

**CITY OF MANTECA**  
**MEMORANDUM ON INTERNAL CONTROL**  
**AND**  
**REQUIRED COMMUNICATIONS**  
**FOR THE YEAR ENDED**  
**JUNE 30, 2011**

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CITY OF MANTECA  
MEMORANDUM ON INTERNAL CONTROL  
AND  
REQUIRED COMMUNICATIONS

For the Year Ended June 30, 2011

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**ACCOUNTANCY CORPORATION**  
 3478 Buskirk Ave. - Suite 215  
 Pleasant Hill, California 94523  
 (925) 930-0902 • FAX (925) 930-0135  
 maze@mazeassociates.com  
 www.mazeassociates.com

## MEMORANDUM ON INTERNAL CONTROL

December 16, 2011

To the City Council of  
 the City of Manteca, California

In planning and performing our audit of the financial statements of the City of Manteca as of and for the year ended June 30, 2011, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

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

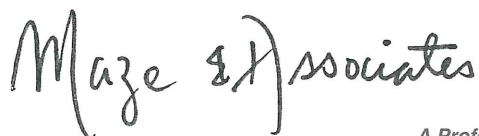
A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination 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 identified certain deficiencies in internal control that we consider to be material weaknesses that are included on the Schedule of 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 identified certain deficiencies in internal control that we consider to be significant deficiencies that are included on the Schedule of Significant Deficiencies.

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

The City'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 generally accepted government auditing standards, and is not intended to be and should not be used by anyone other than these specified parties.



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CITY OF MANTECA  
MEMORANDUM ON INTERNAL CONTROL  
SCHEDULE OF MATERIAL WEAKNESSES

**2011-01      Recording Loans Receivable**

The City should record loans receivable in the general ledger at the time the loan is disbursed; however the City did not record loans receivable for two new loans that were issued during the fiscal year. The first loan was to Manteca Atherton Associates for the Juniper Apartments project in the amount of \$12,750,000 and the second was a predevelopment loan to Hope Shelter with a balance of \$416,686 as of June 30, 2011 to fund the design phase of the rehabilitation and expansion of the shelter. Prior to the start of the year end audit, the disbursements related to the above loans receivable had been recorded as expenditures, but they had not been recorded as loans receivable.

We understand that the Manteca Atherton Associates loan had not been recorded, because the Finance Department was not made aware that the loans had been issued since they were handled by the City Manager and Redevelopment Agency. We understand the Hope Shelter loan was not recorded as a loan receivable, because it is expected that it will ultimately be forgiven; however, the City normally records such loans as a receivable with an offsetting provision for the eventual forgiveness.

The City should develop a process during the issuance of loans to ensure that the Finance Department is notified of the terms of the transactions so they can be recorded and properly accounted for. The City cannot adequately track interest accruals and repayments if the loans are not recorded in the general ledger.

***Management's Response:***

The Finance Department has assigned analytical staff to coordinate the review of all agenda items that have a financial impact to the City. Additionally, the analytical staff will be reviewing all After Action City Council Reports to identify loans that have been approved by the City Council.

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**CITY OF MANTECA**  
**MEMORANDUM ON INTERNAL CONTROL**  
**SCHEDULE OF SIGNIFICANT DEFICIENCIES**

**2011-02**      **Timely Posting of Journal Entries**

The City should be posting journal entries to the general ledger within a reasonable amount of time after the related activity occurs. We selected a sample of forty journal entries for testing and noted that three of the entries were not posted to the general ledger on a timely basis.

One of the journal entries was posted to the general ledger approximately three and a half months after the activity occurred, the second was posted approximately six months after the activity occurred, and the other was posted approximately four months after the activity occurred and the journal entry had been prepared. Journal entries should be posted to the general ledger within a reasonable amount of time after the activity has occurred so that the general ledger holds the most accurate and up to date budget and financial information.

The Accountant stated that the three journal entries were posted late due to the following reasons: for the first entry staff was trying to decide what account the activity should be posted to, for the second entry staff was waiting to close the books until the end of January and the third entry was due to staff waiting to close the books until the audit was completed in December. The City should prepare and post journal entries to the general ledger within a reasonable amount of time after the event occurs to ensure interim financial reports reflect activity in the proper period.

***Management's Response:***

While the journal entries above were prepared and entered into the financial system in a timely manner, they were not immediately posted to the general ledger until final determination of ending balances could be determined. In the future, staff will both prepare and post journal entries in a timely manner.

