

CITY OF CALEXICO

Review Report

INTERNAL CONTROL SYSTEM

July 1, 2015, through June 30, 2017



BETTY T. YEE
California State Controller

January 2019



BETTY T. YEE
California State Controller

January 24, 2019

David B. Dale, City Manager
City of Calexico
608 Heber Avenue
Calexico, CA 92231

Dear Mr. Dale:

State Controller's Office conducted a review of the City of Calexico's internal control system to evaluate the adequacy of the city's controls for conducting its operations, preparing financial reports, safeguarding assets, and ensuring proper use of public funds.

We used *Standards for Internal Control in the Federal Government* (Green Book), established by the Government Accountability Office, to assess various aspects of the city's internal control system. The Green Book outlines the fundamental components, principles, and attributes of effective internal control systems. Of the 48 control attributes evaluated, we found that 12, or 25%, were not present and not functioning; 25, or 52%, were present but not functioning; and 11, or 23%, were present and functioning.

Our review found deficiencies in the city's internal control system. The results of our review and evaluation of the city's internal control are included in this report. Our evaluation of the internal control system was based on the conditions that existed during the review period of July 1, 2015, through June 30, 2017.

It should be noted that the city has taken effective corrective actions and continues to make efforts to enhance its internal control system. The city should be commended for taking these matters seriously and being proactive in resolving the noted deficiencies. We would like to express our thanks to city staff and management, who were extremely helpful throughout our review process.

If you have any questions, please contact Efren Loste, Chief, Local Government Audits Bureau, by telephone at (916) 324-7226.

Sincerely,

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

JLS/lis

cc: The Honorable Lewis Pacheco, Mayor
City of Calexico
Miguel Figueroa, Assistant City Manager
City of Calexico
Karla Lobatos, Finance Director
City of Calexico
Jesus Eduardo Escobar, Mayor Pro Tem
City of Calexico
Bill Hodge, Council Member
City of Calexico
David Romero, Council Member
City of Calexico
Rosie Arreola-Fernandez, Council Member
City of Calexico

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Review Report

Introduction

The State Controller's Office (SCO) reviewed the City of Calexico's internal control system for the period of July 1, 2015, through June 30, 2017 (fiscal year [FY] 2015-16 and FY 2016-17). We expanded our testing as necessary to include prior-year and current-year transactions to follow up on issues we identified by interviewing city officials, and by reviewing other audit reports and work performed by independent auditors.

We conducted this review pursuant to Government Code (GC) section 12464. We questioned the city's ability to provide reliable and accurate information regarding required financial reports. Therefore, under GC section 12464(a), we conducted an investigation/review to validate the information that is required to be filed with the SCO. Under GC section 12464(b), the costs of this investigation/review, including preparing a report of the results and transmitting copies to the City Council Members, will be borne by the city.

Additionally, we conducted a review of the city's internal control system pursuant to GC section 12422.5, which authorizes the Controller to "audit any local agency for purposes of determining whether the agency's internal controls are adequate to detect and prevent financial errors and fraud."

We used *Standards for Internal Control in the Federal Government* (Green Book), established by the Government Accountability Office, to assess various aspects of the city's internal control system. The Green Book outlines the fundamental components, principles, and attributes of effective internal control systems. This assessment is intended to help management evaluate how well the city's internal control is designed and implemented, and determine where improvements can be made.

This report presents the findings and conclusions that we reached in our review of the city's internal control system.

Background

The City of Calexico is a city in Imperial County, California. The city has a total area of 6.2 square miles, with a population of 38,572 as of 2010.

The city is a general law city and was incorporated April 16, 1908. General law cities operate under the Government Code and the Constitution of the State of California. The city also sets its own laws and policies by ordinance, resolution, and meeting minute action.

The city maintains a City Council/City Manager form of government. Five City Council Members are elected to overlapping four-year terms. The City Council Members select the Mayor and Mayor Pro Tem from among themselves each year. The City Council adopts the annual City budget and establishes goals, objectives, and performance measures for the City Manager. The City Manager is appointed by the City Council by majority vote and acts as the Chief Executive Officer of the city. The City Manager implements the legislative policies of the City Council, manages the day-to-day operations of the city, and is responsible for efficient and effective delivery of municipal services.

Objective, Scope, and Methodology

The objective of our review was to evaluate the city internal control system for FY 2015-16 and FY 2016-17 to ensure:

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

To achieve our objective, we:

- Evaluated the city's formal internal policies and procedures;
- Conducted interviews with city employees and observed the city's business operations to evaluate the city's internal control system;
- Reviewed the city's supporting documentation, including financial records;
- Performed tests of transactions on a non-statistical sample basis to ensure adherence with prescribed policies and procedures, and to test and validate effectiveness of controls; and
- Evaluated various aspects of the city's internal control system in accordance with the Green Book.

Conclusion

Our review found deficiencies in the city's internal control system, as described in the Findings and Recommendations section. These deficiencies include:

- Deficit fund balance in the General Fund (Finding 1);
- Insufficient oversight of cash flows (Finding 2);
- Lack of supporting documentation for credit card charges (Finding 3);
- Insufficient oversight of a forensic audit and related invoices (Finding 4);
- Lack of a written contract and City Council approval for change orders (Finding 5);
- Mismanagement of grants (Finding 6);
- Failure to collect Transient Occupancy Tax Revenues in a timely manner (Finding 7);
- Performance evaluations were not conducted in a timely manner (Finding 8);
- Inadequate journal entry controls (Finding 9);
- Lack of staff to perform critical functions (Finding 10); and
- Incomplete and outdated administrative policies and procedures manuals (Finding 11).

Of the 48 control attributes evaluated, we found that 12, or 25%, were not present and not functioning; 25, or 52%, were present but not functioning; and 11, or 23%, were present and functioning. The results of our review and evaluation of the city's internal control system are included in this report as an Appendix.

