

Garza/Gonzalez & Associates

CERTIFIED PUBLIC ACCOUNTANTS

CITY OF WINDCREST, TEXAS
REPORT ON THE CONDUCT OF AUDIT
For The Year Ended September 30, 2011

Garza/Gonzalez & Associates

CERTIFIED PUBLIC ACCOUNTANTS

Honorable Mayor and Members
of City Council
City of Windcrest, Texas

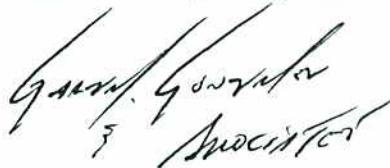
We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Windcrest, Texas (*the City*) as of and for the year ended September 30, 2011, and have issued our report thereon dated June 15, 2012. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards as well as certain information related to the planned scope and timing of our audit. We communicated such information to the audit committee in a meeting on March 19, 2012. Professional standards also require that we communicate to you the following information related to our audit.

- the conduct of our audit (Parts I – VIII),
- *internal* control and other matters (Part IX),
- noncompliance with state requirements (Part X)

This letter does not affect our report dated June 15, 2012, on the financial statements of the City. Our comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve the internal control structure and ensure compliance with state requirements.

This report is intended solely for the use of the Audit Committee, City Council and management of the City and is not intended to be and should not be used by anyone other than these specified parties.

We would like to take this opportunity to acknowledge the courtesy and assistance extended by the personnel of the City during the course of our audit.

A handwritten signature in black ink, appearing to read "Garza/Gonzalez & Associates". The signature is written in a cursive style and is positioned above the date.

June 15, 2012

CITY OF WINDCREST, TEXAS
REPORT ON THE CONDUCT OF AUDIT
For the Year Ended September 30, 2011

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I. The Auditors' Responsibility under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated September 27, 2011, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit involved judgment about the number of transactions examined and the areas tested.

In planning and performing our audit, we considered the City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting.

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit.

We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

II. Qualitative Aspects of Accounting Practices

Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note I to the financial statements. The City adopted Government Accounting Standards Board Statement No. 54, "Fund Balance Reporting and Governmental Fund Type Definitions" which revised the reporting classifications of fund balances for the governmental fund types. The implementation of the GASB Statement did not have an impact on the total fund balances reported by the City. The purpose of the Statement was to enhance the usefulness of fund balance information by providing clearer fund balance classifications.

Effective September 30, 2011, the City commenced the reporting of warrants receivable and the related allowance for uncollectible accounts and deferred revenue. The effect of this reporting is to increase assets and liabilities by \$120,399. Also, in fiscal year 2011, the City reported the City of Windcrest Economic Development Corporation (Corporation) as a blended component unit, which was previously reported as a discretely presented component unit. There is no cumulative effect on prior years since the ending net assets/fund balance as of September 30, 2010 is the beginning net assets/fund balance for the year ended September 30, 2011. Additionally, we noted no transactions entered into by the City during the 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.

Prior period adjustments, which restated, both the beginning fund balance and net assets by a net increase of \$6,088,248 and \$2,408,580, respectively, were made to correct the reporting of component units, capital assets, capital leases, and municipal court fine revenue. All other significant transactions appear to have been recognized in the financial statements in the proper period.

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. The most sensitive estimates affecting the City's financial statements are depreciation, and the allowance for uncollectible receivables. Following are the bases used by management for such estimates:

- depreciation is based on estimated useful lives of the respective capital asset class;
- allowance for uncollectible municipal court fines receivable represents 90% of the warrants receivable balance outstanding.
- allowance for uncollectible property taxes receivable represents receivables that have been outstanding for 4 years or more at year end.

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

Financial Statement Disclosures

Certain financial statement disclosures are particularly sensitive because of their significance to the financial statement users. The financial statement disclosures are neutral, consistent, and clear.

