CITY OF NAPA
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS

FOR THE YEAR ENDED
JUNE 30, 2012

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CITY OF NAPA
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS

For the Year Ended June 30, 2012

Table of Contents

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MAZE & ASSOCIATES

MEMORANDUM ON INTERNAL CONTROL

April 24, 2013

To the City Council of
the City of Napa, California

We have audited the financial statements of the City of Napa for the year ended June 30, 2012, and have issued our report thereon dated April 24, 2013. In planning and performing our audit of the financial statements of the City of Napa as of and for the year ended June 30, 2012, 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 our auditing procedures 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 significant deficiencies or material weaknesses and, therefore, there can be no assurance that all such deficiencies have been 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.

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 identified certain deficiencies in internal control that we consider to be material weaknesses that are included on the Schedule of Material Weaknesses.

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. We identified certain deficiencies in internal control that we consider to be significant deficiencies that are included on the Schedule of Significant Deficiencies.

Included in the Schedule of Other Matters are recommendations not meeting the above definitions that we believe to be of potential benefit to the City.

The City'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.

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 generally accepted government auditing standards, and is not intended to be and should not be used by anyone other than these specified parties.

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CITY OF NAPA
MEMORANDUM ON INTERNAL CONTROL
JUNE 30, 2012

SCHEDULE OF MATERIAL WEAKNESSES

2012-01 – Preparation of Financial Statements

Criteria: The City's financial statements must be complete and accurate prior to the start of the final phase of the audit in order for the audit to be completed on a timely basis.

Condition: The City's financial statements provided for our audit in October 2012 were not completed. As a result, the financial statements were significantly revised several times between October 2012 and March 2013.

Effect: Substantial amount of time was spent in order to get the City's financial statements to its final version. As a result, the audit opinion could not be issued until April 2013.

Cause: The combination of the City's goal to provide roll-ups to the auditors (for the first time), along with the separation of the Finance Manager in March 2012, and the additional work resulting from the dissolution of the Redevelopment Agency impacted the City's ability to meet the October deadline for preparation of the preliminary financial statements.

Recommendation: In order to ensure that the financial statements are ready for the audit timely, adequate staff resources should be allocated for the financial statements preparation. A detailed time schedule should be mapped out for the process. In addition, proper support in the form of education and training throughout the year should be provided to staff that prepares the financial statements.

Management Reponses: The City has been able to create backup reports in the financial system that will significantly reduce the amount of time required by staff to prepare the financials in anticipation of the audit team's arrival.

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SCHEDULE OF SIGNIFICANT DEFICIENCIES

2012-02 – Timely Preparation of Bank Reconciliations

Criteria: Cash and investments are the asset at greatest risk of misappropriation. Reconciliations of these items play an important role in the effectiveness of an entity's internal control structure. Reconciliations should be prepared on a timely basis, generally within 30 day of receiving the statements from the financial institutions, and reviewed by an employee other than the preparer.

Condition: During our interim and final phase of the audit, we tested the City's bank and investment reconciliations and noted the following:

> Investment accounts: We reviewed the State of California Local Agency Investment Fund (LAIF) reconciliations for Napa Community Redevelopment Agency (NCRA), the City of Napa Public Facilities Financing Authority (NPFFA), the Housing Authority of the City of Napa, and the City for the month of January 2012 and noted that the City accountant prepared the reconciliations. However, there was no evidence of a review.
>
> Checking accounts: We reviewed bank reconciliations for the City's general checking account, MDF collections, and MDF refunds for the months of August 2011 and January 2012 and noted that a City accountant prepared the reconciliations. However, there was no evidence of a review. In addition, we also reviewed reconciliations for the credit card, liability insurance, CRD recware, and the Housing Authority of the City of Napa account for the month of August 2011. We noted a City accountant prepared the reconciliations but the reconciliations were not reviewed until February 2012. We also noted the June 2012 bank reconciliations were not prepared and/ or reviewed timely for the following bank accounts: primary checking account, credit card, CDR recware, the Housing Authority of the City of Napa, Laurel Manner, MDF collection, Rapid Pay, RSSS escrow account, and the Successor Agency to the Napa Community Redevelopment Agency.

Effect: Any errors and/or check fraud may not be detected in a timely manner. The Uniform Commercial Codes provides that under certain conditions, the most important being timely bank reconciliation, depositors who detect fraudulent transactions and inform their banks timely may not be responsible for the fraud loss.

