - As the inventory for foreclosed property declines, housing values and the median housing values should stabilize.
  - Furthermore when property values begin to recover, properties that have been reassessed downward by the assessor, but not due to a sale of the property, are not limited to the 2% increase in values.
    - The assessed values of these properties will increase at the market rate until they recover their assessment values at the time of reassessment plus the lost 2% annual increase.
- The recent decrease in the County's median housing values since September combined with declines in assessed values in.
- The last collapse of a housing bubble in California occurred in 1990.
  - Northern California did not recover its 1990 housing values until 1994.
  - It took Southern California longer to recover its lost housing values. Not until 1996, a period of six years, did southern California recover its 1990 housing values.
  - In our opinion, the housing market may be depressed for multiple years.

## **Sales Tax Revenues**

The rise or decline in a community's sales tax revenues is a reflection of the health of the local economy.

We obtained the "Quarterly Allocation Summary of Bradley Burns Local Tax Allocation" for the quarterly payment periods beginning with the quarter ended December 31, 2005 and ending with the quarter ended, September 30, 2010. These reports, prepared by the California State Board of Equalization, contain information regarding the 1% Bradley-Burns local sales tax collected by the State and allocated and paid to each city and county, showing the County's share of the sales tax, the State's 0.25% share of the sales tax, the City's share of the sales tax and the State's administrative expenses deducted from the local government's sales tax allocation. Furthermore, these quarterly allocation summaries reflect the sales taxes collected during the quarter by resellers, not the period when the State collected the tax from the retailers or when the State paid



the County its share of the sales tax collections. There is an approximate three month delay from the collection of the sales tax by the State and the payment to local government.

We have prepared the following table showing the Bradley Burns local sales tax allocated to the County of Butte before the State’s administrative expense deduction. We cannot correlate the sales tax revenues shown in the tables to the sales tax reported in the CAFR since the County also receives sales tax revenues from other sources. By analyzing current year Bradley-Burns local sales tax revenues, we can gauge the economic activity in the County, and obtain insight into the growth or decline of the County’s sales tax revenues from all sources.

The different quarters have different sales pattern. For instance, the quarters ending December 31 of each year contain the Christmas season, when retail sales are greatest. As such, sales tax revenues should be much higher in that quarter than other quarters.

**Quarterly Allocation Summary of Bradley Burns Local Tax Allocation  
For the County of Butte**

Quarter Ended	Total Local Sales Tax	\$ Change	Quarterly % Change	Yearly \$ Change	Yearly % Change
December 31, 2005	874,456	N/A	N/A	N/A	N/A
March 31, 2006	743,167	(131,289)	(15.01%)	N/A	N/A
June 30, 2006	997,517	254,350	34.23%	N/A	N/A
September 30, 2006	981,977	(15,540)	(1.56%)	N/A	N/A
December 31, 2006	799,132	(182,845)	(18.62%)	(75,324)	(8.61%)
March 31, 2007	714,874	(84,258)	(10.54%)	(28,293)	(3.81%)
June 30, 2007	877,445	162,571	22.74%	(120,072)	(12.04%)
September 30, 2007	815,028	(62,417)	(7.11%)	(166,949)	(17.00%)
December 31, 2007	681,990	(133,038)	(16.32%)	(117,142)	(14.66%)
March 31, 2008	589,226	(92,764)	(13.60%)	(125,648)	(17.58%)
June 30, 2008	857,753	268,527	45.57%	(19,692)	(2.24%)
September 30, 2008	804,258	(53,495)	(6.24%)	(10,770)	(1.32%)
December 31, 2008	663,952	(140,306)	(17.45%)	(18,038)	(2.64%)
March 31, 2009	609,151	(54,801)	(8.25%)	19,925	3.38%
June 30, 2009	763,920	154,769	25.41%	(93,833)	(10.94%)
September 30, 2009	691,238	(72,682)	(9.51%)	(113,020)	(14.05%)
December 31, 2009	633,862	(57,376)	(8.30%)	(30,090)	(4.53%)
March 31, 2010	570,957	(62,905)	(9.92%)	(38,194)	(6.27%)
June 30, 2010	724,806	153,849	26.95%	115,655	18.99%
September 30, 2010	816,733	91,927	12.68%	52,813	6.91%

As shown in this table, since the quarter ended September 30, 2006 the County’s sales tax revenues, adjusted for any difference in the number of days, declined from the prior year’s comparable quarter in thirteen of the sixteen quarters presented.



- This decline is due to several factors:
  - The collapse of the local housing market, and
  - The recession.
- However, in the last two quarters ended June 30, 2010, and September 2010, sales taxes increased over the comparable quarter in the prior year. This increase may signal a stabilization of sales tax revenues and represent an economy that may be improving.
  - The rise in the Bradley-Burns sales tax revenues in the last two quarters indicates the retail sales tax activity has increased.
  - This indicates that other sales tax revenues, such as the “Public Safety” sales tax revenues and any special districts sales tax revenues should also increase.

We have also obtained the monthly sales tax payments from the SBOE to the County of Butte beginning July 2008 through February 2010. The SBOE makes monthly allocations to 764 California jurisdictions based on a formula that includes historical allocations, growth factors, transfers/audits and actual cash receipts. The monthly payment in the month the quarterly allocation is released includes the final payment for the quarter just ended and the first payment of the next quarter. Sales tax collections reported in the quarterly sales tax report cannot be compared to the monthly sales tax payments. The quarterly reports show only the sales taxes collected by retailers during the quarter, and not the sum of the monthly payments. The following table and graph presents the monthly sales tax payments from the SBOE.

**Monthly Allocation Summary of Bradley Burns Local Tax  
For the County of Butte**

Month	2008-2009	2009-2010	2010-2011	2009-2010		2010-2011	
				Dollar	%	Dollar	%
July	236,100	191,900	195,400	(44,200)	(18.721%)	3,500	1.824%
August	314,900	255,700	225,200	(59,200)	(18.800%)	(30,500)	(11.928%)
September	282,997	304,583	282,589	21,586	7.628%	(21,994)	(7.221%)
October	222,300	191,200	184,400	(31,100)	(13.990%)	(6,800)	(3.556%)
November	296,300	254,900	245,800	(41,400)	(13.972%)	(9,100)	(3.570%)
December	231,546	213,675	359,596	(17,871)	(7.718%)	145,921	68.291%
January	177,700	169,200	169,200	(8,500)	(4.783%)	0	0.000%
February	237,000	225,700	225,500	(11,300)	(4.768%)	(200)	(0.089%)
March	222,924	213,105	0.00	(9,819)	(4.405%)	N/A	N/A
April	159,700	151,700	0.00	(8,000)	(5.009%)	N/A	N/A
May	212,800	221,700	0.00	8,900	4.182%	N/A	N/A
June	261,921	234,676	0.00	(27,245)	(10.402%)	N/A	N/A
	<b>2,856,188</b>	<b>2,628,039</b>	<b>N/A</b>	<b>(228,149)</b>	<b>(7.988%)</b>	<b>N/A</b>	<b>N/A</b>

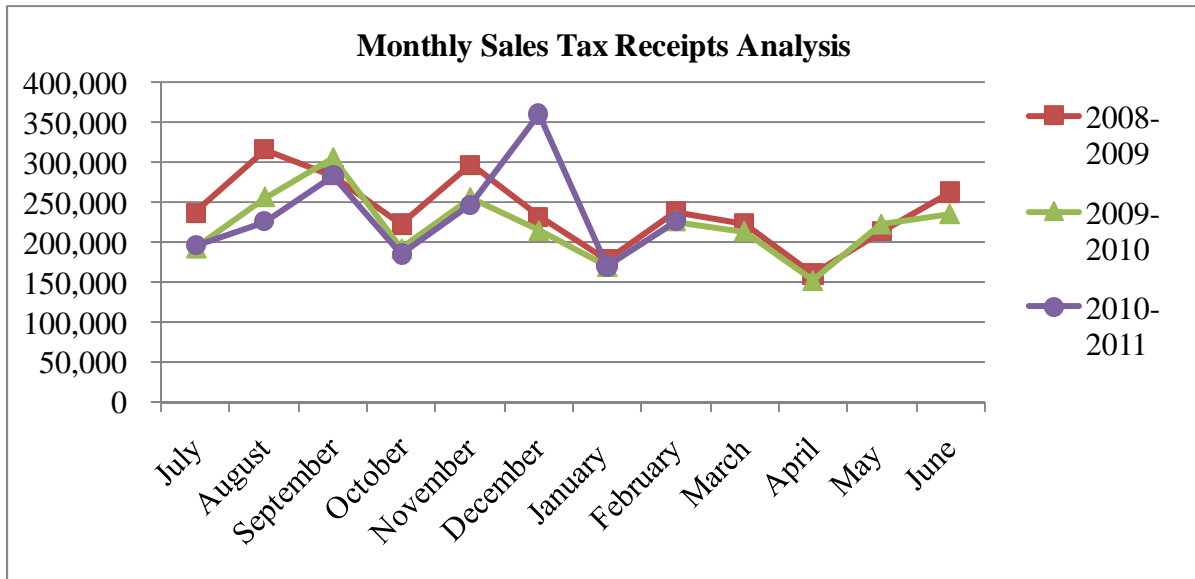
In the twenty months beginning July 2009:

- Monthly sales tax receipts were below the prior year’s comparable month fifteen times.



