CITY OF LINDSAY

SINGLE AUDIT REPORT

JUNE 30, 2011

CITY OF LINDSAY
SINGLE AUDIT REPORT
JUNE 30, 2011

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BROWN ARMSTRONG
Certified Public Accountants

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, 2011, which collectively comprise the City's financial statements and have issued our report thereon dated September 24, 2012. We did not express an opinion on the City's 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, the City failed to post an accrual for compensated absences, the City has failed to implement Governmental Accounting Standards Board (GASB) Statement No. 45 for calculating and recording Other Postemployment Benefits (OPEB), the City's internal controls over cash disbursements were not operating effectively, 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 lacks internal controls over wire transfers, 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 is out of compliance with several bond agreements, the City was out of compliance with several Federal grant awards. City personnel lack adequate knowledge of internal controls, accounting principles generally accepted in the United States of America (GAAP), and OMB Circular A-133. The City inflated purchases of land held for redevelopment and the City's Redevelopment Agency is out of compliance with multiple debt covenants. 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 City'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 2011-01 through 2011-36 and Federal award findings 2011-SA-01 through 2011-SA-08 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 2011-08, 2011-10, 2011-25, 2011-26, 2011-29, 2011-30, 2011-31, 2011-33, 2011-34, 2011-35, 2011-36, and 2011-SA-01 through 2011-SA-08.

We noted certain other matters that we reported to management of the City in a separate letter dated September 24, 2012.

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 responses and, accordingly, we express no opinion on them.

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

Brown Armstrong
Accountancy Corporation

Bakersfield, California
September 24, 2012

BROWN ARMSTRONG
ARMSTRONG
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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 (the City), California's 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, 2011. 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 2011-SA-01 through 2011-SA-08 in the accompanying schedule of findings and questioned costs, the City, did not comply with requirements regarding accounting of programs activities allowed or unallowed, reporting, Davis-Bacon Act, equipment and real property management, procurement, and allowable costs 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), U.S. Department of Agriculture, Community Facilities Loans (CFDA # 10.766), and U.S. Department of Housing and Urban Development, HOME Investment Partnership Program (CFDA # 14.239). 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, 2011, 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 2011-SA-01 through 2011-SA-08 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, 2011, and have issued our report thereon dated September 24, 2012. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the City's 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 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'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, the City failed to post an accrual for compensated absences, the City has failed to implement Governmental Accounting Standards Board (GASB) Statement No. 45 for calculating and recording Other Postemployment Benefits (OPEB), the City's internal controls over cash disbursements were not operating effectively, 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 lacks internal controls over wire transfers, 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 is out of compliance with several bond agreements, the City was out of compliance with several Federal grant awards. City personnel lack adequate knowledge of internal controls, accounting principles generally accepted in the United States of America (GAAP), and OMB Circular A-133. The City inflated purchases of land held for redevelopment and the City's Redevelopment Agency is out of compliance with multiple debt covenants. 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

Brown Armstrong
Accountancy Corporation

Bakersfield, California
September 24, 2012

CITY OF LINDSAY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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	06-EDEF-2725	$ 80,169
Community Development Block Grant	*	14.228	05-EDBG-2181	769,902
Community Development Block Grant	*	14.228	08-STBG-4843	905,605
Community Development Block Grant	*	14.228	08-EDEF-5786	22,502
Community Development Block Grant	*	14.228	09-EDEF-6362	11,024
Community Development Block Grant	*	14.228	09-PTAE-6560	12,900
Community Development Block Grant	*	14.228	09-NSP1-6270	13,527
Total Community Development Block Grant				1,815,629
HOME Investment Partnership Program		*14.239	07 -HOME-3081	276,885
HOME Investment Partnership Program		*14.239	06-HOME-2406	1,225,345
Total HOME Investment Partnership Program				1,502,230
Total U.S. Department of Housing and Urban Development				**3,317,859**
U.S. Department of Education:				
21st Century Community Learning Centers		84.287	N/A	64,896
Total U.S. Department of Education				**64,896**
U.S. Department of Agriculture:				
Community Facilities Loans (Library)	*	10.766	97-12	294,344
Community Facilities Loans (Wellness Center)	*	10.766	97-13	216,845
Total U.S Department of Agriculture				**511,189**
U.S. Department of Justice:				
DOJ - COPS-in School		16.710	#2009RKWX0171	14,001
Total U.S Department of Justice				**14,001**
U.S. Department of Homeland Security:				
Homeland Security - Public Safety		97.067	N/A	20,000
Homeland Security - Public Safety		97.036	CALEMA107-41712	36,613
Total U.S. Department of Homeland Security				**56,613**
U.S. Department of Transportation:				
Passed through from the California Department of Transportation:				
Transportation Enhancement Act	*	20.205	CML-5189-022	57,301
Transportation Enhancement Act	*	20.205	CML-5189-023	57,815
Transportation Enhancement Act	*	20.205	CML-5189-025	207,944
Transportation Enhancement Act	*	20.205	CML-5189-028	10,472
Transportation Enhancement Act	*	20.205	CML-5189-031	9,490
Total U.S. Department of Transportation				**343,022**
Total				**$ 4,307,580**

* 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, 2011

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 financial statements.

NOTE 2 – LOAN BALANCES

The City had the following loan balances outstanding at June 30, 2011. 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	$ 2,051,962
USDA - Sewer	10.706	6,014,762
USDA - Sewer	10.706	436,329
USDA - Tulare Road	10.766	1,493,177
USDA - Wellness Center	10.766	1,472,476
		$ 11,468,706

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

CITY OF LINDSAY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2011

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
10.766	U.S Department of Agriculture Community Facilities Loans
14.239	U.S Department of Housing and Urban Development HOME Investment Partnership Program

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

2011-01: Land Held for Resale

Criteria:

In accordance with Governmental Accounting Standards, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial 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 (the City) without any appropriate land appraisals. The total of the land transactions were $3,690,000, for which the Lindsay Redevelopment Agency (the Agency) incurred debt to fund. Furthermore, for one land purchase totaling $1,700,000, the transaction was never completed between the two parties as staff failed to transfer the title of land to the Agency despite the payment being made to the City. Currently, according to the County of Tulare Assessor, the City of Lindsay still holds title to the land.

Cause of Condition:

The City/Agency lacks adequate controls and procedures for the performance of transactions involving the purchase of land held for redevelopment. The City/Agency also failed, and continues to fail, to track all land held for resale transactions that occur throughout the year. Furthermore, the City/Agency also failed 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 redevelopment balances appear to be materially overstated. Since the City and the Agency failed to have these properties appraised since the purchase, the potential impairment has not been assessed. Also, the Agency reported 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 transactions. These procedures should include obtaining appropriate appraisals prior to the purchase of any lands to ensure that all land purchases are completed at fair market value. We also recommend that the City and the Agency established new procedures to periodically perform an inventory count and assessment of these lands to ensure that either the City or the Agency still holds the titles and is reporting these lands at an appropriate value.

Management's Response:

The City has developed new procedures for all land transactions that include obtaining a certified appraisal for all property to be bought or sold. As the Lindsay Redevelopment Agency ceased to exist as of August 23, 2011, pursuant to the dissolution legislation, ABX126, further purchase transactions on behalf of the former redevelopment Agency is a moot point. Staff is working with the Successor Agency and Oversight Board to identify and dispose of, or transfer, all former redevelopment properties in accordance with the State Department of Finance guidelines.

2011-02: 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 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:

- During our test of controls, we noted 1 out of 40 payroll disbursements selected for testing where the City was unable to provide a copy of this employee's timesheet.
- During our test of controls, we noted 10 out of 40 payroll disbursements selected for testing where the employee's timesheet did not have all required signatures.
- During our test of controls, we noted 1 out of 40 payroll disbursements selected for testing where the "Authorization to Hire" form was missing the signature of the Department Head, the Personnel Officer, and/or City Manager.
- During our test of controls, we noted 2 out of 40 payroll disbursements selected for testing where the current "Change in Payroll Status" was missing from the employee's personnel file.
- During our test of controls, we noted 29 out of 40 payroll disbursements selected for testing where the employee was missing proper authorization on either "Authorization to Hire" and/or "Change in Payroll Status."
- During our test of controls, we noted 2 out of 40 payroll disbursements selected for testing where the signature of approval appears to be a PDF Signature Stamp.
- During our test of controls, we noted 2 out of 40 payroll disbursements selected for testing where the Bi-weekly amount paid to the employee did not match their "Change in Payroll Status" in their personnel file.

Cause of Condition:

The City did not enforce their control procedures relating to approval and documentation of personnel and time keeping. Oftentimes, these controls were bypassed due to a lack of staffing in the Human Resources Department.

Effect of Condition:

The effects of the stated control deficiencies are as follows:

- By not maintaining time sheets, employees could either be over or underpaid based on the number of hours they actually work.
- Bypassing controls relating to signatures on time sheets can cause incorrect hours to be paid to employees and therefore impacting the payroll expenses of departments.
- Bypassing controls relating to signatures on Authorization to Hire forms could cause individuals to be hired that are not qualified or approved for a position.
- Bypassing 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.
- Bypassing controls relating to signatures on Authorization to Hire forms and Change in Payroll Status forms could cause individuals to be hired that are not qualified or approved for a position and can cause employees to be paid at a rate which they have not earned or are not actually approved to be paid.
- Bypassing controls relating to signatures by using a PDF stamp could allow an individual to approve items they are not authorized to approve.
- 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.

Recommendation:

We recommend that the City maintain time sheets for each employee and for each pay period, which includes signatures of the employee and his or her supervisor. We also 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. 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. Lastly, we recommend that the City update their payroll system in order to ensure that the appropriate amounts are being paid to employees each pay period. We also recommend that the City personnel become familiar with what line items make up individual's payroll payments.

Management's Response:

Staff has implemented a number of new control policies and procedures which incorporate all of the above-mentioned recommendations. A new Human Resource Management position has been created to ensure proper protocols are followed for hiring and employee file maintenance. The new Manager has worked closely with the Payroll Department to verify the personnel files match the payroll system. All Department Heads have been informed of the importance of the employee signature, supervisor signature and overtime/comp accrual verification, and review by the Department Head of all time sheets/cards before submittal to the payroll department. The Payroll edit sheet is reviewed by the Director of Finance prior to check printing. It should be noted that exempt employees (management who are not eligible for overtime) do not ordinarily maintain a time sheet, with the exception of grant-funded project(s) time allocation.

2011-03: 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:

During our wire transfer walkthrough and fraud testing, we noted that there is no second party review or approval of wire transfers. In addition, the City currently does not have a Wire Transfer Policy.

Cause of Condition:

The City lacks control procedures over the wire transfer process evidenced by the City's lack of a Wire Transfer Policy.

Effect of Condition:

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 the City Council or the City Manager. Lastly, due to lack of a formal wire transfer policy, we are unsure of proper procedures and controls that should be followed.

