

**CITY OF EL CERRITO**  
**MEMORANDUM ON INTERNAL CONTROL**  
**AND**  
**REQUIRED COMMUNICATIONS**  
**FOR THE YEAR ENDED**  
**JUNE 30, 2009**

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

**For the Year Ended June 30, 2009**

**Table of Contents**

|   | <b><u>Page</u></b> |
|---|--------------------|
| <b><i>Memorandum on Internal Control</i></b> .....                      | 1                  |
| Schedule of Significant Deficiencies .....                              | 3                  |
| Schedule of Other Matters.....  | 5                  |
| Status of Prior Year Schedule of Significant Deficiencies.....          | 12                 |
| Status of Prior Year Schedule of Other Matters .....                    | 13                 |
| Status of Prior Year Schedule of Other Matters not yet Implemented..... | 21                 |
| <b><i>Required Communications</i></b> .....                             | 25                 |
| Financial Statement Audit Assurance.....                                | 25                 |
| Other Information Included with the Audited Financial Statements.....   | 25                 |
| Accounting Policies .....   | 25                 |
| Unusual Transactions, Controversial or Emerging Areas .....             | 26                 |
| Estimates.....  | 26                 |
| Disagreements with Management .....                                     | 27                 |
| Retention Issues .....  | 27                 |
| Difficulties .....  | 27                 |
| Audit Adjustments .....   | 27                 |
| Uncorrected Misstatements .....   | 27                 |

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December 1, 2009

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, 2009, 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 City'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 City's financial statements that is more than inconsequential will not be prevented or detected by the City'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 City'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.

Very truly yours,



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

**SCHEDULE OF SIGNIFICANT DEFICIENCIES**

**2009-01      Building Permits – Manual Calculations**

Due to the results of our building permits testing in the prior year (See 2008-03), we selected 30 building permit receipts to recalculate the rates charged in accordance with the Council approved rate schedule and found the following:

- a. One permit fee had been reduced by the Community Development Director by \$440 due to an “unhappy customer”. This fee reduction also affected the other fees that are based on the permit fee. Therefore, the total reduction for this permit amounted to \$531.
- b. One permit undercharged the customer \$2 due to “human error” when the calculation of the 60/40 split of fees between planning and building was miscalculated. Although it is not a material difference, it is unclear as to why the error occurred – the system should not involve manual calculations.
- c. One permit fee was reduced \$3,245 due to a reduction in the scope of work. The fee was manually reduced.
- d. One permit fee was reduced \$385 due to the scope of work and the size of the job. The fee was manually reduced.
- e. One permit fee was reduced \$129 due to the scope of work and the size of the job. The fee was manually reduced.
- f. One permit was calculated using the 2008 fee schedule, rather than the 2009 schedule, resulting in an error of \$69.
- g. One permit was calculated using the 2008 fee schedule, but it appears that the permit was initiated during 2009, resulting in an error of \$19.
- h. Five permits included fees related to the Fire Department and were coded on the permit as fire review fees, however those fees were recorded in the building permit revenue account. Only one other of our tested permits had the fire review fee and that fee *was* recorded in the fire review fee account.
- i. The City now splits the permit fee between plan check and building fee 60/40, however that change was not consistently applied throughout the fiscal year. In only 12 of the 18 applicable permits tested, was the correct 60/40 split applied to the two revenue codes. In most of the 6 exceptions, the plan check was calculated at a 1 hour fee rate and the balance of the permit was applied to building. The 60/40 split should be incorporated into the permit system so it is not a manual process.

When we selected the sample of 30 permits for testing and we attempted to recalculate using only the Master Fee Schedule, we found that it was not possible for 29 of the permits. While we understand that permit fees may be payable under a different rate schedule, depending on when the original permit application was filed, we found that most of the permits tested required additional research and documentation from City staff in order to recalculate the permits. The documentation for manual calculations or reductions was not readily available in the permit system.

