

**CITY OF EL CERRITO**  
**MEMORANDUM ON INTERNAL CONTROL**  
**AND**  
**REQUIRED COMMUNICATIONS**  
**FOR THE YEAR ENDED**  
**JUNE 30, 2016**

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

**For the Year Ended June 30, 2016**

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## MEMORANDUM ON INTERNAL CONTROL

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

In planning and performing our audit of the basic financial statements of the City of El Cerrito, as of and for the year ended June 30, 2017, 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 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 and 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 material weaknesses and other deficiencies 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 consider the deficiencies in internal control included on the Schedule of Material Weaknesses 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 to be of potential benefit to the City.

Management 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 generally accepted *Government Auditing Standards*, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in dark ink that reads 'Maze & Associates' in a cursive, stylized script.

Pleasant Hill, California  
April 21, 2017

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

**SCHEDULE OF MATERIAL WEAKNESSES**

**2016-01      Cash and Available Fund Balances for General Fund and Capital Improvement Funds and Interfund Borrowings**

As discussed in comments from prior years (2015-01, 2014-01, 2013-03 and 2012-04), the City's General Fund budget and liquidity remain a significant concern and while it appears the financial health of the General Fund has improved slightly, cash and fund balance levels remain low. As of June 30, 2016, the General Fund had a cash balance of \$5.1 million, with a note payable balance of \$5 million due on July 14, 2016. General Fund unassigned fund balances amounted to \$1.7 million – but when compared to the General Fund's budgeted expenditures for fiscal year 2015-2016 of \$30.7 million, this is a very low level of available resources. Furthermore, the General Fund's cash balance continued to be depleted as it provided short-term borrowings to other City funds in the amount of \$1.2 million.

Another fund of concern is the Capital Improvement Fund, and while its fund deficit has improved from a deficit balance of \$1.5 million as of June 30, 2015 to a deficit balance of \$882K, this fund only had approximately \$65 thousand in receivables. Also, the Capital Improvement Fund owes the General Fund a balance in excess of \$800 thousand.

During this year's audit, we again reviewed the City's financial condition and satisfied ourselves that the City had sufficient resources available to fund operations through June 30, 2017. Although the City continues to issue Tax Revenue Anticipation Notes to supplement cash temporarily during the fiscal year, if spending at current levels without an increase in resources were to continue, it reduces the likelihood that the City will have sufficient cash resources available.

In reviewing the City's adopted budget for 2017, it appears the City is expecting a surplus within the General Fund of approximately \$237 thousand, leaving a positive fund balance of \$3.1 million. The capital improvements program is projecting \$4.5 million in expenditures, furthering the negative fund balance. The City should continue reviewing the current capital projects outstanding to determine if any of them can be delayed since sufficient funding does not appear to be currently available. Any projects that are grant funded must be accompanied by timely grant reimbursement requests to alleviate the cash flow problem.

The City should continue to monitor actual revenues and expenditures to ensure they are in line with expected results. Close management and comparison of actual activity against the budget *must* continue to be employed to ensure further costs reductions are made as necessary. All increases in expenditures should be specifically approved through the budget amendment process to ensure cash resources are available to fund the increase.

**Management's Response in Current Year:**

The City is taking steps to increase General Fund cash reserves at a sustainable rate, based on revenue growth. In fact, the General Fund reserve ratio has improved from 4% in FY 2015 to a little over 6% over the past year. The FY 2017-18 adopted Budget projects a 9% reserve ratio consistent with \$3.1 million in fund balance. If this improving trend continues, barring unexpected expenditures, the reserve ratio is projected to exceed 10% within the next two fiscal years and beyond.

Steps are also being taken to monitor Capital Expenditures closely. There was a fund balance deficit of \$1.5 million in FY 2014-15 which has dropped to a deficit of \$0.9 million in FY 2015-16. The City expects this improving trend to continue. In keeping with the audit recommendation, the City is working to better manage capital project spending.

**CITY OF EL CERRITO**  
**MEMORANDUM ON INTERNAL CONTROL**  
**SCHEDULE OF MATERIAL WEAKNESSES**

**2016-02:      Timeliness and Accuracy of Year-End Close**

This recommendation was also provided in the prior year (see comment #2015-02). The City should strive to limit the amounts and numbers of adjusting journal entries (AJEs) after year end closing. It is crucial that control procedures be maintained throughout the year in order to produce accurate and timely financial data. See prior year comment #2015-03 for a related discussion on internal controls over major transactions cycles and accounting processes.

