

**CITY OF SAN RAFAEL
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS
FOR THE YEAR ENDED JUNE 30, 2016**

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

For The Year Ended June 30, 2016

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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, 2016, and have issued our report thereon dated October 12, 2016. 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 that are appropriate in the circumstances 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 material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist and that were not identified. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected on a timely basis. We 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 deficiencies in internal control included on the Schedule of Significant Deficiencies to be significant deficiencies.

Included in the Schedule of Other Matters are recommendations not meeting the above definitions that we believe are opportunities for strengthening internal controls and operating efficiency.

Management'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 *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 12, 2016

CITY OF SAN RAFAEL
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SCHEDULE OF SIGNIFICANT DEFICIENCIES

2016 – 01: Internal Controls over Revenue at Community Center

Criteria: The following are some of the essential procedures in maintaining good internal controls in a cash collection site:

- When a transaction system is interfaced indirectly (i.e. manual transfer of data required) with the general ledger, periodic reconciliations between the systems must be performed to ensure the proper amounts are recorded in the general ledger.
- Procedures should be established for handling billing and receivables.
- Accounts receivable details should be kept and reconciled periodically.
- Collection of cash receipts should be secured by a locked container.

Condition: In March 2016, we conducted a site visit at the San Rafael Community Center, part of the Community Services Department, to gain an understanding of the cash collection procedures in place. After interviewing various staff in the Community Center as well as the Finance Department, we found the following:

- The Community Services Department uses a separate software system, CLASS, to account for revenue transactions related to program registrations and facility rentals. This system is not directly interfaced with the City's general ledger system, Eden. An intermediary cash receipts system, Quadrant, is used for the manual recording of cash, check and credit card receipts from the CLASS system. As of March 2016, there had been no current reconciliations performed among the three systems.
- The Community Center has three types of revenue that allow for installment payments. They are facility rentals, junior volleyball league, and language classes held at elementary schools. The City sends e-mail reminders to customers for payments but there is no formal policy to invoice for those payments or follow up on delinquent payments.
- As of March 31, 2016, the City's general ledger showed an accounts receivable balance of \$229,193, corresponding to the CLASS subsidiary system. However, the Community Services CLASS system carried an accounts receivable balance of only \$170,136. The difference could not be identified. Accounts receivable amounts of \$76,547 and \$57,147 were written off as of June 30, 2015 and June 30, 2016, respectively.
- In the three Community Centers, cash and checks collected were not controlled by a cash register during the day. They were kept in a zippered pouch located in an unlocked drawer behind the registration counter.

Effect: The City is exposed to the possibility of unauthorized cash receipt interception, potential fraud, and lost revenue.

Cause: The mapping of revenue and receivable accounts are inconsistent among the three systems. With transactions and cash receipts flowing through personnel in two departments and three systems, details are lost or posted incorrectly during the transition. Therefore, the accounts receivable balances on the general ledger could not be verified against the customer receivable information maintained in the CLASS software system.

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SCHEDULE OF SIGNIFICANT DEFICIENCIES

In addition, the receivable ledger in the CLASS system is currently used as a billing ledger. All amounts billed (e.g. rental deposits, class registration fees...etc.) are recorded as accounts receivable. However, procedures are not set up to require staff to adjust the accounts receivable ledger to address events happens subsequent to billing, such as class registration cancellation.

Recommendation: We recommend the following:

- The City should review the set-up of all subsystems that record revenue transactions in the City that are not directly integrated with the general ledger. The mapping of accounts from those systems via Quadrant to the general ledger should be consistent. The City should ensure that timely and regular reconciliations are performed between the software systems used by these departments and the general ledger. The reconciliation should cover the areas of revenue, cash receipts, and accounts receivable. The employee that performs the reconciliations should not be the person who is responsible for cash receipts processing. Furthermore, these departments should develop and document proper procedures for the handling of common business transactions processed by the subsystems.
- The Community Services Department should establish written procedures to address how billing and collection for overdue payments are handled and the proper maintenance of accounts receivable ledger. These procedures should cover the frequency of billing, how bills are reviewed and by whom, and follow-up procedures for overdue payments.

