CITY OF ALAMEDA
MEMORANDUM ON INTERNAL CONTROL

FOR THE YEAR ENDED JUNE 30, 2018

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For the Year Ended June 30, 2018

Table of Contents

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MAZE & ASSOCIATES

MEMORANDUM ON INTERNAL CONTROL

To the City Council of
the City of Alameda, California

We have audited the basic financial statements of the City of Alameda, California, for the year ended June 30, 2018, and have issued our report thereon dated March 27, 2019. Our opinions on the basic financial statements and this report, insofar as they relate to the Alameda Municipal Power Enterprise Fund, are based solely on the reports of other auditors. In planning and performing our audit of the basic financial statements of the City as of and for the year ended June 30, 2018, 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 audit 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 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. 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 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.

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 are opportunities for strengthening internal controls and operating efficiency.

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Management's written 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, 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
March 27, 2019

MEMORANDUM ON INTERNAL CONTROL

SCHEDULE OF SIGNIFICANT DEFICIENCIES

2018-01 Segregation of Duties in Major Control Areas

During our review of the City's internal controls for proper segregation of duties and procedures, we noted areas in which controls need to be improved and employee's access and/or duties revised. Good internal controls require that employees with access to the City's assets not have access to the City's accounting records for the same assets. Inappropriate access could potentially result in undetected errors.

a) Access to Customer Database and Cash Receipts/ Non-Sufficient Funds Checks

City staff that is involved in the cash receipts process should not normally be allowed to have access to make changes to the customer database. And, employees that generate accounts receivable billings should not be involved with the collection of cash receipts or processing of non-sufficient funds checks and ability to adjust the general ledger.

The Finance Supervisor and the Accounting Technician handle cash receipts and have access to the customer database, non-sufficient funds checks and can adjust the general ledger, while it does not appear that changes to the customer database are reviewed. And, the Accounting Technician generates accounts receivable billings.

We understand the Finance Department was understaffed, which resulted in a need to reallocate certain employee duties.

The access to make changes to the customer database should be removed from the Finance Supervisor and the Accounting Technician and in the event the system does not allow such a change, there should be a review and approval of all changes to the customer database on a regular basis to ensure all changes were authorized. In addition, the processing of non-sufficient funds checks should be transferred to an employee that is not involved with both billings and collections and if the Accounting Technician continues to prepare accounts receivable billings, she should not be involved with cash collections.

b) Finance Staff with General Ledger Super User Rights

A system super-user is an individual who has full access over the City's financial system including all modules and all functions. Accounting staff should not normally be allowed to have super-user rights in the City's general ledger system.

We noted that the City's Finance Supervisor has super-user access to the City's general ledger system.

When accounting staff have super-user rights, there is a potential risk of restricting or allowing access to other user's abilities to access the different modules in the accounting system. In addition, unauthorized transactions and misstatements may occur without timely detection and correction.

We understand that City staff believes sufficient controls are in place to mitigate the risk.

2018-01 Segregation of Duties in Major Control Areas (Continued)

The City should consider restricting super user rights to as few employees as possible, preferably to those outside of the Finance Department, such as Information Technology personnel, since they are not involved with processing or approving general ledger transactions. Until that is possible, the City should implement mitigating controls such as a review and approval of changes made to the system by the above employee.

City staff must develop procedures to review the City's internal controls to ensure there is proper segregation of duties and that there is documentation of the review and approval of transactions and reconciliations in key control areas. Where internal control conflicts exist, if mitigating controls cannot be put in place to reduce the internal control risk, then either the ability to process the transaction or the access to the asset should be transferred to another appropriate employee.

Management's Response:
It is not feasible to remove super-user rights from all Finance Department staff. However, in order to mitigate the chances of unauthorized transactions, the City has implemented other internal controls. These measures include, but are not limited to, restricted access to check stock; all wire transfers are required to have second approval from another manager; the super-user does not have access to Human Resources functions, such as setting up employees; all journal entries and check requisitions must be approved by a manager, but not the one initiating the transaction; and the City's checking account is reconciled on a monthly basis and the investment accounts are reconciled on a quarterly basis by someone other than the supervisor with super-user access.

The City will review and reassess the access of the Finance Supervisor and the Accounting Technician to the customer database and cash receipts, including insufficient funds checks.

The City is in the process of selecting a new Enterprise Resource Planning (ERP) system. The implementation of which is expected to begin in the fall 2019. With the more robust system, there will be opportunities to review and reevaluate the Finance Department staff access and system rights to further address the segregation of duties.

