CONSENT AGENDA

AGENDA ITEM 12.14
MINUTES
AUDIT COMMITTEE
JULY 11, 2011

ROLL CALL 3:31 PM

Roll Call 3:34 PM
Present:
Paul Canepa, Chair

Absent:
Katherine Miller, Member, Susan Talamantes Eggman, Alternate Member, and Dale Fritchen, Vice Chair.

Note: Vice Chair Fritchen arrived at 3:34 p.m.

Staff present:
F. Michael Taylor, City Auditor
Jim Henthorn, Assistant City Auditor
Susan Mayer, Administrative Services Director/CFO
Lynne Farrar, Accounting Manager
Laurie Montes, Deputy City Manager
John Luebberke, City Attorney
Florence Low, Program Manager
Bret Hunter, Assistant City Clerk
Bonnie Paige, City Clerk

Others present:
Cory A. Biggs, CEO, Maze & Associates

PUBLIC COMMENT 3:32 PM

None.

ISSUE(S) TO BE DISCUSSED: 3:32 PM

2. Audit Plan for FY 2011-12 audits by the Office of the City Auditor 3:32 PM

City Auditor Mike Taylor reported that each year the City Auditor conducts an audit plan that is based on a combination of need and also resources that are available from the Auditor’s Office to do audit work. This year the focus will be on internal controls compliance. Staff would like to do more work in the area of performance but with the changes that have happened in the organization there are holes, structurally, from all the departures which raises questions regarding
the status of internal controls, both the design and the operation controls in the City. The City Auditor does not have the capacity to do some of the audit work in areas of performance measurement. There was a time when the Auditor was trying to produce an annual report on Service Efforts and Accomplishments, but as the economy deteriorated and staff had to spend most of their time on budget issues and fiscal sustainability, that effort was put aside and will remain put aside for the next year. City Auditor Taylor emphasized good internal controls, i.e. those that are cost effective which will save the organization money. The Plan includes assignments that touch multiple departments and assignments that are centered in a single unit. Among the assignments that touch multiple departments, is a look at American Reinvestment Recovery Act (ARRA) compliance. City Auditor Mike Taylor reported that City management is engaging outside auditors to address Innoprise and Workers' Compensation. Whatever work City staff conducts will be dove-tailed with the outside Auditors to avoid duplication of effort. Mr. Taylor provided background regarding Innoprise implementation; contract management; Control Environment Assessment; Workers' Compensation; Management Action Plan follow-up; Fleet Utilization; Delta Water Supply Project; Street Maintenance; Central Parking District; Police Property Room; Solid Waste.

Chair Canepa, referencing Revenue Auditing asked for clarification with regard to the substantial percentage of the underlying tax.

City Auditor Taylor responded stating that vendors pay sales tax to the State and then the State allocates the local share to the City. City Auditor Taylor explained that if mistakes are made in the paperwork, the allocation could be sent elsewhere. Audit staff receives data from the State and does data analysis work to identify mismatches or anomalies and report back to the State so that misallocations can be corrected and sent to us. If the City identifies misallocations or underreporting by or before the time the contractor does, the City does not have to pay the contractor a percentage of the taxes that are recovered.

Vice Chair Fritchien asked if the audit on the Landscape and Maintenance Districts includes contract compliance and whether the funding is being allocated accurately.

City Auditor Taylor responded confirming that staff is looking at contract compliance at this time, but certainly could include the funding component.

**RECOMMENDATION:** Staff recommended that the 2011-12 Audit Plan be accepted and forwarded to the City Council for approval.
Motion: Approve accepting the 2011-12 Audit Plan, and forward to the City Council with a recommendation for approval.
Moved by Dale Fritchen, Vice Chair, seconded by Paul Canepa, Chair

Vote: Motion carried 2-0

Yes: Dale Fritchen, Vice Chair, and Paul Canepa, Chair.
Absent: Katherine Miller, Member, and Susan Talamantes Eggman, Alternate Member.