Over the past three years, the City has experienced a significant amount of turnover within its Finance Department and key accounting positions had been vacant or filled with temporary personnel with little experience in governmental accounting, with a new Finance Director with governmental experience hired very late in the fiscal year. This had a significant impact on the fiscal year 2015 and 2016 year-end audits in spite of staff's diligence and providing full cooperation to our audit.

Once the audit commenced, there were still a significant number of audit adjustments we proposed that had to be posted as many of the account balances were still materially misstated. This was caused by a lack of capacity and experience within the Finance Department throughout the fiscal year, as transactions were not being properly reviewed throughout the year, reconciliations were not being performed timely and no analytical review of the account balances were being performed by Finance on a regular basis.

The above conditions delayed the completion of the close and increased the risk that errors could have gone undetected by staff and corrections may not be made in a timely manner. Audit effort was substantially increased in response to these increased risks.

Now that the City's Finance Department is fully staffed and there is now a Finance Director and General Ledger Accountant in place that have experience in governmental accounting, we recommend the City review its transaction cycles and ensure controls are in place, and that all transaction cycles, including bank reconciliations and journal entries, are reviewed by appropriate personnel.

**Management's Response:**

As noted above, for a number of years, key accounting positions had been filled with temporary staff that lacked the necessary accounting skills. This had resulted in misstatements, lack of review and inadequate oversight of accounting processes. Starting in FY 2016-17 however, new staff with significant exposure to governmental accounting and auditing procedures, have been added to strengthen the Accounting department. A new Finance Director joined the City in July 2016 and an Accountant II with CPA certification was hired in March 2017 to replace the redundant Management Analyst Position. The Accounting Supervisor's role has also been revamped so as to provide more review of transactions and accounting processes.



**CITY OF EL CERRITO**  
**MEMORANDUM ON INTERNAL CONTROL**  
**SCHEDULE OF MATERIAL WEAKNESSES**

**2016-03      Proper Recording of Capital Assets**

The City should expense and capitalize assets in the fiscal year they relate to. During our testing of construction in progress in fiscal year 2016, we noted that construction expenses from the prior year amounting to \$446,023 were not expensed or capitalized until the current fiscal year. As a result, capital asset balances and capital outlay expenses were understated as of June 30, 2015. This required the City to restate beginning net position of Governmental Activities, as well as the Street Improvement Capital Projects Fund.

The City should review all capital outlay expenditures during the year to ensure that all expenditures are included in the correct fiscal year.

**Management's Response:**

The newly created Accountant II position will ensure that expenditures are recorded correctly and the Accounting Supervisor will review transactions for accuracy.

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

**SCHEDULE OF SIGNIFICANT DEFICIENCIES**

**2016-04:      Internal Controls Over Major Transactions Cycles and Accounting Processes**

This recommendation was also provided in the prior year (see comment #2015-03). Accounting transactions and registers or reconciliations, including journal entries, bank reconciliations, and payroll registers, should be reviewed and approved consistently and timely by someone other than the preparer to ensure they are prepared accurately. All transactions should have proper supporting documentation. During our testing of controls over the City's major transactions cycles and processes we noted the following:

- a) We are aware that journal entries were not reviewed by the former Finance Director throughout the fiscal year. We selected forty journal entries for testing and noted that thirty-eight of the journal entries selected did not show any indication of the date of preparation and review. Of these thirty-eight journal entries, we noted seven entries that did not appear to have been reviewed at all by another employee. Additionally, we noted that the two remaining journal entries that were reviewed had a significant delay between the times the journal entries were prepared and when they were reviewed.
- b) We are aware that bank reconciliations were not completely reconciled to the general ledger, nor were they reviewed by the former Finance Director throughout the fiscal year.
- c) We reviewed five payroll registers for proper approval and noted one register did not show any indication of review and approval.
- d) We selected forty receipts for testing, however, the Business License Technician was not able to locate supporting documentation for six of the items.

Without consistent and timely review and approval, the likelihood of an error or improper accounting treatment is increased. We understand the previous Finance Director lacked the skills and knowledge to effectively review transactions and reconciliations, and that the current Finance Director hired in June 2016 does possess these skills and knowledge. The Finance Director/City Treasurer *must* ensure all journal entries, bank reconciliations and payroll registers are properly reviewed, approved, and signed off on a timely basis. In the event the Finance Director/City Treasurer or Accounting Supervisor cannot complete the review, the duty should be assigned to another appropriate employee or a designated outside party. Review should include making sure there is appropriate supporting documentation for all transactions posted to the general ledger.

