CITY OF MENLO PARK

STAFF REPORT

City Council
Meeting Date: **7/14/2026**
Staff Report Number: **26-118-CC**

Informational Item: **Update on the City of Menlo Park's internal controls assessment report**

Recommendation

This is an informational item that does not require City Council action. Staff recommends the City Council receive this update on the Assessment of Internal Controls report (Attachment A).

Policy Issues

California Government Code Section 12422.5 requires the State Controller to establish internal controls for local agencies, including cities, counties, special districts and other local government entities, excluding school districts. Accordingly, the State Controller's Office issued a 2015 report entitled, "Internal Control Guidelines – California Local Agencies" to establish a system of internal controls to safeguard assets and prevent and detect financial errors and fraud.

In September 2024, the City Council authorized the City's response to the 2023-24 San Mateo County Civil Grand Jury report and committed to completing an internal control assessment and reporting the results to the City Council. This action fulfills that commitment and establishes a framework for ongoing annual assessment and reporting going forward. The City is committed to continuous improvement in creating and monitoring effective internal controls at all levels of the organization.

Background

Per the Standards of Internal Control in the Federal Government (the Green Book), an effective internal control system includes five primary components. The City relies on the Green Book as a recognized framework for evaluating and strengthening internal controls because it provides a comprehensive and widely accepted standard for governmental entities. This framework is also consistent with recommendations cited in Civil Grand Jury report.

- Control Environment – sets the tone for the organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control.
- Risk Assessment – the identification and analysis of relevant risks to the achievement of objectives, forming a basis for how the risks should be managed.
- Control Activities – policies and procedures that help ensure management directives are carried out.
- Information and Communication – systems or processes that support the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.
- Monitoring – processes used to assess the quality of internal control performance over time.

Internal controls help an entity achieve its objectives, run its operations efficiently and effectively, report reliable information about its operations, and comply with applicable laws and regulations. Internal controls apply to all entities, regardless of size; however, large complex entities have different risk profiles than small, less-complex entities. All entities seek to control risk appropriate for their operations and design and implement internal controls for their own particular risk profiles. While Menlo Park is a smaller municipality, it is a full-service city that operates its own police department, library, water utility and childcare services, with fire protection and sanitary services provided by separate special districts and contracted aquatics programming. All of these components contribute to the City's overall risk profile.

The San Mateo County Civil Grand Jury is a fact-finding body that makes specific recommendations on a wide range of topics to help improve local government operations. On June 27, 2024, the 2023-2024 San Mateo County Civil Grand Jury released a report entitled "Assessing and Reporting Internal Controls in San Mateo County Agencies and School Districts," which focused on the control environment, information and communication and monitoring principles of internal control. An accompanying letter asked for a response from the City of Menlo Park regarding the Grand Jury's findings and recommendations. The Council approved the draft letter Sept. 24, 2024 (Attachment B) and provided the response to the Superior Court judge by the due date of Sept. 25, 2024.

Analysis

In response to the Civil Grand Jury's findings and recommendations, the City contracted with DKG Consultants (DKG) to conduct an independent assessment of the City's internal controls and develop an enterprise risk assessment framework.

<u>Assessment methodology</u>

DKG reviewed the Memorandum of Internal Controls and Required Communications issued by the City's external auditors for the fiscal years 2020-21 through 2024-25. DKG then conducted a series of interviews with staff in Finance and each operating department to assess policies, processes, procedures, documentation and controls across nine functional areas, as applicable: procurement, credit cards, accounts payable, revenue management, cash handling, bank reconciliation, payroll administration, financial system access and budgetary appropriation control.

<u>Assessment results</u>

Overall, the results of the assessment demonstrate that the City has reasonable internal controls and staff who are generally well trained and knowledgeable of best practices. The City's existing control activities, segregation of duties, and financial reporting processes provide a solid foundation to continue fortifying. DKG's review identified opportunities to further strengthen internal controls and operational processes, many of which the City has already begun addressing through enhanced oversight and system improvements. The recommendations in this assessment are intended to build on those efforts and further strengthen the City's financial management practices.

During the internal control assessment, payroll control weaknesses were identified that are consistent with findings noted by the Pun Group during interim payroll audit testing, including instances in which employee timesheets were processed before documented supervisory approval. Based on the City's preliminary assessment, these issues appear to be related to workflow and process changes associated with the transition from paper-based timesheets to digital timekeeping systems, rather than intentional non-compliance. In response, staff has strengthened payroll controls by requiring documented supervisory approval before payroll processing with built-in reminders and an escalation procedure to ensure compliance before the processing deadline each pay period. Staff developed a comprehensive payroll procedure to further standardize payroll administration and reinforce internal controls.

In addition, recognizing the increasing prevalence of fraudulent Automated Clearing House (ACH) payment and banking change requests targeting public agencies, staff has developed a formal ACH verification procedure establishing standardized authentication, independent verification, and approval requirements before vendor banking information can be created or modified. This enhanced control is intended to reduce the risk of payment fraud and strengthen vendor management practices.

The assessment recommendations, discussed in greater detail in Attachment A, are intended to complement these proactive improvements and further strengthen the City's internal control environment. In DKG's opinion, the highest-priority recommendations relate to system access and configuration, particularly within OpenGov, the City's financial system, and UKG, the City's payroll system, as well as vendor management, revenue tracking and cash reconciliation.

