

CITY OF ATWATER

Review Report

ADMINISTRATIVE AND INTERNAL ACCOUNTING CONTROLS

July 1, 2011, through June 30, 2013



JOHN CHIANG
California State Controller

December 2014



JOHN CHIANG
California State Controller

December 3, 2014

The Honorable Joan Faul
Mayor of City of Atwater
750 Bellevue Road
Atwater, CA 95301

Dear Mayor Faul:

Enclosed is the report of the State Controller's Office (SCO) review of the City of Atwater's (City) administrative and internal accounting controls. The review was conducted to assess the adequacy of the City's controls to safeguard public assets and to ensure proper use of public funds.

Our review found weaknesses with the City's accounting and administrative controls system. We also noted the deficiencies included in the Findings and Recommendations section of our report.

As a part of the review, we assessed various aspects of the City's internal control components and elements based on guidance by the General Accounting Office. Of the 79 control elements evaluated pertaining to internal control components, we found 51 controls, or 65%, that were considered to be adequate.

The results of our review and evaluation of the elements of internal control are included in this report as an Appendix. Our assessments of the elements were based on the conditions that existed during our review period of fiscal year (FY) 2011-12 and FY 2012-13. To the extent feasible, we made inquiries to assess whether the control deficiencies have been addressed since the conclusion of FY 2012-13.

It should be noted that the City generally agreed with the findings noted in the report and is in the process of developing corrective actions and implementing our recommendations. Therefore, the City should be commended for taking these matters seriously and being proactive in resolving the noted deficiencies.

As always, my staff and I are available to address your questions. You may contact Mike Spalj, Acting Chief, Local Government Audits Bureau, by telephone at (916) 324-6984, or by email at mspalj@sco.ca.gov.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB/mh

cc: Frank Pietro, City Manager-Police Chief
City of Atwater
Lakhwinder Deol, Finance Operations Manager
City of Atwater
Bill Zenoni, Consultant
City of Atwater
Patty Dominguez, Accountant II
City of Atwater

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Review Report

Introduction

The State Controller's Office (SCO) reviewed the City of Atwater's (City) system of administrative and internal accounting controls for the period of July 1, 2011, through June 30, 2013 (fiscal years (FY) 2011-12 and FY 2012-13). As necessary, we expanded our testing to include prior and current transactions to follow up on issues identified, through interviews of City officials and through our review of the work of the independent auditors and other audit reports.

On April 17, 2014, the SCO notified Bill Zenoni, Interim Finance Director, that the City did not comply with state law regarding the timely submittal of the annual Financial Transaction Reports for FY 2008-09 through FY 2012-13. In addition to the delinquent reports, the following information serves as a basis for this review:

Financial Transaction Reports

- The City did not submit Financial Transaction Reports by the required due date for FY 2008-09 through FY 2012-13.
- Prior-period adjustments as a percentage of beginning fund balance ranged from 11% in FY 2008-09 to 266% in FY 2010-11.
- Operating deficits for FY 2010-11 and FY 2011-12 were 53% and 40%, respectively.

Independent Auditor's Reports (FY 2011-12 and FY 2012-13)

- Independent Auditor's reports expressed substantial doubt about the City's ability to continue as a going concern.
- The City's General Fund deficit fund balance increased from \$3.9 million in FY 2011-12 to \$4.2 million in FY 2012-13.
- The City's General Fund, Sanitation Enterprise Fund, and Water Fund operated with a cash deficit. These funds did not generate sufficient revenues in FY 2011-12 and FY 2012-13 to cover expenditures.

After considering the above information, we concluded that there is reason to believe that the Annual Report of Financial Transactions submitted by the City was misstated, incomplete, or incorrect. Therefore, under Government Code (GC) section 12464(a), the SCO conducted an investigation of the information provided in the reports mentioned above. Pursuant to GC 12464(b), the City will bear the costs of this investigation, preparation of a report of the results, and transmission of copies to the City Council of Atwater.

In addition, the SCO reviewed any programs with State general or special funding and/or any federal funding passed through by a State agency to the City. These additional activities were conducted under GC 12410, which authorizes the Controller to "...superintend the fiscal concerns of the state. The Controller shall audit all claims against the

state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provisions of law for payment.” While the focus of the review was on FY 2011-12 and FY 2012-13, issues may have arisen in which a review of financial activities necessitated a review of transactions in current and/or prior periods.

In a letter dated April 23, 2014, the SCO notified the City that it would conduct the following audits/reviews:

- Administrative and Internal Accounting Controls
- State and Federal Funds (passed through by a State agency)

The letter stated that the reviews will focus on FY 2010-11 and FY 2011-12 unless issues come to our attention that will necessitate expanding our work to prior and/or current periods.

This report presents the results of findings and conclusions reached in our review of the city’s administrative and internal accounting controls system.

Background

The City of Atwater is located along State Route 99 in Merced County, California. The City is eight miles west-northwest of Merced, at an elevation of 151 feet. The population, as of the 2010 census, is 28,168. The railroad reached Atwater in the 1870s, and first post office opened in 1880. The City incorporated in 1922. The City’s name honors Marshall D. Atwater, a wheat farmer whose land was used by the railroad for its station.

Objective, Scope, and Methodology

The objective of this review was to evaluate the City of Atwater’s system of administrative and internal accounting controls to ensure:

- Effectiveness and efficiency of operations;
- Reliability of financial reporting;
- Compliance with applicable laws and regulations; and
- Adequate safeguard of public resources.

To accomplish our objective, we performed the following procedures:

- Evaluated the City’s formal written internal policies and procedures;
- Conducted interviews with city employees and observed the City’s business operations for the purpose of evaluating city-wide administrative and internal accounting controls;
- Reviewed the City’s documentation and supporting financial records;
- On a limited basis, performed tests of transactions to ensure adherence with prescribed policies and procedures and to validate and test the effectiveness of controls; and

- Assessed various aspects of the City's internal control components and elements in accordance with guidelines established by the General Accounting Office.

Conclusion

In our review of the City of Atwater's (City) administrative and internal accounting controls, we found weaknesses in the City's administrative and internal accounting controls system, resulting in findings that should be addressed and corrected by the City.

As part of our review, we made an assessment of various aspects of the City's internal control components and elements based on the guidelines established by the General Accounting Office's Internal Control Management and Evaluation tool.

Of the 79 control elements evaluated pertaining to internal control components, we found 51 elements, or 65%, for which controls were considered to be adequate. The results of our review and evaluation of elements of internal control are included in this report as an Appendix.

Views of Responsible Officials

We issued a draft report on October 16, 2014. Lakhwinder Deol, Finance Operations Manager, responded by email dated October 30, 2014. The City generally agreed with the findings and is in the process of implementing our recommendations. The City's response is included in this final review report as an attachment.

