CITY OF MANTECA

MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS

FOR THE YEAR ENDED
JUNE 30, 2013

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CITY OF MANTECA
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AND
REQUIRED COMMUNICATIONS

For the Year Ended June 30, 2013

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MAZE & ASSOCIATES

MEMORANDUM ON INTERNAL CONTROL

To the City Council of
the City of Manteca, California

We have audited the basic financial statements of the City of Manteca for the year ended June 30, 2013, and have issued our report thereon dated March 27, 2014. In planning and performing our audit of the basic financial statements of the City of Manteca, 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 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 identified certain deficiencies in internal control that we consider to be significant deficiencies that are included in the Status of Prior Year Significant Deficiencies as items 2012-02, 2010-01 and 2010-03.

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, others within the organization, and agencies and pass-through entities requiring compliance with generally accepted 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, 2014

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SCHEDULE OF OTHER MATTERS

2013-01 Terminated Employees

When employees are terminated or leave employment, the City should remove them from the payroll system at the time of their departure. We selected a sample of ten employees terminated during fiscal year 2013 and noted that four of the employees selected had final pay dates between March 2009 and September 2011. The City stated that it does not remove employees from the payroll system in case they come back for future employment, such as seasonal employees. The City should remove terminated employees from the payroll system immediately upon their departure and if they are re-hired at a future date they should be re-entered into the system.

Management's Response:
The Human Resources Department has revised its policy regarding terminations to include all employees.

2013-02 Variable Interest Rate for the 2005 Tax Allocation Refunding Bonds

The City should monitor the variable interest rates for the 2005 Tax Allocation Refunding Bonds when interest payments are made in order to ensure that the City is being charged the correct amount for each interest payment. City staff was unable to provide us with the June 30, 2013 variable interest rate for the 2005 Tax Allocation Refunding Bonds and we had to obtain it from another client that has bonds with the same variable rate structure.

In our conversations with the Finance Director, she noted that the employee at Piper Jaffray (the bondholder and remarketing agent) who was in charge of preparing the Manteca Swap Performance spreadsheet that tracks the daily variable interest rate on the bonds and the variable interest rate related to the swap agreement is no longer with the company and no one has taken over his duties to prepare this information.

The City should contact Piper Jaffray to ensure they provide the City with the periodic variable interest rates on the Bonds. In addition, the City should request the calculation of the interest payments due in order to ensure that interest payments are accurate.

Management's Response:
The City will be contacting Piper Jaffray to ensure that the City receives all information regarding the 2005 Tax Allocation Refunding Bonds including periodic variable interest rates.

2013-03 Information Technology Best Practices Recommendations

We conducted an Information Systems Review with our audit which encompassed the City's financial information system and the network environment that houses it. Our work goes 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.

2013-03 Information Technology Best Practices Recommendations (Continued)

Currently, there are no Information Technology 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. Our Information Technology staff have reviewed these informal guidelines and concluded that the certification and accreditation framework developed by the National Institute of Standards and Technology (NIST) for the Federal Information Security Management Act (FISMA) are the most appropriate for local government[1]. NIST and FISMA represent the minimum security requirements for federal government agencies information systems. NIST recommends these for 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 noted an area which could be improved to conform to NIST guidelines. A summary of the recommendations which we believe are "best practices" are 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. The City should ensure that applicable controls are put in place to comply with the PCI-DSS.

Management's Response:
The City is in the process of moving all of its finance systems to newer software. As this occurs, the exposure associated with credit cards will be partially mitigated by outsourcing of transaction processing to a third party. Staff is in the process of implementing additional controls associated with payment card industry compliance.

[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

SCHEDULE OF OTHER MATTERS

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 abreast of developments:

EFFECTIVE FISCAL 2014:

GASB 70 - ***Accounting and Financial Reporting for Nonexchange Financial Guarantees***

Some governments extend financial guarantees for the obligations of another government, a not-for-profit entity, or a private entity without directly receiving equal or approximately equal value in exchange (a nonexchange transaction). As a part of this nonexchange financial guarantee, a government commits to indemnify the holder of the obligation if the entity that issued the obligation does not fulfill its payment requirements. Also, some governments issue obligations that are guaranteed by other entities in a nonexchange transaction. The objective of this Statement is to improve accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees.

This Statement requires a government that extends a nonexchange financial guarantee to recognize a liability when qualitative factors and historical data, if any, indicate that it is more likely than not that the government will be required to make a payment on the guarantee. The amount of the liability to be recognized should be the discounted present value of the best estimate of the future outflows related to the guarantee expected to be incurred. When there is no best estimate but a range of the estimated future outflows can be established, the amount of the liability to be recognized should be the discounted present value of the minimum amount within the range.

