

**CITY OF LINDSAY**

Transportation and Transit Funds

Audited Financial Statements  
For the Fiscal Years Ended June 30, 2010 and 2009

**CITY OF LINDSAY**

Transportation and Transit Funds  
Years ended June 30, 2010 and 2009

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## INDEPENDENT AUDITOR'S REPORT

City Council  
City of Lindsay  
Lindsay, California

We were engaged to audit the accompanying financial statements of the Transportation and Transit Funds of the City of Lindsay, California (City), as of and for the years ended June 30, 2010 and 2009, as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. Because of matters described in the basis for disclaimer paragraph below, we were not able to obtain sufficient appropriate audit evidence to provide a basis for our opinion.

As discussed in Note 1A, the financial statements present only the Transportation and Transit Funds and do not purport to, and do not present fairly the financial position of the City, as of June 30, 2010 and 2009, and the changes in its financial position and cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The bases for disclaiming an opinion on the City of Lindsay's financial statements are as follows: the City failed to implement basic internal controls during the year to prevent misstatements and errors in the financial statements, the City didn't reconcile the cash account balances reflected in the general ledger to their corresponding bank statements on a monthly basis, the City's Due to and Due from accounts and its transfer in and out accounts were never reconciled, the City's internal controls over cash disbursement were not operating effectively and several expenditures lacked supporting documentation and were miscoded, the City lacks internal controls over posting journal entries, the City lacks internal controls over contract change orders, and the City misused Measure R grant money. As a result of these matters, we were unable to determine the extent of the adjustments necessary to the financial statements.

Because of the significance of the matters described in the basis for disclaimer of opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide an audit opinion. Accordingly, we do not express an opinion on the financial statements referred to above and the respective financial position of the Transportation and Transit Funds of the City of Lindsay, California, as of June 30, 2010, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 6, to the financial statements, the City is having difficulties maintaining operating cash balances and paying for City expenditures and is out of compliance with several debt agreements. These conditions raise substantial doubt about the City's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 8, 2011, on our consideration of the City's internal control over financial reporting as it relates to the Transportation and Transit Funds, and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

*Pressley & Associates, Inc.*

Accountancy Corporation

November 8, 2011

**CITY OF LINDSAY**  
Local Transportation Fund

Balance Sheets  
June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
<u>Assets</u>		
Cash in City Treasury	\$ 16,981	\$ 13,088
Intergovernmental receivable	<u>466,257</u>	<u>181,423</u>
Total Assets	<u>\$ 483,238</u>	<u>\$ 194,511</u>
 <u>Liabilities and Fund Balance</u>		
Liabilities		
Accounts payable	\$ 22,728	\$ 76,581
Accrued wages	15,512	-
Due to other funds	-	900,150
Due to other governments	<u>1,048,443</u>	<u>-</u>
Total Liabilities	1,086,683	976,731
Fund Balance Deficit	<u>(603,445)</u>	<u>(782,220)</u>
Total Liabilities and Fund Balance	<u>\$ 483,238</u>	<u>\$ 194,511</u>

The accompanying notes are an integral part of these financial statements.

**CITY OF LINDSAY**  
Local Transportation Fund

Statement of Revenues, Expenditures, and Changes in Fund Balance  
For the Years Ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Revenues		
Local Transportation Funds	\$ 247,995	\$ 280,583
Measure R - Local	135,228	176,487
Measure R - Transit/Bike/Environmental	3,340,228	222,904
Other grants	134,618	4,112
Other revenues	10,381	-
Interest	-	-
	<u>3,868,450</u>	<u>684,086</u>
Expenditures		
Streets and roads construction and maintenance	3,536,111	2,188,599
Debt service		
Principal	52,300	-
Interest	91,490	-
Capital outlay	-	-
	<u>3,679,901</u>	<u>2,188,599</u>
Revenues Over Expenditures	<u>188,549</u>	<u>(1,504,513)</u>
Other Financing Sources (Uses)		
Loan proceeds	461	1,599,539
Repayment of ineligible cost to other governments	(1,048,443)	-
Operating Transfer In	2,603,406	-
Operating Transfer Out	(1,565,198)	-
	<u>(9,774)</u>	<u>1,599,539</u>
Revenues Over (Under) Expenditures and Other Financing Sources (Uses)	178,775	95,026
Fund Balance Deficit, July 1	<u>(782,220)</u>	<u>(877,246)</u>
Fund Balance Deficit, June 30	<u>\$ (603,445)</u>	<u>\$ (782,220)</u>

The accompanying notes are an integral part of these financial statements.

