CITY OF LINDSAY

SINGLE AUDIT REPORT

JUNE 30, 2012

CITY OF LINDSAY
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JUNE 30, 2012

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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 have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of City of Lindsay, California (the City), as of and for the year ended June 30, 2012, which collectively comprise City's basic financial statements and have issued our report thereon dated July 23, 2013. 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.

<u>Internal Control Over Financial Reporting</u>
Management of the City is responsible for establishing and maintaining effective 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 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 and 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 and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be material weaknesses: 2012-01 through 2012-15 and Federal award findings 2012-SA-01 through 2012-SA-03.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We noted no deficiencies to be significant deficiencies, all deficiencies described in the accompany schedule of findings and questioned costs are assessed as 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 2012-06, 2012-12, 2012-14, and 2012-SA-01 through 2012-SA-03.

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 them.

This report is intended solely for the information and use of management, the City Council, others within the City, and 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
July 23, 2013

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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 have audited the City of Lindsay's, California (the City) compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (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, 2012. The City's major federal programs are identified in the summary of the 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 the 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 2012-SA-02 and 2012-SA-03 in the accompanying schedule of findings and questioned costs, the City, did not comply with requirements regarding accounting of program equipment and real properly management and subrecipient monitoring 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 Agriculture, Community Facilities Loans (CFDA #10.766). Compliance with such requirement is necessary, in our opinion, for the City, to comply with the requirement applicable to that program.

In our opinion, the City did not comply, in all material respects, with the compliance requirement referred to above that could have a direct and material effect on each of its major Federal programs for the year ended June 30, 2013, as a result of noncompliance items described in the preceding paragraph. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB A-133 and which are described in the accompanying schedule of findings and questioned costs as item 2012-SA-01.

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 and other deficiencies that we consider to be significant deficiencies.

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 2012-SA-01 through 2012-SA-03 to be material weaknesses.

A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We noted no deficiencies to be significant deficiencies, all deficiencies described in the accompany schedule of findings and questioned costs are assessed as 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 them.

This report is intended solely for the information and use of management, 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
July 23, 2013

CITY OF LINDSAY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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	05-EDBG-2181	$ 1,189
Community Development Block Grant	*	14.228	08-EDEF-5786	116,395
Community Development Block Grant	*	14.228	09-EDEF-6362	32,274
Community Development Block Grant	*	14.228	09-PTAE-6560	2,930
Total Community Development Block Grant				152,788
Total U.S. Department of Housing and Urban Development				**152,788**
U.S. Department of Agriculture:				
Community Facilities Loans (Library)	*	10.766	97-12	149,060
Community Facilities Loans (Wellness Center)	*	10.766	97-13	487,706
Total U.S. Department of Agriculture				**636,766**
U.S. Department of Justice:				
DOJ - COPS-in School		16.710	#2009RKWX0171	81,664
Total U.S. Department of Justice				**81,664**
Total				**$ 871,218**

* 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, 2012

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 U.S. Office of Management and Budget (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, 2012. 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	$ 2,008,777
USDA - Sewer	10.706	5,886,772
USDA - Sewer	10.706	429,795
USDA - Tulare Road	10.766	1,436,337
USDA - Wellness Center	10.766	1,688,285
USDA - Library	10.766	532,422
		$ 11,982,388

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

CITY OF LINDSAY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2012

SECTION I – SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued: Qualified

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: Qualified

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
10.766	U.S Department of Agriculture Community Facilities Loans

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

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

SECTION II – FINANCIAL STATEMENT FINDINGS AND QUESTIONED COSTS

Material Weakness

2012-01: Accounts Receivable

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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 the City of Lindsay's (the City) accounts receivable, we noted that multiple material adjustments were required to arrive at the accurate and complete accounts receivable balance as of June 30, 2012.

Cause of Condition:

The City does not reconcile accounts receivable and we have noted various deficiencies in the Accounts Receivable Cycle which include the following: first, 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 while being capable of overriding the system; second, the City does not currently have a written policy for the write-off of receivables; and lastly, 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.