Restricted Use

This report is solely for the information and use of the City of Atwater and the SCO; it is not intended to be and should not be used by anyone other than these parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

December 3, 2014

Findings and Recommendations

Noncompliance with Government Code section 12464

Pursuant to Government Code section 12464, our review determined the following reporting issues:

Financial Transactions Report (FTR) for fiscal year (FY) 2011-12:

- Revenues were understated by \$7,564,576 (reported \$25,861,103 instead of the actual of \$33,425,679)
- Revenues for an Extraordinary Item (RDA dissolution) of \$5,666,091 were not reported
- Expenditures were overstated by \$14,551,755 (reported \$48,705,153 instead of the actual of \$34,153,398)
- Sewer expenditures were overstated by \$18,567,348 (reported \$27,965,643 instead of the actual of \$9,398,295)

Financial Transactions Report (FTR) for FY 2012-13:

- Revenues were overstated by \$349,339 (reported \$28,859,335 instead of the actual of \$28,509,996)
- Expenditures were understated \$1,633,652 (reported \$29,062,001 instead of the actual of \$30,695,653)
- Prior-period adjustments of (\$4,931,818) were made without an explanation

Recommendation:

The City should take into consideration the above issues when preparing future Financial Transaction Reports. The City's Financial Transactions Reports submitted to the State Controller's Office (SCO) should include all year-end final closing adjustments. If year-end closing adjustments are not available at the time of report submittal, the City should notify the SCO's Division of Accounting and Reporting of this and follow up with an amended report. Also, the City should ensure that internal control findings and recommendations noted in this report are reviewed and evaluated for their impact on future reporting.

City's Response

Management concurs with the State Controller's Office recommendation. For the fiscal year ended June 30, 2014, the City's audit firm, JJA CPA, Inc. prepared and submitted the City's Financial Transactions Report which included year-end final closing adjustments.

SCO's Comments

The City agrees with our recommendation and has taken steps to remedy the situation.

The finding remains as stated.

Results of Analysis of City's Administrative and Internal Accounting Controls

Our review of the City's administrative and internal accounting controls focused on FY 2011-12 and FY 2012-13. However, we did expand our tests of selected transactions into prior and future periods as necessary to follow up on related issues.

As a part of our internal control review, we assessed various aspects of the City's internal control components and elements based on guidelines established by the General Accounting Office's Internal Control Management and Evaluation tool. Of the 79 control elements evaluated pertaining to internal control components, we found 51 (65%) that were considered adequate (see Appendix for the results of our evaluation of internal control elements).

Using the results of our internal control matrix, we performed reviews of selected transactions to document examples of weak and nonexistent controls. The specific findings described in this report resulted, at least in part, from these deficiencies.

Recommendation

While we have made specific recommendations to address the findings described in this report, from a broader perspective we recommend that the City develop a comprehensive remedial plan to address the deficiencies noted in Appendix 1. The plan should identify the tasks to be performed, as well as milestones and timelines for completion. In addition, we recommend that the Atwater City Council require periodic updates at public meetings on the progress of the remedial plan's implementation.

City's Response

A remedial plan to address the issues noted in Appendix 1 will be developed and reviewed with the City Council on periodic basis.

SCO's Comments

The City will develop a remedial plan to address the issues noted in Appendix 1 and provide it to City Council for review.

The finding remains as stated.

City's Suggested changes to Appendix 1 Questionnaire:A3. Audit Committee

d. Yes. Audit committee meets on a regular basis once a month except for the period from January through June of 2013.

A4. Management Philosophy and Operating Style

c. Yes. Current City Manager has been in place since 2012. Due to reorganization and budget constraints, vacant Finance Director position was replaced with Finance Operations Manager position. Finance Operations Manager provides financial management services.

f. Yes. City manager and department heads meet regularly on every Monday.

g. Yes. Beginning July 2013, City Manager and City Council receive regular financial updates. Due to limited staffing, Financial Statements issuance for FY 2012-13 was late until February 2014 due to Redevelopment Agency close-out issues.

A5. Organizational Structure

a. Yes. Staffing reduced because City reorganized due to Fiscal constraints. The Fire department is contracted out. Finance operations manager reports directly to City Manager.

c. Yes. Organization chart is available.

A6. Assignment of authority and responsibility

b. Yes. This has been corrected beginning in FY 2013-14. Utility billing adjustments are approved by Accountant II.

A7. Human Resources policies and practices

a. Yes. Policies and procedures are established for hiring, training, and promoting employees and management.

c. Yes. Finance Operations Manager is hired in August 2014 to replace previous Finance Director position which was re-structured based upon organizational needs. In the interim period, Finance department staff was supervised by the City Manager's office.

E1. On-going monitoring

a. Yes. Audit recommendations have been implemented.

d. Yes. Full time finance operations manager is hired in August 2014.

f. Yes. City does not have Auditors' Office. Currently, City has contract with JJCPA, Inc. and regular recommendations for improvements in internal control are provided. City management is taking appropriate follow-up actions to implement suggested improvements.

E2. Separate evaluation

d. Yes. Audit recommendations have been implemented.

E3. Reporting deficiencies

d. Yes. Audit recommendations have been implemented.

SCO's Comments

The city should be commended for taking these matters seriously and being proactive in resolving some of the noted deficiencies in its administrative and internal accounting controls. However, the findings disclosed in this report are based on the conditions that existed during the review period and not any subsequent changes made by the city. Therefore, we will not make the suggested changes to the Appendix 1 Questionnaire.

**FINDING 1—
Continued decline in
General Fund, Water
Fund, and Sanitation
Enterprise Fund balances**

Based on our review of FY 2006-07 through FY 2012-13, the year-end fund balance of the City's General Fund and net positions of two enterprise funds have been in continuous decline. The cumulative decline is approximately \$10 million for the General Fund, \$7.5 million for the Water Fund, and \$4.3 million for the Sanitation Fund. Year-end balance amounts were as follows:

General Fund

<u>Fiscal Year</u>	<u>Beginning Balance</u>	<u>Ending Balance</u>	<u>Ending Balance Increase/(Decrease)</u>
2006-07	\$ 5,962,689	\$ 4,973,891	\$ (988,798)
2007-08	4,973,891	3,974,766	(999,125)
2008-09	3,974,766	4,639,887	665,121
2009-10	4,639,887	3,078,115	(1,561,772)
2010-11	3,078,115	(278,947)	(3,357,062)
2011-12	(278,947)	(3,913,630)	(3,634,683)
2012-13	(3,913,630)	(4,184,252)	(270,622)
		Total	\$ (10,146,941)

Water Fund

<u>Fiscal Year</u>	<u>Beginning Balance</u>	<u>Ending Balance</u>	<u>Ending Balance Increase/(Decrease)</u>
2006-07	\$ 13,232,117	\$ 13,189,988	\$ (42,129)
2007-08	13,189,988	12,540,244	(649,744)
2008-09	12,540,244	11,126,389	(1,413,855)
2009-10	11,126,389	9,435,751	(1,690,638)
2010-11	9,435,751	7,846,361	(1,589,390)
2011-12	7,846,361	6,510,228	(1,336,133)
2012-13	6,510,228	5,731,333	(778,895)
		Total	\$ (7,500,784)

