



MEETING DATE: 01/17/06  
ITEM NO. 15

## COUNCIL/AGENCY AGENDA REPORT

DATE: JANUARY 17, 2006

TO: MAYOR AND TOWN COUNCIL/REDEVELOPMENT CHAIR AND MEMBERS OF THE REDEVELOPMENT AGENCY

FROM: TOWN MANAGER/EXECUTIVE DIRECTOR 

SUBJECT: ACCEPT THE 2004/05 COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) AND MANAGEMENT LETTER

### RECOMMENDATION:

Accept the 2004/05 Comprehensive Annual Financial Report (CAFR) and Management Letter.

### BACKGROUND:

This CAFR presents the Town of Los Gatos and Town of Los Gatos Redevelopment Agency's financial condition, results of operations and current economic condition, for the fiscal year ended June 30, 2005. The 2005 CAFR received an unqualified opinion from C.G. Uhlenberg LLP, the Town's external auditors. An unqualified opinion indicates the financial data of the Town is fairly presented according to general accounting principles. Additionally, C.G. Uhlenberg LLP issued a Management Letter on internal control structure to report on any material weaknesses in the Town's internal controls. A material weakness is a significant deficiency which could lead to a material misstatement of the financial statements. The auditor's report found the Town's internal control structure to have no reportable material weaknesses.

### DISCUSSION:

C.G. Uhlenberg LLP, the Town's auditors, conducted an audit in accordance with generally accepted auditing standards and the standards for financial audits contained in the Government Audit Standards (1994 Revision), issued by the Comptroller General of the United States. These standards require that they plan and perform the audits to obtain reasonable assurance as to whether the financial statements are free of material misstatement.

Staff and Town's auditors, C.G. Uhlenberg LLP, met with the Council's Finance Committee on Monday, January 9th, 2006 for an in-depth review of this year's reports to the Finance Committee.

PREPARED BY: STEPHEN D. CONWAY  
Finance and Administrative Services Director

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Reviewed by: DL Attorney SO Finance PSJ Asst. Town Mgr

Revised: 1/12/06 2:48 pm

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MAYOR AND TOWN COUNCIL

SUBJECT: 2004-05 COMPREHENSIVE ANNUAL FINANCIAL REPORT.

January 17, 2006

The Committee was advised by staff that the audited statements for the year ended June 30, 2005 received an unqualified or "clean" opinion for the year, meaning the financial statements are fairly presented and contain no material misstatements. In addition, C.G. Uhlenberg LLP reviewed the Management Letter with the Town staff and the Council's Finance Committee. One current year finding was reviewed with the Committee and staff explained its response to the auditor's comments. The audit Management Letter and the Town's response are included as Attachment 1 to this agenda item. The internal control comments were of a more routine financial housekeeping nature. The Town's response to each finding describes how staff will address each issue this fiscal year.

The Town has applied for and received the Government Finance Officers Association (GFOA), Certificate of Achievement for Excellence in Financial Reporting, for the last ten years. This report is the Town's third CAFR prepared under the new reporting format required by the Governmental Accounting Standards Board (GASB) Statement #34.

CONCLUSION:

As noted in the auditor's opinion, the CAFR fairly presents the fiscal year ending June 30, 2005 financial activity for the Town of Los Gatos and Redevelopment Agency. After reviewing the financial documents with the Town's external auditors and Town staff, the Committee recommends that the Council accept the CAFR and audit Management Letter for year ending June 30, 2005.

ENVIRONMENTAL ASSESSMENTS:

Is not a project defined under CEQA, and no further action is required.

DISTRIBUTION:

CAFR's and audit Management Letter are available in the Clerk Department, and on file in the library.

ATTACHMENT:

- (1) CAFR
- (2) Audit Management Letter

**ATTACHMENT 1**

**COPY OF THE COMPREHENSIVE ANNUAL FINANCIAL  
REPORT IS AVAILABLE FOR REVIEW IN THE CLERK  
DEPARTMENT**

**TOWN OF LOS GATOS**

**MANAGEMENT LETTER  
FOR THE FISCAL YEAR  
ENDED JUNE 30, 2005**

*Submitted by:*



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Certified Public Accountants  
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Redwood Town, CA 94065

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Contact: Jeffrey J. Ira

**September 23, 2005**

**ATTACHMENT 2**

January 3, 2006

The Honorable Mayor  
Town of Los Gatos, California

We have audited the basic financial statements of the Town of Los Gatos California (the "Town"), as of and for the year ended June 30, 2005, and have issued our reports thereon dated September 23, 2005.

In planning and performing our audit of the basic financial statements of the Town, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance of internal control. As part of our audit, we made a study and evaluation of internal controls, including applicable internal administrative controls used in administering federal award programs, to the extent we considered necessary to evaluate such controls as required by auditing standards generally accepted in the United States of America; *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*.

A description of the responsibility of the management for establishing and maintaining the internal control structure, and of the objective of inherent limitations in such a structure, is set forth in the attached Appendix 1, and should be read in conjunction with this report.

We did *not* note any matters involving the internal control and its operation that we consider to be reportable conditions. *Reportable conditions* involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting and compliance that, in our judgment, could adversely affect the Town's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material, in relation to the basic financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We did *not* note any matters involving the internal control structure and its operations that we consider to be material weaknesses as defined above. The following comments present our findings with suggested solutions for your consideration and possible implementation. These comments and recommendations, all of which have been discussed with the appropriate

members of management, are intended to improve internal control or result in other operation efficiencies.

Our comments contained herein are based solely on observations made during our audit of the Town's 2004-2005 basic financial statements and, accordingly, are not based on the results of any special studies designed to report on these matters. Accordingly, additional information and study may be required before acting on our suggestions.

