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DEPARTMENT OF
FINANCE

BETTY MASUOKA
DIRECTOR

CITY OF SACRAMENTO
CALIFORNIA

February 23, 1989
FA:89031:BM:KMF

CITY HALL
ROOM 14
915 I STREET
SACRAMENTO, CA
95814-2685

916-449-5736

DIVISIONS:
ACCOUNTING
BUDGET
REVENUE
RISK MANAGEMENT

Budget and Finance Committee
Sacramento, California

Honorable Members in Session:

SUBJECT: Touche Ross Letter of Recommendations

SUMMARY

The current contract with the City's external audit firm requires that they provide the City with a report on recommendations for improving financial controls. These recommendations are a by-product of the annual financial audit. Attached is the external auditor's letter of recommendations for the fiscal year ended June 30, 1988. This report was heard by the City Council on March 7, 1989 and referred to the Budget and Finance Committee for review.

BACKGROUND

See attached report.

ANALYSIS

See attached report.

FINANCIAL DATA/POLICY CONSIDERATION

None.

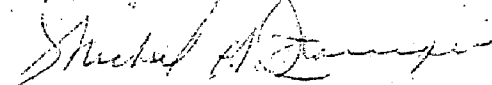
MBE/WBE

No impact.

RECOMMENDATION

This report is being referred to Committee for information only. No action is requested.

Respectfully submitted,



FOR BETTY MASUOKA
Director of Finance

Attachment

APPROVED FOR COMMITTEE INFORMATION:



JACK R. CRIST
Deputy City Manager

CONTACT PERSON: BETTY MASUOKA
Director of Finance
449-5736

March 14, 1989
All Districts



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MANAGER
FEB 28 1989

DEPARTMENT OF
FINANCE

BETTY MASUOKA
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City Council
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Honorable Members in Session:

SUBJECT: Touche Ross Letter of Recommendations

SUMMARY

The current contract with the City's external audit firm requires that they provide the City with a report on recommendations for improving financial controls. These recommendations are a by-product of the annual financial audit. Attached is the external auditor's letter of recommendations for the fiscal year ended June 30, 1988.

It is recommended that this report be referred to the City Council Budget and Finance Committee for review.

BACKGROUND

Annually, an audit of the City's financial statements is performed by an independent external audit firm. As a part of this audit, the external auditor evaluates the City's system of internal control as a basis for reliance thereon. As a by-product of this evaluation, the City receives a letter of recommendations containing comments on actual or potential internal control deficiencies noted by the external auditor.

Customarily, the auditor's comments are transmitted to the full City Council for informational purposes with referral to the Budget and Finance Committee for review. Attached are recently received comments for the prior year. The report includes management responses prepared by the affected departments.

ANALYSIS

The included management responses were prepared by the following departments:

<u>RECOMMENDATION</u>	<u>RESPONDING DEPARTMENT(S)</u>
Pension	Personnel
Investments	Treasury
Cash Disbursements	Finance
Payroll	Finance
Journal Vouchers	Finance
Cash Receipts - Bingo Operations	Finance
Accounting - Fixed Assets	Finance
Other - Electronic Data Management	Data Management
Other - Grant Management	Finance

FINANCIAL DATA/POLICY CONSIDERATION

None.

MBE/WBE EFFORTS

No impact.

RECOMMENDATION

It is recommended that the attached Touche Ross report be referred to the City Council Budget and Finance Committee for review.

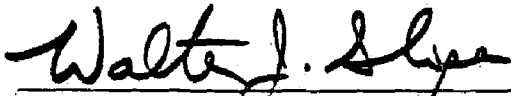
Respectfully submitted,



For BETTY MASUOKA
Director of Finance

Attachment

RECOMMENDATION APPROVED:



WALTER J. SLUPE
City Manager

CONTACT PERSON: BETTY MASUOKA
Director of Finance
449-5736

March 7, 1989
All Districts

CITY OF SACRAMENTO
LETTER OF RECOMMENDATIONS
Year Ended June 30, 1988

January 20, 1989

Honorable Mayor
and City Council
City of Sacramento
Sacramento, California

We have examined the general purpose financial statements of City of Sacramento, California, for the year ended June 30, 1988, and have issued our report thereon dated December 7, 1988. As part of our examination, we made a study and evaluation of the system of internal accounting control of City of Sacramento, California, to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards and the standards for financial and compliance audits contained in the U.S. General Accounting Office Standards for Audit of Governmental Organizations, Programs, Activities, and Functions. For the purpose of this report, we have classified the significant internal accounting controls in the following categories:

