



**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***

City Council
City of Beaumont
Beaumont, California

We have audited, in accordance with the 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, the financial statements of the governmental activities, business-type activities, each major fund and the aggregate remaining fund information of the City of Beaumont (City), as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated January 4, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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 of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control 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 2016-1 through 2016-14 in the accompanying schedule of findings and responses to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free from 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 an instance of noncompliance or other matter that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and responses as item 2016-15.

City of Beaumont's Responses to Findings

The City's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. The City's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the City's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Van Lant & Fankhaed, LLP

January 4, 2018

CITY OF BEAUMONT
SCHEDULE OF FINDINGS AND RESPONSES
Year Ended June 30, 2016

2016-1: Policies and Procedures

Findings:

Our audit procedures involved obtaining and evaluating various policies and procedures. During our audit, it became apparent that the City lacked formal policies and guidelines in certain areas, including the following:

- Accounting Policies and Procedures
- Appropriate Level of Unrestricted Fund Balance in the General Fund
- Debt Management Policy
- Fraud Prevention and Detection Policy (Code of Conduct)
- Capital Assets

Although the City may have informal policies in these areas, we believe the City could benefit from a more formal and comprehensive policies and procedures manual, approved by the City Council, which would provide detailed guidance to employees and management. This will help to ensure consistency in these areas, even if there is staff turnover. The following provides more detail regarding these policies and procedures:

Accounting Policies and Procedures

Communication is an essential component of a comprehensive framework of internal controls. One method of communication that is particularly effective for controls over accounting and financial reporting is the formal documentation of accounting policies and procedures. A well-designed and properly maintained system of documenting accounting policies and procedures enhances both accountability and consistency. The resulting documentation can also serve as a useful training tool for staff.

The documentation of accounting policies and procedures should be evaluated annually and updated periodically, as necessary. It should be readily accessible to all applicable employees.

An accounting policies and procedures manual should include a comprehensive list of accounting procedures along with an indication of the employees responsible for completing the procedures. It should delineate the authority and responsibility of all employees, including review and approval procedures. Procedures should be described as they are actually intended to be performed, rather than in some idealized form. The documentation of accounting policies and procedures should explain the design and purpose of control-related procedures to increase employee understanding.

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2016-1: Policies and Procedures - Continued

Appropriate Level of Unrestricted Fund Balance in the General Fund

The City has reported negative unrestricted fund balance in its general fund for several years, including the 2015-16 fiscal year. As of June 30, 2016, the City is reporting a deficit of approximately \$4.3 million. The City's recent audit reports have included language regarding the City's ability to continue as a "going concern." It is essential that governments maintain adequate levels of fund balance to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenditures) and to ensure stable tax rates. In most cases, discussions of fund balance will properly focus on a government's general fund. Nonetheless, financial resources available in other funds should also be considered in assessing the adequacy of unrestricted fund balance in the general fund.

The Government Finance Officers Association has issued a "Best Practice" regarding the appropriate level of unrestricted fund balance in the general fund. Among other things, GFOA states that, "the adequacy of unrestricted fund balance in the general fund should take into account each government's own unique circumstances. For example, governments that may be vulnerable to natural disasters, more dependent on a volatile revenue source, or potentially subject to cuts in state aid and/or federal grants may need to maintain a higher level in the unrestricted fund balance. Articulating these risks in a fund balance policy makes it easier to explain to stakeholders the rationale for a seemingly higher than normal level of fund balance that protects taxpayers and employees from unexpected changes in financial condition. Nevertheless, GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted budgetary fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures. The choice of revenues or expenditures as a basis of comparison may be dictated by what is more predictable in a government's particular circumstances."

While we recognize the City has been taking steps to address the deficits, the City should consider developing and establishing a policy regarding unrestricted fund balance in its general fund.

