

**Independent Auditor's Report on Internal Control over Financial Reporting and
on Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

City Council
City of Clearlake
Clearlake, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the City of Clearlake (City), as of and for the year ended June 30, 2020, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated April 14, 2022.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described in the accompanying schedule of findings and responses, we did identify certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and responses as items 2020-001 and 2020-002 to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings and responses as items 2020-003, 2020-004, and 2020-005 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

City of Clearlake's Responses to Findings

The City's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. The City's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the City's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in dark ink that reads "Van Lant & Fankhaenel, LLP". The signature is written in a cursive, flowing style.

April 14, 2022

CITY OF CLEARLAKE
SCHEDULE OF FINDINGS AND RESPONSES
Year Ended June 30, 2020

2020-001 Timeliness and Accuracy of Accounting Records

Condition:

In preparation for the annual audit, the City's Finance staff performed significant analysis and reconciliations of various accounts in the City's general ledger. However, when we began our year-end audit fieldwork, it became apparent that certain accounts had not yet been thoroughly analyzed and reconciled to supporting records. This includes accounts payable, accounts receivable, and capital assets. In addition, while performing audit procedures, we identified and proposed many material adjusting entries to the City's accounting records. Furthermore, *Statements on Auditing Standards No. 115, "Communicating Internal Control Related Matters Identified in an Audit"* states that "indicators of material weaknesses in internal control include: identification by the auditor of a material misstatement of the financial statements under audit in circumstances that indicate the misstatement would not have been detected by the entity's internal control."

Reconciliation and review of all balance sheet accounts and various revenue and expenditure accounts on a recurring basis, and especially at year-end, is a vital part of maintaining the integrity of the accounting and financial reporting system. Periodic reconciliations of balance sheet and other selected accounts provide accurate data from which to base decisions, prevent costly errors and provide ease in identifying potential adjustments and corrections. In addition to this, the City should also conduct budget-to-actual comparisons on a regular basis. If this is not done in a timely manner throughout the fiscal year, the year-end closing process tends to be more difficult and time-consuming, and may contribute to delays in issuing year-end reports. It should be noted, adjusting journal entries were being made to the City's accounting records as late as May 2021, approximately 2 years after the end of the fiscal year.

Criteria:

The City's management is responsible for establishing and maintaining effective internal controls over financial reporting to help ensure that appropriate goals and objectives are met. This responsibility includes the selection and application of accounting principles, ensuring that financial information is reliable and properly recorded, and evaluating and monitoring ongoing activities.

Cause of Condition:

Turnover in the Finance Department and delays in completing the year-end financial close process due to COVID-19.

CITY OF CLEARLAKE
SCHEDULE OF FINDINGS AND RESPONSES
Year Ended June 30, 2020

2020-001 Timeliness and Accuracy of Accounting Records - Continued

Recommendation:

Therefore, in order to maintain the integrity of the accounting and financial reporting system, and to ensure timely reporting, we recommend that all balance sheet accounts and other selected accounts be analyzed on a monthly, quarterly or other periodic basis as appropriate. We suggest a schedule of accounting functions to be performed monthly, quarterly, etc., be prepared with the provision for signing off by date and initials when the procedure is complete. We understand significant turnover in the finance department along with the onset of the COVID-19 pandemic were contributing factors to the finding described above.

Views of Responsible Officials:

Management concurs with Auditor's Recommendations. Significant process has been made during the 2020 and 2021 fiscal years. During the period of this audit, the City revised and greatly improved its Chart of Accounts. While this delayed the recording process at the time, it improved the overall accounting system significantly.

Procedures for monthly processes have started, and all recommendations have been implemented as of December 31, 2021. Furthermore, the Finance Department is now fully staffed thereby mitigating most of the staffing concerns.

CITY OF CLEARLAKE
SCHEDULE OF FINDINGS AND RESPONSES
Year Ended June 30, 2020

2020-002 Controls Over the City's Disbursements and Procurement Process

Condition:

As part of our audit we reviewed and evaluated the controls over the City's purchasing and check disbursement process in order to gain an understanding and perform our required risk assessment process. While performing these procedures, we noted the following conditions:

- a) After reviewing a selection of disbursements and supporting documentation, we found that many invoices did not include an approval or authorization from the department or department head that initiated and made the purchase. It should be noted however, that the invoices did include approval from the Finance Department.
- b) When evaluating the controls over creating vendors, approving invoices, and signing checks, we noted that the Finance Director position during the 2020 fiscal year had the authority to do all of these tasks, creating a conflict in controls over segregation of duties.
- c) In some cases, we found through inquiry and review of various procedures, checks, once printed and signed, were being hand delivered by City staff to the vendor.

