

**CITY OF SAN RAFAEL
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS**

FOR THE YEAR ENDED JUNE 30, 2013

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**CITY OF SAN RAFAEL
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS**

For The Year Ended June 30, 2013

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MEMORANDUM ON INTERNAL CONTROL

To the City Council of
the City of San Rafael, California

We have audited the basic financial statements of the City of San Rafael for the year ended June 30, 2013, and have issued our report thereon dated October 18, 2013. Our opinions on the basic financial statements and this report, insofar as they relate to San Rafael Sanitation District (District), are based solely on the report of other auditors. In planning and performing our audit of the basic financial statements of the City of San Rafael, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

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. 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.

Our consideration of internal control was for the limited purpose described in the first 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. We did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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.

Maze & Associates

Pleasant Hill, California
October 18, 2013

**CITY OF SAN RAFAEL
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

2013 - 1: Reconciliation of Worker's Compensation Claims Paid

Criteria: The City should ensure that workers' compensation claim-related payments are consistent with its claim files.

Condition: The City's workers' compensation claims are administered by a third-party administrator. The administrator processes claims payments on behalf of the City and sends the City a monthly activities report. While the City reconciles the worker's compensation bank account to checks issued, payments made out from the account are not compared to claim files.

Cause: Following staffing changes and reductions, the City ceased its review of payments initiated by the third-party administrator from the workers' compensation bank account.

Effect: Disbursements not authorized by the City could be made out from the account.

Recommendation: To ensure that only payments authorized by the City are made out from the workers' compensation bank account, the City should reconcile payments made to claim files. Alternately, the City can request a Service Organization Control (SCO) report from the third-party administrator. A SCO report provides information regarding the service organization's controls and effectiveness of the controls.

Management Response: The City's Human Resources Office will reconcile payments initiated by the third-party administrator from the workers' compensation bank account to the City's internal claim files on a quarterly basis.

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SCHEDULE OF OTHER MATTERS

NEW GASB PRONOUNCEMENTS OR PRONOUNCEMENTS NOT YET EFFECTIVE

The following comment represents new pronouncements taking affect in the next few years. We have cited them here to keep you abreast of developments:

EFFECTIVE FISCAL 2014:

GASB Statement 65 – Items Previously Reported as Assets and Liabilities

This Statement establishes accounting and financial reporting standards that reclassify certain items that were previously reported as assets and liabilities as deferred outflows of resources or deferred inflows of resources, and certain items that were previously reported as assets and liabilities recognizes as outflows of resources or inflows of resources.

This Statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term *deferred* in financial statement presentations.

Statement No. 63 established the financial statement presentation for deferred inflows and deferred outflows, and Statement No. 65 makes other changes and defines certain transactions subject to this new presentation.

GASB Statement 66 – Technical Corrections—2012—an amendment of GASB Statements No. 10 and No. 62

The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

This Statement removes the GASB Statement No. 10 provision that limits fund-based reporting of an entity's risk financing activities to the general fund and the internal service fund type.

This Statement also amends Statement 62 by modifying the specific guidance on accounting for (1) operating lease payments that vary from a straight-line basis, (2) the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans, and (3) servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate. These changes clarify how to apply Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases*, and result in guidance that is consistent with the requirements in Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, respectively.

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SCHEDULE OF OTHER MATTERS

GASB 67 – *Financial Reporting for Pension Plans—an amendment of GASB Statement No. 25*

This statement is applicable when a Trust arrangement is established to hold the employer contributions prior to payment to the retirees (i.e. funding changes to prefunding rather than the current pay-as-you-go funding).

This Statement replaces the requirements of Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 50, *Pension Disclosures*, as they relate to pension plans that are administered through trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statements 25 and 50 remain applicable to pension plans that are not administered through trusts covered by the scope of this Statement and to defined contribution plans that provide postemployment benefits other than pensions.

EFFECTIVE FISCAL 2015:

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

This Statement will have material impact on the City's financial statements. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions.

This Statement establishes standards for measuring and recognizing liabilities, deferred outflows of resources, and deferred inflows of resources, and expense/expenditures. For defined benefit pensions, this Statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service.