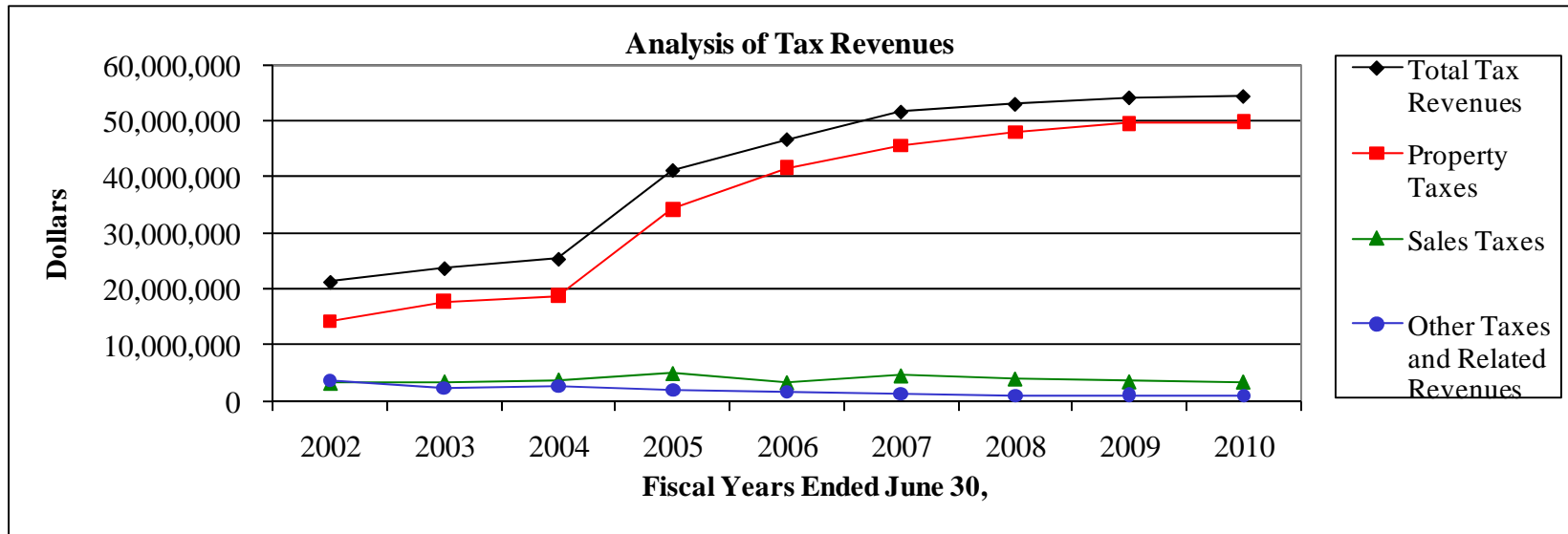
- However, the monthly receipts for January and February 2011, payments from the SBOE exceeded or equaled the prior year's comparable month.
  - This may indicate that economic activity in the County has stopped declining and sales tax revenues may flatten out or begin a recovery.

The following chart is a graphic representation of the monthly receipts.

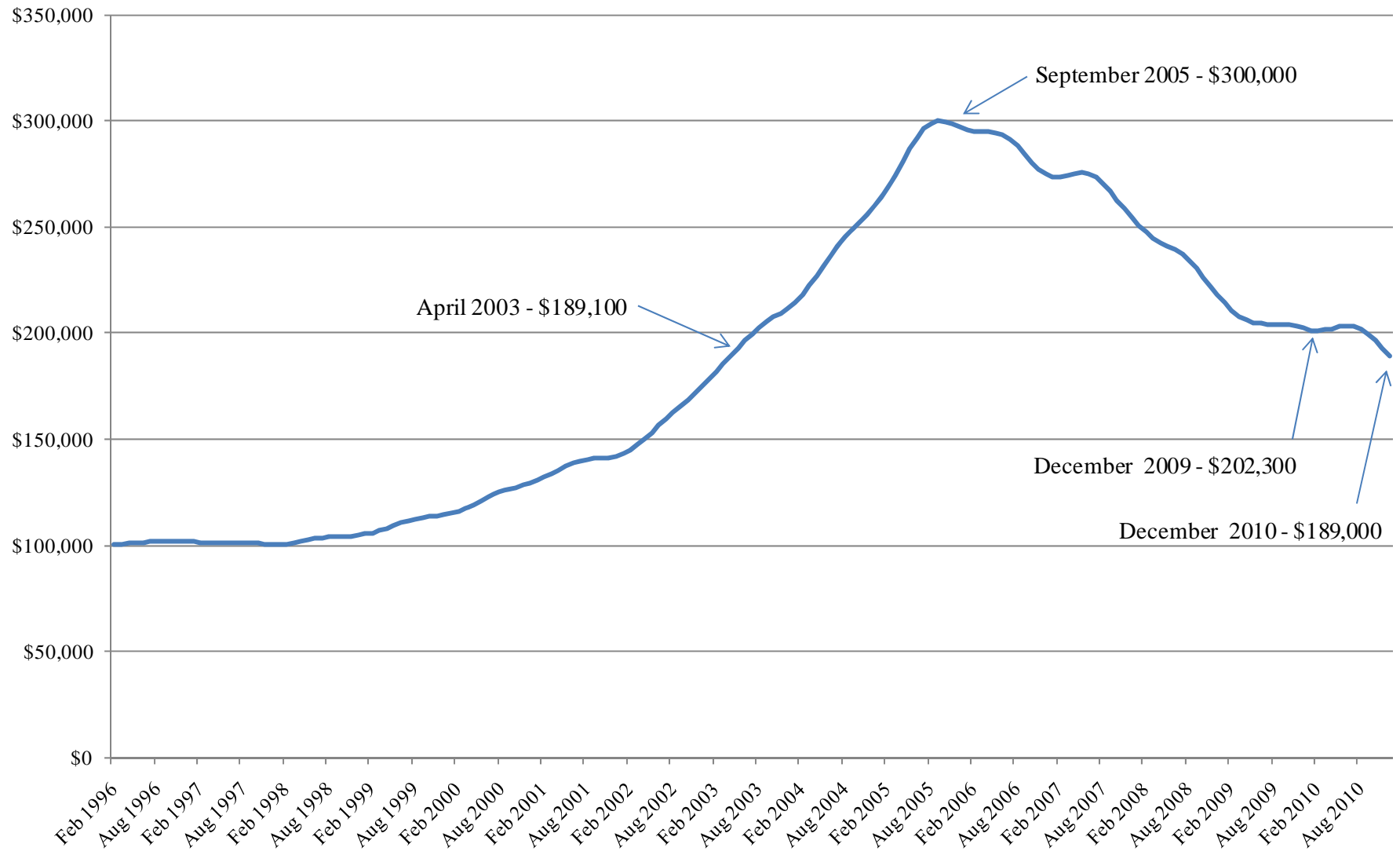


**EXHIBIT II-A  
COUNTY OF BUTTE  
ANALYSIS OF GENERAL GOVERNMENT TAX REVENUES**

Fiscal Year Ended June 30,	Total Tax Revenues	% Change From Prior Year	Property Taxes	% Change From Prior Year	Sales Taxes	% Change From Prior Year	Other Taxes and Related Revenues	% Change From Prior Year
2002	21,237,501	N/A	14,269,289	N/A	3,278,612	N/A	3,689,600	N/A
2003	23,669,603	11.45%	17,798,624	24.73%	3,517,481	7.29%	2,353,498	(36.21%)
2004	25,332,734	7.03%	18,770,212	5.46%	3,846,573	9.36%	2,715,949	15.40%
2005	41,148,541	62.43%	34,260,317	82.52%	4,952,509	28.75%	1,935,715	(28.73%)
2006	46,652,107	13.37%	41,656,548	21.59%	3,371,227	(31.93%)	1,624,332	(16.09%)
2007	51,550,123	10.50%	45,641,947	9.57%	4,551,697	35.02%	1,356,479	(16.49%)
2008	52,924,998	2.67%	47,928,940	5.01%	4,006,588	(11.98%)	989,470	(27.06%)
2009	54,091,251	2.20%	49,534,039	3.35%	3,525,252	(12.01%)	1,031,960	4.29%
2010	54,334,212	0.45%	49,822,100	0.58%	3,502,003	(0.66%)	1,010,109	(2.12%)
IRR since 2002		<u>12.46%</u>		<u>16.92%</u>		<u>0.83%</u>		<u>(14.95%)</u>
IRR since 2006		<u>3.88%</u>		<u>4.58%</u>		<u>0.96%</u>		<u>(11.20%)</u>



**EXHIBIT II-B  
COUNTY OF BUTTE  
ZILLOW.COM MEDIAN HOME VALUES**





**Exhibit II-C** is an analysis of the County's Revenues for all of its governmental type funds from 2002 through 2010. As shown in this Exhibit, the total revenues for governmental type funds experienced weak to moderate growth with an IRR of 3.22% for eight years since 2002 and a 3.25% rate for the four years since June 30, 2006.

- Weak annual growth rates in 2003, 2004, 2006, 2009, and 2010 offset stronger growth rates in 2005, 2007, and 2008.
- The most important non-tax revenue, aid from other governments, had an IRR for the eight years since 2002 of 1.79%, and a stronger, though not impressive, IRR of 2.82% since 2006.
  - These low IRR's are due to negative growth rates from 2003 through 2005 and the weak to moderate annual growth rates from 2007 through 2010.
  - Due to this revenues dependency on other governments' funding policies, this revenue source is not dependable.
  - Furthermore, many of these revenues are restricted to specific uses.
- Other than taxes, which we have already discussed, the only other material revenue is charges for services.
  - This revenue source has experienced strong growth since 2002 and 2006 with IRRs of 6.89% and 10.6% respectively.
- The other non-tax revenues are immaterial that have experienced mixed growth rates.

