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CENTURY CITY

SAN DIEGO

To the Management and Audit Committee
of the City of Fresno, California

Management and Members of the Audit Committee:

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Fresno, California (City) as of and for the year ended June 30, 2009, 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 over financial reporting. 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 would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a certain deficiency in internal control that we consider to be a significant deficiency.

A *control deficiency* 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 misstatements on a timely basis. A *significant deficiency* is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the organization's internal control. We consider the following deficiency to be a significant deficiency in internal control.

GRANTS REVENUE AND DEFERRED REVENUE

Comment

During our audit, we noted that the City understated deferred revenue and overstated revenue in the fund financial statements at June 30, 2009, related to the Grants Fund. This resulted in a material audit adjustment of \$2,333,675. The misstatement was the result of miscommunication between City departments relating to grant revenue activity occurring subsequent to the balance sheet date.

Recommendation

We recommend the City develop a procedure to improve communication between and within departments to ensure all activity which occurs subsequent to the balance sheet is appropriately reflected in the financial statements.

Response

GASB 33 establishes and provides accounting and financial reporting guidance with respect to Grant Revenues. Federal and state grants are usually either non-reimbursable grants or expenditure driven grants. Non-reimbursable grants are usually received up front and recorded as revenue at the time of receipt and not contingent on incurring an expenditure. Expenditure-driven grants are nonexchange transactions which require revenue to be recorded after the expenditures are incurred and are equal to the expenditures. Under GASB 33, for grants where cash is received up-front the entry normally would be to debit cash and credit deferred revenue until such time as the associated expenditures are incurred. Since the City reflects most transactions on the cash basis, the Department receiving any grant would record a debit to cash and a credit to revenue upon receipt of the cash.

Since the City predominantly has received grants whereby the expenditures are first incurred and then reimbursed through a grant draw, at June 30, 2009, during their search for unrecorded receivables and unrecorded liabilities, the CAFR team mistakenly accrued expenditure-driven Grant monies. The monies were received in July for a grant dated in June. Since the team members had no reason to suspect otherwise, they assumed that the funds were reimbursing expenditures all ready incurred. As noted above, the City has not had the benefit of many expenditure-driven grants whereby monies are received in advance of the incurrence of expenditures. On a go-forward basis the Departments will continue to record grants when the money is received and will do so as revenue, however the CAFR team will appropriately adjust out of revenue and into deferred revenue any expenditure-driven grant receipts that have not incurred the associated expenditures. The accrual at June 30, 2009 was simply a misunderstanding as to the type of grant that had been received. The team is also aware that American Recovery and Reinvestment Act (ARRA) grants will need to be examined more carefully to ensure that the appropriate recognition or deferral takes place.

Several procedures have been put into place to ensure this type of confusion does not occur in the future:

- The Grant spreadsheet that is prepared to assist with the completion of the Single Audit is being revised to include a column to indicate whether the particular grant or portions of the grant are expenditure-driven. This should alert the CAFR team to watch for grant receipts and to explore the nature of the grant with the in-house Finance Department Grant Coordinator and/or the department receiving the grant funds to ensure proper recording. Finance will also be requesting that when departments are posting grant revenue receipts into PeopleSoft that they enter the grant ID# in the description line or in the journal line reference to assist Finance in identifying the grant specifics which will assist both the Single Audit, ARRA Reporting and CAFR accruals.
- Beginning with the 2010 CAFR, all CAFR adjustments will be formally reviewed by the Finance Department's Controller, Assistant Controller, and/or Grant Coordinator prior to posting to ensure that adjustments are not impacted or subject to information known only to the Controller, Assistant Controller, and/or Grant Coordinator. There may be instances where information has come to the attention of these individuals which has not been communicated or filtered through to members of the CAFR team; information which could significantly impact the proposed CAFR adjustment.

We consider the following to items to be control deficiencies:

UTILITY BILLING RECEIPTS

Comment

As part of the information gathering process and understanding of the utility billing system, we noted that the general ledger software used by the City is Peoplesoft, while the utility billing software is HTE (SunGard). Currently, HTE does not automatically interface with Peoplesoft, therefore a manual journal entry is required to post utility billing revenue in Peoplesoft. The posting of this journal entry is a multi-step process: daily revenue is posted to a "suspense" account in PeopleSoft, while a monthly revenue report is generated by HTE and, based on this report; "actual" revenue is transferred from the suspense account to the revenue accounts. This comment was also noted on our letter dated February 25, 2009. During current year testwork, we noted the City has made steps to improve the reconciliation process; however, a manual journal entry is still required.

Recommendation

We recommend that the City continue to create an automatic interface between the HTE and Peoplesoft to ensure utility revenue is properly recognized and recorded in the general ledger.

Response

As a result of legislation, the City of Fresno is legally mandated to install water meters on all of its residential water customer's properties and prepare billings based upon actual consumption. All meters must be installed by January 1, 2013.