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 serious 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 that 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 adjustments on paper cards approved by the Billing Clerk then final approval and posting by the Reconciling Accountant or 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:

The administration recognizes that this is a weakness in our daily operating routine and will take steps to establish better controls relative to both the adjustment and the reconciliation procedures. The City did write and implement a write/off adjustment policy in fiscal year 2012 as part of the new Accounting Policy and Procedure Manual (#11. Uncollectible Receivables page 65), but will take greater steps toward ensuring the write-off procedure includes reconciling the approved adjustments to both the general ledger and Utility Billing Software module.

2012-02: Accounts Payable

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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 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. Also, noted during our search for unrecorded liabilities the City failed to post $480,858 in accrued expenses.

Cause of Condition:

The City does not have a formal policy on how to treat long outstanding checks. Therefore, outstanding checks are reported as an outstanding bank reconciling item for months without proper consideration of state escheat laws. In addition, the City overlooked material expenses for goods and services provided prior to the fiscal year-end that should have been accrued.

Effect of Condition:

Long outstanding checks may be improperly reported as bank reconciling items when they should be removed per State escheat laws. Non-compliance with State escheat laws may cause the cash balance at year-end to be misstated. In addition, failure to accrue expenses that were incurred prior to fiscal year end result in the misstatement of accounts payable.

Recommendation:

We recommend that the City adopt a formal long outstanding check policy that adheres to state escheat laws. We also recommend that the City perform its own search for unrecorded liabilities as part of the City's financial close process in order to detect and accrue any expenses representing goods and services that were provided before year-end.

Management's Response:

Staff will develop and implement a formal long-outstanding check policy that adheres to state escheat laws before the end of fiscal year 2013.

2012-03: Capital Assets

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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 capital assets, we noted several material deficiencies affecting capital assets as follows:

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

- No inventory for capital assets was performed to insure all assets included on the capital asset schedules were accounted for and properly stated.
- The City failed to post current year depreciation expense.
- The City failed to properly track multiple capital outlay additions and deletions.
- Noted during our physical observation of assets the City failed to delete an obsolete asset from their capital asset tracking software. Further, the City replaced the obsolete asset with a new asset that was improperly excluded from the City capital asset listing.

Cause of Condition:

The City lacks adequate controls and staff lack adequate knowledge of capital asset 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 provide opportunities for errors which can accumulate and 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. In addition, the absence of performing an annual physical asset inventory results in the reporting of obsolete assets and/or the omission of newly acquired assets from the City's financial statements. Lack of a physical asset inventory also increases the risk and opportunity of theft as assets may be taken without detection. Because the procedures recommended below were not in place during the year ended June 30, 2012, these are considered material weaknesses because a material misstatement of the financial statements could have occurred and not been prevented or detected by the City's existing internal controls.

Recommendation:

We recommend management establish the following functions:

- 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.
- City should keep better track of all cost for construction related assets to insure all assets/costs can be accounted and vouched for.
- City should perform an inventory of capital assets each year to insure all assets are accounted for and still being used by the City. Any assets that are not in use should be deleted from the City's capital asset system.
- As part of the closing process, the City should make the necessary entries to account for depreciation expense.

Management's Response:

The City has made tremendous improvements in the area of accounting for capital assets compared to previous years; however, we recognize that improvements are still needed and more staff time needs to be allocated for this process. This is a complex process that requires a level of expertise current staff does not possess. In order to rectify the problem, we will be adding more staff training and bringing in a CPA specialist to assist with capital asset management and depreciation calculations both for year-end for fiscal year 2013 and quarterly for fiscal year 2014.

2012-04: Notes Receivable

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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. As a result, several material adjustments were made to properly report the true year-end balance of notes receivable.

Cause of Condition:

During our walkthrough of the notes receivable process we noted the City 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 made 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:

Now that all balances have been properly defined, staff will reconcile quarterly in fiscal year 2013 with the goal of monthly reconciliations to being in fiscal year 2014.

2012-05: Lack of Segregation of Duties

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, internal controls should be designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.