Criteria:

In a strong internal control environment, procedures and controls should be established in the above listed areas to ensure proper authorization and approval of invoices, segregation of duties, compliance with the City's purchasing and procurement policies, and controls over issued checks. Controls in these areas are vital to prevent misappropriation of City funds through the purchasing and disbursement process.

Cause of Condition:

Turnover in the Finance Department and lack of detailed guidance to City staff.

Potential Effect of Condition:

With a lack of controls over the disbursement process, the possibility of misappropriation of funds is increased.

Recommendation:

We recommend the City implement various controls over the purchasing and disbursement process based on the conditions identified above. Our recommendations are the following:

CITY OF CLEARLAKE
SCHEDULE OF FINDINGS AND RESPONSES
Year Ended June 30, 2020

2020-002 Controls Over the City's Disbursements and Procurement Process - Continued

- a) All invoices should be signed and approved by the individual that initially authorized the purchase and received the goods/services. This will ensure that the City is paying for goods/services that were received and were satisfactory.
- b) Incompatible duties should be segregated so that the same individual does not have the ability or authority to setup a vendor in the finance system, authorize and approve payments, and sign checks.
- c) The City should establish controls to ensure the purchasing and procurement policies are followed, including detailed guidance to City staff for purchases that require competitive bids from vendors. The detailed guidance should include the various purchasing thresholds (when required), services, supplies, equipment, and projects that require bids, and whether the process is a formal or informal bid process.
- d) Policies should be established to require that all checks be mailed to the vendor address on file and signed checks should never be returned to the employee authorizing and approving the payment.

We understand the City has taken actions to correct some of the above mentioned findings after the fiscal year 2020 period under audit and we recommend the City continue to evaluate the procurement policy to ensure controls are properly implemented and operating effectively.

View of Responsible Officials:

Management substantially concurs with Auditor's Recommendations. The City took steps to improve segregation of duties in the 2020-21 fiscal year, and finalized processes in the 2021-2022 fiscal year. Staffing limitations are a constraint in this area; however, the City will continue to identify ways to balance this with additional monitoring. The City recently completed an update to the Procurement Ordinance, Procurement Procedures and Policy Manual, and conducted training in September and November of 2021. The invoice process has been updated to require approval by the requesting department.

CITY OF CLEARLAKE
SCHEDULE OF FINDINGS AND RESPONSES
Year Ended June 30, 2020

2020-003 Credit Card Use Policy

Condition:

While conducting audit procedures relating to disbursements/expenditures, we did not identify a detailed credit card use policy. The City has reimbursement policies for meals and travel expenses; however, there is no detailed policy for credit card use when traveling or for the purchase of meals. In addition, through reviewing credit card purchase activity, it appears that the City could benefit from a credit card use cover sheet for each cardholder to be submitted along with the receipts each month.

Criteria:

Credit card usage should be well documented and subject to established City policies. Use of City credit cards by City staff should have sufficient supporting documentation to detail the specific reasons for using the credit cards, including when used for meals and travel. In addition, the specific reasons for the travel costs incurred should provide enough information to be able to verify the amounts charged for meals and travel are in accordance with set standard amounts, such as those established by the General Services Administration (GSA).

Cause of Condition:

The City's credit card policies do not appear to provide sufficient detailed guidance on allowable use. In addition, there is no cover sheet required to be submitted indicating the purpose for purchases made on the City's credit card.

Potential Effect of Condition:

The potential for unauthorized purchases or excessive costs incurred is increased.

Recommendation:

We recommend the City establish detailed policies on the appropriate use of City credit cards and implement procedures to ensure that the review and purpose of purchases made with City credit cards is thoroughly documented. Credit card policies should be established to ensure conservative, efficient use of City funds. In addition, policies for allowable use of City credit cards while traveling should also be clearly defined. The supporting documentation should include the purpose for travel and a reconciliation of the travel costs with a set standard of limits for meals and lodging.

