



Caporicci & Larson, Inc.
A Subsidiary of Marcum LLP
Certified Public Accountants

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

To the Honorable Mayor and Members of City Council
of the City of Eureka
Eureka, California

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of City of Eureka (City) as of and for the year ended June 30, 2010, which collectively comprise the City's basic financial statements and have issued our report thereon dated November 29, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our audit procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies or material weaknesses have been identified. However, as discussed in the schedule of findings and responses, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

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 City's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and responses as items FS 2010-01 and FS2010-02 to be material weaknesses.

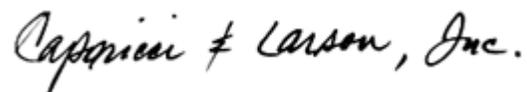
A significant deficiency is a deficiency, or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the accompanying schedule of findings and responses as items FS 2010-03 and FS 2010-04 to be significant deficiencies.

To the Honorable Mayor and Members of City Council
of the City of Eureka
Eureka, California
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Compliance and Other Matters

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 grant agreements, 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, and accordingly, we do not express such an opinion. The result of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, which are described in the accompanying schedule of findings and responses as SA2010-01, SA2010-02 and SA2010-03.

The City's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. We did not audit City's response and, accordingly, we express no opinion on it. This report is intended solely for the information and use of management, the City Council, others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



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Certified Public Accountants
San Francisco, California
November 29, 2011

City of Eureka
Schedule of Findings and Responses
For the year ended June 30, 2010

FS 2010-01 Restatement of Previously Issued Financials (Material Weakness)

Criteria:

The City is responsible for the fair presentation of the financial statements in conformity with accounting principles generally accepted in the United States of America.

Condition:

The City has restated its previously issued financial statements to record a Net Pension Asset, to report expenditures in the correct fiscal year, to write off a previously capitalized project, and to recognize grant revenues in the proper fiscal year. The effects of the restatements were a \$212,260 increase to the governmental activities net assets and \$2,527,369 decrease to the business-type activities net assets.

Cause:

The City's internal controls over financial reporting did not identify the misstatements in a timely manner resulting in the restatements.

Effect:

The previous financial statements were not fairly stated in conformity with accounting principles generally accepted in the United States of America.

Recommendation:

We recommend that the City enhance its internal control over financial reporting to ensure complete and accurate financial reporting. The City can accomplish this by expanding its year-end closing procedures to ensure that all nonroutine and nonsystematic transactions were accounted for, the appropriate accounting standards were applied, and transactions were accounted for in the proper period.

View of Responsible Officials and Planned Corrective Action:

At the time of the year end close, the City had significant turnover within the Finance Department, including the Finance Director position, which remained vacant for several months. During the audit, the City lost both accountants, one leaving for employment elsewhere, and one due to retirement.

The City has enhanced its internal control over financial reporting by implementing a year end process which includes checklists assigned to specific staff, each responsible for ensuring that all non routine and non systematic transactions are accounted for, the appropriate accounting standards are applied, and transactions are accounted for in the proper period.

City of Eureka
Schedule of Findings and Responses, Continued
For the year ended June 30, 2010

FS 2010-02 Internal Controls over Financial Reporting (Material Weakness)

Criteria:

An effective internal control system and timely financial reporting provides reasonable assurance for the safeguarding of assets, the reliability of financial information and compliance with laws and regulations.

Condition:

We have determined that processes utilized for closing and reporting of financial activity for the fiscal year ended June 30, 2010 were not effective, which contributed to the city's unpreparedness for the audit. We experienced continuing delays throughout the audit process due to the City's inability to provide the requested supporting documents in timely manner and the inadequacy of supporting documents received.

Cause:

The City's policies and procedures for recording financial transactions were disrupted due to significant turnover in the finance department.

Effect:

The City was not able to close its books and generate year end reports in timely manner. As the result, during the performance of financial audit for the year ended June 30, 2010, there were significant delays in receiving the requested audit documents and various schedules that subsequently require further reconciliations and adjustments upon receipt and audit review process.

Recommendation:

We recommend that the City close its books in a timely manner and have all accounts reconciled and balanced to the general ledger, and a detailed review of all financial statements be conducted prior to the start of the audit fieldwork. We also recommend that all reconciliations and detailed listings be reviewed to ensure accuracy.