Cause: Although the preparation and review of bank reconciliations is a high priority of the Finance Department (both the Accountants, the Audit & Accounting Supervisor, and the Finance Manager), the impact of the Finance Manager's departure resulted in a number of items falling off-schedule.

Recommendation: The City should consider reconciliation of bank and investment accounts as a high priority. Review and approval of all bank reconciliations should be completed timely.

Management Reponses: In order to more appropriately distribute the workload, and ensure the bank reconciliations are completed in a timely manner, the preparation of a number of the bank reconciliations has been reassigned to Account Technicians in the department. Additionally, a full-time Accountant was hired in September, 2012 replacing a part-time consultant, which will also enable the timely review and reconciliation of the City's Investment and Checking accounts.

SCHEDULE OF SIGNIFICANT DEFICIENCIES

2012-03 – Internal Controls Over Wire Transfers

Criteria: For a good internal control in wire transfers, all wire transfers should be initiated by one employee and authorized by a different employee.

Condition: During our testing of wire transfers, we noted a wire transfer from the City's liability insurance account to the City's operating checking account, initiated on January 31, 2012, was prepared and phoned in by the same employee.

Effect: The lack of segregation of duties in wire transfers created potential risk for undetected fraud and error.

Cause: The City has set up an online banking system that does not allow the same person to prepare and authorize the same wire transaction. However, we were informed by City staff that the City had technical issues with using the software. As a result, the phone-in system was used instead.

Recommendation: We recommend the City work with the bank to resolve issues of the online banking in order to utilize the online wire transfer feature in the system.

Management Reponses: The City now requires the on-line entry of a wire transfer by one employee (Accountant), and the on-line authorization of the wire transfer (via the use of a token) by a second employee (Director of Finance, Finance Manager, Accounting & Audit Supervisor). It is no longer possible for a single employee to conduct a wire transfer from City accounts.

CITY OF NAPA
MEMORANDUM ON INTERNAL CONTROL
JUNE 30, 2012

SCHEDULE OF OTHER MATTERS

2012-04 - Outstanding Checks

Criteria: The City should have a policy to follow up on stale dated checks that have been outstanding for a period of time.

Condition: Per review of the outstanding checklists accompanying the January 2012 bank reconciliation, we noted the following:

> General checking: There were 96 checks that totaled to $19,250 in the City's checking bank account that had been outstanding for more than 6 months. These checks are dated as far back as 7/16/09.
>
> MDF refunds: There were 30 checks that totaled to $19,751 in the MDF refunds bank account that had been outstanding for more than 6 months. These checks are dated as far back as 12/10/07.
>
> The Housing Authority of the City of Napa: There were 130 checks that totaled to $8,825 in the Housing Authority checking account that had been outstanding since 5/1/07.

Per review of the outstanding checklists accompanying the June 2012 bank reconciliation, we noted the following:

> There were 267 accounts payable checks that totaled $43,339. These checks are dated as far back as 6/3/2005. There were 29 Payroll Checks that totaled $2,577. These checks are dated as far back as 4/15/2005.

Effect: The City's cash balance could have been misstated due to the stale dated checks.

Cause: The City does not have an established procedure in handling for outstanding checks.

Recommendation: The City should implement a policy to follow up, every six months, on checks that have been outstanding for a period of time.

Management Reponses: In accordance with the approved policy, each year the Finance department will identify each item in an amount greater than $15.00 that has remained unclaimed for three (3) years or more. After following the outlined procedure, the funds will be transferred to the General Fund. Checks of less than $15.00 that have remained unclaimed for a period of one (1) year or more will be transferred to the General Fund after going through the procedure outlined in the policy. HUD funds that have remained unclaimed for a period of three (3) years or more as of the fiscal year end, will be transferred to the State of California in accordance with the policy (and California Code of Civil Procedure Sections 1500).

SCHEDULE OF OTHER MATTERS

2012-05 - The Accounting and Audit Supervisor's Access to Disbursements and Payroll Modules

Criteria: Employees who have access to the electronic signatures and blank check stock should not have access to the general ledger, payroll module or the accounts payable module. In addition, payroll and accounts payable processing should be segregated from the function of check register review and bank reconciliations.

