

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, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Fresno as of and for the year ended June 30, 2010, in accordance with auditing standards generally accepted in the United States of America, we considered City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all such deficiencies have been identified. 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 combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in City's internal control to be significant deficiencies:

UNEARNED REVENUE

Comment

As disclosed in Note 13.d. of the notes to the basic financial statements for the City of Fresno, there was a widespread occurrence of DBCP, an agricultural pesticide in certain groundwater throughout Fresno. At various City well sites, DBCP exceeds drinking water limits and is removed by Granular Activated Carbon treatment. The City fronted the costs of clean up with respect to the known wells and reimbursed itself from a litigation settlement (with Shell) in an original amount of \$21 million, \$10 million was stipulated to be used toward past costs, and \$11 million was to be applied toward the installation of carbon filtration treatment units and capital costs of the installation of granular activated carbon treatments at wells exceeding maximum contaminant levels. Generally at the end of each fiscal year, the City evaluates the costs incurred in the current fiscal year and records an entry to move the unearned revenue into revenue to match the current year expenses. As of June 30, 2010, the City did not evaluate

or review the current year expenses; therefore, revenue was not properly recognized for the year resulting in an overstatement of unearned revenue and an understatement of revenue in the amount of \$1,057,908.

Recommendation

We recommend that the City create or update a year end task list to include evaluation of the DBCP Settlement to ensure the activity is evaluated annually and unearned revenue and revenue are properly reflected each year.

Response

The City agrees with this recommendation.

CAFR staff working on the Water Fund initially ran the expense query early in their work on the fund. Subsequent to the completion of their work there were additional expense adjustments made. In addition, they overlooked transfers as part of their analysis; therefore the figure used to journal unearned revenue to earned revenue was understated.

As a result of budgetary contraction and the loss of staff resulting from retirements and layoffs, several CAFR responsibilities related to the preparation of various fund financial statements have been reallocated to different staff. Naturally a learning curve must take place and staff did not think to go back and run another query prior to providing MGO with the trial balance. This process has been added to our "To Do" list.

The understatement of revenue in the Water Fund represents slightly less than 1% of total Operating Revenue. Upon discovery of the understatement by the Auditors, it was determined that the oversight would not have a significant impact on the Water Fund nor would it impact debt service coverage. The correcting entry was therefore passed upon. The CAFR team however has made note of this oversight so as to prevent a reoccurrence in future years.

BUSINESS LICENSE RECEIPTS

Comment

The City processes approximately 26,000 Business License Renewals every quarter. In January 2010 the City installed and implemented new business license software. As part of the implementation of the new software, the invoices developed did not contain the proper bar coding; therefore, payments received by mail from January through June 2010 had to be manually entered into PeopleSoft. In addition, due to current economic conditions, the City reduced the staff size in the Business License Department from 5 employees to 2 employees. During the period January through June 2010, the City kept all payments received by mail locked in the vault until the receipts were processed. Furthermore, checks were not deposited into the bank until the payment was processed, which in some cases occurred 3 months after receipt of payment. As part of the year end process, the City evaluated the collection of business license receipts and accrued \$2,439,066 of payments processed in September 2010, which actually related to activity for the year ended June 30, 2010, to properly capture business license receivables and revenues. The City has made efforts to bring the business license receipts posting up to date by using additional resources within the Finance Department. As of the date of this letter the City is up to date except for those receipts that have unresolved issues.

Recommendation

We recommend the City establish or revise its procedures for depositing checks during times of transition or reduced staffing, to ensure checks are deposited in a timely manner. These procedures could include making copies of all checks received by mail and attaching them to the remittance advices to ensure proper recording in PeopleSoft.

Response

The City agrees with the recommendation to revise its procedures and has taken steps to do so.

At June 30, 2010, the Business License Division experienced what could be called the “perfect storm”. As noted above by the Auditors, the Division installed and implemented new Business License Software replacing a system that predated Y2K. The old main frame system left a great deal to be desired and did not provide for automation of many of the business license processes. Conversion to the new system was painful and tedious and required numerous changes in processes and procedures. At the same time the conversion to the new system was taking place, the Business License quarterly reporting statements had to be revised.

For the first two quarters of calendar year 2011, the business license tax returns were sent out late and filing due dates were extended. In addition, initially the returns did not include the proper bar coding needed for automated posting due to some software modifications that were required. As a result, none of the business filings could be read electronically by the “NCR” machine. This required that all 26,000 Business License renewals be keyed in manually for both the March quarter end as well as the June quarter end. To add fuel to the fire, due to budget cuts, the Division lost three Customer Service Clerks at June 30, who otherwise would have been keying in Business License Receipts. The remaining staff, still fairly new to the system, were keying in data at a slower pace than they ultimately will in order to avoid data entry errors as they learned the new system.

