

**ATTACHMENT 3**

**CITY OF LOS ALTOS  
MEMORANDUM ON INTERNAL CONTROL  
AND  
REQUIRED COMMUNICATIONS  
FOR THE YEAR ENDED JUNE 30, 2021**

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**CITY OF LOS ALTOS  
MEMORANDUM ON INTERNAL CONTROL  
For The Year Ended June 30, 2021**

**Table of Contents**

	<b><u>Page</u></b>
<i>Memorandum on Internal Control</i> .....	1
Schedule of Other Matters .....	5
Status of Prior Year Other Matters .....	15

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## MEMORANDUM ON INTERNAL CONTROL

To the City Council of  
the City of Los Altos, California

In planning and performing our audit of the basic financial statements of the City of Los Altos (City) as of and for the year ended June 30, 2021, 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 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 were not identified. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented or detected and corrected on a timely basis. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

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

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

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

This communication is intended solely for the information and use of management, City Council, others within the organization, and agencies and pass-through entities requiring compliance with *Government Auditing Standards* and is not intended to be and should not be used by anyone other than these specified parties.

Pleasant Hill, California  
December 15, 2021

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## MEMORANDUM ON INTERNAL CONTROLS

### SCHEDULE OF OTHER MATTERS

#### **2021-01: Timely Invoice payments**

The city should pay vendor invoices in a timely manner, within 30-45 days of receiving the invoices.

During our interim audit sampling testing, we noted that the city did not pay three invoices sampled in a timely manner. According to the Finance staff, the delay was due to the delayed approval by the Department.

Accounting records may not be properly reflected in the correct reporting periods if the invoices were not processed in a timely manner. Expenditures may be understated and cash available may be overstated due to the delay.

We recommend the City should communicate with the other departments in the City and establish corresponding standard procedures to ensure the submission of invoices to Finance in a timely manner.

#### **Management Response:**

The issue originated from new procedures that were implemented during COVID-19, Departments were asked to send emails to approved invoices to Accounts payable, not all departments were following these procedures and were saving the invoices using old instructions. When this was found out there was a large backlog of invoices as well as the Finance department was short-staffed due to turnover.

The New Director and Manager have set revised procedures for invoice payments and have communicated the same to departments, we are also in the process of training departments to enter their invoices directly into the financial system. This will avoid invoices being missed and Finance will have a better way of monitoring invoices and following up with departments if they are entered too late.

#### **2021-02: Outdated Signature Cards**

Signature cards for the bank and investment accounts should be updated immediately whenever there is a change in authorized signers.

As of November 4, 2021, we found that the former Administrative Services Director and City Manager were listed as authorized signers for the City's Union Bank account. According to the Finance staff, the delay was due to the staff shortage and turnover.

Keeping inactive employees as authorized signers exposes the city to the risk of misappropriation of assets.

We recommend that the city immediately remove the ex-employees from the authorized signer lists of all bank accounts. In the future, a step should be added to the employee departure checklist to ensure that outside parties (such as banks, investment advisors, and bond trustees) are informed that the departed employee no longer represents the City.

#### **Management Response:**

Union Bank was the original custodian for the city's investment portfolio, In January of 2021 US bank bought the custody business from Union bank. US bank informed clients that the transition would be automatic and that the union bank accounts would be closed. This happened in August of 2021 as a result we do not have an account with Union bank anymore. The signature cards to US bank were updated in time.

## MEMORANDUM ON INTERNAL CONTROLS

### SCHEDULE OF OTHER MATTERS

#### **2021-03: Information System Risk Management Policy**

Risk management policy is to provide guidance regarding the management of risk to support the achievement of corporate objectives, protect staff and business assets and ensure financial sustainability.

During the information system review with the City, we noted that the IT department has no written risk management policy.

Without a specific Risk Management Policy, the City is leaving the determination of how to deal with cyberattacks to individual employees, which could impede financial statement reporting.

We recommend that the City to set up a former Information System Risk Management Policy to ensure the security of the financial system and be well prepared for unexpected cyberattacks.

***Management Response:*** The City currently does not have a written risk management policy for financial systems. However, the City does have an IT support platform for employees to report suspicious activity and potential cyberattacks. Daily backup of data is performed to protect important financial data. Besides, City's Financial systems are not accessible from public sources only authorized VPN users can have access to the systems from a remote location. The Division will consider adopting a formal policy in the future.