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CITY OF MANTECA  
MEMORANDUM ON INTERNAL CONTROL

SCHEDULE OF OTHER MATTERS

**2011-03      Monitoring Current and Future Redevelopment Agency-Related Transactions**

During fiscal year 2011, the Redevelopment Agency initiated a number of transactions, including making certain findings required by the Health and Safety Code, that resulted in the conveyance and transfer of Agency assets to the City for redevelopment and public improvement projects. Although the transactions appear to have been completed in compliance with current Redevelopment Law, the City and Agency must develop new policies and procedures to ensure that all future transactions continue to be in compliance with those laws. During our audit we noted the following:

- **Assets Derived from Capital Assets Must be Restricted**

Land previously recorded as capital assets of the Agency were conveyed and transferred to the City during the fiscal year and are recorded in the City's Governmental Activities as capital assets as of June 30, 2011. In accordance with the Resolution that authorized the conveyance and transfer of the land, the assets are to be used for Redevelopment projects and activities.

The City should establish procedures to ensure that any assets derived from the use of these properties, such as sales proceeds or other income, is segregated and restricted for redevelopment purposes.

- **Continuous Monitoring of Agency-Funded Projects is Necessary**

Historically, and under the terms of a Resolution adopted in fiscal year 2011, the City expends funds on capital projects on behalf of the Agency and the Agency often transfers the required funds to the City prior to the start of the project. Any unspent funds are returned to the Agency upon completion of the project. With the State-enacted legislation on June 28, 2011 to potentially dissolve redevelopment, any transactions of the Agency are subject to revised Health and Safety Code requirements and may be subject to detailed scrutiny by the State and others.

The City and Agency must establish procedures to ensure that all Agency-funded projects continue to comply with current redevelopment law and any unspent project funds are tracked and accounted for separately so that any unspent funds are returned to the Agency.

***Management's Response:***

Currently, all project expenditures funded via bond proceeds are tracked for arbitrage purposes. Pending the final outcome of AB X26 and ABX27, the City and Agency will establish any additional procedures required to track project funds to ensure they meet all applicable aspects of the Health and Safety Code.

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CITY OF MANTECA  
MEMORANDUM ON INTERNAL CONTROL

STATUS OF PRIOR YEAR SCHEDULE OF SIGNIFICANT DEFICIENCIES

**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.
- 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 policies 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.

CITY OF MANTECA  
MEMORANDUM ON INTERNAL CONTROL

STATUS OF PRIOR YEAR SCHEDULE OF SIGNIFICANT DEFICIENCIES

2010-02      **Review and Approval of Reconciliations and Transaction Reports**

All account reconciliations and transaction reports should be reviewed and approved by someone other than the preparer. And, the preparer and the reviewer should sign or document in some other manner that the work and review has been performed. The review and approval process is an important part of internal controls and we recommend that Finance staff leave a trail of the review in order to make sure the control is in place. Without the initials or some other indication, we cannot verify who prepared the reconciliations and that another employee actually reviewed and approved the reconciliations. We noted a number of areas in which documentation was not present:

a. **Bank Reconciliations**

The Accountant prepares the monthly bank reconciliations and they are reviewed by the Finance Director. We reviewed the City's bank account reconciliation for March 2010 and noted that they are not being signed off by the preparer and the reviewer after they have been completed and reviewed. Finance staff should ensure that all bank reconciliations are reviewed and that the review and date are indicated on each reconciliation, or in some other formal manner determined by staff. In addition, the reconciliations should be signed or initialed and dated by the preparer in some formal manner.

b. **Accounts Receivable Reconciliations**

The accounts receivable reconciliations should be reviewed for accuracy by the Accounting Manager after they have been performed by the Senior Accounting Technician. We reviewed the April 2010 reconciliation and noted that the accounts receivable reconciliations are not being reviewed by the Accounting Manger or any other responsible employee after being completed by the Senior Accounting Technician. The City's accounts receivable reconciliation could have errors and mistakes that could be detected and corrected during a review. While we understand the City has a limited number of staff available to perform and review reconciliations, the City should consider implementing a review of the accounts receivable reconciliations.

c. **Review of Payroll for Reasonableness**

Payroll data for each pay period should be reviewed for accuracy and signed off by the Deputy Director of Finance. We noted that the payroll data is not being signed off by the Deputy Director of Finance after being reviewed each pay period. The Deputy Director of Finance was unaware that she should be signing off on the payroll data after she completes her review. In order to provide evidence that the review process is being executed, we recommend that the Deputy Director of Finance signs off after reviewing the payroll data each pay period.

