CITY OF LINDSAY

SINGLE AUDIT REPORT

JUNE 30, 2010

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

The Honorable Mayor and City Council
of the City of Lindsay, California

We were engaged to audit the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Lindsay, California (the City), as of and for the year ended June 30, 2010, which collectively comprise the City's basic financial statements and have issued our report thereon dated September 10, 2011. We did not express an opinion on the City's basic financial statements because we were not able to obtain sufficient appropriate audit evidence to provide a basis for an opinion.

The basis for disclaiming an opinion on the City's financial statements are as follows: the City failed to implement basic internal controls during the year to prevent misstatements and errors in the financial statements, the City failed to perform monthly cash accounts reconciliation to the general ledger and bank statements, the City failed to reconcile its notes receivable balance, the City failed to reconcile its due to and due from accounts and its transfer in and out accounts, the City was unable to reconcile the City's accounts receivable balances to the aging report and the general ledger, the City did not take an inventory of its capital assets and the City was unable to provide support for several of their capital assets, the City's depreciation expense has not been properly recorded, the City's internal controls over payroll were not operating effectively and payroll was misallocated to the enterprise funds, the City's compensated absences were misallocated to the enterprise funds, the City did not record their other postemployment benefit liability, the City's internal controls over cash disbursement were not operating effectively and several expenditures lacked supporting documentation and were miscoded to the wrong accounts, the City was unable to provide support for numerous credit card and travel expenditures, the City lacks internal controls over posting journal entries, the City does not keep track of its budget and no budget amendment or tracking was conducted during the year, the City lacks internal controls over contract change orders, the City did not properly spend its bond proceeds on authorized expenditures and it is also out of compliance with several bond agreements, the City misused Measure R grant money and was out of compliance with several Federal grant awards. The City inflated purchases of land held for redevelopment and the City's Redevelopment Agency has been allocating the incorrect amount of property tax increments. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary to the financial statements. Except as discussed in preceding sentence, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as items 2010-01 through 2010-35 and federal award findings 2010-SA-01 through 2010-SA-09 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 2010-22, 2010-23, 2010-25, 2010-27, 2010-28, 2010-29, 2010-30, 2010-31, 2010-32, 2010-34, 2010-35, and 2010-SA-01 through 2010-SA-09.

We noted certain other matters that we reported to management of the City in a separate letter dated July 21, 2011.

The City's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the City's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the Mayor, City Council, others within the City, federal awarding agencies, and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Bakersfield, California
September 10, 2011

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

The Honorable Mayor and City Council
of the City of Lindsay, California

Compliance
We were engaged to audit the City of Lindsay, California's (the City) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have direct and material effect on each of the City's major federal programs for the year ended June 30, 2010. The City's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the City's management. Our responsibility is to express an opinion on City's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the City's compliance with those requirements.

As described in items 2010-SA-01 through 2010-SA-09 in the accompanying schedule of findings and questioned costs, the City, did not comply with requirements regarding accounting of programs, reporting, Davis-Bacon Act, equipment purchases, program income, procurement, and allowable expenditures that are applicable to its U.S. Department of Housing and Urban Development Community Development Block Grant (CFDA # 14.228) and U.S. Department of Transportation, Transportation Enhancement Act Grant (CFDA # 20.205). Compliance with such requirements is necessary, in our opinion, for the City to comply with the requirements applicable to that program.

In our opinion, the City did not comply, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2010, as a result of noncompliance items described in the preceding paragraph.

Internal Control Over Compliance

Management of the City is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the City's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over compliance.

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

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2010-SA-1 through 2010-SA-9 to be material weaknesses.

The City's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the City's responses and, accordingly, we express no opinion on the responses.

Schedule of Expenditures of Federal Awards

We were engaged to audit the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City as of and for the year ended June 30, 2010, and have issued our report thereon dated September 10, 2011. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133, and is not a required part of the basic financial statements. Because of matters described in the basis for disclaimer paragraph below, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an opinion.

The basis for disclaiming an opinion on the City of Lindsay's financial statements are as follows: the City failed to implement basic internal controls during the year to prevent misstatements and errors in the financial statements, the City failed to perform monthly cash accounts reconciliation to the general ledger and bank statements, the City failed to reconcile its notes receivable balance, the City failed to reconcile its due to and due from accounts and its transfer in and out accounts, the City was unable to reconcile the City's accounts receivable balances to the aging report and the general ledger, the City did not take an inventory of its capital assets and the City was unable to provide support for several of their capital assets, the City's depreciation expense has not been properly recorded, the City's internal controls over payroll were not operating effectively and payroll was misallocated to the enterprise funds, the City's compensated absences were misallocated to the enterprise funds, the City did not record their other postemployment benefit liability, the City's internal controls over cash disbursement were not operating effectively and several expenditures lacked supporting documentation and were miscoded to the wrong accounts, the City was unable to provide support for numerous credit card and travel expenditures, the City lacks internal controls over posting journal entries, the City does not keep track of its budget and no budget amendment or tracking was conducted during the year, the City lacks internal controls over contract change orders, the City did not properly spend its bond proceeds on authorized expenditures and it is also out of compliance with several bond agreements, the City misused Measure R grant money and was out of compliance with several Federal grant awards. The City inflated purchases of land held for redevelopment and the City's Redevelopment Agency has been allocating the incorrect amount of property tax increments. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary to the financial statements.

Because of the significance of the matters described in the basis for disclaimer of opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide an audit opinion. Accordingly we do not express an opinion of the financial statements or the accompanying schedule of expenditures of federal awards

This report is intended solely for the information and use of management, the Mayor, City Council, others within the City, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Bakersfield, California
September 10, 2011

CITY OF LINDSAY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

Federal Grantor/Pass-Through Grantor/Program or Cluster Title		Federal CFDA Number	Pass-Through Entity Identifying Number		Federal Expenditures
U.S. Department of Housing and Urban Development:					
Passed through from the California Department of Housing and Urban Development:					
Community Development Block Grant	*	14.228	08-STBG-4843	$	358,460
Community Development Block Grant	*	14.228	08-PT AE-5408		46,840
Community Development Block Grant	*	14.228	08-EDEF-5786		11,510
Community Development Block Grant	*	14.228	06-EDEF-2725		50,852
Community Development Block Grant	*	14.228	05-EDBG-2181		931,765
Total Community Development Block Grant					1,399,427
HOME Investment Partnership Program		14.239	07 -HOME-3081		160,122
HOME Investment Partnership Program		14.239	06-HOME-2406		22,901
HOME Investment Partnership Program		14.239	06-HOME-2466		50,000
Total HOME Investment Partnership Program					233,023
Neighborhood Stabilization Program		14.256	09-NSP1-6270		103,105
Total U.S. Department of Housing and Urban Development					1,735,555
U.S. Department of Education:					
21st Century Community Learning Centers		84.287	N/A		101,848
U.S. Department of Agriculture:					
Community Facilities Loans		10.766	N/A		508,195
U.S. Department of Justice:					
ARRA- Community Oriented Policing Services (COPS)		16.710	N/A		65,000
U.S. Department of Homeland Security:					
Homeland Security		97.067	N/A		1,498
U.S. Department of Transportation:					
Passed through from the California Department of Transportation:					
Transportation Enhancement Act	*	20.205	STPLER-5189-019		336,540
Transportation Enhancement Act	*	20.205	CML-5189-017		313,196
Transportation Enhancement Act	*	20.205	CML-5189-017		27,000
Transportation Enhancement Act	*	20.205	RPSTPLE-5189-8		32,030
Total U.S. Department of Transportation					708,766
Total				$	3,120,862

* Denotes major program.

See accompanying notes to schedule of expenditures of federal awards and independent auditor's report on compliance with requirements that could have a direct and material effect on each major program and on internal control over compliance in accordance with OMB Circular A-133.

CITY OF LINDSAY
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010

NOTE 1 – BASIS OF ACCOUNTING

The accompanying schedule of expenditures of Federal awards includes the Federal grant activity of the City of Lindsay, California (the City), and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

NOTE 2 – LOAN BALANCES

The City had the following loan balances outstanding at June 30, 2010. The portion of the loan balance expended for the project is included in the Federal expenditures presented in the schedule.

Program Title	CFDA Number	Amount Outstanding
USDA - Water	10.706	$ 2,093,788
USDA - Sewer	10.706	6,138,723
USDA - Sewer	10.706	442,589
USDA - Tulare Road	10.766	1,547,700
USDA - Wellness Center	10.766	1,296,890
		$ 11,519,690

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

CITY OF LINDSAY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2010

SECTION I – SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued: Disclaimer

Internal control over financial reporting:

- Material weakness identified? X Yes ____ No
- Significant deficiencies identified that are not considered to be material weaknesses? ____ Yes X None Reported

Noncompliance material to financial statements noted? X Yes ____ No

Federal Awards

Type of auditor's report issued on compliance for major programs: Disclaimer

Internal control over major federal programs:

- Material weakness identified? X Yes ____ No
- Significant deficiencies identified that are not considered to be material weaknesses? ____ Yes X None reported

Any audit findings disclosed that are required to be reported in accordance with OMB Circular A-133, Section .510(a)? X Yes ____ No

Identification of major programs:

CFDA #(s)	Name of Federal Program or Cluster
14.228	U.S. Department of Housing and Urban Development Community Development Block Grant
20.205	U.S. Department of Transportation, Transportation Enhancement Act

The threshold for distinguishing type A & B programs was $300,000.

Auditee qualified as low-risk auditee? ____ Yes X No

SECTION II – FINANCIAL STATEMENT FINDINGS AND QUESTIONED COSTS

Material Weakness

2010-01: Cash and Cash Equivalents

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

While performing our cash testing, we noted the following deficiencies:

1. The City is not performing cash reconciliations to the general ledger on a timely basis and at times cannot get bank reconciliations to tie the general ledger.

2. During our audit of cash, we noted two of the City's bank accounts could not be reconciled by City staff from the bank balance to the general ledger balance.

3. The City's Pay Pal account was not reported on the general ledger correctly and no reconciliation of the Pay Pal Account has been made throughout the year.

4. During our audit of cash, we noted that the City had many large outstanding checks in its cash account reconciliations at year end. This was a result of checks being printed prior to June 30, 2010, but not mailed out due to the City's cash flow issues. As of June 30, 2010, we are unable to determine the actual cash balance and accounts payable since City staff had custody of several checks that were printed but not mailed out.

Cause of Condition:

The causes of the deficiencies noted above are as follows:

1. The City Finance Department was short staffed and did not have an accountant that could reconcile cash accounts on a monthly basis.

2. Cash accounts could not be reconciled as, under prior City management, reconciliations were not performed on a regular basis. Due to the short staff of the Finance Department and finance staff required to take additional responsibilities regarding McDermont Field House operations, certain responsibilities had to be delayed, which included the performing of reconciliations.

3. Pay Pal activities were only accounted for when transfers between Pay Pal and McDermont Field House bank account occurred. Management was not aware of an additional reconciliation that needed to be made.

4. The City had cash flow issues during fiscal year 2009-10 and was unable to pay its bills on a timely basis. As a result, the City would print checks and hold onto them until it had sufficient funds to pay its expenses. The City prints checks on a weekly basis, but would hold onto those for which it did not have sufficient funds to pay.

Effect of Condition:

The effects of the above stated deficiencies are as follows:

1. By not regularly performing cash reconciliations, errors or discrepancies are allowed to accumulate and create difficulty in reconciling accounts. Additionally, items which should be removed from the outstanding check list may remain on the listing as they are not reviewed or reconciled.

2. Pay Pal activity could not be reported correctly on the City general ledger.

3. The City would have many large outstanding checks as it would print them and hold onto them until it had the necessary funds to pay them. This makes reconciliations difficult as many large dollar items are outstanding. Additionally, it could create additional charges for late payments and penalties. As a result, we cannot determine the actual cash balance of the City since the number of printed checks on hand at June 30, 2010, was unknown and, therefore, cash and accounts payable balances should be increased. We were unable to determine the magnitude of the misstatement.

Recommendation:

Our recommendations address the conditions listed above:

1. We recommend that the City perform cash reconciliations for all accounts on a monthly basis.

2. Due to unreconciled balances carrying over from the prior year, we recommend the City spend additional time to reconcile the differences; if these differences cannot be determined, the City or management should post a journal entry to correct the unreconciled difference.

3. A new Pay Pal account should be added to the general ledger and the Pay Pal account should be reconciled on a monthly basis.

4. We recommend that the City only print checks when it is planning on sending them out. Printing them early could allow for checks to be lost or accidently sent out before the proper fund balances exist in the bank accounts. Also, printing checks too early will increase the number of voided checks as management may decide to wait to send out payment.

Management's Response:

1. Once staff has an opportunity to catch up with and rectify the many, many issues from previous management, reconciliations will be performed on a monthly basis.

2. Once staff has an opportunity to catch up with and rectify the many, many issues from previous management, the two accounts that were not reconciled from the previous year will be thoroughly reviewed, with the help of an independent accountant if necessary, to discern the true balance which shall be properly maintained thereafter. In previous years, the City had opened and maintained up to 13 different bank accounts, including the Local Agency Investment Fund account, not counting the bond accounts. Current management has reduced that number to 9, including a CD investment account. We believe that streamlining the bank accounts will prove to aid in the reconciliation process. In addition, a clerk with bank authorization shall check and record the balances daily to ensure all automated clearing house (ACH) activity is properly recorded.

3. A new Pay Pal account has been added to the general ledger and shall be reconciled on a monthly basis to reflect the bi-monthly membership billing going in from the recurrent billing system of McDermont Field House and the subsequent transfer to the McDermont Field House checking account. Management was not aware of the need for this additional general ledger account, therefore, it was not set up until May 2011; all of the transactions from the recurrent billing system were already posted and accounted for in the bank accounts through May 2011. The new general ledger account has been in use since June 2011.

4. At this time, management disagrees with the audit team regarding the weekly printing of accounts payable checks. We believe by that posting the expense, which only happens when the check process is complete, we present a more accurate accounting of the financial situation and activities of the City as well as maintain a more accurate remaining budget balance. Every two weeks the check register is presented as a consent item on the City Council agenda to ensure the governing board and the citizenry are kept apprised of our expenditures. There have been very few voided checks this past fiscal year. All printed checks are kept locked in the vault until they are released. Adequate cash flow is still an issue for the City; however, under the guidance of the new City manager who has implemented very strict internal control policies, particularly as relates to purchasing and procurement, the release time for printed checks has been reduced from 3 weeks to 2 weeks and our goal for fiscal year 2011-12 is to be able to release all checks within one week of the print date.

2010-02: Petty Cash Findings

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

While performing our walkthrough and fraud testing for the City's petty cash process, we noted the following deficiencies:

1. During our fraud testing, for 3 out of 25 petty cash disbursements selected for testing, we noted that the individual that received the petty cash was the same individual that approved the petty cash disbursement.

2. During our fraud testing, for 3 out of 25 petty cash disbursements selected for testing, we noted there was no signature of approval on the petty cash receipt.

3. During our fraud testing, for 1 out of 25 petty cash disbursements selected for testing, we noted the City paid concert performers for an event at McDermont Field House out of petty cash in the amount of $7,500.

4. During our fraud testing, for 2 out of 25 petty cash disbursements selected for testing, we noted the City paid for an individual's labor out of petty cash.

5. During our fraud testing, for 5 out of 25 petty cash disbursements selected for testing, we noted a lack of any support for the petty cash disbursement. We were unable to determine if it was misplaced or if it was a result of abuse or fraud.

Cause of Condition:

The respective causes of the deficiencies noted above are as follows:

1. Prior City management did not enforce control procedures requiring authorization from someone other than the individual receiving the petty cash.

2. Prior City management did not enforce control procedures relating to petty cash approval and supporting documentation.

3. Prior City management did not enforce control procedures relating to the amount of petty cash which could be distributed or the types of expenditures which could be paid by petty cash.

Effect of Condition:

The effects of the above stated deficiencies are as follows:

1. By-passing controls relating to separate individuals approving and receiving the petty cash could allow for petty cash to be used improperly by either not being used for the stated purpose or used in unreasonable amounts.

2. By-passing controls relating to petty cash approval could allow for petty cash to be used improperly or in unreasonable amounts.

3. By-passing controls relating to the amount which can be distributed through petty cash, or the types of expenditures which can be paid from petty cash, can create a misappropriation of petty cash as large amounts are kept on hand at any one time.

4. By-passing controls relating to the usage of petty cash allows for situations to arise, as noted in our testing, where individuals are compensated for their labor from petty cash instead of through proper payroll procedures. As a result, IRS regulations on payroll taxes and reporting are by-passed and can become an illegal activity.

5. By-passing controls relating to providing support for petty cash disbursements can lead to cash being used for improper purposes or in unreasonable amounts.

Recommendation:

Our recommendations address the separate conditions listed above are as follows:

1. We recommend that the City require separate individuals to receive and approve each petty cash disbursement.

2. We recommend that the City require signatures of approval on all petty cash receipts.

3. We recommend that the City place a limit on the amount of cash which can be distributed for any single expenditure as well as the total cash which can be on hand at any one time. We also recommend that the City place limits on which types of expenses can be paid from petty cash.

4. We recommend that the City only pay employees from payroll, not from petty cash.

5. We recommend that the City maintain support for each petty cash disbursement, which should include a petty cash receipt which is completely filled out with the description, date, amount, code charged to, signature of individual receiving the cash, and signature of individual approving the disbursement. Additionally, these should be accompanied by their corresponding receipts.

Management's Response:

Use of petty cash was discontinued in its entirety effective June 1, 2011. The remaining cash in the petty cash drawer was reconciled and returned to City's coffers June 14, 2011. All employees have been notified verbally and in writing that the City no longer has a provision for cash reimbursement. All requests for reimbursement must be pre-approved, properly documented, and submitted to the Finance Department via the proper chain of authority for the warrant run. Employees have been notified that purchases made without proper pre-approval by a supervisor authorized to purchase will not be reimbursed in any form.

2010-03: Notes Receivable-General Ledger Not Properly Updated

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

The City's general ledger did not reflect the appropriate or accurate balance for notes receivable as of June 30, 2010.

Cause:

The City failed to record journal entries for loans receivable and deferred revenue to properly record transactions related to notes receivable. In addition, we have identified notes that were not included in the City's reconciliation of notes receivable, which was used to track the balances and activity.

Effect:

Notes receivable and deferred revenue had to be substantially changed from what they were originally posted.

Recommendation:

We recommend that the City reconcile notes receivable on a monthly basis, or at the very least quarterly.

Management's Response:

Staff will reconcile notes receivable on a quarterly basis for fiscal year 2010-11 and monthly beginning fiscal year 2011-12. A new input code was created in April 2011 for the revenue management system that now records an additional entry for every loan payment, at the time the payment is received, which will bring the reconciliation into "real-time."

2010-04: Due To and Due From Other Funds

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

While performing our audit of transfers and due to and due from, we noted the following deficiencies:

1. The City does not reconcile its due to and due from schedule on a regular basis.
2. During our testing of the City's due to and from transfers, we noted that many of the due to and due from borrowing last for more than one year.

Cause of Condition:

The causes of the deficiencies noted above are as follows:

1. Prior City management did not enforce controls relating to reconciling items such as due to and due from other funds.
2. Due to the City's cash flow issues, prior management would transfer funds from one fund to another in order to avoid showing negative cash balances. However, this was usually done without the intention of the funds being paid back.

Effect of Condition:

The effects of the above stated deficiencies are as follows:

1. By not reconciling the due to and due from schedule, it is possible for errors to occur and accumulate over time, going unnoticed. We noted due to and due from transactions were posted from Redevelopment Agency funding which is restricted for special purposes. Year after year, management has increased due to and due from in order to keep funds in the positive cash balance instead of addressing the actual problem of overspending.

2. Allowing due to and due from transactions to last more than one year creates misleading fund balances. Due to and due from transactions are intended to be short-term in nature and, therefore, transfers which exceed one year are long-term.

Recommendation:

Our recommendations address the conditions listed above:

1. We recommend that the City reconcile its due to and due from schedules on a monthly basis. At a minimum, this reconciliation should be performed quarterly. This would clearly show where funds are going to and coming from.

2. We recommend that the City transfer funds using due to and due from only if the funds are expected to be paid back within one year.

