

**CITY OF BENICIA
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS
FOR THE YEAR ENDED JUNE 30, 2016**

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**CITY OF BENICIA
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS**

For The Year Ended June 30, 2016

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MEMORANDUM ON INTERNAL CONTROL

To the City Council of
the City of Benicia
Benicia, California

In planning and performing our audit of the basic financial statements of the City of Benicia as of and for the year ended June 30, 2016, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore material weaknesses or significant deficiencies may exist and that were not identified. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control included on the Schedule of Material Weaknesses to be material weaknesses.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies in internal control included on the Schedule of Significant Deficiencies to be significant deficiencies.

Included in the Schedule of Other Matters are recommendations not meeting the above definitions that we believe are opportunities for strengthening internal controls and operating efficiency.

Management's written responses included in this report have not been subjected to the audit procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This communication is intended solely for the information and use of management, City Council, others within the organization, and agencies and pass-through entities requiring compliance with *Government Auditing Standards*, and is not intended to be and should not be used by anyone other than these specified parties.

Maze & Associates

Pleasant Hill, California
December 20, 2016

**CITY OF BENICIA
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SCHEDULE OF MATERIAL WEAKNESS

2016-01 Effective Controls over Journal Entries

Criteria: To be an effective internal control tool, the journal entry (JE) log reviewed by management should contain information that accurately corresponds to that in the City's general ledger.

Condition: The City's current financial software system cannot generate a JE log in a numerical sequence. As a result, the City keeps a manual log in an Excel workbook in order to keep track of the JEs. In the beginning of each fiscal year, a new workbook is created with JE numbers in sequence. When a JE is needed, a staff member marks the JE in use on the Excel workbook. Then, the staff member inputs the same JE number as well as the entry into the general ledger. At the end of each month, any unused JE numbers for that month will be marked as "deleted". The Assistant Financial Director approves all monthly JE logs.

During our audit, we selected for testing fifteen manually prepared JEs between July 2015 and April 2016, representing ten percent of the entries made during that period. We found one entry that had a different number on the JE log than in the general ledger. We also found another entry on the general ledger that contains a JE number which was shown as "deleted" in the JE log.

Effect: When information on the JE log is inconsistent with the general ledger, the effectiveness of the log is reduced as a control tool. Inconsistency in JE numbers between the log and the general ledger makes it difficult for staff to retrieve supporting document for a particular JE, which is filed by general ledger JE number. In addition, review performed by management on the JE log, will not cover entries that are in the general ledger but not on the log.

Cause: The errors on the JE log identified above appeared to be caused by staff oversight. However, without proper reconciliation between the JE log and the general ledger, the control procedures of JEs are subject to human errors.

Recommendation: We understand that the new financial software system which the City is in the process of implementing has the capability to generate a JE log directly from the system. Until the new system is fully implemented, we recommend that the City determine a method of reconciliation to ensure both existence and completeness of the listings on the JE log.

Management Response: The City concurs with the finding and recommendation. The City is implementing a new ERP system that will generate a JE log that will eliminate this finding. The current system does not have any reports available that will show a listing of JE batches that we can compare to the manual JE log. In the meantime, staff has to be very careful in selecting the correct JE number for the correct month that the JE is being used for and making sure that the correct JE number is being entered in the system.

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SCHEDULE OF SIGNIFICANT DEFICIENCIES

2016-02 Timely Preparation of Bank Reconciliations

Criteria: Bank reconciliations are one of the most important internal controls a City can have, and the bank reconciliation cannot be considered complete until it has been reviewed and approved. To be an effective control, bank reconciliations and the associated review should be completed in their entirety as soon as reasonably possible after each month-end, usually within thirty to forty-five days of bank statement date.

Condition: During the interim audit in June 2016, we selected the November 2015 and February 2016 bank reconciliations for testing of timely preparation and documentation of review and approval. We noted that the November 2015 bank reconciliation was completed until March 3, 2015, and February 2016 bank reconciliation April 25, 2016.

Potential Effect: By not completing and reviewing the bank reconciliations timely, accounting errors, misstatements and/or unauthorized activities may not be identified or corrected in a timely manner.

Cause: City staff indicated that they were behind in preparing and reviewing the bank reconciliations due to the implementation of a new accounting system and an increase in workload.