Management Corrective Action Plan:

Management acknowledges there was some delay in the year end closing due to significant turnover within the Finance Department, including the Finance Director position, which remained vacant for several months. During the audit, the City lost both accountants, one leaving for employment elsewhere, and one due to retirement. The issue has now been addressed, as the Accounting department is now fully staffed.

However, Management strongly disagrees with the assertion that it was unable to provide during this time period, requested supporting documents in a timely manner and that they were inadequate. Furthermore, the City experienced continuing delays throughout the audit process due to duplicate information requests and apparent lack of prioritization of City's audit. There were periods spanning months at a time in which updates on progression of audit were not received and extensive periods of time in which there was a complete lack of response from the auditors.

City of Eureka
Schedule of Findings and Responses, Continued
For the year ended June 30, 2010

FS 2010-03 Internal Controls over Cash Receipt Processing (Significant Deficiency)

Criteria:

An effective internal control system over cash receipts processing provides reasonable assurance for the safeguarding of assets and the reliability of financial information.

Condition:

We noted that the cash receipt deposits from offsite locations are being dropped off at the front counter at the Finance Department in City Hall every day without any formal log in procedures or reconciliation at time of deposit.

Cause:

The City currently does not have any formal policies and procedures to keep log of the cash deposits from offsite location.

Effect:

The absence of the tracking mechanism to ensure all cash deposits are properly accounted for provide opportunities for fraudulent activities and increase the risk of misappropriation of asset.

Recommendation:

We recommend that the cash receipts deposited from offsite locations are reconciled when they are turned in to Finance department to ensure that all cash receipt are properly accounted for and agreed by the offsite location staff and finance staff to reduce the risk for misappropriation of assets.

Management Corrective Action Plan:

Management agrees that deposits were dropped off at the front counter of the Finance Department without any formal login procedures. We do however disagree that the deposits were not reconciled, as they were re-counted by cashiers and tied to supporting documentation. Upon mention of this finding at the time fieldwork was being performed, City immediately implemented the process of logging in deposits from offsite locations, and it is the City's continuing policy to reconcile these deposits to supporting documentation immediately. Also, Brinks now picks up the deposits from offsite locations, and those are brought to the Finance Department where they are counted the same day.

City of Eureka
Schedule of Findings and Responses, Continued
For the year ended June 30, 2010

FS 2010-04 Internal Controls over Utility Billing Process (Significant Deficiency)

Criteria:

An effective internal control system over billing procedures provides reasonable assurance for the safeguarding of assets and the reliability of financial information.

Condition:

We noted that there is lack of segregation of duties in the Utility Billing process. The Accounting Specialist prepares, reviews, and prints Utility Billing and is also responsible to process cash receipts at the front counter. These duties require the Accounting Specialist to have access to both the assets and the recordkeeping, which increase the risk for misappropriation of asset.

Cause:

The City has limited resources that minimize the possibility to segregate the billing function from the cash receipt function.

Effect:

The lack of segregation of duties increases the risk for misappropriation of assets.

Recommendation:

We recommend that the City implement mitigating procedures to address and minimize the risk of misappropriation of assets due to segregation of duties in the Utility billing and cash receipt process. Such mitigating procedures may include the following:

- Implementation of job rotation in the utility billing process.
- Implementation of an independent review of daily cash reconciliations and utility billing reconciliations.

Management Corrective Action Plan:

Management agrees with the assertion that there has been a lack of segregation of duties in the Utility billing process. City has implemented use of permanent cashiers, removing Utility billing clerks from the cash handling duties. During the daily deposit preparation process, total Utility receipts are independently reviewed.

City of Eureka
Schedule of Findings and Responses, Continued
For the year ended June 30, 2010

SA2010-01 Schedule of Expenditures of Federal Awards, Control Activities and Compliance (Significant Deficiency)

Program:

Non-urbanized assistance Program (CFDA Number 20.509, US Department of Transportation, State of California Department of Transportation, Award number 648006)

Criteria:

In accordance with the Basic Guidelines section of OMB's, all Federal grant expenditures must be reported on the City's Single Audit Report in the year the expenditure had occurred.