Recommendation summary

The assessment report includes detailed recommendations for each functional area. A summary of the priority recommendations is as follows:

- Strengthen procurement governance by refining City Council Policy requirements, clarifying expectations, providing post-update training, and centralizing oversight of policy exceptions and waiver approvals to improve consistency of compliance. These efforts align with the proposed adoption of the revised purchasing policy, which further clarifies procurement procedures and responsibilities.
- Enhance credit card oversight by periodically analyzing spending patterns for potential cost efficiencies and reinforcing ongoing diligence in credit card purchase review and approval processes.
- Improve accounts payable controls by formalizing vendor setup and banking change verification procedures, strengthening safeguards around ACH payment requests, and ensuring clear segregation of duties in vendor creation and payment processing.
- Standardize revenue management practices by establishing structured procedures for tracking receivables, defining roles for billing and follow-up, implementing escalation timelines, and formalizing write-off and collections policies.
- Strengthen cash handling controls by improving reconciliation procedures, enhancing secure storage of cash collections, and reducing reliance on manual transport of funds where feasible.
- Maintain bank reconciliation discipline by continuing timely reconciliation practices as a key control and risk mitigation activity.
- Strengthen payroll administration controls by enhancing system access restrictions, improving approval workflows, implementing payroll variance monitoring, reinforcing supervisory review of timecards, and formalizing overtime policies and training.
- Standardize financial system access controls by reviewing and aligning user permissions with job responsibilities, documenting role-based access profiles, and implementing ongoing monitoring across financial and related systems.
- Improve budgetary control reporting by working to prevent expenditure from exceeding approved appropriations requiring clear explanation and disclosure when expenditures exceed approved

appropriations in financial reports.

Enterprise risk assessment framework and ongoing reporting
The assessment also includes a proposed enterprise risk assessment framework aligned with the five components of the Green Book. Staff concurs with the identified risks and will implement the recommended enhancements over the next two years, prioritizing actions that address the highest-risk areas and provide the greatest improvement to internal controls. In addition, staff will incorporate a summary of the City's annual risk assessment and any resulting changes to internal control activities into the staff report accompanying the Annual Comprehensive Financial Report (ACFR) on an ongoing basis. This reporting approach fulfills Civil Grand Jury Recommendation R3 and supports compliance with Recommendations R1 and R2 by ensuring that organizational risks are formally documented, assessed annually, and reported to the governing body as part of the City's established financial reporting process.

Impact on City Resources
There is no impact on City resources at this time.

Environmental Review
This action is not a project within the meaning of the California Environmental Quality Act (CEQA) Guidelines Sections 15378 and 15061(b)(3) as it will not result in any direct or indirect physical change in the environment.

Public Notice
Public notification was achieved by posting the agenda, with the agenda items being listed, at least 72 hours prior to the meeting.

Attachments
A. Assessment of Internal Controls report
B. Hyperlink – Sept. 24, 2024, Staff Report #24-169-CC: www.menlopark.gov/files/sharedassets/public/v/1/agendas-and-minutes/city-council/2024-meetings/agendas/20240924/f4-20240924-cc-gjr-internal-controls.pdf

Report prepared by:
Adrian Patino, Management Analyst II

Report reviewed by:
Fenny Lei, Assistant Administrative Services Director

DKG CONSULTANTS

July 7, 2026

Executive Summary

Based on the findings and recommendations of a report from the San Mateo Civil Grand Jury, the City of Menlo Park contracted with DKG Consultants (DKG) to assess its internal controls and overall risk environment. Overall, the results of the assessment demonstrate that Menlo Park has reasonable internal controls and staff that are generally well trained and aware of related best practices. There are a number of recommendations for consideration for the City to strengthen overall controls, which are discussed in detail throughout the report. In DKG's opinion, the highest priority recommendations are those related to system access and configuration, both in the OpenGov financial system and the UKG payroll system; vendor management; revenue tracking; and cash reconciliation. While the system access and configuration recommendations will require a commitment of staff resources across the organization, the other priority recommendations should only require a modest investment. A risk assessment framework was also developed for consideration to manage and mitigate financial risk on an ongoing basis.

Methodology

The first step in the assessment process was a review of the Memorandum on Internal Controls and Required Communications, both of which are provided by the external auditor to the City's management, including the City Council. These documents were reviewed for fiscal years 2020-21 through 2024-25, and material weaknesses and significant deficiencies were identified in fiscal years 2020-21, 2021-22, and 2024-25. Issues identified included incorrect classification of land purchased for resale, timeliness issues with bank reconciliations, the number of correcting journal entries required to close the fiscal year and other year-end close deficiencies, and a significant prior period adjustment ($3.9 million) to reallocate investment interest income to the correct funds. In response to these findings, City management indicated these issues were predominantly the result of staff turnover and financial system conversions.

The next step was a series of interviews with staff in Finance and in the operating departments to assess policies, processes, procedures, documentation, and controls as it relates to the functional areas of:

- Procurement
- Credit cards
- Accounts payable
- Revenue management
- Cash handling
- Bank reconciliation
- Payroll administration
- Financial system access
- Budgetary appropriation control

After all interviews, including any necessary follow-ups, concluded, the overall risk assessment and framework were developed and summarized in the subsequent sections of this report.

