



Moss, Levy & Hartzheim 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**

Board of Directors
Los Osos Community Services District
Los Osos, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Los Osos Community Services District, as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the Los Osos Community Services District's basic financial statements and have issued our report thereon dated June 30, 2016.

Internal Control Over Financial Reporting

In connection with our engagement to audit the financial statements of the District, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

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 a 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. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings that we consider to be significant deficiencies. We consider the deficiencies described in the accompanying schedule of findings and responses to be significant deficiencies (findings 2015-1 through 2015-5).

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Los Osos Community Services District's financial statements are free from 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 results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings as item Finding 2015-3.

Los Osos Community Services District's Responses to Findings

The Los Osos Community Services District's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. The Los Osos Community Services District's responses were not subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Moss, Remy & Haugheim LLP

Santa Maria, California
June 30, 2016

Finding 2015-1
Bank Statement Reconciliations

Criteria:

The District should reconcile the cash accounts to the general ledger on a timely basis. The reconciling items should consist mostly of outstanding checks and deposits in transit rather than adjusting journal entries to force the reconciliation.

Condition:

When we examined the cash accounts, the bank reconciliations were not completed in a timely fashion and the initial reconciliations received were reconciled mostly by journal entries to cash.

Cause:

District personnel lacked proper training and knowledge to produce a proper reconciliation.

Effect:

The District's cash and expenses or revenue in various accounts were overstated or understated and the reconciliations had to be re-performed at a later date by a consultant.

Recommendation:

The District should ensure that all bank statements are reconciled properly in a timely manner. Staff must be trained in how to properly reconcile cash accounts.

District's Corrective Action Plan:

The District has hired a qualified accounting practice to reconcile each bank account on a monthly basis. The District requires its contractors, including those providing financial accounting services, to assign trained, qualified, and experienced staff of the practice to work our account. Maintaining these contract services increases the District's capacity for separation of financial duties and reduces internal training and staffing requirements.

Finding 2015-2
Journal Entries

Criteria:

The District's internal control procedures should be able to process receipts, payroll, disbursements, etc. and result in the transactions being accurately reported into the general ledger. With few exceptions, journal entries should not routinely be made to adjust cash reconciliations and fund balance. All journal entries should be printed, signed in approval, and retained with their supporting documentation for transparency.

Condition:

During our examination of account balances in the general ledger, we noticed that journal entries were made directly to the cash and fund balance accounts which is unusual for an accounting system. The standard internal control process over receipts, payroll, disbursements, etc. should be able to result in correctly recorded transactions and does not require many cash adjustments for the bank statements to reconcile. In addition, the journal entries were not printed, signed in approval from someone other than the accountant preparing the entry, and retained with their supporting documentation.

Cause:

Lack of proper controls over the bank reconciliation and journal entry process.

Effect:

Staff turnover and weaknesses in the reporting internal controls. The general ledger is difficult to follow and trace balances. In addition, management's override of the internal controls creates a lack of proper segregation of duties which could result in a misstatement in the financial statements and conceal any misappropriation of assets.

Recommendation:

The District's internal controls and procedures over the bank reconciliation process should ensure that journal entries are not required to force cash reconciliations. All journal entries should be made only by the District accountant and they should be printed and filed with an approval signature of the review performed by the General Manager.

District's Corrective Action Plan:

The District hired Warmerdam CPA Group on April 1, 2016 as a consultant. The consulting firm is processing the disbursements, processing payroll, filing the appropriate payroll filings with the IRS and EDD, and making sure the District is following accounting standards and California law. Journal entries will be made by the accounting consultant after the recommendation and approval of the District General Manager.

Finding 2015-3
Payroll

Criteria:

The District vacation, overtime and other accrued compensation must follow California law, the employment memorandum of understanding, and/or contract.

Condition:

During our testing of payroll controls and processes, we found that: the General Manager overused allowed administrative leave by 8 hours, one employee was paid at an overtime rate for 1.5 hours instead of regular rate because sick leave used during that day was improperly included in the calculation of 8 hours of regular time, and multiple occasions during pay periods where the payroll system was not properly tracking leave hours which then had to be manually corrected in the software at a later date.

Cause:

Inadequate tracking of compensated leave hours by the District's payroll software and lack of training on overtime rules.

