CITY OF
HAYWARD
HEART OF THE BAY

DATE: February 16, 2010

TO: Mayor and City Council

FROM: Director of Finance

SUBJECT: Transmittal of the Comprehensive Annual Financial Report for the Year Ended June 30, 2009; and of the "Communication of Internal Control Related Matters" and "Communication with Those Charged with Governance"

RECOMMENDATION

That Council receives transmittal of the City's Comprehensive Annual Financial Report (CAFR) and reads and comments on this report; and reads and comments on the attached "Communication of Internal Control Related Matters" and "Communication with Those Charged with Governance."

DISCUSSION

The City's audit firm has completed its audit of the City's financial records for the fiscal year ended June 30, 2009 (FY 2009). In addition to the audited financial statements, the auditors have completed and provided the required letters entitled Communication of Internal Control Related Matters (Attachment II) and Communication with Those Charged with Governance (Attachment III).

Comprehensive Annual Financial Report

The City's Comprehensive Annual Financial Report (CAFR) (Attachment IV) includes all funds of the City including the General Fund, Redevelopment Agency, water, sewer, airport, and all other funds. Staff is pleased to report that, as in previous years, the auditor's opinion on the financial statements for 2009 is without exception and is unqualified. That is, the auditor's report is not restricted (qualified) in some manner, nor does it take exception to any of the information contained in the City's financial statements. While a qualification or exception is not necessarily detrimental, staff is pleased to report that the City's financial statements continue to earn a "clean opinion."

This Report has been submitted to the Government Finance Officers Association (GFOA) award program, which is a prestigious national award recognizing conformance with the highest standards for preparation of local government financial reports. The City of Hayward has received this award for the last twenty-three consecutive years.

FY 2009 General Fund Financial Results – The FY 2009 budget was presented and adopted in June 2008. The adopted budget presented a balanced budget. During the FY 2009 mid-year review, many actions were taken by Council to maintain a balanced budget including departmental budget cuts, employee furloughs and concessions, and one-time land transfers to make up a $7.5 million projected revenue shortfall. Based on the actual revenues, which came in better than expected in certain areas, such as construction related charges; and expenditures ending approximately $2 million under budget, plus the one time land sale, the actual net effect of year-end income and spending resulted in a $6 million surplus. The majority of the surplus was attributed to the $4 million land transfer and employee services savings. A summary of the General Fund activity for FY 2009 is reflected in Attachment I.

Implementation of New Accounting Principles – During this FY 2009, staff implemented Statement 45 of the Governmental Accounting Standards Board (GASB), related to retiree medical benefits. The accounting rules state that, in our financial statements, cities should measure, recognize, and present information on the value of "other postemployment benefits" (OPEB). At present, most employers pay for retiree health care benefits on a pay-as-you-go basis, covering the costs for current retirees, but putting no money aside to pay for the benefits the city faces in the future. The new standards only say that cities should account for and report their long-term retiree medical benefits, not that they must fund them. However, a funding plan is integral to agencies that determine bond ratings and rate the creditworthiness of governmental organizations. The new rules also state that cities can have up to 30 years to spread out (amortize) these liabilities. The details required by GASB Statement 45 are included in the footnotes to the financial statements, beginning on page 69. The City of Hayward's net other post employment benefit (OPEB) obligation for the year ended June 30, 2009 is $4.4 million. This is the annual unfunded cost of these benefits. The City's funding policy includes the creation of a trust account with California Employers Retiree Benefit Trust, administered by PERS. The City will begin to set aside monies for the OPEB obligation as funding allows.

Communication Letters from Auditors

Auditing standards require auditors to formally communicate with the governing body. The purpose being to establish direct and effective two-way communication with the Council and staff, to convey audit matters, the scope of work, difficulties, adjustments to financial statements, or disagreements with management. The *Communication with Those Charged with Governance* did not report any difficulties in performing the audit or any disagreements with management. The letter does outline two corrections or adjustments to the financial statements that the auditors assisted staff with as noted in Attachment III and summarized below:

- An adjustment was proposed by the auditors to charge a portion of the July 2009 water bill to FY 2009 because it covered overlapping dates in both June and July. Staff agreed to this adjustment.
- An adjustment was proposed to include reimbursable revenue due the City from federal grants rather than recording the revenue when cash was received. Staff agreed to this adjustment.