Operational Summary and Areas of Identified Risk

Procurement

The procurement process begins with the requisitioning of goods and services, with the requirements for the appropriate competitive process based on dollar threshold of the purchase outlined in City Council Policy #CC-21-024. This policy aligns procurement procedures with Chapter 2.42 of the Menlo Park Municipal Code. It should be noted that the City Manager's Signature Authority (CMSA) is addressed in this policy; however, the value of the CMSA is updated annually via an addendum to the policy. Purchases above $2,000 require a purchase order, and these purchases are initiated by the department in the OpenGov system. Included in the requisition are all the pertinent details of the purchase request, including the information on the competitive process that was conducted (or if the department determined the procurement warranted a bid waiver). Requisitions are automatically routed for approval in OpenGov based on the amount of the purchase and assigned levels of signature authority. Staff in Finance review requisition information submitted for compliance with the policy and work directly with departments to address issues; however, it is ultimately up to the departments whether to submit a requisition for approval that is not aligned with the policy. During interviews with Finance staff and the individual departments, there was some lack of clarity regarding the policy itself and who is responsible for oversight and compliance.

With a decentralized procurement process that relies on the individual departments and Finance to monitor and manage policy compliance, the policy document, departmental procedures, Finance procedures, and system controls are all necessary components to mitigate risk. Overall, these functions are working well to mitigate risk related to fraud in the procurement process, with one exception. Best practice related to the purchase of goods is for the person ordering the goods to not be the same person receiving the goods. This separation of duties is a key fraud prevention mechanism to ensure goods ordered are properly received, necessary for the operation, and are available for utilization. For the most part during the departmental interviews, it was determined that the person buying goods is the same person receiving the goods. While the invoice is approved by someone else, that approver is not necessarily able to confirm all purchased goods were received and put into operation. In all cases, this procedure is the result of operational need and the relative size of that operation. For example, employees in specific assignments are procuring goods and materials specific to that assignment and are the only person able to verify the goods/materials received match the order in terms of price, quantity, and condition. If administratively feasible, assigning someone other than the buyer to receive the goods and confirm the contents of the order would provide better risk mitigation. If not, this risk should be identified as a part of ongoing training to ensure approvers are aware that this condition exists, emphasizing the need to be thorough in confirming price, quantity, and condition of goods and materials received.

<u>Procurement – Recommendations for the City's Consideration</u>

The City's procurement-related risks are more a function of compliance with Council Policy #CC-21-024. Interviews with the employees involved in this process indicate that they are aware of and are attempting to follow the policy. There are aspects of the policy, however, that could be refined to better clarify policy intent and facilitate more consistent policy compliance. It is important to note that these aspects of the policy as currently written do not represent material risk of fraud. DKG has previously reviewed this policy and made suggestions for staff consideration regarding potential revisions. These suggestions are currently under consideration. Upon completion of this update and approval by City Council, the City should provide training to all employees involved in the procurement process on the policy. The City should also establish centralized authority to manage and enforce policy compliance, including the review and consideration of approval for policy exception and waiver to bid requirements requests.

Credit Cards

City credit cards are administered centrally by Finance, and there are a number of controls in place to mitigate the risk of fraud or misuse. Cards are issued on an as-needed basis, with all departmental requests being approved by the department head prior to being submitted to the City Manager for approval. Prior to the card being issued to the employee, the employee is required to read the credit card policy and pass a test on its contents. All cards have set spending limits, both for single transactions and monthly totals, which can be adjusted as needed. For the most part, the single transaction limit is at or below the threshold for needing a purchase order. Credit card limits above the threshold still require a purchase order. The credit cards are also limited in the types of purchases that can be made with them, based on merchant codes, which also provides risk mitigation for improper purchases, and US Bank, the card issuer, has good fraud detection systems.

Credit Cards – Recommendations for the City's Consideration

The City's processes and procedures related to credit card usage and administration provide reasonable risk mitigation against fraud and misuse and support an efficient mechanism for small purchases. Given the overall performance of this program, there are only two modest recommendations for the City's consideration.

1. To the extent resources will allow, conduct a spend analysis on frequent credit card purchases to determine if alternative purchasing mechanisms would provide greater benefit to the City. For instance, establishing a Citywide blanket purchase order with a vendor(s) selected through a competitive process for high-volume goods and materials.
2. Continue to emphasize through regular training to credit card approvers the need to be vigilant with reviews and approvals of credit cards to ensure the City's funds are being spent appropriately and the City is getting the best value.

Accounts Payable

The City's accounts payable function (AP) is decentralized, with departments responsible for selecting vendors and securing vendor payment information (W-9 and ACH information), receiving goods and services, reviewing and confirming invoices, and creating a payment requisition. Finance reviews the payment requisition, confirms adequacy, and issues payments as appropriate. In Finance, there is one staff member responsible for interfacing with the departments on payment requisitions, confirming accuracy of these requisitions (including confirming the sales tax calculation, if applicable), confirming available funds in the purchase order, and transitioning the information from the Monday Board to the OpenGov financial system. At this point, this employee, a Senior Accounting Assistant, has confirmed the accuracy of the information and indicated that the invoice is ready for payment. Prior to the payment being initiated, however, the process then transitions to a Senior Accountant in Finance to review and approve all invoices, which effectively serves as a second confirmation on the appropriateness of the payment requisition. Once approved by the Senior Accountant, a batch approval is initiated in OpenGov, which creates a journal entry and corresponding report. This information is provided to another Accounting Assistant to review and create an upload file to the City's bank.

