

**CITY OF EL CERRITO**  
**MEMORANDUM ON INTERNAL CONTROL**  
**AND**  
**REQUIRED COMMUNICATIONS**  
**FOR THE YEAR ENDED**  
**JUNE 30, 2008**

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**CITY OF EL CERRITO  
MEMORANDUM ON INTERNAL CONTROL  
AND  
REQUIRED COMMUNICATIONS**

**For the Year Ended June 30, 2008**

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**MEMORANDUM ON INTERNAL CONTROL**

November 5, 2008

To the City Council of  
the City of El Cerrito  
City of El Cerrito, California

In planning and performing our audit of the financial statements of the City of El Cerrito as of and for the year ended June 30, 2008, 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 opinion 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 control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control that we consider to be significant deficiencies that are included on the Schedule of Significant Deficiencies.

Included in the Schedule of Other Matters are recommendations not meeting the above definitions of a significant deficiency or material weakness 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, 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.

*Maze & Associates*

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**CITY OF EL CERRITO  
MEMORANDUM ON INTERNAL CONTROL STRUCTURE**

**SCHEDULE OF SIGNIFICANT DEFICIENCIES**

**2008-01      Capital Lease Transactions and Accounting**

The City issued a capital lease in December 2007. The equipment to be purchased with the lease was not received by the City prior to June 30, 2008, therefore the cash balance in the escrow account with the bank should have been recorded on the general ledger in the Internal Service Fund. However, when the City prepared the general ledger for audit, the cash balance in the escrow account including interest income for the fiscal year, totaling \$584,145, and the corresponding lease payable of \$575,835, had not been recorded in the general ledger. In addition, the City had not recorded activity related to the City's capital leases that were issued in previous years in the Internal Service Fund. The debt service on the previous capital leases had been recorded in the City's General Fund, rather than the Internal Service Fund. The City should ensure that all lease transactions are recorded in the general ledger timely and activity is recorded in the correct fund.

***Management's Response:***

The City realizes that this should have been recorded promptly and will do so in the future.

**CITY OF EL CERRITO  
MEMORANDUM ON INTERNAL CONTROL STRUCTURE**

**SCHEDULE OF OTHER MATTERS**

**2008-02      Purchasing Policy Compliance**

We selected thirty disbursements for testing of compliance with the City's purchasing policies and procedures and noted the following:

- a. The City's Purchasing Policy requires the use of a purchase order for all purchases of equipment and supplies greater than \$5,000. Although the purchases were approved for payment by City staff, purchase orders were used in only ten of the twenty disbursements that appeared to require the use of purchase orders. Future purchases should be made in compliance with the Purchasing Policy requirements, or the City should revise the Policy to reflect current practices.
- b. Two disbursements in excess of \$5,000 were not supported by an agreement, contract or evidence that an informal bid process took place, and one of those disbursements did not have a purchase order. One disbursement in the amount of \$13,225 was for the purchase of petroleum, and the other in the amount of \$19,285 was for the purchase of data switches. While we understand that the City staff calls three vendors to obtain informal quotes to compare prices, documentation of this practice is not maintained. The City's Purchasing Policy requires that for purchases below \$25,000 the informal bid process be documented on the purchase order, and that the applicable department maintain documentation supporting the informal bids.
- c. One disbursement for less than \$5,000 for the annual servicing of fire extinguishers was not supported by an agreement, contract or purchase order. Although the Purchasing Policy appears to exclude this type of disbursement from these documents, the Policy does require that the "Department Head or designee...evaluate the regular suppliers of small purchases against competitors at least annually to determine if a change should be made. This review may be done by comparison of equipment and supplies...in catalogues, via the internet, by published price lists...." Again, we understand that City staff called vendors to obtain informal quotes, but documentation was not maintained.

The City should perform a review of current purchasing procedures in conjunction with the Purchasing Policy and determine whether the Policy should be revised to reflect current practices, or if the Policy requirements should be enforced.