**Views of
Responsible
Officials**

We issued a draft review report on December 10, 2018. Karla Lobatos, Finance Director, responded by letter dated January 15, 2019. The city stated that it has taken steps to address the issues noted in our findings and will continue to make efforts to enhance its internal control system. The city's response is included in this final review report as an Attachment.

Restricted Use

This review report is solely for the information and use of the City of Calexico 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 review report, which is a matter of public record.

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

January 24, 2019

Findings and Recommendations

FINDING 1—Deficit fund balance in the General Fund

From FY 2014-15 to FY 2016-17, the city did not adhere to its General Fund Contingency Reserve section of the *Fund Balance Policy for General Fund*, and operated with a deficit fund balance in the General Fund due to:

- Significant deficit spending;
- Inaccurate budgetary information; and
- A lack of timely financial reports.

The General Fund Contingency Reserve section of the *Fund Balance Policy for General Fund* states, in part:

The Contingency Reserve policy calls for the City Manager and Finance Director to make recommendations to the City Council annually on the amount that shall be withdrawn from the unassigned (undesignated) fund balance in General Fund and deposited to the Contingency Reserve until fund balance reaches 20% of the General Fund operating expenditures or sufficient resources to finance operations for approximately 2.4 months.

As reported in the city’s financial records, the deficits in the General Fund balance are as follows:

Fiscal Year	Beginning Fund Balance	Net Change in Fund Balance	Ending Fund Balance	Condition
2014-15 ¹	\$ 4,058,048	\$ (4,173,020)	\$ (114,972)	Deficit
2015-16	(114,972)	(3,927,206)	(4,042,178)	Deficit
2016-17 ¹	(3,515,753)	435,535	(3,080,218)	Deficit

¹Restated Beginning Fund Balance

Significant deficit spending

The city engaged in significant deficit spending in the General Fund during FY 2014-15 and FY 2015-16.

From FY 2014-15 to FY 2015-16, expenditures and transfers out exceeded revenues by over \$8.1 million, turning a \$4.1 million General Fund surplus at the beginning of FY 2014-15 into a \$4.0 million deficit at the end of FY 2015-16.

On June 30, 2016, the City Council approved Resolution No. 2016-22 to advance \$3.5 million to the General Fund from the Wastewater Fund to cover General Fund cash shortages. The city also reduced General Fund expenditures in FY 2016-17, which helped reduce the deficit fund balance to \$3.0 million.

Inaccurate budget information

We reviewed the General Fund budgetary supplemental information of the financial statements for FY 2014-15 and found that the budgeted amounts were inaccurate, contributing to the General Fund deficit balance.

The city did not prepare its budget correctly due to a lack of communication between members of city management, and a lack of understanding on the treatment of Measure H revenues. In addition, city management did not perform monthly budget-to-actual reviews.

According to the city's budget for FY 2014-15, the city overstated its General Fund beginning balance, when compared to its fund balance from its audited financial statements, by \$4.9 million, as shown below:

<u>Beginning Fund Balance</u>	
Per Budget	\$ 9,001,415
Per Financial Statements	4,058,048
Difference	<u>\$ 4,943,367</u>

According to the city's budget for FY 2014-15, the city also double-counted the \$2.6 million in anticipated Measure H revenue in its General Fund.

Due to the overstated beginning balance in the General Fund and the double-counted Measure H revenue, the city anticipated having \$7.5 million more than was actually available, as summarized below:

General Fund balance overstatement	\$ 4,943,367
Double-counted Measure H revenue	2,623,928
Total Error	<u>\$ 7,567,295</u>

Lack of timely financial reports

The city failed to produce the financial statements for FY 2013-14 through FY 2016-17 or adopt the budget for FY 2015-16 in a timely manner due to insufficient resources.

The following table shows the report due dates and the dates on which they were issued.

<u>Report Name</u>	<u>Due Date</u>	<u>Date Adopted/Issued</u>	<u>Number of Months Late</u>
FY 2015-16 Budget	July 7, 2015	June 30, 2016	12
FY 2013-14 Basic Financial Statements	December 31, 2014	July 17, 2015	6
FY 2014-15 Basic Financial Statements	December 31, 2015	November 2, 2016	10
FY 2015-16 Basic Financial Statements	December 31, 2016	May 2, 2017	4
FY 2016-17 Basic Financial Statements	December 31, 2017	April 11, 2018	3

The lack of timely annual financial reports is troubling, as such reports provide critical information that could have been used by the City Council and city management to identify potential issues and take prompt action to address them. Timely and complete financial reporting is especially important for the city given its continued financial challenges.

In contrast with the requirements of its Municipal Code, the city operated without an adopted budget for FY 2015-16.

Section 3.36.010 of the Calexico Municipal Code states:

The city council shall adopt a budget no later than its first regularly scheduled meeting during the month of July.

Without an adopted budget, the city could not incorporate budgetary information into its accounting system; doing so could have enabled the city to monitor revenues and expenditures throughout the year.

City officials acknowledged that immediate steps were necessary to address the city's General Fund deficit. In addition, the city remains focused on addressing its long-term financial stability through improved budget monitoring and adjustment efforts to ensure that expenditures are accounted for with available resources.

Recommendation

We recommend that the city:

- Establish policies and procedures to ensure that information presented in the budget is accurate and adopted in a timely manner;
- Perform monthly budget-to-actual reviews to ensure that variances are investigated in a timely manner;
- Direct more resources toward completing its audited financial statements no later than six months after the fiscal-year-end;
- Continue to adhere to its long-term plan to eliminate fund balance deficits and reduce inter-fund borrowing;
- Adhere to the General Fund Contingency Reserve Policy and procedures to ensure that the city has an appropriate level of General Fund reserves; and
- Review all funds with deficit fund balances and develop an appropriate action plan.

City's Response

- a) During FY 2014-15, FY 2015-16 and 2016-17, City did not adhere to its Contingency Policy, as of FY 2017-18 City has been recovering from prior years deficits and started building up a Contingency reserve to meet City's policy. City is committed to its long-term plan to eliminate fund balance deficits and reduce interfund borrowing. Any additional revenues are being held as reserves as opposed to increase expenditures.