In financial statements prepared using the economic resources measurement focus and accrual basis of accounting, a single or agent employer that does not have a special funding situation is required to recognize a liability equal to the net pension liability. The net pension liability is required to be measured as of a date no earlier than the end of the employer's prior fiscal year (the measurement date), consistently applied from period to period.

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SCHEDULE OF OTHER MATTERS

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

Note disclosure and required supplementary information requirements about pensions also are addressed. Distinctions are made regarding the particular requirements for employers based on the number of employers whose employees are provided with pensions through the pension plan and whether pension obligations and pension plan assets are shared.

The following are the major impacts:

- This Statement requires the liability of employers and nonemployer contributing entities to employees for defined benefit pensions (**net pension liability**) to be measured as the portion of the present value of projected benefit payments to be provided through the pension plan to current active and inactive employees that is attributed to those employees' past periods of service (**total pension liability**), less the amount of the pension plan's **fiduciary net position**.
- Actuarial valuations of the total pension liability are required to be performed at least every two years, with more frequent valuations encouraged. If a valuation is not performed as of the measurement date, the total pension liability is required to be based on update procedures to roll forward amounts from an earlier actuarial valuation (performed as of a date no more than 30 months and 1 day prior to the employer's most recent year-end).
- The actuarial present value of projected benefit payments is required to be attributed to periods of employee service using the entry age actuarial cost method with each period's service cost determined as a level percentage of pay. The actuarial present value is required to be attributed for each employee individually, from the period when the employee first accrues pensions through the period when the employee retires.

GASB 69 – Government Combinations and Disposals of Government Operations

This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this Statement, the term *government combinations* includes a variety of transactions referred to as mergers, acquisitions, and transfers of operations.

GASB 70 - Accounting and Financial Reporting for Nonexchange Financial Guarantees

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

CITY OF SAN RAFAEL
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SCHEDULE OF OTHER MATTERS

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

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

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

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

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

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**CITY OF SAN RAFAEL
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STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

2012-01: Controls over Cash Receipts and Billing in Fire Department

Criteria: To strengthen internal control, employees who handle cash receipts collection should not also maintain the accounts receivable ledger, process billing, or have the authority to write off accounts receivable. In addition, reconciliations should be done on a regular basis to ensure that all revenue generated have been recorded in the City's general ledger.

Condition and Effect: As part of our internal control evaluation of the City's revenue cycle, we conducted an interview at the City's Fire Department cash collection site in May 2012. We noted the following:

1. There is no evidence of review of bills sent. The Battalion Chief initiates billing by providing documents to the Administrative Assistant II to generate bills. The Administrative Assistant II then prepares the invoices and the Battalion Chief reviews them for accuracy before mailing. However, there is no evidence that a review has been performed. Therefore, it will be difficult for the City to provide evidence that the review has taken place.
2. Receivables are not recorded on the City's general ledger at the time of billing. The Administrative Assistant II keeps copies of invoices sent in an "A/R" folder in the Fire Department. She checks periodically to make sure payments have been received. If a payment has not been received within one month, she informs the Battalion Chief to follow up on the payment. However, Finance is not notified about the amount of accounts receivable outstanding. By not recording the accounts receivable in the general ledger and relying on one employee to keep track of collectability, the City is exposed to the risk of cash receipts interception and/or the understatement of accounts receivable as well as revenue balances can result.
3. There is no cash register used in the Fire Department. Checks received by mail or over the counter are placed in a folder kept in the "Outgoing Mail" slot. However, these checks are not endorsed until they are delivered to the Finance Department. Cash received by mail or over the counter is kept in a locked drawer. By not immediately endorsing the checks and keeping them locked up during the hours of operation, the possibility of the interception of revenues increases.
4. The numeric sequence of cash receipts is not accounted for. If payment is received over the counter, the Administrative Assistant II fills out a receipt for the customer, but the receipts are not pre-numbered. Without accounting for the numeric sequence of the cash receipts, it is possible for an employee to intercept money collected.
5. Cash receipts batches are not reviewed by another employee in the Fire Department. In addition, the Fire Department does not reconcile revenue generated to cash receipts collected. The responsibility of reconciliation falls onto the Finance Department. Without the reconciliation between services provided by the Fire Department and revenue collected, the City is exposed to the risk of cash interception.

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STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

Cause: Cash receipt and department billing processes throughout the City have not been reviewed since several departments reorganized their administrative processes over the past few years in response to staff reductions and attrition. One of the consequences of this is the weakening of some internal controls.

