

**GOVERNMENTAL REPORTS AND  
OTHER REQUIRED COMMUNICATION**

## GOVERNMENTAL REPORTS

# FRANK CAMPOS, CPA

A Professional Limited Liability Company

## 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, 2014, 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 March 23, 2015.

### 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.

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 described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and 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 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. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be material weaknesses. (2013-1, 2013-2, 2013-3)

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### 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*.

### 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 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.

*Frank Campos*

Frank Campos, CPA, PLLC  
Palestine, TX

March 23, 2015

# FRANK CAMPOS, CPA

A Professional Limited Liability Company

## INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133

To the Honorable Mayor and City Council  
Palestine, Texas

### Report on Compliance for Each Major Federal Program

We have audited the City of Palestine, Texas's (the City), compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the City's major federal programs for the year ended September 30, 2014. The City's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

### Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

### Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the City's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of City's compliance.

### Opinion on Each Major Federal Program

In our opinion, the City of Palestine, Texas, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2014.

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## Other Matters

The results of our auditing procedures disclosed no instances of noncompliance, which are required to be reported in accordance with OMB Circular A-133. Our opinion on each major federal program is not modified with respect to these matters.

## Report on Internal Control Over Compliance

Management of the City of Palestine, Texas is responsible for establishing and maintaining effective internal control over compliance with requirements referred to above. In planning and performing our audit of compliance, we considered the City's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over compliance.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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, as of and for the year ended September 30, 2014, and the related notes to the financial statements, which collectively comprise City of Palestine, Texas's basic financial statements. We issued our report thereon dated March 23, 2015, which contained unmodified opinions on those financial statements. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and

other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

*Frank Campos*

Frank Campos, CPA  
March 23, 2015

**CITY OF PALESTINE, TEXAS**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2014**

**A. SUMMARY OF AUDITOR'S RESULTS**

*FINANCIAL STATEMENTS*

Type of auditor's report issued:	<i>Unmodified</i>
Internal control over financial reporting:	
• Material weakness identified?	Yes
• Significant deficiencies identified that are not considered to be material weaknesses?	Yes
Noncompliance material to financial statements noted?	No

*FEDERAL AWARDS*

Internal control over major programs:	
• Material weakness identified?	No
• Significant deficiencies identified that are not considered to be material weaknesses?	No
Type of auditor's report issued on compliance for major programs:	<i>Unmodified</i>
Any audit findings disclosed that are required to be reported in accordance with section 501(a) of OMB Circular A-133?	No

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
14.239	Home Investment Partnership Program
14.228	Community Development Block Grant

Dollar threshold used to distinguish between Type A and type B programs:	<u>\$300,000</u>
Auditee qualified as low-risk auditee?	No

**CITY OF PALESTINE, TEXAS**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2014**

**B. FINDINGS BASIC FINANCIAL STATEMENT**

**2013-1 AIRPORT GRANT FUND**

**Finding**

The City has not recorded airport grant transactions in the general ledger during 2014. 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.

**2013-2 UTILITY CUSTOMER ADJUSTMENTS**

**Finding**

During audit testing, we noticed several adjustments to customer accounts that either did not have documentation for adjustment or insufficient documentation. We also noticed three different employees making adjustments to customer accounts.

**Effect**

Unauthorized or incorrect adjustments can occur without detection if proper documentation is not retained.

**Recommendation**

Procedures and training should be developed to ensure proper documentation is retained for customer utility adjustments and only department supervisor or authorized employee should make adjustments to utility billing accounts.

**2013-3 UTILITY CUSTOMER ADJUSTMENT POLICIES**

**Finding**

There are no formal written policies regarding adjustments to customer accounts. There are informal policies regarding adjustments that have been used over the years.

**Effect**

Without formal adjustment policies, adjustments could be applied to the detriment of the City without any accountability.

**Recommendation**

A policy regarding customer utility account adjustment should be written. One of the items the policy should include is the dollar threshold the UB Supervisor should be allowed to approve without City Manager approval.