2018-02 Charging Building Permit Fees and False Alarm Fees in Accordance with the Master Fee Schedule

The fees charged in the City's billing system should be accurately calculated based on the Master Fee Schedule approved by City Council. As soon as City Council approves an update to the Master Fee Schedule, the billing system should be updated timely.

We selected twenty-five cash receipts to test for supporting documentation and calculations in accordance with the Master Fee Schedule and noted the following exceptions:

- The Technology Fee for one permit, which is based on 5% of certain components of the permit, was incorrectly calculated as $42.50, instead of $51.75.

2018-02 **Charging Building Permit Fees and False Alarm Fees in Accordance with the Master Fee Schedule (Continued)**

- The City's 1% Improvement Tax for one permit was calculated using the project's original valuation instead to the project's amended valuation, resulting an understatement of the permit fee in the amount of $150.

- One remittance for false alarm fees charged by the Police Department was comprised of nine payments and four of the false alarm fees were invoiced for $158, instead of the correct rate of $163, and two were invoiced for $78, instead of the correct rate of $81. We also noted that the false alarm fees were paid late, but the customers had not been charged a late fee. Finally, these invoices were for customer billings that dated back to fiscal year 2017 and we did note that the City had corrected the fee amounts charged to customers in fiscal year 2018.

We understand the Technology Fee error was due to was due to the fee being set up incorrectly in the system, the Improvement Tax error was due to staff oversight and the false alarm fee error was due to the Police Department staff not being aware of the change to the Master Fee Schedule.

Although the fee errors are individually small, they could accumulate to significant balances. Without setting up the system correctly, the City could be under- or overcharging customers.

The City should ensure that all rate and fee calculations are reviewed and agree to the applicable Master Fee Schedule. The City also should ensure that fees are set up correctly in the system and inform all City Departments of rate and fee changes. And, after fee changes are implemented, City staff should spot check customer invoices to ensure they are being calculated correctly.

Management's Response:
The City staff updates Master Fee Schedule annually, which then is approved by the City Council with effective date of July 1, a start of the new fiscal year. Finance Department staff will work with all City departments to ensure the revised Master Fee Schedule is used to update various City systems that calculate fees and charges. In addition, each department will assign another staff to review fees for accuracy after input is complete.

2018-03 **Purchasing Policy Compliance**

The City's Purchasing Policy Appendix A states that Materials and Services over $25,000, and Professional and Personal services for $5,000 to $75,000, and over $75,000 require a standard contract approved by City Council. In addition, the City should process invoices and scheduled payments in a timely manner.

We selected forty-six disbursements to test for supporting documentation and compliance with the City's purchasing policy and noted the following:

- One payment was comprised of three vendor invoices totaling $1,774 that were individually below the threshold requiring a contract, but the City used the vendor throughout the fiscal year for various door repairs/replacements totaling $129,830.

2018-03 Purchasing Policy Compliance (Continued)

- One payment was for landscape services in the amount of $1,325, which does not individually require a contract, but payments to the vendor for the fiscal year totaled $296,284.

- One payment for truck repairs that was comprised of two vendor invoices totaling $46,637 that were individually below the threshold requiring a contract, so only a purchase order was used.

- One payment for operating expenses (utility, trash/compost, & water service charges) in a landscaping and lighting district for which there is no contract. We understand the City took over the responsibilities from another entity dating back to 1986, but a contract was not established with the City and instead a purchase order is used. We also understand a formal agreement is in process.

- There were two payments to vendors whose contracts had expired – one for cell phone services and one for psychological services.

It appears contracts should have been in place for all of the disbursements noted above. Without valid contracts, the City may experience problems if disagreements with vendors arise and there are no enforceable contracts in place. Although the City's Purchasing Policy does not address whether the use of vendors throughout the fiscal year for unrelated purchases that collectively exceed the authorization thresholds require the use of purchase orders, two of the vendors noted above were used for ongoing services.

The City should ensure that contracts are in place for vendors that meet the thresholds in the purchasing policy and payments to vendors are made only when a current contract is in place. The City should review the contracts often, and make sure they are in effect and in compliance. The City should also develop a procedure to review the services throughout the year for the same vendor rather than just looking at one individual invoice to determine if a contract should be in place.

Finally, the City should clarify in the Purchasing Policy for whether the use of one vendor throughout the fiscal year for which disbursements cumulatively exceed the authorization thresholds trigger the need to comply with the contract requirements of the Policy.

