CITY OF SAN PABLO

MEMORANDUM ON INTERNAL CONTROL

FOR THE YEAR ENDED JUNE 30, 2025

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CITY OF SAN PABLO

MEMORANDUM ON INTERNAL CONTROL

FOR THE YEAR ENDED JUNE 30, 2025

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MEMORANDUM ON INTERNAL CONTROL

To the City Council of
the City of San Pablo, California

In planning and performing our audit of the basic financial statements of the City of San Pablo (City) as of and for the year ended June 30, 2025, 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 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 a deficiency in internal control that we consider to be a significant deficiency.

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 did not identify any deficiencies in internal control that we consider 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 deficiency in internal control included on the Schedule of Significant Deficiency to be a significant deficiency.

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.

Government Auditing Standards require the auditor to perform limited procedures on the City's response to the findings identified in our audit and described in the accompanying Schedule of Significant Deficiency. The City's response was not subjected to the other auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

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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 17, 2025

CITY OF SAN PABLO

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SCHEDULE OF SIGNIFICANT DEFICIENCY

2025-01: <u>Accuracy of Cash Balances in the General Ledger</u>

Criteria:

Timely and accurate bank reconciliations are a critical component of the City's internal control framework. Effective reconciliation requires that the book balance used in the bank reconciliation process agrees with both the pooled cash accounts and the individual fund-level general ledger cash balances.

Condition:

During our audit, we identified a variance of $1,316,920 between the City's general checking bank reconciliation and the aggregate general ledger cash balances by fund as of June 30, 2025. Upon investigation, management determined that the discrepancy resulted from cumulative adjustments recorded in the pooled cash accounts between 2007 and 2025, which were not consistently reflected in the corresponding individual fund cash accounts. To correct the discrepancy, the City posted an adjustment during the current fiscal year.

Effect:

When reconciling items are not appropriately identified and reflected in the bank reconciliation, and when individual fund-level general ledger accounts are not considered, there is a risk that cash balances recorded in the general ledger may be misstated. This increases the likelihood that a misstatement may go undetected or uncorrected in a timely manner.

Cause:

In FY 2025, further investigation identified that cumulative adjustments made to pooled cash over many years without corresponding entries at the individual fund level were the actual source of the discrepancies. This issue is now understood to be the root cause underlying both the FY 2024 and FY 2025 variances, with the FY 2024 payroll explanation reflecting the City's understanding at that time before the deeper pooled cash imbalance was uncovered.

Recommendation:

We recommend that the City enhances its reconciliation procedures to ensure that:

- All reconciling items—including payroll-related items—are reviewed, investigated, and included each month;
- Both pooled cash and individual fund-level general ledger cash accounts are incorporated into the monthly reconciliation process; and
- Reconciling items are cleared promptly once the underlying activity is complete.

These actions will improve the accuracy and completeness of cash balances recorded in the general ledger.

Management's Response:

The City of San Pablo agrees with the auditor's FY 2024/25 finding. During FY 2024/25 audit, the City's Finance Department identified that cumulative pooled cash adjustments recorded between 2007 and 2025 were not consistently posted to the corresponding individual fund accounts. This underlying pooled cash imbalance was determined to be the root cause of both the FY 2023/24 and FY 2024/25 variances; the FY 2023/24 payroll explanation reflected the City's findings at that time before the broader pooled cash issue was fully assessed.

An adjusting entry was recorded in FY 2024/25 to correct the variance. The City's Finance Department has strengthened its fund reconciliation procedures to ensure all reconciling items: including payroll, pooled cash activity, and fund-level cash balances are fully reviewed, documented, and incorporated each month. A secondary supervisory review has also been implemented, and reconciling items are now monitored and cleared promptly.

These improvements enhance internal controls, improve the accuracy of reported cash balances, and reduce the risk of future discrepancies.

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SCHEDULE OF OTHER MATTERS

NEW GASB PRONOUNCEMENTS OR PRONOUNCEMENTS NOT YET EFFECTIVE

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

EFFECTIVE FISCAL YEAR 2025/26:

GASB 103 – *Financial Reporting Model Improvements*

The objective of this Statement is to improve key components of the financial reporting model to enhance its effectiveness in providing information that is essential for decision making and assessing a government's accountability. This Statement also addresses certain application issues.

Management's Discussion and Analysis - This Statement continues the requirement that the basic financial statements be preceded by management's discussion and analysis (MD&A), which is presented as required supplementary information (RSI). MD&A provides an objective and easily readable analysis of the government's financial activities based on currently known facts, decisions, or conditions and presents comparisons between the current year and the prior year. This Statement requires that the information presented in MD&A be limited to the related topics discussed in five sections: (1) Overview of the Financial Statements, (2) Financial Summary, (3) Detailed Analyses, (4) Significant Capital Asset and Long-Term Financing Activity, and (5) Currently Known Facts, Decisions, or Conditions. Furthermore, this Statement stresses that the detailed analyses should explain why balances and results of operations changed rather than simply presenting the amounts or percentages by which they changed. This Statement emphasizes that the analysis provided in MD&A should avoid unnecessary duplication by not repeating explanations that may be relevant to multiple sections and that "boilerplate" discussions should be avoided by presenting only the most relevant information, focused on the primary government. In addition, this Statement continues the requirement that information included in MD&A distinguish between that of the primary government and its discretely presented component units.