- b) Significant deficit spending. FY 2014-18 [sic] and FY 2015-16 City's expenditures exceeded its revenues. On FY 2016-17 City drastically reduced its expenditures to help reduce General Fund deficit. Continuing this practice for FY 2017-18 as well as FY 2018-19. City reduced its workforce as well reducing expenditures while continuing to provide outstanding customer service. City placed a freeze on all new hires only replacements are authorized.
- c) Inaccurate Budget Information. City has improved management communication and prepares monthly Budget to actual reports. Finance staff reviews on regular basis deficit fund balances and meets with Department head to develop action plans in a timely manner.
- d) Lack of timely financial reports. City is working on preparing timely and accurate financial information, for FY 2018-19 City has been preparing quarterly reports to provide to City Council and the community.

**FINDING 2—
Insufficient oversight
of cash flows**

The city did not exercise sufficient oversight of its cash flows and lacked several controls, including:

- Prompt bank reconciliations;
- Treasurer's reports;
- Adequate segregation of duties; and
- Sufficient oversight over cash receipts.

Bank reconciliations were not prepared in a timely manner

For FY 2015-16 and FY 2016-17, we noted that none of the bank reconciliations were prepared within 30 days after the close of the month. In the most extreme case, the city completed the July 2015 reconciliation 462 days late and the July 2016 reconciliation 336 days late.

In addition, no review was performed for 23 of 24 bank reconciliations. Only the June 2017 bank reconciliation, which was completed 129 days late, contained a reviewer signature.

The city's *Cash Management Policy and Procedures* state, in part:

The financial institution where the City's account is maintained should be requested to have the account statement date at the month-end-cut-off to facilitate reconciliation and proper reporting at year-end. All bank accounts should be reconciled within 30 days after the ending statement.

Failure to perform prompt bank reconciliations adversely affects the city's ability to detect errors or irregularities in a timely manner.

Treasurer's reports were not completed

The city failed to comply with GC Section 41004, as it failed to complete treasurer's reports for FY 2015-16 and FY 2016-17.

GC section 41004 states, in part:

Regularly, at least once each month, the city treasurer shall submit to the city clerk a written report and accounting of all receipts, disbursements, and fund balances.

Compliance with GC section 41004 increases the accountability of receipts, disbursements, and fund balances.

Inadequate segregation of duties

For FY 2015-16 and FY 2016-17, a city employee had incompatible cash-handling duties.

Based on interviews with staff, we noted that one employee had physical access to the city's cash and the key to the city vault in the Finance Department, the ability to record and approve journal entries, and access to city bank accounts, and was the main contact for the armored car delivery service.

Proper segregation of duties helps to ensure that funds and assets are properly recorded, protected, and appropriated.

Deficiencies in cash receipt process

For FY 2015-16 and FY 2016-17, the city had internal control deficiencies in the cash receipt process.

We found that the city does not have a daily limit in its cash registers used to receive payments. Moreover, the city does not have a staff member who confirms the beginning balances, which should be \$375, in the cash registers, as is required by city policy. Furthermore, the city does not have desk procedures to provide guidance to city employees.

Cities that collect significant amounts of cash for customer payments are vulnerable to theft. The presence of cash is a vulnerability until the cash is deposited into the bank. With no one to confirm the beginning cash balances, the risk of theft is high.

Recommendation

We recommend that the city:

- Prepare bank reconciliations with dates and signatures, and reconcile items in a timely manner;
- Comply with GC section 41004 and ensure that the City Treasurer submits to the City Clerk monthly written reports and an accounting of all receipts, disbursements, and fund balances;
- Implement policies and procedures to segregate incompatible functions; and
- Develop policies and procedures regarding the cash receipt process and ensure that employees are aware of the requirements for cash handling, including assigning a separate individual to confirm the cash registers' beginning balances.

City's Response

- a) Bank reconciliations were not prepared in a timely manner. City is preparing bank reconciliations within the following 10 days of month end, bank reconciliations are signed and dated by Finance Director.
- b) Treasure's [sic] reports were not completed. City treasurer provides City Clerk and City council biweekly reports of disbursements.
- c) Inadequate segregation of duties. City has implemented procedures to ensure cash handling and segregated incompatible duties

**FINDING 3—
Lack of supporting
documentation for
credit card charges**

The city does not maintain supporting documentation for credit card charges.

For FY 2015-16, we tested \$12,805 (26%) of \$49,975 in credit card charges and found that the city did not have any supporting documentation, such as receipts, for the selected charges.

For FY 2016-17, we tested \$13,811 (28%) of \$49,288 in credit card charges and found that the city did not have any supporting documentation for \$6,120.

The city had some documentation for the remaining \$7,691 in credit card charges in FY 2016-17, but the documentation was insufficient. For example, the city provided us with purchase orders and email confirmations for \$7,586 in hotel charges instead of receipts.

The city should review itemized receipts and Travel-reconciliation Reports for travel expenses such as lodging, meals, and other incidental expenses to adequately support the credit card charges.

The Credit Card Usage section of the city's *Purchasing Policy and Procedures* states, in part:

3. City credit cards shall be available to the City Council and staff for the conduct of official City business included but not limited to the following purposes:
 - b) Authorized travel expenses and hotel charges, which shall subsequently be documented on the travel reconciliation report
 - c) To charge the cost of meals when required in the conduct of official business except when an employee is traveling in a per diem basis
3. [sic] Only the City Manager, Finance Director and City Council are authorized to carry a bank credit card at all times.
4. All receipts must be turned in when credit card is turned in.

The city failed to enforce its credit card usage policy and, as a result, \$26,616 in credit card charges were inadequately documented. It is unclear whether these charges were work-related and allowable.

