

**Deloitte.**

City of Fort Worth,  
Texas

Report to Management  
Year Ended September 30, 2009



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March 23, 2010

The Honorable Mayor and City Council Members  
City of Fort Worth  
Fort Worth, Texas

Dear Mayor and City Council Members:

In planning and performing our audit of the financial statements of the City of Fort Worth (the "City") as of and for the year ended September 30, 2009 (on which we have issued our report dated March 23, 2010, which included a reference to other auditors), in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, in connection with our audit, we have identified, and included in the attached Appendix, certain matters involving the City's internal control over financial reporting that we consider to be material weaknesses or significant deficiencies under standards established by the American Institute of Certified Public Accountants.

We have previously communicated certain matters noted during our audit of the financial statements of the City for the year ended September 30, 2008, which we considered to be material weaknesses or significant deficiencies, in our report to management and those charged with governance dated June 23, 2009. As of the date of this report, we believe the City has not remediated certain of these material weaknesses or significant deficiencies. We have outlined in the attached Appendix those previously reported matters which we believe have not yet been remediated.

We have also identified, and included in the attached Appendix, other deficiencies involving the City's internal control over financial reporting and other matters as of September 30, 2009 that we wish to bring to your attention.

This report does not include the communications of the other auditors on internal control over financial reporting and other matters that are reported on separately by those auditors.

The definitions of a deficiency, a material weakness, and a significant deficiency are also set forth in the attached Appendix.

A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix and should be read in conjunction with this report.

Although we have included management's written response to our comments in the attached Appendix, such responses have not been subjected to the auditing procedures applied in our audit and, accordingly, we do not express an opinion or provide any form of assurance on the appropriateness of the responses or the effectiveness of any corrective actions described therein.

This report is intended solely for the information and use of management, the City Council, others within the organization, and federal and state awarding agencies and is not intended to be, and should not be, used by anyone other than these specified parties.

Yours truly,

*Deloitte & Touche LLP*

## SECTION I — MATERIAL WEAKNESSES OR SIGNIFICANT DEFICIENCIES IDENTIFIED IN A PREVIOUS AUDIT THAT HAVE NOT YET BEEN REMEDIATED

We identified and previously communicated the following deficiencies that were considered to be a material weakness or significant deficiency in the City's internal control over financial reporting during our audit of the financial statements of the City for the year ended September 30, 2008. As of the date of this report, we believe these deficiencies have not yet been remediated by the City:

### *Material Weakness: Accounting for Capital Assets (updated from fiscal years 2004-2008)*

Criteria – Proper accounting for capital assets requires the maintenance of an accurate, detailed listing of all expenditures that meet the City's criteria for capitalization – those that are long-lived and meet the City's capitalization threshold.

Condition – A significant amount of effort has been made by the City over the past several years to improve the practices used to account for and report the City's investment in capital assets. For fiscal 2008 and 2009, we did not note the level of errors that were noted in previous years related to capital assets. Audit adjustments for fiscal 2008 and 2009 related to capital assets were not material and were generally isolated to specific areas of the accounting process. However, there are certain matters that remain unresolved; and when considered cumulatively, we believe these matters represent a potential risk of material error in future years and therefore warrant continued attention by City management. These matters include:

- A lack of formal written capital asset policies and procedures to be applied by all departments of the City.
- An inconsistent application by various departments of the City's policies and procedures as currently implemented.
- A lack of proper communication between the Financial Management Services Department and other City departments regarding Construction-in-Progress ("CIP"), resulting in improper classification of certain projects within CIP.
- A loss of data from the previous fixed asset system that contributed to improper amounts in disposals of replaced water pipe.

Context – Capital assets represent the City's single largest asset. As of September 30, 2009, the City has over 1,500 projects set up to track and manage CIP costs.

Cause – The City has multiple departments and contractors managing construction projects and capital assets without consistent, complete guidance on the proper procedures to account for transactions or purchases. Formal procedures are not in place to establish timely communication regarding capital asset transactions between the various departments and the Financial Management Services Department.

