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BROWN ARMSTRONG

Certified Public Accountants

To the Honorable City Council
City of Pasadena
Pasadena, California

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Pasadena (the City) as of and for the year ended June 30, 2012, 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. However, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies in internal control over financial reporting. 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. The significant deficiencies are presented in the "Significant Deficiencies and Other Matters" attachment.

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 entity's financial statements will not be prevented, or detected and corrected on a timely basis.

As a service to the City, we also identified during our audit certain matters that provide you an opportunity to enhance your existing internal controls. These matters are provided as recommendations for your consideration and are not considered to be material weaknesses or significant deficiencies in internal control. The other matters are presented in the "Significant Deficiencies and Other Matters" attachment.

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.



REGISTERED with the Public Company
Accounting Oversight Board and
MEMBER of the American Institute of
Certified Public Accountants

This communication is intended solely for the information and use of management, City Council, others within the City, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

*Brown Armstrong
Accountancy Corporation*

Pasadena, California
November 29, 2012

SIGNIFICANT DEFICIENCIES AND OTHER MATTERS

CURRENT YEAR SIGNIFICANT DEFICIENCIES

12-01 Accounts Payable

During our testing of unrecorded liabilities, we selected a sample of forty (40) material cash disbursements that occurred subsequent to fiscal year-end and reviewed support to ensure that they were accrued in accordance with accounting requirements. The results of our testing showed the following:

- One (1) of the forty (40) disbursements was not adequately accrued. The total of the disbursement totaled \$97,424.30.
- One (1) of the forty (40) disbursements lacked sufficient support. The total of the disbursement totaled \$155,925.

Recommendation

We recommend that the City's Accounts Payable Division enter the activity periods for each invoice received into the City's accounting software, PeopleSoft. This provides the Finance Department the ability to do query searches based on activity date to assist in its determination of accounts payable completeness and accuracy. In addition, we recommend that the Accounts Payable Division actively seek to maintain complete records of its transactions.

Management's Comments Regarding Corrective Actions Planned

In conjunction with the Accounting Division, Accounts Payable establishes a cut-off date to receive and process invoices from the previous fiscal year. The Accounts Payable staff works diligently with departments to make sure that invoices are submitted in timely. Going forward, amendments have been made to the Accounts Payable end-of-year process in order to more effectively capture all accrueable expenses. Accounts Payable has taken steps to extend the initial accrual cut-off date as well as provide for a longer accrual period following the initial cut-off date. Also, with the implementation of AvidXchange, the City's new electronic invoice routing system, Accounts Payable staff will be able to track invoices more efficiently.

Specifically, in reference to the \$155,925 disbursement, which was a reimbursement to the Pasadena Unified Court for state mandated fees collected by the City of Pasadena, the documentation provided for these types of transactions furnish a breakdown of the number of citations and the amounts collected for various penalties. This court payment breakdown document is signed by the Municipal Services supervisor and countersigned by the City Treasurer. For future payment requests, Accounts Payable has requested the Treasury division to submit the corresponding report that is generated from the parking system as back-up documentation to be attached to its request for payment. Accounts Payable will continue to require sufficient back-up documentation from departments for all invoices and other payment request.

With respect to the auditor's recommendation to enter the activity periods for each invoice received into the City's accounting software, this function is currently is not available in PeopleSoft. The City is presently soliciting proposals to engage a new ERP system citywide. Accounts Payable will explore the options to accomplish the purpose of the auditor's recommendation in the course of implementing the new accounting system.

12-02 Personnel File Requirements

To test the City's controls over payroll, we selected a sample of forty (40) City employees. During our analysis, we noted four (4) out of forty (40) employees selected for testing did not have documents validating information on their I-9 forms.

Reform and Control Act of 1986 (IRCA) requires that all employers verify the employment eligibility and identity of all employees hired to work in the United States after November 6, 1986. Compliance with IRCA is documented through the completion and maintenance of Employment Eligibility Form I-9.

