

**CITY OF ALAMEDA
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS**

**FOR THE YEAR ENDED
JUNE 30, 2014**

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**CITY OF ALAMEDA
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS**

For the Year Ended June 30, 2014

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MEMORANDUM ON INTERNAL CONTROL

To the Honorable Mayor, City Council, and City Auditor
of the City of Alameda
Alameda, California

We have audited the financial statements of the City of Alameda (City) for the year ended June 30, 2014, and have issued our report thereon dated October 15, 2014. Our opinions on the basic financial statements and this report, insofar as they relate to the Alameda Municipal Power, are based solely on the report of other auditors. In planning and performing our audit of the basic financial statements of the City, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

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 material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist and that were not identified. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected on a timely basis. We did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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 in internal control included on the Schedule of Significant Deficiencies to be significant deficiencies.

Included in the Schedule of Other Matters are recommendations not meeting the above definitions that we believe to be of potential benefit to the City.

Management responses included in this report have not been subjected to the audit procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This communication is intended solely for the information and use of management, City Council, City Auditor others within the organization, and agencies and pass-through entities requiring compliance with *Government Auditing Standards*, and is not intended to be and should not be used by anyone other than these specified parties.

Maze & Associates

Pleasant Hill, California

October 15, 2014

**CITY OF ALAMEDA
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF SIGNIFICANT DEFICIENCIES

2014-01 – Continuing Disclosure Requirement of Long-Term Debt

Criteria: Under the covenants of the City's Sewer Revenue Bonds Series 2012 A, the City must prepare an Annual Report no later than seven months (March 31, 2014) after the end of the City's fiscal year. The Report should be filed by either the City or the bond trustee with the Municipal Securities Rule making Board (MSRB).

Condition: Per review of the MSRB website, the City did not file the continuing disclosure required for the Sewer Revenue Bonds Series 2012 A for the fiscal year ended June 30, 2013 by the deadline.

Effect: The City is not in compliance with the annual reporting requirement associated with the Sewer Revenue Bonds Series 2012 A.

Cause: The Finance Department staff member who was responsible for submitting the Annual Report with the MSRB left the City during the current fiscal year. The City was aware that the Annual Report had not been submitted, but did not have the staffing resources to fulfill this responsibility.

Recommendation: The City should ensure that the Annual Report is filed timely with MSRB. If the trustee is responsible for the filing, the City should follow up to make sure that the filing is being completed by the deadline as stated on the bond covenants.

Management's Response: The City's Finance Department has hired Digital Assurance Certification, LLC to do a thorough review of all existing debt issues to identify all Continuing Disclosure Requirements and if the postings to EMMA were complete. Due to staffing limitations, the City has also retained Digital Assurance Certification, LLC to ensure all future Continuing Disclosure Requirements are timely posted on EMMA.

2014-02 – Super User Status in the General Ledger System

Criteria: The system administrator rights, or Super-User rights, allow full access of all the financial system functions as well as assigning access functions to other staff. To maintain a better internal control, Finance staff is recommended not to have Super-User rights over the City's financial system.

Condition: Per review of Security Access list dated March 5, 2013, four Finance staff has super-user rights to City's financial system: the Finance Director, Finance Supervisors, and Finance Supervisor (Part Time).

Effect: The Finance Supervisor who reviews payroll also has access to blank check stock, electronic signature plates in addition to the payroll module and payroll database. Unauthorized transactions may go undetected when employees are granted too much access to the financial system.

Cause: The City believes that the need to access the general ledger system to correct any errors in a moment's notice far outweighs the benefits of having super-user rights delegated to someone outside the Finance Department. Furthermore, the practicality of having the ability to manage the accounting system is also a motivating factor to not designate it to anyone outside the Finance Department.

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SCHEDULE OF SIGNIFICANT DEFICIENCIES

Recommendation: We recommend that the City review the necessity of granting the above employees super-user rights to the financial system. For any module within the financial system that these employees do not need to edit, their access should be limited to read only. At the minimum, the duties and financial system access of the Finance Supervisor who reviews payroll should be evaluated to strengthen internal controls.

Management's Response: The City has recently converted to a cloud based version of the currently utilized financial software. As part of this conversion, the City is reviewing the super-user status and security allowed in the cloud based financial system to ensure proper internal controls are maintained.

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SCHEDULE OF OTHER MATTERS

NEW GASB PRONOUNCEMENTS OR PRONOUNCEMENTS NOT YET EFFECTIVE

The following comment represents new pronouncements taking affect in fiscal year 2014-15. We have cited them here to keep you abreast of developments:

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

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

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

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

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

The following are the major impacts:

- This Statement requires the liability of employers and nonemployer contributing entities to employees for defined benefit pensions (**net pension liability**) to be measured as the portion of the present value of projected benefit payments to be provided through the pension plan to current active and inactive employees that is attributed to those employees' past periods of service (**total pension liability**), less the amount of the pension plan's **fiduciary net position**.
- Actuarial valuations of the total pension liability are required to be performed at least every two years, with more frequent valuations encouraged. If a valuation is not performed as of the measurement date, the total pension liability is required to be based on update procedures to roll forward amounts from an earlier actuarial valuation (performed as of a date no more than 30 months and 1 day prior to the employer's most recent year-end).
- The actuarial present value of projected benefit payments is required to be attributed to periods of employee service using the entry age actuarial cost method with each period's service cost determined as a level percentage of pay. The actuarial present value is required to be attributed for each employee individually, from the period when the employee first accrues pensions through the period when the employee retires.