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. And, documentation of the manual calculations should be retained in the permit system to reduce the need to “research” the cause of differences when the Master Fee Schedule is used to calculate the permit fee. Finally, any reductions in the fees charged should be documented on the permit and include approval by appropriate personnel.

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

**SCHEDULE OF SIGNIFICANT DEFICIENCIES**

**2009-01      Building Permits – Manual Calculations (Continued)**

*Management's Response:*

The City has taken this recommendation very seriously and reviewed these issues with staff and our legal counsel to determine the extent of the issue. Procedures have been put into place in accordance with the recommendation and a simplified fee schedule is being considered that would make it easier to test and review. Staff has been directed to stop doing manual calculations and fees needing adjustments have been analyzed and will be included in the Master Fee Schedule for FY2010-11.

**2009-02      Accounting for Loans Receivable**

Long-term agreements should be reviewed by the City and the Redevelopment Agency to ensure they are properly accounted for in the general ledger. Prior to the interim audit, we requested information so we could plan the audit approach and determine what footnote disclosures needed to be revised, what long-term documents needed to be reviewed, etc. During the interim audit, we were told that there were no Redevelopment Agency loans outstanding. However, upon our review of the Council minutes, we found that during fiscal year 2009 the Agency had approved a predevelopment, acquisition and construction loan agreement with Ohlone Gardens, L.P. for \$3,500,000 to assist with the acquisition and construction of an affordable housing development. During the year end phase of the audit, we found that the loan had been disbursed in the amount of \$3,022,703, but it had not yet been recorded in the general ledger as a loan receivable, because staff believed the transaction was to be accounted for as a grant to the developer.

In addition, to the Ohlone loan above, during the fiscal year 2009 audit we were told that the Agency had entered into an Owner Participation Agreement for Idaho Apartments in 1997 in which the Agency agreed to make a loan to the project in the future. In August 2000, the Agreement was amended to reaffirm the Agency's commitment to make a loan of up to \$350,000. In accordance with its 1997 and 2000 commitments, the Agency disbursed \$350,000 to the developer during the year ended June 30, 2009. This loan is repayable in 126 months from the date of occupancy, but it too had not been recorded as a loan receivable when we started the audit, again because staff believed the transaction was to be accounted for as a grant to the developer.

Without direction from Council regarding the treatment of loans, City staff should record loan transactions as they are specified in the loan documents and not assume they will be reverted to a grant.

Staff should review all agreements to ensure that documentation is accurate and that all approved transactions are recorded in the general ledger correctly and summarized for disclosure in the financial statements. In addition, significant commitments, such as the original Idaho Apartments loan commitment, should be disclosed in the financial statements when the agreements are executed.

*Management's Response:*

During the interim phase of the audit, there were questions regarding the proposed Ohlone Gardens development that caused Redevelopment staff to question whether the development would ever be approved. Since no funds had been disbursed, the Redevelopment staff was unsure if there was an agreement to discuss. After the interim phase, when the agreement was finalized and the payment made to the developer, it was the Administrative Services Director's incorrect determination that recorded the activity as a grant instead of as a loan. Any further activities of this type will be recorded as a loan.

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

**SCHEDULE OF OTHER MATTERS**

**2009-03      Documentation of the Review of Daily Community Development Receipts**

We reviewed the cash collection procedures at the Building/Community Development counter and noted the following:

- a. At the close of the business day, a Finance Department employee reconciles the daily cash collections from the binders to the Payment Edit Report. The cash receipts and reports are then reviewed by the Finance Department's Accounting Supervisor for accuracy and completeness. After review by the Accounting Supervisor, the reports are returned to the Finance Department employee to be input into the finance system. However, the review by the Accounting Supervisor is not indicated on the documents. Evidence of the review should be clearly indicated on the face of the document or in a log system that shows the reports were reviewed by a second person.
- b. We understand that checks received for which the account coding is unknown are not deposited until the coding can be determined. City staff should be informed that all checks are to be deposited immediately upon receipt. In the event the initial coding of a receipt is unclear, it should be posted to a clearing account in the general ledger until the correct coding can be determined.
- c. The cash receipts (checks) collected over the counter are placed in a plastic zipper pouch inside a binder that contains the activity information for the day. Although the checks are restrictively endorsed upon receipt, the City should consider the use of a cash register system or some other more secure method of handling the daily cash receipts.