Accounts Payable – Recommendations for the City's Consideration

Overall, the systems, procedures, and processes within Finance and throughout the departments provide reasonable assurance that the City is accurately paying its vendors for goods and services received. Regardless, there are a few areas where the City has risks that should be considered for additional mitigation measures.

1. Vendor set up is accomplished by the same person that manages the actual disbursements. The controls issue with this is that one person has the ability to set up vendors and disburse funds, which creates increased risk for fraudulent vendors being set up and paid. There are, however, two controls in place to help mitigate this risk:
   a. The City has a low limit for purchases requiring a purchase order ($2,000), and a separate employee in Finance sets up purchase orders. Thus, issues with fraudulent invoices being created, submitted, and paid would be limited to under $2,000.
   b. Another Finance employee reviews and approves the payment requisitions submitted by the employee responsible for setting up vendors and disbursing payments. Fraudulent invoices would likely be caught during this review because there would be no supporting documentation.
2. The City's preferred method of paying vendors is via ACH, which is convenient, efficient, and cost effective. In recent years, however, fraudulent behavior related to vendor payments via ACH has increased significantly and has become more sophisticated. AP staff are aware that changes to vendor information require confirmation to avoid fraudulent requests; however, the process for verification is not documented, including roles and responsibilities. During interviews, Finance indicated that the departments are responsible for confirming vendor changes, and for the most part, the departments confirmed they are aware that this is their responsibility. The gap, however, is there is not a clear understanding of proper procedures and protocols for confirming changes to vendor information. As a part of this review, DKG was asked to develop a standard operating procedures document for vendor management. This document is included as Exhibit A.

Revenue Management

The core revenue management function is managed centrally within Finance and includes receiving, reconciling, and recording citywide revenues such as taxes. In some cases, like for business license taxes, a third-party collects (and bills, as appropriate) on behalf of the City. All revenues are reconciled to formal documentation, such as property tax remittances from the County, and recorded appropriately.

Departments that have revenue-generating operations have a role in revenue management. The four departments that bring in significant revenue outside of Finance are Community Development, Library and Community Services (LCS), Public Works, and Police. Police Department revenues are significantly lower than Community Development and LCS, and a large portion of Public Works revenues are handled by Community Development and LCS through their systems. For Community Development and LCS, service charge revenue is received through cash, check, and credit card and is managed at the department level through their respective operational software (Xplor Recreation for LCS and Accela for Community Development). In each case, revenues are recorded in these systems, with reports generated regularly and provided to Finance along with cash and checks received. Finance reconciles the cash, checks, and credit card information with the reports provided, and once any discrepancies are addressed, records the transaction in OpenGov.

Most of the service charge revenues generated are paid prior to the service being provided, ensuring that the City receives the revenue it is due. However, there are revenues from all areas of the operation that are not paid until after services are provided, and there are gaps that were identified in processes that create risk for services being provided that are not paid for by customers.

- In Community Development, Planning fees are initially deposit-based, and when the deposit funds are exhausted, staff time is charged hourly through Accela. Invoices are auto-generated quarterly and past due notices are sent after payments are 30 days delinquent. For planning applications that move forward to the permitting stage, unpaid charges must be resolved before permits are issued. The issue is with planning applications that do not move forward into permitting, as follow-up and tracking of unpaid planning fees is inconsistent.
- There are similar issues in the Police Department and Public Works, although the volume of post-service payment activity is limited. In these operations, there is no formal tracking mechanism for the outstanding payments, instead the individual program managers or supervisors are relied upon to ensure revenues due to the City are received.
- In Public Works, there is no formal policy or mechanism for water accounts that are past due. Currently, only inactive accounts are being sent to collections for payment.

<u>Revenue Management – Recommendations for the City's Consideration</u>
In all areas where the City provides service in advance of collecting fees, the City should develop policies and procedures to:

- Track revenues receivable, preferably through the OpenGov system;
- Establish roles and responsibilities related to follow-up communications/billing;
- Establish a timeline for escalation of follow-ups, including turning accounts over to collections agencies;
- Determine when bad debt to the City will be written off and disclosed.

<u>Cash Handling</u>
While the prevalence of non-cash payments has increased over the years, the City still takes cash for various services. Cash transactions increase the risk of mistakes or fraud, and therefore it is imperative that the City has appropriate systems, procedures, and processes in place to prevent cash-related fraud. Overall, the City has good systems in place to prevent cash-related fraud; however, there are a few controls gaps that should be addressed.

While most of the operations that take payments can take cash, the majority of cash transactions occur within the Library and Community Services operation, and this includes taking cash payments for water bills at certain LCS facilities. The Xplor Recreation system is where transactions are conducted, and this includes entering water payments received at recreation facilities into Xplor so that a deposit reconciliation can occur. Cash payments are deposited daily in a safe at the close of business, and only full-time employees have access to the safe. Cash counts and reconciliation of the safe contents to Xplor registration reports are done on a weekly basis, and a second count and reconciliation is done by another member of the department administration staff. There are limited circumstances when only one person is present when cash transactions are occurring, and the utilization of an electronic registration system is an effective tool to ensure all funds being received by the department are accounted for properly.