Effect – Inconsistent practices have developed throughout the City for accounting for CIP. Errors in accounting for capital assets could have a material effect on the City's financial statements. We believe that the City's current system of accounting for capital assets (both electronic and manual) is not sufficiently designed or implemented to prevent or detect potential material errors

in capital assets without a significant effort made at year-end to review transactions for the existence of such errors.

Recommendation – The following recommendations should be considered by City management.

- Implement a more sophisticated system of accounting for capital assets. Such a system should contain automated controls to ensure proper accounting and reconciliation of capital assets. However, consider the importance of fully integrating an electronic capital asset system with the City's general ledger system and plan appropriate timing for the implementation of any new capital asset system relative to the City's overall ERP implementation time-table.
- Develop a City-wide policy that defines when CIP projects are considered complete and should be transferred to completed assets. Develop a City policy that defines the date on which developer contributions should be added to capital assets. In addition, develop consistent policies on accounting for capital assets in general and the related reconciliation processes. Ensure that such policies are implemented and enforced.
- Implement a policy to count the assets of each department on a rotation basis. Ensure that each asset is counted at least biennially, in order to comply with the requirements established for Federally-funded assets.
- On an overall basis, improve communication between the operating departments and the Financial Management Services Department related to capital assets.

Views of Responsible Officials – Concur. At the end of the 3rd quarter of each fiscal year, City departments will receive all asset listings pertaining to their group regardless of type of asset (i.e. improvements, buildings, infrastructure, etc.) This will ensure that each department's assets are consistent with calculated depreciation, yearly additions and deletions.

The Financial Management Services Department's (FMS) Accounting Division will require each department to compare its information – resolving any differences with Accounting's records. This process will allow for a common information stream for internal and external users.

Additionally, the FMS is currently working with an outside consultant to identify and document processes and procedures related to construction-in-progress and capital asset tracking. The City is also seeking to partner with an external consultant to complete citywide policies relative to capital asset management. These efforts should result in improved identification, accounting, and reporting of the City's capital assets. This includes 1) properly capturing and accounting for contributed assets; 2) reconciling detailed capital asset records to the general ledger; 3) assessing if all assets are accounted for (i.e. counting assets on a rotation basis); 4) evaluating the useful life and salvage value for classes or types of capital assets; 5) complying with grant requirements for federally funded assets; and 6) otherwise ensuring proper internal controls for City capital assets.

To better improve communications with departments, FMS is also using the Fiscal Accountability Committee to educate and coordinate capital asset matters. Future plans are to develop and administer training on accounting and fiscal topics, which includes providing guidance and instruction on proper capital asset management.

The abovementioned will be facilitated with the selection and implementation of an Enterprise Resource Planning (ERP) financial system. This system will provide the means to better administer and enforce policies and procedures for overall accounting operations, inclusive of

capital assets. Planning, requirements gathering, and system selection is in the initial stage, with system implementation scheduled for Fiscal Year 2012.

***Significant Deficiency: Accounting for Contractual Arrangements in a Decentralized Environment (updated from two related Material Weakness in fiscal year 2008)***

Criteria – Proper and timely accounting for all contractual arrangements is important to a proper presentation of the business operations of the City within the financial statements.

Condition – During fiscal 2009 the Financial Management Services Department (“FMS”) was informed that in a previous year, the City had entered in to a lease purchase obligation that placed approximately \$9 million into trust for the purchase of certain equipment. However, the transaction was not recorded in the City’s financial statements. Upon discovery of the account, FMS personnel researched the issue and recorded an adjustment to the City’s accounting records.

Context – The total amount of the funds in this case was approximately \$9 million.

Cause – There appears to be incomplete communication between various departments and the Financial Management Services Department. Currently, the accounting function is decentralized throughout the City with certain financial operations being handled by individuals within the operating departments rather than by Financial Management Services Department personnel.

Effect – Improper or untimely recording of contracts and transactions that occur within the various departments of the City could cause the City’s financial statements to be misstated.