**Management's Response:**

The City has implemented a system to log all general journal entries. Journal entries are being tracked using this log, with the preparer's name, approver's name and the name of the person posting the entry being recorded in an Excel Spreadsheet for review and control on a shared drive. Physical copies of all journal entries will be retained and will have the preparer's name and signature and be approved and signed off by the supervisor. Additionally, the Finance Director will ensure all journal entries, bank reconciliations and payroll registers are properly reviewed, approved, and signed off on a timely basis. Other tracking mechanisms, especially in the area of revenue recording and bank reconciliations, have been implemented so as to aid in the tracking of individual bank deposits and supporting documentation.

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

**SCHEDULE OF SIGNIFICANT DEFICIENCIES**

**2016-05:      Super-User Status in the General Ledger System and Lack of Segregation of Duties**

This recommendation was also provided in the prior year (see comment #2015-06). Accounting staff should not normally be allowed to have Super-User rights in the City's general ledger system. We noted that three City employees (the Finance Director, Finance Manager and Information Services Manager) have super-user rights to the general ledger system.

When accounting staff have super-user rights, there is a potential risk of allowing access to different modules in the accounting system that employees may not require access in order to perform their daily tasks. In addition, unauthorized transactions could be processed without proper review and approval.

While we understand the City has a limited number of staff available to provide system administration functions and review and approval procedures in critical accounting areas partially mitigate the conflict, the lack of review in approval in other critical areas pose a significant control risk and the City should consider restricting super user rights to as few employees as possible.

In addition, we understand that due to a system limitation, the payroll function and the Human Resources function are combined into one module. As a result, the payroll clerk has access to the payroll database and has the ability to make changes such as adding an employee or changing pay rates. 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.

**Management's Response:**

As noted above, the Finance Director and the Accounting Supervisor have Super-User status. However, with the retirement of the previous Information Services Manager earlier this year, the new incumbent has not been given Super-User rights to the General Ledger system. The other accounting and payroll staff have duties that are appropriately segregated, but have no Super-user rights either. Given the small size of the City, past experience has shown that it is necessary to have this arrangement in place so as to ensure smooth functioning during unexpected employee absences. There have been three such sudden extended health related absences in Accounting and HR this past year alone. The Super User risk in the General Ledger Module has been somewhat mitigated by the use of the Journal Entry log system that has been deployed. The City will 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 payroll function.

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

**SCHEDULE OF OTHER MATTERS**

**2016-06:      Investment Report – Compliance with Requirements of Government Code Section 53646 and the City’s Investment Policy**

This recommendation was also provided in the prior year (see comment #2015-04). In accordance with the California Government Code Section 53646, when a treasurer’s investment report is submitted to the City Council, it “shall include a statement denoting the ability of the local agency to meet its pool’s expenditure requirements for the next six months, or provide an explanation as to why sufficient money shall, or may, not be available.”

We reviewed the City’s Investment Report as of June 30, 2016 for compliance with the Government Code and noted that although the City’s June 30, 2016 Investment Report Investment Report contained the applicable statement above as required by California Code Section 53646 (b)(3) and the City’s Investment Policy, the balance of the pooled unrestricted investments as of that date on the Report was \$2,706. This does not appear to be sufficient funds to meet the City’s expenditure requirements for the subsequent six months, however the Report did not include further explanation as required by the Code.

We recommend the City evaluate its statement addressing its ability to meet its pooled expenditures for the six months following the quarterly reports and provide additional explanation as needed.

**Management’s Response:**

The City is aware of the impact that timing of cash flows from property taxes have on its ability to meet operational needs. Aided by its strong credit rating from Standard & Poor’s, the City has been successful since 2012 in meeting its monthly cash flow needs through a combination of borrowings and budgeted revenues. In fact, the City’s single largest expense item is the bi-weekly payroll and it is worth noting that to date, the City has never missed a payroll. With the refunding and rescheduling of most of the City’s debt and the cessation of payments to Contra Costa County under the OFA DDR and the Sales Tax sharing agreement with the City of Richmond next year, the cash position is expected to improve further.