We understand that the Community Services Department has plans to implement new registration and facility rental software within the next year. Prior to transitioning to the new system and designing new procedures, the City should incorporate our recommendation above. In addition, a cash register or cash box with locking feature should be installed immediately to safeguard cash and checks received by the Community Centers.

Management Response: In July 2016, the City initiated a full reconciliation between CLASS, the Quadrant cash receipts and the Eden general ledger systems. The City was able to update the general ledger, and validate revenue and deposit amounts by verifying against Community Services customer account folders as of June 30, 2016.

A written policy regarding cash handling for the Community Services Department has been drafted and is in the implementation process. The policy addresses the need for courier pickup from the three Recreation Centers, end of day cash closing, and limit of \$100 in the pouch maintained at the desk. Each location is equipped with a safe, and any cash in excess of the minimum allowed at the counter is put in the safe. At the end of the business day, staff counts the cash and the bank deposit is put in the safe for courier pickup. Managers no longer transport cash in their cars.

Although there was no detailed substantiation of the accounts receivable general ledger write-offs of the past two years, the City was able to establish that most of the write offs were due to CLASS system hard coding of the Volleyball class, which led to charging customers the full fee for registration, even when the enrollment was not completed.

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SCHEDULE OF SIGNIFICANT DEFICIENCIES

Although the Community Services Department has been operating without formal, written collection and write-off policies and procedures, the supervisors do monitor accounts receivable aging and routinely send reminder and collection emails and letters with a copy of the registration document and amount due. Customers with overdue balances are restricted from future registration until their accounts are returned to current status. The Community Services Department will formalize its policies and procedures for this accounts receivable management and collections activity.

Community Services management commits to the monthly reconciliation between CLASS and Eden. The software product performance has proven to be an impediment to establishing routine reconciliations, due to a limitation on the frequency of deposits (weekly), as well as the inability of the vendor to guarantee timely crediting of credit and debit card transactions. The Community Services Department intends to replace the CLASS system during fiscal year 2016-2017, and will take steps to mitigate the issues generated by the functionality of the current system. This mitigation will include a procedure by which all payments received by the Community Services Department will be recorded in CLASS, and then sent to Finance.

The City will review the set-up of all revenue transaction systems that are not directly integrated into the general ledger. Regular reconciliation procedures will be developed and assigned to those employees who are responsible for the collection of these revenues.

2016 – 02: Timely Preparation and Review of Bank Reconciliations

Criteria: Bank reconciliations are an important element of the City's internal control structure. In order to be an effective control, the City should complete bank reconciliations as soon as possible after each month-end, usually within 30-45 days of receipt of the bank statements, and subsequently reviewed by a second employee. Additionally, reconciliations should be dated when prepared and reviewed to leave a proper audit trail.

Condition: During our testing of internal controls over bank reconciliations, we noted the following as of March 23, 2016:

- ❖ The bank reconciliations for the Master Operating Account were prepared through September 2015. However, the reconciliations were considered incomplete due to unreconciled differences noted on the reconciliations. In addition, the reconciliations had not been signed off as reviewed by the Accounting Manager.
- ❖ The bank reconciliations for the Payroll, General Liability and Successor Agency accounts had been reconciled only through October 2015.
- ❖ With the exception of the November 2015, December 2015, January 2016 and February 2016 Worker's Compensation reconciliations, there was no evidence of when the City's bank reconciliations in the current year were reviewed.

Effect: The City's book balances of the above accounts do not reflect the correct balances during the year. Errors, mistakes, and unauthorized transactions in these accounts would not be detected and remedied in a timely fashion.

Cause: The delay in completion of the bank reconciliations is due to a shortage in Finance personnel following the retirement of the Accountant II in November 2015.