Condition:

While performing our test of controls and walkthrough of the City's journal entry process, we noted several journal entries did not have a signature of approval on the journal entry or the Finance Director would prepare, enter, and approve the journal entry. While performing our audit procedures over cash we noted that cash reconciliations were not being completed in a timely manner as the Finance Director was the only City personnel with adequate accounting knowledge required to complete the reconciliations. Lastly, we noted during the financial reporting process that the Finance Director handled most all the year-end closing procedures including calculating and posting year-end accruals, preparation of final trial balance figures, reconciling due to/due from and transfers in/out, and implementing new GAAP and GASB Statements.

Cause of Condition:

City staff lack adequate knowledge of governmental accounting that would ensure the accounting records are correctly stated for preparation of the financial statements. Currently, the Finance Director is the only City personnel with knowledge of governmental accounting.

Effect of Condition:

The Finance Director is able to post journal entries, prepare cash reconciliations, and conduct financial closing procedures with little oversight. This may result in the misstatement of financial information due to improper postings of journal entries or improper financial closing procedures. In addition, lack of governmental accounting knowledge by City personnel has resulted in late filing of both the Comprehensive Annual Financial Report (CAFR) and Single Audit report.

Recommendation:

We recommend that the City either hire individuals with governmental accounting knowledge to aid the Finance Director in completing financial reporting duties or train current staff to obtain a basic understanding of governmental accounting. To improvement segregation of duties, cash reconciliations should be prepared by an individual other than the Finance Director, limiting the Finance Director's role to review and approval of reconciliations. In addition, journal entries should be approved by someone other than the preparer of the entry.

Management's Response:

The Account Clerk III will be trained to take over the duties of cash reconciliations now that all cash accounts have been accurately balanced and brought up-to-date. A limited budget prohibits any additional staff or consulting arrangements with individuals well-versed in public finance procedures in fiscal year 2013, but we will make provisions for additional training and oversight procedures in fiscal year 2014, including retaining a CPA, or qualified outside professional, to review all reconciliations on a quarterly basis and provide an independent report certifying correctness or irregularities. We hope to be able to afford a position of P/T Finance Manager in fiscal year 2015 to provide the necessary separation of duties and oversight.

2012-06: GANN Limit

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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 to 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 has not 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:

That oversight was discovered, self-reported, and corrected while preparing the fiscal year 2013 budget – the City is now in compliance with the GANN Appropriations Limit Act – the City was well under the ceiling.

2012-07: 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 accounting principles generally accepted in the United States of America (GAAP).

Condition:

During our fieldwork, we noted that the City did not have year-end closing procedures in place which would have allowed the financial statements to be issued in a timely manner. We noted that the closing procedures currently in place 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 statement 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. In addition, the City has not implemented training programs for staff with financial reporting responsibilities.

Effect of Condition:

Untimely closing and lack of financial statement preparation procedures resulted in final fieldwork for the audit of the City's being postponed. This was aggravated by employees who were not properly trained in financial closing processes. As a result, material adjustments were proposed and posted to the City's financial statements for the year ended June 30, 2012, and the Single Audit March 31, 2013, 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. Lastly, we recommend the City invest in training and cross-training programs for those employees with financial reporting responsibilities.

Management's Response:

We concur that this is, by far, been our greatest failing as we have focused on the implementation of other internal control policies and procedures we felt were more pressing to regain control of the City's finances. We have not adequately addressed the year-end process. Implementing the auditor recommendation above is the number one priority, in addition to the cash reconciliations, for the new fiscal year to ensure the accuracy of the financial statements and the timeliness of our next audit report.

2012-08: Due to/Due from Other Governments

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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:

Prior 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. 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 administration made one (1) Due To/From entry for fiscal year 2012 that was immediately reversed in fiscal year 2013 as is the norm. There were no other entries made, thus nothing to reconcile except the inherited balances we know to be incorrect – refer back to the "Cause of Condition" section. Since the amounts in the Due To/From general ledger line are compounded amounts from many, many years worth of entries, without any supporting documentation, proper reconciliation is impossible. The best we can hope to do is unravel the stated amounts, tracing back through the many years of entries and attempt to discern the proper reconciling entries. As there was never any supporting documentation for the original entries year-after-year, staff is moving slowly on this issue to ensure that the adjusting entries necessary to correct this problem are fully supportable and correct.

