



CITY OF
HAYWARD
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DATE: January 29, 2008
TO: Mayor and City Council
FROM: Director of Finance and Internal Services
SUBJECT: Comprehensive Annual Financial Report and Memorandum on Internal Control Structure for the Year Ended June 30, 2007.

RECOMMENDATION

That the Council receives transmittal of the City's Comprehensive Annual Financial Report (CAFR); and reads and comments on this report and attached Memorandum on Internal Controls.

BACKGROUND

The City's audit firm has completed its audit of the City's financial records for the fiscal year ended June 30, 2007. Staff has previously provided the City Council a copy of the audited Comprehensive Annual Financial Report (CAFR). In addition to the audited financial statements, the auditors have completed and provided the required Memorandum on Internal Control Structure.

There are two major objectives of the Memorandum on Internal Control Structure. The first is to advise the Council of any significant deficiencies or material weaknesses in the City's systems of internal financial controls. The second is to communicate to the Council any opportunities for improved controls or efficiencies that the auditors may have noted during the course of their audit. The Internal Control Memo may also advise the Council of upcoming accounting regulations, which may affect the City's financial records. A copy of the auditor's Internal Control Memo is attached for your review. Staff's response to the auditor's comments and recommendations is also provided below.

DISCUSSION

Comprehensive Annual Financial Report

The City's Comprehensive Annual Financial Report (CAFR) 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 2007 is without exception or 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-one consecutive years.

FY 2007 General Fund Financial Results - The FY 2007 budget was presented and adopted in June 2006. The adopted budget estimated a \$471,000 surplus, which was revised to a \$1.5 million shortfall at midyear.

Revenues for FY 2007 were estimated at \$105 million, including transfers. However, revenues actually came in at \$109.5 million or \$4.5 million more than the budget. Some of the changes in revenue include:

- A 4% increase in property taxes;
- Receipt of \$1.5 million in reimbursements from the State for animal adoption costs previously incurred by the City;
- A 15% increase in licenses and permits;
- Better than expected results in investment earnings;
- Significant increases in development related services charges; and
- A 19% decrease in real property transfer tax revenue due to the slowing housing market.

Expenditures in FY 2007 were estimated at \$107 million, including transfers and interdepartmental charges. However, the total expenditures actually totaled \$109. The increased expenditures are related to public safety and development related costs. Based on the actual revenues and expenditures the net effect of income and spending resulted in a \$457,000 surplus; approximately the amount originally presented in the adopted budget. This surplus has been allocated to General Fund contingency reserves, as approved by Council.

A summary of the General Fund activity for FY 2007 is reflected in Attachment A.

Memorandum on Internal Control Structure Comments and Staff's Response

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. The auditors made comments and recommendations based on assessments made during the audit, which they believe would be of benefit to the City, if implemented. This memo is provided as Attachment B. Staff's response, which follows, summarizes and discusses each of the auditor's recommendations. In many cases, action was taken to address the audit comments.

Fraud Prevention - While reviewing the City's cash management fraud prevention practices, the auditors noted that the City would benefit by implementing additional fraud prevention security measures, such as Positive Pay. The Positive Pay system would provide assurances that fraudulent or counterfeit checks would not be paid by the City's bank.

The City already includes certain fraud prevention security features on its checks and performs timely, monthly verifications of checks that clear the City's accounts. However, the City previously identified the benefits of implementing the Positive Pay system during recent negotiations with the City's bank and staff has scheduled implementation of this system during the current year.

Person's Authorized to Make Investment Transactions with the Local Agency Investment Fund (LAIF) - While reviewing the City's investment procedures, the auditors noted that two of the City's investment accounts had not been updated, as to the names of the persons authorized to make investment transactions.

Due to the arrival of the City's Director of Finance and Assistant City Manager, the persons authorized to make investment transactions were updated in January and February 2007. However, the approval of transition of these two accounts was not completed until the City Council adopted LAIF approved resolutions. These resolutions were approved on July 10, 2007, therefore this discrepancy has been corrected. Staff does not expect to encounter this delay in the future due to the revised LAIF resolutions and documented procedures for updating authorized persons for all City banking and investing activities.

New Accounting Pronouncement - As part of the Internal Control Memo the auditors noted two new accounting rules effective in the coming years. It is staff's intention to comply with all applicable GASB Pronouncements.

Governmental Accounting Standards Board Statement 45 (GASB 45) will be required for the June 30, 2008 financial statements. GASB 45 requires cities to record retiree health care benefits much like cities already account for pension benefits. Currently, cities record these benefits based on the amount actually paid. GASB is requiring cities to determine their "annual required contribution" or present value of future benefits, which is calculated by an actuarial valuation. Cities will be required to record a liability for any amount in which the "annual required contribution" is greater than the amount actually paid. The actuarial valuation is required every two years. Staff understands the new requirement and is preparing for its impact to the City financial statements. An actuarial valuation to determine the City's liability has already been completed and will be presented to the Council in March 2008. GASB does not require cities to fund these amounts, although many cities may choose to reserve certain amounts to offset these liabilities, which can be significant.

