CITY OF SAN LEANDRO
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS

FOR THE YEAR ENDED
JUNE 30, 2014

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CITY OF SAN LEANDRO
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS

For The Year Ended June 30, 2014

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MEMORANDUM ON INTERNAL CONTROL

To the City Council of
the City of San Leandro, California

In planning and performing our audit of the basic financial statements of the City, 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.

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.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all such deficiencies have been 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. Given the above 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.

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.

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

Maze & Associates

Pleasant Hill, California
November 17, 2014

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SCHEDULE OF OTHER MATTERS

2014-01: New GASB Pronouncements or Pronouncements Not Yet Effective

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

Effective Fiscal 2015:

GASB 68 - Accounting and Financial Reporting for Pensions (an amendment of GASB 27)

This Statement will have material impact on the City's financial statements. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions.

This Statement establishes standards for measuring and recognizing liabilities, deferred outflows of resources, and deferred inflows of resources, and expense/expenditures. For defined benefit pensions, this Statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service.

In financial statements prepared using the economic resources measurement focus and accrual basis of accounting, a single or agent employer that does not have a special funding situation is required to recognize a liability equal to the net pension liability. The net pension liability is required to be measured as of a date no earlier than the end of the employer's prior fiscal year (the measurement date), consistently applied from period to period.

Note disclosure and required supplementary information requirements about pensions also are addressed. Distinctions are made regarding the particular requirements for employers based on the number of employers whose employees are provided with pensions through the pension plan and whether pension obligations and pension plan assets are shared.

The following are the major impacts:

- This Statement requires the liability of employers and nonemployer contributing entities to employees for defined benefit pensions (**net pension liability**) to be measured as the portion of the present value of projected benefit payments to be provided through the pension plan to current active and inactive employees that is attributed to those employees' past periods of service (**total pension liability**), **less** the amount of the pension plan's **fiduciary net position**.

- Actuarial valuations of the total pension liability are required to be performed at least every two years, with more frequent valuations encouraged. If a valuation is not performed as of the measurement date, the total pension liability is required to be based on update procedures to roll forward amounts from an earlier actuarial valuation (performed as of a date no more than 30 months and 1 day prior to the employer's most recent year-end).

SCHEDULE OF OTHER MATTERS

- The actuarial present value of projected benefit payments is required to be attributed to periods of employee service using the entry age actuarial cost method with each period's service cost determined as a level percentage of pay. The actuarial present value is required to be attributed for each employee individually, from the period when the employee first accrues pensions through the period when the employee retires.

GASB 69 - Government Combinations and Disposals of Government Operations

This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this Statement, the term *government combinations* includes a variety of transactions referred to as mergers, acquisitions, and transfers of operations.

GASB 71 - *Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68*

The objective of this Statement is to address an issue regarding application of the transition provisions of Statement No. 68, Accounting and Financial Reporting for Pensions. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or non-employer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability.

Statement 68 requires a state or local government employer (or non-employer contributing entity in a special funding situation) to recognize a net pension liability measured as of a date (the measurement date) no earlier than the end of its prior fiscal year. If a state or local government employer or non-employer contributing entity makes a contribution to a defined benefit pension plan between the measurement date of the reported net pension liability and the end of the government's reporting period, Statement 68 requires that the government recognize its contribution as a deferred outflow of resources. In addition, Statement 68 requires recognition of deferred outflows of resources and deferred inflows of resources for changes in the net pension liability of a state or local government employer or non-employer contributing entity that arise from other types of events. At transition to Statement 68, if it is not practical for an employer or non-employer contributing entity to determine the amounts of all deferred outflows of resources and deferred inflows of resources related to pensions, paragraph 137 of Statement 68 required that beginning balances for deferred outflows of resources and deferred inflows of resources not be reported.

Consequently, if it is not practical to determine the amounts of all deferred outflows of resources and deferred inflows of resources related to pensions, contributions made after the measurement date of the beginning net pension liability could not have been reported as deferred outflows of resources at transition. This could have resulted in a significant understatement of an employer or non-employer contributing entity's beginning net position and expense in the initial period of implementation.

SCHEDULE OF OTHER MATTERS

This Statement amends paragraph 137 of Statement 68 to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability. Statement 68, as amended, continues to require that beginning balances for other deferred outflows of resources and deferred inflows of resources related to pensions be reported at transition only if it is practical to determine all such amounts.

