

The Honorable Mayor and
Members of City Council and
Management of the City of Tustin
Tustin, California

We have audited the financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of Tustin, California, and its blended component units, including the Tustin Community Redevelopment Agency (the City), as of and for the year ended June 30, 2011, which collectively comprise the City's basic financial statements and have issued our report thereon dated December 29, 2011. In planning and performing our audit of the financial statements of the City of Tustin (the City) as of the year ended June 30, 2011, 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 deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain matters involving the internal control and other operational matters that are presented for your consideration. This letter does not affect our report dated December 29, 2011 on the financial statements of the City. Our comments and recommendations are intended to improve the internal control or result in other operating efficiencies. Our comments with our recommendation for improvements are summarized as follows:

Wire Transfer Activities

Auditors' Comment

During our audit, we noted that wire transfers are initiated and approved by the same employee. Also, the bank contacts the same employee for authorization and approval. We recommend that the City implement a procedure whereby the bank confirms wire transfers with another employee within the City.

Management's Response

Management will establish a procedure whereby the bank confirms wire transfers with another employee within the City.

Controls over Receipts not yet Deposited

Auditors' Comment

We noted that checks that are not yet deposited are stored in the vault that is accessible to unauthorized persons during the day. As a result, the checks are vulnerable to loss from burglary, misplacement or misappropriation. We recommend that checks be kept in a locked box or cabinet accessible only to those with proper authorization.

Management's Response

Management will keep checks in a safe accessible only to those with proper authorization.

Purchasing Policy

Auditors' Comment

During our audit, we noted that City does not have a formal purchasing policy. We recommend that City adopts a formal purchasing policy that will give guidance on the following items:

- Employees authorized to approve purchases
- Use of purchase orders
- Limits or threshold on various levels of purchases
- Informal and formal bidding requirements

Management's Response

The City will adopt a formal purchasing policy that will give guidance on the following items:

- Employees authorized to approve purchases
- Use of purchase orders
- Limits or threshold on various levels of purchases
- Informal and formal bidding requirements

Water Utility Billing

Auditors' Comment

During our utility billing testing, we noted 5 instances where City used incorrect water billing rates for customers who downsized their water meters. Per further inquiry, we noted that when the customers' meters were downsized, this information was not communicated to the finance department. Therefore, the utility billing system was not updated accordingly. We recommend that the City establish proper communication procedures between the Finance Department and other departments to ensure that accurate information is timely forwarded to the Finance Department for utility billing and financial reporting purposes.

Management's Response

Management acknowledges that at one time staff did downsize meters at the customer's request and that information was not provided to the billing staff. Both field services staff and utility billing staff were instructed by management that meters are not to be downsized for any reason, therefore, the issues of the incorrect billing rates billed to the wrong meter size should not occur in the future.

Assessment of Internal Controls

Auditors' Comment

The City has a fiduciary responsibility as a steward of public funds. In order to fulfill this responsibility, the City has implemented internal controls that serve as the first line of defense in safeguarding assets. Additionally, these controls are designed to ensure: (1) effective and efficient operations, (2) reliable financial reporting and (3) compliance with applicable laws and regulations. The Committee on Sponsoring Organizations of the Treadway Commission (COSO) has established a nationally recognized framework for internal control in its *Internal Control-Integrated Framework* and its related *Guidance for Smaller Public Companies: Reporting on Internal Controls over Financial Reporting*. The COSO framework establishes five elements of internal control: (1) Control Environment; (2) Risk Assessment; (3) Control Activities; (4) Information and Communication; and (5) Monitoring. Risk Assessment and Monitoring are integral parts of internal control and management should periodically evaluate the risks and monitor the changes facing the City. This process involves evaluating both previously identified risks and potential new risks and providing assurance that (1) controls are designed properly to address significant risks and (2) controls are operating effectively.

The Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) adopted a set of eight Statements on Auditing Standards (SAS No. 104 through 111), which, among other things, require auditors to assess an organization's design of controls and determine whether the controls have been placed in operation for all elements of internal control over financial reporting. If controls do not exist, are poorly designed or not operating effectively, the auditor must evaluate the control deficiency and report the deficiency to management, including whether the control deficiency is a significant deficiency or material weakness.

The City's management has documented some of its internal controls over significant accounting areas (e.g. cash receipts, cash disbursements). The City does not have a formal monitoring plan to ensure procedures are adequate and effective to continually mitigate potential risk to financial reporting.

We recommend the City review its existing internal control assessment process and formalize a comprehensive risk assessment plan, which would include monitoring the adequacy and effectiveness of internal control procedures. This risk should be evaluated at least annually to consider any changes to the City's operating environments.

Management's Response

The City will review its existing internal controls and formalize a comprehensive risk assessment plan. Due to current fiscal issues, lack of funds available to hire outside consultants, and lack of staff, the Finance Department will work on two to three areas within the next fiscal year and continue until it has completed a comprehensive risk assessment plan.

Policies and Procedures

Auditors' Comment

We noted that the City does not have a comprehensive policies and procedures manual for all of the accounting functions of the City.

We recommend the City identify the major transaction streams and processes with the greatest potential risk of fraud or misstatement of the financial statements to begin the process of developing a policies and procedures manual for all accounting functions of the City. This will ensure consistent application of internal controls and City policies.

Management's Response

The City will begin to look at each of the accounting functions and identify the major transaction streams and processes with the greatest potential risk of fraud or misstatement of the financial statements and develop policies and procedures documented in a manual. Due to limited staff this endeavor will be an ongoing project. Dates will be set for expected completion for each accounting area.

Credit Card Policy

Auditors' Comment

We noted that the City does not have a formal credit card policy. The absence of a credit card policy that requires receipts be attached to the monthly billing statements for reconciliation purposes and review of propriety of charges through the approval for payment process, increases the risk of fraud and abuse related to items purchased with a credit card. During our testwork, nothing came to our attention to indicate fraud or abuse existed in credit card transactions.

We recommend the City develop a policy and procedure for City issued credit cards. The procedure should require receipts to be attached to the monthly credit card statements, the statements should be reviewed and approved by appropriate personnel in a timely manner. This will ensure proper authorization of charges on the credit card and reduce the risk of fraud or abuse related to charges on credit cards and ensures timely payment of all credit card payments.

Management's Response

The City will develop a policy and procedure for City issued credit cards.

Indirect Cost Allocation Plan

Auditors' Comment

During our review of interfund charges, we noted expenses from various departments were allocated to various funds based on an informal allocation plan, which may result in the related costs that were allocated to the funds to not be in accordance with relative benefits received. We recommend the City develop, document, and implement policies and procedures to ensure expenses are allocated in accordance with relative benefits received and in accordance with standard accounting practices and 2 CPR Part 225, *Cost Principles for State, Local, and Indian Tribal Governments* (OMB Circular A-87) Attachment A (3) (a), "A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received".

Management's Response

Management will hire a consulting firm to develop, document and implement policies and procedures to ensure expenses are allocated in accordance with relative benefits received and in accordance with standard accounting practices and 2 CPR Part 225, *Cost Principles for State, Local, and Indian Tribal Governments* (OMB Circular A-87).

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

White Nelson Dick Evans LLP

December 29, 2011
Irvine, California