



CITY AUDITOR'S OFFICE
FINAL REPORT

City of Modesto
INTERNAL CONTROLS REVIEW

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I. EXECUTIVE SUMMARY

As part of the fiscal year 2023-2024 internal audit program, the City of Modesto (the City) requested that Moss Adams LLP (Moss Adams) conduct a review of the City's internal controls framework. The internal controls review took place between December 2023 and March 2024 and focused on assessing select key controls in areas deemed important to protecting the City's assets and resources as well as processing and reporting timely financial information.

We conducted this internal controls review in accordance with Generally Accepted Government Auditing Standards (GAGAS). Those standards require that we plan and perform the internal controls review to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our objectives. The internal controls review objectives, scope, methodology, and conclusions are included in the report body.

This internal controls review did not constitute an audit of financial statements in accordance with GAGAS. Moss Adams LLP was not engaged to and did not render an opinion on the City's internal controls or over financial management systems.

Specific areas where controls were reviewed included:

- Accounts Receivable
- Cash Management
- Financial Reporting, Close, and Reconciliations
- Fixed Assets and Asset Management
- Inventory
- Information Technology (IT) General Controls
- Overall Control Environment
- Payroll and Timekeeping
- Purchasing and Accounts Payable
- Revenue and Billing

The City appeared to have internal controls developed for many functions, and the City was in the process of implementing internal controls for other functions. Some examples of commendable activities that, based on the review performed, appeared to have well-designed internal controls, include:

- Monitoring and reconciliation controls related to:
 - Accounts Receivable
 - Cash Management
 - Financial Reporting, Close, and Reconciliation
 - Overall Control Environment
- Performing occasional surprise cash audits across City departments
- Performing timecard audits at the close of each pay period



- Performing weekly blind inventory counts of Central Store inventory
- Setting standards for a strong IT security environment
- Establishing a strong foundation of accountability and segregation of duties by incorporating a number of review processes across financial-related functional areas

Similar to most cities, there is an opportunity to strengthen controls, policies, procedures, and systems. Although minor gaps in internal controls of varying degrees were discovered across six of the ten functions reviewed, the City appears to have a strong internal control environment.

Suggested priorities to address over the next six to 12 months include, but are not limited to:

- Fixed Assets and Asset Management
 - Updating policies and procedures
 - Reconciling newly added fixed assets
- Inventory
 - Updating policies and procedures
 - Developing a process to ensure that an independent review and close-out occurs for Fleet work orders and parts requests
- IT General Controls
 - Confirming which IT assets are disposed of by third-party companies
- Payroll and Timekeeping
 - Updating policies and procedures
 - Updating the paid-time-off (PTO) accrual rate change process
 - Reviewing and updating user access to payroll-related forms
 - Defining roles and responsibilities for ensuring that all documentation related to the annual negotiated salary increase is retained
- Purchasing and Accounts Payable
 - Verifying that procurement card (P-Card) users have signed the P-Card Agreement and completed the required training prior to receiving their P-Card



II. SCOPE AND METHODOLOGY

The scope of our internal controls review included an evaluation of the City's key internal controls to determine the general adequacy of internal controls and identify areas warranting more in-depth review in the future.

The scope of the internal controls review included the following functional areas:

- Accounts Receivable
- Cash Management
- Financial Reporting, Close, and Reconciliations
- Fixed Assets and Asset Management
- Inventory
- IT General Controls
- Overall Control Environment
- Payroll and Timekeeping
- Purchasing and Accounts Payable
- Revenue and Billing

For each functional area assessed, we conducted a review of key controls which included:

- Identifying control objectives in specific areas and controls that would satisfy each control objective
- Reviewing policies and procedures
- Examining relevant documentation in support of select key controls
- Performing control walkthroughs to observe the design of key controls and understand workflow processes
- Obtaining an understanding of the characteristics of each relevant control activity (who performs it, how often it is designed to operate, whether it is designed to mitigate fraud, whether it is a manual or programmed (automated) control, and whether it is a preventive, detective, or corrective control)
- Assessing whether the controls in place would prevent or detect errors
- Providing recommendations on key controls that need to be implemented or changed

The work performed included interviews with employees involved in managing functions, processing key accounting transactions, and handling physical assets in the following departments:

- Finance
- Human Resources
- Technology Services
- Public Works



In support of the internal controls review, the matrix provided in Section III provides results by including the:

- Control objective
- Control issue
- Corresponding recommendation
- Likelihood of occurrence
- Impact of occurrence

Likelihood of occurrence is defined as the probability of a negative event occurring. Impact of occurrence is defined as the level of significance if a negative event occurs. Risk levels of low, moderate, or high were used to rate the likelihood of occurrence and impact of occurrence for each finding.