Recommendation – Implement a formal communication process between all other departments and the Financial Management Services Department to properly report on a timely basis all new contractual arrangements that occur throughout the year. Consider consolidation of all financial operations within the Financial Management Services Department so that all contracts and other special transactions are accounted for in a proper and timely manner.

Views of Responsible Officials – Concur. Controls over capturing, recording, and reporting of all financial transactions are of the utmost importance to the City. Financial Management Services (FMS) has established the Fiscal Accountability Committee (FAC) as a means to promote more effective communications throughout the City regarding fiscal matters. FMS has also employed an outside consultant to assist in developing fiscal related policies (Finance Directives), which should help with consistency and serve as guidelines to departments for proper accounting and financial reporting. This includes better communication between FMS and other departments.

The City is also in the process of implementing an Enterprise Resource Planning system. As part of phase II of this implementation, the City is completing a re-organization to properly align City resources with business objectives. This process has prompted discussions with the City Manager’s Office regarding centralization of fiscal services. This concept is slated to be discussed during the upcoming budget preparation sessions. In addition, a Request for Proposal is currently being prepared for consulting services to assist the City in determining the best model for providing citywide fiscal services. This action is anticipated to be completed by Fiscal Year 2012.

***Significant Deficiency: Documentation of Policies and Procedures Related to Accounting and Financial Reporting (updated from fiscal years 2006-2008)***

Criteria – Policies and procedures related to control activities should be adequately documented in order to provide a consistent framework for the application of accounting and reporting.

Condition – There is currently a general lack of documented policies and procedures related to accounting and reporting. As a result, there are instances of improper accounting entries recorded that require subsequent correcting journal entries. The City is currently using a combination of intensive internal supervisory reviews as well as additional reviews by an outside consultant to analyze year-end trial balances and make corrections before performing final closes and preparing financial statements. This process appears to be identifying most errors; however, a better process would be the correct recording of entries initially and prior to review by supervisors or consultants. Heavy reliance on this review process could result in some errors not being detected and corrected on a timely basis.

Context – Current governmental accounting and reporting requirements are very complex and require thoughtful and consistent policies and procedures that are well-documented in order to ensure consistent application.

Cause – A rapidly changing public sector environment, combined with an outdated system has created many situations in which consistent application of procedures is difficult and often absent.

Effect – The lack of formal policies and procedures contributes to inconsistent application of accounting and reporting methodologies and creates an environment in which changes in personnel can result in errors in the City's accounting and financial reporting.

Recommendation – We recognize that the City is working on a project to provide appropriate documentation of all accounting and reporting policies and procedures. We recommend swift completion and implementation of this project, including continuous training of all accounting personnel. Consider a periodic update to ensure that all policies and procedures remain appropriate in the changing municipal financial environment. Ensure that documented policies and procedures cover all aspects of the City's financial operations, including both manual and IT-driven procedures. In addition, ensure that training is provided to all appropriate accounting and departmental personnel, and that adherence to these policies and procedures is monitored.

Views of Responsible Officials – Concur. The City recognizes the need for policies and procedures that address all aspects of its financial management, accounting and reporting responsibilities. Management has engaged external assistance in developing and implementing financial policy directives and procedures for the City. The scope of work for this project included developing and documenting the directives, training City staff, and aligning departmental procedures with new and revised policy directives. The City anticipates that this process will be complete by September 2010. The process will include periodic review, and update of all policies to include communication of changes once the development and implementation phase of the project are complete.

***Significant Deficiency: Computer System Access Controls (updated from fiscal years 2006-2008)***

Criteria – Access controls are key controls to the City’s financial systems to protect financial data from improper accounting and reporting. The City is currently reestablishing and documenting policies and procedures related to controls.

Condition and Cause – The following deficiencies were noted during the review of general computer controls over the City’s financial system and the water billing system:

*Policies and Procedures:* Formal security policies, procedures and standards have not been updated by management. A draft report is currently under review, but has not been approved by City management as of the date of the audit.