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SCHEDULE OF SIGNIFICANT DEFICIENCIES

The City anticipated the retirement and contracted with a third party to perform the bank reconciliations of the Master Operating Account. The consultant was unable to allocate sufficient resources to bring these reconciliations forward until April 2016.

Recommendation: The City has since caught up the reconciliation process. Going forward, bank reconciliations should remain a high priority and be completed and reviewed timely. Additionally, we recommend that the reconciliations be dated at time of review in order to leave an audit trail.

Management Response: The City encountered a staffing shortage upon the retirement of the prior Accountant II. For the subsequent several months, the City was dependent upon third party support to perform bank reconciliations. Although the position remains vacant, the Finance Department has been able to use a combination of the third party support and part-time staffing resources to bring all bank account reconciliations up to date and has re-established its previous pattern of timely bank reconciliations.

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SCHEDULE OF OTHER MATTERS

NEW GASB PRONOUNCEMENTS OR PRONOUNCEMENTS NOT YET EFFECTIVE

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

Effective in fiscal year 2016-17:

GASB 73 – *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68*

This Statement establishes requirements for defined benefit pensions that are not within the scope of Statement No. 68, *Accounting and Financial Reporting for Pensions*, as well as for the assets accumulated for purposes of providing those pensions. In addition, it establishes requirements for defined contribution pensions that are not within the scope of Statement 68. It also amends certain provisions of Statement No. 67, *Financial Reporting for Pension Plans*, and Statement 68 for pension plans and pensions that are within their respective scopes.

GASB 74 – *Financial Reporting for Post-employment Benefit Plans Other Than Pension Plans*

The objective of this Statement is to improve the usefulness of information about post-employment benefits other than pensions (other post-employment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all post-employment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency.

GASB 77 – *Tax Abatement Disclosures*

This Statement establishes financial reporting standards for tax abatement agreements entered into by state and local governments. The disclosures required by this Statement encompass tax abatements resulting from both (a) agreements that are entered into by the reporting government and (b) agreements that are entered into by other governments and that reduce the reporting government's tax revenues.

GASB 78 – *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*

This Statement amends the scope and applicability of Statement 68 to exclude pensions provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension plan that (1) is not a state or local governmental pension plan, (2) is used to provide defined benefit pensions both to employees of state or local governmental employers and to employees of employers that are not state or local governmental employers, and (3) has no predominant state or local governmental employer (either individually or collectively with other state or local governmental employers that provide pensions through the pension plan). This Statement establishes requirements for recognition and measurement of pension expense, expenditures, and liabilities; note disclosures; and required supplementary information for pensions that have the characteristics described above.

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SCHEDULE OF OTHER MATTERS

GASB 80 – *Blending Requirements for Certain Component Units—an amendment of GASB Statement No. 14*

This Statement amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of Statement No. 39, *Determining Whether Certain Organizations Are Component Units*.

GASB 82 – *Pension Issues—an amendment of GASB Statements No. 67, No. 68, and No. 73*

The objective of this Statement is to address certain issues that have been raised with respect to Statements No. 67, *Financial Reporting for Pension Plans*, No. 68, *Accounting and Financial Reporting for Pensions*, and No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. Specifically, this Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

Effective in fiscal year 2017-18:

GASB 75 – *Accounting and Financial Reporting for Post-employment Benefits Other Than Pensions*

The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for post-employment benefits other than pensions (other post-employment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all post-employment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency.

GASB 81 – *Irrevocable Split-Interest Agreements*

This Statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. Furthermore, this Statement requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests. This Statement requires that a government recognize revenue when the resources become applicable to the reporting period.

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SCHEDULE OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

2015 – 1: Accuracy of Special Assessment Tax Rolls

Criteria: Currently, there are seven special assessments applicable to the City. On behalf of the City, the County maintains a database for each of these assessments. These assessments are included in the applicable tax bills sent to the property owners served by the City. The City is responsible for ensuring that tax revenue is correctly calculated, charged and received.