The Treasurer’s Quarterly Investment Reports to Council have been expanded to provide additional language explaining that “the balance of the pool’s unrestricted investments in combination with anticipated operating cash inflows and the balance in the general checking account will be used to meet the expenditure requirements for the next six months.” This has proven to be an accurate assessment based on the City’s revenue and expenditure pattern over the past several years. As such, Management is of the considered opinion that this explanation is adequate in terms of the California Code Section 53646(b)(3) and the City’s Investment Policy and that no further explanation is necessary.

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

**2016-07:        Upcoming Governmental Accounting Standards Board (GASB) Pronouncements**

**Effective in fiscal year 2016-17:**

**GASB 73 – *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68***

This Statement establishes requirements for defined benefit pensions that are not within the scope of Statement No. 68, Accounting and Financial Reporting for Pensions, as well as for the assets accumulated for purposes of providing those pensions. In addition, it establishes requirements for defined contribution pensions that are not within the scope of Statement 68. It also amends certain provisions of Statement No. 67, Financial Reporting for Pension Plans, and Statement 68 for pension plans and pensions that are within their respective scopes.

**GASB 74 – *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans***

The objective of this Statement is to improve the usefulness of information about postemployment benefits other than pensions (other postemployment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency.

**GASB 77 – *Tax Abatement Disclosures***

This Statement establishes financial reporting standards for tax abatement agreements entered into by state and local governments. The disclosures required by this Statement encompass tax abatements resulting from both (a) agreements that are entered into by the reporting government and (b) agreements that are entered into by other governments and that reduce the reporting government's tax revenues.

**GASB 78 – *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans***

This Statement amends the scope and applicability of Statement 68 to exclude pensions provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension plan that (1) is not a state or local governmental pension plan, (2) is used to provide defined benefit pensions both to employees of state or local governmental employers and to employees of employers that are not state or local governmental employers, and (3) has no predominant state or local governmental employer (either individually or collectively with other state or local governmental employers that provide pensions through the pension plan). This Statement establishes requirements for recognition and measurement of pension expense, expenditures, and liabilities; note disclosures; and required supplementary information for pensions that have the characteristics described above.

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

**SCHEDULE OF OTHER MATTERS**

**GASB 80 – *Blending Requirements for Certain Component Units an amendment of GASB Statement No. 14***

This Statement amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of Statement No. 39, Determining Whether Certain Organizations Are Component Units.

**GASB 82 – *Pension Issues—an amendment of GASB Statements No. 67, No. 68, and No. 73***

The objective of this Statement is to address certain issues that have been raised with respect to Statements No. 67, Financial Reporting for Pension Plans, No. 68, Accounting and Financial Reporting for Pensions, and No. 73, Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68. Specifically, this Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

**Effective in fiscal year 2017-18:**

**GASB 75 – *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions***

The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency.

**GASB 81 – *Irrevocable Split-Interest Agreements***

This Statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. Furthermore, this Statement requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests. This Statement requires that a government recognize revenue when the resources become applicable to the reporting period.

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

**STATUS OF PRIOR YEAR MATERIAL WEAKNESSES**

**2015-01      Cash and Available Fund Balances for General Fund and Capital Improvement Funds and Interfund Borrowings**

As discussed in comments from prior years (2014-01, 2013-03 and 2012-04), the City's General Fund budget and liquidity remain a significant concern and while it appears the financial health of the General Fund has improved slightly, cash and fund balance levels remain low. As of June 30, 2015, the General Fund has a cash balance of only \$1 and City-wide, unrestricted cash balances total only \$286,457. General Fund unassigned fund balances amounted to \$1.3 million – but when compared to the General Fund's budgeted expenditures for fiscal year 2014-2015 of \$28.6 million, this is a very low level of available resources.

In addition, the Capital Improvement Fund's fund deficit amounted to \$1.4 million as of June 30, 2015, which is an increase of almost \$400 thousand over prior year.

The cash balances of both of these funds remained depleted due to short-term cash borrowings from other City funds. The General Fund and Capital Improvement Fund had borrowed \$2.2 million from other funds as of fiscal year end, including borrowing from restricted funding resources such as the Integrated Waste Management Enterprise Fund and the Municipal Services Corporation Special Revenue Fund.

During this year's audit, we again reviewed the City's financial condition and satisfied ourselves that the City had sufficient resources available to fund operations through June 30, 2016. Although the City continues to issue Tax Revenue Anticipation Notes to supplement cash temporarily during the fiscal year, if spending at current levels without an increase in resources were to continue, it reduces the likelihood that the City will have sufficient cash resources available.