**Exhibit II-D** is a graphic representation of the growth of the County's various revenues.

### **Findings**

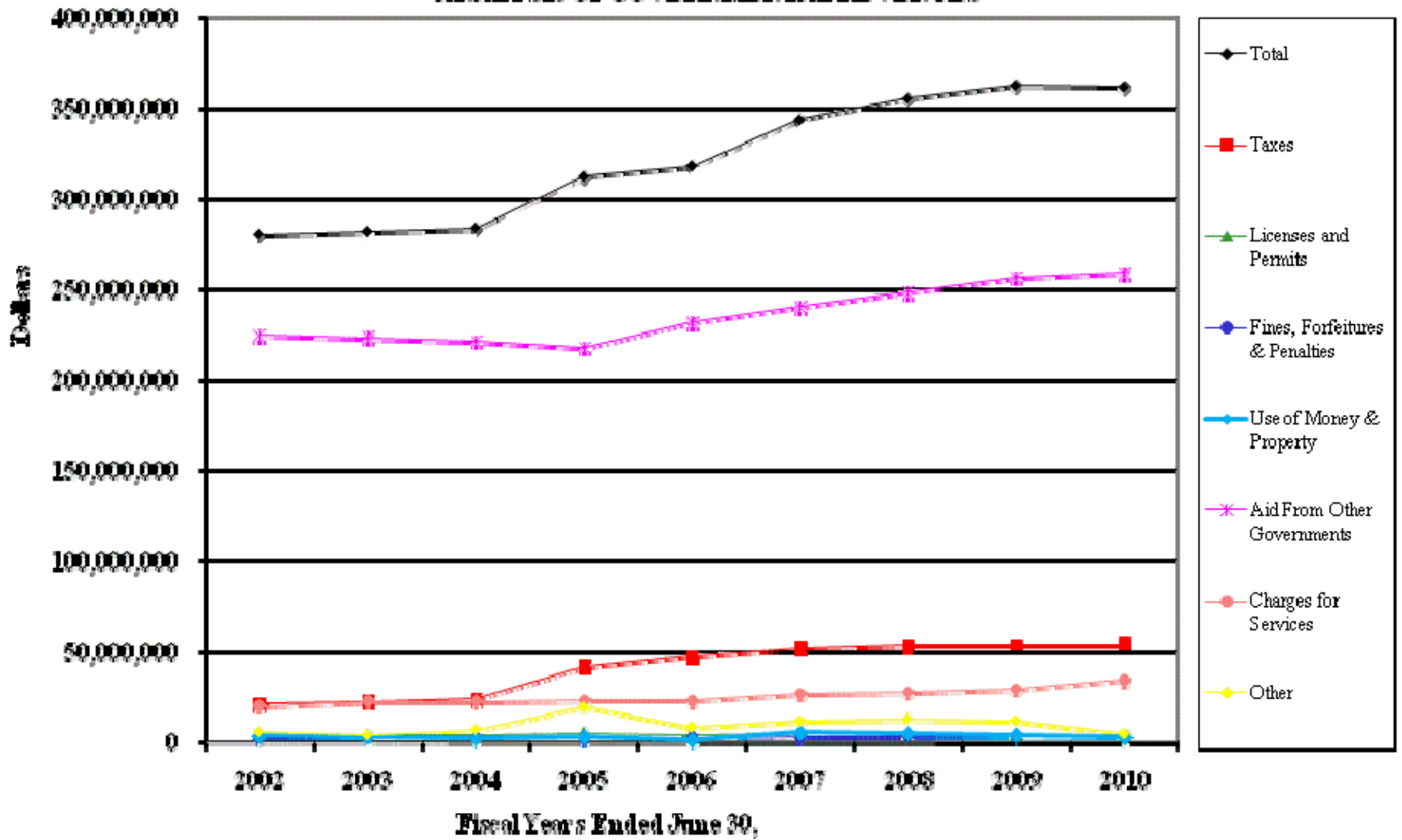
- The County's revenues have flattened, or are declining.
  - Current trends indicate future revenues will either be flat or decline in the immediate future.
- The County's most important tax revenue, property taxes have declined the past two years due to declining assessed values,
  - Current information shows that the County's residential property values, after stabilizing in April 2009, began to decline again in September 2010, indicating possible assessed value declines for the 2011-2012 fiscal year and corresponding declines in property tax revenues.
- The most important County revenue, aid from other governments, experienced low growth over the period covered by our report.
  - This revenue is dependent on the Federal and State governments and is not a dependable source, especially grants from the State.
  - Future revenues from both the State and the Federal government are questionable.

**EXHIBIT II-C**  
**COUNTY OF BUTTE**  
**ANALYSIS OF GENERAL GOVERNMENT REVENUES**

Fiscal Year Ended June 30,	Total	% Change From Prior Year	Taxes	% Change From Prior Year	Licenses and Permits	% Change From Prior Year	Fines, Forfeitures & Penalties	% Change From Prior Year	Use of Money & Property	% Change From Prior Year
2002	280,693,834	N/A	21,237,501	N/A	3,398,347	N/A	2,115,318	N/A	3,533,053	N/A
2003	282,300,872	0.57%	22,753,793	7.14%	3,988,539	17.37%	2,255,129	6.61%	3,053,170	(13.58%)
2004	284,196,490	0.67%	23,874,775	4.93%	4,360,823	9.33%	2,741,657	21.57%	2,240,655	(26.61%)
2005	312,510,969	9.96%	41,845,457	75.27%	5,143,170	17.94%	1,829,081	(33.29%)	3,081,942	37.55%
2006	318,402,433	1.89%	47,395,136	13.26%	4,322,084	(15.96%)	2,446,572	33.76%	1,337,150	(56.61%)
2007	343,865,019	8.00%	52,384,206	10.53%	4,861,476	12.48%	2,728,930	11.54%	5,285,289	295.27%
2008	355,591,442	3.41%	53,797,238	2.70%	4,604,498	(5.29%)	3,139,816	15.06%	4,982,969	(5.72%)
2009	362,649,180	1.98%	54,091,251	0.55%	3,720,735	(19.19%)	3,307,221	5.33%	4,063,901	(18.44%)
2010	361,813,400	(0.23%)	54,334,212	0.45%	3,123,312	(16.06%)	3,835,387	15.97%	2,766,269	(31.93%)
IRR since 2002		<u>3.22%</u>		<u>12.46%</u>		<u>(1.05%)</u>		<u>7.72%</u>		<u>(3.01%)</u>
IRR since 2006		<u>3.25%</u>		<u>3.47%</u>		<u>(7.80%)</u>		<u>11.90%</u>		<u>19.93%</u>

Fiscal Year Ended June 30,	Aid From Other Governments	% Change From Prior Year	Charges for Services	% Change From Prior Year	Other	% Change From Prior Year
2002	224,680,201	N/A	20,091,942	N/A	5,637,472	N/A
2003	223,632,528	(0.47%)	22,705,240	13.01%	3,912,473	(30.60%)
2004	221,567,801	(0.92%)	22,558,577	(0.65%)	6,852,202	75.14%
2005	217,938,378	(1.64%)	23,166,702	2.70%	19,506,239	184.67%
2006	231,688,344	6.31%	22,885,477	(1.21%)	8,327,670	(57.31%)
2007	240,529,554	3.82%	26,645,205	16.43%	11,430,359	37.26%
2008	248,376,861	3.26%	27,757,939	4.18%	12,932,121	13.14%
2009	256,476,762	3.26%	29,300,650	5.56%	11,688,660	(9.62%)
2010	258,983,988	0.98%	34,248,626	16.89%	4,521,606	(61.32%)
IRR since 2002		<u>1.79%</u>		<u>6.89%</u>		<u>(2.72%)</u>
IRR since 2006		<u>2.82%</u>		<u>10.60%</u>		<u>(14.16%)</u>

**EXHIBIT II-D  
COUNTY OF BUTTE  
ANALYSIS OF GOVERNMENTAL REVENUES**





### EXHIBIT III

The **budget** is an economic and political document that prioritizes a government's spending. As the year progresses, budgets are amended due to changing economic conditions, new information or shifting priorities. Amendments can occur up to the date the financial statements are issued. **Exhibit III** demonstrates the transitory and conservative manner in which budgets are made and amended versus what actually happens. A variance is the difference between the budget amounts and the actual amounts. A "favorable" revenue variance occurs when actual revenues exceed budgeted revenues and a "favorable" expenditure variance occurs when budgeted expenditures exceed actual expenditures. "Unfavorable" variances are the opposite of favorable variances.

The County changed the presentation of the County's budgetary to actual comparison in 2006. In 2005, the County reported total transfers from and to the General Fund as other financing sources (uses). Beginning in 2006, the County eliminated reporting total transfers to and from the General Fund as other financing sources (uses), but reported them as expenses in the line items in the budget to actual comparison. Due to time and budget restraints, we did not change the County's presentation in our exhibits for the years ended June 30, 2006 through June 30, 2010.

#### Revenues

- The County's actual revenues exceeded the adopted budget revenues in four of the six years presented.
  - These favorable variances ranged from a low of \$110,878 in 2008 (0.1% of budgeted revenues) to a high of \$7.6 million (4.94% of budgeted revenues) in 2006.
    - In 2010, the favorable variance was \$6.1 million or 5.4% of budgeted revenues.
    - 2007's unfavorable variance of \$58.3 million is due to the creation of the Public Health Fund and the Behavioral Health Fund during the fiscal year ended June 30, 2007.
      - In the adopted budget, the County budgeted the revenues and expenditures not in the two new funds, but in the General Fund.
    - The unfavorable variance in 2009 was due to the recession.
- The County's amendments increased the adopted budget revenues in four of the six years presented.
  - The amendments increasing the General Fund's budgeted **revenues** reduced the favorable variances in two years and resulted in unfavorable in the other two years.
- The largest adjustment to revenues occurred in 2007 when budgeted revenues decreased \$66.3 million due to the transfer of the budget revenues to the two new funds.
- The General Fund's final budgeted revenues experienced three favorable variances in the six years covered by our report.



## Expenditures

- General Fund's adopted budgeted expenditures experienced large favorable variances in five years of the six years covered by our report.
  - The smallest favorable variances of \$10.6 million occurred in 2006 (6.27% of budgeted expenditures) to a high of \$79.3 million (41.52% of budgeted revenues) in 2007.
    - The high 2007 favorable variance was due to budgeting expenditures in the General Fund that were transferred to the two new funds during the year.
- The County amended the budgeted expenditures upward in all years presented, even during the last three years of the County's budget crisis.
- The final expenditure budget experienced larger favorable variances all six years presented ranging from a low of \$12.1 million in 2005 to a high of \$21.8 million in 2010.

## General Fund Surplus (Deficit)

The County's General Fund experienced large favorable variances in all years for both the adopted budget and the final budget. In most years, the favorable variances of the final budget were larger than those of the adopted budget.

- The smallest total favorable adopted budget variance totaled \$7.5 million in 2005, 5.65% of expenditures.
  - The largest favorable total adopted budget variance totaled \$20.9 million in 2010, 16.92% of the adopted budget expenditures.
- The smallest favorable total final variance was \$12.4 million and the largest total final budget favorable variance was \$24.6 million.
- These favorable variances represent the difference between large budgeted operating deficits for the adopted budget and final budget in each year covered by our report and two much smaller actual deficits and four actual surpluses.

The County of Butte prepared its budget on a basis other than GAAP in 2006 and 2007. The third page of **Exhibit III-A** is a reconciliation of the actual budget basis accounting surplus (deficit) to the GAAP accounting basis surplus (deficit) and a reconciliation of the beginning General Fund's fund balance to the ending General Fund's fund balance.

- In 2006 and 2007, the General Fund performed better under the GAAP basis of accounting than the budget basis of accounting.
- As shown in this exhibit, the General Fund's fund balance declined from \$39.9 million at July 1, 2004 to \$34.8 million at June 30, 2010, a decline of \$5.1 million.
  - This decline was due to a \$20.2 million equity transfers in 2007 to create the Public Health Fund and the Behavior Health Fund.
  - Prior period adjustments also decreased the fund balance by an additional \$448,526 during the period covered by our report.
- The General Fund had GAAP surpluses in four of the six years presented and a cumulative surplus of \$15.5 million.