Governmental Accounting Standards Board Statement 48 (GASB 48) will be required for the June 30, 2008 financial statements. The major impact of GASB 48 is the requirement for additional or expanded disclosure of information related to repayment of debt. There are other topics included in GASB 48, which will have negligible impacts on City operations.

Government Accounting Standards Board Statement 49 (GASB 49) will be required for the June 30, 2009 financial statements. GASB 49 requires accounting and financial reporting for pollution remediation obligations; and will require cities to estimate expected outlays for pollution remediation if it knows a site is polluted and certain criteria are met.

FISCAL IMPACT

There is no fiscal impact associated with this report.

PUBLIC CONTACT

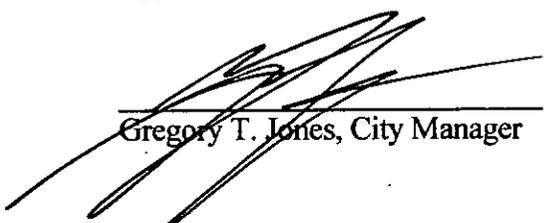
Staff presented the CAFR and Internal Control Memo to the Council Budget and Finance Committee on January 23, 2008.

Recommended by:



Debra C. Auker, Director of Finance and Internal Services

Approved by:


Gregory T. Jones, City Manager

Attachments: General Fund Overview for FY 2007 - Attachment A
Memorandum on Internal Control Structure – Attachment B

General Fund Overview For FY 2007
(\$ in millions)

ATTACHMENT A

Resources	Actual FY 2006	Revised Budget FY 2007	Actual FY 2007
Sales Tax	\$26,686	\$28,933	\$28,858
Property Tax	21,446	23,680	24,688
Vehicle License Fee	12,886	11,002	10,822
Real Property Tfr Tax	9,708	8,755	7,120
Franchise Tax	7,102	6,927	6,972
All Other	22,195	21,016	25,955
Subtotal	<u>100,023</u>	<u>100,313</u>	<u>104,415</u>
Transfers In	4,966	5,084	5,042
Total Resources	<u>\$104,989</u>	<u>\$105,397</u>	<u>\$109,457</u>

Operating Requirements

Employee Services	\$82,627	\$84,542	\$86,305
Maintenance and Utilities	4,613	4,209	4,853
Supplies and Services	10,259	11,351	11,444
Capital Expense	506	801	348
Subtotal	<u>98,005</u>	<u>100,903</u>	<u>102,950</u>
Transfers Out	7,001	6,049	6,050
Total Expenditures	<u>\$105,006</u>	<u>\$106,952</u>	<u>\$109,000</u>
Excess of Revenues Over (Expenditures)	(\$17)	(\$1,555)	\$457

General Fund Balance

Beginning Fund Balance	\$23,085	\$23,068	\$23,068
Ending Fund Balance	<u>23,068</u>	<u>21,513</u>	<u>23,525</u>

Reserves and Designations:

Other Deposit Funds	1,041	1,261	(185)
Encumbrances	925	856	502
Economic Uncertainty	7,000	7,000	7,000
Liquidity	3,500	3,500	3,500
RDA Loan	1,336	1,336	1,336
Police Safety	0	0	1,000
Public Safety Radio System	380	380	0
Hotel Conference Center	1,250	1,250	1,250
Contingency	7,636	5,930	9,122
Total Fund Balance	<u>\$23,068</u>	<u>\$21,513</u>	<u>\$23,525</u>

MAZE & ASSOCIATES

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October 31, 2007

To The City Council of the
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, 2007, 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 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.

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 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.

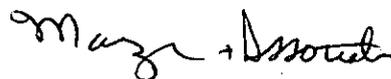
A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

Included in the Schedule of Other Matters are recommendations not meeting the above definitions that we believe to be of potential benefit to the City.

The City's written responses included in this report 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 management, City Council, others within the organization, and agencies and pass-through entities requiring compliance with generally accepted government auditing standards, and is not intended to be and should not be used by anyone other than these specified parties.



CITY OF HAYWARD
MEMORANDUM ON INTERNAL CONTROL STRUCTURE
SCHEDULE OF OTHER MATTERS

2007-01 Implementation of Positive Pay Fraud Prevention Security Features

Although the City includes certain fraud prevention security features on its checks and performs monthly amount verifications through cleared checks download, the City should consider using Positive Pay. The benefit of Positive Pay is that the City electronically sends a listing of all disbursements and key information to its financial institution. The financial institution then would be limited to disbursing funds for only those items submitted in the City listing. We understand the City is currently considering implementing Positive Pay. This additional service, which the City's bank can provide, would simplify the City's bank reconciliation.