Recommendation:

We recommend that a second party, of authority, review and approve all wire transfers. We recommend that this is performed by the City Manager. Furthermore, we recommend the City implement a Wire Transfer Policy to insure controls and procedures are always followed and a proper audit trail can be maintained.

Management's Response:

The City Manager does initial authorization of all wire transfers which are restricted to be made only between one city account and another – the City does not engage in any wire transfers-out with the exception of the Bond and USDA Loan payments that are set up to be paid via ACH auto payment system; the City Manager will also initial those payments and a Wire Transfer Policy will be added to the City's new Financial Management Procedures internal control policy.

2011-04: Receivables

Criteria:

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

Condition:

While performing our audit procedures and walkthrough for the City's accounts receivable, we noted several control deficiencies:

- During our analysis of the City's accounts receivable accounts, we were unable to determine the balance of accounts receivable as of June 30, 2011 for accuracy and completeness.
- Billing Clerks 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.
- There is no reconciliation of accounts receivable module to the general ledger which has caused a difference between the accounts receivable aging report and the general ledger of $146,000. In response to our audit recommendation made in the prior year regarding this issue, management made multiple adjusting journal entries to write-off uncollectable accounts receivable balances to bring accounts receivable to its true balance. However, reconciliation of accounts receivable was not completed throughout the fiscal year.
- The City does not currently have a written policy for the write-off of receivables

Cause of Condition:

The City lacks adequate control procedures relating to the recording and reconciliation of accounts receivable.

Effect of Condition:

The ability of the Billing Clerk to make changes to the Utility Billing Software, as well as make adjustments that are not reviewed, presents a lack of segregation of duties. In addition, although the City has made multiple adjustments to bring accounts receivable to its true balance, not reconciling accounts receivable on a consistent basis throughout the year may cause accounts receivable and revenue to be overstated. Management has stated at times adjustments get posted to the accounts receivable module and not updated on the general ledger, contributing to the need for consistent reconciliation of accounts receivable.

Recommendation:

The City should consider implementing controls to insure that only the Finance Director can post an adjustment to an account by having the Billing Clerk write down adjustment on paper cards approved by the clerk then final approval and posting by the Reconciling Accountant or the Finance Director. The City should also implement a write off/adjustment policy to insure a standardized process can be followed for writing off accounts and making adjustments. Lastly, we recommend the City reconcile the accounts receivable module directly to the general ledger on a monthly basis to insure both modules reconcile.

Management's Response:

Staff changes have been made to strengthen the segregation of duties; an adjustment log is maintained by the billing clerk and we are in the process of implementing the adjustment card system as recommended. A write-off/adjustment policy has been included within the Financial Management Procedures manual that was approved by the City Council and was in place prior to the write-off actions that were taken in an effort to reconcile an AR system that had never been reconciled. The Director of Finance has reconciled the AR/UB ledgers on a quarterly basis and will strive to implement the recommendations of a monthly reconciliation, however, it must be noted that the City currently bills every 30 days, but allows 40 days to pay before an account becomes delinquent and penalties assessed. Having this long an AR period makes it difficult to reconcile and staff will be working on changing the billing cycle timing to create a system like all other agencies that bills and penalizes within the same month. Changing the timing in this manner will not only eliminate a costly software modification that the City must renew and pay each year because of the irregular billing/penalty cycle, but it will also ensure that the AR is correctly stated.

2011-05: Purchase Card Disbursements (P-Cards)

Criteria:

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

Condition:

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

- Per review of all credit card statements for the entire year we were unable to account for $18,856.09 (44% of all expenditures selected for testing) in expenditures, several cost appeared questionable but we were unable to review any supporting documentation. We believe possible abuse/fraud has been committed with the use of the City P-Cards due to the lack of controls by prior City management.
- We noted several P-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.
- During our fraud testing, we noted several instances where P-Card payments was a below 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 the City's cash flow issues resulting from mismanagement of City operations.
- We noted the City lacks a P-Card Policy. The City did create a Credit Card Policy, but it did not go into effect until July 2011, after year-end.

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 supporting transactions we were unable to determine if P-Card transactions were valid City expenditures or if they allowed for possible fraud or abuse of credit cards.

Recommendation:

We recommend the City implement P-Card policy. We also recommend the City cut down the number of credit cards it currently has to limit the number of credit card transactions. Lastly, we recommend Management further investigate missing supporting documentation to determine if misuse of City funds can be recovered.

Management's Response:

A Credit Card Policy has been developed and is strictly enforced. The current City Manager did cancel and destroy all but 4 of the City VISA cards immediately upon his appointment (midyear fiscal year 2011) which has resulted in a decrease in VISA charges from $82,442.54 city-wide in fiscal year 2010-11 to a total city-wide for fiscal year 2011-12 of $18,559.75 – all of which is fully documented and supported with the majority of use for travel and training, mainly by the Public Safety Department which receives partial reimbursement from POST. The City currently has only 3 active VISA cards: Chief of Police, City Services Director, and Finance Department card that is kept in a locked cabinet and only available to authorized users who must sign it in and out. Original receipts are required to be attached to the authorization form, which must be coded and initiated by the department head, or their designee. All P-card accounts are now paid in full each month. Staff is committed to living within our means and maintaining strict accountability standards.

2011-06: 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:

- During our fraud testing, we noted 6 out of 25 travel expenditures selected for testing where the City was unable to provide any supporting documentation, we were unable to determine if the transaction was an abuse of the City's funds or potential fraud.
- During our testing, we noted 2 of the 25 travel expenditures selected for testing which were not travel related. They were both expenditures at local restaurants.

Cause of Condition:

Prior City management did not enforce their control procedures relating to approval and supporting documentation for travel expenditures. Oftentimes, these controls were bypassed as the former Finance Director did not enforce their policy requiring employees to submit all receipts for travel expenditures.

Effect of Condition:

Bypassing 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 was perpetrated by City personnel.

Recommendation:

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.

Management's Response:

It should be noted that all deficiencies noted herein were under *previous* management. Current management has written, adopted, and distributed a formal travel policy which includes standardized forms that must be coded, have supporting documentation attached, and be *pre-approved* by the appropriate Department Head and the City Manager and reviewed and approved by the Director of Finance prior to the printing of applicable travel warrants.

2011-07: Voided Check Fraud 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 fraud testing for the City's voided check process, we noted the following deficiencies:

- During our fraud testing, we noted 6 out of the 25 expenditures selected for testing where the check number did not agree to the preprinted check number. For example, a check in the City's system may be listed as #101, whereas it could be on the check stock of #103. Per further inquiry of City staff, when checks are printed, sometimes the check stock jams in the printer and can become unusable, resulting in check numbers differing from the system. Checks can also get out of order in the printer.
- During our fraud testing, we noted 1 out of the 25 expenditures selected for testing where we were unable to locate the voided check in the voided check files. Per inquiry with City staff, the City will occasionally enter the same check number for multiple invoices. Because of this, the City is unable to reissue that check number upon request for a replacement check. As a result, they will enter a letter at the end of the check number to issue a check.
- One check although voided in the City's system, still cleared the bank.

Cause of Condition:

The City lacks adequate internal controls over the cash disbursements process which includes the processing of voided checks.

Effect of Condition:

The City has difficulty reconciling checks with the bank. It is also more difficult to track if the check stock is being properly used and to determine that damaged check stock is not used.
Lastly, it can be more challenging to reconcile outstanding checks.

Recommendation:

We recommend that the City create a reconciliation which shows the check number the City recognizes and the check number the bank recognizes for all checks which have a discrepancy. This reconciliation should also note which check stock becomes damaged in order to determine which check numbers should not be used. We also recommend that the City purchase a new printer in order to significantly reduce or eliminate this issue. Lastly, we recommend that the City review invoices and checks before they are entered into the system in order to reduce, or prevent, the number of instances where a check number is entered twice, resulting in the check number not matching the actual check.

Management’s Response:

Per last year’s auditor recommendation the City did purchase a new computer which has eliminated the damage to check stock and we have also implemented a check ledger system whereby all check stock is secured in locked cupboards and only removed as needed, being duly noted on the ledger as to the date, batch number, and beginning and ending check numbers. A second ledger is kept for any manual or void checks. This system has greatly improved the efficiency and accountability of the accounts payable process; all checks for fiscal year 2012 to current are duly accounted for, without duplicates

2011-08: GANN Limit

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 procedures for GANN Limit, we noted that the City has not been in compliance with annual appropriation limits established in accordance with Article XIIIB of the California Constitution. Under this article of the California Constitution, the City must compute an annual appropriations limit that places a ceiling on the total amount of tax revenues the City can actually appropriate annually.

Cause of Condition:

The City lacks internal controls over the GANN Limit compliance process. This is evidenced by the City failing to established an appropriations limit that places a ceiling on the total amount of tax revenues the City can actually appropriate annually.

Effect of Condition:

As the City has not established a GANN Limit, the City is not properly or accurately setting a ceiling on the total amount of tax revenues the City can actually appropriate annually, which could allow the City to appropriate more than the ceiling would allow.

Recommendation:

We recommend that the City establish a GANN Limit, which would set a ceiling on the total amount of tax revenues the City can appropriate annually.

Management’s Response:

This deficiency was discovered, self-reported, and corrected during the budget process for fiscal year 2012-13. As Council has not initiated any tax increases during the time period indicted in which the GANN Limit was not properly calculated and set per resolution, there was no violation as regards to the appropriation limit.

2011-09: Petty Cash Fraud 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 petty cash process, we noted the following deficiencies:

- During our fraud testing, we noted 6 out of 25 petty cash disbursements selected for testing where the individual that received the petty cash had no signature of approval to do so.
- During our fraud testing, we noted 1 out of 25 petty cash disbursements selected for testing where they purchased iTunes, electronics, food, and something from a trophy shop that was claimed to be a business meeting expense (travel).
- During our fraud testing, we noted 3 out of 25 petty cash disbursements selected for testing where there was no way to tell whether or not the same person who approved the expenditure was also the person to receive it. There was only an "approved by" signature, but not a "received by" signature.
- During our fraud testing, we noted 11 out of 25 petty cash disbursements selected for testing where no support existed for the petty cash disbursement. One out of those 11 did not even have a "petty cash receipt" that would show approval.

Cause of Condition:

City management did not enforce control procedures requiring authorization from someone other than the individual receiving the petty cash. In addition, controls were not in place to prevent the purchase of prohibited items as many petty cash transactions were not supported.

Effect of Condition:

Bypassing 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. In addition, bypassing controls relating to approval, amount, 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.

Recommendation:

We recommend that the City require separate individuals to receive and approve each petty cash disbursement. In addition, 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 the individual approving the disbursement. Petty Cash Receipts should be accompanied by their corresponding receipts. Lastly, we recommend that the City place a limit on the amount of cash which can be distributed for any single expenditure, limit the total cash which can be on hand at any one time, and limit which types of expenses can be paid from petty cash.

Management's Response:

It must be noted that this condition existed under the *previous* city management as the current management team eliminated the use of petty cash entirely effective January 1, 2011, with all amounts reconciled and remaining cash funds returned to the city's general operating account by February 29, 2011. No city department has a petty cash fund; Period – problem solved.