**CITY OF LINDSAY**  
Transit Fund

Balance Sheets  
June 30, 2010 and 2009

	2010	2009
<u>Assets</u>		
Cash in City Treasury	\$ 51,766	\$ 1,145
Intergovernmental receivable	-	-
Due from other funds	-	113,745
Total Assets	\$ 51,766	\$ 114,890
 <u>Liabilities and Fund Balance</u>		
Liabilities		
Accounts payable	\$ -	\$ -
Due to other funds	-	87,612
Total Liabilities	-	87,612
 Fund Balance		
Restricted for PTMISEA Funds	50,304	-
Unrestricted	1,462	27,278
Total Fund Balance	51,766	27,278
Total Liabilities and Fund Balance	\$ 51,766	\$ 114,890

The accompanying notes are an integral part of these financial statements.

**CITY OF LINDSAY**  
Transit Fund

Statement of Revenues, Expenditures, and Changes in Fund Balance  
For the Years Ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Revenues		
Fares	\$ 14,346	\$ 20,615
Local Transportation Funds	-	-
Measure R Transit Funds	22,084	433,845
Proposition 1B - PTMISEA Funds	50,304	-
Other revenues	<u>1,000</u>	<u>-</u>
Total Revenues	87,734	454,460
Expenditures		
General and administrative	2,792	750
Capital outlay	<u>-</u>	<u>433,845</u>
Total Expenditures	2,792	434,595
Revenues Over Expenditures	<u>84,942</u>	<u>19,865</u>
Other Financing Sources (Uses)		
Operating Transfer In	-	-
Operating Transfer Out	<u>(148,066)</u>	<u>(87,612)</u>
Total Other Financing Sources and Uses	<u>(148,066)</u>	<u>(87,612)</u>
Revenues Over (Under) Expenditures and Other Financing Sources (Uses)	(63,124)	(67,747)
Fund Balance, July 1	<u>114,890</u>	<u>95,025</u>
Fund Balance, June 30	<u><u>\$ 51,766</u></u>	<u><u>\$ 27,278</u></u>

The accompanying notes are an integral part of these financial statements.

**CITY OF LINDSAY**  
Transportation and Transit Funds

Notes to Financial Statements  
June 30, 2010 and 2009

Note 1: **Summary of Significant Accounting Policies**

**A. Reporting Entity**

The financial statements are intended to reflect the financial position, results of operation and compliance of the Transportation Development Act (TDA), Public Transportation Modernization Improvement and Service Enhancement Account (PTMISEA) and Measure R funds allocated for Transportation and Transit purposes of the City of Lindsay with the laws, rules and regulations of the Transportation Development Act, certain bond act requirements and the Tulare County Association of Governments. They do not present fairly the financial position and results of operations of the City of Lindsay, in conformity with generally accepted accounting principles.

**B. Fund Accounting**

The accounts of the City are organized on the basis of funds and account groups, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures or expenses, as appropriate. Government resources are allocated to and accounted for in individual funds based upon the purpose for which they are to be spent and the means by which spending activities are controlled. The various funds are grouped, in the financial statements in this report, into one generic fund types and one broad fund category as follows:

**Government Fund Types**

Special Revenue Funds are used to account for the proceeds of specific revenue sources (other than expendable trusts or major capital projects) that are legally restricted to expenditures for specified purposes.

**C. Basis of Accounting**

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences are recorded only when payment is due. Capital asset acquisitions are reported *expenditures* in governmental funds. Proceeds of general long-term debt and acquisitions under capital leases are reported as *other financing sources*.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted as they are needed.