**C. FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS**

**NONE.**

**CITY OF PALESTINE, TEXAS**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2014**

<b>FEDERAL GRANTOR/PASS-THROUGH GRANTOR/PROGRAM TITLE</b>	<b>CFDA NUMBER</b>	<b>PASS-THROUGH GRANTOR NO.</b>	<b>FEDERAL EXPENDITURES</b>
<b>U.S. DEPARTMENT HOUSING AND URBAN DEVELOPMENT</b>			
PASSED THROUGH THE TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS			
HOME INVESTMENT PARTNERSHIP PROGRAM	14.239	2012-0071	53,038
PASSED THROUGH THE TEXAS DEPARTMENT OF AGRICULTURE			
COMMUNITY DEVELOPMENT BLOCK GRANT	14.228	713372	<u>142,575</u>
<b>TOTAL U.S. DEPARTMENT HOUSING AND URBAN DEVELOPMENT</b>			<u><u>195,613</u></u>
<b>U.S. DEPARTMENT OF TRANSPORTATION</b>			
AIRPORT PROJECT PARTICIPATION AGREEMENT	20.106	1410PALST	<u>50,649</u>
<b>TOTAL U.S. DEPARTMENT OF TRANSPORTATION</b>			<u><u>50,649</u></u>
<b>U.S. DEPARTMENT OF HOMELAND SECURITY</b>			
PASSED THROUGH THE TEXAS DEPARTMENT PUBLIC SAFETY			
EMERGENCY MANAGEMENT PERFORMANCE GRANT	97.042	23TX-EMPG-1356	<u>30,056</u>
<b>TOTAL U.S. DEPARTMENT OF HOMELAND SECURITY</b>			<u><u>30,056</u></u>
<b>TOTAL FEDERAL ASSISTANCE</b>			<u><u>\$ 276,318</u></u>

**NOTE A - BASIS OF PRESENTATION**

The accompanying schedule of expenditures of federal awards include the federal grant activity of the City of Palestine, Texas and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations".



# City of Palestine

## CORRECTIVE ACTION PLAN

U.S. Department of Commerce

City of Palestine, Texas respectfully submits the following corrective action plan for the year ended September 30, 2014.

Frank Campos, CPA, PLLC  
P.O. Box 232  
Palestine, Texas 75802

Audit Period: September 30, 2014

The findings from the March 23, 2015 schedule of findings and questioned costs are discussed below. The findings are numbered consistently with the number assigned in the schedule.

### FINDINGS – FINANCIAL STATEMENT AUDIT

#### 2013-1 AIRPORT GRANT FUND

##### **Recommendation**

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

**Action Taken:** We concur with the recommendation.

#### 2013-2 UTILITY CUSTOMER ADJUSTMENTS

##### **Recommendation**

Procedures and training should be developed to ensure proper documentation is retained for customer utility adjustments and only department supervisor or authorized employee should make adjustments to utility billing accounts.

**Action Taken:** We concur with the recommendation.

#### 2013-3 UTILITY CUSTOMER ADJUSTMENT POLICIES

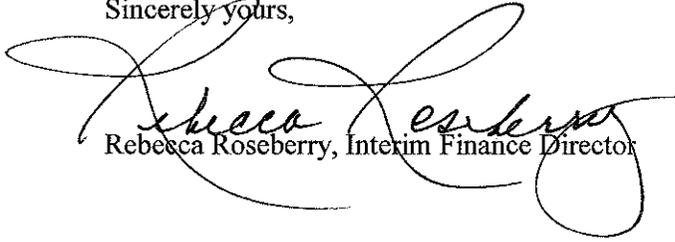
##### **Recommendation**

A policy regarding customer utility account adjustment should be written. One of the items the policy should include is the dollar threshold the UB Supervisor should be allowed to approve without City Manager approval.