*Strong Password Enforcement:* The City’s IT system users are required to use multiple levels of authentication to access the financial systems and the network level passwords are relatively strong. However some of the internal IT systems were noted to lack the functionality to enforce strong passwords and in some systems the configurations can be improved to force the users to use a strong password.

*User Access Privilege Reviews:* As of September 30, 2009, the City does not have a comprehensive user access privilege review in place for all layers of the IT environment. The City has implemented and completed a process to review the Active Directory users on an annual basis in October and November 2009. Although this process was performed at the network level, it did not cover the access privilege reviews on the application, database and operating system layers.

*User Access Termination:* Based on limited testing, three instances of terminated employees accounts or unnecessary accounts with access to the IT systems were noted. It was also noted that the City considers it to be the responsibility of the department heads to log a helpdesk ticket when a user is terminated or transferred. In such instances, a control requiring periodic user access review would allow management to detect and correct any inappropriate access.

*Configuration Reviews:* The password configuration, access control configurations, and user roles are not reviewed on a periodic basis. This includes the appropriateness of access controls to datasets that are not protected by the security mechanisms (RACF protected dataset), direct access to data (direct database update access or command line access) and definition of key user roles within the applications.

*Security Administration Privileges:* Noted a number of instances of excessive administrator privileges to various IT systems.

Context - Management is ultimately responsible for ensuring that all systems are secure and that unauthorized users do not have access to sensitive data. As such, access should be reviewed periodically and security strengthened to minimize such risks.



Effect- Unauthorized access to an entity's information systems can potentially allow damage to the data which can lead to the integrity of the system or information maintained in the system being compromised.

Recommendation - The following should be considered:

- Formal security policies, procedures and standards should be implemented by management. Periodic reviews or monitoring controls should be established to ensure that the established policies are appropriately implemented on all the systems and remain pertinent.
- User access privileges of all user accounts at the application, database, operating system, networks and key security configuration should be reviewed on a regular basis to ensure it is appropriate at all times.
- User access monitoring controls should be established and implemented based on the assessed risk.

Views of Responsible Officials – Concur. The City continuously reviews and updates system access controls. Over the past year the Security Policy has been published, passwords have been strengthened in the Windows and Mainframe environments, and user access reviews have been initiated in the Windows environment. Corrective Action Plan milestones for items identified in this deficiency include:

February 8, 2010 - City Manager approved the City's formal security policy, Administrative Regulation D-5: Information Technology Security which establishes improved security processes and risk assessments.

March 15, 2010 – Affected Departments notified of Computer System Access Controls deficiencies that they need to address and are required to create a Remediation Plan in accordance with the City's Administrative Regulation D-5, Information Security Technology and the System Access Review Procedure. To ensure correction of this deficiency, Department's Remediation Plan will include completing two reviews of user access and key security configurations in Fiscal Year 2010.

***Significant Deficiency: Change Management of Computer Controls (updated from fiscal years 2006-2008)***

Criteria – As changes are made to the City's systems (programs, databases, operating systems and networks), those changes should be fully tested and authorized by management to ensure integrity of data during the change process.

Condition – The City has designed and implemented a Change Management Policy, but the current processes do not require that all changes are processed through the change management policy. Some of the specific cases noted were as follows:

*Change Management:* The programmers are given access to make changes directly in the production environment using special access (emergency access) to correct problems that are to be fixed on an urgent basis. Management has implemented additional control to remove the emergency access after 4 hours to limit the time available for a programmer

to access the production system. When programmers are given such access, the programmer is required to submit a log of actions performed while using that account. The log could be modified by the programmer and it is possible for a programmer to make unauthorized changes using this special access privilege. In addition, when changes are required for reports, the change tickets are not opened for all changes.

*Migrating Changes:* In the Water Services IT department, where there is not an adequate number of personnel, the Administrators implement changes in the production environment and also perform programming duties. In such cases, if unauthorized changes are made, they may not be detected by management.

Context – The City’s IT department regularly reviews changes submitted through the change control process, but does not prevent IT personnel from making changes outside of the City’s policy.

Effect – Any potential unauthorized changes may lead to material changes going undetected in the system.