***Current Status:***

Procedures have been put in place to ensure that all reconciliations and transaction reports have signatures/initials of both the preparer and senior management.

CITY OF MANTECA  
MEMORANDUM ON INTERNAL CONTROL

STATUS OF PRIOR YEAR SCHEDULE OF SIGNIFICANT DEFICIENCIES

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.

b. Wire Transfers – Second Employee Verification

Wire transfers should be approved by more than one employee. The current procedure for wire transfers is that the Finance Director or the Deputy Finance Director calls the bank and gives them a pin number to authorize a wire transfer. The bank does not call back to verify the transfer with a second employee. A call back procedure could help to catch any errors with a wire transfer by verifying the terms with a second employee. Unauthorized or incorrect wire transfers could take place. We understand that the Finance Director is taking steps to remedy this procedure in order to secure more control over the wire transfer process. The City should work with its bank in order to create a process that includes an authorization from a second employee.

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.

CITY OF MANTECA  
MEMORANDUM ON INTERNAL CONTROL

STATUS OF PRIOR YEAR SCHEDULE OF SIGNIFICANT DEFICIENCIES

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

*Current Status:*

- a. The City is currently in the process of implementing new ERP software. User and Super-User rights are being carefully evaluated to establish appropriate internal control procedures.
- b. Staff has prepared revisions to the current wire transfer instructions to require call back verification on all phone wires.
- c. Staff has reviewed all current demand reports available with the current software and one does not exist regarding changes to the vendor 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 vendor file
- d. 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.

2010-04      Journal Entry Posting – Segregation of Duties

As part of our testing of internal controls, we selected thirty journal entries for testing of supporting documentation, review and approval. We found two journal entries that were prepared, reviewed, and posted by the Finance Director. To make sure that journal entries are reliably recorded into the system, segregation of duties is essential. No one employee should be able to prepare, review, and post his/her own journal entries. An authorized approver should always review a preparer to certify the correctness of an entry. To ensure proper control over journal entries and segregation of duties, the City should designate a second person, to review and approve the entries initiated by the Finance Director.

*Current Status:*

Procedures have been put into place to ensure that all journal entries prepared by the Finance Director are reviewed and posted by either the Accounting Manager or the Deputy Director of Finance.



CITY OF MANTECA  
MEMORANDUM ON INTERNAL CONTROL

STATUS OF PRIOR YEAR SCHEDULE OF OTHER MATTERS

**2010-05      Monitoring Lease Escrow Account and Recording of Associated Transactions**

City staff should receive, monitor and review all cash and investment accounts of the City, and applicable transactions should be recorded in the general ledger. The City has a lease escrow account with a bank that is used to pay for the costs of equipment authorized under the lease agreement. The balance in the lease account was \$459,129 at June 30, 2009 and the balance at June 30, 2010 was \$52,962, but activity in the account consisting of various equipment purchases was not recorded in the City's general ledger until the year end audit, because the bank did not send periodic statements to the City. The City should ensure that the bank sends periodic statements to the City and the applicable reconciliations are performed and activity is recorded in the general ledger timely. In the future, the City should ensure that any new bank agreements provide for periodic statements to the City.

***Current Status:***

Funds for the leases in question have been fully utilized. Staff now receives periodic statements for all new leases so that transactions can be recorded on a timely basis.

**2010-06      Monitoring Status of Delinquent Loans and Obtaining Approval for Write-off of Defaulted Loan Balances**

It is the City's policy to write off loans that are in default in the down payment assistance and rehabilitation loan programs after the final notice has been received from the County notifying the City that the defaulted property has been sold. We reviewed the City's detailed listing of bankruptcies and defaults for the down payment assistance and rehabilitation loan programs and noted that a number of the loans had been in default for over one year, but follow up with the County regarding the status of the loans had not been completed.

We also noted that there is an economic development loan for \$25,000 to a local business which is bankrupt. The City deemed the loan uncollectible in fiscal year 2009, but has not recorded an allowance for doubtful accounts or determined the status of the bankruptcy.

City staff should periodically review the status of loans that are in default to determine whether the associated properties have been sold and if the City is due any residual proceeds from the sale. In the event the City is not due proceeds and the property sale is complete, the loan should be written off in accordance with the City's policy after obtaining applicable approval.