**Action Taken:** We concur with the recommendation.

If the U.S. Department of Commerce has questions regarding this plan, please call Becky Roseberry

Sincerely yours,



Rebecca Roseberry, Interim Finance Director

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

**MATERIAL WEAKNESSES**

**13-1 BANK RECONCILIATIONS**

**Finding**

The City's main bank account was not reconciled monthly in a timely manner. As of September 30, 2013, the City's main bank account was five months behind in being reconciled. The fiscal year end bank statement was reconciled in late January 2014. This has been a recurring problem over the last few years.

**Criteria**

The City's bank accounts should be reconciled monthly in a timely manner

**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. Recommendations on improving bank reconciliation process by outside consulting firm should also be implemented.

**Status**

Bank reconciliations as of March 20, 2015 are current.

**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 employee. There has been several employees responsible for utility billing over last few years and none of them have received training from software provider - Encode.

**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 Encode to current employee 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**

In progress.

### **13-3. WRITTEN PROCEDURES AND CROSS TRAINING**

#### **Finding**

There are no written accounting procedures for payroll calculation and check disbursement, bank reconciliations preparation and utility billing. In payroll and bank reconciliation preparation there are no other employees trained to perform accounting functions.

#### **Criteria**

City should have written procedures to perform critical job tasks and should employees cross trained to perform critical job tasks..

#### **Effect**

If either employee leaves or is off for significant amount of time, the City would either have to temporarily hire out functions or have another employee try figure out how to perform tasks. Errors and delays could occur without proper training. Without written procedures, outside help and other employees would have a difficult time in performing tasks.

#### **Recommendation**

The city should cross - train employees in critical areas. The City should also have written procedures for critical areas to help with cross training and replacement of employee if employee leaves.

#### **Status**

In progress.

### **13-4. SANITATION COMMERCIAL PAYABLE INVOICES**

#### **Finding**

The Sanitation collection vendor appears to have been overbilling the City for commercial collection services. The City was recently able to provide additional support to utility billing supervisor to reconcile city's records of commercial sanitation services with billings from sanitation vendor. It appears that the sanitation vendor is billing for addresses that the City does not show as having sanitation service.

#### **Criteria**

City should have controls and procedures in place to ensure vendors are not overpaid.

#### **Effect**

The City is overpaying for commercial sanitation services.

#### **Recommendation**

The City should meet with sanitation vendor and resolve billing issue. The City should also continue monthly to reconcile vendor's bill with City's records.

#### **Status**

Many of customer accounts have been corrected, but not all corrections have been done.

### **13-5. YEAR-END CLOSE OUT OF BOOKS**

#### **Finding**

Over a hundred adjustments were required at year end to adjust 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**

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.

### **13-6. UTILITY ACCOUNT RECEIVABLE AND CUSTOMER DEPOSITS**

#### **Finding**

Utility accounts receivable and customers deposit subledger does not agree with general ledger.

#### **Criteria**

City should have control and procedures in place to ensure accurate accounting of receivables.

#### **Effect**

Errors in customer account balances will remain undetected. Also, errors in customer balances will continue to grow.

#### **Recommendation**

The city should research differences monthly and correct monthly. Training from encode would help in researching differences.

#### **Status**

In progress.

### **13-7 UTILITY ACCOUNT RECEIVABLE (SANITATION ROLL-OFFS)**

#### **Finding**

Utility accounts receivable for sanitation roll-offs has numerous accounts over 120 days old and documentation for charges cannot be located.

#### **Criteria**

City should have control and procedures in place to ensure collection of receivables.

**Effect**

City's cash collections can decrease if receivables are not monitored and paperwork is not stored properly.

**Recommendation**

The city should monitor receivables for outstanding balances and send accounts to collection if payment is not received.

**Status**

New customer service manager is monitoring roll-off receivables.

**12-1 INTERFUND TRANSFERS AND INTERFUND RECEIVABLES/PAYABLES**

**Condition**

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

**Criteria**

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

**Effect**

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

**Recommendation**

Inter fund transfers and inter fund receivables/payables should be reviewed each month to make sure the accounts reconcile.

**Status**

In progress.

