

**GOVERNMENTAL REPORTS AND
OTHER REQUIRED COMMUNICATION**

GOVERNMENTAL REPORTS

FRANK CAMPOS & ASSOCIATES

A Professional Limited Liability Company Of Certified Public Accountants

INDEPENDENT AUDITOR'S 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 City Council
City of Palestine, Texas

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, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of City of Palestine, Texas (the City) as of and for the year ended September 30, 2016, and the related notes to the financial statements, which collectively comprise City of Palestine, Texas's basic financial statements and have issued our report thereon dated August 15, 2017.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered City of Palestine, Texas'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 City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City'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*, 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. We did identify certain deficiencies described in the accompanying schedule of findings and questioned costs, that we consider to be material weaknesses. (2016-001, 2016-002, 2016-003).

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City'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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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City of Palestine, Texas Response to Findings

The City's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. The City's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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 result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. The 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.

Frank Campos

Frank Campos, CPA, PLLC
Palestine, TX
August 15, 2017

CITY OF PALESTINE, TEXAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE YEAR ENDED SEPTEMBER 30, 2016

MATERIAL WEAKNESSES

2016-001 Mall Receivables

Criteria: Internal controls should be in place to provide financial reporting and to provide accurate financial information in a timely manner.

Condition: Monthly rental billings of mall tenants were initiated during current year. Rental billings receivables were overstated at year end.

Cause: Some rental payments from mall tenants were posted to revenue accounts instead of receivable.

Effect or Potential Effect: Rental billing receivables being overstated.

Recommendation: Cashiers should be re-trained to ensure rental payments are posted to receivable accounts and not revenue accounts. Also, finance department should be reviewing receivable balances on a monthly basis to ensure correctness and to ensure payments are being made timely.

Views of responsible officials and planned corrective action: We concur with the recommendation.

2016-002 Grant Accounting

Criteria: Internal controls should be in place to ensure financial reporting that provides accurate financial information in a timely manner.

Condition: The City was awarded two capital grants which are required to be reported and accounted for in their own fund. The City has two funds set up for capital grants. The grant transactions were intermingled between the funds. Grant receipts and disbursements were posted incorrectly to each fund. Both grants are reimbursement grants, so no grant funds were spent in error. Both grants are managed by an outside grant consultant who ensured proper reporting of expenses to the state.

Cause: Finance department was given incorrect information regarding coding of grant transactions.

Effect or Potential Effect: Reporting of each particular grant receipts and disbursements on annual report could be misstated.

Recommendation: City finance department should work with the grant consultant firm and city's department head in charge of grant to determine correct posting of grant transactions.

Views of responsible Officials and planned Corrective action: We concur with recommendation.

CITY OF PALESTINE, TEXAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE YEAR ENDED SEPTEMBER 30, 2016

2016-003 Continuous Accounting Problems

Criteria:	Internal controls should be in place to ensure financial reporting that provides accurate financial information in a timely manner.
Condition:	Audit report is being issued five months late due to City's continuous accounting problems. The major problems are as follows: <ol style="list-style-type: none">1) Monthly bank reconciliations for September 30, 2016, were not complete until mid May 2017 (seven months late).2) Annual depreciation report on City's fixed assets were not complete until August 2017.
Cause:	Turnover in finance directors over last several years has caused delay in accounting work due to lack of supervision. At times, there was no finance director. The City reliance on one employee for certain accounting processes delayed audit. In the past year, the reliance was due to new accounting staff.
Effect or Potential Effect:	Unaudited financial information reported to council and public could be materially misstated. Delays in audit report being issued.
Recommendation:	City should continue training and cross-training finance staff. Priorities should be set for ensuring bank reconciliations, reviewing and adjusting general ledger and depreciation reports are completed in a timely manner.
Views of responsible Officials and planned Corrective action:	Management concurs with the recommendation, has made significant staffing changes, has brought in external training from GL vendor, has taken cross-training seriously, and has demonstrated improvements in current year. Commencing January 2017, all four members of accounting staff (Finance Director, Accounting Manager, and two accountants) reconcile bank accounts. In July 2017, a third accountant was added. Bank reconciliations are current (within 60 days) as of July 2017. All finance staff members reconcile balance sheet accounts across all funds, reviewing and adjusting for errors prior to the next year's audit fieldwork.