***Management's Response:***

- a. Efforts have been made during the year to increase the use of purchase orders to be in compliance with the policy and we are currently discussing the possibility of changing the policy to increase the amount required for purchase orders.
- b. The financial system does not allow the issuance of zero value "blanket purchase orders" which is how consumables such as fuel are normally recorded. Until a new finance system is acquired and implemented, El Cerrito will not be able to record a purchase order for fuel. We have, however, documented our informal bid regarding fuel.
- c. This comment is very timely considering the necessary belt tightening required due to the national economy. All managers and staff that initiate purchases have been instructed to review current recurring vendors pricing and to research competitors pricing where possible.

**CITY OF EL CERRITO  
MEMORANDUM ON INTERNAL CONTROL STRUCTURE**

**SCHEDULE OF OTHER MATTERS**

**2008-03      Building Permits – Manual Calculations**

We selected fifteen building permit receipts to recalculate the rates charged in accordance with the Council approved rate schedule. We found one building permit customer was under-billed by \$336 for the PWD and Planning Division plan review fees. We understand that these fees were manually calculated, rather than relying on the permit system to calculate the fees. The actual fees charged to the customer should have been calculated at 20% of \$3,445 (Room addition – multi story), but the customer was charged \$520.80 (based on 20% of \$2,604 which is the room addition - single story fee).

The City should ensure that all fees are calculated using the permit system, and when manual calculations are necessary they should require the review and approval of a second person.

*Management's Response:*

All permits are calculated by selecting the appropriate set of fees in the system and applying them to the permit. In this specific case the person selected the fee one line item in CRW below the correct one. Because of this there is a manual component to every permit calculation. In the last few months a spreadsheet template that supports the amount charged has been developed to show the fee selections and is prepared by permit staff and reviewed by the Building Official.

**2008-04      Master Fee Schedule**

The Master Fee Schedule for fiscal year 2008 on the City's website does not have the section providing the details of the combined plan and inspection fees for the building section (Section III). We were informed that it was a conscious decision to leave this section out of the website due to the complexity of the information. The City should update the schedule on the website to ensure that the customers have access to the correct rates or at least make an indication on the website that this section has been excluded and that customers should contact the City for further information.

*Management's Response:*

The website has been changed to include all components of the Master Fee Schedule.

**CITY OF EL CERRITO  
MEMORANDUM ON INTERNAL CONTROL STRUCTURE**

**SCHEDULE OF OTHER MATTERS**

**2008-05      Cash Receipts and Accounts Receivable – Finance Counter**

The Business License Clerk accepts cash receipts and prepares the receipts for deposit. She also prepares billings for the Fire Department and other departments in the City and maintains the customer database. We understand that there is no reconciliation of daily receipts performed by a second employee. The daily cash collections should be reviewed by a second employee, which includes accounting for the numerical sequence of receipts issued to the total collected. Because a gap in the numerical sequence could indicate that transactions had been voided without proper approval, the numerical sequence of cash receipts should be reviewed by someone other the staff member that collects the cash receipts.

We understand that the “Customer Database” used to track customer billings is only an excel spreadsheet, not an actual system, therefore any adjustments to the receivables cannot be tracked. The City should consider the use of a database system to tighten controls over cash collection and billing procedures. If that is not possible, the responsibility for maintaining the “database” should be transferred to an employee that is not involved with the cash collections, and access to that database should be restricted.

***Management’s Response:***

The daily batches are reviewed by the Accounting Supervisor and discrepancies are followed up with the account clerk and the bank. Because of our cashiering system sharing receipt numbers with the police department we cannot use numerical sequence of the batches to verify completeness. We could run a report that verifies all cash receipt numbers have been used and could do this on whatever time basis appears appropriate (i.e. monthly, quarterly). Voids cannot be performed by the account clerk without a password protected override where only the accounting supervisor and finance director have the password.

When a new finance system is purchased and implemented the accounts receivable module will be included. At this time there is not another employee to which we could transfer the database.

**2008-06      Recording Deed of Trust**

The City entered into an agreement with the East Bay Municipal Utility District for the purchase of property in the amount of \$6,000 in February 2008. As of November 5, 2008, the deed of trust transferring title of the property to the City had not been recorded with the County. City staff should ensure that deeds of trust are executed and recorded timely.

