

Single Audit Report
City of Hawthorne, California
Year ended June 30, 2011
with Report of Independent Auditors

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**Report of Independent Auditors 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***

**The Honorable Mayor and Members of City Council
City of Hawthorne**

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Hawthorne, California, as of and for the year ended June 30, 2011, and have issued our report thereon dated March 30, 2012. Our report on the basic financial statements of the City of Hawthorne, California was qualified because we were unable satisfy ourselves as to the balance of notes and loans receivable by performing other auditing procedures. Except as discussed in the preceding sentence, we conducted our audit in accordance with 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.

Internal Control Over Financial Reporting

Management of the City of Hawthorne is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the City of Hawthorne's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City of Hawthorne's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City of Hawthorne'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, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

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 as items FS2011-01 to FS2011-06, in combination, to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Hawthorne's financial statements are free of 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 an instance of noncompliance, described as Finding FS 2011-07 in the accompanying schedule of findings and questioned costs that is required to be reported under *Government Auditing Standards*.

We noted certain other matters that we reported to management of the City of Hawthorne in a separate letter dated March 30, 2012.

The City of Hawthorne's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the City of Hawthorne's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the City Council, management, federal and state awarding agencies, and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties.

Vargus + Company LLP

Los Angeles, California
March 30, 2012

Report of Independent Auditors on Compliance with Requirements that Could Have a Direct and Material Effect on Each Major Program and on Internal Control over Compliance, and on the Schedule of Expenditures of Federal Awards, in Accordance with OMB Circular A-133

**The Honorable Mayor and Members of City Council
City of Hawthorne**

Compliance

We have audited the compliance of the City of Hawthorne, California 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 June 30, 2011. The City of Hawthorne's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the City of Hawthorne's management. Our responsibility is to express an opinion on the City of Hawthorne's compliance based on our audit.

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 of Hawthorne'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. Our audit does not provide a legal determination of the City of Hawthorne's compliance with those requirements.

In our opinion, the City of Hawthorne complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2011. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as Finding F2011-01 and F2011-02.

Internal Control Over Compliance

The management of the City of Hawthorne is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the City of Hawthorne's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance 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 of Hawthorne'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.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies. We consider the deficiency described in the accompanying schedule of findings and questioned costs as item F2011-01 to be a significant deficiency. 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.

City of Hawthorne's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the City of Hawthorne's responses and, accordingly, we express no opinion on the responses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Hawthorne as of and for the year ended June 30, 2011, and have issued our report thereon dated March 30, 2012, which contained a qualified opinion on those financial statements. Our opinion on the basic financial statements of the City of Hawthorne was qualified because we were unable satisfy ourselves as to the balance of notes and loans receivable by performing other auditing procedures. Our audit was performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis in accordance with OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements. In our opinion, except for the effect on the accompanying schedule of expenditures of federal awards, of adjustments, if any, as might have been determined to be necessary to correct the balance of loans and notes receivables and record adequate allowance for doubtful accounts, the accompanying information is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

This report is intended solely for the information and use of the City Council, management, federal and state awarding agencies, and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties.

Varguez + Company LLP

**Los Angeles, California
March 30, 2012**

City of Hawthorne
Schedule of Expenditures of Federal Awards
Year ended June 30, 2011