2011-10: Other Postemployment Benefits (OPEB)

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 procedures for payroll and Other Postemployment Benefits (OPEB), we noted that the City has not implemented Governmental Accounting Standards Board (GASB) Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*, for calculating and recording their OPEB. This was required to be implemented for the City as of fiscal year 2010-11 due to the governmental phase they were in per GASB Statement No. 45.

Cause of Condition:

The City lacks adequate internal controls over the payroll process which includes OPEB. As a result, the City has not had an actuarial valuation performed for their OPEB liability. Based on the size of the OPEB plan, fewer than 200 members, the City is required to have a valuation report prepared at least triennially.

Effect of Condition:

As the City has not implemented GASB Statement No. 45, it is not properly or accurately recording their OPEB liability as of June 30, 2011.

Recommendation:

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

Management's Response:

The City has contracted with Bickmore Risk Services, in response to our RFP, to perform an OPEB actuarial valuation report that will include fiscal year 2012 and two years going forward per GASB 45.

2011-11: Cash Receipts 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 receipt process, we noted several control deficiencies.

- 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.
- All Finance Department Employees hold the password code to the main Finance Safe where cash is held at the close of each day.
- 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 test of controls, we noted the Finance Department is only reviewing a summery excel report of total daily cash receipts, and not reconciling to the Daily Cash Receipt report generated through McDermont Field House's accounting system.
- During our walkthrough, we noted that McDermont Field House does not have an account where overages or shortages are accumulated. Instead, they are just carried over month to month and added into the entrance fees.

Cause of Condition:

The City lacks adequate internal controls over the cash receipt process which includes McDermont Field House, an off-site cash collection location.

Effect of Condition:

The effects of the stated control deficiencies are as follows:

- 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.
- 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 is weak. An employee could easily misappropriate assets without detection.
- Cash discrepancies are not thoroughly investigated to determine source of cash shortage/overage.
- The 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.
- Due to the fact that overages and shortages are thrown into entrance fees, employees could easily misappropriate assets without detection since they are not keeping track of how much in excess they have or how short they are for the month.

Recommendation:

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

- 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.
- 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 to insure misappropriations of assets does not occur.
- 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.
- The Finance Department should also review to insure that summary reconciliation ties directly to the McDermont Field House accounting system to insure no override in controls occurred on the cash receipt reporting cycle.
- Create a separate account where overages/shortages are accumulated and can be tracked on a monthly basis.

Management's Response:

Staff has made many improvements in the cash receipts system: We now post daily, as opposed to monthly which identifies any discrepancies within 24 hours of occurrence; the duties have been adequately segregated to conform to acceptable security standards; the Director of Finance compares the transaction ledger to the deposit and initials, also reviewing and initialing the bank-stamped deposit slip upon return from the bank; an over/short line has been added to the McDermont accounting detail to track any cash discrepancies coming from that department; McDermont staff attach the computer-generated detail from their receipt system to the daily deposit transmittal that is submitted to Finance – those reports are maintained in separate files; only key finance staff have the code to the vault where the receipts are kept overnight before reconciliation and deposit; for further security, the beginning cash drawer and all receipts are kept in a locked cabinet within the vault to ensure custodial safekeeping during hours when there are many employees in and out of the vault that also serves as a record storage areas.

2011-12: Cash Disbursements

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:

- During our test of controls we noted 3 out of 41 expenditures selected for testing were missing cover sheets which shows the vendor, invoice number, check number, and what expense account the expenditure will be recorded in.
- During our test of controls we noted 20 out of 41 expenditures selected for testing were missing an approval signature authorizing the transaction for payment.
- During our test of controls we noted 1 out of 41 expenditures selected for testing was missing supporting documentation and/or cover sheet, we couldn't determine if the expenditure was a valid City expenditure or if it was a result of fraud or abuse by the City.
- During out test of controls we noted 3 out of 41 expenditures selected for testing had check numbers that did not match their records.

Cause of Condition:

City management did not enforce control procedures, and at times bypassed controls to expatiate cash disbursement process.

Effect of Condition:

The effects of the stated control deficiencies are as follows:

- Bypassing of coversheet control can cause for incorrect coding of invoice to the correct Fund/expense account.
- Invoices not having proper approval can lead to errors on recording the expense to the correct Fund/Account; which can also lead to unauthorized expenditures being paid out of the City's expense account with limited or no review.
- Issuing payments without proper supporting documentation can lead to misuse of City funds or possible fraud by City management.
- By processing checks with numbers that do not match their records, it makes it hard to keep proper documentation.

Recommendation:

Our recommendations address the four separate conditions listed above:

- We recommend that all expenditures be reviewed for completeness by the City Finance Department initiating the expenditure and final approval by the Finance Director. Once the Finance Director approves the invoice for payment he/she should insure that proper coversheet has been filled out prior to submitting the invoice to the Accounts Payable Clerk.
- We recommend that all invoices be approved by the Finance 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.
- It should be City policy that no payments will be issued without proper invoice/supporting documentation on file and has been approved by the City Department which initiated the transaction and the Finance Director.

Management's Response:

It should be made clear that this audit period is from July 1, 2010, thru June 30, 2011, and the deficiencies described existed under *previous management* which did not enforce proper internal controls. Current staff has implemented a number of internal controls based on the Brown Armstrong audit recommendations made in the fiscal year 2010 audit report, including all those listed above. Finance staff appreciates the complete support of the City Manager who whole-heartedly sanctions the rejection of any check request not properly authorized and supported. All current Department Heads and Supervisors have embraced the new accountability standards and this negative condition has been eliminated.

2011-13: Accounts Payable

Criteria:

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

Condition:

During out audit of accounts payable we noted that the City does not have a policy on how to handle long outstanding checks. Checks not cashed 6 months after issuance are voided and written off. If this occurs the vendor/payee must request another issuance of the check.

Cause of Condition:

The City lacks control procedures over accounts payable evidenced by the City's lack of a formal policy on how to treat long outstanding checks.

Effect of Condition:

Long outstanding checks may be improperly reported as bank reconciling items when they should removed per State escheat laws. Noncompliance with State escheat laws may cause the cash balance at year-end to be misstated.

Recommendation:

We recommend that the City adopt a formal long outstanding check policy that adheres to State escheat laws.

Management's Response:

This issue is addressed in Section 5-C of the *Financial Management and Accounting Procedures & Internal Controls Policy* that was approved by the City Manager on January 26, 2012, and by City Council, via the consent calendar, on the February 14, 2012, agenda. This policy is included as part of the fiscal year 2013 budget and can be found on page 102 of that document which is posted on-line.

2011-14: 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 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:

- During our journal entry testing, we noted 5 of our 20 entries selected for testing where the City was unable to provide support for the entry.
- During our journal entry testing, we noted 12 of our 20 entries selected for testing where there was no approval signature on the journal entry cover sheet or other supporting documentation. On all journal entries tested we noted there was no second approval signature, therefore a second person is not reviewing and approving journal entries.
- During our journal entry testing, we noted there were several journal entries containing multiple code corrections.
- During our journal entry testing, we noted several journal entries which were long and complex with limited support.
- During our accrued wages payable testing, we noted the City failed to accrue its year-end wages payable.

Cause of Condition:

The City lacks adequate controls and the staff lacks adequate knowledge of governmental accounting to ensure the accounting records are correctly stated for preparation of the financial statements.

Effect of Condition:

The effects of the stated control deficiencies are as follows:

- Bypassing controls relating to support and approval for journal entries could allow for inappropriate journal entries to be created or improper accounts to be charged.
- Bypassing 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.
- By creating code corrections, the City could improperly charge funds or accounts.
- By creating long and complex journal entries, the City is more likely to make a mistake in recording an entry.
- By not recording the year-end wages payable, the City will not be able to record the correct amount.

Recommendation:

Our recommendations address the five separate conditions listed above:

- We recommend that the City maintain a Journal Entry coversheet 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. We also recommend that the City keep better track of journal entries and journal entry support.
- We recommend that the City maintain a Journal Entry coversheet which describes all accounts affected by the journal entry which requires an approval signature for each journal entry.
- 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.
- 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.
- We recommend that the City make the necessary accruals when they close their books.

Management's Response:

Staff has implemented all the above recommendations.

2011-15: 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 deficiencies affecting capital assets as follows:

- The City does not have an up-to-date capital asset policy that covers all City owned assets.
- Useful lives for assets being depreciated vary and are not consistent with the stated policy.
- Management does not maintain a capital asset reconciliation that is updated throughout the fiscal year.
- Assets including the McDermont Field House building, City Swimming Pool, and City Library were taken out of construction in progress on July 1, 2009. These assets were actually completed between 2007 through 2008; depreciation expense is understated for these assets as they should have been removed from construction in progress in the previous years.
- Management is unable to provide cost information for several equipment and construction items, due to a lack of monthly or quarterly reconciliation of capital assets.
- No inventory for capital assets was performed to insure all assets included on the capital asset schedules are accounted for and properly stated.
- The City failed to post depreciation, capitalize assets correctly, and posted capital outlay to incorrect fund.

Cause of Condition:

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 of Condition:

The absence of performing monthly and/or routine capital asset 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, 2011, these are considered material weaknesses; a material misstatement of the financial statements could have occurred and would not have been prevented or detected by the City's existing internal controls. City management is unable to determine actual capital asset accounting as policy is out dated and does not cover all capital assets needing to be reported.

Recommendation:

We recommend management establish the following functions:

- Implement a thorough capital asset policy that covers all assets maintained by the city and provide appropriate useful lives for each asset category.
- We recommend the City perform reconciliation of all capital assets on a monthly/quarterly basis to insure assets can be capitalized in a timely manner.
- The City should keep better track of all cost for construction related assets to insure all assets/costs can be accounted for and vouched.
- The City should perform an inventory of capital assets each year to insure all assets are accounted for and still being used by the City.

Management's Response:

Staff has implemented a thorough Capital Asset Policy and corrected all useful life figures for each assets category. A senior account clerk has been given the duty of maintaining the capital assets database throughout the year as qualified purchases are made and obsolete equipment is disposed or removed from inventory. We are in the midst of updating the software system to include a tagging inventory system and to integrate the capital assets system with our accounting system which are currently two separate databases; this requires much duplication which increases the margin for error of omission. Due to the recommendations made last year by the Brown Armstrong auditors, staff has made a number of improvements and corrections to ensure the proper recording of both capital assets and construction-related capital improvements that increase the value of existing assets. The Director of Finance will attend an *Accounting and Financial Reporting for Capital Assets* training, sponsored by the Government Finance Officers Association that will enhance her ability to correctly calculate and record depreciation in conformity with GAAP principles.

2011-16: Understanding of Generally Accepted Accounting Principles (GAAP)

Criteria:

Government Auditing Standards state; "Government managers are responsible for providing reliable, useful, and timely information for accountability of government programs and their operations." To achieve this standard, all City staff must be adequately trained. We have also noted that the City has not implemented cross training programs.