**D. Cash and Investments**

The City reporting entity considers highly liquid investments (including restricted assets) with an original maturity of three months or less when purchased to be cash equivalents. City investment policy authorizes investment in the State of California Local Agency Investment Fund to a maximum of \$10,000,000, and certificate of deposit and U.S. Governmental Securities with maturities not exceeding five years.

**CITY OF LINDSAY**  
 Transportation and Transit Funds

Notes to Financial Statements  
 June 30, 2010 and 2009

California banks and savings and loan associations are required to secure a city's deposits by pledging government securities as collateral. The fair value of the pledged securities must equal at least 110 percent of a city's deposits. The City Treasurer, at his or her discretion, may waive the 110 percent collateral requirement for deposits that are insured up to the \$250,000 by the FDIC. It is the City's policy to waive the collateral requirement in order to receive a higher interest yield on its deposits. It is also the City's policy not to deposit more than \$250,000 in a savings and loan association or a small bank.

California law allows financial institutions to secure city deposits by pledging first trust deed mortgage notes having a value of 150 percent of a city's total deposits. It is the City of Lindsay's policy not to accept this form of collateral.

**E. Use of Management Estimates**

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Accordingly, actual results could differ from those estimates.

Note 2: **Cash and Cash Equivalents**

*Investments authorized by the California Government Code and the City of Lindsay's Investment Policy*

The table below identifies the investment types that are authorized by the California Government Code and the City's investment policy. The table also identifies certain provisions of the California Government Code and/or the City's investment policy that address interest rate risk, credit risk and concentration of credit risk. This table does not address investments of debt proceeds held by bond trustee that are governed by the provisions of debt agreements of the City, rather than the general provisions of the California Government Code or the City's investment policy.

<u>Authorized investment type</u>	<u>Maximum maturity</u>	<u>Maximum percentage of portfolio</u>	<u>Maximum investment in one issuer</u>
U.S. Treasury Securities	5 years	None	None
U.S. Agency Securities	5 years	None	None
Bankers Acceptances	270 days	30%	30%
Certificates of deposits	5years	None	10%
Passbook deposits	N/A	None	None
Repurchase aggrements	1 year	30%	None
Mutual funds	N/A	15%	None
Money Market Mutual Funds	N/A	25%	10%
Commercial paper	180 days	30%	None
Local Agency Investment Fund (LAIF)	On demand	None	None

**CITY OF LINDSAY**  
Transportation and Transit Funds

Notes to Financial Statements  
June 30, 2010 and 2009

*Disclosures relating to interest rate risk*

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the City manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

*Investments with fair values highly sensitive to interest rate fluctuations*

The City of Lindsay's investment policy does not permit investment in securities that are highly sensitive to interest rate fluctuations.

*Custodial credit risk*

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the City's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure City deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

*Investment in State Investment Pool*

The Agency is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The fair value of the City's investment in this pool is reported in the accompanying financial statements at amounts based upon the City's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis.

**CITY OF LINDSAY**  
Transportation and Transit Funds

Notes to Financial Statements  
June 30, 2010 and 2009

**Note 3: PTMISEA**

In November 2006, California voters passed a bond measure enacting the Highway Safety, Traffic Reduction, Air Quality and Port Security Bond Act of 2006. Of the \$19.925 billion of state general obligation bonds authorized, \$4 billion was set aside by the State as instructed by statute as the Public Transportation Modernization Improvement and Service Enhancement Account (PTMISEA). These funds are available to the California Department of Transportation for intercity rail projects and to transit operators in California for rehabilitation, safety or modernization improvements, capital service enhancements or expansions, new capital projects, bus rapid transit improvements or for rolling stock procurement, rehabilitation or replacement.

During the fiscal year ended June 30, 2009, the City purchased a Paratransit Bus and Two Ford Vans, with the proceeds of \$87,612 from the State's PTMISEA account which was for the procurement of a CNG passenger vehicle. During the fiscal year ended June 30, 2010, the City applied for and received proceeds of \$50,304 from the State's PTMISEA account for the procurement of a bus shelter. As of June 30, 2010, the city incurred no qualifying expenditures, resulting in an unexpended restricted fund balance of \$50,304. Qualifying expenditures must be encumbered within three years from the date of the allocation and expended within three years from the date of the encumbrance. As of June 30, 2010, PTMISEA funds received and expended were as follows:

	2010	2009
PTMISEA Beginning fund balance	\$ -	\$ 87,612
PTMISEA Revenues	50,304	-
Qualifying expenditures incurred	-	87,612
Unexpended proceeds at June 30:	\$ 50,304	\$ -

**Note 4: Prior Period Adjustment**

The Local Transportation Fund for the year ended June 30, 2009 includes and additional accrual for \$107,728, which also increased the fund balance in that fund by the same amount.