Effect:

Misappropriation of assets as one employee was overpaid overtime and the General Manager received excess leave pay.

Recommendation:

Ensure management is properly trained on overtime rules and work with the payroll software vendor to ensure the leave balance tracking is operating properly.

District's Corrective Action Plan:

The District hired Warmerdam CPA Group on April 1, 2016 as a consultant. The consulting firm is processing the disbursements, processing payroll, filing the appropriate payroll filings with the IRS and EDD, and making sure the District is following accounting standards and California law. Leave Forms are now required to be prepared for all approved leave and signed by the appropriate supervisor or administrative employee for the General Manager leave. The payroll consulting firm is required to verify Leave Form approval, monitor leave balances available, and consult with the General Manager on clarifying questions related to overtime worked.

Finding 2015-4
Petty Cash and District Debit Cards

Criteria:

All restaurant meal purchases using District funds need to be supported by itemized receipts.

Condition:

During our testing of petty cash and debit card usage, the itemized meal receipts were not filed and retained on 3 of 20 transactions tested.

Cause:

Lack of appropriate District oversight on restaurant meal purchasing procedures.

Effect:

Possible misappropriation of cash could occur if the restaurant purchases were not proper.

Recommendation:

The District should ensure that every meal purchased using District funds is supported by an itemized receipt, description of the business purpose of the meal, and a list of whose meals are being purchased in order to ensure that the use of funds is appropriate.

District's Corrective Action Plan:

Each employee submitting for reimbursement or incurring expenses using District credit or debit cards in accordance with District policy will submit to the General Manager and consulting firm the itemized receipt for each transaction as a mandatory performance condition.

Finding 2015-5
Inventory

Criteria:

Inventory must be counted at or near year-end in order to place a value on the inventory on hand at June 30, 2015.

Condition:

No count of inventory on hand was done in the fiscal year ended June 30, 2015.

Cause:

Lack of proper management oversight of required year-end procedures.

Effect:

Inventory balance as of June 30, 2015, is unknown. Possible misappropriation of assets.

Recommendation:

The District should ensure that inventory is counted on June 30th of every year in order to create a list of items, the amount of each item, and total dollar value of the inventory on hand at the end of the fiscal year.

District's Corrective Action Plan:

The District conducted inventory on June 28 – June 30, 2016 and has created a list of items on hand, and will appropriately record the cost of each item and total value of the inventory as of June 30, 2016.

Finding 2014-1
Other Post-employment Benefits (OPEB)

Criteria:

The District must either use the services of an actuarial or use the alternative measurement method for employers with fewer than one hundred plan members as stated in GASB Statement No. 45.

Condition:

During our examination of other post-employment benefits, we noted that the spreadsheet used to estimate the OPEB liability did not follow the GASB Statement No. 45 alternative measurement method nor did the District contract for an actuary.

Cause:

Staff turnover and management oversight.

Effect:

A lack of knowledge of the correct balance as of June 30, 2014, could likely result in a misstatement of the balance.

Recommendation:

The District should either contract with an actuary to obtain its OPEB liability or perform the standard alternative measurement method for employers with fewer than one hundred plan members as allowed by GASB Statement No. 45.

Current Status:

Implemented.

Finding 2014-2
Compensated Absences

Criteria:

Vacation and sick hours were not available for June 30, 2014.

Condition:

During our examination of compensated absences, we noticed that the reported balances were the same as the prior year. Upon further investigation, it was discovered that the payroll system can only run an hours report for the current rate and could not provide a reliable report as of June 30, 2014.

Cause:

Staff turnover caused the knowledge of the payroll systems limited reporting for compensated absences to be lost when the former employee left.

Effect:

A lack of knowledge of the compensated absences balance as of June 30, 2014, could likely result in a misstatement of the balance.

Recommendation:

The District should create either a formal accounting procedures manual to ensure that staff and management is cross trained in the payroll system so that staff turnover does not cause of loss of important historical data.

Current Status:

Implemented.

Finding 2014-3
Management Override of Internal Controls

Criteria:

The District's internal control procedures should be able to process receipts, payroll, disbursements, etc. and result in the transactions being accurately reported into the general ledger. In order to maintain proper segregation of duties, the General Manager should not be directly making journal entries to QuickBooks.

