City of San Leandro

Meeting Date: July 1, 2013

Staff Report

File Number: 13-340

Agenda Section: CONSENT CALENDAR

Agenda Number: 8.H.

TO: City Council

FROM: Chris Zapata
City Manager

BY: David Baum
Finance Director

FINANCE REVIEW: David Baum
Finance Director

TITLE: Staff Report on the Independent Auditor's City of San Leandro Memorandum of Internal Control and Required Communications for the year-ended June 30, 2012

SUMMARY AND RECOMMENDATIONS

Staff recommends that the City Council accept the City's Memorandum of Internal Control and Required Communications for the year ended June 30, 2012.

BACKGROUND

On March 4, 2013, Council accepted the Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2012. In planning and performing the audit of the financial statements, the City's independent auditors considered the City's internal control over financial reporting (internal control) as a basis for designing the auditing procedures for the purpose of expressing opinions on the financial statements. At the completion of the audit, an unqualified, clean opinion was rendered by Maze & Associates.

DISCUSSION

The City's independent auditor completed audits of the City's financial statements, including the Memorandum of Internal Control (MOIC). The audit found no material weaknesses in the internal controls. Maze identified four significant deficiencies. Staff responses are contained in the attached report. The four issues are set forth below.

1. Timeliness of the Preparation of the Comprehensive Annual Financial Report (CAFR) - despite delays, all reporting requirements were met for fiscal year 11-12.
2. Timely Preparation of Bank Reconciliations - reconciliations were sometimes delayed beyond the 30 day performance measure.
3. Shoreline Enterprise Funds Fund Deficit and Advance to the General Fund - the

General Fund has advanced more than $7 million to the Shoreline Fund resulting in a chronic deficit fund balance.

4. Support for Accounts Receivable Advance Payments (General Fund) - contracts in the Engineering Department were missing that would have indicated the deposits made by vendors to the City.

Based on these significant findings, staff has increased its efforts during fiscal year 12-13 to comply with the standards identified by Maze & Associates.

Attached is the MOIC from the City's external auditor which includes constructive recommendations to ensure the City's accounting function is timely, complete and accurate.

CONCLUSION

Staff recommends that the City Council accept the City's Memorandum of Internal Control for the year ended June 30, 2012.

ATTACHMENTS

- Memorandum of Internal Control for the fiscal year ended June 30, 2012

PREPARED BY: David Baum, Finance Director, Finance Department

CITY OF SAN LEANDRO
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS

FOR THE YEAR ENDED
JUNE 30, 2012

CITY OF SAN LEANDRO
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS

For the Year Ended June 30, 2012
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MEMORANDUM ON INTERNAL CONTROL

December 28, 2012

To the City Council of
The City of San Leandro, California

In planning and performing our audit of the financial statements of the City of San Leandro (City) as of and for the year ended June 30, 2012, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

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 did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

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.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all such deficiencies have been identified. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to errors or fraud may occur and not be detected by such controls.

Included in the Schedule of Other Matters are recommendations not meeting the above definitions that we believe to be of potential benefit to the City.

The City's written responses included in this report have not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This communication is intended solely for the information and use of management, the finance committee, City Council, others within the organization, and agencies and pass-through entities requiring compliance with generally accepted government auditing standards, and is not intended to be and should not be used by anyone other than these specified parties.

SCHEDULE OF OTHER MATTERS

2012-01 Timeliness of the Preparation of the Comprehensive Annual Financial Report (CAFR) Draft

Criteria:

The Finance Department prepares the City's CAFR which is then audited by our firm. The CAFR must be complete and accurate prior to the start of the final phase of the audit, in order for the audit to be completed on a timely basis.

Condition:

The City CAFR was not completed by the Finance Department during the majority of our scheduled final audit fieldwork, which was also an issue during the prior year engagement. In addition, once the current year draft report was provided to the auditors, there were numerous corrections and edits that were required to ensure accuracy of the final version. Furthermore, the Finance Department was also dealing with Redevelopment Agency issue's during the course of scheduled fieldwork.

Effect:

Substantial time is required by both City staff and auditors in order to get the City's financial statements to its final version, if the document provided is incomplete and inaccurate.

Cause:

The City's staff has been used for other projects due to the dissolution of the Redevelopment Agency.