**Exhibit III-B** is a graphic representation of information in **Exhibit III-A**.



**Findings:**

- The County's budget process is very conservative as the County has consistently budgeted large deficits in its adopted budget.
- The County's final budget, due to amendments, projected even larger deficits than the adopted budget.
- Instead of these large projected deficits, the County has two much smaller deficits, and four surpluses.
- The General Fund had a cumulative six year surplus of \$15.5 million.
- The fund balance declined \$5.1 million over the period covered by our report due to a \$20.2 million equity transfer that created two new funds in 2007 and to prior period adjustments that further reduced the fund balance by \$448,526.

**EXHIBIT III-A  
COUNTY OF BUTTE  
TRANSITORY AND CONSERVATIVE NATURE OF THE BUDGET  
GENERAL FUND**

	<i>For the Years Ended June 30,</i>					
	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
<b>Revenue</b>						
<i>Adopted</i> Budget	144,353,364	153,734,956	173,132,499	113,559,548	117,165,393	113,235,259
Total Amendments	5,674,788	12,337,124	(66,266,138)	2,979,624	(837,295)	3,372,156
<i>Final</i> Budget	<u>150,028,152</u>	<u>166,072,080</u>	<u>106,866,361</u>	<u>116,539,172</u>	<u>116,328,098</u>	<u>116,607,415</u>
% Change from <i>Adopted</i> Budget	<u>3.93%</u>	<u>8.02%</u>	<u>(38.27%)</u>	<u>2.62%</u>	<u>(0.71%)</u>	<u>2.98%</u>
<i>Actual</i> - Budgetary Basis	<u>150,268,094</u>	<u>161,330,875</u>	<u>114,848,500</u>	<u>113,670,426</u>	<u>113,635,053</u>	<u>119,353,940</u>
<i>Adopted</i> Revenue Variance	<u>5,914,730</u>	<u>7,595,919</u>	<u>(58,283,999)</u>	<u>110,878</u>	<u>(3,530,340)</u>	<u>6,118,681</u>
Variance as a % of <i>Adopted</i> Budget	<u>4.10%</u>	<u>4.94%</u>	<u>(33.66%)</u>	<u>0.10%</u>	<u>(3.01%)</u>	<u>5.40%</u>
<i>Final</i> Revenue Variance	<u>239,942</u>	<u>(4,741,205)</u>	<u>7,982,139</u>	<u>(2,868,746)</u>	<u>(2,693,045)</u>	<u>2,746,525</u>
Variance as a % of <i>Final</i> Budget	<u>0.16%</u>	<u>(2.85%)</u>	<u>7.47%</u>	<u>(2.46%)</u>	<u>(2.32%)</u>	<u>2.36%</u>
<b>Expenditures</b>						
<i>Adopted</i> Budget	132,937,729	169,230,941	191,019,485	130,980,832	129,682,462	123,596,936
Total Amendments	13,630,732	9,155,593	(64,375,029)	6,211,200	436,567	7,028,774
<i>Final</i> Budget	<u>146,568,461</u>	<u>178,386,534</u>	<u>126,644,456</u>	<u>137,192,032</u>	<u>130,119,029</u>	<u>130,625,710</u>
% Change from <i>Adopted</i> Budget	<u>10.25%</u>	<u>5.41%</u>	<u>(33.70%)</u>	<u>4.74%</u>	<u>0.34%</u>	<u>5.69%</u>
<i>Actual</i> - Budgetary Basis	<u>134,450,400</u>	<u>158,628,030</u>	<u>111,703,612</u>	<u>117,820,064</u>	<u>114,995,198</u>	<u>108,801,149</u>
<i>Adopted</i> Expenditure Variance	<u>(1,512,671)</u>	<u>10,602,911</u>	<u>79,315,873</u>	<u>13,160,768</u>	<u>14,687,264</u>	<u>14,795,787</u>
Variance as a % of <i>Adopted</i> Budget	<u>(1.14%)</u>	<u>6.27%</u>	<u>41.52%</u>	<u>10.05%</u>	<u>11.33%</u>	<u>11.97%</u>
<i>Final</i> Expenditure Variance	<u>12,118,061</u>	<u>19,758,504</u>	<u>14,940,844</u>	<u>19,371,968</u>	<u>15,123,831</u>	<u>21,824,561</u>
Variance as a % of <i>Final</i> Budget	<u>8.27%</u>	<u>11.08%</u>	<u>11.80%</u>	<u>14.12%</u>	<u>11.62%</u>	<u>16.71%</u>

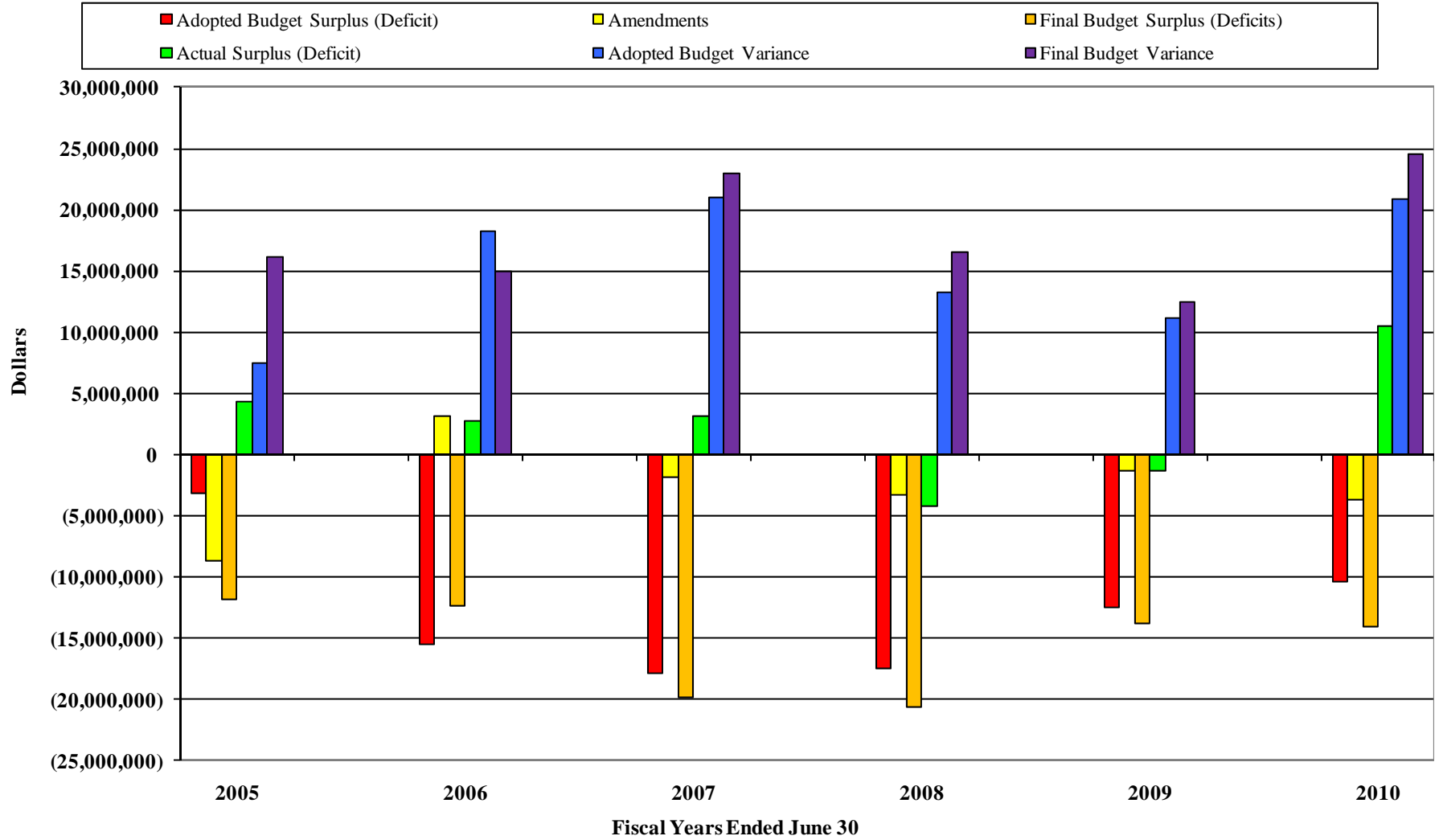
**EXHIBIT III-A  
COUNTY OF BUTTE  
TRANSITORY AND CONSERVATIVE NATURE OF THE BUDGET  
GENERAL FUND**

	<i>For the Years Ended June 30,</i>					
	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
<b>Other Financing Sources (Uses)</b>						
<i>Adopted</i> Budget	(14,563,563)	0	0	0	0	0
Total Amendments	(648,522)	0	0	0	0	0
<i>Final</i> Budget	(15,212,085)	0	0			
% Change from <i>Adopted</i> Budget	4.45%	N/A	N/A	N/A	N/A	N/A
<i>Actual</i> - Budgetary Basis	(11,453,479)	0	0	0	0	0
<i>Adopted</i> Other Financing Sources (Uses)						
Variance	3,110,084	0	0	0	0	0
Variance as a % of <i>Adopted</i> Budget	(21.36%)	N/A	N/A	N/A	N/A	N/A
<i>Final</i> Other Financing Sources (Uses) Variance	3,758,606	0	0	0	0	0
Variance as a % of <i>Final</i> Budget	(24.71%)	N/A	N/A	N/A	N/A	N/A
<b>Total Variance Adopted Budget</b>						
Favorable (Unfavorable)	7,512,143	18,198,830	21,031,874	13,271,646	11,156,924	20,914,468
Variance as a % of Budgeted Expenditures	5.65%	10.75%	11.01%	10.13%	8.60%	16.92%
<b>Total Variance Final Budget</b>						
Favorable (Unfavorable)	16,116,609	15,017,299	22,922,983	16,503,222	12,430,786	24,571,086
Variance as a % of Budgeted Expenditures	11.00%	8.42%	18.10%	12.03%	9.55%	18.81%
<b>Excess (Deficiency) of Adopted Budget Revenues Over Adopted Budget Expenditures Including Other Financial Sources (Uses)</b>	(3,147,928)	(15,495,985)	(17,886,986)	(17,421,284)	(12,517,069)	(10,361,677)
<b>Excess (Deficiency) of Final Budget Revenues Over Final Budget Expenditures Including Other Financial Sources (Uses)</b>	(11,752,394)	(12,314,454)	(19,778,095)	(20,652,860)	(13,790,931)	(14,018,295)
<b>Excess (Deficiency) of Actual Revenues Over Final Actual Expenditures Including Other Financial Sources (Uses)</b>	4,364,215	2,702,845	3,144,888	(4,149,638)	(1,360,145)	10,552,791