Federal Grantor/Pass-Through Grantor/Program Title	Catalog of Federal Domestic Assistance Number	Program Identification Number	Federal Expenditures
<u>U.S. Department of Housing and Urban Development</u>			
Direct Assistance:			
Community Development Block Grant	14.218	B-09-MC-06-0519	\$ 1,161,950
Section 108 Guaranteed Loan	14.248	Various	771,936
Home Investment Partnership Program (HOME)	14.239	M-09-MC-06-0513	530,166
Homeless Prevention Rapid Re-Housing Program - ARRA	14.257	S-09-MY-06-0519	127,309
Housing Assistance Payment Program Section 8	14.871	HAPP Various	6,418,331
Passed through the County of Los Angeles and Other Cities:			
Housing Assistance Payment Program Section 8	14.871	Various	4,804,349
Total U.S. Department of Housing and Urban Development			13,814,041
<u>U.S. Department of Justice</u>			
Direct Assistance:			
Federal Asset Forfeiture Program	16.000	CA0192800	392,914
Juvenile Justice and Delinquency Prevention:			
Bridge to Work Title II	16.540	CSA 352-07	3,020
CalGRIP	16.540	GR 10026850	36,680
Bureau of Justice Assistance:			
Edward Byrne Justice Assistance Grant Program	16.738	2008-DJ-BX-0491	3,718
	16.738	2009-DJ-BX-0471	24,867
	16.738	2010-BJ-DX-1543	39,857
Edward Byrne Justice Assistance Grant Program - ARRA	16.804	2009-SB-B9-2024	32,236
Total U.S. Department of Justice			533,292
<u>U.S. Department of Labor</u>			
Direct Assistance:			
Bridge to Work Earmarked Grant	17.261	EA185900960A6	118,530
Bridge to Work - Science, Technology, Engineering and Mathematics (STEM)	17.261	EA202561060A	94,944
Workforce Investment Act Cluster:			
County of Los Angeles One-Stops	17.260	10-W08	35,588
CTR LA CO	17.260	IT091001	75,000
Passed through the City of Pasadena:			
Foothill Employment and Training Connection (ETC)	17.260	20448	374,035
Passed through the State of California:			
Office of Employment Development Department			
Workforce Investment Act	17.258	K074167	1,460,926
	17.259	K178686	1,098,832
	17.260/17.278	R970563	1,373,476
Workforce Investment Act Cluster - ARRA	17.258/17.259/17.260	R970563	979,741
		K074481	98,006
		K074167	574,253
		K077165	237,137
Total U.S. Department of Labor			6,520,468

See accompanying notes to Schedule of Expenditures of Federal Awards.

City of Hawthorne
Schedule of Expenditures of Federal Awards
Year ended June 30, 2011

<u>Federal Grantor/Pass-Through Grantor/Program Title</u>	<u>Catalog of Federal Domestic Assistance Number</u>	<u>Program Identification Number</u>	<u>Federal Expenditures</u>
<u>U.S. Department of Transportation</u>			
Passed through the State of California Department of Transportation:			
Highway Planning and Construction	20.205	STPL-5253(013)	5,213,849
Passed through the State of California Office of Traffic Safety:			
Sobriety Checkpoint Program	20.600	SC10171	59,251
Seat Belt Compliance Program	20.600	CT09171	2,079
Selective Traffic Enforcement Program	20.600	PT1030	2,711
Total U.S. Department of Transportation			<u>5,277,890</u>
<u>U.S. Department of Energy</u>			
Direct Assistance:			
Energy Efficiency & Conservation Block Grant - ARRA	81.128	DE-SC0002108	<u>431,572</u>
<u>U.S. Department of Education</u>			
Passed through the State of California Department of Education:			
21st Century Community Centers Learning Grant	84.287	19-14535-2377-4A	<u>243,546</u>
<u>U.S. Department of Health and Human Services</u>			
Passed Through County of Los Angeles:			
LA County Single Allocation	93.558	COH07001	14,274,758
Emergency Contingency Fund for Temporary Assistance for Needy Families State Program - ARRA	93.710/93.714	COH07001	63,516,982
Total U.S. Department of Health and Human Services			<u>77,791,740</u>
Total expenditures of federal awards			<u>\$ 104,612,549</u>

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES APPLICABLE TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Scope of Presentation

The accompanying schedule presents only the expenditures incurred by the City of Hawthorne (City) that are reimbursable under programs of federal and selected state agencies providing financial awards. For the purposes of this schedule, financial awards include federal awards received directly from a federal agency and federal funds received indirectly by the City from a nonfederal agency or other organization. Only the portion of program expenditures reimbursable with such federal and selected state and local funds is reported in the accompanying schedule. Program expenditures in excess of the maximum reimbursement authorized or the portion of the program expenditures that were funded with other state, local or other nonfederal funds are excluded from the accompanying schedule.

