

CITY OF HEALDSBURG
MANAGEMENT REPORT
AND
AUDITOR'S COMMUNICATION LETTER

June 30, 2012

CITY OF HEALDSBURG
June 30, 2012

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In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Healdsburg (City), as of and for the fiscal year ended June 30, 2012, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all such deficiencies have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies in internal control, 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. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies presented in the current year recommendations section as Findings 2012-01 through 2012-06 to be significant deficiencies in the internal control.

During our audit, we noted other matters involving internal controls and their operations, and are submitting for your consideration, related recommendations designed to help the City make improvements and achieve operational efficiencies. These recommendations are described in the current year recommendations section as Findings 2012-07 through 2012-11. Our comments reflect our desire to be of continuing assistance to the City.

The City's written responses to the findings identified in our audit are described in the current year recommendations section. We did not audit the City's responses and, accordingly, we express no opinion on them. In addition, we would be pleased to discuss the recommendations in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing these recommendations.

We have included in this letter a summary of communications with the members of the City Council as required by professional auditing standards. We would like to thank the City's management and staff for the courtesy and cooperation extended to us during the course of our engagement. The accompanying communications and recommendations are intended solely for the information and use of management, the members of the City Council, and others within the City, and are not intended to be, and should not be, used by anyone other these specified parties.

Moss, Levy & Hartzheim

MOSS, LEVY & HARTZHEIM LLP
Culver City, CA
February 25, 2013



MOSS, LEVY & HARTZHEIM LLP

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We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Healdsburg for the fiscal year ended June 30, 2012, and have issued our report thereon dated February 25, 2013. Professional standards require that we provide you with the information about our responsibilities under auditing standards generally accepted in the United States of America and, if applicable, Government Auditing Standards and OMB Circular A-133, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter dated July 23, 2012. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City of Healdsburg are described in Note 1 to the financial statements. As discussed in Note 1 of the notes to the basic financial statements, effective July 1, 2011, the City of Healdsburg adopted Governmental Accounting Standards Board (GASB) Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions*. The implementation of GASB Statement No. 64 had no effect on the financial statements. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

The most sensitive estimates affecting the financial statements were the estimated historical cost and useful lives of certain capital assets, the funding progress of the CalPERS pension plan, Other Postemployment Benefits (OPEB) actuarial values, the collectability of receivables (including accounts and notes receivable), and the estimated claims payable. Management's estimates of the estimated historical cost and useful lives of certain capital assets are based on historical data and industry guidelines, while the funding progress of the CalPERS pension plan and the Other Postemployment Benefits actuarial values are based on consultants' estimates. The amount of estimated collectability of receivables is from historical data and the estimated claims payable is based on third party consultant's estimates. We evaluated the key factors and assumptions used to develop these estimates and determined that they are reasonable in relation to the financial statements taken as a whole.

Difficulties Encountered in Performing the Audit

We encountered no difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. Two of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole. The two journal entries were for accounts payable and fixed assets.

Disagreements with Management

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

Management Representations

We have requested certain representations from management that are included in the management representation letter dated February 25, 2013.

Management Consultations with Other Independent Accountants

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

Other Audit Findings or Issues

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

Other Information in Documents Containing Audited Financial Statements

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

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

Very truly yours,

Moss, Levy & Hartzheim

MOSS, LEVY & HARTZHEIM LLP
Culver City, CA
February 25, 2013

CURRENT YEAR RECOMMENDATIONS

Significant Deficiencies

2012-01 Finding – Deficiencies in internal control over cash receipts at the Swim Center and Foss Creek:

During our review of cash receipts internal control at the Swim Center and Foss Creek, we noted the following deficiencies:

- a) Various Shift Summary Sheets were either not reconciled on a daily basis or signed by the Manager for one out of eight cash receipts reviewed.
- b) For drop-in customers, participants could simply sign in and pay the instructor. In addition, no receipts were given to drop-in participants.
- c) There was a lack of segregation of duties over cash receipts at the Swim Center and Foss Creek. The person who collects money also reconciles the cash receipts at the end of the day. In addition, no other person reviews or approves the reconciliation.
- d) The cash box at the swimming pool area was kept in an unlocked drawer and all lifeguards or part-time staff had access to the cash box during operating hours.

Effect:

A lack of segregation of duties and controls over cash receipts increases the risk that errors and irregularities may occur and go undetected, which could lead to a misappropriation of funds.

Recommendation:

We recommend that the City implement policies that will strengthen the City's internal controls at the Swim Center and Foss Creek, such as establishing a tracking system on the number of customers entering, implementing reconciliation of cash being turned in with the amount of cash receipts collected, segregating the duties of cash receipts process, and keeping cash receipts properly secured.