Condition: During our internal control testing, we noted that the Accounting and Audit Supervisor who has full-access to the general ledger, payroll module and the accounts payable module, is also responsible for reviewing the check registers and has access to the electronic signatures and blank check stock.

Effect: An employee who has full access to the various modules, as noted above, could potentially run their own registers and payments without anyone knowing.

Cause: The City feels that the Accounting and Audit Supervisor needs full access to the accounts payable and payroll module because she is the back-up person for the payroll and accounts payable functions.

Recommendation: The City should review the various duties assigned to the Accounting and Audit Supervisor. Her access to the payroll and accounts payable modules should be limited to inquiry only. If she needs full access to the payroll or the account payable module, the function of payroll or accounts payable review should be performed by another employee who cannot run payroll or process accounts payable, and does not have access to blank check stock or electronic signatures.

Management Reponses: The electronic signatures access for payroll checks will be removed from the Accounting and Audit Supervisor as soon as the Finance Department staffing level has stabilized. She currently provides this service in a backup capacity only - however due to numerous vacancies in the department it would not be prudent to not have sufficient backup when two of the three accountants are not in the office every other Friday. Currently the Accountants and the Finance Manager who have read only access to the Payroll module currently have access to the electronic signatures. The creation of all new employees, full time, part time, extra help and retired annuitants, is performed in the Human Resource department (HR). HR department creates the new record, assigns the job classification and step which is tied to the salary or pay rate range. The record is then sent to Finance Department where the benefits are assigned and any other special types of pay such as automobile allowance or telephone stipend. In addition the system has login which is turned on for the Employee Master screen. Any and all changes are logged. The log includes what change was made, the user who made the change, and the date and time stamp for when the change was made. The check stock is locked in a cabinet and the key is held by the Finance Manager.

SCHEDULE OF OTHER MATTERS

Upcoming Governmental Accounting Standards Board Pronouncements

The following pronouncements are effective in fiscal year 2012/13:

GASB 60 - ***Accounting and Financial Reporting for Service Concession Arrangements***

The objective of this proposed Statement is to establish accounting and financial reporting requirements for service concession arrangements (SCAs), which are a type of public-private or public-public partnership arrangement. As used in this proposed Statement, an SCA is an arrangement between a transferor (a government) and an operator (governmental or nongovernmental) in which:

a. The transferor conveys to the operator the right and related obligation to provide public services through the operation of a capital asset (referred to in this standard as "facility").

b. The operator collects and is compensated with fees from third parties.

c. The transferor is entitled to significant residual interest in the service utility of the facility at the end of the arrangement.

d. The transferor determines or has the ability to modify or approve what 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.

Service Concession Arrangements include, but are not limited to:

a. Arrangements in which the operator will design and build a facility and will obtain the right to collect fees from third parties (for example, construction of a municipal complex for the right to lease a portion of the facility to third parties).

b. Arrangements in which the operator will provide an up-front payment or a series of payments in exchange for the right to access an existing facility (for example, a parking garage) and collect fees from third parties for its usage.

c. Arrangements in which the operator will design and build a facility (for example, a new tollway), finance the construction costs, provide the associated services, collect the associated fees, and convey the facility to the government at the end of the arrangement.

Disclosures Related to Service Concession Arrangements (SCA)

The following information should be disclosed in the notes to financial statements of transferors and governmental operators for SCAs:

a. A general description of the arrangement in effect during the reporting period, including management's objectives for entering into it and, if applicable, the status of the project during the construction period.

SCHEDULE OF OTHER MATTERS

b. The nature and amounts of assets, liabilities, and deferred inflows of resources related to an SCA that are recognized in the financial statements.

c. The nature and extent of rights retained by the transferor or granted to the governmental operator under the arrangement.

GASB 61 - *The Financial Reporting Entity – Omnibus – An Amendment for GASB Statement No. 14 and No. 34 – Component Unit Focus*

This Statement modifies certain requirements for inclusion of component units in the financial reporting entity. **For organizations that previously were required to be included as component units by meeting the fiscal dependency criterion, a financial benefit or burden relationship also would need to be present between the primary government and that organization for it to be included in the reporting entity as a component unit.** Further, for organizations that do not meet the financial accountability criteria for inclusion as component units but that, nevertheless, should be included because the primary government's management determines that it would be misleading to exclude them, this Statement clarifies the manner in which that determination should be made and the types of relationships that generally should be considered in making the determination.