#### **NEW GASB PRONOUNCEMENTS OR PRONOUNCEMENTS NOT YET EFFECTIVE**

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

#### **EFFECTIVE FISCAL YEAR 2021/22:**

##### **GASB 87 – Leases**

The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.

A lease is defined as a contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction. Examples of nonfinancial assets include buildings, land, vehicles, and equipment. Any contract that meets this definition should be accounted for under the guidance of the lease, unless specifically excluded in this Statement.



## MEMORANDUM ON INTERNAL CONTROLS

### SCHEDULE OF OTHER MATTERS

**Management Response:** The City will review the applicability of this GASB and implement accordingly, if applicable.

#### **GASB 89 – Accounting for Interest Cost Incurred before the End of a Construction Period**

The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period.

This Statement establishes accounting requirements for interest cost incurred before the end of a construction period. Such interest cost includes all interest that previously was accounted for in accordance with the requirements of paragraphs 5–22 of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which are superseded by this Statement. This Statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund.

This Statement also reiterates that in financial statements prepared using the current financial resources measurement focus, interest cost incurred before the end of a construction period should be recognized as an expenditure on a basis consistent with governmental fund accounting principles.

## MEMORANDUM ON INTERNAL CONTROLS

### SCHEDULE OF OTHER MATTERS

**Management Response:** The City will review the applicability of this GASB and implement accordingly, if applicable.

#### EFFECTIVE FISCAL YEAR 2022/23:

##### **GASB 91 – Conduit Debt Obligations**

The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This Statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures.

A conduit debt obligation is defined as a debt instrument having *all* of the following characteristics:

- There are at least three parties involved:
  - (1) an issuer
  - (2) a third-party obligor, and
  - (3) a debt holder or a debt trustee.
- The issuer and the third-party obligor are not within the same financial reporting entity.
- The debt obligation is not a parity bond of the issuer, nor is it cross-collateralized with other debt of the issuer.
- The third-party obligor or its agent, not the issuer, ultimately receives the proceeds from the debt issuance.
- The third-party obligor, not the issuer, is primarily obligated for the payment of all amounts associated with the debt obligation (debt service payments).

All conduit debt obligations involve the issuer making a limited commitment. Some issuers extend additional commitments or voluntary commitments to support debt service in the event the third party is, or will be, unable to do so.

An issuer should not recognize a conduit debt obligation as a liability. However, an issuer should recognize a liability associated with an additional commitment or a voluntary commitment to support debt service if certain recognition criteria are met. As long as a conduit debt obligation is outstanding, an issuer that has made an additional commitment should evaluate at least annually whether those criteria are met. An issuer that has made only a limited commitment should evaluate whether those criteria are met when an event occurs that causes the issuer to reevaluate its willingness or ability to support the obligor's debt service through a voluntary commitment.

## MEMORANDUM ON INTERNAL CONTROLS

### SCHEDULE OF OTHER MATTERS

#### **GASB 91 – Conduit Debt Obligations (Continued)**

This Statement also addresses arrangements—often characterized as leases—that are associated with conduit debt obligations. In those arrangements, capital assets are constructed or acquired with the proceeds of a conduit debt obligation and used by third-party obligors in the course of their activities. Payments from third-party obligors are intended to cover and coincide with debt service payments. During those arrangements, issuers retain the titles to the capital assets. Those titles may or may not pass to the obligors at the end of the arrangements.

Issuers should not report those arrangements as leases, nor should they recognize a liability for the related conduit debt obligations or a receivable for the payments related to those arrangements. In addition, the following provisions apply:

- If the title passes to the third-party obligor at the end of the arrangement, an issuer should not recognize a capital asset.
- If the title does not pass to the third-party obligor and the third party has exclusive use of the entire capital asset during the arrangement, the issuer should not recognize a capital asset until the arrangement ends.
- If the title does not pass to the third-party obligor and the third party has exclusive use of only portions of the capital asset during the arrangement, the issuer, at the inception of the arrangement, should recognize the entire capital asset and a deferred inflow of resources. The deferred inflow of resources should be reduced, and an inflow recognized, in a systematic and rational manner over the term of the arrangement.

This Statement requires issuers to disclose general information about their conduit debt obligations, organized by type of commitment, including the aggregate outstanding principal amount of the issuers' conduit debt obligations and a description of each type of commitment. Issuers that recognize liabilities related to supporting the debt service of conduit debt obligations also should disclose information about the amount recognized and how the liabilities changed during the reporting period.