Management's Response:

Staff has been counseled on the importance of following cashiering guidelines setup by Finance. The staff at the Swim Center has been counseled on the importance of proper cash handling. The individuals staffing the swim center are young and we make every effort to have them follow our procedures.

2012-02 Finding – Deficiencies in internal control over cash receipts at the Senior Center:

During our review of internal control over cash receipts at the Senior Center, we noted the following:

- a) There was a \$1 fee charged per participant for Bridge that was not on the fee schedule.
- b) One out of 6 cash receipts reviewed did not have the registration form for review.
- c) There was a lack of segregation of duties over the cash receipts at the Senior Center. The person who collects money also reconciles the cash receipts at the end of the day. In addition, no other person reviews or approves the reconciliations.

Effect:

A lack of segregation of duties and controls over cash receipts increases the risk that errors and irregularities may occur and go undetected, which could lead to a misappropriation of funds.

Recommendation:

We recommend that the City ensure that all cash receipts are properly charged based upon the approved fee schedule and booked into the correct account. The City also needs to ensure that there is a sufficient segregation of duties over cash receipts at the Senior Center.

Management's Response:

The Senior Center front counter is staffed by senior volunteers. Finance staff has counseled them on the appropriate steps to follow. Due to staffing levels, staff is unable to segregate duties any more than we already do.

CURRENT YEAR RECOMMENDATIONS (Continued)

Significant Deficiencies (Continued)

2012-03 Finding – Non-compliance with use of impact fee:

During our review of revenues and expenditures, we noted there appears to be non-compliance with the use of impact fees. Transfers of funds are made to the General Fund with no support as to what the use is.

Effect:

The City is not in compliance with the intended purpose of impact fees.

Recommendation:

We recommend the City ensure expenditures of impact fee revenue is compliant.

Management's Response:

Staff has been counseled on the appropriate use of these funds.

2012-04 Finding – Lack of control over capital assets:

During the review of internal controls over capital assets, the following were noted:

1. Assets purchased with federal funds may not be identified;
2. There is no listing by department of potential impaired assets.
3. Physical inventory should be performed and reconciled with the capital asset listing annually.

Effect:

Without an annual review, the City's capital assets schedule may not be updated for obsolete, impaired, and disposed capital assets, which could result in a misstatement of the value of capital assets. Consistent use of the capitalization policies is needed to have an accurate classification of the City's capital assets.

Recommendation:

We recommend the City implement procedures to review capital assets at least annually and update the capital assets schedule, accordingly.

Management's Response:

Staff will, in the future, identify all capital assets purchased with federal money and will identify assets which are no longer in service during Fiscal Year 2012-2013.

2012-05 Finding – Lack of supporting documentation:

Program: US Department of Transportation - Highway Safety Improvement Program-ARRA – CFDA 20.205

Criteria:

OMB Circular A-133 Compliance Supplement requires that a qualification based selection process in conformance with the Brooks Act be utilized by any contracting agency to procure engineering and design-related services using Federal-aid highway funding. All supporting documentation in regards to the selection process must be documented and available for review.

Condition:

During our review of procurement, we noted a lack of supporting documentation for the Healdsburg Bridge project for design and engineering per the Brooks Act requirements.

CURRENT YEAR RECOMMENDATIONS (Continued)

Significant Deficiencies (Continued)

2012-05 Finding – Lack of supporting documentation: (Continued)

Effect:

The City is not in compliance with the retention of documents requirement under the Brooks Act and the requirements of *OMB Circular A-133 Compliance Supplement* in regards to procurement and record retention.

Questioned Cost:

Unknown

Recommendation:

We recommend the City retain all procurement related documents for the required time period in accordance with Federal requirements.

Management's Response:

Supporting documentation was inadvertently discarded with all non-successful proposals approximately 24 months after the City Council awarded the design contract to the most qualified proposer. Supporting documentation for federal aid contract procurement will hereafter be immediately scanned and archived along with other relevant information into the project files.

2012-06 Finding – Lack of documentation for sole source justification:

Program: US Department of Transportation - Highway Safety Improvement Program-ARRA – CFDA 20.205

Criteria:

OMB Circular A-133 Compliance Supplement requires that a qualification based selection process in conformance with the Brooks Act be utilized by any contracting agency to procure engineering and design-related services using Federal-aid highway funding. All supporting documentation in regards to the selection process must be documented and available for review.

Effect:

The City is not in compliance with the retention of documents requirement under the Brooks Act and the requirements of *OMB Circular A-133 Compliance Supplement* in regards to procurement and record retention.

