

From: Phil Koen

Sent: Monday, May 09, 2022 8:55 AM

To: Ron Dickel; Kyle Park

Cc: Town Manager <Manager@losgatosca.gov>; Arn Andrews <aandrews@losgatosca.gov>; Jak Van Nada; Rick Van Hoesen; David Weissman; Rob Rennie <RRennie@losgatosca.gov>; Matthew Hudes <MHudes@losgatosca.gov>; Shelley Neis <sneis@losgatosca.gov>

Subject: Staff memo and single audit - FC Agenda Item #3

Dear Chair Dickel and Vice Chair Park,

In reading the Staff Memo for agenda item #3 and the accompanying Single Audit Report, the auditors identified "certain deficiencies in internal control that we consider to be a material weakness and significant deficiencies".

As a result the Town has received a "modified opinion" for the Federal Award CFDA 21.019 Coronavirus Relief Fund regarding compliance with the program. Essentially the Town failed to comply with the Federal requirements regarding the Coronavirus Relief Fund.

This is a significant development and requires more transparency. I would appreciate answers to the following questions.

1. Does the Staff agree and accept the auditor's findings of "certain deficiencies in internal controls that are considered to be material weakness"? If not, why not?
2. What exactly were the deficiencies that were identified by the Auditor? The language suggests more than one deficiency.
3. If the Staff does agree with Auditor's findings, what steps are being taken to correct the deficiencies so as to avoid a material weakness finding in the future? Does the Staff plan on testing for more internal weaknesses beyond the limited testing done?
4. What are the ramifications of having a modified opinion and finding of non-compliance with regard to the Coronavirus Relief Fund? Will this result in increased reporting requirements? Will this negatively impact the Town's ability to receive any future State or Federal Grants for which the Town has applied?
5. The Auditors opinion is dated December 31, 2021. Why is this now only coming to light, essentially 5 months after the issuance auditors report? Was this previously disclosed to the Town Council? If so, when was it disclosed?

In closing, the LGCA had warned the Finance Commission about the importance of the Single Audit many months ago when there were ongoing discussions regarding the proper accounting for lost revenue. I am only pointing this out to reiterate the importance of having proper systems and controls in place to fully comply with the requirements of federal and state grants.

Thank you,

Phil Koen
LGCA

ATTACHMENT 2



TOWN OF LOS GATOS
FINANCE COMMISSION REPORT

MEETING DATE: 05/09/2022

ITEM NO: 3

Item 3.

DATE: May 5, 2022
TO: Finance Commission
FROM: Laurel Prevetti, Town Manager
SUBJECT: Receive FY 2020/21 Federal Single Audit Report

RECOMMENDATION:

Staff recommends that the Finance Commission receives the Federal Single Audit Report for the fiscal year ended June 30, 2021 prepared by Badawi and Associates.

DISCUSSION:

Based on the Town's understanding of the initial guidance released April 22, 2020 regarding the Coronavirus Aid, Relief, and Economic Security (CARES) Act eligible uses, rent forgiveness support was classified as eligible under the Small Business Assistance category of expenditures. As such, the Town Council opted to assist certain Town lessees by forgiving their rent (a voluntary write-off of rents due to the Town) to support these entities during the height of the pandemic.

In performing the Single Audit for FY 2020/21, the Town's independent auditor Badawi and Associates concluded that the rent forgiveness to be "lost revenue" and thereby a "questioned cost" which under their interpretation of the federal guidelines would not be eligible for federal CARES Act reimbursement funding. Losses in revenues due to the pandemic such as a decline in sales taxes or property tax was not eligible under the federal rules. The questioned cost determination of rent forgiveness is identified as a material weakness in the Single Audit Report that requires corrective action by the Town.

Staff was aware that lost revenue was not eligible for federal funds but did not consider the voluntary rent forgiveness to be "lost revenue" under the initial federal guidelines promulgated at the height of the pandemic. In retrospect, for Single Audit purposes it appears

PREPARED BY: Stephen Conway
Finance Director

Reviewed by: Town Manager, Town Attorney, and Assistant Town Manager

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SUBJECT: FY 2020/21 Single Audit

DATE: May 5, 2022

DISCUSSION (continued):

that the better solution would have been to have the lessees pay the full rent due to the Town. Upon receipt of the full rent, the Town could then have paid the lessees back in the form of a rental assistance grant which would have accomplished the same objective without raising a deliberation about whether the voluntary forgiveness of rent is an expense to the Town or a lost revenue under the federal guidelines.

If the federal government subsequently determines that this cost were to be disallowed, the Town has significant other qualifying expenditures in categories such as payroll for public safety that could be substituted for the small business rental assistance.

Attachments:

1. FY 2020/21 Single Audit

Town of Los Gatos

Los Gatos, California

Single Audit Reports

For the year ended June 30, 2021



Town of Los Gatos
Single Audit Reports
For the year ended June 30, 2021

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**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**

INDEPENDENT AUDITOR'S REPORT

To the Honorable Mayor and Members of the Town Council
of the Town of Los Gatos
Los Gatos, 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, the aggregate remaining fund information, and the budgetary comparison for the General Fund of the Town of Los Gatos, California (Town), as of and for the year ended June 30, 2021, and the related notes to the financial statements, which collectively comprise the Town's basic financial statements and have issued our report thereon dated December 31, 2021.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Town'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 Town's internal control. Accordingly, we do not express an opinion on the effectiveness of the Town's internal control.