Cause – The current processes and system configurations do not prevent a programmer or IT administrator from implementing a change that has not been approved by management. There is a lack of clear segregation of duties due to lack of technical knowledge or availability of adequate personnel.

Recommendation – Management should implement adequate preventive controls that restrict the same person or programmer from implementing a change to the system without adequate testing or approval. In cases where it is not feasible to have adequate segregation of IT functions, management should consider implementing monitoring controls, such as a review of the log of changes or a peer review of all changes performed.

Views of Responsible Officials – Concur. The City has reasonable and adequate change control procedures and continues to enhance them. The Change Management Policy was updated to improve controls regarding Emergency Changes, Change Migration, and improve monitoring.

Corrective Action Plan milestones for items identified in this deficiency include:

March 15, 2010 – Affected Departments notified of Change Management of Computer Controls deficiencies that they need to address and are required to create a Remediation Plan in accordance with the City’s Administrative Regulation D-5, Information Security Technology and IT Solutions facilitated Change Management Policy.

April 15, 2010 – Affected Departments submit Remediation Plan to IT Security Manager for approval.

June 1, 2010 – Remediation actions complete.

## SECTION II — REMEDIATED MATERIAL WEAKNESSES OR SIGNIFICANT DEFICIENCIES

In prior years, we identified the following deficiencies that were considered to be material weaknesses or significant deficiencies in the City's internal control over financial reporting, and which were remediated by the City as of September 30, 2009:

### ***Material Weakness: Cash Management Controls***

Criteria – Proper and timely accounting of all cash and investment transactions within the City's general ledger is critical to adequate controls over those balances.

Condition – In December 2007 the City issued certain water bonds, but the City's Financial Management Services Department did not become aware of the transaction until March 2009. After the City recorded the transaction in March we noted that although the funds were now included in total cash and investments, they were not included within the City's overall reconciliation of cash and investments. Upon our notification to the City of this fact, the additional account was also added to the overall cash and investments reconciliation process.

Context – The total amount of the funds were approximately \$30 million.

Cause – There appears to be incomplete communication of all of the cash and investment transactions between the treasury department and the Financial Management Services Department. Although the transaction occurred in the early part of fiscal year 2008, the Financial Management Services Department did not learn of the transaction or record it until well after year end.

Effect – The absence of the funds from the City's records created an imbalance between the funds actually on deposit, or invested with the bank, and the City's general ledger. This occurred because Financial Management Services Department personnel were not aware of the additional account.

Recommendation – Implement a formal communication process between the treasury function and the accounting function to properly report on a timely basis all debt issuances and new account deposits that occur throughout the year. In addition, on a monthly basis prepare an overall summary of all the individual bank and investment account reconciliations in order to reconcile the total of all accounts to the general ledger.

### ***Material Weakness: Reporting Component Units***

Criteria – Governmental Accounting Standards Board ("GASB") Statement No. 14, *The Financial Reporting Entity* and GASB Statement No. 39 *Determining Whether Certain Organizations are Component Units* provides guidance on the reporting of related organizations in the City's basic financial statements.

Condition – The City did not accurately classify some organizations closely related to the City as component units. While the City has a process in place to identify potential component units, it did not include a thorough consideration of all criteria set forth in GASB Statement No. 14 and GASB Statement No. 39. Final conclusions for these related entities were not reviewed by someone knowledgeable of the guidance and the City's relationship to the entities. There is no

consistent process in place to review activities of component units to determine whether their activities are properly accounted for in the City's general ledger.

Context – There are a number of potential component units (or related organizations) for the City that require assessment each year regarding their classification as component units and their financial activities.

Effect – Improper assessment of component units creates the potential for under-reporting of the reporting entity.

Cause – There is no formal process for monitoring the status and financial activities of component units. Arrangements between the City and related organizations are frequently made by various departments within the City without proper communication of these relationships to the Financial Management Services Department.