Management's Response:
The City staff is aware of the current Purchasing Policy deficiencies. Finance Department, with assistance from a consultant, completed an assessment of the citywide procurement process and review of existing procurement policies and procedures. The next planned steps are to redesign current process to provide for greater efficiencies and streamline process. The Purchasing Policy and related City Ordinances will be reviewed and proposed changes will be presented to the City Council for approval. In addition, all city staff will be trained on the new policies and procedures. However, Finance Department staff in collaboration with the Departments will review and provide training for staff on current practices for compliance with the existing policy and make adjustment in the interim period.

MEMORANDUM ON INTERNAL CONTROL

SCHEDULE OF OTHER MATTERS

2018-04 Timely Cutoff of Terminated Employees from Payroll System

The elapsed time between an employee's final pay check and their termination in the payroll system should be minimized to reduce fraud risks as well as with being removed from having access to the General Ledger.

We selected fifteen terminated employees for testing of proper and timely cutoff in the City's computer system and noted seven part-time employees had been terminated in the system more than 30 days subsequent to their final check date. We also noted that six employees still had access to the general ledger as their accounts were never erased.

When an employee's access from the computer system is not terminated upon their departure from the City, there is a possibility of that employee gaining unauthorized access to the City records.

We understand the six accounts that are still active in the system are retained as "placeholder" accounts so City staff does not have to create a new profile for the job title once a new person fills in the position.

The City should develop policies and procedures to ensure that an employee's system access is disabled in a timely manner after termination. And, the City should not retain access in the system with a "placeholder account" and instead eliminate the terminated employees from the computer system and create a new account once the position is filled.

> ***Management's Response:***
> Finance Department staff in collaboration with Human Resources and Information Technology Departments staff will review current practices and procedures as it relates to the part-time employees termination process, in an effort to align them with the full-time employee termination process. However, because the part-time employees work schedule can be sporadic, there are times when an employee may chose not to return to work and not inform the City of such a decision until a later date. For those part-time employees with general ledger access, the City will disable their access when they are in unpaid status for two consecutive pay periods.

2018-05 Timely Posting of Journal Entries

Journal entries are an important transaction cycle that affects all aspects of accounting and financial reporting. Prudent internal control concepts dictate that journal entries should be posted within a timely manner that is within 30 to 45 days after the period date for which the journal entry is intended to record.

We selected forty journal entries and noted two that were not posted timely.

- One journal entry was to record fuel charges for the month of December 2017. The journal entry was prepared on March 1, 2018 and posted on March 29, 2018.
- One journal entry posted in June 2018 was to record Engineering Charges for the month of March 2018.

We understand the Finance department was heavily involved in preparing budget reports during the month of December 2017, coupled with a shortage in department staff, that caused the delay in posting the fuel charge journal entry. As for the delay in posting the Engineering Charges activity was due to the Engineering department's project time (billable time) not being integrated with the general ledger system. As a result, City staff has to manually enter all transactions, which can be a tedious and time consuming process.

2018-05 Timely Posting of Journal Entries (Continued)

The delay in posting journal entries could potentially affect the timeliness of all aspects of accounting and financial reporting.

The City should develop procedures to ensure that all journal entries are prepared, reviewed and posted within 30 to 45 days after the period date for which the journal entry is to be recorded, including Engineering Department's time billing.

> ***Management's Response:***
> Finance staff will work with Public Works Department to improve communication and timeliness of submission of supporting documentation for allocating charges to various City departments. While Finance procedures already establish timely processing of journal entries, Finance Department has experienced high staff turnover and a loss of rote knowledge with the continued level of workload, which caused and continues to cause delays. The Finance Department is working closely with the Human Resources Department to hire for these positions so it is back to appropriate staffing levels.

2018-06 Develop a Review Process for Deposits Payable

To ensure that deposits payable balances are accurate, deposit payable details should be reviewed on a regular basis, such as monthly or quarterly.

We selected forty journal entries for testing and noted one was for the reclassification of a Business Improvement Area deposit that was collected in August 2017 and paid out in September 2017. The deposit payable remained in the deposit account, because the disbursement was coded to an expense account and the error was identified and corrected in December 2017.

We understand the City does not have a procedure in place to review Business Improvement Area deposits to ensure that payment activity is reconciled to the deposits payable activity. Lack of review could result inaccurate accounting for the deposits payable balances.

The City should develop a review process for the Business Improvement Area deposits payable to ensure all balances are outstanding and were not refunded in a prior period.