Recommendation: The City has since caught up the reconciliation process. Going forward, bank reconciliations should remain a high priority and be completed and reviewed timely.

Management Response: The City concurs with the finding and recommendation. Bank reconciliations are a high priority and staff is consciously making every effort to complete them in a timely manner.

2016-03 Segregation of Duties

Criteria: Good internal controls require that employees with access to the City's assets not have access to the City's accounting records for the same assets.

Condition: In our fiscal year 2015 audit, we noted the following significant deficiencies. Details of these deficiencies are listed in the Current Status of Prior Year Significant Deficiencies and Other Matters section of this report.

- 2015-01: Review of Payroll Register
- 2015-02: Access to the Payroll Database

During the current year audit, we followed up on the status of these deficiencies. We noted that they had not been mitigated.

Effect: As a result, we consider the above deficiencies to be significant deficiencies in current year.

Cause: The City is in the process of implementing a new accounting system. The City plans to implement the related recommendations in the new system.

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SCHEDULE OF SIGNIFICANT DEFICIENCIES

Recommendation: Since the City has pushed back the implementation date of the new system, during the interim period, the City should consider having an employee who has no access to the payroll module to verify key information on the payroll run of the employees who have access to the module.

Management Response: : The City concurs with the finding and recommendation. Since the Payroll implementation has been pushed back to 2018, in the meantime, the Assistant Finance Director reviews and approves any payroll changes entered into the system. Any major adjustments are also being reviewed by the Finance Director. In addition, management will assign staff who does not have access to the payroll module, to review the Pre-List Report for Finance staff who have access to the payroll module.

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SCHEDULE OF OTHER MATTERS

NEW GASB PRONOUNCEMENTS OR PRONOUNCEMENTS NOT YET EFFECTIVE

The following comment represents new pronouncements taking effect in the next few years. We have cited them here to keep you abreast of developments:

Effective in fiscal year 2016-17:

GASB 73 – *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68*

This Statement establishes requirements for defined benefit pensions that are not within the scope of Statement No. 68, *Accounting and Financial Reporting for Pensions*, as well as for the assets accumulated for purposes of providing those pensions. In addition, it establishes requirements for defined contribution pensions that are not within the scope of Statement 68. It also amends certain provisions of Statement No. 67, *Financial Reporting for Pension Plans*, and Statement 68 for pension plans and pensions that are within their respective scopes.

GASB 74 – *Financial Reporting for Post-employment Benefit Plans Other Than Pension Plans*

The objective of this Statement is to improve the usefulness of information about post-employment benefits other than pensions (other post-employment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all post-employment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency.

GASB 77 – *Tax Abatement Disclosures*

This Statement establishes financial reporting standards for tax abatement agreements entered into by state and local governments. The disclosures required by this Statement encompass tax abatements resulting from both (a) agreements that are entered into by the reporting government and (b) agreements that are entered into by other governments and that reduce the reporting government's tax revenues.

GASB 78 – *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*

This Statement amends the scope and applicability of Statement 68 to exclude pensions provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension plan that (1) is not a state or local governmental pension plan, (2) is used to provide defined benefit pensions both to employees of state or local governmental employers and to employees of employers that are not state or local governmental employers, and (3) has no predominant state or local governmental employer (either individually or collectively with other state or local governmental employers that provide pensions through the pension plan). This Statement establishes requirements for recognition and measurement of pension expense, expenditures, and liabilities; note disclosures; and required supplementary information for pensions that have the characteristics described above.

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SCHEDULE OF OTHER MATTERS

GASB 80 – *Blending Requirements for Certain Component Units—an amendment of GASB Statement No. 14*

This Statement amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of Statement No. 39, *Determining Whether Certain Organizations Are Component Units*.

GASB 82 – *Pension Issues—an amendment of GASB Statements No. 67, No. 68, and No. 73*

The objective of this Statement is to address certain issues that have been raised with respect to Statements No. 67, *Financial Reporting for Pension Plans*, No. 68, *Accounting and Financial Reporting for Pensions*, and No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. Specifically, this Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

Effective in fiscal year 2017-18:

GASB 75 – *Accounting and Financial Reporting for Post-employment Benefits Other Than Pensions*

The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for post-employment benefits other than pensions (other post-employment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all post-employment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency.