Recommendation

We recommend that the city:

- Adhere to its credit card usage policy;
- Review and approve all credit card charges; and
- Retain supporting documents, such as receipts.

City's Response

City has implemented internal controls to ensure employees are adhering to Credit Card policy. Furthermore, city staff ensures all credit charges follow purchasing procedure including signature approval. Receipts for credit card purchases are kept along with statement.

**FINDING 4—
Insufficient oversight
of a forensic audit
and related invoices**

The city did not exercise sufficient oversight of a “forensic audit” and failed to review the invoices associated with it.

We reviewed eight of 14 professional-service contract agreements from FY 2015-16 to FY 2016-17 to determine whether the city adhered to the terms, conditions, and elements of service agreements with vendors. We found one professional-service agreement that was questionable.

According to the professional service agreement, Ahern, Adcock, Devlin, LLP (Ahern) was contracted to perform a forensic audit and provide the city with a report on its results. The service agreement was written in a memo style, and lacked key clauses such as an insurance requirement and a maintenance-of-accounting-records clause. In addition, the scope of work did not include a detailed description of the work to be performed or a completion date.

We discussed the professional services agreement with city management during our fieldwork. According to city management, Ahern was contracted to provide income reports for the Community Development Block Grant (CDBG) program for its Housing Department. However, the contract with Ahern states, in part:

Ahern will provide forensic audit services for specifically identified funds, which will be identified at an initial meeting between City and Ahern, and/or in any follow-up communications. The time period under audit will be from July 1, 2010 through June 30, 2015. Ahern will issue a report with respect to conclusions reach as a result of the work performed.

The city failed to amend the original contract to reflect the change in the level of services received.

As of July 2018, the city paid Ahern \$173,429 for its services. We reviewed three of 31 invoices and noted that the invoices were not properly itemized as required per the agreement, which states, in part:

Ahern will provide periodic (monthly) progress billings during the course of its engagement. One reason for itemized periodic bills is to give the city the opportunity to bring any problems promptly to Ahern's attention.

City management failed to properly administer a contract for reporting services, as it:

- Mischaracterized the report-preparation services as forensic auditing services;
- Neglected to amend the contract; and
- Approved and paid invoices that lacked sufficient detail.

Recommendation

We recommend that the city:

- Establish a contract management system to ensure that city management is monitoring service contracts;
- Ensure that contract service agreements include a detailed description of the work to be performed, a completion date, an insurance requirement, and a maintenance-of-accounting-records clause;
- Review invoices to ensure that they contain sufficient detail about services rendered; and
- Amend contracts when there is a change in the level of service.

City's Response

Through City Clerk's office City ensures contracts and agreements include a detailed description of the scope of work to be performed, completion date and all necessary requirements. Once services have been rendered and payment is required Finance staff reviews invoice for accuracy.

FINDING 5— Lack of a written contract and City Council approval for change orders

The city did not have a formal contract for a public works utility project. Furthermore, the city did not adhere to the change order process. City management approved of two change orders without the City Council's approval.

We attempted to review two of 16 public works contract agreements from FY 2015-16 to FY 2016-17 to verify the city properly followed its contract procurement process. However, the city could not provide one of the two agreements, which was with Unicom Government, Inc.

Subsequently, we reviewed invoices, a purchase order, and City Council meeting minutes to obtain information related to the Unicom Government, Inc. project. We determined that on January 6, 2015, city management hired Unicom Government, Inc. to upgrade water meters for \$4,814,131. However, instead of providing a written contract, the project was initiated by a purchase order approved by the Public Works Director, Finance Director, and City Manager.

In addition, the City Manager approved of two change orders for \$29,290 and \$706,948; however, change orders require City Council approval. In total, \$736,238 in change orders did not comply with the city's Purchasing Policy and Procedures.

The city's *Purchasing Policy and Procedures* states, in part:

All public works and utility construction and/or improvement contracts in the amount of \$100,000 or more that require a Change Order, which results in either an increase or a deduction in the original contract amount must be approved by the City Council.

The city circumvented its *Purchasing Policy and Procedures* when it bypassed City Council approval for Unicom Government Inc.'s purchase order and change orders.

Recommendation

We recommend that the city:

- Establish a contract management system to ensure that contract agreements are properly approved;
- Retain original contracts for record-keeping purposes; and
- Adhere to the *Purchasing Policy and Procedures* as it pertains to change orders for public works contracts.

City's Response

Through City Clerk's office City ensures contracts and agreements follow Purchasing Policy and Procedures to include a detailed description of the scope of work to be performed, completion date and all necessary requirements, per City's guidelines.

FINDING 6— Mismanagement of grants

The California Department of Housing and Community Development (HCD) froze the city's housing grants because the city mismanaged the grants and did not comply with its *Grant Management Policy and Procedures*.

HCD conducted a monitoring review of the city's CDBG program. In a letter dated December 29, 2015, HCD sent the city the results of its review, which indicated that the city did not provide all of the records that were requested. In its report, HCD identified, in part, the following issues:

- The City did not provide evidence to show which program accounts were charged after accounting reconciliations were made.
- The City spent Program Income funds after the State CDBG Program had informed the City, in writing, on December 9, 2014 that all grant and Program Income fund expenditures were to cease immediately.
- The City financial records are not adequate to properly account for specific CDBG expenditures.
- The City's CDBG Program Income account was running negative balances in 2015.

Because of these deficiencies, HCD froze the city's housing grants, and the city lost its opportunity to apply for future grants. In addition, we found that the city failed to follow its *Grant Management Policy and Procedures*.

The city's *Grant Management Policy and Procedures* state, in part:

ROLES AND RESPONSIBILITIES

Grant award and implementation

- b. Maintain financial and other records in accordance with grant requirements.
- c. Complete and submit required reports timely, including requests for refunds.
- d. Monitor grant expenditures to ensure expenses are recorded in the proper accounts; compare budget to actual and prepare Transfer of Appropriation forms and submit to the Finance Department as necessary.
- g. Ensure compliance with grant requirements, paying special attention to those areas where the grantor's administrative procedures are different than the City's.