> ***Management's Response:***
> The staff agrees with the proposed recommendation and will develop a review process for the Business Improvement Area deposits payable.

2018-07 Timely Remittance of Invoices from Each Department to the Finance Department

The City should pay vendor invoices in a timely manner and departments should remit invoices to the Finance Department in a timely manner.

We selected 46 disbursements for testing and noted one disbursement in February 2018 in the amount of $46,637 was for invoices from a vendor dated August and November 2017 with net 30 payment terms.

2018-07 **Timely Remittance of Invoices from Each Department to the Finance Department (Continued)**

When we inquired about the cause of the delay in payment, we understand that the Public Works Department lost the invoice and it went unnoticed until the vendor asked for payment. We also understand the Department has revised its workflow to minimize the possibility of recurrence.

When invoices are not paid timely, the City runs the risk of unpaid invoices and incurring late fees.

The City should ensure that all departments implement procedures to submit all invoices to Finance in a timely manner.

Management's Response:
Staff processes invoices within one to two weeks from the date of receipt in Finance Department. The City has a decentralized procurement process in which invoices and payment requests are handled by individual departments before being processed by the Finance Department. However, Finance staff will work with individual departments to improve processing times.

2018-08 **Review of Service Organization Reports**

The City has several independent contractors which process transactions for various City activities including fiscal agent cash, investments, ambulance billing services, parking citations and others. The City should review the Statements on Standards for Attestation Engagements #16 (SSAE 16) reports from their service organizations.

City staff does not currently request and review SSAE 16 reports from the service organizations to ensure that findings are addressed by the entities and such findings do not involve or affect the City's transactions.

The procedures used by these service organizations are outside the scope of City oversight and staff review, nor are these controls part of the scope of an audit of the City's financial statements. Typically, cities may employ a variety of approaches to gain comfort that service organizations are performing their functions in a prudent manner and producing reliable data. For example, trust departments manage funds held pursuant to debt indentures, but cities rarely have audits performed as City staff review transactions and verify the trust data. Less frequently, special audits are performed to determine adequacy of controls and to verify the data produced. There is a third option which is to request a review and report on internal controls pursuant to the requirements of Statements on Standards for Attestation Engagements #16.

We understand that City staff was unaware that SSAE 16 reports were available for review and should be requested and reviewed on an annual basis.

The City should request a SSAE 16 report from its independent contractors. Any weaknesses or system problems disclosed by that audit should be addressed and resolved by the contractor to the satisfaction of the City.

Management's Response:
As part of the year-end procedures, the City will request SSAE16 reports from identified service organizations.

2018-09 **<u>Alameda County Transportation Commission Timely Use of Funds Policy</u>**

In December 2015, the Alameda County Transportation Commission (ACTC) approved a Timely Use of Funds Policy. This policy was adopted to encourage Measure B/Measure BB/Vehicle Registration Fee (VRF) recipients to expend voter-approved transportation dollars expeditiously on transportation improvements and operations that the public can use and benefit from immediately.

Under the terms of the Policy, a recipient of Measure B, BB or VRF cannot carry a fiscal year end fund balance greater than 40% of the direct local distribution revenue received for that same year for four consecutive fiscal years within each funding program. ACTC will monitor the recipient agencies' annual ending fund balance to revenue received ratio, cumulatively across the recipient's programmatic categories by fund program, to verify Policy compliance.

If the recipient does not meet the requirements of the Policy, the ACTC may determine that the recipient does not need Measure B, BB or VRF funding and rescind the recipient's subsequent fiscal year's Measure B, BB or VRF direct local distribution in part or in its entirety and redistribute those funds to the same program type.

The provisions of the Timely Use of Funds Policy begin with the Measure B, BB, or VRF funding received in fiscal year 2017, which means that if the fund balance for any program exceeds 40% of the distribution consecutively in each of the fiscal years of 2017 to 2020, funding for fiscal year 2021 could be at risk. ACTC provided the recipient agencies with a flow chart to assist in determining compliance and track the funds. In the event the recipient's fund balance for a program does exceed the maximum allowed percentage, there are provisions in the Policy for submitting a request for exemption with a justification and implementation plan, which resets the consecutive fiscal year "clock." However, ACTC will only allow exemptions under extraordinary circumstances and the recipient must provide a timely expenditure plan for use of the funds.

The City should ensure that it is using the flow chart and any other compliance tools necessary to ensure that the City is spending the funds as intended and not accumulating ending fund balance in any of the three programs in excess of the maximum allowed percentage for four consecutive fiscal years, or request an exemption, if applicable.