CITY OF PALESTINE, TEXAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE YEAR ENDED SEPTEMBER 30, 2016

PRIOR YEAR
MATERIAL WEAKNESSES

2015-1 AIRPORT GRANT FUND

Finding

The City did not record airport grant transactions in the general ledger during 2015. The grant is administered by the State. Financial reports are sent to the City by the State, so the City can record transactions.

Effect

City's financial statements would be materially misstated due to omission of grant revenue and expenditures.

Recommendation

The City needs to record transactions in the general ledger from financial reports sent by the State.

Management's Response

The City concurs. The new Assistant City Manager/CFO has started improving the underlying communication between Public Works and Finance to become informed of State expenditures on behalf of the City for Airport Grant Fund project work. We believe future transactions will be communicated and recorded properly.

Status

Corrected. No capital airport grant received in fiscal year.

2015-2 MANAGEMENT OVERRIDE OF INTERNAL CONTROLS

Finding

During the audit, current administration disclosed that the prior administration during the year overrode controls by purchasing a gate that was not approved by council and created a purchase order using an ex-employee authorization code.

Effect

Even though the City appears to have controls that are well designed and effective, controls that are otherwise effective can be overridden by management, which can result in errors or fraud.

Recommendation

The City is encouraged to develop a whistle-blower policy and program. The City should also develop a checklist for key positions that have authorization to bank accounts, investment accounts and purchase orders to remove or inactivate approval/authority when an employee separates from the city.

Management Response

The City concurs. While the State Whistle-blower Act is posted in employee areas, Finance and HR staff has had preliminary discussions to formulate a whistle-blower policy and a checklist for terminating access to bank and investment accounts and the City accounting system upon separation from employment.

Status

Corrected. Whistle-blower policy was issued to employees and procedures for terminating access to bank and investment accounts from terminated employees are in place.

CITY OF PALESTINE, TEXAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE YEAR ENDED SEPTEMBER 30, 2016

2015-3 BANK RECONCILIATIONS

Finding

The City's main bank account was not accurately reconciled monthly in a timely manner. Although the bank account was reconciled timely, the reconciliation was inaccurate having numerous deposits in transit and outstanding transfers throughout the current year that were not cleared at year end. Issues with bank reconciliation have been a recurring problem over the last few years.

Effect

Errors and fraud will take longer to discover when accounts are not reconciled timely. Also, monthly financial reports may contain errors since accounts are not reconciled.

Recommendation

Bank reconciliations need to be prepared and reviewed monthly in a timely manner to ensure all cash transactions are recorded. Training from InCode may be needed to make sure the City is using InCode software to its capabilities.

Management Response

The City concurs. The newly-hired Assistant City Manager/CFO and Assistant Finance Director have begun cross-training among staff positions with the Finance department to train more than one employee on the complexities of the posting from receipting to system input to merchant processor to bank posting, on the multiple types of debits and credits that post to the accounting system and the bank. The recent turnover in Finance staff created a strain on senior employees to both maintain processing and train new employees; however the structure is in place with proper segregation of duties to implement correction. Staff also concurs that both InCode training and dialogue with similar municipalities would be of help.

Status

Bank reconciliations for fiscal year September 30, 2016, were completed in May 2017. InCode training specific to the process from cash handling through bank reconciliation was done in May 2017. All finance staff is cross-training to reconcile multiple bank accounts. The City's main bank account is currently reconciled through May 2017 as of July 2017, a 60 day lag. Finance director maintains a log of bank reconciliations for all cash and investment accounts and is monitoring monthly.

2015-4 MANAGEMENT OVERSIGHT OF MALL LEASE REVENUE

Finding

During the audit, we noticed a lessee was several months behind in monthly lease payments. Until discovery during audit, the City was unaware of failure of lessee payments. In prior administration, the finance department was responsible for managing the collection of mall lease revenue.

Effect

The City could lose revenue from lack of oversight of collection of mall lease revenue.

Recommendation

The department head in charge of the mall, along with the finance department should work together to ensure collection of lease revenue.

CITY OF PALESTINE, TEXAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE YEAR ENDED SEPTEMBER 30, 2016

Management Response

The City concurs. The new Assistant Finance Director is implementing a correcting action plan to review contracts for all leases and implement the accrual-basis AR processes in InCode that are in place for other AR segments.

Status

Corrected.