***Current Status:***

Staff reviews all outstanding loans and obtains Council approval to write-off any loans deemed uncollectible per City policy.

CITY OF MANTECA  
MEMORANDUM ON INTERNAL CONTROL

STATUS OF PRIOR YEAR SCHEDULE OF OTHER MATTERS

**2010-07      Annual Adoption of the Investment Policy**

The City did not re-adopt the Investment Policy for the current fiscal year. Although California Government Code Section 53646 no longer requires the annual adoption of the investment policy, Section XXIV of the City's Investment Policy states, "The City of Manteca's Investment Policy shall be adopted by Resolution of the City Council on an annual basis." We understand that since the City did not make any changes to the Investment Policy, it was not re-adopted in the current fiscal year. However, since the Investment Policy states that it shall be adopted on an annual basis, we recommend that the City follow its policy and adopts the Investment Policy each year, even if no changes were made or the City should revise the Investment Policy to conform to the City's current practices.

***Current Status:***

The City is working with PFM to complete a review and update of the current investment policy. Beginning with the 2011-12 budget, the investment policy will be reviewed annually and will be incorporated with the budget adoption process.

**2010-08      Review of Statements on Auditing Standards (SAS) 70 Reports**

The City has several independent contractors which process various City activities including fiscal agent cash and investments. The City should review the SAS 70 reports from its service organizations.

The procedures used by these service organizations are outside the scope of city oversight and staff review, these controls are not part of the scope of an audit of the City's financial statements. Typically City's 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 City's 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 *Statement on Auditing Standards #70—Service Organizations (SAS 70)*.

SAS 70 establishes auditing standards to be followed to ensure that any service organization's systems and controls are adequately designed and are operating. SAS 70 has two parts. Part one is designed to review controls over the service provided at a particular date and to report on whether the design of these controls appear to be adequate on that date. Part two is designed to test these controls over a six month period and to report on whether the design of the controls appears adequate and whether the auditor can reasonably conclude that the controls were operating effectively.

We understand that the City thought that the SAS 70 reports were only obtained for the Auditors to review. The City should request a SAS 70 report from its independent contractors. It would be preferable if the contractor had both parts of a SAS 70 audit performed and that the report be furnished directly to the City for review. Any weaknesses or system problems disclosed by that audit should be addressed and resolved by the Contractor to the satisfaction of the City. If a service provider does not have a SAS 70 report, the City should determine whether the City's current level of review of transactions processed by the service provider are sufficient.

***Current Status:***

Implemented.

**ACCOUNTANCY CORPORATION**  
3478 Buskirk Ave. - Suite 215  
Pleasant Hill, California 94523  
(925) 930-0902 • FAX (925) 930-0135  
maze@mazeassociates.com  
www.mazeassociates.com

## REQUIRED COMMUNICATIONS

To the City Council of  
the City of Manteca, California

We have audited of the financial statements of the City of Manteca as of and for the year ended June 30, 2011 and have issued our report thereon dated December 16, 2011. Professional standards require that we advise you of the following matters relating to our audit.

**Financial Statement Audit Assurance:** Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit in accordance with generally accepted auditing standards does not provide absolute assurance about, or guarantee the accuracy of, the financial statements. Because of the concept of reasonable assurance and because we did not perform a detailed examination of all transactions, there is an inherent risk that material errors, fraud, or illegal acts may exist and not be detected by us.

**Other Information Included with the Audited Financial Statements:** Pursuant to professional standards, our responsibility as auditors for other information in documents containing the City's audited financial statements does not extend beyond the financial information identified in the audit report, and we are not required to perform any procedures to corroborate such other information. Our responsibility also includes communicating to you any information that we believe is a material misstatement of fact. Nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the financial statements. This other information and the extent of our procedures are explained in our audit report.

**Accounting Policies:** Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the City is included in Note 1 to the financial statements. There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during 2011. As described in notes to the financial statements, during the year, the City implemented the following new standards:

**GASB Statement No. 54 – Fund Balance Reporting and Governmental Fund Type Definitions**  
– This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

Disclosure of the policies in the notes to the financial statements is required. The definitions of the general fund, special revenue fund type, capital projects fund type, debt service fund type, and permanent fund type are clarified by the provisions in this Statement. Interpretations of certain terms within the definition of the special revenue fund type have been provided and, for some governments, those interpretations may affect the activities they choose to report in those funds. The capital projects fund type definition also was clarified for better alignment with the needs of preparers and users. Definitions of other governmental fund types also have been modified for clarity and consistency.

