CITY OF SAUSALITO
MEMORANDUM ON INTERNAL CONTROL

FOR THE YEAR ENDED
JUNE 30, 2020

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For the Year Ended June 30, 2020

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MEMORANDUM ON INTERNAL CONTROL

To the City Council of
the City of Sausalito, California

In planning and performing our audit of the basic financial statements of the City of Sausalito as of and for the year ended June 30, 2020, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing 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 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. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. However, as discussed below, 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 City's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies in internal control included on the Schedule of Material Weakness to be a material weakness.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Included in the Schedule of Other Matters are recommendations not meeting the above definitions that we believe are opportunities for strengthening internal controls and operating efficiency.

Management's written responses included in this report have not been subjected to the audit procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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This communication is intended solely for the information and use of management, City Council, others within the organization, and agencies and pass-through entities requiring compliance with *Government Auditing Standards*, and is not intended to be and should not be used by anyone other than these specified parties.

Maze & Associates

Pleasant Hill, California
March 18, 2021

CITY OF SAUSALITO
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SCHEDULE OF MATERIAL WEAKNESS

FS2020 – 01: Staffing Resource Plan

Criteria: Adequate staffing of the City's finance function is essential to ensure data are processed and recorded timely and reported in a meaningful way. Permanent staff at appropriate levels is needed to provide for good checks and balances and ensure data accuracy is maintained at a high level.

Cause and Condition: The City experienced significant staff shortage and turnover during fiscal year 2019-20. In December 2019, two staff members in the Finance division retired. From January to June 2020, the City utilized a few temporary staff to fill those positions. In June 2020, the Senior Accountant departed the City, creating another vacancy.

In addition to significant staff shortage and turnover, the City was further affected by the financial strains and changing work environment caused by COVID-19. As a result, the Finance division's main focus during the last four months of the fiscal year 2019-20 was to revise its current year budget as well as drafting the next year's budget.

Due to the above factors, we noted that there were patterns of delay in the areas of cash receipts processing, cash disbursements processing, journal entries processing, and bank reconciliations. In addition, the delay in Treasurer's Report submission to City Council and an outdated provision stated on the City's Investment Policy caused the City to be out of compliance with certain provisions of its Investment Policy and the California Government Code 53646 during the year.

Effect: Delayed transactional processing increases the risk of unidentified errors or unauthorized transactions. In addition, the City was not in compliance with certain provisions in its Investment Policy and the California Government Code 53646.

Recommendation: We understand that the City has since filled some vacancies in the Finance division. We recommend the City evaluate its succession plan in the Finance division to ensure that key functions could be carried out during staff shortage and turnover.

Management Response: The Finance Department has been operating at a limited capacity for the majority of the fiscal year. Additionally, when the COVID pandemic emerged in March 2020, the workload significantly increased due to having to transfer the traditionally onsite financial operations to a new remote environment to address all other departments' service needs while maintaining internal control and complying with the continually changing COVID regulations. These challenges caused some delays in cash receipts, disbursements, journal entries processing, bank reconciliation, and preparing the Treasurer's Reports.

The staff has already addressed the staffing deficiency noted by the auditors. The succession plan included renegotiating the existing contract with Eide Bailly, the CPA firm that the Council already approved, to increase the scope of services beyond the year-end assistance to add partial backfill of the Finance Manager's duties to ensure that the essential functions continue to be carried forward during staff shortage/turnover.

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SCHEDULE OF OTHER MATTERS

NEW GASB PRONOUNCEMENTS OR PRONOUNCEMENTS NOT YET EFFECTIVE

The following comment represents new pronouncements taking affect in the next few years. We cite them here to keep you informed of developments:

EFFECTIVE FISCAL YEAR 2020/21:

GASB 84 – *Fiduciary Activities*

The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported.

This Statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities.

GASB 90 – *Majority Equity Interests—an amendment of GASB Statements No. 14 and No. 61)*

The primary objectives of this Statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units. It defines a majority equity interest and specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment. A majority equity interest that meets the definition of an investment should be measured using the equity method, unless it is held by a special-purpose government engaged only in fiduciary activities, a fiduciary fund, or an endowment (including permanent and term endowments) or permanent fund. Those governments and funds should measure the majority equity interest at fair value.