13-2 UTILITY BILLING

Finding

Multiple accounts in utility billing were under billed due to transponders failing and lack of training. The billing errors were from prior employees responsible for billing and not the current employees. There have been several employees responsible for utility billing over last few years, none of which have received training from software provider - InCode.

Criteria

City employees should be properly trained to perform job tasks.

Effect

Errors in billing can occur without proper training. A decrease in revenue could occur.

Recommendation

Provide training from InCode to current employees on utility billing and use of reports to locate errors. The City should also consider replacing transponders. In some utility routes more than half of transponders are not working.

Status

Corrected.

13-5 YEAR-END CLOSE OUT OF BOOKS

Finding

Over a hundred adjustments were required at year-end to adjust the City's general ledger to be materially correct under GAAP. Average adjustment amounts were \$263,500. The City should have controls in place to ensure general ledger is materially correct at year-end. The City could either ensure general ledger is adjusted or could hire an outside firm to assist City staff in closing out books.

Criteria

The city should have controls and procedures in place to ensure proper close-out and adjustments of fiscal year-end general ledger.

Effect

Preliminary reports to council will have numerous errors. Delays in issuing annual financial report will probably continue.

Recommendation

The City should hire outside firm to assist finance staff in adjusting general ledger at year-end. A thorough review and monthly adjustment of general ledger should also be done.

CITY OF PALESTINE, TEXAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE YEAR ENDED SEPTEMBER 30, 2016

Status

In progress. Due to change in finance staff, the finance department was behind in their financial reporting. No change for finding fiscal year ended September 30, 2016.

12-1 INTERFUND TRANSFERS AND INTERFUND RECEIVABLES/PAYABLES

Condition

Interfund transfers and interfund receivables/payables did not reconcile at year-end.

Criteria

Internal controls should be in place to provide reasonable assurance that interfund receivables/payables reconcile.

Effect

Because of the failure of proper review of financials by city staff, monthly financial reporting may be inaccurate.

Recommendation

Interfund transfers and interfund receivables/payables should be reviewed each month to make sure the accounts reconcile.

Status

In progress. This function is being added during FY1617 to cross-training areas that finance staff assigns to accountants so that accounting manager is not the sole staff member reviewing interfund activity.

11-2 CIVIC CENTER RENTALS

Finding

Duties for collection of payment and scheduling of rentals for the Civic Center are done at the Civic Center with no oversight.

Recommendation

The City needs to develop a system to ensure payment is received for all rentals. An alternative is for the Finance Department to perform internal testing on rentals.

Management Response

Heather will provide a copy of the calendar of events at the Civic Center and Carnegie each month and Finance Staff will randomly observe the facility to determine usage.

Status

Corrected. Civic Center staff was terminated and replaced. All collection of payments for Civic Center are now done centrally at Finance Dept. at City Hall. Additionally, monthly actual-to-budget reports issued within 10 days after each month-end enables budgetary control to be more effective.

11-3 MONTH-END CLOSING PROCEDURES

Finding

It appeared the City lacked a formal process for closing books at the end of each month. A number of adjustments were required at year-end during the audit process to correct general ledger account balances after the audit commenced. Accordingly, it did not appear that some subsidiary ledgers and other supports were being compared to the general ledger on a monthly basis to ensure that interim financial reporting was correct.

CITY OF PALESTINE, TEXAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE YEAR ENDED SEPTEMBER 30, 2016

Recommendation

The City should develop a formal closing process at month-end, including reviewing supporting subsidiary ledgers and other supporting documents to determine accuracy and to ensure the general ledger is appropriately adjusted and the financial statements are accurate.

Management Response

Finance Director will develop a formal monthly closing schedule.

Status

In progress. Finance Director has improved monthly closing schedule; staff has been restructured so that Finance Dept. admin issues monthly actual-to-budget reports to City Manager and department heads on the 10th of every month, summary reports to City Council are posted publicly on website, and balance sheet reconciliations are being assigned to accounting staff now that the bank reconciliation cross-training process has been achieved. All billing and receivables has been migrated to Utility Billing to centrally manage the AR subledger.

07-8 FINANCIAL STATEMENT PRESENTATION

Finding

The City has engaged a licensed certified public accounting firm to prepare and audit the City's annual financial report. The City ensures the quality of its annual financial report by engaging a qualified audit firm with particular experience in governmental audits and reading a preliminary draft of the report. The City does not have specific controls in place to separately review the selection and application of accounting principles and resulting disclosures and presentations with the financial statements. Although it is common within the government sector and most private companies to rely on their audit firm for these services, an audit firm cannot be considered part of its client's internal control by professional standards currently in effect. Since some presentations and disclosures may be material to the financial statements, this weakness in internal control would be classified material.

