CITY OF PASADENA

TASK FORCE ON FINANCIAL ADMINISTRATION AND INTERNAL CONTROLS

SUMMARY REPORT

October 3, 2015

City of Pasadena
Task Force on Financial Administration and Internal Controls
Summary Report
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TASK FORCE MEMBERS

C. Douglas Kranwinkle, Chair
Robert E. Carlson
Robert C. Davidson, Jr.
James F. Dowling
Donald C. Nanney
Charlotte K. Reith
Raul F. Salinas

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The City of Pasadena's Task Force on Financial Administration and Internal Controls ("the TF") is providing this Summary Report to the Mayor, City Council and City Manager of Pasadena, California. This Summary Report and the Reports of the TF Subcommittees which are delivered with it are collectively referred to as "the Reports." The Reports will be reviewed at a meeting of the TF on Saturday, October 3, 2015, commencing at 9 am.

I. TF Formation and Assignment

In 2014 the City became aware of an apparent misappropriation by a City employee of a large amount of public funds which had occurred over a period of 11 years (the "Embezzlement"). One response to the Embezzlement was the creation of the TF, which was appointed on February 23, 2015 by then Mayor William J. Bogaard. Its members – Robert Carlson, Robert Davidson, James Dowling, Douglas Kranwinkle (chair), Donald Nanney, Charlotte Reith and Raul Salinas – brought various disciplines and experiences to the work of the TF. Resumes of the TF members highlighting those disciplines and

experiences may be found on the Pasadena City Web Site along with other information concerning the creation and work of the TF.

According to a Statement of Purpose issued by the City and thereafter elaborated upon by both former Mayor Bogaard and his successor, Mayor Terry E. Tornek, in comments at public meetings of the TF, the job of the TF was to:

1. Advise regarding the City's actions to review its financial administration and reporting;
2. Review the integrity and effectiveness of the City's financial reporting and controls;
3. Assess the City's internal audit function, and the pros and cons of an ongoing citizen-based audit advisory committee; and
4. Make such other recommendations as the Task Force may determine will strengthen the City's financial administration and internal controls and minimize risk.

The purposes as set forth above and as further explicated by Mayors Bogaard and Tornek formed the charter of the TF. The TF was advised that those purposes intentionally did not include pursuing or determining culpability in connection with the Embezzlement or a search for other preexisting misdeeds. Instead, the TF's focus was to be forward looking – that is, to review and assess the City's financial statements, systems, administration and controls and – if deemed appropriate by the TF – to make recommendations for change with a view towards preventing future misappropriations of funds and improving the integrity and usability of City financial statements and information. Other institutions and persons have been directly pursuing questions of culpability for the Embezzlement and the recovery of the embezzled funds. These are, among others, the office of the District Attorney of Los Angeles County; the office of the Pasadena City Attorney; an ad hoc committee of the Pasadena City Council; and an investigator hired by the City to investigate whether others contributed to or had some responsibility for the conditions that resulted in the Embezzlement. The TF has not been privy to any of the activities,

findings or conclusions of any of these separate persons and entities. The Members of the TF are aware of a recommendation by an entity named Management Partners to move control of the program that was the subject of the Embezzlement from the Public Works Department to the Water and Power Department. Until very recently, the TF was not provided with the work of Management Partners and expresses no opinion on the recommendation.

II. Work on the TF

The TF had its first meeting March 9, 2015 and met monthly thereafter through July in noticed sessions that were open to and attended by the public including representatives of the press. At those sessions the TF received presentations and questioned various City government officials and others concerning City financial statements, systems, and administration, as well as internal controls and other processes relevant to prevention of misappropriations of City funds. Two Subcommittees of the TF were formed at the first meeting, each

charged with studying and making recommendations with respect to specific aspects of the overall TF assignment. These were:

1. A Financial Administration and Reporting Subcommittee (the "Financial Subcommittee") chaired by Mr. Carlson and including Messrs. Nanney and Salinas; and
2. An Internal Controls and Internal Audit Subcommittee (the "Internal Controls and Audit Subcommittee") chaired by Ms. Reith and including Messrs. Davidson and Dowling.

The Subcommittees met frequently and reviewed a substantial amount of written material relating to the processes of Pasadena City Government. They also examined best practices of other similar governmental bodies. In addition they interviewed a number of Pasadena City officials and others who could provide information of relevance. Specifics of their work are detailed in their respective Reports and the Exhibits thereto.

Neither the TF nor the Subcommittees looked, as a discrete matter, into the financial statements and controls of various legally separate entities (such as the Rose Bowl Operating

Committee), which are included in the City's financial statements, but rather considered the financial statements and financial information of the City as a whole.

In conducting its work the TF did not have subpoena power nor was it provided with a staff or budget. Its members served without compensation. The Office of the Pasadena City Attorney provided legal advice to the TF and the Office of the Pasadena City Manager provided assistance in calling and documenting meetings as well as arranging for oral presentations and interviews and responding to document requests.

A significant volume of requests for information and documentation was made to City staff by the TF and its Subcommittees. Many of the requests were timely satisfied by the staff, but some documentation was not provided until September 17 at a meeting of three members of the TF and the City Manager. At the meeting, the City Manager reminded the TF members present that a number of key City positions have been unstaffed during the time period when the document requests were

pending and that existing City staff has been heavily occupied with implementation of a new data management system and other important matters during that same time period. Neither the TF nor its Subcommittees have had an opportunity to review in any depth the newly provided documentation but, based upon conversations with the City Manager and a cursory review of the new documentation, the TF does not believe it would change the Reports.

III. Overview

The separate Reports of the Financial and the Internal Controls and Audit Subcommittees set forth a significant number of specific, detailed observations and suggestions. A summary list paraphrasing these observations and suggestions is at the end of this Report.

In formulating the observations and suggestions, the members of the Subcommittees and the TF have been mindful that too much required process can lead to lack of effective process if, as a result of

imposing the process, employees seek "work arounds" or simply neglect those processes that they deem stupid, unnecessary or unduly burdensome. But purposeful, sensible process is vital and the establishment of a strong "control environment" in the operations of the government of the City of Pasadena is essential to avoiding future misappropriations, particularly of the kind that last for a substantial period of time. The TF believes that the observations and suggestions it is making are important, purposeful and sensible – not overkill – and that they should be implemented as soon as possible. While there can be no guarantee that the suggested changes, if implemented, will prevent all future misappropriations, they should prevent any lengthy, continuing misappropriation of City funds like the Embezzlement which went unchecked for 11 years.

The brief overview in this Summary Report does not cover all areas of concern dealt with by the TF and the Subcommittees. Additional observations, as well as greater detail and background information concerning the rationales for the TF observations and suggestions set forth in this Summary Report, are contained in the

Subcommittee Reports. The TF urges that management of the City study those important documents.

Internal Controls

A number of observations and suggestions involve the TF's view that a vastly improved financial control "climate" or attitude is needed in Pasadena's City operations. KPMG in its November 11, 2014 report to the City regarding the Embezzlement made 43 recommendations for changes in internal controls. That large number of KPMG comments on controls is – in itself – a strong indication that a major overhaul of the City's internal controls environment is needed. This calls for management of the City to set a stronger tone which, among other things, makes clear that complying with internal control processes and procedures is expected of all employees and that serious consequences will flow to those who don't do so. The TF has been advised by the City Manager that efforts to accomplish this have been underway. These efforts should be continued and increased.

It is important that the stronger tone emphasizing the importance of complying with controls be constantly and consistently

communicated, not only to new employees but also to those who have been on the payroll for years. There were in fact processes in place that should have stopped the Embezzlement in its early stages. But a climate of complacency appears to have developed and the processes were at best disregarded. Perhaps what is most troubling about the Embezzlement is not the aggregate amount taken, but that it continued unnoticed for over eleven years!

The City has recently begun to implement a new data management system, the Tyler Technologies Munis Enterprise Resource Planning System ("ERP). City management is placing significant emphasis and reliance on the institution of the ERP as one of the key steps towards establishing more effective financial controls. The TF agrees that the ERP clearly has the potential to be of great assistance in that respect, but the TF is concerned regarding several aspects of the ability of the ERP to fix control deficiencies.

First, in implementing the initial phases of the ERP, the City did not run its prior system on a parallel basis until "bugs" in the ERP could be discovered and fixed. The TF expressed concern about that approach

to City management and, as recently reported, problems have in fact occurred. None of the TF members – most of whom have lived through data management system conversions in their private business and professional lives – has ever before seen a major data management system conversion attempted without the parallel operation of the outgoing system for a reasonable period of time.

More importantly, while the TF is impressed with the capability of the ERP, no data management system can be truly effective until processes and procedures fitting the particular needs and peculiarities of the specific user (in this case the City of Pasadena) are developed, written, taught to and understood by the employees who will be interfacing with the system. Among the documents delivered to members of the TF at the September 17 meeting referred to above were drafts of processes and procedures relative to the ERP. The TF has not had an opportunity to review those documents in any detail and does not express a view on the quality or completeness of the particular processes and procedures reflected in the drafts.

The Internal Controls and Audit Subcommittee also reviewed the City's actual and proposed responses to the 43 comments put forth by KPMG. The Subcommittee's Report contains a number of observations and suggestions for needed improvements to those responses, including fully and adequately responding to all comments, providing greater specificity in the responses and setting forth timetables for implementation. The Report noted that the City had not, for example, fully addressed the comments made by KPMG regarding the use of special handling request forms. The repeated use of such forms was a critical tool used by the person who perpetrated the Embezzlement. KPMG's report was issued to the City in November 2014. It made 7 specific recommendations concerning needed changes in the use of the special handling form. The Internal Controls and Audit Subcommittee Report recommends that the City accelerate implementation of the KPMG control suggestions and provides guidelines for the City to use in approaching the KPMG comments and any future auditor comments regarding internal control improvements.

Hiring Delays

As noted in several places in this Report, well before the TF came into existence the City had determined to hire a new Finance Director and an Internal Audit Manager, and had proposed to engage an outside vendor to conduct a City-Wide Fraud Risk Assessment. The City has not had a permanent Finance Director since January 2015 and has been without an internal audit function on staff for several years.

The positions of Director of Finance and Internal Audit Manager are key to the financial integrity of the City. After 8 months without a Finance Director the City on September 17 announced the hiring of a person to fill that position. Having a strong Finance Director in place will be critical to successful implementation of many of the suggestions for change made in the Reports. The Internal Audit Manager position is also very important to the matters covered by the Reports and it should be filled post haste.

Fraud Risk Assessment; Future External Audits

A proposal to hire an outside vendor and move forward with a City-Wide Fraud Risk Assessment has similarly been "in the works" since prior to formation of the TF. Completing that study has been described as "critical to reduction of the future possibility of embezzlement" by a Special Assistant to the City Manager. Former Mayor Bogaard expressed considerable interest in the City moving forward with the study. Although to date no firm has been retained for the fraud risk assessment assignment, the TF has been advised that the City is about to hire a vendor. Again, the TF recommends that the selection not be further delayed. When the Fraud Risk Assessment project has been completed, the vendor's report should be provided to the City Manager on an initially confidential basis.

In addition, as a related step, the TF recommends that future audits by the City's external auditors be conducted on a risk basis with emphasis on fraud detection and prevention.

Financial Statements

While the Internal Controls and Audit Subcommittee was principally focused on financial system controls and audit functions, the Financial Subcommittee concentrated on reviewing the various financial statements and financial information issued from time to time by the City and/or available on the City Web Site. The City produces a significant and comprehensive amount of financial information on a regular basis. Neither the Financial Subcommittee nor the TF as a whole suggests that such information is in any way materially misstated. The information, however, is often quite lengthy and not particularly easy to access, sort, understand and use – in some instances even for experienced reviewers. A number of suggestions contained in the Report of the Financial Subcommittee are directed towards correcting this so that the City's published financial information is more useful to the general public and to those who need to understand and use it, such as members of the City Council.

The Financial Subcommittee and the TF as a whole believe that ordinary citizens and elected officials have a right to accessible,

understandable and usable financial information from City government. The Report of the Financial Subcommittee puts forward a number of suggestions for improvement, including the presentation of summary financial information in so-called "dashboard" or graphic formats as well as the inclusion of links and tools for accessing and sorting information. It also encourages the inclusion of definitional and other educational information to assist the reader in understanding complex financial data and the adoption of certain widely accepted tools for appraising the City's financial health.

Ethical Training

The TF believes that an overwhelming majority of City employees are ethical and honest. However, even the most ethical and honest of us can benefit from regular reminders of the ethical obligations that are expected of us. Accordingly, the TF and each of the Subcommittees also urge that the City substantially step up its ethical training and retraining of employees and that annual certification of knowledge of, and agreement with, the Pasadena City Code of Ethical Standards be required.

