



INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

The Honorable City Council
of the City of Pasadena
Pasadena, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, 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, California (the City), as of and for the year ended June 30, 2020, and the related notes to the basic financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated February 8, 2021.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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.

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 that were not identified. However, as described below, we identified certain deficiencies in internal control that we consider to be a material weakness and 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 entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described below to be a material weakness.

MATERIAL WEAKNESS

General Claims Liability

Auditors' Comment and Recommendation

An important element of financial reporting is accounting for an entity's exposure to potential general liability claims. During our analysis of the City attorney's confirmation response, we noted a general liability claim that met the criteria for accrual that had not been included in the City's estimate of its general claims liability as of the fiscal year ended June 30, 2020. During management's verification of this general liability claim, they identified some additional general claims liabilities that had been booked twice, as part of accounts payable and as part of the total general claims liability. The City's year-end procedures include reviewing the accounts payable detail for the names of cases listed in the City attorney's confirmation response prior to recording the adjustment to the general claims liability account to ensure the liability is not booked twice. The line items in accounts payable were listed with the case attorney's name instead of the name of the claimant listed on the attorney's confirmation. Therefore, when the City recorded the adjustment to the general claims liability, it included items already recorded in accounts payable. The effect of the identified discrepancies was a material overstatement of the general claims liability and the related expenses. We recommend that management review and update its year-end closing procedures related to the estimation of the general claims liability to ensure the accuracy of the recorded amount at year-end.

Management's Response

The City concurs with this finding and has implemented the recommendation by updating its year-end closing procedures to include additional steps, which address this matter. As part of the required audit procedures at the end of the audit, the City Attorney provides the auditors with an "Attorney Letter," which provides summary information on claims against the City. In the past, this information was used to adjust the balance of outstanding claims against the City. Finance will now request an additional report of the outstanding claims against the City after year-end, but prior to the beginning of the audit. Finance will book the required liability at this time and review and adjust any open or changed claims, reported on the final Attorney Letter. Additionally, Finance will verify that Accounts Payable accruals contain no duplication of liability.

SIGNIFICANT DEFICIENCIES

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 described below to be significant deficiencies.

Inventory

Auditors' Comment and Recommendation

Internal controls over inventory should be designed to identify, account for, and report all transactions related to the inventory. As part of our audit procedures, we performed an inventory observation of a cycle count for the Water and Power Department and noted that twenty-two of the twenty-five items tested had variances between our count and the inventory listing provided by the Department. Through inquiry with the Department, we were able to resolve most of the variances; however, we noted that the variances occurred because of a lack of controls over the inventory process. The effect of the lack of controls was an overstatement of inventory and understatement of the related expenses.

SIGNIFICANT DEFICIENCIES (CONTINUED)

Inventory (Continued)

Auditors' Comment and Recommendation (Continued)

We recommend the Department establish procedures and controls to ensure that the inventory of the City's Water and Power Department is maintained and that adequate supporting records of purchases, dispositions, and retirements of the inventory are received in order to accurately report the inventory balances for financial reporting purposes. In addition, we recommend that the Water and Power Department make plans to perform a complete physical inventory count as of the end of the next fiscal year in order to ensure the accuracy of the inventory balances in the general ledger system.

Management's Response

The City concurs with the finding related to internal controls over inventory. The processes for conducting cycle counts have been reviewed and additional controls will be put in place to improve timeliness and accuracy. Additional controls include a formal schedule for conducting cycle counts with a focus on high value items, ensuring that any discrepancies are subject to recounts by different personnel than those who performed the original counts and management review of any inventory adjustments for discrepancies. The current inventory management software is outdated and has limited automation functionality which requires significant manual processing during and after the completion of cycle counts. The Water and Power Department will be performing a needs assessment during the next fiscal year to replace the current inventory management software. The Department is discussing plans to conduct a complete physical inventory count at June 30, 2021, which will require careful preparation because the inventory materials are subject to continuous movement due to the nature of utility operations.