Basis of Accounting

The expenditures included in the accompanying schedule were reported on the modified accrual basis of accounting. Under the modified accrual basis of accounting, expenditures are incurred when the City becomes obligated for payment as a result of the receipt of the related goods and services. Expenditures reported included any property or equipment acquisitions incurred under the federal program.

NOTE 2 RELATIONSHIP TO FEDERAL FINANCIAL REPORTS

Grant expenditure reports as of June 30, 2011, which have been submitted to grantor agencies, will, in some cases, differ from amounts disclosed herein. The reports for grantor agencies are typically prepared at a later date and often reflect refined estimates of the year-end accruals.

NOTE 3 RELATIONSHIP TO FINANCIAL STATEMENTS

In accordance with the governmental Accounting Standards Board's Statement No. 39 "Determining Whether Certain Organizations are Component Units – an Amendment of GASB Statement No. 14," activities relating to all federal financial assistance programs are blended in the City's financial statements as special revenue funds.

NOTE 4 MAJOR PROGRAMS

The following Catalog of Federal Domestic Assistance (CFDA) programs were tested as major programs:

Workforce Investment Act Cluster	CFDA #17.258-17.260
Workforce Investment Act Cluster - ARRA	CFDA #17.258-17.260
Emergency Contingency Fund for Temporary Assistance for Needy Families State Program – ARRA	CFDA # 93.710/93.714
Temporary Assistance for Needy Families - LA County Single Allocation	CFDA # 93.558
Energy Efficiency and Conservation Block Grant - ARRA	CFDA #81.128

NOTE 5 PAYMENTS TO SUBRECIPIENTS

There were subrecipient grants awarded from U.S. Department of Housing and Urban Development, Community Development Block Grant - Entitlement Grant. These subrecipient grants totaled \$457,950.

Section I – Summary of Auditors’ Results

Financial Statements

Type of auditors’ report issued on the financial statements: Qualified

Internal control over financial reporting:

- Material weakness(es) identified: Yes
- Significant deficiency(ies) identified that are not considered to be material weaknesses? No

Noncompliance material to the financial statements noted: No

Federal Awards

Internal control over its major programs:

- Material weakness(es) identified: No
- Significant deficiency(ies) identified that are not considered to be material weaknesses? Yes

Type of auditors’ report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in accordance with Section .510(a) of OMB Circular A-133? Yes – F2011-01 and F2011-02

Identification of Major Programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
17.258 -17.260	Workforce Investment Act Cluster
17.258 -17.260	Workforce Investment Act Cluster- ARRA
93.710 – 93.714	Emergency Contingency Fund for Temporary Assistance for Needy Families State Program – ARRA
93.558	Temporary Assistance for Needy Families – LA County Single Allocation
81.128	Energy Efficiency and Conservation Block Grant - ARRA

Dollar threshold used to distinguish between Type A and Type B programs: \$3,000,000

Auditee qualified as a low-risk auditee: No

Section II – Financial Statement Findings

FS 2011-01: Year-end Closing Process

Condition and Context

This year's closing process was delayed because some important procedures were not performed on time. These include:

- Reconciliation of major balance sheet accounts. Notes and loans receivable were not updated and reconciled with the general ledger in a timely manner.
- Grants receivable, deferred revenues, interfund balances and transfers were also not reconciled.
- Cut off procedures. Cut off procedures relating to year-end accruals were inadequate to ensure the recording of transactions in the proper period.

Cause and Effect

During the prior years, there was major personnel turnover in the City including the resignation of the Finance Director. Currently, the skill set of the accounting personnel and support does not appear to address the needs of department as evidenced by delays in producing closing entries, trial balances, schedules, reconciliations, account analysis, and other financial reports needed by management and the auditors and also the need for numerous post-closing adjustments.