***Management’s Response:***

The deed is in the final phase of being recorded. It took a while to receive the documentation from EBMUD and then the County required additional information.

**CITY OF EL CERRITO  
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**SCHEDULE OF OTHER MATTERS**

**2008-07      Stale Dated Checks**

We reviewed the December 2007 outstanding check listing and noted there were outstanding checks totaling \$16,780 that dated from calendar year 2003 to 2006. We understand that the City has a process for resolving outstanding checks, that includes publishing the items as "unclaimed property" in the newspaper, but this process has not been implemented. The City should implement the process to resolve the old outstanding checks.

*Management's Response:*

The City will implement the stale dated check process in fiscal year 2008-09.

**2008-08      Asset Seizure Special Revenue Fund**

The City established the Asset Seizure Special Revenue Fund in fiscal year 2005, however the Fund has not had any expenditure activity to date. The City should review the purpose of this Fund and determine whether any applicable expenditures can be or should be applied to the Fund.

*Management's Response:*

This had been discussed with the Chief of Police and applicable expenditures are being determined.

**2008-09      Information Technology Best Practices Recommendations**

We conducted an Information Systems Review with our audit which encompassed the City's financial information system and the network environment that houses it. We expanded our work in previous years beyond simply looking at financial information systems as a result of greater risks of unauthorized access caused by overall industry growth of web-based commerce and internet based financial systems. Internal controls that are present in the overall network environment have become more important and relevant to understanding the internal controls over the financial system. We believe Information System controls must be continuously improved and enhanced to stay ahead of the ever increasing sophistication of hackers and criminals.

Currently, there are no Information Technology standards to which local governments are required to conform. Indeed there are a wide variety of informal guidelines and suggested controls from many different organizations which local governments can use to implement appropriate controls to ensure adequate security over information technology. Our Information Technology staff have reviewed these informal guidelines and concluded that the certification and accreditation framework developed by the National Institute of Standards and Technology (NIST) for the Federal Information Security Management Act (FISMA) are the most appropriate for local government. NIST and FISMA represent the minimum security requirements for federal government agencies information systems. We understand the U.S. Department of Justice recommends these for local governments. Our procedures included performing an external network scan based on NIST criteria and in determining that internal control provides for:

**CITY OF EL CERRITO**  
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**SCHEDULE OF OTHER MATTERS**

**2008-09      Information Technology Best Practices Recommendations (Continued)**

- Internet access defenses including hacker prevention, detection and deterrent systems
- Security of data from physical or network access
- Adequately protecting data from unauthorized internal access
- Reasonable measures to ensure continuation of service

While the results of our work did not indicate material weaknesses, we noted a few areas which could be improved to conform to NIST guidelines. A summary of these recommendations which we believe are “best practices” are as follows:

- *Payment Card Industry Compliance* – The City has point-of-sale credit card processing. Any organization that processes credit cards is required to comply with the Payment Card Industry Data Security Standard (PCI-DSS), even if the processing is outsourced. The standard was developed to minimize the risk of loss due to security breaches in processing credit card transactions. Merchants which conform to the Standard pay lower transaction fees and minimize their liabilities which may result from security breaches than those that do not comply. The Standard requires varying levels of controls depending on transaction levels. In general, merchants must:
  1. Fill out a self-assessment questionnaire (SAQ).
  2. Submit the SAQ to acquiring banks.
  3. Perform quarterly external network scans and submit the results to acquiring banks.
  4. Have a full independent PCI audit performed by a Qualified Security Assessor (QSA) and submit it to acquiring banks. (Required for level 1 merchants only).

We believe the City qualifies as a Level 3 or 4 merchant due to activity levels of less than 1 million transactions and currently it need only complete and maintain the SAQ in-house. However, we understand SAQ submissions will become mandatory for Level 3 and 4 merchants in the near future. Staff have not completed the SAQ, but should do so and prepare for the submission requirement.