Members of City management have indicated to the TF doubt as to the need for, and the utility and efficacy of, such training and certification. The TF disagrees. Many of the TF members in their private occupations have been involved with ethical training and annual certifications of the type suggested here and believe it can be effective. The City Manager has indicated willingness to reconsider this issue.

The TF understands that the Code of Ethical Standards has recently been updated and reissued and that the City Manager regularly discusses elements of the Code with City employees. The TF recommends that the entirety of the Code be discussed with all employees of the City on a regular basis so that the ethical principles of the Code become an integral part of the culture of City Hall.

Mandatory Time Away Policy

The TF believes that the City should consider adopting a policy of mandatory time away from their jobs for those employees who occupy positions that could be used, directly or indirectly, to misappropriate City funds. This could, for example, apply to persons in accounting, human resources and cash management functions. Employees subject

to the policy should be cross-trained to do the jobs of others who are also subject to the policy during their respective time away periods.

Mandatory time away policies are widely regarded as an important safeguard against crimes like the Embezzlement. Such crimes to be successful over time usually require the constant presence of the wrongdoer so that others do not come across evidence of the misdeeds.

The City Human Resources Director advised the TF that existing union contracts would not permit such a policy. The TF suggests that the subject be reviewed with labor counsel and, if appropriate, pressed with the affected unions.

Financial Administration

At this time, the Financial Subcommittee and the TF have largely deferred commenting regarding financial administration as such, other than to call – as described earlier – for acceleration of the hiring of an Internal Audit Manager. The KPMG recommendations and the recommendations of the TF are not likely to be adequately responded to until the new Finance Director is in place.

Vendor Scrutiny

This is another area where both Subcommittees have much to observe and suggest. The suggestions begin with a focus on greater control over a master list of the vendors and contractors who have been approved to do business with the City. The legitimacy of each vendor or contractor who is to appear on or be later added to the master list should be verified and documented and vendor and contractor performance and payment should be tracked and reviewed in "real time" to promote greater accountability. It seems to the TF highly unlikely that the two churches, which, as part of the Embezzlement scheme, were named on a total of 131 invoices, would have been added to an "Approved Vendor" list had even a minimal diligence investigation of vendors been required.

Significant data as to the top 100 vendors and contractors should be made available in the dashboard-type financial information discussed earlier in this Report and in greater depth in the Report of the Financial Subcommittee

Other Matters

The Subcommittee Reports cover many other areas. Included among these are *Enhanced Employee Training and Supervision, Special Revenue Funds, Insurance Recovery and Coverage* and *Establishment of an On-Going Citizen Based Audit Advisory Committee.* With respect to training, the Internal Controls and Audit Subcommittee Report describes and recommends that the City develop a "commitment to competence" program with ongoing training and minimum competency standards among other things. This suggestion builds upon several recommendations in the KPMG Report.

With regard to special revenue funds, the TF notes that the Underground Utility Program, which was the program through which the Embezzlement was perpetrated, grew in size way ahead of any actual expenditures. In addition, the processing of invoices for that Program was largely unsupervised. Thus the fund became a very attractive target for the Embezzlement. While the TF's focus was on future looking matters, the TF observes that it would be wise to examine

other funds on a regular basis to gain comfort that similar situations do not develop.

The City has made claim for recovery of most of the embezzled funds under applicable insurance policies. It is recommended by the TF that such recovery be aggressively pursued, including through litigation if necessary. The City's various insurance policies should also be carefully reviewed to assure that adequate coverage of risks continues to be in place.

For the reasons set forth in the Report of the Internal Controls and Audit Subcommittee, the TF recommends that the City Council approve and name a citizen-based audit advisory committee to assist and advise the Council and community regarding audits and related matters.

IV. Observations and Suggestions

Based upon its work and that of its subcommittees, the TF makes the following observations and suggestions:

1. A stronger management tone emphasizing the importance of internal controls and compliance with such controls should be established and maintained.
2. Control procedures for the ERP should be developed, documented and monitored.
3. Accounting policies and procedures should be completed for the ERP, as well as for all manual processes, then updated and monitored continuously, with changes made as necessary from time to time.
4. As a result of the advent of the ERP and the hiring of a new Finance Director, the City's finance organizational structure should be reviewed to assure appropriate supervision, staffing and segregation of duties and the proper alignment of control processes.
5. An Internal Audit Manager should be hired without further delay and consideration should be given to that individual having a reporting relationship to the Audit Committee of the City Council.

6. The hiring of a vendor to conduct a city-wide fraud risk assessment should also proceed without further delay and the work product should be delivered to the City Manager on an initially confidential basis.
7. Future external audits should be conducted on a risk basis with emphasis on fraud detection and prevention.
8. A mandatory time away from the job program for certain employees (or if that is not permissible, its functional equivalent) should be considered.
10. The City's response to the KPMG comments needs greater clarity and follow-through.
11. All KPMG recommendations regarding special handling requests should be implemented immediately.
12. A reliable master vendor list and data-base should be created listing all approved vendors. No vendor should appear on the list or be added to it later until such time as the legitimacy of the vendor has been established and documented. No vendor should be hired by the City who is not on the master list. The Finance

Director should be actively involved in establishing the list and the rules and procedures that will govern it.

13. Information regarding the City's top 100 vendors should be available to the public in dashboard format, with relevant information concerning the services or products being provided by the vendors and with links to contracts and purchase orders.

14. Vendor purchasing should be tracked on a real time basis and the tracking reports should be publicly available.

15. Accounts payable policies and procedures should be reviewed, updated and strengthened, and should include :

    a. A requirement that there be adequate supporting documentation – no verbal approvals permitted;
    b. Documentation of adequate diligence regarding payables; and
    c. A prohibition against original documents leaving the payables department.

16. City financial statements and financial information should be made easier to access and more understandable and readily searchable.
17. Simplified data should be made available, perhaps in the formats of dashboards or graphs, and other forms of "Popular" or "community" financial information should be considered for use by the City.
18. Tools that provide insights into a city's financial health should be utilized and the results made available to the public.
19. The City's Web Site and other places where City financial information is presented should include educational information such as definitions of technical terms to assist the public in interpreting the information.
20. "A commitment to competence" program should be developed and periodic training in functional competence should be required of all employees.
21. Performance appraisals should follow and be closely related to competency development.

22. The Pasadena Code of Ethical Standards should be regularly reviewed, updated and continuously reemphasized. All employees should undergo annual ethics training and annual certification should be required. Vendors and contractors should also certify to their knowledge of the Code and their compliance with it in dealings with the City.
23. All City revenue fund balances should be regularly reviewed and forensically tested for discrepancies.
24. All avenues for recovery of the funds taken in the Embezzlement should be pursued, including litigation if necessary.
25. Insurance coverage should be reviewed for adequacy.
26. An on-going, citizen-based Audit Advisory Committee could provide substantial value to the City and the City Council should consider creating such a body.

V. Submission of Report

This Summary Report is submitted by the City of Pasadena Task Force on Financial Administration and Internal Controls.

_____/s/_____

By C. Douglas Kranwinkle, Task Force Chair

CITY OF PASADENA
TASK FORCE ON FINANCIAL REPORTING AND INTERNAL CONTROLS

FINANCIAL ADMINISTRATION AND REPORTING SUBCOMMITTEE -- REPORT

SEPTEMBER 23, 2015

1. BACKGROUND

This memorandum is intended to serve as a draft report by the Subcommittee on Financial Administration & Reporting ("Financial Subcommittee"). The Financial Subcommittee was one of two Subcommittees of the Task Force on Financial Administration and Internal Controls ("TF"). Its members are Robert E. Carlson, Donald C. Nanney and Raul F. Salinas. The TF was formed as one of the City's responses to an alleged misappropriation of $6.4 million by an employee (the "Embezzlement").

2. EXECUTIVE SUMMARY

2.1. Summary of Financial Subcommittee Actions

The Financial Subcommittee performed the following actions (in addition to regular meetings of the full Task Force):

1. Interviewed, and received briefings by, senior City staff members.

2. Interviewed members of the City Council.

3. Interviewed a Tyler Technologies' employee regarding Tyler's Munis financial software that the City is implementing.

4. Reviewed the most recent available examples of many financial reports routinely prepared by City staff for submission to the City Council.

5. Reviewed the availability and transparency of financial reports and "Open Data" on the City website, including consideration of the ease of access and understandability of the financial information made publically available.

6. Researched financial reporting practices of numerous other cities, both within and outside California.

7. Researched sources of “best practices” for financial reporting and Financial Transparency, including those of relevant associations of government finance officers, Statements of the Governmental Accounting Standards Board, as well as the International Monetary Fund Code of Good Practices on Fiscal Transparency.

8. Reviewed and considered “popular” or “community” forms of summary financial reporting, including “dashboard” and other graphical methods of reporting financial information.

9. Obtained and considered financial health indicators and formulas used by municipal auditors.

10. Reviewed and considered numerous other documents and materials regarding the City's investigation of, and response to, the Embezzlement, including reports and recommendations of outside investigating auditors and experts, the referral to the Los Angeles County District Attorney for criminal investigation and prosecution of the former employee and alleged accomplices, the employee crime/fidelity insurance coverage and claim; the City's lawsuit against the former employee and alleged accomplices, and news reports relating to the Embezzlement.

2.2. <u>Summary of Financial Subcommittee Observations</u>:

<u>Financial Management System Upgrades</u>

1. Prior to the Embezzlement coming to light, the City had commenced efforts to update its systems, including the acquisition and customizing of the Tyler's Munis Enterprise Resource Planning (ERP) system. The Embezzlement emphasizes the need to complete those efforts on an expedited basis. The new ERP system went on-line in part as of July 1, 2015, and it is expected to improve financial reporting, transparency, streamline existing report generation, facilitate the creation of new reports, and institute a more complex system of checks and balances. Restricted computerized access supposedly should insure that requisite authorizations are made by appropriate individuals delegated with such authority. We are informed that "system short cuts" and bypassing of required authorizations of the type that may

have enabled the Embezzlement to exist and go unnoticed for as long as it did will be prevented with the new system. Given the recent startup of the ERP system on July 1, the Finance Subcommittee is unable to comment on the accuracy of financial reporting, although the ERP system is expected to enhance accuracy.

The Finance Subcommittee also reviewed certain aspects of the City's financial administration relative to its implementation of the ERP. A key focus of this review was to learn more about the City's segregation of duties as it rolls out its new ERP. The review consisted of interviewing a Tyler Technologies' employee. Tyler's Munis is the ERP software purchased by the City and designed specifically for public sector financial management and other core functions. The system handles core functions including financial report generation, human resource management, and revenue tracking.

In 2013, the City retained SoftResources, a company which specializes in conducting independent public sector need assessment. The company performed such an assessment and also graphically mapped the City's financial, human resource and revenue tracking processes in order to make recommendations for improvement. SoftResources also developed the Request for Proposal used to solicit ERP vendors, including Tyler. The City selected Tyler's Munis software in the spring of 2014, and in July 2014, City staff began the process of data transfer (converting from paper to paperless) in preparation for the ERP rollout, a process that took about a year.

Tyler's Munis software is being implemented in three phases. Phase 1, which went live July 2015, consists of nine (9) modules: Budget, General Ledger, Accounts Receivable, General Billing, Accounts Payable, Project Accounting, Fund Accounting, Contracts, and Requisition/Purchasing. In October 2015, the second phase, referred to as Phase 1A, is scheduled to go live with a Revenue Module and Business License Module.

The third phase, referred to as Phase 2, is planned currently to go live January 1, 2017, with a Core Human Resources Module and a Payroll Module.

One of several key features of ERP is that it provides a role-based security system in which no employee, acting alone, is able to post and approve invoices for approval. This computerized segregation of duties is intended to prevent any one person from improperly processing vendor invoices without proper approval.

City staff members are still working through stabilization of Phase 1. At time of writing, we are two months into Phase 1 with the anticipated learning curve as City employees adjust to the new paperless system. Additionally, Phase 1 is still undergoing a review to determine whether the system can be streamlined to require fewer approvals without breaching checks and balances. We urge caution in connection with any reduction of safeguards.

Based on the very limited time in which the City has rolled out Phase 1 of the ERP system, the Financial Subcommittee believes it lacks sufficient information to comment upon whether the ERP system will ultimately perform as planned.

2. In response to the Embezzlement, the City ended its employment relationship with its Finance Director (without cause) in January 2015. The Finance Department is short staffed. The extended absence of a Finance Director and other staff has impeded our ability to review and fully understand how the Finance Department will be managed going forward.

3. City management intended to fill an Internal Audit Manager position first, but should have given top priority (or at least concurrent top priority) to engaging a new Finance Director. While we understand the apparent desire of current City management to manage the response and change in management systems, those factors which led and/or contributed to the Embezzlement will not be fully addressed until the Finance Department can be reorganized under direction of the new Finance Director going forward.

4. Given the financial management changes that are in process, the Financial Subcommittee is not at this time expressing views on the financial administration of the City.