Recommendation:

We understand that due to the dissolution of the Redevelopment Agency, the City's staff has been used for other projects, but the City should schedule time to ensure the completeness and accuracy of the CAFR prior to handing that document over to the auditors.

Management Response:

City staff will make sure that prior to a pre-agreed deadline, a draft of the CAFR will be available. Due to the decrease in staff, we may seek assistance in future audits to assemble unaudited information for the CAFR to expedite its delivery. Despite the delay, all reporting requirements were met for Fiscal Year 2011-12

2012-02 Timely Preparation of Bank Reconciliations

Criteria:

Cash is the asset at greatest risk of misappropriation. Bank reconciliations play an important role in the effectiveness of an entity's internal control structure. They should be prepared on a timely basis, generally within 30 day of receiving the statements from the financial institution, and reviewed by an employee other than the preparer.

Condition:

During our testing on July 23, 2012, we noted that the May 2012 bank reconciliation had not been reviewed.

Effect:

The City is not finalizing its monthly bank reconciliations in a timely manner, increasing the potential that mistakes or bank error would not be caught timely.

Cause:

City staff has overlooked completing the bank reconciliation process due to other job assignments.

Recommendation:

We suggest that bank accounts be reconciled and all differences between book and bank balances are reviewed on a timely basis by appropriate accounting personnel, so that errors and adjustments can be quickly identified and corrected.

Management Response:
City staff will continue to strive to prepare bank reconciliations within 30 days as it is already in place.

2012-03 Shoreline Enterprise Funds Fund Deficit and Advance to the General Fund

Criteria:

The City should have a balanced budget for its various funds.

Condition:

The Shoreline Fund had deficit net assets of $2,817,982 as of June 30, 2012, yet the Shoreline Fund has an advance of $7,106,392 from the General Fund to finance capital improvements at the Marina and Golf Course. Principal payments are made annually provided the fund has sufficient resources.

SCHEDULE OF OTHER MATTERS

Effect:

The fund may be disclosing a liability that the Shoreline Fund may not be able to repay.

Cause:

The City is experiencing sustained accumulated operating losses in the Shoreline Fund.

Recommendation:

The City should continue to research ideas for revenue collection and to work towards a balanced budget. Furthermore, the City should evaluate the collectability of this advance to the Shoreline Fund.

Management Response:
There are development studies and projects currently being discussed at City Council to improve the Marina Shoreline in trying to attract businesses. The Shoreline Fund produced improved revenue and reduced expenditures in Fiscal Year 2011-12 to reduce the deficit approximately $200,000.

2012-04 Support for Accounts Receivable Advance Payments (General Fund)

Criteria:

The City should be able to support amounts that are reported in the financial statements and general ledger system.

Condition:

During the course of the audit we requested five samples that were selected from the detail listing for general ledger account 010-220-2201, the City was unable to provide any documentation for the sample.

Effect:

Information that is presented in the financial statements and amounts recorded in the City's general ledger system may be incorrect or may not be an obligation of the City.

Cause:

These are contracts with the Engineering department that have made deposits for projects.

Recommendation:

We recommend the City retain proper documentation for all obligations, transactions, and managerial estimates.

SCHEDULE OF OTHER MATTERS

Management Response:
The Engineering and Transportation department is continuing to improve its contract database.

2012-05 Upcoming Governmental Accounting Standards Board Pronouncements

The following pronouncements are effective in fiscal year 2012/13:

GASB 60 - *Accounting and Financial Reporting for Service Concession Arrangements*

The objective of this proposed Statement is to establish accounting and financial reporting requirements for service concession arrangements (SCAs), which are a type of public-private or public-public partnership arrangement. As used in this proposed Statement, an SCA is an arrangement between a transferor (a government) and an operator (governmental or nongovernmental) in which:

a. The transferor conveys to the operator the right and related obligation to provide public services through the operation of a capital asset (referred to in this standard as “facility”).

b. The operator collects and is compensated with fees from third parties.

c. The transferor is entitled to significant residual interest in the service utility of the facility at the end of the arrangement.

d. The transferor determines or has the ability to modify or approve what services the operator is required to provide, to whom the operator is required to provide the services, and the prices or rates that can be charged for the services.