Our consideration of internal control over financial reporting 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. 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.

To the Honorable Mayor and Members of the Town Council
of the Town of Los Gatos
Los Gatos, California
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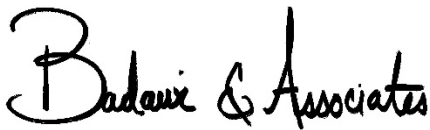
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Town'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 financial statements. 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*.

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 entity'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 entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Badawi & Associates, CPAs
Berkeley, California
December 31, 2021



**REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND REPORT ON
INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH THE UNIFORM GUIDANCE
AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

INDEPENDENT AUDITOR'S REPORT

To the Honorable Mayor and Members of the Town Council
of the Town of Los Gatos
Town of Los Gatos, California

Report on Compliance for Each Major Federal Program

We have audited the Town of Los Gatos, California (Town)'s compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the Town's major federal programs for the year ended June 30, 2021. The Town's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the Town's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Town's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Town's compliance.

To the Honorable Mayor and Members of the Town Council
 of the Town of Los Gatos
 Los Gatos, California
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Basis for Qualified Opinion on CFDA 21.019 Coronavirus Relief Fund

As described in the accompanying schedule of findings and questioned costs, the Town did not comply with requirements regarding CFDA 21.019 Coronavirus Relief Fund as described in finding numbers 2021-001 for Activities Allowed or Unallowed, and Allowable Costs and Cost Principles. Compliance with such requirements is necessary, in our opinion, for the Town to comply with the requirements applicable to that program.

Qualified Opinion on CFDA 21.019 Coronavirus Relief Fund

In our opinion, except for the noncompliance described in the Basis for Qualified Opinion paragraph, the Town complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on CFDA 21.019 Coronavirus Relief Fund for the year ended June 30, 2021.

Unmodified Opinion on Each of the Other Major Federal Programs

In our opinion, the Town, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its other major federal programs identified in the summary of auditor's results section the accompanying schedule of findings and questioned costs for the year ended June 30, 2021.

Other Matters

The Town's response to the noncompliance findings identified in our audit is described in the accompanying schedule of findings and questioned costs. The Town's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

Management of the Town is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Town's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Town's internal control over compliance.

To the Honorable Mayor and Members of the Town Council
 of the Town of Los Gatos
 Los Gatos, California
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A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. **We did identify certain deficiencies in internal control over compliance, described in the accompanying schedule of findings and questioned costs as item 2021-001, that we consider to be a material weakness.**

The Town's response to the internal control over compliance findings identified in our audit is described in the accompanying schedule of findings and questioned costs. The Town's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

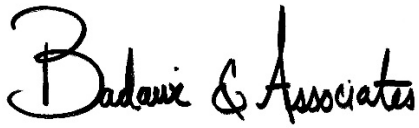
Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City, as of and for the year ended June 30, 2021, and the related notes to the financial statements, which collectively comprise the City's basic financial statements. **We issued our report thereon dated December 31, 2021, which contained unmodified opinions on those financial statements.** Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other

To the Honorable Mayor and Members of the Town Council

of the Town of Los Gatos
Los Gatos, California
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additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

A handwritten signature in black ink that reads "Badawi & Associates". The signature is written in a cursive, flowing style.

Badawi & Associates, CPAs
Berkeley, California
April 25, 2022, except for the schedule of expenditures
of federal awards, which is as of December 31, 2021

Town of Los Gatos
Schedule of Expenditures of Federal Awards
For the year ended June 30, 2021

Grantor Agency and Grant Title	Federal Catalog Number	Pass-through Number	Program Expenditures
U.S. Department of Transportation:			
<i>Highway Planning and Construction Cluster</i>			
<i>Passed through State of California</i>			
Highway Planning and Construction	20.205	HSIPL-5067(021)	120,220
Highway Planning and Construction	20.205	CML-5067(022)	245,253
Subtotal Highway Planning and Construction Cluster			365,473
Total U.S. Department of Transportation			365,473
Department of Homeland Security:			
Emergency Management Performance Grants	97.042		2,365
<i>Passed through County of Santa Clara</i>			
Fire Management Assistance Grant	97.046	FM-5336-CA	12,627
Total Department of Homeland Security			14,992
Department of Justice:			
Bulletproof Vest Partnership Program	16.607		1,309
Total Department of Justice			1,309
Department of the Treasury:			
Coronavirus State and Local Fiscal Recovery Funds	21.027		200,911
<i>Passed through State of California</i>			
COVID19 - Coronavirus Relief Fund	21.019	n/a	388,181
Total Department of the Treasury			589,092
Total Expenditures of Federal Awards			\$ 970,866

Town of Los Gatos
Notes to the Schedule of Expenditures of Federal Awards
For the year ended June 30, 2021

A. Reporting Entity

The financial reporting entity consists of (a) the primary government, Town of Los Gatos, California (Town), (b) organizations for which the primary government is financially accountable, and (c) other organizations for which the primary government is not accountable, but for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete.