Recommendation

The City should continue to read its annual financial report and ensure the quality of both the document and the preparer. No changes in operation are recommended.

Management Response

We concur with the recommendation.

07-9 AUDIT ADJUSTMENTS

Finding

In the normal course of the audit process, the auditor recommends adjustments to the City's accounting records, as well as proposes other adjustments needed for preparing full accrual statements in compliance with GASB No. 34. The City does not have specific controls in place to eliminate all adjustments or to review other calculations required by GASB No. 34. Although it is common within the government sector and most private companies to rely on their audit firm for these services, an audit firm cannot be considered part of its client's internal control by professional standards currently in effect. Since some adjustments and calculations may be material to the financial statements, this weakness in internal control would be classified material.

Recommendation

The City should continue to read its annual financial report and ensure the quality of both the document and the preparer. No changes in operation are recommended.

Management Response

We concur with the recommendation

OTHER REQUIRED COMMUNICATION

FRANK CAMPOS & ASSOCIATES

A Professional Limited Liability Company of Certified Public Accountants

MANAGEMENT LETTER

To the Honorable Mayor, City Council
And Management
City of Palestine, Texas

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Palestine, Texas (the City), as of and for the year ended September 30, 2016, in accordance with auditing standards generally accepted in the United States of America, we considered the City of Palestine's internal control over financial reporting (internal control) as a basis for designing our auditing procedures 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 City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph 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. However, as discussed below, we identified certain deficiencies in internal control 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 entity's financial statements will not be prevented, or detected and corrected on a timely basis. The attached schedule lists the material weaknesses of the City of Palestine, Texas.

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 comment designated in the attached schedule of deficiencies in the City of Palestine, Texas's internal control to be a significant deficiency.

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

Frank Campos

Frank Campos, CPA
August 15, 2017

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**CITY OF PALESTINE, TEXAS
SUMMARY SCHEDULE OF AUDIT FINDINGS**

MATERIAL WEAKNESSES

2016-001 Mall Receivables

Criteria:	Internal controls should be in place to provide financial reporting and to provide accurate financial information in a timely manner.
Condition:	Monthly rental billings of mall tenants were initiated during current year. Rental billings receivables were overstated at year end.
Cause:	Some rental payments from mall tenants were posted to revenue accounts instead of receivable.
Effect or Potential Effect:	Rental billing receivables being overstated.
Recommendation:	Cashiers should be re-trained to ensure rental payments are posted to receivable accounts and not revenue accounts. Also, finance department should be reviewing receivable balances on a monthly basis to ensure correctness and to ensure payments are being made timely.
Views of responsible officials and planned corrective action:	We concur with the recommendation.

2016-002 Grant Accounting

Criteria:	Internal controls should be in place to ensure financial reporting that provides accurate financial information in a timely manner.
Condition:	The City was awarded two capital grants which are required to be reported and accounted for in their own fund. The City has two funds set up for capital grants. The grant transactions were intermingled between the funds. Grant receipts and disbursements were posted incorrectly to each fund. Both grants are reimbursement grants, so no grant funds were spent in error. Both grants are managed by an outside grant consultant who ensured proper reporting of expenses to the state.
Cause:	Finance department was given incorrect information regarding coding of grant transactions.
Effect or Potential Effect:	Reporting of each particular grant receipts and disbursements on annual report could be misstated.
Recommendation:	City finance department should work with the grant consultant firm and city's department head in charge of grant to determine correct posting of grant transactions.
Views of responsible Officials and planned Corrective action:	We concur with recommendation.