Service Concession Arrangements include, but are not limited to:

a. Arrangements in which the operator will design and build a facility and will obtain the right to collect fees from third parties (for example, construction of a municipal complex for the right to lease a portion of the facility to third parties)

b. Arrangements in which the operator will provide an up-front payment or a series of payments in exchange for the right to access an existing facility (for example, a parking garage) and collect fees from third parties for its usage

c. Arrangements in which the operator will design and build a facility (for example, a new tollway), finance the construction costs, provide the associated services, collect the associated fees, and convey the facility to the government at the end of the arrangement.

Disclosures Related to Service Concession Arrangements (SCA)

The following information should be disclosed in the notes to financial statements of transferors and governmental operators for SCAs:

a. A general description of the arrangement in effect during the reporting period, including management’s objectives for entering into it and, if applicable, the status of the project during the construction period

SCHEDULE OF OTHER MATTERS

b. The nature and amounts of assets, liabilities, and deferred inflows of resources related to an SCA that are recognized in the financial statements

GASB 60 - *Accounting and Financial Reporting for Service Concession Arrangements (Continued)*

c. The nature and extent of rights retained by the transferor or granted to the governmental operator under the arrangement.

GASB 61 - *The Financial Reporting Entity – Omnibus – An Amendment for GASB Statement No. 14 and No. 34 – Component Unit Focus*

This Statement modifies certain requirements for inclusion of component units in the financial reporting entity. **For organizations that previously were required to be included as component units by meeting the fiscal dependency criterion, a financial benefit or burden relationship also would need to be present between the primary government and that organization for it to be included in the reporting entity as a component unit.** Further, for organizations that do not meet the financial accountability criteria for inclusion as component units but that, nevertheless, should be included because the primary government's management determines that it would be misleading to exclude them, this Statement clarifies the manner in which that determination should be made and the types of relationships that generally should be considered in making the determination.

This Statement also amends the criteria for reporting component units as if they were part of the primary government (that is, blending) in certain circumstances. **For component units that currently are blended based on the "substantively the same governing body" criterion, it additionally requires that (1) the primary government and the component unit have a financial benefit or burden relationship or (2) management (below the level of the elected officials) of the primary government have operational responsibility (as defined in paragraph 8a) for the activities of the component unit. New criteria also are added to require blending of component units whose total debt outstanding is expected to be repaid entirely or almost entirely with resources of the primary government.** The blending provisions are amended to clarify that funds of a blended component unit have the same financial reporting requirements as a fund of the primary government. Lastly, additional reporting guidance is provided for blending a component unit if the primary government is a business-type activity that uses a single column presentation for financial reporting.

GASB 62 - *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*

The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements:

1. Financial Accounting Standards Board (FASB) Statements and Interpretations
2. Accounting Principles Board Opinions
3. Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure.

SCHEDULE OF OTHER MATTERS

GASB 62 - *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements (Continued)*

This Statement also supersedes Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, thereby eliminating the election provided in paragraph 7 of that Statement for enterprise funds and business-type activities to apply post-November 30, 1989 FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements. However, those entities can continue to apply, as other accounting literature, post-November 30, 1989 FASB pronouncements that do not conflict with or contradict GASB pronouncements, including this Statement.

The provisions of this Statement are organized by topic. Each topic contains provisions derived from FASB and AICPA pronouncements that address the subject matter. The order in which the topics are presented corresponds to the order of the primary locations within the GASB *Codification of Governmental Accounting and Financial Reporting Standards*, where the topics are codified.

The requirements in this Statement will improve financial reporting by contributing to the GASB's efforts to codify all sources of generally accepted accounting principles for state and local governments so that they derive from a single source. **This effort brings the authoritative accounting and financial reporting literature together in one place**, with that guidance modified as necessary to appropriately recognize the governmental environment and the needs of governmental financial statement users. It will eliminate the need for financial statement preparers and auditors to determine which FASB and AICPA pronouncement provisions apply to state and local governments, thereby resulting in a more consistent application of applicable guidance in financial statements of state and local governments.

SCHEDULE OF OTHER MATTERS

GASB 63 - *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*

This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. *Concepts Statement No. 4, Elements of Financial Statements*, introduced and defined those elements as a consumption of net assets by the government that is applicable to a future reporting period, and an acquisition of net assets by the government that is applicable to a future reporting period, respectively. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities.