Recommendation

We recommend that the City of Hawthorne establish and document proper closing and reconciliation procedures and assign responsibility for completing the procedures to specific City personnel. The closing procedures should be documented in a checklist that indicates who will perform each procedure and when completion of each procedure is due and is accomplished. The timing of specific procedures could be coordinated with the timing of management's or the auditor's need for the information. These reconciliations will provide assurance that financial statements are meaningful and accurate.

We also recommend that the City ensure that key internal control processes are implemented including timely updating of subsidiary records and reconciliation of account balances, proper recording of transactions, and timely closing of the books.

Management Response

The City has a year-end closing process that includes the update of subsidiary records and reconciliation of account balances, proper recording of transactions, and timely closing of the books. However, the agreement between the City and the former auditing firm was cancelled in July 2011, leaving a short period of time to request proposals for a new audit firm. The preparation was further delayed by an outstanding audit by the U.S. Department of Housing and Urban Development of the City of Hawthorne Housing Authority.

The City will take the necessary steps to ensure that key internal control processing is resolved to ensure timely delivery of records for the annual year-end audit.

FS 2011-02: Notes and Loans Receivable

Condition and Context

Our audit procedures on notes and loans receivable include confirming annually on a sample basis certain notes and loans receivable. From our sample of 40 accounts, only 31 confirmations were mailed out because the City cannot find any information regarding the borrowers including current addresses for the other 9. Out of the 31 confirmations mailed out, we received only 13 responses. Five of the 13 responses do not agree with the borrower's records and two other confirmations were returned to our office as undeliverable.

We noted that the schedule of notes and loans receivable was not updated and reconciled with the general ledger. Moreover, review of collectibility of the accounts was not performed.

Cause and Effect

This is a recurring finding from the prior year. The accounting records are still not updated and reconciled because of lack of coordination between departments and inadequately trained accounting personnel. Not reconciling the accounts on a timely basis means that errors or irregularities might not be detected and resolved on a timely basis.

Recommendation

We recommend that the City of Hawthorne review the collectibility of all notes and loans receivable and reconcile the balance to the general ledger. Moreover, all documents including loan agreements supporting the balance of each loan should be properly filed.

Management Response

It has been the policy of the City to reconcile all notes and loans receivables at least once per year. Adjusting entries were made to correct the balance in the general ledger. Notes and loans receivables are fully offset by deferred revenue in equal amount so there is no effect on fund balances and net assets.

The City is committed to establishing a proper filing system to ensure that loan documents and other supporting information is kept on file. In addition, such notes and loans receivables will be reconciled to the general ledger at least once per year and reconciled as part of the year-end closing process.

FS 2011-03: Grants Receivable and Deferred Revenue

Condition and Context

During our audit of grants receivable and deferred revenue, we noted that grants receivable and deferred revenue were not reconciled to the general ledger at the end of the fiscal year. This situation required the recording of several audit adjusting entries to accrue grants receivable for expenditures incurred and eligible for reimbursement under the grant. Moreover, deferred revenues for grants received in advance had not been reviewed and adjusted at the end of the year.

Cause and Effect

Management does not have a system in place for monitoring and reviewing grants receivable and deferred revenues. Not reconciling the accounts on a timely basis might result in errors or irregularities not being detected and resolved on a timely basis.

Recommendation

We recommend that all grant activities be reconciled regularly and shortly after fiscal year end to ensure that all grants receivable and related deferred revenue are properly recorded.

Management Response

In a management decision, a turnover of key management personnel was the result of certain budgetary restrictions. One area in particular has been the Finance Department staffing level that has been affected by these decisions. The shortage of staff has required the Finance Department to rely more heavily on those departments which receive funding from granting agencies. In the process, the monitoring, reviewing, and reconciling were delayed.

With the help of the departments who receive grant funding, the City is committed to restructuring the monitoring, reviewing, and reconciling of grants to the general ledger. Such reconciliation will likely occur on a monthly basis and at fiscal year end to ensure that all grants receivables and related deferred revenue are properly set up.