**EXHIBIT III-A**  
**COUNTY OF BUTTE**  
**RECONCILIATION OF BUDGET BASIS ACCOUNTING TO GAAP BASIS ACCOUNTING**  
**GENERAL FUND**

	<i>For the Years Ended June 30,</i>					
	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
<b>Excess (Deficiency) of Actual Revenues Over Final Actual Expenditures Including Other Financial Sources (Uses) - Budget Basis</b>	4,364,215	2,702,845	3,144,888	(4,149,638)	(1,360,145)	10,552,791
Proceeds from sale of assets	0	0	24,014	0	0	0
Proceeds from inception of capital lease	0	0	0	0	0	0
Encumbrances	0	260,910	0	0	0	0
Difference	0	0	10	0	0	0
<b>Total difference between Budget and GAAP basis of Accounting</b>	<u>0</u>	<u>260,910</u>	<u>24,024</u>	<u>0</u>	<u>0</u>	<u>0</u>
<b>Excess (Deficiency) of Actual Revenues Over Final Actual Expenditures Including Other Financial Sources (Uses) - GAAP Basis</b>	4,364,215	2,963,755	3,168,912	(4,149,638)	(1,360,145)	10,552,791
<b>Beginning Fund Balance</b>	39,914,193	44,278,408	47,027,402	30,025,768	25,876,130	24,464,463
Equity transfer	0	0	(20,170,546)	0	0	0
Prior period adjustment	0	(214,761)	0	0	(51,522)	(182,243)
<b>Ending Fund Balance</b>	<u><u>44,278,408</u></u>	<u><u>47,027,402</u></u>	<u><u>30,025,768</u></u>	<u><u>25,876,130</u></u>	<u><u>24,464,463</u></u>	<u><u>34,835,011</u></u>

**EXHIBIT III-B  
COUNTY OF BUTTE  
BUDGET VARIANCE ANALYSIS**





## EXHIBIT IV

**Exhibit IV** is an analysis of **transfers to and from the General Fund**.

Other funds transferred moneys to the General fund over the period covered by our report. It appear that the transfers are inconsistent and do not appear to represent revenues that fund expenditures that are the responsibility of the General Fund.

The General Fund transferred moneys to other funds over the period covered by our report. It appears that the transfers from the General Fund to the following funds expenditures that are the responsibility of the General Fund.

- The General Fund has continued to provide the Public Health Fund and the Behavioral Health Fund, both created in 2007, assistance.
- Per the description of the transfers to the non-major funds, the transfers are to the same funds and to provide the same services on an annual basis.

### **Findings:**

- The transfers to the General Fund are not similar to revenues and should not be included in the General Fund's revenues when computing the ratio of unreserved fund balance to revenues.
- The transfers from the General Fund do not represent expenditures that are the responsibility of the General Fund. As such, they should not be included in expenditures when computing the unreserved fund balance to expenditures.
- The transfers from the General Fund to the Public Health Fund, the Behavioral Health Fund and the non-major funds represent expenditures that are the responsibility of the General Fund. As such, they should be included in expenditures when computing the unreserved fund balance to expenditures.

**EXHIBIT IV**  
**COUNTY OF BUTTE**  
**ANALYSIS OF GENERAL FUND TRANSFERS**

	<i>For the Years Ended June 30,</i>					
	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
<b>Funds Making Transfers To the General Fund</b>						
Nonmajor governmental funds	2,905,381	827,154	0	131,447	0	0
Internal Service Funds (closed funds)	0	0	0	0	0	977,527
	<u>2,905,381</u>	<u>827,154</u>	<u>0</u>	<u>131,447</u>	<u>0</u>	<u>977,527</u>
 <b>Funds Receiving Transfers From the General Fund</b>						
Public Health Fund	0	0	774,308	868,708	972,226	724,304
Behavioral Health Fund	0	0	425,648	464,364	424,727	424,727
Nonmajor governmental funds	<u>12,975,977</u>	<u>18,528,664</u>	<u>18,092,743</u>	<u>19,669,603</u>	<u>16,811,080</u>	<u>15,376,905</u>
	12,975,977	18,528,664	19,292,699	21,002,675	18,208,033	16,525,936
Welfare Fund	1,398,061	0	0	47,746	0	695,658
Road Fund	0	6,140	0	11,710	0	0
	<u>14,374,038</u>	<u>18,534,804</u>	<u>19,292,699</u>	<u>21,062,131</u>	<u>18,208,033</u>	<u>17,221,594</u>



## EXHIBIT V

**Exhibit V-A** analyzes the County's **General Fund's liquidity**. The cash and investments demonstrate the ability to "write the check", and fund balances available demonstrates the availability of funds (unreserved-undesignated), as well as those only designated for administrative priorities. **The cash and investments balance and the fund balances must be compared to each other with the lesser amount of the two being the portion truly available at June 30th of each year.** We have also summarized the General Fund's other assets and liabilities to aid in our analysis.

The creation of the Public Health Fund and the Behavioral Health Fund in 2007 resulted in a substantial decrease in cash and investments and in the fund balance.

### **Assets and Liabilities**

The cash and investment balance is affected by other factors besides actual surpluses and deficits. The increase in receivables and other current assets, and the decline in liabilities cause cash and investments to decline, which can offset an actual surplus or increase the effects of a deficit. The opposite is true for decreasing receivables and other current assets, and the growth of liabilities which increase cash and investment balances.

- In 2006, the payoff of an \$18.7 million General Fund's Tax Revenue Anticipation Note (TRAN) by restricted cash held with a fiscal agent, substantially reduced liabilities, increasing the asset to liability ration and allowing unrestricted cash and investment to increase due to the 2006's operating surplus.
- The General Fund's unrestricted cash and investments dramatically decreased in 2007 due to the creation of the two funds discussed above in 2007.
- Increased receivables in the years ended June 30, 2008, combined with the deficit, reduced the cash and investment balance by \$11.7 million from \$29.5 million to \$17.8 million.
  - Decreased receivables at June 30, 2009, and 2010 had positive impacts on the ending cash.
- The increase in the General Fund's liabilities in 2009 had a positive effect on the cash balance,
  - The payoff of liabilities in 2010 to their lowest balance during the six years covered by our report reduced the effects of the \$10.6 million surplus, on cash and investments in 2010.
- Taking into account the \$20.1 million equity transfer in 2007 to create two new funds, and the reduction of liabilities to their lowest balance in the six years covered by our report, cash and investments attained its healthiest balance in 2006.

### **Asset to Liability Ratio**

As a rule, financial health would dictate that both total assets and this ratio increase or maintain over time. If the ratio is already healthy, it should remain relatively constant. Though this ratio can vary widely due to the timing of tax, grant collections or the payment of bills, any large drop should be explained. A ratio barely over 1 leaves very little fund balances, and a ratio below 1 is a serious problem.



- Except for 2006 and 2007, both the rise and decline in this ratio over the period covered by our report is due primarily to the actual annual GAAP surpluses and deficits.
  - Increased assets enhanced the effects of the surplus in 2009 and 2010.
    - In 2008, the decline in assets helped lower the ratio.
  - Increased liabilities offset or enhanced the effects of the deficit in 2009,
  - Decreased liabilities in 2006, 2007, and 2010 contributed to the growth in the ratio.
- The ratio grew in the fiscal year ended June 30, 2010 to 6.32, meaning that for every \$1 of liability, the General Fund has \$6.32 of assets.

### **Fund Balance**

While the rise and decline of cash and investments are affected by several factors, as shown in **Exhibit III** the change in the total fund balance, except for 2007, is primarily due to the fund's actual surpluses or deficits. Other important highlights:

- The surpluses in 2005, 2006, 2007, and 2010 primarily affected the unreserved portion of the unreserved fund balance.
- The creation of the two new funds discussed above in 2007, substantially reduced the fund balance.
  - The reduction to the fund balance due to the equity transfers of \$20.1 million to create the Public Health Fund and the Behavioral Health Fund came mostly from the unreserved fund balance.
- The annual surpluses or deficits generally affected the unreserved portion of the fund balance.
  - The reserved portion of the fund balance grew in 2008 and 2010.
    - The growth of the reserved fund balance in 2008 enhanced the effect of the operating deficit, enhancing the effect of the deficit on reducing the unreserved fund balance.
- Taking into account the \$20.1 million equity transfer in 2007, both the unreserved and the total fund balance attained their highest balance in 2010 due to the \$10.6 million surplus.

**Exhibit V-B** is a graphic representation of the General Fund's cash and investments and fund balances.

### **Findings:**

- Taking account of a \$20.1 million equity transfer to create two funds and the reduction of liabilities to their lowest balance during the six years covered by our report, the General Fund's cash and investments 2010 balance attained its strongest balance since 2006.

**EXHIBIT V-A  
COUNTY OF BUTTE  
GENERAL FUND**

	<i>For the Years Ended June 30,</i>					
	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
<b>Assets</b>						
Cash and investments	43,570,183	44,994,426	29,513,324	17,775,854	26,326,468	33,249,953
Cash with fiscal agent	19,480,554	792,978	808,994	801,259	1,127,040	1,572,685
Imprest cash	45,145	45,095	45,595	44,095	44,245	84,345
Other assets	9,224,575	16,660,982	6,887,956	14,603,927	6,747,366	6,479,054
<b>Total Assets</b>	<u>72,320,457</u>	<u>62,493,481</u>	<u>37,255,869</u>	<u>33,225,135</u>	<u>34,245,119</u>	<u>41,386,037</u>
<b>Liabilities</b>	<u>28,042,049</u>	<u>15,466,079</u>	<u>7,230,101</u>	<u>7,349,005</u>	<u>9,780,656</u>	<u>6,551,026</u>
<b>Asset to liability ratio</b>	<u>2.58</u>	<u>4.04</u>	<u>5.15</u>	<u>4.52</u>	<u>3.50</u>	<u>6.32</u>
<b>Fund Balance</b>						
Reserved for:						
Encumbrances	5,130,723	5,535,099	2,829,192	4,164,873	2,437,136	2,348,768
Imprest cash	45,145	45,095	45,595	44,095	44,245	84,345
Prepaid items	4,140	15,503	1,138	0	1,888	1,848
Deposits with others	2,500	2,500	2,500	2,500	2,500	2,500
General restrictions	3,165,083	5,196,551	5,586,824	10,611,120	11,560,087	13,844,851
Inventories	0	0	0	0	0	154,369
Debt service	787,482	792,978	808,994	801,259	1,127,040	1,572,685
<b>Total reserved balance</b>	<u>9,135,073</u>	<u>11,587,726</u>	<u>9,274,243</u>	<u>15,623,847</u>	<u>15,172,896</u>	<u>18,009,366</u>
Unreserved						
Unreserved - designated	24,366,630	19,626,639	3,894,494	91,826	232,510	115,000
Unreserved - undesignated	10,776,705	15,813,037	16,857,031	10,160,457	9,059,057	16,710,645
<b>Total unreserved balance</b>	<u>35,143,335</u>	<u>35,439,676</u>	<u>20,751,525</u>	<u>10,252,283</u>	<u>9,291,567</u>	<u>16,825,645</u>
<b>Total Fund Balance</b>	<u>44,278,408</u>	<u>47,027,402</u>	<u>30,025,768</u>	<u>25,876,130</u>	<u>24,464,463</u>	<u>34,835,011</u>
<b>Total Liabilities and Fund Balance</b>	<u>72,320,457</u>	<u>62,493,481</u>	<u>37,255,869</u>	<u>33,225,135</u>	<u>34,245,119</u>	<u>41,386,037</u>