Recommendation – Perform an annual re-assessment of all potential component units to insure that their classification remains appropriate. This analysis should consider the basic criteria of GASB 14, but should also consider the additional criteria of GASB 39. In addition, the financial activities of these related entities should be monitored to insure that proper accounting for their financial activities are recorded in the City's financial statements.

#### ***Significant Deficiency: Grant Management***

Criteria – OMB Circular A-133 requires the City to annually prepare a Schedule of Expenditures of Federal and State Awards (“SEFA”) that lists all expenditures related to Federal and State award programs for that year.

Condition – The City worked very hard to prepare an accurate SEFA for the year ended September 30, 2008. However, numerous errors were noted which required adjustment in the schedule. Although not material to the City as a whole, these errors required substantial effort to research and correct.

Context – For the year ended September 30, 2008, the City managed more than 150 different Federal and State grant awards. The funding methods and provisions for these grant awards vary, requiring the Financial Management Services Department to evaluate proper accounting and reporting for each grant award.

Cause – Large numbers of grants accounted for in multiple funds create a difficult process in accumulating the data for the schedule. Nonstandard grants require research that was not properly or timely performed by grant accounting personnel.

Effect – An improperly prepared SEFA misstates the expenditures for grant awards reported to the granting agencies. Further, errors in revenue recognition or untimely capital asset recording can occur when related expenditures are not properly reported.

Recommendation – Develop standard policies and procedures for identifying and reporting grants in the general ledger. Continue to educate personnel in all departments on the requirements related to proper accounting and reporting for grants. This information should also include guidance on the nature of grants, both monetary and non-monetary. Use standard funds for

accounting for such grants and perform periodic reviews of all departments to ensure that grant accounting standards and compliance requirements are met.

***Significant Deficiency: Court System Accounts Receivable and Escrow Liabilities***

Criteria – The activities of the City’s municipal courts system generates both accounts receivable and escrow liabilities. The court fines and fees should be appropriately calculated, recorded, and reserved, as necessary.

Condition – Based upon a review by Internal Audit, certain deficiencies were noted in the calculation and recording of court costs payable to the State of Texas. The City completed a reconciliation of these accounts in February 2009 and has recorded certain adjustments to the City’s general ledger.

Context – Although a formalized review of the system has now been completed, a final conclusion and settlement has not yet been reached and agreed to by the State of Texas. An audit by state auditors is now underway.

Cause – The City implemented a new court system in calendar year 2006. With this implementation certain errors in the calculation and allocation of court fines and fees occurred and were not initially detected.

Effect – Improper use of the courts system could result in errors in processing of court fines and fees and improper assessment of the amounts due to or due from the City related to citizens or other parties.

Recommendation – Work to resolve any remaining issues with the state auditors and make any necessary final corrections to the records. Insure that any deficiencies noted in the City’s processes are fully addressed.

***Significant Deficiency: Processing Expenditures in Excess of Budget***

Criteria – City policy requires that budgeted funds be available before expenditures can be processed within the system. City Council has the authority to amend the original budget to realign funds or release additional funds for spending; however, such spending should not occur until approval of such amendments has taken place.

Condition – In certain instances, we noted that expenditures were incurred before the City Council approved an amended budget, thus resulting in actual expenditures that were in excess of budgetary amounts.

Context – Budgetary comparison reports for June 2009 reflected overspent budgets for several funds, including the General Fund, without prior approval from the City Council.

Cause – There is currently no system control in place to prevent such unauthorized over-expenditure.

Effect – In order for the budgetary control process to be an effective control over City expenditures, approval must be obtained prior to the expenditure of the funds.

Recommendation – The budgetary process for a large city is a very complex and inexact process. However, the strengths and benefits of pre-approval of expenditure levels by City Council are worthy of the efforts it takes to ensure the process is effective. Reconsider the required procedures that would allow for a more timely approval of expenditures by the City Council. Such consideration might include:

- A reconsideration of the actual requirements of the City charter as they relate to specific approval of expenditures.
- A reconsideration of the annual budgetary process to more closely plan for anticipated expenditures.
- A reconsideration of the usefulness of an encumbrance process in anticipating contemplated expenditures that might exceed the original budget and require amendment.
- A reconsideration of the timing and form of monthly reporting of expenditures as compared to budget, accompanied by estimations of future additional expenditures.
- A reconsideration of the budgetary level of control desired by City Council – whether at the functional, departmental, or some other level of reporting.