As discussed in Note 9 to the financial statements, the City implemented the provisions of the Statement during the year ended June 30, 2011.

**GASB Statement No. 59 - *Financial Instruments Omnibus*** – The objective of this Statement is to update and improve existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. This is a technical clean up pronouncement that had no material impact to the financial statements.

**Unusual Transactions, Controversial or Emerging Areas:** No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus. There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during 2011.

As discussed in Note 17 to the financial statements, prior to June 30, 2011, in an effort to balance its budget, the State passed ABx1 26, which substantially changes California redevelopment law, suspends redevelopment activities and dissolves redevelopment agencies effective October 1, 2011. The State also passed ABx1 27 which provided a voluntary program under which agencies may opt out of the mandatory dissolution provided they pay substantial annual contributions to local schools and special districts. In addition, the Acts give the State the power to review transactions on or after January 1, 2011 between the Redevelopment Agency and City and to require the return of assets by the City to the Redevelopment Agency it finds violate the provisions of the Acts.

On July 18, 2011, the California Redevelopment Association, the League of California Cities and other parties filed suit with the California Supreme Court challenging the validity and constitutionality of the measures and sought a stay of the provisions of the Acts until the Court renders a decision on the case. On August 11, 2011, as modified on August 17, 2011, the Court granted a hearing and issued a partial stay regarding suspension of the effectiveness of ABx1 26-27 until it can rule on the validity and constitutionality of these two bills. A ruling is expected by January 15, 2012.

These facts indicate that there is more than a remote possibility the Redevelopment Agency may not continue as a going concern beyond October 1, 2011. The continuation of the Redevelopment Agency beyond October 1, 2011 will initially depend on whether the court rules in favor of the petitioners. Should the court uphold the provisions of the Acts, the Redevelopment Agency's continuation will then depend on whether the City adopts an opt-in ordinance electing participation in the voluntary program, pays the 2011-12 annual contribution of \$5,344,012, as estimated by the State, as well as meeting any other provisions of the Acts which may be upheld by the court.

The provisions of ABx1 26, the Dissolution Act, are more severe. If upheld, it requires Redevelopment Agencies to preserve assets and revenues and minimize obligations and liabilities and expressly states that enforceable obligations to be paid by successor agencies created under the Acts to assume Redevelopment activities, do not include agreements, contracts or arrangements between Redevelopment Agency and the City and that there should be no asset transfers from a Redevelopment Agency to the City after January 1, 2011. Prior to dissolution, any transfers of Agency assets subsequent to January 1, 2011 to the City including those discussed in Note 4, that were not obligated to third parties or encumbered may be subject to the State Controller's review discussed above and required to be returned to the Agency. Asset transfers may occur under certain conditions provided there is a third party commitment or outstanding encumbrances.

**Estimates:** Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on 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 markedly from management's current judgments. The most sensitive accounting estimates affecting the financial statements are the fair value of investments, depreciation and compensated absences.

*Estimated Fair Value of Investments:* As of June 30, 2011, the City held approximately \$274 million of cash and investments as measured by fair value. Fair value is essentially market pricing in effect as of June 30, 2011. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2011.

*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 City has one Swap arrangement with Piper Jaffray Financial Products, Inc. with a negative fair value of \$6,491,163, as disclosed in Note 8C to the financial statements. Fair value is essentially market pricing in effect as of June 30, 2011. The fair value is not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2011.

*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.

**Disagreements with Management:** For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the City's financial statements or the auditor's report. No such disagreements arose during the course of the audit.

Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

**Retention Issues:** We did not discuss any major issues with management regarding the application of accounting principles and auditing standards that resulted in a condition to our retention as the City's auditors.

**Difficulties:** We encountered no serious difficulties in dealing with management relating to the performance of the audit.

**Audit Adjustments:** For purposes of this communication, professional standards define an audit adjustment, whether or not recorded by the City, as a proposed correction of the financial statements that, in our judgment, may not have been detected except through the audit procedures performed. These adjustments may include those proposed by us but not recorded by the City that could potentially cause future financial statements to be materially misstated, even though we have concluded that the adjustments are not material to the current financial statements.

We did propose audit adjustments that, in our judgment, could have a significant effect, either individually or in the aggregate, on the City's financial reporting process related to recording of the City's loans receivable that are described in item 2011-01 of the Memorandum on Internal Control.

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

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

*Maze & Associates*

December 16, 2011