Management Response: The City has included positive pay services in the new banking contract with Bank of the West. Finance Department staff, with the assistance of Technology Services, is currently researching what needs to be done in order to utilize these services.

2007-02 Authorized Persons for the Redevelopment Agency and Housing Authority Local Agency Investment Fund Accounts

We noted that as of June 30, 2007, Authorized Persons were updated for the City's Local Agency Investment Fund (LAIF) account but not for the Housing Authority or the Redevelopment Agency. We understand that the City is currently in process of correcting the two accounts. We recommend that the City simultaneously update all applicable cash and investment accounts for signatories and/or authorized persons when appropriate.

Management Response: The City has updated all cash and investment accounts, including the LAIF accounts noted above, with current authorized persons. The City Council approved three resolutions on July 10, 2007 confirming the authorized LAIF account signers.

CITY OF HAYWARD
MEMORANDUM ON INTERNAL CONTROL STRUCTURE
SCHEDULE OF OTHER MATTERS

2007-03 - GASB Statement No. 48 - Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues (effective for Fiscal Year 2007-2008)

This GASB Statement establishes financial reporting for several categories of transactions. We have ordered the topics to those we believe are most relevant to cities and the other topics:

- *Disclosures of Revenue Pledged for Repayment of Debt:* Though this GASB does not appear to impact the recording of debt with pledged revenues, it will expand disclosure requirements. We have italicized what we believe to be the *change* from current disclosures as follows:
 1. Identification of the specific revenue pledged and *the approximate amount of the pledge* [e.g. remaining debt service].
 2. Identification of, and general purpose for, the debt secured by the pledged revenue.
 3. The *term of the commitment* [e.g. remaining term of the debt].
 4. *The relationship of the pledged amount to the total for that specific revenue*, if estimable—that is, the proportion of the specific revenue stream that has been pledged.
 5. *A comparison of the pledged revenues recognized during the period to the principal and interest requirements for the debt directly or indirectly collateralized by those revenues*. For this disclosure, *pledged revenues recognized during the period may be presented net of specified operating expenses, based on the provisions of the pledge agreement*; [e.g. revenue coverage calculation] however, the amounts should not be netted in the financial statements.

There are a variety of other topics included in the statement which will have negligible impacts, if any on the City's operations. These include, intra-entity transfers of assets at carrying value, financing authority revenue recognition, exchanges of specific receivables/revenues for cash, and residual interests and recourse provisions,

Management Response: It is the City's intention to comply with all GASB Pronouncements.

CITY OF HAYWARD
MEMORANDUM ON INTERNAL CONTROL STRUCTURE
SCHEDULE OF OTHER MATTERS

2007-04 - GASB Statement No. 49 - Accounting and Financial Reporting for Pollution Remediation Obligations (Effective for Fiscal Year 2008-2009)

This Statement addresses accounting and financial reporting for pollution remediation obligations (including contamination), which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. This Statement excludes pollution prevention and landfill closure or post-closure costs. A municipality must estimate expected outlays for pollution remediation if it knows a site is polluted and any of the following recognition triggers occur:

- Pollution poses an imminent danger to the public or environment and a government has little or no discretion to avoid fixing the problem.
- A government has violated a pollution prevention-related permit or license.
- A regulator has identified (or evidence indicates it will identify) a government as responsible (or potentially responsible) for cleaning up pollution, or for paying all or some of the cost of the clean up.
- A government is named (or evidence indicates that it will be named) in a lawsuit to compel it to address the pollution.
- A government begins or legally obligates itself to begin cleanup or post-cleanup activities (limited to amounts the government is legally required to complete).

Liabilities and expenses would be estimated using an "expected cash flows" measurement technique, which is used by environmental professionals but will be employed for the first time by governments. Statement 49 also will require governments to disclose information about their pollution obligations associated with clean up efforts in the notes to the financial statements.

Pollution remediation outlays should be capitalized in the government-wide and proprietary fund statements when goods and services are acquired if acquired for any of the following circumstances:

- a. To prepare property for sale. Capitalized costs (including pollution remediation costs) continue to be limited to lower of cost or net realizable value
- b. To prepare property for use when the property was acquired with known or suspected pollution that was expected to be remediated. Governments should capitalize only those pollution remediation outlays expected to be necessary to place the asset into its intended location and condition for use.
- c. To perform pollution remediation that restores a pollution-caused decline in service utility that was recognized as an asset impairment. Governments should capitalize only those pollution remediation outlays expected to be necessary to place the asset into its intended location and condition for use.
- d. To acquire property, plant, and equipment that have a future alternative use. Outlays should be capitalized only to the extent of the estimated service utility that will exist after pollution remediation activities uses have ceased.

For outlays under criteria a and b, capitalization is appropriate only if the outlays take place within a reasonable period prior to the expected sale or following acquisition of the property, respectively, or are delayed, but the delay is beyond the government's control.

Management Response: It is the City's intention to comply with all the GASB Pronouncements.