Subsequent to June, four additional staff from the Finance Department has been trained to assist with data entry particularly during end of quarter crunch times; the bar code issue has been resolved and so now, the “NCR” system with electronic data entry into the Business License system is fully functional. These two modifications alone have resolved a great deal of the back log issue that was experienced in June. Staff is still experiencing some issues related to the NCR automatic read that results from customers entering the amount being paid incorrectly into the fields used by the NCR machine to read the payment submissions. In these instances, the NCR machine “kicks-out” the payment and the data must be entered manually. These types of read errors are the kind of data entry that are passed on to the “back up” Finance staff for manual data entry. This frees up the experienced Business License staff to focus on delinquent or problem accounts.

Additional process changes which are in the early implementation and investigation stages are the ultimate addition of electronic payment presentment which would allow the business owner to renew and pay online either by using a credit card or creating an electronic draft from the business owner’s checking/bank account. Both of these options however have additional processing costs to the City associated with them that the City is investigating as to whether or not they can be passed on to the customer so as to avoid lost revenue to the City.

Even with these enhancements, there will still be those business license returns that will require special attention and hand processing. With the training of the additional staff in Finance, the degree of backlog should no longer be an issue but the situation will be monitored closely.

To ensure that checks are deposited timely, the City intends to create a new clearing account for recording batched business license deposits. Treasury will reconcile bank deposits to the PeopleSoft clearing account and Business License will process the receipts in the Progressive System by batch and clear the clearing account once the batch has been completed.

We consider the following 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 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 24, 2010. During current year testwork, we noted that the City has continued to make steps to improve the reconciliation process; however, a manual entry is still required.

Recommendation

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

Response

The City continues to agree with this recommendation and is working diligently to make it a reality.

While it is true that a manual journal entry is still required to record the Utility receipts on the PeopleSoft books, part of the contract with the outside consultant assisting the City in it’s conversion over to water meters is to build the interface necessary for the HTE system to post daily into PeopleSoft. The interface will be built toward the end of the project as the City had to first complete the conversion of the HTE system from bimonthly billing to monthly billing – which it did; fully capture all reads from the newly installed water meters and complete the creation of bills reflecting charges based upon actual usage rather than a flat rate. Water meters are still being installed throughout the city of Fresno and as such the system and interface are still in progress.

The Utility Advisory Committee made up of citizens from Fresno, make recommendations to the City Council as to what they believe the appropriate Utility rates should be for the City of Fresno for the next five years. They also made suggestions as to how best to roll out the water meter program to the citizens of Fresno and will be taking their most current recommendations to Council in the early Spring of 2011 with respect to the suggested tiered rate the City should implement with respect to water usage. Currently the City is billing a charge for the size of meter installed with a flat rate for water, no matter how much is used. Later, in mid-to late 2011, the billings are expected to be converted from a flat water rate to a rate that reflects actual usage based upon reads from the meters installed. After testing and upon reaching the comfort level that meter reads are accurate and billings based upon these reads are also properly calculated and accurate, then will the bridge program be created enabling the direct posting of Utility payments into the PeopleSoft system on a daily basis. At this time, it is not expected that the interface

will be completed by June 30, 2011 but will be in place sometime in calendar year 2012. Until that time, the manual posting will continue along with the reconciliation procedures necessary to ensure that the amounts journaled into PeopleSoft from HTE reports are accurate.

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. This comment was also noted in our letter dated February 24, 2010. During the current year testwork, we noted that the City has continued to make steps to "clean up" old deposits and the remaining deposits under review relate primarily to the Planning and Development Department.

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 worked diligently to "clean up" deposits in Fund 63509 prior to June 30, 2010. All departments were contacted and provided a listing of their deposits outstanding. Where deposits could be transferred to another project associated with the same developer or individual, they were. When the department provided Finance the necessary information to refund the deposits, this was done. When departments could not identify the deposits or associate them with another project, a listing was published twice in the Fresno Business Journal. The balance of the unidentified and unclaimed monies were via journal entry #175567 moved into the General Fund prior to the end of June. One department, Planning and Development was delayed in responding to Finance's request for assistance in identifying the old deposits. As a result their list continues to be worked on diligently by Finance. Finance is also researching monies long held in Trust Funds and working to "clean up these balances. Finance will continue working with on these accounts and hopes to have all work completed or substantially complete prior to the close of Fiscal Year 2011.

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 would not be capitalized for CAFR purposes. This functionality is available for departments to use if they so desire and as a result the AO was rewritten and resubmitted for management consideration. The AO was approved by the Labor Management Task Force last fiscal year and was submitted to the City Manager's Office for review and consideration.

INFORMATION TECHNOLOGY

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 in our letter dated February 24, 2010.