GASB 81 – *Irrevocable Split-Interest Agreements*

This Statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. Furthermore, this Statement requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests. This Statement requires that a government recognize revenue when the resources become applicable to the reporting period.

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CURRENT STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

2015-01: Review of Payroll Register

Criteria: A payroll register should be reviewed and signed for approval by an employee who does not process payroll. Without a review by a second employee, there is a risk that the payroll register may include omissions and errors.

Condition: During our review of internal controls over the City's payroll cycle, we noted the City currently does not perform a review of the payroll run.

Cause: We were informed by the City management that the City is aware of the importance of a review as part of the internal controls. However, the current set up of the payroll system does not produce reports to allow for a meaningful review. The City expects to implement this review process in the new system.

Effect: Without the involvement of a second employee reviewing payroll runs, there is a risk that the payroll register may include omissions and errors.

Recommendation: We recommend that the City establish procedures to have an employee, who does not have access to payroll module and payroll database, to review payroll runs. This employee should also document that the review has taken place (e.g. by signing off on the payroll register) in order to allow for monitoring of such review activities.

Fiscal Year 2014-15 Management's Response: The City concurs with the finding and recommendation. The City is currently implementing a new ERP system that includes a payroll module that produces meaningful payroll reports that management can review and approve. New payroll procedures are being established and the Finance Director will be reviewing and approving the payroll registers once the payroll module is live. In the meantime, the Assistant Finance Director is reviewing and approving any changes, including new employees, termination, and step increases, which are entered into the system when a Personnel Action Form (PAF) is sent by the Human Resources Department.

Current Year Status Recommendation not implemented. The City expects to implement this recommendation in the new ERP system. The payroll module of the new ERP system is expected to be in place in July 2018.

Fiscal Year 2015-16 Management's Response: The City concurs with the finding and recommendation. Since the Payroll implementation has been pushed back to 2018, in the meantime, the Assistant Finance Director reviews and approves any payroll changes entered into the system. Any major adjustments are also being reviewed by the Finance Director. In addition, management will assign staff who does not have access to the payroll module, to review the Pre-List Report for Finance staff who have access to the payroll module.

2015-02: Access to the Payroll Database

Criteria: The function of payroll processing and editing of payroll database should be segregated.

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CURRENT STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

Condition: During the audit, we noted that the City's Account System Supervisor, whose responsibilities include entering timesheets, processing payroll and holding unclaimed W-2's, also has access to unclaimed paychecks and payroll database. In addition, the City's Account System Supervisor has edit access to the employee database which includes setting up new employees in the payroll module.

Cause: All payroll duties are performed by the Account System Supervisor due to the City did not train other employees for the payroll processing.

Effect: The combination of the ability to process payroll, access to unclaimed W-2's and paychecks, as well as altering data in the payroll and employee databases creates opportunities for fake employees, and unauthorized changes in payroll data such as pay rates and vacation accruals.

Recommendation: As we discussed in Significant Deficiency 2015-01 above, another employee needs to be involved in the review of the payroll process. In addition, the City should segregate the duties of the maintenance of the two databases from payroll processing. Employee who can alter data in the payroll or employee database should not have the ability to process payroll.

Fiscal Year 2014-15 Management's Response: The City concurs with the finding and recommendation. As the City is in the process of implementing a new ERP system, procedures and policies are being reviewed and established. The segregation of duties is being reviewed carefully and all Human Resources duties and functions will be performed by a Human Resources staff member, such as setting up new employees and making changes to personnel data. Only payroll functions will remain with the Finance Department. Currently, the Senior Accounting Technician is being cross-trained in payroll to alleviate any omissions and errors that may occur.

Current Year Status: Recommendation not implemented. The City expects to implement this recommendation in the new ERP system. The payroll module of the new ERP system is expected to be in place in July 2018.

Fiscal Year 2015-16 Management's Response: The City concurs with the finding and recommendation. The Senior Accounting Technician has been performing the payroll functions with a review from the Assistant Finance Director. Major adjustments are being reviewed by the Finance Director. Once the new ERP system is in place, the Human Resources functions will stay with the Human Resources staff and only Finance functions will be performed by Finance staff.