- *Audit/Event Logging* – We believe this is one of the more important standards of NIST. The City does not appear to have audit logs documenting any change, addition or deletion of user accounts within the financial information system. The City should have audit/event logs of any addition, deletion or change in financial information system user accounts and the logs should be monitored by someone without the rights to effect such changes to ensure only authorized appropriate changes are made. In addition, any administrative access such as upgrades or application modifications by IT personnel, outside consultants or vendors should also be logged and reviewed.

***Management’s Response:***

PCI Compliance –The City has completed the self-assessment questionnaire and will maintain it in-house for review by any acquiring banks. Additional training has been scheduled to assure we are in compliance with the new regulations.

Audit/Event Logging – Our current financial system does not maintain records of the changes that could be reviewed with the log activity and the ability to change user accounts is restricted to the IT department. We will make this a requirement of any new system selected.

**CITY OF EL CERRITO**  
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**SCHEDULE OF OTHER MATTERS**

**2008-10**      **GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets***  
**(Effective for Fiscal 09/10) - Retroactive Application Required**

Governments have different types of intangible assets, such as easements, water rights, patents, trademarks, and computer software. Easements are referred to in the GASB 34 description of capital assets which has raised questions about whether and when intangible assets should be considered capital assets for financial reporting purposes.

The absence of specific authoritative guidance has resulted in inconsistencies in the recognition, initial measurement, and amortization of intangible assets among governments. The objective of this Statement is to establish accounting and financial reporting requirements for intangible assets to reduce inconsistencies and enhance comparability.

A summary of the statement:

- Intangible assets should be classified, accounted for and reported as capital assets, unless excluded from the scope. Guidance in this statement is in addition to existing capital asset guidance.
- GASB 51 specifically addresses the nature of intangible assets.
  - *Lack of physical substance.* An asset may be contained in or on an item with physical substance, for example, a compact disc in the case of computer software. An asset also may be closely associated with another item that has physical substance, for example, the underlying land in the case of a right-of-way easement. These modes of containment and associated items should not be considered when determining whether or not an asset lacks physical substance.
  - *Nonfinancial nature.* In the context of this Statement, an asset with a nonfinancial nature is one that is not in a monetary form similar to cash and investment securities, and it represents neither a claim or right to assets in a monetary form similar to receivables, nor a prepayment for goods or services.
  - *Initial useful life greater than one year.*
- GASB 51 excludes:
  - Assets acquired or created primarily for the purpose of directly obtaining income or profit.
  - Assets resulting from capital lease transactions reported by lessees.
  - Goodwill created through the combination of a government and another entity.
- Recognition of an intangible asset occurs only if it is considered identifiable. That is when either of the following apply:
  - The asset is separable from the government. That is it can be sold, transferred, licensed, rented, or exchanged.
  - The asset arises from contractual or other legal rights, regardless of whether transferable or separable.

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**SCHEDULE OF OTHER MATTERS**

**2008-10**    **GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets***  
**(Effective for Fiscal 09/10) - Retroactive Application Required (Continued)**

- Specific conditions must present to recognize internally generated intangibles. Capitalization of costs begins after all of the following criteria are met:
  - Determination of specific objectives of the project and the nature of the service capacity expected upon the completion.
  - Demonstration of the feasibility that the completed project will provide its expected service capacity
  - Demonstration of the current intention, ability, and effort to complete or continue development of the intangible asset.
  - Internally generated computer software is used as an example in applying the specific conditions approach.
  
- Amortization lives are addressed:
  - Limited by contractual or legal provisions.
    - Renewal periods for rights may be considered if there is evidence that the government will seek and be able to achieve renewal and that any anticipated outlays to be incurred as part of achieving the renewal are nominal. Such evidence should consider the required consent of a third party and the satisfaction of any conditions required to achieve renewal.
  - An indefinite life (no amortization) is permitted so long as there are:
    - No limiting legal, contractual, regulatory, technological, or other factors, and
    - No subsequent change in circumstances.
    - A permanent right-of-way easement is an example.