FS 2011-04: Interfund Activity

Condition and Context

During our analysis of interfund activity, it was determined that advances to and from and due to and from other fund accounts were not in balance.

Cause and Effect

Management does not have a system in place for monitoring and reviewing interfund transactions. In addition, journal entries to record interfund transactions prepared by accounting personnel were not in balance, thus, causing the general ledger to be out of balance.

Recommendation

We recommend that management enhance the review process to provide for monitoring of accounts that should be balance to ensure that they are in balance and properly recorded in the general ledger. In addition, all journal entries should be reviewed for propriety, reasonableness and accounting accuracy by appropriate and knowledgeable personnel before posting to general ledger.

Management Response

All journal entries are reviewed for propriety, reasonableness, and accounting accuracy prior to entry in the City's financial system. Due to a shortage of staff, such reviews were handled by interim staff hired following the termination of key management personnel.

The City is committed to ensuring that all journal entries are reviewed by appropriate and knowledgeable personnel before posting to the general ledger.

FS 2011-05: Errors in Journal Entries

Condition and Context

During our audit of long-term debt and reconciliation of beginning fund balance, we noted material errors in recording of proceeds from bond issuance and repayment of outstanding debt.

Cause and Effect

Management does not have a system in place to make sure that journal entries are properly reviewed prior to posting to the general ledger. Audit adjustments were made to correct the errors.

Recommendation

We recommend that journal entries made by accounting personnel be reviewed for propriety, reasonableness and accounting accuracy by appropriate and knowledgeable personnel before posting to general ledger. Moreover account balances should be reviewed timely to ensure that balances are correct and reconciled with the general ledger.

Management Response

During the fiscal year, interim personnel within the Finance Department were instrumental in the refinancing of two bond issues. During that same time period, the recording of such issuances and repayments of outstanding debt were partially completed in a haste to record the bond proceeds to the General Fund.

The City is not anticipating any further bond refinancing projects. As such, any journal entries are precluded from happening. However, the City is committed to establishing proper recording procedures for any/all journal entries as well as reviewing account balances in a timely manner so that balances can be corrected and reconciled with the general ledger.

FS 2011-06: Capital Assets

Condition and Context

During our audit of capital assets, it was noted that capital projects for which construction was not completed at the end of the fiscal year are not classified as construction in progress and reclassified as capital assets when projects are completed. Journal entries were made to properly record the capital assets in the fiscal year 2011 financial statements.

Cause and Effect

This is a recurring finding from prior year based on our inquiry of City personnel. It appears that these capital assets were missed because of lack of communication and coordination between the City departments.

Recommendation

We recommend that the City analyze its capital outlay expenditures at the end of the fiscal year and capitalize capital assets in accordance with its capitalization policy. We also recommend that capital projects not completed at the end of the fiscal year be classified as construction in progress and reclassified as capital assets when projects are completed.

Management Response

It was the City's policy to capitalize improvement projects in the year the grant was completed. It was intended that capital projects not completed at the end of the fiscal year be classified as construction in progress and reclassified as capital assets when projects were completed.

The City is committed to ensuring the accuracy of capital outlay expenditures and to classify capital projects not completed at fiscal year end as construction in progress with reclassification of the capital assets when the projects are completed.

Section III – Compliance Findings

FS 2011-07: Expenditure Exceeding Appropriations

Condition and Context

As required by the provisions of the City's Municipal Code, the City shall adopt a balanced budget before the beginning of the fiscal year. The City's annual budget provides the legal authority for expenditures and a means of control of municipal operations throughout the fiscal year.

For the year ended June 30, 2011, the City had several expenditure items which exceeded the approved budget during the year, details of which are disclosed in Note 2 to the City's financial statements. Moreover, there were transfers that exceeded the budgeted amount during the year.

Cause and Effect

The City did not budget some of the expenditure items recorded in special revenue funds. It appears that the City does not have a budget process in place which incorporates the best practices in budget preparation. This was further evidenced by the late adoption of the fiscal year 2010-2011 and 2011-2012 budget.