1. Audit Plan for the City's June 30, 2011 financial statements by Maze & Associates 3:45 PM

Cory Biggs CEO, Maze & Associates - Audit process overview, audit objective; highlighted the following: emergency declaration of budget passed by Council; management taking steps to deal with the financial position of the city; 2010 CAFR; prior year control issues; turnover of high level financial management within the city; new events and entertainment operator; timing of audit process - before the end of September (aggressive target date), exit conference with staff regarding interim work; interim work is the first phase and it is approximately one-third of the way completed.

Chair Canepa - asked regarding OMB Circular A-133 to which Mr. Biggs responded that is the Federal Regulations that design and define how an audit of Federal awards is conducted.

Chair Canepa asked if OMB Circular A-133 coincides with the ARRA Funding to which City Auditor Taylor explained that ARRA Funding is a component of the overall Federal funding and it is included in the scope of Federal funds that are subject to the Single Audit.

Cory Biggs CEO, Maze & Associates - spoke to fraud considerations stating that with every financial statement audit his staff does have to consider the potential for fraud. Cash receipts, Revenue Cash collection sites and journal entries are areas with a high risk of fraud.

Chair Canepa - asked about the checks and balances with regard to transferring funds from one account to another.

Mr. Biggs responded that with any interfund borrowing there needs to be a reasonable period of collectability expectation.

Vice Chair Fritchen - asked if the audit includes the Redevelopment Agency and Mr. Biggs confirmed that it does.

Chair Canepa inquired relative to the audit procedures and asked for
clarification regarding asking the attorneys for information on the liability side.

Mr. Biggs responded, stating that with every Financial Statement Audit his staff will prepare a legal letter request to the significant attorneys. The auditors are seeking to get information regarding claims, assessments, and legal issues, then evaluate if that information should be disclosed in the financials.

Vice Chair Fritchen asked if transactions are audited to determine if they received the proper approval authority.

Mr. Biggs confirmed that samplings are taken to determine that proper authority has been provided for transaction approvals.

Cory Biggs CEO, Maze & Associates stated that staff informed him that a consultant was being hired to provide a full-blown internal control review and analysis and that review will be much more in depth and much more detailed than the Financial Statement Audit. There should be some commonality between the two reports, but if the Financial Statement Audit is completed first and the Internal Control Audit comes out after, it is going to have more significant issues in terms of changes to be made, processes to be simplified and/or improved than what is found in the Financial Statement Audit.

ADJOURNMENT 4:10 PM

AUDIT COMMITTEE

Councilmember Paul Canepa (Chair)

Councilmember Dale Fritchen (Vice Chair)

Vice Mayor Katherine Miller, (Member)
CITY OF STOCKTON

CITY COUNCIL COMMITTEE
NOTICE

COMMITTEE NAME: AUDIT

DATE: July 11, 2011 TIME: 3:30 p.m.

PLACE: Council Chambers, City Hall, 425 N. El Dorado St., Second Floor

COMMITTEE MEMBERS:
Paul Canepa, Chair
Katherine Miller, Member

Dale Fritchen, Vice Chair
Susan Talamantes Eggman, Alternate Member

STAFF NOTICED:
Bob Deis, City Manager
Laurie Montes, Deputy City Manager
Mike Locke, Deputy City Manager
John Luebberke, City Attorney
Susan Mayer, Chief Financial Officer
Connie Cochran, Public Information Officer
Florence Low, Program Manager III
Bonnie Paige, City Clerk (Recorder)

OTHERS INVITED:
Maze & Associates
The Record

RESPONSIBLE DEPARTMENT
AND STAFF FOR ITEMS ON THE
AGENDA:
F. Michael Taylor, City Auditor

PUBLIC COMMENT

ISSUE(S) TO BE DISCUSSED:
1. Audit Plan for the City's June 30, 2011 financial statements by Maze & Associates
2. Audit Plan for FY 2011-12 audits by the Office of the City Auditor

ATTACHMENT(S):
1. Letter dated June 1, 2011 from Cory Biggs, CEO, Maze & Associates

cc: City Council

For information contact the City Clerk's office at 209-937-8458.
JULY 11, 2011
AUDIT COMMITTEE
COUNCIL CHAMBERS, CITY HALL, 3:30 P.M.
SIGN-IN SHEET