Recommendation

While new Personnel File Requirements have been developed over time and firmly implemented within the past four years (per discussion with Human Resources Manager), there are no monitoring procedures within the Human Resources Department for personnel files that have missing requirements. To ensure federal compliance of the IRCA, we suggest that the City actively seek to maintain complete records for each City employee. We suggest that monitoring procedures be developed and implemented which will periodically review personnel files for missing required documents (Form I-9 and copies of the supporting documents).

Management's Comments Regarding Corrective Actions Planned

The City agrees with the recommendation and will implement it.

CURRENT YEAR OTHER MATTERS

12-03 Payroll Vacation Accrual

To test the City's controls over payroll, we selected a sample of forty (40) City employees. During our analysis, we noted three (3) out of forty (40) employees tested were a part of the Fire Department. The testing of internal controls over payroll revealed an issue with the City's payroll system's recording of accrued vacation hours remaining for Fire Department employees. The result of this issue is that paystubs for Fire Department employees are not displaying the accurate number of accrued vacation hours remaining.

Recommendation

We recommend the City notify the Fire Department employees of this issue and provide them with accurate numbers for their accrued vacation hours remaining balance immediately and continue to update the employees with accurate balances for every pay period until the issue is resolved.

Management's Comments Regarding Corrective Actions Planned

This is a technical issue that the City has been fully aware of. The Fire Department is aware there are a few differences and do not necessarily rely on their pay stubs, but utilize their timekeeping system, Telestaff. Fire and Payroll are coordinating data, however, some differences remain. This issue will be addressed with the new ERP system. In the interim, however, coordination with the City's IT department to improve the accuracy of these accruals will continue.

12-04 Police Department and Human Services and Recreation Revenue Cycle

During our walkthrough of the City's Police Department and Human Services and Recreation revenue cycle, we noted the following items:

- A Human Services and Recreation pool and a recreation center not recording and reconciling cash.
- Police Department not reporting a transfer of cash within the department to the City.

Recommendation

We recommend that the Human Services and Recreation Department and the Police Department review the procedures regarding monitoring of cash receipts to ensure the above points are addressed.

Management's Comments Regarding Corrective Actions Planned

In regards to Human Services and Recreation, the City agrees with this finding and has already addressed the issues presented. All Human Services and Recreation Department staff that process customer transactions have been provided with the City's cash handling policies. The Department also retrained all part-time staff working at these sites during the seasonal period in question. The Department will continue to convey the policy and appropriate cash handling practices on an annual basis as seasonal part-time staff are hired to process customer program registrations and reconcile financial transactions. Additionally, the Department continues to advertise online registration to encourage users to register online to minimize the amount of cash handling. Staff is also creating registration incentives using discounts to further encourage online registration. The Department is developing a business plan that will require the updating of Department wide policy and procedures, which will include required practices for cash handling.

In regards to the Police Department, the City agrees with this finding and will implement the recommendation of the independent auditor.

PRIOR YEAR SIGNIFICANT DEFICIENCIES

11-01 Accrual of Payables

During our testing of unrecorded liabilities, we selected a sample of thirty (30) material cash disbursements that occurred subsequent to fiscal year-end and reviewed support to ensure that they were accrued in accordance with accounting requirements. The results of our testing showed that two (2) of the thirty (30) disbursements were not adequately accrued. The total of the two (2) disbursements totaled \$363,413. During further discussion with the Accounts Payable Division, it was noted that accounts payable had an initial accrual cut-off of July 15, 2011, for accrual of expenses related to Fiscal Year 2011. For invoices that were received after this date, the Finance Department would accrue the expenses if the invoice was dated June 30, 2011, or earlier, and the value of the invoice was \$250,000 or more. We consider these inadequate procedures as the City may fail to accrue invoices that are dated after June 30, 2011, but is billing for activity that occurred before or goods that were received before the fiscal year-end.

Recommendation

We recommend that the City's Accounts Payable Division enter the activity periods for each invoice received into the City's accounting software, PeopleSoft. This provides the Finance Department the ability to do query searches based on activity date to assist in its determination of accounts payable completeness and accuracy.

Also, it is our opinion that the City's materiality threshold of \$250,000 be lowered to a more reasonable amount.