*Retroactive Application* -- For GASB 34 Phase I & II governments, retroactive reporting is required for intangible assets acquired in fiscal years ending after June 30, 1980. Retroactive reporting is not required for intangible assets with indefinite useful lives as of the effective date of this Statement nor for internally generated intangibles.

Retroactive reporting for Phase III governments is not required.

***Management's Response:***

The City will implement the provisions of the Statement in fiscal year 2010 for any applicable assets.

CITY OF EL CERRITO  
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SCHEDULE OF OTHER MATTERS

2008-11      **GASB Statement No. 53 Accounting and Financial Reporting for Derivative Instruments (Effective for fiscal 09/10)**

This Statement is intended to improve how state and local governments report information about derivative instruments in their financial statements. Specifically, GASB 53 requires governments to measure most derivative instruments at fair value in their financial statements that are prepared using the economic resources measurement focus and the accrual basis of accounting (proprietary and entity-wide financial statements). Governments enter into derivative instruments as investments; as hedges of identified financial risks associated with assets or liabilities, or expected transactions (that is, hedgeable items); or to lower the costs of borrowings. Governments often enter into derivative instruments with the intention of effectively fixing cash flows or synthetically fixing prices. Common types of derivative instruments used by governments include interest rate and commodity swaps, interest rate locks, options (caps, floors, and collars), swaptions, forward contracts, and futures contracts. In addition, this standard addresses hedge accounting requirements.

*Management's Response:*

The City will implement the provisions of the Statement in fiscal year 2010 for any applicable transactions.

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**CITY OF EL CERRITO  
MEMORANDUM ON INTERNAL CONTROL STRUCTURE**

**STATUS OF PRIOR YEAR SCHEDULE OF OTHER MATTERS**

**2007-01      Accounts Payable Supporting Documentation**

We selected thirty disbursements for testing of compliance with the City's purchasing policies and procedures and noted the following:

- One disbursement in the amount of \$13,632 for the purchase of petroleum was not supported by a contract or purchase order. The City's Purchasing Policy does not appear to require the use of a purchase order for this recurring expenditure, however it does not appear to exclude the use of a contract. We understand that the City has used this vendor for many years and that City staff call three vendors annually to compare the prices, but this practice is not documented. City staff should determine whether a contract should be in place or at a minimum document the annual review of vendor pricing comparisons.
- One disbursement in the amount of \$16,405 for the purchase of truck parts was not supported by a purchase order. The City's Purchasing Policy requires the use of a purchase order for all purchases of equipment and supplies greater than \$5,000. Future purchases should be made in compliance with the Purchasing Policy requirements, or revise the Policy to reflect current practices.

***Current Status:***

We will review our procedures related to these items, but since the purchase of the fire truck parts was an emergency we did not create a purchase order for parts that were already on the truck. We would like to be able to issue blanket purchases for vendors where we make continuous or emergency purchases but our software system does not allow for blanket purchase orders. When we get a new system we will be able to utilize blanket purchase orders. In regards to the purchase of petroleum, City staff has begun retention of the information used to determine the vendor in the policy approved informal bid method.

**2007-02      Procurement Card Purchase Documentation**

We selected sixteen procurement card disbursements for testing of compliance with the City's policies and procedures and noted the following:

- One disbursement authorization form was not signed by the approving official. All authorizations should be reviewed and completed prior to payment of the statement.
- One disbursement's supporting documentation was signed by an employee on behalf of the card holder. We understand that an administrative employee signs on behalf of firefighters when they are not available. When an employee is not available to sign his/her own documentation submission, a memo should accompany the documentation to indicate the reason, and the memo should be approved by the "approving official".
- Supporting documentation for one disbursement could not be located by Finance staff. In the event supporting documentation is misplaced, City policy requires the completion of a "loss of receipt" form, but that form could not be located. Finance staff should ensure that all documentation is retained in the appropriate files.

***Current Status:***

We will review our procedures with the card users and finance will continue to review at time of payment to assure we have all of the signatures, but we are still concerned that the missing documentation was the result of the audit staff. All of the requested test items were checked off of our list so our documentation shows that it was given to the audit staff.

