



Town of Atherton

CITY COUNCIL STAFF REPORT

**TO: THE HONORABLE MAYOR AND MEMBERS OF
THE CITY COUNCIL**

FROM: AUDIT COMMITTEE

DATE: NOVEMBER 15, 2000

**SUBJECT: AUDIT COMMITTEE'S REPORT TO THE CITY COUNCIL ON
THE FY 1999/2000 AUDIT**

INTRODUCTION

On May 17, 2000, the City Council approved the formation of the Audit Committee. Among its responsibilities and duties were the presentations of both verbal and written reports to the City Council at the same meeting in which the Auditors present their Final Audit to the City Council. This Report is to cover the audit process, recommendations on how the audit process could be improved in the following year, and how the Town might improve its financial operations to comply with the Auditor's recommendations.

The following are the recommendations of the Audit Committee:

1. Approve the utilization of the Town's outside auditors, Caporicci, Cropper & Larson, LLP, to perform two additional one-day follow-up reviews during the current fiscal year.
2. Contract with a third party consultant to assist in recording the Town's fixed assets in the General Ledger and installing an asset tracking system.
3. Approve the Audited Financial Statements for the fiscal year ended June 30, 2000, as audited by Caporicci, Cropper & Larson, LLP.

4. Formalize the Council's operational oversight role in reviewing monthly expenditures, and quarterly reviewing actual revenues and expenses against budget.

Since May, the Committee has met a total of five times. Three of the meetings were with representatives of the Town's outside auditing firm, Caporicci, Cropper & Larson, LLP. During the first meeting, the Auditors discussed their proposed Scope of the Audit with the Committee. The audit was to focus on reviewing the Town's annual financial records and statements using generally accepted auditing standards and Government Auditing Standards. The audit would also include a review of the Town's internal financial controls. The number of transactions that they would review would be determined by their findings related to internal controls. It was noted the audit would be a financial audit as contrasted to an operational audit, such as the C.G. Uhlenberg audit earlier in the year.

During the second meeting, the Auditors indicated that due to the small size of the financial staff, the Town had not been able to implement internal controls to the extent the Auditors needed, and they would be expanding the scope of their audit. The Auditors typically encounter this problem in organizations with small Finance Departments. This resulted in the Auditors expanding the number of transactions they reviewed, and going into more depth in looking at the financial processes. The Committee felt it benefited from the expanded review and the resulting observations, suggestions, and Management Letter comments. The Committee also felt that they have a good foundation to work from in going forward with its oversight role.

The Committee spent time alone with the Auditors, without staff members present, to ask further questions regarding the Auditors' findings. The Auditors' primary concern was how the small staff didn't allow the department to stay current with reconciling accounts and adequately segregating duties in the transaction systems.

At the third meeting, the Auditors presented a draft of the Town's financial statements, which were discussed in detail. In their draft of the Management Letter, the Auditors stated they would be qualifying their audit opinion, as in the past, since they could not verify the value of fixed assets. Cities have not been legally required to record fixed assets, and many smaller towns elect not to inventory, value and track fixed assets. The Town can expect to receive future qualified opinions on its audited financial statements until it elects to record these assets.

ANALYSIS OF THE MANAGEMENT LETTER RECOMMENDATIONS

YEAR-END CLOSING: When the Auditors arrived, the staff had not completed all of its preparations for the audit, and the Auditors were required to spend more time than planned to complete their audit. The Town staff felt they were overly optimistic when they set an aggressive schedule for the close of the year's books. Having to do all the account reconciliations at year-end, was a major contributor to the longer closing cycle.

Systematic reconciling of accounts during the year requires having adequate people resources, and an organizational discipline and structure in the process. The hiring of an additional accountant should provide the people resources required to accomplish putting this process in place.

BANK ACCOUNT RECONCILIATION: Monthly reconciliation of bank accounts is essential, and is part of the increased discipline that needs to be in place. The Committee feels this must be a priority for the staff, and may require hiring an outside person on a part-time basis. The reconciliation process for other accounts must be implemented when the additional accountant is hired, but reconciling bank accounts needs to be undertaken each month. The Committee will recommend that the Auditors be brought back for an additional two days to do follow-up work on the past audit, including verifying that bank accounts are being reconciled accurately each month.

SEGREGATION OF DUTIES: The addition of the accountant will make it easier for tasks to be divided between staff members to adequately segregate duties. The Committee understands the Town's staff has already made certain that the person signing checks is no longer the same person entering transactions into the system. During their audit, the Auditors found no improprieties resulting from duties not being segregated.

FIXED ASSETS: Because the Town's fixed assets are not recorded in the General Ledger, the outside Auditors "qualified" their opinion on the financial statements, as was the case in past years. Changes in legal requirements will compel cities and towns to inventory and value their fixed assets in the future, although the Town, because of its smaller size, will have a longer period to comply. However, the Town can expect to continue to receive a "qualified" opinion.

CONCLUSIONS BY THE COMMITTEE

1. The Committee recommends that the Council contract with the Town's auditors to perform two additional one-day audits during this fiscal year. The additional cost to will be \$1,000 to \$2,000. The details for the reviews should be worked out among the Town staff, the Audit Committee and the outside auditors. It is felt that this follow-up on the Audit Letter comments will keep the staff focused on becoming more disciplined in its processes. The goal is to make certain that the comments in this year's management letter will not have to be repeated in next year's Audit Letter.
2. The Committee recommends the Council approve funding the hiring of an outside third-party to undertake an inventory of the Town's fixed assets and implement a fixed asset tracking system. The cost is estimated to be \$15,000 to \$20,000. The Committee sees the following benefits:
 - a. The Town's Auditors would not have to qualify their opinion on the financial statements, which is more acceptable to outside parties that may use these statements.
 - b. It is anticipated that the Town will eventually be legally required to include fixed assets on the balance sheet.
 - c. Tighter financial control over fixed assets represents another tangible step towards demonstrating commitment to good stewardship and maintaining good internal financial controls.

