CITY OF SOUTH SAN FRANCISCO

MEMORANDUM ON INTERNAL CONTROL

FOR THE YEAR ENDED
JUNE 30, 2024

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CITY OF SOUTH SAN FRANCISCO

MEMORANDUM ON INTERNAL CONTROL

For the Year Ended June 30, 2024

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MEMORANDUM ON INTERNAL CONTROL

To the City Council of
The City of South San Francisco, California

We have audited the basic financial statements of the City of South San Francisco, California, for the year ended June 30, 2024, and have issued our report thereon dated December 19, 2024. Our opinions on the basic financial statements and this report, insofar as they relate to the South San Francisco Conference Center Authority, are based solely on the report of other auditors. In planning and performing our audit of the basic financial statements of the City as of and for the year ended June 30, 2024, 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 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 significant deficiencies.

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 did not identify any deficiencies in internal control that we consider to be 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 consider the deficiencies in internal control included on the Schedule of Significant Deficiencies to be significant deficiencies.

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 or other informational items.

Government Auditing Standards require the auditor to perform limited procedures on the City's response to the findings identified in our audit and described in the accompanying Schedule of Significant Deficiencies and Schedule of Other Matters. The City's responses were not subjected to the other auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the responses.

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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
December 19, 2024

CITY OF SOUTH SAN FRANCISCO
MEMORANDUM ON INTERNAL CONTROL
SCHEDULE OF SIGNIFICANT DEFICIENCIES

2024-01 <u>Trial Balance Review and Analysis During Year-End Close</u>

The year-end financial closing and preparation of the general ledger data should be completed timely and accurately. The year-end closing procedures should provide enough time for a final analysis and review of general ledger balances to ensure closing entries were not overlooked.

During the year-end audit, City staff provided twelve post-closing adjustments, some of which were known at the start of the audit and some that were discovered as the audit progressed, including corrections to beginning fund balance in two funds of $102,651 and $27,045, correction to increase cash and investments of $719,980, correction to balance interfund transfers of $30,980, correction to reduce accounts receivable for a transposition of $270,000, correction to record sewer service charges receivable of $961,093, entry to record a lease receivable of $1,889,840 that had been issued during the year, and corrections to revenue of $51,076 and $201,752 recorded in the wrong funds and accounts.

We understand the beginning fund balance issues were due to one entry being posted to beginning fund balance in error and one entry being posted backward. However, the errors went undetected, until the general ledger was provided for audit. We understand the significant number of post-closing adjustments were a byproduct of staff retirements and turnover in the Finance Department that put the analysis of some activities during the year and the closing procedures behind and did not allow enough time to complete the analysis of balances prior to providing the general ledger for audit.

When the closing procedures do not include time to analyze fund activity to ensure closing entries are accurate and not missing, it increases the risk that errors or misstatements may go undetected by staff and corrections may not be made in a timely manner. In addition, for corrections that were for activities posted during the fiscal year, it means interim reports provided to City Council or other internal and external parties may be inaccurate.

The City should develop procedures to ensure that accounts are analyzed throughout the fiscal year and after the year end close to ensure that all funds are in balance and additional closing entries or corrections to existing balances are not required prior to providing the general ledger for audit.

> ***Management's Response:***
> In order to reduce the risk of missed entries and/or unidentified errors and misstatements, Finance will investigate the feasibility of implementing additional internal analytical reviews and account analysis at the end of the fiscal year on a fund level, in order to identify any significant variances that may indicate potential items to be recorded or adjustments to be made. Additionally, the city's finance department will proactively coordinate with various other departments to confirm all necessary adjustments and amounts have been recognized and recorded, and that any corrections needed are identified and made in a timely manner.

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2024-02 Timely Payment of Disbursements

Payments to vendors should be made timely, usually within thirty to forty-five days of receiving the related invoice from the vendor.

During the audit we selected 25 disbursements to test for compliance with the City's Purchasing Policy and timeliness of the payments. We noted one disbursement in the amount of $229,245 that was paid in May 2024 for the purchase of information technology equipment that was due in April 2024, and one disbursement in the amount of $270 that was paid in April 2024 for the purchase of office supplies that was due in March 2024.