### **SECTION III — OTHER DEFICIENCIES**

We identified the following other deficiencies involving the City’s internal control over financial reporting as of September 30, 2009 that we wish to bring to your attention:

#### ***Component Unit Updates and Cash Reconciliations***

Criteria – Governmental Accounting Standards Board (“GASB”) Statement No. 14, *The Financial Reporting Entity* and GASB Statement No. 39 *Determining Whether Certain Organizations are Component Units* provides guidance on the reporting of related organizations in the City’s basic financial statements.

Condition – The City now maintains a list of all potential component units. However, the assessment for classification as component units was not fully updated from previous years related to changes in board composition or significance of operations. Further the cash reconciliations for certain component units were not prepared on a timely basis.

Context – There are a number of potential component units (or related organizations) for the City that require assessment each year regarding their classification as component units and their financial activities.

Effect – Improper assessment of component units creates the potential for under-reporting of the reporting entity.

Cause – There is no formal process for annual reassessment of component units.

Recommendation – Perform an annual re-assessment of all potential component units to ensure that their classification and accounting remains appropriate. This analysis should consider the basic criteria of GASB 14, but should also consider the additional criteria of GASB 39. The financial activities of these related entities should be monitored to ensure that proper accounting for their financial activities are recorded in the City’s financial statements.

***Water Billing Master File (updated from fiscal years 2006-2008)***

Criteria – A Master File of all water customers should be appropriately maintained.

Condition – Changes to the water billing master file are not appropriately reviewed for accuracy and timeliness.

Context – Annually the City receives approximately \$300 million in water revenues.

Cause – The volume of changes required for the number of customers the City bills makes it difficult to properly segregate duties around the customer master file.

Effect – A lack of segregation of duties in maintaining the water customer master file or an inadequately reviewed master file could result in improper collection of water revenues through adjustments to accounts or improper coding of revenues to be received from customers.

Recommendation – Any changes to the Master File should be made by or reviewed by a person independent of the one responsible for sending out bills.

***Employee Master File Controls (updated from fiscal years 2007-2008)***

Criteria - All changes to employee master file data should be logged and reviewed for accuracy by someone independent of those making the changes.

Condition - Human resources employees, who are responsible for processing changes to employee master files, are also responsible for reviewing their own changes. In addition, each department coordinator has the ability to change employee addresses and the payroll department has the ability to make temporary changes to the pay rate and changes to direct deposit information. These changes are not tracked or logged and thus, can be made without approval.

Context - Access to employee master files should be carefully controlled to prevent unauthorized changes to employee data.

Cause – The volume of employee master file data changes processed makes it difficult to properly segregate duties around the employee master file.

Effect - Unauthorized or unapproved changes to employee master file data could result in payment errors.

Recommendation - Establish formal procedures for tracking, logging, and approving all changes to employee master file data.

***Business Continuity Plan and Disaster Recovery Planning (updated from fiscal years 2005-2008)***

Criteria – Anticipation of and preparation for business disasters is important to the safeguarding of City assets and data and ensuring that the City is able to deliver critical services after a disaster within the predetermined time frame to meet its business and service obligations. Such disasters could be physical in the form of natural or man-made disasters, or electronic in the form of system crashes.

Condition and Cause - The City does not have a comprehensive Business Continuity Plan or Disaster Recovery Plan. Although the City performs IT disaster recovery preparedness functions such as back-up and offsite storage of back-ups, the effectiveness of these functions cannot be verified without periodic testing.

Context - Management is ultimately responsible for ensuring that all systems and information is available within a predetermined period of time after the occurrence of a business disruption to meet its business and service obligations.