**EXHIBIT V-B  
COUNTY OF BUTTE  
ANALYSIS OF THE GENERAL FUND'S FUND BALANCE**

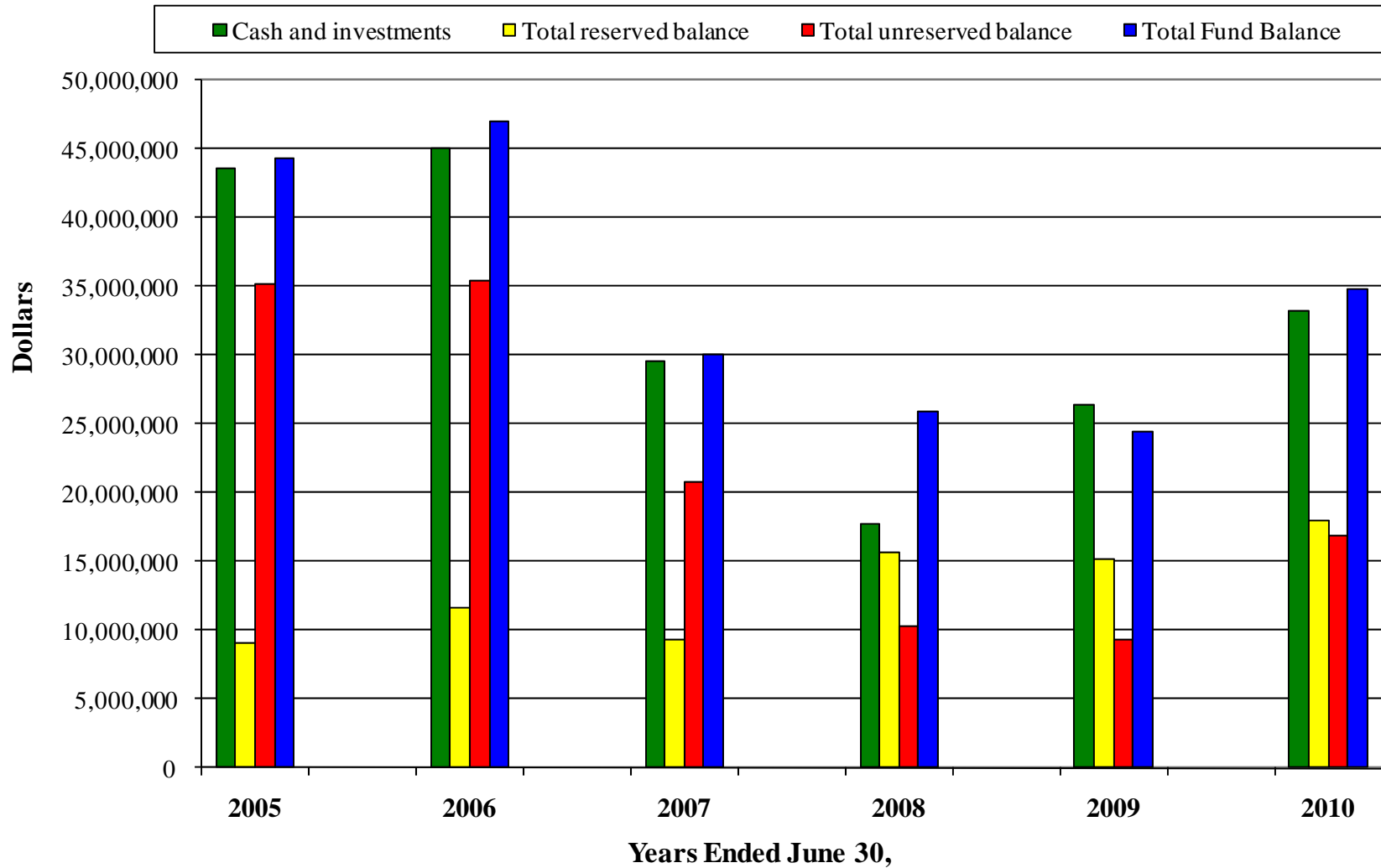




EXHIBIT VI

Exhibit VI calculates two ratios, the General Fund’s unreserved fund balance to its annual revenues and General Fund’s unreserved fund balance to its annual expenditures, and compares them to historical benchmarks. The ratios calculated in this exhibit are intended to serve as a measure of resources available so they can be compared to a benchmark or standard in determining the financial health of the General Fund. Historically, a 5% ratio of the unreserved fund balance to either its annual revenues or expenditures has been considered the minimum ratio in determining a healthy fund balance.

Local governments sometimes classify as reserves to fund balances items that more properly should be classified as designations to the unreserved fund balances. In these instances, the improperly classified reserves should be included in the unreserved fund balance in order to calculate the ratios of the unreserved fund balance to either revenues or expenditures. We have reviewed the General Fund’s reserved fund balance and in our opinion the reserved fund balances meet the criteria of a reserved fund balance. As such, no adjustments are needed to the unreserved fund balance.

Transfers to or from the General Fund should be analyzed to determine if they are regular, continuing, and whether they are a funding responsibility of the General Fund. Transfers to the General Fund that meet these criteria should be included in revenues and transfers from the General Fund should be included in expenditures.

We have determined that the transfers to the General Fund should be not included in revenues. We have also determined in our analysis of transfers in our Exhibit IV that certain transfers from the General Fund should also be included in expenditures in order to compute the 5% benchmark. The following table shows our calculation of the adjusted expenditures.

Computation of Adjusted Expenditures

Fiscal Year Ended June 30,	Expenditures	Tranfers	
		from Exhibit IV	Adjusted Expenditures
2005	134,450,400	12,975,977	147,426,377
2006	139,832,316	18,528,664	158,360,980
2007	92,410,913	19,292,699	111,703,612
2008	96,757,933	21,002,675	117,760,608
2009	96,784,165	18,208,033	114,992,198
2010	92,208,154	16,525,936	108,734,090

Exhibit VI-A computes the ratio of the unreserved fund balance to the adjusted revenue and the unreserved balance to the adjusted expenditures ratio and compares them to the 5% benchmark for both revenues and expenditures for each year presented in our report.



- Both the revenue and expenditure ratios were very healthy, more than four times the 5% benchmark in 2005 and 2006, the years before the equity transfer to create the Public Health Fund and the Behavioral Health Fund.
- In 2007, revenues, expenditures, and the unreserved fund balance declined sharply due to the \$20.1 million equity transfer to create the two new funds and the transfer of the revenues and related expenditures to the new funds.
  - After this transfer both ratios declined: the revenue ratio to 18.07% and the expenditure ratio to 18.58%.
- In 2008 and 2009, both ratios declined to their lowest percentage during the period covered. The revenue ratio to 9.04% and 8.18% respectively and the expenditure ratio to 8.71% and 8.08 respectively.
  - The revenue and expenditure ratio declines are due to the operating deficits in both 2008 and 2009 and to the increase in reserved fund balances.
- In 2010, both ratios recovered, principally due to the 2010 operating surplus.
  - The expenditure ratio also increased due to the \$6.2 million decrease in adjusted expenditures from 2009.
  - The decrease in the denominator does not indicate fiscal health, but signals a response to declines in the local economy, indicating that future revenues may decline, thus reducing sources available to finance ongoing expenditures.
  - Strong growth in the numerator, the unreserved fund balance, which grows at a faster rate than that of revenues and expenditures, indicates fiscal health.

**Exhibit VI-B** and **Exhibit VI-C** are graphic representations of Exhibit VI-A data.

**Findings:**

- Both ratios, even though they have declined from their highs, are healthy.