#### ***How the Changes in this Statement will Improve Financial Reporting***

The requirements of this Statement will improve financial reporting by eliminating the existing option for issuers to report conduit debt obligations as their own liabilities, thereby ending significant diversity in practice. The clarified definition will resolve stakeholders' uncertainty as to whether a given financing is, in fact, a conduit debt obligation. Requiring issuers to recognize liabilities associated with additional commitments extended by issuers and to recognize assets and deferred inflows of resources related to certain arrangements associated with conduit debt obligations also will eliminate diversity, thereby improving comparability in reporting by issuers. Revised disclosure requirements will provide financial statement users with better information regarding the commitments issuers extend and the likelihood that they will fulfill those commitments. That information will inform users of the potential impact of such commitments on the financial resources of issuers and help users assess issuers' roles in conduit debt obligations.

**Management Response:** The City will review the applicability of this GASB and implement it accordingly, if applicable.

## MEMORANDUM ON INTERNAL CONTROLS

### SCHEDULE OF OTHER MATTERS

#### **GASB 94 – Public-Private and Public-Public Partnerships and Availability Payment Arrangements**

The primary objective of this Statement is to improve financial reporting by addressing issues related to public-private and public-public partnership arrangements (PPPs). As used in this Statement, a PPP is an arrangement in which a government (the transferor) contracts with an operator (a governmental or nongovernmental entity) to provide public services by conveying control of the right to operate or use a nonfinancial asset, such as infrastructure or other capital assets (the underlying PPP asset), for a period of time in an exchange or exchange-like transaction. Some PPPs meet the definition of a service concession arrangement (SCA), which the Board defines in this Statement as a PPP in which (1) the operator collects and is compensated by fees from third parties; (2) the transferor determines or has the ability to modify or approve which services the operator is required to provide, to whom the operator is required to provide the services, and the prices or rates that can be charged for the services; and (3) the transferor is entitled to a significant residual interest in the service utility of the underlying PPP asset at the end of the arrangement.

This Statement also provides guidance for accounting and financial reporting for availability payment arrangements (APAs). As defined in this Statement, an APA is an arrangement in which a government compensates an operator for services that may include designing, constructing, financing, maintaining, or operating an underlying nonfinancial asset for a period of time in an exchange or exchange-like transaction.

**PPPs** – This Statement requires that PPPs that meet the definition of a lease apply the guidance in Statement No. 87, Leases, as amended, if existing assets of the transferor that are not required to be improved by the operator as part of the PPP arrangement are the only underlying PPP assets and the PPP does not meet the definition of an SCA. This Statement provides accounting and financial reporting requirements for all other PPPs: those that either (1) meet the definition of an SCA or (2) are not within the scope of Statement 87, as amended (as clarified by this Statement). The PPP term is defined as the period during which an operator has a noncancelable right to use an underlying PPP asset, plus, if applicable, certain periods if it is reasonably certain, based on all relevant factors, that the transferor or the operator either will exercise an option to extend the PPP or will not exercise an option to terminate the PPP.

A transferor generally should recognize an underlying PPP asset as an asset in financial statements prepared using the economic resources measurement focus. However, in the case of an underlying PPP asset that is not owned by the transferor or is not the underlying asset of an SCA, a transferor should recognize a receivable measured based on the operator's estimated carrying value of the underlying PPP asset as of the expected date of the transfer in ownership. In addition, a transferor should recognize a receivable for installment payments, if any, to be received from the operator in relation to the PPP. Measurement of a receivable for installment payments should be at the present value of the payments expected to be received during the PPP term. A transferor also should recognize a deferred inflow of resources for the consideration received or to be received by the transferor as part of the PPP. Revenue should be recognized by a transferor in a systematic and rational manner over the PPP term.

This Statement requires a transferor to recognize a receivable for installment payments and a deferred inflow of resources to account for a PPP in financial statements prepared using the current financial resources measurement focus. Governmental fund revenue would be recognized in a systematic and rational manner over the PPP term.