**CITY OF PALESTINE, TEXAS
SUMMARY SCHEDULE AUDIT FINDINGS**

2016-003 Continuous Accounting Problems

Criteria:	Internal controls should be in place to ensure financial reporting that provides accurate financial information in a timely manner.
Condition:	Audit report is being issued five months late due to City's continuous accounting problems. The major problems are as follows: 3) Monthly bank reconciliations for September 30, 2016, were not complete until mid May 2017 (seven months late). 4) Annual depreciation report on City's fixed assets were not complete until August 2017.
Cause:	Turn over in finance directors over last several years has caused delay in accounting work due to lack of supervision. At times, there was no finance director. The City's reliance on one employee for certain accounting processes delayed audit. In the past year due the reliance was due to new accounting staff.
Effect or Potential Effect:	Unaudited financial information reported to council and public could be materially misstated. Delays in audit report being issued.
Recommendation:	City should continue training and cross-training finance staff. Priorities should be set for ensuring bank reconciliations, reviewing and adjusting general ledger and depreciation reports are completed in a timely manner.
Views of responsible Officials and planned Corrective action:	Management concurs with the recommendation, has made significant staffing changes, has brought in external training from GL vendor, has taken cross-training seriously, and has demonstrated improvements in current year. Commencing January 2017, all four members of accounting staff (Finance Director, Accounting Manager, two accountants) reconcile bank accounts. In July 2017, a third accountant was added. Bank reconciliations are current (within 60 days) as of July 2017. All finance staff members reconcile balance sheet accounts across all funds, reviewing and adjusting for errors prior to the next year's audit fieldwork.

**CITY OF PALESTINE, TEXAS
SUMMARY SCHEDULE OF AUDIT FINDINGS**

**PRIOR YEAR
MATERIAL WEAKNESSES**

2015-1 AIRPORT GRANT FUND

Finding

The City did not record airport grant transactions in the general ledger during 2015. The grant is administered by the State. Financial reports are sent to the City by the State, so the City can record transactions.

Effect

City's financial statements would be materially misstated due to omission of grant revenue and expenditures.

Recommendation

The City needs to record transactions in the general ledger from financial reports sent by the State.

Management's Response

The City concurs. The new Assistant City Manager/CFO has started improving the underlying communication between Public Works and Finance to become informed of State expenditures on behalf of the City for Airport Grant Fund project work. We believe future transactions will be communicated and recorded properly.

Status

Corrected. No capital airport grant received in fiscal year.

2015-2 MANAGEMENT OVERRIDE OF INTERNAL CONTROLS

Finding

During the audit, current administration disclosed that the prior administration during the year overrode controls by purchasing a gate that was not approved by council and created a purchase order using an ex-employee authorization code.

Effect

Even though the City appears to have controls that are well designed and effective, controls that are otherwise effective, can be overridden by management, which can result in errors or fraud.

Recommendation

The City is encouraged to develop a whistle-blower policy and program. The City should also develop a checklist for key positions that have authorization to bank accounts, investment accounts and purchase orders to remove or inactivate approval/authority when an employee separates from the city.

Management Response

The City concurs. While the State Whistle-blower Act is posted in employee areas, Finance and HR staff has had preliminary discussions to formulate a whistle-blower policy and a checklist for terminating access to bank and investment accounts and the City accounting system upon separation from employment.

Status

Corrected. Whistle-blower policy was issued to employees and procedures for terminating access to bank and investment accounts from terminated employees are in place.

**CITY OF PALESTINE, TEXAS
SUMMARY SCHEDULE AUDIT FINDINGS**

2015-3 BANK RECONCILIATIONS

Finding

The City's main bank account was not accurately reconciled monthly in a timely manner. Although the bank account was reconciled timely, the reconciliation was inaccurate having numerous deposits in transit and outstanding transfers throughout the current year that were not cleared at year end. Issues with bank reconciliation have been a recurring problem over the last few years.

Effect

Errors and fraud will take longer to discover when accounts are not reconciled timely. Also, monthly financial reports may contain errors since accounts are not reconciled.

Recommendation

Bank reconciliations need to be prepared and reviewed monthly in a timely manner to ensure all cash transactions are recorded. Training from InCode may be needed to make sure the City is using InCode software to its capabilities.

Management Response

The City concurs. The newly-hired Assistant City Manager/CFO and Assistant Finance Director have begun cross-training among staff positions with the Finance department to train more than one employee on the complexities of the posting from receipting to system input to merchant processor to bank posting, on the multiple types of debits and credits that post to the accounting system and the bank. The recent turnover in Finance staff created a strain on senior employees to both maintain processing and train new employees; however the structure is in place with proper segregation of duties to implement correction. Staff also concurs that both InCode training and dialogue with similar municipalities would be of help.