Debt Management Policy

The City has various outstanding debt issuances. Based on our audit procedures, it appears the City has not established a formal debt management policy. The Government Finance Officers Association (GFOA) has issued a "Recommended Practice" regarding this issue. Specifically, GFOA recommends that all local governments intending to issue debt develop a comprehensive debt policy. Examples of elements that should be addressed in such a policy include:

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2016-1: Policies and Procedures - Continued

- The purpose for which the debt may be issued;
- Legal debt limitations established by policy;
- Types of debt permitted to be issued and criteria for issuance;
- Structural features that may be considered, such as maturity of debt, setting the maturities of the debt equal to or less than the useful life of the project; use of zero coupon bonds, discount bonds, premium bonds, etc.;
- Credit objectives;
- Authorized methods of sale;
- Method of selecting outside finance professionals;
- Policy on refunding debt

A debt policy should be formally adopted by the legislative body, and the debt program should be continuously monitored to ensure compliance with the debt policy. We recommend the City consider establishing a formal debt policy, taking into consideration the recommendations of GFOA.

Code of Conduct (including fraud prevention and detection policies)

The City Council and Management are responsible for designing and implementing systems and procedures for the prevention and detection of fraud, and for ensuring a culture and environment that promotes honesty and ethical behavior. This includes the responsibility to develop and implement a formal fraud risk assessment program.

Fraud can range from minor employee theft and unproductive behavior to misappropriation of assets and fraudulent financial reporting. Although external auditors are required to consider the risk of fraud in the audit process, it should be noted that external auditors are not considered part of the City's controls over the prevention and detection of fraud. Rather, external auditors are required to evaluate the City's fraud prevention and detection program, in relation to the audit of the financial statements.

The risk of fraud can be reduced through a combination of prevention, deterrence, and detection measures. However, fraud can be difficult to detect because it often involves concealment through falsification of documents or collusion among management, employees, or third parties. Therefore, it is important to place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals that they should not commit fraud because of the likelihood of detection and punishment. Moreover, prevention and deterrence measures are much less costly than the time and expense required for fraud detection and investigation.

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2016-1: Policies and Procedures - Continued

During our audit we noted the City has taken steps to address the risk of fraud in certain areas, such as segregation of duties and other internal controls. However, the City should consider developing and expanding its formal fraud policies. For example, the City's current policies do not provide a thorough description of fraud. They also do not provide direction as to what employees should do if they suspect fraud is occurring.

The City should consider establishing a more formal training program for all employees regarding fraud. New employees should be trained at the time of hiring about the entity's code of conduct (and fraud policies). This training should explicitly cover expectations of all employees regarding (1) their duty to communicate certain matters; (2) a list of the types of matters, including actual or suspected fraud, to be communicated along with specific examples; and (3) information on how to communicate those matters. In addition to the training at the time of hiring, employees should receive refresher training periodically thereafter.

As mentioned above, management needs to provide information to employees on how to communicate fraud related matters. Research has shown that most fraud is detected by fellow employees, and not by outside auditors or internal controls. It is important for the City to establish and communicate to employees a reporting system that is appropriate for the City. The City should consider establishing a confidential reporting mechanism, not only for employees, but also for vendors and customers of the City.

Overall, the City should establish a formal fraud risk assessment program, to ensure that the risk of fraud is being periodically evaluated, monitored, and that appropriate action is taken to address the identified risks.

In summary, the City has established controls over fraud in certain areas. However, the City should consider expanding its fraud prevention program as discussed above. The above comments do not address all components of a strong antifraud program. Additional information can be provided regarding this issue.

Capital Assets Policies

As described in the City's financial statements for the current year and prior years, the City has not maintained adequate records for capital asset reporting for governmental activities. In addition, it appears the City lacks formal policies regarding capital assets.

We recommend the City establish formal policies regarding capital assets, including capitalization thresholds, depreciation methods and useful lives estimation guidelines, procedures for periodic inventories of tangible assets, procurement and disposal policies, and guidance regarding planning and funding of the City's future capital needs.

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2016-1: Policies and Procedures - Continued

As described above, the City should establish procedures for periodic inventories of capital assets. It is essential that governments establish and maintain appropriate inventory systems for their tangible capital assets. Such systems are needed to protect tangible capital assets from the danger of loss or misuse.

As described by GFOA, "Many governments have installed "perpetual" inventory systems to maintain effective control over their tangible capital assets. Perpetual inventory systems are constantly updated to reflect additions and deletions of tangible capital assets, thus providing managers with direct access throughout the year to reliable information on current balances in tangible capital asset accounts. One advantage of establishing and maintaining a sound perpetual inventory system for tangible capital assets is that such a system can relieve a government of the burden of performing an annual inventory of its tangible capital assets. Such a system, however, still requires periodic verification to ensure that it is continuing to function properly as designed."