3. The Committee has reviewed the Town's General Purpose Financial Statements for the Year Ending June 30, 2000, and recommends their acceptance by the Council.
4. While the Audit Committee's charter is focused on financial operations, the Committee recommends to the Council that more formalized procedures be established in reviewing expenditures and undertaking quarterly reviews of actual revenues and expenses compared to budget. These quarterly reviews will augment the Mid-year Budget Review that is a regular part of the City Council's review process of the budget each year. The Committee feels that these additional reviews would enhance the overall control environment for the Town. Although the Finance Committee does not appear to have a formal charter, the Council may wish to formally have it come up with specific procedures to recommend to the whole Council.
5. A subcommittee consisting of Ronald Fick and Robert O'Donnell looked into the San Mateo County Investment Pool in which a substantial portion of the Town's funds is invested. Their conclusion was that this investment pool is a reasonable and conservative investment vehicle. Although the Town had a small loss in principal this past year due to rising interest rates, the total return of the pool remained positive. A smaller portion of the Town's funds is invested in the State's Local Agency Investment Fund (LAIF) which has not yet been reviewed by the subcommittee.
6. The Committee notes the Interim City Manager and staff have adopted several changes in procedures to improve the internal control process. The Committee will expect to see continued progress towards achieving a more "disciplined" approach to maintaining the financial records, including systematic reconciliation of balance sheet accounts. The Committee would like to see management achieve the goal of having a level of internal controls in place that the auditors can rely upon for next fiscal audit. The Interim City Manager plans to address all the issues contained in the Management Letter, by December 31, 2000.
7. The Committee agrees that the additional staff accounting person is essential in instituting and maintaining the level of professional execution a more "disciplined" process demands. It is the Committee's expectation that the new salary range and job description should make the position more attractive to potential candidates.
8. The Committee compliments the outside auditing firm of Caporicci, Cropper & Larson, LLP on its conduct of the audit, and particularly on its open communication with the Audit Committee. Audit Partner Steve Larson provided the Committee with important insight and advice in answering many questions from Committee members. Likewise, the Committee appreciates the cooperation it received from the Interim City Manager and the Interim Finance Manager in all matters.
9. The Audit Committee plans to continue to monitor the progress on all the issues that were raised above. Members of the Audit Committee appreciate being part of the process to help restore the feeling of financial integrity in Town government, and helping to rebuild

a measure of “trust” with the Town’s citizens. Once adequate control processes are in place and an acceptable level of financial integrity within the accounting system has been achieved, the Committee anticipates it will meet at least once a quarter. However, the Committee is available to address other issues if directed by the City Council.

RESPECTFULLY, SUBMITTED BY THE AUDIT COMMITTEE

s/Ronald G. Fick
Ronald G. Fick

s/Robert L. Jenkins
Robert L. Jenkins

s/Arlan H. Kertz
Arlan H. Kertz

s/Robert G. O’Donnell
Robert G. O’Donnell

s/Alan B. Carlson
Alan B. Carlson

s/Dianne M. Fisher
Dianne M. Fischer

s/Jerome W. Carlson
Jerome W. Carlson
Chairman

Reviewed/Approved by:

Ralph Freedman
Interim City Manager

ATTACHMENT 1

RESPONSIBILITIES AND DUTIES OF AUDIT COMMITTEE*

THE GENERAL PURPOSE OF THE AUDIT COMMITTEE

1. Establish formal oversight of the annual audit.
2. Provide the auditors with those issues of concern and importance to the Town of Atherton on a yearly basis prior to the commencement of the Audit.
3. Meet with the auditors to discuss the Draft Audit Report, and give feedback to them.
4. Present a verbal and written report to the City Council on the audit process, recommendations on how the audit process could be improved in the following year and how the Town might improve its financial operations to comply with the Auditor's recommendations.
5. Meet throughout the year with staff to discuss financial processes of the Town and to monitor the implementation of recommendations of the Auditors and the Audit Committee.
6. In the future, make recommendations to the City Council on the selection of a new auditor and those areas that need to be examined by the auditor in the annual audit.

TO MEET THE ABOVE RESPONSIBILITIES, THE AUDIT COMMITTEE SHOULD BE PREPARED TO DO THE FOLLOWING:

1. Discuss with the Town's auditors their qualitative judgments about the appropriateness, not just acceptability, of accounting principles and financial disclosures used or proposed to be used in the audit. In addition, the degree of conservatism or aggressiveness that they intend to employ in their accounting principles.
2. Discuss with the Town's auditors whether management accounting principles are consistent with those principles of other public organizations.
3. Discuss with the Town's auditors whether the disclosure practices of the Town need to be modified or are they reasonable in the auditor's opinion?
4. Be a part of the selection process of a new Finance Director by the City Manager. The City Manager should seek the advice and counsel of the Audit Committee prior to formalizing a selection of a new Finance Director.
5. After the preparation of the Draft Report, the Audit Committee will meet with the auditors to discuss their findings, and give feedback to the auditors on the process and the audit document. The Audit Committee should then prepare a written report that summarizes the audit process, and makes recommendations on how the Town might improve its financial operations to comply with the Auditor's recommendations. This Report should be presented to the Council at the same meeting in which the Auditors present their Final Audit to the City Council.

*Adopted by City Council May 17, 2000.