Sanitation Fund

<u>Fiscal Year</u>	<u>Beginning Balance</u>	<u>Ending Balance</u>	<u>Ending Balance Increase/(Decrease)</u>
2006-07	\$ 116,881	\$ (173,783)	\$ (290,664)
2007-08	(173,783)	(711,861)	(538,078)
2008-09	(711,861)	(1,463,805)	(751,944)
2009-10	(1,463,805)	(2,089,544)	(625,739)
2010-11	(2,089,544)	(2,770,263)	(680,719)
2011-12	(2,770,263)	(3,359,853)	(589,590)
2012-13	(3,359,853)	(4,170,100)	(810,247)
		Total	\$ (4,286,981)

Based on our analysis, and as reflected in the above tables, the City did not receive sufficient revenue to fund the level of services provided for FY 2006-07 through FY 2012-13. The City has implemented several cutbacks to reduce expenditures, including a reduction of its workforce to 78, down from a high of 134 employees in FY 2008-09; implementation of a 10% furlough; and adoption of a four-day workweek. In addition, beginning October 2012, the city council waived

receipt of auto allowances, and beginning in 2013, waived receipt of salaries and in-lieu-of-insurance pay.

Recommendation

The City should monitor the changes to its cash and fund balances to ensure that revenues received are equal to or more than expenditures incurred. Doing so will ensure that the City will be able to continue to provide current services and avert fiscal emergencies.

City's Response

City Management and the City Council have continued to closely monitor the City's cash and fund balances. Monthly and quarterly reports are presented to the City Council and Audit and Finance Committee. The City Council adopted a balanced budget on June 23, 2014. The City Council has implemented significant cost reduction measures to address the reduction in revenue resulting from the national economic crisis endured over the past several years. The City has also developed a Five Year Forecast for the General Fund which will be reviewed and updated on a regular basis.

SCO's Comments

The City did not dispute this finding. The City has begun to implement our recommendation and is taking steps to improve oversight of its financial and operational activities.

The finding remains as stated.

FINDING 2 — Cash impairment in the City's investment pool

The General Fund is the main operating fund for the City and its cash is maintained in an investment pool with cash from other funds, including the Gas Tax and State and federal funds. During our review, we noted that the City's operating costs of the General Fund were paid for by funds from the City's investment pool, without regard for the source of funds.

The actual General Fund cash balances were negative during FY 2011-12 and FY 2012-13. When the General Fund cash balances are negative, cash from the Gas Tax and State and federal funds, and other restricted local funds with positive cash balances, is used to pay for General Fund-related expenditures. Thus, any of these funds and other restricted local funds that have a positive cash balance are potentially impaired and may not be able to make timely payments of required expenditures.

The City's General Fund cash balances were as follows:

<u>General Fund</u>	
<u>Fiscal Year Ending</u>	<u>Cash Balance</u>
June 30, 2012	\$ (2,747,921)
June 30, 2013	\$ (3,141,199)

It is clear that General Fund expenditures were charged to funds with positive cash balances, such as the Gas Tax and State and federal funds within the investment pool. However, we could not determine the specific impact to the Gas Tax and State and federal funds or any other funds, because the City's investment pool does not provide information on the balances on each fund, or document specific loans to the General Fund from these other funds.

Recommendation

The City should develop and implement policies and procedures to ensure that it does not impair other funds' cash, especially that of the restricted funds, by using it to pay for general operating costs that should be paid from the General Fund. Additionally, the City's finance department should determine each fund's balance in the investment pool and ensure that withdrawals from that pool are used only to address costs that can be paid from each fund. In addition, to the extent that it is allowable to use cash from one fund to pay for expenditures that should be paid from another, such loans should be documented, and the City should ensure that the loan is repaid as soon as required, with interest.

City's Response

The City Council, in February 2014, approved an Inter-Fund Loan Policy which provides clear guidelines for the advance, reporting and repayment (with interest) of all inter-fund loans. The City does account for the cash balances of each fund in the investment pool. This information is included in the annual financial audit.

SCO's Comments

The City implemented our recommendation and has taken steps to remedy the situation.

The finding remains as stated.

FINDING 3— Lack of comprehensive accounting policies and procedures

The City has a Purchasing System Manual that mainly covers processing of procurement of goods and services. However, this manual does not include policies and procedures for other accounting processes. The manual has not been updated since September 2007.

Specific deficiencies in the City's Purchasing System Manual are found in the policies and procedures for:

- Budget and Planning: specifically, adoption of a timely, balanced, and conservative budget (see Finding 4); budget monitoring throughout the appropriation cycle; and accurate and timely reporting of financial information to the governing body.
- Accounts Receivable: processing of Accounts Receivable should be included in the Manual. Accordingly, our review of the City's Financial Statement Reports for the fiscal years ended June 30, 2012, and June 30, 2013, noted the following:

- Lack of review of journal entries prepared to record revenue, unearned revenue, and capital assets prior to posting into the accounting system;
 - Overstatement of accounts receivable and revenue as a result of failure to delete from accounting records the uncollectible receivables; and
 - Incorrect revenue balances as a result of misapplication of availability criteria and failure to defer revenues.
- Accounts Payable: failure to include proper documentation and authorization of transactions (see Finding 8). Accordingly, the City's Financial Statement Reports for the fiscal years ended June 30, 2012, and June 30, 2013, noted the following: understatement of accounts payable as a result of failure to recognize expenditures when incurred; lacking supervisory approvals of utility billing adjustments.
 - Fixed Assets: policies and procedures for procuring and safeguarding of assets should be part of the Manual.
 - Personnel and Payroll: policies and procedures maintained by the Human Resources/Payroll unit should be integrated into comprehensive accounting procedures and policies.

Further, the City does not have a process in place to routinely review and update the manual. Therefore, the City lacks sufficient documentation for completeness, accuracy, and consistency with existing processes.

A well-designed and properly maintained system of accounting policies and procedures enhances both accountability and consistency. The resulting documentation also can serve as a useful training tool for staff. The documentation of accounting policies and procedures should be evaluated and updated periodically, according to a predetermined schedule. Changes in policies and procedures that occur between these periodic reviews should be updated and documented promptly. Documentation provides guidance for implementing controls and serves as a basis for training new personnel in implementing them, and provides evidence that the controls are operating effectively.

Undocumented policies and related internal controls result in unclear roles and responsibilities and lead to improper handling of transactions. An essential element of internal control is monitoring, which includes verification by management that policies and procedures are updated to adequately address new challenges identified by ongoing risk assessments.

