



**Independent Auditor's Report on Internal Control over Financial Reporting and  
on Compliance and Other Matters Based on an Audit of Financial Statements  
Performed in Accordance with *Government Auditing Standards***

City Council  
City of Lemon Grove  
Lemon Grove, 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, business-type activities, each major fund and the aggregate remaining fund information of the City of Lemon Grove (City), as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated December 20, 2018.

**Internal Control Over Financial Reporting**

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control that we consider to be material weaknesses.

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 deficiencies described in item 2018-1, 2018-5 and 2018-6 in the accompanying schedule of findings and responses 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 described in the accompanying schedule of findings and responses as items 2018-2, 2018-3 and 2018-4 to be significant deficiencies.

### **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 Lemon Grove's Responses to Findings**

The City's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. 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 City's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Van Lant & Fankhaed, LLP*

December 20, 2018

**CITY OF LEMON GROVE**  
**SCHEDULE OF FINDINGS AND RESPONSES**  
**Year Ended June 30, 2018**

***2018-1 Segregation of Incompatible Duties***

*Condition:*

This finding is carried forward from our prior year report dated April 10, 2018. Our audit procedures included a review and evaluation of the City's business license function, including the billing and collection of business license fees. Based on our procedures, we noted that the cash receipts clerk at City Hall is responsible for administering the business license program. This includes the billing and collection functions, and maintaining the business license database.

*Criteria:*

In a strong internal control environment, the billing and collection functions should be segregated. The individual responsible for administering the business license function should not also be handling incoming payments. If this is not practical, personnel independent of the business license function should periodically reconcile the information in the business license software with the revenue recorded in the general ledger and also the bank deposits.

*Cause of Condition:*

Incompatible duties performed by the same individual creates opportunity for business license revenues to be received but not recorded in the City's general ledger.

*Potential Effect of Condition:*

Lack of internal controls in the City's business license function could result in payments being collected that are not ultimately recorded in the City's general ledger and deposited into the City's bank accounts.

*Recommendation:*

We recommend the City evaluate the business license function to determine if the collection function could be segregated from the administration/billing function. At a minimum, City management should establish procedures for independent personnel to reconcile the business license activity to the revenue in the general ledger and bank deposits.

*Management's Response:*

The City agrees that in a strong internal control environment, billing and collection functions should be segregated. The City's Finance Department has limited staff and complete segregation of duties is not always achievable. The City will institute several mitigating controls (for example: tasking the Accounting Analyst the responsibility of matching the business license reports with bank deposits on a monthly basis) to reduce the risks of fraud and errors that can occur with weak internal controls.

**CITY OF LEMON GROVE  
SCHEDULE OF FINDINGS AND RESPONSES  
Year Ended June 30, 2018**

***2018-2 Old Outstanding Checks***

*Condition:*

This finding is carried forward from our prior year report dated April 10, 2018. Our review of various bank account reconciliations indicated that the City was reporting several old outstanding (uncleared) checks each month. Some of these checks were issued in 2010, which does not appear to be in compliance with the City's established procedures. It should be noted that the City's current management has been taking steps to address this issue.

*Criteria:*

The City's "Financial Policy and Procedures Manual" includes a section regarding bank account reconciliations. This includes a section providing guidance on stale dated checks identified during the bank reconciliation process. It describes in detail the procedures to be performed for old outstanding checks.

*Cause of Condition:*

Established procedures regarding stale dated checks may have been overlooked due to the lack of consistency in the Finance Department's management function (employee turnover).

*Potential Effect of Condition:*

The City has recorded decreases to cash along with the related expenditures, for checks issued many years ago, which have not cleared the bank account. This can potentially result in cash (and fund balance) being understated, and the opportunity for the old outstanding checks to be misappropriated.

*Recommendation:*

We recommend the City continue in its efforts to address this issue and establish procedures to ensure compliance with the Financial Policy and Procedures Manual.

*Management's Response:*

City staff followed established procedures in the Financial Policy and Procedures Manual regarding stale dated checks by publishing public notice in the newspaper of record on July 26, 2018 and August 2, 2018 for outstanding checks over three years old. Forty-five days after the initial public notice, stale dated checks that were not claimed were credited to the funds they were original drawn from. Moving forward, the City is dedicated to following the procedure to clear stale dated checks at least once per fiscal year.