Management's Response:

Staff concurs with the conditions as stated by the auditor due to the fact that previous management did not reconcile the funds in the proper manner which created misleading fund balances. It is believed this was not done with intent to misinform, but more likely because of former staff having been improperly trained and educated regarding this type of transaction. Current staff has sought counsel and training regarding the proper procedures for due to and due from transactions and how to properly maintain the schedule from one fiscal year to the next. Current staff is confident in the stated fund balances at fiscal year ending June 30, 2011, and shall reconcile the balances at a minimum of a quarterly basis with the goal of monthly reconciliations for all transactions made after September 30, 2011.

Due to and due from transactions shall be limited to duration not to exceed three (3) months.

2010-05 Accounts Receivable

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

We are unable to determine the balance of accounts receivable as of June 30, 2010, for accuracy and completeness.

Cause:

The City does not reconcile accounts receivable and we have noted various deficiencies in the accounts receivable cycle, such as:

1. Lack of Segregation of Duties: Currently, the billing clerk can make changes to the utility billing software along with post adjustments that are not reviewed by a second person. At times the billing clerk will collect utility payments at the front desk and at the same time has the capabilities of overriding the system.

2. The City does not currently have a written policy for the write-off of receivables.

3. No reconciliation of the accounts receivable module to the general ledger has been performed, which has caused there to be a difference between the accounts receivable aging report and the general ledger of $483,000. Management is unable to reconcile the current difference.

Effect:

We have noted an unreconciled balance in accounts receivable utility billing of approximately $483,000. In addition, accounts receivable and revenue may be overstated as a result of the City not reconciling accounts receivable. Management has stated that, at times, adjustments get posted to the accounts receivable module and not updated on the general ledger. This can account for the material difference.

Recommendation:

We recommend that the City consider the following recommendations:

1. Consider the idea of outsourcing the billing side of utility services to save internal cost and improve internal controls.

2. Ensure that only the finance director can post an adjustment to an account by having the billing clerk write down adjustments on paper cards approved by the clerk then final approval and posting by reconciling accountant or finance director.

3. City should implement a write-off/adjustment policy to insure a standardized process can be followed for writing off accounts and making adjustments.

4. We also recommend the City reconcile the accounts receivable module directly to the general ledger on a monthly basis to ensure both modules reconcile.

Management's Response:

Without doubt, this is one of the most seriously deficient areas of the Finance Department. The prior finance director did not ever properly reconcile the utility billing accounts receivable as it was never brought to his attention by previous auditors until the fiscal year 2007-08 audit; thus, the current finance director is having difficulty determining the correct amount, but is certain that it is grossly overstated. Determining the correct amount of the accounts receivable and maintaining the reconciliation on a monthly basis is a top priority for this administration.

1. Outsourcing of the billing is not feasible at this time as it only pertains to printing and mailing the billing statements which would not address the internal control issues as all entry and file maintenance would still have to be done in-house – this was researched.

2. Utility billing clerk shall write all adjustment requests on a blue card and forward to the finance director for approval and input. Computer authorization access for adjustments has been withdrawn from the utility billing clerk and granted to the payroll clerk, who may key adjustments that have been authorized by the finance director, or the finance director shall key said adjustments herself. A ledger shall be maintained of all adjustments and the reason for same.

3. Staff shall develop a write-off policy to insure a standardized process that shall be followed for all adjustments and write-offs, including forwarding delinquent accounts to a contracted collection agency.

4. The City shall reconcile the accounts receivable module directly to the general ledger on a monthly basis to ensure both modules reconcile.

2010-06: McDermont Field House Notes Receivable Findings

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

While performing our notes receivable testing, we noted the following deficiencies:

1. We noted that loans were created and paid out of the general fund to employees to operate and manage various attractions at McDermont Field House.

2. These loans were mismanaged as there was limited or no review of loan applications and many individuals who received these loans were not qualified to participate in the program.

3. We noted that some employees of McDermont Field House were being paid directly out of petty cash.

Cause of Condition:

The causes of the deficiencies noted above are as follows:

1. Prior City management enacted a program with the goal of deferring some operational costs of McDermont Field House by loaning money to vendors to essentially run small businesses, which were the attractions, within McDermont Field House.

2. Prior City management did not review loan applications in detail and often gave loans to individuals who did not qualify.

3. During fiscal year 2009-10, multiple employees were paid directly out of petty cash instead of through the traditional payroll methods.

Effect of Condition:

The effects of the above stated deficiencies are as follows:

1. The effect of this condition is the general fund, which was already depleted, expended more funds during fiscal year 2009-10. The loans relating to McDermont Field House grew by over $150,000 after June 30, 2010, to $443,872 by the end of the program in November 2010.

2. The result of this condition is that an excessive amount of money was expended in loans for McDermont Field House operations out of the general fund which led to a mismanagement of funds.

3. As a result, we are unable to determine if any IRS regulations were by-passed and if all required federal and state taxes were paid. Additionally, if employees are paid out of petty cash, the employer may not maintain all necessary personnel documentation.

4. At this point, it is doubtful whether any of the funds will be recovered and, if that is the case, the City will have lost $443,872 of taxpayer money due to the City's mismanagement.

Recommendation:

Our recommendations address the conditions listed above:

1. We recommend that the City no longer engage in loan programs for start up businesses that will operate within the McDermont Field House. We also recommend that the City properly review all loan applications and only provide loans of any type to individuals who qualify.

2. We recommend that the City only pay its employees through traditional payroll methods. No employee should be paid out of petty cash.

Management's Response:

1. The City of Lindsay has adopted a formal agreement with CSET, a non-profit employment training agency, to manage the micro-loan program including, but not limited to, program announcements, orientation, applicant screening, applicant underwriting, loan application processing, continued maintenance, and training and support to approved participants. City staff is basically removed from the process entirely, with the exception of paying the administrative fee to CSET (from the administrative portion of the grant). This agreement has been vetted and approved by the State agency in charge of the micro-business loan program. This arrangement with CSET will ensure that an unbiased, experienced, and impartial loan underwriting team will provide all qualifying applicants an equal opportunity to open a business anywhere within appropriately zoned areas within the City limits.

2. It should be clarified that cash payments were not given to City employees; individuals who were hired by the various business owners on an independent contractor basis, were to have been properly accounted for by each individual business owner that utilized their services. As not every business had its own checking account, cash payments based on submitted requests and charged according to the requesting business owner, were given to be distributed to the individual(s) who had provided assistance to that business. All tax forms and records were, and are, the responsibility of the business owner who arranged for their services, per the contract with each business owner, and signed declaration of each independent contractor.

The City has eliminated the use of petty cash in its entirety. The fund was abolished in January 2011 and the receipts reconciled to the general expense ledger and any remaining monies were returned to the general fund in June 2011.

2010-07: Capital Asset Reconciliation and Accounting Controls

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

During our testing for capital assets, we noted several material weaknesses affecting capital assets as follow:

1. The City does not have an up-to-date capital asset policy that covers all City owned assets.

2. Useful lives for assets being depreciated vary and are not consistent with the stated policy.

3. Management does not maintain a capital asset reconciliation that is updated throughout the fiscal year.

4. Assets including the McDermont Field House building, the City swimming pool, and the City library were taken out of construction in progress on July 1, 2009. These assets were actually completed between 2007 through 2008; accumulated depreciation is understated for these assets as they should have been removed from construction in progress in previous years.

5. Management is unable to provide cost information for several equipment and construction items due to no monthly or quarterly reconciliation of capital assets.

6. No inventory for capital assets was performed to ensure all assets included on the capital asset schedules are accounted for and properly stated.

7. Management failed to implement requirements for Governmental Accounting Standard Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, implementation of capital assets as of June 30, 2004. The result of failing to properly implement GASB Statement No. 34 resulted in a current year prior period adjustment in capital assets of over $20 million dollars.

Cause:

The City lacks adequate controls and staff lack adequate knowledge of capital assets accounting to ensure capital assets are correctly accounted for on the financial statements and reconciled on a timely basis.

Effect:

The absence of performing monthly and/or routine capital asset reconciliations provides an opportunity that errors can accumulate and these errors may go undetected. The benefit of monthly reconciliations is that errors do not accumulate, but can be identified and attributed to a particular period (month), which makes it easier to perform future reconciliations. Because the procedures recommended below were not in place during the year ended June 30, 2010, these are considered material weaknesses because a material misstatement of the financial statements would have occurred and not been prevented or detected by the City's existing internal controls. City management is unable to determine actual capital asset accounting as the policy is out dated and does not cover all capital assets needing to be reported.

Recommendation:

We recommend management establish the following functions:

1. Implement a thorough capital asset policy that covers all assets maintained by the City and provide appropriate useful lives for each asset category.

2. We recommend the City perform a reconciliation of all capital assets on a monthly/quarterly basis to ensure assets can be capitalized in a timely manner.

3. The City should keep better track of all costs for construction related assets to ensure all assets/costs can be accounted for and vouched.

4. The City should perform an inventory of capital assets each year to ensure all assets are accounted for and still being used by the City.

Management's Response:

It should be noted that this condition developed under previous management.

Staff is currently developing a thorough capital assets policy that will cover all assets maintained by the City and provide appropriate useful lives for each asset category as the previous policy is outdated and too vague.

Staff has been working diligently to reconcile the capital assets schedule and bring the schedule current and are confident that all assets will be accurately accounted for in the period ended June 30, 2011, and shall be maintained as assets are purchased or disposed in subsequent years. This updated schedule is to be presented to the City Council in its entirety once per year, no later than October, following the close of the previous fiscal year.

Staff is committed to maintaining an accurate record of construction in progress (CIP) and record dates when projects may be transitioned out of the CIP and onto the capital assets deprecation schedule. The finance director has appointed the accounts payable clerk to enter data into the capital assets schedule when payment is rendered for qualifying purchases. The finance director shall be responsible for maintaining the CIP and real property portion of the data base. Both employees will undergo training in this area in fiscal year 2011-12 to obtain adequate knowledge regarding capital asset management.

2010-08: Accounts Payable Internal Controls

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

While performing our walkthrough and test of controls for the City's accounts payable process, we noted several control deficiencies:

1. Currently, blank check stock is located inside the City-wide safe that is used for storing City documents. This safe remains open and unsupervised throughout the day. Checks are maintained in an unlocked cabinet within the safe.

2. Check stock is not reconciled and maintained to ensure all City checks are accounted for and stored securely.

3. Currently, each check issued by the City requires two approval signatures, one of the Mayor and the other of another authorized check signer. During our walkthrough, we noted that the Mayor's signature is actually a signature stamp. This stamp is currently used by the accounts payable clerk to stamp all outgoing City checks. The stamp can often be found next to the unsecured blank checks in the unlocked City safe during the day; an area which is accessible to all City employees entering the Finance Department.

4. During our walkthrough of internal controls, we noted the accounts payable clerk's duties include:
   i. Opening mail
   ii. Posting invoices to the general ledger
   iii. Maintaining blank check stock
   iv. Printing checks
   v. Using the Mayor's signature stamp to provide one signature on each check
   vi. Stuffing checks and mailing out checks

5. The City's printer, which is used to print checks, has a problem of jamming on a regular basis. Oftentimes the printer will grab more than one check when printing a check. Additionally, from time to time it damages the check stock and renders it unusable.

Cause of Condition:

The respective causes of the five control deficiencies noted above are as follows:

1. It has been City custom to store blank checks in an unlocked cabinet.

2. The City Finance Department was not aware that check stock should be reconciled and tracked on a continuous basis.

3. The Mayor's stamp was created by prior City management in order to expedite the cash disbursement process. It was created to act as an authorization signature for check disbursements.

4. Due to the City's limited staff in the Finance Department, the accounts payable clerk performs a multitude of duties in regards to the cash disbursement process.

5. The City currently uses an antiquated printer for printing its checks. This results in check stock regularly being damaged or printing checks out of order.

Effect of Condition:

The effects of the stated control deficiencies are as follows:

1. The effect of this condition is that the blank check stock could be misplaced or stolen as there are no controls over their security.

2. The effect of this condition is that if the check stock was to be misplaced or removed from the safe where it is stored, the City would not be aware that any check stock is unaccounted for. This would lead to checks in the City's system not having the same check number as the preprinted number, and could lead to misappropriation of assets if the missing check stock is used in a manner other than for City expenses.

3. By having the Mayor's stamp unsecured in the vicinity of unused check stock, individuals have the ability to approve disbursements that are not for City expenses. Additionally, it effectively only requires one signature of approval on all disbursements, as the Mayor's stamp is accessible to anyone entering the City's safe.

4. The result of the duties performed by the accounts payable clerk is that there is no segregation of duties in the cash disbursement process. As there is no segregation of duties, there is no way to detect or prevent errors in the cash disbursement process during the year.

5. The result of this condition is that the City is printing checks where the check number in the City's system does not match the preprinted check number.

Recommendation:

Our recommendations address the five separate conditions listed above:

1. We recommend that the City maintain all unused check stock in a locked cabinet. We also recommend that only two Finance Department employees have keys for this cabinet; neither of which should be involved with accounts payable or cash disbursements.

2. We recommend that the City implement a check reconciliation sheet which will help the Finance Department to track its check stock at all times. This reconciliation should be completed each time check stock is removed from the locked cabinet. It should be signed by the individual in possession of the key which opened the cabinet, and should state the beginning and ending check numbers of the check stock removed from the cabinet. This will help ensure checks are used in a sequential order, and it should be reviewed on a regular basis to make certain the reconciliation is being completed correctly and all check stock is accounted for.

3. We recommend that the Mayor's stamp be in the Mayor's possession at all times or is destroyed. As it is currently maintained, the Mayor's stamp effectively inhibits internal controls as it is usable by anyone.

4. We recommend that the City separate the duties of the current accounts payable clerk. The same individual should not have the ability to authorize payment, record the payment or invoice, maintain custody of the checks, and reconcile the same area. These duties should be distributed to different individuals in order to improve internal controls.

5. We recommend that the City purchase a new printer which will alleviate the issues of misprinted checks. Additionally, if an error does take place in the printing of checks, the misprinted check should be voided in the City's system and reissued with a different number. Checks should not be printed where the number per the City's system is different than the preprinted check number.

Management's Response:

1. The City has purchased and installed a multiple-drawer file cabinet within the vault and secured all blank check stock within this cabinet. Only the finance director and the payroll clerk have keys to this cabinet.

2. A check reconciliation sheet has been developed for both blank stock and void checks; this reconciliation includes areas to record the Date, Batch Number, Beginning Check Number, Ending Check Number, Total Number of Checks in the Batch, applicable Cash Account, and Signature of Employee removing the check stock from the locked cabinet. This will most likely be the finance director which will ensure that the reconciliation is being maintained and all blank check stock is accounted for.

3. Eliminating the stamped signature of the Mayor is a top priority of the fiscal year 2011-12; this recommendation comes too late for fiscal year 2010-11. In order to be able to eliminate the stamp, staff is working on a printing schedule that is amenable with either the Mayor or one of the other designated signatories, most of whom work away from the City and are not always readily available. The stamp is now kept locked inside a locked box that is locked inside the cabinet inside the vault and only used in the event no authorized signer is available.

4. The accounts payable duties have been separated and each Finance Department employee has been assigned a separate duty; gathering, opening, stamping, and distributing the mail is now the responsibility of the front desk customer service clerk. The coding is entirely the responsibility of each department head; cover sheets are written out by the P/T finance clerk; final review and approval of coding and backup are performed by the finance director who also obtains blank stock from the cabinet and maintains the stock reconciliation, these checks shall be placed directly onto the printer; accounts payable clerk shall then finish the processing of the run and print all applicable reports, forwarding to finance director the total from the run. Checks are then copied and made available for review and signature to the signers by the payroll clerk; once the checks have been signed, the P/T finance clerk shall prepare for mailing by ensuring each check has appropriate backup so that the vendor can properly credit the City's account. A written schedule of duties has been prepared for the Finance Department staff, including who is assigned to backup whom in the event of absence.

5. The City did purchase and install a new printer on July 13, 2011.

2010-09: Miscellaneous Cash Receipts Internal Control Weakness

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

While performing our walkthrough and test of controls for the City's cash receipt process, we noted several control deficiencies.

1. Currently, there is only one cash drawer at the front customer service desk used by all Finance Department employees for collecting cash/check receipts. We noted that the cash drawer is kept unlocked throughout the day.

2. All Finance Department employees hold the password code to the main Finance Safe where cash is held at the close of each day.

3. During our test of controls, we noted no formal policy regarding cash shortage/discrepancies on daily reconciliations of cash receipts and accounts receivable. During our testing, we noted one cash deposit out of a sample of 30 that had a cash shortage of $10.

4. During our test of controls, we noted one cash deposit lacked McDermont Field House and Finance Department approval. We also noted the Finance Department is only reviewing a summary excel report of total daily cash receipts, and not reconciling to the daily cash receipt report generated through McDermont Field House's accounting system.

Cause of Condition:

The respective causes of the four control deficiencies identified above are as follows:

1. Due to the small size of the City's Finance Department, the use of one cash drawer has been the historically practical means of collecting cash receipts.

2. Due to the small size of the City's Finance Department, distributing the safe code to all employees makes access to the safe assured if key employees are absent.

3. The City has not experienced large cash discrepancies in the cash receipts/accounts receivable process. Consideration of a policy addressing discrepancies therefore has not been required.

4. Lack of Finance Department initials on McDermont Field House cash receipt reconciliations are most likely due to human error. McDermont Field House staff only submit excel reconciliations of daily cash receipts to the Finance Department.

Effect of Condition:

The effects of the stated control deficiencies are as follows:

1. Use of one cash drawer by all Finance Department employees during the collection of cash/check receipts makes it impossible to trace shortages/overages to a single employee. Due to this situation and due to the fact the drawer is unlocked throughout the day, it is possible for an employee to misappropriate cash receipts without detection.

2. Because all Finance Department employees have the password to the City safe, safeguards over the City's assets, including the cash receipts collected during the day, are weak. An employee could easily misappropriate assets without detection.

3. Cash discrepancies are not thoroughly investigated to determine source of cash shortage/overage.

4. Lack of initials on McDermont Field House receipt reconciliations indicates that they are not being properly reviewed by both McDermont Field House and the Finance Department. Finance Department cannot confirm that total cash receipts recorded in the McDermont Field House accounting system reconcile to the summary schedules provided to the Finance Department.

Recommendation:

The following are recommendations to better improve the cash receipt cycle:

1. Each cashier should be given their own cash drawer so that cash/check overages/shortages are easily traceable to one individual. If an employee goes to lunch or is away from the cash receipt position, then the cash receipt drawer should be locked or placed back in the safe.

2. Distribution of the safe code should be limited to key employees and/or management. As a good practice, the safe should remain locked when not used in order to ensure misappropriation of assets does not occur.

3. A formal policy for cash discrepancies should be developed. Policy should include investigative procedures to determine source of cash shortage/overages as well as procedures for making journal entry adjustment at the end of the month for accumulated shortages/overages.

4. All McDermont Field House receipt reconciliations should be initialed by a McDermont Field House and Finance Department employee indicating proper review. The Finance Department should also review to ensure that the summary reconciliation ties directly to the McDermont Field House accounting system to ensure no override in controls occurred on the cash receipt reporting cycle.

Management's Response:

1. A second cash drawer has been procured and the beginning cash has been split to $450 for the main drawer (Register 1) and $50 for the backup drawer (Register 2). A second employee has been assigned the backup drawer – which is kept locked in a cabinet within the vault – to work from during interval breaks and the lunch break of the main cashier and for the last half hour of the work day when the main cashier balances her drawer. The main drawer will be locked in the cabinet during the lunch break and interval breaks of the main cashier. All drawers shall have a 2nd count by a 2nd member of the Finance Department staff to ensure both the beginning balance and the daily receipts and locked in the cabinet under dual custody. Each drawer shall enter work according to its assigned register so that reports can be run specific to each register to balance the receipts to the collected money, thus making it possible to identify which drawer (which employee) is responsible in the event of an out-of-balance (over/short) situation. A written list of the dual custody procedure has been developed.

2. A locking file cabinet has been purchased and installed in the vault, which also contains records and files that need to be readily available. Only two supervisory employees have the keys, and it is now mandatory that all cash box transfers in-and-out be made under a dual custody arrangement. We believe this safeguard overrides any deficiency regarding safe-keeping of the City's cash receipts.

3. Cash discrepancies over the amount of $10 have always been thoroughly investigated by matching all checks to receipts and completely reviewing all the day's work by a 2nd employee of the Finance Department. A written policy regarding consequences of out-of-balance drawers shall be developed by the finance director. Journal entry adjustments have always been done as part of the utility billing receipts posting to account for the shortage/overage in order to facilitate bank reconciliations.