GFOA recommends that every "local government periodically inventory its tangible capital assets so that all such assets are accounted for, at least on a test basis, no less often than once every five years. While well-designed and properly maintained perpetual inventory systems can eliminate the need for an annual inventory of a governments tangible capital assets, no inventory system is so reliable as to eliminate completely the need for a periodic physical inventory."

We recommend the City take the necessary steps to ensure that capital assets and related depreciation are properly and consistently reported, including the establishment of formal policies and procedures in this area.

Recommendation:

We recommend the City develop and establish formal policies and procedures as discussed above. The policies and procedures should be developed by appropriate personnel and approved by the City Council. The City should consider GFOA's recommended practices and other resources during the process.

Management's Response:

Accounting Policies and Procedures –

As part of the Annual Budget for fiscal year 2016-2017, accounting, financial management, investment, fixed asset and capital improvement policies were drafted. On August 1, 2016, these policies were discussed, edits were made, and the Finance and Audit committee recommended approval to the City Council. On September 20, 2016, City Council approved and adopted the final version of policies. More specific Finance Department policies and procedures are being developed with review by the Finance Committee and will be recommended to City Council for

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2016-1: Policies and Procedures - Continued

acceptance in January 2018. Financial policy and procedure manuals will continue to be refined, and existing policies and procedures will be reviewed by the Finance Committee on an annual basis.

Appropriate Level of Unrestricted Fund Balance in General Fund –

The Financial Management Policies outlined a long-term goal of establishing an unassigned ending fund balance of 16% of the General Fund Operating Budget revenues (or two months of operating revenues).

Debt Management Policy –

Currently the City has oversight and administration responsibilities for CFDs. The only secured debt currently maintained by the City is a capital lease agreement for three police department vehicles. Other debt has been recorded in a long-term debt fund and repayment terms have been established for only one of the debt line items. Debt payments, where applicable, have been made timely and no defaults have occurred. A formal Debt Management policy was adopted as part of the Financial Management Policies.

Fraud Prevention and Detection Policy –

A formalized fraud prevention and detection policy is being drafted and will be implemented before the end of fiscal year 2016-2017. The software implementation in December 2016 included automatic approval processes for accounting functions including City Council level approval for threshold amounts of transactions.

Capital Assets –

Fixed Asset Policies and Capital Improvement Policies were adopted by City Council on September 20, 2016. The City recognizes assets on the balance sheet only for the enterprise (business-type) funds at this time. The City had an inventory and valuation of assets performed in May 2017 for pavement and fixtures. Land and structural inventory is currently in process. Management intends to have all assets valued and included on the financial reports of fiscal year 2016-2017.

2016-2: Accounting Records and Financial Reporting

Findings:

The City's Management and City Council are responsible for the preparation and fair presentation of financial statements in accordance with applicable accounting pronouncements. This includes the design and implementation of relevant internal controls to ensure accurate and timely financial reporting. At the start of the 2015-16 audit process, it became apparent that significant analysis and adjustments were yet to be performed for the fiscal year ended June 30, 2016. It appeared various

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2016-2: Accounting Records and Financial Reporting - Continued

accounts in the City's general ledger had not been properly analyzed and adjusted. Throughout the audit process, the City's Finance staff provided us with the necessary analysis and adjustments, as requested. However, much of the analysis, reconciliations and adjustments were completed several months after year-end. As noted in the prior year, much of the accounting work for the 2014-15 fiscal year had to be performed by new Finance personnel who joined the City in 2016. The 2014-15 accounting records were in disarray prior to the current staff, and a significant amount of effort was expended to analyze and adjust these records. This caused delays in the year-end accounting and audit process for both the 2014-15 and 2015-16 financial statements.

For example, the City was still performing analysis in 2017 for the year ended June 30, 2016. Some of the necessary analysis and adjustments were a result of improper accounting and incorrect balances in years prior to the 2015-16 fiscal year (some of which were corrected resulting in prior period adjustments in the City's financial statements). It should also be noted, we identified material audit adjustments based on our audit procedures, which were proposed to management and ultimately posted to the City's accounting records.