The provisions of this Statement are required to be applied simultaneously with the provisions of Statement 68.

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CURRENT STATUS OF PRIOR YEAR MATERIAL WEAKNESS

FS2013-01: Closing of General Ledger and Private Purpose Trust Fund Accounting

Criteria: The City had elected to be the Successor Agency to the former Redevelopment Agency. Accordingly, the City has a responsibility to make sure that the financial data recorded in the general ledger for the Successor Agency to the former Redevelopment Agency Private Purpose Trust Fund (PPT Fund) are proper and accurate.

Condition:

- The general ledger for the Successor Agency to the Redevelopment Agency Private Purpose Trust Fund (PPT Fund) required material audit journal entry adjustments. These adjustments required both the auditor and City staff a considerable amount of time to balance the fund and to ensure that the amounts are accurate. For example, the PPT Fund required a $6.76 million audit journal entry adjustment to record the King Properly settlement long-term liability. There was also another $3.98 million audit journal entry adjustment to write down the amount of land held for resale in the PPT Fund.

- Footnote disclosures for Successor Agency are complex for the City of San Leandro. It also required substantial amount of time during the audit to make sure that they were updated and accurate.

Effect: As a result, material audit journal entries adjustments were made to ensure that the financial statements are fairly stated. Substantial amount of time was spent by both the City staff and the auditor in order to assemble the City's Comprehensive Annual Financial Report (CAFR) and to properly record and disclose the transactions and account balances for the PPT Fund.

Cause:

- It appears that Community Development Department and Finance Department did not have sufficient coordination and communication to make sure that PPT Fund financial data are accurately recorded in the general ledger; and footnote disclosures are accurately updated.

- City staff was unaware of all the intricate accounting issues associated with properly recording transactions for the PPT Fund.

Recommendation:

- The Successor Agency has a number of intricate and unusual accounting transactions. In addition, there are several upcoming Governmental Accounting Standards Board Statements that are required to be implemented. As such, Finance should have adequate staffing, knowledge and training to make sure that these transactions are recorded accurately. If needed, the City should consider sending Finance staff to outside training.

- Finance Department and Community Development Department should coordinate and have sufficient communications during the year and at year-end closing to make sure that all significant activities are properly and accurately recorded in the general ledger. Footnote disclosure related to Successor Agency activities should be reviewed and revised to make sure that the disclosures are accurately updated.

CURRENT STATUS OF PRIOR YEAR MATERIAL WEAKNESS

Management Response: Finance Department staff seeks training especially for new accounting requirements. Funding for staff to coordinate financial reporting for the dissolved redevelopment agency is extremely limited. Community Development Business Manager has been the lead during the dissolution of the Redevelopment Agency and is in charge of the Successor Agency accounts. However, there will be a much better communication between the Finance staff and the Business Manager to understand the activities, how transactions affect the financial reports and discussions for the footnote section.

Current Status: Corrected and implemented

CURRENT STATUS OF PRIOR YEAR OTHER MATTERS

FS2013-02: Super-User Rights of the Financial System

Criteria: The financial system super-user is an individual who has full access to the City's financial system including all modules and all functions. In a good internal control environment, no employee in the Finance Department should have super-user rights.

Condition: We noted that one employee; an Accountant II, has super-user rights to the Eden Accounting Software System.

Effect: When an accounting staff has super-user rights, there is an increased risk that unauthorized transactions or adjustments may be made to the general ledger without proper review and approval.

Cause: The City believes that it has a small Finance Department and therefore the employee within Finance need to have access to be able to change the system administration functions.

Recommendation: While we understand the City has a limited number of staff available to provide system administration functions, the City should consider restricting super user rights. The City should remove the super user rights from all Finance Department employees. Each employee should only have access to the module he/she is responsible for managing. Access to other modules of the financial system not required to perform the duties of a given employee should be limited to a read only basis.

Management Response: The super user rights for the Finance staff is necessary as the user needs to give other staff the rights for the various modules, reports, and review. The super user also trains users and guides them when users have problems that need to be resolved in all of the various modules in the EDEN financial system. The financial system has an audit report that records access and changes, which is monitored by management.