This Statement also amends the criteria for reporting component units as if they were part of the primary government (that is, blending) in certain circumstances. **For component units that currently are blended based on the "substantively the same governing body" criterion, it additionally requires that (1) the primary government and the component unit have a financial benefit or burden relationship or (2) management (below the level of the elected officials) of the primary government have operational responsibility (as defined in paragraph 8a) for the activities of the component unit. New criteria also are added to require blending of component units whose total debt outstanding is expected to be repaid entirely or almost entirely with resources of the primary government.** The blending provisions are amended to clarify that funds of a blended component unit have the same financial reporting requirements as a fund of the primary government. Lastly, additional reporting guidance is provided for blending a component unit if the primary government is a business-type activity that uses a single column presentation for financial reporting.

SCHEDULE OF OTHER MATTERS

GASB 62 - ***Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements***

The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements:

1. Financial Accounting Standards Board (FASB) Statements and Interpretations
2. Accounting Principles Board Opinions
3. Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure.

This Statement also supersedes Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, thereby eliminating the election provided in paragraph 7 of that Statement for enterprise funds and business-type activities to apply post-November 30, 1989 FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements. However, those entities can continue to apply, as other accounting literature, post-November 30, 1989 FASB pronouncements that do not conflict with or contradict GASB pronouncements, including this Statement.

The provisions of this Statement are organized by topic. Each topic contains provisions derived from FASB and AICPA pronouncements that address the subject matter. The order in which the topics are presented corresponds to the order of the primary locations within the GASB *Codification of Governmental Accounting and Financial Reporting Standards*, where the topics are codified.

The requirements in this Statement will improve financial reporting by contributing to the GASB's efforts to codify all sources of generally accepted accounting principles for state and local governments so that they derive from a single source. **This effort brings the authoritative accounting and financial reporting literature together in one place**, with that guidance modified as necessary to appropriately recognize the governmental environment and the needs of governmental financial statement users. It will eliminate the need for financial statement preparers and auditors to determine which FASB and AICPA pronouncement provisions apply to state and local governments, thereby resulting in a more consistent application of applicable guidance in financial statements of state and local governments.

SCHEDULE OF OTHER MATTERS

GASB 63 - *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*

This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. *Concepts Statement No. 4, Elements of Financial Statements*, introduced and defined those elements as a consumption of net assets by the government that is applicable to a future reporting period, and an acquisition of net assets by the government that is applicable to a future reporting period, respectively. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities.

Concepts Statement 4 also identifies net position as the residual of all other elements presented in a statement of financial position. This Statement amends the net asset reporting requirements in *Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and **by renaming that measure as net position, rather than net assets.**

The objective of this Statement is to provide guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position and related disclosures.

State and local governments enter into transactions that result in the consumption or acquisition of net assets in one period that are applicable to future periods. *Concepts Statement No. 4, Elements of Financial Statements*, identifies those consumptions or acquisitions as deferred outflows of resources and deferred inflows of resources, respectively, and distinguishes them from assets and liabilities. This Statement provides guidance for reporting deferred outflows of resources and deferred inflows of resources balances.

Concepts Statement 4 identifies net position as the residual of all other elements presented in a statement of financial position. It is the difference between (a) assets and deferred outflows of resources and (b) liabilities and deferred inflows of resources. This Statement provides guidance for reporting net position within a framework that includes deferred outflows of resources and deferred inflows of resources, in addition to assets and liabilities.

SCHEDULE OF OTHER MATTERS

SUMMARY:

- *Statement of Net Position* The statement of net position should report all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position. Governments are encouraged to present the statement of net position in a format that displays assets, plus deferred outflows of resources, less liabilities, less deferred inflows of resources, equals net position, although a balance sheet format (assets plus deferred outflows of resources equals liabilities plus deferred inflows of resources, plus net position) may be used. Regardless of the format used, the statement of net position should report the residual amount as net position, rather than net assets, proprietary or fiduciary fund balance, or equity. Net position represents the difference between all other elements in a statement of financial position and should be displayed in three components—net investment in capital assets; restricted (distinguishing between major categories of restrictions); and unrestricted.