Transparency of Financial Reports and Data

5. From a nontechnical perspective, the select City's financial reports the Financial Subcommittee reviewed appear generally to be prepared consistent with applicable accounting and municipal standards and much financial data is available to the public. The Financial Subcommittee is unaware of any finding by the City's External Auditors that the City's reports fail to comply with applicable standards. This is not to say that those reports are capable of being readily understood by members of the public. To the contrary, many of the reports are formatted with technical financial detail that makes it difficult to fully understand their content from the perspective of a member of the general public and even from the perspective of members of the City Council.

6. Only a few of the financial reports are readily identifiable on the City's website. Other financial materials and reports are available too on the website, but they are difficult to find in the absence of indexing at a single logical webpage. For example, some of the financial reports and information can only be found by searching for the applicable meeting where presented to the Council as part of an agenda packet, or through the general search window using search terms that may or may not identify the desired materials.

7. In 2014, prior to the discovery of the Embezzlement, the City began to make Open Data[1] available on the website and the City initiated efforts to develop a "dashboard" style presentation of financial information and indicators. While City management recognizes the need, those efforts are just beginning and will require significant greater development by City staff. Data compiled by the ERP, however, should reduce the human resource effort needed to implement such a sustainable reporting system.

8. The financial information on the City's website is generally kept up to date but not consistently so. Suitable allocation of staff resources is needed to keep the information timely and accurate.

[1] Open Data includes a wide variety of information about the City. In the financial context, Open Data includes raw data (e.g., names and amounts of all vendor payments during a fiscal period) that can be reviewed and manipulated into various summary formats as desired by the viewer. Had such data been publically available and searchable years sooner, someone on the City staff or a member of the public might have noticed and questioned years sooner why so many payments were being made to two churches from the Underground Utility Program fund. This new capability should help to avoid or detect fraud going forward.

9. Consistent with well-developed and available principals, policies and guidelines for Financial Transparency (both in the United States and internationally), the citizens and elected officials of Pasadena have a right to transparent and understandable financial information about the City's finances and management.

10. At present, notwithstanding good intentions and initial efforts, there is much lacking in easy access and understandability of City financial information. Stronger directed effort is required.

11. A City resident without financial expertise would find it difficult to understand core measures of the City's financial condition. In addition, even a resident having some accounting or financial experience would have difficulty understanding the City's financial reports in the context of its municipal operations. For example, the City has unfunded obligations which a public member may not easily or readily understand. While there is a central source of information for tracking change orders affecting the City's large capital improvements projects, such as the Glenarm Repowering Project, it is not easily accessible on the City's Website. Greater clarity in the formatting and presentation of financial reports would aid the understandability and transparent nature of City operations.

12. Improved transparency and understandability would be of assistance also to elected officials, some of whom are not steeped in municipal finance upon election, and even for those who are experienced in financial accounting matters.

13. The "Budget in Brief" received rave reviews by users. There was shared sentiment among interviewed stakeholders and the Finance Subcommittee that similar forms of summary information, including "dashboard" and other graphical presentations, would be of great assistance to all concerned, with more detailed information and formats available as needed. In addition, we were informed that the new ERP system will facilitate nearly automatic creation of desired dashboards and graphics from raw financial data, as a programming exercise for IT staff.

14. It was observed by us that – in order to serve both the public and elected officials – the financial reports and information made available on the City website should include (in the text or through

links) an educational component explaining the meaning of terms and presentations. Less sophisticated readers might then have a better opportunity to understand.

15. Among the advantages of good financial transparency and its associated educational value is improved opportunity for members of the public – as well elected officials and senior staff – to spot potential problems and raise questions that can lead to early discovery and correction of improper activities or practices. It would also add to greater civic engagement by residents and other stakeholder groups.

Employee Training in Code of Conduct and Ethical Standards

16. As explained by the City's Human Resources Director, the ability of the City to detect and weed out dishonest candidates at the hiring stage appears to be limited by laws and regulations governing the hiring process. This makes it all the more important for the City to implement best financial management practices, controls and oversight of existing employees.

17. Best practices should include training and instruction of employees in what is expected of them with regard to their conduct and ethics. The Embezzlement has shown that the tendency of City management to trust the good intentions and honesty of employees can lead to a culture of inattentiveness to adequate financial management and controls that are needed to prevent or catch theft by dishonest employees. It was observed to us repeatedly during interviews that the Embezzlement could not have occurred in its amount and duration without inattentiveness (or worse) by those in position to detect it.

18. The City has written policies setting forth separately a Code of Conduct" and a delineated set of "Ethical Standards". While new employees may be informed of those policies, the City does not adequately emphasize them periodically to City personnel. There is no program for annual re-certification of understanding and adherence to the Code of Conduct or to the Ethical Standards, such as is required of personnel of numerous other agencies at all levels of government and even large corporate entities. Many of these annual re-certifications can be implemented (and are in other public and private sector settings) using widely available computerized modules.

19. It was expressed to us that annual re-certifications are not favored because they are ineffective, essentially because exhortations to be honest are demeaning and unnecessary for honest employees and futile for dishonest employees. This attitude may have contributed to the culture of inattentiveness that allowed the embezzlement to occur and continue.

20. An increased level of training regarding the Code of Conduct and the Ethical Standards would help to emphasize to a dishonest employee that this is an important subject that has management attention, perhaps deterring bad acts, and it would also help to facilitate adverse personnel action should an employee choose to behave improperly notwithstanding clear knowledge and acknowledgement of the Code of Conduct and the Ethical Standards.

21. The City has a laudable program called the Pasadena Training Academy. The 2014 – 2015 Course Catalog includes a wide range of educational classes for employee education and advancement. Significantly, the City's Code of Conduct is nowhere mentioned as an element of instruction. The word "Ethics" appears once, in the Pasadena Leadership Academy course, without any indication of the nature and scope of that topic. Management staff recently reviewed the Code of Conduct and Ethical Standards, last updated in 2002, and it is being incorporated as part of an existing program identified in the 2015-2016 Course Catalog. Greater ownership over the implementation and City-wide emphasis of these important values is an achievable and essential component to restoring public confidence in light of the City's embezzlement scandal.

Other concerns

22. The Underground Utility Program fund did not have a fund balance (or cash reserve) policy. This allowed the fund to become excessive, way ahead of funding needs, without supervisory attention, making the fund an attractive target for theft, which became more blatant as the inattention continued.[2]

[2] Our task does not include review of the City's handling going forward of the Underground Utility Program and its funding. We understand that the City is reviewing the

23. Prior to commencing the ERP implementation, the City did not track its vendor purchasing on a "real time" basis, but did so on a quarterly basis. Consequently, it remains unclear whether expenditures by City personnel in the fourth quarter (or any quarter) may be driven in whole or in part by a desire to maintain a departmental budget rather than out of actual necessity. In making the observation, the Finance Subcommittee does not suggest that City personnel are in fact engaged in such practices. Rather, tracking "real time" expenditures (and income) is a common business practice, and given the size of the City's budget, should be implemented to promote greater accountability and transparency, and could lead to potential cost efficiencies. Management advises the capacity to track on a "real time" basis is capable of being done under the new ERP.

Accuracy and Integrity of Financial Reporting

24. We are unable to comment on the accuracy and integrity of financial reporting going forward. Financial reports may "accurately" reflect fraudulent transactions or payments, as occurred in the Embezzlement. Management believes the ERP system is expected to enhance accuracy and integrity of inputs as well as timely opportunity to identify and investigate potentially inappropriate financial transactions where integrity may be lacking.

Practical Limitations on Recommendations

25. Ultimately, improvements in financial reporting and management cannot eliminate crime and infidelity by dishonest personnel, but can significantly reduce the opportunity, scope and duration before discovery, so that a scandal such as the embezzlement case need not occur again.

26. We leave to our sister Subcommittee on Internal Controls and Audit (or to the Task Force as a whole) any observations and assessment as to whether there should be an ongoing citizen-based audit advisory committee.

Underground Utility Program and will be deciding its fate and disposition of funds separately from the TF effort.

27. We understand that implementation of our recommendations will depend greatly on the sustained commitment and ability of the City to devote the necessary resources. Our recommendations are more goal oriented, as their implementation will require management directive and staff input as to resources, means and methods.

2.3. Summary of Finance Subcommittee Recommendations:

The City Response

1. The City should aggressively continue all avenues of response with a view toward correcting shortcomings in financial management, improving transparency of financial reporting, recovering stolen funds or insurance proceeds and restoring public confidence as expeditiously as possible.

2. The fraud risk assessment is an important component of restoring public confidence and should not be delayed any longer.

3. We understand that the fraud risk assessment will be done in tranches on a priority basis, as resources permit, eventually extending to all 131 funds (besides the Underground Utility Program fund that has already been extensively investigated). If feasible, additional resources should be devoted to shorten the time needed to complete this process. In addition, the fraud risk assessment should be more than forward looking and should include some retrospective forensic accounting examination. Fundamentally, this is necessary in order to satisfy the public as to whether the embezzlement case was isolated or whether other misappropriation of funds has occurred.

4. At time of writing, National Union Fire Insurance Company of Pittsburgh, PA (the City's insurer under its Crime/Fidelity policy) has not yet responded to the claim for embezzlement losses other than to investigate the claim. Coverage for embezzlement losses occurring over an 11 year period is, of course, a complex matter. If the claim is denied, the City should still pursue the claim, including litigation, if necessary. Depending on the results of the claim – and the reasons for the results – further assessment may be needed regarding the City's understanding and management of its insurance coverages, exclusions, terms and conditions and what steps are needed timely to preserve and pursue an insurance claim. In addition, the City should review its coverages to ensure that it is obtaining the coverage that it is expecting and to negotiate better terms to meet expectations. Given the large amount of insurance coverages obtained by the City, at a premium cost of more than $3 million per year in the last couple of years, the City is in a position

to obtain favorable terms and it should take advantage of that opportunity.

Financial Management System Upgrades

5. The City should aggressively continue its implementation and training regarding the Tyler's Munis ERP system to benefit from its advantages for financial management as soon as possible.

Finance Department in Transition

6. The City must hire a permanent Internal Audit Manager as soon as possible. If added budgetary appropriations are required to make this hire, City staff should take this to the Council forthwith and we urge the Council to approve such requests.

Transparency of Financial Reports and Data

7. The City should develop an easy-to-use index in one place on the City's website (logically in the Finance Department webpage) including identification of, and links to, all the financial reports and data available on the City's website.

8. The City should devote sufficient staff resources to keep the financial information accurate and up to date. Financial reports and data should be posted to the index with links to the material promptly upon becoming available.

9. The City should continue and enhance its efforts to be transparent in its financial affairs by providing:

    a. Open Data, including expanded data and information of a financial nature.

    b. Increased and improved functionality to facilitate use and analysis of financial Open Data into desired formats and summaries, with links to explanatory materials regarding use of such programs. The ability to sort alphabetically, chronologically, by dollar amount (low-to-high, high-to-low), and by vendor/industry group, should be made available to the public in an easy to use format.

    c. The vendor payment information in Open Data should be searchable by industry sector and should include:

        i. Summary reference to the nature of the work or services performed or the product obtained for the payments (or link to that information).

ii. Link to the contract or purchase order pursuant to which the payments were made (omitting only confidential or trade secret information that the City is bound to keep confidential).

d. Dashboard summary of the top vendors in dollar amount annually. The example of such a dashboard under development by City staff was for the top 20 vendors in 2014. That dashboard should be expanded going forward to include the top 100 vendors. Instructions should be provided as to how to obtain more information about vendors and industry sectors in the Open Data page on the website.

e. Summary reports and materials, such as the Budget-in-Brief (a useful current City publication filled with pie charts and other easy to understand information) should be developed with respect to other financial reports, including "popular" or "community" financial reports, in addition to the Comprehensive Annual Financial Report ("CAFR") required of all cities.

f. Increased use of dashboards and graphical displays of financial data. See Column 6 of Exhibit "1" for additional specific recommendations regarding enhanced use of graphics in various financial reports.

g. The City's "Financial Overview," dated September 22, 2014 (available on the Finance Department webpage) is a good start for summary reporting using graphics. Priority should be given to improving that material, likely aided by the Tyler's Munis ERP system.

10. The City should assess for adoption and use a number of available analytical tools and formulas that can be used to gain insight into the financial health or distress of the City or its various funds. These include the Financial Measurement Indicators for the City of Pasadena, provided by LSL Certified Public Accountants, and the California Municipal Financial Health Diagnostic from the League of California Cities. As an important part of transparency, such tools and formulas should be applied to relevant data and the results provided in summary form, including dashboard and graphic formats. The "Financial Overview" mentioned above includes some of this kind of information, but it is just a start. It should be improved with additional indicators and more easily understandable explanations of the meaning and significance of the indicators. Such indicators should be available on a City-wide basis as well as broken down by department and fund. Finally, where feasible, financial indicators should be developed to

facilitate assessment as to how the City is performing as compared to similar cities (for instance, is the City more expensive, less expensive or about the same as similar cities with respect to annual utility costs per capita).