Beyond those controls that have been noted within this report as an issue, additional controls were reviewed without exception. It should be noted that many controls were reviewed multiple times in relevant, separate department reviews, but not all controls or departments were reviewed. Departments were selected to provide a broad understanding of the City's control environment. Key controls with exception conditions are reported in this document.



III. INTERNAL CONTROLS REVIEW

NO.	CONTROL OBJECTIVE	CONTROL ISSUE	RECOMMENDATION	LIKELIHOOD OF OCCURRENCE	IMPACT OF OCCURRENCE
A. Fixed Assets and Asset Management					
1	The City performs reconciliations of fixed assets entered into the Oracle system to physically issued tag numbers to ensure accuracy and consistency of fixed asset inventory records.	The City was not completing a reconciliation of the asset tag numbers to the Oracle system to ensure that all assets were issued a tag and that the tag numbers were appropriately recorded in Oracle. Without this reconciliation, the risk for asset loss or theft increases because assets may not be as easily located or identified.	The City should develop a process that would require City staff that are responsible for overseeing fixed asset inventory to complete a monthly reconciliation that would verify whether fixed assets entered into Oracle that month were properly tagged. The process should clearly define: <ul style="list-style-type: none">• Who is responsible for performing this reconciliation• How they should perform and document the reconciliation• Where the reconciliation documentation is maintained• How they should investigate any variances• Who should review and approve the reconciliation	High	Moderate



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2	The City's Asset Safeguarding Directive includes specific controls related to preventing asset loss.	The City's current Asset Safeguarding Directive does not include specific controls describing the detailed steps/actions that the City deploys to prevent asset loss.	The City should update the current Asset Safeguarding Directive to include preventative steps relating to asset loss, which might include: <ul style="list-style-type: none">• Conducting regular inventory checks to ensure that assets are accounted for and to identify any missing or stolen assets• Implementing access controls to limit access to assets to appropriate employees• Installing surveillance systems to monitor assets and deter theft or vandalism• Providing training to educate employees about the importance of safeguarding assets and the policies in place to protect the City's assets	High	Moderate
3	Monthly Mass Addition reports are reviewed, and evidence of the review is documented via signature and date.	Although there was evidence that the Monthly Mass Addition reports, which details all asset additions across the City each month, were being reviewed, there was no evidence of who completed the review and when.	The City should develop a policy and procedure around the review of the Monthly Mass Addition reports specifically addressing who completes the review, what the review is meant to achieve, and a requirement for the City staff members completing the review to sign off and date the report as evidence that the review was completed. This formal signoff and date should signify that the reviewer believes the Monthly Mass Addition is complete and accurate. This review helps to support the financial	High	Moderate



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			reporting and asset safeguarding functions at the City.		
4	The City's record retention policy includes a retention requirement for documents/records relating to asset auctions.	During our assessment of the supporting documentation for a recent City auction, the City was able to provide the supporting Equipment Auction List; however, the email correspondence from Accounts Receivable, which provides notification that the assets were ready for auction, could not be provided. The supporting email is meant to ensure that the correct assets are identified for, and included in, the auction.	The City should review its record retention policy to ensure that the requirements for disposed asset records are maintained for at least six years after the disposal date based on best practices set by Generally Accepted Recordkeeping Principles. The policy should address what supporting documentation must be maintained to support auctioned assets. Making these updates will help to promote better accountability and reliability that the correct assets are identified for auction and are the same assets that end up being auctioned.	High	Moderate
B. Inventory					
1	Fleet inventory counts are performed in alignment with regular inventory blind counts.	During our preliminary procedures, we found that the last fleet inventory count was performed approximately two years ago. There are currently no standards or guidance that require the fleet inventory to be a part of the City's current annual inventory blind count procedures.	The City should update its current inventory reconciliation and count processes to include the fleet inventory as part of the annual inventory blind counts. An annual count will give the City a more reliable and accurate count of inventory while also promoting the proper safeguarding of assets. The City should ensure to document the results of the count each year along with any variances that are observed to best address any potential inventory issues and mitigate potential risks of loss or theft in the future.	Moderate	Moderate