Questioned Cost:

Unknown

Recommendation:

We recommend the City retain documentation supporting the conduct of proper procurement procedures for sole sourcing.

Management's Response:

Procurement procedures were not documented and preserved in the project files. The City was notified by the office of its U.S. Representative (Mike Thompson, California 1st Congressional District) of an impending loss of \$1.3 million in funding he had procured for the City, if a deadline was not met. As the timeframe was extremely short, staff had to contact full-service design consultants (including civil engineering, surveying, landscape, structural and irrigation) by phone to discuss the project scope, needs, and timing urgency, and to request a proposal for providing services.

CURRENT YEAR RECOMMENDATIONS (Continued)

Significant Deficiencies (Continued)

2012-06 Finding – Lack of documentation for sole source justification: (Continued)

Management’s Response: (Continued)

Regardless of scheduling challenges and resource shortages, senior staff responsible for the project shall document in writing all steps and procedures taken in procuring professional service contracts. Furthermore, supporting documentation for contract procurement will hereafter be immediately scanned and archived along with other relevant information into the project files located on the City’s network files.

Other Matters

2012-07 Finding – Deficiency in internal control over payroll:

During our review of internal control over payroll, we noted that one out of 25 employees tested did not have a W-4 form on file.

Effect:

Without proper and sufficient payroll documentation, we cannot verify if the employees were paid correctly and it may increase the possibility of fictitious employees.

Recommendation:

We recommend the City implement procedures to ensure that all appropriate payroll documentation is obtained and retained.

Management’s Response:

Staff tasked with obtaining and managing payroll related documentation has been counseled of the importance of complete payroll information and the need to obtain and retain it.

2012-08 Finding – Deficiency in internal control over cash receipts in the Finance Department:

During our review of internal control over cash receipts in the Finance Department, we noted that two out of 10 cash receipts reviewed did not have adequate supporting documentation.

Date	Receipt	Amount
8/1/11	135746	\$149,452.79
10/31/11	135973	\$12,365.35

Effect:

Without sufficient supporting documentation, it is difficult to ascertain that all cash receipts are deposited in a timely manner and could lead to a misappropriation of funds.

Recommendation:

We recommend that the City ensure that detailed and related supporting documentation be obtained and/or retained for all cash receipts.

Management’s Response:

Receipts in question were pulled and we found that on one of the receipts, all backup was attached as is the City’s policy. On the other receipt, we have instructed staff to attach the backup for bad debt collection when received by the City. This is a rare occurrence.

CURRENT YEAR RECOMMENDATIONS (Continued)

Other Matters (Continued)

2012-09 Finding – Deficiencies in internal control over cash receipts at the Community Development Center:
During our review of internal control over cash receipts at the Community Development Center, we noted three out of six cash receipts had incorrect fee charges when calculated based upon the Council approved fee schedule.

Effect:

By not correctly calculating fees, these customers may be under or over charged. In addition, a misappropriation of funds could occur.

Recommendation:

We recommend the City establish procedures over the cash receipts system in the Community Development Center and ensure that all service fees charged are calculated correctly according to the Council approved fee schedule.

Management’s Response:

Staff has been counseled on the importance of using the fees agreed upon by Council.

2012-10 Finding – Deficiencies in cash receipts internal control at the Police Department:

During the review of internal control at the Police Department, we noted the following deficiencies:

- a) Cash receipts are not reconciled on a daily basis.
- b) Two out of six cash receipts reviewed did not have sufficient supporting documentation.

Date	Receipt	Amount
9/1/11	70009	\$29
2/24/12	70035	\$24

Effect:

Without restricted access to the cash drawer, a misappropriation of cash is more likely to occur. In addition, lack of supporting documentation and daily reconciliation increase the risk of misappropriation of funds that may occur and go undetected.

Recommendation:

We recommend that the City ensure that all cash drawers are locked and access limited to an employee with cash handling responsibilities only. Cash receipts need to be reconciled daily to avoid the increased risk of a misappropriation of funds. Additionally, detailed and related supporting documentation need to be obtained and/or retained for all cash receipts.

Management’s Response:

- a) The volume and value of the money taken into the police department does not always warrant a deposit. The police department makes a deposit twice a week if they take in money.
- b) Staff has been counseled and asked to attach all supporting documentation requested.

CURRENT YEAR RECOMMENDATIONS (Continued)

Other Matters (Continued)

2012-11 Finding – Sick and vacation policy is inconsistent with the MOU:

During our review of City policies, we noted that the employee handbook does not agree with the MOU with regard to time for sick and vacation accrual.