Condition:

The City's staff does not possess an adequate understanding of prudent financial reporting, internal controls, accounting principles generally accepted in the United States of America (GAAP) and OMB Circular A-133, *Compliance Requirements*. Also, the City's staff with financial reporting responsibilities has not received adequate training. To achieve the goal of providing reliable, useful, and timely information for accountability of government programs and their operations, the City's staff should be adequately trained. Training has not been provided in the following areas:

- Governmental Accounting Standards Board pronouncements
- Accounting Principles Generally Accepted in the United States of America
- OMB Circular A-133
- *Government Auditing Standards*
- The financial reporting and internal control systems of the City
- Debt Management

Cause of Condition:

The City lacks adequate internal controls over financial reporting and has not implemented training programs for staff with financial reporting responsibilities to address this deficiency.

Effect of Condition:

When employees are not adequately trained, the potential for material misstatements in the financial statements, reports, and other communication is significantly increased.

Recommendation:

For the City to provide accurate, reliable, and timely information, City employees with financial reporting responsibilities must be trained. In addition, as the City has a small staff, cross training is very important. The City must develop and implement a training program which covers all financial and regulatory areas for City staff.

Management's Response:

Adequate training, including cross-training, has been a top priority as time and funds allow and many improvements have been made over the past year that will be evident during the fiscal year 2012 audit.

2011-17: Financial Reporting

Criteria:

The City should design and implement internal controls over the financial reporting process to ensure the following: 1) that the general ledger undergoes adequate procedures to ensure the proper application of fiscal year cut-off, 2) that the general ledger fiscal year period is closed and related financial statement supporting schedules are prepared in a timely manner allowing for a more efficient audit, and 3) that the final trial balance figures are subject to sufficient management review so that balances are presented in accordance with GAAP.

Condition:

During our fieldwork, we noted that the City did not complete the year-end closing procedures in a timeframe which would have allowed the financial statements to be issued in a timely manner. We noted that the closing procedures did not include a sufficient review of the information before it was provided to the external auditors. Based upon our audit we noted there were several post-close adjustments made by the City which included errors that led to additional adjustments and reversal of adjustments. Adjustments made by management considered to be material to the financial statements were related to beginning fund balance/net assets for prior period adjustments, accounts payable, accounts receivable, deferred revenue, capital assets, long-term debt, and revenue and expenditure/expense accounts. Also, during our testing of year-end cutoff procedures and over financial statements account balances we proposed audit adjustments to properly state the year-end account balances of certain accounts in accordance with GAAP. All adjustments that were proposed during the current year audit were presented to management and subsequently posted to the financial statements.

Cause of Condition:

Internal controls have not been suitably designed and implemented over the financial reporting process to ensure that the timely closure of the general ledger and sufficient management supervision of this process results in reliable and materially correct ending account balances in accordance with GAAP.

Effect of Condition:

Untimely closing procedures and financial statement preparation resulted in final fieldwork for the audit of the City's being postponed until August 2012. In addition, material adjustments were proposed and posted to the City's financial statements for the year ended June 30, 2011, and the Single Audit March 31, 2012, filing deadline was not met.

Recommendation:

We recommend that the City implement stronger policies and procedures to ensure that a comprehensive closing of the general ledger is performed in a timely manner and that sufficient resources and adequate oversight are available to oversee the City's year-end closing procedures and preparation of the financial statement supporting schedules. We also recommend that the City strengthen its year-end closing procedures to ensure that all transactions related to the fiscal year are properly captured and recorded in the general ledger to ensure the accuracy and completeness of the financial statements.

Management's Response:

While staff does not dispute that our year-end closing practices fell well short of optimum for fiscal year 2011, for which the current Director of Finance takes full responsibility, it should be noted that staff has been inundated with constant public information requests and audit reviews by TCAG, HCD, CDBG, and DOT that stretched staff's time and resources to the limit over this past year and a half. In addition, a great deal of time and effort was dedicated to writing and implementing all the missing policies referenced throughout this audit report to ensure the recommended controls and procedures are in place going forward. We have made many improvements, but acknowledge that we have many more areas to address and improve. We are committed to constantly improving our practices based upon recommendations we have received from the various audit teams that have been through the City over this past year.

2011-18: 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:

- The City is not performing cash reconciliations to the general ledger on a timely basis and, at times, cannot get bank reconciliations to tie to the general ledger.
- During our audit of cash and cash equivalents, 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.
- The City's PayPal account was not reported on the general ledger correctly and no reconciliation of the PayPal account has been made throughout the year.
- During our audit of cash, we noted that the City had many large outstanding checks in their cash account reconciliations at year-end which resulted in checks being printed prior to June 30, 2011, but not mailed out due to the City's cash flow issues. As of June 30, 2011, we were 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 City lacks adequate internal controls over the recording, reconciling, and reporting of cash and cash equivalents.

Effect of Condition:

The effects of the above stated deficiencies are as follows:

- By not regularly performing cash reconciliations, errors or discrepancies are allowed to accumulate making it difficult to reconcile accounts. Additionally, items which should be removed from the outstanding check list may remain on the listing, as they are not reviewed or reconciled. Regular reconciliations would address discrepancies as they arise and aid in preparing year-end reconciliations.
- Regular reconciliations would address discrepancies as they arise and aid in preparing year-end reconciliations.
- Pay Pal Activity could not be reported correctly on the City's general ledger.
- The City would have many large outstanding checks as they would print them and hold onto them until they 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, 2011 is unknown and therefore cash balance should be increased and accounts payable balance should increase, we are unable to determine the correct difference.

Recommendation:

Our recommendations address the conditions listed above:

- We recommend that the City perform cash reconciliations for all accounts on a monthly basis.
- Due to un-reconciled balances carrying over from prior year, we recommend that the City spend additional time to reconcile the differences, if these differences cannot be determined client should post a journal entry to correct the unreconciled difference.
- A new PayPal account should be added to the general ledger and the PayPal account should be reconciled on a monthly basis.
- We recommend that the City only print checks when they are 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 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:

We have made a number of improvements in this area: The most important improvement was the consolidation of the receipts and accounts payable functions into one operating account which has virtually eliminated the need to transfer funds between accounts; we have established a PayPal account in the general ledger (it should be noted that this account is solely for the recurring billing of McDermont Field House memberships); we have re-assigned duties to allow the senior account clerk to dedicate more time to bank reconciliations; we have improved the City's cash flow situation to the point that we are able to print checks weekly and mail within 5 days of printing once all applicable remittance support has been attached to the payment.

2011-19: Notes 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:

During our audit of the City's notes receivable account, we noted several notes receivable that were improperly omitted from prior year accounting records. In addition, we noted that prior year ending balances for notes receivable, per the schedules provided, did not tie to current year beginning balances.

Cause of Condition:

During our walkthrough of the notes receivable process we noted the City lacks controls over the Notes Receivable process and, most notably, does not reconcile notes receivable. The lack of this reconciliation process most likely led to the omission of notes receivable in the prior year and the inability to tie prior period notes receivable balances per the schedule provided to beginning balances per the general ledger.

Effect of Condition:

Although the City makes adjustments to bring notes receivable to its true balance, not reconciling notes receivable on a consistent basis throughout the year may cause notes receivable and revenue to be overstated.

Recommendation:

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

Management's Response:

The City has made improvements in this area by adding an additional entry code, per the auditors' fiscal year 2010 recommendation, that ensures the notes receivable line and the deferred revenue line are adjusted as payments are made which should solve this issue by ensuring that we are in balance at the time a payment is received and entered. Additional reconciling processes are being developed to include a monthly review.

2011-20: Due To/From Other Governments

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 that the City does not reconcile its due to and due from schedule on a regular basis. We also noted during our audit procedures that many of the due to and due from borrowing last for more than one year.

Cause of Condition:

City management did not enforce controls relating to reconciling items such as due to and due from other funds. 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:

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

Recommendation:

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 and coming from. In addition, 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:

This condition has created one of the most difficult quandaries for current management as we strive to bring all funds into proper and supportable balance with proper identification and recording of all fund activity. Due to many years of Due To/From transactions being made at the end of each fiscal year, *but not being reversed* – as is the norm – at the beginning of the next fiscal year, the problem compounded to the point that determining a true and accurate fund balance for every city fund has been challenging. We have made great improvements in this area and are confident that this issue will be satisfactorily resolved going forward. The current Finance Director did use this function sparingly and all June 30, 2011 transactions were duly recorded on a Due To/From schedule that was then reversed July 1, 2012.

2011-21: McDermont Field House Notes 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:

While performing our notes receivable testing we noted several deficiencies regarding the McDermont Field House notes receivables. First, we noted that loans were created and paid out of the general fund to employees to operate and manage various attractions at the McDermont Field House. 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. Lastly, we noted that some employees of McDermont Field House were being paid directly out of petty cash.

Cause of Condition:

The City lacks internal controls over notes receivable. In several cases, City management bypassed controls by not reviewing loan applications in detail and giving loans to individuals who did not qualify. In addition, as outlined in Management Letter Item 2011-09, the City lacks adequate internal controls over petty cash.

Effect of Condition:

The effect of this condition is that the general fund, which was already depleted, expended more funds during fiscal year 2010-11. The loans relating to the McDermont Field House grew by over $150,000 after July 1, 2010, to $443,872 by the end of the program in November 2010.

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

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.

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:

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

Management's Response:

The City has implemented all the recommendations as set forth above and has gone a step further by outsourcing all loan processing to qualified specialists: CSET is the loan administrator for the State small business grant program that was supposed to have funded the McDermont loans and Self-Help Enterprises, Inc. processes all home loan applications. We do take issue with the last sentence regarding the loss of tax payer money as some of these businesses did become operational – the laser tag, the birthday party enterprise, the concessions, and the vending machines – which did generate revenue that was deposited into the city accounts with the understanding that the loan obligation of the assisted entrepreneurs would be reduced by the amount of revenue generated by these independent business owners.

2011-22: 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 regulation.

Condition:

We were unable to conduct audit procedures on compensated absences as all balances were carried over from prior year and were not adjusted to present current year balances.

Cause of Condition:

The City lacks adequate internal controls over payroll including compensated absences. Per discussion with current management, due to an increase in work load and limited staff, the adjustment to account for compensated absences was overlooked.

Effect of Condition:

The balance of compensated absences is misstated in the financial statements for the year ended June 30, 2011.

Recommendation:

We recommend that the City prepare a schedule of compensated absences at least at year-end and adjust the accounting records so that the correct balance of accrued leave is presented in the financial statements.

Management Response:

The Finance Director takes full responsibility for failing to make this entry which is very important as reducing the liability has been a top priority of the current administration; the overall liability went from $332,269 at the end of fiscal year 2010 to $220,719 at the end of fiscal year 2011 – a liability reduction of $111,550 which means the City is $111,550 better off than the financials indicate. The liability for compensated leaves payable is now identified and included on the newly established Long-term Debt schedule; the schedule of accrued leaves at June 30, 2012, has been completed by the payroll clerk and shall be posted to the General Ledger as part of the fiscal year-end closing procedures to ensure that the balance of compensated absences is not misstated going forward and can be cross checked against the Long-Term Debt Schedule.