**12-2 MISCELLANEOUS ACCOUNT RECEIVABLE**

**Condition**

The City's miscellaneous account receivable subledger does not agree with the general ledger.

**Criteria**

Internal controls should be in place to provide reasonable assurance that miscellaneous account receivables reconciles with the general ledger.

**Effect**

Because of the failure to properly review miscellaneous receivables, misstatement of revenue and collections can be misstated.

**Recommendation**

The miscellaneous account receivable subledger should be analyzed and corrected. Once corrected, the miscellaneous account receivable subledger should be reviewed each month to make sure the account reconciles to the general ledger.

**Status**

In progress.

### 12-3 CASH MANAGEMENT

#### **Condition**

At the end of the fiscal year, the pool cash bank account per bank reconciliation showed a negative cash balance of \$1,887,820. The bank statement balance at end the of the fiscal year was a positive \$379,000.

#### **Criteria**

Internal controls should be in place to provide reasonable assurance that bank accounts have enough funds to cover checks when written.

#### **Effect**

Because of the failure of proper control over cash balances, the City could become overdrawn on bank accounts.

#### **Recommendation**

Although the bank did not show the City's bank account overdrawn, the City should review its cash balances and requirements weekly and transfer funds to checking accounts on a timely basis to ensure accounts will not be overdrawn.

#### **Status**

In progress.

### 12-10 BANK RECONCILIATIONS

#### **Condition**

The City's main bank account was not reconciled monthly in a timely manner. 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.

#### **Criteria**

The City's bank accounts should be reconciled monthly in a timely manner.

#### **Effect**

Because of the failure to reconcile bank accounts in a timely manner, errors or fraud may not be recognized in a timely manner.

#### **Recommendation**

Bank reconciliations need to be prepared and reviewed monthly in a timely manner to ensure all cash transactions are recorded.

#### **Status**

In progress.

### 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. 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.

**11-3 MONTH END CLOSING PROCEDURES**

**Finding**

It appeared the City lacked a formal process for closing the 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 support were being compared to the general ledger on a monthly basis to ensure 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 accurate.

**Management Response**

Finance Director will develop formal monthly closing schedule.

**Status**

In progress.

**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 34. The City does not have specific controls in place to eliminate all adjustments or to review other calculation required by GASB 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.

## **07-10 SEGREGATION OF DUTIES**

### **Background**

Segregation of duties refers to assigning tasks among personnel so that no one person handles substantially all aspects of a transaction. The extent to which the City can segregate duties is limited based on the number of personnel, their skill set and work load, and the organizational structure of the City.

### **Finding**

As with other cities of the same staff size, there are instances where additional controls could be put in place if more personnel were available and further segregation in duties could be achieved. While the City's segregation of duties appear reasonable given the number of personnel, there are some inherent risks given the City's staff size.

This matter is being reported to comply with new reporting requirements pertaining to matters commonly known or previously reported.

### **Recommendation**

The City should continue to evaluate opportunities for greater segregation of duties.

### **Management Response**

We concur with the recommendation.

## OTHER REQUIRED COMMUNICATION

# FRANK CAMPOS, CPA

A Professional Limited Liability Company

## *The Auditor's Communication with Those Charged with Governance*

March 23, 2015

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, 2014. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and applicable, *Government Auditing Standards and OMB Circular A-133*, 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 September 17, 2014. 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 2013-14. 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 collectibility 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.

#### ***Difficulties Encountered in Performing the Audit***

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

#### ***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

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### ***Corrected and Uncorrected Misstatements, continued***

- 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).

### ***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.

### ***Management Representations***

We have requested certain representations from management that are included in the management representation letter dated March 23, 2015.

### ***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 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, CPA, PLLC

# FRANK CAMPOS, CPA

A Professional Limited Liability Company

## 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, as of and for the year ended September 30, 2014, 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 Governmental Unit's internal control. Accordingly, we do not express an opinion on the effectiveness of the Governmental Unit'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 attached schedule of deficiencies in the City of Palestine, Texas's internal control to be significant deficiencies.