PLEASE SIGN IN:

<table>
<thead>
<tr>
<th>NAME</th>
<th>CONTACT INFORMATION</th>
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</thead>
<tbody>
<tr>
<td>Mike Taylor</td>
<td>Cbs. Audit</td>
</tr>
<tr>
<td>Jim Hethorn</td>
<td>Cbs Audit</td>
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<td>Lynne Ferrar</td>
<td>Cbs- Accounting</td>
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<tr>
<td>Susan Mamer</td>
<td>CFO</td>
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July 6, 2011

TO: City Council Audit Committee
FROM: F. Michael Taylor, City Auditor
SUBJECT: PROPOSED 2011-2012 ANNUAL AUDIT PLAN

Recommendation:

Accept the attached 2011-12 audit plan, and forward to the City Council with a recommendation for approval.

Background:

Each year, the Office of the City Auditor prepares an audit plan. Our process for determining the areas to be included combines risk assessment, requests from management and City Council members, and an assessment of the resources in our office.

Internal controls remain a primary focus for our office in 2011-12. There are control implications associated with additional staffing reductions and organizational changes.

Though internal controls are a primary focus, performance cannot be ignored. We are not able to commit the resources needed to produce a comprehensive look at City performance, but we will examine performance measures in select areas, when possible.

F. MICHAEL TAYLOR
CITY AUDITOR

Attachment
City of Stockton
Office of the City Auditor
Annual Audit Plan for 2011-2012

Audits:

Fleet Utilization
Worker's Compensation
Delta Water Supply Project
Innoprise Implementation
Street Maintenance
Control Environment Assessment
Central Parking District
Police Property Room
Water Fund
Radio Inventory
Solid Waste
ARRA Funding Compliance
Contract Management
Landscape and Maintenance Districts
Construction & Demolition Recycling Permits

Management Action Plan Follow-up

Revenue Auditing

External Audit Coordination

Ethics/Fraud Hotline

Technical Assistance to Departments, Boards, Committees and Council
PRELIMINARY AUDIT OBJECTIVES:

Fleet Utilization
In this audit, we will examine utilization of equipment in fleet and evaluate internal controls over fleet operations.

Worker’s Compensation
The primary focus of this audit will be an evaluation of internal controls, and contract compliance. We also plan to benchmark against other agencies to compare injury rates and costs.

Delta Water Supply Project
This audit will focus on work to date, including compliance with contract terms and legal requirements.

Innoprise Implementation
Moving from Sungard HTE to Innoprise will be a major undertaking for the City. It is also an opportunity to evaluate internal controls and transaction processing cycles.

Street Maintenance
We will evaluate internal controls in the street maintenance program, which will include data in the City’s pavement management system. We will also look at compliance with requirements of funding sources.

Control Environment Assessment
The primary objective of this assignment is to assess the control environment. The combination of management’s attitude and approach to internal controls, combined with written rules, has a major impact on the actual practice of internal controls.

Central Parking District
We will evaluate internal controls over cash handling, and procedures for monthly parking.

Police Property Room
Proper custody and recordkeeping for items in a property room are critical. We will evaluate the system of internal controls for property and evidence.

Water Fund
The objective of this audit is to evaluate compliance with contract terms for water purchases.

Radio Inventory
We will evaluate internal controls over the City’s inventory of radios.
Solid Waste

The objective of this audit is to evaluate compliance with the Stockton Municipal Code and with terms of the City’s contracts with waste haulers.

ARRA Funding Compliance

In this second in a series of audits of federal stimulus funds, we will test the timeliness and accuracy of the data submitted to funding agencies.

Contract Management

City policy calls for each department to have a contract coordinator and for each City contract to have a named contract managers to oversee contract performance. The purpose of this audit is to determine if departments have a contract coordinator and to determine if contracts have been assigned to a City employee.

