City of Garland, Texas

Report to Management
Year Ended September 30, 2013

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March 24, 2014

Honorable Mayor and Members of the City Council
City of Garland, Texas

Dear Honorable Mayor and Members of the City Council:

In planning and performing our audit of the financial statements of the City of Garland, Texas (the "City") as of and for the year ended September 30, 2013, on which we have issued our report dated March 24, 2014, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, in connection with our audit, we have identified, and included in the attached Appendix I, certain matters involving the City's internal control over financial reporting that we consider to be significant deficiencies under standards established by the American Institute of Certified Public Accountants.

The definitions of a deficiency, a material weakness, and a significant deficiency are also set forth in the attached Appendix I.

Although we have included management's written response to our comments in the attached Appendix I, such responses have not been subjected to the auditing procedures applied in our audit and, accordingly, we do not express an opinion or provide any form of assurance on the appropriateness of the responses or the effectiveness of any corrective actions described therein.

A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with this report.

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

Yours truly,

Deloitte & Touche LLP

SECTION I — SIGNIFICANT DEFICIENCIES

We consider the following deficiencies in the City's internal control over financial reporting to be significant deficiencies as of September 30, 2013:

Capital Assets Accounting and Reporting

Criteria — Proper accounting and reporting for capital assets is crucial for reliable financial reporting.

Condition and Context — A number of errors were noted in the capital assets balances that required adjustments. These errors included:

- Failure to properly evaluate an asset that was not in use for impairment in accordance with the Governmental Accounting Standards Board (GASB) Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries;*
- Failure to transfer completed assets from construction in progress in a timely manner; and
- Improperly calculating capitalized interest on bond-funded projects in the water fund.

Effect — The lack of a timely, detailed ongoing reconciliation process for capital assets, the ineffective communication of relevant capital assets data among City departments, and the absence of regular review procedures for capital assets accounting and reporting increases the risk of erroneous financial reporting.

Cause — These errors resulted from a lack of a detailed review of year end construction in progress balances to determine whether projects were completed and weaknesses in communication among City departments with regards to capital asset transactions.

Recommendation — Implement policies and procedures that require the timely reconciliation and review of capital asset information. These procedures should include:

- Developing, performing, and documenting procedures for evaluation of capital assets for impairment on annual basis;
- Tracking the status of completion of construction in progress and transferring completed projects to the proper asset category on a timely basis;
- Reviewing the City's methodology for capitalizing interest on construction in proprietary funds and determining the appropriateness of the calculation; and
- Identifying the financial statement reporting requirements of capital assets are communicated and understood and ensuring that staff have the proper training and knowledge of the related GASB reporting requirements.

Views of Responsible Officials — Policies and procedures that require timely reconciliation and review of capital asset information will be implemented during the completion of the 2014 Fiscal year.

Control Environment

Criteria — The City's internal control environment should be supported by effective policies and procedures for each of its key business processes including periodic risk assessments to identify risks of fraud, periodic review of the appropriateness of individuals' access to databases, and appropriate policies regarding employee performance evaluations.

Condition and Context — While the City has standard operating policies and procedures for many of its processes, we noted a number of issues that are summarized below that collectively increase the risk of fraud, waste, and abuse for the City:

- While the City has established an internal audit department and an Audit Committee in recognition of the importance of maintaining fraud prevention and detection programs, the City has not performed a formal, comprehensive update of its risk assessment documents or process, engaging the various stakeholders, including upper management and the audit committee.

- During our test of general information technology (IT) controls over the City's financial systems, we noted 6 users (out of 49 database administrator accounts) in the City's accounts with administrative access to the Oracle database supporting Banner that was not necessary for their job function.

- Personnel interviewed throughout our audit indicated they have not been evaluated in their job performance in the past three years.

Effect — A control environment that is not supported by thoroughly documented and consistently enforced policies and procedures exposes the City to the potential for fraud, waste, and abuse and increases the risk that errors and irregularities occur and do not get detected on a timely basis by employees in their normal course of business.

Cause — Procedures have not been put in place that require 1) that the periodic update of the fraud risk assessment, 2) the periodic review of who has access to databases and 3) annual performance of employee evaluations.