2012-09: Reconciling Accounts to Supporting Documentation

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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 does not reconcile its general ledger accounts to supporting documents. In order to make the interim and annual financial statements meaningful, we recommend the City reconcile the general ledger accounts for cash with fiscal agent; accounts receivable; notes receivable; 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.

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, 2012, these are considered material weaknesses because a material misstatement of the financial statements could have occurred and not been prevented or detected by the City'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 investments held with the City'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.

- An aging schedule for accounts receivable should be generated from the City's financial system on a monthly basis. Anything deemed uncollectable per the aging schedule should be written off. The proper recordation of uncollectable accounts receivable balances will provide for fair presentation of the accounts receivable balance per the year-end financial statements.

- Notes receivable should be reconciled from the payment history reports month-end balance to the notes receivable schedules kept by City personnel on a monthly basis to ensure that all note holder payments are properly recorded. The proper recordation of note holder payments will provide for fair presentation of the notes receivable balance per the year-end 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 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:

Staff appreciates the thorough and concise recommendations made by the audit team and will strive for immediate implementation.

2012-10: Cash and Cash Equivalents

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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 procedures over cash and cash equivalents, we noted the following deficiencies:

- They 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, we noted that two of the City's bank accounts could not be reconciled by City staff from the bank balance to the general ledger balance.
- We noted for one of the cash accounts, McDermont Field House and Recreation Center, credit card receipts are not being tracked properly as a reconciling item.

Cause of Condition:

The City Finance Department is short staffed and did not have an accountant that could reconcile cash accounts on a monthly basis. Further, under prior City management, reconciliations were not completed on a regular basis, resulting in the accumulation of several years worth of errors affecting cash balances, making it difficult for current City management to reconcile cash.

Effect of Condition:

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

Recommendation:

We recommend that the City perform cash reconciliations for all accounts on a monthly basis. Due to un-reconciled balances carrying over from the prior year, we recommend that the City spend additional time to reconcile the differences. If the source of these differences cannot be determined we recommend the client post the necessary journal entries to correct the un-reconciled difference.

Management's Response:

We have finally been able to reconcile our cash differences and all bank accounts are now balanced through May 31, 2013.

2012-11: Land Held for Resale

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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 that the City's former Redevelopment Agency (the Agency), now the Successor agency, engaged in three land purchases from the City without any appropriate land appraisals. The total of the land transactions were $3,690,000, for which 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 still holds title to the land.

Cause of Condition:

The City lacks adequate controls and procedures for the performance of transactions involving the purchase of land held for redevelopment. The City also fails to track all land held for resale transactions that occur throughout the year. Furthermore, the City 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 City's current land held for redevelopment balances appear to be materially overstated. Since the City 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 implement new procedures for all land for redevelopment transactions. These procedures should include obtaining appropriate appraisals prior to the purchase of any land to ensure that all land purchases are completed at fair value. We also recommend that the City establish new procedures to periodically perform an inventory count and assessment of these land parcels to ensure that the City still holds the title and is reporting these land parcels at an appropriate value.

Management's Response:

The City Planner has updated the real property inventory list for all City-held property and that of the former Agency. At this time, very few have had, or will have, updated appraisals due to the $400 fee per appraisal that is a cost we cannot afford at this time. The City does not anticipate the purchase of any new property and the former redevelopment agency is prohibited from such activity. We acknowledge the importance of this recommendation and will certainly implement strict procedures in the future regarding the purchase of any real property as well as continue to maintain and update the real property inventory schedule.

2012-12: 2005, 2007, 2008 and 2009 Bond Covenant 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 City's former 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 eight 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."

Condition:

Pursuant to California Legislature adopted Assembly Bill (AB) x1 26, the State dissolved all redevelopment agencies. As a result, effective February 1, 2012, all redevelopment agencies including the City's Agency ceased to exist. In January 31, 2012, the City became the Successor Agency for the former City of Lindsay Redevelopment Agency.