Management's Response:
The City of Alameda has traditionally used Measure B, BB and VRF funding to support a variety of transportation related projects throughout the City and these funding sources currently support more than a dozen Capital Projects and operational programs. However, in response to the Timely Use of Funds Policy, the City has prioritized Measure B, BB and VRF funding towards the City's annual pavement management program. Through mid-March in Fiscal Year 2019, the City has expended approximately $5.5 million in Measure B, BB and VRF funding for pavement restoration including $4.8 million in direct construction costs. The recent focus on pavement projects in conjunction with ongoing work on other Capital Improvement Program projects and operational programs, the City is expecting to reduce ending fund balance for Fiscal Year 2019 to less than 40% of the direct local distribution revenue.

2018-10 Information Technology Best Practices Recommendations

We conducted an Information Systems Review with our audit which encompassed the financial information system and the network environment that houses it. We expanded our work in previous years beyond simply looking at financial information systems as a result of greater risks of unauthorized access caused by overall industry growth of web-based commerce and internet based financial systems. Internal controls that are present in the overall network environment have become more important and relevant to understanding the internal controls over the financial system. We believe Information System controls must be continuously improved and enhanced to stay ahead of the ever-increasing sophistication of hackers and criminals.

Currently, there are no Information Systems standards to which local governments are required to conform. Indeed, there are a wide variety of informal guidelines and suggested controls from many different organizations which local governments can use to implement appropriate controls to ensure adequate security over information technology. A voluntary risk-based Cybersecurity Framework has been developed by the National Institute of Standards and Technology (NIST) per Presidential Executive Order 13636 (12 FEB 2013). The *Framework for Improving Critical Infrastructure Cybersecurity* version 1.0 (12 FEB 2014) offers some appropriate standards. Our Information Systems auditors have reviewed the voluntary framework and concluded that the risk management framework developed by NIST for the Federal Information Security Management Act (FISMA) is the most appropriate for local governments[1]. The NIST risk management framework represents the minimum security requirements for federal government agencies and recommends these controls for private industry and state and local governments. Our procedures included performing an external network scan based on NIST criteria and in determining that internal control provides for:

- Internet access defenses including hacker prevention, detection and deterrent systems
- Security of data from physical or network access
- Adequately protecting data from unauthorized internal access
- Reasonable measures to ensure continuation of service

We again noted areas which could be improved to conform to NIST guidelines. A summary of these recommendations which we believe are “best practices” as follows:

Payment Card Industry Compliance

The City is not in compliance with the Payment Card Industry Data Security Standard (PCI-DSS). Any organization that processes credit cards is required to comply with PCI-DSS, even if the processing is outsourced. Failure to meet compliance requirements results in higher transaction fees and liability if a security breach is found. Because the City accepts credit cards as a form of payment, the City must be compliant with the applicable controls.

[1] "State, local, and tribal governments, as well as private sector organizations are encouraged to consider using these guidelines, as appropriate." NIST SP 800-37 Rev 1 pg 11

2018-10 Information Technology Best Practices Recommendations (Continued)

Audit/Event Logging
The City does not appear to have audit logs on the financial application server, such that any change, addition or deletion of user accounts within the application are tracked and monitored. The City should have audit/event logs of any addition, deletion or change in financial application user accounts and that log should be monitored by someone without the rights to effect such changes. Also, any administrative access such as upgrades or application modifications by IT personnel, outside consultants or vendors should also be logged and reviewed.[2]

Session Locks
The City does not have session locks turned on for the financial application or the workstation operating systems. A session lock is a temporary lockout of the operating system or financial application when a user stops work and typically moves away from the immediate physical vicinity of the computer. Employees may leave their workstation for lunch or break and not log off or log out of the application. This leaves the operating system or financial application open and available to any passerby. Any person with physical access would be able to perform any tasks the absent user has privileges or rights to do. At the very least workstations should be set to lock out the workstation after a period of inactivity. Best practice would be to have both the operating system and financial application have lockouts after a period of inactivity.

General Information Systems Controls
Our administrative and technical control review is based on the National Institute of Standards and Technology (NIST) control catalog NIST SP 800-53 rev. 4 for a moderate system as defined by NIST SP 800-60. Although there is no required IT standard for local governments, NIST encourages state, local and tribal governments to consider the use of these guidelines, as appropriate. In adopting NIST standards, the local government demonstrates due diligence in designing and implementing appropriate controls around its information systems.

