

CITY COUNCIL MEETING

February 18, 1981

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AUDIT

The City Clerk presented a reply which had been received regarding the Council's inquiry addressed to David T. Christensen of Ernst and Whinney regarding the delay in receiving the F.Y. 1979-80 Audit. Council was also apprised that the Management Letter for this Audit had just been received and it was presented to Council for review. At the direction of Mayor Katnich, the City Clerk was asked to agenda this item for the February 24, 1981 Informal Informational Meeting of the Council.

# Ernst & Whinney

555 Capitol Mall, Suite 650  
Sacramento, California 95814

February 5, 1981

916/447-3237

Ms. Alice M. Reinche, City Clerk  
City of Lodi  
221 West Pine Street  
Lodi, California 95240

Dear Alice:

Thank you very much for your letter of January 28, 1981. In response to your first question regarding the report date of October 27, 1980, and your receipt of the actual report on January 7, 1981, the delay was due primarily to questions raised in correspondence with your attorney. Briefly, in connection with an annual audit we inquire of your internal and external attorneys regarding asserted and unasserted claims and the potential outcome thereof. The purpose of the inquiry is to determine whether or not all appropriate accruals and necessary disclosures have been made in your annual financial statements. Several of the responses from the attorneys indicated the possibility of significant contingent liabilities. Therefore, rather than issuing our report with a "qualified" opinion, we thought it was in the best interest of the City to work toward resolving the issues or obtaining more refined estimates of the probable losses and consequently issue an "unqualified" opinion. Final input from the various attorneys was received in our office on December 17, 1980, at which time we completed our second-partner review procedures, etc., as quickly as possible.

With respect to the management letter, all management letter-type items have been previously discussed with representatives of the City in the course of our examination. Also, we have recently formalized these comments and forwarded a discussion draft for Fred Wilson's review prior to final issuance.

Please feel free to call us if we can provide any further input or help. Also, should the Council wish to meet with us, we would be available at its convenience. Again, thank you for your letter and if we can provide any further assistance, please do not hesitate to call.

Very truly yours,



David T. Christensen  
Partner

DTC:smh

cc: Mr. Henry A. Glaves, Jr.  
Mr. Jerry Glenn  
Mr. Fred Wilson

E&M

# Ernst & Whinney

555 Capitol Mall, Suite 650  
Sacramento, California 95814

916/447-3237

City Council  
City of Lodi  
Lodi, California

Our examination of the financial statements of the City of Lodi for the year ended June 30, 1980, included a review of the system of internal controls and accounting procedures. We would like to take this opportunity to bring to your attention certain items which we feel merit specific consideration.

Our comments and recommendations are submitted as constructive suggestions to assist in strengthening controls and procedures; they are not intended to reflect on the honesty or integrity of any employee. The recommendations, of course, do not include all possible improvements which a more extended special examination might develop, but only those important areas of potential improvement which came to our attention during our examination of the financial statements.

All of these recommendations have been discussed with appropriate management personnel. We appreciate the opportunity to present these comments and recommendations for your consideration, and are prepared to discuss them further at your convenience.

Very truly yours,

*Ernst & Whinney*

Sacramento, California  
February 3, 1981

## NATIONAL COUNCIL ON GOVERNMENTAL ACCOUNTING

In meeting current needs, the National Council on Governmental Accounting has issued two statements which are to be adopted by all governmental entities with fiscal years ending after June 30, 1980.

We recommend that the City of Lodi fully adopt the provisions of these statements in the June 30, 1981 financial statements. These changes would primarily consist of revised groupings within revenue and expenditure categories.

### CASH PROCEDURES

#### Internal Control and Segregation of Duties

Internal controls are designed to safeguard assets and help prevent losses from employee dishonesty or error. A fundamental concept in a good system of internal control is the segregation of duties.

Cash is a highly liquid asset which is easily misappropriated and difficult to recover. Therefore, it is essential that adequate internal controls be maintained over this asset by proper segregation of duties.

During our review we noted that the segregation of duties in the area of payroll procedures was limited. Specifically, the same employee prepares the payroll data, signs the checks with the check signing machine and distributes the checks.

We recommend that payroll checks not be drawn, signed with the check signing machine and distributed by the same employee responsible for preparation of the payroll data.