In reviewing the City's adopted budget for 2016, it appears the City is expecting a surplus within the General Fund of approximately \$340 thousand, leaving a positive fund balance of \$1.8 million. The capital improvements program is projecting \$1.8 million in expenditures, leaving a negative fund balance of \$592 thousand. The City should continue reviewing the current capital projects outstanding to determine if any of them can be delayed since sufficient funding does not appear to be currently available. Any projects that are grant funded must be accompanied by timely grant reimbursement requests to alleviate the cash flow problem.

The City should continue to monitor actual revenues and expenditures to ensure they are in line with expected results. Close management and comparison of actual activity against the budget *must* continue to be employed to ensure further costs reductions are made as necessary. All increases in expenditures should be specifically approved through the budget amendment process to ensure cash resources are available to fund the increase.

While the General Fund only had a balance of \$1, it also had accounts receivables totaling \$3.2 million. The outstanding revenue included sales tax, franchise fees, utility users fees and other like revenues for June. Unlike reimbursements for expenditures that require the City prepare and submit invoice, these revenues are sent to the City by the agency directly. They don't require any action by the City and there are no additional measures the City can take to collect these revenues any sooner. The month needs to close and then the City must wait for the revenues to be sent within the next 30-60 days.

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

**STATUS OF PRIOR YEAR MATERIAL WEAKNESSES**

**2015-01      Cash and Available Fund Balances for General Fund and Capital Improvement Funds and Interfund Borrowings (Continued)**

In addition to waiting on \$3.2 million in outstanding revenue, a \$5 million payment in May was required to repay the TRAN. This put a significant drain on cash.

Even with a 15% reserve, the City would not have a sufficient surplus of cash. The available cash must be used to bridge the gap between year-end payment of invoices and the receipt of large revenues that won't be received until late July or August.

**Current Year Status:** See comment #2016-01.

**2015-02:      Timeliness and Accuracy of Year-End Close**

The City should strive to limit the amounts and numbers of adjusting journal entries (AJEs) after year end closing. It is crucial that control procedures be maintained throughout the year in order to produce accurate and timely financial data. See comment #2015-03 for a related discussion on internal controls over major transactions cycles and accounting processes.

The City has experienced a significant amount of turnover within its Finance Department and key accounting positions have been vacant or filled with temporary personnel with little experience in governmental accounting. This had a significant impact on the fiscal year 2015 year-end audit in spite of staff's diligence and providing full cooperation to our audit.

However, there was a delay in commencing the audit fieldwork as staff had to re-reconcile its cash for the fiscal year, which impacts many balances. Once the audit commenced, there were still a significant number of audit adjustments we proposed that had to be posted as many of the account balances were still materially misstated. This was caused by a lack of capacity and experience within the Finance Department, as transactions are not being properly reviewed throughout the year, reconciliations are not being performed timely and no analytical review of the account balances were being performed by Finance on a regular basis.

The above conditions delayed the completion of the close and increased the risk that errors could have gone undetected by staff and corrections may not be made in a timely manner. Audit effort was substantially increased in response to these increased risks.

We recommend the City fill vacant positions for the key accounting positions, and strive to obtain personnel with governmental accounting backgrounds who can analyze the account balances on a regular basis. The City should also review and redesign its accounting procedures in order to achieve a more timely and accurate close of its books in fiscal year 2016. Items noted in comment #2015-03 should be considered and the City should ensure the various accounting processes have someone with the proper background designated to review the major transaction cycles. The City should also consider seeking outside specified government accounting training for existing personnel.

**Current Year Status:** See comment #2016-02.

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

**STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES**

**2015-03:      Internal Controls Over Major Transactions Cycles and Accounting Processes**

Accounting transactions and registers or reconciliations, including journal entries, bank reconciliations, and payroll registers, should be reviewed and approved consistently and timely by someone other than the preparer to ensure they are prepared accurately. All transactions should have proper supporting documentation. During our testing of controls over the City's major transactions cycles and processes we noted the following:

- a) We selected forty journal entries for testing and noted that twenty-two of the journal entries selected, which were prepared by the Accounting Supervisor, did not show any indication of having been reviewed. Additionally, we noted that three of the remaining eighteen journal entries that were reviewed, had a significant delay between the time the journal entries were prepared and when they were reviewed.
- b) We reviewed the bank reconciliations for the City's bank and trustee accounts for the months of November 2014 and March 2015 and noted the following significant delays:
  - The bank reconciliation for the City's General Checking account for the month of November 2014 was prepared timely on December 9, 2014, however it was not reviewed until February 5, 2015. The reconciliation for the month of March 2015 was not signed off when it was prepared and there was no indication it had been reviewed.
  - The Workers Compensation account for the month of November 2014 was prepared timely on December 9, 2014, however, it was not reviewed until February 5, 2015.
  - The reconciliation for the Municipal Services Corporation account for the month of November 2014 was not prepared until January 22, 2015, and it was not reviewed until April 19, 2015. The reconciliation for the month of March 2015 did not include a sign off by the preparer. And there was no indication it had been reviewed.
  - The Flex Spending Account reconciliations for the months of November 2014 and March 2015 did not include a sign off by the preparer or reviewer.
  - The bank reconciliations for the month of March 2015 for the Trustee accounts had not been prepared as of year-end.
- c) We reviewed six payroll registers for proper approval and noted one register did not show any indication of review and approval.
- d) We selected forty disbursement transactions for testing and noted eleven appear to have been paid sixty days after services were rendered. According to Finance Staff, it appears individual departments often do not forward invoices to finance for timely payment.
- e) We selected twenty five receipts for testing, however, the Business License Technician was not able to locate supporting documentation for ten of the items.

Without consistent and timely review and approval, the likelihood of an error or improper accounting treatment is increased. The Finance Director/City Treasurer *must* ensure all journal entries, bank reconciliations and payroll registers are properly reviewed, approved, and signed off. In the event the Finance Director/City Treasurer or Accounting Supervisor cannot complete the review, the duty should be assigned to another appropriate employee or a designated outside party. Review should include making sure there is appropriate supporting documentation for all transactions posted to the general ledger.

**Current Year Status:** See comment #2016-04.

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

**STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES**

**2015-04:      Investment Report – Compliance with Requirements of Government Code Section 53646 and the City’s Investment Policy**

In accordance with the California Government Code Section 53646, when a treasurer’s investment report is submitted to the City Council, it “shall include a statement denoting the ability of the local agency to meet its pool’s expenditure requirements for the next six months, or provide an explanation as to why sufficient money shall, or may, not be available.” Furthermore, section 15.0 of the City’s Investment Policy states that “the City of El Cerrito’s investment policy will continue to be reviewed and adopted by the City Council annually, even if not required by California Government Code 53646.”

We reviewed the City’s Investment Report for the quarter ended March 31, 2015 for compliance with the Government Code, as well as reviewed the City’s most current Investment Policy and noted the following:

- The City’s March 31, 2015 Investment Report contained the statement above as required by California Code Section 53646(b)(3), however, the balance of the pooled unrestricted investments as of that date on the Report was only \$2,706. This does not appear to be sufficient funds to meet the City’s expenditure requirements for the subsequent six months, however, the Report did not include a further explanation as required by the Code.
- The City Council has not reviewed and adopted the Investment Policy since February 2012.

We recommend the City evaluate its statement addressing its ability to meet its pooled expenditures for the six months following the quarterly reports and provide additional explanation as needed. In addition, the City Council should follow the investment policy and review and adopt it annually, or consider changing the policy.

**Current Year Status:** The City Council reviewed and approved the updated Investment Policy in November 2015. See Current Year comment #2016-06 regarding the disclosure in the Investment Report.

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

**STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES**

**2015-05:      Compliance with Debt Reserve Requirement**

The City's individual debt indentures outline the minimum reserve requirements, which the City is responsible for maintaining at all times. According to the bond indenture for the 2012 Lease Revenue Bonds, the City was required to maintain a minimum balance of \$185,332, however, we noted the City's reserve account showed a balance of \$166,933 at June 30, 2015. Therefore, the City is not in compliance with the above bond covenant requirement.

We recommend the City periodically review the balances of its reserve accounts to ensure compliance with reserve requirements.