Status

Bank reconciliations for fiscal year September 30, 2016, were completed in May 2017. InCode training specific to the process from cash handling through bank reconciliation was done in May 2017. All finance staff is cross-training to reconcile multiple bank accounts. The City's main bank account is currently reconciled through May 2017 as of July 2017, a 60 day lag. Finance director maintains a log of bank reconciliations for all cash and investment accounts and is monitoring monthly.

2015-4 MANAGEMENT OVERSIGHT OF MALL LEASE REVENUE

Finding

During the audit, we noticed a lessee was several months behind in monthly lease payments. Until discovery during audit, the City was unaware of failure of lessee payments. In prior administration, the finance department was responsible for managing the collection of mall lease revenue.

Effect

The City could lose revenue from lack of oversight of collection of mall lease revenue.

Recommendation

The department head in charge of the mall, along with the finance department should work together to ensure collection of lease revenue.

Management Response

The City concurs. The new Assistant Finance Director is implementing a correcting action plan to review contracts for all leases and implement the accrual-basis AR processes in InCode that are in place for other AR segments.

**CITY OF PALESTINE, TEXAS
SUMMARY SCHEDULE AUDIT FINDINGS**

Status

Corrected.

13-2 UTILITY BILLING

Finding

Multiple accounts in utility billing were under billed due to transponders failing and lack of training. The billing errors were from prior employees responsible for billing and not the current employees. There have been several employees responsible for utility billing over last few years, none of which have received training from software provider - InCode.

Criteria

City employees should be properly trained to perform job tasks.

Effect

Errors in billing can occur without proper training. A decrease in revenue could occur.

Recommendation

Provide training from InCode to current employees on utility billing and use of reports to locate errors. The City should also consider replacing transponders. In some utility routes, more than half of transponders are not working.

Status

Corrected.

13-5 YEAR-END CLOSE OUT OF BOOKS

Finding

Over one hundred adjustments were required at year-end to adjust the City's general ledger to be materially correct under GAAP. Average adjustment amounts were \$263,500. The City should have controls in place to ensure general ledger is materially correct at year-end. The City could either ensure general ledger is adjusted or could hire an outside firm to assist City staff in closing out books.

Criteria

The city should have controls and procedures in place to ensure proper close out and adjustments of fiscal year-end general ledger.

Effect

Preliminary reports to council will have numerous errors. Delays in issuing annual financial report will probably continue.

Recommendation

The City should hire outside firm to assist finance staff in adjusting general ledger at year-end. A thorough review and monthly adjustment of general ledger should also be done.

Status

In progress. Due to change in finance staff, the finance department was behind in their financial reporting. No change for finding fiscal year ended September 30, 2016.

12-1 INTERFUND TRANSFERS AND INTERFUND RECEIVABLES/PAYABLES

Condition

Interfund transfers and inter fund receivables/payables did not reconcile at year-end.

**CITY OF PALESTINE, TEXAS
SUMMARY SCHEDULE AUDIT FINDINGS**

Criteria

Internal controls should be in place to provide reasonable assurance that interfund receivables/payables reconcile.

Effect

Because of the failure of proper review of financials by city staff, monthly financial reporting may be inaccurate.

Recommendation

Interfund transfers and interfund receivables/payables should be reviewed each month to make sure the accounts reconcile.

Status

In progress. This function is being added during FY1617 to cross-training areas that finance staff assigns to accountants so that accounting manager is not the sole staff member reviewing interfund activity.

11-2 CIVIC CENTER RENTALS

Finding

Duties for collection of payment and scheduling of rentals for the Civic Center are done at the Civic Center with no oversight.

Recommendation

The City needs to develop a system to ensure payment is received for all rentals. An alternative is for the Finance Department to perform internal testing on rentals.

Management Response

Heather will provide a copy of the calendar of events at the Civic Center and Carnegie each month and Finance Staff will randomly observe the facility to determine usage.

Status

In progress. Civic Center staff was terminated and replaced. All collection of payments for Civic Center are now done centrally at Finance Dept. at City Hall. Additionally, monthly actual-to-budget reports issued within 10 days after each month-end enables budgetary control to be more effective.

11-3 MONTH-END CLOSING PROCEDURES

Finding

It appeared the City lacked a formal process for closing books at the end of each month. A number of adjustments were required at year-end during the audit process to correct general ledger account balances after the audit commenced. Accordingly, it did not appear that some subsidiary ledgers and other supports were being compared to the general ledger on a monthly basis to ensure that interim financial reporting was correct.