This situation may be the result of various factors, including turnover in City management, inadequate oversight by the City's management, and the lack of formal policies and procedures discussed in Finding 2016-1 above. The year-end closing process, including necessary analysis, reconciliations, and adjustments, should normally be completed within a few months after year-end. If accounting records are consistently and accurately maintained throughout each fiscal year, the year-end closing process can be completed in a much more efficient manner. If balances and transactions have not been analyzed and reconciled in a timely manner, it could be an indication that City management is not receiving accurate financial information throughout each fiscal year. In addition, the City may not be able to comply with various reporting requirements in a timely manner (State and Federal deadlines).

Recommendation:

We recommend the City take steps to evaluate the current accounting policies and procedures, and determine what revisions may be necessary to ensure timely and accurate financial reporting. In addition to the formal accounting policies and procedures manual discussed above, we recommend the City prepare a schedule of accounting procedures to be performed each month, quarter, and at year-end, as applicable. The schedule should include a detailed description of the required analysis and adjustments, along with due dates for the various procedures. The schedule should include provisions for sign-off, indicating when the applicable procedures were performed and reviewed as necessary. Applicable City staff should be thoroughly trained and knowledgeable regarding generally accepted accounting principles as they relate to local governments. This will help to ensure accurate, consistent and timely financial reporting.

Management's Response:

Financial policies were adopted on September 20, 2016. The Finance and Audit Committee has been established to assist in the development and documentation of procedures as well as the

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2016-2: Accounting Records and Financial Reporting - Continued

implementation of internal controls. With a new software implementation in December 2016 some procedures are being developed as the software is utilized to provide the most current use and oversight measures. The finance department has created a monthly, quarterly, semi-annual and annual checklist of various functions that are to occur to provide the most current reporting once the new software is fully operational.

2016-3 Segregation of Duties for Cash Receipts – City Hall

Condition:

Customer Service Coordinators (cashiers) at City Hall can edit and void transactions in Incode, the City's cash receipts system, subsequent to the receipt being issued. Also, the Accounting Technician that enters payments into the Great Plains general ledger accounting system does not independently obtain reports from Incode for all cashiers.

Criteria:

In a strong internal control environment, cashiers should not be able to edit or void transactions after a receipt has been issued unless an appropriate audit trail is created and additional review procedures established by individuals outside of the cash collection process.

Cause of Condition:

Restrictive controls over the cashier's functions have not been established and procedures to review an audit trail of voided transactions have not been implemented.

Potential Effect of Condition:

Transactions could be voided by cashiers and amounts collected could be misappropriated without being detected.

Recommendation:

We recommend the City implement procedures for the Accounting Technician to obtain reports directly from the Incode cash receipts program and establish a process to track and monitor the number of voided transactions from various cashiers.

Management's Response:

Cash receipt function was changed to add daily reconciliation and secondary sign off. Software issues are being addressed with an upgrade to the cashiering software that is being scheduled, limiting the ability of void entries by cashiering staff.

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2016-4 Segregation of Duties for Cash Receipts – Police Department

Condition:

Dispatchers at the Police Department can accept payment by check or cash after hours. Manual receipts are being issued to customers upon payment. The copy of the manual receipt and the cash and checks are then provided to the Customer Service Coordinator; however, the Customer Service Coordinator is not keeping track of the numerical sequence of the manual receipts that are being issued.

Criteria:

In a strong internal control environment, manual receipts should be used in very limited situations; and when used, strong controls over the numerical sequence should be established to ensure completeness of the receipts issued.

Potential Effect of Condition:

Receipts and payments could be collected and not properly recorded in the City's general ledger and ultimately deposited into the City's bank account.

Recommendation:

We recommend the City implement procedures for the Customer Service Coordinator to verify the numerical sequence of the manual receipts issued.

Management's Response:

Cash receipt function is being addressed currently, and strict requirements for manual receipts during off hours will be enforced with only one active receipt book.