11. The City should also include more material of an educational nature, such as links to definitions of financial terms and other explanations, to make the financial materials more readily understandable to members of the public who are not as skilled as financial or accounting experts.

12. As one of the largest economic drivers in the region, and one of it's (if not the) most prominent city in the region, Pasadena should be a standout leader in the area of financial transparency using the most innovative and effective reporting tools available. Due perhaps to numerous reasons, the City has much opportunity to develop in this regard.

13. The Financial Subcommittee recommends the City meet its full ERP implementation schedule given its significant importance. The Financial Subcommittee understands that once fully implemented the ERP will increase the difficulty of concealing the theft of money or city property, equipment, supplies and/or other materials.

14. The ERP purportedly works upon a platform of internal checks and balances so that no one department can manipulate the City's purchasing ordinance. It should help protect against the use of document falsification by a single employee. Again, the Financial Subcommittee urges the expedited implementation and training associated with a complete rollout of the ERP system.

Employee Training in Code of Conduct and Ethical Standards

15. The City should adopt a system for annual training or reminders and reaffirmation by employees in writing with respect to the City's "Code of Conduct" and the "Ethical Standards" (in addition to the training provided during initial orientation upon employment).

16. The Pasadena Leadership Academy course should include an expanded component to ensure that the portion on "Ethics" includes the City's "Ethical Standards" and the "Code of Conduct" that are not mentioned in the Pasadena Training Academy 2014 – 2015 Course Catalogue. While management staff advises the subject matter is incorporated in the 2015-2016 training program, the Financial Subcommittee strongly believes it should be called out in the course catalog more significantly. It should also be considered whether these subjects can be worked in at some

relevant point in other courses, to reach other employees besides those seeking to assume supervisory or leadership roles.

17. While the City has written policies setting forth its "Code of Conduct"[3] and "Ethical Standards"[4] required of all employees,

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[3] A relevant portion of the City's Code of Conduct states as follows:

> Because the City is tax-supported and exists to promote the general health and welfare of the community, employees of the City have responsibilities greater than their counterparts in private industry. Pasadena City employees are in the "public eye", and employment with the City carries an obligation of personal integrity and conduct that series to establish public respect, confidence and trust.
>
> Employees represent the City of Pasadena and the quality of City service is judged through their appearance and demeanor. The residents of Pasadena have the right to expect that City employees will provide services in an efficient, complete and courteous manner. Employees must be "public relations": conscious and service oriented. ***It is intended that the rules and procedures which follow will assist employees in maintaining high ethical standards and proper job performance, and in avoiding potential conflicts of interest both in fact and appearance….***

(See, Manual of Personnel Rules, Practices, and Procedures ("Personnel Manual") Section 1.00, Subject: 1.05 Code of Conduct, 1992.) (Emphasis and italics added.)

[4] A relevant portion of the City's Ethical Standards states as follows:

> I. Employees of the City are required to discharge the duties and responsibilities of their positions with professional impartiality, regardless of personal considerations, and recognizing that the public interest, as articulated by City policy, is their primary concern. The conduct of employees in their official capacity must be beyond reproach. Their conduct shall be such that when viewed by the reasonable person, it is a credit to the integrity of City government.
>
> II. To meet this above stated requirement, employees must:
>
> A. Respect and comply with the rules, ordinances and statutes establishing standards of ethical conduct, both on and off the job….
>
> F. City funds or property may never be used for personal or private gain or benefits and employees must be absolutely honest in all dealings, in whatever capacity, with City funds, properties or facilities.

those policies were last updated in January 2002 and are not reviewed annually by all City employees. The City does not have a computerized program requiring its employees to review and reaffirm their understanding and compliance with such policies. These types of annual compliance reviews are routinely performed in various governmental agencies and numerous private sector agencies. The failure to update these policies and make them a part of the evaluation process creates an appearance that they are not given high priority within the City. As written, the Code of

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G. Never accept or engage in employment or activities that may appear to be, or are incompatible with public duties, whether on or off duty. Employees of the City should not become involved or affiliated with any agency or entity that receives funds from the City, either directly or indirectly, where that association or affiliation may create a conflict of interest, or an appearance of a conflict of interest or impropriety….

I. Disclose all financial interests which may constitute a conflict of interest with official duties, and disclose the nature and extent of personal interests in any business entity engaging in any transaction with the City to the extent required under the City's conflict of interest resolution.

J. Refuse to accept gifts, favors, services or promise of future benefit from any person or entity doing business with the City of Pasadena, such as, but not limited to, vendors, contractors, developers, agents, attorneys or others where such gift, favor, serviced or promise could compromise independence of judgment or action as a public official or employee, and disclose any offer of gift, favor, service or promise to the employee's supervisor.

K. Not act in any manner, whether or not specifically prohibited by rule, practice or procedure, which could be construed by an objective, reasonable person to result in or create the appearance of:

1. Using public office for personal gain.

2. Giving preferential treatment or partiality to any person or group.

3. Willfully impeding governmental responsiveness, efficiency or effectiveness.

4. Making a governmental decision outside the established, official City procedures or beyond the authority of the employee.

(See, Personnel Manual, *supra*, Section 1.00, Subject: 1.10 Ethical Standards.) (Emphasis and italics added.)

Conduct and the Ethical Standards provide clear direction how employees are to govern themselves in the workplace and when dealing with the public. Avoiding actual and/or perceived conflicts of interest situations are prominently noted and strongly encouraged. One can only wonder whether the embezzlement would have been detected sooner than the 11 years it lasted if these policies had been highlighted more prominently in the workplace. Stated otherwise, would the alleged embezzlement have been detected sooner by one or more vigilant coworkers had they been reminded annually to be mindful of ethical standards imposed on each City employee?

Other Concerns

18. The City should review its fund balance (or cash reserve) policy to determine whether additional funds should have such a policy, including any funds with balances significantly exceeding annual expenditures.

19. The City should track its vendor purchasing on a real time basis. This would enable assessment as to whether purchasing is based on need or primarily to expend budgets. It should be confirmed whether the new Tyler's Munis ERP system will facilitate such tracking, or it should be tweaked as necessary to do so. In addition, policies and procedures will be needed to assure that the tracking occurs and employees will need to be trained and assigned to review the tracking results.

20. The City should provide additional reports forecasting its unfunded obligations, such as pension costs and capital improvement overruns.

3. SCOPE OF WORK OF FINANCIAL SUBCOMMITTEE

3.1. Scope

1. The Financial Subcommittee defined its scope of work as assessing and making recommendations, from the perspective of the public member, on the following matters:

   a. The extent to which the City's financial reports serve their intended purpose based on accountability, understandability in light of their intended purpose, timeliness, computerized search accessibility;

   b. The extent to which the reports provide succinct and key financial indicators of the City's financial condition, vendor payments, actual operating results compared to budget, a list of the top 25 (or more) vendors and recipients of

payments (excluding employee salaries and other wage related items), and other financial information in a "dashboard" fashion on an annual-year and multi-year basis;

c. The extent to which the CAFR report can be summarized for easy use by the general public, without special financial expertise, through a combination of summaries, condensed reports, line and bar charts, using plain language;

d. A comparison of financial reports generated by other cities for purposes of informing the Financial Subcommittee of better practices available for providing municipal financial operational reports;

e. The nature and extent of financial reports provided to the City's Finance Committee; and

f. The City's Financial Administration, primarily the organization, structure, functioning and staffing of its Department of Finance.

4. Approach

4.1. City Websites Reviewed

Pasadena, California
Glendale, California
Riverside, California
Los Angeles, California
San Jose, California
Santa Monica, California
Long Beach, California
Boulder, Colorado

4.2. Financial Reports

The Financial Subcommittee reviewed 16 financial reports and insurance documentation, as set forth below. Each of the financial reports generally contains detailed accounting information respecting various municipal operations and budgets. A more detailed discussion of these reports, including suggested recommendations, is provided in Exhibit "1", attached.

	Report
A.	Annual Report on Procurement
B.	Property/Casualty Insurance Renewals
C.	Financial Status Report
D.	General Fee Schedule
E.	Schedule of Taxes, Fees and Charges

F.	FPRS Supplemental Contribution from City
G.	Gann Limit
H.	Budget Adoption
I.	Amendments to FY 2015 Adopted Budget
J.	Quarterly Investment Report
K.	2014-2015 Investment Policy
L.	Annual Audit Plan Update
M.	CAFR-Comprehensive Annual Financial Report
N.	Fund Policy Update
O.	Commitment of Fund Balance Agenda Report
P.	Annual Audit
Q.	CAPER-Consolidated Annual Performance and Evaluation Report

4.3. Other Documents Reviewed

A list of other documents reviewed not included in the above categories is provided below.

	Report or Document Type
A.	Report Letter re Underground Utility Program, Public Works Department Engineering Division, by KPMG, LLP, dated November 11, 2014
B.	Management Letter for FY ending June 30, 2014, by Brown Armstrong Accountancy Corporation, dated November 14, 2014
C.	Other documents and staff presentations submitted to the City Council at the Special Meeting on January 5, 2015, for Underground Utilities Program Audit Discussion
D.	The Agenda Packet for the Regular Meeting of the Council's Municipal Services Committee, Tuesday, May 13, 2014, including the Agenda Report: Review of Underground Utility Program
E.	Audit Plan Update, Department of Finance, October 20, 2014
F.	Employee Crime/Fidelity Policy and Insurance Claim Documentation
G.	Underground Utilities Program Follow-Up to Task Force from Julie A. Gutierrez, Assistant City Manager, dated May 4, 2015.
H.	Manual of Personnel Rules, Practices and Procedures, Section 1.10 (Personal Conduct and Standards of Employment), Subject 1.05 (Code of Conduct), and Subject 1.10 (Ethical Standards), dated January 1, 2002.
I.	Status Report: Glenarm Repowering Project, Combined Cycle Power Plant (GT-5), dated April-May 2015
J.	Request for Proposals for Fraud Risk Assessment by City of Pasadena, Department of Finance, dated February 18, 2015.
K.	Fraud Risk Assessment, Questions from Vendors, provided by Julie Gutierrez on April 7, 2015
L.	PowerPoint Presentation regarding Open Data, by Department of Information Technology, dated April 7, 2015.
M.	Financial Overview Report, City of Pasadena, dated September 22, 2014.

N.	PowerPoint Presentation regarding Enterprise Resource Planning (ERP), dated April 7, 2015.
O.	"Budget in Brief Fiscal Year 2015", City of Pasadena, prepared by City of Pasadena Finance Department.
P.	Internal Audit Manager Job Bulletin and Job Description.
Q.	Pasadena Training Academy 2014-2015 Course Catalog
R.	California Municipal Financial Health Diagnostic, League of California Cities
S.	Financial Measurement Indicators for the City of Pasadena, provided by LSL Certified Public Accountants
T.	Financial documents and information available on the City website, including through the Finance Department webpage and the Open Data webpage.
U.	City of Bell, Audit Report, Administrative and Internal Accounting Controls, by John Chiang, California State Controller, September 2010
V.	City of Berkeley, Office of City Auditor: "$52,000 Theft: More Can Be Expected Without Citywide Changes in Culture and Procedures," April 1, 2014
W.	Guidelines For Public Finance Data Dissemination And Access, Final version, Activity 1.7, May 2012, by The Twining project, an institutional cooperation between Italy and Turkey, co-financed by the European Union and the Republic of Turkey
X.	Code of Good Practices on Fiscal Transparency (2014), International Monetary Fund
Y.	News articles in the Pasadena Star News and other local and national press regarding the embezzlement case.

4.4. Links Reviewed.

A list of websites and their links reviewed by the Subcommittee for additional information is provided below.

Finance Department's Work Plan	http://www.ci.pasadena.ca.us/WorkArea/linkit.aspx?LinkIdentifier=id&ItemID=8589938786&libID=8589938790
Public Work's Work Plan	http://www.ci.pasadena.ca.us/WorkArea/linkit.aspx?LinkIdentifier=id&ItemID=8589938788&libID=8589938792
Internal Audit Manager Job Description:	http://agency.governmentjobs.com/pasadena/default.cfm?action=viewclassspec&classSpecID=60208&agency=1166&viewOnly=yes
California Public Procurement Officers Associations	http://www.gfoa.org/
National Association of State Procurement Officials	http://www.naspo.org/dnn/
Local Budgeting Oregon	http://www.oregon.gov/dor/PTD/docs/local-budgeting-oregon_504-400.pdf
Local Budgeting Manual	www.oregon.gov/dor/PTD/docs/local-budgeting-manual_504-420.pdf

California Society of Municipal Finance Officers	www.csmfo.org
Government Finance Officers Association	http://www.gfoa.org/
League of California Cities	https://www.cacities.org/
Fiscal Transparency, International Monetary Fund	http://www.imf.org/external/np/fad/trans/

4.5. Individuals Interviewed

City Council Members:[5]

Victor Gordo
John Kennedy
Steve Madison
Gene Masuda
Margaret McAustin

City Staff:

Michael Beck, City Manager
Julie Gutierrez, Assistant City Manager and Interim Director of Finance
Larry Schroeder, Consulting Interim Director of Finance
Kristi Recchia, Director of Human Resources
Phillip Leclair, CIO, Department of Information Technology
Theresa Fuentes, Assistant City Attorney
Nicholas Rodriguez, Special Assistant to the City Manager

Non-City Staff:

Maria Bailey, Implementation Consultant, Tyler Technologies, Inc.