All cash (and checks) from operational activities comes into Finance on a weekly basis (more frequently if a department identifies a large transaction that needs immediate attention). Cash and checks are accompanied with a voucher/deposit slip that reconciles to the deposit amount; however, the reconciliation against system reports appears inconsistent and insufficient. A risk with cash transactions is that the cash is provided by the customer to the City, but the transaction is not recorded and the cash is retained by the employee conducting the transaction. Controls such as two or more people being present (and/or security cameras) and registration systems that produce automated transaction reports help to significantly mitigate this risk. For the latter, however, it is important that additional controls are in place, particularly when cash is transitioned within the City operation for processing and deposit.

The current transition consists of Recreation providing cash and checks, along with a summary voucher(s) that reconciles to the total deposit amount and the system-based transaction report, to Finance. One employee in Finance is responsible for reconciling the cash/checks against the voucher and preparing the journal entry, and another employee in Finance is responsible for reviewing and approving the journal entry. Because there can be multiple cash vouchers in a batch, it is important that reconciliations are checked at each transition, and that this reconciliation includes confirmation that all dates of operation are accounted for appropriately. For example, the transaction report from Xplor should be checked to confirm not only the amount of the cash voucher matches the report total, but that the report captures all dates of operation. Otherwise, a cash batch could be removed from the aggregate deposit and go undetected.

Cash Handling – Recommendations for the City's Consideration

Core cash handling processes within the City are solid and provide reasonable risk mitigation against fraudulent activity. The City should consider tightening reconciliation procedures to better ensure that all cash-based transactions are reflected in the general ledger and deposited into the City's bank account. Other minor recommendations for consideration include:

- Utilizing a more secure money storage mechanism for Community Development. Currently a small lockbox is used, and based on the amount of cash handled, this is relatively low risk. However, something more secure, such as a small safe or drop box, would be better.
- Utilizing a secure courier service to pick up deposits as opposed to having employees transport funds to City Hall and to the bank, which is a security risk. While this would be an increase in expenses, it would free up staff time for other priorities.

Bank Reconciliation

Bank reconciliation is a critical internal control mechanism, as timely and accurate bank reconciliation is an effective way to prevent and detect fraudulent activity. Bank reconciliation is a core function in Finance, with one employee responsible for management of the overall process and several other employees involved in a supporting role.

The City's bank reconciliations are completed monthly and are up to date with the most recent bank statements. The process includes reconciliation of all transactions against the bank statements, with the source of record for the transaction information being the system where the transaction is recorded. For instance, the UKG and CalPERS reports are utilized to reconcile payroll information against the bank statements. For cash vouchers and other revenue transactions, the bank statements are compared against system reports such as the ones from HdL (business license), Accela, and Xplor Recreation. Journal entries are created to book transaction details into the general ledger once the reconciliation to the banking information is confirmed.

The monthly bank reconciliation also serves to create and maintain a list of outstanding checks. Checks over six months are no longer payable, and the City is notified of this by its bank. There is an internal process within Finance to utilize this information to work with departments to determine if a check needs to be reissued.

Bank Reconciliation – Recommendations for the City's Consideration

The City's bank reconciliation processes are good, and there are no recommendations other than to continue to prioritize a timely bank reconciliation process as a key risk mitigation activity.

Payroll Administration

The City manages the payroll function internally and utilizes the UKG software for payroll and benefits administration. Payroll is processed on a bi-weekly basis. Roles and responsibilities within the payroll function are well defined, with the employees being responsible for directly entering their time into UKG and Finance serving in an oversight capacity reviewing, approving, and administering bi-weekly payroll.

With payroll constituting such a substantial portion of the City's General Fund budget, ensuring the integrity of the payroll process through strong internal controls is imperative. The following are some of the key internal controls required for a best practice-based payroll process, as well as an assessment of the City's level of compliance.

1. Separation of Duties: To ensure the integrity of the process, it is important that duties are structured such that the person who is responsible for processing payroll is also not the person responsible for the entry of pay and benefits information into system. The City has the appropriate separation of duties in place, as Human Resources staff are responsible for direct data entry into the system, with Finance staff making limited changes that are documented and subject to review and approval. It should be noted that many pay and benefits functions in UKG are self-serve, with employees making benefits elections and changes as needed and HR and Finance employees reviewing and approving. While the operational separation of duties within the payroll and benefits administration function appears adequate, there are system functionality and access concerns that are discussed in more detail later in this section where adjustments are recommended.
2. Timecard Review and Approval: Payroll accuracy relies on supervisors reviewing timecards for accuracy and compliance with City and departmental policy. If reviews and approvals are cursory in nature, other payroll-related controls become less effective. UKG automatically routes timecards that have been entered directly by the employees to their supervisors for review and approval. However, if a supervisor does not approve the timecard in advance of the payroll process closing, Finance is able to process the payroll and include the timecards that have not been approved. While Finance attempts to secure approval on all timecards prior to payroll processing by following up as necessary with supervisors, it does not always happen.