Concepts Statement 4 also identifies net position as the residual of all other elements presented in a statement of financial position. This Statement amends the net asset reporting requirements in *Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and **by renaming that measure as net position, rather than net assets.**

The objective of this Statement is to provide guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position and related disclosures.

State and local governments enter into transactions that result in the consumption or acquisition of net assets in one period that are applicable to future periods. *Concepts Statement No. 4, Elements of Financial Statements*, identifies those consumptions or acquisitions as deferred outflows of resources and deferred inflows of resources, respectively, and distinguishes them from assets and liabilities. This Statement provides guidance for reporting deferred outflows of resources and deferred inflows of resources balances.

Concepts Statement 4 identifies net position as the residual of all other elements presented in a statement of financial position. It is the difference between (a) assets and deferred outflows of resources and (b) liabilities and deferred inflows of resources. This Statement provides guidance for reporting net position within a framework that includes deferred outflows of resources and deferred inflows of resources, in addition to assets and liabilities.

SUMMARY:

- *Statement of Net Position* The statement of net position should report all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position. Governments are encouraged to present the statement of net position in a format that displays assets, plus deferred outflows of resources, less liabilities, less deferred inflows of resources, equals net position, although a balance sheet format (assets plus deferred outflows of resources equals liabilities plus deferred inflows of resources, plus net position) may be used. Regardless of the format used, the statement of net position should report the residual amount as net position, rather than net assets, proprietary or fiduciary fund balance, or equity. Net position represents the difference between all other elements in a statement of financial position and should be displayed in three components—net investment in capital assets; restricted (distinguishing between major categories of restrictions); and unrestricted.

SCHEDULE OF OTHER MATTERS

GASB 63 - *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position (Continued)*

- *Net Investment in Capital Assets Component of Net Position* The net investment in capital assets component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt also should be included in this component of net position. If there are significant unspent related debt proceeds or deferred inflows of resources at the end of the reporting period, the portion of the debt or deferred inflows of resources attributable to the unspent amount should not be included in the calculation of net investment in capital assets. Instead, that portion of the debt or deferred inflows of resources should be included in the same net position component (restricted or unrestricted) as the unspent amount.

- *Restricted Component of Net Position* The restricted component of net position consists of restricted assets reduced by liabilities and deferred inflows of resources related to those assets. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported.

- *Unrestricted Component of Net Position* The unrestricted component of net position is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

- *Financial Reporting for Governmental Funds* Deferred outflows of resources and deferred inflows of resources that are required to be reported in a governmental fund balance sheet should be presented in a format that displays assets plus deferred outflows of resources, equals liabilities plus deferred inflows of resources, plus fund balance.

SCHEDULE OF OTHER MATTERS

EFFECTIVE FISCAL 2013/14:

GASB 65 - ***Items Previously Reported as Assets and Liabilities***

This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.

Concepts Statement No. 4, *Elements of Financial Statements*, introduced and defined the elements included in financial statements, including deferred outflows of resources and deferred inflows of resources. In addition, Concepts Statement 4 provides that reporting a deferred outflow of resources or a deferred inflow of resources should be limited to those instances identified by the Board in authoritative pronouncements that are established after applicable due process. Prior to the issuance of this Statement, only two such pronouncements have been issued. Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, requires the reporting of a deferred outflow of resources or a deferred inflow of resources for the changes in fair value of hedging derivative instruments, and Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, requires a deferred inflow of resources to be reported by a transferor government in a qualifying service concession arrangement. This Statement amends the financial statement element classification of certain items previously reported as assets and liabilities to be consistent with the definitions in Concepts Statement 4.

This Statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term *deferred* in financial statement presentations.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will improve financial reporting by clarifying the appropriate use of the financial statement elements deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting.

SCHEDULE PRIOR YEAR OF OTHER MATTERS

2011-01 Evidence of Journal Entry Review Being Reviewed

Criteria:

The City should maintain segregation of duties and adequate controls by ensuring that the person charged with reviewing journal entries does not prepare and post them as well. The City should also make some type of mark on the journal entry voucher to show the person reviewing is separate from the person preparing and posting the entry.