2011-23: 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 in the City's financial accounting system.

Cause of Condition:

The City lacks adequate internal controls over the budget process. 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:

This reference is in regards to the budget year 2010-11 which was the second of a two-year budget that was passed by former management who failed to either adhere to the budget or keep council apprised of gross variances through the use of budget amendments or budget updates. Current staff does engage in quarterly updates to Council and has requested budget amendments as needed. However, improvement is still needed in this area to adjust the revenue side of the budget when receipts exceed estimates – at this time, those adjustments will be presented somewhat after-the-fact as part of the year-end closing report made to the City Council.

2011-24: 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:

- 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.
- 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.
- 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 City lacks adequate internal controls over IT.

Effect of Condition:

The effects of the stated control deficiencies are as follows:

- 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.
- 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.
- 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:

- 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.
- 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.
- 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:

The City has implemented a formal password policy that requires passwords to be changed July 1 and January 1 of each year. No user shares a password and privileges have been restricted for each user to allow only those functions essential to their job duties. The City is in the midst of transitioning the Financial Accounting System to an ASP system, which will eliminate the need for an on-site server and ensure constant and continual backup of the major accounting system by the software company via the internet auto backup and restore feature. The hard drive data of each staff member will continue to be backed up to the backup server every Monday that is remotely located in an inaccessible area of the Planning Department; steps shall be taken by the city services staff to address the addition of a locking cabinet feature. Staff members, such as the City Manger and City Planner, shall have additional backup features depending on the sensitivity and importance of their data.

2011-25: 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.

Condition:

- 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.

- 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.

- 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 California Department of Transportation (CalTrans) reimbursement requests.

Cause of Condition:

The City lacked adequate internal controls over the tracking of eligible expenditures on the project. In several cases, it appears to have over-charged the project due to cash flow difficulties.

Effect of Condition:

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. On April 2, 2012, a Settlement Agreement was signed between the City and the Tulare County Transportation Authority (TCTA) whereby the City is required to repay $1,048,443 of the $3,746,967 funds received in connection with its Downtown Project under the TCAG Measure R grant. Principal payments shall be made in 80 quarterly installments commencing on October 1, 2012 in addition to interest on the outstanding balance.

Recommendation:

- 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.
- 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.
- 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.
- 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 has implemented all of the recommendations as set forth above including the writing and passing of a Financial Management for Grants Policy. Current practices have been reviewed by the California Department of Transportation (DOT) during a field review conducted in January 2012, which resulted in a letter from DOT, dated March 27, 2012, that found the majority of the SA findings from the previous year to be either resolved, or partially resolved, and current practices meet acceptable standards. The City has also undergone two separate quarterly reviews by the independent auditor, at the behest of the TCAG Board, which has duly noted the improvement in current practices.

2011-26: 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.

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:

The City lacks adequate internal controls over the purchasing process which includes CCOs. In addition, City management bypassed established controls and 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 has implemented all the recommendations as set forth above including passage of a new Contract Change Order policy to which we have strictly adhered. A separate CCO Policy, specific to grant-funded projects, has been included in the *Financial Management of Grants Funds Policy*. All CCOs over the past year have been duly authorized and included on Council Agendas.

2011-27: 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 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 the 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, 2011, these are considered material weaknesses because a material misstatement of the financial statements could have occurred and would not have 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:

- Cash and cash equivalents 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.
- 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 the City or the 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:

All cash and investments held with the City and Redevelopment Obligation Retirement Fund (RORF) fiscal agents have been reconciled with all interest earned, or transfers from the bond reserve accounts, recorded to the general ledger as of June 30, 2012, including the accrued interest that was received in July 2012.

The City will not be issuing any additional long-term debt within the next five years.

Land transactions shall be duly recorded within a reasonable time of escrow closing.

2011-29: Excess Surplus

Criteria:

Per Health & 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 Tulare 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, they have not instituted the required sanctions where excess surplus funds were not expended or encumbered within the statutory timeframe.

Cause:

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

Effect:

The Agency is currently out of compliance with Health & 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 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 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 Response:

Per California legislation AB1X26, all redevelopment agencies were dissolved as of February 1, 2012. In the case of the former Agency, the governing Board took action to dissolve as of October 1, 2011, the original date specified in the legislation, and reaffirmed the dissolution with Resolution No. 12-02 adopted on January 10, 2012.

An oversight board has been established to assist with the dissolution process which includes the filing of a Recognized Obligation Payment Schedule that identifies the former Agency's outstanding debt to be paid. A report identifying all assets and housing assets has been compiled and presented to the oversight board for approval. Staff is currently in negotiations with the Tulare County Housing Authority to transfer all housing assets to that agency. Current staff has no doubt that the excess surplus balance is materially misstated from years of incorrect recording; the County of Tulare has contracted with a special auditor to conduct an agreed upon procedure (AUP) on each former agency and the successor agent now responsible for the dissolution process; City staff has provided all requested documents in an effort to complete the "wind-down" process.

2011-30: Five Year Implementation Plan

Criteria:

In accordance with Health & 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:

The Agency lacks adequate controls and knowledge of redevelopment 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:

The Agency is currently out of compliance with Health & Safety Code §33490, which could affect further funding for the 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 law requirements. We also recommend that the Agency take appropriate steps to complete the five year implementation plan.

Management Response:

As a consequence of AB1X26, the Agency was formally dissolved as of October 1, 2011 – with a reaffirmation of the dissolution via Resolution No. 12-02, dated January 10, 2012. Under these circumstances adoption of a five year implementation plan is a moot point.

2011-31: Submission of Reports to California State Controller-Accounting and Administrative Controls

Criteria:

In accordance with Health & 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, financial transactions 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, or the property report. Furthermore, the Agency also failed to submit the financial transactions report and loan report by the deadline of December 31, 2011.

Cause:

The Agency lacks adequate controls and knowledge of redevelopment 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:

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

As a consequence of AB1X26, the Agency was formally dissolved as of October 1, 2011 (initially August 23, 2011) – with a reaffirmation of the dissolution via Resolution No. 12-02, dated January 10, 2012. Under these circumstances, the referenced reports are no longer relevant.

2011-32: Related Party Land Transactions between the City of Lindsay (the City) and 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 that the Agency engaged in three land purchases from the City without appropriate land appraisals. The total of the land transactions were $3,690,000, which is equal to the total amount of the California and the California Housing Finance Agency (CalHFA) Loan No. RDLP-090806-03, which was to be used to land acquisition and development of three separate housing developments.

Per the City Council Resolution No. 08-06 dated March 27, 2007, and Agency Board Resolution LRA0-01 dated February 12, 2008, the Board of Directors and the City Council 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 Council Resolution No. 08-65 dated August 26, 2008, and Agency Board Resolution LRA08-06, the Board of Directors and the City Council 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 Council Resolution No. 09-40 dated June 30, 2009, that the City 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 their assets in order to comply with Governmental Accounting Standards Board (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 the Agency performed this transaction as a way to extract funds from the Agency to supplement the City's cash flow needs.

Cause:

The Agency lacks adequate controls and procedures for the performance of transactions involving the purchase of land held for redevelopment. The Agency also fails to track all land held for resale transactions that occurred throughout the year. Furthermore, the Agency also fails to periodically perform an inventory count on land held for redevelopment or to assess any impairments to reflect appropriate values.

Effect:

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

Management Response:

It should be noted that the statement of condition determines the time period to have been "*previous fiscal years"* and the condition was created under former management. Current staff has established a complete listing of all properties identified via the County assessor's office as belonging to the former Agency and are currently in the process of transferring all housing assets to the Tulare County Housing Authority, identifying properties that should be classified as "for the public good" that will be retained (parking lots, park areas, etc.), and preparing the remaining inventory – all of which has been recorded to the fixed asset software program – to be sold with the proceeds to be used to retire debt associated with the former Agency. Property sales may not begin until July 1, 2012, according to the guidelines set forth in ABX126.

2011-33: Noncompliance with California Housing Financing Agency (CalHFA) Loan No. RDLP-090806-03

Criteria:

In August 2007, the Agency 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.

Condition:

During our analysis of compliance with debt agreements of the Agency, 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 2011-32, 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 for which one of the projects was to be completed on. 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.

Cause:

The Agency lacks adequate controls to ensure that the Agency stays in compliance with debt agreements.

Effect:

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.

Recommendation:

We recommend that the Agency work with counsel and contact the CalHFA to communicate the noncompliance with the debt agreement. Ultimately with the hopes that the loan will not be called.

Management Response:

It should be noted the year this condition was created was 2007 under previous management. Current management has been in contact with the CalHFA to apprise them of the situation and to request an extension of the repayment. CalHFA is awaiting these audited financial statements in order to have all relevant information on which to base their decision. This debt has been duly noted on the Recognized Obligation Payment Schedule and considering the Agency no longer exists, the "going concern" finding becomes a moot point.

2011-34: Pooled Investment Earnings Allocations – Accounting Controls

Criteria:

Health & 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 City and 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 City's and Agency's assets known as "Due from other Funds," were not reimbursed to the City and 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:

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 or Agency's funds are accurate when computing the quarterly interest income allocations.

Effect:

Since the balances in the "Due from Other Funds," held by the City or 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 Board of Directors.

Management Response:

Due To and Due From other Funds activity recorded by previous management has been found to be flawed and unsupported to the point that it has been extremely difficult to ascertain proper balances under those designations. Prior to its dissolution, current staff had set up and maintained a separate savings account at Local Agency Investment Fund (LAIF) and carefully recorded the amount of deposits and interest designated for the Capital Projects Fund vs. the Housing Set-Aside Fund. This is now a moot point; all cash funds have been reclassified to the RORF and are maintained, including allocation of interest credit, within that restricted fund.

2011-35: Due to/From

Criteria:

In accordance with Governmental Accounting Standards, transfer of funds using due to/from are intended to be short-term in nature. A due to/from remaining outstanding over an entity's operating cycle is essentially a loan and should be classified as such.

Condition:

While performing our audit of due to/from we noted that approximately $3,000,000 is due from the City to the Agency that has been outstanding for more than one year. Due to the City not being a going concern as of June 30, 2011, and City funding shortages we believe that there is a low probability this $3,000,000 will be paid back to the Agency.

Cause:

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;

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

Recommendation:

We recommend that the City transfer funds using due to/due from only if the funds are expected to be paid back within one year. We also recommend that the City reclassify the $3,000,000 due from the City as a loan made to the City from the Agency to more accurately represent the nature of this transaction in the financial statements. In conjunction with the reclassification of the $3,000,000, we recommend that the Agency also receive interest payments in addition principal payments using a comparable rate of interest for a similar debt issuance.