**Note 5: Fund Presentation**

Presentation of the FYE June 30, 2009 financial statements of the Local Transportation Fund and the Transit Fund was changed in order for the information to be comparable with the presentation of the FYE June 30, 2010 financial statements for those funds.

**CITY OF LINDSAY**  
Transportation and Transit Funds

Notes to Financial Statements  
June 30, 2010 and 2009

**Note 6: Going Concern**

During the last few years, the City began experiencing financial difficulties due to the large number and dollar amount of construction projects it undertook, which resulted in expenditures well exceeding revenues. The excessive spending has caused the City's unrestricted cash balances to drop to only \$1,550,992 as of June 30, 2010. In addition, the City's Redevelopment Agency (Agency) is out of compliance with two separate debt agreements with CalHFA. The two debt agreements in question are the RDLP-090806-03 agreement totaling \$3,690,000 and HELP-080806-03 agreement totaling \$1,250,000. In addition to the above principal amounts borrowed, the Agency also has an estimated outstanding balance of accrued interest of \$332,500 total for two loans. As a result of the Agency's noncompliance, the principal and interest could be called immediately by the CalHFA, making these loans current liabilities. The total amount of the City's and the Agency's current liabilities owed to external parties as of June 30, 2010, was \$8,607,796.

In response to these fiscal pressures, the City and the Agency have taken several measures to improve the current situation, including a construction project freeze and implementing a City-wide reduction in staffing and overall expenditures. The Agency has also hired an attorney who specializes in redevelopment agency law who will advise the Agency on how to proceed.

The ability of the City and the Agency to continue as a going concern is dependent upon the success of these actions.

The financial statements do not include any adjustments that might be necessary if the City or the Agency are unable to continue as a going concern.

**Note 7: Commitments and Contingencies**

Measure R Funding: The City and the Tulare County Association of Governments (TCAG) are in dispute over the misuse of Measure R grant funding. The City has determined that approximately \$1,048,443 in expenditures, out of a total of \$3,746,977 charged to the grant, were ineligible. The City has accrued the \$1,048,443 as of June 30, 2010, and intends to repay this amount when City's financial condition improves. However, additional amounts might be considered ineligible in the future pending a final resolution of the dispute.

**Note 8: Fund Deficit**

The Transportation Fund presently has a fund deficit. This deficit is expected to be repaid with future General Fund transfers.

**OTHER REPORTS**

**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*,  
TRANSPORTATION DEVELOPMENT ACT, PUBLIC TRANSPORTATION MODERNIZATION  
IMPROVEMENT AND SERVICE ENHANCEMENT ACCOUNT (PTMISEA) AND MEASURE R**

City Council  
City of Lindsay  
Lindsay, California

We were engaged to audit the accompanying financial statements of the Transportation and Transit Funds of the City of Lindsay, California (City), for the years ended June 30, 2010 and 2009, and have issued our report thereon dated November 8, 2011. We did not express an opinion on the City's Transportation and Transit Fund financial statements because we were not able to obtain sufficient appropriate audit evidence to provide a basis for an opinion.