3. Oversight and Approval of Changes: The separation of duties is only effective if there is oversight and approval of changes that are made. Otherwise, one person could have the opportunity to make changes to employee pay and benefits without proper authorization. The City has best practice approvals in place for payroll-related changes, which are supported by UKG system functionality. Changes that require approvals such as step increases and specialty pays go through an automated Personnel Action Form (PAF) workflow in UKG, with changes affecting pay being approved by the City Manager. The HR and Finance teams involved in this process also meet each payroll cycle to review changes that have been submitted to ensure everything is in order. Any notes or other information regarding changes that have been submitted via a PAF in UKG are kept in a OneNote file that all team members are able to access. One area of risk/vulnerability with respect to oversight and approvals relates to the system functionality for pay increases, as the pay rate is entered manually as opposed to an employee job code being tied to a salary table. While there are a total of three reviews of a pay rate change that is submitted, having the rate manually entered increases the risk of a mistake being made, with small errors in pay rates less likely to be caught and corrected prior to being processed.
4. Overtime: Overtime is utilized throughout all functions of the City for a variety of operational reasons. Internal controls related to overtime focus on ensuring the operational need for overtime, that overtime has been appropriately approved, and that overtime hours submitted for payment have been reviewed and verified. The general terms and conditions related to overtime are covered in the various memoranda of understanding with the associations, including the approval mechanism for overtime. The Police Department also has two administrative policies related to overtime to further clarify procedures and responsibilities. Interviews with the departments indicated that overtime was being managed appropriately, with operational need, approvals, and post-overtime verification of time being confirmed.
5. System Functionality and Access: UKG's functionality prioritizes ease of use, flexibility, and overall efficiency. While these functional benefits are important and allow for a more automated and customer-friendly payroll experience, there are some features of UKG's functionality that create risk for the City that requires mitigation measures. Areas of identified risk include:
    a. While user security profiles are good in terms of providing the access that is needed for the employees to conduct self-service pay and benefits administration, the access for the HR and Finance users may be too broad. For instance, there are five people in the 'HR Admin' security group, and these people have the ability to make any changes to employee profiles, including pay rates. While the Finance employees involved in payroll cannot make changes to pay rates, they are able to do things like adjust leave accruals.
    b. Users with certain access rights can make adjustments to their own records, with two instances noted during interviews (vacation cashout and open enrollment).
    c. As noted previously, pay rates are changed manually, with the new rate being entered as opposed to being tied to a system table and automatically updated, increasing the risk of error.
    d. Also as noted previously, payroll can be processed without supervisor approval being secured for all employee timecards.
6. Post-Payroll Processing Review: Prior to payroll closing, a Finance employee does a final check of payroll through a standard report in UKG that provides a comparison by pay and deduction code between the current payroll and the prior payroll. This is a dynamic report that allows the user to drill-down on specific pay and deduction codes to research significant variances. This review, along with all of the pre-processing reviews conducted, contributes to ensuring an accurate payroll cycle.

One payroll is processed, a Senior Accountant assigned to month-end close activities takes on pay and benefits reconciliation duties to ensure all the financial components of payroll and benefits administration, including CalPERS reporting, wage garnishments, association dues, and deferred compensation, are appropriately reflected on the City's general ledger. This also serves as an important separation of duties function, with a person completely outside of payroll processing reviewing the final product.

Payroll Administration – Recommendations for the City's Consideration:

1. Determine if the UKG system can be configured to address some of the access issues previously identified, including:
    a. Limiting access to make changes to pay rates, accruals, and other benefits elections to only those who need to make those changes. This includes eliminating access for Finance employees to make changes.
    b. Requiring department-level approval within UKG of all timecards prior to payroll being processed. If it is operationally infeasible to ensure this is accomplished by the direct supervisors, departments could utilize a central administrative person as a secondary approver.
    c. Prohibiting any HR or Finance employee with access to make changes to pay rates, accruals, and other benefits elections from making changes to their own files.
    d. Using salary tables that are linked to job codes and steps to administer changes in pay as opposed to managers entering in the information manually.
    e. Developing a custom report that pulls employees who have a 10% or greater variance in pay between the current pay period and the last pay period, with a Finance manager assigned to review that report and follow up as needed.
2. Assign a Finance manager to review the bi-weekly pay detail for all the Finance and Human Resources employees involved in the payroll and benefits administration process.
3. Each department should have policies and procedures related to overtime that are operationally feasible and allow for appropriate oversight and approvals. The Police Department's policies could be used as a template for the development of these policies.
4. Expectations of supervisors related to the approval of payroll, including overtime, should be emphasized as a part of regular training. Payroll accuracy relies on supervisors reviewing timecards for accuracy and alignment with department policy.

Financial System Access

Access to the OpenGov financial system is managed centrally within the Information Technology (IT) Department. OpenGov access is based on various functional modules, and within those modules there are different tiers of access rights (inquiry only, user, lead, superuser, and administrator). Requests for access to OpenGov are made directly by the department, and there is no documented standard for user access. The departments will typically request access for new users based on existing users with similar usage patterns, and the IT administrator will also work with the departments to assign users to the appropriate level of access. Once these security access rights are granted, specific administrative settings will be configured that effectively serve to limit access to departmental tasks. For instance, in the Purchase Order module, the user is set up into a specific group such as a submitter or approver within a department. This ties their access to department-specific functions and limits their access to unrelated functions.