Condition:

During our interim audit testing of 40 journal entries for segregation of duties and adequate controls in the journal entry process, a total of 3 discrepancies were noted. 2 of the selections were found to be missing proper approval prior to being posted; and 1 sample was prepared and approved by the same person. After interim, the City went back and reviewed all journal entries to ensure that they were all properly reviewed and authorized. During the final phase of the audit we selected an additional 20 journal entries to be tested and noted no discrepancies.

Effect:

Unapproved changes could be made to journal entries or erroneous journal entries may be made posted without detection and potentially leading to material misstatement in financial reporting.

***Cause*:**

For the above noted journal entries, the City did not have segregation of duties in order to ensure that the person reviewing journal entries did not post and prepare them as well. The person who reviewed and approved the journal entry prior forgot to initial on the face of the journal entry voucher to document that that it was reviewed and approved.

Recommendation:

The City should implement a procedure where journal entry vouchers contain evidence of review and approval on the face of the document prior to being posted. There should be segregation of duties and so that the journal entry preparer cannot also approve or review the same journal entry.

Current Status:
There is segregation of duty to ensure in the supervisor approved budget adjustments and journal entry of the preparer. We'll make sure that all journals entries and adjustments will be approved by someone other than the preparer.

SCHEDULE PRIOR YEAR OF OTHER MATTERS

2011-02 Timely Preparation of Bank Reconciliations

Criteria:

Bank reconciliations should be performed on a timely basis, ideally within 30 days of the end of a given month.

Condition:

Per review of the March 2011 bank reconciliation during our interim in July 2011, it appears it had not been entirely completed.

Effect:

The City is not finalizing its monthly bank reconciliations in a timely manner, increasing the potential that mistakes or bank error would not be caught timely.

Cause:

City staff has overlooked completing the bank reconciliation process due to other job assignments.

Recommendation:

The City must ensure monthly bank reconciliations are completed within 30 days of the close of each month for good cash management controls.

Current Status:
Resolution stated and noted in 2012-02

2011-03 Accuracy of the Treasurer's Report

Criteria:

The Treasurer's Report should tie to the monthly investment reconciliation prepared by the City.

Condition:

We reviewed the March 2011 Treasurer's Report and the March 2011 Investment Reconciliation. The general ledger correctly recorded the amount of cash and investments. However, we noted that the value of the investments reported on the Treasurer's Report did not agree to what was reported as the value of the investments on the investment reconciliation – including a $2 million transfer from the City's Local Agency Investment Fund account.

SCHEDULE PRIOR YEAR OF OTHER MATTERS

Effect:

The Treasurer's Report is misreporting the proper value of the investments for which the City is currently holding.

Cause:

The preparer of the Treasurer Report did not include all activity in the quarter to reflect the correct balance of the City's investments.

Recommendation:

When preparing the Treasurer's Report, the City should capture all activities in a given period to reflect the most current and up to date value of the City's investments.

Current Status:
The Treasurer's report is a compilation of data from the investment firm and cities financial information system. City staff will continue to strive for accuracy and review the data reported by the investment firm prior to submitting report to City Council.

2011-04 Timesheet Procedures

Criteria:

The City is required to have timesheets of hourly, part-time employees, and exception-only basis submitted and have the appropriate employee and supervisor signatures on timesheets in order to ensure that all time entered have been properly reviewed and approved.

Condition:

Per review of the City's timesheets, one timesheet that could not be provided and of the twenty-three timesheets selected for review, four did not have the proper employee signature, one did not have the supervisor's signature, and one had two signatures on the supervisor signature line with no employee signature. In addition, it was noted that the department heads' timesheets were signed off by an employee within their respective department.

Cause & Effect:

The missing timesheets and timesheets without review for accuracy could indicate that the time recorded in the system does not correspond to the true hours worked by the employee.

Recommendation:

The City should make sure all employees turn in their timesheets and have them properly approved, entered, and filed.

SCHEDULE PRIOR YEAR OF OTHER MATTERS

Current Status:
Staffs is continuously monitoring the timesheets signature requirements including department head time sheets and strive to adhere with the requirements that employees and supervisors have properly approved and reflect the correct hours to be paid for each pay period. Staffs is also looking at online timesheet reporting and attempting to be on-line by 13/14 . In the meantime, signatures will be monitored.

