

CITY OF TUSTIN

Single Audit Report

For the Year Ended June 30, 2010



MACIAS GINI & O'CONNELL LLP

CERTIFIED PUBLIC ACCOUNTANTS & MANAGEMENT CONSULTANTS

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To the Honorable City Council
of the City of Tustin, California

Independent Auditor's 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*

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 (City), as of and for the year ended June 30, 2010, which collectively comprise the City's basic financial statements, and have issued our report thereon dated January 24, 2011, except for Note 6 as to which the date is March 1, 2011. We conducted our audit in accordance with 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting 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 described in accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

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 deficiencies described in items 2010-01, 2009-01 and 2009-02 in the accompanying schedule of findings and questioned costs to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's basic financial statements are free of 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*.

We noted certain matters that we reported to management of the City in a separate letter dated March 1, 2011.

The City's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the City's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the City Council, management and others within the City, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Certified Public Accountants
Newport Beach, California

Macias Jini & O'Connell LLP

March 1, 2011

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance 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 a deficiency in internal control over compliance that we consider to be a material weakness.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 10-01 to be a material weakness.

Schedule of Expenditures of Federal Awards

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 as of and for the year ended June 30, 2010, and have issued our report thereon dated January 24, 2011, except for Note 6 as to which the date is March 1, 2011. Our audit was performed for the purpose of forming our opinions on the financial statements that collectively comprise the City's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

The City's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the City's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of the City Council, management and others within the City, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Certified Public Accountants
Newport Beach, California



March 1, 2011

CITY OF TUSTIN
Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2010

Federal Grantor/Pass-through Grantor Program Title	CFDA Number	Program Identification Number	Federal Expenditures
<u>U.S. Department of Housing and Urban Development</u>			
Direct programs:			
Community Development Block Grant Entitlement Cluster			
Community Development Block Grant	14.218	B-03-MC-06-0583	\$ 21,131
Community Development Block Grant	14.218	B-05-MC-06-0583	17,580
Community Development Block Grant	14.218	B-06-MC-06-0583	84
Community Development Block Grant	14.218	B-07-MC-06-0583	14,388
Community Development Block Grant	14.218	B-08-MC-06-0583	52,765
Community Development Block Grant	14.218	B-09-MC-06-0583	352,887
ARRA - Community Development Block Grant ARRA Entitlement Grant	14.253	B-09-MY-06-0583	<u>188,254</u>
Subtotal Community Development Block Grant Entitlement Cluster			<u>647,089</u>
Total U.S. Department of Housing and Urban Development			<u>647,089</u>
<u>U.S. Department of Transportation</u>			
Passed through the State of California:			
Click-It or Ticket Program	20.600	CT09 439	523
Alcohol and Traffic Safety and Drunk Driving Preventive Incentive Grant	20.601	SC09 439	<u>10,179</u>
Total Highway Safety Cluster			<u>10,702</u>
Highway Planning and Construction Grant	20.205	STPL-5271(014)	208
ARRA - Highway Planning and Construction Grant	20.205	ESPL-5271 (020)	<u>813,324</u>
Total Highway Planning and Construction Cluster			<u>813,532</u>
Total U.S. Department of Transportation.			<u>824,234</u>

(Continued)

CITY OF TUSTIN
Schedule of Expenditures of Federal Awards (Continued)
For the Year Ended June 30, 2010

Federal Grantor/Pass-through Grantor Program Title	CFDA Number	Program Identification Number	Federal Expenditures
<u>U.S. Department of Justice</u>			
Passed through the County of Orange:			
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2009-DJ-BX-0033	16,240
ARRA - Edward Byrne Memorial Justice Assistance Grant Program	16.738	2009-SB-B9-0271	<u>65,930</u>
Total U.S. Department of Justice			<u>82,170</u>
<u>U.S. Department of Energy</u>			
Direct program:			
ARRA - Energy Efficiency and Conservation Block Grant Program	81.128	DE-SC0002328	<u>30,000</u>
Total U.S. Department of Energy			<u>30,000</u>
Total Expenditures of Federal Awards			<u><u>\$ 1,583,493</u></u>

See Accompanying Notes to the Schedule of Expenditures of Federal Awards.

CITY OF TUSTIN
Notes to the Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2010

(1) Reporting Entity

The City of Tustin, California, for purposes of the Schedule of Expenditures of Federal Awards includes all funds of the primary government and its blended component units as defined by Governmental Accounting Standards Board Statement No. 14, *The Financial Reporting Entity*.

(2) Basis of Accounting

The Schedule of Expenditures of Federal Awards reports expenditures on the modified accrual basis of accounting. Accordingly, expenditures represent amounts incurred during the fiscal year which meet federal grant eligibility requirements.

CITY OF TUSTIN
Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2010

Section I – Summary of Auditor’s Results

Financial statements:

Type of auditor’s report issued:	Unqualified
Internal control over financial reporting:	
• Material weakness(es) identified?	Yes
• Significant deficiency(ies) identified not considered to be material weaknesses?	None Reported
• Noncompliance material to financial statements noted?	No

Federal Awards:

Internal control over major programs:	
• Material weakness(es) identified?	Yes
• Significant deficiency(ies) identified not considered to be material weaknesses?	None Reported
Type of auditor’s report issued on compliance for major programs:	Unqualified
Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133?	Yes

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
14.218/14.253	CDBG-Entitlement Grants Cluster
20.205	Highway Planning and Construction Cluster

Dollar threshold used to distinguish between Type A and Type B programs:	\$300,000
Auditee qualified as a low-risk auditee?	No

CITY OF TUSTIN
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2010

Section II – Financial Statement Findings

2010-01 Financial Reporting and Year-End Close Procedures

Comment:

During the performance of our audit procedures, we identified the material audit adjustments relating to the following --- accounts receivable, deferred revenue, interest earnings, and revenue. The number of the adjustments resulted from the deficiencies in the City's internal controls over financial reporting and the year-end close process. After the financial statements were issued, management identified a material misstatement related to an overstatement in revenues and accounts receivable resulting in the financial statements originally issued on January 24, 2011 to be reissued on March 1, 2011.