[5] Former Mayor Bogaard attended two public meetings of the Task Force, including its initial meeting where, as Mayor, he welcomed and oriented the Task Force, and another meeting after his term as Mayor had ended. Current Mayor Terry Tornek also attended a few of the public meetings of the Task Force, both while a member of the Council and as the new Mayor. The Finance Subcommittee did not meet with former Vice Mayor Jacque Robinson or new Council members Tyron Hampton and Andy Wilson.

4.6. Meetings Held

The Financial Subcommittee held meetings, had briefings or conducted interviews on the following days:

March 17	June 16
March 26	June 22
April 7	July 6
April 21	July 16
May 18	July 25
May 28	September 3
June 11	

Members of the Financial Subcommittee also attended the meetings of the Task Force held on the following dates: March 9, April 7, May 5, June 2, and July 7. Members of the Finance Subcommittee also collaborated in the preparation of this Memorandum through in person and telephonic meetings.

5. SUMMARY

The City generates a substantial number of reports. These reports are by their nature technical and highly detailed, and are intended to be used by accounting professionals and those having highly specialized municipal financial expertise. Those reports, however, were never intended to prevent the type of alleged embezzlement that resulted in the creation of this Task Force.

The City is implementing a new system of financial reporting and data retrieval. The system, we are told, will also provide a computerized system of checks and balances that would greatly prevent the type of alleged embezzlement suffered by the City. But, more can and should be done to provide greater financial transparency. Many members of the general public lack the capacity and/or time required to understand and interpret the financial information intended to be reflected in those reports. Thus, while the reports may serve their intended purpose to comply with state reporting standards imposed on all cities, they fail to serve the needs of the growing public seeking greater electronic access as to how their local government agency is spending taxpayer dollars.

The observations and suggested recommendations set forth above are intended to help address this disconnect. The Financial Subcommittee also strongly encourages a system where the City's Code of Conduct and Ethical Standards are placed more prominently in the minds of City employees on an annual basis. The Financial Subcommittee recommends that City staff research financial reporting models used by other cities, within and outside the State, to better refine its reporting templates, including budget compliance, fund balances, spending and revenue trends, deficit accounts, change order expenditures, and other similar financial analytics.

The Financial Subcommittee respectfully submits this report to the Task Force for its review and formal adoption of recommendations as set forth above.

Respectfully submitted,

Financial Administration & Reporting Subcommittee

Robert E. Carlson, Subcommittee Chair
Donald C. Nanney, Member
Raul F. Salinas, Member

EXHIBIT "1"

TASK FORCE ON FINANCIAL ADMINISTRATION AND INTERNAL CONTROLS
SUBCOMMITTEE ON FINANCIAL ADMINISTRATION AND REPORTING

(1) Doc. Id.	(2) Type of Report	(3) Frequency	(4) Summary	(5) Relevance to Financial Results or Financial/ Condition	(6) Recommended Use of Visual Graphs to Improve Public Understanding	(7) Other Notes
A.	Report on Procurement	Annual. Last issued for calendar year 2013 and approved by City Council in December 2014.	The report tracks city wide procurement as required by PMC 4.08 and tracks W/MBE and local hiring spending. The report excludes utility purchases, attorney service agreements, intra government contracts and other transactions considered not procurement related. Also tracks overall spending trends for the past seven (7) years.	Nominal.	Highly recommended to the extent that the City should track its diversity spend and spend to local businesses based in Pasadena. The report or a supplemental report should be prepared to track professional services and other items involving significant expenditures.	Available online.

B.	Property/Casualty Insurance Renewals	Issued annually for Council approval in June for FY commencing July 1	Contains summaries of approx. 17 insurance coverages with staff recommendations for renewal, replacement or discontinuance	Not relevant (except that one of the policies is the employee crime/fidelity policy under which claim is in process for embezzlement loss)	Not applicable	Total annual premium cost in excess of $3 million each of last two years; Available as staff report for the Council meeting when considered.
C.	Quarterly Financial Status Report	Quarterly	Forecasts for the balance of the year results of operations and financial position compared to budget, as revised, with textual explanations of significant budget variances and other items; uses various charts and other graphic illustrations; contains a 5 year forecast; covers the general fund and other major funds (will in the future cover all other funds) and results of the 3 city operating enterprises; includes in easy to understand language management's discussion and analysis of key financial issues.	Highly relevant.	An informative report that should be easily accessible to the public on the city's website. Increased uses of graphs, charts and the like and shorter narratives would help its usefulness and public readership. A more detailed version could be for use by the council and other financial experts, while a more streamlined version with larger print for some financial tables is presented to the public	Available on line it could be the model for a more simplified, less detailed and more understandable CAFR for the general public, a CAFR-in-Brief.

D.	General Fee Schedule	General on an annual basis. However, may be revised in part more frequently during each fiscal year.	This report is reviewed annually by the City Council to determine if there should be increases or decreases in rates assessed by the City for providing municipal services. In 2015 the fee schedule consisted of 1824 separate fee ledger items contained in a 96 page report. The report compares FY 2015 fees to 2014 fees.	Limited.	None recommended. The report as currently formatted is highly detailed and easy to comprehend. The use of visual aids would not likely aid the public's understanding of this report.	Available online.
E.	Schedule of Taxes, Fees and Charges	Issued annually for Council approval in June for FY commencing July 1	Contains table listing for each item: applicable Municipal Code section; the current FY rate; and rate recommended for next FY	Not relevant	Not applicable. Only includes the rates; staff presentation slides show aggregate annual increase in revenues for next FY based on CPI adjustment; but not a sufficient source for total revenues generated annually that could be used for financial indicator (e.g., high/low tax city on per capita basis as possible comparison to other cities)	Available on-line.

F.	FRPS Supplemental Contribution from City	As needed.	Used to support a Council resolution approving a commitment or an actual transfer of funds of the General Fund or other fund to another fund of the city, like an emergency fund or a specified pension fund.	Limited.	Should consider putting this report on the website in a format that is accessible to the public under a financial report category separate from the particular council meeting at which the council resolution approving the transfer was adopted.	Is online under the particular council meeting.
G.	Gann Limit	Annual	This is an annual City Council resolution required under Government Code § 7910. The resolution sets an appropriations limit for the following fiscal year. The appropriation limit is based upon certain selected indices such as the California Per Capita Income and the populations increase. The Gann limit for FY 2015 was established at $245,273,577. This limit is further reduced by any expenditures for debt service or capital; therefore, the appropriation such to the limit in the City's FY	Limited.	None recommended. This report is statutorily required of every city. The format of the current resolution is relatively straightforward. The use of visual aids would not likely improve the public's understanding other than to possibly track growth trends in the appropriation limits over a 10 year multi-year period.	Available online.

			2015 budget are $111.6 million. The appropriation limit applies only to those expenses funded through tax proceeds.			
H.	Operating Budget Adoption	Annual Council resolution and Operating Budget in June for FY commencing July 1; $675.2M for FY2015; proposed $683.3M for FY2016.	Voluminous, detailed, with narrative material, tables, some charts/graphs; covers city as a whole, plus breakdown of 17 city departments and 4 affiliates (e.g., Rose Bowl Op. Co.). General Fund and numerous other funds. Not easy to review and understand. Budget-in-Brief helps.	High – for public understanding; Low – for usefulness in spotting theft (e.g., no ID of vendors).	For public understanding: Highly recommended to expand on existing graphics and make more understandable to non-accountants. Includes 5-year budget projection, but only retrospective for one or two years; consider 5-years both ways, past and future, with trend graphics. Consider adding financial indicators relevant to budget.	Available on-line, for FY2006 through FY2015. FY2016 budget recommendation on-line, not yet as adopted.

I.	Amendments to Previously Adopted Budget.	Whenever an adopted budget is amended.	**Each fiscal year, budget amendments are usually necessary to account for unanticipated changes to the adopted budget.** These amendments are presented to the council for approval and the agenda report sets out the details of the amendments, the reasons for the changes and its fiscal impact.	Limited.	Should consider putting this report on the website in a format that is accessible to the public under a financial report category separate from the particular council meeting at which the council resolution approving the transfer was adopted.	Is online under the particular council meeting.
J.	Investment Report	Quarterly. Last report reviewed for quarter ending 3/31/15.	The report tracks five (5) separate portfolios: Pooled Investment, Capital Endowment, Power Reserve, Miscellaneous, and Investments held by Trustees. The report is highly technical in nature and compliant with state law. The report also indicates it is compliant with the City's Investment Policy.	Moderate.	Highly recommended. By their very nature, these reports contain a highly technical numerical/statically quantitated data. City residents not possessing the requisite familiarity in reviewing financial portfolios may find it difficult to fully understand the contents of this report. The use of dashboard matrix of core measures would aid greatly in making this report more user friendly to the general public.	Available online.

K.	Investment Policy	Annual? Copy in binder is for FY2014-2015, dated August 11, 2014	Contains investment policy statements.	Not relevant.	Not applicable.	Could not easily find on-line. Found earlier ones via word search of city website.
L.	Annual Audit Plan Update	Annually.	After the close of the fiscal year and before the annual audit begins, the City, in cooperation with the auditors, prepares a detailed plan of the proposed audit, covering units and funds of the City to be audited (e.g., parking operations, transient occupancy tax), scope of and procedures to be followed in the audit. Revisions to the plan are reported in an update to the plan.	Limited.	The annual audit plan should be prepared on the basis of best practices for such plan by reviewing the extensive materials available online for such plans. The plan should include the scope of the audit; departments, units, entities and funds to be included. The scope and areas to be audited should be selected and prioritized using a risk-based approach and should reflect input from a wide range of key staff persons and from the City Council. It should also identify the estimated time required to complete the audit, be flexible and dynamic tool that can be amended to reflect changing and updated city risks and priorities. The	The materials given to us as the complete list of financial reports included the amended audit plan but not the original plan.

					annual audit plan should be reviewed and approved by the City Council.	
M.	Comprehensive Annual Financial Report (CAFR)	Annual	This comprehensive financial report is required of every city on an annual basis. It references the annual Auditors' Report, basic financial statements, various statements relating to revenues and expenses, cash flow, and tracks the City's various funds.	Highly Relevant.	Highly recommended. A number of cities use various dashboard, graphs, pie charts and other visual aids to simplify the public's understanding of a city's financial condition. Pasadena currently uses a Budget-in-Brief to help convey this information to its residents.	Available online.
N.	Fund Balance Policy Update	Apparently only occasional. Copy in binder is dated August 15, 2011	Contains reserve policies for General Fund and various funds, with a number of references noting that if have reserves in excess of policy, use of excess to be considered in budget process. The Underground Utility Program was not included in the 2011 version of the policy, unfortunately.	No, but if the UUP had been included in the reserve policy, it would have been detected years ago as wildly excessive funding on hand, making it a target for theft (to say nothing of the excessive collections from taxpayers in advance of	Not applicable.	Consider recommending fund balance policy for UUP and any other funds that don't have such a policy and should.

				funding needs).		
O.	Commitment of Fund Balance Agenda Report	As needed.	Appears to be substantially similar to the FPRS Supplemental Contribution from City (# 2 above) in purpose, content and format.	Limited.	Should consider putting this report on the website in a format that is accessible to the public under a financial report category separate from the particular council meeting at which the council resolution approving the transfer was adopted. The use of the Agenda Report format makes it difficult for the average person to locate it without knowing the date of the council meeting or the particular fund balance transaction included in the agenda report.	Is online under the particular council meeting date.
P.	Annual Audit	Annual	This report is prepared independently by the auditors in conformity with specific and highly technical accounting standards.	Highly relevant.	None at this time.	Available online.

Q.	Consolidated Annual Performance and Evaluation Report (CAPER)	Annual. No copy in binder.	Complies with reporting obligations for use of federal (e.g., HUD) (and other public?) grant funding for supported programs.	Not relevant.	But could use dashboard graphics for better understanding.	Not easy to find on website. Raul found one dated Sept. 26, 2011, for 2010-2011 Program Year; others available through word search; Should be more readily indexed on website.