While performing our audit of debt we noted that the Agency (now the Successor 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 June 1, 2013, the City had not issued financial statements for the year ended June 30, 2012. As the City serves as the Successor Agency for the Agency and may be held financially responsible debt noncompliance, lack of compliance with debt covenant number six could have an effect on the City's ability to maintain its going concern status.

Cause of Condition:

The City has been unable to issue financial statements within the 180 days of year-end due to multiple accounting issues requiring additional audit procedures. The City was unable to issue financial statements for the year ended June 30, 2011, within 180 days of the 2011 fiscal year-end, placing the Agency further behind timely issuance for the June 30, 2012, year-end financial statements.

Effect of Condition:

Non-compliance with debt covenants puts the City's Successor Agency, and as a result, the City at risk for an event of default. Per the 2005, 2007, 2008, and 2009 Tax Allocation Refunding Bond agreements, upon the occurrence of 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 City's Redevelopment Successor Agency at default for the 2005, 2007, 2008, and 2009 Tax Allocation Bonds, the total amount of principal and interest accrued outstanding that would be due as of June 30, 2012, is $22,160,597.

Recommendation:

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

Management Response:

The City shall take the necessary steps to comply with all debt covenants.

2012-13: Related Party Land Transactions between the City of Lindsay (the City) and the Agency

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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 City of Lindsay's former Redevelopment Agency (the Agency) engaged in three land purchases from the City of Lindsay without appropriate land appraisals. The total of the land transactions were $3,690,000, which is equal to the total amount of the CalHFA Loan No. RDLP-090806-03, which was to be used to land acquisition and development of three separate housing developments.

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

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

These transactions were related party transactions between the Agency and the 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 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.

Pursuant to California Legislature adopted Assembly Bill ABx1 26, the State dissolved all redevelopment agencies. As a result, effective February 1, 2012, all redevelopment agencies, including the City of Lindsay's Agency, ceased to exist. In January 31, 2012, the City became the Successor Agency for the former City of Lindsay Redevelopment Agency. Noted during the 7 month period that the Agency still existed, that there were no steps taken to amend the inflated land values outlined above. The inflated land values were transferred to the Successor Agency as of February 1, 2012. During the 5 month period the City served as the Successor Agency to the former Redevelopment Agency, there again were no steps take to amend the inflated land values outlined above.

Cause of Condition:

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

Effect of Condition:

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

Recommendation:

We recommend that the City 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 value. We also recommend that the City establish new procedures to periodically perform an inventory count and assessment of these lands to ensure that the City still holds title and is reporting these lands at an appropriate value.

Management's Response:

NOTE: The audit team does identify this condition as coming from previous fiscal years. The Lindsay Redevelopment Agency was formally dissolved August 21, 2011, with confirmation of the resolution again January 31, 2012, when the California legislature upheld ABx126. All conditions described herein were under the previous management. The current management has been left with the challenge of dissolving the former RDA and reconciling the conditions that were in effect prior to November 2010, including the irregular conditions as described above. Regarding the appraisal issue: This issue is complicated by the fact there are loans involved for which the former RDA, and now City as Successor Agent, is responsible as well as the fact that a portion of the property identified above has been transferred to the Tulare County Housing Authority (TCHA) per ABx126 and will be removed from the financial statements in FY13; there was no compensation received for the transfer of the property under ABx126, therefore, the value is irrelevant. We are moving cautiously and with legal counsel, regarding the devaluing on the property when the amount of the corresponding debt obligation will not be reduced. Due to the RDA dissolution restrictions, all activity involving the former RDA must be cleared through the Department of Finance (DOF) – one cannot just devalue an asset, even with an appraisal, and adjust their financials without DOF permission. Further, considering the fact that the RDA no longer exists, there is no potential for future impairment – per the dissolution act, the Successor Agent may only *retire* debt, not incur more (here is where use of an overinflated financial statement would be an issue). The only revenue coming into the fund is specifically for debt service and dissolution management and must be identified and requested two times per year via the Recognized Obligation Payment Schedule. Once the City and Successor Agent are authorized by the Department of Finance to proceed with the disposal of former RDA property, proper certified appraisals will be obtained; the City (Successor Agent) cannot afford to pay for appraisals now and again six months from now. And, lastly, as identified above, the formal title transfer never occurred, but a resolution was passed returning title to the City, so between that and the transfer to the TCHA, there is no land to be valued.