Although both invoices were paid within four days of being received by the Finance Department, we understand the delay for the first invoice being provided to Finance for payment was due to an Information Technology staff being on administrative leave and the second payment was delayed in being provided to Finance due to turnover in mail room staff.

When invoices are not paid timely, it increases the likelihood of late fees from the vendor and increases the risk that errors or misstatements surrounding the invoice payment may occur.

The City should develop procedures to ensure that all invoices are paid timely, usually within thirty to forty-five days after being received by the mail room or Department staff, regardless of whether there is staff turnover.

Management's Response:
The City acknowledges that two specific invoices went unpaid beyond the invoice due date, noting that timely payments were hampered due to employee turnover and absences. Overall, the City intends to work closely with its respective departments to enable greater internal coordination, thereby ensuring that vital functions within departments are not dependent on solely one or two people, as well as to overhaul leave procedures to ensure that key personnel are not simultaneously absent without any backup capacity or staffing. The City also recognizes a need for departments to have more proactive leave management policies to ensure important, time-critical functions are planned for in advance of absences and leaves of key employees.

2024-03 Developer Deposits Receivable

Developers often make deposits with the City to pay for project plan check and other fees. As the City incurs costs related to the project, the deposit payable is reduced. In the event costs incurred exceed the amount on deposit, the City must bill the developer for the amount due.

We noted the Developer Contributions Special Revenue Fund had an accounts receivable balance of $1.2m as of June 30, 2024 that is primarily comprised of amounts due from developers related to the cost of work performed by City staff that exceeded the developer deposit. The majority of that balance is related to amounts dating from fiscal years 2020 to 2023 and the individual deposits receivable amounts range from $60 to $108 thousand.

2024-03 **<u>Developer Deposits Receivable (Continued)</u>**

We understand that Economic and Community Development staff are working to bill the developers and determine if the amounts are collectible. When balances due age, the likelihood of collection is reduced.

The City should develop procedures to ensure developers are notified when the deposit may be exhausted and ensure additional amounts are paid to replenish the deposit in a timely manner. City staff should also confirm that all applicable developers have been billed for the amounts due and pursue collection.

Management's Response:
The City acknowledges the shortcoming noted by the auditors regarding developer deposits. Management is currently overhauling the previous, deposit-based process in which services, primarily inspections, were performed while deposits were not fully collected or tracked. Management is currently working on replacing this prior system with a fee-based model in which there are no longer deposits made, but fees billed and received as part of the regular development process and approval. This will eliminate the need for tracking deposits specifically as a separate item and reduce the risk of missed payments and uncollected receivables.

NEW GASB PRONOUNCEMENTS OR PRONOUNCEMENTS NOT YET EFFECTIVE

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

EFFECTIVE FISCAL YEAR 2024/25:

GASB 101 – *Compensated Absences*

The objective of this Statement is to better meet the information needs of financial statement users by updating the recognition and measurement guidance for compensated absences. That objective is achieved by aligning the recognition and measurement guidance under a unified model and by amending certain previously required disclosures.

GASB 102 – *Certain Risk Disclosures*

State and local governments face a variety of risks that could negatively affect the level of service they provide or their ability to meet obligations as they come due. Although governments are required to disclose information about their exposure to some of those risks, essential information about other risks that are prevalent among state and local governments is not routinely disclosed because it is not explicitly required. The objective of this Statement is to provide users of government financial statements with essential information about risks related to a government's vulnerabilities due to certain concentrations or constraints.

This Statement defines a concentration as a lack of diversity related to an aspect of a significant inflow of resources or outflow of resources. A constraint is a limitation imposed on a government by an external party or by formal action of the government's highest level of decision-making authority. Concentrations and constraints may limit a government's ability to acquire resources or control spending.

This Statement requires a government to assess whether a concentration or constraint makes the primary government reporting unit or other reporting units that report a liability for revenue debt vulnerable to the risk of a substantial impact. Additionally, this Statement requires a government to assess whether an event or events associated with a concentration or constraint that could cause the substantial impact have occurred, have begun to occur, or are more likely than not to begin to occur within 12 months of the date the financial statements are issued.

