



MEETING DATE: 03/15/04  
ITEM NO. 15

### COUNCIL/AGENCY AGENDA REPORT

DATE: MARCH 10, 2004  
TO: MAYOR AND TOWN COUNCIL/REDEVELOPMENT CHAIR AND MEMBERS OF THE REDEVELOPMENT AGENCY  
FROM: TOWN MANAGER/EXECUTIVE DIRECTOR   
SUBJECT: ACCEPT THE 2002-03 COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) AND MEMORANDUM ON INTERNAL CONTROL STRUCTURE

RECOMMENDATION:

Upon review by the Town Council's Finance Committee, accept the 2002-03 Comprehensive Annual Financial Report (CAFR) and Memorandum on Internal Control Structure.

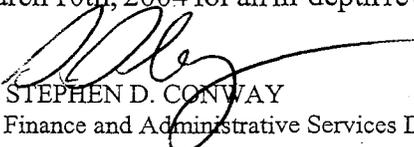
BACKGROUND:

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, 2003. The 2003 CAFR received an unqualified opinion from Maze and Associates, the Town's external auditors. An unqualified opinion indicates the financial data of the Town is fairly presented according to general accounting principles. Additionally, Maze and Associates issued a Memorandum 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:

Maze & Associates, 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, Maze and Associates, met with the Council's Finance Committee on Wednesday March 10th, 2004 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: OK Attorney xx Finance PSS Asst. Town Mgr

Revised: 3/4/04 5:28 pm

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MAYOR AND TOWN COUNCIL

SUBJECT: 2002-03 COMPREHENSIVE ANNUAL FINANCIAL REPORT.

March 10, 2004

The Committee was advised by staff that the audited statements for the year ended June 30, 2003 received an unqualified or "clean" opinion for the year, meaning the financial statements are fairly presented and contain no material misstatements. In addition, Maze and Associates reviewed the Memorandum on Internal Control Structure with the Town staff and the Council's Finance Committee. Six items were discussed with the Committee and staff explained its response to the auditor's comments. The Memorandum on Internal Control Structure 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 nine years. This report is the Town's first 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, 2003 financial activity for the Town of Los Gatos and Redevelopment Agency. The Town's Finance Committee, having reviewed the CAFR and Memorandum on Internal Control Structure with the Town's external auditors and Town staff, recommends their acceptance for the year ended June 30, 2003.

ENVIRONMENTAL ASSESSMENTS:

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

DISTRIBUTION:

CAFR's and Memorandums on Internal Control Structures are available in the Clerk's Office, and on file in the library.

ATTACHMENT:

- (1) Memorandum on Internal Control Structure and Town Response
- (2) CAFR

November 7, 2003

To the Town Council of  
the Town of Los Gatos

Under generally accepted auditing standards in the United States of America, auditors are encouraged to report various matters concerning an entity's internal control structure noted during an audit, and are required to report certain of those matters. Matters that are required to be reported are significant deficiencies in the design or the operation of the internal control structure that, in the auditor's judgment, could adversely affect the organization's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

As part of our audit of the financial statements of the Town of Los Gatos for the year ended June 30, 2003, we considered the Town's internal control structure in determining the scope of our audit procedures for the purpose of rendering an opinion on the financial statements. While our purpose was not to provide assurances on the internal control structure, certain matters came to our attention that we want to report to you. These matters, along with our recommendations, are described in the accompanying memorandum.

A material weakness is a significant deficiency in which the design or operation of one or more of the 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 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.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses as defined above. However, none of the significant deficiencies described in the accompanying memorandum is believed to be a material weakness.

The accompanying memorandum on internal control structure is intended solely for the use of management and the Town Council. This restriction is not intended to limit the distribution of this letter and the accompanying memorandum which, upon acceptance by the Town Council, are a matter of public record. To the extent that the Town Council intends to rely upon this letter and the accompanying memorandum, such reliance should take into account the limited basis on which our recommendations were developed, as described above, and the limitations inherent in the internal control structure. In addition, the Town Council should understand that the criteria used by us in considering the internal control structure could differ significantly from the criteria the Town Council may be using for its purpose.

We wish to express our appreciation for the courtesies and cooperation extended to our representatives during the course of their work. We would be pleased to discuss these recommendations in greater detail or otherwise assist in their implementation.

Very truly yours,

**ATTACHMENT 1**

**TOWN OF LOS GATOS**  
**Memorandum on Internal Control Structure**

**CASH AND INVESTMENTS**

*Treasurer's Report*

The California Government Code §53646 requires that the Town Treasurer submit a quarterly investment report to the Town Council within 30 days following the end of the quarter covered by the report. The Town Treasurer has elected to submit these reports on a monthly basis, which is allowed by the California Government Code. We have noted, however, that the December 31, 2002, March 31, 2003, and June 30, 2003 reports were not submitted within the required timeframe.

**Town Response:**

The Town Treasurer agrees to the finding. The Treasurer believes she can meet the submitted requirement date of 30 days after month end by considering the date the report is submitted to the Town's Agenda review process as the "date submitted". Workload and timely receipt of bank statements, have occasionally led to delays in the Treasurer meeting this deadline, but she informs staff that she has taken steps to meet the deadline submission dates.

*Timely Reconciliations of Bank Accounts*

We noted that the December 2001 and March 2002 bank statements were not reconciled in a timely manner. As we recommended to the Town Treasurer last year, bank reconciliations must be completed within 30 days of receipt of the bank statements. After 30 days, the financial institutions have the discretion of holding the Town responsible for any bank errors.

**Town Response:**

The Town agrees with this recommendation. The Treasurer and staff will work to develop a calendaring memorandum or other automated system where positive confirmation that the Treasurer reconciliation has taken place will be confirmed by a designated Finance staff person.

*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.

*Petty Cash Funds – Surprise Counts*

We understand a surprise petty cash fund count has not been performed since December of 2001. We recommend these be done at least quarterly.

**TOWN OF LOS GATOS**  
**Memorandum on Internal Control Structure**

Town Response:

The Town agrees that surprise counts of petty cash were delayed due to workload issues. This is an important internal control procedure. We are pleased to announce that a surprise count was performed in September 2003 and is now scheduled for quarterly preparation by the Town Accountant. We do believe because of the relatively small size our total (8 petty cash accounts totaling \$2,400 for all accounts), a quarterly surprise count may be to frequent to support a cost vs. benefit analysis. We believe perhaps three surprise counts a year should be considered as an alternative.

**FORMAL PURCHASING POLICY**

The purchasing policy that the Town currently follows was issued in 1997. We recommend it 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.

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.

**CAPITAL ASSETS**

Although the Town maintains a detailed listing of capital assets, a physical inventory of these fixed assets has not been completed in several years. We recommend that the Town complete a physical inventory and update its listing of capital assets and related accumulated depreciation.

Town Response:

The comment is correct as of the period ending June 30, 2003. However, the Town is pleased to report that a Town-wide inventory of capital assets was completed by staff in September 2003.