**EXHIBIT VI-A  
COUNTY OF BUTTE  
% OF UNRESERVED FUND BALANCE TO GAAP REVENUES AND EXPENDITURES  
GENERAL FUND**

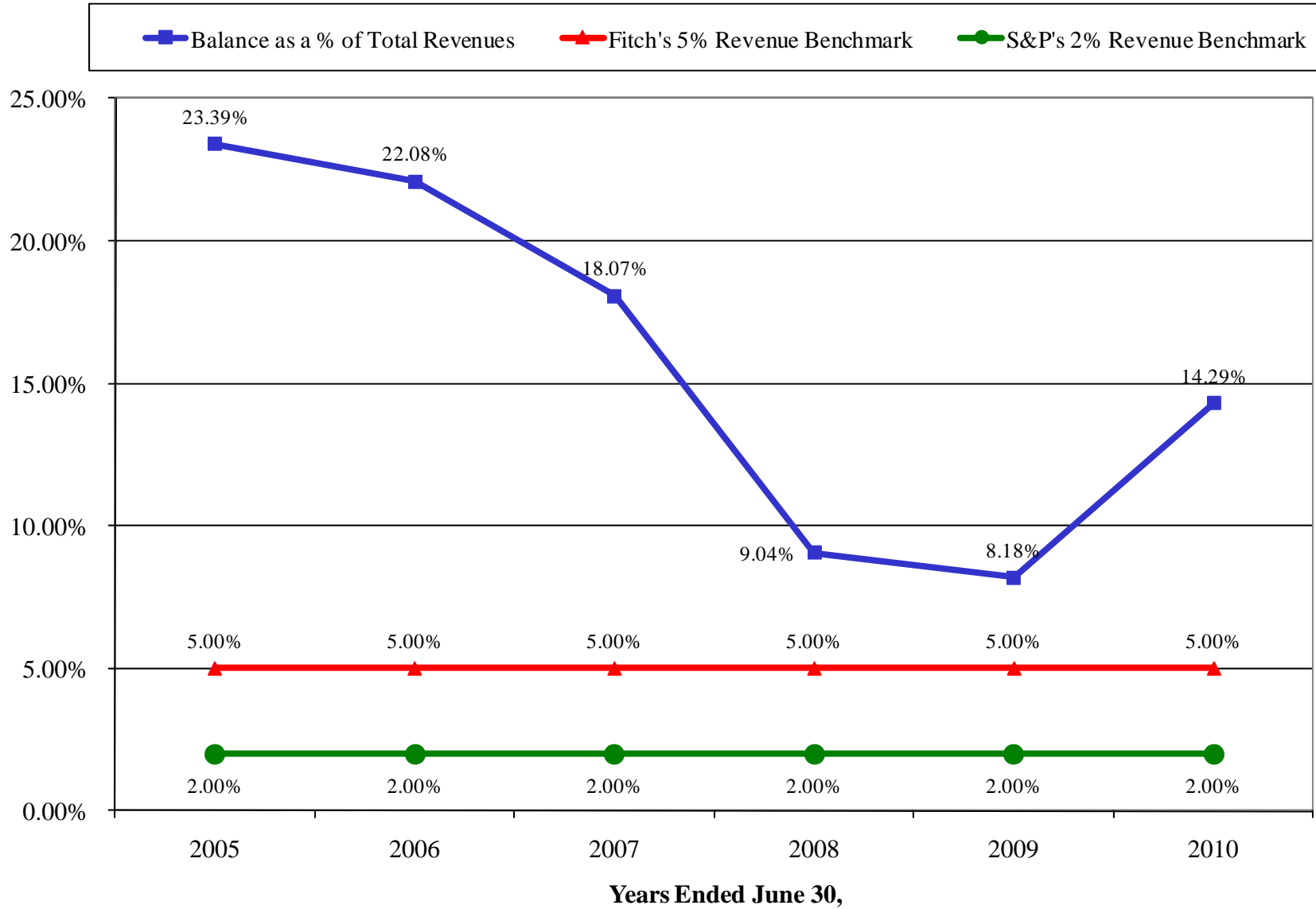
**Unreserved Fund Balance to GAAP Revenues**

<i>Year Ended June 30,</i>	<i>Unreserved Fund Balance</i>	<i>GAAP Revenues</i>	<i>Balance as a % of</i>		<i>Unreserved Fund Balance in Excess of 5%</i>
			<i>Total Revenues</i>	<i>5% of Revenues</i>	<i>of Revenues</i>
2005	35,143,335	150,268,094	23.39%	7,513,405	27,629,930
2006	35,439,676	160,480,748	22.08%	8,024,037	27,415,639
2007	20,751,525	114,824,975	18.07%	5,741,249	15,010,276
2008	10,252,283	113,396,995	9.04%	5,669,850	4,582,433
2009	9,291,567	113,600,901	8.18%	5,680,045	3,611,522
2010	16,825,645	117,712,036	14.29%	5,885,602	10,940,043

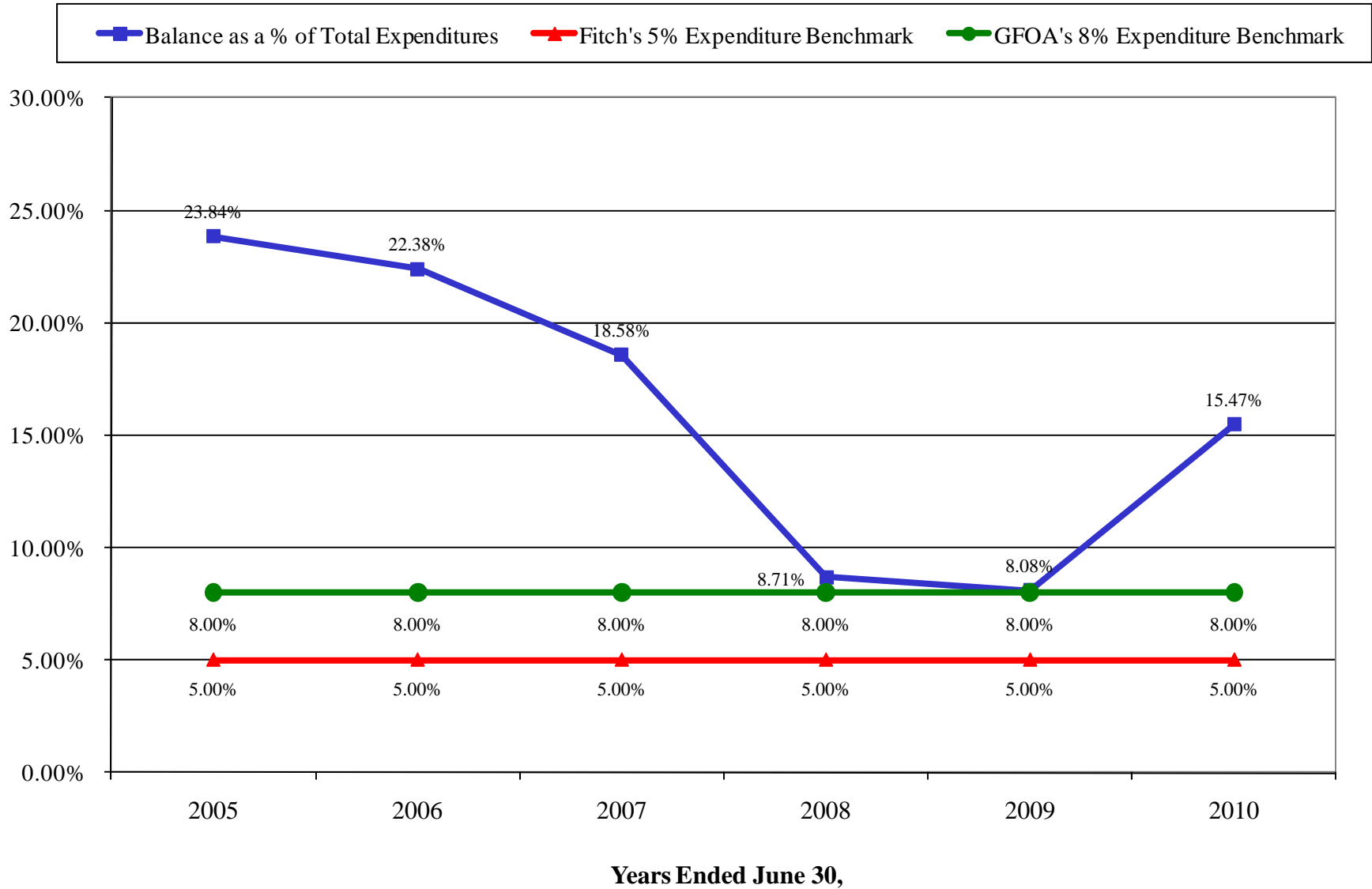
**Unreserved Fund Balance to GAAP Expenditures**

<i>Year Ended June 30,</i>	<i>Unreserved Fund Balance</i>	<i>Adjusted GAAP Expenditures</i>	<i>Balance as a % of Total Adjusted</i>		<i>Unreserved Fund Balance in Excess of 5%</i>
			<i>Adjusted Expenditures</i>	<i>5% of Expenditures</i>	<i>of Adjusted Expenditures</i>
2005	35,143,335	147,426,377	23.84%	7,371,319	27,772,016
2006	35,439,676	158,360,980	22.38%	7,918,049	27,521,627
2007	20,751,525	111,703,612	18.58%	5,585,181	15,166,344
2008	10,252,283	117,760,608	8.71%	5,888,030	4,364,253
2009	9,291,567	114,992,198	8.08%	5,749,610	3,541,957
2010	16,825,645	108,734,090	15.47%	5,436,705	11,388,940

**EXHIBIT VI-B  
COUNTY OF BUTTE  
UNRESERVED FUND BALANCE AS A % OF TOTAL REVENUES**



**EXHIBIT VI-C  
COUNTY OF BUTTE  
UNRESERVED FUND BALANCE AS A % of TOTAL EXPENDITURES**





## EXHIBIT VII

The purpose of this exhibit is analyze the financial health of selected **Internal Service Funds, the Self Insurance Fund and the Workers Compensation Fund** to determine if there are excess moneys that could be returned to the General Fund.

Internal Service Funds are created to provide services to other departments or funds of the government. The creation of an Internal Service Fund is not mandatory, but is a voluntary decision on the part of management in order to match the liability to the period it arose and to accumulate resources to fund ongoing operations. Furthermore, the government itself controls the size of the fund's annual revenues and the fund's net assets as the government sets the rate structure charged to the various departments and manage the collection of revenues. **As such, the size of an internal service fund's net assets is not indicative of financial health.** These funds should maintain its unrestricted net assets at a minimum positive balance. **Internal Service Funds that contain both large cash balances and large unrestricted net assets may have excess resources that could be returned to the General Fund.**

The County did include the internal service funds in its 2005 Basic Financial Statement. This information became available when the County started to issue CAFRs in 2006.

The **Self-Insurance Fund** accounts for the County's liability claims, the administration costs of the insurance program, and the associated legal and adjustment expenses.

- This fund has maintained a cash and investment balance of in excess of \$1.6 million in all years covered by our report.
- This fund's net assets have fluctuated, increasing in two of the four years presented, with an overall increase from \$498,541 in 2006, to \$811,694 in 2010.
  - This fund's net assets are divided into two components, a small net assets invested in capital assets net of related debt that declined from \$10,493 to \$8,359 and unrestricted net assets.
  - Though it decreased in two of the four years since 2006, unrestricted net assets improved significantly; growing from \$498,541 to \$803,335 at June 30, 2010.
- The fund's ratio of cash and investments to expenses has been very high over the period covered by our report, exceeding 70% of the fund's annual expenses all five years presented and exceeding 100% of the annual expenses in three years.
- The fund's ratio of unrestricted net assets to expenses has also been high in four of the five years presented.

The **Worker's Compensation Insurance Fund** accounts for the disability, medical, and rehabilitation expenses and related costs associated with on-the-job injuries.

- This fund's cash and investment balance experienced tremendous growth, increasing from \$1.9 million at June 30, 2006 to \$13 million at June 30, 2010.
- This fund's net assets have also experienced tremendous growth, increasing each year since 2006, from a negative \$661,153 to \$8.9 million.
  - This fund's net assets are also divided into two components, a small net assets invested in capital assets net of related debt that declined from \$6,632 to \$4,456 and unrestricted net assets.