**CITY OF EL CERRITO  
MEMORANDUM ON INTERNAL CONTROL STRUCTURE**

**STATUS OF PRIOR YEAR SCHEDULE OF OTHER MATTERS**

**2007-03      Cash Collection Site – Community Center**

We reviewed the cash collection and handling procedures for the City's Community Center and noted the following:

- The Center invoices customers for various programs and services. However, the Center does not forward the invoices to Finance to record the balances as accounts receivable in the City's general ledger. The Center only forwards receipts to Finance when payments are received. If receivables in the RecWare system are deemed overdue/uncollectible (over 6 weeks), the Center's personnel notify the Finance Department to record the uncollectible receivables in the general ledger and initiate collection procedures accordingly. At June 30, 2007 the accounts receivable balance was \$33 thousand and of that balance, \$10 thousand was 90 days overdue. The two Departments should establish procedures to record and reconcile the receivable balance between the two systems at least quarterly in order to ensure all the billings are current, accurate and collected on a timely basis.
- There are total 15 employees who work at the Center, which include 3 Supervisors, one Management Assistant, and the Community Center Director. Depending on the day or time, each shift may have a different number of employees working. Although the Center's account write-off procedure requires the approval of the Center Director, we noted that all the employees have the ability to void receipts without approval of the Director. To strengthen internal controls, cashiers should not be able to void a transaction without prior approval of another supervisory employee.
- The Center has three cash collection windows. The Center's cash receipts are not controlled by a cash register. All cash receipts are kept in unlocked drawers at the front counter. All the employees who work at the Center office have access to the cash drawers. Although all three cash collection windows are observed by cameras, the video recordings are only reviewed when cash collection variances occur. To improve controls, the cash receipts should be controlled either by a cash register or a locked drawer.
- The Center's Management Assistant delivers the daily deposit, summary report, detailed report, deposit slip, and reconciliation reports to the City's Finance Department, however, the Center does not use a locked bag to deliver the batch to the Finance Department. The Center should consider the use of a locked bag for the batch delivery.

***Current Status:***

- A process has been developed and implemented to send customers to collections.
- A procedure has been developed to require a supervisor to approve voids.
- The drawers have been modified so they can be locked.
- We have obtained and are using locking bags for the transport of Community Center deposits.

CITY OF EL CERRITO  
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STATUS OF PRIOR YEAR SCHEDULE OF OTHER MATTERS

2007-04      Accounts Receivable Adjustments

During our review of the City's internal controls for proper segregation of duties and procedures, we noted that the Accounting Manager can adjust accounts receivable balances and processes non-sufficient funds checks. Good internal controls require that employees with access to the City's assets not have access to the City's accounting records for those same assets. Finance staff should consider having another employee handle one of the duties to provide better internal controls.

*Current Status:*

The Accounting Supervisor does not process the non-sufficient funds checks other than to list them on his Cash Management worksheet in preparation for the bank reconciliation and record the journal entry. The account clerk performs the billing and collection process. No changes in our procedure are proposed.

2007-05      GASB Statement No. 48 - Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues (effective for Fiscal Year 2007-2008)

This Statement establishes financial reporting of several categories of transactions. We have ordered the topics to those we believe are most relevant to cities, followed by the other topics:

*Issues Most Relevant to Cities:*

- *Intra-Entity Transfers of Assets @ Carrying Value:* This Statement stipulates that governments should *not* revalue assets that are transferred between financial reporting entity components. Therefore, any assets (or future revenues) sold or donated within the same financial reporting entity should continue to be reported at their current carrying value when those assets or future revenues are transferred. Differences between the sales price and carrying value are recognized as a gain/ (loss) on the seller's statements and as an expense/ (revenue) on the buyer's statements. A transfer or subsidy treatment should be used in the basic financial statements.
- *Disclosures of Revenue Pledged for Repayment of Debt:* Though this GASB does not appear to impact the recording of debt with pledged revenues, it will expand disclosure requirements. We have italicized what we believe to be the *change* from current disclosures as follows:
  1. Identification of the specific revenue pledged and *the approximate amount of the pledge* [e.g. remaining debt service].
  2. Identification of, and general purpose for, the debt secured by the pledged revenue.
  3. The *term of the commitment* [e.g. remaining term of the debt].
  4. *The relationship of the pledged amount to the total for that specific revenue*, if estimable—that is, the proportion of the specific revenue stream that has been pledged.