Recommendation — The City should consider the following strategies:

- The timely performance of a Citywide risk management analysis under the direction of the Audit Committee to identify vulnerabilities to significant fraud, operational and financial risks. A review and approval by the Audit Committee, on an annual basis, of the City's documented risk assessment should be incorporated into the process. A comprehensive risk assessment process should include meeting with upper management and the Audit Committee to discuss changes in operations, regulations, and financial transactions.
- A system to routinely evaluate and monitor the design and operating effectiveness of information technology controls including the review of access controls.
- The performance of annual employee evaluations to identify and communicate areas of improvement, as well as provide recognition to high performers. This provides the employee and supervisor an overview of the prior year results as well as future goals and expectations concerning the employee's performance.

View of Responsible Officials

1. Staff will implement a citywide risk management analysis into the 2014 audit plan that is presented and approved by the Audit Committee.

2. IT staff will review administrator accounts on by August 31, 2014 to assure that users are granted the appropriate level of security. Security for the accounts with administrative access has been changed to match the level of database access necessary to perform their job duties.

3. A new employee evaluation process has been implemented and the employee review process will be completed March 31, 2014.

Financial Closing and Reporting

Criteria — Financial Statements for the City are required to be prepared in accordance with generally accepted accounting principles.

Condition and Context — Several errors were noted during the audit that resulted in significant adjustments to the current year financial statements. During the audit process, we noted weaknesses in the general condition of the accounting records relating to many areas, including the following:

- Proceeds from the issuance of debt was not recorded in the proper fund
- A number of fund level accounting transactions were recorded as part of the year end closing adjustments, rather than recorded at the time the transaction occurred
- City Council approved a transfer to be made from the Electric Fund to the Garland Foundation, however the journal entry to make the transfer was recorded in the Capital Projects Fund
- Certain transactions were recorded as current assets or liabilities when they should have been recorded as noncurrent
- Allowances for certain uncollectible receivables were not been reevaluated based on actual collection rates
- Net position categories were misclassified (restricted/unrestricted) based on incorrect calculations
- Unavailable franchise fees were improperly recognized as revenue

Effect — All of the above resulted in adjustments (recorded or passed) to the City's financial statements. These also resulted in more complicated processes in closing the books and delays in preparing final financial statements. Errors with income statement impact (revenues and expenses) may ultimately affect the City's ongoing monitoring of budget to actual and operating analysis. We noted that a number of the adjustments identified had potential budgetary impacts to the City.

Cause — Lack of critical review of transactions to determine proper treatment in accordance with generally accepted accounting principles.

Recommendation — Evaluate current reporting responsibilities and review processes and procedures to ensure that the most effective and efficient transaction flows and approvals are in place to strengthen internal controls and reliability of the financial information. Require the recording and review of all fund level entries during the year to minimize the volume of entries required to be made and reviewed at year-end closing. Implement procedures that require additional review of non-routine transactions into which the City enters to ensure proper accounting and reporting.

View of Responsible Officials — Fiscal year end processes will be reviewed and changes will be implemented to minimize the number of adjustments made during the 2014 year end process.

SECTION II — DEFINITIONS

The definitions of a deficiency, a material weakness, and a significant deficiency are as follows:

A *deficiency* in internal control over financial reporting 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 deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when (a) a properly designed control does not operate as designed, or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

A *material weakness* is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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APPENDIX II

MANAGEMENT'S RESPONSIBILITY FOR, AND THE OBJECTIVES AND LIMITATIONS OF, INTERNAL CONTROL OVER FINANCIAL REPORTING

The following comments concerning management's responsibility for internal control over financial reporting and the objectives and inherent limitations of internal control over financial reporting are adapted from auditing standards generally accepted in the United States of America.

Management's Responsibility

The City's management is responsible for the overall accuracy of the financial statements and their conformity with generally accepted accounting principles. In this regard, management is also responsible for establishing and maintaining effective internal control over financial reporting.

Objectives of Internal Control over Financial Reporting

Internal control over financial reporting is a process effected by those charged with governance, management, and other personnel and designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition may include controls related to financial reporting and operations objectives. Generally, controls that are relevant to an audit of financial statements are those that pertain to the entity's objective of reliable financial reporting (i.e., the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles).

Inherent Limitations of Internal Control over Financial Reporting

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected and corrected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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