Recommendation:

We recommend that the City develop and document a year-end close process policy that encompasses all facets of financial reporting. We further recommend the City incorporate into the policy the review of year-end account balances and perform reconciliations on account balances prior to completion of the year-end processing and before the commencement of the audit to ensure proper financial reporting.

Management Response:

Management (the Finance Director) was aware of the challenge for closing the June 30, 2010 fiscal year and being prepared for the auditors due to the implementation of new finance software and the vacancy of the Finance Manager position. Management will develop and document a year-end close process policy and in the event that the Finance Manager position is not filled, will hire contract labor to ensure the year-end closing is complete before the commencement of the audit to ensure proper financial reporting.

Section III – Federal Award Findings and Questioned Costs

Finding 10-01: Schedule of Expenditures of Federal Awards – Federal Expenditure Reporting

Criteria:

In accordance with the OMB Circular A-133 , *Audits of States, Local Governments and Non-Profit Organizations*, Subpart C §__.300 (d) and §__.310 (b), auditee responsibilities include identifying in its accounts, all Federal awards received and expended and the Federal programs under which they were received. The auditee shall also prepare a schedule of expenditures of Federal awards identifying as applicable, the CFDA title and number, award number and year, name of the Federal Agency, and name of the pass-through entity.

CITY OF TUSTIN
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2010

Condition:

The SEFA was prepared and provided prior to the recording of all adjustments as the result of our financial statement audit procedures. The numerous adjustments resulted in a financial statement material weakness finding noted in Section II – Financial Statement Findings noted above.

Recommendation:

We recommend that the City develop procedures that encompass all facets of financial reporting. We further recommend that the City record all required adjustments prior to the preparation of the SEFA. The SEFA should be reviewed prior to providing it to the auditors.

Management Response:

Management will develop procedures that encompass all facets of financial reporting and record all required adjustments prior to the preparation of the SEFA and review the SEFA prior to providing it to the auditors

CITY OF TUSTIN
Schedule of Prior Audit Findings
For the Year Ended June 30, 2010

Section I – Status of Prior Year’s Financial Statement Findings

2009-01 Information Technology Policies and Procedures

Comment

We noted the following items as it related to information technology (IT) policy and procedures:

- IT personnel are not prohibited from initiating or authorizing transactions.
- IT personnel are not prohibited from initiating changes to master files and there are no other control procedures to monitor those changes.
- When changes are made to master files, the requesting department is not provided a report demonstrating the changes made.
- Lack of separation of duties between programmers, system administrators, and users.
- Programmers have access to applications in live operation, job control language, and live data files.
- Lack of procedures to prevent testing of new or revised applications on live data files.
- Passwords are not required to be changed at regular intervals.
- Logs are not maintained for administrator activities. With the absence of logs of administrator activities, supervisory personnel are unable to review for unusual entries.
- System administrators are not required to report system failures, restart and recovery, or other unusual incidents to appropriate supervisory personnel for review.
- Access to the Data Center is not limited to IT personnel only, causing a potential breach in physical security over the IT Data Center.

Recommendation

We recommend the City review its existing internal control policy and procedures specifically related to the above enumerated items related to information technology and formalize a comprehensive policy and procedures operation, which would include monitoring the adequacy and effectiveness of the internal control procedures established. This risk should be evaluated at least annually to consider any changes to the City’s operating environments.

Management Response

Management (the Finance Director) is aware of these items regarding IT policy and procedures. An information technology firm was hired to do a more in-depth analysis of the City’s IT infrastructure, network configuration and procedures. When that analysis is complete, recommendations from the items mentioned in this report and the analysis will be implemented unless is it financially prohibitive.

Status of Corrective Action

Partially corrected. The City implemented a policy and procedures to require passwords to be changed at regular intervals. The City also implemented new accounting software during the fiscal year to address the issues noted however this comment is repeated for the June 30, 2010 as many of the items listed above were present during the majority of the fiscal year.

CITY OF TUSTIN
Schedule of Prior Audit Findings (Continued)
For the Year Ended June 30, 2010

2009-02 Capital Asset Records

Comment

We noted that the City had difficulty in preparing the capital asset records during the fiscal year resulting from a lack of information and monitoring of certain ongoing capital improvement projects. The lack of information included whether the improvement projects were owned by the City and the funding source of the capital improvement projects. Several adjusting journal entries were required including a restatement of prior year net assets to properly account for the City's capital assets.

Recommendation

We recommend that the City develop and implement procedures to ensure that all improvement projects are properly identified and monitored to ensure that all of the City's capital related assets are accounted for properly:

Management Response

Management (the Finance Director) was aware of this problem and hired appropriate staff to correct the capital asset records while the audit was being completed. The Finance Department is currently implementing processes to prevent errors and ensure accountability regarding capital asset records.

Status of Corrective Action

Partially Corrected. The June 30, 2010 financial statements required adjustments to beginning net assets for the Governmental Activities and Water Enterprise Fund. These adjustments were detected by management and resulted from different circumstances than ownership and funding. This comment is repeated for the June 30, 2010 audit based on the ongoing research by management to account for capital assets.