Recommendation

The City should revisit and review its budget process to make sure that: (1) department heads are involved in the budget process, (2) budget amounts are critically reviewed and justified, and (3) there are financial resources or sufficient revenue inflows that would fund the budgeted expenditures.

Management Response

It has been the practice of the City to implement a mid-year budget adjustment to account for unanticipated expenditures so that they do not exceed the appropriations approved by the governing body. Both FY 2010-11 and FY 2011-12 Annual Budgets were adopted late as a result of the termination of certain key management personnel.

The City is prepared to ensure that the annual budget is adopted prior to June 30 of each fiscal year for the following fiscal year. Such adoption is a result of the combined efforts of department head involvement, Finance Department review for justification of expenditures, and verification of sufficient funding resources to cover budgeted expenditures.

Section IV – Federal Award Findings

F2011-01: Incorrect amount of federal expenditures reported in the Schedule of Expenditures of Federal Awards (SEFA)

Condition and Context

During our audit of EECBG grant, it was noted that the amount reported in the SEFA of \$934,972 is not correct. This amount includes expenditures funded by local funds. The total federal award for EECBG is only \$769,900. Of this amount, \$338,328 was already reflected in the FY 2009-10 single audit report. Therefore, the remaining federal expenditures that should have been recorded in SEFA for FY 2010-11 would only be \$431,572.

Cause and Effect

The accounting personnel and support are not adequately skilled and trained to ensure compliance with federal reporting requirements.

Recommendation

We recommend that the City ensure that key internal control processes are implemented including proper classification and recording of expenditures that are funded by federal funds. Adequate review of the SEFA should be performed by personnel knowledgeable of federal requirements.

Management Response

In a management decision, a turnover of key management personnel was the result of certain budgetary restrictions. One area in particular has been the Finance Department staffing level that has been affected by these decisions. The shortage of staff has required the Finance Department to rely more heavily on those departments which receive funding from granting agencies. In the process, compliance with federal reporting requirements may have been overlooked as personnel other than accounting personnel are complying with federal reporting requirements.

With the help of the departments who receive grant funding, the City is committed to ensuring that proper classification and recording of expenditures for federally funded programs are reviewed by key accounting personnel prior to the submittal of such reporting. Additionally, the review of such filings shall be compliant with federal reporting requirements.

Finding F2011-02 – Reporting

Federal Program Information

<i>Federal Catalog Number:</i>	81.128
<i>Federal Program Name:</i>	Energy Efficiency & Conservation Block Grant - ARRA
<i>Federal Agency:</i>	Department of Energy
<i>Pass-Through Entity:</i>	N/A
<i>Federal Award Number and Award Year:</i>	DESC0002108, FY 2010-11

Criteria or Specific Requirement

Per OMB Circular A-133, recipients of EECBG are required to comply with reporting requirements. Quarterly federal financial reports (SF-425) are due on or before the 30th of the month following the end of each quarter.

Also, per Department of Energy Recovery Act reporting requirements, prime recipients are responsible for reporting quarterly metrics on or before the 30th of the month following the end of each quarter.

Condition

During our audit, we noted that the following reports were submitted late during the year.

- Federal Financial Report (SF-425) Qtr 1 - July 1, 2010 - September 30, 2010 – submitted November 30, 2010 (31 days late)
- Quarterly reporting to DOE (via PAGE) Qtr 3 – January 1, 2011 – March 31, 2011 – submitted June 13, 2011 (44 days late)

Possible Asserted Cause and Effect

Monitoring controls are not in place to ensure that required reports are submitted timely. These untimely reports constitute noncompliance with the grant terms and condition which may be grounds for sanctions.

Questioned Costs

Not applicable

Recommendation

The City should review its current procedures over financial and program reporting to ensure timely submission of the required reports.

Views of Responsible Officials and Planned Corrective Action

As stated earlier, a management decision led to a turnover of key management personnel resulting in minimum monitoring and review of federal funding requirements and reporting procedures.