4. All McDermont Field House receipt reconciliations now include the computer-generated report that is compared to the summary reconciliation sheet to ensure it ties back to the McDermont Field House accounting system and those reports are kept in a separate file for ease of review and reference. All transmittals are initialed by both McDermont Field House and Finance Department staff.

2010-10: Utility Billing Cash Receipts

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

While performing our walkthrough and test of controls for the City's Utility Billing process, we noted that there were several control deficiencies.

1. During the meter reading process to obtain water consumption records, some missed meter readings are not reported to City services in order to send the meter reader out to obtain a re-read. Instead, the utility billing clerk will record zero water consumption based on the passed month's trend of zero consumption or will call the customer to read the meter in order to obtain the monthly meter reading.

2. We noted that utility billing rate schedule lacks a disposal rate for 2 yard bins, picked up 5 times a week; however, the customer is charged a flat rate not in the billing schedule for that service.

3. We noted sewer charges for industrial plants (i.e. packing plants) are not charged a uniform rate. Currently a City Engineer conducts a physical inspection of the industrial site and establishes a rate based on observation and/or field tests.

4. During our testing of 30 utility samples, we noted one sample was missing the pre-interface reports/receipts edit lists. These reports cannot be retroactively printed so there is no way to trace cash receipt to pre-interface report/receipt edit list to reconcile the daily cash receipts.

Cause of Condition:

The respective causes of the four control deficiencies noted above are as follows:

1. The City services meter reader manually reads and writes down meter information, meaning that the likelihood of human error is high. To save the meter reader some time, the utility billing clerk contacts customers directly under the knowledge that a correct meter reading will be obtained by the City Services meter reader the following month if the customer does not provide an accurate reading.

2. The utility billing rate schedule has not been updated since February 2009, meaning that newer rates may have been established but not yet reflected in the formal rate schedule.

3. Historically, sewer charges for industrial plants have been left to the discretion of the City Services Department.

4. The utility billing clerk did not print and file the pre-interface reports/receipts edit lists as she was still learning the general ledger program, Pentamation Enterprises.

Effect of Condition:

The effects of the stated control deficiencies are as follows:

1. A customer contacted by the utility billing clerk could provide the City with a false reading, meaning that the customer may be undercharged for water consumption. Although contacting the customer directly is a control deficiency, it is most likely corrected the following month when the City Services meter reader obtains the following month's meter read.

2. An outdated utility billing rate schedule makes it difficult to ascertain that customers charged a newly implemented billing rate are being charged correctly.

3. Lack of uniform utility billing rate schedule for sewer usage by an industrial plant makes it difficult to ascertain that industrial plants are charged fairly. Because sewer charges are largely subject to the City services discretion, it is possible for two seemingly identical plants to be charged two different rates for City sewer usage.

4. Missing pre-interface reports/receipt edit lists make it difficult to reference utility billing receipts. Individual customer account balances and payments can be historically referenced using Pentamation Enterprises; however, this does not provide an easily accessed summary of daily utility billing recipes.

Recommendation:

Our recommendations address the four separate conditions listed above:

1. Only the City Services meter reader should be charged with obtaining meter readings. If a meter read is overlooked by the meter reader's first reading, all missed meter reads should be compiled in a re-read report. The re-read report should then be promptly submitted to the meter reader for a second read. Utility billing clerks should not obtain meter readings directly from customers, and management should monitor the number of misreads that occur each month and instruct the meter reader on the importance of correctly reporting meter readings to the best of their abilities.

2. The utility billing rate schedule should be updated annually and approved by the City Council to ensure City residents are aware of all approved rates. In addition, rates charged to customers that are not presented in the utility billing rate schedule (i.e. disposal rate for 2 yard bins picked up 5 times a week) should be added.

3. A uniform and/or systematic utility billing rate schedule should be established for sewer usage by industrial plants. Sewer charges should be relatively comparable among similar industrial plants. Methods for charging industrial plants should be presented to the Board of Directors for City Council approval.

4. Pre-interface reports/receipt edit lists should be printed for everyday receipts are collected and filed away.

Management's Response:

It is believed there may have been some lack of communication between the auditor and the utility billing clerk during the assessment interview as it is already the policy of the billing department to print a re-read sheet for any missed reads and any accounts that have a very large variance from the previous month (these sheets are run every month and are available for review). Many times there are customers who dispute that the meter reader is actually reading their meter and they are advised that they may want to obtain their own read and bring it in to compare to the read that is written on the sheet that was presented to the billing clerk by the reader. One system upgrade that will be implemented in the fiscal year 2011-12 is that the City will begin using hand-held electronic reading devices. The meters that have been updated within the past three years can be read electronically by a wand that interacts with the device. The meters not yet updated can be manually read and input into the pre-programmed device. While it will be quite time-intensive to program the devices and set up new routes, in the long run it will quite effectively reduce the potential for human error both on the part of the meter reader and the billing clerk who manually inputs the reads into the computer system. We are currently revising the route from one route that incorporates the entire City, and which requires the printing of a cumbersome 316 page workbook into which the meter reader hand writes the reads, to multiple routes that can utilize the electronic meter reading and data collection devices that can then be uploaded directly into the computer system. The billing process will become more efficient and read errors more readily identifiable and corrected *before* the bills are printed and mailed.

2010-11: Payroll Testing

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

While performing our walkthrough and test of controls for the City's payroll process, we noted several control deficiencies:

1. During our test of controls, for 4 out of 40 payroll disbursements selected for testing, we noted a lack of the two required signatures on the employee's time sheet.

2. During our test of controls, for 10 out of 40 payroll disbursements selected for testing, we noted only one required signature on the employee's time sheet.

3. During our test of controls, for 10 out of 40 payroll disbursements selected for testing, we noted a lack of Authorization to Hire form in the individual's personnel file.

4. During our test of controls, for 14 out of 40 payroll disbursements selected for testing, we noted that the Authorization to Hire form was missing approval signatures.

5. During our test of controls, for 24 out of 40 payroll disbursements selected for testing, we noted the employee's Change in Payroll Status form was missing approval signatures.

6. During our test of controls, for 1 out of 40 payroll disbursements selected for testing, we noted an instance where an employee's personnel file stated they should be paid $10 per hour; however, the employee was actually being paid $15 per hour.

7. During our test of controls, for 14 out of 40 payroll disbursements selected for testing, we noted differences between employee approved pay rates and the calculated pay rate per pay period. Differences ranged from $11 to $295 and could not be reconciled.

8. During our test of controls, for 3 out of 40 payroll disbursements selected for testing, the City was unable to provide the individual's personnel file.

9. During our test of controls, for 6 out of 40 payroll disbursements selected for testing, we noted the lack of Direct Deposit Authorization forms for those employees having their checks direct deposited.

10. During our test of controls, for 2 out of 40 payroll disbursements selected for testing, we noted instances where the employee's personnel file contained a Direct Deposit Authorization form, but their checks were not being direct deposited.

11. During our test of controls, for 15 out of 40 payroll disbursements selected for testing, the City was unable to provide a copy of the employee's time sheet.

<u>Cause of Condition:</u>

All instances noted above were as a result of prior City management not enforcing their control procedures relating to approval and documentation of personnel. Oftentimes, these controls were by-passed due to a lack of staffing in the Human Resources department.

<u>Effect of Condition:</u>

The effects of the stated control deficiencies are as follows:

1. By-passing controls relating to signatures on time sheets can cause incorrect hours to be paid to employees, thereby impacting payroll expenses of departments.

2. Employees not having an Authorization to Hire form in his or her personnel file could mean that the employee is not approved to be working for the City or is not actually an employee.

3. By-passing controls relating to signatures on Authorization to Hire forms could cause individuals to be hired that are not qualified or approved for a position.

4. By-passing controls relating to Change in Payroll Status forms can cause employees to be paid at a rate which they have not earned or are not actually approved to be paid.

5. Paying employees at a rate different from that in his or her personnel file indicates that personnel files are not maintained or updated regularly and that employees have the ability to be paid at rates other than those at which they are approved.

6. By not being able to tie the calculated rate per employee to his or her personnel file's approved rate indicates that employees can be paid at rates other than their approved rate and that client personnel are not aware of all items that make up an individual's salary.

7. By not maintaining personnel files, we cannot determine if individuals are actual employees of the City and if they are being paid at appropriate rates.

8. By-passing controls relating to Direct Deposit indicates that the City is not maintaining their personnel files and could allow for employees' checks to be deposited into inappropriate accounts.

9. By not maintaining time sheets, employees could be over or underpaid based on the number of hours they actually work.

Recommendation:

Our recommendations address the conditions listed above:

1. We recommend that the City maintain time sheets for each employee for each pay period which includes signatures of the employee and his or her supervisor.

2. We recommend that the City maintain Authorization to Hire forms for each employee which states the position for which they were hired and are signed by the department head and the City manager.

3. We recommend that the City maintain Change in Payroll Status forms for each employee which state the individual's position, previous pay rate, and new pay rate. Additionally, these should be signed by the Department Head and the City manager.

4. We recommend that the City update its payroll system in order to ensure that the appropriate amounts are being paid to employees each pay period. We also recommend that City personnel become familiar with what line items make up individual's payroll payments.

5. We recommend that the City maintain updated personnel files for all employees.

6. We recommend that the City maintain Direct Deposit Authorization forms for each employee that has elected to participate in Direct Deposit. Also, the City should note on these forms if the employee eventually decides to withdraw from Direct Deposit.

Management's Response:

1. Time sheets for every employee, with the exception of administrative personnel who are exempt from overtime, shall be kept by each department and signed by both the employee and the supervisor prior to submittal to the payroll department. The payroll clerk shall return any time sheets lacking the appropriate signatures to the supervisor who shall immediately bring them into compliance.

2. The new director of human resources has reviewed all files of active employees to ensure each file has the properly signed authorization to hire form which states the position, rate of pay, and date of hire. The payroll clerk shall check each new hire document to ensure all proper signatures, the City manager, personnel, and department head, and signatures are affixed.

3. The new director of human resources has reviewed all personnel files to ensure each file has the properly signed Change in Status forms for all employees who have had any changes, i.e. change of name or address, pay rate, position, and/or additional pays added or deducted from his/her original Authorization to Hire form and subsequent Change in Status forms to properly account for each employee pay and position history.

4. The payroll clerk has worked closely with the Director of Human Resources to ensure that the computerized payroll system is in-sync with the hard-copy personnel files so that the pay rates are correct according to the authorized paperwork in the files.

5. All personnel files have been updated to reflect any changes, i.e. pay rate; step; personal information; and deduction requests, that have occurred since the original date of hire.

6. The new director of human resources has reviewed all active personnel files to ensure the election forms for Direct Deposit are current, including cessation date, if applicable.

7. The payroll clerk, in conjunction with the Human Resources department, has developed a check list that is affixed to the front inside cover of each personnel file that confirms each required document, including all I9s; W4s; deduction and beneficiary documents; hire forms; and change-in-status forms, are contained within the file.

2010-12: Inappropriate Payroll Allocations

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

While performing our fraud testing for the City's payroll expenditure process, we noted that the City charged the salaries of many of its employees to funds which were not applicable to their positions. We tested the top ten highest paid employees and noted several which had salaries charged to improper funds, or to funds at inappropriate percentages. After reviewing the City's allocation schedule, we noted a majority of the inappropriate payroll allocations were being made directly to the Sewer and Water funds. We were unable to determine the actual cost of inappropriate allocations to the Sewer and Water funds but can determine it was in excess of $200,000 per review of the salary allocation schedule.

Cause of Condition:

Prior City management allocated salaries to various funds due to cash flow issues the City was experiencing. Management needed to continue to pay employees, so salary allocations were altered in order to do so, while maintaining some liquidity. We noted City schedules have this problem going back several years.

Effect of Condition:

By inappropriately allocating salaries to the Sewer and Water funds, City residents were over charged for sewer and water services or amounts that should have been accumulating as reserves for the Water and Sewer funds were being used to pay for City payroll that did not belong in the Water and Sewer funds. For the fiscal year ending June 30, 2010, we have determined that payroll expenditures charged to City funds are materially incorrect and do not correctly reflect the actual fund expenditures.

Recommendation:

We recommend that the City revise its payroll allocation in order to expense salaries to funds at appropriate percentages. Management should only allocate salaries to funds for which the employee is actually involved. It would be recommended the City perform a time study of employee time charges at least twice a year, to ensure allocations stay current and get reported in the correct fund.

Management's Response:

Current management did also discover this disproportionate salary allocation during the current budget process for fiscal year 2011-12. Reallocations were immediately implemented according to actual staff time required to provide the services and are reflected in the fiscal year ending June 30, 2011, as well as all years going forward. In order to ensure adequate cost verse, revenue accounting for the Enterprise Funds. Those funds are now being monitored quarterly to ensure they are in balance and not over, or under, funded to meet the requisite governmental activities. Staff has already alerted the City Council that these funds are being monitored to assess adjustment possibilities and have recommended reducing the sewer rate from the current $36.86 (as determined by the 2005 Sewer Rate study) to $30.00 which will result in a short-fall to the sewer budget which is to be made up from the surplus that is in the Sewer fund.

The governing body and staff have relied on the Registered Professional Engineer's Report, dated January 2004, along with the Sewer Rate study of 2005 by Corollo Engineering, which were used to establish the utility rates, along with the schedule of CPI increases and scheduled and adopted increases, and do dispute that citizens were overcharged. However, staff does concede that much of the allocations that should have gone toward capital replacement projects, reserves, and street maintenance accounts, as outlined in the report, were instead allocated by former management to salary lines. Further research has brought to light that no capital outlay reserve or contingency funds have been set aside in previous years to meet the needs of emergencies and/or expansion requirements relative to water and waste water services and infrastructure. This situation has been rectified and the budget for fiscal year 2011-12 is clearly reflective of same including allocations for street repair projects. Lastly, it has been difficult to determine the actual fund balances for the Enterprise Funds as former management did not follow proper accounting practices when recording due to and due from activity between funds. The 2005 Sewer Study shows a Due To Other Funds (from the Sewer Fund) of $226,000 and there was supposed to have been accounts set up to account for the principal and interest schedule as outlined in the report. This was never done. Staff has spent many hours researching previous years and utility studies and documents, such as the 2005 Sewer Rate Study, to determine the correct fund balances for the Enterprise Funds, but due to the issue going back several years, the proper fund balance for both the Sewer and Water fund could not be determined. Management shall be diligent in accounting for payroll going forward.

Additionally, the following steps shall be taken to ensure proper communication to the City Council and the citizens regarding salary allocation to the Enterprise Funds: the Salary Allocation schedule, by percentage, shall be included with every new fiscal year budget and Enterprise Fund Statements shall be provided as a City Council agenda attachment on a quarterly basis, beginning with the quarter ended September 30, 2011, and every quarter thereafter, in the month immediately subsequent to the end of the quarter being reported.

A time study sheet has been developed and time studies are scheduled to take place the 3rd week of August 2011, and again the 2nd week of February 2012, in order to ensure that all salary is properly allocated amongst all funds according to the percentage of time each employee dedicates to each respective governmental activity. Any changes to the adopted budget, which includes the salary allocation as a part thereof, shall come before the City Council for approval prior to implementation.

2010-13: Other Postemployment Benefits (OPEB) Findings

Criteria:

In accordance with GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* the City should have implemented this GASB Statement as of June 30, 2009. Furthermore, because the City has less than 200 members, it should have an actuarial evaluation performed at least triennially.

Condition:

While performing our procedures for payroll and OPEB, we noted that the City has not implemented GASB Statement No. 45 for calculating and recording its OPEB liability.

Cause of Condition:

The City staff lacks the appropriate accounting knowledge and technical skills to ensure that the City is following all new accounting standards.

Effect of Condition:

As the City has not implemented GASB Statement No. 45, it is not properly or accurately recording its OPEB liability as of June 30, 2010.

Recommendation:

We recommend that the City obtain an actuarial valuation report in order to properly report its OPEB in order to comply with GASB Statement No. 45.

Management's Response:

The finance director has contacted Geoffrey L. Kischuk of Total Compensation Systems, Inc., specialists in public employer actuarial services including GASB Statement No. 43 and 45 compliance. Pending approval of the City manager and the City Council, this firm will be engaged to perform a comprehensive valuation of the City's OPEB liability with an expected completion date of September 30, 2011, which will allow the liability to be properly recorded in the fiscal year 2010-11 financial statements and all fiscal years going forward.

2010-14: Compensated Absences

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

While performing our audit of compensated absences, we noted that the City charged all of the compensated absence expense to Enterprise Funds (the Water, Sewer, and Refuse funds).

Cause of Condition:

As noted in the payroll finding 2010-12, the City was misallocating salary expenses. This existed for compensated absences as well; however, all compensated absences were charged to the Enterprise Funds.

Effect of Condition:

The effect of this condition is that the City's Enterprise Funds have too much compensated absence expense allocated to them, which will pass along these expenditures to the citizens paying into the Water, Sewer, or Refuse funds.

Recommendation:

We recommend that the City revise its compensated absences allocation in order to expense compensated absences to funds at their appropriate percentages. Management should only allocate compensated absences to funds for which the employee is actually involved. It would be recommended the City perform a time study of employee time charges at least twice a year, to ensure allocations stay current and are reported in the correct fund.

Management's Response:

It should be noted that this is a condition that existed under prior management and has already been corrected under the current administration. Salary allocation percentages have been made according to time spent in governmental activities dedicated to each fund; compensated absences are in accordance to salary expense. Time studies will be conducted annually to ensure accuracy in allocation. Under the new management team, the percentages are clearly denoted for each position in the salary section of the City budget, a public document.

2010-15: Cash Disbursement Testing

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

While performing our walkthrough and test of controls for the City's cash disbursement process, we noted several control deficiencies:

1. During our test of controls, we noted 4 out of 60 expenditures selected for testing were missing cover sheets which show the vendor, invoice number, check number, and what expense account the expenditure will be recorded in.

2. During our test of controls, we noted 34 out of 60 expenditures selected for testing were missing approval signature authorizing the transaction for payment.

3. During our test of controls, we noted 4 out of 60 expenditures selected for testing were missing supporting documentation and/or cover sheets. We could not determine if the expenditure was a valid City expenditure or if it was a result of fraud or abuse by the City.

4. During our test of controls, we noted 7 out of 60 expenditures selected for testing were charged to incorrect expense accounts that did not correspond to the correct line item.

Cause of Condition:

The respective causes of the four control deficiencies noted above are as follows:

1. Prior City management did not enforce control procedures, and at times by-passed controls to expedite cash disbursement process, including instances where prior City management requested the accounts payable clerk to print checks without supporting documentation.

2. Incorrect coding was used by department heads when coding/approving invoices, due to improper training or human error.

Effect of Condition:

The effects of the stated control deficiencies are as follows:

1. By-passing of cover sheet control can cause incorrect coding of the invoice to the correct fund/expense account.

2. Invoices not having proper approval can lead to errors on recording the expense to the correct fund/expense account. This can also lead to unauthorized expenditures being paid out of the City's expense account with limited or no review.

3. Issuing payments without proper supporting documentation can lead to misuse of the City funds or possible fraud by City management.

4. Expenditures miscoded can present classification issues on the financial statements and can also misappropriate fund balances if it is coded to the incorrect fund.

Recommendation:

Our recommendations address the four separate conditions listed above:

1. We recommend that all expenditures be reviewed for completeness by the City Department initiating the expenditure and final approval by the finance director. Once the finance director approves the invoice for payment, he/she should ensure that the proper cover sheet has been filled out prior to submitting the invoice to the accounts payable clerk.

2. We recommend that all invoices be approved by the department that initiated the expense and secondly approved by the finance director for completeness. Once the finance director has reviewed the invoice for proper coding and approval, it should then be forwarded to the accounts payable clerk for processing.

3. It should be City policy that no payments will be issued without proper invoice/supporting documentation on file and until it has been approved by the City Department which initiated the transaction and the finance director.

4. We recommend the finance director review all department account coding to ensure expenditures are charged to the correct fund/expense accounts.