2012-14: Noncompliance with California Housing Financing Agency (CalHFA) Loan No. RDLP-090806-03

Criteria:

In August 2007, the City's former Redevelopment Agency (the Agency) entered into an agreement with the State of California and the California Housing Finance Agency, 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 of Lindsay. 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 California Housing Finance Agency to demand payment in full of previously disbursed funds that have been applied to the project.

Condition:

Pursuant to California Legislature adopted ABx1 26, the State dissolved all redevelopment agencies. As a result, effective February 1, 2012, all redevelopment agencies including the City of Lindsay's Agency ceased to exist. In January 31, 2012, the City became the Successor Agency for the former City of Lindsay Redevelopment Agency.

During our analysis of compliance with debt agreements of the Agency (now the Successor Redevelopment Agency), we noted that of the three projects that were to be completed with the borrowed funds, the former Redevelopment Agency had only begun working on the completion of one infill project and did not have adequate resources to begin the other two projects before dissolution occurred on February 1, 2012. 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 2012-14, the City sold these properties to the Agency in the exact amount of the loan without proper appraisals being completed. Furthermore, the Agency did 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 of Lindsay still holds title to the land.

Cause of Condition:

The City, as the Successor Agency for the former Redevelopment Agency, lacks adequate controls to ensure that the former Redevelopment Agency (now the Successor Agency) stays in compliance with debt agreements.

Effect of Condition;

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

Recommendation:

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

Management Response:

NOTE: This is not a new condition, but one that occurred in FY08. The City has been in contact with CalHFA and has submitted a loan extension and repayment proposal to them which is currently being reviewed by their legal department. Our understanding is that the loan will not be called, we will be granted an extension, and the only issues remaining are the annual payment amounts and terms regarding allocation of the payment.

2012-15 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 the total $5.5 million due to/from balance was composed of transactions outstanding for more than one year. Further, we noted that $4.8 million of the outstanding balance was attributable to amounts owed to other funds from the City's General Fund. Due to the City not being a going concern as of June 30, 2012, and City funding shortages we believe that there is a low probability this $4.8 million will be paid back to the corresponding funds.

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. Due to a current shortage of funds, the City has been unable to fix these improper transfers made by prior management.

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 take the necessary steps to reclassify, reverse, or pay-down the outstanding $5.5 million balance due to/from balance composed of transactions outstanding for more than one year.

Management Response:

There were no Due To/Due From transactions made in FY11 (other than correcting entries), FY12, or FY13 that exceeded 24 hours from the temporary loan at the end of one fiscal year to the immediate reversal at the beginning of the new fiscal year. The City has been taking steps to reclassify, reverse, or pay-down the outstanding balance(s), however this is a slow process as no adjustments are made without due diligence and fully supportable transactions; this condition did not occur in the space of one or two years, but over many, many years, and will take some time and forensic research to properly reclassify and correct.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

2012-SA-01- Federal Clearinghouse Data Collection Form Submission

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; 14.228
Award Number: 05-EDBG-2181, 09-EDEF-6362, 08-EDEF-5786, 09-PTAE-6560
Pass-Through Entity: California Department of Housing and Urban Development

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

Criteria:

U.S. Office of Management and Budget (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 of Lindsay (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's accounting records were not closed in a timely fashion which did not 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:

The report for fiscal year 2012 is 3-4 months earlier than it has been in the past five years; staff has been working diligently to implement strict internal controls, to correct all fund balances not properly reconciled in past years, and to make improvements to our financial management system that will ensure accuracy and that all future reports will be filed timely beginning with the fiscal year 2013 audit report.