Management Response:

A five-year history of these general ledger Lines – *Due To/From* for both the former Agency and the former LMI Funds, indicate that past entries were made at the end of each fiscal year, not based on actual activity, but rather in an effort to avoid showing negative cash balances in other funds and the paper transactions were never reversed in the subsequent fiscal year. Because the majority of these entries lack any supporting documentation it is impossible, without a forensic audit, to determine the true amount that may, or may not, be owed from the City to the former Agency or vice-versa. It is apparent that projects that did utilize Agency or LMI funds were not properly posted with a Transfer In/Out entry which would have been the proper accounting entry in many instances and provided a more accurate accounting of Redevelopment Activity and contribution to public projects.

For example: There is a *Due From* entry in the former Agency Fund made in fiscal year 2007-08 denoted as "Library Fund Expense" for $1,064,646 that would have been the Agency's contribution to the construction of the new City Library; this entry should have been a *Transfer-Out* from the Agency Fund with a corresponding *Transfer-In* to the Library Fund which shows a "*Due To Other Funds"* balance of $1,194,185. This indicates that the former Finance Director was incorrectly using *Due To/From* when there were instances, such as that described above, when he should have been using the *Transfer In/Out* accounting codes instead that would properly have accounted for the project contribution(s) of the Agency.

Unfortunately, this issue is not confined to the former Agency and LMI funds, but was routinely applied to all City funds, rendering all *Due To/From* balances suspect. Current staff is hoping to have these balances corrected in fiscal year 2012, but will only make adjustments that can be fully supported with the proper documentation regarding the transaction. Past administration did not support any of the fiscal year-end entries; it is noted there are auditor entries for which staff will have to request work papers in order to determine if the entry was truly a *Due To/From* or if it should more correctly be a *Transfer In/Out.* In preparing this response, the Director of Finance only ran a five year history, but it is apparent that this practice of miscoding extends back at least twenty years, so it will take some time to sort through and determine proper balances. This research has clearly shown that many of the Agency contributions to public benefit projects were not properly recorded.

Therefore, the City will not reclassify the amount of approximately $3,000,000, or any other amount at this time, until a forensic audit of that activity determines which agency, if either, owes the other.

2011-36: 2005, 2007, 2008, and 2009 Tax Allocation Bond Non-Compliance

Criteria:

In accordance with debt covenant number six in the debt agreements for the 2005, 2007, 2008, and 2009 Tax Allocation Refunding Bonds, "the Agency covenants and agrees that it will at all times keep, or cause to be kept, proper and current books and accounts (separate from all other records and accounts) in which complete and accurate entries will be made of all transactions related to the Project Area and the Redevelopment Project, Pledged Tax Revenues and other funds relating to the Project Area and will prepare within one hundred eighty days after the close of its Fiscal Years a complete financial statement or statements for such year in reasonable detail covering such Pledged Tax Revenues and other funds, certified by a certified public accountant or firm of certified public accountants selected by the Agency, and will furnish a copy of such statement or statements to the Trustee, the Bonds Insurer, any rating agency which maintains a rating on the Bonds and to any Bond owner upon written request."

In accordance with debt covenant number thirteen in the, "the Agency covenants and agrees that it has not and will not incur any loans, obligation or indebtedness repayable from Pledged Tax Revenues such that the total aggregate debt service on said loans, obligations or indebtedness incurred from and after the date of adoption of the Redevelopment Plan, when added to any predecessor debt, the total aggregate debt service on the Bonds, will exceed the maximum amount of Pledged Tax Revenues to be divided and allocated to the Agency pursuant to the Redevelopment Plan."

Condition:

While performing our audit of debt we noted that the Agency was out of compliance with debt covenant number six described above. Per debt covenant number six, financial statements are required to be issued within 180 days after the close of the respective fiscal year. As of August 1, 2012, the Agency had not issued financial statements for the year ended June 30, 2011.

While performing our audit of debt we noted that the Agency was out of compliance with debt covenant number thirteen as described above. Per debt covenant number thirteen, the Agency promises not to incur indebtedness that would cause current debt payments to exceed current revenue. As of June 30, 2011, the Agency had $6.2 million indebtedness due within one year which exceeded total revenues of $1.6 million for fiscal year 2011.

Cause:

The Agency has been unable to issue financial statements within the 180 days of year-end due to multiple accounting issues requiring additional audit procedures. The Agency was unable to issue financial statements for the year ended June 30, 2010, within 180 days of the fiscal year 2010 end, placing the Agency further behind a timely issuance for the June 30, 2011, year-end financial statements.

Effect:

Noncompliance with debt covenants puts the Agency at risk for an event of default. Per the 2005, 2007, 2008, and 2009 Tax Allocation Refunding Bond agreements, upon an event of default the Trustee (US Bank) may, with the consent of the Bond Insurer, and shall at the direction of the Bond Insurer or the Owners of not less than a majority of the aggregate principal amount of the Bonds at the time outstanding with the consent of the Bond Insurer, declare the principal of all the Bonds then outstanding and the interest accrued thereon, to be due and payable immediately.

If the Trustee (US Bank) declares the Agency at default for the 2005, 2007, 2008, and 2009 Tax Allocation Bonds, the total amount of principal outstanding that would be due as of June 30, 2011, was $16,198,290.

Recommendation:

We recommend that Agency take the necessary steps to comply with debt covenants in relation to the 2005, 2007, 2008 and 2009 Tax Allocations Bonds.

Management Response:

The Legislature of the State of California, at the direction of the Governor, passed ABX126 which called for the dissolution of all Redevelopment Agencies within the state and further complicated the issue by rushing to pass this flawed legislation that did not provide adequate guidelines for the dissolution process resulting in mass confusion at the state, county, and local levels. Additional legislation (AB1484) has been passed in an effort to clarify and "clean-up" the process, but the State Department of Finance (DOF) has sent out confusing and/or conflicting instructions which continue to complicate matters as staff strives to meet new conditions and deadlines for the Successor Agency that was formed to administer the dissolution process of the former redevelopment agency – Deadlines that contain stiff penalties if not met. This process includes identification of enforceable payment obligations (such as the bonds), payment source, i.e. tax revenue vs. property sales, etc., identification and sale or transfer of assets, etc. This is an extremely complicated process, particularly in the case of the former Lindsay RDA; any error in the process, due to haste, could prove costly to the Successor Agency (City) – staff has been providing documents and working to determine the ownership of certain tangible assets as there was more integration between the City and the RDA in previous years than there should have been; we have discovered a number of projects that included the RDA as part of the leverage amount, but are working to ascertain if the *transfer out* transactions were properly recorded to the General Ledger to reflect this participation.

Part of the dissolution process is the requirement that the Successor Agency obtain the services of a qualified independent CPA to perform a special Agreed-Upon-Procedure (AUP) known as a Due Diligence Review (DDR) that is intended to provide the aforementioned clarity with a deadline of October 1, 2012. Unfortunately, due to the incomplete procedural guidelines of the DOF, the California Association of CPAs is cautioning its members regarding this procedure. Staff is anxious to engage in the DDR as we believe it will provide the needed clarity going forward that will enable all future audits to be completed timely and in compliance with the debt covenants.

As far as exceeding the indebtedness levels: Only the bonds have *tax revenue* as a pledged repayment source – this obligation is clearly stated on the Recognized Obligation Payment Schedule (ROPS) that must be passed every six months declaring the amount of revenue needed from all sources, including the Redevelopment Property Tax Trust Fund (RPTTF) – the State of California has declared that the dissolution process will NOT adversely affect enforceable obligations that are covered by tax revenue deposited into the RPTTF as long as there is sufficient revenue to meet those obligations. Only the Tax Allocation Bond Payments are requested from the RPTTF and tax revenues are sufficient to meet all bond payment obligations at this time.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Material Weakness

2011-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 (022), CML 5189 (023), CML 5189 (025)
Pass-Through Entity: California Department of Transportation

Federal Grantor: U.S. Department of Housing and Urban Development
Title and CFDA: Community Development Block Grants; 14.228
Award Number: 05-EDBG-2181, 08-STBG-4843
Pass-Through Entity: California Department of Housing and Urban Development

Questioned Costs: None
Compliance Requirement: Internal Controls, Activities Allowed or Unallowed, and Allowable Costs/Cost Principles
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 an 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:

Staff has implemented new control procedures and written a Policy and Procedures Manual as well as a Financial Management and Accounting Manual that were submitted to, and approved by, the City Council to address and correct this issue; all employees that participate in the administrative and/or clerical level of a grant project have been provided a copy. This is an on-going effort and just recently a Financial Management of Grants Funds Policy was added to the controls policies to ensure greater specificity relevant to grants management. This audit finding is based on a review of issues in fiscal year 2010-11 and does not acknowledge any of the aforementioned improvements that were made in fiscal year 2012.

2011-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 (019)
Pass-Through Entity: California Department of Transportation

Questioned Costs: $137,592.26
Compliance Requirement: Internal Controls – Reporting
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.

Condition:

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

1. The City had submitted a reimbursement request to CalTrans which included too many employee hours as reimbursable costs. In particular, one employee charged 1,950 hours to this grant, approximately 93% of the total hours worked in an entire year.
2. The City has not implemented adequate controls over the reimbursement process, as there is no review from management to ensure that the reimbursement request correctly reflect all those expenditures that are eligible for reimbursement.
3. 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 do not reconcile the reimbursement requests to their accounting records.

Effect:

As a result of the lack of internal controls over the reimbursement requests, the City was reimbursed for more hours worked than they should have been.

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 proper amounts are being requested. Additionally, 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:

The invoice date for the above-referenced is dated November 22, 2010 - *before* the current control measures were implemented. Staff agrees that this invoice is exactly why new, stricter policies and procedures needed to be implemented and did self-report the condition to both the independent auditors and to CalTrans who is currently conducting their own audit and investigation (A&I) of incurred costs relevant to this project to identify any deficiencies, incorrect or duplicate billings. Previous staff did lack both the training and the oversight by administrative management personnel that has resulted in a current liability to the Measure R Fund to repay $1,048,443 in ineligible costs (a payment arrangement agreement is in place) and may result in additional ineligible costs that may have to be repaid to the Department of Transportation depending on the outcome of the current A&I results.

Management does now review all outgoing invoices and reimbursement requests as well as reconcile the incoming revenue to the proper project.

2011-SA-03: Lack of Controls over Payroll and Fringe Benefit Payments

Federal Grantor: U.S. Department of Housing and Urban Development
Title and CFDA: Community Development Block Grants; 14.228
Award Number: 09-EDEF-6362, 08-EDEF-5786, 06-EDEF-2725, 08-STBG-4843, 09-PTAE-6560
Pass-Through Entity: California Department of Housing and Urban Development

Federal Grantor: U.S. Department of Housing and Community Development
Title and CFDA: HOME Investment Partnership; CFDA 14.239
Award Number: 06-HOME-2406
Pass-Through Entity: California Department of Housing and Community Development

Questioned Costs: None
Compliance Requirement: Internal Controls and Allowable Costs/Cost Principles
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 governmental unit.