CITY OF EL CERRITO  
MEMORANDUM ON INTERNAL CONTROL STRUCTURE

STATUS OF PRIOR YEAR SCHEDULE OF OTHER MATTERS

2007-05      **GASB Statement No. 48 - Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues (effective for Fiscal Year 2007-2008) (Continued)**

5. *A comparison of the pledged revenues recognized during the period to the principal and interest requirements for the debt directly or indirectly collateralized by those revenues. For this disclosure, pledged revenues recognized during the period may be presented net of specified operating expenses, based on the provisions of the pledge agreement; [e.g. revenue coverage calculation] however, the amounts should not be netted in the financial statements.*

- *Financing Authorities:* The Statement does not change the substance of accounting for revenues received by a government which are pledged for repayment of debt issued by a financing authority. The Statement requires the financing authority to recognize revenue when the pledging government is obligated to make the payments. This is essentially the counterparty perspective of recognizing debt service when due.

***Other Topics:***

- *Exchanges of Specific Receivables/Revenues for Cash:* Statement #48 states that “Governments sometimes exchange an interest in their expected cash flows from collecting specific receivables or specific future revenues for immediate cash payments—generally, a single lump sum. The issue addressed is whether exchanges should be reported as a sale or as a collateralized borrowing resulting in a liability. A sale treatment is permitted only if the government relinquishes control of the exchanged receivable/revenue. Specific criteria are listed in the Statement which are used to determine whether control is retained (indicating a borrowing treatment) or relinquished (indicating a sales treatment)

Exchange examples listed include the sale of future tobacco settlement revenues and the sale of delinquent property tax liens. These types of transactions are highly unusual and infrequent. This would have been helpful for those cities which securitized the VLF receivables.

- *Residual Interests and Recourse Provisions:* This Statement also includes guidance to be used for recognizing other assets and liabilities arising from a sale of specific receivables or future revenues, including residual interests and recourse provisions.

***Current Status:***

The City implemented the applicable provisions of the Statement, disclosures of revenue pledged for the repayment of debt, in the 2007-08 Fiscal Year.

CITY OF EL CERRITO  
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STATUS OF PRIOR YEAR SCHEDULE OF OTHER MATTERS

2007-06      GASB Statement No. 49 - Accounting and Financial Reporting for Pollution Remediation Obligations (Effective for Fiscal Year 2008-2009)

This Statement addresses accounting and financial reporting for pollution remediation obligations (including contamination), which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. This Statement excludes pollution prevention and landfill closure or post-closure costs. A municipality must estimate expected outlays for pollution remediation if it knows a site is polluted and any of the following recognition triggers occur:

- Pollution poses an imminent danger to the public or environment and a government has little or no discretion to avoid fixing the problem.
- A government has violated a pollution prevention-related permit or license.
- A regulator has identified (or evidence indicates it will identify) a government as responsible (or potentially responsible) for cleaning up pollution, or for paying all or some of the cost of the clean up.
- A government is named (or evidence indicates that it will be named) in a lawsuit to compel it to address the pollution.
- A government begins or legally obligates itself to begin cleanup or post-cleanup activities (limited to amounts the government is legally required to complete).

Liabilities and expenses would be estimated using an “expected cash flows” measurement technique, which is used by environmental professionals but will be employed for the first time by governments. Statement 49 also will require governments to disclose information about their pollution obligations associated with clean up efforts in the notes to the financial statements.

Pollution remediation outlays should be capitalized in the government-wide and proprietary fund statements when goods and services are acquired if acquired for any of the following circumstances:

- a. To prepare property for sale. Capitalized costs (including pollution remediation costs) continue to be limited to lower of cost or net realizable value
- b. To prepare property for use when the property was acquired with known or suspected pollution that was expected to be remediated. Governments should capitalize only those pollution remediation outlays expected to be necessary to place the asset into its intended location and condition for use.
- c. To perform pollution remediation that restores a pollution-caused decline in service utility that was recognized as an asset impairment. Governments should capitalize only those pollution remediation outlays expected to be necessary to place the asset into its intended location and condition for use.