Recommendation

The City should develop and implement a comprehensive accounting policies and procedures manual. A good starting point would be to update the current Purchasing System Manual and incorporate other accounting policies and procedures. Doing so would ensure consistency with current processes and organizational structure. The City also should perform periodic and ongoing reviews to ensure proper documentation,

accuracy, and completeness in its accounting and financial transactions and records.

The Accounting Policies and Procedures Manual should be readily available to all responsible employees. It should clearly describe the authority and responsibility of all employees, especially the authority to authorize transactions and the responsibility for the safekeeping of assets and records. The manual also should indicate which employees are to perform which procedures. Procedures should be described as they are actually intended to be performed. Also, the documentation of accounting policies and procedures should explain the design and purpose of procedures related to controls, to increase employee understanding of, and support for controls.

City's Response

Management concurs with the State Controller's Office recommendation. A comprehensive accounting policies and procedures manual will be developed by June 30, 2015.

SCO's Comments

The City agrees with the recommendation and is planning on developing a comprehensive accounting policies and procedures manual by June 30, 2015.

The finding remains as stated.

**FINDING 4 —
Annual budgets were not
balanced, reflect
unfavorable variances,
and are adopted
subsequent to start of
fiscal year**

We found that for FY 2011-12 and FY 2012-13, the proposed annual budgets were not approved by the City Council until December 12, 2011, and February 12, 2013, respectively. For each of the fiscal years noted above, the budgets were approved well after the start of the fiscal year. In addition, as shown in the table below, the City's General Fund annual budgets from FY 2008-09 through FY 2012-13 were not balanced, and the estimated expenditures exceeded the estimated revenues. Additionally, variances between the actual amounts and budgeted amounts for the five fiscal years were mostly unfavorable, with actual revenues less than estimated amounts, and actual expenditures more than the budgeted amounts.

Adoption of a timely budget allows local officials and others to use budget numbers as a reference against which to compare expenditures and revenues throughout the year. As such, the budget provides an ongoing financial management tool to ensure that the City spends within its means and balances expenditures against revenues. In addition, late approval of the budget prevents the City from initiating procurement processes at the start of the financial year based on the approved budget.

General Fund

Fiscal Year	Revenues			Expenditures			Deficiency of Revenues under Expenditures (Budgeted)
	Budgeted	Actual	Variance	Budgeted	Actual		
2008-09	11,961,742	10,540,413	(1,421,329)	13,659,375	13,907,011	(247,636)	(1,697,633)
2009-10	11,274,931	10,884,403	(390,528)	13,738,195	14,032,151	(293,956)	(2,463,264)
2010-11	12,215,449	9,741,432	(2,474,017)	14,011,567	13,612,616	398,951	(1,796,118)
2011-12	9,918,423	9,077,696	(840,727)	12,841,672	12,864,566	(22,894)	(2,923,249)
2012-13	10,203,595	10,970,749	767,154	11,079,872	11,118,701	(38,829)	(876,277)

Recommendation

The City should develop policies and procedures to ensure that proposed budgets are approved before the start of the new fiscal year, are balanced, and that variances between budgeted and actual revenues and expenditures are minimal.

City’s Response

Beginning July 1, 2013, the City Council has received quarterly revenue and expenditure status reports. The City Council, on February 24, 2014 adopted mid year budget adjustments to reduce variances between budgeted and revised projections for revenues and expenditures. The City Council adopted a balanced budget for the 2014-15 fiscal year on June 23, 2014.

SCO’s Comments

The City did not dispute this finding. The City has begun to implement our recommendations and is taking steps to improve oversight over its budgeting processes by making timely budget adjustments and adopting a budget.

The finding remains as stated.

**FINDING 5—
Employee evaluations
not performed in a
timely manner**

Our review of the employee performance evaluations revealed that of the 78 current city employees, 37, or 47.4%, have not received an evaluation within the last year. As noted in table below, a significant number of employee’s evaluations were for periods in excess of two years.

Current 7/1/13 – 6/30/14	41	52.6%
2-5 years 7/1/09 – 6/30/13	21	26.9%
5-10 years 7/1/04 – 6/30/09	11	14.1%
Older than 10 years	5	6.4%

According to City of Atwater website, the goal of the Human Resources Department is to implement employment best practices and to ensure fair and impartial professional and technical support services in the overall administration of the City’s personnel program.

An important element of internal control is an organization's commitment to competence. It is important for an organization to demonstrate commitment to attract, develop, and retain competent individuals in alignment with the organization's objectives. One of the tools commonly used to achieve this element is evaluating employee performance.

As a result of not performing employee evaluations on time, the City failed to comply with its human resources goals and commitment to competence.

Recommendation

The Human Resources Department should ensure that all city departments complete all of the past-due employee performance evaluations. It also should require that all city departments conduct employee performance evaluations on a regular basis in order to determine if the knowledge, skills, and abilities of the employees are sufficient to perform their respective functions, and monitor this on a regular basis. Performance evaluation is an important tool that helps identify employees' training needs. Training is especially important under current circumstances given the significant staff reductions resulting from the City's financial distress.

City's Response

Under the direction of the City Manager, the City's labor attorney provided training to all supervisors on January 16, 2014 regarding HR policies. Said training included Performance Evaluations and provided a new format. In February, 2014, the Administrative Manager began sending out a monthly email to all department directors with a list of employees who are due evaluations. Said list includes the past due evaluations, evaluations due during the current month, and evaluations due the following month. Employees remain on the list until evaluation is received. Department directors who are not in compliance receive follow up by the City Manager.

SCO's Comments

The City is implementing our recommendation by taking appropriate steps to ensure that employee performance evaluations are completed regularly.

The finding remains as stated.

**FINDING 6 —
Questionable allocation of salaries**

The allocation method employed by the City to allocate certain employee salaries to different fund sources appears questionable. We could not assess whether the allocated charges reflect the services received by the benefiting funds because the City’s allocation methodology does not provide a clear audit trail.

The City currently allocates some of its employee salaries to different funds based on management discretion as a part of the budget process. It is not clear what methodology the City uses to decide what fund(s) to charge part of an employee salary. The process appears arbitrary and is not based on any type of reasonable approach. In fact, it does not appear that the allocated costs are equitable or based on the benefits received. The table below shows examples of salary allocations for the City Manager and Public Works Director. In addition to this cost allocation, the City also made a subsequent administrative allocation of unallocated administrative costs.

FY 2009-10				
	General Fund Administration	Water Fund	Sewer Fund	Sanitation Fund
City Manager	67%		33%	
Public Works Director		33%	33%	33%
FY 2010-11				
	General Fund Administration	Water Fund	Sewer Fund	Sanitation Fund
City Manager	50%		50%	
Public Works Director		25%	50%	25%
FY 2011-12				
	General Fund Administration	Water Fund	Sewer Fund	Sanitation Fund
City Manager	50%		50%	
Public Works Director		25%	50%	25%
FY 2012-13				
	General Fund Administration/ Police	Water Fund	Sewer Fund	Sanitation Fund
City Manager	25%	25%	25%	25%
Public Works Director		25%	50%	25%

Our review of the administrative cost allocations found that the City Manager’s salary, charged to the General Fund, was subsequently changed to other funds, including a 19% charge to the Sewer Fund, which already had been changed for the City Manager’s salary. The Public Works Director’s salary mainly was charged to the three enterprise funds: Water, Sewer, and Sanitation. According to the City’s Municipal Code, the Public Works Director is responsible for the supervision and conduct of the following Public Works activities: building inspection, water and sewer systems refuse collection, parks, public construction, building maintenance, and street construction and maintenance. However, only the water, sewer, and sanitation funds incur all of the Public Works Director’s salary costs.