**CITY OF LEMON GROVE  
SCHEDULE OF FINDINGS AND RESPONSES  
Year Ended June 30, 2018**

***2018-3 Manual Cash Receipts***

*Condition:*

The majority of the City's incoming revenues/receipts are initially entered in the cash receipt module of the City's Finance software. However, the City occasionally utilizes manual cash receipt forms (multipart) as necessary, e.g. if the Finance software is temporarily down. Although the manual receipt forms are numbered, our audit procedures indicated that the manual receipt forms were not always used in numerical order, and that the copies of the receipts issued were not necessarily reconciled to the amounts eventually recorded in the Finance software.

*Criteria:*

While the issuance of manual receipts may be necessary at times, it is important to maintain numerical control over these forms, to ensure that all incoming revenue is ultimately recorded in the general ledger and included in the bank deposits. An individual independent of the cash receipt process should maintain custody of unused cash receipt forms, and should also maintain a log of the receipt books issued.

*Cause of Condition:*

This condition may be a result of inconsistency in Finance management positions in previous fiscal years, resulting in a general lack of oversight. It is unclear why the manual receipt forms are sometimes issued out of order.

*Potential Effect of Condition:*

Receipt forms could be issued without the incoming revenues/receipts being posted in the City's general ledger or included in the bank deposits.

*Recommendation:*

We recommend the City evaluate the use of the manual cash receipt forms to determine if controls could be strengthened in this area, including establishing a custodian of the unused forms.

*Management's Response:*

The City will establish a custodian of unused manual cash receipt forms and will reconcile manual receipt forms used to amounts recorded in the Finance software.

**CITY OF LEMON GROVE**  
**SCHEDULE OF FINDINGS AND RESPONSES**  
**Year Ended June 30, 2018**

***2018-4 Travel Expenses/City Credit Cards***

*Condition:*

As noted in our prior year report regarding travel expenses, our audit procedures indicated that required travel authorization forms were not always included in the supporting documentation for certain travel expenses paid by the City's credit cards. Due to the timing of our audits, current City management was not able to fully resolve this issue for the 2017-18 fiscal year, but has been taking steps to address this finding for future fiscal years.

*Criteria:*

The City has established policies regarding the use of City credit cards and travel expenses. This includes the utilization of a "Travel Authorization/Expense Report."

*Cause of Condition:*

The City experienced turnover and vacancies in certain key positions in previous fiscal years, which may have contributed to this situation. Current management has been taking steps to address this issue.

*Potential Effect of Condition:*

The City's travel expenses and other payments by credit card may not be adequately reviewed and approved. The condition described above could result in a lack of transparency for some of the City's disbursements/expenditures.

*Recommendation:*

We recommend the City continue in its efforts to ensure that all travel costs and credit card payments are properly reviewed, approved and documented, in accordance with established policy.

*Management's Response:*

In summer 2018 the City's travel form was updated to conform to the City's travel policy. Staff is required to complete the "Travel Authorization/Expense Report" in compliance with the City's Financial Policy and Procedure Manual. All City travel costs and credit card payments will be reviewed, approved and documented, in accordance with the established policy.

**CITY OF LEMON GROVE  
SCHEDULE OF FINDINGS AND RESPONSES  
Year Ended June 30, 2018**

***2018-5 Allocation of Overhead to Restricted Funds***

*Condition:*

This finding is carried forward from our prior year report dated April 10, 2018. Based on our testing of costs charged to funds with restricted revenue, it appears the City is charging both direct salaries and indirect overhead costs to certain funds. Various percentages are used to allocate the salaries of certain positions, including Finance and Human Resources personnel. However, the City's staff was not able to provide us with documentation in support of these allocation methods. For example, we were not able to find a cost allocation study which would provide evidence that these allocations are reasonable.