Grants are essential to a city's financial health, as indicated in the city's *Grant Management Policy and Procedures*, which state, in part:

Grants can be a valuable resource in challenging economic times, especially to fund capital expenditures. The City of Calexico is faced with an overall decline in revenues and grants provide services and activities that might not otherwise be available to our residents. Grants have become more competitive as funding resources are reduced, therefore seeking grants that help the city to achieve its goals and objectives must play a key role in the City's financial planning.

The City will seek grant funding for activities that are determined to be in the best interest of the residents and that further the functions of the city....

Current city staff is working to re-create records and maintain an adequate filing system. HCD recognized the city's effort to improve its grant-management process and resumed accepting applications from the city for housing grants.

Recommendation

We recommend that the city:

- Monitor its CDBG program to ensure compliance with HCD requirements; and
- Adhere to the *Grant Management Policy and Procedures*.

City's Response

Housing and Finance Department has City staff working collectively to ensure compliance and monitoring of expenditures according to each specific grant.

**FINDING 7—
Failure to collect
Transient Occupancy
Tax Revenues in a
timely manner**

The city did not monitor the collection process for the Transient Occupancy Tax (TOT) and failed to assess delinquent taxes in a timely manner.

We reviewed the city's TOT worksheet and noted that \$508,460 in TOTs for June 30, 2015, to September 30, 2017, was not collected within the required timeframe. Subsequently, we reviewed the city's TOT delinquent letters and found that the city understated delinquent TOTs by \$53,577 for June 30, 2015, to September 30, 2017. We also found that the city did not mail the letters until May 2018.

The city has collected TOTs totaling \$508,460; it is currently working to collect the remaining \$53,577 in delinquent taxes.

Municipal Code section 3.24.070 Penalties and Interest states:

- A. Original Delinquency. Any operator who fails to remit any tax imposed by this chapter within the time required shall pay a penalty of ten percent of the amount of the tax in addition to the amount of the tax.
- B. Continued Delinquency. Any operator who fails to remit any delinquent remittance on or before a period of thirty days following the date on which the remittance first became delinquent shall pay a second delinquency penalty of ten percent of the amount of the tax in addition to the amount of the tax and the ten percent penalty first imposed.

The timely collection of the TOT is vital to the city because it assists in funding the city's General Fund and the city's safety services.

Recommendation

We recommend that the city adhere to its Municipal Code and establish policies and procedures to monitor, bill, and collect the TOT within the required timeframe.

City's Response

City adheres to its municipal code and is following Policies and Procedures. Revenue Officer is monitoring Transient Occupancy Tax payments, if delinquencies are found businesses are notified on a timely manner via mail.

**FINDING 8—
Performance
evaluations were not
conducted in a timely
manner**

The city did not conduct performance evaluations consistently.

For FY 2015-16, we reviewed the city's employee roster and requested to review performance evaluations for 21 of 160 employees. The city informed us that it did not prepare any performance appraisals for that year. For FY 2016-17, we requested to review performance evaluations for 21 of 153 employees and found that the city had completed only one evaluation of the 21 employees.

An organization should attract, develop, and retain competent individuals in alignment with the organization's objectives. Performance evaluations are a key tool in helping an organization evaluate and develop its employees.

The Performance Evaluations section of the city's *Personnel Policies and Procedures Manual* states, in part:

A performance evaluation for each employee shall be made at the end of the employee's probationary period and annually thereafter.

By not evaluating the performance of its employees in a timely manner, the city failed to demonstrate its commitment to competence.

Recommendation

We recommend that the city conduct performance evaluations in a timely manner and retain copies in the employees' personnel files.

City's Response

Human Resources Manager is enforcing performance evaluations by Managers/Directors/Department Heads, monthly HR Manager will remind Department Heads of the need to comply with employee evaluations, by complying with employee evaluations City demonstrates its commitment to provide an excellent level of service and to competency.

**FINDING 9—
Inadequate journal
entry controls**

The general application controls of the city's accounting system are inadequate because the city does not restrict the ability to create and post journal entries to only authorized individuals. All Finance Department employees have the ability to enter and process journal entries without management approval.

Without adequate journal entry controls, the city may be unable to detect or prevent individuals from altering data to conceal fraudulent transactions.

Recommendation

We recommend that the city restrict accounting system access to authorized individuals, and require management approval for journal entries.

City's Response

Finance Management has already implement controls to ensure Journal entry posting is limited only to Management. Finance Staff is limited to creating Journal Entries for management approval, once approved by management, Finance Manager or Finance Director will post and commit to General Ledger.

**FINDING 10—
Lack of staff to
perform critical
functions**

Between FY 2015-16 and FY 2016-17, the city's Finance Department did not train back-up staff to perform critical functions and did not develop a succession plan.

We found that the city lacked back-up staff for critical functions such as daily deposit reconciliations, bank reconciliations, billing and collection, and payroll functions. These positions are critical for the success of the city's finance operations. We also noted that the majority of staff members in the Finance Department was not cross-trained.

It is important for the city to cross-train back-up staff in case of a vacancy or an emergency, or for when staff is busy with other duties. Having cross-trained back-up staff avoids disruptions in the city's day-to-day operations.

We also noticed that the city did not have a succession plan. A succession plan encourages the city to develop staff and prepares staff members to succeed in key positions. A succession plan would help the city ensure that there is a smooth transition when key individuals leave city employment.

Recommendation

We recommend that the city:

- Train Finance Department staff to perform back-up duties for accounting functions; and
- Develop a succession plan to help staff transition smoothly into positions with additional responsibilities.

City's Response

Finance Management is working on professional development and back up for key positions as well as succession plan to aide staff when transitioning.

FINDING 11— Incomplete and outdated administrative policies and procedures manuals

The city did not periodically review and update its administrative policies and procedures manuals, which are currently incomplete and inconsistent with existing processes.