Recommendation

The City should analyze its organization and administrative activities and establish policies and procedures for charging administrative costs among funds, that are based on equitable and actual costs incurred for these activities.

City’s Response

The methodology for allocating employees labor costs among the various funds was updated with the Fiscal Year 2013-14 budget and is based upon the benefits received by the various funds.

SCO’s Comments

The City is implementing our recommendation and is taking steps to remedy the situation.

The finding remains as stated.

**FINDING 7—
Non-compliance with the
City’s contracting
policies**

We noted that some payments to contractors exceeded the originally approved contract amounts. We also noted that these payments lacked supporting documentation of proper review and approval.

The City’s Purchasing Manual states: “Any substantial change to a Purchase Order shall be documented as a Change Order. Change Orders shall be reviewed by the Purchasing Division and shall be approved by the City Manager. A Purchase Order may not be increased by more than 10% or \$2,500, whichever is less, without a Change Order. . . .”

We tested eight vendor payments and found the following three instances in which the payments exceeded the originally approved contract amounts:

<u>Vendor Percent Increase</u>	<u>Contract Amount</u>	<u>Payments</u>
G. Ramirez Concrete (34.07%)	29,960.00	40,167.50
North Star Engineering (88.46%)	20,535.00	38,700.10
West Coast Arborists, Inc. (588.99%)	12,990.00	89,500.00

- G. Ramirez Concrete: On October 10, 2008, the City entered into an agreement with G. Ramirez Concrete for City Hall concrete improvements, with a contract amount not to exceed \$29,960. The vendor and the City processed two Change Orders for additional work, totaling \$10,207.50. However, the Change Orders lack sufficient information as to the reasons for additional work. In addition, the Change Orders did not reflect City Manager approval.
- North Star Engineering: On September 23, 2009, the City entered into an agreement with North Star Engineering Group, Inc. for consulting services on a Winton Way overly project, with a contract amount not to exceed \$20,535. The City paid the vendor a total of \$38,700.10, an increase of \$18,165.10, or 88.46% over the contracted amount. Our review of the supporting documentation for

payments to the vendor showed that two of the nine payment requests by the City's Purchasing Agent to the Finance Department included a note requesting increases to the Purchase Order of \$3,770 and \$5,540. These requests, however, did not reflect City Manager approval.

- West Coast Arborists, Inc.: On July 26, 2010, the City entered into an agreement with West Coast Arborists, Inc. for street tree maintenance, with a contract amount not to exceed \$12,990. Total payment made to the vendor upon completion of the project was \$89,500, an increase of \$76,600, or 589% over the contracted amount. On February 14, 2011, the City and the vendor amended the contract to increase the contract amount to a total of \$87,010. Although the City amended the contract to increase the amount, the amendment was made after the vendor already had performed work totaling \$49,300, and the City already had paid the vendor an additional \$37,300.

Recommendation

The City should ensure that vendor payments do not exceed the approved contract amounts. If issuing Change Orders, the City should comply with the City's Procedures on Change Orders as outlined in the City's Purchasing Manual. In addition, the City should determine whether it should request competitive bids for additional work.

City's Response

Management concurs with the State Controller's Office recommendation. The Purchasing Manual will be reviewed and updated as necessary. Staff training will be provided to ensure compliance with the provisions of the Purchasing Manual.

SCO's Comments

The City agrees with our recommendation.

The finding remains as stated.

FINDING 8— Lack of proper time- keeping system

As part of the Gas Tax audit procedures, we reviewed the Regional Surface Transportation Program (RSTP) Exchange Funds the City receives from the Merced County Association of Governments (MCAG). For FY 2012-13, the city submitted to MCAG a list of street projects that were to be funded with the RSTP funds. According to city staff, these projects typically are performed by the City personnel. A review of public works employees' timesheets showed that time spent on specific projects are not tracked or identified on the timesheets. Timesheets reflect only the type of work done, such as "street" or "sewer," making it difficult to determine if a grant was used for its intended purpose.

As timesheets do not reflect the specific projects the employees work on, we were unable to determine whether the \$340,524 of RSTP money received during FY 2012-13 was spent on activities for which the funds were intended.

Recommendation

The City should establish procedures to include project cost activity information on its employee timesheets. Recording time by specific project would help ensure compliance with use of different fund sources.

City's Response

The Management concurs with the State Controller's Office recommendation.

SCO's Comments

The City agrees with our recommendation.

The finding remains as stated.

**Observation—
Excessive auto allowance
for City Council
members**

The City Council compensation package included pay and benefits, in-lieu-of-insurance pay, and auto allowance. As a result of the City's fiscal crises, the City Council waived auto allowance payments in October of 2012, and it waived payment of the in-lieu-of-insurance pay during 2013.

The City Council and the Mayor received monthly auto allowances of \$700 and \$750, respectively. In 2012, the auto allowance was reduced to \$350 per month until the beginning of October 2012, when the City Council waived this benefit.

It appears that at the time the City Council members were receiving this benefit, the amount of \$700 per month was excessive. At a federal mileage reimbursement rate of .555 cents per mile, this would amount to more than 15,000 annual miles travelled to conduct business, mainly within a six-square-mile city.

Recommendation

If and when the City resumes making payments to City Council members, it should consider developing a more equitable methodology, including the in-lieu-of-insurance pay and auto allowance.

City's Response

At this time, the City has no plans to resume in-lieu-of-insurance and automobile allowance payments for City Council members.

SCO's Comments

The City does not plan to resume in-lieu-of-insurance and automobile allowance payments for City Council members.

The observation remains as stated.