The bases for disclaiming an opinion on the City of Lindsay's financial statements are as follows: the City failed to implement basic internal controls during the year to prevent misstatements and errors in the financial statements, the City didn't reconcile the cash account balances reflected in the general ledger to their corresponding bank statements on a monthly basis, the City's Due to and Due from accounts and its transfer in and out accounts were never reconciled, the City's internal controls over cash disbursement were not operating effectively and several expenditures lacked supporting documentation and were miscoded, the City lacks internal controls over posting journal entries, the City lacks internal controls over contract change orders, and the City misused Measure R grant money. As a result of these matters, we were unable to determine the extent of the adjustments necessary to the financial statements. Except as discussed in the preceding sentence, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and responses as items 2010-01 – 2010-08 to be material weaknesses.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's Transportation and Transit Fund financial statements are free of material misstatement, we performed tests of 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. Our audit was further made to determine that TDA and Measure R funds allocated to and received by the City were expended in conformance with applicable statutes, rules and regulations of the TDA, Measure R Ordinance and allocation instructions and resolutions of Tulare County Association of Governments and Tulare County Transportation Authority as required by Section 6667 of Title 21 of the California Code of Regulations. Our audit was expanded to include verification of receipt and appropriated expenditures of PTMISEA bond funds in accordance with Government Code 8879.55(f). 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*, the TDA, Measure R and PTMISEA and which are described in the accompanying schedule of findings and City responses as items 2010-04 – 2010-08.

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

This report is intended solely for the information and use of the City Council, management, the Tulare County Association of Governments, and the State Controller's Office and is not intended to be and should not be used by anyone other than these specified parties.

*Pressley & Associates, Inc.*

Accountancy Corporation  
Bakersfield, California  
November 8, 2011

**CITY OF LINDSAY**  
Transportation and Transit Funds

Schedule of Findings and Responses  
For the Year ended June 30, 2010

**2010-01: Reconciling Cash Accounts**

**Criteria:** City policy and procedures require monthly bank reconciliations.

**Condition:** Bank reconciliations are not being reviewed in a timely fashion.

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

**Effect:** The general ledger may not reflect the appropriate cash balances and interest allocation can not be properly calculated.

**Recommendation:** Finance Director should review monthly bank reconciliations. Adjustments to the general ledger from the bank reconciliation process should be posted in the proper accounting period.

**Management's Response:** Prolonged medical absences of the former Director of Finance, combined with lack of training and inadequate staffing, have resulted in the deficiency of the bank accounts not being reconciled in a timely manner. The current city manager has rectified this problem by including a proviso in each department head contract, including the current Director of Finance, that states clearly that any key individual will be replaced if absent for more than 90 days. Additionally, although the department still struggles with inadequate staffing due to budget constraints and diversion to public records request responses, there has been a reassignment of duties to ensure both the proper segregation of duties as well as completion of duties; the current Director of Finance does review and take ultimate responsibility for the work product of all finance department staff, including review and reconciliation procedures, and the recording of adjustments and applicable interest, payable, and receivable activity. This is an on-going process with improvements made near the end of FY2011 and strengthened in FY2012. The City has engaged the services of a member of the Brown Armstrong audit team to conduct quarterly reviews of current practices and procedures to ensure compliance with internal control and reconciliation polices.

**2010-02: Cash Disbursement Testing**

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

**Condition:** City personnel are responsible for preparing and submitting appropriate documentation to support reimbursement for approved Measure R projects. While performing our expenditure testing of Measure R requests for reimbursement, and the accompanying documentation, we noted the following control deficiencies:

During our testing we noted multiple expenditures selected for testing were missing cover sheets that show vendor, invoice number, check number, and the general ledger account number for the expenditure. 68% of the expenditures tested were lacking the appropriate approval by city personnel. 80% of expenditures tested lacked account coding on the face of the invoice. In some instances we were unable to locate an invoice that was included in the overall request for reimbursement.

It was also noted that expenditures selected for testing were miscoded on the expenditure line item, in the incorrect fund, or both. 63% of payroll charges included in the reimbursement request were lacking general ledger support, and were recorded in the incorrect fund. It was also noted that one invoice was submitted to TCAG for request for reimbursement more than one time.

**Cause:** City personnel did not adequately prepare, review, or account for expenditures that may have been eligible for Measure R funding. Accounting controls over cash disbursement activities were not sufficiently adhered to, which created an environment susceptible to error and/or incomplete reporting.

**Effect:** Expenditures processed for payment that lack cover sheets, account coding, and approval may result in material errors in expenditure and/or fund account balances. Invoices that were processed without approval may lead to unauthorized, erroneous or duplicate billing. Internal control policies facilitate accurate and reliable reporting of expenditures by the city, and the absence of those controls may lead to material errors or omissions. Requests for Measure R funding that are not supported by adequate documentation may be declined for reimbursement or result in limited funding for future projects.