Specific deficiencies related to the city's administrative policies and procedures are as follows:

- The *Personnel Rules and Regulations Manual*, setting forth the policies and procedures related to the city's employment practices, was last revised on June 1995. Furthermore, the city is only now finalizing a formal employee handbook.
- The *Financial Policies and Procedures Manual* is outdated. In particular, the city did not have policies and procedures to offer guidance on its new accounting system, which was implemented during FY 2014-15.

Following are outdated city accounting policies and procedure documents and the dates on which they were last revised:

- *Internal Control Policy*, last revised July 2011;
- *Cash Management Policy & Procedures*, last revised July 2011;
- *Purchasing Policy & Procedures*, last revised March 19, 2014;
- *Capital Assets Policy & Procedures*, last revised March 17, 2011;
- *General Fund Contingency Reserve Policy*, last revised January 18, 2011;

- *Grant Management Policy & Procedures*, last revised September 8, 2010;
- *Budget Adoption Process, Budget Calendar, & Budget Guide*, last revised January 1, 2010;
- *Appropriation Limit*, last revised June 16, 2009;
- *Budget Stabilization Policy*, last revised January 18, 2011;
- *Fund Balance Policy for General Fund*, last revised June 29, 2011;
- *Interfund Loan/Advance Policy*, last revised November 1, 2011; and
- The city lacks a written computer disaster policy to help minimize disruptions from computer failure following a disaster.

As a way of implementing best practices, the Government Finance Officers Association (GFOA) recommends that governments establish computer disaster-recovery policies and procedures for minimizing disruptions in technologies following a disaster. As stated on the GFOA website, computer disaster recover policies and procedures should:

- Formally assign disaster recovery coordinators for each agency or department to form a disaster recovery team. The responsibilities of team members should be defined and a current list of team members and their telephones numbers should be maintained...
- Require the creation and preservation of back-up data. A governments procedures in this regard should cover the regular and timely back-up of computer data... The government should also ensure the security of back-up data both during transport off site and during storage off site.
- Make provisions for alternative processing of data following a disaster.

Although most city employees know their own current processes, the formal policies and procedures are outdated and need revision.

A well-designed and properly maintained system of accounting policies and procedures enhance both accountability and consistency. The resulting documentation can also serve as a useful training tool for staff. Undocumented and outdated policies may result in unclear roles and responsibilities, and lead to improper handling of transactions.

Recommendation

We recommend that the city:

- Review and update its *Personnel Rules and Regulations Manual* and develop an employee handbook;
- Review and update its *Financial Policies and Procedures Manual* to ensure consistency with current processes and organizational structure, including the Springbrook accounting system;

- Develop and maintain a written computer disaster policy; and
- Disseminate the updated administrative policies and procedures manuals to all employees. The manuals should clearly state the authority and responsibility of all employees, especially the authority to approve transactions and the responsibility for the safekeeping of assets and records.

City's Response

Human Resources is currently working on updating City's Personnel Rules and Regulations Manual and developing an Employee Handbook, goal is to complete both manuals before end of current Fiscal Year, once completed City's personnel will receive an update copy. Finance will start working on reviewing and updating City's Accounting Manual Next [sic] Fiscal Year to ensure Policies and Procedures are current and relevant.

Appendix— Evaluation of Internal Control System¹

Internal Control Attributes		Present? Y / N		Functioning? Y / N		Explanations/Conclusions
CONTROL ENVIRONMENT						
1.	Demonstrates Commitment to Integrity and Ethical Values					
	a. Sets the tone at the top	X		X		
	b. Establishes standards of conduct	X			X	The city lacked updated policies and procedures, as well as a formal employee handbook. Refer to Finding 11.
	c. Evaluates adherence to standards of conduct	X			X	The city did not conduct performance evaluations in FY 2015-16, and only conducted one in FY 2016-17. Refer to Finding 8.
2.	Exercises Oversight Responsibility					
	a. Establishes oversight structure and responsibilities	X		X		
	b. Provides oversight for the system of internal control	X			X	The city lacked a budget throughout FY 2015-16, precluding budget-to-actual monitoring. City management failed to exercise oversight by failing to update the city’s policies and procedures to reflect its new Springbrook accounting system. Refer to Finding 11.
	c. Provides input for remediation of deficiencies in the internal control system	X		X		

Appendix (continued)

Internal Control Attributes		Present?		Functioning?		Explanations/Conclusions
		Y	N	Y	N	
3.	Establishes Structure, Authority, and Responsibility					
	a. Considers organizational structures	X		X		
	b. Defines, assigns, and limits authorities and responsibilities	X			X	The city did not limit journal entry privileges to only authorized users. Refer to Finding 9.
	c. Develops and maintains documentation of the internal control system		X		X	The city did not develop and maintain documentation of its current internal control system related to the Springbrook accounting system. Refer to Finding 11.
4.	Demonstrates Commitment to Competence					
	a. Establishes expectations of competence for key roles	X		X		
	b. Attracts, develops, and retains competent personnel	X			X	The city experienced high turnover between FY 2013-14 and FY 2016-17.
	c. Plans and prepares for succession		X		X	The city does not have a succession plan to back up staff for key positions. Refer to Finding 10.
5.	Enforces Accountability					
	a. Enforces accountability of personnel through mechanisms such as performance appraisals and disciplinary actions	X			X	The city did not conduct annual employee performance evaluations. Refer to Finding 8.
	b. Considers excessive pressures	X		X		
RISK ASSESSMENT						
6.	Defines Objectives and Risk Tolerances					
	a. Defines objectives in specific and measurable terms		X		X	The city did not have a budget in place in FY 2015-16. Refer to Finding 1.
	b. Considers risk tolerances for the defined objectives		X		X	Refer to 6.a

Appendix (continued)