## MEMORANDUM ON INTERNAL CONTROLS

### SCHEDULE OF OTHER MATTERS

#### **GASB 94 – Public-Private and Public-Public Partnerships and Availability Payment Arrangements, (Continued)**

This Statement also provides specific guidance in financial statements prepared using the economic resources measurement focus for a government that is an operator in a PPP that either (1) meets the definition of an SCA or (2) is not within the scope of Statement 87, as amended (as clarified in this Statement). An operator should report an intangible right-to-use asset related to an underlying PPP asset that either is owned by the transferor or is the underlying asset of an SCA. Measurement of the right-to-use asset should be the amount of consideration to be provided to the transferor, plus any payments made to the transferor at or before the commencement of the PPP term, and certain direct costs. For an underlying PPP asset that is not owned by the transferor and is not the underlying asset of an SCA, an operator should recognize a liability measured based on the estimated carrying value of the underlying PPP asset as of the expected date of the transfer in ownership. In addition, an operator should recognize a liability for installment payments, if any, to be made to the transferor in relation to the PPP. Measurement of a liability for installment payments should be at the present value of the payments expected to be made during the PPP term. An operator also should recognize a deferred outflow of resources for the consideration provided or to be provided to the transferor as part of the PPP. Expense should be recognized by an operator in a systematic and rational manner over the PPP term.

This Statement also requires a government to account for PPP and non-PPP components of a PPP as separate contracts. If a PPP involves multiple underlying assets, a transferor and an operator in certain cases should account for each underlying PPP asset as a separate PPP. To allocate the contract price to different components, a transferor and an operator should use contract prices for individual components as long as they do not appear to be unreasonable based on professional judgment or use professional judgment to determine their best estimate if there are no stated prices or if stated prices appear to be unreasonable. If determining the best estimate is not practicable, multiple components in a PPP should be accounted for as a single PPP.

This Statement also requires an amendment to a PPP to be considered a PPP modification, unless the operator's right to use the underlying PPP asset decreases, in which case it should be considered a partial or full PPP termination. A PPP termination should be accounted for by a transferor by reducing, as applicable, any receivable for installment payments or any receivable related to the transfer of ownership of the underlying PPP asset and by reducing the related deferred inflow of resources. An operator should account for a termination by reducing the carrying value of the right-to-use asset and, as applicable, any liability for installment payments or liability to transfer ownership of the underlying PPP asset. A PPP modification that does not qualify as a separate PPP should be accounted for by remeasuring PPP assets and liabilities.

**APAs** – An APA that is related to designing, constructing, and financing a nonfinancial asset in which ownership of the asset transfers by the end of the contract should be accounted for by a government as a financed purchase of the underlying nonfinancial asset. This Statement requires a government that engaged in an APA that contains multiple components to recognize each component as a separate arrangement. An APA that is related to operating or maintaining a nonfinancial asset should be reported by a government as an outflow of resources in the period to which payments relate.

**Management Response:** The City will review the applicability of this GASB and implement it accordingly, if applicable.

## MEMORANDUM ON INTERNAL CONTROLS

### SCHEDULE OF OTHER MATTERS

#### ***GASB 96 – Subscription-Based Information Technology Arrangements***

This Statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users (governments). This Statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset—an intangible asset—and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires note disclosures regarding a SBITA. To the extent relevant, the standards for SBITAs are based on the standards established in Statement No. 87, Leases, as amended.

A SBITA is defined as a contract that conveys control of the right to use another party's (a SBITA vendor's) information technology (IT) software, alone or in combination with tangible capital assets (the underlying IT assets), as specified in the contract for a period of time in an exchange or exchange-like transaction.

The subscription term includes the period during which a government has a noncancelable right to use the underlying IT assets. The subscription term also includes periods covered by an option to extend (if it is reasonably certain that the government or SBITA vendor will exercise that option) or to terminate (if it is reasonably certain that the government or SBITA vendor will not exercise that option).

Under this Statement, a government generally should recognize a right-to-use subscription asset—an intangible asset—and a corresponding subscription liability. A government should recognize the subscription liability at the commencement of the subscription term, —which is when the subscription asset is placed into service. The subscription liability should be initially measured at the present value of subscription payments expected to be made during the subscription term. Future subscription payments should be discounted using the interest rate the SBITA vendor charges the government, which may be implicit, or the government's incremental borrowing rate if the interest rate is not readily determinable. A government should recognize amortization of the discount on the subscription liability as an outflow of resources (for example, interest expense) in subsequent financial reporting periods.

The subscription asset should be initially measured as the sum of (1) the initial subscription liability amount, (2) payments made to the SBITA vendor before commencement of the subscription term, and (3) capitalizable implementation costs, less any incentives received from the SBITA vendor at or before the commencement of the subscription term. A government should recognize amortization of the subscription asset as an outflow of resources over the subscription term.