Evaluation of Elements of Internal Control

Internal Control Elements		Yes	No	Comments
Management Oversight and Control (Control Environment)				
A1.	Integrity and Ethical Values			
	a. Are codes of conduct and other policies regarding acceptable business practices, conflicts of interest, or expected standards of ethical and moral behavior established and communicated to all City managers and employees?	X		
	b. Is the reasonable management attitude of "Tone at the Top" established and communicated to City management and staff?	X		
	c. Is every-day interaction with vendors, clients, auditors and other parties based on honesty and fairness?	X		
	d. Is appropriate remedial action taken in response to non-compliance?	X		
	e. Is management appropriately addressing intervention or overriding established controls?	X		
A2.	Commitment to Competence			
	a. Is management identifying and defining the tasks required to accomplish particular jobs and fill various positions?	X		
	b. Does the City conduct appropriate analysis of the knowledge, skills, and abilities needed to perform job assignments?		X	Performance evaluations are not performed on a timely basis. See Finding 5
	c. Is the City providing training and counseling in order to help employees maintain and improve their job competence?	X		

A3.	Audit Committee			
	a. Does the City have an audit committee that is appropriate for the size and nature of the entity?	X		
	b. Are members of the audit committee independent from the City management?	X		
	c. Do audit committee members have sufficient knowledge, experience, and time to serve effectively?	X		
	d. Does the audit committee meet regularly to set policies and objectives, review the City's performance, and take appropriate actions; and are minutes of such meetings prepared and signed on timely basis?		X	The audit committee met on a regular basis once a month, except from January through June of 2013. During these months, we did not find evidence that the audit committee conducted meetings.
	e. Do the members of the audit committee regularly receive the information they need to monitor management's objectives and strategies?	X		
	f. Does the audit committee review the scope and activities of the internal and external auditors?	X		
	g. Does the audit committee meet privately with the Chief Financial Officer/and or accounting officers, internal auditors, and external auditors to discuss the reasonableness of the financial reporting process, the system of internal control, significant comments or recommendations, and management performance?	X		
	h. Does the audit committee take actions as a result of its audit findings?		X	
A4.	Management Philosophy and Operating Style			
	a. Is management conservative in accepting risks, and does management move carefully and proceed only after careful evaluation?		X	Meetings were conducted to discuss and address risk as a result of dwindling cash reserves in the General Fund, and Water and Sewer Enterprise Funds; however the City moved slowly in addressing the fiscal emergency. As noted in Finding 1, the fund balances for the City's General Fund, Water Fund, and Sanitation Fund continued to decline during FY 2006-07 through FY 2012-13.
	b. Are procedures or activities in place to regularly educate and communicate to management and employees the importance of internal controls and to raise the level of understanding control?		X	Inadequate written Administrative and Internal Accounting Policies and Procedures. See Finding 3

	c. Is personnel turnover in key functions at an acceptable level?		X	Excessive turnover at key management positions. From 2010 through present, there were five different City Managers. The Finance Director position has not been filled since March of 2013. The City currently contracts with a consultant who works at the City only one day each week to perform limited financial-management services.
	d. Does management have a positive and supportive attitude toward internal control and audit functions?	X		
	e. Are valuable assets and information safeguarded from unauthorized access or use?	X		
	f. Are there frequent interactions of senior management and operations management?		X	Certain city departments indicated that prior department heads did not disseminate information to them.
	g. Is management attitude appropriate towards financial, budgetary and other operational reporting?		X	Annual Budgets for FY 2011-12 and FY 2012-13 were adopted after the beginning of the fiscal year, on December 2011 and February 2013, respectively. Financial Statements issuance was consistently late. For FY 2012-13, FY 2011-12, FY 2010-11, and FY 2009-10, city financial statement were issued February 2014, March 2013, August 2012, and March 2011, respectively.
	A5. Organizational Structure			
	a. Is the City's organizational structure appropriate for its size and the nature of its operation?		X	Department heads have been significantly reduced, from seven to two. The City previously had department heads for the following departments: Community Development, Economic Development, Finance, Police, Fire, Public Works, and Community Services. Currently, only the Community Development and Public Works departments have department heads; the City Manager also is the Police Chief, and the Finance Department has a consultant, who performs limited financial management services.
	b. Are key areas of authority and responsibility defined and communicated throughout the organization?	X		
	c. Have appropriate and clear reporting relationships been established?		X	City was unable to provide a current organizational chart.
	d. Does management periodically evaluate the organization's structure and make changes as necessary in fluctuating conditions?	X		
	e. Does the City employ an appropriate number of employees, particularly in managerial positions?		X	See A5a.

A6.	Assignment of authority and responsibility			
	a. Is the City appropriately assigning authority and delegating responsibility to the proper personnel to deal with organizational goals and objectives?	X		
	b. Does each employee know how his or her work interrelates to others in the way in which authority and responsibility are assigned, and how duties are related concerning internal control?		X	The City's audited Financial Statements reports for FY 2011-12 and FY 2012-13 noted audit findings regarding lack of supervisory approval of utility billing adjustments.
	c. Is delegation of authority appropriate in relation to the assignment of responsibility?	X		
A7.	Human Resources policies and practices			
	a. Are policies and procedures established for hiring, training, and promoting employees and management?		X	Policies and procedures are established; however, performance evaluations are not performed in a timely manner.
	b. Are background checks conducted on candidates for employment?	X		
	c. Are employees provided the proper amount of supervision?		X	The Finance Department does not have a Finance Director or Finance Manager to provide adequate supervision of accounting activities. The City currently contracts with a consultant who works at the city only one day each week to perform limited financial management services. In addition, see A5a.
Risk Assessment				
B1.	Establishment of Entity-wide Objectives			
	a. Are there entity-wide objectives that were established by management?	X		
	b. Are City-wide objectives clearly communicated to all employees, and does management obtain feedback signifying that communication has been effective?	X		
	c. Is there a relationship and consistency between the department's operational strategies and the City-wide objectives?	X		

	d. Is there an integrated management strategy and risk assessment plan that considers the City-wide objectives and the relevant sources of risk from internal management factors and external sources, and that establishes a control structure to address those risks?	X		
B2. Risk Identification				
	a. Is management appropriately and comprehensively identifying risk using various methodologies?	X		
	b. Are there mechanisms in place to anticipate, identify, and react to routine events or acts that impact achievement of objectives?	X		
	c. Do adequate mechanisms exist to identify risks to the City arising from external factors?	X		
	d. Is management assessing other factors that may contribute to or increase the risk to which the City is exposed?	X		
	e. Is management identifying risks City-wide and for each significant activity level of the City?	X		
B3. Risk Analysis				
	a. After risks to the City have been identified, does management undertake a thorough and complete analysis of the possible effects?	X		
	b. Has management developed an approach for risk management and control based on how much risk can be prudently accepted?	X		
Control Activities				
C1. Policies and Procedures (General Applications)				
	a. Do appropriate procedures, techniques, and mechanisms exist with respect to each of the City's activities?		X	See A4b
	b. Are the control activities identified as necessary, in place, and being applied?		X	Contract Change Orders are not properly approved. Also, see A6b and Finding 7.