2011-05 Super-User Rights

Criteria:

Accounting staff should not normally be allowed to have Super-User rights in the City's general ledger system.

Condition:

We noted that one City employee; an Accountant II has super-user rights to the Eden Accounting Software System.

Effect:

When accounting staff have super-user rights, there is a potential risk of restricting or allowing access to other user's abilities to access the different modules in the accounting system (i.e. unauthorized adjustments can be made to the general ledger). In addition, unauthorized transactions could be processed without proper review and approval.

Cause:

The City believes that it has a small Finance Department and therefore the people within Finance need to have access to be able to change the system administration functions.

Recommendation:

While we understand the City has a limited number of staff available to provide system administration functions, the City should consider restricting super user rights to as few employees as possible.

Current Status:
As mentioned above that Finance Department has few accounting staff and the super user rights are being reviewed for any changes made by the supervisor.

REQUIRED COMMUNICATIONS

December 28, 2012

To the City Council of
the City of San Leandro
San Leandro, California

We have audited the financial statements of the City of San Leandro (City) as of and for the year ended June 30, 2012, and have issued our report thereon dated December 28, 2012. Professional standards require that we advise you of the following matters relating to our audit.

Financial Statement Audit Assurance: Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit in accordance with generally accepted auditing standards does not provide absolute assurance about, or guarantee the accuracy of, the financial statements. Because of the concept of reasonable assurance and because we did not perform a detailed examination of all transactions, there is an inherent risk that material errors, fraud, or illegal acts may exist and not be detected by us.

Other Information Included with the Audited Financial Statements: Pursuant to professional standards, our responsibility as auditors for other information in documents containing the City's audited financial statements does not extend beyond the financial information identified in the audit report, and we are not required to perform any procedures to corroborate such other information. Our responsibility also includes communicating to you any information that we believe is a material misstatement of fact. Nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the financial statements. This other information and the extent of our procedures is explained in our audit report.

Accounting Policies: Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the City is included in Note 1 to the financial statements. There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during 2012. The following pronouncement became effective but did not have a material effect on the financial statements:

- **GASB 64 - *<u>Derivative Instruments: Application of Hedge Accounting Termination Provisions, an amendment of GASB Statement No. 53</u>***

  Some governments have entered into interest rate swap agreements and commodity swap agreements in which a swap counterparty, or the swap counterparty's credit support provider, commits or experiences either an act of default or a termination event as both are described in the swap agreement. Many of those governments have replaced their swap counterparty, or swap counterparty's credit support providers, either by amending existing swap agreements or by entering into new swap agreements. When these swap agreements have been reported as hedging instruments, questions have arisen regarding the application of the termination of hedge accounting provisions in Statement No. 53, Accounting and Financial Reporting for Derivative Instruments. Those provisions require a government to cease hedge accounting upon the termination of the hedging derivative instrument, resulting in the immediate recognition of the deferred outflows of resources or deferred inflows of resources as a component of investment income.

  The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. This Statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied.

Unusual Transactions, Controversial or Emerging Areas: No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus. There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during 2012. However, the dissolution of the Redevelopment Agency had a material impact to the financial statements of the City and its component units:

As discussed in Note 18 to the financial statements, the State enacted laws which dissolved Redevelopment Agencies effective January 31, 2012. The City elected to become a Housing Successor to the Redevelopment Agency and pursuant to the laws it is recipient to the encumbered housing assets of the former Redevelopment Agency. All other assets were distributed to and all of the Redevelopment Agencies liabilities were assumed by a Successor Agency governed by an Oversight Board. This Successor Agency is reported as a private purpose trust fund.

Pursuant to ABx1 26 adopted by the State of California which was validated by the California Supreme Court on December 28, 2011, the Redevelopment Agency has been dissolved and certain assets turned over to and liabilities assumed by a Successor Agency effective February 1, 2012.