Condition: In June of 2015, during the Finance Department’s review of the senior exemptions for the Library Parcel Tax, it was discovered that there were errors in certain commercial properties tax assessments. Subsequently in July 2015, the Finance Department conducted a comprehensive review of the tax roll information provided by the County for the fiscal year 2015-16 assessment. The review focused primarily on commercial and industrial properties that had not been charged. During the review, the Finance staff found that there were inconsistencies (missing or conflicting data) among its tax rolls. In addition, it was discovered that some properties were undercharged due to new or existing developments which were not reflected on the tax rolls or properties which were miscoded and or listed as vacant.

Effect: The City submitted the following corrections to the County, for the fiscal year 2015-16 assessment:

	Total Assessment	Corrections	%
	2015/16	Submitted	Change
San Rafael Paramedic	\$3,860,412	\$474,278	12.29%
CSA #13 Paramedic	52,841	-	0.00%
CSA #19 Paramedic	226,322	-	0.00%
Marinwood Paramedic	155,454	-	0.00%
Run Off Fee	866,077	88,263	10.19%
Inspection Fees	345,959	9,921	2.87%
Library Parcel	869,409	(4,572)	-0.53%
	\$6,376,474	\$567,890	8.91%

Cause: Once a week, the City provides building permits, plans and related information regarding parcel changes or updates to the County. It is assumed that the County uses the information to update the City’s various tax rolls. Every July, the County sends the City the Preliminary Tax Roll report for the coming assessment. The City has approximately thirty days to submit corrections of the tax roll to the County. Due to limited staff resources and the format of the Preliminary Tax Roll prior to 2015, the City had not comprehensively verified information on the Preliminary Tax Roll in prior years.

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SCHEDULE OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

2015 – 1: Accuracy of Special Assessment Tax Rolls (Continued)

Recommendation: The City should review all of its special assessments collected through the County tax rolls for accuracy.

Since most of the changes in assessments are triggered by modification or improvement of the parcels, the City should establish interdepartmental procedures so that a centralized log is kept to keep track of parcel changes or updates. This log should be used as supplemental information to the permits and building plans that are already provided in the regular dissemination of information to the County. Annually, the City should review the Preliminary Tax Roll report sent by the County. As part of the review, information on the Tax Roll should be compared to the centralized log to ensure that changes are made throughout the various tax rolls. In addition, if the City does not have resources to verify all information on the Preliminary Tax Roll report, a representative sample should be pulled every year to ensure that information on the report is consistent with the City's records of the properties.

Management's Response: Management agrees with the characterization of this issue and the recommendations. City staff is continuing with the analysis and correction of assessments for the current tax year (FY2015-16).

The City will collaborate with the County to identify the optimal process for updating property types (Use Codes) and square footage metrics in a real-time manner that ensures that this information is properly incorporated into the City's special assessments, and accurate upon the preparation of the Preliminary Tax Rolls. The ongoing process will evaluate whether changes to parcels have occurred, including status of parcel (vacant, residential, commercial, etc.), number of living units, and building/land square footage.

Finance staff will review the Preliminary Tax Rolls annually, using information provided by Community Development and Public Works, to verify that changes that have taken place during the past year have been correctly applied to the assessments. Staff will also sample parcels that have not undergone changes, in order to verify the continued accuracy of City tax assessments on these parcels.

Current Year Status: Recommendation partially implemented. Since discovering the inaccurate tax assessment information, the City has dedicated a fixed-term analyst to complete the review of the fiscal year 2015-2016 assessments. This effort has been completed and yielded additional Paramedic Tax revenues. In July 2016, the City used a third-party industry specialist to develop a comprehensive database of key property assessment information. This information was used to assist City staff with the review of the City's data to ensure the accuracy of fiscal year 2016-2017 assessments.

The City plans to develop internal operating procedures during fiscal year 2016-2017 to ensure that the ongoing administration of all assessments are coordinated between the Finance and Community Development, and that up-to-date and accurate tax assessment information is maintained and used to inform assessment-related transmissions to the County.