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Internal Controls and Audit Subcommittee
Preliminary Report
September 14, 2015

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NOTE: At the time of the writing of this report, there were several references to requested documents that were still pending receipt. These documents were delivered to the Internal Control and Audit Subcommittee Chair on Thursday, September 17, 2015. Due to the late receipt, the inventory and review of these documents has not been incorporated into this report.

I. Objective and Scope

The **objective** of the Internal Controls and Audit Subcommittee was to provide advice and recommendations regarding the embezzlement of public funds from the Underground Utilities Program account, on a go-forward basis, by:

- Reviewing the integrity and effectiveness of the City's internal controls;
- Assessing the City's internal audit function;
- Assessing the pros and cons of an ongoing citizen-based audit advisory committee; and
- Making any other recommendations that will strengthen the City's internal controls; thereby minimizing risk.

The **scope** and work plan of the Internal Controls and Audit Subcommittee was to examine and report on:

- The City's implementation of the forty-three (43) recommendations outlined in KPMG's Report Memorandum dated November 11, 2014;
- The Department of Finance's Request for Proposal for Fraud Risk Assessment dated February 18, 2015 as submitted to the Pasadena City Council's Audit Committee; and to be updated as to the selection process;
- The Control Environment surrounding the forthcoming Tyler Technologies Munis ("TM") Enterprise Resource Planning ("ERP") software system; including the internal rulesets and exception reporting so as to determine if the software is compliant with the recommendations of KPMG as well as the benchmarks/best practices as established by The Association of Local Government Auditors ("ALGA");

- The anticipated process revolving around the current hiring of an Internal Audit Manager; including how this position will be utilized in determining the risk assessment of the City; how this position will interrelate to/with the external auditors; and how this new position will help to determine the internal audit program for the City.

II. Summary of Work Performed, Observations and Open Items Pertaining to the City's implementation of the forty-three (43) recommendations outlined in KPMG's Report Memorandum dated November 11, 2014

Background and Work Performed

The Internal Controls and Audit Subcommittee reviewed KPMG's Report Letter dated November 11, 2014, including Appendix A and Exhibits 1 through 49. The purpose of this Report Letter was to communicate KPMG's findings from the work they performed in connection with an internal investigation conducted by the City into suspected misappropriation and misuse of City funds and other unauthorized actions related to the City's Street Lighting and Electric Underground Program ("Underground Utility Program" or "UUP"), a program administered by the Department of Public Works, Engineering Division.

Section VII of Appendix A outlines forty-three (43) recommendations (opportunities for operational improvements). These recommendations were set forth by KPMG for the City's consideration in improving and strengthening the City's policies, processes and system of internal controls in the areas of the UUP and Finance Department. The recommendations were divided into 8 sections: UUP, Special Handling Requests, Vendor Master List, Form 1099-MISC, Purchase Orders, Accounts Payable Function, Internal Audit Function and Personnel and Training Considerations.

On May 4, 2015, Internal Controls and Audit Subcommittee members Charlotte K Reith and James F Dowling met with Julie Gutierrez, Assistant City Manager and acting Director, Finance; and Flo Langilotti, Operations Manager for Public Works Building Systems and Fleet Management. In preparation for our meeting, Ms. Gutierrez prepared a Follow-Up Memorandum pertaining to KPMG's recommendations, including 3 attachments: an updated Accountability Work Plans for Department of Public Works, an updated Accountability Work Plan for the Department of Finance, and a copy of the City's responses to KPMG recommendations. During this meeting, Ms. Gutierrez, Ms. Reith and Mr. Dowling reviewed the City's responses to the first 25 recommendations. Subsequently, the Internal Controls and Audit Subcommittee met separately to complete their review of the documents provided.

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On June 5, 2015, the Internal Controls and Audit Subcommittee prepared a summary of the additional information that was needed. See Exhibit **A**, Review of KPMG Recommendations - Additional Information Needed, June 5, 2015. To date, the Internal Controls and Audit Subcommittee has not received a response to this request.

Internal Controls and Audit Subcommittee's General Observations

- **CONTROL ENVIRONMENT** - Based on the volume of recommendations from KPMG, as well as the lack of basic internal controls as outlined by KPMG; it **appears** that significant areas of the **"control environment"** need substantial improvement. A sound control environment is created by management through communication, attitude and example. It is frequently referred to as "the tone at the top." This environment is the foundation for all other components of internal control (risk assessment, monitoring and review, information and communication and control activities) and is influenced by management's philosophy. A control environment provides discipline, structure, authority and responsibility. It organizes and develops its people.

- **RELIANCE ON COMPUTER SYSTEMS** - Management is placing considerable reliance on the TM ERP software system for checks and balances within the procurement and payables processes; however, employees still have considerable responsibilities pertaining to data input. One key element in placing reliance on computer processes is the quality of the input into the system as well as the quality of supporting documentation. Additionally, control procedures regarding data input must be developed, documented and monitored. For example, control over data input to the vendor master file, a database of all approved vendors, is paramount. A vendor's existence in this master file allows purchase orders to be issued and checks to be "cut" to these vendors. It also controls whether a Form 1099 is properly issued. Before vendor information is input, procedures need to be followed in verifying that the vendor is legitimate; authorized, and that the check is being sent to the proper address. All of these checks are part of an internal control environment that is paramount. So, while a computer system can certainly enhance a control environment, it cannot stand alone.

- **WRITTEN POLICIES AND PROCEDURES** - Accounting policies, as well as procedures, are a key component to a strong control environment. These accounting policies and procedures need to be enhanced, updated, reviewed and tested by Management with their staff on a continual basis.

They need to include the manual as well as computer tasks or concepts that are to be followed. Accounting processes (purchasing a product or service and/or paying a vendor's invoice) often times originate in a department other than Accounting/Finance and as such, written policies and procedures must be an integral part of the entire process including operating and other departments within the City from cradle to grave.

- **ORGANIZATIONAL STRUCTURE AND SEGREGATION OF DUTIES** - Organizational structure, including reporting structure, lines of command, authority and responsibility, is another key component of a strong control environment. Maintaining the appropriate level of staffing while insuring the necessary segregation of duties needs to be considered in all reorganizations (upsizing, downsizing, reporting hierarchies). For all reorganizations or changes to a reporting structure, the ramifications on the control environment should be an important component of the decision-making process. Has the reorganization or change in reporting structure maintained the necessary checks and balances.

- **MANDATORY VACATION OR MANDATORY TIME AWAY ("MTA")** - a mandatory vacation or MTA policy or periodic rotation of duties among employees would allow management to observe if there are any noticeable changes (for example, a marked increase in cash receipts) while another person is performing the duties. These alternative controls also help lessen potential disruptions caused by employee turnover.
- All organizations should have a vacation or MTA policy which provides that all personnel in accounting, human resources and cash handling functions be absent from their duties for an uninterrupted period of not less than two consecutive weeks. Cross train employees so that someone else does their job during the vacation. Such a policy is considered an important internal safeguard largely because perpetration of an embezzlement of any substantial size usually requires the constant presence of the embezzler in order to manipulate records, respond to inquiries from customers or other employees, and otherwise prevent detection. Management should recognize the benefits of this policy may be substantially, if not totally, eroded if the duties performed by an absent individual are not assumed by someone else.
- Fraudulent activity can also be detected by rotating personnel at random. Planned and unannounced rotation of duties is an important principle of internal controls. The rotation should be of sufficient duration to be effective. Rotation of personnel, besides being an effective internal check, can be a valuable aid in the overall training program.

- A vacation is not the same as MTA. They're not reciprocal. While MTA can be used as a vacation and *is* a vacation, it more importantly serves as a safety check to mitigate financial risk and to detect and reduce losses.
- The Task Force on Financial Administration and Internal Controls ("TF) questioned the Human Resources (HR) Director on several occasions regarding the possibility of having key personnel within the City to take a two-week vacation or MTA during certain financial reporting periods or have those employees reassigned to other business areas during that timeframe. Each time the TF questioned the HR director regarding this basic anti-fraud principle, we were advised without hesitation or further consideration that the labor contracts with union employees would not allow for this.

- **VAGUENESS OF CITY'S RESPONSES TO KPMG RECOMMENDATION AND LACK OF A TIME FRAME FOR IMPLEMENTATION**
- Writing an audit finding response can be relatively easy if the following guidelines are used:
    - Respond directly to the finding and its recommendation(s);
    - Provide specific actions that management commits to take to correct the finding;
    - Make the response clear and concise;
    - Exclude information that is not pertinent to the finding or its corrective action plan;
    - Identify specific positions, if applicable, responsible for implementation;
    - Provide a specific and realistic timetable for implementation;
    - Include interim deadlines and identify the person(s) responsible for completing those tasks.
- The Internal Controls and Audit Subcommittee found the responses to KPMG's lacking in specificity; such as identifying a city official who was accountable for the remediation or a deadline for completion.

Further Observations pertaining to UUP (#1 to #6)

- The processing of UUP reimbursements/refunds (as well as all other exceptions) should be strengthened. Since these reimbursements/refunds are exceptions (not part of the typical purchase order/contract/agreement procedures), it is not enough to just determine that the reimbursements/refund is for a property within an active district. There should be procedures established that require the support for these reimbursements to include documentation showing that the work was completed, that reimbursement is appropriate and that a reimbursement for this property has not been processed previously. Additionally, the addition of these vendors to the

Vendor Master List should be handled the same as any other vendor. All vendors added to the City's Vendor Master List should undergo initial and ongoing due diligence.

Further Observations pertaining to Special Handling Requests ("SHR") (#7 to #13)

- The SHR form was allegedly used by those who perpetrated the fraud against the City to bypass internal controls. This critical document was at the center of the fraudulent activity. KPMG had seven specific recommendations regarding the Special Handling Request ("SHR") process. As of May 4, 2015, six months after KPMG's report was issued, the City had only implemented two recommendations:

  1). to conduct training in the proper use and processing of the Special Handling Request forms; and;

  2). to implement procedures to use only original forms containing original approval signatures.

- Below are excerpts from the City's responses pertaining to KPMG recommendations regarding the SHR:
  - KPMG Recommendation 12 - *Finance should conduct periodic regular review of SHR Forms for any unusual trends such as high volumes from a specific department or employee, high volumes of payments to a specific vendor, repetitive dollar amounts, or spikes in use around certain timeframes. Follow up should be performed on any unusual or excessive activity identified.*
    - City's Response: *Concur and will begin implementing these reviews;*
    - Internal Controls and Audit Subcommittee Observation: A regularly scheduled review of these forms could identify other potential fraudulent activity that is yet unknown and should become part of the review process immediately. This periodic review should be outlined in the appropriate Accounting policy and procedure manual and each documented review should be signed off by the Director, Finance
  - KPMG Recommendation 13 -*In addition to conducting periodic regular reviews of processed SHR Forms. We recommend the City perform an operational compliance audit of the SHR Form process to assess the process, procedures and actual practices. The audit should cover activity in recent fiscal years (i.e. the last 3 to 5 years) to determine unusual patterns or trends that may be indicative of fraudulent activity and to identify areas of potential internal control weaknesses.*

- City's Response: *The SHR form is being reworked and will eventually be eliminated and a new system will be put in place for times when it is necessary to provide a City check directly to an employee.*
- Internal Controls and Audit Subcommittee Observation: This response is considered nonresponsive. The City has not addressed the recommendations by KPMG to conduct a three to five-year look back at trends and patterns in the use of the SHR form to identify other fraudulent activities that may have taken place. Although the controls within the TM ERP software system will encompass emergency payments, special controls need to be developed within the software system to insure proper controls around such emergency payments. Additionally, special "Exception" reports should be generated by the TM ERP system on a regular basis and reviewed by Senior Management.
- The Internal Controls and Audit Subcommittee was told that a majority of the SHR forms are used by the City Attorney's Office. Our committee recommends that the City Attorney's Office use the normal channels for payments. The SHR form should be used for exceptions only.

Further Observations pertaining to Vendor Master List (#14 to #19)

- As referenced in the General Observations above, a Vendor Master List is another key component of a strong control environment. The initial implementation of the TM database of approved vendors should include the oversight of the Director, Finance. Policies and procedures for additions to this database should be in align with the critical nature of this control. It is our understanding that the City has adopted a new policy, including a new vendor checklist; however, the Internal Controls and Audit Subcommittee has not been provided these documents.
- It is recommended and concurred by the City that "payment requests for vendors not found on the Vendor Master List should be followed-up with the requesting City Department for reasons why payment is outside of established vendor procurement policy." It is further recommended that no payment should be made unless and until the vendor has been validated according to policies and procedures of the Finance Department.

Further Observations pertaining to Form 1099-MISC ("1099s") (#20 to #25)

- The City concurred with each of KPMG's recommendations; however, the Internal Controls and Audit Subcommittee has not been able to evaluate the City's new 1099 reporting policies and procedures since we never received a copy.