- . Utility billings and accounts receivable
- . Cash receipts
- . Purchasing and accounts payable
- . Cash disbursements
- . Payroll
- . Budgetary
- . Books and records
- . Fixed assets
- . Investments

Our study included all of the control categories listed above except that we did not evaluate the accounting controls over fixed assets because fixed asset amounts were tested substantively without significant reliance on internal accounting controls. The purpose of our study and evaluation was to determine the nature, timing, and extent of the auditing

City of Sacramento
January 20, 1989
Page Two

procedures necessary for expressing an opinion on the City's financial statements. Our study and evaluation was more limited than would be necessary to express an opinion on the system of internal accounting control taken as a whole or on any of the categories of controls identified above.

The management of City of Sacramento, California, is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any system of internal accounting control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation made for the limited purpose described in the first paragraph would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system of internal accounting control of the City of Sacramento taken as a whole or on any of categories of controls identified in the first paragraph. However, our study and evaluation disclosed no condition that we believed to be a material weakness. In order to further improve and strengthen the system of internal accounting control, certain conditions and our recommendations for improvement are detailed on the attached pages.

* * * * *

City of Sacramento
January 20, 1989
Page Three

This report is intended solely for the use of management and the Mayor and City Council of the City of Sacramento, and should not be used for any other purpose. This restriction is not intended to limit the distribution of this report which, upon acceptance, is a matter of public record.

Touche Ross & Co.

Certified Public Accountants

CITY OF SACRAMENTO

LETTER OF RECOMMENDATIONS

Year ended June 30, 1988

Pension

During our review and testing of the internal controls over retiree benefit payments, we noted the following condition:

Condition #1: Through inquiry we learned that the retirement masterfile was reviewed monthly. A signature documenting the review process, however, was not required.

Recommendation: We recommend that a method to document the review process be implemented to improve the accountability for the review. This process should include the reviewer signing and dating the retirement masterfile to evidence the review.

Management Response: The Retirement System Manager has implemented a review form that will be attached to each monthly pension payroll, certifying that the pension masterfile and the related warrant register have been reviewed and are in balance.

CITY OF SACRAMENTOLETTER OF RECOMMENDATIONS

Year ended June 30, 1988

Investments

During our review and testing of the internal controls over investments, we noted the following conditions:

Condition #1: City employees responsible for investing the City's cash occasionally exceeded the limits of authority prescribed by the City's investment policy.

Recommendation: We recommend the limits as defined by the investment policy be followed which includes having responsible persons approve the transactions as outlined in the investment policy.

Management
Response:

The investment which exceeded the approved limits was a \$5 million repurchase agreement. A repurchase agreement represents an overnight loan, collateralized at 102% with 100% guaranteed U.S. Government Securities. The importance of these limits has been reiterated to the investment staff.

It may become necessary to raise the authority for all investment staff specifically for a repurchase agreement. However, as a result, the City Treasurer is in the process of re-evaluating the authorized limits, as they were established several years ago when the average size of Pool A was half of what it is today.

CITY OF SACRAMENTO

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LETTER OF RECOMMENDATIONS

Year ended June 30, 1988

Investments (Continued)

Condition #2:

In the letter of recommendations dated April 15, 1988, we noted that certain members of the Investment Committee, which reviews and reports on the investment activities and strategies, were not independent based on their responsibilities in executing the investment transactions. The aforementioned condition still exists. Discussions at the September 13, 1988, Budget and Finance Committee meeting suggested that the Budget and Finance Committee or another committee review the investment activities and strategies of the City Treasurer's Office. However, no action has been taken with respect to these suggestions.

Recommendation:

We recommend that a responsible committee outside of the Investment Committee review the investment activities and strategies.

Management
Response:

The Treasurer has always submitted quarterly reports of investment activity to the Budget and Finance Committee and to the City Council for review and consent. The Treasurer will begin to make formal presentations of these quarterly reports to the Budget and Finance Committee.