Recommendation

The City should develop a formal closing process at month-end, including reviewing supporting subsidiary ledgers and other supporting documents to determine accuracy and to ensure the general ledger is appropriately adjusted and the financial statements are accurate.

Management Response

Finance Director will develop a formal monthly closing schedule.

**CITY OF PALESTINE, TEXAS
SUMMARY SCHEDULE AUDIT FINDINGS**

Status

In progress. Finance Director has improved monthly closing schedule; staff has been restructured so that Finance Dept. admin issues monthly actual-to-budget reports to City Manager and department heads on the 10th of every month, summary reports to City Council are posted publicly on website, and balance sheet reconciliations are being assigned to accounting staff now that the bank reconciliation cross-training process has been achieved. All billing and receivables has been migrated to Utility Billing to centrally manage the AR subledger.

07-8 FINANCIAL STATEMENT PRESENTATION

Finding

The City has engaged a licensed certified public accounting firm to prepare and audit the City's annual financial report. The City ensures the quality of its annual financial report by engaging a qualified audit firm with particular experience in governmental audits and reading a preliminary draft of the report. The City does not have specific controls in place to separately review the selection and application of accounting principles and resulting disclosures and presentations with the financial statements. Although it is common within the government sector and most private companies to rely on their audit firm for these services, an audit firm cannot be considered part of its client's internal control by professional standards currently in effect. Since some presentations and disclosures may be material to the financial statements, this weakness in internal control would be classified material.

Recommendation

The City should continue to read its annual financial report and ensure the quality of both the document and the preparer. No changes in operation are recommended.

Management Response

We concur with the recommendation.

07-9 AUDIT ADJUSTMENTS

Finding

In the normal course of the audit process, the auditor recommends adjustments to the City's accounting records, as well as proposes other adjustments needed for preparing full accrual statements in compliance with GASB No. 34. The City does not have specific controls in place to eliminate all adjustments or to review other calculations required by GASB No. 34. Although it is common within the government sector and most private companies to rely on their audit firm for these services, an audit firm cannot be considered part of its client's internal control by professional standards currently in effect. Since some adjustments and calculations may be material to the financial statements, this weakness in internal control would be classified material.

Recommendation

The City should continue to read its annual financial report and ensure the quality of both the document and the preparer. No changes in operation are recommended.

Management Response

We concur with the recommendation

FRANK CAMPOS & ASSOCIATES

A Professional Limited Liability Company of Certified Public Accountants

The Auditor's Communication with Those Charged with Governance

August 15, 2017

To the Honorable Mayor and City Council
City of Palestine, Texas

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of City of Palestine, Texas for the year ended September 30, 2016. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and applicable, *Government Auditing Standards and Uniform Guidance*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated October 18, 2016. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by City of Palestine, Texas are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2016. We noted no transactions entered into by the governmental unit during the year 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 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 financial statements was:

Management's estimate of the allowance for doubtful accounts is based on historical water, sewer and sanitation revenues, historical loss levels, and an analysis of the collectability of individual accounts. We evaluated the key factors and assumptions used to develop the allowance in determining that it is reasonable in relation to the financial statements taken as a whole.

Financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

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.

Member of Texas Society of CPAs and American Institute of CPAs
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903-723-6064 Fax 903-723-2076

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. Management has corrected all such misstatements. The following material misstatements detected as a result of audit procedures were corrected by management:

- Applied principle payments to bonds outstanding and capital leases.
- Capitalization of assets.
- Correct vacation and sick leave
- Correct sales tax and franchise tax accruals
- Correct property tax deferral and reserve for uncollectible
- Correct allowance for bad debts for utility fund and miscellaneous account receivable
- Post grant receivable and airport grant transactions.
- Correct inter fund transactions (transfers and payables).
- Correct unbilled revenue
- Correct Grant receivable

Management Representations

We have requested certain representations from management that are included in the management representation letter dated August 15, 2017.

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 governmental unit’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 to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the governmental unit’s auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Matters

We applied certain limited procedures to budgetary schedules, schedule of contributions, schedule of changes in net pension liability and related ratios, and schedule of funding progress for TMRS and Post-Employment Benefits which are required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on combining statements and schedules, which accompany the financial statements but are not RSI. With respect to this supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

Restriction on Use

This information is intended solely for the use of Mayor, council members and management of City of Palestine, Texas and is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

Frank Campos

Frank Campos & Associates, PLLC