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2	Only Fleet Supervisors or Crew Leads review and close out work orders and parts requests within the AssetWorks system.	For three work orders assessed, there was no evidence that the Fleet Supervisor or Crew Lead closed out the related parts request. We verified that the listed employee on the parts request was not a Fleet Supervisor or Crew Lead via the Fleet Crew Organizational Chart. Without an independent supervisor review, there is a risk that parts could be misappropriated and not be identified.	<p>The City should develop a process to ensure that only Fleet Supervisors or Crew Leads are reviewing and closing out work orders and parts requests. The review and close-out process should help to ensure that the close-out records are complete. Having an independent final review and close-out of work orders and parts requests will help to instill segregation of duties, which will help to protect against potential asset loss or theft.</p> <p>The City should consider whether it can restrict access within the AssetWorks system for only Fleet Supervisors or Crew Leads to have the ability to close work orders and parts requests.</p>	High	Moderate
C. IT General Controls					
1	IT assets are properly disposed of.	The City provided a listing of the IT assets that were inventoried for destruction, and the listing contained evidence that the City documented the date the items were picked up by California Electronic Asset Recovery (CEAR) for destruction. However, there was no corresponding destruction receipt from CEAR, which documents the specific IT assets that were picked up and subsequently destroyed.	For all IT asset destructions, the City should request that CEAR provide a listing of the specific assets that were picked up and subsequently destroyed. The destruction receipt provides evidence that all identified IT assets were picked up, and subsequently destroyed, by CEAR which helps increase accountability, prevent misappropriation, and ensure records of IT asset destructions are complete. The City should then designate an independent employee to compare the listing that was initially sent to	Moderate	Moderate



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			<p>CEAR prior to destruction and the listing that CEAR provides to the City after destruction to verify that the listings reconcile (i.e., all IT assets were provided to CEAR and destroyed).</p>		
2	<p>Daily activity log reviews are completed, and a confirmation of completion is emailed to the IT Supervisor.</p>	<p>The daily activity log reviews are intended to identify any security anomalies, such as an unauthorized individual trying to gain access to the City's network. Based on interviews, the daily activity log reviews are being conducted by IT; however, there is no documentation or evidence to verify that it is being completed.</p>	<p>The City should develop a process that requires the IT staff member conducting the daily activity log review to document its completion by emailing a confirmation to the IT Supervisor. The IT Supervisor should expect this daily email and contact the IT staff member with any questions or concerns about that day's activity log.</p>	High	Low
D. Payroll and Timekeeping					
1	<p>Access to adjust paid time off (PTO) accrual rates is appropriately restricted and adjustments to accrual rates are properly monitored. In addition, there is not a defined process for monitoring PTO balance adjustments.</p>	<p>The City provides access to all Payroll employees to change PTO accrual rates, and there is not a defined process for a designated employee to monitor PTO accrual rates, and adjustments to those rates, to ensure that they are appropriate.</p>	<p>The City should designate a singular Payroll employee and a secondary Payroll employee as a backup, if the employee is unavailable, to have access to and be responsible for changing PTO accrual rates. Restricting access to change these rates will help to prevent any unauthorized changes. The City should review these access levels regularly, as needed but at least annually, to ensure they are updated based on personnel changes or employee role changes that occur.</p> <p>As an additional control, the City should designate a separate</p>	Moderate	Low



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			<p>employee to monitor PTO balance adjustments to ensure that all PTO changes are appropriate and properly supported. This review should be completed once a month based on the number of PTO balance adjustments made. The employee should communicate any unusual or unsupported PTO balance adjustments to the HR Director.</p>		
2	<p>PTO accrual rate changes are monitored and reviewed by both the Finance Director and HR Department.</p>	<p>During our review of the email correspondence for the Accrual Rounding for 2024 - 27 Pay Period, we noted that the HR Department was not involved in the correspondence, nor did they provide a review and approval of the changes. HR's review and approval helps to ensure that the City is following current labor regulations.</p>	<p>The City should review its current PTO accrual change policies and procedures to ensure that, along with the Finance Director, the HR Department is involved with the PTO accrual change process based on their extensive knowledge of labor regulations. Including the HR Department in these reviews will help align the City with any changes to labor regulations that may occur throughout the year. The HR Department should designate at least one individual to monitor and review PTO accrual rate changes and document any decisions made via email.</p>	High	Moderate
3	<p>The annual negotiated salary increase is properly documented, reviewed, and approved and the overall process is supported by standard operating procedures</p>	<p>Based on interviews performed, the HR Department does not have documentation to evidence that the annual negotiated salary increase review was completed, as this was done via email and the related emails were not</p>	<p>The City should update the Across the Board Increase SOP to ensure that evidence of this process is documented and retained for no less than four years based on the statute of limitations for legal actions related to wage and hour claims set by California through California Labor</p>	High	Moderate



