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ATTACHMENT D

City Council

City of Pasadena
Pasadena, California

In planning and performing our audit of the financial statements of the City of Pasadena (City) as of and for the year ended June 30, 2008, 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 opinion 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 control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the City's financial statements that is more than inconsequential will not be prevented or detected by the City's internal control. The matter described below as item 06-2 conforms to this definition.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the City's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. **We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.**

Statement on Auditing Standards (SAS) No. 112 requires that all matters identified by the audit process be reported to the governing board, even those that are not practical for correction (except for those matters that are clearly inconsequential). Our recommendations resulting from our audit process are as follows:

(08-1) Estimate for Incurred but Not Reported (IBNR) Claims Liability

The City maintains self-insurance programs for general liability and workers' compensation. A case reserve is established for each claim and a claim liability is reported in the General Liability and Workers' Compensation Internal Service Funds based on the requirements of GASB Statement No. 10, which requires a liability for claims be reported if information prior to the issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial

statements and the amount of loss can be reasonably estimated, including incurred but not yet reported claims.

As of June 30, 2008, \$10,815,334 and \$15,567,686 has been recorded for reported general liability claims and workers' compensation claims, respectively. As of June 30, 2008, \$500,000 and \$225,000 has been recorded for estimated *incurred but not reported* (IBNR) general liability claims and workers' compensation claims, respectively. The estimate for IBNR claims liability was determined several years ago and has only been reevaluated based on professional judgment and without a formal or analytical review and not adjusted since then.

Recommendation

IBNR is an estimate and should be based on past experience adjusted for current trends, and any other factors that would modify past experience. The estimate for IBNR claims liability should be reevaluated using past experience adjusted for current trends in order to determine whether the amount that has been recorded is reasonable.

Management's Comments Regarding Corrective Action Planned

Management concurs with this recommendation and will perform a more formal and analytical review of the IBNR claims liability for the following year and periodically thereafter.

(08-2) Annual Progress Report for the Supportive Housing Program

The City is required to submit an Annual Progress Report for the Supportive Housing Program within 90 days after the end of each operating year. An Annual Progress Report for the Supportive Housing Program was due September 30, 2007. However, the report was not submitted until March 24, 2008.

Recommendation

We recommend that the City submit Annual Progress Reports in a timely manner.

Management's Comments Regarding Corrective Action Planned

An Annual Progress Report (APR) Tracking System was recently implemented by Supportive Housing Services to ensure timely submittal of the APR. The APR that was cited for late submittal was a report that required more than typical correction from the project sponsor and was an anomaly. Annual Progress reports are typically submitted within the HUD-required time frame.

STATUS OF PRIOR YEAR AUDIT FINDINGS

During the audit for the year ended June 30, 2008, we determined the status of prior year audit findings previously communicated to City Council. The original comments as well as the status of those comments are included in this report.

(07-1) Internal Controls over Purchase Cards

During the audit for the year ended June 30, 2007, we reviewed the City's corporate purchasing card activity for a thirty-day period ending March 15, 2007. We obtained credit card statements and supporting documentation for the ten cards with the highest dollar value of transactions.

During our review, we noted the following:

- Five cardholder statements had not been reviewed by an individual other than the cardholder.
- For four transactions, the relationship of the transaction to the business purpose of the department was not self-evident based upon the name of the vendor or the description on the receipt provided for that transaction.
- One receipt was missing and a Purchasing Card Lost Receipt Form was not filled out by the cardholder until an inquiry was made. In addition, one cardholder statement had not been turned in to the Department of Finance.

Recommendation

We recommended that each cardholder statement be reviewed by another individual in that department who can verify whether the goods or services were actually received and whether those expenses related to the City department's business purpose or in lieu of a detailed review of each cardholder statement, it was determined to be substantially equivalent if management reports be reviewed by a responsible and knowledgeable reviewer in each Department.

With respect to missing receipts and cardholder statements, the City's Purchasing Policy states that "statement reconciliation is mandatory...upon reconciliation, all statements must be received in the Department of Finance, Budget and Purchasing Division no later than the 1st working day of the month following the billing cycle." We recommended that management enforce adherence to the City's Purchasing Policy.

Resolution

During the audit for the year ended June 30, 2008, we reviewed the City's corporate purchasing card activity for a thirty-day period ending May 15, 2008. We obtained credit card statements and supporting documentation for the five cards with the highest dollar value of transactions and noted no exceptions.

(07-2) Excess Collection Refunds

Excess collection refunds resulting from various types of overpayments are processed by Municipal Services. A report is created in excel by an individual in Municipal Services and is then sent via email to the Department of Information Technology (IT). IT formats the report and sends it to Accounts Payable for processing. We recommend the controls below to reduce the risk that IT might add an unauthorized refund to the report since the final amount disbursed is not compared to what was initially approved by Municipal Services.

Recommendation

We recommended that the report that is created, reviewed, and approved in Municipal Services be signed and forwarded to Accounts Payable. Accounts Payable should ensure that the final amount disbursed agrees to what was initially approved by Municipal Services.

Status

The excel based report is still sent from Municipal Services to IT for formatting. In addition, a word based document is attached to that initial email from Municipal Services to IT in which Municipal Services indicates the total amount to be processed. IT then forwards these two documents along with the formatted file to Accounts Payable for processing. However, there is still a risk that the excel based report and word documents that are sent from Municipal Services could be altered and then an unauthorized refund could be processed and concealed since the final amount disbursed is not compared to what was actually approved by Municipal Services. The word based report that is sent to IT is printed out and signed by an individual in Municipal Services; however, that report is filed and kept in Municipal Services and is not forwarded to Accounts Payable. We recommend that this signed report be forwarded to Accounts Payable who should ensure that the final amount disbursed agrees to what was approved by Municipal Services.