2016-5 Segregation of Duties for Cash Receipts – Community Pool

Condition:

Cash receipts collected at the pool are entered into a generic cash register. A "z-tape" is printed from the register each day which details the cash entries for the day. On June 15, 2016, we observed the cash receipting and collection process at the City's Pool Facility and noted the cash register tape was out of ink, and therefore, could not print a "z-tape" for reconciliation.

Criteria:

In a strong internal control environment, all cash receipts should be recorded through a point of sale mechanism and a receipt generated to ensure completeness of receipts issued and payments collected.

Cause of Condition:

The register ink ran out and the City did not have any on hand to replace.

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2016-5 Segregation of Duties for Cash Receipts – Community Pool - Continued

Potential Effect of Condition:

With no way to reconcile the cash register, money could be misappropriated.

Recommendation:

We recommend the City maintain an appropriate level of inventory for the register tape ink to ensure proper reconciliation can be performed on a daily basis.

Management's Response:

Cash receipt function is only in place for a few months in the summer, when the pool is open. Adopting policies that ensure adequate supplies and oversight are always in place to maintain proper supervision and accountability of the pool staff and receipts. The cash register is currently in good working order, and is able to generate the register "z-tape". Additional ink ribbons and paper roll supplies are maintained onsite to avoid any loss of data or reporting.

2016-6 Segregation of Duties for Business Licenses

Condition:

The permit technician accepts payments for business licenses and has the ability to issue and distribute business licenses. There is no independent reconciliation of the business licenses issued from the HdL system with the amounts collected and posted in the Incode cash receipts system.

Criteria:

In a strong internal control environment, the same individual should not have access to the payments from customers and the ability to issue business licenses unless an appropriate mitigating control has been implemented.

Potential Effect of Condition:

Business licenses could be issued without a corresponding cash receipt being recorded in the City's general ledger and ultimately deposited into the City's bank account.

Recommendation:

We recommend the City implement a procedure to generate reports from the HdL business license program, periodically (daily, weekly, monthly), and have someone independent of the business license issuance and collection functions review and reconcile the amounts from these reports to the revenues posted in the City's general ledger.

Management's Response:

Business license system is being integrated with the software upgrade currently in progress. Once full implementation has been completed, an internal audit step will be developed for the finance department to ensure that all business license receipts are being properly recorded.

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2016-7 Segregation of Duties for Building Permits

Condition:

The permit technician in the Community Development Department issues building permits and plan checks and collects the payments from customers. There is no reconciliation of the building permits and plan checks issued with the amounts collected and receipted in the City's general ledger.

Criteria:

In a strong internal control environment, the same individual should not have access to the payments from customers and the ability to issue building permits unless an appropriate mitigating control has been implemented.

Potential Effect of Condition:

Building permits and plan checks could be issued without a corresponding cash receipt being recorded in the City's general ledger and ultimately deposited into the City's bank account.

Recommendation:

We recommend the City implement a procedure to generate reports from the Salesforce permit system, periodically (daily, weekly, monthly), and have someone independent of the permit issuance and collection functions review and reconcile the amounts from these reports to the revenues posted in the City's general ledger.

Management's Response:

Building permit system is being integrated with the software upgrade currently in progress. Once full implementation has been completed, an internal audit step will be developed for the finance department to ensure that all building permit receipts are being properly recorded.

2016-8 Segregation of Duties for Bus Passes

Condition:

The same City staff issuing bus passes are also responsible for collecting and receipting payments from customers into the City's cash receipts system. Also, there does not seem to be any sort of inventory control over the bus passes or any way to reconcile bus passes sold to corresponding receipts.

Criteria:

In a strong internal control environment, the same individual should not have access to the payments from customers and the ability to issue bus passes unless an appropriate mitigating control has been implemented.

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2016-8 Segregation of Duties for Bus Passes - Continued

Potential Effect of Condition:

Bus passes could be issued without a corresponding cash receipt being recorded in the City's general ledger and ultimately deposited into the City's bank account.

Recommendation:

We recommend the City implement a procedure to control the inventory of the bus passes, such as numerical sequence control, in order to reconcile the number of bus passes sold and the amounts recorded as revenue and posted in the City's general ledger.