Activities associated with a SBITA, other than making subscription payments, should be grouped into the following three stages, and their costs should be accounted for accordingly:

- Preliminary Project Stage, including activities such as evaluating alternatives, determining needed technology, and selecting a SBITA vendor. Outlays in this stage should be expensed as incurred.
- Initial Implementation Stage, including all ancillary charges necessary to place the subscription asset into service. Outlays in this stage generally should be capitalized as an addition to the subscription asset.
- Operation and Additional Implementation Stage, including activities such as subsequent implementation activities, maintenance, and other activities for a government's ongoing operations related to a SBITA. Outlays in this stage should be expensed as incurred unless they meet specific capitalization criteria.

## MEMORANDUM ON INTERNAL CONTROLS

### SCHEDULE OF OTHER MATTERS

#### ***GASB 96 – Subscription-Based Information Technology Arrangements, (Continued)***

In classifying certain outlays into the appropriate stage, the nature of the activity should be the determining factor. Training costs should be expensed as incurred, regardless of the stage in which they are incurred.

If a SBITA contract contains multiple components, a government should account for each component as a separate SBITA or nonsubscription component and allocate the contract price to the different components. If it is not practicable to determine a best estimate for price allocation for some or all components in the contract, a government should account for those components as a single SBITA.

This Statement provides an exception for short-term SBITAs. Short-term SBITAs have a maximum possible term under the SBITA contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised. Subscription payments for short-term SBITAs should be recognized as outflows of resources.

This Statement requires a government to disclose descriptive information about its SBITAs other than short-term SBITAs, such as the amount of the subscription asset, accumulated amortization, other payments not included in the measurement of a subscription liability, principal and interest requirements for the subscription liability, and other essential information.

#### ***How the Changes in this Statement will Improve Financial Reporting***

The requirements of this Statement will improve financial reporting by establishing a definition for SBITAs and providing uniform guidance for accounting and financial reporting for transactions that meet that definition. That definition and uniform guidance will result in greater consistency in practice. Establishing the capitalization criteria for implementation costs also will reduce diversity and improve comparability in financial reporting by governments. This Statement also will enhance the relevance and reliability of a government's financial statements by requiring a government to report a subscription asset and subscription liability for a SBITA and to disclose essential information about the arrangement. The disclosures will allow users to understand the scale and important aspects of a government's SBITA activities and evaluate a government's obligations and assets resulting from SBITAs.

**Management Response:** The City will review the applicability of this GASB and implement it accordingly, if applicable.

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## MEMORANDUM ON INTERNAL CONTROLS

### STATUS OF PRIOR YEARS SCHEDULE OF OTHER MATTERS

#### **2020-01: Timely Preparation of Bank Reconciliations and Investment Reconciliations**

Bank and investment reconciliations are an important element of the City's internal control and bank reconciliations and related adjustments should be completed after month end, generally within 30-45 days.

During our testing of internal controls over bank and investment reconciliations, we selected bank and investments reconciliations for the months of January and February 2021 to test, however, these reconciliations were not ready as of August 2021. The June 2021 bank reconciliations were not completed until late December 2021, six months later.

According to the Finance staff, the delay was due to the staff shortage and turnover.

Without the timely completion of bank and investment reconciliations, errors or unauthorized transactions in these accounts might not be detected and remedied in a timely manner.

We recommend that the City ensure that the bank and investment reconciliations are prepared and reviewed timely within 30 to 45 days of the end of the reporting period.

**Current Status:** During the fiscal year 2021 audit, we noted that the Bank reconciliation for December 2020 was not reviewed until 5/11/21. The March 2021 bank reconciliation was not yet performed as 5/31/21. The June 2021 bank reconciliation was not prepared until 10/18/21.

**Management Response on Current Status:** The Department has been without leadership for over nine months, at the same time there has been a lot of turnovers, which has caused delays in reconciliation. Even currently after getting in a new Finance Director and a new Finance Manager, the department has lost 2 of its longer-tenured staff, a senior accountant and an accounting Technician, as the department manages to hire the new staff it will return to having these items prepared in time.

#### **2020-02: Accrual for legal liabilities**

According to the Governmental Accounting Standard Board (GASB) Statement 56 Paragraph 11, litigation payment made before the issuance of the financial report should be accrued in the applicable fiscal year when the event that gave rise to the litigation had taken place prior to the settlement date.