This Statement requires a government that has issued an obligation guaranteed in a nonexchange transaction to recognize revenue to the extent of the reduction in its guaranteed liabilities. This Statement also requires a government that is required to repay a guarantor for making a payment on a guaranteed obligation or legally assuming the guaranteed obligation to continue to recognize a liability until legally released as an obligor. When a government is released as an obligor, the government should recognize revenue as a result of being relieved of the obligation. This Statement also provides additional guidance for intra-entity nonexchange financial guarantees involving blended component units.

This Statement specifies the information required to be disclosed by governments that extend nonexchange financial guarantees. In addition, this Statement requires new information to be disclosed by governments that receive nonexchange financial guarantees.

The provisions of this Statement are effective for reporting periods **beginning after June 15, 2013.** Except for disclosures related to cumulative amounts paid or received in relation to a financial guarantee, the provisions of this Statement are required to be applied retroactively. Disclosures related to cumulative amounts paid or received in relation to a financial guarantee may be applied prospectively.

SCHEDULE OF OTHER MATTERS

GASB 70 - *Accounting and Financial Reporting for Nonexchange Financial Guarantees (Continued)*

How the Changes in this Statement Will Improve Financial Reporting

The requirements of this Statement will enhance comparability of financial statements among governments by requiring consistent reporting by those governments that extend nonexchange financial guarantees and by those governments that receive nonexchange financial guarantees. This Statement also will enhance the information disclosed about a government's obligations and risk exposure from extending nonexchange financial guarantees. This Statement also will augment the ability of financial statement users to assess the probability that governments will repay obligation holders by requiring disclosures about obligations that are issued with this type of financial guarantee.

EFFECTIVE FISCAL 2015:

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.

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**.

SCHEDULE OF OTHER MATTERS

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

- 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.

Single and Agent Employers

- 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.

- The pension expense and deferred outflows of resources and deferred inflows of resources related to pensions that are required to be recognized by an employer primarily result from changes in the components of the net pension liability—that is, changes in the total pension liability and in the pension plan's fiduciary net position.

- This Statement requires that most changes in the net pension liability be included in pension expense in the period of the change. For example, changes in the total pension liability resulting from current-period service cost, interest on the total pension liability, and changes of benefit terms are required to be included in pension expense immediately. Projected earnings on the pension plan's investments also are required to be included in the determination of pension expense immediately.

SCHEDULE OF OTHER MATTERS

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

- The effects of certain other changes in the net pension liability are required to be included in pension expense over the current and future periods. The effects on the total pension liability of (1) changes of economic and demographic assumptions or of other inputs and (2) differences between expected and actual experience are required to be included in pension expense in a systematic and rational manner over a closed period equal to the average of the expected remaining service lives of all employees that are provided with benefits through the pension plan (active employees and inactive employees), beginning with the current period. The effect on the net pension liability of differences between the projected earnings on pension plan investments and actual experience with regard to those earnings is required to be included in pension expense in a systematic and rational manner over a closed period of five years, beginning with the current period. Changes in the net pension liability not included in pension expense are required to be reported as deferred outflows of resources or deferred inflows of resources related to pensions.

- Employer contributions subsequent to the measurement date of the net pension liability are required to be reported as deferred outflows of resources.

- In governmental fund financial statements: A net pension liability should be recognized to the extent the liability is normally expected to be liquidated with expendable **available** financial resources. Pension expenditures should be recognized equal to the total of (1) amounts paid by the employer to the pension plan and (2) the change between the beginning and ending balances of amounts normally expected to be liquidated with expendable available financial resources.

- Notes to financial statements of single and agent employers include descriptive information, such as the types of benefits provided and the number and classes of employees covered by the benefit terms. Single and agent employers also should disclose the following information:

    - For the current year, sources of changes in the net pension liability.

    - Significant assumptions and other inputs used to calculate the total pension liability, including those about inflation, salary changes, ad hoc postemployment benefit changes (including ad hoc COLAs), and inputs to the discount rate, as well as certain information about mortality assumptions and the dates of experience studies.

    - The date of the actuarial valuation used to determine the total pension liability, information about changes of assumptions or other inputs and benefit terms, the basis for determining employer contributions to the pension plan, and information about the purchase of allocated insurance contracts, if any.

SCHEDULE OF OTHER MATTERS

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

- Required Supplementary Information: Single and agent employers are required to present in required supplementary information the following information, determined as of the measurement date, for each of the 10 most recent fiscal years:

  - Sources of changes in the net pension liability.

  - The components of the net pension liability and related ratios, including the pension plan's fiduciary net position as a percentage of the total pension liability, and the net pension liability as a percentage of covered-employee payroll.