Recommendations: The City needs to review its entire cash collection procedure in the Fire Department in order to implement better internal control. Good internal control dictates that one employee should not have access to records used to maintain related assets. Good internal control further dictates that another employee should be involved in the records or assets so that they provide good checks and balances. At minimum, reconciliations should be done to ensure that all revenue generated by the fire officials is recorded in the general ledger. This includes reconciliation between the following:

- Services provided with amounts billed
- Amounts billed with accounts receivable on the general ledger
- Amounts collected with amounts sent to Finance
- Amounts sent to Finance with amount deposited to the bank account

Current Year Status: We conducted a follow-up interview at the above cash collection site during our current year's audit. We were informed that the City has implemented new procedures to address the issue above.

MEMORANDUM ON INTERNAL CONTROL
SCHEDULE OF PRIOR YEAR OTHER MATTERS

2012-02: Outdated Signature Cards

Signature cards for the bank and investment accounts should be updated immediately whenever there is a change in authorized signers. As of May 18, 2012, we found that the previous Finance Director was listed as an authorized signer for the City's Bank of New York trust account. In addition, the previous Interim Finance Director was listed as an authorized signer for the City's Local Agency Investment Fund (LAIF) accounts. Keeping ex-employees as authorized signers on the City's bank and investment accounts exposes the City to the risk of misappropriation of City assets. We were advised by the City that the City will update the signature cards of the accounts after the City fills the Finance Director position. We recommend that the City immediately remove the ex-employees from the authorized signer lists of all bank accounts. In the future, a step should be added to the employee departure checklist to ensure that outside parties (such as banks, investment advisors, and bond trustees) are informed that the departed employee no longer represents the City.

Current Year Status: Signature cards have been updated.

2012-03: Capital Asset Inventory

The Finance Department should perform a physical inventory of the City's capital assets on a rotational basis to ensure that capital assets records are complete and physical assets are safeguarded. Annually, Finance sends out capital asset listings to department heads for updates. Finance then adjusts its capital assets records based on these updates. Without a periodic inventory of the City's capital assets, the City may not be able to detect capital assets impairment, misplacement, or theft. We recommend that the City conduct a physical inventory once a year on a rotational basis to ensure that capital assets records are accurate.

Current Year Status: Capital assets inventory was conducted in current fiscal year.

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REQUIRED COMMUNICATIONS

October 18, 2013

To the City Council of
the City of San Rafael, California

We have audited the basic financial statements of the City of San Rafael for the year ended June 30, 2013. Professional standards require that we communicate to you the following information related to our audit under generally accepted auditing standards and, *Government Auditing Standards* and OMB Circular A-133.

Significant Audit Findings***Accounting Policies***

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City of San Rafael are described in Note 1 to the financial statements. The following Governmental Accounting Standards Board (GASB) pronouncements became effective, but did not have a material effect on the financial statements:

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

GASB 61 – *The Financial Reporting Entity: Omnibus, an amendment of GASB Statements No. 14 and No. 34*

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

The following pronouncements became effective, and required a format change in the Statement of Net Assets and certain nomenclature revisions in the footnotes accompanying the financial statements.

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

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

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

Unusual Transactions, Controversial or Emerging Areas

We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period. However, the dissolution of the former Redevelopment Agency had a material impact to the financial statements of the City and its component units. Details of the dissolution's is discussed in Note 15 of the financial statements.

Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate(s) affecting the City's financial statements was (were):

- *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 1. 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.
- *Accrued compensated absences:* are estimated using accumulated unpaid leave hours and hourly pay rates in effect at the end of the fiscal year. 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 Investments:* As of June 30, 2013, the primary government of the City, held approximately \$49 million of cash and investments, as measured by fair value. Fair value is essentially market pricing in effect as of June 30, 2013. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2013.

Disclosures

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. Management has corrected all/certain such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in a management representation letter dated October 18, 2013.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the governmental unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Information Accompanying the Financial Statements

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

With respect to the required supplementary information accompanying the financial statements, we applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not express an opinion nor provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

The Introductory and Statistical Sections included as part of the Comprehensive Annual Financial Report have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we did not express an opinion nor provide any assurance on them.

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

Very truly yours,

Maze & Associates