III. Difficulties Encountered in Performing the Audit

We encountered no difficulties in dealing with management in performing and completing our audit. However, since information related to the City's obligations for the land held in trust for the revitalization and development projects was not readily available and was required to be researched by and obtained from the City's general counsel, the completion of audit fieldwork and financial statements was delayed.

IV. Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. All misstatements, whether identified by us or management, were corrected by the adoption of audit adjustments. These audit adjustments had the net effect of increasing assets, liabilities, and revenues by \$1,467,331; \$1,324,418; and, \$165,852, respectively; and, decreasing fund balance, expenditures, and other financing sources by \$8,187; \$19,583; and, \$34,335, respectively.

V. Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, 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.

VI. Management Representations

We have requested certain representations from management that are included in the management representation letter dated June 15, 2012.

VII. Management Consultations with Other Independent 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 City’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 or determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

VIII. Other Issues

Other Information in Documents Containing Audited Financial Statements

Our responsibility for the supplementary information accompanying the financial statements, as described by professional standards, is to evaluate the presentation of the supplementary information in relation to the financial statements as a whole and to report on whether the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Matters Discussed with Management Prior to Appointment

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

IX. Internal Control and Other Matters

Our consideration of internal control was for the limited purpose described in Part I above and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore there can be no assurance that all such deficiencies have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses, other deficiencies that we consider to be significant deficiencies, and other control deficiencies.

A. Material Weaknesses

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. We consider the following deficiencies in the City’s internal control to be material weaknesses:

Capital Assets

Our review of internal controls over capital assets indicated the following:

- The capital asset policy states that capital assets are all assets with a cost of \$2,500 or more *and* a useful life of three years or more. However, the capital assets subsidiary list includes a significant number of items that do not meet the \$2,500 threshold.
- The capital asset policy does not identify the different types of capital asset classes (i.e. land, buildings, etc.) which are considered capital assets or their useful lives.

- A physical inventory count of capital assets was not performed in the current year and staff is unaware of the date the latest one occurred. As a result, the capital asset subsidiary list may not include all capital assets and may include items that no longer exist. For example, equipment totaling approximately \$815,000 and the corresponding amortization of \$445,000, related to leases entered into in previous years, were not included in the capital asset subsidiary list.
- Significant audit adjustments were required to be made to properly reflect all current year capital asset additions in the capital asset subsidiary list.
- Useful lives for furniture and equipment, including vehicles, may not be reasonable since a significant portion of these assets are fully depreciated and yet are still in use.

We recommend the City:

- Review and revise its capital asset policy for capitalizing assets to clearly state the intent of management and the Council; and, to include the various capital asset classes and their useful lives.
- Review the capital asset subsidiary list and ensure only those assets which meet the capital asset policy are included.
- Perform a complete physical inventory count of capital assets at least every two years and reconcile the subsidiary list to the control accounts.
- Review the useful lives of asset classes to ensure the useful lives are reasonable.
- Review and record capital asset additions throughout the fiscal year.

Management’s Response

Staff will begin working on revisiting all capital assets, as well as bringing the policy before the City Council to ensure that the policy serves the wishes of the Council (i.e. should the policy be \$2,500 and an useful life longer than 1 year, or \$2,500 or a useful life longer than 1 year). Based on current staffing levels this will be a drawn out process. Staff hopes to have the majority reviewed and corrections made by year-end.

B. Significant Deficiencies

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in the City’s internal control to be significant deficiencies:

1. Procurement

Our review of the City’s procurement function identified the following deficiencies:

- *State Requirements* – The State requires that purchases of \$50,000 or more be competitively procured through a formal bid process. Our review of 8 vendors paid more than \$50,000 over the fiscal year, indicated that bid documentation was not available for 6 vendors. Staff indicated the vendors were selected in prior years and; therefore, procurement packets were not available.