CITY OF EL CERRITO  
MEMORANDUM ON INTERNAL CONTROL STRUCTURE

STATUS OF PRIOR YEAR SCHEDULE OF OTHER MATTERS

2007-06      GASB Statement No. 49 - Accounting and Financial Reporting for Pollution  
Remediation Obligations (Effective for Fiscal Year 2008-2009) (Continued)

- d. To acquire property, plant, and equipment that have a future alternative use. Outlays should be capitalized only to the extent of the estimated service utility that will exist after pollution remediation activities have ceased.

For outlays under criteria a and b, capitalization is appropriate only if the outlays take place within a reasonable period prior to the expected sale or following acquisition of the property, respectively, or are delayed, but the delay is beyond the government's control.

*Current Status:*

The City will implement the provisions of the Statement in fiscal year 2010 for any applicable transactions.

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## REQUIRED COMMUNICATIONS

November 5, 2008

To the City Council of  
the City of El Cerrito  
City of El Cerrito, California

We have audited the financial statements of the City of El Cerrito as of and for the year ended June 30, 2008 and have issued our report thereon dated November 5, 2008. 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. As described in notes to the financial statements, during the year, the City implemented the following new standard:

## CITY OF EL CERRITO

### REQUIRED COMMUNICATIONS

#### GASB Statement No. 48 - Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues

This Statement establishes financial reporting of several categories of transactions. There was no cumulative effect on prior year financial statements from this change. A summary of the financial statement impact follows:

- **Intra-Entity Transfers of Assets at Carrying Value:** This Statement stipulates that governments should *not* revalue assets that are transferred between financial reporting entity components. Therefore, any assets (or future revenues) sold or donated within the same financial reporting entity should continue to be reported at their current carrying value when those assets or future revenues are transferred. Differences between the sales price and carrying value are recognized as a gain/ (loss) on the seller's statements and as an expense/ (revenue) on the buyer's statements. A transfer or subsidy treatment should be used in the basic financial statements.

This principle had no impact on the City during the year.

- **Disclosures of Revenue Pledged for Repayment of Debt:** Although this GASB does not impact the recording of debt with pledged revenues, it expands disclosure requirements. See Note 6 to the financial statements. We have italicized what *changed* from prior year disclosures as follows:
  1. Identification of the specific revenue pledged and *the approximate amount of the pledge* [e.g. remaining debt service].
  2. Identification of, and general purpose for, the debt secured by the pledged revenue.
  3. *The term of the commitment* [e.g. remaining term of the debt].
  4. *The relationship of the pledged amount to the total for that specific revenue*, if estimable—that is, the proportion of the specific revenue stream that has been pledged.
  5. *A comparison of the pledged revenues recognized during the period to the principal and interest requirements for the debt directly or indirectly collateralized by those revenues*. For this disclosure, *pledged revenues recognized during the period may be presented net of specified operating expenses, based on the provisions of the pledge agreement*; [e.g. revenue coverage calculation] however, the amounts should not be netted in the financial statements.

**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 2008.

**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 depreciation and compensated absences.

## CITY OF EL CERRITO

### REQUIRED COMMUNICATIONS

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 5 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.

Accrued compensated absences which are comprised of accrued vacation and sick leave is estimated using accumulated unpaid leave hours and hourly pay rates in effect at the end of the fiscal year, as disclosed in Note 1H to the financial statements. We evaluated the key factors and assumptions used to develop the accrued compensated absences 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.

**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 propose audit adjustments that, in our judgment, could have a significant effect, either individually or in the aggregate, on the City's financial reporting process related to recording of the City's capital lease activity that is described in item 2008-01 of the Memorandum on Internal Control Structure.

**CITY OF EL CERRITO**

**REQUIRED COMMUNICATIONS**

**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 Council.

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

*Mane & Associates*