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, time studies have not been performed that would provide the City with a basis of properly allocating 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 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 time studies so all future payroll and payroll related charges are properly allocated amongst all Federal grants and City activity.

Response and Corrective Action Plan:

The City did conduct a time study in February 2011 and again in August 2011; however, we did also adopt a policy that only time actually worked on a project, recorded to a City time sheet at the time of the activity, and posted to the payroll distribution system at payroll input will be considered an eligible reimbursable expense. Although Federal grants do allow for reimbursement of leave time per a written leave policy, which the City of Lindsay does not have, current administration chooses to error on the side of caution and disallow all leave time for reimbursement purposes and use only documented *actual- time-worked*. This eliminates the issue of improper allocation entirely.

2011-SA-04: 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; 14.228
Award Number: 05-EDBG-2181, 08-STBG-4843
Pass-Through Entity: California Department of Housing and Urban Development

Questioned Costs: None
Compliance Requirement: Internal Controls and Davis-Bacon
Reporting Requirement: Material Weakness

Criteria:

In accordance with the Davis-Bacon Act (USC 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. We were unable to determine whether or not the City had received these week's certified payrolls as the City lacks an adequate method of tracking the receipt of the certified payrolls. Furthermore, for the certified payrolls which were received by the City, many were not completed correctly by the contractors as they lacked signatures of an authorized contractor representative.

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 all 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 contract 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 of those contractors that fail to comply with all Davis-Bacon Act and contract agreements.

Response and Corrective Action Plan:

The City did develop and approve a Davis Bacon Act (DBA) policy as part of our overall comprehensive internal control policy manual. Further, the Administrative Assistant to the City Services Director did attend a Davis Bacon Act training workshop in Sacramento on October 5, 2011, to ensure staff is adequately trained to enforce and maintain compliance with the DBA requirements for all projects to which to which the act applies.

2011-SA-05: Federal Clearinghouse Data Collection Form Submission

Federal Grantor: U.S. Department of Housing and Community Development
Title and CFDA: HOME Investment Partnership; CFDA 14.239
Award Number: 06-HOME-2406, 07-HOME-3081
Pass-through Entity: California Department of Housing and Community Development

Federal Grantor: U.S. Department of Agriculture
Title and CFDA: Community Facilities Loans (Library and Wellness Center); 10.766
Award Number: 97-12, 97-13
Pass-through Entity: N/A

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 the 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 OMBs 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:

Management is making every effort to resolve all weaknesses and deficiencies from previous years and ensure strict accounting controls are maintained going forward in order to be in compliance with reporting deadlines.

2011-SA-06: City's Purchasing and Contracting Provisions

Federal Grantor: U.S. Department of Housing and Community Development
Title and CFDA: HOME Investment Partnership; CFDA 14.239
Award Number: 06-HOME-2406, 07-HOME-3081
Pass-through Entity: California Department of Housing and Community Development

Federal Grantor: U.S. Department of Agriculture
Title and CFDA: Community Facilities Loans (Library and Wellness Center); 10.766
Award Number: 97-12, 97-13
Pass-through Entity: N/A

Federal Grantor: U.S. Department of Housing and Urban Development
Title and CFDA: Community Development Block Grants; 14.218
Award Number: 05-EDBG-2181, 09-EDEF-6362, 09-NSP1-6270, 08-EDEF-5786, 06-EDEF-2725, 08-STBG-4843, 09-PTAE-6560
Pass-through Entity: California Department of Housing and Urban Development

Questioned Costs: N/A
Compliance Requirement: Procurement
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 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."

Per OMB Circular A-102, “Federal agencies shall not award assistance to applicants that are debarred or suspended, or otherwise excluded from or ineligible for participation in Federal assistance programs under Executive Order 14249. Agencies shall established procedures for the effective use of the List of Parties Excluded from Federal Procurement or Non-procurement programs to assure that they do not award assistance to listed parties in violation of the Executive Order.”

Condition:

The City approved, through its competitive bid process, a Wellness Center parking lot project and a Library Landscape Project. However, over a period of a year, 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 CCOs 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.

During procurement testing, we noted that the City is not performing a verification check for covered transactions, by checking the Excluded Parties List System (EPLS), collecting certification form the entity, or adding a clause or condition to the covered transaction with the City.

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. Furthermore, lack of EPLS verification could result in the granting of a contract to a barred party.

Cause:

Management did not require the entire scope of the construction project to be included in the formal bid process. In addition, in regards to the EPLS expectation, management was not aware of the EPLS verification requirement.

Recommendation:

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. Furthermore, we also recommend that the City obtain an agreement for all CCOs before the commencement of the work. Lastly, we recommend that the City check all vendors against EPLS before granting contracts or entering into any type of agreement for goods or services.

Response and Corrective Action Plan:

All recommendations as outlined above have been implemented into current procedures: Bidding Procedures are clearly outlined in Article II/Section 2 of the City’s new *Financial Management and Accounting Procedures & Internal Controls Policy Manual;* the updated Contract Change Order Policy is included in the previously referenced control manual and was adopted by Council as a stand-alone policy - the restrictions and approval requirements are stricter than those recommended above; Contract preparation and administrative procedures are also outlined in the new manual; staff now prints and attaches to every winning file the EPLS verification, the state license verification, and bond and workmen’s compensation insurance verification. In addition to the new Procedure and Control manual being provided to every employee that has purchasing authority or project management authority, a copy is also included with the City’s annual budget which is posted on the City’s website.

2011-SA-07: Equipment and Real Property Management

Federal Grantor: U.S. Department of Agriculture
Title and CFDA: Community Facilities Loans (Library and Wellness Center); 10.766
Award Number: 97-12, 97-13
Pass-Through Entity: N/A

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

Criteria:

In accordance with OMB Circular No. A-110, recipients of Federal awards must maintain accurate equipment and real property records that contain, among other things, the funding source of the equipment and real property, including the award number. Also, when disposing of equipment and real property 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 and real property, 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 used to track equipment and real property 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 and real property that have been purchased with the 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:

Staff has implemented the auditor recommendations and has created a category within our fixed assets accounting software program to uniquely identify all equipment purchased with federal funds. Further, the Director of Finance will be attending training on the proper identification and accounting for fixed assets in September 2012 which will ensure the proper identification, depreciation, and disposal or retirement of assets purchased using federal funds.

2011-SA-08: SEFA Reconciliation

Federal Grantor: U.S. Department of Housing and Community Development
Title and CFDA: HOME Investment Partnership; CFDA 14.239
Award Number: 06-HOME-2406
Pass-Through Entity: California Department of Housing and Community 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 (SEFA) for the period covered by the recipient's financial statements and provide total Federal awards expended for each individual Federal program.

Condition:

During our SEFA reconciling procedures, we discovered $1.1 million in federal expenditures that was not reported on the SEFA provided by the City.

Effect:

As a result of the City's current procedures, the SEFA was not a complete or accurate schedule of all the City federal awards.

Cause:

The City lacks an adequate SEFA reconciling process to ensure that the SEFA contains all federal awards were presented and accurate.

Recommendation:

We recommend that the City create and implement a process that includes the participation of all City employees handing management of grant monies to ensure that the City correctly and accurately reports all federal awards awarded and administered by the City.

Response and Corrective Action Plan:

The SEFA is a schedule of expenditures for federally funded projects; the amount in question was for The Groves Senior Villas Apartment Project, which was a Partnership *Loan* between the City and the Project Owners who used multiple funding sources including a commercial loan from Wells Fargo, the USDA and other sources in addition to the HOME Loan on this $8.1 million project that City leaders felt should be assisted as it would improve the affordable housing options for our senior citizens. In accordance with the HOME Loan Program guidelines, the City would secure repayment of the loan with a Deed of Trust duly recorded with the County Recorder and was to record the amount of the loan onto its financials as an asset. Both requirements were done and the asset is reflected in the Notes Receivable and Deferred Revenue category. That being said, staff concurs with the auditor's statements and recommendations and has already implemented a new procedure for accurately reconciling the SEFA report which includes educating all key personnel in what should be included on the report, including any Partnership Grant and/or loan awards that are facilitated by the City.

NOTE FROM CITY MANAGEMENT: All findings contained herein are based on an examination of records for activity between July 1, 2010 (before current management took over in November 2010) and June 30, 2011. The following conditions existed under the previous management: Lack of adequate internal controls, including many direct overrides; improper fund accounting practices regarding proper use of funds; lack of adherence, or adjustment to the approved budget; and failure to fully inform the governing body regarding the financial status of all City funds, or provide adequate or complete information upon which to base its decisions. These deficiencies were not formally identified by the previous auditors, despite the fact that all these conditions existed in previous fiscal years, particularly fiscal years 2007-09. The current audit firm did not come in and begin its review until February 2011 and did not issue its preliminary recommendations until April 2011, just two months before the end of the fiscal year that this audit report covers. The financial management system is slowly being rectified through the implementation of the current auditor recommendations, creation and adoption of strict procedural and control polices, thorough and accountable oversight practices that provide an effective checks and balances system between departments to ensure compliance at every step, outsourcing loan administration, establishment of a local loan review committee comprised of four members (versus only two on the previous committee), communication to the governing body which was previously lacking (including quarterly financial updates), and enhanced training for staff.

Current practices (fiscal year 2011-12) have been reviewed by many state and federal agencies (DOT, HCD, CDBG, etc.) over this past year to verify that the City has remedied the deficiencies identified herein. The City did receive a Management Letter from the California Department of Transportation, dated March 27, 2012, regarding the results of their Audit and Investigation of current practices which found the City to have implemented, or be in the process of implementing, all the recommendations made by the various audit teams that have come through and to be within acceptable standards. This was also found to be the case in the last AUP Quarterly Review from the Independent Auditor dated July 20, 2012. Both these documents may be reviewed in the Finance Department and were included as an informational item with the Council Agenda of September 25, 2012.

Staff is committed to operating within the highest possible standards and providing the greatest amount of information and transparency possible to our elected officials and their constituents as we move forward into a new era of recovery, conservation, and prosperity for the City of Lindsay.

SECTION IV – STATUS OF PRIOR YEAR 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 to 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 PayPal account was not reported on the general ledger correctly and no reconciliation of the PayPal account has been made throughout the year.

4. During our audit of cash and cash equivalents, 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, 2011, but not mailed out due to the City's cash flow issues. As of June 30, 2011, 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 the 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 the 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 making it difficult to reconcile 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, 2011, 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 PayPal account should be added to the general ledger and the PayPal 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 clearinghouse (ACH) activity is properly recorded.

3. A new PayPal account has been added to the general ledger and shall be reconciled on a monthly basis to reflect the bi-monthly membership billing going on from the recurrent billing system of the 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 that by 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 they relate 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.

Current Year Status:

See current year finding at 2011-18.

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 the 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. Bypassing 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. Bypassing controls relating to petty cash approval could allow for petty cash to be used improperly or in unreasonable amounts.

3. Bypassing 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. Bypassing 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. Bypassing 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.