Management's Response:

The Finance Department has ordered and distributed coding stamps to each department head that requires them to note the date the invoice was received for coding, the general ledger line to be debited which must correspond to an existing budget line item, and a line for their initials authorizing the payment. Information technology (IT) staff has enabled computer access to the general ledger system for all departments so they can access the financial ledgers to ensure proper coding and budget allocation. Once they have completed their portion, the invoices are sent to the finance clerk for a cover sheet and forwarded to the finance director for review and approval. No checks may be printed without all proper authorizations in place; the purchasing and procurement policy has been updated to reflect this internal control policy. The practice of hand-typing checks has been abolished – all checks must be generated via an accounts payable run in order to ensure the validity of the cash disbursement process and immediate posting to the general ledger. Finance staff has decreased the time between check runs to one week, thus eliminating any need to expedite a disbursement. Current top management is totally supportive of this policy, all department heads are in compliance with the policy, and the finance director reviews every disbursement request.

Current top management has informed all employees that proper procedures will be followed every time, including obtaining proper documentation, enforcing contract and engagement letter limits, unless otherwise approved for increase via formal change order and council approval, coding according to budget lines, and prompt processing of all invoices. Accountability standards have been implemented and are strictly adhered to on all levels.

Further, to ensure compliance with the policy and the strength of the oversight function, the new City manager has added a proviso to each department head contract that eliminates the possibility of long-term absences; no department head may be absent in excess of three (3) months for any reason or their contract is subject to termination. All department heads have been instructed to assign oversight authority to another department head, or one of their mid-managers, in the event of taking any type of leave in excess of 48 hours. At no time will the oversight function be allowed to lapse as in the previous year with the prolonged absence of the finance director.

2010-16: Credit Card Findings

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

While performing our walkthrough and fraud testing for the City's credit card expenditure process, we noted several deficiencies:

1. Per review of the majority of the employee issued credit card statements for the entire fiscal year, we were unable to account for $50,132 in expenditures. Several costs appeared questionable; however, we were unable to review any supporting documentation. We believe possible abuse or fraud has been committed with the use of the City's credit cards due to the lack of controls by prior City management. It must be noted that we did not review credit card expenditures for credit cards that are issued in the City's name.

2. We noted one instance where the prior City manager paid for 2 rooms for the same night in Avila Beach for $730 dollars per night. The supporting documentation was missing and we could not determine the reasoning for the travel expense. The hotel charge per night appears to be excessive and unreasonable.

3. We noted several credit card expenditures where the credit card purchase form did not have the approval signature of the department head or several instances where the form was missing.

4. During our testing, we noted several instances where City payments on credit card balances were below the minimum payment required on a credit card bill. This resulted in numerous credit card fees, including fees resulting from over limits. This was caused by City cash flow issues resulting from mismanagement of City operations.

5. We noted the City lacks a formal credit card policy.

Cause of Condition:

Prior City management did not enforce their control procedures relating to necessary support and approval for all credit card transactions, as well as bid requirements for large expenditures. Employees could use credit cards without any accountability or oversight.

Effect of Condition:

Due to the number of missing support for transactions, we were unable to determine if credit card transactions were valid City expenditures or if possible fraud and/or abuse of credit cards occurred.

Recommendation:

Our recommendations to address conditions listed above:

1. We recommend the City draft and implement a formal credit card policy.

2. We also recommend the City cut down the number of credit cards it currently has to limit the number of credit card transactions.

3. We recommend management further investigate missing supporting documentation to determine if misuse of City funds can be recovered.

Management's Response**:**

1. The new City manager has implemented a credit card policy as part of its overall Internal Controls policy and is committed to strict enforcement of same.

2. The new City manager did cancel all City credit cards with the exception of the cards for the Chief of Police, City Services Director, Community Development Director, and City card which must be checked in and out via a register in the Finance Department.

3. The credit card policy clearly states that failure to obtain an original receipt at the time of purchase shall deem the purchase ineligible and the employee will be required to reimburse the City for the purchase. All receipts must be attached to an authorization card that is to be coded to the project or program, include the date of the transaction, the name of the vendor, be signed by the employee, and include the authorizing signature of the department head.

4. All accounts are now paid in full each month. There were no purchases made via credit card City-wide during the month of March 2011 and very little in the month of April 2011. The City is committed to better planning and a pay-as-we-go policy that has virtually eliminated the use of credit cards.

5. Per City Council authorization, a forensic accountant was engaged to review all credit card purchases made by the former City manager. He concluded that there was no discernible fraud; however, it was discovered that he had inadvertently used the wrong card during a personal stay at Avila Beach. The City card was on file at the hotel as he had stayed there while researching some "green" building options for the City. Since this was brought to light, the former City manager has contacted the hotel to have them charge his personal card, refund the charge to the City credit card, and write a letter to the City regarding the mix-up – this has all been received and documented.

2010-17: Journal Entry Testing

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

While performing our test of controls for the City's journal entry process, we noted multiple control deficiencies:

1. During our journal entry testing, for 1 of our 21 entries selected for testing, we noted the City was unable to provide support for the entry.

2. During our journal entry testing, for 1 of our 21 entries selected for testing, we noted the amount on the journal entry cover sheet differed $52,672.54 less than the total journal entry amount per the journal entry report.

3. During our journal entry testing, for 14 of our 21 entries selected for testing, we noted there was no approval signature on the journal entry cover sheet or other supporting documentation. Furthermore, for all journal entries tested, we noted there was no second approval signature; therefore, a second person is not reviewing and approving journal entries.

4. During our journal entry testing, for 8 of our 21 entries selected for testing, the journal entry included multiple code corrections.

5. During our journal entry testing, we noted several prior year accruals which were not reversed in the current year or, when reversed, were done so incorrectly.

6. During our journal entry testing, we noted several journal entries which were long and complex with limited support.

<u>Cause of Condition:</u>

The respective causes of the control deficiencies noted above are as follows:

1. The City did not maintain appropriate support or approval for journal entries under prior City management.

2. The City manually corrected some automated journal entries in order to properly allocate to different funds.

3. The City does not reconcile its trial balance on a regular basis. Doing so would catch accrual errors such as these.

4. The City creates journal entries which address multiple areas and become extremely long and complex.

<u>Effect of Condition:</u>

The effects of the stated control deficiencies are as follows:

1. By-passing controls relating to support and approval for journal entries could allow for inappropriate journal entries to be created or improper accounts to be charged.

2. By-passing controls relating to approval for journal entries could allow for inappropriate journal entries to be entered which could have been prevented if proper procedures were followed.

3. By creating code corrections, the City could improperly charge funds or accounts.

4. Misstatements can go unnoticed and can be extremely difficult to reconcile at year end.

5. By creating long and complex journal entries, the City is more likely to make a mistake in recording an entry.

<u>Recommendation:</u>

Our recommendations address the separate conditions listed above:

1. We recommend that the City maintain a journal entry cover sheet which describes all accounts affected by the journal entry and has an approval signature for each journal entry and a detail description of what is being done.

2. We recommend that the City address its code correction issues at their source, instead of on a journal entry. This would help prevent inappropriate funds or accounts being charged and additional subsequent code corrections for the same transactions.

3. We recommend that the City reconcile its trial balance monthly or at least quarterly in order to avoid misstatements.

4. We recommend that the City address only one transaction type per journal entry in order to alleviate the chances of a misstatement or an incorrect fund or account being used. Additionally, this should help streamline the reconciliation process.

Management's Response:

1. The former finance director was on medical leave for an extended period with no one in the Finance Department given any oversight authority in his absence; thus, many items were not properly reviewed, including journal entries. This condition has been rectified. All journal entry sheets are not only being reviewed by the new finance director, but actually keyed as well. Any journal entries that are originated by the finance director shall be reviewed and authorized by the assistant City manager to ensure they are detailed in description, have appropriate backup attached, and are authorized by a higher authority.

2. The journal entry cover sheet shall describe all accounts affected and have approval from a higher authority than the originating employee.

3. Prior management had instructed the journal entry clerk to use the term "code corrections" when writing a journal entry to reallocate payroll or grant payments when the proper term should have been descriptive of the action being taken, i.e. payroll reallocation, loan payment reallocation for interest, extra payments, general ledger, budget allocation adjustment, etc. By using the term "code correction," it presented an incorrect picture that many items were not originally entered or adjusted correctly when that was not the case. All journal entries are now entered with as much descriptive information as the system will allow.

4. The trial balance shall be reconciled quarterly to avoid misstatements.

5. Only one transaction type per journal entry shall be included with each journal entry in order to alleviate the chances of a misstatement or an incorrect fund or account being used.

2010-18: Travel Testing

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

While performing our walkthrough and fraud testing for the City's travel expenditure process, we noted several deficiencies:

1. During our testing, for 12 out of 25 travel expenditures selected for testing, the City was unable to provide any supporting documentation; thus, we were unable to determine if the transaction was appropriate or instances of abuse and/or potential fraud of City funds.

2. During our testing, for 1 of the 25 travel expenditures selected for testing, the City was unable to provide an original invoice which hindered our ability to determine if the expenditure was an appropriate City-related travel expense.

3. During our testing, for 1 of the 25 travel expenditures selected for testing, we noted that the expenditure was not travel related. Per discussion with the accounts payable clerk, this expenditure should have been recorded under special events, as it was reimbursement for food purchased for an event at McDermont Field House.

Cause of Condition:

The causes of the control deficiencies noted above are as follows:

Prior City management did not enforce their control procedures relating to approval and supporting documentation for travel expenditures. Oftentimes, these controls were by-passed as the finance director did not enforce their policy requiring employees to submit all receipts for travel expenditures.

Effect of Condition:

The effects of the stated deficiencies are as follows:

1. By-passing controls relating to support for travel expenditures could allow for improper expenditures to be reimbursed by the City. We were unable to determine if these expenditures were allowable under City guidelines or if possible fraud/abuse occurred by City personnel.

2. By-passing controls relating to reviewing journal entries can allow for inappropriate funds and accounts to be charged, as evidenced by this transaction.

Recommendation:

Our recommendations address the separate conditions listed above:

1. We recommend that the City implement a formal travel policy which addresses the types of expenditures which are and are not allowed, as well as all required support for reimbursement.

2. We recommend that the City review account coding on all journal entries in order to ensure that proper funds and accounts are charged.

Management's Response:

Management has implemented a formal travel policy as part of its overall Internal Controls policy which includes a list of acceptable and non-reimbursable expenses. This policy requires that all travel be pre-approved by the department head or their designee, with a minimum of one week's notice to Finance Department, in order to receive any per diem or lodging checks, if applicable, as the use of petty cash has been eliminated. Current management has taken action to ensure an adequate number of available fleet vehicles and has established a clear policy for same. The policy clearly states that City vehicles are now available for use, mileage reimbursement for use of personal vehicles will not be reimbursed unless the employee has submitted a written request to use their personal vehicle and has sufficiently supported their reasons for use of personal vehicle in lieu of a fleet vehicle. Forms have been developed with this policy that must be filled out completely by the requesting party; authorized by the department head; and must include supporting documentation, i.e. conference flyer, workshop specifics, etc. regarding the nature of the travel. There is an area on the form for the appropriate coding by the Department Head to ensure the proper funds and accounts are charged and have adequate budget to cover the expense before approval is given. Any reimbursement requests not submitted on the requisite form, with the proper authorization, shall be rejected.

Failure to abide by the policy, or provide receipts when using the City credit cards, shall result in the denial for reimbursement and/or a charge to the employee incurring the expense without obtaining the receipt(s). Current top management will strictly enforce this policy.

2010-19: Wire Transfer Testing

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

While performing our walkthrough and fraud testing for the City's wire transfers, we noted the following deficiencies:

1. During our wire transfer walkthrough and fraud testing, we noted that there is no second party review or approval of wire transfers.

2. City currently does not have a wire transfer policy.

Cause of Condition:

The cause of the above stated deficiencies is as follows:

1. Currently, the finance director prepares all wire transfers. However, the transfers are not reviewed or approved by anyone else.

2. City management was not aware of the need of a wire transfer policy.

Effect of Condition:

The effect of the stated deficiencies is as follows:

1. By not reviewing transfers, money could be transferred to improper bank accounts or in inappropriate amounts. In addition, if reserve amounts are maintained at each bank, wire transfers can reduce reserves without proper approval of City Council or City manager.

2. Without a wire transfer policy proper procedures and controls regarding wire transfer may not be followed.

Recommendation:

Our recommendation addresses the conditions listed above:

1. We recommend that a second party of authority review and approve all wire transfers. We recommend that this is performed by the City manager.

2. We recommend the City implement a wire transfer policy to ensure controls and procedures are always followed and proper audit trail can be followed.

Management's Response:

It should be noted that the only wire transfers in fiscal year 2009-10 were transfers between City bank accounts, the City Local Agency Investment Fund (LAIF) checking account, and bond payments to US Bank (trust account at US Bank), all of which were clearly denoted in the financial management system and via hardcopy documentation of the transactions in the cash transfer binder or bond payments file. In every instance the funds were going from one City account to another City account; there were no outside purchases or wires to accounts that did not include the City or the Lindsay Redevelopment Agency at both ends of the transaction. All transfers are entered as checks to the accounting system to ensure they will appear in the warrant register that is presented to the City Council on a biweekly basis. With the ever increasing use of electronic banking transactions for recurring payments on outstanding loans and bonds and the use of electronic transfer to investment accounts including the Wellness Center CD and LAIF accounts, the City will continue to employ that method of transaction to ensure both timeliness and security of the transactions; however, we will have the assistant City manager, who is an authorized signatory, review and initial all transactions. Fund transfers will be reflected separately from the warrant register so as not to skew the accounts payable balance.

A wire transfer policy shall be implemented that limits wire transfers to transactions solely between the City, or the Lindsay Redevelopment Agency, bank accounts and pre-authorized payments for loans and bonds per a written schedule presented to the City Council no later than July 1st of each new fiscal year.

2010-20: Recording Budget Amendments

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

Management is responsible for establishing and maintaining internal controls, including monitoring, that allow for the fair presentation of the City's required supplementary information, which presents the results of actual operations compared to the City's final adopted budget. Currently, the City adopted a two-year budget. During this two-year period, the City Council will adopt various amendments to the original adopted budget; however, these amendments are not recorded to the City's financial accounting system.

Cause of Condition:

Currently, management has not recorded budget expenditure appropriation adjustments, revised revenue estimates, or other financing sources and uses budget items authorized by the City Council to its financial accounting system.

Effect of Condition:

The absence of the internal accounting and administrative control to ensure the budget amendments are recorded to the financial accounting system is considered a significant deficiency because the potential exists that a more than inconsequential but less than material misstatement of the financial statements could occur and not be prevented or detected by the City's internal control.

Recommendation:

We recommend all budget amendments approved and authorized by the City Council be recorded to the financial accounting system to ensure proper preparation and presentation of the Statement of Revenues, Expenditures, and Changes in Fund Balance – Budget and Actual. This statement is required supplementary information when reporting the City results of operation in conformity with accounting principles generally accepted in the United States of America.

Management's Response:

The current management team is committed to providing the governing body and the citizens of the community the most comprehensive financial reporting possible to ensure all vested parties are kept fully apprised of the City's financial health at all times. Toward this end, the finance director shall present an updated budget document that will include budgeted and actual year to date figures; if it appears the projected budgeted amounts are incorrect, an adjustment will be scheduled for the consent calendar to be approved by the City Council as a budget adjustment that will then be recorded into the general ledger and the budget document. Items requiring an adjustment to the budget, such as new personnel positions or emergency equipment repair and/or purchase, shall be presented to the City Council for approval and the budget and general ledger adjusted accordingly. A ledger shall be kept on all approved budget adjustments that will be considered supplementary information to the approved fiscal year budget.

2010-21: Information Technology (IT) System Internal Controls

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

While performing our walkthrough of controls for the City's IT system policy, we noted the following control deficiencies:

1. The City's servers are not kept in a locked isolated or self contained location. We noted the City main server is kept in an unlocked room located in the Community Development Department. The finance server housing the City's accounting system is kept next to the main entrance of the City Finance Department office and sitting directly on the floor.

2. Currently, the City has no policy for computer passwords. Additionally, per discussion with City employees, many will share usernames and passwords for accessing the Pentamation Enterprise system.

3. The City performs backups on a weekly basis. However, they are not functioning correctly as many employees do not leave their computers on for the backup to run.

Cause of Condition:

The respective causes of the control deficiencies noted above are as follows:

1. Currently, the City's server is unsecured as it is located in the Community Development room. Additionally, the Pentamation Enterprise server, which is used for the financial aspect of the City, is located on the floor next to the main entrance of the Finance Department.

2. No controls have been implemented for the City in regards to passwords. As such, many employees use simple passwords and often use one another's username and password. Every user has different capabilities assigned depending on the user and their responsibilities. Having access to multiple users can cause for override in controls.

3. Proper backups are not occurring on a weekly basis as many employees will turn their computers off when they leave work on the day the backup is to be performed. In order for the backup to be completed successfully, all employees must leave their computers on for the backup to run.

Effect of Condition:

The effects of the stated control deficiencies are as follows:

1. By not securing the City's servers, data loss and security are issues. Servers should be stored in secure locations to negate the risk of data loss, theft, or damage to the server. Servers should be at a minimum of six inches off the ground to prevent any type of water damage.

2. By not implementing a password policy, it is possible for City employees to gain access to other user's accounts and perform functions which they are not authorized to do.

3. By not properly backing up all data, there is an increased chance of data loss. Backups are designed to save all data at a point in time so, if need be, one could revert back to that point. However, since employees are shutting their computers off on the night the backup is performed, their information is not being backed up and, therefore, the backup is not functioning properly.

Recommendation:

Our recommendations address the conditions listed above:

1. The City should acquire IT cabinets, put the servers in these cabinets, and ensure these cabinets are kept locked and access is monitored. These cabinets should be maintained at a minimum of six inches from the ground.

2. We recommend that the City implement a formal password policy which requires passwords to be changed on a regular basis. Additionally, we recommend that employees not share usernames or passwords with one another as they are designed to only let employee's access their profile in the accounting system.

3. We recommend that the City improve its backup policy by reminding all employees on the day the backup is to be performed. This will help ensure that backups are completed and all necessary data is saved.

Management's Response:

1. It is cost prohibitive at this time to install locking cabinets for the servers. The current servers are not accessible to the public and are kept in locked facilities that are adequately served by an alarm system that would alert the Public Safety Department in the event of a breach during non-working hours. Considering the proximity of the Public Safety Department, that could reasonably respond in less than 15 seconds to a triggered alarm, staff feels our servers are sufficiently secure at this time. The City backup server is located in a cabinet more than six inches off the ground in an area to which the public has no immediate access without being in the company of City staff; the finance server sits on a base that is 2 inches off the ground with no water source in immediate proximity and is also in a room off-limits to the general public and is never unattended during working hours. Staff feels the security measures regarding these servers are adequate and there is neither a safety nor compliance issue regarding the City server locations and security.

2. A password policy has been established: all employees with access to the financial management system have been issued a unique password and been clearly instructed not to share them with anyone. All authorized users have had their privileges checked to ensure they have only the access required to do their assigned job and no more. All former employee users have been deleted from the system, thus ensuring no unauthorized use and all "electronic fingerprints" can be easily traced to the user. The passwords shall be changed at the beginning (July 1st) and mid-year (January 1st) of each fiscal year.

3. The finance director shall personally check each computer on the assigned day for backup to ensure the computers are on and the backups capture all recent updates to the system. In her absence, that duty shall be performed by the customer service clerk.

2010-22: Noncompliance for Tulare County Association of Governments (TCAG) Measure R Grant Funding

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

The City was awarded a grant from TCAG to supplement the Downtown Revitalization projects that were being funded with federal funds. While performing an agreed upon procedures engagement on behalf of the City and TCAG, we reviewed the agreements with TCAG and all reimbursement requests and expenditures to determine the validity of the reimbursement requests submitted to and paid by TCAG. Per review of the TCAG Measure R Grant cooperative and supplemental agreements, we were unable to determine the eligibility of every expense. As a result, we categorized the expenses as Eligible, Questionable, and Ineligible. Eligible expenses were those expenses that were adequately supported, related to the projects, and were only requested for reimbursement once; these expenses included contractor payments, construction materials, equipment rentals, contracted construction labor charges, and direct City construction and administrative payroll costs. Questionable expenses were those expenses that we were unable to determine as eligible and include indirect administrative payroll charges, tools, supplies, and equipment. Ineligible expenses are those expenses which were not adequately supported by invoice or receipt, were for unrelated project, ineligible employee's payroll expenses, and requested for reimbursement on other TCAG Measure R Grant or CalTrans reimbursement requests.