Effect:

The City may not be complying with the terms of the MOU. Policies conflict with the agreement.

Recommendation:

We recommend the City ensure that the policies are consistent with the MOU and that the Council approves such changes.

Management's Response:

The Personnel Rules (Employee Handbook) were adopted January 1, 2008. Subsequent MOUs have been negotiated, which contain different policies. The Rules are not revised each time an MOU is approved. The next time the Rules are revised, the policies will be updated to reflect the language in the MOUs.

STATUS OF PRIOR YEAR RECOMMENDATIONS

Significant Deficiencies

2011-01 Finding – Deficiencies in internal control at the Swim Center:

During the review of internal controls at the Swim Center, we noted the following:

- a. Various daily pool reports were not signed by the cashier at the end of the day, and numerous daily pool reports were only signed by one person (same person was the cashier and the end of the day balancer).
- b. For drop-in customers, participants could simply sign in and pay the instructor. No receipts were given to drop-in participants.

Effect:

Lack of control over cash receipts increases the risk of misappropriation of funds.

Recommendation:

We recommend the City implement policies that will strengthen the City's internal controls at the swim center, such as establishing a tracking system on implementing reconciliation of cash being turned in with the amount of cash receipts collected and daily entry of number of customers.

Current Status:

Not implemented – See Finding #2012-01

2011-02 Finding – Lack of proper internal control over cash receipts at the Community Development Center:

During our test of cash receipts, we noted the following internal control deficiencies at the Community Development Center:

- a. Two out of 6 receipts reviewed where zoning plan fees were incorrectly charged when calculated according to the fee schedule.
- b. No restriction for access to the petty cash box.
- c. There is a lack of segregation of duties with respect to the money received. The lack of segregation of duties exists because no close out at each shift, the same employee counts the money, reconciles with the receipts, prepares, signs off, and delivers the money to the City Hall.

Effect:

- a. By not correctly calculating fees, these customers may be under or over charged.
- b. Without restricted access to the cash drawer, a misappropriation of cash is more likely to occur.
- c. A deficiency in internal control increase the risks that errors and irregularities may occur and go undetected. It adversely affects the City's ability to initiate, authorize, record, process or report financial data reliably, which can lead to a misappropriation of funds.

STATUS OF PRIOR YEAR RECOMMENDATIONS (Continued)

Significant Deficiencies (Continued)

2011-02 Finding – Lack of proper internal control over cash receipts at the Community Development Center (Continued):

Recommendation:

We recommend the City establish procedures over the cash receipts system in the Community Development Center:

- a. All service fees charged are calculated correctly according to the Council approved fee schedule.
- b. The key to the cash drawer should be locked and access limited to employees with cash handling responsibilities only.

Someone other than the cashier should reconcile the cash and prepare the count sheet at the end of the day. Also management should review and sign off on the report.

Current Status:

Partially implemented – See Finding #2012-04

2011-03 Finding – Unrestricted access to cash drawer at the Police Department:

During the review of internal control at the Police Department, it was noted that the police cash drawer is always unlocked and all employees have the access to the drawer.

Effect:

Without restricted access to the cash drawer, a misappropriation of cash is more likely to occur.

Recommendation:

We recommend the City ensure that all cash drawers are locked and access limited to an employee with cash handling responsibilities only.

Current Status:

Implemented

STATUS OF PRIOR YEAR RECOMMENDATIONS (Continued)

Other Matters

2011-04 Finding – Missing or incomplete payroll related documentation:

During our test of the payroll system, we noted the following:

- a. Eight out of 24 I-9 forms were incomplete.
- b. Two out of 24 positions were not listed on the Council approved salary schedule.
- c. One out of 24 salary rate paid to the employee was more than range listed on the Council approved salary schedule.
- d. Three out of 24 employment applications were not obtained/retained.

Effect:

If an audit by the Department of Justice were to be performed, fines could be levied upon the City for employees that do not have a completed I-9 form on file. Without proper and sufficient payroll documentation, we cannot verify if the employees were paid correctly and it may increase the possibility of fictitious employees.

Recommendation:

We recommend the City implement procedures to ensure that all appropriate payroll documentation is obtained/retained.

Current Status:

Partially implemented – See Finding #2012-11

2011-05 Finding – No proper approval on the contract agreement and pay rate:

During our review of personnel files, the contract agreement and pay rate between instructor and the Park and Recreation department were not obtained/retained to determine how the compensation will be based on a 60/40 split.

Effect:

The City could be paying for unauthorized items, which could result in a misappropriation of funds.

Recommendation:

We recommend that the City and the Department review and obtain proper approval for contract agreements and pay rate.

Current Status:

Implemented