If a government determines that those criteria for disclosure have been met for a concentration or constraint, it should disclose information in notes to financial statements in sufficient detail to enable users of financial statements to understand the nature of the circumstances disclosed and the government's vulnerability to the risk of a substantial impact. The disclosure should include descriptions of the following:

- The concentration or constraint.
- Each event associated with the concentration or constraint that could cause a substantial impact if the event had occurred or had begun to occur prior to the issuance of the financial statements.
- Actions taken by the government prior to the issuance of the financial statements to mitigate the risk.

EFFECTIVE FISCAL YEAR 2025/26:

GASB 103 – *Financial Reporting Model Improvements*

The objective of this Statement is to improve key components of the financial reporting model to enhance its effectiveness in providing information that is essential for decision making and assessing a government's accountability. This Statement also addresses certain application issues.

Management's Discussion and Analysis

This Statement continues the requirement that the basic financial statements be preceded by management's discussion and analysis (MD&A), which is presented as required supplementary information (RSI). MD&A provides an objective and easily readable analysis of the government's financial activities based on currently known facts, decisions, or conditions and presents comparisons between the current year and the prior year. This Statement requires that the information presented in MD&A be limited to the related topics discussed in five sections: (1) Overview of the Financial Statements, (2) Financial Summary, (3) Detailed Analyses, (4) Significant Capital Asset and Long-Term Financing Activity, and (5) Currently Known Facts, Decisions, or Conditions. Furthermore, this Statement stresses that the detailed analyses should explain why balances and results of operations changed rather than simply presenting the amounts or percentages by which they changed. This Statement emphasizes that the analysis provided in MD&A should avoid unnecessary duplication by not repeating explanations that may be relevant to multiple sections and that "boilerplate" discussions should be avoided by presenting only the most relevant information, focused on the primary government. In addition, this Statement continues the requirement that information included in MD&A distinguish between that of the primary government and its discretely presented component units.

Unusual or Infrequent Items

This Statement describes unusual or infrequent items as transactions and other events that are either unusual in nature or infrequent in occurrence. Furthermore, governments are required to display the inflows and outflows related to each unusual or infrequent item separately as the last presented flow(s) of resources prior to the net change in resource flows in the government-wide, governmental fund, and proprietary fund statements of resource flows.

Presentation of the Proprietary Fund Statement of Revenues, Expenses, and Changes in Fund Net Position

This Statement requires that the proprietary fund statement of revenues, expenses, and changes in fund net position continue to distinguish between operating and nonoperating revenues and expenses. Operating revenues and expenses are defined as revenues and expenses other than nonoperating revenues and expenses. Nonoperating revenues and expenses are defined as (1) subsidies received and provided, (2) contributions to permanent and term endowments, (3) revenues and expenses related to financing, (4) resources from the disposal of capital assets and inventory, and (5) investment income and expenses.

GASB 103 – *Financial Reporting Model Improvements (Continued)*

In addition to the subtotals currently required in a proprietary fund statement of revenues, expenses, and changes in fund net position, this Statement requires that a subtotal for operating income (loss) and noncapital subsidies be presented before reporting other nonoperating revenues and expenses. Subsidies are defined as (1) resources received from another party or fund (a) for which the proprietary fund does not provide goods and services to the other party or fund and (b) that directly or indirectly keep the proprietary fund's current or future fees and charges lower than they would be otherwise, (2) resources provided to another party or fund (a) for which the other party or fund does not provide goods and services to the proprietary fund and (b) that are recoverable through the proprietary fund's current or future pricing policies, and (3) all other transfers.

Major Component Unit Information

This Statement requires governments to present each major component unit separately in the reporting entity's statement of net position and statement of activities if it does not reduce the readability of the statements. If the readability of those statements would be reduced, combining statements of major component units should be presented after the fund financial statements.

Budgetary Comparison Information

This Statement requires governments to present budgetary comparison information using a single method of communication—RSI. Governments also are required to present (1) variances between original and final budget amounts and (2) variances between final budget and actual amounts. An explanation of significant variances is required to be presented in notes to RSI.