<u>Condition:</u>

1. Per testing performed on reimbursement request details, we noted that the City billed TCAG Measure R Grant for expenses that could not be substantiated with an itemized invoice to show the items purchased. As a result, we were unable to determine that the expenses were valid to the downtown, roundabout, and lighted crosswalks projects. A total of possibly $933,573 in ineligible costs were found and should be repaid to TCAG Measure R Grant.

2. Per inquiry of the assistant engineer and review of reimbursement requests, we noted that the expenses were not being coded to the correct general ledger account code. Expenses/invoices were being booked into both Fund 262 and Fund 263. This made it difficult for the City to track the amount of expenses that were being charged to each program and contributed to the City requesting reimbursement for expenses on multiple reimbursement requests.

3. When invoice reimbursement billings were being prepared, the City staff was not tracing the total expense amounts to general ledger reports. Also, the City staff was not having the reimbursement requests reviewed by another staff member to ensure the accuracy of the billing amount. These conditions also contributed to the City including the same expenses on multiple TCAG Measure R Grant and/or CalTrans reimbursement requests.

<u>Cause of Condition:</u>

Previous management did not properly record and track eligible expenditures on the project and it appears to have over-charged the project due to cash flow difficulties.

<u>Effect of Condition:</u>

As a result of the conditions noted above, TCAG has determined that the City is out of compliance with the grant agreements and is now subject to legal actions by TCAG to recover the funds that TCAG feels were misspent by the City.

<u>Recommendation:</u>

1. We recommend that the City set up unique account codes for each project that the City undertakes. The City should implement a grant management policy and adequately train staff in account coding and the eligibility of expenses.

2. We also recommend that the City train staff to run general ledger reporting for each grant they manage and ensure that each reimbursement request ties directly to the general ledger.

3. Furthermore, we recommend that all reimbursement requests are reviewed by management before being finalized and sent to the funding agency. These steps would help the City ensure that each reimbursement request is accurate and does not contain duplicate billings.

4. We recommend the City work with TCAG Measure R Grant and determine what expenditures will be allowed or disallowed and begin to make repayments for the ineligible expenditures.

Management's Response:

The City recognizes the shortcomings detected in the above inquiry regarding the billing procedures used in TCAG Measure R Grant and like projects. The City has implemented a much more participative management role in ensuring that a cooperative and inclusive grant management policy be pursued and adopted. The City, in future project endeavors, will set up unique project account codes specifically detailed toward the project and be able to, upon request and during the project, have a balanced real time ledger to show allocated funds and expenditures associated with each specific project.

Under the direction of the newly appointed City administration, all invoicing conducted on behalf of the City will be submitted for review by the Finance Department to ensure the figures are properly supported by the general ledger detail, include adequate backup, and only forwarded to the funding agency with the approval of the finance director, or assigned designee, who will set up a file inclusive of the grant contract and specific parameters to ensure full compliance with reimbursable expenses eligibility guidelines. City staff have been trained in the process of correct coding; however, the process of correct coding of invoices and the ability to tie direct project costs to the general ledger will be conducted through the remedial training process including training on the project management feature of the accounting software.

Through the implementation of these practices and policies, the City believes it will have an improved internal control mechanism in place to mitigate any future or like occurrences.

The City of Lindsay did pay $4,800 for a separate limited special review, or Agreed Upon Procedure (AUP) of just the Downtown Project that thoroughly reviewed and documented all submitted 10 TCAG invoices, cross-referencing them to all the CalTrans (the other project funding source) reimbursement requests, the result of which $568,276 was determined to be *ineligible* and $365,297 was determined to be *questionable* based on differing interpretations of the TCAG guidelines and lack of supporting documentation. The TCAG Board refused to accept this AUP and insisted on a more in-depth forensic accounting review. At their behest, the City did send out an RFP, endorsed by TCAG, and the firm of Mann, Urrutia, Nelson, CPAs and Associates, LLP was mutually agreed upon by both parties to conduct a forensic accounting of the Downtown Project. That audit is currently underway.

2010-23: Contract Change Orders (CCO) Measure R Grant

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

As noted at Finding 2010-22, we were engaged to review the Measure R grant between TCAG and the City. In addition to the reimbursement requests for the grant, we were also engaged to review the CCOs related to the Measure R grant projects.

Condition:

Per inquiry of City services staff, we noted that the assistant engineer and City services director had the authority to initiate and approve a CCO for any amount as long as the City was the party initiating the CCO. According to the City's purchasing and contracting ordinance, any purchase over $75,000 must go out to formal bid and be approved by the City Council. We also noted that an agreement for the CCO stating the scope of the extra work and price was never obtained prior to the commencement and completion of work. For the City's Downtown project with Halopoff and Sons, Inc., the amount of the original contract was $808,936.94 and grew to $2,053,689.70 through CCOs. The amount for the City's roundabout project for the same contractor grew from $331,688.92 to $407,048.56 through additional CCOs.

Cause of Condition:

Previous management did not properly require that all CCO over $75,000 be approved by the City Council or that the new CCO stated the scope or price of the extra work prior to the commencement and completion of the work.

Recommendation:

We recommend that the City obtain a CCO agreement prior to the commencement of work. This would help protect the City against possible overbilling by the contractor. We also recommend that the City update its purchasing and contracting policy to include the procedures that should be taken for every CCO that is performed on any City contract. The updated policy should include obtaining City Council approval of all significant CCOs.

Management's Response:

The City currently utilizes the specifications of public work construction as our guideline in responding to CCOs. The City will explore and adopt a CCO agreement to provide to contractors prior to the commencement of any work.

The City will update its Purchasing and Contracting Policy to include specific procedures in regards to the approval process of all CCOs and distinguish an approval authority rather than the amount is within the scope and authority of the City manager, or needs City Council approval prior to the commencement of the CCO.

2010-24: Wasteful Spending

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

While performing our audit of long-term debt, we noted the following deficiency:

Per review of current year capital asset additions, we noted that the City acquired the "Hippo World's Largest Inflatable Slide." This slide was purchased for McDermont Field House, and was purchased with very little money down.

Cause of Condition:

The cause of the deficiency noted above is as follows:

We noted that this slide cost $87,400 to purchase. However, due to the City's financial condition, they were only able to make a down payment of $12,400. The remaining $75,000 was financed over five years at an interest rate of approximately 10.5% which will result in a total purchase price of approximately $109,240.

Effect of Condition:

The effect of the above stated deficiency is as follows:

By purchasing excessively priced items such as the Hippo slide, the City has created a financial situation which has caused doubts about the City's ability to continue as a going concern to rise.

Recommendation:

Our recommendation addresses the conditions listed above:

We recommend that the City not enter into wasteful and excessive contracts, especially given its current financial condition. Currently, there are doubts about the City's ability to continue as a going concern. As a result, excessive amounts of money should not be spent on entertainment purposes.

Management's Response:

Prior management did not provide enough information regarding the City's financial condition to the governing body for them to accurately assess the prudence of authorizing a large purchase or entering into new debt agreements. The City Council is now aware that they placed too much trust in the integrity and veracity of prior management that led them to approve some debt contracts that they never would have, had they been given the true financial picture of the City or the amortization schedules that would give the true cost inclusive of all interest and processing fees. In the instance cited, the City Council was only given the overly optimistic revenue-generating side of the equation and was never informed of the dire financial straits of the City. Current management is committed to improving the financial condition and information reporting to the City Council in order to provide a true and accurate picture of the City's financial condition at all times. These reports shall include, but are not limited to, a monthly treasurer's report, a quarterly financial report of all funds based upon the approved budget, and a quarterly update on the debt schedule. Any new debt proposal must include a full disclosure, including loan processing fees and interest amortization schedule. Current City staff will not be making any purchase requests for large value items, unless there is grant funding in place to pay for it and the item has been planned and declared within the current budget.

The City has adopted a new attitude of conservation, living within our means on a cash-only basis (no new debt incurred) and strict fiscal responsibility, transparency, and accountability as we move forward to overcome actions of prior management that has created a going concern situation. We expect that designation to be removed by fiscal year 2011-12.

2010-25: Potential Conflict of Interest

Criteria:

California Fair Political Practices Commission, Statements of Economic Interests or Form 700s are important documents used to determine where potential conflicts of interest may exist. They "include information about the sources of an official's income, investments, business positions, real property holdings and gifts. Merely reporting an economic interest is not a conflict in itself; a conflict arises when an official governmental decision, made by the official, impacts their economic interests."

We reviewed the City's Conflict of Interest Policy and noted that, "the use of public office or employment for private gain is prohibited. All officers and employees of the city are admonished to avoid any situations where private interests might be enhanced through official actions and the violation of any such common law principle shall be deemed to be a misdemeanor and shall be punishable as such. Appearances by or statements made to influence exercised by city officials or employees to, before or to any city officer, department, or employee, or any city agency, authority or corporation on behalf of private interests are prohibited."

Condition:

While performing inquiries, we discovered the following conditions:

It was brought to our attention concerns about for profit businesses operated by the former finance director and City manager. Upon further review, we noted that these individuals operated at least three consulting firms which included Rural Community Development Services, CSM Development, and Light Stone Development. The companies listed above, owned and operated by prior City manager and finance director, provided grant writing and management services to regional cities. It was brought to our attention that prior management would prepare a grant application for the City of Lindsay and use it as a template for all the other clients they consulted with by changing the pertinent details, and prepare applications for other cities in surrounding areas.

Upon inquiry with City staff, a search of all City computers used by previous management was performed and evidence was found that these businesses did exist. Additionally, materials from these businesses can still be found within City Hall premises, which showed that work had been performed on behalf of other surrounding cities using City of Lindsay facilities and resources. Based on the information we were able to obtain, these businesses appear to have operated for at least ten years, with operations continuing into 2007 and possibly beyond. Also, it appears that these businesses were operated during normal working hours.

It appears the prior City manager and finance director profited from using the City of Lindsay Facility to run their consulting firms in conjunction with City operations. Based on the information we obtained, it appears these individuals benefitted from operating the business within the City's facilities, and were able to make it very profitable.

Additionally, none of these businesses were reported on either the former finance director or former City manager's Form 700s. Based on the evidence found on City computers, it appears that these businesses continued to operate and seek out new business during the employment of the former City manager and finance director.

Cause of Condition:

The City lacks adequate controls and knowledge of conflict of interest laws and regulations to ensure all requirements are being met. Additionally, the former finance director and City manager became proficient in obtaining grants, and began using this skill for their personal gain using City of Lindsay resources.

Effect of Condition:

The effect of these conditions is that the former City manager and finance director created a situation which gives the appearance of potential conflict of interest. By engaging in personal businesses, the prior City manager and finance director were able to benefit from City resources.

Recommendations:

We recommend that City officials not engage in personal businesses which may create the appearance of a conflict of interest. Additionally, we recommend that all City employees be required to fill out Form 700s to report all personally owned businesses or investments to ensure sufficient disclosure to the public and the City Council members.

Management's Response:

The new City manager has included a proviso in the department head contracts that require them to seek written permission for all outside employment activities and will deny any requests that may create even the appearance of a conflict of interest. There is also a clause in the employee handbook that specifically addresses prohibition of outside employment and or lobbying type activities: "Sec 22.2 Outside Activities. A full-time employee may not carry on concurrently with his/her public service, any private business or undertaking, attention to which affects the time or quality of his/her work or which casts discredit upon or creates embarrassment for the city government."

Regarding the recommendation that all City employees fill out a Form 700, all department heads, the City attorney, all City Council members, and the City clerk have always filled out Form 700 on an annual basis and the City clerk maintains a file of these forms to ensure compliance. In future, the scope will be expanded to include mid-management personnel as well. However, it is not feasible, nor warranted, to require the form of the time-clock employees below the administrative level. Unfortunately, the information on the Form 700 is only as reliable as the person filling out and signing the form. The City attorney did conduct an Ethics Training in July 2011 for all council and administrative personnel and has conducted such training in the past as required to meet the compliance guidelines regarding this issue and will continue to conduct them in the future. We believe this to be a very isolated issue and do not expect to see this type of finding ever again.

Current management can neither confirm nor deny that the allegations specified under this finding regarding Potential Conflict of Interest and it had been removed from the DRAFT audit as an initial determination was made that this was more of a matter for the investigative agencies to whom these allegations have been referred as opposed to an audit finding. However, it is being included herein as current management, in consensus with the independent audit team, feel it is better to address *all* issues denoted by the audit team during this process and provide written responses regarding corrective action that has been implemented to prevent future recurrence of any questionable activity. It must be noted that City employees are not prohibited, nor under the American system of government, should be prohibited, from investing and/or participating in business activity outside the scope of their employment as long as such activity does not interfere or conflict with their public service and is not conducted during hours for which they are being compensated as public employees.

2010-26: Reconciling Accounts to Supporting Documentation – Accounting Controls

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

The City and the Lindsay Redevelopment Agency (the Agency) do not reconcile their general ledger accounts to supporting documents. In order to make the interim and annual financial statements meaningful, we recommend the City and Agency reconcile the general ledger accounts for cash with fiscal agent; property held for resale; and bond issuance proceeds, premiums, and issuance costs to supporting documentation on a monthly or routine basis. During our audit, we identified numerous adjustments to general ledger assets and liabilities that impacted the operating results of the City and the Agency.

Cause of Condition:

Management has not reviewed its policies and procedures to ensure that the general ledger accounts are supported on a monthly basis. Management is responsible for establishing and maintaining internal controls, including reconciling general ledger accounts to supporting documents.

Effect of Condition:

The absence of performing monthly and/or routine reconciliations provides an opportunity for errors to accumulate and these errors may go undetected. The benefit of monthly reconciliations is that errors do not accumulate, but can be identified and attributed to a particular period (month), which makes it easier to perform future reconciliations. Because the procedures recommended below were not in place during the year ended June 30, 2010, these are considered material weaknesses because a material misstatement of the financial statements would have occurred and not been prevented or detected by the Agency's existing internal controls.

Recommendation:

We recommend management establish monthly and/or routine reconciliation policies and procedures, including the performance of the following functions:

1. Cash and investments held with the City and Agency's fiscal agent should be reconciled from the bond trustee's statement balance to the general ledger balance on a monthly basis to determine that all cash transactions, including investment earnings, have been recorded properly, and to discover trustee errors. The proper recordation of fiscal transactions will provide for the fair presentation of the financial statements.

2. Upon the issuance of long-term debt, such as bonds, the recording of bond proceeds, premiums/discounts, and bond issuance costs should be recorded to the appropriate general ledger accounts based on supporting information found in the official bond statement. Typically, the official bond statement will report the sources and uses of the bond issuance. The proper recordation of the bond issuance to the general ledger will provide for the fair presentation of the financial statements, which is the responsibility of management.

3. Upon the purchase and/or sale of the City or Agency real property, the inventory adjustment to property held for redevelopment and the corresponding gain/loss on the sale of real property should be recorded to the general ledger accounts and reconciled to supporting documentation provided by the title company. The recording of real property transactions should be performed shortly after the transactions have closed escrow. These reconciliations and adjustments to the general ledger accounts will ensure meaningful and accurate interim and annual financial statements.

Management's Response:

Management will perform monthly reconciliation of cash and investments held with the City's and Agency's fiscal agent. The reconciliation to the bond trustee statement balance will be made to the general ledger. Management will also properly record all bond proceeds and sales of property.

2010-27: Fraudulent/Excessive Loans to City Employees and/or City Employee Relatives and (CalHFA and the Agency Low/Moderate Noncompliance).

Criteria:

On March 30, 2004, the City of Lindsay Redevelopment Agency (the Agency), a component unit of the City of Lindsay, entered into an agreement (CalHFA Loan No. HELP-080803-06) with the State of California and the California Housing Finance Agency (CalHFA) to borrow $1.25 million dollars. The Agency was to use these funds exclusively for the first time homebuyer primary loan program. Per the loan agreement, the Agency would be in default if any misrepresentation of material facts as stated in the application or other project information submittals. If the loan is determined to be in default, the unpaid balance of the principal together with all accrued interest thereon and charges owing, shall, at the option of the CalHFA became immediately due and payable. According to the Agency's loan application, the Agency was to service 35 units at 80% of Annual Median Income (AMI) and service individuals that meet certain debt ratio requirements.

Furthermore, in accordance with Health and Safety Code §33334.3, any repayments or other income to the agency for loans, advances, or grants, of any kind from the Low and Moderate Income Housing Fund, shall accrue to and be deposited in, the fund and may only be used in the manner prescribed for the Low and Moderate Income Housing Fund. Health and Safety Code §33763.5 requires that all loans made by a redevelopment agency shall be made according to a loan program that contains standards, qualifications, and criteria for the making and approval of loans and that has been adopted by the redevelopment agency at a public meeting. Health and Safety Code §50093 defines persons and families of low or moderate income as those persons and families whose income does not exceed 120% of AMI.

Condition:

During our analysis of the Agency's compliance with loan agreements and outstanding notes receivable, we noted various deficiencies, noncompliance, and instances of override by prior management. We have indicated below the various instances of noncompliance with the CalFHA Loan and redevelopment laws.

1. The City/Agency failed to service the 35 units proposed to receive of $1,250,000 funding. Only 11 units were serviced using the $1,250,000, and 10 out of the 11 units were to City employees and/or their relatives.

2. During our testing we noted, 7 out of the 10 loans to City employees and/or relatives exceeded the debt ratio requirement of 42%.

3. During our testing we noted, 2 out of the 10 loans to City employees and/or relative exceeded the AMI% of 80%.

4. Prior management failed to report all recipients of CalHFA funding, as presented in the CalHFA status report. Those who did not meet the AMI% were deliberately excluded from the status report, which resulted in the Agency reporting $999,902 of the $1,250,000 funded and already expended.

5. In determining eligibility, the Agency deliberately failed to include the several recipients' total income. As a result, the loans were provided to applicants that only appeared to have met the income and debt requirements. However, many individuals exceeded the CalHFA income and debt requirements, deeming them ineligible to receive funding.

6. Several recipients were not first time homebuyers as defined by CalHFA Guidelines, wherein buyers will be first time homebuyers if they have not owned a home for the previous three years.

7. No Agency approval of loans. We noted that the loan committee consisted of the City manager and City finance director, who had the authorization to approve these loans without Board of Directors' approval. We have concluded that these individuals used their authority to override compliance on loans funded by CalHFA, as the various eligibility requirements were deliberately ignored.

8. Community development specialists do not review the various grant guidelines and eligibility requirements.

9. We noted in one recipient case file direct management override by the prior finance director, directing the community development specialist to exclude recipient's existing home from debt/income calculation overriding compliance requirements.

10. As of June 30, 2010, the Agency has an outstanding obligation for CalHFA loans in the amount of approximately $1.25 million. Of the $1.25 million, approximately $1.1 million are deemed to be out of compliance and are fraudulent loans to City employees and/or their relatives.

Fraudulent Excessive Loans-Redevelopment Agency (Low/Moderate) Noncompliance

11. Per review of accounting records, we noted that the outstanding notes receivables, and related revenues, were not accounted for as part of the Low and Moderate Income Housing Fund.

12. Per the Agency's most current Five Year Implementation Plan, which is out of compliance as it has lapsed, the issuing of home loans is not an approved activity for the Low and Moderate Income Housing Fund.

13. We noted the lack of the required loan program as required by Health and Safety Code §33763.5. Furthermore, City residents were not aware of the available funding for the Low and Moderate Income Housing Fund loans.

14. The prior City manager and prior finance director identified and selected Agency and/or City of Lindsay employees and/or relatives for these large, excessive, zero percent interest, 30 year deferred loans. We believe this is an abuse of authority and wasteful spending of public funds.

15. We noted one recipient's AMI% was 126%, when maximum AMI% for moderate income is 120%, deeming this individual ineligible and the City out of compliance.

16. Large redevelopment agency loans to Agency/City employees were combined with CalHFA home loans, giving 5 employees loans ranging between $200,000 through $330,000 with over 50% of these individual loans having zero percent interest and deferred for 30 years. As of June 30, 2010, the Low and Moderate Income Housing Fund has a notes receivable balance of $1,830,751, which serviced 16 different loans, 5 of these loans make up a balance of $1,336,732.

Cause of Condition:

The Agency lacks adequate controls for proper issuance of home loans. The approval and awarding of these loans lied with two individuals and no further oversight. Also, prior management overrode the eligibility requirements of the loan program as required by the California Housing Finance Agency and issued loans to participants that were not eligible for these programs.

The Agency lacks adequate controls and staff lack adequate knowledge of redevelopment laws to ensure that the Agency remains in compliance with all redevelopment laws.