Management's Response:

Inventory of bus passes and accountability for bus pass sales is being reviewed currently between the finance office and transit office. Prenumbered books are obtained for RTA transit passes and the Transit department is now tracking those books to determine that all revenues have been recorded. City Transit passes are color coded on a monthly basis with a specific stamp identifier which also changes each month. A tracking system is being developed to ensure that all revenues are properly captured and recorded, and that there is accountability for all of the passes.

2016-9 Transient Occupancy Tax (TOT) and Utility User's Tax (UUT)

Condition:

Although Finance staff are maintaining a spreadsheet for tracking TOT payments each fiscal year, there does not appear to be anyone checking the TOT returns for accuracy, or keeping track of delinquencies. It also does not appear that the City is requiring the hotels to submit supporting documentation for exemptions. In addition, there have been no recent audits of the hotels. The Finance staff prepared a spreadsheet for tracking UUT payments for 2014-15, but apparently stopped tracking this revenue for amounts received after June 30, 2015.

Criteria:

Because the UUT and TOT revenues are significant to the City, strong internal controls should be established and procedures developed to track these revenues closely each month/quarter, including investigating any unusual fluctuations and delinquencies, and possibly perform periodic audits to ensure the hotels and utility companies are properly reporting and submitting the required taxes.

Cause of Condition:

Turnover and lack of City staff; lack of accounting policies and procedures.

Potential Effect of Condition:

Hotels and utility companies could be underreporting these taxes with no consequences, resulting in lower revenues to the City.

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2016-9 Transient Occupancy Tax (TOT) and Utility User's Tax (UUT) - Continued

Recommendation:

We recommend the City establish stronger controls and oversight for these revenues and possibly schedule "audits" of the hotels and/or utility companies.

Management's Response:

The current revenue percentages are in accordance with the City Ordinances. Currently TOT and UUT tables are maintained recording the source, amount, and reporting period to aid in the monitoring process. An internal audit function is a future consideration based on priorities and staff availability. If an internal audit function is not available or sufficient, contracting with an external consultant can be considered if the potential recovery of revenues were greater than the cost of the consultant.

2016-10 Development Impact Fees (DIF)

Condition:

The City uses a manual system for issuing DIF invoices. Also, it appears that one individual is responsible for calculating the DIF (manual calculation) and applying applicable fee credits, if any, with little or no oversight. In addition, the various DIF are restricted for certain purposes; however, the City has recorded all of these revenues in one fund over the years (comingled), without keeping track of the expenditures and remaining unspent balances of each type of DIF. It appears the former finance director maintained Excel spreadsheets (separate from the accounting records) each year, and would then force the DIF fund balance to match his spreadsheet.

Criteria:

Strong internal controls should be established over the billing and collection functions for all significant revenues, to ensure the appropriate fees are being assessed, collected, deposited, and recorded in the City's accounting records.

Cause of Condition:

Lack of policies and procedures and oversight by top management in this area.

Potential Effect of Condition:

The opportunity for DIF revenues to be misstated due to error or fraud.

Recommendation:

The City should establish formal policies regarding the billing and collection of DIF, to ensure the billing of the DIF is subject to oversight and review, and that the City Council's approved fees are being accurately and consistently assessed, collected and recorded. The City should consider replacing the current manual system with a more automated system, in which fees cannot be billed and collected without Finance's knowledge. The calculation of the DIF and application of fee credits should be subjected to independent analysis and oversight.

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2016-10 Development Impact Fees (DIF) - Continued

Management's Response:

Development impact fees (DIF) have been reconciled by type in order to establish balances at June 30, 2016. The new accounting software establishes a separate accounting fund for each DIF fee. The gross, fee credit, and net cash receipt are now tracked manually and recorded into the software. Continued reconciliation is performed to identify all fee credit agreements and trace them to the accounting records. The permit and fees process will be integrated into the accounting software during fiscal year 2017-2018. Once full implementation has been completed, manual tracking can be replaced with an internal audit step for the finance department to ensure that all DIF receipts are being properly recorded and tracked.

2016-11 Lack of Competitive Bidding for Vendor Contracts and Purchases

Condition:

Through review of a sample of disbursements made throughout the fiscal year, we found the City did not maintain evidence or document that a competitive bidding and procurement process was followed when entering into contracts for various services and purchases. Also, the City lacked detailed guidance in the form of policies and procedures for the procurement of professional services.