Further Observations pertaining to Purchase Orders (#26 to #29)

- KPMG recommended that invoices should be properly matched to correct purchase orders and that invoices over $100 without a purchase order should not be paid without a memo containing proper authorization. The Internal Control and Audit Subcommittee believes that this KPMG recommendation will only partially create the necessary controls surrounding vendor payments and customer rebates similar to those processed through the UUP. The City's response of requiring an "electronic requisition which will be converted to a Purchase Order by the Purchasing Section" which will then be part of a "three-way match" within the TM ERP software system between the Purchase Order, receipt documentation and invoice payment will, only partially create the necessary controls.
    - **The key control that was missing** (and still is under the above procedures) **was the supporting documentation to validate the payment request.** In the case of the UUP payments, supporting documentation should have included the property owner's submission of a Right-of-Entry to the City documenting that the City would perform the underground of the utility lines; or the property owner's submission of supporting documentation showing that the owner hired a private contractor, that the contractor performed the work and that the owner pay the contractor for the work. In cases where the City performed the underground or contracted for the underground directly, documentation evidencing the completion of the work and signed off by the property owner (third-party evidence) should have been attached to either a purchase requisition or reimbursement form. In addition there should be procedures to independently spot check the authenticity of those documents. These key controls should be part of a written, detailed accounting policies and procedures manual and should be part of an ongoing verification process. Key controls, such as described above, should be part of an ongoing oversight program of testing for compliance.

Further Observations pertaining to Accounts Payable Function (#30 to #34)

- The City's response to KPMG's recommendation that the City validate payment request information prior to payment was "explained away" by placing reliance on system controls (TM ERP software system). Their response did not address KPMG's comment that Accounts Payable perform a more robust and diligent review of invoice payment requests submitted by City departments. The lack of concern about the supporting documentation submitted with payment requests and the sense that "the system" is the answer to all of the frailties is an overriding theme in the City's responses to many of KPMG's recommendations. While all supporting documentation is now being scanned into

the TM ERP system and available for review at the time of on-line approval by Accounts Payable, there still needs to be a diligent review of these documents for reasonableness and completeness by the approvers. Supporting documentation of payment requests is another key control in an overall sound control environment. Updated, detailed written Accounts Payable procedures are another key control. Both of these key controls need to be documented and followed. These procedures should also be monitored for compliance on a continual basis.

- KPMG recommended that the Accounts Payable staff should document their payment request review and approval process. As such, KPMG stated that verbal and/or oral approvals should not be accepted under normal circumstances. The City concurred with this recommendation and indicated that only written justifications for exemptions would be accepted. While the City Manager has indicated that verbal and/or oral approvals have never been part of the Accounts Payable procedures, it is our added observation that verbal and/or oral approvals should not be accepted under ANY circumstances. While Accounts Payable procedures should not "tie the hands" of the Accounts Payable department; exceptions to the rules need to be minimal; well documented and the approval process needs to be at an appropriate level (Assistant City Manager or above) and written approval should be documented.
- KPMG recommended that individuals submitting invoices may not have access to those invoices until after disbursements have been processed and checks have been cut. It is the Internal Controls and Audit Subcommittee's further recommendation that original invoices should NEVER leave the control of the Accounts Payable Department. All invoices, once paid, should be stamped as paid or "cancelled" and requests for copies should be minimal and the copies should be noticeably marked as paid. It is the Subcommittees understanding that the TM ERP systems insures that the documents, once scanned, are marked and labeled as having been processed. Additionally, the Internal Controls and Audit Subcommittee would recommend that checks not be returned to a requestor, but mailed directly by the Accounts Payable Department. Any request for a check to be returned to the requestor would need additional approval at the appropriate level; and these requests should be minimal.
- KPMG's recommendations #33 and #34 address the overall control environment (or lack thereof) for the Accounts Payable department. The City's responses were that they concurred but was non-responsive to the immediate and imperative need to enhance the overall control environment of Accounts Payable. The role of the Accounts Payable Department is key to the safeguarding of the City's assets and, as such, policies, procedures, employee training, monitoring and compliance should be at the forefront of any Finance Department. The Internal Controls and Audit Subcommittee recommends that the Accounts Payable Department policies and procedures be reviewed and updated as quickly as possible and that training and compliance become an immediate and on-going element within the Department.

Further Observations pertaining to the Internal Audit Function (#35 to #39)

- KPMG recommended that the City should consider re-establishing an internal audit function and the City Council approved an Internal Audit Manager position in August, 2014. The City's response was that this person would be selected by May, 2015. The Internal Controls and Audit Subcommittee is in complete agreement with this recommendation and had outlined in our work plan that the Internal Controls and Audit Subcommittee would examine and report on the process revolving around the current hiring of this position. The City's status report to the Task Force on Financial Administration and Internal Controls on July 7, 2015 was that the two final candidates for the Internal Audit Manager position declined the City's offer and that the City had determined that the current search would be discontinued until further research could be done on the appropriate classification of this position. For example, in addition to reporting to the City Manager, the independent auditor perhaps could have a reporting relationship with the Audit Committee of the City Council;
- The Internal Controls and Audit Subcommittee strongly agrees with the City Manager's office that "our organization is too large and complex to adequately manage an internal audit function with a part-time manager" (see City Council Meeting of 7/28/2014, Agenda Item No. 14). It has been one year since the City Council authorized this new Internal Audit Manager position. The City should determine the appropriate classification of this position immediately and make the selection process one of its highest priorities. The implementation of KPMG's Recommendations 36, 37, 38 and 39, which are critical to the overall control environment of the City, are dependent on the hiring of this position. The need to implement these recommendations on a timely basis adds even more urgency. The City should also explore the reporting structure of this position so as to provide the necessary independence;
- Additionally, the City should explore the possibilities of establishing an Internal Audit Department. There are many positives to having audits done internally; as well as having sufficient internal audit staffing to perform much needed tasks that are currently not being performed, such as:
- Maintaining within the City the institutional knowledge learned during the audits;
    - Providers of outsourced auditing services generally have little understanding of the organization they audit and generally are NOT as committed to it in the same way as in-house staff;
    - In one study, internal auditors saw three important educational roles: they trained their own staff, they educated line managers in control and risk management, and they provided a function where new entrants to the organization, or existing staff, could spend a short period as a means of enhancing their understanding of the organization/business.
- Providing a pool of financial employees to fill vacancies within the City's Finance Department;

- Providing more timely and focused internal audits of City departments to help not only in the establishment of an overall control environment within the City, but to help with operational improvements as well;
- Maintaining sufficient staffing to review on a continual basis all Finance Department's policies and procedures and staffing alignments, as well as for all other City departments;
- Maintaining sufficient staffing to follow-up on recommendations from internal as well as external audits;

  Follow-up by Internal Audit is imperative when comments such as "Management was receptive to our findings and agreed to consider our recommendations for implementation" are part of the findings of an external audit. Without follow-up, why do the audits? If Management is only considering the recommendations without a written action plan to follow up on the recommendations and document the changes, it nullifies the purpose of an audit.
  - "Seamless" auditing - not having to go through the requisition process for each audit undertaken.

Further Observations pertaining to Personnel and Training Considerations (#40 to #43)

- The City's response to KPMG's recommendation 41 ("enhance employee supervision and oversight requirements") was to have each department be reviewed, as part of the Fraud Risk Assessment, for instances where one employee is responsible for an entire program and/or service process; and if a instance is identified, a segregation of functions will be implemented. This response does not address the recommendation of enhanced employee supervision and oversight. Daily supervision and oversight is imperative to the overall control environment of an organization. This recommendation is addressing the need for better supervision, which includes coaching, the act or process of watching and directing what someone does or how something is done, overseeing the productivity and progress of employees who report directly to the supervisors. Supervision is a management activity and supervisors typically are considered to have a management role in the organization. Supervision is a daily activity.
- KPMG Recommendation 42 and 43 pertains to the City conducting annual training programs, including having employees sign an acknowledgement accepting compliance of their jobs' roles and responsibilities with documentation maintained by the Human Resources Department. Additionally, KPMG recommended that the City should "endeavor to provide new hiring training and refresher training programs to current employees on a periodic basis." KPMG stated further that "although training often times is conducted as on-the-job training, at no point should training be taught based on unwritten historical practices of the department which are inconsistent with the City's own policies and procedures.

  - The City's response included:
    - Focused training for the Procurement Group;
    - Continued Citywide training;
    - The commitment to properly training new employees.

- As part of an overall control environment, the City should develop a "commitment to competence". This commitment should include the following elements:
  - Written policies and procedures relating to areas of competence, including areas such as recruitment, hiring and training. These policies and procedures should be communicated to all the employees;
  - Minimum competency standards should be established for each position within each function and should be evidenced by documented job descriptions. competency framework;
  - Ongoing training on functional competency is encouraged and provided in a timely fashion to ***all employees*** (not just newly hired) and should be evidenced by training and development calendars, as well as actual data on trainings undertaken;
  - Management should encourage cross-training, but with a view on segregation of duties;
  - Management should be evaluated on its competency both before joining the City and regularly during their tenure through ongoing training;
  - If and when competency is found to be lacking, management should take proactive steps to consult with external experts and consultants;
  - When any business change occurs, Management should seek to enhance competency levels in the organization to address business and other issues that may arise; and.
- The Performance Appraisal System of the City should closely follow the competency development of individuals within the organization. The Internal Controls and Audit Subcommittee also believes that all employees should be required to take a code of conduct training course on an annual basis and sign a certification that they understand the City's Code of Conduct;
  - The City's response to the sub-committee was that it would take too much time to have city employees take this type of training and that this type of certification would not withstand a legal challenge if employee violated the Code of Conduct.
  - The Internal Controls and Audit Subcommittee believes that the Code of Conduct is the core principle by which all organizations, large and small, exists. Emphasizing that the City not only has a Code of Conduct but that every single employee and contractor shall adhere to these principles is critical. As far as the City's response to the legality of such a form, the TF will defer to the multitude of cases in which the courts have affirmed this issue. If nothing else, the Code of Conduct training course and attestation of attendance demonstrates the proper "tone" of Senior Management and establishes expectations for all employees to conduct themselves in accordance with the City's Code of Conduct.

Requested Documents Still Pending from Internal Controls and Audit Subcommittee's Review of KPMG's Recommendations

- Copy of the Management Partners' (a management consulting firm specializing in helping government organizations improve their operations) review of the internal controls and processing procedures for the UUP. It is our understanding that this analysis was to be completed in June, 2015; (KPMG Recommendation 1 response)
- Copy of written desk procedures for UUP (KPMG Recommendation 1 response);
- Copy of detailed mapping for the Procurement Process, as well as the updated, written policies and procedures (KPMG Recommendation 4 response);
- Copy of Reimbursement Form and detailed procedures for use (KPMG Recommendation 6 response);
- Copy of new Vendor Master checklist (KPMG Recommendation 19 and 20 response);
- Copy of McGladrey, LLP report regarding their review of the City's policies, procedures and practices related to vendor management, etc. (Phase 2 if contracted);
- Copy of the most current Organizational charts showing that Purchasing reports to the City Controller rather than Accounts Payable (KPMG Recommendation 29 response);
- Copy of current policies and procedures for:
    - 1099 reporting
    - What is an acceptable written justification for approval of payment requests outside the norm (KPMG Recommendation 31 response);
    - Instructions to Accounts Payable that only original documents with original signatures should be accepted (KPMG Recommendation 33 response);
    - Invoice processing where additional internal controls are outlined (KPMG Recommendation 34 response);

III. Summary of Work Performed, Observations and Open Items Pertaining to the Department of Finance's Request for Proposal ("RFP") for Fraud Risk Assessment ("FRA")

Background and Work Performed

The Internal Controls and Audit Subcommittee performed an initial, perfunctory review of the RFP dated February 18, 2015 for the performance of an FRA. The responses to this RFP were to be submitted to the City on later than March 23, 2015. This date was amended to April 13, 2015. . A committee is to determine a recommended bidder to the City Council. That recommendation, together with a copy of

the submitted RFP from that bidder were to be provided to the Internal Controls and Audit Subcommittee for review and a member(s) of the Internal Controls and Audit Subcommittee would be included in the interview process of this bidder. As stated in a memo to the City Council Finance Committee from Larry Schroeder, Special Assistant to the City Manager, "this audit is critical to the reduction of the future possibility of embezzlements.

At the February 23, 2015 regular meeting of the Finance Committee, Mayor Bogaard requested that the TF-FRIC be kept abreast of the FRA RFP process.

A copy of the Questions from Vendors regarding the FRA RFP was given to the TF at the April 7, 2015 Special Meeting. Also, the Internal Controls and Audit Subcommittee submitted a document request to the City which included the following item:

- Copies of all Requests for Proposals (RFP's) for the Fraud Risk Assessment that are submitted to the Pasadena City Council's Audit Committee; and
- Copies of any and all documentation on the City's progress toward the appointment of the firm awarded the Fraud Risk, Assessment assignment.