Effect - The lack of an adequate business continuity plan becomes evident only in the event a disaster actually occurs. However, such occurrences can never be anticipated and must be prepared for in advance. The existing plans should be periodically tested to ensure that the IT systems and Business process are recoverable as planned.

Recommendation - Develop and implement a business continuity and disaster recovery plan to help ensure the continuation of the City's operations and system processing in the event of a disaster. The plan should also include periodic testing requirements and a process to update the plan based on business requirements. The City should:

- Develop and implement a business continuity plan
- Test the plan on a regular basis and make adjustments based on the results of the tests
- Create short term and long term information and operational strategies that support the overall business strategy and the information system requirements
- Compare the actual results with the created short and long term strategies on a periodic basis and make adjustments as needed.
- Implement a succession and cross training plan for key positions.

## **SECTION IV — OTHER MATTERS**

Our observations concerning other matters related to operations, compliance with laws and regulations, and best practices involving internal control over financial reporting that we wish to bring to your attention are as follows:

### **RECENTLY ISSUED GOVERNMENTAL ACCOUNTING STANDARDS BOARD (“GASB”) STATEMENTS**

*GASB 51: Accounting and Financial Reporting for Intangible Assets* – In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This Statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. This Statement also provides authoritative guidance that specifically addresses the nature of these intangible assets. Such guidance should be applied in addition to the existing authoritative guidance for capital assets. This standard is effective for the City in fiscal year 2010.

*GASB 53: Accounting and Financial Reporting for Derivative Instruments* – In June 2008, the GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. This Statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. The statement requires that the fair value of financial arrangements called “derivatives” or “derivative instruments” be



reported in the financial statements of state and local governments. Additional information about derivatives is disclosed in the notes to the financial statements, including identification of the risks to which hedging derivative instruments themselves expose a government. This Statement is effective for the City in fiscal year 2010.

GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, addresses the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. This Statement is effective for the City in fiscal year 2011.

GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple Employer Plans*, clarifies that when actuarially determined Other Post-Employment Benefits (“OPEB”) measures are reported by an agent multiple-employer OPEB plan and its participating employers, those measures should be determined as of a common date and at a minimum frequency to satisfy the agent multiple-employer OPEB plan’s financial reporting requirements. This Statement is effective for the City in fiscal year 2012.

GASB Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*, provides accounting and financial reporting guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code. It requires governments to re-measure liabilities that are adjusted in bankruptcy when the bankruptcy court confirms (that is, approves) a new payment plan. For governments that are not expected to emerge from bankruptcy as going concerns, this Statement requires re-measurement of assets to a value that represents the amount expected to be received. This Statement classifies gains or losses resulting from re-measurement of liabilities and assets as an extraordinary item. This Statement is effective for the City in fiscal year 2010.

Recommendation – Review the recently issued standards to determine the approach the City will take to implement them as they become effective.

## **SECTION V — DEFINITIONS**

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The definitions of a deficiency, a material weakness, and a significant deficiency that are established in AU 325, *Communicating Internal Control Related Matters Identified in an Audit*, are as follows:

A *deficiency* in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A deficiency

in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when (a) a properly designed control does not operate as designed, or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

A *material weakness* is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

## **SECTION VI — MANAGEMENT'S RESPONSIBILITY FOR AND THE OBJECTIVES AND LIMITATIONS OF INTERNAL CONTROL**

The following comments concerning management's responsibility for internal control over financial reporting and the objectives and inherent limitations of internal control over financial reporting are adapted from auditing standards generally accepted in the United States of America.

### **Management's Responsibility**

The City's management is responsible for the overall accuracy of the financial statements and their conformity with generally accepted accounting principles. In this regard, management is also responsible for establishing and maintaining effective internal control over financial reporting.

### **Objectives of Internal Control over Financial Reporting**

Internal control over financial reporting is a process affected by those charged with governance, management, and other personnel and designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition may include controls related to financial reporting and operations objectives. Generally, controls that are relevant to an audit of financial statements are those that pertain to the entity's objective of reliable financial reporting (i.e., the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles).

### **Inherent Limitations of Internal Control over Financial Reporting**

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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