Criteria:

Title 3, Chapter 3.00, Section 010, of the City's Municipal Code, states, "In order to establish efficient procedures for the purchase of supplies and equipment at the lowest possible cost and to assure the quality of purchases, a purchasing system is hereby adopted." Furthermore, Section 040, requires "Purchasing supplies, equipment and personal property shall be by competitive negotiation...". Competitive procurement of goods and services is a necessary procedure to ensure a government agency is receiving the best possible service at the best price. Management and those charged with governance have an obligation to the citizens and taxpayers of the City to safeguard the tax money it receives in order to provide the best service possible to its citizens. In a City in significant financial distress, this process is vital to avoid overspending the City's scarce financial resources.

Cause of Condition:

Lack of strong policies and procedures for competitive procedures to follow for the procurement of professional services and a lack of oversight by top management and City Council.

Potential Effect of Condition:

Without following a competitive procurement process, City staff could hire vendors that are not the most qualified and at prices that are above what could be charged if competitively bid. Controls over the City's assets are significantly reduced without strong controls over the procurement process.

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2016-11 Lack of Competitive Bidding for Vendor Contracts and Purchases - Continued

Recommendation:

It should be noted, current City staff, management, and City Council have implemented purchasing policies and procedures and updated the City's Municipal Code to provide for greater transparency and detailed guidance over the purchasing function during the fiscal year ended June 30, 2016. In July 2015, the City adopted Ordinance 1060 which provides detailed guidance regarding the procedures to be followed when procuring professional services. Our recommendation is to continue to monitor the purchasing policies and procedures to ensure they are properly implemented and used throughout the City for all major contracts and purchases.

Management's Response:

Competitive bidding for vendor contracts and purchases has already been added to the City Ordinances and City staff has followed the process since July 2015. Additional refinement of the Ordinances has been submitted to and approved by City Council on November 21, 2017.

2016-12 Lack of Controls Over Payroll

Condition:

One Accounting Technician is responsible for administering all payroll related information on the Paychex payroll website, including updating employee pay rates, vacation accruals, direct deposit information, and setting up new employees. Although the Accounting Technician provides a copy of the payroll register to the Finance Manager, the register is provided by the Accounting Technician and not obtained independently by the Finance Manager. In addition, the payroll register provided is the preliminary register. Also, all changes made by the Accounting Technician to the Paychex information (payroll database) are included in a report provided by the Accounting Technician and given directly to the Finance Manager; however, this report is not obtained from the Paychex system directly by the Finance Manager. Also, the physical payroll checks printed by Paychex are received directly by the Accounting Technician.

Criteria:

In a strong internal control environment, the individual responsible for reviewing the payroll register should obtain the information directly from the payroll system, compare preliminary payroll register with the final register, and independently generate reports each pay period that include all changes made to the payroll database since the previous pay period, verifying changes with applicable supporting documentation. Also, the physical payroll checks should not be in the possession of the accounting technician responsible for administering the payroll system.

Cause of Condition:

Lack of segregation of duties over payroll processing and payroll database.

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2016-12 Lack of Controls Over Payroll - Continued

Potential Effect of Condition:

Unauthorized changes could be made to the payroll database and errors in the payroll function could go undetected without sufficient review and oversight by City staff independent of payroll processing. Payroll errors could cause significant financial effects on the City's financial statements.

Recommendation:

Procedures should be implemented to ensure sufficient oversight and review by someone independent of the payroll function. We recommend the individual responsible for review and oversight of the payroll function obtain payroll reports directly from the payroll system, compare preliminary and final payroll reports, generate an audit trail report each pay period and reconcile all changes made to applicable supporting documentation. In addition, we recommend physical payroll checks be held and distributed by an individual outside of the payroll processing function.

Management's Response:

Payroll has several levels of approval and oversight prior to the submission of data to the third-party preparer. Hours are approved through the software by applicable Directors or Managers, which then releases that data to the payroll preparer. For staff not utilizing the hourly software, reports are provided to the payroll preparer that contain the appropriate approvals and other documentation. Any changes to status or other adjustments are documented with the approval of the Director of Administration. Additional procedures for review and approval after the checks and reports are received from the third-party preparer have been implemented.