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SCHEDULE OF OTHER MATTERS

GASB 69 - *Government Combinations and Disposals of Government Operations*

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

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

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

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

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

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

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

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SCHEDULE OF PRIOR YEAR OTHER MATTERS

2013-01 - Access to Financial System

Criteria: The system administrator rights, or super-user rights, allows full access to all of the financial system functions as well as assigning access functions to other staff.

Condition: During our interim audit, we reviewed the security access list dated April 16, 2013 and noted that four employees in the Finance Department have super-user rights to the City's financial system.

Effect: When Finance staff has super-user rights while they are also a part of the day to day activities, there is the potential risk of restricting and/or allowing access to other staff in the different modules within the accounting system. In addition, unauthorized transactions could be processed without proper review and approval.

Cause: Due to system limitation, in order to review transactions electronically, a review needs to have full access to the module.

Recommendation: Subsequent to our communication of the above condition to the Finance Department, the City has implemented compensating controls which added a layer of review by employees who do not have full access to the particular modules. While the new procedures appear to mitigate the condition noted above, it also has added workload for the Finance staff. We understand that the City expects to upgrade its financial system to a cloud environment in June 2014. We recommend that the City implement the segregation of duties into its cloud environment in order to eliminate the extra layer of review.

Current Year Status: See Significant Deficiency 2014-02

2013-02 - Vendor Edit Audit Report Review

Criteria: Whenever there is a change to any vendor information in the financial system, the financials system generates a vendor edit audit report. This report reflects all the changes made to the vendor database for a specific period of time. Typically, this report is reviewed by the Purchasing and Payables Coordinator to ensure that there is proper approval for any changes made to a vendor or the creation of a new vendor.

Condition: During the current year audit, the review the vendor edit audit report was not performed.

Effect: Since the City's Accounts Payable Clerks have access to the vendor database, without the review of the vendor edit audit report by another employee, who does not have access to the accounts payable run, creates a potential risk of unauthorized or non-existent vendors being added to the database without anyone knowing. Furthermore, once vendors are added to the system, there is also the possibility that unauthorized disbursements could be made to these vendors.

Cause: We understand that in the prior years, the Purchasing and Payables Coordinator would produce the reports and would ensure that the reports were being reviewed and approved. During this fiscal year she was on leave, therefore, the reports were not produced or reviewed.

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SCHEDULE OF PRIOR YEAR OTHER MATTERS

Recommendation: We recommend the City resume the practice of the review process above for good internal control.

Current Year Status: The City has resumed reviewing the vendor edit audit report on a weekly basis.

2013-03 - Funding Retiree Medical Liabilities

As disclosed in the notes to the financial statements, the City's liability for post-employment healthcare benefits amounted to \$91 million based on the January 1, 2013 actuarial valuation.

The unfunded liabilities are long-lived liabilities that are expected to come due over an extended period. The City has not funded retiree medical costs and no funds have been set aside against this liability. Retiree medical liabilities will continue to grow unless sound funding strategies are adopted.

Sound fiscal policy should be established to fund long-lived liabilities and that funding should be incorporated into the City's annual budgets and operations as well as financial projections and forecasts.

Management's Response: The City has worked with a third party vendor to establish an OPEB trust and will continue to address its OPEB liability as part of its annual budget and future forecasts.

Current Year Status: The City's management continues to address the long-term OPEB liability.

REQUIRED COMMUNICATIONS

October 15, 2014

To the Honorable Mayor, City Council, and City Auditor
of the City of Alameda
Alameda, California

We have audited the basic financial statements of the City of Alameda (City) for the year ended June 30, 2014. Professional standards require that we communicate to you the following matters relating to our audit under generally accepting auditing standards and, *Government Auditing Standards* and OMB Circular A-133.,

Significant Audit Findings

Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the financial statements. The following Governmental Accounting Standards Board (GASB) pronouncements became effective, but did not have a material effect on the financial statements:

GASB 66 - Technical Corrections—2012—an amendment of GASB Statements No. 10 and No. 62

GASB 70 - Accounting and Financial Reporting for Nonexchange Financial Guarantees

Unusual Transactions, Controversial or Emerging Areas

We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Estimates

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

As of June 30, 2014, the City's cash and investments were measured by fair value. Fair value is essentially market pricing in effect as of that date. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2014.

Management's estimate of depreciation is based on useful lives determined by management. These lives have been determined by management based on the expected useful life of assets as disclosed in Note 5 to the financial statements. We evaluated the key factors and assumptions used to develop the depreciation estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.

Disclosures

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

Difficulties Encountered in Performing the Audit

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

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

Disagreements with Management

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

Management Representations

We have requested certain representations from management that are included in a management representation letter dated October 15, 2014.

Management Consultations with Other Independent Accountants

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

Other Audit Findings or Issues

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

Other Information Accompanying the Financial Statements

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

With respect to the required supplementary information accompanying the financial statements, we applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not express an opinion nor provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

The Introductory and Statistical Sections included as part of the Comprehensive Annual Financial Report have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we did not express an opinion nor provide any assurance on them.

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

Maze & Associates

Pleasant Hill, California
October 15, 2014

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