B. Basis of Accounting

Funds received under the various grant programs have been recorded within the general, special revenue, and capital projects funds of the Town. The Town utilizes the modified accrual basis of accounting for the general, special revenue, and capital projects funds. Expenditures of federal awards reported on the Schedule of Expenditures of Federal Awards (Schedule) are recognized when incurred.

C. Relationship of Schedule of Expenditures of Federal Awards to Financial Statements

The accompanying Schedule presents the activity of all federal financial assistance programs of the Town. Federal financial assistance received directly from federal agencies as well as federal financial assistance passed through the State of California and the County of Santa Clara is included in the Schedule.

The Schedule was prepared only from the accounts of various grant programs and, therefore, does not present the financial position or results of operations of the Town.

D. Pass-Through Entities' Identifying Number

When federal awards were received from a pass-through entity, the Schedule shows, if available, the identifying number assigned by the pass-through entity. When no identifying number is shown, the Town determined that no identifying number is assigned for the program or the Town was unable to obtain an identifying number from the pass-through entity.

E. Indirect Costs

The Town did not elect to use the 10% de minimis indirect cost rate.

Town of Los Gatos
Schedule of Findings and Questioned Costs
For the year ended June 30, 2021

Section I – Summary of Auditor’s Results

Financial Statements

Types of auditors’ report issued on whether financial statements audited were prepared in accordance with GAAP: Unmodified

Internal control over financial reporting:

- Material weakness(es) identified? No
- Significant deficiency(ies) identified? None noted

Any noncompliance material to the financial statements noted No

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? Yes
- Significant deficiency(ies) identified? None noted

Type of auditor’s report issued on compliance for major programs Qualified

Any audit findings disclosed that are required to be reported in accordance with section 200.516(a) Yes

Identification of major programs:

CFDA Number(s)	Name of Federal Program or Cluster	Expenditures
20.205	Highway Planning and Construction Cluster	\$ 365,473
21.019	Coronavirus Relief Fund	\$ 388,181
Total Expenditures of All Major Federal Programs		\$ 753,654
Total Expenditures of Federal Awards		\$ 970,866
Percentage of Total Expenditures of Federal Awards		77.6%

Dollar threshold used to distinguish between type A and type B program \$750,000

Auditee qualified as low-risk auditee under section 200.520? No

Town of Los Gatos
Schedule of Findings and Questioned Costs, Continued
For the year ended June 30, 2021

Section II - Current Year Findings

No financial statement findings were noted.

Section III- Federal Award Findings and Questioned Costs

Finding: 2021-001

Awarding Agency	Department of the Treasury
Passed through	State of California (State)
Program	Coronavirus Relief Fund
AFN#	21.019

Criteria:

Per 2 CFR section 225 App. A, Paragraph C.1.d, "to be allowable under Federal awards, costs must meet the following general criteria:

Conform to any limitations or exclusions set forth in these principles, Federal laws, terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items."

Condition:

During our audit, we noted that per the Coronavirus Relief Fund (Fund) program guidance in the Federal Register dated January 15, 2021, revenue replacement is not a permissible use of Fund payments. On April 21, 2020, the Town Council approved a waiver of rent and utilities for a set of non-profit lessees. When preparing a listing of grant expenditures for reporting to the State, the Town chose to use their rent and utility waivers as a qualifying expenditure.

Cause:

The Town did not equate rental waivers and lost revenue replacement. The Town staff's interpretation of lost revenue was understood to be unavoidable losses of revenue due to the pandemic.

Questioned Costs:

During our testing, we determined that \$73,054 of federal expenditures were not allowable costs or allowable activities with total questioned costs of \$94,998.

Context and Effect:

The Town was not in full compliance with neither the allowable costs and cost principles, nor the allowable activities compliance requirements of the program.

Town of Los Gatos
Schedule of Findings and Questioned Costs, Continued
For the year ended June 30, 2021

Section III- Federal Award Findings and Questioned Costs, Continued

Finding: 2021-001, Continued

Recommendation:

We recommend the Town double-check for disallowed costs and activities when administering new grant programs.

Management Response:

The Town's independent auditor has opined that the Town's efforts to provide economic relief in the form of waivers of rent (rent forgiveness) to a number of non-profits and other entities should be considered as "lost revenue" and therefore disallowable because lost revenue is precluded as an expenditure for the CARES act. Based on the Town's understanding of the CARES act rent forgiveness support was classified as eligible under the Small business assistance category of expenditures. As such, the Town Council opted to assist these groups by forgiving their rent (a voluntary write-off of rents due to the Town) to support these entities during the height of the pandemic. If the Federal Government determines that this cost were to be disallowed, the Town has significant other qualifying expenditures in categories such as payroll for public safety that could be substituted for the small business rental assistance.

Section IV – Prior Year Financial Statements Findings

No financial statement findings were noted.

Section V – Prior Year Findings and Questioned Costs – Major Federal Award Program Audit

No findings or questioned costs were noted.