As discussed in Note 18, the Redevelopment Agency repaid the Plaza Project Area General Fund loan in the amount of $2.1 million in fiscal 2010-11. ABx1 26 directs the State Controller to review the activities of all redevelopment agencies to determine whether an asset transfer between an agency and the sponsoring public agency occurred on or after January 1, 2011 and if such a transfer occurred, the State Controller is to require that the transfer be reversed. As of the date of our report, the review has not been completed and the amount of repayment to be returned, if any, is not determinable at this time.

As of June 30, 2012, the Successor Agency reported a $2 million advance to the City for Joint Project Area General Fund Loan approved by the Redevelopment Agency prior to dissolution. The State Department of Finance (DOF) has objected to this advance and stated it does not believe the Loan is an enforceable obligation. AB 1484 states that such liabilities are to be reamortized at an interest rate equivalent to that earned on Local Agency Investment Fund assets. Management has not reamoritzed this loan as it believes the Loan is a valid enforceable obligation. Management has requested a meet and confer process with the DOF to settle the matter.

Pursuant to AB 1484, a Due Diligence Review was conducted on the former Redevelopment Agency's Low and Moderate Income Housing Assets. The DOF has objected to the treatment of an Owner Participation Agreement as an enforceable obligation and requested that the City remit approximately $3.9 million currently held in the Affordable Housing Asset Fund to the Alameda County Auditor Controller. Management has requested a meet and confer process with the DOF to settle the matter.

The City's position on these matters is not a position of settled law and there is considerable legal uncertainty regarding these matters. It is possible that a legal determination may be made at a later date by an appropriate judicial authority that would resolve this issue favorably or unfavorably to the City. No provision for liabilities resulting from the outcome of these uncertain matters has been recorded in the accompanying financial statements.

Estimates: Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments. The most sensitive accounting estimates affecting the financial statements are fair values of investments and depreciation of capital assets.

- *Estimated Fair Value of Investments* (Note 2 to the financial statements) -As of June 30, 2012, the City, held approximately $96.6 million of cash and investments as measured by fair value. Fair value is essentially market pricing in effect as of June 30, 2012. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2012.

Management's estimate of depreciation is based on useful lives determined by management. These lives have been determined by management based on the expected useful life of assets as disclosed in Note 1H to the financial statements. We evaluated the key factors and assumptions used to develop the depreciation estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.

Disagreements with Management: For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the City's financial statements or the auditor's report. No such disagreements arose during the course of the audit.

Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

Retention Issues: We did not discuss any major issues with management regarding the application of accounting principles and auditing standards that resulted in a condition to our retention as the City's auditors.

Difficulties: We encountered no serious difficulties in dealing with management relating to the performance of the audit.

As discussed in Note 18 to the financial statements, the State enacted ABx1 26 and AB1484 (Dissolution Laws) which dissolved California redevelopment agencies effective January 31, 2012. The provisions of the Dissolution Laws are extremely complex and contain provisions requiring the unwinding of transactions recorded in prior years and remeasurement of amounts due to the City and its component units. The Dissolution Laws also give the State Controller's Office and Department of Finance approval powers over transactions and asset transfers and require a plethora of filings, processes and special procedures to be performed by external audit firms. These matters required an exorbitant amount of staff's time and attention. This in turn had an adverse effect on audit timing and effort.

Audit Adjustments: For purposes of this communication, professional standards define an audit adjustment, whether or not recorded by the City, as a proposed correction of the financial statements that, in our judgment, may not have been detected except through the audit procedures performed. These adjustments may include those proposed by us, but not recorded by the City, that could potentially cause future financial statements to be materially misstated, even though we have concluded that the adjustments are not material to the current financial statements.

We did not propose any audit adjustments that, in our judgment, could have a significant effect, either individually or in the aggregate, on the City's financial reporting process.

Uncorrected Misstatements: Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. We have no such misstatements to report to the City Council.

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This report is intended solely for the information and use of the City Council, its committees, and management and is not intended to be and should not be used by anyone other than these specified parties.

City of San Leandro

Meeting Date: July 1, 2013

Minute Order - Council

File Number:	13-342	**Agenda Section:**	CONSENT CALENDAR
		Agenda Number:	

TO: City Council

FROM: Chris Zapata
City Manager

BY: David Baum
Finance Director

FINANCE REVIEW: David Baum
Finance Director

TITLE: MOTION: Motion Accepting the City's Memorandum of Internal Control for the Year Ended June 30, 2012