

March 20, 2015

Ms. Jone Hayes, Administrative Services Director
City of Healdsburg
401 Grove Street
Healdsburg, CA 95448

Dear Ms. Hayes:

In planning and performing our audit of the financial statements of the City for the year ended June 30, 2014, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control.

In accordance with *Government Auditing Standards*, we have issued our report dated March 20, 2015 on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. As stated in that report, **we did not identify any deficiencies in internal control that we considered to be material weaknesses.**

However, during our audit, we noted certain matters involving internal control and other operational matters that are presented for your consideration below. We will review the status of these comments during our next audit engagement.

This letter by its very nature is critical and does not highlight the many positive features of the City's internal control. These comments and recommendations are intended to improve the internal control or result in other operating efficiencies and are summarized as follows:

Finding No. 1 - Fraud Prevention and Detection Program

Management of the City is 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. Fraud can range from minor

employee theft and unproductive behavior to misappropriation of assets and fraudulent financial reporting.

Effect:

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.

Recommendation:

While the City has taken steps to address the risk of fraud in certain areas, such as segregation of duties and other internal controls, we recommend the City consider taking a more formal, proactive approach to fraud prevention and deterrence. This would involve establishing an ongoing program of formally identifying and measuring fraud risks, taking steps to mitigate identified risks, and implementing and monitoring any necessary preventive and deterrent measures.

For example, the City should consider establishing a more formal training program for its employees regarding fraud. New employees should be trained at the time of hiring about the entity's values and its code of conduct. 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 the majority of fraud is detected by fellow employees, and not 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, which may include a combination of internal reporting and an anonymous tip hotline, not only for employees, but also for vendors and customers of the City.

In summary, the City has established controls over fraud in many areas. However, the City should evaluate whether a more formal, proactive approach to preventing fraud would be appropriate. The above comments do not address all components of a strong

antifraud program. Additional information can be provided to the City's management regarding this issue.

Management's Response:

The City is in the process of creating a comprehensive employee training program and will ensure that a fraud prevention component will be included. We will also establish a fraud reporting system prior to June 30, 2015.

Finding No. 2 - Community Development Center Permits

As part of our audit procedures we reviewed the process of issuing permits by the Community Development Center in order to gain an understanding of the internal controls in this area. During our review we noted the same individual responsible for issuing the permits also collects the payments from the customers. In addition, there is no indication that an individual independent of the cash collection and permit issuance is reconciling the permits issued with the receipts collected to verify that all permits issued have a corresponding cash receipt.

Effect:

When there is no reconciliation of permits issued and corresponding cash receipts, there is a potential for permits to be issued without the cash being deposited and ultimately recorded in the City's accounting records.

Recommendation:

We recommend the City review the internal controls over the issuance of permits by the Community Development Center and determine what changes, if any, should be implemented in order to strengthen the internal controls over this process. For example, on a periodic basis (weekly/monthly), an independent party should review the activity to verify that the number of permits issued agrees with the number of cash receipts related to the applicable permits.

Management's Response:

The City will implement the suggested review process on a monthly basis. The City is also currently evaluating ERP vendors with the hope of purchasing a system which will integrate the permitting process with the Financial system, thereby eliminating the use of hand written receipts.

Finding No. 3 - Cash Disbursements - Segregation of Duties

While obtaining an understanding of the internal controls of the accounts payable and cash disbursements process, we found there is a lack of segregation of incompatible

duties for the Accounting Clerk II – Accounts Payable. The Accounting Clerk II, enters new vendors into the vendor file, changes/updates vendor information, inputs the payments to be made for each check run, obtains the signed and printed checks from the printer, and places the checks in envelopes to be mailed.

Effect:

In a strong internal control environment, the individual that inputs payments to be made for each check run should not have access to the vendor master file and also should not have access to the checks once they have been printed and signed because of the potential to misappropriate City funds.

Recommendation:

We recommend the City determine which duties could be delegated to other City staff to strengthen internal controls over the cash disbursements process. This should include assigning the responsibilities for distributing signed checks to someone other than the Accounts Payable Clerk.

Management's Response:

The segregation of duties suggested above has already taken place. In the second half of 2014 a new supervisor of Accounts Payable was designated, Janet Kinney. She is responsible for vendor maintenance and check distribution.

Finding No. 4 - Credit Card Approvals

As part of our audit procedures, we tested credit card activity for reasonableness, and to verify that credit card charges were supported by appropriate documentation, including necessary approvals and receipts. Based on our review, we noted 5 credit card statements that were missing the required approval signatures.

Effect:

Without proper approvals of credit card charges, internal controls over the credit card purchases are minimized.

Recommendation:

Therefore, we recommend the City determine what procedures should be implemented to ensure that all payments of credit card balances are properly documented with the necessary approval signatures prior to payment.

Management's Response:

A procedure has already been implemented to verify all required signatures have been obtained.

Finding No. 5 - Travel Policy

During our review of credit card activity as noted above, we found that various City employees travel for conferences, training, etc. Employees use the City's credit card to purchase hotel rooms and meals while traveling on City business. However, we could not find any detailed guidance regarding travel requirements other than the "City Paid Meals and Per Diem" policy dated March 2001. This indicates that the maximum amount for any given day to be paid for meals is the IRS per diem rate. It does not appear that there has been any reconciliation of these per diem rates as compared to the actual costs incurred. As a result, it appears there is no independent verification to determine if the traveling employees are complying with the City's travel policies.

Effect:

If there is no reconciliation of amounts charged on City credit cards by employees while traveling on City business to adopted City policies, there is a potential for charges to exceed City policies and go unnoticed.

Recommendation:

Therefore, we recommend the City implement procedures to reconcile the per diem rate with the actual charges for employee meals while traveling on City business. The City should also consider whether more detailed and updated policies should be implemented.

Management's Response:

The City will implement this procedure prior to June 30, 2015.

Summation

We would like to take this opportunity to express our appreciation for the assistance extended us during the course of our audit. If we can be of further assistance, or if you have any questions regarding our recommendations, please call our office. This letter is intended solely for the information and use of management and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,

Van Lant + Fankhaed, LLP