The second letter presented to management is the *Communication of Internal Control Related Matters.* This letter has two major objectives: (1) to advise the governing body or City Council of any significant deficiencies or material weaknesses in the City's systems of internal financial controls; and (2) to communicate to the Council any opportunities for improved controls or efficiencies that the auditors may have noted during the course of their audit. This letter may also advise the Council of upcoming accounting regulations, which may affect the City's financial records. Staff's responses to the auditor's comments and recommendations are noted in the Letter at Attachment II.

Staff is pleased to report that the auditors did not identify any deficiencies that would be considered a material weakness in the City's system of internal controls. However, the auditors made one comment and recommendation based on assessments made during the audit, which if implemented, they believe would be of benefit to the City. The audit recommendation was to increase timely depositing and reconciliation of the seized cash amounts for the Police Property and Evidence Unit. The Finance and Police Department have implemented new procedures to address these concerns.

Our auditor's stated that the City's internal controls are currently structured to provide assurances that any errors would be detected; however, they could be improved so that errors would be more likely to be prevented with additional Finance Department staff and technology improvements. The City's independent auditors often can provide assistance in meeting internal-control related responsibilities, but their contribution can never be substituted for the direct involvement of management throughout the organization with internal controls.

Staff agrees that there is a need for technology improvements to our financial system, which will improve internal controls, reduce the potential for data entry errors, and reduce processing time. The Finance and Technology Services Departments have been developing strategies to address these needs in the Technology Strategic Plan.

PUBLIC CONTACT

Staff presented the CAFR and Internal Control letters to the Budget and Finance Committee on January 27, 2010.

Prepared by: Debra C. Auker, Director of Finance

Approved by:

Gregory T. Jones, City Manager

Attachments: I. General Fund Overview for FY 2009
II. Communication of Internal Control Related Matters

III. Auditor Communication to Those Charged With Governance
IV. Comprehensive Annual Financial Report (CAFR) located on the city website
http://www.hayward-ca.gov/departments/finance/documents/COH_2009_CAFR.pdf

General Fund Overview For FY 2009

ATTACHMENT I

($ in thousands)

Resources	Revised Budget FY 2009	Actual FY 2009
Property Tax	$40,077	$40,123
Sales Tax	26,600	25,630
Franchise Fees	8,406	8,400
Other Taxes	5,500	5,686
Licenses & Fees	3,230	4,147
Other Revenue	3,854	6,342
Intergovernmental	3,533	4,772
Real Property Tfr Tax	3,300	3,852
Construction Related	2,370	3,393
All Other	2,183	2,521
Subtotal	99,053	104,866
Sale of Land Asset	4,190	4,190
Transfers In	13,508	11,631
Total Resources	$116,751	$120,687
Operating Requirements		
Employee Services	$90,783	$89,660
Maintenance and Utilities	2,287	2,089
Supplies and Services	17,077	16,209
Capital Expense	323	388
Subtotal	110,470	108,346
Transfers Out	6,281	6,286
Total Expenditures	$116,751	$114,632
Excess of Revenues Over (Expenditures)	$0	$6,055
General Fund Balance		
Beginning Fund Balance	26,532	26,532
Ending Fund Balance	$26,532	$32,587
Reserves and Designations:		
Encumbrances		974
Inventory and Prepaid Expenses		13
Advances To Other Funds		9,841
Economic Uncertainty		7,000
Liquidity		3,500
Police Safety		1,000
Retirement Reserve		522
Hotel Conference Center		1,000
Contingency		8,737
Total Fund Balance		$32,587

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The Honorable Mayor and City Council
City of Hayward, California

