

INDEPENDENT AUDITORS' 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 of the
City of Palos Verdes Estates
Palos Verdes Estates, California

We have audited, in accordance with 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, each major fund, and the aggregate remaining fund information of the City of Palos Verdes Estates, California (the City), as of and for the year ended June 30, 2017, 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 17, 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.

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. 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.

Our consideration of internal control was for the limited purpose described in the first 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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, as described below, that we consider to be significant deficiencies.

Segregation of Duties

Auditors' Comment and Recommendation

A good system of internal control provides for a proper segregation of the accounting functions whereby no one person has access to both physical assets and the related accounting records or to all phases of a transaction. The result of these types of situations is the risk that intentional or unintentional errors could be made and not be detected. One of the most critical areas of separation is cash. With regard to cash, we noted the following:

1. There is no dual custody of cash payments received either at City Hall or downstairs at the police counter.
2. Cash receipts are only deposited once a week at most, which is due to the limited size of the accounting department.
3. The same employee has the ability to modify vendor listings, record disbursements, and prepare checks and is occasionally responsible for mailing checks.

Although the size of the City's accounting staff prohibits complete adherence to the concept of segregation of duties, we recommend the implementation of the following practices to improve existing internal control without impairing efficiency:

1. Where possible, dual custody of all cash payments should be enforced.
2. A formal cash receipts policy should be adopted whereby there are procedures in place to allow for weekly cash deposits for routine amounts and the possibility of same-day deposits when amounts exceed a predetermined amount.
3. A daily review of the reconciliation of actual cash receipts to the accounting records should be performed by someone who is not involved with the collection of the cash receipts.
4. All edit sheets should be compared to the final check runs to ensure there are no discrepancies; these should be initialed as reviewed by management. Additionally, the City should consider the use of positive pay service with the bank whereby a person outside of the accounts payable process prepares the positive pay listing utilizing the approved edit sheet, which is prepared by the accounts payable clerk.

Management's Response

The City provides segregation of cash handling through its available staff. Staff includes two Financial Services Technicians for Accounts Payable and Payroll. Receipts are stored daily in a locked file cabinet, deposits slips are created weekly and reconciled weekly. One technician prepares the deposit, the other technician prepares the weekly cash receipt batch for recording within the financial system. Financial Services Manager, then reviews all documents for accuracy and completeness.

Cash receipts (cash or checks) are placed in an unsecure vault, and are only deposited once a week at most. Measures have been put in place so that the staff person making the deposit is not the same individual preparing the deposit.

Segregation of Duties (Continued)

Management's Response (Continued)

Daily deposits are secured in a locked file cabinet within the City's vault. Further, only members of the Finance Department have keys to the cabinet. Due to the small volumes and dollar amounts, deposit (generally) are only performed at the end of the week. However, when large dollar amounts are received they are deposited that day.

Beginning in calendar year 2017, all Business License Tax collection is being handled through a contract administrator. Cash and checks are not being collected at the City's public counter.

Prepare and Review Bank Reconciliations Timely

Auditors' Comment and Recommendation

As part of our audit procedures, we sampled a selection of monthly bank reconciliations within the 2016-2017 fiscal year. We noted that the bank reconciliations for the months of January 2017 and March 2017 were not prepared timely. An important element of internal controls over cash is the reconciliation process to identify differences between the bank's reconciliation and the general ledger and resolve differences timely. When differences are not properly identified, the bank reconciliation is not complete and can result in misappropriation of assets. Furthermore, during our review of the monthly bank reconciliations, we noted that there were checks issued in subsequent periods that were posted to the previous month in the general ledger system. As a result, the bank balances had large reconciling items to reflect the general ledger balance. We recommend that all bank accounts be reconciled within 30 days after the end of the month and that all bank reconciliations be initialed and dated by the preparer to indicate that the reconciliation was prepared in a timely manner so that large reconciling items can be identify and rectified immediately.

Management's Response

Staff agrees with the recommendation and is committed to improving the timeliness of bank reconciliations. Due to staff vacancies during the year, notably the Senior Account position and use of temporary personnel in the interim, reconciliations and the posting of some checks were delayed. With filling the vacant positions and the future continuity of staff, reconciliations will be completed in a timely manner.

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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

City's Responses to the Auditors' Comments and Recommendations

The City's responses to the comments and recommendations identified in our audit are described above. 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.

In addition, we noted other matters involving internal control and its operation that we have reported to management of the City in a separate letter dated January 17, 2018.

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 City's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

White Nelson Dick Evans LLP

Irvine, California
January 17, 2018