Landscape and Maintenance Districts

The City contracts for landscape maintenance. In this audit, we will evaluate compliance with contract terms.

Construction & Demolition Recycling Permits

Over the past two years, our office assisted Public Works by conducting site audits of companies that applied to be certified centers for the recycling of construction materials. It is anticipated that a small number of companies will seek certification during 2011-12. We will perform testing of those companies to determine if they meet the criteria for approval.

MANAGEMENT ACTION PLAN FOLLOW-UP:

Our office maintains a database of all open findings. Each quarter, we ask departments for a status report. We verify implementation of those findings that management reports as being corrected. On an annual basis, we report the status of audit findings to the City Council.

REVENUE AUDITING:

The City contracts with an outside vendor for sales tax revenue auditing services. If the Office of the City Auditor is able to identify misallocations or underreporting by or before the time the contractor does, the City is able to save audit fees, which can be a substantial percentage of the underlying tax.

EXTERNAL AUDIT COORDINATION:

Our office manages the contract with the commercial audit firm that performs the financial audit of the City’s financial statements.

ETHICS/FRAUD HOTLINE:
Use of Ethics/Fraud Hotlines is increasing in public and private sector organizations. These hotlines are not just for reporting fraudulent behavior. Hotlines can be used to report wasteful practices or abuse. Hotlines can deter bad behavior. They also serve as a mechanism for employees to seek guidance when asked to do something they think may be unethical.

TECHNICAL ASSISTANCE TO DEPARTMENTS, BOARDS, COMMITTEES, AND COUNCIL:

Our office allocates time each year to offer limited technical assistance upon request. These requests should take no more than a few hours each and generally do not result in a formal report.
June 1, 2011

Audit Committee
City of Stockton
425 North El Dorado Street
Stockton, CA 95202-1997

Dear Committee Members:

We have been engaged to conduct an audit of the City’s financial statements for the year ended June 30, 2011. Audit standards require us to communicate with the Council or other appropriate persons about the audit process. Topics include audit scope, management representations, fraud considerations and audit timing. We have presented an overview of these below:

**Audit Scope, Management Representations and Fraud Considerations**

Accompanying this letter is an Audit Process Overview attachment. It defines what an audit of the City’s financial statements is and discusses management representations, internal control, fraud considerations and management responsibilities for data contained in financial statements. It is the standard used when a financial statement audit is to be conducted. This letter and the attachment are clarifications of the audit process contemplated in the contract we have entered into with the City pursuant to the Council’s approval.

**Audit Timing**

We have met with staff and agreed to the following schedule:

- May 2011 Interim audit fieldwork completed
- 3 weeks starting September 26, 2011: Final audit fieldwork is scheduled
- Prior to the End of November: Issuance of our opinions and a presentation the Committee

**Fraud Risk Considerations**

Audit standards require us to have discussions with our clients to discuss both the potential for and any occurrences of fraud and the impact on financial statements. “Fraud” is defined as an intentional act that results in a *material misstatement in financial statements* that are subject to audit. In this case, fraud includes two concepts. The first is fraudulent financial reporting, including misapplication of accounting principles, the omission of data or disclosures, fictitious transactions or sham transactions and concealment of relevant data. The second concept is that of misappropriations of assets, including theft, its concealment and conversion to cash.
In accordance with audit standards, we met with management and asked:

a. Is management aware of known instances of fraud?

b. Are there areas management believe are "Susceptible to Fraud"
   
   i. Areas presumed susceptible to fraud under audit standards:
      
      i. Improper revenue recognition
      ii. Management override of Internal Control

Communicating the Audit Process

We discussed the above topics with staff and wish to do so with you to provide the Committee an opportunity to participate in the audit process prior to its completion.

I look forward to our discussion.