EFFECTIVE FISCAL YEAR 2021/22:

GASB 87 – *Leases*

The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.

SCHEDULE OF OTHER MATTERS

GASB 89 – *Accounting for Interest Cost Incurred before the End of a Construction Period*

The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period.

This Statement establishes accounting requirements for interest cost incurred before the end of a construction period. Such interest cost includes all interest that previously was accounted for in accordance with the requirements of paragraphs 5–22 of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,* which are superseded by this Statement. This Statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund.

This Statement also reiterates that in financial statements prepared using the current financial resources measurement focus, interest cost incurred before the end of a construction period should be recognized as an expenditure on a basis consistent with governmental fund accounting principles.

GASB 92 – *Omnibus 2020*

The objectives of this Statement are to enhance comparability in accounting and financial reporting and to improve the consistency of authoritative literature by addressing practice issues that have been identified during implementation and application of certain GASB Statements.

GASB 93 – *Replacement of Interbank Offered Rates*

Some governments have entered into agreements in which variable payments made or received depend on an interbank offered rate (IBOR)—most notably, the London Interbank Offered Rate (LIBOR). As a result of global reference rate reform, LIBOR is expected to cease to exist in its current form at the end of 2021, prompting governments to amend or replace financial instruments for the purpose of replacing LIBOR with other reference rates, by either changing the reference rate or adding or changing fallback provisions related to the reference rate.

Statement No. 53, Accounting and Financial Reporting for Derivative Instruments, as amended, requires a government to terminate hedge accounting when it renegotiates or amends a critical term of a hedging derivative instrument, such as the reference rate of a hedging derivative instrument's variable payment. In addition, in accordance with Statement No. 87, Leases, as amended, replacement of the rate on which variable payments depend in a lease contract would require a government to apply the provisions for lease modifications, including remeasurement of the lease liability or lease receivable.

The objective of this Statement is to address those and other accounting and financial reporting implications that result from the replacement of an IBOR.

SCHEDULE OF OTHER MATTERS

GASB 97 – *Certain Component Unit Criteria, and Accounting for and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*

The primary objectives of this Statement are to (1) increase consistency and comparability related to the reporting of fiduciary component units in circumstances in which a potential component unit does not have a governing board and the primary government performs the duties that a governing board typically would perform; (2) mitigate costs associated with the reporting of certain defined contribution pension plans, defined contribution other postemployment benefit (OPEB) plans, and employee benefit plans other than pension plans or OPEB plans (other employee benefit plans) as fiduciary component units in fiduciary fund financial statements; and (3) enhance the relevance, consistency, and comparability of the accounting and financial reporting for Internal Revenue Code (IRC) Section 457 deferred compensation plans (Section 457 plans) that meet the definition of a pension plan and for benefits provided through those plans.

EFFECTIVE FISCAL YEAR 2022/23:

GASB 91 – *Conduit Debt Obligations*

The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This Statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures.

GASB 94 – *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*

The primary objective of this Statement is to improve financial reporting by addressing issues related to public-private and public-public partnership arrangements (PPPs). As used in this Statement, a PPP is an arrangement in which a government (the transferor) contracts with an operator (a governmental or nongovernmental entity) to provide public services by conveying control of the right to operate or use a nonfinancial asset, such as infrastructure or other capital asset (the underlying PPP asset), for a period of time in an exchange or exchange-like transaction. Some PPPs meet the definition of a service concession arrangement (SCA), which the Board defines in this Statement as a PPP in which (1) the operator collects and is compensated by fees from third parties; (2) the transferor determines or has the ability to modify or approve which services the operator is required to provide, to whom the operator is required to provide the services, and the prices or rates that can be charged for the services; and (3) the transferor is entitled to significant residual interest in the service utility of the underlying PPP asset at the end of the arrangement.

This Statement also provides guidance for accounting and financial reporting for availability payment arrangements (APAs). As defined in this Statement, an APA is an arrangement in which a government compensates an operator for services that may include designing, constructing, financing, maintaining, or operating an underlying nonfinancial asset for a period of time in an exchange or exchange-like transaction.

SCHEDULE OF OTHER MATTERS

GASB 96 – ***Subscription-Based Information Technology Arrangements***

This Statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users (governments). This Statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset—an intangible asset—and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires note disclosures regarding a SBITA. To the extent relevant, the standards for SBITAs are based on the standards established in Statement No. 87, Leases, as amended.

STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

FS2017 – 02: Timely Completion of Bank and Investments Reconciliations

Criteria: Bank and Investment reconciliations are one of the most important internal controls a City can have and cannot be considered complete until it has been reviewed and approved. To be an effective control, bank and investment reconciliations and the associated review should be completed in their entirety as soon as reasonably possible after each month-end, usually within thirty days of bank statement month end, and reconciliations should include documentation of preparation and review.

Condition: During our testing of internal controls over bank reconciliations, we noted that the City's bank reconciliations of its main operating account for July 2016 and August 2016 were not completed until February 2017. Furthermore, we noted that the reconciliations from September 2016 through February 2017 did not include documentation of preparation and review with dates and signatures of the responsible employees. Since March 2017, however, the City has implemented new procedures to perform bank reconciliations in a timely manner. We noted the March 31, 2017 bank reconciliation was completed on May 9, 2017, which is within the 30-45 day window to be considered timely.

This is a continued finding from fiscal year 2016.

Effect: The City's book balance of the main operating account does not reflect the correct balances during the year. There is an increased risk that errors, misstatements, or unauthorized transactions in this account will not be detected or corrected in a timely manner.

Cause: The delay in completion of the bank reconciliation is due to a shortage in Finance personnel. Additionally, the City has implemented new procedures since then to ensure timely preparation and review of bank reconciliations.

Recommendation: We recommend that the City continue to prepare and review bank and investment reconciliation in a timely manner.

Current Status: See FS2020-01.

STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

FS2017 – 03: Timely Submission of Treasurer's Report to City Council

Criteria: According to the City's Investment Policy and Government Code 53646, the Treasurer shall provide the City Council a quarterly Treasurer's Report within 30 days after the end of the quarterly reporting period.

Condition: During our testing of internal controls over investments, we noted that the September 30, 2016 Treasurer's Report had not been submitted to Council as of May 2017. Also, it was noted that the Treasurer's Reports subsequent to September 30, 2016 have not been completed. See FS2017 – 02.

Effect: The City is out of compliance with its Investment Policy and Government Code 53646.

Cause: The delay in completion of the Treasurer's Reports is due to a shortage in Finance personnel. The City is in the process of implementing new procedures in order to complete the Treasurer's Report in a timely manner.

Recommendation: We recommend City adhere to the Investment Policy and submit quarterly Treasurer's Reports to Council in a timely manner for approval. Furthermore, the City should continue to work on implementing procedures to ensure preparation and review of Treasurer's Reports is done in a timely manner.

Current Status: See FS2020-01.

FS2016 – 01: Timely Completion of Bank and Investments Reconciliations

Criteria: Timely bank and Investment reconciliations are one of the most essential internal controls a City can have and cannot be considered complete until it has been reviewed and approved. To be an effective control, these reconciliations and the associated review should be completed in their entirety as soon as reasonably possible after each month-end, usually within thirty days of bank statement month end.

According to the City's Investment Policy and Government Code 53646, the Treasurer shall provide the City Council a quarterly Treasurer's Report within 30 days after the end of the quarterly reporting period.

Condition: During our testing of internal controls over bank reconciliations, we noted that the City's main operating account bank reconciliation for the month of September 2015 was not completed, reviewed, and approved until more than six months later in April 2016,

The June 30, 2016 bank reconciliation was not completed until January 2017.

The September 2015 Treasurer's Report was submitted to Council in June 2016, more than eight months after the period ended.

The June 2016 Treasurer's Report was not submitted to the Council until October 2016, more than 3 months after the end of the period.

STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

FS2016 – 01: Timely Completion of Bank and Investments Reconciliations, (Continued)

Effect: As a result, there is an increased risk that errors, material misstatements or unauthorized transactions may occur and not be detected and corrected timely.

The City is also out of compliance with its Investment Policy and California Code without City Council receiving the quarterly Treasurer's Report within 30 days of quarter end.

Cause: The delay in completion of the bank and investment reconciliation is due to a shortage in Finance personnel.

Recommendation: We recommend that the City should prepare and review bank and investment reconciliation on a monthly basis and adhere to its Investment Policy and the California Government Code by submitting the quarterly Treasurer's Report to the City Council timely.

Current Status: See FS2020-01.

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