In planning and performing our audit of the financial statements of the City of Hayward as of and for the year ended June 30, 2009, in accordance with auditing standards generally accepted in the United States of America, we considered the City of Hayward's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

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

Material Weaknesses
None noted

Significant Deficiencies
None noted

Control Deficiencies

(1) Property and Evidence Unit Cash Receipting

A) During our review of cash receipting at the Police Department Property and Evidence Unit, we noted that cash evidence is typically transferred to City Hall for deposit on a less than monthly basis. However, if a large amount of cash is collected, it is sent to City Hall immediately. While the Property and Evidence Unit must legally hold on to cash evidence for a certain period of time, most cash is eligible to be deposited into the City's bank account after 30 days.

(1) Property and Evidence Unit Cash Receipting, (Continued)

B) At June 30, 2009, the Property and Evidence Unit has collected approximately $477,000 of amounts that are categorized as Deposits Payable in the City's financial statements. When the Unit forwards the deposits to City Hall, they do not keep a record of who the money is owed to. Additionally, City Hall does not keep a separate record of who the money is owed to. It is possible that these deposits have been forfeited and are no longer refundable.

Recommendation

A) Ideally, all offsite cash receipting locations should transfer cash receipts to City Hall for deposit at least weekly. However, when cash is held for evidence purposes, the Finance Department should work with the Property and Evidence Unit to set up a regular deposit schedule that meets the Police Department requirements, regardless of the amount of cash collected.

B) We recommend that the City research the details of the deposits payable account to determine who amounts are owed to and whether or not they are still refundable. If amounts have been forfeited, the City should reduce the deposits payable account and record revenue.

Management's Comments

A) The City has recently reorganized the Police Department Property and Evidence Unit. A Property and Evidence Manager has been appointed to the Unit and will be responsible for monitoring all cash transactions. A cash receipts policy requiring monthly deposit of cash receipts, that are not on hold for evidence purposes, to be made to the Finance Department has been implemented.

B) Police and Finance Departments are working together to review all outstanding deposit records and compile a list of deposits payable. Funds indentified to be forfeited will be transferred to the Unit's Purged Evidence account, which may be used for police purposes.

The City's written comments to the issues identified in our audit have not been subjected to the audit procedures applied in the audit of financial statements and, accordingly, we express no opinion on them.

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

Mayer Hoffman McCann P.C.

Irvine, California
December 21, 2009

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The Honorable Mayor and City Council
City of Hayward, California

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the City of Hayward ("City") for the year ended June 30, 2009, and issued our report December 21, 2009. Professional standards require that we provide you with the following information related to our audit.

Our Responsibilities under U.S. Generally Accepted Auditing Standards and OMB Circular A-133

Our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. In planning and performing our audit, we considered the City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with U.S. Office of Management and Budget (OMB) Circular A-133.

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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. Also in accordance with OMB Circular A-133, we examined, on a test basis, evidence about the City's compliance with the types of compliance requirements described in the OMB Circular A-133 Compliance Supplement applicable to its major federal program for the purpose of expressing an opinion on the City's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the City's compliance with those requirements.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our letter dated June 22, 2009.

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. We will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the City are described in Note 1 to the financial statements. As described in note 13 to the financial statements, the City changed its method of accounting for postemployment benefits for the fiscal year ended June 30, 2009. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

Examples of significant judgments and estimates reflected in the City's financial statements include:

- Judgments involving the useful lives and depreciation methodology to use for capital assets, including infrastructure

- Judgments involving collectability of outstanding receivables

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. Material misstatements detected during the audit process included:

- Adjustment to accrue a portion of the July 2009 water bill that covered dates in both June and July. June expenses were estimated to be $625,612.
- Adjustment to record additional receivables on federal grants in the amount of $559,532 to match expenditures incurred during the fiscal year.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We requested certain representations from management that are included in the management representation letter dated December 21, 2009.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

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

Mayer Hoffman McCann P.C.

Irvine, California
December 21, 2009