- *Net Investment in Capital Assets Component of Net Position* The net investment in capital assets component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt also should be included in this component of net position. If there are significant unspent related debt proceeds or deferred inflows of resources at the end of the reporting period, the portion of the debt or deferred inflows of resources attributable to the unspent amount should not be included in the calculation of net investment in capital assets. Instead, that portion of the debt or deferred inflows of resources should be included in the same net position component (restricted or unrestricted) as the unspent amount.

- *Restricted Component of Net Position* The restricted component of net position consists of restricted assets reduced by liabilities and deferred inflows of resources related to those assets. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported.

- *Unrestricted Component of Net Position* The unrestricted component of net position is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

- *Financial Reporting for Governmental Funds* Deferred outflows of resources and deferred inflows of resources that are required to be reported in a governmental fund balance sheet should be presented in a format that displays assets plus deferred outflows of resources, equals liabilities plus deferred inflows of resources, plus fund balance.

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SCHEDULE OF CURRENT STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

2011-01: Internal Controls over Wire Transfers

Criteria: Wire transfers should be initiated by one employee and authorized by another. Furthermore, employees who authorize wire transfers should not perform bank or investment account reconciliation.

Condition: During the interim phase of the audit, we noted that the City's bank only performed call-back confirmations on wire transactions over $1,000,000. In addition, out of the six employees who could authorize wire transfers, one was a super-user to the City's financial system and three others performed bank or investment account reconciliations.

Effect: Allowing an employee to generate a wire transfer as well as to perform account reconciliations creates an opportunity for undetected fraud and error.

Cause: The City was in the process of setting up an online banking system that will not allow the same person to prepare and authorize/approve wire transactions.

Recommendation: During the interim phase of the audit, we recommended the City implement the online banking system as soon as possible.

Management Response 2010-2011: While there are 6 employees who can initiate wire transfers, the City's internal practice was to have a wire transfer initiated by one employee, and approved by a second employee who does not perform bank reconciliations. The bank performed call back verifications on wire transfers over $1 million, but the wires were internally approved by a supervisor regardless of amount. The City has since implemented call back verifications for wire transfers of any amount, and is working toward completing the implementation of the online wire transfer system which requires one person to initiate a wire, and a second person to approve the wire before it is released by the bank.

Current Year Status: See Current Year Significant Deficiency 2012-03.

Management Response: The City now requires the on-line entry of a wire transfer by one employee (Accountant), and the on-line authorization of the wire transfer (via the use of a token) by a second employee (Director of Finance, Finance Manager, Accounting & Audit Supervisor). It is no longer possible for a single employee to conduct a wire transfer from City accounts. Although these transfers also now require authorization via a token, it should be noted that in this particular transfer, funds moved between City Accounts, and never left the bank.

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CITY OF NAPA
MEMORANDUM ON INTERNAL CONTROL
JUNE 30, 2012

SCHEDULE OF CURRENT STATUS OF PRIOR YEAR OTHER MATTERS

2011-02: The Accounting and Audit Supervisor's access over Payroll

Criteria: Employees who have access to electronic signatures should not also have access to blank check stock or payroll module.

Condition: The Accounting and Audit Supervisor who has full-access to the payroll module is responsible for reviewing payroll register. The Accounting and Audit Supervisor also has access to electronic signatures, blank check stock, and general ledger module.

Effect: Without proper review by another employee, one who has various accesses as mentioned above could create a fake employee or adjust one's pay without being detected.

Cause: The City feels that the Accounting and Audit Supervisor needs full access to the payroll module because she is the back-up person to run payroll, and because the City is still in process of implementing the remainder of the HR and Payroll modules, and the Accounting and Audit Supervisor is the project manager for that implementation. In addition, as a mitigating factor, the Accounting and Audit Supervisor needs the Finance Manager's approval to access the check stock.

Recommendation: The City should review the various duties assigned to the Accounting and Audit Supervisor. Her access to the module should be limited to inquiry only. If she needs full access to the payroll module, the function of payroll review should be done by another employee who cannot run payroll run, and do not have access to the blank check stock or electronic signatures.

Management Response 2010-2011: The electronic signatures access for payroll checks can be removed from the Accounting and Audit Supervisor. Currently the Accountants and the Finance Manager who have read only access to the Payroll module currently have access to the electronic signatures. The creation of all new employees, full time, part time, extra help and retired annuitants, is performed in the Human Resource department (HR). HR department creates the new record, assigns the job classification and step which is tied to the salary or pay rate range. The record is then sent to Finance Department where the benefits are assigned and any other special types of pay such as automobile allowance or telephone stipend. In addition the system has logging which is turn on for the Employee Master screen. Any and all changes are logged. The log includes what change was made, the user who made the change, and the date and time stamp for when the change was made. The check stock is locked in a cabinet and the payroll technician obtains the key from the Finance Manager.