Management's Comments Regarding Corrective Actions Planned

The City has already taken steps to reduce the threshold for accrual and will take additional steps to improve this year-end process by setting appropriate thresholds, providing for a longer accrual period, and investigating the possibility of using the additional software feature. This year-end procedure has been in place for a number of years.

Current Year Status

Item completed. The City initiated new procedures for accrual of payables for the fiscal year ended June 30, 2012. Accounts Payable staff was instructed to accrue all payables regardless of amount through August 31, 2012. After the August deadline, the materiality threshold was increased to \$25,000. With respect to the auditor's recommendation to enter the activity periods for each invoice received into the

City's accounting software, this function is currently not available in PeopleSoft. The City is presently soliciting proposals to engage a new ERP system citywide. Accounts Payable will explore the options to accomplish the purpose of the auditor's recommendation in the course of implementing the new accounting system.

11-02 Need to Improve Control over Paramedic Billing and Collections

During our review of the accounts receivable, we noted that the recorded Paramedic Receivables as of June 30, 2012, were over \$3 million with allowance for doubtful accounts calculated as 50% of the receivable amount. Fiscal year 2011 is the second year that the City contracted a third party to perform billing and collection for Paramedic Receivables. The total in the year-end accounts receivable aged report provided by the City's contractor does not have the same exact balance as the monthly reconciliation that was presented for audit purposes because the City is unable to obtain an accurate report from its contractor. We reviewed the report that the City obtained from the contractor which shows a summary of monthly billing amounts and collections and noted that there is a column for "Unbilled and Write Off" that amounted to over \$1 million. Per our inquiry with City personnel, this amount represents amounts that are not billed pending additional information to complete the billing, that are contractual write-offs, or are simply not billable. As a best practice, a year-end aging report should be periodically reviewed for old and slow-paying accounts. Additionally, the City should be able to obtain a detail of the unbilled and write-off balance to be reviewed and ensure that there have not been any write-offs unauthorized by the City. Fiscal year 2011 was the second year of this significant deficiency (see 10-01).

Recommendation

We recommend that the City continue its effort in working together with the contractor to improve control over billing and collection of the Paramedic Receivable or consider hiring another vendor.

Management's Comments Regarding Corrective Actions Planned

The City agrees with this finding. It appears that the City's former contractor does not follow best practices and has been unable to provide reports that meet the City's requirements. This is one of the reasons that the City has chosen to change vendors for Paramedic billings. The City is confident that the reports provided by the new vendor will fully address this finding.

Current Year Status

Item completed. The City hired a new vendor effective December 10, 2011. The reports provided by new vendor are easier to understand, comply with accounting principles generally accepted in the United States of America, and agree to the City's general ledger. The City's Collections Section staff continues to aggressively attempt collection of receivables established by the previous vendor.

11-03 Long Outstanding Receivables

During our analysis of long time outstanding receivables, we noted a material receivable included in the general ledger for which the City did not expect to receive payment. Upon further client inquiry, it was noted the receivable had been settled in March of 2011 when the State received payment and the City had failed to remove it from its books. Once proper documentation was received, the City did record this transaction.

Recommendation

We recommend that the Finance Department review all pending material long outstanding receivables at year-end and consider their appropriateness.

Management's Comments Regarding Corrective Actions Planned

The City did remove this from the books upon receipt of proper documentation. At issue was receipt of a copy of the reconveyance documenting the transaction involved. The City is very diligent in not removing obligations from the books until appropriate to do so. The City agrees that a more thorough review and better documentation of the year-end review is appropriate.

Current Year Status

Item completed. The City reviewed all material long term receivables for the fiscal year ended June 30, 2012, and believes them to be collectable.

11-04 Capital Asset Cycle

During our walkthrough of the City's capital asset cycle, the following were noted:

- Inventories of capital assets kept in logs at various departments are not regularly reconciled to PeopleSoft, the City's system of record,
- Construction in process (CIP) is only cycled to completed assets on an annual basis, and
- PeopleSoft system has some software errors that allow capital assets to potentially depreciate beyond their cost.