Condition:

During the performance of the audit, we noted that the expenditures in the amount of \$7,549, which were incurred for the month of June 2010 were not reported on the Schedule of Expenditures of Federal Awards for the fiscal year ended June 30, 2010.

Cause:

The expenditures were excluded primarily because the untimely reporting of grant expenditures to the City's finance department responsible for preparation of the City's Schedule of Expenditures of Federal Awards. The error was noted when the reimbursement request for those grant expenditures were later prepared in the subsequent fiscal year.

Context and Effect:

The expenditures of federal awards for this program were not accurately reported on the Schedule of Expenditures of Federal Awards for the fiscal year ended June 30, 2010.

Questioned Costs:

No questionable costs were involved.

Recommendation:

We recommend that the City personnel responsible for preparation of the Schedule of Expenditures of Federal Awards inquire with program personnel responsible over grant reporting regarding the completeness of grant expenditures recorded in the respective grant expenditure accounts prior to preparation. We also recommend the Schedule of Expenditures of Federal Awards be reviewed by personnel responsible over grant reporting after it is prepared.

Management Corrective Action Plan:

Management concurs with the finding of an expenditure omission, and Finance staff has increased ongoing communication with program personnel responsible over grant reporting to ensure the correct expenditure reporting on federal schedules related to grants. Such finding is an isolated incident, and Management believes that current procedures are adequate to provide reasonable level of completeness.

City of Eureka
Schedule of Findings and Responses, Continued
For the year ended June 30, 2010

SA2010-02 American Reinvestment and Recovery Act Report, Control Activities and Compliance (Significant Deficiency)

Program:

Highway Planning and Construction (CFDA Number 20.205, US Department of Transportation, State of California Department of Transportation, Project Number ESPL- 5127(023))

Criteria:

In accordance with the grant agreement the pass-through agency, the California Department of Transportation's (CalTrans) Division of Local Assistance requires that the City include monthly employment status reports. The monthly employment status reports are required to accurately summarize the number of employees that have been employed with the respective American Reinvestment and Recovery Act award funds.

Condition:

During the performance of the audit, it was noted that one out of two total reports submitted to the pass-through agency, the California Department of Transportation's (CalTrans) Division of Local Assistance did not include accurate employment hours.

Cause:

The monthly employment status report was prepared without payroll information from one of the subcontractors, and the City's internal controls over compliance with reporting requirements did not prevent the error in a timely manner.

Context and Effect:

The monthly employment status report submitted to the pass-through agency, CalTrans was inaccurate.

Questioned Costs:

No questioned costs were involved.

Recommendation:

We recommend the City implement independent review procedures over the monthly employment status reports to mitigate the risk of inaccurate reporting.

Management Corrective Action Plan:

Management concurs with the finding of reporting inaccuracies, and is in the process of implementing recommended procedures.

City of Eureka
Schedule of Findings and Responses, Continued
For the year ended June 30, 2010

SA2010-03 American Reinvestment and Recovery Act Report, Control Activities and Compliance (Significant Deficiency)

Program:

Preventative maintenance project (CFDA Number 20.509, US Department of Transportation, State of California Department of Transportation, Award number 649818)

Criteria:

The pass-through agency, the California Department of Transportation's (CalTrans) Division of Local Assistance requires that the City submit monthly employment status reports relating to the American Reinvestment and Recovery Act within 30 days of month end.

Condition:

During the performance of the audit, we noted that two out of five reports tested were not submitted to the pass-through agency in a timely manner.

Cause:

The pass-through agency initially required the filing of quarterly reports, however it changed the reporting requirement that the monthly employment status report be submitted it on a monthly basis. The City did not become aware of the change in reporting requirement in a timely manner.

Context and Effect:

The City did not accurately report the employment status to the CalTrans in a timely manner.

Questioned Costs:

No questioned costs were involved.

Recommendation:

We recommend the City implement risk assessment procedures over changing compliance requirements by such as frequent inquiry with the City's assigned pass-through agency contact and review of pass-through agency bulletins.

Management Corrective Action Plan:

Management concurs with the finding of reporting inaccuracies, and is in the process of implementing recommended procedures.