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SCHEDULE OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

2015 -- 2: Internal Control over Employee Benefits and Claims Activities

Criteria: Changes made to employee benefits in the City's Financial System, Eden, should be reviewed by a second employee who has the specialty to conduct such review. New benefit line items created in Eden should also be reviewed for accurate coding. In addition, payments processed by a third-party administrator (TPA) should be reviewed and reconciled for proper authorization and accuracy.

Condition: During our audit, we noted that the City has not established formal review procedures for employee benefit changes made to the personnel database in Eden. The Human Resources Department (HR) is responsible for making changes to employee benefits in the personnel database in Eden. Once changes are made, HR sends a memo, along with employee Personnel Actions Forms, and other relevant data, to the Finance Department. Finance Department then uses the information to process payroll. Occasionally, when Finance notices any discrepancies between what is reported in Eden and the employees benefit information during payroll processing, HR will be notified. However, the City's current practice does not require a qualified employee to review data changed in the personnel database.

In addition, when a new line item is set up in the personnel database, such as a new benefit, the City does not have any procedures established requiring a review by a qualified employee to ensure that the appropriate categories, such as tax exempt status, have been selected.

Furthermore, the City contracts with TPAs to administer transactions of the Workers' Compensation, General Liability, Dental, and 125 Flexible Employee Benefits activities. Payments relating to these activities are processed by the TPAs. Monthly, the Finance Department performs reconciliations to ensure that activities reported to the City by the TPAs reconciles with the related bank accounts. However, this reconciliation only verifies the existence of these activities, not their validity. In addition to the monthly bank reconciliation, certain control procedures are performed by City staff:

- For Workers' Compensation, HR reviews reports from the TPA on a monthly basis and checks for any unusual items. Any unusual items are followed up with the TPA. Monthly report is then forwarded to Finance. Final claim settlements are traced to City's authorization.
- For General Liability, reports from TPA are reviewed by the City Attorney's Office. Any discrepancies are followed up with the TPA. Final claim settlements are traced to City's authorization.
- For Dental and 125 Flexible Benefits, City staff verifies whether the claimants stated on the TPA reports are current City employees.

Although various control activities are performed by the City to monitor activities in these accounts, the City does not verify the validity of each transaction processed by these TPAs.

CITY OF SAN RAFAEL
MEMORANDUM ON INTERNAL CONTROL

SCHEDULE OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

2015 -- 2: Internal Control over Employee Benefits and Claims Activities (Continued)

Effect: Without a proper review of changes made to personnel database, errors may not be detected in a timely manner.

For the Workers' Compensation, General Liability, Dental, and 125 Flexible Employee Benefits accounts, the procedures used by these TPAs are outside the scope of City oversight and staff review, nor are these controls part of the scope of an audit of the City's financial statements. Without, procedures to gain comfort that these TPAs are performing their functions in a prudent manner, errors made by the TPAs may not be detected in a timely manner.

Cause: Assumptions were made amongst departments that changes in Eden were reviewed.

Additionally, City staff was unaware that their current procedures in monitoring the Workers' Compensation, General Liability, Dental, and 125 Flexible Employee Benefits activities managed by the TPAs are insufficient.

Recommendation: The City should develop review procedures for changes made to the personnel database. A qualified City employee who has knowledge of human resources rules and regulations should be designated to conduct the review. When discrepancies or errors in payroll processing are brought to the City's attention, we recommend the City consider performing sampling tests to determine if the discrepancy is an isolated incident, or needs to be investigated further as a system-wide error.