Recommendation

To enhance internal controls over capital assets, we recommend that the City review its listing of capital assets by department twice a year off-cycle to the annual audit (i.e., March and September), requiring certification from the department's signatory authority over the accuracy of the inventory. This would alleviate much of the loading and unloading of capital assets close to year-end and spread the work throughout the year.

Management's Comments Regarding Corrective Actions Planned

The City agrees with this finding. Finance and the Department of Information Technology (DoIT) are working together to identify a solution to the PeopleSoft Asset Management system errors. Current resources will make it difficult to work on off cycle inventories twice a year, but the City will enhance procedures to ensure confirmations of accurate and timely inventories from all Departments.

Current Year Status

Partially completed. In fiscal year 2012, Finance and DoIT worked together and identified some possible solutions to resolve PeopleSoft Asset Management errors. These steps were paused as the City started a process of acquiring a new or upgrading the current ERP system. Finance added requirements for an effective capital asset system for the ERP system.

11-05 Personnel File Requirements

To test the City's controls over payroll, we selected a sample of forty (40) City employees. During our analysis, we noted the following:

- Six (6) out of the forty (40) employees selected for testing did not have an Employment Eligibility Verification Form I-9 in their personnel file.
- Seven (7) of the forty (40) employees selected for testing did not have the necessary documents included in their personnel file that would allow us to verify information on the Form I-9 (i.e., driver's license, social security card, birth certificate, or passport).
- Six (6) of the forty (40) employees selected for testing did not have an application included in their personnel file.

Reform and Control Act of 1986 (IRCA) requires that all employers verify the employment eligibility and identity of all employees hired to work in the United States after November 6, 1986. Compliance with IRCA is documented through the completion and maintenance of Employment Eligibility Form I-9. Per further discussion with Management, we noted that there were no monitoring procedures within the Human Resource Department to ensure that all files are complete, having no missing required documents.

Recommendation

To ensure federal compliance of the IRCA, we suggest that the City actively seek to maintain complete records for each City employee. We suggest that monitoring procedures be developed and implemented, including a periodic review of personnel files for missing required documents (i.e., Employment Eligibility Form I-9 and copies of the supporting documents).

Management's Comments Regarding Corrective Actions Planned

The City agrees with this finding. Over the past several months City staff audited the I-9 records, identified missing information and has completed obtaining the records and updating the files. The I-9 forms are maintained in a separate file and the verification is kept in the personnel file.

Current Year Status

Item completed. All files were reviewed and brought into compliance.

PRIOR YEAR OTHER MATTERS

11-06 Parks and Recreation Revenue Cycle

During our walkthrough of the City's Parks and Recreation revenue cycle, we noted the following items:

- Cash deposits are not collected on a daily basis,
- Hand written receipts are dated with the events date, not the date of receipt, and
- Cash receipt report not updated on a daily basis.

Recommendation

We recommend that the Parks and Recreation Department review the procedures regarding its management and monitoring of cash receipts to ensure the above points are addressed.

Management's Comments Regarding Corrective Actions Planned

The City agrees with this finding and will rearrange resources to increase spot checks of departmental cash deposit activity and conduct additional staff trainings to address these issues.

Current Year Status

Item completed. Staff has worked with security staff to ensure daily collection of cash deposits; additionally, new safes are being installed at all locations where cash and checks are collected to ensure proper security when cash is collected at front desk areas. The department has also advised and trained staff to date hand written receipts with the date receipt was issued to emulate receipt-generation in ActiveNet Recreation Management Application.

11-07 Disbursements and Accounts Payable Cycle

During our walkthrough of the City's disbursements and accounts payable cycle, we noted the following procedures were not present:

- Timely rotation of accounts payable clerks,
- Initiation of an intercept program (matching receivables to payables), and
- Escheat property transfers to the General Fund on a timely basis.

Recommendation

The City should enhance its accounts payable process in the following ways to improve the City's overall budget and operational effectiveness.

- Consider rotating its accounts payable clerks among vendors to prevent collusion between vendors and clerks. Currently, clerical staff has managed the same vendors for a lengthy period of time.
- During batch processing of transactions the City should net receivable and payables from vendors.
- The City should transfer as much property on an annual basis that it can in accordance with the California Government Code from escheat property to the General Fund. This should be performed as part of the closure of books on or before August 31 annually (to account for any in-transit revenues).