The City should review the cash collection procedures to ensure that proper review and approval procedures are in place and cash collections are kept secure from time of receipt to deposit with the bank.

***Management's Response:***

- a. The business license/cash receipts clerk does the reconciliation and the Accounting Supervisor reviews and signs off on the reconciliation sheet. The clerk then inputs the information from CRW into the finance system. Evidence of the review is now shown.
- b. There is usually a less than 24 hour turnaround on a very small amount of checks.
- c. Since there is a very limited amount of cash collected over the counter and the checks are restrictively endorsed upon receipt the City is not currently considering utilizing a cash register for the permit counter at this time. With the use of the two different systems it would make the reconciliation process even more difficult. With the implementation of the new .Net version of our finance system we are planning on developing a bridge that would bring CRW data into New World and at that time we will consider a cash register system for permits.

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

**SCHEDULE OF OTHER MATTERS**

**2009-04      Purchasing Policy Compliance**

The City's Purchasing Policy requires the use of a purchase order for all purchases of equipment and supplies greater than \$5,000. We selected thirty-one disbursements for testing of compliance with the City's purchasing policies and procedures and noted that purchase orders were used in only 6 of the 13 disbursements that appeared to require the use of purchase orders. The City's purchasing policy was last revised in August 2006. 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:***

The purchasing policy revision is currently in process with the goal of being completed after the implementation of the new finance software in February, 2010.

**2009-05      Journal Entry Review**

We selected a sample of twenty-five journal entries to test the effectiveness of journal entry processing, procedures and adequacy of documentation. One of the journal entries tested was both prepared and approved by the Administrative Services Director without a second person's review. Although the journal entry was posted to the general ledger system by the Accounting Supervisor, to ensure proper control over journal entries and segregation of duties, the City should designate a second person, such as the Accounting Supervisor, to review and approve the entries initiated by the Administrative Services Director.

***Management's Response:***

That policy has been implemented.

**2009-06      Internal Controls – Segregation of Duties**

During our review of the City's internal controls for proper segregation of duties and procedures, we noted areas in which controls need to be improved and employee's access and/or duties revised. Good internal controls require that employees with access to the City's assets not have access to the City's accounting records for the same assets.

a. Payroll Review and Super-User Status

The payroll edit report (payroll register) should be reviewed by a second person to verify all checks are accurate and only authorized amounts are paid. This review should be performed by an employee that does not have access to the payroll module. The Accounting Supervisor reviews the payroll edit report, however he has access to the payroll system and has access to the check stock and the signature plate. In addition, he is a system "super user". An independent review of changes to the payroll database (new employees, pay rate changes, etc) should be performed by an employee not involved with the processing and review above.

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

**SCHEDULE OF OTHER MATTERS**

**2009-06      Internal Controls – Segregation of Duties (Continued)**

b. Access to Payroll System and Human Resources Module

We understand that due to a system limitation, the payroll function and the Human Resources function are combined into one module. Therefore, the payroll clerk has access to the payroll database and could make changes such as adding an employee or changing pay rates. Again, the City should determine whether a report of changes to the payroll database can be generated with each check run and reviewed and approved by an employee independent of the function.

c. Accounts Receivable Adjustments and NSF Checks

The Business License Clerk has access to the accounts receivable “database” and is responsible for processing NSF checks. And, the Senior Accountant can adjust accounts receivable balances and also has access to NSF checks. Employees with access to the NSF checks should not be involved with the cash collection or receivable procedures.

