



BROWN ARMSTRONG

Certified Public Accountants

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, 2011, 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 was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all such deficiencies have been identified.

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

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

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.

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

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Pasadena, California
December 29, 2011

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SIGNIFICANT DEFICIENCIES AND OTHER MATTERS

CURRENT 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 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, People Soft. 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.

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, 2011, 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.

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.

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.

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., drivers 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 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 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.

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.

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, they 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.

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.

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.

PRIOR YEAR SIGNIFICANT DEFICIENCIES

10-01 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, 2010, were over \$7 million with allowance for doubtful account calculated as 50% of the receivable amount. Fiscal Year 2010 is the first year that the City contracted a third party to perform billing and collection for Paramedic Receivables. There was no year-end accounts receivable aged report that was presented for audit purposes because the City is unable to obtain such 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. 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.

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.

Management's Comments Regarding Corrective Actions Planned

Management concurs with the auditor's recommendations. As commented on above, the outside vendor was unable to provide a detailed accounts receivable aging at year-end. Subsequently such a report has been received and staff is carefully reviewing and will implement further actions to validate the vendor data and improve the timely receipt of proper documentation from the vendor.

Current Year Status

See current year 11-02.

PRIOR YEAR OTHER MATTERS

10-02 Develop an IT Strategic Plan

During our review of Information Technology (IT) General Controls, we noted the City does not have an IT Strategic Plan. IT strategic planning is a significant step for aligning IT resources with the business strategy and priorities. An IT Strategic Plan defines, in cooperation with relevant stakeholders (personnel affected by strategic planning), how IT goals will contribute to the City's strategic objectives and related costs and risks. The plan should:

- Improve key stakeholders' understanding of IT opportunities and limitations, assess current performance, identify capacity and human resource requirements, and clarify the level of investments required.
- Include how IT will support IT-enabled investment programs, IT services and IT assets.
- Define how the objectives will be met, the measurements to be used, and the procedures to obtain formal sign-off from the stakeholders.
- Cover investment/operational budgets, funding sources, sourcing strategy, acquisition strategy, and legal and regulatory requirements.

Without appropriate strategic planning, the City will not be able to maximize the potential to build a better relationship between management and their users or between the City and its citizens.

Recommendation

We recommend the City develop and implement an IT Strategic Plan.

Management's Comments Regarding Corrective Actions Planned

The City of Pasadena is already underway with the development of a comprehensive IT Strategic Plan. The City is committed to the effective use of the City's IT investment while implementing new technology to ensure the efficient and effective delivery of City services to our community. In order to maximize the return on investment in technology and minimize duplication, the City is in the process of creating a comprehensive IT Strategic Plan for technology advancements which meets the goals, objectives and vision of the community and our organization. The IT Strategic Plan will be completed in February 2011.

Current Year Status

Completed.

10-03 Enhancing Security Controls Over Information Technology Systems

During our review of user access controls and password settings for users logging onto the City's internal network, we noted that certain security policies and procedures could be enhanced to provide better security over the City's network and application processing environment.

1. The default domain password settings are set to the following specifications:

- Minimum Password Length – 6
- Password Change Interval – 180 days
- Password Complexity – Disabled
- Password History Remembered – 3 passwords
- Account Lockout Threshold – 50 attempts

For increased security over system resources, industry best practice recommends the following default domain password settings:

- Minimum Password Length – 8
- Password Change Interval – 90 days or less
- Password Complexity – Enabled

- Password History Remembered – 4 passwords (or at least 1 year when used in conjunction with the Password Change Interval)
- Account Lockout Threshold – 3-5 attempts

Password complexity requirements typical force user passwords to include at least 2 of the following:

- a. uppercase character,
 - b. number, and
 - c. special character.
2. A sample of 25 terminated users were selected for testing to ensure their access to City resources were removed. We noted the following during testing:
- 5 of 25 terminated users have active network accounts.
 - 6 of 25 terminated users have active financial system accounts.
 - 4 of 25 terminated users have active remote access accounts.

Access controls limit or detect inappropriate access to computer resources, thereby protecting them from unauthorized modification, loss, and disclosure. Logical access controls require users to authenticate themselves (through the use of secret passwords or other identifiers) and limit the files and other resources that authenticated users can access and the actions that they can execute. Our testing of logical access controls included a review of policies and procedures, organizational structure, access control lists, and password settings.

Without adequate access controls, unauthorized individuals, including outside intruders and former employees, can surreptitiously read and copy sensitive data and make undetected changes or deletions for malicious purposes or personal gain. In addition, authorized users can intentionally or unintentionally read, add, delete, modify, or execute changes that are outside their span of authority. Inadequate access controls diminish the reliability of computerized data and increase the risk of destruction or inappropriate disclosure of data.

Recommendations

We recommend the City:

1. Enhance password controls to better align with industry best practice.
2. Enhance internal controls to ensure terminated users logical and physical access is removed timely following their termination date (i.e., within 1-3 business days).
3. Implement procedures to review user access on a periodic basis to ensure access is current and appropriate. The review should also be used to determine appropriate segregation of duties for users of financial software.