Current Status: Corrected and implemented

CURRENT STATUS OF PRIOR YEAR OTHER MATTERS

FS2013-03: Investment Policy – Internal Control

Criteria: Per the City's Fiscal Year 2012-2013 Investment Policy Statement (Reso. 2012-093, adopted on July 16, 2012), page 7 of 13, under the heading **"Internal Control and Review"**:

> "The Finance Director will establish an annual review process to be conducted by an independent external auditor. The review will provide internal control by assuring compliance with established City policies and procedures."

Condition: In planning and performing our audit of the City's basic financial statements, our considerations of the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures is for the limited purpose of expressing our opinions on the financial statements. We have not been specifically engaged to perform any review the City's Investment Policy internal control or compliance. We understand that no such reviews are conducted by other independent external auditors.

Effect: It appears that the City is not in compliance with this part of the Investment Policy.

Cause: We understand that the City's former auditors were, at one point, engaged to conduct this type of review. In addition, due to transitions of Finance Directors, it appears that the City has not had the opportunity to update this section of the Investment Policy.

Recommendation: If deemed not necessary, the City should remove this section from the Investment Policy. Alternatively, as required by the Investment Policy, the City should engaged an independent external auditor to perform an agreed upon procedures to review the internal control and compliance with the City's Investment Policy.

Management Response: City will further review the Investment Policy and, if appropriate, change or remove the statement that requires external auditor review to ensure that the City complies with its Investment Policy. Staff currently provides annual updates to the City's Investment Policy, quarterly performance reports and distributes monthly transaction detail for the City Investment portfolio.

Current Status: The City adopted a new Investment Policy effective in FY14/15 which excludes the statement that requires external auditor to perform annual review to ensure City's compliance with established policies.

REQUIRED COMMUNICATIONS

To the City Council of
the City of San Leandro, California

We have audited the basic financial statements of the City of San Leandro for the year ended June 30, 2014. Professional standards require that we communicate to you the following information related to our audit under generally accepted auditing standards and, *Government Auditing Standards* and OMB Circular A-133.

Significant Audit Findings

Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by City of San Leandro are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year except for the following:

- GASB 65 - *Items Previously Reported as Assets and Liabilities*

  This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. This Statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term deferred in financial statement presentations.

  For the fiscal year ended June 30, 2014, the Successor Agency to the Redevelopment Agency Private-purpose Trust Fund is required to implement the provisions of GASB No. 65, *Items Previously Reported as Assets and Liabilities*. The implementation resulted in the write-off of the previously outstanding unamortized bond issuance costs. As a result, beginning net position of the Private-purpose Trust Fund was reduced by $608,831.

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- GASB 70 - _Accounting and Financial Reporting for Nonexchange Financial Guarantees_

  Some governments extend financial guarantees for the obligations of another government, a not-for-profit entity, or a private entity without directly receiving equal or approximately equal value in exchange (a nonexchange transaction). As a part of this nonexchange financial guarantee, a government commits to indemnify the holder of the obligation if the entity that issued the obligation does not fulfill its payment requirements. Also, some governments issue obligations that are guaranteed by other entities in a nonexchange transaction. The objective of this Statement is to improve accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees.

  This Statement requires a government that extends a nonexchange financial guarantee to recognize a liability when qualitative factors and historical data, if any, indicate that it is more likely than not that the government will be required to make a payment on the guarantee. The amount of the liability to be recognized should be the discounted present value of the best estimate of the future outflows related to the guarantee expected to be incurred. When there is no best estimate but a range of the estimated future outflows can be established, the amount of the liability to be recognized should be the discounted present value of the minimum amount within the range.

  The pronouncement became effective, but did not have a material effect on the financial statements.

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.

Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's 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 estimate(s) affecting the City's financial statements were:

> *Estimated Fair Value of Investments:* As of June 30, 2014, the City held approximately $81.5 million of cash and investments as measured by fair value as disclosed in Note 2 to the Financial Statements. Fair value is essentially market pricing in effect as of June 30, 2014. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2014.
>
> *Estimate of 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 1 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.

Disclosures

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosure(s) affecting the financial statements was the disclosure of Redevelopment Agency dissolution and in Note 17 to the financial statements.

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

Difficulties Encountered in Performing the Audit

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 all/certain such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

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 November 17, 2014.

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 City'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 governmental unit'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 Matters

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, we 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 [modify for any portion that is not applicable] 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 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
November 17, 2014