Effect of Condition:

As a result of the noncompliance with the debt agreement, CalHFA Loan No. HELP-080803-06, the Agency is subject to having the total loan balance and accrued interest being called by the CalHFA. At this point, the Agency lacks sufficient funds to pay the outstanding balance should the balance be called. This in large part has caused the City/Agency to be deemed a going concern.

Recommendation:

We recommend that the Agency establish a loan committee that includes those who are informed and educated about CalHFA requirements, redevelopment laws, and are not biased in opinion. It may also include a member of the Board of Directors, which will also aid in ensuring that those charged with governance are appropriately informed and understand the Agency's loan activities. In addition, community development specialists, those who work directly with the funding of loans, should review the grant guidelines and stipulations of eligibility when calculating and reviewing eligibility of recipients. We further recommend the Agency exclude City employees from applying for these housing loans, in order to keep the interest of City residents as first priority.

Management's Response:

A loan committee has been established that includes the Director of Community and Economic Development, the Housing Specialist, the Director of Finance, the City manager, and the City planner. Each member of the loan committee has been given a written copy of the housing guidelines as well as a written copy of the loan committee guidelines that define how the loan committee shall engage in the process of loan application review. The loan committee is currently in the process of updating the City guidelines to ensure fairness, uniformity of application and decision-making, and to eliminate any vague and non-specific language that could possibly create any ambiguity or arbitrary application. The current finance director has listed all open CDBG and FTHB grants in the City budget, a public document, to ensure both the City Council and the citizens can identify the funding opportunities and track the grant disbursements. Formal minutes of every loan committee meeting are now kept by a non-member and all action taken – review, acceptance, modification, or denial – of loan applications by the Loan Committee shall be reported as an informational item on the first council meeting agenda immediately following the loan committee meeting in which the action was taken. Every loan that is funded will appear with the name of the escrow company, the amount of the loan and the loan description on the check register that is presented as a consent item on the bi-monthly City Council agenda, also a public document.

Upon notification by the audit team of the above-mentioned irregularities, current management did bring this to the attention of the City Council members who had never been consulted regarding this override practice nor kept apprised of the excessive amounts that were granted. With their consent, and at their direction, current management has informed those external agencies that may be affected by this noncompliance issue, i.e. CalHFA, California State Controller Office, US Bank, including a request to County and State oversight and law enforcement agencies to conduct a criminal investigation into the actions of prior management.

2010-28: Noncompliance with CalHFA Loan No. RDLP- 090806-03 and 2009 Tax Allocation Bond Lack of Allocation of Bond Proceeds to the Low and Moderate Income Housing Fund and Misuse of Bond Proceeds

Criteria:

In August 2007, the City entered into an agreement with the State of California and the CalHFA, wherein the Agency would borrow $3,690,000 to assist with site acquisition to develop 123 housing units of a 128 unit homeownership project within three infill developments in three separate locations within the City. In accordance with the agreement dated August 7, 2007, the Agency would default on the loan and the outstanding balance, including interest, would become immediately due if the Agency failed to perform or observe any provision of the agreement. Furthermore, if a project was sold or transferred, the outstanding balance and accrued interest would become due on the fourth anniversary of the loan agreement date.

Also noted in the agreement was the "Timely Progress" provision of the agreement which states that failure of the borrower to timely commence or proceed with the implementation of the projects shall entitle the CalHFA to demand payment in full of previously disbursed funds that have been applied to the project.

In accordance with Health and Safety Code §33334, if Low and Moderate Income Housing Fund money or revenue was pledged as all or part of the collateral for a debt issuance then an appropriate amount of debt proceeds, in addition to the 20% of gross tax increment allocation, must be deposited into the Low and Moderate Income Housing Fund.

As noted in the 2009 Bond Issuance, the intended use of the bond proceeds were to construct street improvements, traffic roundabout, provide first time homebuyer program grants, or for other permitted redevelopment purposes.

Condition:

During our analysis of compliance with the Agency's debt agreements, we noted that of the three projects that were to be completed with the borrowed funds, the Agency has only begun working on the completion of one infill project and currently does not have adequate resources to begin the other two projects. According to the agreement's project timeline, all three projects were to begin in 2007 and be completed in 2009.

Furthermore, as noted in Finding 2010-30, the City sold these properties to the Agency in the exact amount of the loan without proper appraisals being completed. Furthermore, the Agency currently does not own the land on which one of the projects was to be completed. The land was never transferred over to the Agency and, according to the County of Tulare assessor map, the City still holds title to the land.

The Agency issued $1 million in Tax Allocation Bonds during the current year. During analysis of the bond issuance documents, we noted that the Agency pledged Low and Moderate Income Housing Fund revenue for repayment. When reviewing the accounting records of the Agency regarding the debt proceeds for this issuance, we noted that the Agency did not allocate 20% of the bond proceeds to the Low and Moderate Income Housing Fund.

Additionally, the City could not provide verification that the funds were used for the above mentioned projects or other redevelopment purposes. At the time the City received the proceeds, the City was having cash flow difficulties and it appears that the Agency transferred the proceeds to the City to pay outstanding accounts payable balances for the City.

Cause of Condition:

The City lacks adequate controls to ensure that the Agency stays in compliance with debt agreements. Also, the City's staff lacks adequate knowledge of redevelopment laws to ensure that the Agency remains in compliance with all redevelopment laws.

Effect of Condition:

As a result of the noncompliance with the debt agreement, the Agency is subject to having the total loan balance and accrued interest being called by the CalHFA. At this point, the Agency lacks sufficient funds to pay the outstanding balance should the balance be called. This in large part has raised substantial doubt about the Agency's ability to continue as a going concern. See the associated note disclosure in the financial statements.

As a result of the lack of adequate knowledge and controls, the City did not allocate the correct amount of debt proceeds to the Low and Moderate Income Housing Fund, making it out of compliance with redevelopment law and the bond agreement.

Recommendation:

We recommend that the City and the Agency work with counsel and contact the CalHFA to communicate the noncompliance with the debt agreement and attempt to delay the calling of the loan. We also recommend that the City staff obtain proper education and/or training to gain the appropriate knowledge so that they will be able to correctly carry out all redevelopment law requirements. We also recommend that the City take appropriate steps to implement policies to ensure that all debt issuances are correctly recorded in the Agency's general ledger and the funds that were used for City of Lindsay expenditures be calculated and returned back to the Agency.

Management's Response:

Current management has retained an attorney who specializes in redevelopment agency law and consulted with the governing body regarding options in light of the discovery of gross mismanagement, compounded with a lack of adequate knowledge regarding appropriate administration of redevelopment activities by prior administration - that stretches back many, many years - coupled with the June 29th, 2011, passage by the State Legislature of ABX126 and ABX127 that essentially eliminated all redevelopment agencies statewide. Staff will be working with the Agency attorney to comply with all provisions of ABX126 (elimination of the Agency on, or before, October 1, 2011) and establish a repayment plan to ensure the Agency and its assigned successor (the City) does not default on any debt obligations; the enforceable obligation payment schedule will be prepared and placed on the Agency's agenda of August 23, 2011, for review and approval of the plan to be forwarded to the State Controller's Office prior to the August 28, 2011, deadline set by the State Legislature.

2010-29: 20% Gross Tax Increment

Criteria:

Health and Safety Code §33334.2 requires that 20% of the gross tax increment allocated to the Agency be deposited in the Low and Moderate Income Housing Fund before any administrative fees, pass-through payments to taxing entities, negotiated fiscal agreements, and waivers, or other transfers from the balance of the tax increment allocated to the Agency. Also, an agency may be allowed to deposit less than the 20% of the gross tax increment if they have an adopted exemption or deferral finding for the reduction.

Condition:

During our analysis of Agency's 20% gross tax increment allocation to the Low and Moderate Income Housing Fund, we noted that the Agency was not allocating the correct amount. The Agency was depositing 20% of the net tax increment received after transfers from the tax increment that was received by the Agency. The Agency did not have an adopted exemption or deferral finding for the reduction in the allocation.

Cause of Condition:

The Agency lacks adequate controls and staff lack adequate knowledge of redevelopment laws to ensure that the correct amount of the tax increment is being deposited into the Low and Moderate Income Housing Fund annually.

Effect of Condition:

As a result of the lack of adequate knowledge and controls, the Agency has been allocating the incorrect amount of the tax increment into the Low and Moderate Income Housing Fund for numerous years. This has resulted in the Agency being out of compliance with Health and Safety Code §33334.2. Because the incorrect amounts have been transferred, the Agency is also reporting the incorrect balance of excess surplus as required by Health and Safety Code §33334.12. Since it could not be determined how many years the Agency was incorrect transferring funds, the fund balance of the Low and Moderate Income Housing Fund could be materially misstated.

Recommendation:

We recommend that the Agency staff obtain proper education and/or training to gain the appropriate knowledge so that they will be able to correctly carry out all redevelopment agency law requirements. We also recommend that the Agency take appropriate steps to further investigate and determine the total amount of funds that the Low and Moderate Income Housing Fund was shorted.

Management's Response:

Current management has retained an attorney who specializes in redevelopment agency law and consulted with the governing body regarding options in light of the discovery of gross mismanagement, compounded with a lack of adequate knowledge regarding appropriate administration of redevelopment activities, by prior administration - that stretches back many, many years - coupled with the June 29th, 2011, passage by the State Legislature of ABX126 and ABX127 that essentially eliminated all redevelopment agencies statewide. Staff will be working with the redevelopment agency attorney to comply with all provisions of ABX126 (elimination of the Agency on, or before, October 1, 2011) and establish a repayment plan to ensure the Agency and its assigned successor (the City) does not default on any debt obligations; the enforceable obligation payment schedule will be prepared and placed on the Agency's agenda of August 23, 2011, for review and approval of the plan to be forwarded to the State Controller's Office prior to the August 28, 2011, deadline set by the State Legislature.

2010-30: Related Party Land Transactions between the City of Lindsay (the City) and the City of Lindsay Redevelopment Agency (the Agency)

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

During our analysis of land held for redevelopment, we noted that in prior fiscal years the Agency engaged in three land purchases from the City of Lindsay without appropriate land appraisals. The total of the land transactions was $3,690,000, which is equal to the total amount of the CalHFA Loan No. RDLP-090806-03, which was to be used to land acquisition and development of three separate housing developments.

Per the City of Lindsay Board Resolution No. 08-06 dated March 27, 2007, and Agency Board Resolution LRA0-01 dated February 12, 2008, the Boards approved the land sale between the two entities for APN 201-150-001 for $570,000 and APN 205-320-001 and APN 205-030-044 for a total of $1,410,000.

Per the City of Lindsay Board Resolution No. 08-65 dated August 26, 2008, and Agency Board Resolution LRA08-06, the Boards approved the sale and purchase of land parcel APN 201-150-002 for $1,700,000. This particular transaction was never completed as City/Agency staff failed to transfer the title of the land to the Agency despite the payment being made to the City. It was also noted per City Board Resolution No. 09-40 dated June 30, 2009, that the City of Lindsay accepted a grant deed from the Agency for this same property for no compensation.

These transactions were related party transactions between the Agency and City; however, because of the lack of appraisals, these transactions were not completed at arm's length. In 2004, an evaluation was done on all City property to assess the value of its assets in order to comply with GASB Statement No. 34; the estimated cost to the City for these three properties was a combined $232,818. It appears that the prior management of the City and Agency performed this transaction as a way to extract funds from the Agency to supplement the City's cash flow needs.

Cause of Condition:

The Agency and City lack adequate controls and procedures for the performance of transactions involving the purchase of land held for redevelopment. They also failed to track all land held for resale transactions that occur throughout the year. Furthermore, the Agency also fails to periodically perform an inventory count on land held for redevelopment to appropriate valuations.

Effect of Condition:

As a result of the lack of appraisals, the Agency's current land held for redevelop balances appear to be materially overstated. Since the Agency has failed to have these properties appraised since the purchase, the potential impairment has not been assessed. Also, the Agency was reporting land held for redevelopment for which they were not named as the owner on the title of land.

Recommendation:

We recommend that the City and Agency implement new procedures for all land held for redevelopment or sale transactions. These procedures should include obtaining appropriate appraisals prior to the purchase of any lands to ensure that all land purchases are completed at a fair value. We also recommend that the City and Agency establish new procedures to periodically perform an inventory count and assessment of these lands to ensure that the City and Agency still holds title and is reporting these lands at an appropriate value.

Management's Response:

This finding is directly indicative of the negligent practices of prior management. Current management has worked diligently to identify and schedule all land, buildings, and land-held-for-resale, bring the asset schedule up-to-date, and present the same to the City Council as part of the annual update for the previous fiscal year as part of the City Council agenda packet, a public document. Report to be presented to the City Council no later than the second meeting in August.

Pursuant to ABX 127, the Redevelopment Agency will be dissolved and the assets liquidated according to state guidelines; therefore, the development of new procedures for Redevelopment is a moot point. Every real estate transaction shall include a certified appraisal, issued within the past two years, with the exception of foreclosure properties that may be bought to protect the City's interest if there is a loan attached and sold at fair market value determined by area comparable sales. Current management shall create and maintain files for all property that will include the Deed of Trust, appraisal, and activity relative to the purchase and disposal of the property.

2010-31: Excess Surplus

Criteria:

Per Health and Safety Code §33334.12, upon failure of the Agency to expend or encumber excess surplus in the Low and Moderate Income Housing Fund within one year from the date the moneys become excess surplus, the Agency must transfer funds to the county housing authority or to another public agency exercising housing development powers, or to expend or encumber its excess surplus within two additional years. The Agency must track each year's excess surplus to correctly determine the timing of expenditure or transfer mandates.

Condition:

During our analysis of the Agency's excess surplus calculation, we noted that the Agency does not track the amount of excess surplus it accrues for each fiscal year. As a result of the Agency not tracking the excess surplus per year, it has not instituted the required sanctions where excess surplus funds were not expended or encumbered within the statutory timeframe. Also, as a result of the Agency failing to transfer the correct 20% of the gross tax increment, the Agency is not currently reporting the correct amount of excess surplus.

Cause of Condition:

The Agency lacks adequate controls and knowledge of redevelopment agency laws to ensure that the excess surplus for the Agency is correctly reported and tracked over several fiscal years.

Effect of Condition:

The Agency is currently out of compliance with Health and Safety Code §33334.12 as it is not correctly reporting the excess surplus and has not taken the necessary steps to ensure that the proper sanctions are assessed for those funds that were not expended or encumbered within the statutory timeframe. Since the correct amount of excess surplus could not be determined by Agency staff and the Agency failed to transfer the correct amount of tax increment, the fund balance of the special revenue housing fund could be materially misstated.

Recommendation:

We recommend that Agency staff obtain proper education and/or training to gain the appropriate knowledge so that they will be able to correctly carry out all redevelopment agency law requirements. We also recommend that the Agency take appropriate steps to further investigate and determine the proper amount of excess surplus and those sanctions that need to be assessed for those funds that were not expended or encumbered.

Management's Response:

Current management has retained an attorney who specializes in redevelopment agency law and consulted with the governing body regarding options in light of the discovery of gross mismanagement, compounded with a lack of adequate knowledge regarding appropriate administration of redevelopment activities, by prior administration - that stretches back many, many years - coupled with the June 29th, 2011, passage by the State Legislature of ABX126 and ABX127 that essentially eliminated all redevelopment agencies statewide. Staff will be working with the redevelopment agency attorney to comply with all provisions of ABX126 (elimination of the Agency on, or before, October 1, 2011) and establish a repayment plan to ensure the Agency and its assigned successor (the City) does not default on any debt obligations; the enforceable obligation payment schedule will be prepared and placed on the Agency's agenda of August 23, 2011, for review and approval of the plan to be forwarded to the State Controller's Office prior to the August 28, 2011, deadline set by the State Legislature.

2010-32: 5 Year Implementation Plan

Criteria:

In accordance with Health and Safety Code §33490, redevelopment agencies must produce implementation plans for each project area every five years.

Condition:

During our analysis of the Agency's five year implementation plan, we noted that the Agency's last implementation plan covered through fiscal year 2003-04. Since that time, the Agency has not adopted a five year implementation plan for the project area even though the Agency continued to implement projects and programs that aimed to alleviate blight conditions and addressed housing needs within the project area.

Cause of Condition:

The Agency lacks adequate controls and knowledge of redevelopment agency laws to ensure that the redevelopment requirements are completed properly and in a timely manner as to not be out of compliance with the governing laws.

Effect of Condition:

The Agency is currently out of compliance with Health and Safety Code §33490, which could affect further funding for the redevelopment agency.

Recommendation:

We recommend that the Agency staff obtain proper education and/or training to gain the appropriate knowledge so that they will be able to correctly carry out all redevelopment agency law requirements. We also recommend that the Agency take appropriate steps to complete the five year implementation plan.

Management's Response:

Current management has retained an attorney who specializes in redevelopment agency law and consulted with the governing body regarding options in light of the discovery of gross mismanagement, compounded with a lack of adequate knowledge regarding appropriate administration of redevelopment activities, by prior administration - that stretches back many, many years - coupled with the June 29th, 2011, passage by the State Legislature of ABX126 and ABX127 that essentially eliminated all redevelopment agencies statewide. Staff will be working with the redevelopment agency attorney to comply with all provisions of ABX126 (elimination of the Agency on, or before, October 1, 2011) and establish a repayment plan to ensure the Agency and its assigned successor (the City) does not default on any debt obligations; the enforceable obligation payment schedule will be prepared and placed on the Agency's agenda of August 23, 2011, for review and approval of the plan to be forwarded to the State Controller's Office prior to the August 28, 2011, deadline set by the State Legislature.

2010-33: Miscoding of Expenditures

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

During our testing of the Agency's expenditures, we noted two instances where the expenditure was miscoded to the incorrect account. As a result of the miscoding, the Agency paid for expenditures that should have been paid by the City. The expenditures were not related to redevelopment activities and should not have been charged to the Agency.

Cause of Condition:

The Agency lacks adequate controls and proper training of employees. Cash disbursements were not reviewed by a person with appropriate knowledge of redevelopment agency laws and adequate knowledge of proper controls over cash disbursements.

Effect of Condition:

As a result of the miscoding, the Agency paid for City expenses and was never subsequently reimbursed for those payments. Furthermore, it cannot be determined how long the Agency has had this problem and the overall effect it has had on the financial statements.

Recommendation:

We recommend that the Agency implement adequate controls, which should include proper review of all the expenditures being charged to the Agency. Upon proper review by a person with adequate knowledge of redevelopment laws, the Agency will be able to catch all those expenditures that are miscoded and not related to redevelopment activities.

Management's Response:

Current management has retained an attorney who specializes in redevelopment agency law and consulted with the governing body regarding options in light of the discovery of gross mismanagement, compounded with a lack of adequate knowledge regarding appropriate administration of redevelopment activities, by prior administration - that stretches back many, many years - coupled with the June 29th, 2011, passage by the State Legislature of ABX126 and ABX127 that essentially eliminated all redevelopment agencies statewide. Staff will be working with the redevelopment agency attorney to comply with all provisions of ABX126 (elimination of the Agency on, or before, October 1, 2011) and establish a repayment plan to ensure the Agency and its assigned successor (the City) does not default on any debt obligations; the enforceable obligation payment schedule will be prepared and placed on the Agency's agenda of August 23, 2011, for review and approval of the plan to be forwarded to the State Controller's Office prior to the August 28, 2011, deadline set by the State Legislature.

2010-34: Pooled Investment Earnings Allocations – Accounting Controls

Criteria:

Health and Safety Code §33334.3(b) states that any interest earned by Low and Moderate Income Housing Fund and any repayments or other income to the Agency for loans, advances, or grants, of any kind from the Low and Moderate Income Housing Fund, shall accrue to and be deposited in the fund.

Condition:

The Agency follows the practice of pooling cash and investments of all the funds except for monies required to be held by outside fiscal agents under the provisions of bond indentures. Interest income earned on the pooled cash and investments is allocated quarterly to the various funds based on the monthly cash balances. During our audit, we identified that the Agency's assets known as "Due from Other Funds" were not reimbursed to the Agency within one year. Generally, "Due from Other Funds" are considered short-term lending arrangements to cover cash flow requirements in other funds; however, these funds should be repaid within no later than one year.

Cause of Condition:

Management has not reviewed its internal accounting controls to ensure that monies due from other funds are repaid within one year, which will ensure that monthly cash balances in each of the Agency's funds are accurate when computing the quarterly interest income allocations.