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CITY OF SACRAMENTO

LETTER OF RECOMMENDATIONS

Year ended June 30, 1988

Cash Disbursements

During our review and testing of the internal controls over cash disbursements, we noted the following conditions:

Condition #1: Access was not restricted to the check signing room where the signature plate, blank checks, and the check signing machine are located.

Recommendation: We recommend the signature plate be controlled by a responsible person on days which commercial and manual checks are prepared.

Management Response: The signature plate is currently returned to the vault at the end of each commercial check run day. The Accounting Division will ensure that the plate is returned to the vault immediately after the checks are signed.

Condition #2: The control log for the key to the vault containing the signature plate was not being updated on a regular basis.

Recommendation: In order to improve control over the vault key, we recommend the control log be updated immediately by the responsible employee in order to improve employee accountability.

Management Response: The Accounting Division will ensure that the control log for the vault key is kept up to date on a regular basis.

CITY OF SACRAMENTO

LETTER OF RECOMMENDATIONS

Year ended June 30, 1988

Cash Disbursements (Continued)

Condition #3: Authorized signer cards for the Material Receiving Report were missing for several departments.

Recommendation: We recommend that Material Receiving Report authorized signer cards be maintained for all departments in order to verify that goods were received.

Management Response: The Accounting Division will update the authorized signature cards on file for material receiving reports and implement a system to keep the cards up to date.

Condition #4: On occasion, the accountant in charge of blank checks was also responsible for signing checks using the signature plate.

Recommendation: We recommend the accountant in charge of blank checks not participate in the check signing process.

Management Response: The accountant in charge of blank check stock has been removed from the check signing process.

Condition #5: Supporting invoices for both automated and manually written checks were not cancelled.

Recommendation: We recommend all supporting invoices be cancelled in order to prevent duplicate payments.

Management Response: The Accounting Division agrees with the recommended action and will pursue an appropriate remedy.

CITY OF SACRAMENTO

LETTER OF RECOMMENDATIONS

Year ended June 30, 1988

Payroll

During our review and testing of the internal controls over payroll, we noted the following conditions:

Condition #1: A list of authorized signers for employee timecards was not maintained by payroll personnel.

Recommendation: We recommend that a listing of authorized signers be maintained by payroll personnel in order to verify that employee time cards were properly approved.

Management
Response:

Maintenance and proper use of an up-to-date authorized signature file for employee timecards would require considerable effort by all City departments. However, City policy requires that every employee timecard be approved by the respective department supervisor before acceptance by Payroll. The Payroll staff enforces this policy as part of the process to prepare timecards for key entry. Accordingly, City policy provides a compensating control to mitigate the noted condition. The additional cost to maintain and use an authorized signature file for employee timecards would substantially outweigh any additional benefit derived.

Condition #2: Several payroll worksheets are being calculated manually.

Recommendation: We recommend that City management consider using a computerized spreadsheet in order to improve the efficiency of staff and accuracy of accounting records.

Management
Response:

The Accounting Division is in the process of converting manual payroll worksheets to computerized formats.

CITY OF SACRAMENTO

LETTER OF RECOMMENDATIONS

Year ended June 30, 1988

Journal Vouchers

During the review and testing of internal controls over journal vouchers, we noted the following conditions:

Condition #1: Journal vouchers entered into the computer system are not verified for correct posting.

Recommendation: We recommend that a review process for journal vouchers posted be performed by an employee independent of the entry function to determine that journal vouchers were properly entered.

Management Response: Journal vouchers posted are currently reviewed on a sample basis by the Accounting Manager. This review occurs as part of the journal voucher approval process.

Condition #2: Journal vouchers were being prepared in pencil.

Recommendation: We recommend that journal vouchers be prepared in ink to prevent unauthorized modification.

Management Response: The Accounting Division will ensure that all journal vouchers are prepared in ink.

CITY OF SACRAMENTO

LETTER OF RECOMMENDATIONS

Year ended June 30, 1988

Cash Receipts

Bingo Operations

During the performance of agreed-upon procedures with respect to selected bingo operations, we noted the following conditions:

Condition #1: Certain licensees were not adhering to the applicable sections of Chapter 18 of the Sacramento City Code.