How the Changes in this Statement Will Improve Financial Reporting

The requirements for MD&A will improve the quality of the analysis of changes from the prior year, which will enhance the relevance of that information. They also will provide clarity regarding what information should be presented in MD&A.

The requirements for the separate presentation of unusual or infrequent items will provide clarity regarding which items should be reported separately from other inflows and outflows of resources.

The definitions of operating revenues and expenses and of nonoperating revenues and expenses will replace accounting policies that vary from government to government, thereby improving comparability. The addition of a subtotal for operating income (loss) and noncapital subsidies will improve the relevance of information provided in the proprietary fund statement of revenues, expenses, and changes in fund net position.

The requirement for presentation of major component unit information will improve comparability.

The requirement that budgetary comparison information be presented as RSI will improve comparability, and the inclusion of the specified variances and the explanations of significant variances will provide more useful information for making decisions and assessing accountability.

EFFECTIVE FISCAL YEAR 2026/27:

GASB 104 – *Disclosure of Certain Capital Assets*

State and local governments are required to provide detailed information about capital assets in notes to financial statements. GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, requires certain information regarding capital assets to be presented by major class. The objective of this Statement is to provide users of government financial statements with essential information about certain types of capital assets.

This Statement requires certain types of capital assets to be disclosed separately in the capital assets note disclosures required by Statement 34. Lease assets recognized in accordance with GASB Statement No. 87, *Leases*, and intangible right-to-use assets recognized in accordance with GASB Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*, should be disclosed separately by major class of underlying asset in the capital as-sets note disclosures. Subscription assets recognized in accordance with GASB Statement No. 96, *Subscription-Based Information Technology Arrangements*, also should be separately disclosed. In addition, this Statement requires intangible assets other than those three types to be disclosed separately by major class.

This Statement also requires additional disclosures for capital assets held for sale. A capital asset is a capital asset held for sale if (a) the government has decided to pursue the sale of the capital asset and (b) it is probable that the sale will be finalized within one year of the financial statement date. Governments should consider relevant factors to evaluate the likelihood of the capital asset being sold within the established time frame. This Statement requires that capital assets held for sale be evaluated each reporting period. Governments should disclose (1) the ending balance of capital assets held for sale, with separate disclosure for historical cost and accumulated depreciation by major class of asset, and (2) the carrying amount of debt for which the capital assets held for sale are pledged as collateral for each major class of asset.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will improve financial reporting by providing users of financial statements with essential information about certain types of capital assets in order to make informed decisions and assess accountability. Additionally, the disclosure requirements will im-prove consistency and comparability between governments.

2023-01 **<u>Timely Escrow Retention Account Reconciliations</u>**

Certain arrangements with construction contract vendors require that the City deposit the retentions payable into an escrow account. At the end of the project, the retention is then released to the vendor and withdrawn from the account. The balance in the escrow account should be recorded in the general ledger and agree to the balance of the retention payable.

The City had five escrow accounts recorded in the general ledger when we started the audit. After we asked for the associated June 2023 bank statements and account reconciliations in October 2023, City staff determined that transactions in four of the accounts had not been recorded in the general ledger and the balances did not agree to the retentions payable.

One account had been closed in December 2022 when the retention was released to the vendor, but the balance in the general ledger provided for audit was $244,715, and one account had been closed in June 2023, but the balance in the general ledger provided for audit was $434,324. In addition, two other accounts required adjustments to the cash and retentions payable in the amounts of $258 and $1,401.

Although we understand that Finance staff attempted to obtain the retention account information from other departments well before the year-end closing, the final information was not provided to the Finance Department until October 2023 and the final reconciliation and adjustment was completed after the year-end audit began. We also understand that the Finance department performs these reconciliations on an annual basis and relies upon other departments to notify Finance when retentions are released and to provide the escrow account statements.

When bank account activity is not reconciled to the general ledger and recorded in a timely manner, errors or unauthorized transactions could go undetected. And, when retention escrow account activity is not recorded in the general ledger, the cash and retentions payable balances could be over- or understated.

The City should develop procedures to ensure that the escrow account statements are provided to the Finance Department throughout the fiscal year and when accounts are opened and closed, and the City should consider adjusting the balance in the general ledger on a more frequent basis, such as monthly or quarterly.