Effect of Condition:

Since the balances in the "Due from Other Funds" held by the Agency were not repaid on a timely basis, monthly cash balances were understated during the fiscal year, which resulted in an understatement of interest earnings.

Recommendation:

It is recommended that management review its policies and procedures to ensure that interest earned from deposits, especially in the Low and Moderating Income Housing Fund, are deposited or accrued to each fund in a manner that is equitable and accurate insofar as each fund earns its proportionate share of the pooled investment earnings. Because the Agency is a separate legal entity, we also recommend any monies loaned and/or transferred to/from the City be approved and authorized by the Agency's Board of Directors.

Management's Response:

Current management has retained an attorney who specializes in redevelopment agency law and consulted with the governing body regarding options in light of the discovery of gross mismanagement, compounded with a lack of adequate knowledge regarding appropriate administration of redevelopment activities, by prior administration - that stretches back many, many years - coupled with the June 29th, 2011, passage by the State Legislature of ABX126 and ABX127 that essentially eliminated all redevelopment agencies statewide. Staff will be working with the redevelopment agency attorney to comply with all provisions of ABX126 (elimination of the Agency on, or before, October 1, 2011) and establish a repayment plan to ensure the Agency and its assigned successor (the City) does not default on any debt obligations; the enforceable obligation payment schedule will be prepared and placed on the Agency's agenda of August 23, 2011, for review and approval of the plan to be forwarded to the State Controller's Office prior to the August 28, 2011, deadline set by the State Legislature.

2010-35: Submission of Reports to California State Controller – Accounting and Administrative Controls

Criteria:

In accordance with Health and Safety Code §33080.1, §33080.4, and §33080.7, redevelopment agencies must submit the audited financial statements, housing activities report, blight progress report, loan report, and the property report 6 months after the end of the Agency's fiscal year end date.

Condition:

During our analysis of the Agency's annual reports, we noted that the Agency has not submitted the financial statements, housing activities report, blight progress report, loan report, or the property report. Furthermore, the Agency also failed to submit the housing activities report by the deadline date of December 31, 2010.

Cause of Condition:

The Agency lacks adequate controls and knowledge of redevelopment laws to ensure that the redevelopment requirements are completed properly and in a timely manner so as to not be out of compliance with the governing laws.

Effect of Condition:

The Agency is currently out of compliance with Health and Safety Code §33080.1, §33080.4, and §33080.7, which could affect further funding for the redevelopment agency.

Recommendation:

We recommend that the Agency staff obtain proper education and/or training to gain the appropriate knowledge so that they will be able to correctly carry out all redevelopment agency law requirements. We also recommend that the Agency take appropriate steps to ensure that the proper controls are put in place to ensure that all the information needed for the reports are tracked sufficiently to allow for the timely submission of all these reports.

Management's Response:

Current management has retained an attorney who specializes in redevelopment agency law and consulted with the governing body regarding options in light of the discovery of gross mismanagement, compounded with a lack of adequate knowledge regarding appropriate administration of redevelopment activities, by prior administration - that stretches back many, many years - coupled with the June 29th, 2011, passage by the State Legislature of ABX126 and ABX127 that essentially eliminated all redevelopment agencies statewide. Staff will be working with the redevelopment agency attorney to comply with all provisions of ABX126 (elimination of the Agency on, or before, October 1, 2011) and establish a repayment plan to ensure the Agency and its assigned successor (the City) does not default on any debt obligations; the enforceable obligation payment schedule will be prepared and placed on the Agency's agenda of August 23, 2011, for review and approval of the plan to be forwarded to the State Controller's Office prior to the August 28, 2011, deadline set by the State Legislature.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Material Weaknesses:

2010-SA-01: Lack of Controls Over Expenditures

Federal Grantor: U.S. Department of Transportation
Title and CFDA: Transportation Enhancement Act; CFDA 20.205
Award Number: CML 5189 (017), STPLHSR 5189 (019), RPSTPLE 5189 (008)
Pass-Through Entity: California Department of Transportation

Federal Grantor: U.S. Department of Housing and Urban Development
Title and CFDA: Community Development Block Grants; 14.218
Award Number: 08-STBG-4843, 08-PTAE-5408, 08-EDEF-5786, 06-EDEF-2725, 05-EDBG-2181
Pass-Through Entity: California Department of Housing and Urban Development

Questioned Costs: None
Compliance Requirement: Internal Controls
Reporting Requirement: Material Weakness

Criteria:

OMB Circular No. A-133 states that recipients of Federal awards must maintain internal controls over Federal programs that provide reasonable assurance that the recipient is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

Condition:

While testing the City's expenditures and reviewing the internal controls over expenditures that are charged to Federal grants, we noted that the City lacks adequate controls. There was not adequate review of those expenditures that were charged to the Federal grants to ensure that they were valid expenditures and being recorded into the City's general ledger correctly.

Effect:

As a result of the lack of controls, expenditures were being miscoded and charged to the incorrect general ledger account. Also, it could not be determined that all of the Federal expenditures were allowable and/or valid expenditures for all the Federal grants for the City.

Cause:

The City lacks adequate internal controls over those expenditures that are charged to Federal grants.

Recommendation:

We recommend that the City implement new controls over all expenditures that are charged to Federal grants with adequate review and supervision for those individuals processing the expenditures. Furthermore, we also recommend that the City train all employees that handle any process of the Federal grant to ensure that they are aware of all those expenditures that are allowable and valid.

Response and Corrective Action Plan:

The new City manager has implemented very strict internal control policies over all expenditures, Federal and otherwise. Copies of all grant award and/or other agency-financing guidelines shall be forwarded to the Finance Department and all staff involved in the process of ordering, purchasing, procuring, coding, and compiling reimbursement requests shall be trained according to the stipulations in the guidelines. All expenditures must be reviewed and initialed by the staff member generating the request, the appropriate department head, and the finance director prior to payment to ensure eligibility and proper coding.

2010-SA-02: Lack of Controls Over Reporting

Federal Grantor: U.S. Department of Transportation
Title and CFDA: Transportation Enhancement Act; CFDA 20.205
Award Number: CML 5189 (017), STPLHSR 5189 (019), RPSTPLE 5189 (008)
Pass-Through Entity: California Department of Transportation (CalTrans)

Federal Grantor: U.S. Department of Housing and Urban Development
Title and CFDA: Community Development Block Grants (CDBG); 14.218
Award Number: 08-STBG-4843, 08-PTAE-5408, 08-EDEF-5786, 06-EDEF-2725, 05-EDBG-2181
Pass-Through Entity: California Department of Housing and Urban Development

Questioned Costs: $114,436.31
Compliance Requirement: Reporting
Reporting Requirement: Material Weakness

Criteria:

OMB Circular No. A-133 requires that recipients of Federal awards must maintain internal controls over Federal programs that provide reasonable assurance that the recipient is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

Per CDBG Grant Agreement #08-STBG-4843, the City was to submit the semi-annual Financial and Accomplishment Report (FAR) by January 31st and July 31st during the term of the agreement.

Condition:

During the testing of the City's reimbursement requests we noted the following conditions:

1. The City has not implemented adequate controls over the reimbursement process, as there is no review by management to ensure that the reimbursement requests correctly reflect all those expenditures that are eligible for reimbursement.

2. All reimbursement requests should be reconciled back to the City's accounting records to ensure that the reimbursement requests are complete and accurate; however, we found that City staff does not reconcile the reimbursement requests to their accounting records.

3. While reviewing expenditures and reimbursement requests for the City's Measure R Grant that was used to supplement the City's Federally funded projects, we noted that the City received reimbursement from Measure R and the CalTrans for the same expenditures.

4. The FAR reports for the 08-STBG-4843 grant were not submitted by the required deadline.

Effect:

As a result of the lack of controls over the reimbursement requests, the City was reimbursed for the same expenditures from two different agencies. The City received excess reimbursement equal to the questioned costs stated above. Furthermore, the City is out of compliance with the 08-STBG-4843 agreement, which could allow the State to terminate the agreement and be relieved of any payments.

Cause:

The City lacks adequate internal controls over the reimbursements for Federally funded projects.

Recommendation:

We recommend that the City implement new controls over all reimbursement requests. All reimbursement requests should be reconciled to the City's accounting records to ensure that the same expenditures are not requested for reimbursement from two separate grants. Furthermore, the City should require that all reimbursement requests be prepared by knowledgeable staff and reviewed by management with adequate knowledge of all Federal requirements.

Response and Corrective Action Plan:

Current management has implemented strict internal control policies and accountability consequences for all staff. The request for proposal (RFP) development procedure has been reassessed to ensure that the scope of any project is clearly defined and all project delivery costs are duly accounted for in the bid specifications which will significantly reduce subsequent contract change orders (CCOs); the departments responsible for project accounting, billing, and reporting are forwarding all work product to the finance director for review and approval to ensure proper coding and recording. They are also maintaining a project spreadsheet of budgeted costs that is updated and reconciled quarterly to account for all reimbursable expenditures and percentage of completion. The finance director will personally set up all new identifying Fund/Department accounting codes for each project to ensure no commingling of funds and/or expenses; thus only eligible expenses in the identifying Fund/Department can be billed to a specific project and the possibility of double billing has been eliminated.

Prior management failed to properly exercise their oversight responsibility, due in part to the long-term medical absence of the prior finance director and the failure of the prior City manager to authorize or engage alternate staff to assume the review and oversight process. This is a situation that has not only been rectified by current management, but all administrative contracts now contain a proviso prohibiting any absence to extend beyond 3 months and all departments have reorganized assigned duties to ensure there is never a lapse in review and oversight relative to any expenditure approval or reimbursement requests.

City staff did catch an overpayment by Caltrans during the audit and close-out phase of the Downtown Project and did show the amount as a credit payable to Caltrans on the final report submission. That project was a jointly funded project by Tulare County Association of Governments (TCAG) and Caltrans that prior staff did not do a good job of coding and maintaining separation due to lack of training and poor oversight on the part of City staff and poor communication and oversight on the part of TCAG that has subsequently challenged the project and some invoices previously submitted for their review and payment. City staff was never informed of the ineligible expenses until well after the project was completed. That matter is now in mediation.

2010-SA-03: Lack of Controls over Payroll and Fringe Benefit Payments

Federal Grantor: U.S. Department of Transportation
Title and CFDA: Transportation Enhancement Act; CFDA 20.205
Award Number: CML 5189 (017), STPLHSR 5189 (019), RPSTPLE 5189 (008)
Pass-Through Entity: California Department of Transportation

Federal Grantor: U.S. Department of Housing and Urban Development
Title and CFDA: Community Development Block Grants; 14.218
Award Number: 08-STBG-4843, 08-PTAE-5408, 08-EDEF-5786, 06-EDEF-2725, 05-EDBG-2181
Pass-Through Entity: California Department of Housing and Urban Development

Questioned Costs: None
Compliance Requirement: Internal Controls
Reporting Requirement: Material Weakness

Criteria:

In accordance with OMB Circular No. A-133, recipients of Federal awards must maintain internal controls over Federal programs that provide reasonable assurance that the recipient is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

In accordance with OMB Circular No. A-87, salary charges for authorized absences from the job, such as annual leave, sick leave, holidays, court leave, military leave, and other similar benefits are allowed if they are provided under written leave policies, the costs are equitably allocated to all related activities, including Federal awards, and the accounting basis selected for costing each type of leave is consistently followed by the City.

Condition:

While testing the City's payroll and payroll related charges, we noted several instances where sick leave, vacation, and/or holiday pay was being charged to Federal grants. Although these charges are allowable, the City was not equitably allocating these charges amongst all activities. Also, timestudies have not been performed that would provide the City with a basis of properly allocated payroll and payroll related charges to all Federal grants. Furthermore, we noted that the City lacked adequate controls over their payroll process, which resulted in the City mischarging payroll charges to the correct Federal grants.

Effect:

As a result of the lack of controls, we cannot be certain that all the payroll charges that were charged to the Federal grants were valid and accurate. Furthermore, the City is now out of compliance with both OMB Circulars A-87 and A-133 and subject to the loss of future funding and possible repayment of Federal funds.

Cause:

The City lacks adequate internal controls over the payroll process for those expenditures that are charged to Federal grants.

Recommendation:

We recommend that the City implement new controls over all payroll expenditures that are charged to Federal grants with adequate review and supervision for those individuals processing the expenditures. We also recommend that the City perform a timestudy so that all future payroll and payroll related charges are properly allocated amongst all Federal grants and City activity.

Response and Corrective Action Plan:

The City has a time study planned for the 3rd week of August and again for the 2nd week of February to ensure personnel are being properly allocated according to actual job performance. In the instance of grant projects, time sheets are kept daily according to project activity. Former management had failed to properly instruct the grants department regarding the proper allocation of leaves and benefits to the various grant projects; that oversight has now been corrected and the time sheets shall now require the initial of the finance director and appropriate department head to ensure the allocation is correct and based on time worked, or allowable allocation for project activity that would have been performed based on the usual percentage normally charged to the specific grant.

2010-SA-04: Tracking of Equipment Purchased with Federal Funds

Federal Grantor: U.S. Department of Housing and Urban Development
Title and CFDA: Community Development Block Grants; 14.218
Award Number: 08-STBG-4843, 08-PTAE-5408, 08-EDEF-5786, 06-EDEF-2725, 05-EDBG-2181
Pass-Through Entity: California Department of Housing and Urban Development

Questioned Costs: None
Compliance Requirement: Equipment and Real Property Management/Internal Controls
Reporting Requirement: Material Weakness

Criteria:

In accordance with OMB Circular No. A-110, recipients of Federal awards must maintain accurate equipment records that contain, among other things, the funding source of the equipment, including the award number. Also, when disposing of equipment with a fair market value of greater than $5,000, the recipient shall request disposition instructions from the Federal awarding agency or pass-through entity, which may include returning the proceeds of disposition back to the administering agency.

Condition:

While reviewing the City's equipment, we noted that the City does not track the equipment that has been purchased with Federal funds. As such, we could not verify that all the appropriate information as required by OMB Circular No. A-110 was maintained. Furthermore, it could not be determined whether the City is accurately disposing of all the equipment purchased with federal funds in the way required by OMB Circular No. A-110.

Effect:

As a result of the inadequate records to track equipment purchased with Federal funds, we could not determine that those items were still in use by the City or that those items were disposed of in the proper way and all proceeds were returned to the awarding agency. The City is out of compliance with OMB Circular No. A-110 and the grant agreements.

Cause:

The City lacks adequate internal controls over the capital assets process to ensure that the accounting records maintain accurate records that would allow City staff to appropriately track all equipment that has been purchased with Federal funds.

Recommendation:

We recommend that the City implement new controls over all capital assets that are purchased with Federal funds to ensure that the required information is available through their accounting records. We also recommend that the City perform annual or bi-annual inventory counts of all equipment to ensure that their records correctly reflect all capital assets that are still in use by the City.

Response and Corrective Action Plan:

Management is currently updating the capital assets policy to ensure that all City assets are properly scheduled and accounted for. All equipment purchased with grant funding provided by another government agency shall be scheduled on a supplemental schedule in addition to the capital assets schedule, to account for the purchase, inventory maintenance, and disposition of said item. Every department shall submit to the finance director, with a cc to the account clerk in charge of maintaining the capital assets schedule, a form (to be provided by the finance director) denoting any changes in inventory, not fully depreciated, for which that department is responsible. Each department shall maintain a file on all inventories with a useful life of 3 years or more at the department level and a master file shall be maintained in the Finance Department to be updated monthly, with the depreciation to be calculated on a quarterly basis.

The finance director is currently researching an inventory system that has the capability of printing a barcode permanent label, complete with funding source and general ledger account code, that will ensure proper accounting for all the City's capital assets.

2010-SA-05: Tracking of Davis Bacon Requirements for Federally Funded Construction Projects

Federal Grantor: U.S. Department of Housing and Urban Development
Title and CFDA: Community Development Block Grants; 14.218
Award Number: 08-STBG-4843, 08-PTAE-5408, 08-EDEF-5786, 06-EDEF-2725, 05-EDBG-2181
Pass-Through Entity: California Department of Housing and Urban Development

Questioned Costs: None
Compliance Requirement: Internal Controls
Reporting Requirement: Material Weakness

Criteria:

In accordance with the Davis Bacon Act (USC No. 40 3141-3144, 3146, and 3147) all laborers and mechanics employed by contractors or subcontractors to work on construction contracts in excess of $2,000 financed by Federal assistance funds must be paid wages not less than those established for the locality of the project (prevailing wage rates). Non-federal entities shall include in their construction contracts subject to Davis Bacon Act a requirement that the contractor or subcontractor comply with the requirements of the Davis Bacon Act and Department of Labor regulations (29 CFR §5.5-5.6). This includes a requirement for the contractor or subcontractor to submit to the recipient weekly, for each week in which any contract work is performed, a copy of the payroll and a statement of compliance (certified payrolls).

Condition:

While testing the City's compliance with the Davis Bacon Act requirements, we noted that several weeks of certified payroll reports could not be located. It could not be determined whether or not the City received these weeks' certified payrolls as the City lacks an adequate method of tracking the receipt of the certified payrolls. Furthermore, for the certified payrolls that were received by the City, they were not completed correctly by the contractors as they lacked signature from an authorized representative of the contractor.

Effect:

Due to the lack of adequate controls over the tracking of contractor or subcontractor certified payrolls, it could not be determined that the City received the missing certified payrolls. As a result, the City had no way of knowing whether or not the employees of the contractors or subcontractors were being paid in compliance with the Davis Bacon Act. Because the City failed to ensure that all the certified payrolls were received and reviewed, the City is out of compliance with the Davis Bacon Act requirements as stated above.

Cause:

The City lacks adequate internal controls over the tracking of the certified payrolls for all Federally funded construction contracts.

Recommendation:

We recommend that the City implement new controls over all the certified payroll requirements for all Federally funded construction projects. This should include the City implementing an appropriate procedure to ensure that all contractors and subcontractors submit weekly certified payrolls that are accurately completed, and submitted in a timely manner. We also recommend that appropriate steps are taken by the City for those contractors that fail to comply with all Davis Bacon Act and contract agreements.

Response and Corrective Action Plan:

Management has implemented the following procedures in 2011:

1. Staff will track in a calendar format worked days and submittal date of the contractor and/or subcontract payrolls received for the entire contract time.

2. Staff will allow only a two week period delay time after the payroll is due. If payroll is not submitted the City would withhold 10% of the progress payment and will not release it until payroll is received.

3. Staff will be attending Davis-Bacon Act Conference in October to get training in all Davis-Bacon Act requirements.

2010-SA-06: Schedule of Expenditures of Federal Awards

Federal Grantor: U.S. Department of Transportation
Title and CFDA: Transportation Enhancement Act; CFDA 20.205
Award Number: CML 5189 (017), STPLHSR 5189 (019), RPSTPLE 5189 (008)
Pass-Through Entity: California Department of Transportation

Federal Grantor: U.S. Department of Housing and Urban Development
Title and CFDA: Community Development Block Grants; 14.218
Award Number: 08-STBG-4843, 08-PTAE-5408, 08-EDEF-5786, 06-EDEF-2725, 05-EDBG-2181
Pass-Through Entity: California Department of Housing and Urban Development

Questioned Costs: None
Compliance Requirement: Internal Controls
Reporting Requirement: Material Weakness

Criteria:

As stated in OMB Circular No. A-133, recipients of Federal awards must prepare a schedule of expenditures of Federal awards for the period covered by the recipient's financial statements.

Condition:

Upon initial review of the City's schedule of expenditures of Federal awards, we noted that the City was not correctly reporting the amount of federal expenditures.

Effect:

As a result of the City's incorrect reporting and lack of controls over the accounting records, see at finding 2010-SA-1, we could not verify that the correct amounts of Federal expenditures were being reported for every Federal grant.

Cause:

The City lacks adequate internal controls and knowledge of the OMB Circulars that govern Federal awards.

Recommendation:

We recommend that the City implement proper controls over expenditures to ensure that all Federal transactions are being accounted for separately. This will allow the City to track the amount of Federal expenditures to be reported on the schedule of expenditures of Federal awards.

Response and Corrective Action Plan:

Current management has implemented a number of strict internal control policies including restructuring all awards and projects to be reviewed by Finance at critical progress points to ensure the expenditures are in accordance with City and OMB procurement policies and are recorded correctly into the general ledger. The finance director will be implementing a training program for all employees involved in the process to ensure proper coding, payment, recording, and reimbursement requests and will be exercising due diligence and oversight over all reimbursable projects, including federal projects and maintain an accurate and up-to-date schedules relative to same.