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	(SOP) that address required documentation.	retained. Based on a review of the City's Across the Board Increase SOP, the annual negotiated salary increase review process must be documented and that documentation must be retained.	Code section 1194. The HR Department should also develop an internal process, which includes defined roles and responsibilities, for ensuring that all email correspondence related to the annual negotiated salary increase review process is retained. The City could also consider documenting this annual review in a form or memo format, as opposed to email, to better reduce the risk of unauthorized changes or any version control issues that might be more difficult to address via email. This form or memo should then be signed by all parties involved in the review process to document their participation in the review and approval of the resulting salary increase.		
4	Formal policies and procedures for a City-wide vacation request process are well-documented and current.	Time Off Request Forms are required for employees submitting vacation requests, but there are no formal City-wide policies or procedures that departments are required to follow to standardize the process.	<p>The City Manager should use the Personnel Rules Number 13.4 to establish a formal City-wide vacation request policy and procedure for all City departments that will outline a formal vacation request process to require employees to submit a Time Off Request Form. This policy and procedure should include:</p> <ul style="list-style-type: none"> ● The timing of when employees should submit these requests (i.e., at least two weeks prior to the requested time off) ● The preferred method that employees should submit these 	Moderate	Low



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			<p>forms to their supervisor (i.e., via email)</p> <ul style="list-style-type: none"> • How the supervisor will review and approve the forms • Who will maintain these approved forms and how they should be maintained (in case the Payroll Team or HR Department requests to see the approved forms) 		
5	Access to electronic Payroll Team forms is monitored, reviewed, and updated as needed.	Based on a comparison of the Payroll organization chart to the employees listed within the Electronic Payroll Form Access List, there were some employees who had access that were not part of the Payroll Team and should not have access to these sensitive payroll forms. Unauthorized access to payroll forms, such as salary information or other personnel information, could subject the City to data privacy concerns.	The City should develop a process to ensure that access permissions for the electronic payroll forms is reviewed regularly, at least annually and when personnel changes occur. The City should also remove any unauthorized employees from accessing these forms to ensure that the electronic payroll forms are only accessible by employees whose job requires this access.	Moderate	High
E. Purchasing and Accounts Payable					
1	P-Card requestors complete the mandatory training and sign the P-Card Agreement before receiving access to a P-Card.	In our assessment of the supporting documentation for a sample of P-Card holders, we identified one employee that did not have a signed P-Card Agreement on file and did not complete the required training, but received their P-Card. The required training ensures that	The City should develop SOPs detailing how Administrative Directive 7.27 Procurement Card Policies and Procedures will be enforced including a defined process, and related roles and responsibilities, for ensuring that all employees complete the required training and sign the P-Card	Moderate	High



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		<p>employees understand their role, and related responsibilities, in utilizing a City-issued P-Card and the P-Card Agreement documents the employee's understanding and agreement to the terms of use.</p>	<p>Agreement Form prior to receiving a City-issued P-Card.</p> <p>The P-Card program administrators should develop processes to designate:</p> <ul style="list-style-type: none"> • Who will send out the P-Card Agreement to the employee • Who will track the incoming signed agreements • Who will retain signed agreements and where they will be retained • Who will track which employees have completed the required training and how they will track this • Who will verify that the employee has a signed agreement on file and has completed the required training prior to handing over the P-Card 		
2	<p>The annual review of an Open Encumbrance Report is signed and dated by the Finance Director, Budget Manager, and City Manager.</p>	<p>The Finance Director, Budget Manager, and City Manager will review an Open Encumbrance Report prior to year-end close so that any issues with purchase orders can be resolved before the close of the year. There was a meeting invite showing that these three employees met to discuss this topic; however, there was no documentation that the review occurred and what procedures were performed, such as</p>	<p>The City should develop a process to document the annual Open Encumbrance Report review that is performed by the Finance Director, Budget Manager, and City Manager. Documentation should include when the review was performed, who participated in the review, any research performed for identified issues and the resolution of those issues. Adding this formal documentation of the review process helps to verify that:</p>	High	Low



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		<p>reviewing for purchase orders that should be closed and researching and resolving any identified issues.</p>	<ul style="list-style-type: none"> • This Open Encumbrance Report review took place • The Open Encumbrance Report review was satisfactory • Any action items from this review can be carried out efficiently and effectively 		
F. Revenue and Billing					
1	<p>Monthly accounts receivable reconciliations contain documentation of who performed the reconciliation and when it was performed.</p>	<p>Based on a review of the supporting documentation for three monthly accounts receivable reconciliations, it was evident that the reconciliations occurred; however, there was no documentation of who completed the reconciliation and when it was performed.</p>	<p>The City should develop a process that will require the employee conducting the monthly accounts receivable reconciliation to document its completion, which could be via system signoff, email to their supervisor, or physical signature. The employee should also ensure to note the date that they completed the reconciliation to demonstrate that they completed the reconciliation timely, which should be within about 30 days of month-end.</p> <p>The City should also ensure that the appropriate supervisor reviews and approves this monthly reconciliation. Documentation of approval should be made via system signoff, email, or physical signature. This approval signifies that the supervisor agrees that the reconciliation is appropriate and that any item warranting follow-up discussion have been addressed and documented within the reconciliation.</p>	High	Low