Current Year Response: See Current Year Other Matter 2012-05.

Management Response: The electronic signatures access for payroll checks will be removed from the Accounting and Audit Supervisor as soon as the Finance Department staffing level has stabilized. She currently provides this service in a backup capacity only - however due to numerous vacancies in the department it would not be prudent to not have sufficient backup when two of the three accountants are not in the office every other Friday. Currently the Accountants and the Finance Manager who have read only access to the Payroll module currently have access to the electronic signatures. The creation of all new employees, full time, part time, extra help and retired annuitants, is performed in the Human Resource department (HR). HR department creates the new record, assigns the job classification and step which is tied to the salary or pay rate range. The record is then sent to Finance Department where the benefits are assigned and any other special types of pay such as automobile allowance or telephone stipend. In addition the system has login which is turned on for the Employee Master screen. Any and all

SCHEDULE OF CURRENT STATUS OF PRIOR YEAR OTHER MATTERS

changes are logged. The log includes what change was made, the user who made the change, and the date and time stamp for when the change was made. The check stock is locked in a cabinet and the key is held by the Finance Manager.

2011-03: Long-Term Debt Continuing Disclosure

Criteria: Under the covenants of the City's Parkway Plaza Redevelopment Bond Series 2003 A and B, the 2004 Solid Waste Revenue Bonds, and the 2007 Water Revenue Bonds, the City must prepare an Annual Report no later than nine months after the end of the City's fiscal year. The Report should be filed by either the City or the bond trustee with the Municipal Securities Rule making Board (MSRB). These covenants have been made in order to comply with Securities Exchange Commission Rule 15c2-12(B)(5).

Condition: As of June 8, 2011, the City had not filed the Annual Reports, due March 31, 2011, for the Parkway Plaza Redevelopment Bond Series 2003 A and B, the and the 2007 Water revenue bonds.

Effect: The City was not in compliance with the Bond covenant.

Cause: The trustee is responsible for filing the Annual Report for the City's Parkway Plaza Redevelopment Bonds Series 2003 A and B, and the 2007 Water Revenue Bonds. The City is responsible for filing the Annual Disclosure for the 2004 Solid Waste Revenue Bonds. The Annual Report for the 2004 Solid Waste Revenue Bonds was filed on March 29, 2011. Due to significant changes in staffing, the City did not have a mechanism in place to ensure that the trustee filed the Annual Reports for the Parkway Plaza Redevelopment Bond Series 2003 A and B or the 2007 Water Revenue Bonds.

Recommendation: The City should ensure that the Annual Report is filed timely with MSRB. If the Trustee is responsible for the filing, the City should follow up to make sure that the filing is being completed by the deadline.

Management Response 2010-2011: The City has set up automatic reminders with both the trustee and internal staff to be sure the Annual Reports are filed timely in the future.

Current Year Status: Although the City did provide the trustee with disclosure information on March 30, 2012 for the 2004 Solid Waste Revenue Bonds, the information was not filed on the website until April 12, 2012 the 2004 Solid Waste Revenue Bonds. In addition, the Parkway Plaza Redevelopment Bond Series 2003 A, B and C also were not posted to the website until April 12, 2012.

Management Response: The City has set up automatic reminders with both the trustee and internal staff to be sure the Annual Reports are filed timely in the future. Additionally the City has now established an account on MSRB (EMMA) as a backup to file the disclosures ourselves, in the event Union Bank does not upload our disclosure by the requested date.

2011-04: Capital Asset Physical Inventory

Criteria: The City should conduct a physical inventory of their capital assets periodically to ensure that its capital assets records are complete and physical assets are safeguarded. In addition, the City should tag its capital assets for tracking purposes.

SCHEDULE OF CURRENT STATUS OF PRIOR YEAR OTHER MATTERS

Condition: The City has not performed a physical inventory of its capital assets since May 2009. In addition, the City's capital assets are not tagged.

Effect: Movable capital assets are subject to the risk of misplacement or theft.

Cause: The City capitalizes assets over $5,000. The City feels that most of these assets are fixtures such as roads and bridges that are deemed as unnecessary to inventory.