*Criteria:*

The State Controller's Office has established "Guidelines Relating to Gas Tax Expenditures" to be used by Cities and Counties. Section 440 regarding Overhead indicates, "Overhead will only be allowed via an approved cost allocation plan or an equitable and auditable distribution of overhead to all departments." Other restricted moneys received by the City have similar requirements. For the sake of transparency, the City should ensure that all costs charged to restricted funds are adequately documented. This documentation should include evidence that overhead costs are equitable and reasonable, in relation to all costs incurred by the City.

*Cause of Condition:*

The City was not able to provide us with a formal cost allocation plan in support of the costs mentioned above.

*Potential Effect of Condition:*

Unallowable costs could be charged to restricted funds, including the Gas Tax Fund. In addition, the City might not be allocating allowable costs to restricted funds, resulting in higher expenditures of discretionary money, including expenditures in the General Fund.

*Recommendation:*

Based on discussions with City staff, it appears the City has taken steps to contract with a consultant to perform a salary distribution study. We recommend the City continue in these efforts to ensure all overhead costs are properly documented.

*Management's Response:*

The City is continuing its efforts to ensure all overhead costs are properly documented. The City agrees that a formal overhead cost allocation plan is necessary. To accomplish that goal, in fiscal year 2018-2019 a RFP was issued to find a consultant to perform an overhead cost allocation plan. After receiving three bids, City Council awarded the cost allocation plan project to a firm that will begin work onsite in January 2019.

**CITY OF LEMON GROVE  
SCHEDULE OF FINDINGS AND RESPONSES  
Year Ended June 30, 2018**

***2018-6 Building/Planning/Engineering Fees and Deposits, Master Fee Schedule***

*Condition:*

Based on audit procedures performed for the 2017-18 audit, we noted certain conditions indicating a lack of oversight and internal control in the Developments Services Department. Specifically, while testing Building Permit fees, we found various fees charged which did not agree with the City's "Master Fee Schedule." We also noted that when permits were issued, they were not necessarily marked as closed/finalized in the system.

We tested certain grading and engineering fees collected during the 2017-18 fiscal year, and noted that the amounts charged did not agree to the latest Master Fee Schedule. Based on our testing and inquiry, it appeared the City's software had not been updated for the most recent changes to the Master Fee Schedule.

We also noted that incoming planning deposits were being posted to revenue accounts in the City's general ledger, with the revenue being backed out when the deposits were returned, or paid out.

It should be noted that we brought up these issues to current City management while performing fieldwork, and they immediately took steps to address the situation.

*Criteria:*

It is important for the City to maintain strong internal controls over the collection of fees and deposits in the Building and Planning Departments. Controls should be established to ensure all applicable fees assessed and collected are in accordance with the approved rates, and that all incoming deposits are properly recorded as liabilities in the general ledger.

*Cause of Condition:*

The City experienced turnover and vacancies in certain key positions in previous fiscal years, which may have contributed to the lack of oversight in this area. Current management has been taking steps to address this issue.

*Potential Effect of Condition:*

Fees and deposits collected might not be accurate without effective oversight of this function. Recording deposits in revenues accounts may cause difficulties in tracking the deposits since revenue accounts are closed out each fiscal year.

*Recommendation:*

We recommend that the City's management continue in its efforts to evaluate the activity in the applicable departments, and establish and maintain strong controls and oversight over these functions.



**CITY OF LEMON GROVE  
SCHEDULE OF FINDINGS AND RESPONSES  
Year Ended June 30, 2018**

***2018-6 Building/Planning/Engineering Fees and Deposits, Master Fee Schedule - Continued***

*Management's Response:*

Strong internal controls over the collection of fees and deposits in the Planning and Building Department are essential for transparency and public trust. As stated in the Cause of Condition section, turnover and vacancies in Development Services Department positions contributed to a lack of oversight. When this issue was brought to the attention of staff by the auditors, the software used to calculate the building and planning fees was immediately updated to match the City Council adopted Master Fee Schedule. In addition, the planning deposits were immediately set-up in a deposit account, a transfer from the revenue account to the deposit account was posted, and the fiscal year 2017-2018 planning deposit activity was reconciled. City staff is continuing to work backward to reconcile past years of planning deposit activity, so that the planning deposit account will reflect the true liability of deposits being held by the City.