**Recommendation:** We recommend invoices for projects should be reviewed for completeness, account coding, and supporting documentation. Payments of invoices should not be processed without coding or approval to ensure that they are properly posted to the general ledger. City personnel should retain all invoices and other supporting documentation.

**Management's Response:** Under the new administrative team new and/or stricter internal control policies have been put in place to ensure proper procurement, account coding at the department level by both the appropriate department supervisor and initialed approval by the department head, cover sheet preparation by finance staff that is then reviewed by the Accounts Payable supervisor and reviewed and initialed by the Director of Finance *prior* to check processing. Once a check is issued the cover sheet is completed with the applicable check number, issue date, and batch number. Each department has been issued a copy of their respective budgets and has been given access to the accounting software system to look up budget progress to ensure adhering to the adopted budget and use of correct account codes within their respective budgets. Quarterly fiscal reviews will be held with budget progress presented to the council in an open public session and individually with each department head to review necessary adjustments and/or amendments that may be required of the adopted budget.

All project – grant and loan – reimbursement requests must now be reviewed and approved by the Director of Finance before being sent out to ensure all necessary documentation: i.e. General Ledger Detail, copy of original invoice with proper coding and approvals, change order approvals by council (if applicable), copies of competitive bids (if applicable), and compliance with parameters of the lending or granting agency guidelines and original submitted application are included in the reimbursement request and that all elements reconcile to one another. All reimbursement requests are prepared by period (month) and detailed by period (month) to ensure the accuracy of the request and to provide the funding source reviewer better ease in the verification process.

The Director of Finance has established new account codes within the accounting software system to ensure adequate segregation of project expenses and does now have the full support of an administrator who demands strict adherence to internal control policies.

### **2010-03 Journal entry activity**

**Criteria:** Internal controls designed by management should be in place to ensure that adjusting entries are properly prepared, reviewed and posted in the appropriate accounting period.

**Condition:** Journal entries do not include appropriate backup, are not being posted in the appropriate period, and are not being reviewed by management.

**Cause:** Financial information is not being reviewed in a timely manner, and necessary journal entries are not being made.

**Effect:** The general ledger may not adequately reflect financial activity in the appropriate general ledger account and/or fund. Interim financial information that is relied upon may not provide an accurate financial position.

**Recommendation:** We recommend that the general ledger be reviewed on a monthly basis, and any necessary journal entries be presented for review by management.

**Management's Response:** The Director of Finance shall review all journal entry requests and post them to the proper accounting period. Any journal entries originated by the Director of Finance shall be approved by the City Manager and Director of the department whose budget shall be affected, if applicable. A journal entry ledger has been developed to record the Journal Entry number and all applicable information regarding a posted journal entry for ease of reference. All journal entries shall have the appropriate cover sheet listing all accounts affected and all necessary supporting documentation is to be attached.

A monthly review of all journal entry postings shall be presented by the Director of Finance at the weekly leadership meeting of Department Heads to ensure all staff has been informed of any changes to the general ledger made via the journal entry procedure.

#### **2010-04: Restricted funds interest allocation**

**Criteria:** The PTMISEA moneys are required to remain intact and earn interest income until the time they are spent on eligible expenditures.

**Condition:** The City transfer PTMISEA funds from their appropriate fund not allowing those funds to remain intact.

**Cause:** The City was cleaning up the Due to/from balances and moved the restricted PTMISEA funds.

**Effect:** PTMISEA money was removed from the appropriate fund and interest was not calculated on these funds. Additionally, the funds have the potential of not been tract and expended on eligible expenditures.

**Recommendations:** It is recommended that the City allocate interest to restricted monies and properly tract them until there are spent for their intended use

**Management's Response:** The current Director of Finance has established additional general ledger accounting codes to ensure the proper recording of both revenues and expenditures – particularly those that are restricted in nature such as the PTMISEA funds received at the end of fiscal year 2010 (6/23/2010) which was in the amount of \$50,304. Having been identified by the TCAG auditor as not previously segregated, this amount will be restored to its correct Fund (via prior period adjustment) in order to properly assess the interest in FY2011 and FY2012 (including retroactively applying the \$3.87 of interest that should have been earned in FY2010) and to ensure the funds are used solely for their intended purpose of transit enhancement: These funds were applied for and shall be used for the procurement of bus stop shelters which are expected to be purchased and installed before December 31, 2011.