  - Schedule covering each of the 10 most recent fiscal years that includes information about the actuarially determined contribution, contributions to the pension plan, and related ratios. If the contributions of a single or agent employer are not actuarially determined but are established in statute or by contract, the employer should present a schedule covering each of the 10 most recent fiscal years that includes information about the statutorily or contractually required contribution rates, contributions to the pension plan, and related ratios.

  - Significant methods and assumptions used in calculating the actuarially determined contributions, if applicable, should be presented as notes to required supplementary information. In addition, the employer should explain factors that significantly affect trends in the amounts reported in the schedules, such as changes of benefit terms, changes in the size or composition of the population covered by the benefit terms, or the use of different assumptions.

Cost-Sharing Employers

- Government-wide and accrual basis of accounting financial statements: A cost-sharing employer that does not have a special funding situation is required to recognize a liability for its **proportionate** share of the net pension liability (of all employers for benefits provided through the pension plan)—the collective net pension liability. An employer's proportion is required to be determined on a basis that is consistent with the manner in which contributions to the pension plan are determined, and consideration should be given to separate rates, if any, related to separate portions of the collective net pension liability. The use of the employer's projected long-term contribution effort as compared to the total projected long-term contribution effort of all employers as the basis for determining an employer's proportion is encouraged.

SCHEDULE OF OTHER MATTERS

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

- A cost-sharing employer is required to recognize pension expense and report deferred outflows of resources and deferred inflows of resources related to pensions for its proportionate shares of collective pension expense and collective deferred outflows of resources and deferred inflows of resources related to pensions.

- In addition, the effects of (1) a change in the employer's proportion of the collective net pension liability and (2) differences during the measurement period between the employer's contributions and its proportionate share of the total of contributions from employers included in the collective net pension liability are required to be determined. These effects are required to be recognized in the employer's pension expense in a systematic and rational manner over a closed period equal to the average of the expected remaining service lives of all employees that are provided with pensions through the pension plan (active employees and inactive employees). The portions of the effects not recognized in the employer's pension expense are required to be reported as deferred outflows of resources or deferred inflows of resources related to pensions. Employer contributions to the pension plan subsequent to the measurement date of the collective net pension liability also are required to be reported as deferred outflows of resources related to pensions.

- In governmental fund financial statements, the cost-sharing employer's proportionate share of the collective net pension liability is required to be recognized to the extent the liability is normally expected to be liquidated with expendable available financial resources. Pension expenditures should be recognized equal to the total of (1) amounts paid by the employer to the pension plan and (2) the change between the beginning and ending balances of amounts normally expected to be liquidated with expendable available financial resources.

- Notes to financial statements of cost-sharing employers include descriptive information about the pension plans through which the pensions are provided. Cost-sharing employers should identify the discount rate and assumptions made in the measurement of their proportionate shares of net pension liabilities, similar to the disclosures about those items that should be made by single and agent employers. Cost-sharing employers, like single and agent employers, also should disclose information about how their contributions to the pension plan are determined.

- This Statement requires cost-sharing employers to present in required supplementary information 10-year schedules containing (1) the net pension liability and certain related ratios and (2) if applicable, information about statutorily or contractually required contributions, contributions to the pension plan, and related ratios.

STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

2012-01 Accounting for OPEB Trust Assets and Activity

The City established an investment account during fiscal year 2012 related to the funding of its Other Post-Employment Benefits (OPEB). The account is held in trust form and the assets are held solely for the benefit of the participants in the City's OPEB Plan. The City recorded the activity of the Trust account, including contributions of $944 thousand and the June 30, 2012 investment balance of $425 thousand, in the Payroll Tax Benefit Allocation Internal Service Fund. However, the activity and ending investment balance of the Trust account are not assets of the City and should have been recorded in a separate OPEB Trust Fund. The only activity that should be recorded in the Payroll Tax Benefit Allocation Internal Service Fund are the quarterly contributions to the Trust account.

In the future, when new accounts are established to account for restricted activities, the bank and investment agreements should be reviewed in detail to determine whether they should be recorded in a City fund or in a separate Trust or Agency Fund.

Current Status:
Implemented.

2012-02 Internal Controls – Segregation of Duties

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.

a. Super-User Status in the General Ledger System

Accounting staff should not normally be allowed to have Super-User rights in the City's general ledger system. We noted that three City employees (the Finance Director, the Accounting Manager, and the Deputy Director of Finance) have super-user rights to the HTE Sunguard 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 (i.e. unauthorized adjustments could be made to the general ledger). In addition, unauthorized transactions could be processed without proper review and approval. While we understand the City has a limited number of staff available to provide system administration functions, the City should consider restricting super user rights to as few employees as possible. 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 employees.

b. Reviewing Changes to Vendor Database

The Accounts Payable Senior Accounting Technician processes accounts payable, mails the checks, and has access to the vendor database. Although the check registers are reviewed, there is no review of the vendor database for additions or modifications. An employee other than the Senior Accounting Technician should review the vendor database periodically and approve all additions and modifications.

STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

2012-02 Internal Controls – Segregation of Duties (Continued)

c. Reviewing Changes to Employee Database

The Payroll Clerk processes payroll, and although she cannot add new employees to the employee database, she can modify data within the database. Although the payroll registers are reviewed, there is no review of the employee database for modifications. An employee other than the Payroll Clerk should review the employee database periodically and ensure all modifications have been approved.

Update for 2013 Audit –We again noted the lack of segregation of duties associated with super users and reviewing changes to the vendor and employee databases.

Current Status:

a. The City is completing the process of implementing new ERP software. User and Super-User rights are being carefully evaluated to establish appropriate internal control procedures.

b. Staff reviewed all current demand reports available with the software that was in place during Fiscal Year 2012 and one does not exist regarding changes to the vendor database. With the implementation of new ERP software beginning July 1, 2013 invoices are input at the department level with required electronic approval by authorized personnel outside of the Finance Department. Departments do not have access to the vendor file to make changes. All changes to the vendor file are completed by the Accounts Payable Senior Accounting Technician to provide for an appropriate segregation of duties.

c. Staff has reviewed all current demand reports available with the current software and one does not exist regarding changes to the employee database. Finance staff will be investigating how to create a customer report in the new ERP software to allow for review of changes to the employee data base.

2010-01 Purchasing Policy Compliance

We selected thirty disbursements for testing of controls over purchasing procedures and compliance with the City's policies and procedures and noted the following:

a) The City's Purchasing Policy states that all expenditures, except for capital improvements over $5,000, require a Purchase Order. Sixteen of the disbursements tested did not have the required Purchase Order.

b) The City's Purchasing Policy is split into three different purchasing categories including: Supplies, Materials, Maintenance and Equipment; Professional Services; and Capital Improvements. Two disbursements tested did not appear to fall into one of the three categories of the Purchasing Policy; therefore it was unclear what the requirements for those purchases were. These disbursements included membership dues in the amount of $35,000, and fees for the cost of an environmental impact report in the amount of $6,695. Although the membership dues were approved by Council, the disbursement was not supported by a purchase order or a contract.

STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

2010-01 **Purchasing Policy Compliance (Continued)**

c) The City should maintain supporting documentation for the approval process of disbursements. For five of the disbursements tested, the City was unable to provide us with the authorizing resolution and/or contract that is required by the Purchasing Policy.

d) The City should obtain a new contract or resolution if a vendor leaves the originally approved firm and goes to another one, but remains as a vendor for the City. One of the disbursements tested was for an attorney that had worked for a law firm under contract with the City, but he had subsequently left to start a firm of his own. The City never established a contract with the new firm, and did not have Council complete an approving Resolution to work with the attorney under the name of the new firm.

The City's Purchasing Policy has not been updated since 1997. While we understand that the City is in the process of updating the Purchasing Policy, the City should ensure that the revision reflects the current practices or that staff is trained to comply with the requirements that are included in the current Policy.

In addition, when the Policy is updated the City should consider including a section for exceptions to the standard practices for purchases that do not fit into the normal purchasing function. The City should also develop a system to maintain the appropriate documents that are required for a disbursement to be approved. Finally, the City should make sure that contracts with existing vendors are current and valid.

Current Status:
The City is currently undergoing a financial software conversion. In connection with the conversion, all purchasing polices are being reviewed and updated. Final policies will be based on the recommendations of the Purchasing Policy and any changes required to update current practices and to enhance purchasing efficiencies.

See also Current Status of Comment 2012-06.

2010-03 **Internal Controls – Segregation of Duties**

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.

a. Super-User Status in the General Ledger System

Accounting staff should not normally be allowed to have Super-User rights in the City's general ledger system. We noted that three City employees (the Finance Director, the Accounting Manager, and the Deputy Director of Finance) have super-user rights to the HTE Sunguard 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 (i.e. unauthorized adjustments can be made to the general ledger). In addition, unauthorized transactions could be processed without proper review and approval. While we understand the City has a limited number of staff available to provide system administration functions, the City should consider restricting super user rights to as few employees as possible.

STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

2010-03 **Internal Controls – Segregation of Duties (Continued)**

c. **Reviewing Changes to Vendor Database**

The Accounts Payable Senior Accounting Technician processes accounts payable, mails the checks, and has access to the vendor database. Although the check registers are reviewed (see discussion above), there is no review of the vendor database for additions or modifications. An employee other than the Senior Accounting Technician should review the vendor database periodically and approve all additions and modifications.

d. **Reviewing Changes to Employee Database**

The Payroll Clerk processes payroll, and although she cannot add new employees to the employee database, she can modify data within the database. Although the payroll registers are reviewed (see discussion above), there is no review of the employee database for modifications. An employee other than the Payroll Clerk should review the employee database periodically and ensure all modifications have been approved.