Internal Control Attributes		Present?		Functioning?		Explanations/Conclusions
		Y	N	Y	N	
7.	Identifies, Analyzes, and Responds to Risks					
	a. Identifies risks throughout the entity to provide a basis for analyzing risks		X		X	The city did not identify, analyze, and respond to the General Fund shortfalls until the fund was in a deficit the city did not properly manage its housing grants. Refer to Findings 1 and 6.
	b. Analyzes the identified risks to estimate their significance		X		X	Refer to 7.a.
	c. Determines how to respond to risks		X		X	Refer to 7.a.
8.	Assesses Fraud Risk					
	a. Considers various types of frauds	X		X		
	b. Assesses fraud risk factors - incentives and pressures, opportunities, and attitudes and rationalizations	X			X	One employee in the Finance Department had many incompatible duties and many opportunities to commit fraud. Refer to Finding 2.
	c. Analyzes and responds to identified fraud risks	X		X		
9.	Identifies, Analyzes, and Responds to Change					
	a. Identifies and assesses changes that could significantly impact the entity's internal control system	X			X	The city did not update its policies and procedures when it changed accounting systems. Refer to Finding 11. The city failed to monitor and collect timely TOT revenue. Refer to Finding 7.
	b. Analyzes and responds to identified changes and related risks in order to maintain an effective internal control system	X			X	Refer to 9.a.

Appendix (continued)

Internal Control Attributes		Present? Y / N	Functioning? Y / N	Explanations/Conclusions
CONTROL ACTIVITIES				
10.	Designs Control Activities			
	a. Designs control activities in response to the entity’s objectives and risks	X	X	The city did not limit journal entry privileges to only authorized users. Refer to Finding 9.
	b. Designs appropriate types of control activities for the entity’s internal control system	X	X	The city had insufficient control over cash flows. Refer to Finding 2.
	c. Considers at what level activities are applied	X	X	In FY 2015-16 and FY 2016-17, the city’s credit card charges were unsupported. Refer to Finding 3. The professional service agreement for Ahern lacked a detailed description of work to be performed, and invoices were not properly itemized when submitted for payment. Refer to Finding 4. The contract agreement for Unicom Government, Inc. was not prepared and the City Council did not approve the first two change orders of the contract. Refer to Finding 5.
	d. Addresses segregation of duties	X	X	The city assigned one Finance Department employee incompatible duties. The employee had access to the vault, had physical access to cash, could record the journal entries, had access to city bank accounts, and was the only contact individual who could contact the city’s armored car delivery service. Refer to Finding 2.
11.	Designs General Control over Information System			
	a. Designs the entity’s information system to respond to the entity’s objectives and risks	X	X	The city’s general application control activities of the Springbrook accounting system do not restrict access to only appropriate individuals. Refer to Finding 9.

Appendix (continued)

Internal Control Attributes		Present?		Functioning?		Explanations/Conclusions
		Y	N	Y	N	
b.	Designs appropriate types of control activities – general and application control activities, in the entity’s information system	X			X	Refer to 11.a.
c.	Designs control activities over the information technology infrastructure to support the completeness, accuracy, and validity of information processing	X			X	Refer to 11.a
d.	Establishes relevant security management process control activities	X			X	Refer to 11.a.
e.	Establishes relevant technology acquisition, development, and maintenance process control activities	X		X		
12.	Implements Control Activities					
a.	Documents in policies and procedures the internal control responsibilities of the organization	X			X	The city’s policies and procedures were outdated. Refer to Finding 11.
b.	Reassesses policies and procedures through periodic review of control activities	X			X	Refer to 12.a.
INFORMATION AND COMMUNICATION						
13.	Uses Quality Information					
a.	Identifies information requirements		X		X	The city lacked updated policies and procedures, a formal employee handbook, and an adopted budget for FY 2015-16.
b.	Obtains relevant data from reliable internal and external sources in a timely manner		X		X	Budgetary information was unreliable and basic financial statements were not issued on time. Moreover, the budget report for FY 2015-16 was not adopted in a timely manner. Refer to Finding 1.
c.	Processes the obtained data into quality information within the entity’s information system	X			X	Bank reconciliations and treasurer’s reports were not completed and reviewed in a timely manner. Refer to Finding 2

Appendix (continued)

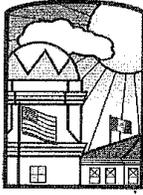
Internal Control Attributes		Present?		Functioning?		Explanations/Conclusions
		Y	N	Y	N	
14.	Communicates Internally					
	a. Communicates internal control information throughout the entity using established reporting lines	X			X	The city did not collaborate on the budget process, which led to inaccurate figures reported in the budget report for FY 2014-15, and the city did not adopt the budget report for FY 2015-16 in a timely manner. Refer to Finding 1.
	b. Selects appropriate methods of communication and considers factors such as audience, nature of information, availability, cost, and legal or regulatory requirements	X			X	Refer to 14.a.
15.	Communicates Externally					
	a. Communicates to external parties, and obtains quality information from external parties using established reporting lines		X		X	The city failed to produce its basic financial statements in a timely manner. Refer to Finding 1.
	b. Selects appropriate methods of communication and considers factors such as audience, nature of information, availability, cost, and legal or regulatory requirements		X		X	Refer to 15.a.
MONITORING						
16.	Conducts Ongoing Monitoring Activities					
	a. Establishes a baseline to monitor the internal control system	X			X	The city did not prepare and review bank reconciliations in a timely manner. Moreover, city management failed to investigate variances between the cash balances of bank statements and the city's financial report. Refer to Finding 2. The city did not adopt the budget report for FY 2015-16 in a timely manner. The city did not conduct annual employee performance evaluations. Refer to Finding 8.
	b. Considers a mix of ongoing and separate evaluations	X			X	Refer to 16.a.