While Finance is one of the primary users of OpenGov and needs greater access than many other users, there are instances where certain functionality is open to more users than is necessary. For example, journal entries can be posted by anyone in the department, and while there is a procedural restriction on staff posting and approving the same entry, there is no system restriction.

Financial System Access – Recommendations for the City's Consideration

The City's oversight and management of access to OpenGov is good; however, an audit of access rights to ensure consistency across positions and that rights granted are appropriate based on job responsibilities should be considered as a priority. Documenting standard access profiles by job function should be included as a part of this initiative. This may require enhanced system configuration to restrict access or ability to conduct certain transactions.

Access to other finance-related systems (i.e. Xplor Recreation and Accela) and accounts (such as the City's bank account(s)) should also be reviewed, with access rights adjusted appropriately to ensure access rights align with business need. Similar to OpenGov and UKG, this may require enhanced system configuration. System access should also be monitored on a regular basis to maintain alignment between user access and business need.

Budgetary Appropriation Control

The City's municipal code section 2.08.080(8) establishes that it is the responsibility of the City Manager "to prepare and submit to the City Council the annual budget." Pursuant to budget policies outlined in the budget document, the City Manager "is authorized to transfer budgetary amounts within a single fund; however, any revisions altering the total expenditures of any fund must be approved by the City Council. Appropriations, which become effective July 1, lapse at the end of the fiscal year, with the exception of appropriations for capital improvement projects and multi-year studies." In addition to outlining this policy within the "Budget Policies and Practices" section of the budget document, the annual budget resolution contains language regarding the City Manager's authority related to appropriations control. For the fiscal year 2025-26 budget, this additional language authorized the City Manager or designee "to transfer budget appropriations within funds and between departments, projects, and/or accounts including between personnel and operating expenditures within a single fund to accomplish the purposes as set forth in the budget document to ensure the efficient and effective administration of City services." Overall, the City's policies and practices related to appropriations control are clear and well documented, with the information provided in the annual budget resolution providing additional clarity and flexibility that can be adjusted year-over-year as fiscal conditions warrant.

Ongoing monitoring of budget appropriations is primarily the responsibility of the departments; however, Finance supports these efforts by providing regular financial reports to the departments, as well as providing oversight and monitoring of the overall budget. Operating and capital budgets are monitored throughout the year, with the City utilizing the mid-year budget review process to request Council approval of adjustments to appropriations that increase the total fund appropriation. Subsequent appropriation requests are made as necessary after the mid-year process.

Budgetary Appropriation Control – Recommendations for the City's Consideration

Despite practical policies and processes related to budgetary appropriations controls, the City has reported expenditures exceeding appropriations for its General Fund in the last three fiscal years' Annual Comprehensive Financial Reports. For 2024-25, the amount of expenditures exceeding appropriations for the General Fund was $4.3 million, with no explanation as to the reason. A review of the financials indicated a significant spending overage in general government activities; however, there was no explanation as to why. Going forward, should the City's General Fund expenditures exceed final Council-approved budgetary appropriations, an explanation of that overage should be provided along with the notes disclosure about the overage.

Enterprise Risk Assessment Framework

In addition to addressing the above recommendations, as well as to be compliant with the recommendations of the Grand Jury report, the City should implement a risk assessment framework that ensures consistent management, monitoring, and reporting of internal controls. A proposed framework follows that aligns with the principles of the Green Book, which is the standard for internal controls in the Federal Government, as issued by the General Accounting Office. These principles identify five components of an effective internal control system, which are the basis for the proposed framework.

1. Control Environment – This component considers the commitment of the organization to integrity and ethical values, which is established by management and effectuated throughout the organization. To maintain the strong existing controls environment, the City should consider the following:
    a. Develop and implement mandatory training as a part of the new-hire training process that reviews the internal controls framework and educates on key internal control practices within the City (as identified throughout this report). For administrative efficiency, this training could be a narrated PowerPoint that employees take at their convenience within a certain time from being hired.
    b. Add a component to the objectives identified in the employee performance review that encompasses performance against internal controls responsibilities. This does not need to be a separate component of the review and can instead be one component of overall performance standards.
2. Risk Assessment – This component ensures that management effectively identifies and analyzes risk, determines its level of risk tolerance, and mitigates identified risk accordingly. Based on the City's existing controls environment and the risks identified from this analysis, the City should consider the following:
    a. Document its response, and actions as appropriate, to the areas of risk identified as a part of this analysis.
    b. Create an annual assessment of areas of risk that focuses on:
        i. Any changes to processes, procedures, or policies that impact existing areas where controls are in place.
        ii. Any new processes, procedures, or policies that introduce new areas of risk.
        iii. Any changes to key personnel involved in internal controls that require process changes or training.
3. Control Activities – This component focuses on the activities the entity puts in place to mitigate risk as identified in the risk assessment. The City already has established control activities, so moving

forward, the focus for new control activities would be a function of any new controls put in place as a result of this assessment or through the annual risk assessment.

4. Information and Communication – This component emphasizes the need for quality information to achieve the entity's objectives and the need to communicate that information internally and externally. The City's existing information systems support a robust internal controls environment, particularly as the recommendations from this report are implemented. Going forward, the City should consider:
    a. Incorporating a summary of its annual risk assessment and any resulting changes to control activities in its report to Council where the Annual Comprehensive Financial Report is shared.
5. Monitoring – This component focuses on ensuring internal controls systems are monitored, evaluated, and remediated, as needed, on a timely basis. Implementing the considerations identified in the prior components will effectively address the monitoring component.

