

CITY OF CHICO, CALIFORNIA

MANAGEMENT LETTER

JUNE 30, 2014



To the Honorable, Mayor and City Council
and Management
City of Chico, California

We have audited the basic financial statements of the City of Chico, California (the City) for the year ended June 30, 2014 and have issued our report thereon dated December 23, 2014. In planning and performing our audit of the basic financial statements of the City, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinions on the basic financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

During our audit we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized as follows:

INFORMATION TECHNOLOGY STRATEGIC PLAN

OBSERVATION:

During our interviews with the City's Information Technology (IT) department, we noted that the IT Department does not have an IT strategic plan. Currently IT priorities are driven by availability of funding from other departments and departmental desires and a variety of projects have been placed on hold. Best practices for governments recommends that an Information Technology Strategic plan be developed in order to prioritize IT Projects that are critical in nature first to provide a multi-year plan of projects and corresponding funding in order to ensure that projects are appropriately prioritized.

RECOMMENDATION:

We recommend that the City consider developing an IT Strategic Plan to provide a document to govern the long term IT priorities of the City in accordance with best practices.

MANAGEMENT'S RESPONSE:

The City already identified the benefit of properly planning to drive operations. City staff has intended to create an IT Strategic Plan to guide its operations.

SELF INSURANCE INTERNAL SERVICE FUND CHARGES

OBSERVATION:

According to the *Government Accounting Standards Board Statement No. 34 – Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*, Internal Service Funds are “to account for the financing of goods or services provided by one department or agency to other departments or agencies of the governmental unit, or to other governmental units, on a cost-reimbursement basis”

During review of the June 30, 2013 financial statements, it was noted that the charges from the Self Insurance Fund to other departments and funds of the government were not sufficient to pay for the operating costs of the fund and to accumulate sufficient assets to liquidate future payments associated with the General Liability and Workers Compensation claims and the Incurred but Not Reported (IBNR) Liability.

We further noted that the approved budget for fiscal year 2012-13 approved charging less than cost reimbursement for the Self Insurance funds including suspending charges of Unemployment Insurance to other funds and departments entirely. As a result, the City’s Self Insurance Fund ended in a deficit net position of \$1,397,410.

We reviewed this condition and noted it continued during fiscal year 2013-14. The City’s Self Insurance Fund ended in a deficit net position of \$1,964,227 at June 30, 2014.

RECOMMENDATION:

We recommend the City review the activities of the Self Insurance Internal Service Fund and ensure that services are charged out to other funds and departments on a cost reimbursement basis to cover both operating expenses in the fund and accumulate resources to pay future required payments related to the City’s General Liability, Worker’s Compensation, and Unemployment claims. We further recommend that the city put into place an action plan to ensure that the deficit of the Internal Service Fund is eliminated over a reasonable period of time.

MANAGEMENT’S RESPONSE:

The City’s Workers’ Compensation (WC) funding level is less than required based on projected costs. The City continues to increase WC rates in order to increase funding. In addition, the City will analyze the WC methodology currently used to charge departments to ensure a proper and systematic approach that charges departments based on actual experience.

PROCUREMENT PRACTICES

OBSERVATION:

Accounting to the Principles and Practices of Public Procurement published by the National Institute of Government Procurement (NGIP), Public Procurement should to the greatest extent practicable, be transparent in its practices, processes, procedures and relationships with all stakeholders, while ensuring protection of confidential information.

Based on performance of our procedures and testing over the City's procurement transaction cycle, we noted certain observations where the City should consider enhancing transparency.

- *Contract Oversight* – We noted during our audit that significant procurement contract awards are not taken to the City Council for approval for any contracts and the City Council is not made aware of procurements that have been approved by City Personnel and the City Manager.
- *Competitive Bidding* – Currently the City of Chico Municipal Code (CMC) Section 3.08.060 Bidding Procedures Dispensation – Exemptions allows when funds have been appropriated in the annual budget, certain procurement requirements not to apply to the purchase of “Consulting, professional, and technical services”. This provision is used by the City to not require competitive bids for any services the city deems as consulting, professional and technical services.

RECOMMENDATION:

We recommend that the City consider reviewing its procurement policies and procedures to ensure that the Council has the opportunity to approve large contracts or are made aware of management awards of large contracts. We further recommend the City consider whether competitive bidding should be required for all types of contracts (above a minimum threshold deemed appropriate) which is the best practice for governmental procurements, and required by federal and state granting agencies.

MANAGEMENT'S RESPONSE:

The City agrees with the recommendation and will be hiring a purchasing manager to oversee the purchasing program and to update purchasing policies that incorporate best practices and ensure compliance with federal, state and local regulations.

STATUS OF PRIOR YEAR MANAGEMENT LETTER COMMENTS

Summarized below is the status of the 2013 management letter comments:

Topic	Status
Budget Policies and Monitoring	Implemented.
Transfers Exceeding Approved Budget	Implemented.
Information Technology Strategic Plan	Not implemented, see status above.
GASB 54 Fund Balance Policy	Implemented.
Internal Service Fund Charges	Not implemented, see status above.
Fund Reclassifications	Implemented.

NEW FINANCIAL REPORTING AND AUDITING STANDARDS

INFORMATIONAL ONLY

GOVERNMENTAL ACCOUNTING STANDARD No. 68

In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*. The objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. This Statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statements No. 27 and No. 50 remain applicable for pensions that are not covered by the scope of this Statement. This Statement is not effective until the fiscal year ending June 30, 2015.

GOVERNMENTAL ACCOUNTING STANDARDS BOARD No. 69

In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*. The objective of this Statement is to improve accounting and financial reporting by State and local governments for government combinations and disposals of government operations. The Statement provides authoritative guidance on a variety of *government combinations* including mergers, acquisitions, and transfers of operations. This Statement is not effective until June 30, 2015.

GOVERNMENTAL ACCOUNTING STANDARDS BOARD No. 71

In November 2013, GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*. The objective of this Statement is to address an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The issue relates to amounts associated with contribution, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. This statement is not effective until June 30, 2015.

To the Honorable Mayor and City Council
City of Chico, California
December 23, 2014
Page 6 of 6

Our audit procedures are designed primarily to enable us to form an opinion on the financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the City gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

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

Varrinik, Trine, Day & Co. LLP

Sacramento, California
December 23, 2014