2012-SA-02: Subrecipient Monitoring

Federal Grantor: U.S. Department of Housing and Urban Development
Title and CFDA: Community Development Block Grants; 14.228
Award Number: 05-EDBG-2181, 09-EDEF-6362, 08-EDEF-5786, 09-PTAE-6560
Pass-Through Entity: California Department of Housing and Urban Development

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

Criteria:

OMB Circular A-133 requires that a pass-through entity be responsible for *During-the-Award Monitoring*, whereby the County is required to monitor the subrecipient's use of federal awards through reporting, site visits, regular contact, or other means to provide reasonable assurance that the subrecipient administers federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreement and that the performance goals are achieved.

Condition:

The City did not have a monitoring policy in place as of June 30, 2012. In addition, the City did not perform required monitoring procedures on subrecipient awards for Community Development Block Grants (CDBG).

Effect:

The City is out of compliance with the subrecipient monitoring requirements as set forth in the OMB Circular A-133, *Compliance Supplement*.

Cause:

The City does not monitor the CDBG subrecipients nor does the City maintain a documented plan for monitoring subrecipients in accordance with federal requirements.

Recommendation:

We recommend that the City implement formal procedures to monitor all subrecipients to ensure required subrecipient monitoring requirements are being met with federal requirements as outlined in OMB Circular A-133.

Response and Corrective Action Plan:

The City has implemented a written subrecipient monitoring policy that has been reviewed and approved by U.S. Department of Housing and Urban Development. The City will monitor all subrecipients in accordance with OMB Circular A-133.

2012- SA-03: 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
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 as required by OMB Circular No. A-110.

Effect:

As a result of the inadequate records 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 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:

The City did set up an accounting code within its capital assets system that is unique to equipment purchased with federal funds – this was done in FY11; no new purchases were made to this category in FY12. The City has budgeted in FY13 to engage a specialist to assist in updating the capital assets, including inventory counts, to correctly reflect all capital assets that are still in use by the City and account for those that have been disposed of, or are impaired to the point of having served their useful lives.

SECTION IV – STATUS OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS

Material Weakness

2011-01: Land Held for Resale

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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 are 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, 2012, pursuant to the dissolution legislation, Assembly Bill (AB) x1 26, 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.

Current Year Status:

See current year finding at 2012-11.

2011-02: Payroll Testing

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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 an 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.

Current Year Status:

Implemented.

2011-03: Wire Transfer Testing

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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, someone 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.

Current Year Status:

Implemented.

2011-04: Receivables

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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, 2012 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 accounts receivable 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 accounts receivable 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 accounts receivable is correctly stated.

Current Year Status:

See current year finding at 2012-01.

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

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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 Purchase Card (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 2012, 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 a P-Card policy. We also recommend the City cut down on the number of credit cards it currently has in order 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 2012) 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.

Current Year Status:

Implemented.

2011-06: Travel Testing

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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.

Current Year Status:

Implemented.

2011-07: Voided Check Fraud Testing

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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.

Current Year Status:

Implemented.

2011-08: GANN Limit

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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 the City 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.

Current Year Status:

See current year finding at 2012-06.

2011-09: Petty Cash Fraud Testing

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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, 2012, with all amounts reconciled and remaining cash funds returned to the City's general operating account by February 29, 2012. No City department has a petty cash fund; Period – problem solved.

Current Year Status:

Implemented.

2011-10: Other Postemployment Benefits (OPEB)

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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, 2012.

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 request for proposal, to perform an OPEB actuarial valuation report that will include fiscal year 2012 and two years going forward per GASB 45.

Current Year Status:

Implemented.

2011-11: Cash Receipts Testing

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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 that 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 finance 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 Field House and Recreation Center accounting detail to track any cash discrepancies coming from that department; McDermont Field House and Recreation Center 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.

Current Year Status:

Implemented.

2011-12: Cash Disbursements

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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 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/expense 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, through June 30, 2012, 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.

Current Year Status:

Implemented.

2011-13: Accounts Payable

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America 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 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 online.

Current Year Status:

See current year finding at 2012-02.

2011-14: Financial Reporting and Journal Entry Testing

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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.

Current Year Status:

See current year finding at 2012-07.

2011-15: Capital Asset Reconciliation and Accounting Controls

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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, 2012, 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 the 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 and vouched for.
- 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 accounting 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.