2010-SA-07: City's Accounting Procedures for Program Income of Federal Grant Awards

Federal Grantor: U.S. Department of Transportation
Title and CFDA: Transportation Enhancement Act; CFDA 20.205
Award Number: CML 5189 (017), STPLHSR 5189 (019), RPSTPLE 5189 (008)
Pass-Through Entity: California Department of Transportation

Federal Grantor: U.S. Department of Housing and Urban Development
Title and CFDA: Community Development Block Grants; 14.218
Award Number: 08-STBG-4843, 08-PTAE-5408, 08-EDEF-5786, 06-EDEF-2725, 05-EDBG-2181
Pass-Through Entity: California Department of Housing and Urban Development

Questioned Costs: None
Compliance Requirement: Internal Controls, Program Income
Reporting Requirement: Material Weakness

Criteria:

OMB Circular A-133 states that a Federal grant recipient should have sufficient accounting procedures to provide reasonable assurance that program income is correctly recorded and used in accordance with the program requirements. The recipient shall identify, in its accounts, all Federal awards received and expended and the Federal programs under which they were received.

Condition:

The City did not adequately account for Federal grant income in specific general ledger accounts. During our audit, we noted Federal revenues were recorded in three funds of the City's general ledger. These transactions were not properly segregated and identified. This required a reconciliation of multiple transactions over multiple funds in order to accurately determine the total activity for a specific grant.

Effect:

This condition, if not corrected, could result in the inaccurate recording of Federal grant revenues.

Cause:

The City lacks adequate internal controls and knowledge of the OMB Circulars that govern Federal awards. The Finance Department did not review the grant accounting on a regular basis

Recommendation:

We recommend that management modify accounting procedures that relate to Federal grants and other matching funding sources. Specific funds should be designated for Federal grant programs and specific accounts should be assigned for related revenues. Transactions should be reviewed periodically to insure that financial reporting for Federal grants is accurate and clearly understandable.

Response and Corrective Action Plan:

A new system of reporting and tracking has been developed by the Finance Department in conjunction with all other departments that have grant activity. The finance director will set up new identifying Fund/Department account codes specific to a project, grant, or funding source in which to track expenditures and a corresponding revenue account line within the same identifying Fund, to track the revenues. The generating department will keep a ledger of draw and/or reimbursement requests that will include the name and Project ID, amount of the original award, applicable general ledger Account Lines, draw date and amount, revenue receipt and amount, and remaining balance. A copy of this ledger shall be forwarded to the Finance Department who will fill in the ledger with the date and amount of receipt when funds are received and include the carbon copy of the receipt to the generating department to ensure communication between departments relative to grant management. The Finance Department has worked with the IT Department to set up general ledger access for all departments to ensure they can access and monitor the progress of their grant/project. The finance director will be conducting training with all personnel involved in purchasing, invoicing, and project management to ensure they are fully trained regarding the City's internal control polices as well as the guidelines and restrictions of the various funding sources being utilized. The finance director will personally review all reimbursement requests and does personally maintain a separate receipt book specific to government awards.

All other agency funding awards shall be reconciled quarterly on both the revenue and expenditure sides to ensure accuracy of reporting and efficient project management.

2010-SA-08: City's Purchasing and Contracting Provisions

Federal Grantor: U.S. Department of Transportation
Title and CFDA: Transportation Enhancement Act; CFDA 20.205
Award Number: CML 5189 (017), STPLHSR 5189 (019), RPSTPLE 5189 (008)
Pass-Through Entity: California Department of Transportation

Questioned Costs: $1,320,112.40
Compliance Requirement: Allowable Costs/Cost Principles
Reporting Requirement: Material Weakness

Criteria:

Per Section 3.04.090 of the City's Purchasing and Contracting provisions: "Formal bid procedure. The procedure set out in this section shall be utilized for all purchases or contracts involving amounts of $75,000 or more. Award of all contracts and purchases made pursuant to the procedures of this section shall be made to the lowest responsible bidder meeting specifications ... The City Council shall award, or may reject, all purchases or contracts developed under the procedures of this section and proposed to be awarded pursuant to this section."

Condition:

The City approved, through its competitive bid process, a construction project. However, over a period of two years, two of the City's projects were subsequently expanded with CCOs in excess of the City's competitive bid threshold. These changes were not submitted to the City Council for approval in accordance with the formal bid process.

Per inquiry of City staff, we noted that the assistant engineer and City services director had the authority to initiate and approve contract change orders for any amount as long as the City was the party initiating the CCO. Furthermore, upon review of the CCOs, we noted that that the City failed to obtain an agreement with the contractor regarding the scope and cost of the CCO prior to the commencement and completion of additional work. For project RPSTPLE 5189 (008), the original contract fees grew from $808,936.94 to $2,053,689.70. Also, for project CML 5189 (017), the same contractor's fees grew from $331,688.92 to $407,048.56.

Effect:

Grant programs are subject to review by grantor agencies. Such review could result in the disallowance of expenditures under the terms of the grant or reductions of future grant funds.

Cause:

Management did not require the entire scope of the construction project to be included in the formal bid process.

Recommendation:

We recommend that management adhere to the City's contract management procedures which include City Council approval for contracts in excess of $75,000, and notification of contract change orders. In addition, we recommend that the complete project scope be included in future formal requests for bids. Furthermore, we also recommend that the City obtain an agreement for all CCOs before the commencement of the work.

Response and Corrective Action Plan:

The current City manager has implemented many strict internal control polices including a written and enforceable CCO policy that includes oversight by the finance director before an invoice is paid to ensure that all change orders are in compliance with the policy and have been duly presented to Council via resolution. In the instance cited above, the project did stay within the budget and scope of the project; however, the method of delivery – it was supposed to have been performed by City crews - was changed to contracted labor in the essence of time as former management had City staff stretched too thin with multiple projects and could not maintain a pace consistent with completing the project in a timely manner which was crucial to the economic survival of our downtown businesses who were negatively impacted during the construction phase of the downtown project. According to the Green Book governing municipal construction projects, it was this exigent circumstance that allowed for the increased amounts, without rebid; this did not negate the responsibility for presenting the CCO to council. Current management will not overextend City labor forces to the point that would allow such a situation to exist. City services staff will be more diligent in their cost analysis and request for proposal (RFP) development to ensure all costs are denoted for prospective bidders and will adhere at all times to the CCO policy that has been developed and approved subsequent to the new administration of 2011.

2010-SA-09: Federal Clearinghouse Data Collection Form Submission

Federal Grantor: U.S. Department of Transportation
Title and CFDA: Transportation Enhancement Act; CFDA 20.205
Award Number: CML 5189 (017), STPLHSR 5189 (019), RPSTPLE 5189 (008)
Pass-Through Entity: California Department of Transportation

Federal Grantor: U.S. Department of Housing and Urban Development
Title and CFDA: Community Development Block Grants; 14.218
Award Number: 08-STBG-4843, 08-PTAE-5408, 08-EDEF-5786, 06-EDEF-2725, 05-EDBG-2181
Pass-Through Entity: California Department of Housing and Urban Development

Questioned Costs: None
Compliance Requirement: Internal Controls/Reporting
Reporting Requirement: Material Weakness

Criteria:

OMB Circular A-133 states that all auditees shall submit the Data Collection Form to the Federal clearinghouse within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit.

Condition:

The City did not timely file the Data Collection Form with the Federal clearinghouse. Our review of the Data Collection Form indicated that it was not timely filed and no approved extension was obtained in advance.

Effect:

Future funding of Federal grants may be delayed, modified, or denied as a result of the City's failure to timely file the Data Collection Form with the Federal clearinghouse.

Cause:

The City lacks adequate internal controls and knowledge of the OMB Circulars that govern federal awards. The City's accounting records were not closed in a timely fashion in order to allow an accurate reporting of the Data Collection Form.

Recommendation:

We recommend management make every effort in the future to timely file the Data Collection Form with the Federal clearinghouse. In the event management determines that the deadline may not be met, we recommend they obtain an advance extension from their cognizant or oversight agency.

Response and Corrective Action Plan:

Each department has been ordered to develop and maintain a schedule of mandatory reporting applicable to their respective departments. This schedule shall include the name of the report agency to whom it is due and the date by which it must be submitted to avoid delinquency and the date of submission. Staff reductions have made it difficult to keep abreast of the work load as all employees have been assigned multiple tasks and responsibilities, it is hoped that creating these report schedules will eliminate any delinquent filings in the future.

SECTION IV – STATUS OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS

Significant Deficiencies:

2009-FS-01: Recording Budget Amendments – Accounting and Administrative Controls

Condition:

Management is responsible for establishing and maintaining internal controls, including monitoring, that allow for the fair presentation of the City's required supplementary information, which presents the results of actual operations compared to the City's final adopted budget. Currently, the City adopted a two-year budget. During this two-year period, the City's Council adopted various amendments to the original adopted budget; however, these amendments are not recorded to the City's financial accounting system.

Cause:

Currently, management has not recorded budget expenditure appropriation adjustments, revised revenue estimates, or other financing sources and uses budget items authorized by the City's Council to its financial accounting system.

Effect:

The absence of the internal accounting and administrative control to ensure the budget amendments are recorded to the financial accounting system is considered a significant deficiency because the potential exists that a more than inconsequential but less than material misstatement of the financial statements could occur and not be prevented or detected by the City's internal control.

Recommendation:

We recommend all budget amendments approved and authorized by the City's Council be recorded to the financial accounting system to ensure proper preparation and presentation of the Statement of Revenues, Expenditures, and Changes in Fund Balance – Budget and Actual. This statement is required supplementary information when reporting the City results of operation in conformity with accounting principles generally accepted in the United States of America.

Response and Corrective Action Plan:

Management will record all future budget amendments approved and authorized by the City's Council.

Current Year Status:

See current year finding 2010-20.

2009-FS-02: Pooled Investment Earnings Allocations – Accounting Controls

Condition:

The City follows the practice of pooling cash and investments of all the funds except for monies required to be held by outside fiscal agents under the provisions of bond indentures. Interest income earned on the pooled cash and investments is allocated quarterly to the various funds based on the monthly cash balances. During our audit, we identified that the City's assets known as "Due from Other Funds" were not reimbursed to the City within one year of July 1, 2008. Generally, "Due from Other Funds" are considered short-term lending arrangements to cover cash flow requirements in other funds; however, these funds should be repaid within no later than one year.

Cause:

Management has not reviewed its internal accounting controls to ensure that monies due from other funds are repaid within one year, which will ensure that monthly cash balances in each of the City's fund are accurate when computing the quarterly interest income allocations.

Effect:

Since the balances in the "Due from Other Funds" held by the City were not repaid on a timely basis, monthly cash balances were understated during the fiscal year, which resulted in an understatement of interest earnings. The estimated understatement of pool investment earnings in the Low and Moderate Income Housing Special Revenue Fund is $10,241, while the understatement of interest earnings in the Agency's Capital Projects Fund is estimated to be $55,269.

Recommendations:

It is recommended that management review its policies and procedures to ensure interest earned from deposits, especially in the Low and Moderate Income Housing Special Revenue Fund, are deposited or accrued to each fund in a manner that is equitable and accurate insofar as each fund earns its proportionate share of the pooled investment earnings. Because the Lindsay Redevelopment Agency is a separate legal entity, we also recommend the any monies loaned and/or transferred to/from the City be approved and authorized by the Agency's Board.

Response and Corrective Action Plan:

Management will review its policies and procedures to ensure that interest earned from deposits accrue to each fund in a manner that is equitable and accurate insofar as each fund earns its proportionate share of the pooled investment earnings.

Current Year Status:

See current year finding 2010-33.

2009-FS-03: Reconciling Bank Reconciliations

Condition:

Bank reconciliations are not being reviewed in a timely fashion.

Effect:

Bank reconciliation needed adjustments up to fourteen months after year end.

Cause:

Bank reconciliation adjustments to the general ledger are not being posted to the proper accounting periods.

Criteria:

City policy and procedures require monthly bank reconciliations.

Recommendation:

Finance director should review monthly bank reconciliations. Accounting supervisor should posted adjustments to the bank reconciliations in the proper accounting period.

Response and Corrective Action Plan:

Finance director will review banks reconciliations monthly with posted adjustments.

Current Year Status:

See current year finding 2010-01.

Material Weaknesses:

2009-FS-04: Reconciling Accounts to Supporting Documentation – Accounting Controls

Condition:

The City does not reconcile its general ledger accounts to supporting documents. In order to make the interim and annual financial statements meaningful, we recommend the City reconcile the general ledger accounts for cash with fiscal agent; property held for resale; and bond issuance proceeds, premiums, and issuance costs to supporting documentation on a monthly or routine basis. During our audit, we identified certain adjustments to general ledger assets and liabilities that impacted the operating results of the City for the year ended June 30, 2009.

Cause:

Management has not reviewed its policies and procedures to ensure that general ledger accounts are supported by adequate documentation on a monthly or routine basis. Management is responsible for establishing and maintaining internal controls, including reconciling general ledger accounts to supporting documents.

We are responsible to communicate significant deficiencies and material weaknesses in accordance with professional standards regardless of management's decisions to establish and monitor its own internal controls.

Effect:

The absence of performing monthly and/or routine reconciliations provides an opportunity that errors can accumulate and these errors may go undetected. The benefit of monthly reconciliations is that errors do not accumulate but can be identified and attributed to a particular period (month), which makes it easier to perform future reconciliations. Because the procedures recommended below were not in place during the year ended June 30, 2009, these are considered a material weakness because a material misstatement of the financial statements would have occurred and not been prevented or detected by the City's existing internal controls.

Recommendations:

We recommend management establish monthly and/or routine reconciliation policies and procedures, including the performance of the following functions:

Cash and investments held with the City's fiscal agent should be reconciled from the bond trustee statement balance to the general ledger balance on a monthly basis to determine that all cash transactions, including investment earnings, have been recorded properly and to discover trustee errors. The proper recordation of fiscal agent transactions will provide for the fair presentation of the financial statements.

Upon the issuance of long-term debt, such as bonds, the recording of bond proceeds, premiums/discounts, and bond issuance costs should be recorded to the appropriate general ledger accounts based on supporting information found in the Official Bond Statement. Typically, the Official Bond Statement will report the sources and uses of the bond issuance. The proper recordation of the bond issuance to the general ledger will provide for the fair presentation of the financial statements, which is the responsibility of management.

Upon the purchase and/or sale of City real property, the inventory adjustment to property held for resale and the corresponding gain/loss on the sale of real property should be recorded to the general ledger accounts, and reconciled to supporting documentation provided by the title company. The recording of real property transactions should be performed shortly after the transactions have closed escrow. These reconciliations and adjustments to the general ledger accounts will ensure meaningful and accurate interim and annual financial statements.

Response and Corrective Action Plan:

Management will perform a monthly reconciliation of cash and investments held with the City's fiscal agent. The reconciliation from the bond trustee statement balance will be made to the general ledger on a monthly basis to ensure that all cash transactions are properly recorded.

For future bond issuances, management will obtain, if necessary, professional consultation services to ensure that transactions are recorded properly.

Management will record the gain or loss from all future property transactions immediately after the sale is recorded.

Current Year Status:

See current year finding 2010-25.

Significant Deficiencies:

2009-SA-01: City's Accounting Procedures for Federal Grant Awards

Federal Grantor: U.S. Department of Transportation
Title and CFDA: TEA; CFDA 20.205
Award No.: RPSTPLE-5189-8
Year: 2007/2008

Pass-Through Entity: California Department of Transportation
Compliance Requirement: Reporting
Reporting Requirement: Significant Deficiency

Criteria:

OMB Circular A-133 states that a Federal grant recipient should have sufficient accounting procedures to provide reasonable assurance that program income is correctly recorded and used in accordance with the program requirements. The recipient shall identify, in its accounts, all Federal awards received and expended and the Federal programs under which they were received.

Condition:

The City did not adequately account for Federal grant income and expenditures in specific general ledger accounts.

Questioned Costs:

None

Context:

During our audit we noted Federal revenues and expenditures were recorded in three funds of the City's general ledger. These transactions were not properly segregated and identified. This required a reconciliation of multiple transactions over multiple funds in order to accurately determine the total activity for a specific grant.

Effect:

This condition, if not corrected, could result in the inaccurate recording of Federal grant revenues and expenditures.

Cause:

The Finance Department did not review the grant accounting on a regular basis.

Recommendations:

We recommend that management modify accounting procedures that relate to Federal grants and other matching funding sources. Specific funds should be designated for Federal grant programs and specific accounts should be assigned for related revenues and expenditures. Transactions should be reviewed periodically to insure that financial reporting for Federal grants is accurate and clearly understandable.

Response and Corrective Action Plan:

City staff prepared journal entries to correct the condition and accurately report Federal grant revenues and expenditures. Management will implement accounting procedures to insure that Federal grant fund activities are properly segregated and reported accurately and clearly in the City's general ledger.

Current Year Status:

See current year finding 2010-SA-7.

Material Weaknesses:

2009-SA-02: City's Purchasing and Contracting Provisions

Federal Grantor: U.S. Department of Transportation
Title and CFDA: TEA; CFDA 20.205
Award No.: RPSTPLE-5189-8
Year: 2007/2008

Pass-Through Entity: California Department of Transportation
Compliance Requirement: Allowable costs/cost principles
Reporting Requirement: Material Weakness

Criteria:

Per Section 3.04.090 of the City of Lindsay's Purchasing and Contracting provisions: Formal bid procedure. The procedure set out in this section shall be utilized for all purchases or contracts involving amounts of seventy-five thousand dollars or more. Award of all contracts and purchases made pursuant to the procedures of this section shall be made to the lowest responsible bidder meeting specifications ... The City Council shall award, or may reject, all purchases or contracts developed under the procedures of this section and proposed to be awarded pursuant to this section."

Condition:

The City approved, through its competitive bid process, a construction project. The project was subsequently expanded with change orders in excess of the City's competitive bid threshold. These changes were not submitted to the City Council for approval in accordance with the formal bid process.

Questioned Costs:

$656,059

Context:

During our audit we tested five invoices which represented 100% of the specific vendor's costs.

Effect:

Grant programs are subject to review by grantor agencies. Such review could result in the disallowance of expenditures under the terms of the grant or reductions of future grant funds.

Cause:

Management did not require the entire scope of the construction project to be included in the formal bid process.

Recommendations:

We recommend that management adhere to the City's contract management procedures which include Council approval for contracts in excess of $75,000, and notification of contract change orders. In addition, we recommend that the complete project scope be included in future formal requests for bids.

Response and Corrective Action Plan:

Staff will adhere to City's contract management procedures which include notification of Council of all change orders. We will also include the complete project scope in future formal bid requests.

Current Year Status:

See finding 2010-SA-8.

2009-SA-03: Federal Clearinghouse Data Collection Form Submission

Federal Grantor: U.S. Department of Agriculture
Title and CFDA: Community Facilities Loans; CFDA 10.766
Award No.: N/A
Year: 2008/09

Pass-Through Entity: N/A
Federal Grantor: U.S. Department of Transportation
Title and CFDA: Transportation Enhancement Act; CFDA 20.205
Award No.: RPSTPLE-5189-8
Year: 2007/08

Pass-Through Entity: California Department of Transportation
Compliance Requirement: Reporting
Reporting Requirement: Material Weakness

Criteria:

OMB Circular A-133 states that all auditees shall submit the Data Collection Form to the Federal clearinghouse within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit.

Condition:

The City did not timely file the Data Collection Form with the Federal clearinghouse.

Questioned Costs:

None

Context:

Our review of the Data Collection Form indicated that it was not timely filed and no approved extension was obtained in advance.

Effect:

Future funding of Federal grants may be delayed, modified, or denied as a result of the City's failure to timely file the Data Collection Form with the Federal clearinghouse.

Cause:

The City's accounting records were not closed in a timely fashion in order to allow an accurate reporting of the Data Collection Form.

Recommendations:

We recommend management make every effort in the future to timely file the Data Collection Form with the Federal clearinghouse. In the event management determines that the deadline may not be met, we recommend they obtain an advance extension from their cognizant or oversight agency.

Response and Corrective Action Plan:

Management will make every effort to timely file the Data Collection Form with the Federal clearinghouse. If it appears that a timely filing is not possible, then an extension will be requested from the cognizant or oversight agency.

Current Year Status:

See finding 2010-SA-9.