Additionally, we recommend the City establish review procedures to ensure that Workers' Compensation, General Liability, Dental, and 125 Flexible Employee Benefits payments processed by TPAs are valid. The City can achieve this in several ways. It can review each transaction to ensure that the transaction is either authorized by the City (such as claim settlement) or reasonable in nature. Alternative, special audits can be performed, either by City staff or a consultant, to determine adequacy of controls and to verify the data produced. A third option is to review Service Auditor's Reports of these TPAs. A Service Auditor's Report contains information regarding the service organization's controls and the effectiveness of those controls. In the case of a Service Auditor's (Type II) Report, a user organization, such as the City, receives a detailed description of the service organization's controls and an independent assessment of whether the controls were placed in operation, suitably designed, and operating effectively specifically to that user organization.

Management Response: The City will establish a new process whereby all employee record/master data changes (e.g., initial employee set-up, benefits, bargaining unit/MOUs, salary schedules) that are entered into the payroll system will be reviewed and approved by qualified staff to ensure the accuracy of the payroll calculation and all requisite tax reporting requirements. HR and Finance Payroll staff will be trained to qualify them to review these types of changes. Any discrepancies or errors in payroll processing will be brought to the attention of the Human Resources Director and/or Finance Director, and sampling tests will be performed to determine the scope of the discrepancy and necessary corrective actions.

In addition, the City is undergoing a review of benefit administration processes in an effort to improve internal controls. The City expects that changes will be made to the internal control processes as a result of this effort.

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SCHEDULE OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

2015 -- 2: Internal Control over Employee Benefits and Claims Activities (Continued)

In addition to reviewing the TPA's monthly reports, the City will institute the following additional review procedures for Workers' Compensation and General Liability payments processed by its third party claims administrator:

- Verify that claim settlement payments are consistent with the written authorization provided by the City of San Rafael.
- Twice per year, select a representative sample of claims payments to review for accuracy.
- Review the Service Auditor's Type II Report to ensure the Workers Compensation TPA has appropriate and effective internal controls.

In addition to verifying that all claimants reported by the TPA are eligible City employees, the City will institute the following additional review procedures for Dental and Section 125 Flexible Benefits payments processed by a third party claims administrator:

- Review the Service Auditor's Type II Report to ensure the TPA has appropriate and effective internal controls.

Current Year Status: Recommendation partially implemented. The Human Resources (HR) department staff verified most employee record/master data changes over the past year. Personnel Action Report (PAR) forms and documentation of health benefits changes with calculated amounts are provided to the Finance Department during payroll processing for additional verification. The City plans to improve this process by attaching the employee documentation with the PAR so that the employee change can be verified with the HR calculations. Over the past year, HR staff has improved internal process controls by utilizing a second reviewer to double check broader group master data/salary changes (e.g., negotiated salaries or benefits, annual open enrollment updates). When discrepancies or errors in payroll processing or benefits are brought to the Finance Department or Human Resources Department's attention, City staff has performed sampling tests to determine if a discrepancy is an isolated incident or needs to be investigated further as a system-wide error. The City plans to continue to evaluate the benefit administration process to improve internal controls and opportunities for employee verification to ensure accuracy of master data changes.

For Workers' Compensation, City staff has verified settlement payments are consistent with the written authorization provided by the City of San Rafael. The Finance Department conducted an audit of a sample of claims payments to ensure accuracy of processing. The City has obtained REMIF's audit report to evaluate effective internal controls, but still needs to obtain any available audit reports for the Dental and Section 125 Flexible Benefits TPA to ensure they have effective internal controls. City staff has verified at least quarterly that claimants reported by the Dental and Section 125 Flexible Benefits TPAs are eligible City employees.

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CITY OF SAN RAFAEL
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SCHEDULE OF PRIOR YEAR OTHER MATTERS

2015 -- 3: Receivable from San Rafael Sanitation District

The San Rafael Sanitation District has no regular full-time employees. Through an original agreement dated November 5, 1969 and various amendments, the City provides the District certain maintenance service, general engineering services and general administrative services. In return, the District reimburses the City for such costs. Both entities believe that such costs should include all payroll cost of those City staff providing services for the District, such as benefits, workers' compensation, and contributions for pension and post-employment benefit (OPEB) trusts.