In addition, 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:***

- a. The Employee Services Manager position has been filled but the account clerk position in Employee Services is vacant and we are not planning on filling it in the near future. The Employee Services Manager is reviewing the payroll changes and does not have access to the database or the check stock.
- b. The new .Net system has much better security and this will no longer be a problem.
- c. We do not have anyone else to do the NSF checks. For the database, we are purchasing New Worlds .Net product for Miscellaneous Receivables that will replace the excel spreadsheet.

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

**SCHEDULE OF OTHER MATTERS**

**2009-07      Monitoring Contractors Processing Transactions**

*Statement on Auditing Standards #70—Service Organizations (SAS 70)* establishes auditing standards to be followed to ensure that any service organization's systems and controls are adequately designed and are operating effectively. SAS 70 has two parts. Part one is designed to review controls over the service provided at a particular date and to report on whether the design of these controls appear to be adequate on that date. Part two is designed to test these controls over a six month period and to report on whether the design of the controls appears adequate and whether the auditor can reasonably conclude that the controls were operating effectively.

The City has a third party fiscal agent, Union Bank of California, that manages the City's debt service transactions and investment of bond proceeds. The procedures used by these service organizations are outside the scope of City oversight and staff review, and these controls are not part of the scope of an audit of the City's financial statements. Typically cities employ a variety of approaches to gain comfort that service organizations are performing their functions in a prudent manner and producing reliable data. For example, fiscal agents manage funds held pursuant to debt indentures, but cities rarely have audits performed as City staff review transactions and verify the trust data. Less frequently special audits are performed to determine adequacy of controls and to verify the data produced. There is a third option which is to request a copy of the entity's review and report on internal controls pursuant to the requirements of SAS 70.

Should the SAS 70 audit reveal weaknesses in the service organization's internal controls, those could go unnoticed by the City. The City should request a copy of the most recent SAS 70 report from its third party fiscal agent, especially in light of the change in fiscal agent during the current fiscal year. It would be preferable if the contractor had both parts of a SAS 70 audit performed and that the report be furnished directly to the City for review. Any weaknesses or system problems disclosed by that audit should be addressed and resolved by the contractor to the satisfaction of the City. This process should take place on an annual basis for all of the City's service organizations.

***Management's Response:***

The most current SAS 70 report was obtained from Union Bank of California and reviewed. The City has made a request to be on the annual dissemination listing for future SAS 70 reports.

**2009-08      OPEB Implicit Rate Subsidy and Potential New OPEB Plan**

Although the City does not directly provide post-retirement healthcare benefits, the City does allow retirees to purchase health care coverage through the City's plan. The difference between the group premium rate paid by those retirees and the rate they would pay if they were to obtain the healthcare as a separate group is termed an implicit rate subsidy and is subject to the GASB Statement 45 reporting requirements.

The City should determine whether the potential liability of the implicit rate subsidy is material, and if so, the City should consider obtaining an actuarial study. The City has approximately 30 retired employees purchasing coverage through the group plan, but current employees eligible to participate also need to be factored into the calculation. One method of determining whether the amount is material is to complete the calculation using the "alternative measurement method" as described in GASB Statement 45. There are also a number of websites that can be used to calculate the liability under the alternative measurement method online.

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

**SCHEDULE OF OTHER MATTERS**

**2009-08      OPEB Implicit Rate Subsidy and Potential New OPEB Plan (Continued)**

The City should determine whether the implicit rate subsidy needs to be disclosed in accordance with the requirements of GASB Statement 45. If so, the City is a "Phase 3" government and would be required to implement the provisions of GASB Statement 45 in fiscal year 2010.

Finally, the City should determine whether the new Employer Participation Agreement for the Post Employment Health Plan for Collectively Bargained Public Employees (Fire) approved in April 2008 is subject to the GASB 45 provisions. Again, if this Plan is subject to GASB Statement 45, the City will need to implement the provisions of the Statement in fiscal year 2010, which could include the need for an actuary study if the Alternative Measurement Method cannot be used for this Plan.