Recommendation: We recommend that the City require annual written attestations from licensees reaffirming compliance with the Sacramento City Code. We also recommend that the responsible City department work with the City's internal auditor to monitor bingo licensees' compliance with the City Code.

Management Response: The City agrees that the recommended action is desirable. However, the cost to the City and the operators of additional compliance auditing outweighs the City's known exposure in this area. The Internal Audit Section will continue with the current level of compliance auditing and, if significant exceptions are identified, the City will reassess its efforts.

Condition #2: Certain bingo operations did not have adequate controls over cash receipts.

Recommendation: We recommend the responsible City department study and evaluate the controls in place at bingo sites to determine that cash received is deposited, recorded and reported to the City.

Management Response: See Management Response to Condition #1.

CITY OF SACRAMENTO

3

LETTER OF RECOMMENDATIONS

Year ended June 30, 1988

Accounting

In conjunction with our examination of the respective areas of the City of Sacramento listed below, we noted the following conditions:

Fixed Assets

Condition #1: Old reconciling items appeared on the reconciliation (from the general ledger to the fixed asset records) of fixed assets.

Recommendation: We recommend that reconciling items between fixed asset records and the general ledger be resolved by department personnel and the City's accountants on a timely basis to strengthen control over compliance with the City's capitalization policy and the safeguarding of assets.

Management Response: The City understands the importance of safeguarding its land, buildings and equipment through an effective accounting and reporting system. The recommended action is necessary and fundamental to the City's well being. City staff is in the process of evaluating improvements to the current fixed assets accounting system in order to correct the stated condition. This evaluation addresses computer software requirements and personnel needs and work priorities in the Accounting Division. Staff will present a report to Council on the costs and benefits of proposed improvements when the study is completed. At this time, resources are not budgeted to address this condition.

Condition #2: Several completed construction projects were not transferred from construction-in-progress to the appropriate fixed asset accounts in a timely manner.

CITY OF SACRAMENTO

LETTER OF RECOMMENDATIONS

Year ended June 30, 1988

Accounting (Continued)

Fixed Assets (Continued)

Recommendation: We recommend all open construction projects be reviewed at year-end to determine whether the projects should be closed out.

Management Response: See Management Response to Condition #1.

Condition #3: Additions to fixed assets were not updated in a timely manner on the detail fixed asset listing.

Recommendation: We recommend the responsible departments which requisition fixed assets notify the accounting department as soon as possible to record additions to fixed assets in a timely manner.

Management Response: See Management Response to Condition #1.

LETTER OF RECOMMENDATIONS

Year ended June 30, 1988

Other

Data Management

Condition #1:

In separate correspondence to the director of Data Management dated December 14, 1988, we identified areas relating to electronic data processing general and application controls which could be strengthened.

Recommendation:

We recommend that a Finance Department liaison also review the nature of these comments to identify those which potentially affect the accounting and budgeting divisions and prepare a report to the Director of Finance summarizing the conditions and planned action steps.

Management
Response:

The Finance Department liaison has reviewed the correspondence and has reported that the issues are being adequately addressed by Data Management.

Grant Management

Condition #1:

In compiling the schedule of federal financial assistance for the year ended June 30, 1988, a significant effort was required by the City's internal auditor to inventory all of the City's grant programs due to the decentralized responsibilities for administration of grants. The absence of a centralized grant management function can potentially result in the City's failure to comply with the terms of grant awards with respect to financial reporting and compliance requirements.

CITY OF SACRAMENTO

LETTER OF RECOMMENDATIONS

Year ended June 30, 1988

Other

Grant Management

Recommendation: We recommend that City management assign one individual from departments which receive federal, state and local grant awards to be responsible for maintaining a current inventory of all federal, state and local grant awards. In addition, a policy should be adopted requiring all departments to report any changes in the status of grant programs to the designated person on a quarterly basis.

**Management
Response:**

The City's Internal Audit Section is responsible for maintaining a current inventory of capital grant programs receiving federal financial assistance. Applicable City departments have designated personnel to notify the Internal Audit Section of any changes in the status of related grant programs.