Deposit Liabilities

Auditors' Comment and Recommendation

Internal controls over deposit liabilities should be designed to identify all outstanding deposits, to account for the refunding of the deposits or the recognition of revenue, where appropriate, and to maintain an accurate detailed subsidiary schedule that reconciles to the general ledger. The City collects deposits for construction and demolition waste in response to State-mandated solid waste reduction goals, and as part of the City's continued efforts to reduce landfilled solid waste, the City adopted the Construction and Demolition Waste Management Ordinance (Chapter 8.62 of the Pasadena Municipal Code (PMC)) in 2002. The City updated the PMC Chapter 8.62 in 2014 to comply with changes in state requirements, which included expanding the scope of applicable construction and/or demolition projects to include residential remodeling projects and to require that applicable projects divert 75 percent of waste either through recycling, salvage, or deconstruction, which is greater than the State requirement of 65 percent. The City also made procedural changes to the PMC Chapter 8.62, including the addition of forfeiture of the deposit if the City determines non-compliance with the ordinance's requirements. We noted that the account balance had grown substantially over the last several years which did not meet our audit analysis expectations. In addition, City management informed us that an investigation had been started to determine the validity and accuracy of the deposit listing. The results of the investigation indicated that some of the deposits had already been refunded, or were old outstanding deposits with a lack of support for inclusion in the current fiscal year, and some that should be forfeited and recognized as revenue. This resulted in an overstatement of deposits payable and an understatement of related revenue.

SIGNIFICANT DEFICIENCIES (CONTINUED)

Deposit Liabilities (Continued)

Auditors' Comment and Recommendation (Continued)

We recommend the City review and update internal control procedures related to the maintenance of an accurate subsidiary deposits payable schedule that includes regular (i.e. monthly) monitoring of the subsidiary schedule to ensure the validity and accuracy of the listed deposits, and the timely determination of when deposits should be refunded, forfeited, or a combination thereof.

Management's Response

The City concurs with this finding and will implement the recommendation. The Department of Finance will conduct quarterly reviews of all deposit liability accounts, to ensure the validity and accuracy of the listed deposits, and monitor the timely disposition of deposits. Regarding the construction and demolition deposits, the City has received the final report and recommendations of an outside consultant, who provided robust and detailed recommendations. All four departments (Public Works, Finance, DoIT, and Planning) have indicated their concurrence on all recommendations. It is expected that they will be implemented prior to June 30, 2021.

Construction in Progress

Auditors' Comment and Recommendation

The City is responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement. An important part of financial reporting is ensuring the accuracy of capital asset classifications and appropriately estimating the use of those capital assets in the form of depreciation expense. As construction in progress is completed and placed in service, the capital assets should be transferred to the appropriate capital asset category and depreciation of the capital assets should commence. We identified several projects included in construction in progress (CIP) in the Light and Power Enterprise Fund that had been completed as of year-end but had not been properly transferred to the appropriate capital asset categories. This occurred because the department did not review the entire CIP listing for projects that were substantially completed and in service. This resulted in an adjustment to reduce CIP and increase depreciable capital asset categories. We recommend that management review and modify existing controls over asset capitalization to ensure that completed CIP projects that have been placed in service are reclassified to the appropriate capital asset categories in a timely manner.

Management's Response

The City concurs with the finding related to construction in progress in the Light and Power Fund. Construction in the Light and Power Fund infrastructure projects, frequently span over multiple-years and involves multiple Project Job Orders. In certain cases, the projects are substantially complete, portions are placed in service before full cost information is recorded and the jobs are formally closed. Management will implement processes, to review the status of Project Job Orders more frequently throughout the year, at least quarterly. This will provide a more timely review of the construction in progress and jobs may be closed regularly and reclassified to the appropriate asset categories.

SIGNIFICANT DEFICIENCIES (CONTINUED)

Bank Account Reconciliations

Auditors' Comment and Recommendation

An important part of internal controls over cash is the monthly reconciliation of the bank accounts. In our review of the bank reconciliations, we noted that items reported as reconciling items were not recorded timely to the general ledger and the bank reconciliations showed unreconciled differences due primarily to a lack of reconciliation of credit card receipts collected at various locations managed by City employees. The City reconciles the monthly activity of credit cards by comparing reports from the bank to a report from the City cash receipts system. During fiscal year 2019-2020 there were reasonable timing differences on the monthly reconciliations. However, there is a significant running total that carries over each month that is not reconciled. An important element of internal control over cash is the bank reconciliation process which enables staff to identify differences between bank balances and general ledger balances and resolve such differences in a timely manner. This process will provide for accurate general ledger balances and minimize the risk of misappropriation of cash. We recommend that procedures related to the reconciliation of credit card transactions be modified to ensure the accuracy of the recording of the transactions related to the credit card receipts and to ensure the timely resolution of reconciling items.

Management's Response

The City concurs with the finding and recommendation. The Department of Finance will review and improve procedures related to the reconciliation of credit card transactions. This will ensure, the accuracy of recording transactions, related to credit card receipts and to ensure the timely resolution of reconciling items.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

City's Responses to Findings

The City's responses to the findings identified in our audit are described above. The City's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the City's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Irvine, California
February 8, 2021