CITY OF ALAMEDA
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS

FOR THE YEAR ENDED
JUNE 30, 2012

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CITY OF ALAMEDA
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS

For the Year Ended June 30, 2012

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MAZE & ASSOCIATES

MEMORANDUM ON INTERNAL CONTROL

December 3, 2012

Honorable Mayor, City Council, and City Auditor
of the City of Alameda
Alameda, California

We have audited the financial statements of the City of Alameda for the year ended June 30, 2012, and have issued our report thereon dated December 3, 2012. Our opinions on the financial statements and this report, insofar as they relate to the Alameda Municipal Power, are based solely on the report of other auditors. In planning and performing our audit of the financial statements of the City of Alameda 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 first 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 errors 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 entity'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 a material weakness.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We identified certain deficiencies in internal control that we consider to be significant deficiencies that are included on the Schedule of Significant Deficiencies.

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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 of Alameda.

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, City Auditor 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.

Maze & Associates

December 3, 2012

SCHEDULE OF SIGNIFICANT DEFICIENCY

2012-01 – Recording Loans Receivable

Criteria: Loans receivable must be recorded in the City's general ledger when the monies have been disbursed in relation to an executed loan agreement to a third party.

Condition: In September 2011, the Community Improvement Commission executed a loan agreement with Alameda Islander, LP in the amount of $8.6 million dollars. As of March 2012 the loan was not recorded in the general ledger.

Effect: This understated the City's loan receivable balance recorded in the general ledger.

Cause: According to staff the loan documents were not submitted to AmeriNational, the third party administrator that handles the City's loans receivable, for processing until February 2012 due to the focus being on other City projects.

Recommendation: We recommend that when monies are disbursed for loans a journal entry should be prepared to record the outstanding receivable in the City's general ledger immediately. We also recommend in conjunction with the loan disbursement that all necessary documents be submitted to AmeriNational timely.

Management's Response:

Finance will work with Housing staff to implement this recommendation.

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SCHEDULE OF OTHER MATTERS

2012-02 - Journal Entry Review

Journal entries are an important transaction cycle that affects all aspects of accounting and financial reporting. Prudent internal control concepts dictate that no single employee should process a transaction without the involvement of another employee. For journal entries, this typically takes the form of a second employee performing a review and approving the proposed entry prior to posting. The review and approval should be documented by a reviewer signing and dating that the review has been completed and the entry is approved.

We selected forty journal entries for testing and noted one did not have written evidence of approval, without proper approval of journal entries the likelihood of error, improper accounting treatments, and potential fraud increases. We understand that the omission was due to an oversight by the employee that was responsible for the review. We recommend that the City reviews all journal entries to ensure proper accounting and financial reporting and also provide evidence that the review process has been completed.

Management's Response:

Finance will implement this recommendation.

2012-03 – Business License Fees

The City collects business license fees for all individuals, partnerships, corporations, and sole proprietors conducting business in the City of Alameda. Per review of the Master Fee Schedule (Schedule), it appears that the current fee for assignment or transfer and lost license is $30.

During our cash receipt testing, we noted two receipts for business license transfers were charged $31 instead of the $30 listed on the Schedule for fiscal year 2011-2012. Upon further conversation with a City staff, it appears that the City has been charging $31 for business license transfers up until December 2011 during which City staff noticed the incorrect fee charged.

The City is not charging its customers in accordance with the fees listed on the Schedule. We were advised that staff was unaware of the changes made to the Schedule.

We understand the effect of the overcharging is immaterial to the City's financial statements. However, we recommend that the City make efforts to return the amount overcharged or apply credits to the overcharged accounts. The City should also make efforts to ensure that, staff responsible for collecting fees, are up to date with any changes made to the Schedule.

Management's Response:

The City will implement this recommendation.

SCHEDULE OF OTHER MATTERS

2012-04 – Monitoring Lease Agreements

The City currently has lease agreements that are being handled by a third party administrator. The third party administrator maintains the rent schedules and bills the lessees the amounts of rent due each month. However, we understand that he City is not currently monitoring these agreements to ensure accurate payments are being received.