The control function of the claims disbursement section of the finance department is to verify the propriety and authenticity of all payment demands. We noted that several invoices were processed for payment without an indication of receipt noted on them. To ensure that payment is made only for purchases which have been received, we recommend that receipt of all items purchased be indicated on the invoice prior to payment.

### PAYROLL PROCEDURES

Adequate documentation of transactions is one of the fundamental concepts of a good system of internal control. By maintaining adequate documentation, you can ensure that the transactions are being properly handled and recorded. It was noted that credit union savings deductions are being withheld from paychecks without signed authorization from employees. We recommend employees sign and date authorization forms for all payroll deductions.

## SUBSIDIARY LISTINGS

### Bad Debt Write-offs

By utilizing a subsidiary listing of accounts receivable that have been written off, it would be easier to record, supervise and direct subsequent receipts made by a collection agency. We recommend that a subsidiary ledger or listing of bad debt write-offs be maintained and periodic collections or non-collections be verified with the agency handling them.

## TRUST DEPOSITS

The City receives trust deposits from a number of sources to be held in a custodial manner. Detail listings must be maintained over the deposits to ensure that the proper amounts are returned to the appropriate person. We believe the following practices could be easily implemented and would increase the efficiency of handling such trust deposits:

1. Maintain a subsidiary listing over Line Reimbursement Trust Deposits received by the City. This listing should be updated periodically reflecting current receipts and disbursements.
2. Establish a subsidiary ledger, updated periodically, for all Utility Trust Deposits. Consideration should also be given to updating the adequacy of the deposits that the City is currently holding. During our examination, we noted that some deposits were received 8 to 10 years ago. In light of current economic trends, we question whether these deposits are sufficient to cover today's costs. Also, attention should be given to the fact that some 8 to 10 year old deposits might be returned to reputable customers.

## ELECTRONIC DATA PROCESSING

### Documentation Standards

Documentation standards are guidelines which ensure that new systems, as well as changes to existing systems, are documented in a thorough and consistent manner. Inadequate program documentation may result in excessive program maintenance costs and undue reliance upon "key" individuals. Improperly documented control procedures may result in erroneous input and processing, undetected out-of-balance conditions, and misinterpreted output reports.

A fully documented set of management approved instructions relating to computer use and user controls does not exist. Lack of such a manual requires job changeover to be done in a word-of-mouth manner and may cause certain job duties to be ignored if the regular clerk is sick or on vacation.

A written set of instructions should be developed that would describe each job function. Included in such a description would be instructions that provide reasonable assurance that users have information to:

- Correctly prepare and identify unacceptable input
- Identify and correctly follow-up on processing errors
- Correctly run and restart applications
- Identify incorrect output
- Distribute and use output

Specific items that the manual might contain are:

- Narrative description of systems and program
- Flowchart of system
- Input data specifications and data preparation instructions
- Output report specifications, output form requirements and distribution instructions
- Control procedures (reconciliations, balancings, etc.)
- Normal and abnormal run instructions including error correction procedures.

While most of these items exist in some form or another, they should be put into one source for each job. This would also assist management in controlling the maintenance of applications.

#### Systems and Program Development

Written policies or procedures do not currently exist for the development of applications. The current AD HOC committee concept is a good way to assure user participation and approval, but a written guideline would serve as a "checklist" to insure all steps are taken and completed.

A written guideline for application development should codify the steps currently taken by the AD HOC committees in development of applications. Such guidelines would serve as a starting point and guide for the committee in application development. Items the guidelines might include are:

- User participation
- User approval at key development points
- Procedures for user acceptance of completed applications or acquired software
- Management approval at key development points
- Management approval of completed applications or acquired software
- Formal testing procedures
- User participation in testing
- Procedures for initial file creation
- Procedures for formal conversion and implementation
- Guidelines for training user department personnel
- Guidelines for training DP personnel
- User department review and appraisal of internal controls

Currently a record of maintenance completed on the system does not exist. Standards should be written to provide guidelines for maintenance of applications. A formal program change procedure and documentation of program changes contributes to the reasonable assurance that:

- All application changes are properly authorized.
- Reasons for changes and intended effects of changes are defined.
- Testing of the changed application is performed before the new application is placed into production.
- Existing documentation is updated to reflect the change.

In addition, documentation of program changes provides a record of the reasons for and descriptions of application changes, and the appropriate management approval of the change.