During fiscal year 2015, the City implemented two accounting pronouncements, Governmental Accounting Statement Board Statements 68 and 71, resulting in the recognition of unfunded pension liability on the City's financial statements. Since portion of this liability was accrued by City staff providing services to the District, it was deemed necessary that a receivable/payable be established to recognize the District's share of the pension liability. In addition, management of both the City and the District determined that a receivable/payable should also be established to reflect the District's share of the unfunded OPEB liability accrued by the same group of employees. As of June 30, 2015, the City reported a receivable of \$4,462,815 from the District for pension and OPEB related costs.

Both entities believe that the cost reimbursement described in the original agreement includes the cost of contributions to the pension and OPEB trusts. However, due to the significant amounts involved, it is crucial that such commitment be formalized with documented approvals from both the City Council and the District Board. We understand that the City and the District are currently working together to formalize the commitment. We will follow up on the progress during the next audit.

Management Response: The City agrees that commitments related to the obligation of the District with respect to pension and OPEB costs, including the allocation of related liabilities, should be formalized. In the course of preparing for the implementation of GASB No. 68, the City Finance Committee and the District Board were informed of the need to measure and allocate these costs from the City to the District. The City and District have prepared an administrative-level agreement that documents the mutual understanding and agreement as to how these amounts are to be calculated for financial reporting purposes. The City will work with the District to revise its City Council and District Board approved operating agreement to explicitly describe and recognize the full range of allocable personnel-related costs to the District.

Current Year Status: Recommendation implemented. In August 2016, the City of San Rafael and San Rafael Sanitation District amended their agreement to include a provision that describes the commitments and obligations of the District with respect to pension and OPEB costs.

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REQUIRED COMMUNICATIONS

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, 2016. We did not audit the financial statements of the San Rafael Sanitation District, as of and for the year ended June 30, 2016, which represent 18%, 30%, and 14% of the assets, net position and revenues, respectively, of the entity-wide reporting entity. These component unit financial statements were audited by another auditor, whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for this entity, is based solely on the report of the other auditor.

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 the Uniform Guidance.

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. No new accounting policies were adopted and the application of existing policies was not changed during the year, except as follows:

The following Governmental Accounting Standards Board (GASB) pronouncements became effective, but did not have a material effect on the financial statements:

GASB Statement No. 76 – *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*

GASB Statement No. 79 – *Certain External Investment Pools and Pool Participants*

The following pronouncement became effective and required modifications to the notes to financial statements.

GASB Statements No. 72 – *Fair Value Measurement and Application*

This Statement addresses accounting and financial reporting issues related to fair value measurements. The definition of *fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

The requirements of this Statement enhance comparability of financial statements among governments by requiring measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. This Statement also enhances fair value application guidance and related disclosures in order to provide information to financial statement users about the impact of fair value measurements on a government's financial position.

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.

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):

- *Estimated Net Pension Liabilities and Pension-Related Deferred Outflows and Inflows of Resources:* Management's estimate of the net pension liabilities and deferred outflows/inflows of resources are disclosed in Note 9 to the financial statements and are based on actuarial studies determined by a consultant, which are based on the experience of the City. We evaluated the key factors and assumptions used to develop the estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.
- *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 to the financial statements. We evaluated the key factors and assumptions used to develop the depreciation estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.
- *Estimated Fair Value of Investments:* As of June 30, 2016, cash and investments were measured by fair value. Fair value is essentially market pricing in effect as of June 30, 2016. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2016.

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.

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

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 12, 2016.

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


We applied certain limited procedures to the required supplementary information that accompanies and supplements the basic financial statements. Our procedures consisted of inquiries of management regarding 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 audit the required supplementary information and do not express an opinion or provide any assurance on the required supplementary information.

We were engaged to report on the supplementary information which accompany the financial statements, but are not required supplementary information. With respect to this supplementary information, 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.

We were not engaged to report on the Introductory and Statistical Sections which accompany the financial statements, but are not required supplementary information. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

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,



Pleasant Hill, California
October 12, 2016