During our cash receipt testing, we noted that out of forty receipts tested, a tower lease remittance from T-Mobile could not be recalculated or traced back to an executed agreement. City staff was unable to locate the current agreement therefore we were unable to agree the amount of the lease remittance to supporting documents. In addition, the City could not confirm if the amount was correct.

It was brought to our attention that there is lack of communication between the City and the third party administrator. In addition, the City is not monitoring their lease agreements that are handled by the third party administrator.

We understand that the third party administrator is under contract to monitor and calculate the rent/lease payments for the City. However, we believe that it is important for the City to be up to date with their lease agreements. Therefore we recommend that the City maintain a file with the most current lease agreements to ensure the payments received are accurate.

Management's Response:

The City will implement this recommendation.

2012-05 – Restrictive Endorsement of Checks and Securing of Receipts

Checks received as payment for City services should be immediately stamped with the City's restrictive endorsement upon collection by a cashier. In addition the checks should be kept in a locked drawer during the hours of operation.

During our review of cash collection procedures at the Community Development Building and Planning counter, located on the first floor of City Hall, we noted that City staff did not immediately endorse checks with the restrictive stamp as they are being collected for payment. Instead the staff that reconciles cash receipts endorses the check during the reconciliation process which is usually done the following day. We also noted that the checks are not being kept in a locked drawer even though there are security cameras in the permit center

By not immediately endorsing the checks and keeping them locked up during the hours of operation, the possibility of the interception of revenues increases.

The City's current procedures has staff endorsing the checks when they are reconciled, which typically occurs the following day. Also, the City relies on security cameras located above the front desk, instead of locking up the checks. To strengthen internal controls, we also recommend that the checks be immediately endorsed and locked up by staff upon receipt of the check.

Management's Response:

The City will implement this recommendation.

SCHEDULE OF OTHER MATTERS

2012-07 - Upcoming Governmental Accounting Standards Board (GASB) Pronouncements Effective for Fiscal Year 2012-2013:

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 toll way), 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.

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

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.

SCHEDULE OF OTHER MATTERS

2012-07 - Upcoming Governmental Accounting Standards Board (GASB) Pronouncements Effective for Fiscal Year 2012-2013 (Continued):

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

Management Response:

Staff will work with the auditors to ensure a timely implementation as needed.

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.

Management Response:

Staff will work with the auditors to ensure a timely implementation as needed.

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.

Management Response:

Staff will work with the auditors to ensure a timely implementation as needed.

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.

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.

SCHEDULE OF OTHER MATTERS

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

- *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.

Management Response:

Staff will work with the auditors to ensure a timely implementation as needed.

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SCHEDULE OF CURRENT STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCY

2010-01 – Information Technology Best Practices Recommendations

Criteria:

In reviewing controls over the information systems, we expect to find a verifiable computer vulnerability management/patch management process, such that critical patches are applied in a timely manner, typically within thirty to sixty days. This patching process can be verified by regular vulnerability scanning. In addition, we expect to find audit logs on critical systems such that any material changes to that system are logged and reviewed for unauthorized activity. This is especially true for financial applications where by data integrity is crucial.

Condition:

We were informed by City staff that the current audit logs on the Financial Application Server, are not reviewed on a regular basis and when they are reviewed do not provide enough information to determine who changed what. Based upon an internal vulnerability scan run on May 6, 2010, we discovered three critical vulnerabilities on the Financial Application Server. These three vulnerabilities were the same vulnerabilities found by our internal scan run on March 11, 2009. The details of the vulnerabilities have been communicated to City staff.

Effect:

We believe it is reasonably possible that an attack on and unauthorized access to the City financial application systems could occur and not be detected during the normal course of operation. Individually, neither the financial application server vulnerability nor the lack of review of audit/event logging constitutes a significant deficiency. However, we believe that together these deficiencies raise the risk that changes to the financial application and/or data could go undetected.