Condition:

During our examination of account balances in the general ledger, we noticed that it was difficult to follow and trace the accounting from one account to another due to the large amount of journal entries made, many of which were cancelling a previous entry. The regular internal control process over receipts, payroll, disbursements, etc. should be able to result in correctly recorded transactions. Also, we found that many adjusting journal entries were made directly into QuickBooks by the General Manager.

Cause:

Staff turnover and weaknesses in the reporting internal controls.

Effect:

Staff turnover and weaknesses in the reporting internal controls. The general ledger is difficult to follow and trace balances. In addition, Management's override of the internal controls creates a lack of proper segregation of duties which could result in a misstatement in the financial statements and conceal any misappropriation of assets.

Recommendation:

The District's internal controls should be strong enough to ensure that the recording of transactions to the general ledger are proper and correct and without the need for adjusting journal entries to correct or reverse previous journal entries. All journal entries should be made only by the District accountant and they should be printed and filed with an approval signature of the review performed by the General Manager.

Current Status:

Not implemented, see Finding 2015-2.

Finding 2014-4
Bank Statement Reconciliations

Criteria:

The District should reconcile the cash accounts to the general ledger on a timely basis.

Condition:

When we examined the cash accounts during fieldwork, the bank reconciliations were not completed until months after the end of the fiscal year.

Cause:

District oversight and staff turnover.

Effect:

The District's cash and expenses or revenue in various accounts were overstated or understated until reconciliations were done.

Recommendation:

The District should ensure that all bank statements are reconciled in a timely manner.

Current Status:

Not implemented, see Finding 2015-1.

Finding 2014-5
Fund Balance and Fund Accounting

Criteria:

In order to qualify as a proprietary fund type, a fund must be supported by some kind of fees for services.

Condition:

The Refuse Fund has cash and fund balance remaining as of June 30, 2014, despite the fact that the Solid Waste Franchise Agreement was sold to the County during the year.

Cause:

District oversight.

Effect:

The District is understating cash in its other funds.

Recommendation:

The District should bring an action item to the Board in order to decide where the remaining assets should be transferred to.

Current Status:

Implemented.

Finding 2014-6
Disbursements

Criteria:

District's policy requires two signatures for every check issued.

Condition:

One of the twenty-five checks examined during our disbursements testing only had one signature.

Cause:

District oversight.

Effect:

A lack of compliance with internal control procedures could cause a material misstatement in the financial statements or possible misappropriation of assets.

Recommendation:

The District should ensure that all checks are signed as per District purchasing policy and when a final review of the checks is performed, they should be checked for proper signatures.

Current Status:

Implemented.

Finding 2014-7
Payroll Timecards

Criteria:

All timecards should be reviewed in order to ensure the time was actually worked and is properly reported. Employees do not receive overtime pay for calls during the normal work hours.

Condition:

Two of the twenty-five employees tested during our payroll test received overtime pay for work done during the normal work hours.

Cause:

District oversight.

Effect:

A misappropriation of assets as the employee was paid at the overtime rate for normal work hours.

Recommendation:

The District should ensure that all timecards are reviewed and approved by an appropriate supervisor to ensure hours are reported to the correct codes.

Current Status:

Implemented.

Finding 2014-8
Petty Cash

Criteria:

The District policy is that petty cash should not be used for purchases over \$50.

Condition:

Two of the petty cash purchases we examined we for purchases were in excess of the District's \$50 limit.

Cause:

District oversight.

Effect:

A potential misappropriation of assets.

Recommendation:

The District should ensure that all users of petty cash are aware of the District's policies.

Current Status:

Implemented.

Los Osos Community Services District
Schedule of Prior Fiscal Year Findings and Responses
June 30, 2015

Finding 2014-9
Capital Assets

Criteria:

The District policy is to capitalize assets purchased over \$5,000 and with a useful life of at least 2 years.

Condition:

In our review of the Board Meeting Minutes and in our repairs and maintenance account search, we identified one purchase of ECG Monitor/Defibrillator Machine for \$32,487 that was expensed as a repair and maintenance expense rather than properly recorded as a capital addition.

Cause:

District oversight.

Effect:

A lack of compliance with internal control procedures could cause a material misstatement in the financial statements.

Recommendation:

When invoices are coded to repair and maintenance expense, the employee coding the item and the person reviewing the coding should always assess if the item would be better recorded as a capital addition or a repair.

Current Status:

Implemented.