A list of the controls that are not fully in place is available in the questionnaire provided to City staff.

Management's Response:
Recognizing there are no material weaknesses in our Information Systems Review, the following measures will be or are being implemented to improve our best practices efforts.

Audit/Event Logging: Our current version of Central Square eFinance Plus is outdated and does not provide the detailed audit logs recommended, however, the city is replacing Central Square eFinance Plus in 2020. The replacement financial system will include detailed audit logs on the financial application for any change, addition or deletion of user accounts and will be tracked and monitored by someone without the rights to effect such changes. This is a requirement for the new financial system.

Any administrative access such as upgrades or application modifications by IT personnel, outside consultants or vendors will be logged and reviewed following the IT Change Control Policy requirements.

[2] For more information on Audit/Event log management see NIST SP 800-92 Guide to Computer Security Log Management.

2018-10 Information Technology Best Practices Recommendations (Continued)

Session Locks: The current financial system, Central Square eFinance Plus, is outdated and does not have a session lock feature. Until the replacement of the financial system in 2020, the workstation operating system will be modified in April 2019, to include a 15 minute session lockout for inactivity for all workstations excluding workstations for presentation use only such as in Council Chambers.

General Information Systems Controls: As part of our IT Governance strategy plan, the city is following the National Institute of Standards and Technology (NIST) to adhere to best practices for cybersecurity. While the city is not yet 100% compliant, we are 32% fully compliant, 19% partially compliant and 49% non-compliant with the NIST cybersecurity framework (CSF) mentioned in the audit; however, the IT Department does have a plan for action to address the partial and non-compliant standards to follow best practices.

2018-11 Uniform Guidance Procurement Standards

The City is required to implement changes to its procurement policies and procedures in accordance with the Uniform Guidance procurement standards in 2 CFR 200.317 through 200.326 for any federally funded procurements beginning on or after July 1, 2018.

Since the City receives federal awards, a few of the general standards over procurement include:

- The City must have documented procurement procedures that reflect federal law, Uniform Guidance standards, and any state regulations.
- The City must maintain an appropriate level of oversight to ensure that contractors perform in accordance with the terms of their contracts or purchase orders.
- Written conflict-of-interest policies are required. No employee or agent of the City may participate in the selection, award, or administration of a contract funded by federal grant dollars if he or she has an actual or apparent conflict of interest.
- Entities should focus on the most economical solution during the procurement process, and must avoid using federal funds for the acquisition of unnecessary items. Organizations are encouraged to consider the use of shared services and intergovernmental agreements to foster greater economy and efficiency.
- The City must maintain records sufficient to detail the history of procurement, including the rationale for the method of procurement, contract type, and the basis for the contractor selection or rejection and price.

In addition to other requirements, the Uniform Guidance also requires full and open competition. Contractors who assist in drafting specifications for invitations for bids or requests for proposals (RFP) must be excluded from competing for those procurements.

2018-11 Uniform Guidance Procurement Standards (Continued)

The Uniform Guidance also outlines five methods of procurement to be followed for federally funded projects:

- Micro-purchase: Purchases where the aggregate dollar amount does not exceed $3,000 (or $2,000 if the procurement is construction and subject to Davis-Bacon). When practical, the City should distribute micro-purchases equitably among qualified suppliers. No competitive quotes are required if management determines that the price is reasonable.

- Small purchase: Includes purchases up to the Simplified Acquisition threshold, which is currently $150,000. Informal purchasing procedures are acceptable, but price or rate quotes must be obtained from an adequate number of qualified sources.

- Sealed bids (formal advertising): Used for purchases over the Simplified Acquisition Threshold, which is currently $150,000. Under this purchase method, formal solicitation is required, and the fixed price (lump sum or unit price) is awarded to the responsible bidder who conformed to all material terms and is the lowest in price. This method is the preferred procurement method for construction contracts if certain provisions apply.

- Competitive proposals: Used for purchases over the Simplified Acquisition Threshold, which is currently $150,000. This procurement method requires an adequate number of qualified sources submitting an offer for either a fixed-price or cost-reimbursement contract, and is used when sealed bids are not appropriate. The contract should be awarded to the responsible firm whose proposal is most advantageous to the program, with price and other factors considered.

- Noncompetitive proposals: Also known as sole-source procurement, this may be appropriate only when specific criteria are met. Examples include when an item is available only from a single source, when a public emergency does not allow for the time of the competitive proposal process, when authorized by the federal awarding agency, or after a number of attempts at a competitive process, the competition is determined to be inadequate.