2016-13 Lack of Controls Over Accrued Vacation

Condition:

The Paychex payroll database tracks the vacation accruals for employees through automatic accruals each pay period for each employee. The City has established, through Memorandums of Understanding (MOUs) with various employee unions, caps on the number of hours that can be accrued by employees. However, there does not appear to be any monitoring of the vacation hours to ensure the payroll system does not continue to accrue vacation hours once the cap has been reached.

Criteria:

The City's MOU's states the maximum vacation accrual shall not exceed the equivalent of the accrual earned for a 2-year period.

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2016-13 Lack of Controls Over Accrued Vacation - Continued

Cause of Condition:

The payroll system does not have a control in place to cap accrual hours once they have exceeded the maximum per the MOUs and no other monitoring by City staff to verify accrued hours are in accordance with the MOUs.

Potential Effect of Condition:

The liability for accrued vacation could be misstated, City employees could use more vacation hours than allowable by the MOUs, and payouts to employees upon retirement could be higher than allowable by the MOUs.

Recommendation:

We recommend the City review the payroll system to determine if a cap control system could be implemented to prevent vacation hours from continuing to accrue once the maximum hours per the MOUs have been reached. In addition, periodically, the City should monitor the vacation accruals to ensure all vacation hours accruing are within the applicable MOU.

Management's Response:

Accrued vacation and accrued sick are negotiated and administered differently from each other. Additionally, sick leave is negotiated and administered differently between the MOUs. Controls and stronger oversight have been implemented, along with goals for future MOU negotiations to align the various contract details.

2016-14 Lack of Oversight for Fuel Credit Card Activity

Condition:

Each City vehicle has a fuel credit card inside the vehicle. Based on our review, the City has not established formal policies over the use of the fuel credit cards. In addition, there is no formal analysis of the fuel credit card use, on a periodic basis, to determine if the fuel costs are reasonable based on known operations of the vehicles.

Criteria:

In a strong internal control environment, policies should be established to provide detailed guidance on the allowable use of the City's fuel credit cards. In addition, effective monitoring and oversight should be established to ensure the fuel charges on the credit cards are reasonable.

Cause of Condition:

Lack of oversight by management and formal policies in this area.

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SCHEDULE OF FINDINGS AND RESPONSES
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2016-14 Lack of Oversight for Fuel Credit Card Activity - Continued

Recommendation:

We recommend the City adopt formal policies providing detailed guidance on the allowable uses of the City's fuel credit cards. In addition, we recommend the City implement procedures to monitor the fuel activity, periodically, to analyze the use of the fuel credit cards. Also, City staff should be made aware of the monitoring and analysis of the fuel usage as an additional deterrent for misuse of the City fuel credit cards.

Management's Response:

Formal policies related to the use of fuel credit cards were drafted for discussion with the Finance and Audit committee on November 6, 2016. The Finance department worked with other departments to implement the policies for use of the fuel cards. Finance department is working with fuel vendors to limit administrative account access and improve monthly reporting.

2016-15 Overhead Cost Allocation

Condition:

The City allocates certain General Fund costs (administration, maintenance, etc.) to the Sewer Enterprise, Gas Tax, Transit Enterprise, and the Community Facilities District (CFD) Fund. The amounts are based on calculations included in schedules maintained by the Finance Department.

Criteria:

Cost allocation plan methodologies should be thoroughly documented for transparency purposes, and updates to the plans should be done periodically in accordance with best practices.

Potential Effect of Condition:

The City could potentially be utilizing allocation methods which result in either less administrative costs or excessive administrative costs being allocated than would be allowable if detailed cost allocation studies were performed on a periodic basis, and in accordance with federal grant requirements. Currently the City is not allocating any indirect costs to federal (or state) grants.

Recommendation:

We recommend the City perform a full cost allocation study of administrative costs to ensure the detailed methodology for the allocation of administrative costs is reasonable and appropriate, based on the current circumstances, and that the methodology is clearly defined and documented.

Management's Response:

An overhead cost allocation review is currently underway. The results of the review will be used to identify any potential impact to the various funds.