Regards,

Cory A. Briggs, CEO

Enclosure
AUDIT PROCESS OVERVIEW

We are pleased to confirm our understanding of the services we are to provide for the City of Stockton for the year ended June 30, 2011. The services we have been engaged to provide are outlined below, but we are also available to provide additional services at the City’s request:

1) Audit of the basic financial statements
2) Assistance with the preparation of the Comprehensive Annual Financial Report
3) Single Audit (if required)
4) Measure W Compliance Report
5) Redevelopment Agency Report
6) Public Financing Authority Financial Statements
7) GANN Limit Report

Audit Objective

The objective of our audit is to express opinions as to whether your financial statements are fairly presented in all material respects in conformity with generally accepted accounting principles in the United States of America and to provide limited assurance on accompanying supplemental information. Other information accompanying will not be audited by us and we will express no opinion on it. The objective also includes reporting on:

- Internal controls related to the financial statements and compliance with laws, regulations, and the provisions of contracts or grant agreements, noncompliance with which could have a material effect on the financial statements in accordance with Government Auditing Standards.

- Internal controls related to major programs and an opinion (or disclaimer of opinion) on compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on each major program in accordance with the Single Audit Act Amendments of 1996 and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations.

The reports on internal control and compliance will each include a statement that the report is intended for the information and use of the Council or their appointed committee, management, specific legislative or regulatory bodies, federal awarding agencies, and if applicable, pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Our audit will be conducted in accordance with generally accepted auditing standards in the United States of America; the standards for financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; the Single Audit Act Amendments of 1996; and the provision of OMB Circular A-133, and will include tests of accounting records, a determination of major program(s) in accordance with Circular A-133 and other procedures we consider necessary to enable us to express such opinions and to render the required reports. If our opinion on the financial statements or the Single Audit compliance opinions are other than unqualified, we will fully discuss the reasons with City management in advance. If, for any reason, we are unable to complete the audit or are unable to form or have not formed opinions, we may decline to express opinions or to issue a report as a result of this engagement.
AUDIT PROCESS OVERVIEW

Management Responsibilities

Management is responsible for the basic financial statements and all accompanying information as well as all representations contained therein. As part of the audit, we will prepare a draft of your financial statements, schedule of expenditures of federal awards, and related notes. Staff is responsible for making all management decisions and performing all management functions relating to the financial statements, the schedule of expenditures of federal awards, and related notes and for accepting full responsibility for such decisions. Staff will be required to acknowledge in the management representation letter that staff have reviewed and approved the financial statements, the schedule of expenditures of federal awards, and related notes prior to their issuance and have accepted responsibility for them. Further, staff is required to designate an individual with suitable skill, knowledge, or experience to oversee any nonaudit services we provide and for evaluating the adequacy and results of those services and accepting responsibility for them.

Management is responsible for establishing and maintaining internal controls, including monitoring ongoing activities; for the selection and application of accounting principles; for the fair presentation in the financial statements of financial position of the City's various activities, major funds, and the aggregate remaining fund information and changes in financial position and, where applicable, cash flows in conformity with U.S. generally accepted accounting principles; and for federal award program compliance with applicable laws and regulations and the provisions of contracts and grant agreements.

Management is responsible for making all financial records and related information available to us, including any significant vendor relationships in which the vendor has the responsibility for program compliance and for the accuracy and completeness of that information. We understand that the City will provide us with the Closing Checklist information required for our audit and that the City is responsible for the accuracy and completeness of that information. Management is responsible for adjusting the financial statements to correct material misstatements and for confirming to us in the representation letter that the effects of any uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

Staff are responsible for the design and implementation of programs and controls to prevent and detect fraud, and for informing us about all known or suspected fraud or illegal acts affecting the government involving (a) management, (b) employees who have significant roles in internal control, and (c) others where the fraud or illegal acts could have a material effect on the financial statements. The City is also responsible for informing us of its knowledge of any allegations of fraud or suspected fraud or illegal acts affecting it received in communications from employees, former employees, grantors, regulators, or others. In addition, the City is responsible for identifying and ensuring that it complies with applicable laws and regulations. Additionally, as required by OMB Circular A-133, it is management's responsibility to follow up and take corrective action on reported audit findings and to prepare a summary schedule of prior audit findings and a corrective action plan. The summary schedule of prior audit findings must be made available for our review.
AUDIT PROCESS OVERVIEW

Management is responsible for establishment and maintenance of a process for tracking the status of audit findings and recommendations. Management is also responsible for identifying for us previous audits or other engagements or studies related to the objectives discussed in the Audit Objectives section of this letter. This responsibility includes relaying to us corrective actions taken to address significant findings and recommendations resulting from those audits or other engagements or studies. Management is also responsible for providing management’s views on our current findings, conclusions, and recommendations, as well as your planned corrective actions.