Currently all non-metered residential customers pay for water services based upon a flat rate per month. The City recently issued bonds to fund specific capital projects, which includes the installation of water meters on single family residential properties. One phase of the project includes the Water Meter Retrofit Project but also includes various other enhancements including the acquisition of new software and the modification of existing software (HTE) necessary to be able to move to consumption billing. As part of the software changes, the City will be moving to monthly vs. bimonthly utility billing and from billing in advance at a flat rate to billing in arrears based on actual consumption. Part of the software "redesign" includes building the automatic interface between HTE and Peoplesoft. This will eliminate the need for the manual journal entry. The goal is to have the data uploaded from HTE into Peoplesoft as part of a nightly update. It is anticipated that testing of this process will begin in mid 2010 with the actual live functionality occurring in late 2010. Before the interface could be built, the water meter vendor and automated reading system had to be selected through the RFP process. Selection was not finalized until February 2010.

BANK RECONCILIATIONS

Comment

During the bank reconciliation review process, we noted that bank statements for July 2008 were not reconciled to the general ledger and appropriately reviewed and approved until October 2008.

Recommendation

We recommend that all bank accounts be reconciled each month within 45 days of month end so that errors or other reconciling matters may be recognized and resolved in a timely manner.

Response

At the end of each fiscal year there is indeed a slight delay in the reconciliation of the July cash balance between the bank statement and the general ledger. This delay is the result of the June books taking a bit longer to close in order to capture all fiscal year end transactions. It is not a true statement however that July 2008 was not reconciled until October 2008. The reconciliation was completed on September 9, 2008 and is noted as such on the reconciliation; the secondary sign-off by the reviewer indeed did not occur until October 2008. This may have been due to workload, vacations or a host of other factors that at this late date cannot be verified. Finance however will certainly work toward more timely secondary review and sign-off of bank reconciliations.

DEPOSITS FROM OTHERS

Comment

During deposits from others testwork, we noted outstanding deposits recorded in the City's general ledger received from 1969 to 2009 that range from \$20 to \$550,000. The City has been either unable to find the depositor or since they are dated, no documentation exists with a number of the deposits. As part of the City's policies and procedures, it is up to each individual department to give the Finance Department the approval to release the deposits.

Recommendation

We recommend that the City perform a reconciliation of outstanding, dated deposits and return the deposit amounts or recognize the revenue of deposits as deemed appropriate. We further recommend that the City develop a policy and procedure relating to the on-going process of all deposits including the collection of receipts, refunds and timely reconciliations.

Response

The Finance Department has attempted to contact departments at least once every other year to obtain confirmation as to whether or not "deposits" should remain on the books and records of the City. As staff has moved between departments, retired or been laid off, it has become more and more difficult to locate staff who are familiar with the deposits or have time to research them. Finance is once again heading up the effort to determine whether or not these deposits are still valid, should be refunded or taken into revenue. The intent is to have deposit amounts reconciled and substantially "cleaned up" by June 30, 2010.

CAPITAL ASSETS

Comment

During capital asset testwork, we noted that the City's capitalization threshold is \$2,000 for all capital assets.

Recommendation

We recommend that the City evaluate the current capitalization threshold and determine if the current amount is reasonable for the City's activities. The Government Finance Officers Association (GFOA) recommends that capitalization thresholds never be less than \$5,000. We further recommend that the City consider a higher threshold for infrastructure assets, such as \$100,000.

Response

For numerous years the Finance Department has had the strong desire to revise the capitalization threshold for capital assets. Revisions to the Administrative Order (AO) were proposed and submitted to Management; approval however was not obtained. It is believed that the confusion resulted from the misconception that by raising the capitalization threshold the tracking of smaller assets would be eliminated. Peoplesoft Asset Management provides for the tracking of smaller assets that are considered "sensitive" which would provide for control and tracking of those assets management considers subject to theft or misuse but which should be capitalized for CAFR purposes. This functionality will be investigated further and the AO rewritten and resubmitted for management consideration. It is likely that if feasible it would be implemented July 1, 2010.

CAL CARD POLICIES

Comment

As part of the information gathering process and understanding of the City's Cal Card policies and procedures, we noted that when an employee is terminated they are responsible for contacting the Purchasing Department to close the Cal Card account. The Purchasing Department's policy is to review active Cal Cards for terminated employees once a year.

Recommendation

We recommend that the City add an additional step to the terminated employee procedures process to inform the Purchasing Department when an employee is terminated in order to ensure the Cal Card account is closed in a timely manner.

Response

Information Services, Human Resources and Finance are working together to develop programming which would, with relative ease, provide for the ability to remove or suspend an individual from access to Peoplesoft and Outlook, as well as notify other departments needing this time sensitive data. As it exists now, this is a rather complex process and is reliant upon the timely preparation and processing of a formal Employee Action Form (EAF).

Currently, payroll contacts each payroll clerk prior to the processing of payroll to inquire as to whether or not individuals are being terminated. This list has been shared with Human Resources for HRA purposes but nothing more. A policy has now been implemented such that this termination listing will be shared with the General Ledger Module Lead as well as the HR Module Lead such that terminated employees may be suspended from access to Peoplesoft. We have also expanded the distribution of the list to Information Services (ISD) so as to be able to suspend access to Outlook and other ISD controlled applications. In addition we will also distribute the list to General Services and Finance Administration so that terminated employees have their Cal Cards and/or Bank of America credit cards closed. HR will also use the listing to ensure that EAF's are processed timely by the departments with terminated employees.

