

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT
OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

INDEPENDENT AUDITOR'S REPORT

City Council
City of Avalon
Avalon, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Avalon, California (City), as of and for the year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated March 27, 2020. Our report includes a reference to other auditors who audited the financial statements of the Avalon Medical Development Corporation, a discretely presented component unit, as described in our report on the City's financial statements. The financial statements of the Avalon Medical Development Corporation were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

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 have not been identified. However, as described below, we identified certain deficiencies in internal control that we consider to be material weaknesses and 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 entity's financial statements will not be prevented or detected and corrected on a timely basis. We consider the following deficiencies to be material weaknesses.

(1) Audit Adjustments

As a result of audit procedures and the City's review of financial information for the fiscal year ended June 30, 2019, there were sixteen material and immaterial audit adjustments. The auditing standards acknowledge that the auditor should not be part of the City's system of internal control because adjusting material transactions in the financial statements creates an independence threat and reduces auditor transparency. An important element of controls over financial reporting is for management to identify adjustments necessary for financial statements to be fairly stated.

Recommendation

We recommend that management prepare and post all adjustments to the accounting records prior to the start of the audit. When this is not possible, management should identify and communicate to the auditors the potential areas of adjustment that may need to be addressed during the audit process. This will help to reduce the risk of material misstatement.

Management's Comments Regarding Corrective Actions Planned

Management agrees with this finding and will work to ensure future adjustments are reflected in the accounting records prior to the start of the audit, or when this is not possible, that the potential areas of adjustment are identified and communicated to the auditors.

(2) Controls over strengthening Internal Controls

During our testing of internal controls surrounding cash receipts, cash disbursements, and payroll, we noted the following:

- For cash receipts, the individual responsible for the collection of customer payments has the ability to modify customer data. We also noted that the individual who prepares the bank deposits and collects cash receipts has the ability to post receipts to the general ledger.
- For cash disbursements, we noted that access to the vendor database was not restricted and accounts payable personnel had the ability to add new vendors without review.
- For payroll, we noted that the employees that process payroll have the ability to add employees to the payroll system.

Recommendations

To ensure proper segregation of duties, we recommend the following:

- The individual responsible for cash receipts should be prohibited from access to the customer database. In addition, the person responsible for the collection of payments should be prohibited from posting these transactions to the general ledger.
- The ability to add, delete or modify vendor data should be segregated from accounts payable personnel.
- The ability to add employees should be segregated from those that process payroll.

Management's Response Regarding Corrective Action Planned or Taken

Management agrees with this finding and has already taken steps to ensure proper segregation of duties. Individuals responsible for cash receipts no longer have system access to post transactions to the general ledger. The Finance Director is currently working with software vendors to implement similar segregations of duties for accounts payable and payroll processes.

(3) Waste Disposal Post Closure Trust

During our review of the trust used to account for funds for closure and post closure costs for the landfill, we noted there was no investment policy or guidance provided to the third-party trustee on how to invest the City's funds.

Recommendation

The California Government Code Section 53601 allows monies held by a trustee and pledged to an obligation of the City to be invested in accordance with the trust agreement, however the trust agreement of the City is vague in regard to how the funds should be invested and any limits imposed on it.

We recommend the City establish an investment policy as to how the funds should be invested and any limits imposed by the City. The investment policy should be provided to the trustee. In addition, the City should monitor the investments on a periodic basis to ensure compliance with the City's investment policy.

Management's Response Regarding Corrective Action Planned or Taken

Management agrees with this finding and will establish an investment policy specific to its trust accounts. Management will provide the policy to its trustee and monitor investment activity for compliance.

(4) Information Technology

We noted the City does not have documented policies and procedures related to IT Logical Security, IT environmental controls, IT network management and data back-up frequencies. Additionally, we noted the potential for increased risks due to the Finance Director having the capability of administering logical access within the SunGard accounting system and that the maximum password age setting of 365 days is too long.

Recommendation

We recommend policies and procedures be put in place surrounding IT Logical Security, IT environmental controls, IT network management and data back-up frequencies. We recommend the Finance Director solely approves access for the SunGard users and changing maximum password age settings, where security is a concern to between 30 and 90 days and when security is not a concern to between 120 and 180 days.

Management's Response Regarding Corrective Action Planned or Taken

Management agrees with this finding and will establish policies and procedures to address the finding.

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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

City of Avalon's Responses to Findings

The City of Avalon's responses to the findings identified in our audit are described within the letter. The City's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Davis Farr LLP

Irvine, California
March 27, 2020