Exhibit A – Vendor Management Standard Operating Procedures

Purpose and Objective

The disbursement of City funds through the Accounts Payable function is subject to significant risk due to the increasing prevalence of fraudulent activity, particularly by individuals and organizations posing as existing City vendors and suppliers. To support timely and accurate payment to vendors for goods and services provided to the City, as well as to mitigate against the risk of making payments based on fraudulent information, the following vendor management procedures shall be followed.

Responsibilities

The responsibility for vendor initiation and management is shared between the departments purchasing the goods and services and Finance, which is responsible for the disbursement of funds. The operating departments are responsible for day-to-day vendor management, including gathering the appropriate vendor information upon initiation of a purchase order or contract. This includes the vendor's contact information, W-9 tax form, and Automated Clearing House (ACH) documentation to allow for electronic payment to vendors. Finance serves in an oversight capacity, ensuring the information provided is accurate and complete. They also serve as subject matter experts on evolving best practices related to vendor management and can consult with departments when questions or uncertainties arise.

Initial Vendor Set-Up

When the City initiates the purchase of goods and/or services with a new vendor, the department procuring the goods and/or services needs to collect the following information:

1. A completed vendor contact information form. This form includes contact information for two of the vendor's employees. One of these employees should be a person responsible for billing the City, and the other should be the main person responsible for the fulfillment of the order (goods and materials) or provision of the services. For small businesses, the second contact can be the Chief Financial Officer, Chief Operating Officer, or Chief Executive Officer/Owner. For sole proprietors, the business owner will be the sole contact but will need to acknowledge that there are no additional employees that can be listed as authorized contacts.
    a. To the extent possible, phone numbers provided should be office phone numbers that are available for verification on the vendor's website.
2. A completed W-9 tax form that includes the vendor contact information and the vendor's tax identification number. The vendor cannot be set up without a completed W-9 tax form, as the City must report the payments it makes to each vendor to the Internal Revenue Service.
3. A completed ACH authorization form, which authorizes the City to make payments directly to the vendor's bank account. This form captures required banking information from the vendor, including a 9-digit routing number and a bank account number.

Changes to Vendor Information

Changes to vendor information need to be considered carefully to ensure they are legitimate requests. When a change is requested, the following procedures shall be followed based on the type of request.

<u>Changes to Vendor Contact Information</u>

- Changes to vendor contacts, address, email, or phone number are to be confirmed by phone with at least one of the two contacts listed in the original vendor information file.
    - If the request is made by a person who is an existing listed contact, that request should be confirmed with the other person listed as the contact.
    - If the request is made by a person who is not an existing listed contact, that request should be confirmed with either of the existing listed contacts, with a call to both existing contacts being preferred.
    - If the vendor contact list is outdated such that neither contact is employed with the vendor or is no longer in an applicable role, the change should be confirmed with the officer of the vendor that is listed on the contract with the City. If this is the case, a new vendor information form should be submitted to the City.

<u>Changes to Vendor ACH Information</u>

- Changes to vendor ACH information should be confirmed by phone with at least one of the two existing contacts **AND** with the officer of the vendor that is listed on the contract with the City.
- If there are timing issues with the verification or there is any degree of uncertainty about the validity of the request, elevate the issue to Finance for resolution. If warranted, the vendor payment will be temporarily shifted to paper checks until proper verification is secured.

<u>Warning Signs of Potentially Fraudulent Activity</u>

As noted previously, the occurrence of fraudulent behavior in the vendor management process has become more common and more sophisticated. Requested changes to vendor information should be considered carefully prior to being made. Some of the common situations that may identify requests that may be illegitimate are as follows but should not be considered an exclusive list.

- Requests for changes via email, even if the email is a known email address. The ability to mimic a legitimate email address has become more prevalent, and while known vendor contacts are likely to initiate a change via email, it is imperative that procedures for verification are followed.
- Requests for changes to contact information that are not made by contacts on file. While this can happen when personnel turn over at a vendor, it is important that procedures outlined in this policy are followed to ensure the changes are intended by the vendor.
- Requests for changes to contact information that amend addresses or phone numbers, particularly those that change contact information from local addresses and phone numbers to non-local addresses and phone numbers. Reviewing information available on the vendor's website is a good check on the appropriateness of addresses, emails, and phone numbers being requested for change.
- Requests for changes that are dated more than 30 days ago, which may be a sign of a compromised vendor information form.

<u>Limitations and Exceptions</u>

This procedures document is intended to cover most scenarios that arise related to vendor management; however, they cannot cover every conceivable situation. Larger companies that serve the City may have billing departments as opposed to individuals responsible for invoicing the City. Smaller businesses may have fewer options for providing two contacts. Situations will arise with vendor management and vendor information change requests that are not contemplated in this standard operating procedures document. In those cases, judgment will need to be applied to that situation, with the ultimate objective being the protection of City resources against fraudulent activity. When these scenarios arise, Finance should be contacted to provide guidance, and exceptions to this procedure can be approved by the Administrative Services Director or his/her designee.