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  
March 23, 2015

Member of Texas Society of CPAs and American Institute of CPAs

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

**CURRENT YEAR FINDINGS**  
**MATERIAL WEAKNESSES**

**2013-1 AIRPORT GRANT FUND**

**Finding**

The City has not recorded airport grant transactions in the general ledger during 2014. 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.

**2013-2 COMMUNICATION BETWEEN DEPARTMENTS**

**Finding**

During the audit, we noticed some of the City's findings are occurring due to lack of communication between departments. Such as customer service informing public works assistant on changes to sanitation customers. Also, when City has Airport grants, the financial documents need to be sent to Finance department so Finance department can record transactions. Finance department needs to be given new grant documents to set up funds and ensure grant expenditures are posted to correct fund.

**Effect**

City's financial statements could be materially misstated if transactions are not reported or reported to incorrect fund. Also, sanitation revenue can be billed incorrectly if customer changes are not communicated to billing department.

**Recommendation**

The City should implement procedures and training to facilitate communication between departments.

**2013-3 UTILITY CUSTOMER ADJUSTMENTS**

**Finding**

During audit testing, we noticed several adjustments to customer accounts that either did not have documentation for adjustment or insufficient documentation.

**Effect**

Unauthorized or incorrect adjustments can occur without detection if proper documentation is not retained.

**Recommendation**

Procedures and training should be developed to ensure proper documentation is retained for customer utility adjustments and only department supervisor or authorized employee should make adjustments to utility billing accounts.

**2013-4 UTILITY CUSTOMER ADJUSTMENT POLICIES**

**Finding**

There are no formal written policies regarding adjustments to customer accounts. There are informal policies regarding adjustments that have been used over the years.

**Effect**

Without formal adjustment policies, adjustments could be applied to the detriment of the City without any accountability.

**Recommendation**

A policy regarding customer utility account adjustment should be written. One of the items the policy should include is the dollar threshold the UB Supervisor should be allowed to approve without City Manager approval.

**PRIOR YEAR FINDINGS  
MATERIAL WEAKNESSES**

**2012-1 BANK RECONCILIATIONS**

**Finding**

The City's main bank account was not reconciled monthly in a timely manner. As of September 30, 2014, the City's main bank account was five months behind in being reconciled. The fiscal year end bank statement was reconciled in late January 2014. This has 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. Recommendations on improving bank reconciliation process by outside consulting firm should also be implemented.

**Status**

Bank reconciliations as of March 20, 2015 are current.

**2012-2 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 employee. There has been several employees responsible for utility billing over last few years and none of them have received training from software provider - Encode.

**Effect**

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

**Recommendation**

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

**Status**

City has providing training to employees and located meters with inoperable transponders. City is planning on replacing meters.

**2012-3 WRITTEN PROCEDURES AND CROSS TRAINING**

**Finding**

There are no written accounting procedures for payroll calculation and check disbursement, bank reconciliations preparation and utility billing. In payroll and bank reconciliation preparation there are no other employees trained to perform accounting functions.

**Effect**

If either employee leaves or is off for significant amount of time, the City would either have to temporarily hire out functions or have another employee try figure out how to perform tasks. Errors and delays could occur without proper training. Without written procedures, outside help and other employees would have a difficult time in performing tasks.

**Recommendation**

The city should cross - train employees in critical areas. The City should also have written procedures for critical areas to help with cross - training and replacement of employee if employee leaves.

**Status**

In progress.

**2012-4 SANITATION COMMERCIAL PAYABLE INVOICES**

**Finding**

The Sanitation collection vendor appears to have been overbilling the City for commercial collection services. The City was recently able to provide additional support to utility billing supervisor to reconcile city's records of commercial sanitation services with billings from sanitation vendor. It appears that the sanitation vendor is billing for addresses that the City does not show as having sanitation service.

**Effect**

The City is overpaying for commercial sanitation services.

**Recommendation**

The City should meet with sanitation vendor and resolve billing issue. The City should also continue monthly to reconcile vendor's bill with City's records.

