



MEETING DATE: 3/19/2007

ITEM NO: 8

**COUNCIL/AGENCY AGENDA REPORT**

DATE: MARCH 19, 2007

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

FROM: DEBRA J. FIGONE, TOWN MANAGER/EXECUTIVE DIRECTOR 

SUBJECT: ACCEPT THE 2005/06 COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR)  
AND MANAGEMENT LETTER

RECOMMENDATION:

Accept the 2005/06 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, 2006. The 2006 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.

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

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Reviewed by: AS Assistant Town Manager/Deputy Director OK Town Attorney/General Counsel  
Clerk Administrator/Secretary SO Finance  
\_\_\_\_\_ Community Development

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

SUBJECT: ACCEPT THE 2005/06 COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) AND MANAGEMENT LETTER

MARCH 19, 2007

Staff and Town's auditors, C.G. Uhlenberg LLP, met with the Council Finance Committee on Wednesday, March 14, 2007 for an in-depth review of this year's reports to the Finance Committee. The Committee was advised by staff that the audited statements for the year ended June 30, 2006 received an unqualified or "clean" opinion for the year, meaning the financial statements are fairly presented and contain no material misstatements.

The Committee also confirmed with staff and the independent auditor that the \$38.6 million of Unrestricted Net Assets shown on page 12 of the CAFR is terminology mandated by the Governmental Accounting Standard Board Statement #34. The amount presented as \$38.6 in unrestricted net assets is accurate, but misleading. Although current accounting practices require the use of the term "Unrestricted Net Assets," these funds are in fact designated for specific purposes. They are an overall financial position indicator and not the amount of current resources available for budgetary purposes.

In addition, C.G. Uhlenberg LLP reviewed the Management Letter with Town staff and the Council 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 report. 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 eleven years. This report is the Town's fourth 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, 2006 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, 2006.

#### ENVIRONMENTAL ASSESSMENT:

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

#### Attachments:

1. Audit Management Letter
2. CAFR

#### Distribution:

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

**TOWN OF LOS GATOS**

**MANAGEMENT LETTER  
FOR THE FISCAL YEAR  
ENDED JUNE 30, 2006**

*Submitted by:*



**C. G. UHLENBERG LLP**  
Certified Public Accountants  
333 Twin Dolphin Rd., Ste. 230  
Redwood Town, CA 94065

Phone: (650) 802-8668

Fax: (650) 802-0866

Contact: Jeffrey J. Ira

**March 7, 2007**

**ATTACHMENT 1**

**TOWN OF LOS GATOS**

MANAGEMENT LETTER  
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FOR THE FISCAL YEAR ENDED JUNE 30, 2006

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**C. G. UHLENBERG LLP**  
**CERTIFIED PUBLIC ACCOUNTANTS**

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ROBERT E. BARSANTI, CPA (RETIRED) • PEGGY H. CHEN, CPA • JEFFREY J. IRA, CPA • KATHERINE CHAO, CPA • JULIE LIN, CPA • SHELDON CHAVAN, CPA

March 7, 2007

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, 2006, and have issued our reports thereon dated December 20, 2006.

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

**C. G. UHLENBERG LLP**  
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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 2005-2006 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*

Jeffrey J. Ira, Partner  
C. G. UHLENBERG LLP

CURRENT YEAR FINDINGS  
AND RECOMMENDATIONS

## TOWN OF LOS GATOS

### CURRENT YEAR FINDINGS AND RECOMMENDATIONS FOR THE FISCAL YEAR ENDED JUNE 30, 2006

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#### **TOWN OF LOS GATOS REDEVELOPMENT AGENCY (THE AGENCY)**

***Finding 06-01*** - Pursuant to Health and Safety Code Section 33334.12(g), "excess surplus" means any unexpended and unencumbered amount in an agency's Low and Moderate Income Housing Fund that exceeds the greater of: one million dollars (\$1,000,000), or the aggregate amount of tax increment deposited into the Low and Moderate Income Housing Fund during the agency's preceding four fiscal years (pursuant to Sections 33334.2 and 33334.6). It was determined that the Agency retained an excess surplus of approximately \$518,803 for the fiscal year ended June 30, 2006, based on the aggregate amount of tax increment deposited in the Low and Moderate Income Housing Fund.