Recommendation: We recommend that the City annually performs a physical inventory on capital assets a rotational basis to verify the existence of capital assets recorded in the City's books. We also recommend that the City tags its movable capital assets to prevent theft.

Management Response 2010-2011: The City is considering the option of increasing the capitalization threshold to $25,000. Fleet assets are tracked within the FleetFocus module and are on a maintenance schedule by which the vehicles are serviced every year. The inventory is thus completed over the duration of the year when the vehicles are brought in for service. The City is currently developing a Capital Asset Policy and Procedure manual, which will include an annual inventory of all assets.

Current Year Status: The City still has not performed a physical inventory of its capital assets since May 2009 and the City's continues not to tag their capital assets.

Management Response: The City is considering the option of increasing the capitalization threshold to $25,000. Fleet assets are tracked within the Fleet Focus module and are on a maintenance schedule by which the vehicles are serviced every year. The inventory is thus completed over the duration of the year when the vehicles are brought in for service. The City is currently developing a Capital Asset Policy and Procedure manual, which will include an annual inventory of all assets. Additionally the City is in the final stages of implementing the Fixed Asset Module in IFAS, which will be finalized to operate as a parallel system for the FY 2012-13 audit.

2011-05: Evidence of Review of Check Register's

Criteria: To ensure proper review of the check register has taken place, there should be documentation indicating the employee who reviewed the check registers and the date that review occurred.

Condition: During the interim phase of the audit, we were informed that the Accounting and Audit Supervisor reviewed the City's check registers. However, there was no indication on the current year check registers that reviews have taken place.

Effect: The lack of physical evidence of review made it hard for the City to ensure that the procedure was in place.

Cause: It was the City's procedure to review the check register electronically. At the time of the interim audit, there was no report developed within set up in the system to indicate a review had been performed.

Recommendation: During the interim phase of the audit, we recommended that the City implement a log to indicate who reviewed the check register and when the review takes place.

SCHEDULE OF CURRENT STATUS OF PRIOR YEAR OTHER MATTERS

Management Response 2010-2011: The City has developed a report within the financial system to show the review and electronic approval of each invoice prior to the printing of the checks.

Current Year Status: The City's check registers continue to lack evidence that there is a review procedure in place. Also see Significant Deficiency 2012-02.

Management Response: The City has developed a report within the financial system to show the review and electronic approval of each invoice prior to the printing of the checks. Additionally a process providing independent review of the payroll register was developed and is currently in the final review stages.

2011-06 -- Information System Review

We conducted an Information Systems Review with our audit which encompassed the financial information system and the network environment that houses it. Currently, there are no Information Technology standards to which local governments are required to conform. Indeed there are a wide variety of informal guidelines and suggested controls from many different organizations which local governments can use to implement appropriate controls to ensure adequate security over information technology. Our Information Technology staff has reviewed these informal guidelines and concluded that the certification and accreditation framework developed by the National Institute of Standards and Technology (NIST) for the Federal Information Security Management Act (FISMA) are the most appropriate for local government[1]. NIST and FISMA represent the minimum security requirements for federal government agencies information systems. NIST recommends these for state and local governments. Our procedures included performing an external network scan based on NIST criteria and in determining that internal control provides for:

- Internet access defenses including hacker prevention, detection and deterrent systems
- Security of data from physical or network access
- Adequately protecting data from unauthorized internal access
- Reasonable measures to ensure continuation of service
- Information systems risk management

While the results of our work did not indicate material weaknesses, we noted the following which could be improved.

Payment Card Industry Compliance

The City is not in compliance with the Payment Card Industry Data Security Standard (PCI-DSS). Any organization that processes credit cards is required to comply with PCI-DSS, even if the processing is outsourced. Failure to meet compliance requirements results in higher transaction fees and liability if a security breach is found. Since the City accepts credit cards as a form of payment, the City must be compliant with the applicable controls.

[1] "State, local, and tribal governments, as well as private sector organizations are encouraged to consider using these guidelines, as appropriate." NIST SP 800-37 Rev 1 pg 11

SCHEDULE OF CURRENT STATUS OF PRIOR YEAR OTHER MATTERS

Management Response:

A policy delineating the steps for the City to comply with the PCI standards is nearing final approval. Following adoption of this policy, the City will conduct training regarding data security for staff who handling credit card data and conduct the tests called for in the policy and the PCI-DSS.