With the help of the departments who receive grant funding, the City is committed to ensuring that such procedures over financial and program reporting of certain grants are undertaken to ensure timely submission of required reports.

City of Hawthorne
Status of Prior Year Findings and Questioned Costs
Year ended June 30, 2011

Finding Reference	Finding Description	Recommendation	Current Status	Explanation if not fully implemented
Financial Statement Findings				
2010-1	The beginning fund balance of the South Bay Workforce Investment Board fund was restated by \$15,413,197 to correct prior year receivables and deferred revenue overstatement. In addition, governmental activities beginning net assets were restated by \$261,325 to correct prior year depreciation expense. As a result, governmental activities beginning net assets have been restated by a total of \$15,674,522.	We recommend management to reconcile accounts on a timely basis to verify the balance on the general ledger is properly recorded.	Not Implemented See FS2011-03	Shortage of resources
2010-2	During the year, the existence of three bank accounts used for City's discretionary expenses and opened by management employees was determined. These bank accounts and their activities were not recorded on the City's general ledger and the disbursements from these accounts were not approved by Council.	We recommend that management enhance the review process that monitors any schedule of accounts to ensure that they are properly recorded in the general ledger.	Implemented	Not Applicable
2010-3	Notes and loans receivable accounts were not reviewed and reconciled with the general ledger. Also, management did not review the collectibility of the accounts.	We recommend that management review the collectibility of all the notes and loans receivable and reconcile the balance to the general ledger.	Not Implemented See FS2011-02	Shortage of resources

City of Hawthorne
Status of Prior Year Findings and Questioned Costs
Year ended June 30, 2011

Finding Reference	Finding Description	Recommendation	Current Status	Explanation if not fully implemented
2010-4	Grants had not been reconciled to the general ledger at the end of the fiscal year resulting in several audit adjusting entries to accrue grants receivables for expenditures incurred and eligible for reimbursement, and to set up deferred revenue.	We recommend that all grant activities be reconciled shortly after fiscal year end to ensure that all grants receivable and deferred revenue be properly set-up.	Not Implemented See FS2011-03	Shortage of resources
2010-5	The payroll benefit liability accounts had not been reconciled. After being notified, the City reconciled the balance and provided an adjusting entry to correct the balances.	We recommend that the payroll benefit accounts be reconciled at least at the end of the fiscal year.	Implemented	Not Applicable
2010-6	During our search for unrecorded liabilities, we noted four invoices where a portion of the goods received and services performed prior to the end of the fiscal year were not recorded as payable at June 30, 2010. Also, we noted one invoice accrued as account payable for goods and services received after June 30, 2010.	We recommend that the City review its year end accounts payable accrual procedures to ensure that expenditures are recorded in the proper accounting period.	Implemented	Not Applicable

City of Hawthorne
Status of Prior Year Findings and Questioned Costs
Year ended June 30, 2011

Finding Reference	Finding Description	Recommendation	Current Status	Explanation if not fully implemented
2010-7	As of our year-end field work on November 15, 2010, capital assets were not reconciled.	We recommend that the City analyze its capital outlay expenditure at the end of the fiscal year and capitalize assets in accordance with its capital assets policy. We also recommend that projects not completed at the end of the fiscal year be classified as construction in progress and reclassified as capital assets when projects are completed.	Not Implemented See FS2011-06	Shortage of resources
2010-8	During the year, the South Bay Workforce Investment Board Fund has over \$189 million in revenues and expenditures budget adjustments that were not properly approved by City Council. The majority of the adjustments were made to the large amount of federal stimulus monies that the City received.	We recommend that all adjustments made to the adopted budget be properly approved by City Council in a timely manner.	Partially Implemented	Shortage of resources
Federal Award Finding				
2010-9	Federal Award - Workforce Investment Act Cluster Programs – Subrecipient Monitoring	The City should develop and document procedures to ensure that monitoring process of the subrecipients is completed in a timely manner and maintain documentation that it was performed in order to comply with the grant requirements.	Implemented	Not Applicable