**Management's Response in prior year:**

A wire transfer, in the amount of \$18,428 was sent to the recipient institution in accordance with the bond covenant requirement. This transaction should have been posted to the City's reserve account, and then used to make the debt service payment. However, when the payment was received, the recipient institution simply passed the payment on to the beneficiary institution, never actually posting said payment to the reserve account. Although the payment was then already received by the beneficiary institution, the recipient institution insisted upon using reserve funds to make the payment in order to stay compliant with the covenant requirements. The recipient institution asked that the original wire be recalled, which was done and upon receipt of said funds, the \$18,428 was returned to the reserve account. Staff was fully aware of the details of this transaction from start to finish.

**Current Year Status:** Recommendation implemented.

**2015-06:      Super-User Status in the General Ledger System and Lack of Segregation of Duties**

Accounting staff should not normally be allowed to have Super-User rights in the City's general ledger system. We noted that three City employees (the Finance Director, Finance Manager and Information Services Manager) have super-user rights to the general ledger system.

When accounting staff have super-user rights, there is a potential risk of allowing access to different modules in the accounting system that employees may not require access in order to perform their daily tasks. In addition, unauthorized transactions could be processed without proper review and approval.

While we understand the City has a limited number of staff available to provide system administration functions and review and approval procedures in critical accounting areas partially mitigate the conflict, the lack of review in approval in other critical areas pose a significant control risk and the City should consider restricting super user rights to as few employees as possible.

In addition, we understand that due to a system limitation, the payroll function and the Human Resources function are combined into one module. As a result, the payroll clerk has access to the payroll database and has the ability to make changes such as adding an employee or changing pay rates. 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.

**Current Year Status:** See comment #2016-05.

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

**STATUS OF PRIOR YEAR OTHER MATTERS**

**2015-07:      Accounting for Receipts and Voided Receipts**

Receipts should be numerically accounted for to ensure that there are none missing while voided receipts should be approved by someone other than the cashier. During our discussion with the Business License Technician, she was not aware she should numerically account for receipts and we also noted cashiers are able to void receipts.

With cashiers being able to void receipts and there being no numerical review of receipts, it increases the risk of errors, misstatement or defalcation. We recommend a process be implemented for the numerical review of receipts, and that authorization of voiding receipts be removed from the cashier function.

**Current Year Status:** Steps have been taken in IT to restrict the ability of non-accounting personnel to void/delete receipts in the New World System. This function has been restricted to the Accounting Supervisor. The Accounting Technician is the only other person that can void receipts with the approval of the Supervisor. All Permit and Business License transactions appear on the CRW Trakit Accounts Summary Report, and this report is reconciled to the daily NWS Revenue Collection Reports. Also, all batches are given to the Accounting Technician who reconciles them to create the weekly deposits. These deposits are given to the Accounting Supervisor to review and post. The backup to each batch is attached and retained. The Recreation Department uses RecTrak to process all of their transactions. The Department Head and the Department Analyst reconcile these batches before they go into NWS. Once they are processed through NWS, they cannot be changed by the user. The Accounting Supervisor is the only one that can make a change. The Police and Recycling Center counters use NWS for all of their transactions, and cannot perform voids or deletions. There is no single unified numerical system in place that can track all counter transactions due to the variety of systems being used. However there is a sequential system in place to track receipts within the individual system such as Planning and Building department receipts. However, once information is entered into NWS a numerical journal is generated. City staff will continue to monitor the effectiveness of these individual systems and are prepared to make changes if necessary.

**2015-08:      Cross Training of Duties**

In order to have proper internal controls and ensure there is proper backup for accounting functions in the case an employee goes on vacation or needs to be absent for an extended period of time, staff should be cross trained for all major accounting functions. Currently, due to staffing limitations, it does not appear there is sufficient backup for the accounting functions. We recommend the City review each function and address what will happen if the position were to become vacant and/or an employee will be absent for a significant amount of time.

**Current Year Status:** Since prior year the City has hired a new Finance Director, as well as a new Accountant. With the Finance department being fully staffed, the department has been working on cross-training staff over the receipts, disbursements and payroll functions.

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## REQUIRED COMMUNICATIONS

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

We have audited the basic financial statements of the City of El Cerrito for the year ended June 30, 2016. Professional standards require that we communicate to you of the following information related to our audit under generally accepted auditing standards and *Governmental Auditing Standards*.

### Significant Audit Findings

#### *Accounting Policies*

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the financial statements.

The following Governmental Accounting Standards Board (GASB) pronouncements became effective, but did not have a material effect on the financial statements:

#### **GASB Statement No. 76 – The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments**

#### **GASB Statement No. 79 – Certain External Investment Pools and Pool Participants**

The following pronouncement became effective and is disclosed in Note 1M and 3G to the financial statements.