	c. Are control activities regularly evaluated to ensure that they remain appropriate and are working as intended?		X	See A4b
C2. Common Categories of Control Activities				
	a. Are top level reviews made of actual performance relative to budgets, forecasts, and prior periods?	X		
	b. Do managers review performance reports?	X		
	c. For information processing, are varieties of controls in place for performing check accuracy, completeness, and authorization of transactions?		X	See C1b.
	d. Are controlled items periodically counted and compared to amounts shown on control records?	X		
	e. For performance indicators, does management compare different sets of data and investigate differences?	X		
	f. Are duties properly segregated among different people to reduce the risk of error or inappropriate actions?	X		
	g. Are administrative and operation policies in writing, current, and do they set clear procedures for compliance?		X	See A4b
Information and Communication				
D1. Information				
	a. Are mechanisms in place to obtain relevant information on legislative or regulatory developments and program, budget, or economic changes?	X		
	b. Is information provided to the appropriate people in sufficient detail, and with sufficient time to enable them to carry out their responsibilities efficiently and effectively?	X		
	c. Is development or revision of information systems based on the strategic plan linked to the entity's overall strategy, and is it responsive to achieving City-wide objectives?	X		

	d. Does management support the development of necessary information systems and show its support by committing appropriate resources.	X		
D2. Communications				
	a. Does management ensure that effective internal communications occur?	X		
	b. Does management ensure that effective external communications occur regarding issues with serious impact on programs, projects, and other activities?	X		
	c. Does the City employ various forms and means of communicating important information with employees and others?	X		
	d. Does the City manage, develop, and revise its information systems in an effort to continually improve usefulness and reliability?	X		
Monitoring				
E1. On-going monitoring				
	a. Does management have a strategy to ensure that ongoing monitoring is effective and will trigger separate evaluations?		X	The City's audited Financial Statements for FY 2012-13 noted unresolved prior-year audit findings, including no supervisory approvals of utility billing adjustments made by the accounting clerk, incorrect revenue balances due to misapplication of the availability criteria, and failure to defer revenue received in advance.
	b. Do City personnel, in the process of performing their regular duties, obtain information about whether internal control is functioning properly?		X	Accounts payables were paid without proper supporting documentation or approval. See Finding 7
	c. Are communications from external parties corroborated with internally-generated data and do they indicate problems with internal control?	X		
	d. Is there appropriate organizational structure and supervision to help provide oversight of internal control functions?		X	Understaffed, undermanaged. See A5a
	e. Are data recorded by information and financial systems periodically compared with physical assets and discrepancies?	X		

	f. Are the City Auditor’s Office and other auditors regularly providing recommendations for improvements in internal control, and is management taking appropriate follow-up action?		X	See E1a.
	g. Are meetings with employees used to provide management with feedback on whether internal control is effective?		X	We are not aware of any formal meetings between management and employees to determine whether internal control is effective.
	h. Are employees regularly asked to state explicitly whether they comply with the City’s code of conduct?		X	Employees do not undergo regular ethics training.
E2. Separate evaluation				
	a. Are the scope and frequency of separate internal control evaluations appropriate for the City?	X		
	b. Are the methodologies for evaluating the City’s internal control logical and appropriate?	X		
	c. If the evaluations are conducted by the City Auditor’s Office, does the office have sufficient resources, ability, and independence?	X		N/A
	d. Are deficiencies found during separate evaluations promptly resolved?		X	See E1a.
E3. Reporting deficiencies				
	a. Are there means of obtaining reports of deficiencies from both internal and external sources?	X		
	b. Is there ongoing monitoring of internal controls?		X	See E1a.
	c. Are deficiencies reported to the person directly responsible and to a person at least one level higher?	X		
	d. Are the identified transactions or events investigated to determine causes and correct problems?		X	See E1a.

**Attachment—
City of Atwater’s Response to
Draft Audit Report**

Spalj, Mike

From: Lakhwinder Deol <Ideol@atwater.org>
Sent: Thursday, October 30, 2014 9:29 AM
To: Cheng, Michael
Cc: Spalj, Mike; Lek, Christopher; Bill Zenoni; Frank Pietro; Lakhwinder Deol
Subject: Audit Response to IC Draft Audit Report
Attachments: Response IC - Findings and Recommendations.docx

Importance: High

Good morning Michael,

Please see attached response for the draft Internal Controls Audit Report from the City of Atwater.

Also, on page 1, second paragraph of the report mentioned Bill Zenoni as Interim Finance Director that needs to be corrected to Financial Consultant.

If you have any questions or concerns, please feel free to contact me at below listed information.

Please confirm receipt.

Thank you,

Lakhwinder Deol
City of Atwater
Finance Operations Manager
Office: (209) 357-6347
Fax: (209) 357-6364



Please note that due to on-going financial constraints, City employees (non-safety) are on mandatory unpaid time off. Employees are also on a "compressed work schedule." City offices are subsequently closed every Friday.

Office hours for the City Finance Department are Monday through Thursday 7:30 AM to 5:30 PM.

Save a Tree: We're doing our part and we urge you to please think twice before printing this email. Thank you.

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City of Atwater



Administrative and Internal Accounting Controls

July 1, 2011, through June 30, 2013

Findings and Recommendations:

Noncompliance with Government Code section 12464

Recommendation:

The City should take into consideration the above issues when preparing future Financial Transaction Reports. The City's Financial Transactions Reports submitted to the State Controller's Office should include all year-end final closing adjustments. If year-end closing adjustments are not available at the time of report submittal, the City should notify the SCO's Division of Accounting and Reporting of this and follow up with an amended report. Also, the City should ensure that internal control findings and recommendations noted in this report are reviewed and evaluated for their impact on future reporting.

Management Response:

Management concurs with the State Controller's Office recommendation. For the fiscal year ended June 30, 2014, the City's audit firm, JJA CPA, Inc. prepared and submitted the City's Financial Transactions Report which included year-end final closing adjustments.

Results of Analysis of City's Administrative and Internal Accounting Controls

Recommendation:

While we have made specific recommendations to address the findings described in this report, from a broader perspective we recommend that the City develop a comprehensive remedial plan to address the deficiencies noted in Appendix 1. The plan should identify the tasks to be performed, as well as milestones and timelines for completion. In addition, we recommend that the Atwater City Council require periodic updates at public meetings on the progress of the remedial plan's implementation.

Management Response:

A remedial plan to address the issues noted in Appendix 1 will be developed and reviewed with the City Council on periodic basis.

City of Atwater



Suggested changes to Appendix 1 Questionnaire:

A3. Audit Committee

d. Yes. Audit committee meets on a regular basis once a month except for the period from January through June of 2013.

A4. Management Philosophy and Operating Style

c. Yes. Current City Manager has been in place since 2012. Due to reorganization and budget constraints, vacant Finance Director position was replaced with Finance Operations Manager position. Finance Operations Manager provides financial management services.

f. Yes. City manager and department heads meet regularly on every Monday.

g. Yes. Beginning July 2013, City Manager and City Council receive regular financial updates. Due to limited staffing, Financial Statements issuance for FY 2012-13 was late until February 2014 due to Redevelopment Agency close-out issues.

A5. Organizational Structure

a. Yes. Staffing reduced because City reorganized due to Fiscal constraints. The Fire department is contracted out. Finance operations manager reports directly to City Manager.

c. Yes. Organization chart is available.