***Management's Response:***

Agreed.

**2009-09      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:

- 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" as follows:

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

**SCHEDULE OF OTHER MATTERS**

**2009-09      Information Technology Best Practices Recommendations (Continued)**

- *Payment Card Industry Compliance* – The City has point-of-sale credit card processing. The City is not in compliance with the Payment Card Industry Data Security Standard (PCI-DSS). Any organization that processes credit cards is required to comply with PCI-DSS, even if the processing is outsourced. Failure to meet compliance requirements results in higher transaction fees and liability if a security breach is found. Because the City accepts credit cards as a form of payment, the City must be compliant with the applicable controls.
- *Audit/Event Logging* - We believe this is one of the more important standards of NIST. The City does not appear to have audit logs on the financial application server, such that any change, addition or deletion of user accounts within the application are tracked and monitored. The City should have audit/event logs of any addition, deletion or change in financial application user accounts and that log should be monitored by someone without the rights to effect such changes. In addition, any administrative access such as upgrades or application modifications by IT personnel, outside consultants or vendors should also be logged and reviewed.
- *General Information Systems Controls* – We reviewed the compliance of the City’s information systems with the National Institute of Standards and Technology (NIST) information security standards based on a moderate risk system. We noted a number of controls that did not appear to be in place. A separate report of those controls was provided to the City’s IT and Finance personnel. We recommend the City choose an appropriate industry standard like NIST to help plan, organize and review information security.

***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.

General Information Systems Controls – The City will review the report of controls provided and determine if any of those controls should be implemented.

**2009-10      Asset Seizure Special Revenue Fund**

The City established the Asset Seizure Special Revenue Fund in fiscal year 2005. However, the Fund has had no expenditure activity to date and has fund balance of \$209,065 at June 30, 2009. We made this same recommendation in the prior year (see 2008-08), but attain the fund had no activity. The City should determine whether these funds may be applied to existing public safety expenditures or whether there are any time limits on use of the funds.

***Management’s Response:***

The monies will be used in to purchase a vehicle with the specified requirements for a K-9 unit as well as other one-time expenditures consistent with the funds regulations.

CITY OF EL CERRITO  
MEMORANDUM ON INTERNAL CONTROL

SCHEDULE OF OTHER MATTERS

**NEW GOVERNMENTAL ACCOUNTING STANDARDS BOARD PRONOUNCEMENT:**

The following comment represents a new pronouncement taking affect in the next few years. We cite it here to keep you abreast of developments:

**2009-11      GASB Statement No. 54 - Fund Balance Reporting and Governmental Fund Type Definitions (Effective for fiscal 2010/11)**

This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

The initial distinction that is made in reporting fund balance information is identifying amounts that are considered **nonspendable**, such as fund balance associated with notes receivable. This Statement also provides for additional classifications as **restricted, committed, assigned, and unassigned** based on the relative strength of the constraints that control how specific amounts can be spent.

The **restricted** fund balance category includes amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers, or through enabling legislation.

The **committed** fund balance classification includes amounts that can be used only for the specific purposes determined by a formal action of the government's highest level of decision-making authority. Amounts in the **assigned** fund balance classification are intended to be used by the government for specific purposes but do not meet the criteria to be classified as restricted or committed. In governmental funds *other than the general fund*, assigned fund balance represents the remaining amount that is not restricted or committed.

**Unassigned** fund balance is the residual classification for the government's general fund and includes all spendable amounts not contained in the other classifications. *In other funds*, the unassigned classification should be *used only to report a deficit balance* resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned. Governments are required to disclose information about the processes through which constraints are imposed on amounts in the committed and assigned classifications.

Disclosure of the policies in the notes to the financial statements is required.

This Statement also provides guidance for classifying stabilization amounts on the face of the balance sheet and requires disclosure of certain information about stabilization arrangements in the notes to the financial statements.