Current Status:
Implemented.

CITY OF SOUTH SAN FRANCISCO
MEMORANDUM ON INTERNAL CONTROL
STATUS OF PRIOR YEAR
OTHER MATTERS

2023-02 **Timely Journal Entry Posting**

Journal entries should be prepared and reviewed in a timely manner for the period in which the entry is to be posted, in order to keep accounts up to date with the current information. Generally, journal entries should be posted within 30-45 days of the transaction. In addition, to have a complete audit trail of the journal entry process, the dates of preparation and review should be documented for all journal entries. And, the post date of journal entries should normally be the date when the transactions occurred.

We selected forty journal entries for testing of controls over the journal entry process and supporting documentation and noted 13 of the journal entries were prepared and posted to the general ledger more than a month after the activity of the transaction took place. Although once the journal entries were prepared, they were reviewed and approved in a timely manner, the posting dates of the journal entries ranged from two to four months after the transaction dates.

Update for June 30, 2024:
We again selected forty journal entries for testing and noted 15 were prepared and posted to the general ledger more than thirty days after the activity of the transaction took place. Although once the journal entries were prepared, they were reviewed and approved in a timely manner, the posting dates of the journal entries ranged from two to six months after the transaction dates. We understand the delays were due to staff turnover and other tasks being considered a higher priority.

Without the timely preparation, review and approval of journal entries, there is an increased risk of errors going undetected and inaccurate interim reporting.

The City should develop procedures to ensure that all journal entries are prepared, reviewed, approved and posted to the general ledger in a timely manner (generally within 30-45 days of the date of activity).

Current Status:
The City agrees that the journal entries should be prepared and posted to General Ledger within reasonable time. Due to significant staff turnover in FY 2023-24, City is aware of posting delays and have implemented measures to have other staff to help with the review and approval.

2023-03 **Unrecorded Loan Receivable**

Loans issued by the City to outside agencies should be recorded in the general ledger.

During our review of the City Council minutes for fiscal year 2023, one action item mentioned a prior loan to a nonprofit agency and we noted that the loan was not recorded in the general ledger and was not included in the City's loans inventory listing.

City staff determined that the loan in the amount of $100,000 had been expensed when the loan was issued in fiscal year 2018.

Although the loan has a forgiveness provision and the City historically offsets such loans with an allowance for collectability, which means the net impact on the general ledger is zero, the City should develop procedures to ensure that all loans are recorded in the general ledger as a receivable when issued.

Current Status:
The City agrees with this finding. The loan receivable happened in 2018 and our Economic and Community Development Department (ECD) had experienced a high staff turnover. Finance will review all the outstanding loans with ECD staff to ensure that all the loans receivable that have a forgivable clause will be reflected properly in the general ledger.

2023-04 **Develop Policy for Processing Terminated Employees**

The City should process terminated employees in a timely manner. This includes terminating the employee from both the payroll and general ledger systems upon issuance of their last check, or shortly thereafter.

We selected twenty terminated employees for testing of proper and timely cutoff in the City's computer system and noted seven were not terminated from the payroll system from four months to up to four years after their last check date, as follows:

Termination Date	Last Check Date
10/14/2022	11/21/2018
11/28/2022	7/28/2022
1/5/2023	3/18/2022
2/17/2023	8/26/2021
2/17/2023	10/7/2021
3/31/2023	7/16/2020
3/31/2023	9/9/2021

The majority of the employees were part-time seasonal employees, and the department did not determine they would be separated from employment until fiscal year 2023. And, although we understand the City's departmental staff like the flexibility of being able to utilize the employees for special events, keeping inactive employees in the payroll and accounting system for extended periods of time could lead to unauthorized payroll payments or unintended access to the City's accounting system.

We also understand the City's payroll system does not have an option for deactivating employees, so seasonal employees will remain active in the system until the department submits a Personnel Action Form (PAF) to the Human Resources department to terminate them. Therefore, the City should work to develop a policy to define a reasonable timeframe for which employees may be inactive in the system before they are terminated.

Current Status:
Implemented.