2015-03: Governmental/Utilities Cash Receipts Procedures

Criteria: For proper internal control, there should be segregation of duties between cash receipts collection and customer database maintenance. Without the segregation, the City could be exposed to the risk of interception of cash receipts.

Condition: Currently, the Customer Service Representatives, who are responsible for governmental and utility billings, have access to cash receipts and general ledger. They also have access to customer database, can adjust the utility accounts for individual customers and are responsible in preparing the daily deposit bags. The Customer Service Representatives are given so much access because they are responsible for billing and revenue collection, as well as recording of receivables.

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Cause: All collection duties and recording of collections is done by the customer service representative at the front desk. Since all recording is done upon collection, access is granted to the customer service representative.

Effect: The City is exposed to the risk of interception of cash receipts.

Recommendation: To strengthen internal control, the following functions should be segregated:

- Revenue collection versus adjustments of customer accounts
- Access to cash receipts versus review of cash receipts batches and preparation of deposit bags
- Access to cash receipts versus general ledger, without an approval of a second employee

Management's Response: The City concurs with the finding and recommendation. City management has reviewed, approved and implemented new procedures in cash handling, as a result of a third party audit. Various departments are also following the new procedures established by the Finance Director. In addition, the hiring of a Finance Account Clerk, who is mainly responsible for the front desk function, receiving customer payments without any access to the database reinforces and strengthens internal control. Cash receipt journals are reviewed and approved by either the Accounting System Supervisor or the Assistant Finance Director. With the new ERP system, all procedures and policies are being reviewed for better internal control.

Current Year Status: Recommendation implemented.

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REQUIRED COMMUNICATIONS

To the City Council of
the City of Benicia, California

We have audited the basic financial statements of the City of Benicia for the year ended June 30, 2016. Professional standards require that we communicate to you the following information related to our audit under generally accepted auditing standards and, *Government Auditing Standards*, and the Uniform Guidance.

Significant Audit Findings

Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year, except as follows:

The following Governmental Accounting Standards Board (GASB) pronouncements became effective, but did not have a material effect on the financial statements:

GASB Statement No. 76 – *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*

GASB Statement No. 79 – *Certain External Investment Pools and Pool Participants*

The following pronouncement became effective and required modifications to the notes to financial statements.

GASB Statement No. 72 – *Fair Value Measurement and Application*

This Statement addresses accounting and financial reporting issues related to fair value measurements. The definition of *fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

The requirements of this Statement enhance comparability of financial statements among governments by requiring measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. This Statement also enhances fair value application guidance and related disclosures in order to provide information to financial statement users about the impact of fair value measurements on a government's financial position.

Unusual Transactions, Controversial or Emerging Areas

We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the City's financial statements were:

Estimated Net Pension Assets and Liabilities and Pension-Related Deferred Outflows and Inflows of Resources: Management's estimate of the net pension assets and liabilities and deferred outflows/inflows of resources are disclosed in Note 10 to the financial statements and are based on actuarial studies determined by a consultant, which are based on the experience of the City. We evaluated the key factors and assumptions used to develop the estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.

Estimated Fair Value of Investments: the City's cash and investments held at June 30, 2016 as measured by fair value are disclosed in Note 3 to the financial statements. Fair value is essentially market pricing in effect as of June 30, 2016. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2016.

Estimate of Depreciation: Management's estimate of the depreciation is based on useful lives determined by management. These lives have been determined by management based on the expected useful life of assets as disclosed in Note 6 to the financial statements. We evaluated the key factors and assumptions used to develop the depreciation estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.

Disclosures

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

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

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

Professional standards require us to accumulate all known and likely uncorrected misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. We have no such misstatements to report to the City Council.

Disagreements with Management

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in a management representation letter dated December 20, 2016.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

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

Other Information Accompanying the Financial Statements

We applied certain limited procedures to the required supplementary information that accompanies and supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the required supplementary information and do not express an opinion or provide any assurance on the required supplementary information.

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

We were not engaged to report on the Introductory and Statistical Sections included as part of the Comprehensive Annual Financial Report but are not required supplementary information. We did not audit or perform other procedures on this other information and we do not express an opinion or provide any assurance on it.

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

Maze & Associates

Pleasant Hill, California
December 20, 2016