



City of San Leandro

Meeting Date: June 18, 2018

Staff Report

File Number: 18-301

Agenda Section: CONSENT CALENDAR

Agenda Number: 8.J.

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, 2017

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, 2017

BACKGROUND

In planning and performing the audit of the financial statements, the City's independent auditors, Maze & Associates, considered the City's internal control over financial reporting (internal control) as a basis for designing auditing procedures for the purpose of expressing an opinion on the financial statements. At the completion of the audit, Maze confirmed the City's financial statements are presented fairly, in all material respects, and issued a clean, unmodified opinion. Maze & Associates found no exception to conformance with generally accepted accounting principles.

DISCUSSION

The City's independent auditors completed audits of the City's financial statements. Through the Memorandum of Internal Control (MOIC), the auditors affirmed the existence and quality of the City's internal controls.

Attached is the MOIC from the City's independent auditors 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, 2017.

ATTACHMENTS

- Memorandum of Internal Control for the fiscal year ended June 30, 2017

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, 2017**

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**CITY OF SAN LEANDRO
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS**

For The Year Ended JUNE 30, 2017

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MEMORANDUM ON INTERNAL CONTROL

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

In planning and performing our audit of the basic financial statements of the City of San Leandro, California, as of and for the year ended June 30, 2017, 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 that are appropriate in the circumstances 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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore material weaknesses or significant deficiencies may exist that were not identified. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. However, as discussed below, we identified certain deficiency in internal control that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the City'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.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency in internal control included on the Schedule of Significant Deficiencies to be a significant deficiency.

Included in the Schedule of Other Matters are recommendations not meeting the above definitions that we believe are opportunities for strengthening internal controls and operating efficiency.

Management's written responses included in this report have not been subjected to the audit 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, City Council, others within the organization, and agencies and pass-through entities requiring compliance with *Government Auditing Standards*, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in blue ink that reads 'Maze & Associates'.

Pleasant Hill, California
April 24, 2018

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CITY OF SAN LEANDRO
MEMORANDUM ON INTERNAL CONTROL
SCHEDULE OF SIGNIFICANT DEFICIENCY

2017-01 Year-End Close

Criteria: Management is responsible for the accuracy of the financial statements and the maintenance of the general ledger system and other records used to prepare the financial statements. Timeliness of the financial statements is key to a best practices approach in providing policy makers the year-end financial results soon enough to be useful and to meet filing deadlines.

Condition: The City provided approximately twenty-five post-closing adjusting journal entries which resulted in a delay in the timely completion of multiple financial statement items primarily pension, cash and investments, and capital assets.

Cause: The City has experienced key staff turnover since fiscal year 2015-2016 and as a result fell behind in the completion of the year-end close process.

Effect: Without adequate staff resources to ensure that the year-end closing was completed properly and accurately, there is an increased risk that material misstatements of the City's financial statements will not be prevented, or detected and corrected on a timely basis.

Recommendation: The City's fiscal year end closing process and journal entries associated with the close should be completed and posted prior to the commencement of year-end fieldwork. Staff should plan accordingly to ensure that a complete close of the books is performed prior to scheduling auditors to perform fieldwork.

Management Response: As noted, the City experienced key staff turnover in fiscal year 2015-2016, which continued through the current fiscal year 2017-18. As a result, the year-end close process fell behind. The Accounting division is now fully staffed as of April 1, 2018 with two new accountants. Management will continue to train new staff to ensure the close of fiscal year 2017-18 results in fewer delays and fewer adjusting journal entries. Furthermore, the final audit for fiscal year 2017-18 is scheduled to be later than it has been in prior years to ensure staff has sufficient time to close the fiscal year.

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**CITY OF SAN LEANDRO
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

NEW GASB PRONOUNCEMENTS OR PRONOUNCEMENTS NOT YET EFFECTIVE

The following comment represents new pronouncements taking effect in the next two years. We have cited them here to keep you abreast of developments:

Effective in fiscal year 2017-18:

GASB 75 – *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*

The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency.

GASB 81 – *Irrevocable Split-Interest Agreements*

This Statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. Furthermore, this Statement requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests. This Statement requires that a government recognize revenue when the resources become applicable to the reporting period.

GASB 85 – *Omnibus 2017*

The objective of this Statement is to address practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits [OPEB]).