Cause:

Due to a weakness in the City's flaw remediation (vulnerability/patch management) process, a critical vulnerability was not patched or by some other means mitigated in a timely manner. In addition, due to a lack of audit and accountability policy and procedures, financial application audit logs are not reviewed regularly and do not produce actionable information. As such, an adverse change to the data within the application would not be caught in the normal course of business. Together the breakdown of control can lead to an unauthorized change to the financial application that could lead to a financial misstatement.

SCHEDULE OF CURRENT STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCY

Recommendation:

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. However, according to the National Institute of Standards and Technology (NIST) "State, local, and tribal governments, as well as private sector organizations, are encouraged to use the guidelines, as appropriate" NIST SP 800-100. In addition, the State of California singled the NIST standards out for adoption for State agencies in the California Information Security Strategic Plan (OCT 2009), "...by adopting the National Institute of Standards and Technology (NIST) 800-37 guidelines for certification and accreditation of information systems. Applying NIST guidelines to state government systems will demonstrate California's leadership in building a resilient, secure, and trustworthy digital infrastructure." We therefore recommend the adoption of NIST standards for information systems controls.

The following specific recommendations are found in the NIST control catalog and relate specifically to our findings:

- *Financial Application Server Vulnerabilities* - These vulnerabilities should be mitigated as soon as possible. The City should also implement a verifiable vulnerability/patch management process. The City should also evaluate and monitor the effectiveness of its information systems control procedures, including periodic vulnerability scans. If the vulnerabilities cannot be corrected, other mitigating controls such as host-based firewalls should be employed.

- *Audit/Event Logging* - We believe this is another important standard of NIST. Audit/event logs provide an effective detective control by automatically creating a record of every change made to the financial application and the server on which it runs on. The logs would include authorized changes and unauthorized changes made, to the server, application or data, by employees or would be hackers. In order for the City to effectively respond to potential unauthorized changes the City will need to have a process to review the audit logs for unauthorized changes on a regular basis. Given the financial system is at greater risk because of vulnerabilities, the systems logging and reviews of those logs are critical in detecting and responding to unauthorized changes in a timely manner. Without review of audit logs the City will not be able to detect material changes to the financial application or financial data during the normal course of business. NIST provides guidelines on audit/event log policies and processes (NIST SP 800-53 rev 3 § AU and NIST SP 800-92 Guide to Computer Security Log Management).

Current Year Status:

The City is planning for the outsourcing to a third party vendor of the computer platform used to host its accounting system in Fiscal Year 2013-14, which will provide for increased security, regular updates to system and accounting software, and daily backups of its data.

CITY OF ALAMEDA
MEMORANDUM ON INTERNAL CONTROL

SCHEDULE OF CURRENT STATUS OF PRIOR YEAR OTHER MATTERS

2011-01 -- Loan Receivable Collectability

On December 16, 2003, the City loaned $2,200,000 to Alameda Power and Telecom, currently Alameda Municipal Power, for the purpose of constructing a hybrid fiber-optic/coaxial telecom network. As of June 30, 2011, the loan receivable was still outstanding with no set repayment date. The City should assess the collectability of this loan. If the collectability is deemed unlikely, the City should write off the loan from its books.

Current Status: The City will evaluate the repayment status of this loan as part of the preparation of the budget for Fiscal Years 2013-14 and 2014-15.

2011-02 – Review of Check Registers

To ensure that sufficient internal controls are in place, check register that details all payments processed should be reviewed by an employee who cannot access the disbursements module of the City's financial system.

During the audit, we noted that the Controller reviews an Edit Batch List generated from the City's financial system prior to each check run. The Edit Batch List details each check that will be printed for that check run. Checks are printed upon the Controller's approval of the List. However, the final check register and the Edit Batch List are not compared after the check run.

The City's current practice allows for the possibility that a payment be added to the check run after the Edit Batch List is approved by the Controller because the review is done prior to the checks being printed.

We recommend that a review of the final check register to be done to ensure that all disbursements were properly approved.

Current Status: This recommendation was implemented in July 2011.