The provisions above are just highlights from the new procurement standards and the City should ensure that all of the procurement standards in the Uniform Guidance have been reviewed and that applicable policies and procedures in place for fiscal year 2019.

If the City determines that it will have different purchasing policies for federally funded vs non-federally funded projects, procedures should be in place to ensure that all contracts awarded related to federally-funded projects are in compliance with the requirements of the Uniform Guidance Procurement Standards. This is critical in the event a grant award allows for the reimbursement of costs incurred prior to award issuance, if those contracts were awarded using procedures that are not in compliance with the Uniform Guidance Procurement Standards.

2018-11 Uniform Guidance Procurement Standards (Continued)

NOTE – we understand that the micro-purchase and simplified acquisition thresholds have been amended by the GSA office for fiscal year 2018 in its February 16, 2018 letter, but the rates in the Uniform Guidance remain at the levels noted above. It is expected that the Uniform Guidance thresholds will be amended to coincide with the Federal Acquisition Regulation (FAR) thresholds, but that cannot be guaranteed.

Therefore, City staff should periodically review the Uniform Guidance thresholds to see if they have been revised.

Management's Response:
Noted. The City will ensure the required procurement standards are reviewed and up-to-date to comply with Uniform Guidance.

NEW GASB PRONOUNCEMENTS OR PRONOUNCEMENTS NOT YET EFFECTIVE

The following comment represents new pronouncements taking affect in the next few years. We cite them here to keep you informed of developments:

EFFECTIVE FISCAL YEAR 2018/19:

GASB 83 – *Certain Asset Retirement Obligations*

This Statement addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this Statement.

This Statement establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for AROs. This Statement requires that recognition occur when the liability is both incurred and reasonably estimable. The determination of when the liability is incurred should be based on the occurrence of external laws, regulations, contracts, or court judgments, together with the occurrence of an internal event that obligates a government to perform asset retirement activities. Laws and regulations may require governments to take specific actions to retire certain tangible capital assets at the end of the useful lives of those capital assets, such as decommissioning nuclear reactors and dismantling and removing sewage treatment plants. Other obligations to retire tangible capital assets may arise from contracts or court judgments. Internal obligating events include the occurrence of contamination, placing into operation a tangible capital asset that is required to be retired, abandoning a tangible capital asset before it is placed into operation, or acquiring a tangible capital asset that has an existing ARO.

This Statement requires the measurement of an ARO to be based on the best estimate of the current value of outlays expected to be incurred. The best estimate should include probability weighting of all potential outcomes, when such information is available or can be obtained at reasonable cost. If probability weighting is not feasible at reasonable cost, the most likely amount should be used. This Statement requires that a deferred outflow of resources associated with an ARO be measured at the amount of the corresponding liability upon initial measurement.

This Statement requires the current value of a government’s AROs to be adjusted for the effects of general inflation or deflation at least annually. In addition, it requires a government to evaluate all relevant factors at least annually to determine whether the effects of one or more of the factors are expected to significantly change the estimated asset retirement outlays. A government should remeasure an ARO only when the result of the evaluation indicates there is a significant change in the estimated outlays. The deferred outflows of resources should be reduced and recognized as outflows of resources (for example, as an expense) in a systematic and rational manner over the estimated useful life of the tangible capital asset.

GASB 83 – ***Certain Asset Retirement Obligations (Continued)***

A government may have a minority share (less than 50 percent) of ownership interest in a jointly owned tangible capital asset in which a nongovernmental entity is the majority owner and reports its ARO in accordance with the guidance of another recognized accounting standards setter. Additionally, a government may have a minority share of ownership interest in a jointly owned tangible capital asset in which no joint owner has a majority ownership, and a nongovernmental joint owner that has operational responsibility for the jointly owned tangible capital asset reports the associated ARO in accordance with the guidance of another recognized accounting standards setter. In both situations, the government's minority share of an ARO should be reported using the measurement produced by the nongovernmental majority owner or the nongovernmental minority owner that has operational responsibility, without adjustment to conform to the liability measurement and recognition requirements of this Statement.

In some cases, governments are legally required to provide funding or other financial assurance for their performance of asset retirement activities. This Statement requires disclosure of how those funding and assurance requirements are being met by a government, as well as the amount of any assets restricted for payment of the government's AROs, if not separately displayed in the financial statements.