A6. Assignment of authority and responsibility

b. Yes. This has been corrected beginning in FY 2013-14. Utility billing adjustments are approved by Accountant II.

A7. Human Resources policies and practices

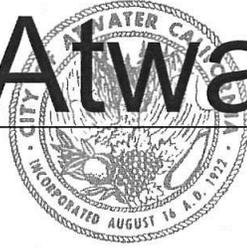
a. Yes. Policies and procedures are established for hiring, training, and promoting employees and management.

c. Yes. Finance Operations Manager is hired in August 2014 to replace previous Finance Director position which was re-structured based upon organizational needs. In the interim period, Finance department staff was supervised by the City Manager's office.

E1. On-going monitoring

a. Yes. Audit recommendations have been implemented.

City of Atwater



d. Yes. Full time finance operations manager is hired in August 2014.

f. Yes. City does not have Auditors' Office. Currently, City has contract with JJCPA, Inc. and regular recommendations for improvements in internal control are provided. City management is taking appropriate follow-up actions to implement suggested improvements.

E2. Separate evaluation

d. Yes. Audit recommendations have been implemented.

E3. Reporting deficiencies

d. Yes. Audit recommendations have been implemented.

Findings

Finding 1 Recommendation:

The City should monitor the changes to its cash and fund balances to ensure that revenues received are equal to or more than expenditures incurred. Doing so will ensure that the City will be able to continue to provide current services and avert fiscal emergencies.

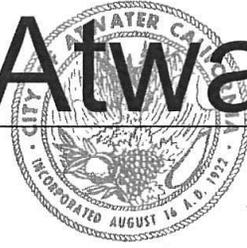
Management Response:

City Management and the City Council have continued to closely monitor the City's cash and fund balances. Monthly and quarterly reports are presented to the City Council and Audit and Finance Committee. The City Council adopted a balanced budget on June 23, 2014. The City Council has implemented significant cost reduction measures to address the reduction in revenue resulting from the national economic crisis endured over the past several years. The City has also developed a Five Year Forecast for the General Fund which will be reviewed and updated on a regular basis.

Finding 2 Recommendation:

The City should develop and implement policies and procedures to ensure that it does not impair other funds' cash, especially that of restricted funds, by using it to pay for general operating costs that should be paid from the General Fund. Additionally, the City's Finance Department should determine each fund's balance in the investment pool and ensure that withdrawals from that pool are used only to address costs that can be paid from each fund. In addition, to the extent that it is allowable to use cash from one fund to pay for expenditures that

City of Atwater



should be paid from another, such loans should be documented, and the City should ensure that the loan is repaid as soon as required, with interest.

Management Response:

The City Council, in February 2014, approved an Inter-Fund Loan Policy which provides clear guidelines for the advance, reporting and repayment (with interest) of all inter-fund loans. The City does account for the cash balances of each fund in the investment pool. This information is included in the annual financial audit.

Finding 3 Recommendation:

The City should develop and implement a comprehensive accounting policies and procedures manual. A good starting point would be to update the current Purchasing System Manual and incorporate other accounting policies and procedures. Doing so would ensure consistency with current processes and organizational structure. The City also should perform periodic and ongoing reviews to ensure proper documentation, accuracy, and completeness in its accounting and financial transactions and records.

The Accounting Policies and Procedures Manual should be readily available to all responsible employees. It should clearly describe the authority and responsibility of all employees, especially the authority to authorize transactions and the responsibility for the safekeeping of assets and records. The manual also should indicate which employees are to perform which procedures. Procedures should be described as they are actually intended to be performed. Also, the documentation of accounting policies and procedures should explain the design and purpose of procedures related to controls, to increase employee understanding of, and support for controls.

Management Response:

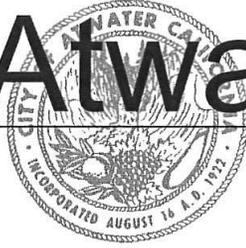
Management concurs with the State Controller's Office recommendation. A comprehensive accounting policies and procedures manual will be developed by June 30, 2015.

Finding 4 Recommendation:

The City should develop policies and procedures to ensure that proposed budgets are approved before the start of the new fiscal year, are balanced, and that variances between budgeted and actual revenues and expenditures are minimal.

Management Response:

City of Atwater



Beginning July 1, 2013, the City Council has received quarterly revenue and expenditure status reports. The City Council, on February 24, 2014 adopted mid year budget adjustments to reduce variances between budgeted and revised projections for revenues and expenditures. The City Council adopted a balanced budget for the 2014-15 fiscal year on June 23, 2014.

Finding 5 Recommendation:

The Human Resources department should ensure that all City departments complete all of the past-due employee performance evaluations. It also should require that all city departments conduct employee performance evaluations on a regular basis in order to determine if the knowledge, skills, and abilities of the employees are sufficient to perform their respective functions, and monitor this on a regular basis. Performance evaluation is an important tool that helps identify employees' training needs. Training is especially important under current circumstances given the significant staff reductions resulting from the City's financial distress.

Management Response:

Under the direction of the City Manager, the City's labor attorney provided training to all supervisors on January 16, 2014 regarding HR policies. Said training included Performance Evaluations and provided a new format. In February, 2014, the Administrative Manager began sending out a monthly email to all department directors with a list of employees who are due evaluations. Said list includes the past due evaluations, evaluations due during the current month, and evaluations due the following month. Employees remain on the list until evaluation is received. Department directors who are not in compliance receive follow up by the City Manager.

Finding 6 Recommendation:

The City should analyze its organization and administrative activities and establish policies and procedures for charging administrative costs among funds, that are based on equitable and actual costs incurred for those activities.

Management Response:

The methodology for allocating employees labor costs among the various funds was updated with the Fiscal Year 2013-14 budget and is based upon the benefits received by the various funds.

Finding 7 Recommendation:

City of Atwater



The City should ensure that vendor payments do not exceed the approved contract amounts. If issuing change orders, the City should comply with the City's procedures on change orders as outlined in the City's Purchasing Manual. In addition, the City should determine whether it should request competitive bids for additional work.

Management Response:

Management concurs with the State Controller's Office recommendation. The Purchasing Manual will be reviewed and updated as necessary. Staff training will be provided to ensure compliance with the provisions of the Purchasing Manual.

Finding 8 Recommendation:

The City should establish procedures to include project cost activity information on its employee timesheets. Recording time by specific project would help ensure compliance with use of different fund sources.

Management Response:

Management concurs with the State Controller's Office recommendation.

Observation

Excessive auto allowance for City Council members

Recommendation:

If and when the City resumes making payments to City Council members, it should consider developing a more equitable methodology, including the in-lieu-of-insurance pay and auto allowance.

Management Response:

At this time, the City has no plans to resume in-lieu-of-insurance and automobile allowance payments for City Council members.

**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874**

<http://www.sco.ca.gov>