JOURNAL ENTRY

Comment

During the final audit testwork, we noted adjusting journal entries created subsequent to the year end close are not reviewed and approved by the Controller or Assistant Controller prior to posting.

Recommendation

We recommend that either the Controller or the Assistant Controller review and sign off on all financial statement adjustments made subsequent to the closing of the City's official books of record in Peoplesoft and Oracle. Subsequent to providing the outside auditors the official CAFR trial balance, approval should be obtained prior to posting.

Response

Beginning with the 2010 CAFR, all CAFR adjustments will be formally reviewed by the Finance Department's Controller, Assistant Controller, and/or Grant Coordinator prior to posting to ensure the adjustments are not impacted or subject to information known only to the Controller, Assistant Controller, and/or Grant Coordinator.

INFORMATION TECHNOLOGY

Policies and Procedures

As part of the information gathering process and understanding of the City's Information Technology policies and procedures, we noted the City does not have a formalized disaster recovery plan. This comment was also noted on our letter dated February 25, 2009.

Recommendation

We recommend management develop and test a formalized disaster recovery plan (DRP). During times of disaster a well documented plan should include but not be limited to the following key fundamentals.

- Understanding an organization's activities and operations and how all of its resources are interconnected
- Assessing an organization's vulnerability in all areas, including operating procedures, physical space and equipment, data integrity and contingency planning
- Understanding how all levels of the organization would be affected in the event of a disaster
- Developing a short-term recovery plan
- Developing a long-term recovery plan, including how to return to normal business operations and prioritizing the order of functions that are resumed
- Testing and consistently maintaining and updating the plan as the business changes
- Annual testing of the disaster recovery plan is also recommended

Response

Information Services is working on a Technology Disaster Plan ("Plan") that they hope to have finalized by the end of fiscal year 2010. The Plan will establish the steps to be taken immediately following a disaster; a planned sequence of events. The Plan will address personnel to be involved, including plans to ensure that recovery workers are provided with resources to meet both physical and emotional needs following an emergency; salvage operations at the disaster site; designation of alternate sites; acquisition of new equipment as necessary and reassembly of components at the alternative site, and restoration of data and restoration of applications. Last but not least, the Plan will address moving back to the restored permanent facility.

The intent of the Plan is to present an orderly course of action for restoring critical computing capability to the City and its operations. It will set criteria for making decisions to recover at an alternate site or repair the affected site. The Plan will describe the organizational structure for carrying out the plan and will provide information concerning personnel that will be required to carry out the plan and the computing expertise required. It will identify equipment and procedures and all other items necessary for the recovery. The key objectives will be to identify activities, resources and procedures; assign responsibilities; ensure coordination with both internal and external points of contact and vendors and maximize effectiveness of contingency operations. The focus by ISD will be operational components that can be tied into a broader plan that the City is creating for disaster recovery as a whole.

User Account Management

During testwork performed of User Rights to Network and Applications, we noted that 5 out of 25 terminated employees selected for testwork had active user accounts after the date of termination. This comment was also noted on our letter dated February 25, 2009.

Recommendation

We recommend management establish formal policies and procedures for user account management. This includes the creation of user accounts as well as the removal of accounts upon separation from the City. We also recommend that when employees change positions or job duties that their user profile in the various applications be reviewed and amended as required. This is a process which needs to be coordinated with Human Resources as well as Information Services and the other departments which control application access.

Response

Information Services, Human Resources and Finance are working together to develop programming which would provide for the ability to remove or suspend an individual from access to Peoplesoft and Outlook with relative ease. As it stands now, this is a rather complex process and is based upon the preparation of a formal EAF.

Currently, payroll contacts each payroll clerk prior to the processing of payroll to inquire as to whether or not individuals are being terminated. This list has been shared with Human Resources for HRA purposes but nothing more. A policy has now been implemented such that this termination listing will be shared with the General Ledger Module Lead as well as the HR Module Lead such that terminated employees may be suspended from access to Peoplesoft/Oracle. Once the EAF is processed, they will be removed permanently. By providing the HR Module Lead the listing as well will enable HR to follow up on the timely receipt and processing of the related EAF. This methodology will be utilized until such time as a more automated process can be found.

The City's responses to the comments identified in our audit are described above. We did not audit the City's responses, and, accordingly, we express no opinion on them.

This communication is intended solely for the information and use of the Audit Committee of the City of Fresno and the management of the City of Fresno and others within the organization and should not be used by anyone other than these specified parties.

We would like to express our appreciation for the courtesy and assistance extended to us during our audit by all your staff.

We would be pleased to discuss with you at your convenience the matters contained in this letter or any other matters which you would like to discuss.

Macias Jini & O'Connell LLP

Certified Public Accountants
Newport Beach, California

February 24, 2010