- *Purchase Orders* – The City’s policies require that a purchase order (P.O.) be used for purchases over \$500, to document purchase authorization. Our review of 55 check disbursements indicated that a P.O. was not used for a purchase of \$1,192 for advertising and in another instance the required director’s approval was not denoted on the P.O for an equipment purchase in the amount of \$2,098.
- *Telephone Quotes* – The City’s policies require that at least 3 telephone quotes be obtained and documented on a Telephone/Written Request Quote Form (Form) for purchases between \$500 and \$3,000. In 5 of the 50 check disbursements tested, a Form was not used. As a result, we were unable to determine if 3 quotes were obtained prior to the purchases.
- *Formal Quotes* – The City’s policies require that 3 formal quotes (mailed or faxed) be obtained for purchases above \$3,000. In 3 of the 50 check disbursements tested, quotes were not obtained by the Corporation. Thus, the Corporation could be using a vendor that does not offer the best price and/or value.
- *Supplier Master File* – The supplier master file is not periodically reviewed to ensure inactive vendors are deactivated.

We recommend the following to improve internal controls over procurement:

- retain procurement documentation (i.e. formal bidding or requests for qualifications) to support the competitive procurement for the acquisition of goods or services in accordance with the City’s retention policy.
- purchase orders be utilized in accordance with established policies to document the authorization of a purchase.
- telephone quotes be obtained and documented on the Form, as required by established policies.
- formal quotes be obtained for purchases over \$3,000, as required by established policies.
- the supplier master file be reviewed periodically to ensure inactive vendors are deactivated to minimize the risk that an inactive vendor will be used.

We further recommend that the City consider centralizing the procurement of goods/services.

Management’s Response

- As contracts come up for renewal, management will ensure the current purchasing policy is followed. Management has discussed this issue with “previous” and current department heads and the Finance Department is requiring all documents prior to the first check being cut to the vendor.
- Management has briefed all “previous” and current department heads during staff meetings to use the Purchasing policy and to follow all regulations stated in the policy and in State law. To ensure this does not occur in the future, it would be more beneficial to have a centralized purchasing clerk to process all purchases over a certain dollar amount.

- An accountant will review the vendor list quarterly and deactivate any vendor who has not had activity in the prior 18 months. The Municipal Finance Officer will review the list of changes and maintain it the automated audit files.
- Management agrees with the recommendation regarding the centralization of the procurement of goods/services.

2. License and Franchise Fees

The City entered into a license agreement in the prior fiscal year and in accordance with the terms of that agreement, the City will receive \$25,000 per year, payable monthly. During the current fiscal year, the City received only 10 monthly payments; therefore, approximately \$4,200 was not collected. In addition, the City receives various franchise fees from an entity and based on our review of the current year activity, 3 quarterly payments could not be located; therefore, it is unknown whether the entity paid the City the applicable fees.

We recommend the City implement procedures to monitor the receipt of payments from various agreements to ensure all are properly remitted.

Management's Response

Excel summaries will be created and updated to track these items.

3. Payroll

Our testing of 40 payroll transactions denoted the following:

- Part-time positions for the lifeguard, maintenance technician, and payroll specialist are not included in the City's pay plan.
- The employee handbook (handbook) states that employees will receive extra pay upon completion or achieved proficiency. Currently, certain employees receive extra pay for certifications that are not described in the handbook. In addition, the City's pay plan does not include the extra pay for the various certifications or proficiencies obtained.
- In one instance the employee's salary was less than the approved budget and our discussions with staff confirmed that the employee was underpaid. In another instance, an employee was underpaid since she received extra pay in an amount approved for receiving an associate instead of a bachelor's degree.

We recommend the City include all employees and all types of pay in their pay plan; review of all employees and positions be conducted to ensure employees are receiving the correct pay; and, that Council approve any revisions to the pay plan.

Management's Response

- Management is in the process of revising the City's pay plan and will ensure all positions are included. With the current workload and budget, this may not be completed until fiscal year 2012-2013.