This Statement also requires disclosure of information about the nature of a government's AROs, the methods and assumptions used for the estimates of the liabilities, and the estimated remaining useful life of the associated tangible capital assets. If an ARO (or portions thereof) has been incurred by a government but is not yet recognized because it is not reasonably estimable, the government is required to disclose that fact and the reasons therefor. This Statement requires similar disclosures for a government's minority shares of AROs.

GASB 88 – ***Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements***

The primary objective of this Statement is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt.

This Statement defines debt for purposes of disclosure in notes to financial statements as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established.

This Statement requires that additional essential information related to debt be disclosed in notes to financial statements, including unused lines of credit; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses.

For notes to financial statements related to debt, this Statement also requires that existing and additional information be provided for direct borrowings and direct placements of debt separately from other debt.

GASB 88 – *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements (Continued)*

How the Changes in This Statement Improve Financial Reporting

The requirements of this Statement will improve financial reporting by providing users of financial statements with essential information that currently is not consistently provided. In addition, information about resources to liquidate debt and the risks associated with changes in terms associated with debt will be disclosed. As a result, users will have better information to understand the effects of debt on a government's future resource flows.

EFFECTIVE FISCAL YEAR 2019/20:

GASB 84 – *Fiduciary Activities*

The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported.

This Statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities.

An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements. Governments with activities meeting the criteria should present a statement of fiduciary net position and a statement of changes in fiduciary net position. An exception to that requirement is provided for a business-type activity that normally expects to hold custodial assets for three months or less.

This Statement describes four fiduciary funds that should be reported, if applicable: (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private-purpose trust funds, and (4) custodial funds. Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria.

A fiduciary component unit, when reported in the fiduciary fund financial statements of a primary government, should combine its information with its component units that are fiduciary component units and aggregate that combined information with the primary government's fiduciary funds.

This Statement also provides for recognition of a liability to the beneficiaries in a fiduciary fund when an event has occurred that compels the government to disburse fiduciary resources. Events that compel a government to disburse fiduciary resources occur when a demand for the resources has been made or when no further action, approval, or condition is required to be taken or met by the beneficiary to release the assets.

GASB 90 - *<u>Majority Equity Interests—an amendment of GASB Statements No. 14 and No. 61)</u>*

The primary objectives of this Statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units. It defines a majority equity interest and specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment. A majority equity interest that meets the definition of an investment should be measured using the equity method, unless it is held by a special-purpose government engaged only in fiduciary activities, a fiduciary fund, or an endowment (including permanent and term endowments) or permanent fund. Those governments and funds should measure the majority equity interest at fair value.

For all other holdings of a majority equity interest in a legally separate organization, a government should report the legally separate organization as a component unit, and the government or fund that holds the equity interest should report an asset related to the majority equity interest using the equity method. This Statement establishes that ownership of a majority equity interest in a legally separate organization results in the government being financially accountable for the legally separate organization and, therefore, the government should report that organization as a component unit.

This Statement also requires that a component unit in which a government has a 100 percent equity interest account for its assets, deferred outflows of resources, liabilities, and deferred inflows of resources at acquisition value at the date the government acquired a 100 percent equity interest in the component unit. Transactions presented in flows statements of the component unit in that circumstance should include only transactions that occurred subsequent to the acquisition.

The requirements of this Statement are effective for reporting periods beginning after December 15, 2018. Earlier application is encouraged. The requirements should be applied retroactively, except for the provisions related to (1) reporting a majority equity interest in a component unit and (2) reporting a component unit if the government acquires a 100 percent equity interest. Those provisions should be applied on a prospective basis.

EFFECTIVE FISCAL YEAR 2020/21:

GASB 87 – ***<u>Leases</u>***

The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.

GASB 87 – ***Leases (Continued)***

A lease is defined as a contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction. Examples of nonfinancial assets include buildings, land, vehicles, and equipment. Any contract that meets this definition should be accounted for under the leases guidance, unless specifically excluded in this Statement.

GASB 89 - ***Accounting for Interest Cost Incurred before the End of a Construction Period***

The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period.

This Statement establishes accounting requirements for interest cost incurred before the end of a construction period. Such interest cost includes all interest that previously was accounted for in accordance with the requirements of paragraphs 5–22 of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,* which are superseded by this Statement. This Statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund.

This Statement also reiterates that in financial statements prepared using the current financial resources measurement focus, interest cost incurred before the end of a construction period should be recognized as an expenditure on a basis consistent with governmental fund accounting principles.

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