2011-03 -- Authorized Signer of City's Investment Account

Signature cards of bank and investment accounts should be updated immediately when there is a change in authorized signers.

As of June 30, 2011, a City employee who retired in August 2008 was still listed as an authorized signer in the City's LAIF account.

We recommend that the City review all its signature cards of cash and bank accounts immediately to ensure that all accounts signers are current and authorized by the Council. In addition, procedures should be established to ensure that outside parties (such as banks, investment safekeepers, investment advisors, and bond trustees) are aware of key employee turnover in a timely manner in order to prevent misrepresentation of the City.

Current Status: This recommendation has been implemented.

SCHEDULE OF CURRENT STATUS OF PRIOR YEAR OTHER MATTERS

2011-04 -- Capitalization Policy Update

The City has a capitalization threshold of $50,000 for its infrastructure currently. While it is essential to capitalize capital expenditures, a lower threshold means that more items are capitalized. Hence, resources are spent in keeping track of these items. To improve efficiency of the City's closing of its books at year end, we recommend that the City consider raising its threshold to a higher amount.

Current Status: The City increased its infrastructure capitalization minimum for each capital project to $100,000 in Fiscal Year 2011-12.

2010-02 -- Bank and Investment Accounts Signature Cards

Signature cards for the bank and investment accounts should be updated immediately when there is a change in authorized signers. During our examination of the City's signature cards, we found that two departed employees were still listed as authorized signers in two bank accounts and one investment account.

We were informed by the City that due to the continuous staff turnover in Finance in recent months, the signature cards of the above accounts were not updated.

We recommend that the City review all of its signature cards immediately to ensure that all authorized signers are current. In addition, a step should be added to the employee departure checklist to ensure that outside parties (such as banks, investment advisors, bond trustees) are informed that the departed employee no longer represents the City.

Current Year Status:

This recommendation has been implemented.

2010-03 -- Payroll Database

Significant changes to the payroll database, such as employee additions and changes in pay rates, should be verified by another employee. Currently, the Administrative Technicians, who process payroll, have the ability to change data and add employees to the payroll database without an independent review by an employee who does not have access to the database.

We were told by Finance that the City's financial system cannot produce a report that tracks changes made to the payroll database for review purposes.

Changes to the personnel database should be reviewed by an employee who does not have access to the database. Also, employees who process payroll should not have the ability to change payroll database.

Current Year Status:

This recommendation has been implemented.

REQUIRED COMMUNICATIONS

December 3, 2012

Honorable Mayor, City Council, and City Auditor
of the City of Alameda
Alameda, California

We have audited the financial statements of the City of Alameda as of and for the year ended June 30, 2012, and have issued our report thereon dated December 3, 2012. 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 any impact on the City's 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.

As discussed in Note 14 to the financial statements, the State enacted ABx1 26 and AB 1484 (Dissolution Laws) which dissolved California redevelopment agencies effective January 31, 2012. The provisions of the Dissolution Laws are extremely complex and contain provisions requiring the unwinding of transactions recorded in prior years and re-measurement of amounts due to the City and its component units. The Dissolution Laws also give the State Controller's Office and Department of Finance approval powers over transactions and asset transfers and require a plethora of filings, processes and special procedures to be performed by external audit firms. These matters required an exorbitant amount of staff's time and attention.

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 $184 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 5 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 auditor.

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

As discussed in Note 14 to the financial statements, the State enacted ABx1 26 and AB1484 (Dissolution Laws) which dissolved California redevelopment agencies effective January 31, 2012. The provisions of the Dissolution Laws are extremely complex and contain provisions requiring the unwinding of transactions recorded in prior years and remeasurement of amounts due to the City and its component units. The Dissolution Laws also give the State Controller's Office and Department of Finance approval powers over transactions and asset transfers and require a plethora of filings, processes and special procedures to be performed by external audit firms. These matters required an exorbitant amount of staff's time and attention. This in turn had an adverse effect on audit timing and effort.

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, its committees, 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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