Garza/Gonzalez & Associates
CERTIFIED PUBLIC ACCOUNTANTS

CITY OF WINDCREST
ECONOMIC DEVELOPMENT CORPORATION
(A Component Unit of City of Windcrest, Texas)

REPORT ON THE CONDUCT OF AUDIT

For The Year Ended September 30, 2011

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Garza/Gonzalez & Associates

CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors
City of Windcrest Economic Development Corporation
Windcrest, Texas

We have audited the financial statements of the City of Windcrest Economic Development Corporation (the Corporation), a component unit 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 Corporation. 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, Board of Directors and management of the Corporation 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.

Garza/Gonzalez & Associates

June 15, 2012

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REPORT ON THE CONDUCT OF AUDIT

For the Year Ended September 30, 2011

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 an opinion 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 Corporation'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 Corporation'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 Corporation are described in Note I to the financial statements. The Corporation 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 balance reported by the Corporation. The purpose of the Statement was to enhance the usefulness of fund balance information by providing clearer fund balance classifications. Also in fiscal year 2011, the Corporation, which was previously reported as a discretely presented component unit, is reported as a blended component unit in the City's financial statements. Additionally, we noted no transactions entered into by the Corporation 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. All significant transactions 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 estimate affecting the Corporation's financial statements is depreciation, which is based on estimated useful lives of the respective capital asset class.

We evaluated the key factors and assumptions used to develop the above estimate in determining that it is 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 Corporation'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 and liabilities by $20,782 and $46,037, respectively; and, decreasing revenues, expenditures, and other financing sources by $2,167, $11,247, 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 Corporation'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
With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management regarding the measurement and presentation to determine that the information complies with accounting principles generally accepted in the United States of America. However, we did not audit the information and express no opinion on it.

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 Corporation'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. <u>Material Weaknesses</u>

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 Corporation's internal control to be material weaknesses:

<u>Capital Assets</u>

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.
- 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 Corporation:

- Review and revise its capital asset policy for capitalizing assets to clearly state the intent of management and the Board; 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.

Management's Response

Staff will begin working on revisiting all capital assets, as well as bringing the policy before the City Council and Board to ensure that the policy serves the wishes of the Council and Board (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 Deficiency

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 deficiency in the Corporation's internal control to be a significant deficiency:

Procurement

The City's policies, which are also applicable to the Corporation, require that 3 formal quotes (mailed or faxed) be obtained for purchases above $3,000. In 3 of the 5 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.

We recommend that management obtain 3 quotes for purchases over $3,000, as required by established policies.

Management's Response

Management has briefed "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.

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 3 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. 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 Corporation:

   - 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 Corporation 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 of Windcrest. 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, which are also applicable to the Corporation, were not presented to the Board 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 Corporation'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 Corporation 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.