The City made two payments in September 2021 and January 2022 accordingly for a legal case settled in April 2021. The legal expenditures were not accrued in the fiscal year 2021, instead, were recorded in 2022. It appeared that the Finance staff overlooked the accrual.

Without the review for proper accrual, the expenditures could have been understated for the fiscal year 2021 and overstated for 2022.

We recommend that the City ensure that the finance staff in charge of year end closing and accrual process reviews the applicable legal liabilities carefully to ensure proper accrual and recording of financial transactions.

**Current Status:** We noted no unrecorded legal liabilities applicable to the fiscal year 2021.

**Management Response on Current Status:** Finance has a process in place to work with the City manager and city attorney to review any paternal settlements prior to the close of books.

## MEMORANDUM ON INTERNAL CONTROLS

### STATUS OF PRIOR YEARS SCHEDULE OF OTHER MATTERS

#### **2020-03: Journal Entries Preparation and Posting**

Segregation of duties is an integral part in maintaining adequate effectiveness in an entity's internal control environment. Journal entries are an important transaction cycle that affects all aspects of accounting and financial reporting. Prudent internal control concepts dictate that no single employee should have the ability to process a transaction without the involvement of another employee.

During our testing of journal entries, we noted that both the Financial Services Manager and Administrative Services Director can prepare and post the journal entries to the finance system directly. It appeared that the Finance System was set up to allow both staff to prepare and post the journal entries.

Allowing the preparer to post their own journal entries, even after review by a 2<sup>nd</sup> staff, could subject the City to the potential risk of the journal entries being manipulated or altered with further verification.

We recommend that the City establish proper procedures to ensure the segregation of duties to mitigate the potential risk of journal entries being altered without verification.

**Current Status:** During the fiscal year 2021 audit, we noted that out of the forty journal entry samples we tested, fifteen of them were posted more than 45 days after the transaction date.

**Management Response on Current Status:** As mentioned above the department is short-staffed, we have procedures in place to have all processes to be in a maker checker format, Journals entered are currently posted within a reasonable period unless there is documentation missing.

#### **2020-04: Treasurer's Report Timeliness**

California Government Code 53646 states that the treasurer or chief fiscal officer may render a quarterly report to the chief executive officer, the internal auditor, and the legislative body of the local agency. The quarterly report shall be so submitted within 30 days following the end of the quarter covered by the report.

Per review of the treasury report dated 12/31/2020, we noted that the report was not presented to council until 4/28/2021, surpassing the 30 days requirement.

According to the Finance staff, the delay was due to the staff shortage and turnover.

We recommend that the City implement procedures to ensure the timely preparation and submission of the treasury report.

**Current Status:** During the fiscal year 2021 audit, we noted that the treasury report dated 12/31/2020 was not presented to the City Council until 3/9/21. During final, 6/30/21 treasury report was also not presented to the City Council until 9/14/21.

**Management Response on Current Status:** The Cities Investment portfolio is managed by PFM and as such we are dependent on them to provide us with the valuations, these valuations are usually only received 30-40 days after the month closes which then causes a further delay in the reporting to the commission and council. We anticipate that going forward we will be able to provide the report to the commission in the second month following the close of the Quarter and to the city council in the following council meeting.

## MEMORANDUM ON INTERNAL CONTROLS

### STATUS OF PRIOR YEARS SCHEDULE OF OTHER MATTERS

#### **2020-05: Cross training for Payroll Duties**

In the event the payroll clerk is out on an extended vacation, another appropriate employee should be trained to assume the duties of payroll processing. Furthermore, for effective internal control, the cross-trained employee should process the payroll for at least one payroll cycle during the fiscal year.

We noted that the City does not have anyone cross-trained for payroll processing during the fiscal year 2021.

According to the Finance staff, due to the staff shortage and turnover, the two new Accounting technicians have not yet been cross trained.

The City is subjected to the potential risk of delay, error and unauthorized transaction in payroll process if it entirely relies on one staff to process the payroll without appropriate backup or rotation.

We recommend the City cross train an employee for the payroll duties. In addition, the City should consider formally documenting the payroll process procedures for backup purposes.

**Current Status:** During the fiscal year 2021 audit, we noted that no staff has been crossed trained to take over the payroll duties yet due to limited staff availabilities.

**Management Response on Current Status:** The City has trained a new accounting Technician on the payroll function that was previously handled by the Senior accountant.