Through the audit process of the past year, the current administration has become better educated regarding the proper recording and maintenance of restricted funds and are confident of being able to accurately account for all monetary funds under their custody and control.

#### **2010-05: Public Transportation Modernization Improvement and Service Enhancement Account compliance**

**Criteria:** In accordance with the California Department of Transportation Public Transportation Modernization Improvement and Service Enhancement Account (PTMISEA) guidelines, an eligible sponsoring agency must submit a Program Expenditure Plan to outline the projects for which they request funding.

**Condition:** While performing our audit we were unable to determine if all PTMISEA monies were spent on qualifying/appropriate expenditures and with the appropriate intended use as defined by the Department of Transportation guidelines and the grant agreement.

**Cause:** The PTMISEA funding was for a CNG passenger vehicle and intended to facilitate the establishment of a public transit system. The City purchased a passenger vehicle and two vans. The costs associated with establishing a public transit operation were determined to be too high, and the City is using the vehicles for activities that appear to be ineligible.

**Effect of Condition:** The City has a passenger vehicle and two vans that were purchased with PTMISEA monies that are not being used for the intended use.

**Recommendation:** We recommend that the City establish a Citywide transit operation in accordance with the granting requirements or return the grant funding.

**Management's Response:** The PTMISEA project to which this finding refers was conceived under the direction of the previous administration in 2008 before the economic crisis which has adversely affected all municipalities got to the extreme levels we are experiencing today. At the time the grant application was prepared, the City was in the midst of multiple projects including the new library and the new recreation center known as McDermont Field House – both located downtown – and the construction of a new wellness center (which included a new aquatic center), new school, and two new planned developments all on the north side of town. A four phase plan was developed to provide fixed route transit services between those two areas, which also includes most of the medical offices within the City of Lindsay, and was also to include the main shopping center plaza. Phase One included purchase of the vehicles, Phase Two included the construction of a main transit center, Phase Three included the development of the fixed route pickup and drop-off locations, and Phase Four was to be the implementation of the service. Phases one through three have been completed. Due to the economic downturn and collapse of the housing market which resulted in the interruption of both planned developments, along with four others, coupled with the fact that the previous administration did not do a cost feasibility study pre-Phase One as they should have, the current administration has determined that the DAR contract with TCAT, the County agency that also provides inter-county fixed route transportation services, is more cost effective and service-efficient than the City of Lindsay would be able to provide and it would be irresponsible to attempt to launch our own municipal transit service at this time.

At this writing (11-14-11), a tele-conference call has been arranged with Zhongping Xu, Associate Transportation Planner, and his immediate supervisor to discuss the available options for sale of the vehicles, return of the PTMISEA funds to the issuing agency, and cancelation of the original request to establish a city-run transit system. The conference is set for 3:30 pm on 11-15-11. City staff will adhere to the direction of the PTMISEA program unit regarding rectifying this situation. Staff will act immediately upon instruction and expect to have a resolution to the issue by November 30<sup>th</sup> when the audit team for CalTrans will be at the City to review all programs and will be able to verify compliance.

#### **2010-06: Measure R accounting compliance**

**Criteria:** Internal controls should be in place to provide reasonable assurance that transactions are identified and recorded in the proper fund and account.

**Condition:** The City did not adequately account for Measure R grant income and expenditures in the appropriate general ledger accounts.

**Cause:** The finance department did not review the grant accounting on a regular basis. During our audit we noted Measure R revenues and expenditures were recorded in two funds of the City's general ledger. These transactions were not properly segregated and identified. This required a reconciliation of multiple transactions over multiple funds in order to accurately determine the total activity for the Measure R grant.

**Effect:** This condition, if not corrected, could result in the inaccurate recording of Measure R grant revenues and expenditures.