**Status**

City has made some progress correcting billing to customers and billings from sanitation vendor, but there still accounts that need to be corrected.

**2012-5 YEAR-END CLOSE OUT OF BOOKS**

**Finding**

Over a hundred adjustments were required at year end to adjust 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.

**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.

**2012-6 UTILITY ACCOUNT RECEIVABLE AND CUSTOMER DEPOSITS**

**Finding**

Utility accounts receivable and customers deposit sub ledger does not agree with general ledger.

**Effect**

Errors in customer account balances will remain undetected. Also, errors in customer balances will continue to grow.

**Recommendation**

The city should research differences monthly and correct monthly. Training from encode would help in researching differences.

**Status**

In progress.

**2012-7 UTILITY ACCOUNT RECEIVABLE (SANITATION ROLL-OFFS)**

**Finding**

Utility accounts receivable for sanitation roll-offs has numerous accounts over 120 days old and documentation for charges cannot be located.

**Effect**

City's cash collections can decrease if receivables are not monitored and paperwork is not stored properly.

**Recommendation**

The city should monitor receivables for outstanding balances and send accounts to collection if payment is not received. New customer service manager is monitoring roll-off receivables.

**Status**

In progress.

**PRIOR YEAR FINDINGS  
SIGNIFICANT DEFICIENCIES**

**2012-8 FUNDS OUT OF BALANCE**

**Finding**

During the audit we noticed a couple of small funds that did not balance (i.e. debits did not equal credits).

**Recommendation**

The City needs to review trial balances to ensure funds balance.

**Status**

Corrected.

**2011-9 INTERFUND TRANSFERS AND INTERFUND RECEIVABLES/PAYABLES**

**Finding**

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

**Effect**

Monthly and annual financial information will be misstated.

**Recommendation**

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

**Status**

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

**2011-10 MISCELLANEOUS ACCOUNT RECEIVABLE**

**Finding**

The City's miscellaneous account receivable sub ledger does not agree with the general ledger.

**Effect**

Errors in customer account balances will remain undetected. Also, errors in customer balances will continue to grow.

**Recommendation**

The miscellaneous account receivable sub ledger should be analyzed and corrected. Once corrected, the miscellaneous account receivable sub ledger should be reviewed each month to make sure the account reconciles to the general ledger.

**Status**

The City's miscellaneous account receivable sub ledger still does not agree with the general ledger.

**2011-11 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. 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 the Finance Staff will randomly observe the facility to determine usage.

**Status**

In progress.

**2011-12 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 supporting reports were being compared to the general ledger on a monthly basis to ensure 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.

**Status**

In progress. Delays in audit field work occurred due to major accounts not being adjusted at year end, such as governmental receivables, utility receivables, governmental and utility notes payable, governmental and utility reserve for bad debts and other accounts.

**2009-13 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.

**2009-14    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 MATTERS**

**1. DEFICIT FUND BALANCE**

**Finding**

I noted the following funds reported a deficit fund balance:

<u>Fund</u>	<u>Deficit</u>
Generator grant	\$     6,994
2006 Series Imp.	\$     42,186
Capital Projects	\$    164,246
Home Grant	\$      3,060
Sanitation	\$    737,026
Sanderson Farms Project	\$   362,323
Health Insurance	\$    810,882
Central Warehouse	\$         405

**Recommendation**

The City should adopt a fund balance policy, whereby each fund has an established target or reserve to meet the objective of that fund.

**Status**

In progress.

**Health Insurance Fund** - The Health insurance fund is self-insured. The general fund has loaned the health insurance fund \$209,456 to pay employee medical claims. The fund balance has a deficit balance of \$810,882. The City should review its health insurance program and consider changing the plan so it is not self-insured. The City should also review employee health benefits to reduce City costs.

**Sanitation Fund** – The Sanitation fund has no cash and owes other funds \$1,043,970. During 2014, the fund had a \$497,446 net operating income and an \$89,453 net income, leaving a negative fund balance of \$737,026.