***Recommendation*** - Pursuant to Health and Safety Code Section 33334.12(a)(1)(B), we recommend that the Agency encumber the excess surplus within two years. The funds should be encumbered to carry out activities consistent with a redevelopment agency as defined in Health and Safety Code Sections 33334.2 and 33334.3.

***Town Response*** - The Town agrees with this finding and acknowledges the need to expend and encumber these funds. The Redevelopment Agency is actively pursuing options to expend and encumber these funds. Within the next two years the Agency intends to initiate affordable housing projects in the Project Area and work with local non-profit developers to produce affordable housing units.

PRIOR YEAR FINDINGS  
AND RECOMMENDATIONS

## TOWN OF LOS GATOS

### PRIOR YEAR FINDINGS AND RECOMMENDATIONS FOR THE FISCAL YEAR ENDED JUNE 30, 2006

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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 2006/07. Staff anticipates incorporating the updates as part of a proposed comprehensive Financial Systems Upgrade planned for FY's 2006/07 & 2007/08.

***Status*** - In progress.

#### **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 is working to identify a solution with a financial services 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*** - Partially Implemented. New check stock safety features were implemented in early FY 2006/07, staff is intending on implementing Positive Pay in conjunction with the proposed financial system upgrade project, the current project schedule spans FY 2006/07 & FY 2007/08.

REQUIRED  
COMMUNICATIONS  
JUNE 30, 2006

## TOWN OF LOS GATOS

### REQUIRED COMMUNICATIONS FOR THE FISCAL YEAR ENDED JUNE 30, 2006

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Professional auditing standards require auditors to communicate with the audit committee, or its equivalents, on a number of subjects. The following information satisfies these requirements, and is solely for use of the Town Council and Town management.

#### **The Auditor's Responsibility Under Auditing Standards Generally Accepted in the United States of America and *Government Auditing Standards***

Our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but no absolute, assurance that the financial statements are free from material misstatements and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered the internal control of the Town. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control. As part of obtaining reasonable assurance about whether the Town's financial statements are free of material misstatement, we performed test of its compliance with certain provisions of laws, regulations, contracts and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

#### **Significant Accounting Policies**

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Town are described in Note 1 to the financial statements. As described in Note 1 to the basic financial statements, the Town implemented Governmental Accounting Standards Board (GASB) Statement No. 46, *Net Assets Restricted by Legislation – an amendment of GASB Statement No. 34*.

We noted no transactions entered into by the Town during the fiscal year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

#### **Accounting Estimates**

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

**TOWN OF LOS GATOS**  
**REQUIRED COMMUNICATIONS**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

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The most sensitive estimates affecting the financial statements were:

- Valuation methodology of infrastructure assets
- Accrual and disclosure of compensate absences
- Depreciation estimates for capital assets, including depreciation methods and useful lives assigned to depreciable property

Management's judgments and estimates were based on the following:

- Valuation methodology of infrastructure assets was based on the Town's consultant study adjusted for annual capital asset activity.
- Accrual and disclosures of compensated absences were based on accrued eligible hours of vacation and sick leave at current pay rates for eligible employees.
- Useful lives for depreciable property were determined by management based on the nature of the capital asset.

We evaluated the key factors and assumptions used to develop the estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

**Audit Adjustments**

For the purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Town's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the Town, either individually or in the aggregate, indicate matters that could have a significant effect on the Town's financial reporting process.

We are also required to inform you about uncorrected misstatements aggregated by us during the current engagement that were determined by management to be immaterial, both individually and in the aggregate, to the basic financial statements taken as a whole. There were no unrecorded misstatements greater than \$2,500 noted during the audit of the year ended June 30, 2006.

**Disagreements with Management**

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

## TOWN OF LOS GATOS

### REQUIRED COMMUNICATIONS FOR THE FISCAL YEAR ENDED JUNE 30, 2006

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#### **Consultations with Other Accountants**

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Town's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

#### **Issues Discussed with Management Prior to Our Retention**

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Town's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

#### **Difficulties in Performing the Audit**

We encountered no significant difficulties in dealing with management in performing our audit.