#### **GASB Statements No. 72 – Fair Value Measurement and Application**

This Statement addresses accounting and financial reporting issues related to fair value measurements. The definition of *fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

The requirements of this Statement enhance comparability of financial statements among governments by requiring measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. This Statement also enhances fair value application guidance and related disclosures in order to provide information to financial statement users about the impact of fair value measurements on a government's financial position.

### *Unusual Transactions, Controversial or Emerging Areas*

We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period. However, issues related to the dissolution of the former Redevelopment Agency continue to remain unresolved. As discussed in Note 15 to the financial statements, the California Department of Finance (DOF) and State Controller's Office (SCO) have demanded the City remit \$1,981,989 to affected taxing agencies pursuant to California Health & Safety Code Section 34179.5, and reverse \$10,158,319 in property conveyances and a payment of \$400,243 in bond proceeds made by the former Redevelopment Agency to the Municipal Services Corporation prior to the dissolution of the former Redevelopment Agency.

As a result, the City and Successor Agency are potentially subject to penalties under California Health & Safety Code Section 34179.6(h), including the withholding of the City's local sales and use tax. The City and Successor Agency elected not to make the payment, or to reverse the property conveyances and payment and instead timely filed a lawsuit challenging the legality and constitutionality of the DOF's and SCO's demands. As the matter continues to be unresolved, the City cannot determine the potential liability or the value of assets that may have to be returned to the Successor Agency.

The City's position on these matters is not a position of settled law and there is considerable legal uncertainty regarding these matters. It is possible that a legal determination may be made at a later date by an appropriate judicial authority that would resolve this issue favorably or unfavorably to the City. No provision for liabilities resulting from the outcome of these uncertain matters has been recorded in the financial statements.

### *Accounting 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 significantly from those expected. The most sensitive accounting estimates affecting the financial statements are:

*Estimated Net Pension Liabilities and Pension-Related Deferred Outflows and Inflows of Resources:* Management's estimate of the net pension liabilities and deferred outflows/inflows of resources are disclosed in Note 10 to the financial statements and are based on actuarial studies determined by a consultant, which are based on the experience of the City. We evaluated the key factors and assumptions used to develop the estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.

*Estimated Net OPEB Obligation:* Management's estimate of the net OPEB obligation is disclosed in Note 10C to the financial statements and is based on actuarial study determined by a consultant, which is based on the experience of the City. We evaluated the key factors and assumptions used to develop the estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.

*Estimated Fair Value of Investments:* As of June 30, 2016, the City held approximately \$11.7 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, 2016. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2016.

*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 6 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 1I 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.

### ***Disclosures***

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosure affecting the financial statements was the disclosure of the Redevelopment Agency dissolution and former Redevelopment Agency funds held by the Municipal Services Corporation in Note 14 and 15 to the financial statements and the State Board of Equalization's sales tax adjustment disclosed in Note 13B to the financial statements. See discussion under *Unusual Transactions, Controversial or Emerging Areas* above regarding the unsettled law and highly contingent nature of these matters.

The financial statement disclosures are neutral, consistent, and clear.

### ***Difficulties Encountered in Performing the Audit***

Other than the discussion noted in comment #2016-02 of the Memorandum on Internal Control, we encountered no significant difficulties in dealing with management in performing and completing our audit.

### ***Corrected and Uncorrected Misstatements***

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. Management has corrected certain such misstatements. As discussed in comment #2016-02, a significant amount of adjustments (32 in total) were required to be posted after the general ledger had been closed and the audit commenced. In addition, there were several reclassifications that were also required to be made to the financial statements.

Professional standards require us to accumulate all known and likely uncorrected 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 City Council.

### ***Disagreements with Management***

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

### ***Management Representations***

We have requested certain representations from management that are included in a management representation letter dated April 21, 2017.

### ***Management Consultations with Other Independent Accountants***

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

### ***Other Audit Findings or Issues***

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

### ***Other Information Accompanying the Financial Statements***

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

With respect to the required supplementary information accompanying the financial statements, applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not express an opinion nor provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

The Introductory and Statistical Sections included as part of the Comprehensive Annual Financial Report have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we did not express an opinion nor provide any assurance on them.

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

*Maze & Associates*

Pleasant Hill, California  
April 21, 2017

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