Appendix (continued)

Internal Control Attributes		Present?		Functioning?		Explanations/Conclusions
		Y	N	Y	N	
	c. Objectively evaluates and documents the results of ongoing monitoring and separate evaluations to identify internal control issues	X			X	Refer to 16.a
17.	Evaluates Issues and Communicates and Remediates Deficiencies					
	a. Reports internal control issues through established reporting lines to the appropriate internal and external parties in a timely manner	X			X	The city failed to produce its basic financial statements in a timely manner. Refer to Finding 1.
	b. Evaluates and documents internal control issues and determines appropriate corrective actions for internal control deficiencies	X		X		
	c. Monitors, completes, and documents corrective actions	X		X		

¹ The evaluation tool is based on the guidelines established by the GAO’s Green Book. It serves as a guideline to aid local agencies in identifying internal control deficiencies. The SCO uses the same evaluation tool on all of its administrative and internal control system reviews of local government agencies, regardless of size.

**Attachment—
City of Calexico's Response to Draft Review Report**



CITY OF CALEXICO

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Finance Department

January 15, 2019

Efren Loste
Chief, Local Government Audits Bureau
State Controller's Office, Division of Audits
Post Office Box 942850

Dear Mr. Loste,

Below response to your findings correspondence dated December 10, 2018, to draft report of the State Controller's Office review of the City of Calexico's internal control system.

FINDING 1- DEFICIT FUND BALANCE IN THE GENERAL FUND

- a) During FY 2014-15, FY 2015-16 and 2016-17, City did not adhere to its Contingency Policy, as of FY 2017-18 City has been recovering from prior years deficits and started building up a Contingency reserve to meet City's policy. City is committed to its long-term plan to eliminate fund balance deficits and reduce interfund borrowing. Any additional revenues are being held as reserves as opposed to increase expenditures.
- b) Significant deficit spending. FY 2014-18 and FY 2015-16 City's expenditures exceeded its revenues. On FY 2016-17 City drastically reduced its expenditures to help reduce General Fund deficit. Continuing this practice for FY 2017-18 as well as FY 2018-19. City reduced its workforce as well reducing expenditures while continuing to provide outstanding customer service. City placed a freeze on all new hires only replacements are authorized.
- c) Inaccurate Budget Information. City has improved management communication and prepares monthly Budget to actual reports. Finance staff reviews on regular basis deficit fund balances and meets with Department head to develop action plans in a timely manner.
- d) Lack of timely financial reports. City is working on preparing timely and accurate financial information, for FY 2018-19 City has been preparing quarterly reports to provide to City Council and the community.

FINDING 2- INSUFFICIENT OVERSIGHT OF CASH FLOWS.

- a) Bank reconciliations were not prepared in a timely manner. City is preparing bank reconciliations within the following 10 days of month end, bank reconciliations are signed and dated by Finance Director.

Viva Calexico!

- b) Treasure's reports were not completed. City treasurer provides City Clerk and City council biweekly reports of disbursements.
- c) Inadequate segregation of duties. City has implemented procedures to ensure cash handling and segregated incompatible duties.

FINDING 3- LACK OF SUPPORTING DOCUMENTATION FOR CREDIT CARD CHARGES.

- a) City has implemented internal controls to ensure employees are adhering to Credit Card policy. Furthermore, city staff ensures all credit charges follow purchasing procedure including signature approval. Receipts for credit card purchases are kept along with statement.

FINDING 4- INSUFFICIENT OVERSIGHT OF A FORENSIC AUDIT AND RELATED INVOICES.

- a) Through City Clerk's office City ensures contracts and agreements include a detailed description of the scope of work to be performed, completion date and all necessary requirements. Once services have been rendered and payment is required Finance staff reviews invoice for accuracy.

FINDING 5- LACK OF WRITTEN CONTRACT AND CITY COUNCIL APPROVAL FOR CHANGE ORDERS.

- a) Through City Clerk's office City ensures contracts and agreements follow Purchasing Policy and Procedures to include a detailed description of the scope of work to be performed, completion date and all necessary requirements, per City's guidelines.

FINDING 6- MISMANAGEMENT OF GRANTS

- a) Housing and Finance Department has City staff working collectively to ensure compliance and monitoring of expenditures according to each specific grant.

FINDING 7- FAILURE TO COLLECT TRANSIENT OCCUPANCY TAX REVENUES IN A TIMELY MANNER.

- a) City adheres to its municipal code and is following Policies and Procedures. Revenue Officer is monitoring Transient Occupancy Tax payments, if delinquencies are found businesses are notified on a timely manner via mail.

FINDING 8- PERFORMANCE EVALUATIONS WERE NOT CONDUCTED IN A TIMELY MANNER.

- a) Human Resources Manager is enforcing performance evaluations by Managers/Directors/ Department Heads, monthly HR Manager will remind Department Heads of the need to comply with employee evaluations, by complying with employee evaluations City demonstrates its commitment to provide an excellent level of service and to competency.

FINDING 9 – INADEQUATE JOURNAL ENTRY CONTROLS.

- a) Finance Management has already implement controls to ensure Journal entry posting is limited only to Management. Finance Staff is limited to creating Journal Entries for management approval, once approved by management, Finance Manager or Finance Director will post and commit to General Ledger.

FINDING 10 – LACK OF STAFF TO PERFORM CRITICAL FUNCTIONS.

- a) Finance Management is working on professional development and back up for key positions as well as succession plan to aide staff when transitioning.

FINDING 11 -INCOMPLETE AND OUTDATED ADMINSTRATIVE POLICIES AND PROCEDURE MANUAL.

- a) Human Resources is currently working on updating City's Personnel Rules and Regulations Manual and developing an Employee Handbook, goal is to complete both manuals before end of current Fiscal Year, once completed City's personnel will receive an update copy. Finance will start working on reviewing and updating City's Accounting Manual Next Fiscal Year to ensure Policies and Procedures are current and relevant.

Regards,



Karla E Lobatos
Finance Director
City of Calexico

Cc: Lewis Pacheco, Mayor City of Calexico
David Dale, City Manager, City of Calexico
Miguel Figueroa, Assistant City Manager
City of Calexico
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