Current Status:
a. Not Implemented – see 2012-02.
c. Not Implemented – see 2012-02.
d. Not Implemented – see 2012-02.

STATUS OF PRIOR YEAR OTHER MATTERS

2012-03 Monitoring Expenditures of the Special Apportionment Streets Fund, Housing Successor, Successor Agency and Ensuring Compliance with the Dissolution Laws

In fiscal year 2011, the Redevelopment Agency provided project funding to the City's Special Apportionment Streets Capital Projects Fund and transferred land to the City for redevelopment purposes consistent with the California Redevelopment Law and to implement and carry out the Redevelopment Plans for the Project area.

The Redevelopment Agency was dissolved as of January 31, 2012 and certain dissolution laws enacted by AB x1 26 require the return of unexpended Redevelopment Agency funds to the Successor Agency to the Redevelopment Agency as of that date. Although certain assets of the former Redevelopment Agency were transferred to the Successor Agency, the City contends that the transfers made in 2011 were lawfully executed and still valid as of that date and the City retained the assets it held. This matter has not yet been settled with the State Department of Finance. Therefore, the City should closely monitor the expenditures of the Special Apportionment Streets Capital Projects Fund to ensure those funded by the Redevelopment Agency funds are made in compliance with California Redevelopment Law as required by the Agreements.

The housing assets of the former Redevelopment Agency as of January 31, 2012, excluding unencumbered cash balances, were transferred to the City as Housing Successor. After January 31, 2012, the Housing Successor may use proceeds from the housing assets only for low and moderate income housing purposes in accordance with California Redevelopment Law. The City must develop procedures to closely monitor the expenditures of the Low and Moderate Income Housing Assets Special Revenue Fund (Housing Successor Fund) to ensure they are made in compliance with California Redevelopment Laws.

Finally, City staff must continue to closely review all expenditures of the Successor Agency to the Redevelopment Agency to ensure they are only for Oversight Board approved and Department of Finance approved items deemed enforceable obligations.

Current Status:
The City is aware of its role as both the Housing Successor and the Successor Agency and will continue to take all necessary steps to be in compliance with AB x1 26 and AB1484.

STATUS OF PRIOR YEAR OTHER MATTERS

2012-04 Timely Adoption of the Annual Budget

The annual budget for the City and Redevelopment Agency should be adopted by the City Council by July 1 every year. Although the City and Agency had adopted Resolutions to continue appropriations and expenditures on the basis of fiscal year 2011 budget until the 2012 budget was adopted, the 2012 budgets were not adopted until April 3, 2012.

While we understand the delayed budget approval arose from the fact that City was in discussions with six bargaining units/associations in order to address the increasing costs of employee compensation and the City also had funds at risk of being seized by the State. The City believed these issues had to be addressed before the budget could be approved. However, an original budget adopted after the three quarters of the fiscal year have passed does not become a meaningful document and tool to control appropriations. In the future, the City should develop procedures to minimize the delay and work to approve a budget for every upcoming fiscal year before the start of that fiscal year.

Update for 2013 Audit - The City did not adopt the City's fiscal year 2013 budget until July 23, 2012.

> ***Current Status:***
> City staff continues to work with Council to adopt the budget by July 1st of each fiscal year. However, Council still preserves its authority to delay budget adoption to allow for full participation by the citizens. For Fiscal Year 2013-14, Council delayed budget adoption by 3 weeks to allow for additional review by the citizens. For Fiscal Year 2014-15 the public hearing for the budget adoption is scheduled for July 1.

2012-05 Adoption of the Appropriations Limit

Government Code Section 7910 requires the City to "by resolution, establish its appropriations limit and make other necessary determinations for the following fiscal year pursuant to Article XIII B of the California Constitution at a regularly scheduled meeting or noticed special meeting." This means the City is to adopt the next year's Limit prior to July 1 of each fiscal year.

As of June 2012, the City had not adopted the Appropriations Limit for the fiscal year ended June 30, 2012, and it was not adopted until October 2012. While we understand the adoption of the Limit was overlooked due to the delay in adopting the 2012 budget, the City is not in compliance with the requirements of the California Constitution. In the future, the annual Limit should be calculated and adopted prior to the start of each fiscal year.

Update for 2013 Audit – The City did not adopt the fiscal year 2013 Appropriations Limit until October 2012.