This letter is intended solely for the information and use of management, the Mayor, and Town Council and should not be used for any other purpose. However, this restriction is not intended to limit the distribution of this letter, which is a matter of public record.

We would be pleased to discuss these matters in greater detail at your convenience.

Very truly yours,

C. G. UHLENBERG LLP

By

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Jeffrey J. Ira

JJI/sc

CURRENT YEAR FINDINGS  
AND RECOMMENDATIONS

**TOWN OF LOS GATOS**

**CURRENT YEAR FINDINGS AND RECOMMENDATIONS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

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**FORMAL PURCHASING POLICY**

*Finding 05-01* - The purchasing policy that the Town currently follows was issued in 1997.

*Recommendation* - This is a repeat recommendation from previous audits. We recommend the purchasing policy be reviewed and updated to provide strict guidelines on current day issues such as petty cash, travel reimbursements, credit card purchases and the amount for which a formal purchase order is required. It should also designate those individuals that are authorized to have a Town credit card and who can approve purchases. Once these policies are established, the rules and guidelines must be enforced and staff training should be provided.

*Town Response* - The Town agrees. An update to the Town's purchasing policies is listed as item #3 in the Finance divisions Work Plan approved for FY 2004/05. Staff anticipates incorporating the updates as part of a proposed comprehensive Financial Systems Upgrade planned to begin in FY 2006/07.

*Status* - In progress.

PRIOR YEAR FINDINGS  
AND RECOMMENDATIONS

## TOWN OF LOS GATOS

### PRIOR YEAR FINDINGS AND RECOMMENDATIONS FOR THE FISCAL YEAR ENDED JUNE 30, 2005

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#### **CREDIT CARD CONTROL AND POLICY**

***Finding 04-01*** - From a sample of twenty employees with assigned credit cards we noted the following areas of control over credit card handling that the Town may want to consider for further review:

1. Supervisor signatures on credit card requests forms. We noted inconsistencies in the approval of the request forms when transferring between departments and when issuing new cards.
2. The list of cardholders by position in the credit card handbook. We noted two cardholder positions were not included in the list kept in the handbook.
3. The list of employees with credit cards. We noted four terminated employees that were still on list of current cardholders.

***Recommendations*** - We recommend the following for each of the above points:

1. We recommend that the Town adhere more diligently to the policy of having the director of finance **and** the department managers approve the credit card request forms before they are sent to the town manager for approval. This should include the approval of new credit card requests and transfers between departments.

***Town Response*** - The Town agrees with this recommendation. Town staff will be reminded that all required signatures or substitute authorized signatures must be obtained before new credit cards are issued or inter-departmentally transferred to Town staff.

***Status*** – The Town has fully implemented this recommendation.

2. We recommend that the Town review the list of cardholders by position annually to ensure the list is current.

***Town Response*** - The Town agrees with this recommendation. The Finance Department will initiate a procedure this fiscal year to include a Town-wide review of the list of current cardholders to ensure the list is current and valid.

***Status*** – The Town has fully implemented this recommendation. The Town continues to monitor and update the cardholder list on an ongoing basis.

3. We recommend the Town adhere more diligently to their policy requiring cardholders to return the cards when their employment ends and that the list of cardholders be reviewed more routinely for terminated employees still on the list.

## TOWN OF LOS GATOS

### PRIOR YEAR FINDINGS AND RECOMMENDATIONS FOR THE FISCAL YEAR ENDED JUNE 30, 2005

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***Town Response*** - The Town agrees with this recommendation. The Town Manager's office will coordinate with its Human Resources function to ensure termination procedures include the return of all Town property, including credit cards. It should be emphasized that current procedures do provide for canceling the card upon termination, whether or not the card is actually returned to the Town for destruction or not.

***Status*** - Fully Implemented. Procedures are in place to immediately cancel the cardholder's card upon notification of termination received by Finance staff from the Town's Human Resources staff.

#### CASH AND INVESTMENTS

***Finding 03-01 - Check Stock Safety Features and Positive Pay*** - Currently, the only safety feature on the Town's check stock is a watermark. First, and foremost, we once again recommend that the Town consider utilizing the Positive Pay system offered by most commercial banks, whereby the bank can only cash checks that are listed on the Town's check register. Until the Town is ready to do this, we recommend that the next time checks are ordered, other safety features are added, such as a "void clause," laser ink printing, etc.

***Town Response*** - The Town agrees that fraud prevention is very important. The Town has contacted a vendor who we will put in touch with our financial system vendor (Pentamation) to see if positive pay has a potential for being implemented in the Town's system.

***Status*** - Upon expiration of the current remaining check stock, staff intends to order new check stock with the suggested additional safety features. Staff believes that Positive Pay will be a feature that can be implemented with the proposed financial system upgrade project which is anticipated to begin in FY 2006/07.

## TOWN OF LOS GATOS

### MANAGEMENT'S RESPONSIBILITY FOR, AND THE OBJECTIVES AND LIMITATIONS OF, THE INTERNAL CONTROL STRUCTURE FOR THE FISCAL YEAR ENDED JUNE 30, 2005

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The following comments concerning management's responsibility for the internal control structure and the objectives of, and the inherent limitations in, the internal control structure are adapted from the Statements on Auditing Standards of the American Institute of Certified Public Accountants.

#### Management's Responsibility

Management is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefit and related costs of the internal control structure policies and procedures.

#### Objectives

The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of basic financial statements in accordance with accounting principles generally accepted in the United States of America.

#### Limitation

Because of inherent limitations in any internal control structure, errors or irregularities may occur and not be detected. Also, projection of an evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.