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 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

During the last audit, ISD, Finance and Personnel were working on an automated system and policies for account management. Since that time, PeopleSoft became the source of authority for terminations. As such, three of the five terminated employees that had log-in dates past their termination date were caught by this change showing that our new process is working. One of the five was intentionally left open as we needed to transfer his duties to another employee and needed his account to do so. This person's termination date was due to being deceased, so this was intentional and closely supervised.

Our findings (including 6 that were audited) are below:

Notes	Dept	Effective Date	Status	Last Login Date	Description
Prior to PeopleSoft and caught by PeopleSoft	Parks	1/1/2010	Disabled	1/2/2010	Disabled 1/6/2010.
PeopleSoft Caught	Fleet	12/24/2009	Disabled	12/31/2009	Disabled 3/2/2010.
PeopleSoft Caught	ISD	12/24/2009	Disabled	2/4/2010 on DC1	Disabled 3/2/2010 -- Daniel was an ISD employee and did not have access to any critical systems.
	DPU Admin	7/18/2009	Disabled	7/23/2009	Was not informed to disable account until 8/10/09 HEAT # 92990
	Parking	1/1/2010	Disabled	5/11/2010	Was not informed to disable account until 6/4/2010 HEAT # 105007
	ISD	10/12/2009	Disabled	12/9/2009	Bruce's account was used for an ACH transfer. This had been corrected after he passed away.

In addition to our new PeopleSoft system, accounts are automatically disabled after 90 days of inactivity. This includes any elevated accounts that are used by administrators. We will continue to audit our newly implemented system and make adjustments as necessary.

Since the City of Fresno has 2929 users, the above findings are promising since this represents less than 1% of our user base. We will continue to audit the new system for the next audit.

In addition to the automated system that has been enacted by ISD, Finance/Payroll continues to generate a list of terminated employees at the end of each pay period and route that listing to all appropriate parties so that login capacity is removed from the various programs as well as credit cards deactivated along with other high risk applications.

Server Room

During our audit, we performed a walkthrough of the server room and noticed the following; 1) the server room contains wet sprinklers, which if discharged would cause extensive damage to the servers, 2) there is a second door to the server room that does not require the use of an electronic key but a manual key, and 3) one side of the server room is a partitioned wall that can be easily moved to allow access.

Recommendation

We recommend the wet sprinkler system be replaced with dry pipe, pre-action sprinklers or a clean agent/gaseous system which are the predominant protection system for high value assets. Additionally,

we recommend the City build a dry wall where the partitioned wall exists to ensure the safety of the server room and implement an electronic key entrance to mirror the other entrance in order to verify who enters the server room.

Response

The City agrees with these recommendations, however, current budgetary constraints may limit the City’s ability to respond immediately to these recommendations particularly those that may have a high dollar cost associated with them.

The City will most certainly need to investigate the various alternatives available to it and evaluate the cost / benefit of each as well as perform a risk assessment so as to make the best use of limited resources. A risk assessment matrix similar to the one below will be used to determine what degree of risk the City is willing to accept.

RISK ASSESSMENT MATRIX

Potential Event	Outcome/Impact of Risk Event			
	<u>Negligible</u>	<u>Marginal</u>	<u>Critical</u>	<u>Catastrophic</u>
<u>Certain</u>	High	High	Extreme	Extreme
<u>Likely</u>	Moderate	High	High	Extreme
<u>Possible</u>	Low	Moderate	High	Extreme
<u>Unlikely</u>	Low	Low	Moderate	Extreme
<u>Rare</u>	Low	Low	Moderate	High

Fire Industry studies indicate that 43% of businesses that are closed by a fire never reopen. While this would not be feasible for a government, it certainly speaks volumes as to the difficulty and the costs associated with recovering from a fire.

Fire research has shown that the pre-combustion stage of a fire allows for the largest window of time to detect and control the progression of a fire. It is this window of time that the fire detection systems can mean the difference between availability and unavailability of critical and vital mission critical facilities and information technology data centers. It is this area that will need to be the immediate focus of the City.

Most fires in mission critical facilities can be prevented if common mistakes are avoided and fire detection is properly specified and monitored. Human error plays a large role in preventing fire hazards and must be eliminated through training and procedures that are enforced. The City will work closely with its Fire Department and the Emergency Preparedness Office to develop the most cost effective resolution to these issues.

As for the temporary partition securing the server room funding, at this time is also a factor in the decision making process. This too will be taken into consideration as part of the overall risk assessment and alternative solutions will be investigated and brought forward to management.

On March 1, 2011, the ISD department re-keyed all of its access doors that still had manual keyed entries and reissued keys to personnel that were deemed to have the necessary credentials and need for access to those areas. This was done in order to allow ISD the time necessary to evaluate the cost associated with installing an electronic key.

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, 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 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.



Certified Public Accountants
Newport Beach, California

March 23, 2011