**Recommendations:** We recommend that management modify accounting procedures that relate to Measure R grants and other matching funding sources. Specific funds should be designated for Measure R grant activity and specific accounts should be assigned for related revenues and expenditures. Transactions should be reviewed periodically to ensure that financial reporting for Measure R grants is accurate and clearly understandable.

**Management's Response:** This condition has been corrected with the establishment of additional general ledger account codes to identify specific projects and related expenses and revenues. Internal control policies have been strengthened to ensure proper project costing and procurement, coding and payment, and adherence to proper support documentation practices. Prior to the current administration, projects were submitted by the previous assistant city manager, with documentation supplied by the city services department, without oversight or review by the Finance Department. This procedure has been rectified by the current city manager who holds weekly leadership meeting to ensure all department heads are informed of all important current matters and that there is no lapse in communication and oversight duties as with the previous administration.

The Director of Finance works in concert with the City Services department, under the direction of the City Manager, to ensure that all projects are adequately researched, developed, approved by Council, and constructed according to the application and funding source guidelines. The City Services Director does review and approve all project expenditures on a weekly basis before forwarding to the Director of Finance who also reviews and approves all invoices on a weekly basis and has override authority should she determine an expense is not coded correctly.

The new accounting procedures also include a quarterly review to the governing body in open session, the leadership group, and each individual department head to ensure adherence to the budget and that all revenues and expenditures are properly recorded.

#### **2010-07: Measure R ineligible expenditures**

**Criteria:** Internal controls should be in place to provide reasonable assurance that transactions are identified and recorded in the proper fund and account.

**Condition:** The City did not identify ineligible expenditure included in the reimbursement request for Measure R grant funding.

**Cause:** The finance department did not review the grant accounting on a regular basis. During our audit we noted Measure R revenues and expenditures were recorded in three funds of the City's general ledger. Ineligible expenditures were not properly segregated and identified.

**Effect:** The City has had two agreed upon procedure (AUP) engagements to review reimbursement requests and expenditures to determine the validity of the reimbursement requests submitted to the Tulare County Association of Governments. The first AUP found a total of \$933,573 ineligible costs and the second found \$1,048,443.

**Recommendations:** We recommend that the public works department responsible for the grant, work with the finance department so that the reimbursement requests are including eligible expenditures and the appropriate general ledger accounts. Prior to submitting the request for reimbursement the documents should be reviewed by management.

**Managements Response:** This condition has been corrected with the establishment of additional general ledger account codes to identify specific projects and related expenses and revenues. Internal control policies have been strengthened to ensure proper project costing and procurement, coding and payment, and adherence to proper support documentation practices. Prior to the current administration, projects were submitted by the previous assistant city manager, with documentation supplied by lower-level staff of the city services department, without oversight or review by the Finance Department. This procedure has been rectified by the current city manager who holds weekly leadership meetings to ensure all department heads are informed of all important current matters and that there is no lapse in communication and oversight duties as with the previous administration. The Director of Finance works in concert with the City Services department, under the direction of the City Manager, to ensure that all projects are adequately researched, developed, approved by Council, and constructed according to the application and funding source guidelines. The City Services Director does review and approve all project expenditures on a weekly basis before forwarding to the Director of Finance who also reviews and approves all invoices on a weekly basis and has override authority should she determine an expense is not coded correctly.

All reimbursement requests are prepared by accounting period (month) and include reconciliation to the general ledger detail for that period and all applicable support documentation. All reimbursement and/or loan draw requests must be submitted to the Director of Finance for review and approval prior to transmission to the funding agency to ensure all expenses are eligible and adequately supported.

The new accounting procedures also include a quarterly review to the governing body in open session, the leadership group, and each individual department head to ensure adherence to the budget and that all revenues and expenditures are properly recorded. The City has also engaged the services of an independent audit firm to conduct quarterly reviews to ensure current internal controls are in place and are being strictly observed.

## **2010-08: Measure R Grant contract change orders**

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

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

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

**Effect:** Grant programs (such as Measure R) 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.

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

**Management's Response:** We disagree with this finding; we contend we did everything appropriately pursuant to our Charter City requirements. The project was formally and properly bid and the scope of the project did not change.