Audit Procedures - General

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit will involve judgment about the number of transactions to be examined and the areas to be tested. Also, we will plan and perform the audit to obtain reasonable rather than absolute assurance about whether the financial statements are free of material misstatement, whether from errors, fraudulent financial reporting, misappropriation of assets, or violations of laws or governmental regulations that are attributable to the City or to acts by management or employees acting on behalf of the City. Because the determination of abuse is subjective, Governmental Auditing Standards do not expect auditors to provide reasonable assurance of detecting abuse.

Because an audit is designed to provide reasonable, but not absolute, assurance and because we will not perform a detailed examination of all transactions, there is a risk that material misstatements or noncompliance may exist and not be detected by us. In addition, an audit is not designed to detect immaterial misstatements, immaterial illegal acts, or violations of laws, or governmental regulations that do not have a direct and material effect on the financial statements or major programs. We will advise the City of any material errors and any fraudulent financial reporting or misappropriation of assets that come to our attention. We will also inform the City of any violations of laws or governmental regulations that come to our attention, unless clearly inconsequential. We will include such matters in the reports required for a Single Audit. Our responsibility as auditors is limited to the period covered by our audit and does not extend to matters that might arise during any later periods for which we are not engaged as auditors.

Our procedures will include tests of documentary evidence supporting the transactions recorded in the accounts, and may include tests of physical existence of inventories, and direct confirmation of cash, investments and certain other assets and liabilities by correspondence with selected customers, creditors and financial institutions. We will request written representations from your attorneys as part of the engagement, and they may bill the City for responding to this inquiry. At the conclusion of our audit we will also require certain written representations from management about the financial statements and related matters.
AUDIT PROCESS OVERVIEW

Audit Procedures - Internal Controls

Our audit will include obtaining an understanding of the City and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing, and extent of further audit procedures. Tests of controls may be performed to test the effectiveness of certain controls that we consider relevant to preventing and detecting errors and fraud that are material to the financial statements and to preventing and detecting misstatements resulting from illegal acts and other noncompliance matters that have a direct and material effect on the financial statements. Our tests, if performed, will be less in scope than would be necessary to render an opinion on internal control and; accordingly, no opinion will be expressed in our report on internal control issued pursuant to Government Auditing Standards.

As required by OMB Circular A-133, we will perform tests of controls to evaluate the effectiveness of the design and operation of controls that we consider relevant to preventing or detecting material noncompliance with compliance requirements applicable to each major program. However, our tests will be less in scope than would be necessary to render an opinion on those controls, and accordingly, no opinion will be expressed in our report on internal control issued pursuant to OMB Circular A-133.

An audit is not designed to provide assurance on internal control or to identify significant deficiencies. However, during the audit, we will communicate to management and the Council internal control related matters that are required to be communicated under professional standards, Government Auditing Standards, and OMB Circular A-133.

Audit Procedures - Compliance

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we will perform tests of the City’s compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our audit will not be to provide an opinion on overall compliance and we will not express such an opinion in our report on compliance issued pursuant to Government Auditing Standards.

OMB Circular A-133 requires that we also plan and perform the audit to obtain reasonable assurance about whether the City has complied with applicable laws and regulations and the provisions of contracts and grant agreements applicable to major programs. Our procedures will consist of tests of transactions and the applicable procedures described in the OMB Circular A-133 Compliance Supplement for the types of compliance requirements that could have a direct and material effect on each major program. The purpose of those procedures will be to express an opinion on the City’s compliance with requirements applicable to major programs in our report on compliance issued pursuant to OMB Circular A-133.