Current Year Status: No change in current year.

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MAZE
& ASSOCIATES

REQUIRED COMMUNICATIONS

April 24, 2013

To the City Council of
The City of Napa, California

We have audited the financial statements of the City of Napa as of and for the year ended June 30, 2012, and have issued our report thereon dated April 24, 2013. Professional standards require that we advise you of the following matters relating to our audit.

Financial Statement Audit Assurance: Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit in accordance with generally accepted auditing standards does not provide absolute assurance about, or guarantee the accuracy of, the financial statements. Because of the concept of reasonable assurance and because we did not perform a detailed examination of all transactions, there is an inherent risk that material errors, fraud, or illegal acts may exist and not be detected by us.

Other Information Included with the Audited Financial Statements: Pursuant to professional standards, our responsibility as auditors for other information in documents containing the City's audited financial statements does not extend beyond the financial information identified in the audit report, and we are not required to perform any procedures to corroborate such other information. Our responsibility also includes communicating to you any information that we believe is a material misstatement of fact. Nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the financial statements. This other information and the extent of our procedures is explained in our audit report.

Accounting Policies: Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the City is included in Note 1 to the financial statements. There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during 2012. The following pronouncement became effective but did not have a material effect on the financial statements:

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GASB 64 - *Derivative Instruments: Application of Hedge Accounting Termination Provisions, an amendment of GASB Statement No. 53*

Some governments have entered into interest rate swap agreements and commodity swap agreements in which a swap counterparty, or the swap counterparty's credit support provider, commits or experiences either an act of default or a termination event as both are described in the swap agreement. Many of those governments have replaced their swap counterparty, or swap counterparty's credit support providers, either by amending existing swap agreements or by entering into new swap agreements. When these swap agreements have been reported as hedging instruments, questions have arisen regarding the application of the termination of hedge accounting provisions in Statement No. 53, Accounting and Financial Reporting for Derivative Instruments. Those provisions require a government to cease hedge accounting upon the termination of the hedging derivative instrument, resulting in the immediate recognition of the deferred outflows of resources or deferred inflows of resources as a component of investment income.

The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. This Statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied.

Unusual Transactions, Controversial or Emerging Areas: No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus. There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during 2012.

- As discussed in Note 17 to the financial statements, the State enacted laws which dissolved Redevelopment Agencies effective January 31, 2012. The City elected to become a Housing Successor to the Redevelopment Agency and pursuant to the laws it is recipient to the encumbered housing assets of the former Redevelopment Agency. All other assets were distributed to and all of the Redevelopment Agencies liabilities were assumed by a Successor Agency governed by an Oversight Board. This Successor Agency is reported as a private purpose trust fund.

Estimates: Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments. The most sensitive accounting estimates affecting the financial statements are fair values of investments and depreciation of capital assets.

As of June 30, 2012, the City, held approximately $108.5 million of cash and investments as measured by fair value. Fair value is essentially market pricing in effect as of June 30, 2012. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2012.

Management's estimate of depreciation is based on useful lives determined by management. These lives have been determined by management based on the expected useful life of assets as disclosed in Note 1H to the financial statements. We evaluated the key factors and assumptions used to develop the depreciation estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.

Disagreements with Management: For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the City's financial statements or the auditor's report. No such disagreements arose during the course of the audit.

Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

Retention Issues: We did not discuss any major issues with management regarding the application of accounting principles and auditing standards that resulted in a condition to our retention as the City's auditors.

Difficulties: We encountered no serious difficulties in dealing with management relating to the performance of the audit.

Audit Adjustments: For purposes of this communication, professional standards define an audit adjustment, whether or not recorded by the City, as a proposed correction of the financial statements that, in our judgment, may not have been detected except through the audit procedures performed. These adjustments may include those proposed by us, but not recorded by the City, that could potentially cause future financial statements to be materially misstated, even though we have concluded that the adjustments are not material to the current financial statements.

We did not propose any audit adjustments that, in our judgment, could have a significant effect, either individually or in the aggregate, on the City's financial reporting process.

Uncorrected Misstatements: Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. We have no such misstatements to report to the audit committee.

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This report is intended solely for the information and use of the City Council and management and is not intended to be and should not be used by anyone other than these specified parties.

Maze & Associates

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