> ***Current Status:***
> The events that led to the delay of the adoption of the Appropriations Limit were directly related to those that led to the delays in budget adoption for Fiscal Years 2012 and 2013. The events that led to the delays in budget adoption were unique in nature and are not anticipated to recur.

STATUS OF PRIOR YEAR OTHER MATTERS

2012-06 **Purchasing Policy Compliance**

We selected forty disbursements for testing of controls over purchasing procedures and compliance with the City's policies and procedures and noted the following:

a) The City's Purchasing Policy states that all expenditures, except for capital improvements over $5,000, require a Purchase Order. Twenty five of the disbursements tested did not have the required Purchase Order.

b) The City's Purchasing Policy is split into three different purchasing categories including: Supplies, Materials, Maintenance and Equipment; Professional Services; and Capital Improvements. Seven disbursements tested for items such as fees, dues, subscriptions, deposit refunds and donations did not appear to fall into one of the three categories of the Purchasing Policy; therefore the documentation requirements for those purchases/disbursements are unclear.

The City's Purchasing Policy has not been updated since 1997. We understand that the City is in the process of updating the Purchasing Policy. The City should revise and update its Purchasing Policy to reflect the current practices or comply with the one that is currently in place.

In addition, when the Policy is updated the City should consider including a section for addressing the purchase categories above or include a section of exceptions to the standard practices for purchases that do not fit into the normal purchasing categories.

Update for 2013 Audit – During our testing of forty disbursements for testing of controls over purchasing procedures and compliance with the City's policies and procedures, we noted the following:

a) Twenty-one of the disbursements tested did not have the required Purchase Order.

b) One disbursement for library funding did not appear to fall into one of the three categories of the Purchasing Policy discussed in b) above; therefore the documentation requirements for that purchase/disbursement is unclear.

Current Status:
Of the disbursements identified, all had appropriate expenditure approval. The majority were for professional services or contracts which are no longer encumbered with a purchase order. Staff acknowledges the need to update the current Purchasing Policy to reflect current practices. With the implementation of the new ERP software, the City will be revising all related policies and procedures including the current Purchasing Policy.

STATUS OF PRIOR YEAR OTHER MATTERS

2012-07 Timely Preparation of Treasurer's Reports

Section XX, Reporting, of the City's Investment Policy requires that the City Treasurer review and make available the monthly investment reports to the City Manager and City Council. As of September 2012, the June 2012 Treasurer's Report had not been made available to the City Council, and the City had not prepared the July or August 2012 Treasurer's Reports. The City should City implement policies to ensure the Treasurer's Report is completed in a timely manner, which typically is within 30 days of the close of a given month, and made available to the City Manager and City Council.

Current Status:
The Accounting Manager and staff have been advised of the need to ensure that the Treasurer's Report is completed within 30 days of the close of any given month.

2012-08 Claims Payable

The City's estimate for claims payable should be based on the uninsured balance of outstanding claims and judgments, including a provision for claims incurred but not reported. Based on the claims activity, the City has not adjusted the total outstanding balance in at least the last two fiscal years, and instead recorded any reduction in known claims as an increase to the provision for claims incurred but not reported. However, the balances of the known claims have declined significantly over the last two fiscal years. Therefore, the City should review the calculation of the claims incurred but not recorded to reduce it to a balance that reflects the experience over last few fiscal years.

Current Status:
Staff has begun to review the liability reserve to develop recommendations for Council's adoption regarding reserve balances for claims incurred by not recorded.

2012-09 Clarify Hope Loan Forgiveness Provisions

On August 3, 2010, the former Redevelopment Agency entered into a predevelopment loan agreement with Helping Others Provide Encouragement (HOPE) Shelter in the amount of $188,750 to fund the design phase of the rehabilitation of the Shelter and to create additional units. On November 16, 2010, the Agency entered into an Owner Participation and Loan Agreement with HOPE to loan an additional $1.2 million to fund the construction phase of the rehabilitation of the Shelter. The predevelopment loan agreement implies that it will be forgiven as soon as HOPE fulfills certain provisions of the agreement, and the construction loan is to be forgiven after fifty-five years if the HOPE Shelter is used for the stated purpose. While it appears that the forgiveness provisions of the predevelopment loan have been fulfilled, we understand that the intent of the predevelopment loan was that it would be incorporated into the construction loan and subject to the 55-year regulatory agreement and not be forgiven until that time had elapsed.

With the dissolution of the Redevelopment Agency, the HOPE Shelter loan was transferred to the City as housing successor. The City should consider clarifying the provisions and documentation of the HOPE loans to ensure that the forgiveness provisions are clear and understood by both the City and HOPE.

Current Status:
Staff is working with special legal counsel to review the forgiveness provisions related this loan to determine if clarifying revisions need to be made to the documents.