Management's Comments Regarding Corrective Actions Planned

The Department of IT has developed password policies around industry standard and best practices. Those policies continue to be adopted in the City.

Standard account terminations are currently handled through Entry/Exit and a process exists for account termination for more sensitive situations. Additionally, a yearly audit is performed for active user accounts per department.

Periodic user access auditing is a process we are looking to implement in the future, as part of the reorganizing of roles and responsibilities within the Department of IT. The Department of IT has a documented and enforced policy of "least privilege," which has been in place for three years. This policy means that IT only grants permissions to what is required to do the job. Additionally, we have implemented "role based access" creating permissions based on a user's role only. Auditing is reviewed

for log on and off events, on a requested basis and attempted password changes, both successful and unsuccessful are reported automatically to IT and the user whose password has been attempted to be changed. In the future efforts are being made to develop and maintain audit log review by the application or data owners.

Current Year Status

Item 1 – Completed.

Item 2 – Partially completed and in progress.

Item 3 – Partially completed and in progress.

10-04 Security Awareness Training

During our review of IT procedures and controls, we noted that security awareness training is not provided to employees and contractors of the City.

Effective security-related personnel policies are critical to effective security. Ineffective personnel policies can result in employees or contractors inadvertently or intentionally compromising security. For example, security may be compromised due to an inadequate awareness or understanding, inadequate security training, or inadequate screening of employees. An ongoing security awareness program should be implemented that includes first-time training for all new employees, contractors, and users; periodic refresher training for all employees, contractors, and users; and distribution of security policies detailing rules and expected behaviors to all affected personnel.

Recommendation

We recommend that an ongoing security awareness program be implemented. Relevant security awareness requirements and guidance can be found in are contained in the Federal Information Security Management Act (FISMA), Office of Management and Budget (OMB) Circular A-130, and the National Institute of Standards and Technology (NIST) SP 800-50, *Building an Information Technology Security Awareness and Training Program*. In addition, employees with significant security responsibilities should receive specialized training, as described in NIST SP 800-16, *Information Technology Security Training Requirements: A Role and Performance-Based Model* (April 1998).

Management's Comments Regarding Corrective Actions Planned

Security training is part of an overall objective towards the goal of City security awareness. In addition to training, awareness is achieved through security policies, standards, and procedures. Formal training is a role that will be performed by the City IT Security Officer, which is a new position identified and recommended as part of the IT Audit and upcoming IT Strategic Plan.

Current Year Status

Partially completed and in progress – limited by resources.

10-05 Improve Environmental Controls and Develop Contingency Plans

During our discussion with management, it was noted there is no contingency plan to deal with short or long-term contingencies. In addition, it was noted that there is no power generator to provide long-term power in the event of an extended power outage and no plans for a backup recovery facility.

Losing the capability to process, retrieve, and protect electronically maintained information can significantly affect the City's ability to accomplish its mission. If contingency planning controls are inadequate, even relatively minor interruptions can result in lost or incorrectly processed data, which can cause financial losses, expensive recovery efforts, and inaccurate or incomplete information.

Controls to ensure service continuity should address the entire range of potential disruptions. These may include relatively minor interruptions, such as temporary power failures, as well as major disasters, such as fires, natural disasters, and terrorism, that would require reestablishing operations at a remote location. If controls are inadequate, even relatively minor interruptions can result in lost or incorrectly processed data. To mitigate service interruptions, it is essential that the related controls be understood and supported by management and staff throughout the City. Senior management commitment is especially important to ensuring that adequate resources are devoted to emergency planning, training, and related testing. Also, the involvement of data and process owners is integral to contingency planning, as they have first-hand knowledge of their data and processes and of the impact of a loss of availability.

Recommendations

We recommend the City develop and document a comprehensive contingency plan that takes into account both short and long-term contingencies. The plan should include possible solutions for providing ongoing power to the primary computer room in the event of an extended power outage. In addition, we recommend the City designate a backup computer room at a remote facility to be used in the event the primary computer room is no longer available. In the event using a specialized third party recovery facility is too expensive, we recommend contacting other local governments to determine if they have the capability to house computer equipment in their computer room in the event of a contingency as part of a reciprocal agreement.

Management's Comments Regarding Corrective Actions Planned

The Department of IT has identified the need to develop a City contingency and disaster recovery plan. This plan will be a priority project for the department over the next year. Currently the Department of IT performs backups of all City data, and they are sent offsite in case of a disaster. The package of data sent offsite includes application data, recovery steps, organizational documentation, passwords, vendor contacts, and more.

Environment controls and contingency plans continue to be an active area that the Department of IT is working towards. The department has explored becoming a recovery site partner with other cities, and has initial plans to use one of the City's four datacenters as a potential mirror or recovery site. Two of the four datacenters managed by the City have full-time generators. The department purchased a site recovery product and plans to implement the product in the near future at one or two of the City datacenters with fulltime generators.

The primary datacenter has a generator hookup and has been successfully tested with a power cutover. The City owns several generators, which can be used in the event of a disaster, and maintains an external generator service provider list. The department has investigated the possibility of a permanent generator, and options continue to be explored around making that investment.

Current Year Status

Partially completed and in progress.