GASB 86 – *Certain Debt Extinguishment Issues*

The primary objective of this Statement is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources—resources other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance.

**CITY OF SAN LEANDRO
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

Effective in fiscal year 2018-19:

GASB 83 – Certain Asset Retirement Obligations

This Statement addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this Statement.

**CITY OF SAN LEANDRO
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

2016-01 Year-End Close

Criteria: Management is responsible for the accuracy of the financial statements and the maintenance of the general ledger system and other records used to prepare the financial statements. Timeliness of the financial statements is key to a best practices approach in providing policy makers the year-end financial results soon enough to be useful and to meet filing deadlines.

Condition: The City provided approximately forty post-closing adjusting journal entries which resulted in a delay in the timely completion of multiple financial statement items primarily including cash and investments and capital assets.

Cause: The City has experienced staff turnover during fiscal year 2015-2016 and as a result fell behind in the completion of the year-end close process.

Effect: Without adequate staff resources to ensure that the year-end closing was completed properly and accurately, there is an increased risk that material misstatements of the City's financial statements will not be prevented, or detected and corrected on a timely basis.

Recommendation: The City's fiscal year end closing process and journal entries associated with the close should be completed and posted prior to the commencement of fieldwork. Staff should plan accordingly to ensure that a complete close of the books is performed prior to scheduling auditors to perform fieldwork.

Current Status: See significant deficiency 2017-01.

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REQUIRED COMMUNICATIONS

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

We have audited the basic financial statements of the City of San Leandro for the year ended June 30, 2017. Professional standards require that we communicate to you the following information related to our audit under generally accepted auditing standards and *Government Auditing Standards* and the Uniform Guidance.

Significant Audit Findings

Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by City of San Leandro are described in Note 1 to the financial statements. No new accounting policies were adopted, and the application of existing policies were not changed during the year, except as follows:

GASB Statement No. 74 – *Financial Reporting for Post-employment Benefit Plans Other Than Pension Plans*

This pronouncement became effective, as disclosed in Note 1P to the financial statements. As a result, the City adjusted beginning net position of the OPEB Trust fund and required new disclosures to the footnotes.

GASB Statement No. 77 – *Tax Abatement Disclosures*

The pronouncement became effective, and applicable agreements are disclosed in Note 12 to the financial statements.

GASB Statement No. 82 – *Pension Issues—an amendment of GASB Statements No. 67, No. 68, and No. 73*

The pronouncement became effective, but did not have a material effect on the financial statements, and only affected the Pension-Related Required Supplementary Information.

The following Governmental Accounting Standards Board (GASB) pronouncements became effective, but did not have a material effect on the financial statements:

GASB Statement No. 73 – *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*

GASB Statement No. 80 – *Blending Requirements for Certain Component Units—an amendment of GASB Statement No. 14*

Unusual Transactions, Controversial or Emerging Areas

We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's 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 significantly from those expected. The most sensitive estimate(s) affecting the City's financial statements were:

Estimated Net Pension Liabilities and Pension-Related Deferred Outflows and Inflows of Resources: Management's estimate of the net pension liabilities and deferred outflows/inflows of resources are disclosed in Note 13 to the financial statements and are based on actuarial studies determined by a consultant, which are based on the experience of the City. We evaluated the key factors and assumptions used to develop the estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.

Estimated Fair Value of Investments: As of June 30, 2017, the City's cash and investments were measured by fair value as disclosed in Note 2 to the financial statements. Fair value is essentially market pricing in effect as of June 30, 2017. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2017.

Estimate of Depreciation: Management's estimate of the 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 1.H. 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.

Disclosures

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

Professional standards require us to accumulate all known and likely uncorrected 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.

Disagreements with Management

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in a management representation letter dated April 24, 2018.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Information Accompanying the Financial Statements

We applied certain limited procedures to the required supplementary information that accompanies and supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the required supplementary information and do not express an opinion or provide any assurance on the required supplementary information.

We were engaged to report on the supplementary information which accompany the financial statements, but are not required supplementary information. With respect to this supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statement or to the financial statements themselves.

We were not engaged to report on the Introductory and Statistical Sections which accompany the financial statements, but are not required supplementary information. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on them.

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

Maze & Associates

Pleasant Hill, California
April 24, 2018