Current Year Status:

See current year finding at 2012-03.

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 communications 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.

Current Year Status:

Implemented.

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, 2012, 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 2012, 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.

Current Year Status:

See current year finding at 2012-07.

2011-18: Cash and Cash Equivalents

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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, 2012, but not mailed out due to the City's cash flow issues. As of June 30, 2012, 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.
- PayPal 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, 2012 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 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:

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.

Current Year Status:

See current year finding at 2012-10.

2011-19: Notes Receivable

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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.

Current Year Status:

See current year finding at 2012-04.

2011-20: Due To/From Other Governments

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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, 2012 transactions were duly recorded on a Due To/From schedule that was then reversed July 1, 2012.

Current Year Status:

See current year finding at 2012-08.

2011-21: McDermont Field House Notes Receivable

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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 2012-09, 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.

Current Year Status:

Implemented.

2011-22: Compensated Absences

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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, 2012.

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 2012 – 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.

Current Year Status:

Implemented.

2011-23: Recording Budget Amendments

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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.

Current Year Status:

Implemented.

2011-24: Information Technology (IT) System Internal Controls

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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.

Current Year Status:

Implemented.

2011-25: Noncompliance for Tulare County Association of Governments (TCAG) Measure R Grant Funding

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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 single audit 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.

Current Year Status:

Implemented.

2011-26: Contract Change Orders (CCO) Measure R Grant

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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.

Current Year Status:

Implemented.

2011-27: Reconciling Accounts to Supporting Documentation – Accounting Controls

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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, 2012, 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.

Current Year Status:

See current year finding at 2012-09.

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 of Condition:

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 of Condition:

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 ABx1 26, 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, 2012, 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.

Current Year Status:

Assessment of corrective action plan is not necessary due to the February 1, 2012, dissolution of the Agency in accordance with ABx1 26.

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 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 as to not be out of compliance with the governing laws.

Effect of Condition:

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 ABx1 26, the Agency was formally dissolved as of October 1, 2012 – 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.

Current Year Status:

Assessment of corrective action plan is not necessary due to the February 1, 2012, dissolution of the RDA in accordance with ABx1 26.

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, 2012.

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 as to not be out of compliance with the governing laws.

Effect of Condition:

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, 2012 (initially August 23, 2012) – 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.

Current Year Status:

Assessment of corrective action plan is not necessary due to the February 1, 2012, dissolution of the Agency in accordance with ABx1 26.

2011-32: Related Party Land Transactions between the City of Lindsay (the City) and the Agency

Criteria:

In accordance with *Government Auditing Standards* and accounting principles generally accepted in the United States of America, 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 of Condition:

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 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 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.

Current Year Status:

See current year finding at 2012-13.

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 of Condition:

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

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.

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.

Current Year Status:

See current year finding at 2012-14.

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 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 City's or 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 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.

Current Year Status:

Assessment of corrective action plan is not necessary due to the February 1, 2012, dissolution of the Agency in accordance with ABx1 26.

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, 2012, and City funding shortages we believe that there is a low probability this $3,000,000 will be paid back to the Agency.

Cause of Condition:

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;

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.

Current Year Status:

See current year finding at 2012-15.

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, 2012.

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, 2012, the Agency had $6.2 million indebtedness due within one year which exceeded total revenues of $1.6 million for fiscal year 2012.

Cause of Condition:

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, 2012, year-end financial statements.

Effect of Condition:

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, 2012, 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 ABx1 26 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 Agency in previous years than there should have been; we have discovered a number of projects that included the Agency 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.

Current Year Status:

See current year finding at 2012-12.

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:

U.S. Office Management and Budget (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 of Lindsay's (the City) 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.

Current Year Status:

Implemented.

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.

Current Year Status:

Implemented.

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 2012 and again in August 2012; 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 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.

Current Year Status:

Implemented.

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, 2012, 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.

Current Year Status:

Implemented.

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.

Current Year Status:

See current year finding at 2012-SA-01.

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 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. 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.

Current Year Status:

Implemented.

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.

Current Year Status:

See current year finding at 2012-SA-03.

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.

Current Year Status:

Implemented.