- All of the growth in this fund’s net assets has affected unrestricted net assets that grew from a negative \$667,985 to \$8.9 million at June 30, 2010.
- The fund’s ratio of cash and investments to expenses has been very high the last three of the five years presented, 148.5% of the fund’s annual expenses in 2008, 784.2% in 2009 and 461.41% in 2010.
  - These are very high ratios.
- The fund’s ratio of unrestricted net assets to expenses has also been high the last four years presented. As of June 30, 2009, and June 30, 2010, the ratios were a very strong 545.95% and 314.25% respectively.
  - These are very strong ratios.

As stated earlier, an internal service fund’s net asset balance is not indicative of financial health due to the government’s complete control of revenues. This is especially true of insurance funds. One of the most important factors in determining the liquidity of a fund’s net assets is the fund’s liabilities. For insurance funds, the most important factor in determining liabilities is insurance claims. The following table traces the growth and decline of the County’s combined general liability and workers compensation insurance liability. This information was obtained from the notes to the financial statements in County’s 2006 through 2010 CAFRs.

**Total Insurance Liability**  
Includes Self-Insurance and Workers' Compensation Insurance

Fiscal Year Ended June 30,	Liability at Beginning of Year	Current Year Claims and Changes In Estimates	Claim Payments	Liability at End of Year	Claim Payments as a % of Liabilities
2005	1,350,000	199,497	(311,497)	1,238,000	25.16%
2006	1,238,000	2,888,471	(117,471)	4,009,000	2.93%
2007	4,009,000	1,480,361	(427,361)	5,062,000	8.44%
2008	5,062,000	7,483,413	(7,296,413)	5,249,000	139.01%
2009	5,249,000	2,146,026	(2,590,026)	4,805,000	53.90%
2010	4,805,000	3,424,383	(3,065,383)	5,164,000	59.36%
		<u>17,622,151</u>	<u>(13,808,151)</u>		

As of June 30, 2010, the Self Insurance Fund showed current liability claims of \$400,000 and long-term liability claims of \$516,000 and the Workers’ Compensation Fund showed \$2 million of current liability claims payable and \$2.248 million long-term liabilities.

- Both fund’s have more than enough resources to cover claim payments.

**In our opinion, the both insurance funds may have excess moneys that can be returned to the General Fund.**

**EXHIBIT VII**  
**COUNTY OF BUTTE**  
**SELECTED INTERNAL SERVICE FUNDS**

		<i>For the Years Ended June 30,</i>				
	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
<b>Self Insurance</b>						
<b>Assets</b>						
Unrestricted cash and investments	N/A	1,876,199	1,611,582	1,616,408	1,913,513	1,609,349
Other current assets	N/A	150,203	43,270	117,967	67,254	152,327
Total current assets	N/A	2,026,402	1,654,852	1,734,375	1,980,767	1,761,676
Non-current assets	N/A	0	10,493	9,782	9,070	8,359
Total Assets	N/A	<u>2,026,402</u>	<u>1,665,345</u>	<u>1,744,157</u>	<u>1,989,837</u>	<u>1,770,035</u>
<b>Liabilities</b>						
Current liabilities	N/A	49,777	388,519	542,964	607,588	442,341
Non-current liabilities	N/A	1,478,084	1,060,724	507,210	514,000	516,000
Total Liabilities	N/A	<u>1,527,861</u>	<u>1,449,243</u>	<u>1,050,174</u>	<u>1,121,588</u>	<u>958,341</u>
<b>Current Assets to Liability Ratio</b>	N/A	<u>40.71</u>	<u>4.26</u>	<u>3.19</u>	<u>3.26</u>	<u>3.98</u>
<b>Net Assets</b>						
Invested in capital assets net of related debt	N/A	0	10,493	9,782	9,070	8,359
Unrestricted (deficit)	N/A	498,541	205,609	684,202	859,179	803,335
Net Assets	N/A	<u>498,541</u>	<u>216,102</u>	<u>693,984</u>	<u>868,249</u>	<u>811,694</u>
Annual expenses	N/A	<u>1,529,535</u>	<u>1,874,700</u>	<u>1,594,421</u>	<u>1,811,322</u>	<u>2,294,650</u>
Ratio of cash and investments to expenses	N/A	<u>122.66%</u>	<u>85.96%</u>	<u>101.38%</u>	<u>105.64%</u>	<u>70.13%</u>
Ratio of unrestricted net assets to expenses	N/A	<u>32.59%</u>	<u>10.97%</u>	<u>42.91%</u>	<u>47.43%</u>	<u>35.01%</u>

**EXHIBIT VII**  
**COUNTY OF BUTTE**  
**SELECTED INTERNAL SERVICE FUNDS**

		<i>For the Years Ended June 30,</i>				
	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
<b>Worker's Compensation</b>						
<b>Assets</b>						
Unrestricted cash and investments	N/A	450,937	63,773	10,825,940	12,681,428	13,031,431
Cash with fiscal agent	N/A	1,416,381	5,350,425	46,706	42,353	42,353
Other current assets	N/A	64,985	52,199	123,097	196,792	171,193
Total current assets	N/A	1,932,303	5,466,397	10,995,743	12,920,573	13,244,977
Non-current assets	N/A	6,832	6,238	5,644	5,050	4,456
Total Assets	N/A	<u>1,939,135</u>	<u>5,472,635</u>	<u>11,001,387</u>	<u>12,925,623</u>	<u>13,249,433</u>
<b>Liabilities</b>						
Current liabilities	N/A	28,288	1,265,255	2,065,123	2,200,928	2,121,833
Non-current liabilities	N/A	2,572,000	2,568,000	2,387,000	1,891,000	2,248,000
Total Liabilities	N/A	<u>2,600,288</u>	<u>3,833,255</u>	<u>4,452,123</u>	<u>4,091,928</u>	<u>4,369,833</u>
<b>Current Assets to Liability Ratio</b>	N/A	<u>68.31</u>	<u>4.32</u>	<u>5.32</u>	<u>5.87</u>	<u>6.24</u>
<b>Net Assets</b>						
Invested in capital assets net of related debt	N/A	6,832	6,238	5,644	5,050	4,456
Unrestricted (deficit)	N/A	(667,985)	1,633,142	6,543,620	8,828,645	8,875,144
Net Assets	N/A	<u>(661,153)</u>	<u>1,639,380</u>	<u>6,549,264</u>	<u>8,833,695</u>	<u>8,879,600</u>
Annual expenses	N/A	<u>4,981,590</u>	<u>2,208,353</u>	<u>7,290,289</u>	<u>1,617,108</u>	<u>2,824,253</u>
Ratio of cash and investments to expenses	N/A	<u>9.05%</u>	<u>2.89%</u>	<u>148.50%</u>	<u>784.20%</u>	<u>461.41%</u>
Ratio of unrestricted net assets to expenses	N/A	<u>(13.41%)</u>	<u>73.95%</u>	<u>89.76%</u>	<u>545.95%</u>	<u>314.25%</u>



## FISCAL YEAR 2010-2011 SECOND QUARTER FINANCIAL REPORT

On February 16, 2011, the County's Chief Financial Officer submitted the 2010-2011 Second Quarter Financial Report. Highlights of this report are as follows.

- Expenditures are on budget and are tracking similar to 2009-2010 expenditures, when the General Fund's expenditures had a \$14.8 million or 11.97% adopted budget favorable expenditure.
  - As of December 31, 2010, the County expended 39% of its budget as compared to 38% in 2009.
  - Only two County departments have exceeded 50% of budgeted expenditures, while the other departments spent between 35% and 50% of budgeted expenditures.
  - The County notes that it is typical for expenditures to be below 50% at the end of the second quarter since many expenditures are not paid until the third and fourth quarters.
    - However, based on our analysis of the County's budget history shown in Exhibit III-A, the conservative budget process and its overestimation of expenditures is also a factor.
- The County's revenues are on budget and tracking similar to 2009.
  - The County noted that property taxes that replaced Vehicle License Fees (VLF) are down and below budget by \$1 million.
    - This is due to the declining housing values and assessed valuations we noted in Exhibit II.
  - This decline in VLF related property taxes revenues was offset by increases in Proposition 172 "Public Safety" sales tax revenues.
    - The increase in these sales tax revenues and any district sales tax revenue is indicative of the increase in retail sales we noted in our discussion of the Bradley-Burns sales tax revenues.
  - The County also received an unexpected reimbursement of the costs of a special election for the State totaling \$480,000.
- The County noted that salaries and compensation cost are expected to decline in the 2011-2012 fiscal year due to the historically low interest rates on the Pension Obligation Bonds (POB), resulting in lower than expected debt service reimbursement from the various departments.
- Per the adopted budget in the report, the "carryover" fund balance at July 1, 2010 was \$16.5 million and is projected to increase to \$18.2 million at July 1, 2011, an increase of \$1.7 million.
  - Per page 10 of the second quarter report, the last forecast projected a \$17 million carryover.
  - The County is also forecasting a \$1.2 million surplus for the 2011-2012 fiscal year.
- The County noted that the forecasts do not include any impacts of current "State Budget proposals, and revenue estimates continue to rely on significant ongoing state revenues."
  - As such, any reduction in State funding could negatively impact the County's forecasts.



## CONCLUSION

Our findings include the following:

- Governmental activities as presented in the government-wide financial statements are healthy and have improved in 2010.
- The County's revenues have flattened, or are declining.
  - Current trends indicate future revenues will either be flat or decline in the immediate future.
- The County's budget process is very conservative as the County has consistently budgeted large deficits in its adopted budget.
  - Instead of these large projected deficits, the County has two much smaller deficits, and four surpluses.
  - The General Fund had a cumulative six year surplus of \$15.5 million.
- The General Fund has maintained strong cash and investments and total fund balance throughout the period covered by our report. Most of the fund balance is unreserved.
- The ratios of the General Fund's unreserved fund balance to revenues and expenditures recovered in 2010.
  - Both ratios declined from their highs, but recovered to approximately three times the unreserved fund balance.
  - These are healthy ratios.
- The County's two insurance funds may have excess one time moneys that can be returned to the General Fund.
- Per the 2010-2011 Second Quarter Financial Report, the County projects a \$1.7 million surplus for the current fiscal year and a \$1.2 million surplus for the 2011-2012 fiscal year.
  - The County has based its forecasts on continuing State revenues and has not included any current proposals to reduce the State's massive projected deficit.
  - As such, any State budget that reduces funding to counties will have a negative impact on these forecasts.

In our opinion, the County of Butte financial position is healthy and has improved. It has maintained its reserves. However, the County's revenues are under strong downward pressure, having flattened over the past two years. Current trends for its most important tax revenue, property taxes, and its most important revenue, aid from other governments, especially from the State, indicate possible declines in future revenues.

Sincerely,

*Bacchecki, Crom & Co., LLP*

BACHECKI, CROM & CO., LLP