Management's Comments Regarding Corrective Action Planned

Accounts Payable had partially implemented the corrective action recommended. The full recommendation is now in place and is being utilized.

(07-3) Changes to Vendor Information

The Accounts Payable Supervisor had system access rights to add vendors, make changes to vendor information, and process invoices for payment within Peoplesoft (the accounting software). This combination of computer system access rights theoretically could allow the Accounts Payable Supervisor to input a fictitious vendor, create an invoice, and process a disbursement without detection by management.

Recommendation

We recommended that the Accounts Payable Supervisor be denied computer access rights to add vendors and to make other changes to vendor master file information.

Resolution

During the audit for the year ended June 30, 2008, we reviewed the system access rights for the Accounts Payable Supervisor and found that he no longer had the ability to add vendors or make other changes to vendor master file information.

(06-1) Verification of Authorized Signatures for Invoice Approval

The City of Pasadena maintains a book of authorized signers for invoice approval, organized by department and level of authorization in accounts payable. Updates to the book should occur throughout the year as departments make changes for authorized signers. The original documents are submitted and filed with the internal audit division, while copies are provided to accounts payable for their book. The book contains the printed name of the authorized individuals and an example of their signature. During our review of cash disbursement internal controls for the year ended June 30, 2006, we noted that an up-to-date book had not been maintained by accounts payable staff and was not being utilized to verify proper authorization. Therefore, based upon the testing performed, it appeared that accounts payable had not been verifying signatures on invoices to the book of authorized signatures.

During our audit for the year ended June 30, 2007, we randomly selected 25 cash disbursements for testing. We noted that 1 out of the 25 disbursements selected for testing was approved by an individual who at the time of disbursement was not an authorized signer. That individual was later added to the list of authorized signers.

Recommendation

We recommended that the book of authorized signatures be properly maintained as updates are received from the departments so as to include all changes in personnel. In addition, we recommended that accounts payable personnel only process invoices that have been properly approved by comparing live signatures on invoices to the book of authorized signatures.

Resolution

During our audit for the year ended June 30, 2008, we randomly selected 25 cash disbursements for testing and noted no exceptions.

(06-2) Construction in Progress

During the year ended June 30, 2006, it was noted that the City had not maintained a detail listing that supported the ending balance of construction in progress at year end by project. Since the City did not have a detailed listing by project, the City was unable to determine if any projects had been mistakenly capitalized that should have been expensed.

During the year ended June 30, 2007, a detailed listing by project for all construction in progress was compiled, which supported the ending balance at year end. However, it was noted that the detailed listing of construction in progress contained \$9,844,831 of non-capitalizable projects, which resulted in a prior period adjustment and a post-closing audit adjustment.

Recommendation

We recommended that the City conduct a review of its construction in progress in order to support its balance outstanding at year end. We also recommended that additions and deletions to construction in progress be analyzed in order to ensure that only capitalizable projects are capitalized and that all completed construction in progress projects are removed.

Status

During the year ended June 30, 2008, additional projects which amounted to \$3,599,089 were identified as being non-capitalizable projects, which had been mistakenly capitalized and recorded as construction in progress. We recommend that the Department of Finance and Public Works personnel meet at least annually to review construction in progress activity and ensure that only capitalizable projects are capitalized.

Management's Comments Regarding Corrective Action Planned

Staff had partially implemented the suggestion through numerous communications between Finance and Public Works and had believed that appropriate capitalization had been accomplished. To further implement corrective action on this item Finance and Public Works will formally meet. Additionally, staff will incorporate a column in our work papers that will identify when a project should be capitalized or expensed.

(06-3) City Management Review of Skidata Reports Provided by Modern Parking

Modern Parking Inc. performs parking garage management services for the Paseo Colorado garages. The three parking garages of the Paseo Colorado Development include the Marengo Avenue Garage, the Subterranean Paseo Colorado Garage, and the Los Robles Avenue Garage. These three parking facilities provide transient and monthly parking for patrons, employees, and residents.

During our audit for the fiscal year ended June 30, 2006, we noted that the City of Pasadena received a Daily Deposits Report, which was an excel based report that summarized the cash receipts that were collected for each parking garage. At the end of each month the City also received a Garage Summary Report, which was an excel based report that summarized the parking revenue for the month. This report was used to record the parking revenue by garage and to reconcile the daily deposits per the Daily Deposits Report and the bank statement. However, the City did not receive any system generated reports from the parking garage's database. The parking garage is operated by a program called Skidata. Skidata tracks the time of entry and exit for each parking ticket, validations, and is integrated with the cashiering system.

Recommendation

We recommended that the City be provided a system generated report from Skidata at least monthly in order to compare the cash receipts reported on the monthly *Garage Summary Report* to actual parking activity per Skidata. This reconciliation will ensure that all cash receipts recorded in Skidata have been deposited.

Resolution

Based on the results of testwork performed, we found that the Parking Division is provided system generated reports by Modern Parking and those reports are reconciled by the City on an impromptu basis to daily cash receipts.

The written responses and comments provided by the City have not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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

Mayer Hoffman McCann P.C.

Irvine, California
December 12, 2008