STATUS OF PRIOR YEAR OTHER MATTERS

2012-10 Development Services Loan Payable to the Successor Agency

During fiscal year 2010 the former Redevelopment Agency made an advance of $1,700,000 to the Development Services Special Revenue Fund to establish the fund. Due to the dissolution of the Redevelopment Agency, the advance became a loan payable to the Successor Agency and is now recorded as a long-term liability of the City. The loan is to be repaid when funds become available, however the City should work with the Successor Agency to the Redevelopment Agency to establish repayment terms.

Current Status:
The Department of Finance called the loan and it has been repaid as of June 30, 2013.

2012-11 Analyze Refundable Deposit Account Balances

Deposit payable balances should consist of active balances that are not yet due to the depositor. In prior years the City established a Housing Relief Capacity Program and collected amounts from applicable developers, but the City had stopped collecting deposits for this program. The balance of the deposits payable under this program was $170,000 at June 30, 2012 and did not have activity during the last three fiscal years. After further inquiry of City staff, we noted that these deposits were made under agreements with the developers that had expired in September 2009 and the agreements do not require the return of the funds to the developers because the developers did not meet certain criteria in the agreements. We understand that the City is in the process of renewing this program and the disposition of the deposits held at year end has not yet been determined. The City should determine whether the balances held at year end should be extended into the new program or recorded as revenue of the City.

Current Status:
Staff has begun an analysis of refundable deposit account balances to determine the status of the deposits. Upon review of the deposit related to the Housing Relief Capacity Program, staff made the determination that the terms of the agreement had not been met and the funds were transferred to the City as of June 30, 2013.

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REQUIRED COMMUNICATIONS

To the City Council of
the City of Manteca, California

We have audited the basic financial statements of the City of Manteca for the year ended June 30, 2013. Professional standards require that we communicate to you the following information related to our audit under generally accepted auditing standards, *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 pronouncements became effective, but did not have a material effect on the financial statements:

GASB 60 - *Accounting and Financial Reporting for Service Concession Arrangements*

The objective of this proposed Statement is to establish accounting and financial reporting requirements for service concession arrangements (SCAs), which are a type of public-private or public-public partnership arrangement. SCAs include, but are not limited to:

a. Arrangements in which the operator will design and build a facility and will obtain the right to collect fees from third parties (for example, construction of a municipal complex for the right to lease a portion of the facility to third parties).

b. Arrangements in which the operator will provide an up-front payment or a series of payments in exchange for the right to access an existing facility (for example, a parking garage) and collect fees from third parties for its usage

c. Arrangements in which the operator will design and build a facility (for example, a new tollway), finance the construction costs, provide the associated services, collect the associated fees, and convey the facility to the government at the end of the arrangement.

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GASB 62 - *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*

This Statement also supersedes Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, thereby eliminating the election provided in paragraph 7 of that Statement for enterprise funds and business-type activities to apply post-November 30, 1989 FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements. However, those entities can continue to apply, as other accounting literature, post-November 30, 1989 FASB pronouncements that do not conflict with or contradict GASB pronouncements, including this Statement.

GASB 61 – *The Financial Reporting Entity – Omnibus – An Amendment of GASB Statement No. 14 and No. 34 – Component Unit Focus*

This Statement modifies certain requirements for inclusion of component units in the financial reporting entity. For organizations that previously were required to be included as component units by meeting the fiscal dependency criterion, a financial benefit or burden relationship also would need to be present between the primary government and that organization for it to be included in the reporting entity as a component unit. Further, for organizations that do not meet the financial accountability criteria for inclusion as component units but that, nevertheless, should be included because the primary government's management determines that it would be misleading to exclude them, this Statement clarifies the manner in which that determination should be made and the types of relationships that generally should be considered in making the determination.

This Statement also amends the criteria for reporting component units as if they were part of the primary government (that is, blending) in certain circumstances. For component units that currently are blended based on the "substantively the same governing body" criterion, it additionally requires that (1) the primary government and the component unit have a financial benefit or burden relationship or (2) management (below the level of the elected officials) of the primary government have operational responsibility (as defined in paragraph 8a) for the activities of the component unit. New criteria also are added to require blending of component units whose total debt outstanding is expected to be repaid entirely or almost entirely with resources of the primary government. The blending provisions are amended to clarify that funds of a blended component unit have the same financial reporting requirements as a fund of the primary government. Lastly, additional reporting guidance is provided for blending a component unit if the primary government is a business-type activity that uses a single column presentation for financial reporting.

The following pronouncement became effective and as disclosed in Note 1H to the financial statements required a format change in the Statements of Net Assets and Balance Sheet and certain nomenclature revisions in the footnotes accompanying the financial statements:

GASB 63 - *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*

This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. *Concepts Statement No. 4, Elements of Financial Statements*, introduced and defined those elements as a consumption of net assets by the government that is applicable to a future reporting period, and an acquisition of net assets by the government that is applicable to a future reporting period, respectively. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities.