Current Year Status:

See current year finding at 2011-09.

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, 2011.

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 the original posted balance.

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."

Current Year Status:

See current year finding at 2011-19.

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 due 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.

Current Year Status:

See current year finding at 2011-20.

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, 2011, 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 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 from the Reconciling Accountant or Finance Director.

3. The 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 that 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 a 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 reasons for the adjustments.

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.

Current Year Status:

See current year finding at 2011-04.

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 the 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 the 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 the McDermont Field House by loaning money to vendors to essentially run small businesses, which were the attractions, within the 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 that the general fund, which was already depleted, expended more funds during fiscal year 2009-10. The loans relating to the McDermont Field House grew by over $150,000 after June 30, 2011, 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 has adopted a formal agreement with Community Services and Employment Training, (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.

Current Year Status:

See current year finding at 2011-21.

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 follows:

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 lacks 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, 2011, these are considered material weaknesses because a material misstatement of the financial statements could have occurred and would not have 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 was 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.

Current Year Status:

See current year finding at 2011-15.

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 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 part-time 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 check run and print all applicable reports, forwarding to Finance Director the total from the check 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 part-time Finance Clerk shall prepare for mailing by ensuring each check has appropriate backup so that the vendor can properly charge 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 an absence.

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

Current Year Status:

See current year finding at 2011-13.

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.

- 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.

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

<u>Cause of Condition:</u>

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. The McDermont Field House staff only submit excel reconciliations of daily cash receipts to the Finance Department.

<u>Effect of Condition:</u>

The effects of the stated control deficiencies are as follows:

- 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.
- 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.
- Cash discrepancies are not thoroughly investigated to determine source of cash shortage/overage.
- Lack of initials on the McDermont Field House receipt reconciliations indicates that they are not being properly reviewed by both the 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.

<u>Recommendation:</u>

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

- 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.
- 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.
- 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.

- 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 are 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.

Current Year Status:

See current year finding at 2011-11.

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.

Current Year Status:

During our test of utility billing we did not note any of the conditions noted above for the fiscal year ending June 30, 2011. Controls over the utility billing process were effective for the year under audit.

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.

Cause of Condition:

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. Bypassing 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. Bypassing 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. Bypassing 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. Bypassing 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.

<u>Recommendation:</u>

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.

Current Year Status:

See current year finding at 2011-02.

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, 2011, 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.

Current Year Status:

During our audit procedures over payroll we did not note any of the conditions noted above for the fiscal year ending June 30, 2011. Payroll allocations tested in the current year appear reasonable.

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, 2011.

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.

Current Year Status:

See current year finding at 2011-10.

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.

Current Year Status:

See current year finding at 2011-22

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:

- 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.

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

- 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.

- 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. Bypassing 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. 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.

Current Year Status:

See current year finding at 2011-12.

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.

<u>Current Year Status:</u>

See current year finding at 2011-05.

2010-17: Journal Entry Testing

<u>Criteria:</u>

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.

<u>Condition:</u>

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.

Cause of Condition:

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.

Effect of Condition:

The effects of the stated control deficiencies are as follows:

1. Bypassing 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. Bypassing 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.

Recommendation:

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.

Current Year Status:

See current year finding at 2011-14.

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 the 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. Bypassing 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. Bypassing 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.

Current Year Status:

See current year finding at 2011-06.

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 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 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 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.

Current Year Status:

See current year finding at 2011-03.

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.

Current Year Status:

See current year finding at 2011-23.

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:

- 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.
- 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.
- 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:

- 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.

- 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.

- 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:

- 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.
- 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.
- 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 the Finance Director's absence, that duty shall be performed by the customer service clerk.

<u>Current Year Status:</u>

See current year finding at 2011-24.

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

<u>Criteria:</u>

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>

- 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.
- 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.
- 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.

Cause of Condition:

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.

Effect of Condition:

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.

Recommendation:

- 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.
- 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.
- 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.
- 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 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 a request for proposal (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.

Current Year Status:

See current year finding at 2011-25.

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.

Current Year Status:

See current year finding at 2011-26.

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 the 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.

Current Year Status:

As a result of our audit procedures for the year ended June 30, 2011, we did not note any instances of wasteful spending.

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 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 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 Facilities 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 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.

Current Year Status:

As a result of reviewing Form 700s for the year ended June 30, 2011, and inquiring with management, we did not note any conflicts of interests affecting current management. We believe that the previous City Manager and Finance Director are still being investigated by the District Attorney for possible violation Government Code Sections 87200-87210.

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

<u>Condition:</u>

The City and 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.

<u>Criteria:</u>

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.

<u>Cause of Condition:</u>

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.

<u>Effect of Condition:</u>

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, 2011, 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.

<u>Recommendation:</u>

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

- Cash and cash equivalents 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.
- 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 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.

Current Year Status:

See current year finding at 2011-27.

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 the Agency, a component unit of the City, entered into an agreement (CalHFA Loan No. HELP-080803-06) with the State of California and the 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, 2011, 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 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, 2011, 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.

<u>Cause of Condition:</u>

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 CalHFA 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 Community Development Block Grant (CDBG) and First Time Home Buyer Grant (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.

Current Year Status:

Per review of a letter provided by the Tulare County District Attorney addressed to the City regarding a formal investigation, they concluded the following:

"[The Tulare County District Attorney's] office has conducted and completed a criminal investigation of the allegation made and a full legal analysis was done of the facts. Although evidence does show that the guidelines were blatantly overridden with four of the CalHFA loans, there is no evidence of criminal activity. [The District Attorney's] review specifically found that although these acts were egregious, there is no evidence to support a criminal charge that the loans were made in violation of the conflict of interest statute (Government Code section 1090), nor is there evidence of an embezzlement of public funds (Penal Code section 424).

In addition to [the District Attorney's] analysis, members of the investigative and prosecurtorial team personally met with an expert in government corruption cases from the Attorney General's office in order further analyze and discuss the facts of the case. After reviewing the facts, the Deputy Attorney General also opined there was no evidence of criminal activity in this situation. As a result of the Attorney General's opinion and [the District Attorney's] findings, we have determined that further action by this office at this time would not be appropriate.

It should be noted that [the District Attorney's] review was limited to determining if any criminal acts had occurred and did not address issues of civil liability, incompetence by officials employed by the City of Lindsay or accounting or procedural errors by such officials. The review also did not address whether a civil remedy is available to the City of Lindsay for any questions related to incompetence or errors by any government officials."

Given this response provided by the Tulare County District Attorney, we will pass on further investigation regarding prior year abuse of Authority and grant noncompliance of excessive loans to City employees and/or employee relatives. Furthermore, we noted in the current year that none of the new loans provided as part of Agency programs were issued to City or Agency employees and/or employee relatives. We also noted that although a formal Loan Committee was not established, Community Development Specialists, those who work directly with the funding of loans, had improved knowledge of grant guidelines and stipulations of eligibility when calculating and reviewing eligibility of recipients.

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 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 29, 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.

Current Year Status:

See current year finding at 2011-33 addressing the noncompliance with CalHFA Loan No. RDLP-090806-03. Per discussion with the Agency's legal counsel regarding the 2009 tax bond allocation, 876,210 of the bond issuance was to be deposited in the redevelopment fund. Of this, 20% or $175,242 was to be transferred to the Low and Moderate Income Housing Fund. The Official Statement states that the Agency intended on using the proceeds for the purpose of construction certain infrastructure improvements in the Downtown area and to provide for first-time homebuyer grants. The Official Statement also reflects that the then current tax and redevelopment law that proceeds could be spent on other permitted redevelopment purposes. One of the critical elements of complying with tax law is that the Agency must reasonably expect to expend proceeds for a governmental purpose within 3 years of the date of delivery. The Notes were issued in November 2009, so it is possible to continue the expenditure for Federal tax purposes through November 2012. The IRS also allows for the reallocation of expenditures during this period to insure that the expenditures are attributable to qualified expenditures. Per the Agency's legal counsel, from a cash flow point of view, if the Agency expended proceeds for a non-qualifying purpose and expended non-bond proceeds for a qualifying purpose during the two year time period, the Agency can reallocate the uses to match up with the requirements of the Federal tax law.

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 29, 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.

Current Year Status:

As of June 30, 2011 the Agency is properly allocating 20% of the gross tax increment to the Low and Moderate Income Housing Special Revenue 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.

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 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 Council Resolution No. 08-06 dated March 27, 2007, and Agency Board of Directors Resolution LRA0-01 dated February 12, 2008, the Board of Directors and the City Council 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 Council Resolution No. 08-65 dated August 26, 2008, and Agency Board of Directors Resolution LRA08-06, the Board of Directors and the City Council 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 Council Resolution No. 09-40 dated June 30, 2009, that the City 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 market 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 the 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 ABX127, 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.

Current Year Status:

See current year finding at 2011-32.

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 29, 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.

Current Year Status:

See current year finding at 2011-29.

2010-32: Five 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 29, 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.

Current Year Status:

See current year finding at 2011-30.

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 29, 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.

Current Year Status:

As of June 30, 2011, the Agency is properly coding expenditures to the correct accounts. We noted that no expenditures were paid by the Agency that should have been paid by the City. In addition, the Agency was dissolved before October 1, 2011, and established a repayment plan as required by the provisions of ABX126 and ABX127.

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 29, 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.

Current Year Status:

See current year finding at 2011-34.

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 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 29, 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.

Current Year Status:

See current year finding at 2011-31.

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: Unable to Determine
Compliance Requirement: Internal Controls, Activities Allowed or Unallowed, and Allowable Costs/Cost Principles
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.

Current Year Status:

See current year finding at 2011-SA-01.

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.

Current Year Status:

See current year finding at 2011-SA-02.

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: Unable to Determine
Compliance Requirement: Internal Controls and Allowable Costs/Cost Principles
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.

Current Year Status:

See finding at 2011-SA-03.

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: Internal Controls and Equipment and Real Property Management
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 supplementary 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.

Current Year Status:

See current year finding at 2011-SA-07.

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: Unable to Determine
Compliance Requirement: Internal Controls and Davis-Bacon
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.

Current Year Status:

See current year finding at 2011-SA-04.

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: Unable to Determine
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 the Finance Department 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.

Current Year Status:

As of June 30, 2011, the City has correctly reported the amount of Federal expenditures on the Schedule of Expenditures of Federal Awards. The City is correctly tracking Federal awards to ensure that all Federal transactions are being accounted for separately.

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: Unable to Determine
Compliance Requirement: Internal Controls and 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.

Current Year Status:

As of June 30, 2011, the Agency is properly tracking program income generated from Federal Grant awards. During our audit procedures over program income for all grants tested we noted that identifying account codes were assigned to each specific project, grant, and funding source. Also, noted that program income is being tracked and reconciled on a timely basis.

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: Activities Allowed or Unallowed, Allowable Costs/Cost Principles, and Procurement
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.

Current Year Status:

See current year finding at 2011-SA-06.

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 and 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.

Current Year Status:

See current year finding at 2011-SA-05.