**CITY OF CLEARLAKE
SCHEDULE OF FINDINGS AND RESPONSES
Year Ended June 30, 2020**

2020-003 Credit Card Use Policy - Continued

View of Responsible Officials:

Management concurs with Auditor's recommendations. The Procurement Card Policy and Procedure's manual and training were completed in November 2021.

CITY OF CLEARLAKE
SCHEDULE OF FINDINGS AND RESPONSES
Year Ended June 30, 2020

2020-004 Internal Controls Over Payroll Processing

Condition:

While obtaining an understanding of the payroll process we noted that the City's Payroll Account Clerk (PAC) is responsible for maintaining the employee master file, adding new employees, removing employees, and inputting all payroll changes for wages, withholdings etc. The PAC also uploads information to the bank to process payroll and posts the journal distribution to the general ledger.

Criteria:

In a strong internal control environment, the same individual should not have the ability to add new employees and process payroll without significant oversight and detailed review performed by someone independent of the individual processing payroll.

Cause of Condition:

Lack of segregation of incompatible duties by the Payroll Account Clerk.

Potential Effect of Condition:

Without proper oversight and controls over the payroll process, the likelihood for errors and misappropriation of assets is increased.

Recommendation:

We recommend the City segregate the incompatible duties of the PAC, including removing the PAC's ability to establish new employees, change pay rates without additional review and oversight.

Views of Responsible Officials:

Management concurs with Auditor's recommendations. The incompatible duties have been substantially transferred to the Administrative Services Department, which handles the Human Resources function, as of May 2021. Changes entered require a second-party check to ensure accuracy.

CITY OF CLEARLAKE
SCHEDULE OF FINDINGS AND RESPONSES
Year Ended June 30, 2020

2020-005 Internal Controls Over Cash Receipts

Condition:

During our review of the City's receipting process, we found that the City utilizes a manual receipt system for payments made at the front desk at City Hall and through the mail. In addition, the Accounts Payable Account Clerk (APAC) receives the cash and check payments, reconciles the numerical receipt listing, maintains the manual receipt book, prepares the monthly journal entry to record the revenues, posts the revenues to the general ledger, brings deposits to the bank, and prepares the bank reconciliation.

Criteria:

In a strong internal control environment, the cash receipting function should have a point of sale system that creates a record of the transaction that can't be manipulated. This is typically found in an electronic cashiering program. Also, the duties of the APAC represent incompatible duties for strong internal controls. The same individual should not have access to cash/checks, receipt number listing (custody), maintain the general ledger and record journal entries (recording) and perform the bank reconciliations.

Cause of Condition:

The City has not established a point of sale cash receipting system and incompatible duties have not been properly segregated by the City's policies and procedures.

Potential Effect of Condition:

The potential for cash receipts and transactions to be misappropriated without detection is increased with a manual receipt system. In addition, the potential for the APAC to misappropriate cash/check payments and cover it up is increased due to the duties that this position also performs.

Recommendation:

It should be noted, during the 2020 fiscal year, a cash receipting program was implemented as part of the City's new general ledger accounting system, which corrected the concerns regarding this finding, although our comment is applicable for the operating activity during approximately 75% of fiscal year 2020, and, therefore, we recommend the City continue to evaluate the cash receipting process to ensure controls are established and operating efficiently. In addition, the duties of the APAC need to be appropriately separated. The APAC should not have access to the cash/checks and also maintain control over the receipt book and recording function.

CITY OF CLEARLAKE
SCHEDULE OF FINDINGS AND RESPONSES
Year Ended June 30, 2020

2020-005 Internal Controls Over Cash Receipts - Continued

Views of Responsible Officials:

Management concurs with Auditor's recommendations. The City implemented a Cashiering module as part of the new ERP system in spring of 2020. Transactions are recorded as they are processed, and an integrated credit card processing system was also included. Daily, cashiering operators close out their drawers, which includes a second party verification of receipts vs payments in hand and deposit all cash into an electronic safe. The safe is managed by the bank and emptied by a courier service. Bank reconciliations are no longer completed by the APAC or PAC.