- Management is in the process of revising the employee handbook and will ensure extra pay for the various certifications or proficiencies obtained are included.
- The 2 instances cited in the finding occurred as a result of staff change over and not having a centralized document used to update payroll changes. A 'payroll status change form' was implemented in March 2011 and is used to submit and process any payroll changes.

4. Segregation of Duties

The municipal finance accountant collects garbage fees from residential and commercial customers, prepares the deposit slip, and updates/maintains the residential and commercial garbage accounts receivable subledger, which results in a lack in the segregation of duties.

We recommend the City strengthen controls and implement proper segregation of duties over garbage fee collections by separating the collection, deposit slip preparation, and accounts receivable subledger posting functions.

Management's Response

Management concurs with the recommendation. Segregation of duties is difficult to achieve with the limited staff in the Finance office. An additional staff person would be beneficial.

C. Control Deficiencies or Other Matters

Other deficiencies not considered material weaknesses or significant deficiencies are described as follows:

1. Journal Entries

Our review of journal entries disclosed there are weak internal controls and audit trail over journal entry preparation since they are not initialed/signed by the preparer or reviewer and supporting documentation was not available in 2 of the 10 entries tested.

We recommend that all journal entries be signed/initialed by the preparer and reviewer to minimize the risk that unapproved or incorrect journal entries are posted to the books of account; and, supporting documentation be attached to document the purpose of the entry and to provide an audit trail.

Management's Response

Management concurs with the recommendation. All journal entries will be reviewed, signed off, and include supporting documentation.

2. Outstanding Check

The City's operating bank reconciliation included an outstanding check in the amount of \$10,530 that has not cleared the bank since February 2009.

We recommend the City investigate the nature of the outstanding check to determine if it is still owed to the third party, should be voided, or is presumed abandoned and should be remitted to the State Comptroller's Office in accordance with State law.

Management's Response

Management concurs with the recommendation. The Municipal Finance Officer will review each bank statement for any checks outstanding for over 4 months.

3. **Information Technology**

Our review of safeguard controls over information technology indicated the following areas for improvement:

- Since data backups are maintained at a location next to City Hall, in the event of a catastrophic loss at City Hall, the backup data may be lost as well.
- A disaster recovery plan does not exist.
- Testing of the backup data has not been performed to ensure that it is valid and can be restored.

We recommend the City:

- Store off-site backups at a remote location (industry standard of 5 miles from main site).
- Develop a disaster recovery plan for information technology and for the City as a whole.
- Periodically test backup data to ensure it can be effectively restored.

Management's Response

Management has contracted with HEI / Digitactics to provide IT Services for the City. In the current year (fiscal year 2012), the City has migrated over 25% of the data to offsite storage (Rackspace), and are in the process of having the rest of it stored more than 5 miles away by the end of the fiscal year (2012). In addition, HEI / Digitactics is assisting in developing the disaster recovery plan; management anticipates having this completed by January 1, 2013.

X. Noncompliance with State Requirements

Public Funds Investment Act

Our testing for compliance with Chapter 2256 of the Texas Government Code, the Public Funds Investment Act (PFIA) resulted in the following:

- The City's investment policy and strategies were not presented to the Council for the required annual review and approval in fiscal year 2011.
- The monthly investment reports prepared did not include the following required information –
 - a detailed description of the City's investment position on the date of the report,
 - signatures of each investment officer,
 - a summary statement showing beginning market values and changes to the market values during the period,

- the book value of each separately invested asset,
 - the maturity date of each asset that has a maturity date,
 - the account, fund, or pooled group fund for which each individual investment was acquired; and,
 - the compliance of the investment portfolio as it relates to the investment strategy, and relevant provisions of the PFIA.
- The City's investment policy was not provided to the financial institutions for review.

We recommend that the City develop policies and procedures to ensure compliance with the requirements of the PFIA.

Management's Response

Management is in the process of completing a new report that will address all of these findings and the reports will be caught up by the end of the 3rd quarter.