An updated document request was submitted to Michael Beck on April 28, 2015 and June 2, 2015. In addition to the two requests included above; the Internal Controls and Audit Subcommittee added this paragraph to the Document Request:

- It is the sub-committee's understanding that the appointment of the firm as well as the Fraud Risk Assessment itself is a "work-in-process" and ever-changing. However, we would like to be kept "in the loop" as to progress toward completion and be given copies of any and all communication documents provided the Audit Committee of the City Council and/or the City Council; or any other communication that the Finance Department believes would help in completion of our work plan.

At each Special Meeting of the TF, there was an agenda item asking for the status of the "Retention of the Firm to Conduct City Wide Risk Assessment".

At the July 7, 2015 Special Meeting of the TF, we were informed that the retention of a firm to perform the FRA was being held in abeyance until the Internal Audit Manager position was filled. At no point prior to this were we told that the City was not following through on the RFP for FRA. At this meeting, we were also informed that the RFP for FRA should be moving forward by the end of July, 2015.

General Observations

- Based on our initial review of the RFP, we felt that this FRA was necessary and the Internal Controls and Audit Subcommittee was in agreement with the Objective and Scope of Services as outlined in the RFP.

Requested Documents Still Pending

- Copies of all RFPs for FRA that are submitted to the City Council's Audit Committee;
- Copies of any and all documentation on the City's progress toward the appointment of the firm awarded the FRA assignment.

IV. Summary of Work Performed, Observations and Open Items Pertaining to the Control Environment surrounding the new TM ERP Software System

Background and Work Performed

The Internal Controls and Audit Subcommittee conducted a review and analysis of TM ERP software system to determine if the software system as modified and implemented by the City would encompass the KPMG recommendations as well as other fraud control measures. The City entered into a contract with Tyler Technologies ("TT") to purchase the TM ERP software system[1] to assist city employees in their financial and administrative duties. The software system is specifically designed for governmental agencies to assist in many aspects of administrative and financial operations. The City had engaged the services of TM prior to the discovery of the alleged fraudulent activity by certain city employees through the UUP. Following an extensive implementation process the City of Pasadena "went live" with Phase 1 of the TM system on July 1, 2015. Phase 1 A is scheduled to go live on October 1, 2015 and Phase 2 is scheduled to go live on January 1, 2017.

The TM ERP software system comes with a "pre-packaged" system of procedures that allow city employees to perform their jobs in an integrated fashion and allows for electronic workflows which will replace cumbersome ineffective "paper processing".

The core components of the TM ERP software system purchased by the City can be aggregated into the areas listed below. In addition, each of these software components includes alerting and control settings for access and approval levels as well as notification to management of process initiation. The components consist of: Accounts Payable activity, Budgeting, Bid Management, Contract Management,

[1] http://www.tylertech.com/solutions-products/munis-product-suite

Employee Expense processing, Fix Asset management, General Ledger activity, Inventory Control, Project Accounting and Purchasing-requisition and purchase orders processing.

Although the TM ERP software system comes with many robust "out-of-the-box" software packages, it is also designed to be customizable by an end-user. The software package, like many others, is designed with the functionality to allow for customization of the processes that are unique to each municipality/governmental agency. As such, it is incumbent upon the City to ensure that they create specific workflows and procedures, as well as safeguards around the City's specific needs.

The TM ERP software system comes with a series of "Rule Sets" which are system requirements controlling such things as system access, approval of authority levels, workflow models and processes assurance and notification to management officials when pre-designated workflow processes are initiated. The system also allows for restricting access and limits on executing certain tasks as determined by the City. Each of the aforementioned core system components have their own system of Rule Sets to ensure proper flow of information and data and to establish a proper control environment.

General Observations

- The Internal Controls and Audit Subcommittee made four requests in writing and verbally to the City requesting a copy of the detailed work plan (an implementation plan including setup, configuration, data conversion and complete end user training), as well as the list of "rule sets" and/or built -in control procedures for the TM ERP software program. While the committee was provided with copies of the Project Implementation Plan created by TT and the general rule sets regarding system capabilities and system specifications, the committee never received the detailed work plan. Additionally, even though the software system went "live" on July 1, 2015, this committee is unaware of the existence of any customized detailed procedures created by the City for their employees. The Internal Controls and Audit Subcommittee was informed by the City that they were in the process of creating these procedures. At this time, a copy of the TT user training manuals were requested but have not been received;
- Although the TM ERP software system is a tremendous improvement over past procedures, there are still significant vulnerabilities that should be addressed. Even though the TM ERP software system appears to be a robust system that will greatly enhance the City's ability to account for administrative and financial operations, it is neither designed nor intended to be an "end all" solution for the City. In order to make sure the software system operates effectively with sufficient fraud controls in place, the City needs to customize procedures, tolerances, access controls and levels of authority for each and every function within the software system. City officials cannot depend upon third-party software vendors to provide this level of detail in the system;

- City officials need to ensure that TM ERP software system provides a manual system of checks and balances when entering beginning budgetary amounts and/or approval amounts for the various subcategories. For example;
    - When UUP budgetary information is entered, the City needs to have a manual system of checks and balances ensuring that the beginning budget amounts entered are correct and that each vendor/subcontractor's budget and payment restrictions are appropriately entered as well;
    - When utilizing the Employee Expense program, currently there are no protocols for entering an approval amount for an employee; rather, the software system relies upon generating alerts to the program personnel to ensure that they approve the expenses. There is no control environment for establishing the limits for those expenses.
- Another example of the need to have customized manual procedures prepared by the City relates to vendor management. Although the TM ERP software system appears to have sufficiently robust controls to ensure vendor payments are made in accordance with certain rule sets, there are no procedures to identify the amounts and levels of authority for those payments;
- The system is not designed to perform Due Diligence on a particular vendor to reduce the risks of fraud from companies, shell corporations, and straw man transactions. As identified in the UUP fraud, the city does not currently have any procedures to properly "vet" potential city vendors or contractors. The City's response to KPMG recommendation #17 (conducting due diligence) on vendors to reduce potential fraud, the City's response was that:

    > *"Vendors will be required to register through Bids Online and be approved by purchasing staff prior to being added to the Vendor Master List."*

    Although this is an indication that the City will have additional procedures to complement the TM ERP software system, the response lacks detail and specificity needed to identify fraudulent vendors. The Internal Controls and Audit Subcommittee did not do an in-depth analysis of the Bid Online program, but it does not appear to be a software program that will conduct due diligence on a vendor.[2] (See additional comments regarding KPMG recommendation #17 on page 7).

[2] http://ww2.cityofpasadena.net/councilagendas/2010%20agendas/Jun_21_10/AR%208%20ATTACHMENT%20C.pdf

Requested Documents Still Pending

- Copy of the City's proposed written policies and procedures manuals for the Procurement and Disbursement cycles using the new ERP system.

V. Summary of Work Performed, Observations and Open Items Pertaining to the Process Revolving around the Current Hiring of an Internal Audit Manager

Background and Work Performed

The Internal Controls and Audit Subcommittee requested any and all documentation on the current hiring of an Internal Audit Manager; together with any documentation as to how this position will be utilized in determining the risk assessment of the City; how this position will interrelate to/with the external auditors; and how this new position will help to determine the internal audit program for the City.

The Internal Controls and Audit Subcommittee did not receive a response to our requests from the City despite numerous requests for information.

General Observations

- See Observations pertaining to the Internal Audit Function (#35 to #39) on pages 9 through 11.
- The establishment of an Internal Audit function (whether one person or a department) is one of the key components of a strong control environment yet the City has not hired anyone since the position was approved in August, 2014 - one year ago. This hire needs to be at the forefront of the City's hiring schedule;
- The City indicated that the salary grade was not comparable to the job description. The City needs to solicit help from an outside search firm to determine the correct salary package for this much needed position;
- Additionally, the City should explore the possibilities of establishing an Internal Audit Department.

Requested Documents Still Pending

- Any and all documentation on the current hiring of an Internal Audit Manager; together with any documentation as to how this position will be utilized in determining the risk assessment of the City;

how this position will interrelate to/with the external auditors; and how this new position will help to determine the internal audit program for the City.

VI. Summary of Observations Pertaining to the Pros and Cons of an Ongoing Citizen-based Audit Advisory Committee

The Internal Controls and Audit Subcommittee believes that an ongoing citizen-based audit advisory committee ("C-B AAC") would be helpful, not only to the City's Audit Committee; but to the citizens of Pasadena in general. However, it must be noted that to be effective, the cooperation from The City and the Audit Committee would be paramount. The C-B AAC would:

- Establish independence in the audit function of the City;
- Play a role in monitoring:
    - follow-up on outstanding audits and/or recommendations; and
    - adherence to any future fraud risk assessment plans;
- Play a role in educating the Audit Committee (best practices, etc.);
- Be experts in governance and have auditing experience;
- Potentially, be members of the City's Audit Committee.

Additional work to be performed and other general observations

- All Special Revenue Funds should be documented as to purpose. This documentation should include a time frame for the expenditure of funds, a description of the type and source of revenue and the intended payments to be made from this fund and should include the policies and procedures for oversight, analysis and review. Each Special Revenue Fund should be reviewed for reasonableness annually by the Finance Department. The Finance Department and/or the Internal Audit Department should review the policies and procedures for compliance with a sound overall Control Environment.
- Interview current External Auditors relative to the overall Control Environment and internal controls in general
- Newly hired Fiscal Services Administrator should coordinate all policy and process improvements with the Internal Audit Department for compliance with a sound overall Control Environment.
- Document the training and education given the Finance Committee (Audit Committee) of the City Council.

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During KPMG's investigation into matters relative to the Underground Utility Program ("UUP"), they made 43 recommendations for improving and strengthening the City's policies, processes and system of internal controls in the areas of UUP and the Finance Department.

One of four main action items of the sub-committee on internal controls and internal audit ("sub-committee") was to examine and provide comment on the City's progress on implementation of the 43 recommendations outlined in KPMG's Report Memorandum dated November 11, 2014.

On May 4, 2015, the sub-committee (Charlotte Reith and Jim Dowling) met with Julie Gutierrez, Assistant City Manager and Interim Director of Finance and Flo Karmiryan, Senior Accountant in Utility Accounting. During this meeting, we reviewed Recommendations 1 through 25. From that meeting, the sub-committee had/has several additional document requests, as follows:

1. **Copy of the Management Partners review of the internal controls and processing procedures for the UPP.** It is our understanding that this analysis is to be completed in June, 2015 and when the report is available, we would appreciate receiving a copy. (See Recommendation 1);

2. **Copy of detailed mapping for the Procurement Process** (See Recommendation 4);

3. **Copy of Reimbursement Form** used for submitting certain invoice payments (See Recommendation 6);

4. **Copy of new Vendor Master checklist.** It is our understanding that this checklist is in process and when completed and available, we would appreciate receiving a copy. (See Recommendation 19 and 20).

On June 5, 2015, the sub-committee (Charlotte Reith, Jim Dowling and Bob Davidson) met (via telephone conference call) to discuss Recommendations 26 through 43. From that meeting, the sub-committee had one additional document requests, as follows:

1. **Copy of McGladrey, LLP report regarding their review of the City's policies, procedures and practices related to vendor management, etc.** (Phase I) It is our understanding that this report was completed in May, 2014 and presented to the Audit Committee thereafter. If Phase II has been completed, we would appreciate receiving a cop of this report as well. (See Item 6 of the Audit Plan - Attachment A dated 10/27/2014).

In addition to the document request above, the sub-committee had several questions regarding Recommendations 26 through 43 as follows:

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1. Recommendation 29 - copy of most current organization chart showing that Purchasing reports to the City's Controller;
2. Recommendation 31 - copy of current policies and procedures for what is an acceptable written justification for approval of payment requests outside the norm;
3. Recommendation 33 - copy of current policies and procedures for instructions to Accounts Payable that only original documents with original signatures should be accepted;
4. Recommendation 34 - copy of current policies and procedures where additional internal controls over invoice process is outlined;
5. Recommendation 35 - Updated Audit Work plan, if available;
6. Recommendation 39 - Updated protocols and procedures , if available;
7. Recommendation 42 - Updated training schedule, if available; together with any training templates/manuals, etc. used in this training.

Additionally, a general observation of the sub-committee was that the responses to the 43 recommendations do not reflect a time frame for implementation.

Also, in reviewing Attachment C - Work Plan - Department of Finance, the sub-committee had the following questions:

1. What is the status of the hiring of a Fiscal Services Administrator?
2. May we have a copy of the City Council Finance Committee's agenda template outlining the monthly reports provided to them? Has any training been provided so that the Finance Committee understands the reports as well as understands what are the key components?
8. What is the status of hiring a consultant to document and update all finance policies reflecting best practices?

Our overall observations and recommendations will be provided in our final report.