Management's Comments Regarding Corrective Actions Planned

The City agrees with the recommendations and will be rotating Accounts Payable staff, will investigate an intercept program, and has already initiated the required actions for escheating of property to the General Fund.

Current Year Status

Items completed. The assignments were rotated, the intercept program was evaluated and determined that the City does not have a systemic solution at this time, and escheat properties have been timely transferred.

11-08 Third Party Administrators for Credit Card Processing

During our walkthrough of the credit card transactions, it was noted that the City uses a third party administrator to process credit card transactions. However, the City does not obtain or review the third party's Report on Controls of the Service Organization.

Recommendation

The City should obtain the administrator's Report on Internal Controls on an annual basis. Once obtained, it should review the report for any items noted that would affect the City.

Management's Comments Regarding Corrective Actions Planned

The City agrees with this finding and will initiate procedures to perform the recommended actions.

Current Year Status

The third party administrator, who processes all credit card transactions, is required to complete a compliance questionnaire administrated by our Merchant processor, Axia, on an annual basis. If the third party administrator does not complete the questionnaire or is out of compliance, the Senior Treasury Analyst is notified via e-mail. The Senior Treasury Analyst will forward such e-mail to the Third Party Administrator to take proper action and reply to the request.

11-09 Vacation Accrual

During our review of current year payroll, we noted numerous employees with vacation accruals that were below zero. Per further discussion with the department Supervisor, it was noted that employees are allowed to go below zero days accrued and it is the City's policy that any vacation days owed would be returned by the employee upon termination. We also noted that there is no formal approval process in place for employees that wish to go below zero vacation days accrued.

Recommendation

The City should implement procedures across all departments for vacation approval subsequent to a review of vacation accrual availability. Hours taken in excess of zero accrual should require additional approval and documentation of reason for vacation.

Management's Comments Regarding Corrective Actions Planned

The City agrees with this finding. The City has negotiated a change to a vacation accrual basis with several bargaining units and is planning on changing the annual January 1 allocation of vacation to an accrual basis as soon as it is administratively possible. The change requires programming with the payroll system. It is anticipated that this change can be implemented before January 1, 2013.

Current Year Status

Partially completed. There have been a few bargaining units that have changed to using the vacation accrual method during this past year and as of next year when it is administratively possible. The recommendation that extra approval would be needed for employees to take their allotment over their accrual only applies to limited circumstances. The employees, whose unit has not changed to the vacation accrual method, do not require permission as they are following their Memorandum of Understanding (MOU) and Salary Resolution as well as the City's Leave of Absence Policy. We provide the biweekly leave reports to departments each cycle, which show both the accrual and allotment for the employees. It also shows on the pay stub for employees. The City continues to negotiate the change to the vacation accrual method as MOUs expire.

11-10 GANN Limit

During our analysis of the City's current year GANN Appropriation Limit Calculation, we noted that the beginning balance as of July 1, 2010, did not reconcile to the audited ending balance for the prior fiscal year, June 30, 2010. State law requires that GANN Limit be "rolled forward" from the prior year's approved amounts. Per further discussion with the City, it was noted that errors existed in spreadsheets used by City staff to determine the current year balance.

Recommendation

We recommend that the GANN Appropriation Limit Calculation and limit setting procedures internal controls be strengthened to include a reconciliation of the prior year limit as approved adjusted for the factors stipulated in the California Constitution as carried forward to the current budget year. Though the City was well within its limitations, a worksheet could be prepared showing the various funds in columns and the various revenue sources in rows with amounts presented adding and agreeing to the budgeted estimated revenues. The Office of the Controller and the Budget Office could then agree on the amounts prior to City Council action.

Management's Comments Regarding Corrective Actions Planned

The City agrees with this finding and will implement added verification steps by individuals other than the individual preparing the calculation.

Current Year Status

Item completed. Budget as reviewed and revised procedures to incorporate specific checks that ensure the numbers in the calculation are correct and tie back to the adopted budget.