The definitions of the general fund, special revenue fund type, capital projects fund type, debt service fund type, and permanent fund type are clarified by the provisions in this Statement. Interpretations of certain terms within the definition of the special revenue fund type have been provided and, for some governments, those interpretations may affect the activities they choose to report in those funds. The capital projects fund type definition was also clarified for better alignment with the needs of preparers and users. Definitions of other governmental fund types also have been modified for clarity and consistency.

***Management's Response:***

The City will implement the provisions of the Statement in fiscal year 2011.

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

**STATUS OF PRIOR YEAR 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.

***Current Status:***

The City realizes that this should have been recorded promptly and has done so for subsequent leases.

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

**STATUS OF PRIOR YEAR 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.

***Current Status:***

- 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. Our informal bid process is being documented for items that fall into this category of the purchasing policy.
- 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 and to maintain documentation of their process.

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

**STATUS OF PRIOR YEAR 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.

***Current Status:***

See response to 2009-01.

**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.

***Current Status:***

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

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

**STATUS OF PRIOR YEAR 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 than 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.

***Current Status:***

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. A report that verifies all cash receipt numbers is run periodically. Voids cannot be performed by the account clerk without a password protected override where only the Accounting Supervisor and Administrative Services 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.

***Current Status:***

The deed has been recorded. It took a while to receive the documentation from EBMUD and then the County required additional information.

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

**STATUS OF PRIOR YEAR 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.

***Current Status:***

The City implemented 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.

***Current Status:***

See response to 2009-10.

**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  
MEMORANDUM ON INTERNAL CONTROL**

**STATUS OF PRIOR YEAR 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.

***Current Status:***

*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  
MEMORANDUM ON INTERNAL CONTROL**

**STATUS OF PRIOR YEAR 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.

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

**STATUS OF PRIOR YEAR 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.

***Current Status:***

The City did not have any applicable assets in FY2008-09 but will implement the statement for any applicable assets in future years.

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

**STATUS OF PRIOR YEAR 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.

***Current Status:***

The City did not have any applicable transactions in FY2008-09 but will implement this statement for any future applicable transactions.

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

**STATUS OF PRIOR YEAR SCHEDULE OF OTHER MATTERS  
NOT YET IMPLEMENTED**

**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:***

See response to 2009-04.

**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.

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

**STATUS OF PRIOR YEAR SCHEDULE OF OTHER MATTERS  
NOT YET IMPLEMENTED**

**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**

**STATUS OF PRIOR YEAR SCHEDULE OF OTHER MATTERS  
NOT YET IMPLEMENTED**

**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 implemented the provisions of the Statement in fiscal year 2009, however there was no material effect on the financial statements from the implementation of this statement.

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## REQUIRED COMMUNICATIONS

December 1, 2009

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, 2009 and have issued our report thereon dated December 1, 2009. 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 standards:

## CITY OF EL CERRITO

### REQUIRED COMMUNICATIONS

**GASB Statement No. 49 - Accounting and Financial Reporting for Pollution Remediation Obligations** – This Statement establishes financial reporting of obligations for pollution remediation. There was no material effect on the financial statements from the implementation of this statement.

**GASB Statement No. 50 Pension Disclosures — an amendment of GASB Statements No. 25 and No. 27** – This Statement amends prior year disclosures for cost sharing defined benefit pension plans by requiring among other things, funding trend data for cost sharing pools. Minor modifications were made to Note 9 to the financial statements to incorporate the requirements of the Statement.

**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 2009.

**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.

*Estimated Fair Value of Investments:* As of June 30, 2009, the City held approximately \$22.2 million of cash and investments as measured by fair value as disclosed in Note 3 to the Financial Statements. Fair value is essentially market pricing in effect as of June 30, 2009. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2009.

*Estimated 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 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.

*Estimated Compensated Absences:* 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, and are 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.

CITY OF EL CERRITO

REQUIRED COMMUNICATIONS

**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 loans receivable activity that is described in item 2009-02 of the Memorandum on Internal Control.

**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*

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