Concepts Statement 4 also identifies net position as the residual of all other elements presented in a statement of financial position. This Statement amends the net asset reporting requirements in *Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets.

The following pronouncement was early-implemented, and as disclosed in Notes 1H and 8G to the financial statements and also affected the format and nomenclature of the financial statements and required a restatement of net position:

GASB 65 - *Items Previously Reported as Assets and Liabilities*

This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. This Statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term deferred in financial statement presentations.

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. However, the dissolution of the former Redevelopment Agency had a material impact to the financial statements of the City:

As discussed in Note 16 to the financial statements, the State enacted laws which dissolved Redevelopment Agencies effective January 31, 2012. The City elected to become the Housing Successor to the Redevelopment Agency and pursuant to the laws it received the encumbered housing assets of the former Redevelopment Agency. Certain other assets were distributed to and all of the Redevelopment Agency's debts were assumed by a Successor Agency governed by an Oversight Board. This Successor Agency is reported as a private purpose trust fund.

Also as discussed in Note 16, the Agency had transferred assets, including capital assets, totaling $58,959,477 to the City during fiscal years 2011 and 2012 under the terms of various agreements. However, under the provisions of Health and Safety Code Section 34171(d)(2) that was created by AB x1 26, agreements between the City and the Agency that were executed after December 31, 2010 are no longer enforceable obligations, and Health and Safety Code Section 34167.5 requires that if the entity that received the assets is not contractually committed to a third party for the expenditure or encumbrance of those funds that they be returned to the Successor Agency.

Health and Safety Code Sections 34167.5 and 34178.8 specifically direct the State Controller to review the activities of all redevelopment agencies to determine whether an asset transfer between an agency and any public agency occurred on or after January 1, 2011. If an asset transfer did occur and the public agency that received the asset is not contractually committed to a third party for the expenditure or encumbrance of the asset, the legislation purports to require the State Controller to order the asset returned to the redevelopment agency.

In May 2012 and August 2012, the City returned cash and investments totaling $14,829,795 to the Successor Agency. The balance of assets held by the City totaled $44,129,682 as of June 30, 2012, comprised of current assets of $43,670,205 and capital assets of $459,477. During fiscal year 2013, the City returned the current assets of $43,670,205 to the Successor Agency and as of June 30, 2013 only the capital assets of $459,477 were held by the City. The City has not received the results of the State Controller's asset transfer review and the amount of assets to be returned is not determinable at this time.

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 estimate(s) affecting the City's financial statements are:

Estimated Fair Value of Investments: As of June 30, 2013, the City held approximately $251.5 million of cash and investments as measured by fair value. Fair value is essentially market pricing in effect as of June 30, 2013. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2013.

Estimate of Depreciation: Management's estimate of the 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 7 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.

Estimate of Compensated Absences: Accrued compensated absences which are comprised of accrued vacation, sick leave and compensated time off is estimated using accumulated unpaid leave hours and hourly pay rates in effect at the end of the fiscal year as disclosed in Note 1G to the financial statements. We evaluated the key factors and assumptions used to develop the accrued compensated absences and determined that it is reasonable in relation to the basic financial statements taken as a whole.

Estimated Fair Value of Swap Agreement: The Successor Agency to the Redevelopment Agency has one Swap arrangement with Piper Jaffray Financial Products, Inc. with a negative fair value of $8,932,504, as disclosed in Note 16D to the financial statements. Fair value is essentially market pricing in effect as of June 30, 2013. The fair value is not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2013.

Estimated Claims Liability: Management's estimate of the claims liability is disclosed in Note 13 to the financial statements and is based on the prior year claims experience of the City. We evaluated the key factors and assumptions used to develop the estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.

Estimated Net OPEB Obligation: Management's estimate of the Net OPEB Obligation is disclosed in Note 11 to the financial statements and is based on actuarial study determined by a consultant, which is based on the experience of the City. We evaluated the key factors and assumptions used to develop the estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.

Disclosures

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosure affecting the financial statements was the disclosure of the Redevelopment Agency dissolution and former Redevelopment Agency in Note 16 to the financial statements. See discussion under *Unusual Transactions, Controversial or Emerging Areas* above regarding the unsettled law and highly contingent nature of these matters.

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, other than those to assist with recording the balances and activity related to the Net OPEB Obligation and the Successor Agency's capital asset and long term debt balances.

Professional standards require us to accumulate all known and likely uncorrected misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. We have no such misstatements to report to the City Council.

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 March 27, 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.

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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, CA
March 27, 2014