Unusual or Infrequent Items - This Statement describes unusual or infrequent items as transactions and other events that are either unusual in nature or infrequent in occurrence. Furthermore, governments are required to display the inflows and outflows related to each unusual or infrequent item separately as the last presented flow(s) of resources prior to the net change in resource flows in the government-wide, governmental fund, and proprietary fund statements of resource flows.

Presentation of the Proprietary Fund Statement of Revenues, Expenses, and Changes in Fund Net Position - This Statement requires that the proprietary fund statement of revenues, expenses, and changes in fund net position continue to distinguish between operating and nonoperating revenues and expenses. Operating revenues and expenses are defined as revenues and expenses other than nonoperating revenues and expenses. Nonoperating revenues and expenses are defined as (1) subsidies received and provided, (2) contributions to permanent and term endowments, (3) revenues and expenses related to financing, (4) resources from the disposal of capital assets and inventory, and (5) investment income and expenses.

GASB 103 – *Financial Reporting Model Improvements (Continued)*

In addition to the subtotals currently required in a proprietary fund statement of revenues, expenses, and changes in fund net position, this Statement requires that a subtotal for operating income (loss) and noncapital subsidies be presented before reporting other nonoperating revenues and expenses. Subsidies are defined as (1) resources received from another party or fund (a) for which the proprietary fund does not provide goods and services to the other party or fund and (b) that directly or indirectly keep the proprietary fund's current or future fees and charges lower than they would be otherwise, (2) resources provided to another party or fund (a) for which the other party or fund does not provide goods and services to the proprietary fund and (b) that are recoverable through the proprietary fund's current or future pricing policies, and (3) all other transfers.

Major Component Unit Information - This Statement requires governments to present each major component unit separately in the reporting entity's statement of net position and statement of activities if it does not reduce the readability of the statements. If the readability of those statements would be reduced, combining statements of major component units should be presented after the fund financial statements.

Budgetary Comparison Information - This Statement requires governments to present budgetary comparison information using a single method of communication—RSI. Governments also are required to present (1) variances between original and final budget amounts and (2) variances between final budget and actual amounts. An explanation of significant variances is required to be presented in notes to RSI.

How the Changes in This Statement Will Improve Financial Reporting

The requirements for MD&A will improve the quality of the analysis of changes from the prior year, which will enhance the relevance of that information. They also will provide clarity regarding what information should be presented in MD&A.

The requirements for the separate presentation of unusual or infrequent items will provide clarity regarding which items should be reported separately from other inflows and outflows of resources.

The definitions of operating revenues and expenses and of nonoperating revenues and expenses will replace accounting policies that vary from government to government, thereby improving comparability. The addition of a subtotal for operating income (loss) and noncapital subsidies will improve the relevance of information provided in the proprietary fund statement of revenues, expenses, and changes in fund net position.

The requirement for presentation of major component unit information will improve comparability.

The requirement that budgetary comparison information be presented as RSI will improve comparability, and the inclusion of the specified variances and the explanations of significant variances will provide more useful information for making decisions and assessing accountability.

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SCHEDULE OF OTHER MATTERS

EFFECTIVE FISCAL YEAR 2026/27:

GASB 104 – ***Disclosure of Certain Capital Assets***

State and local governments are required to provide detailed information about capital assets in notes to financial statements. GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, requires certain information regarding capital assets to be presented by major class. The objective of this Statement is to provide users of government financial statements with essential information about certain types of capital assets.

This Statement requires certain types of capital assets to be disclosed separately in the capital assets note disclosures required by Statement 34. Lease assets recognized in accordance with GASB Statement No. 87, *Leases*, and intangible right-to-use assets recognized in accordance with GASB Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*, should be disclosed separately by major class of underlying asset in the capital assets note disclosures. Subscription assets recognized in accordance with GASB Statement No. 96, *Subscription-Based Information Technology Arrangements*, also should be separately disclosed. In addition, this Statement requires intangible assets other than those three types to be disclosed separately by major class.

This Statement also requires additional disclosures for capital assets held for sale. A capital asset is a capital asset held for sale if (a) the government has decided to pursue the sale of the capital asset and (b) it is probable that the sale will be finalized within one year of the financial statement date. Governments should consider relevant factors to evaluate the likelihood of the capital asset being sold within the established time frame. This Statement requires that capital assets held for sale be evaluated each reporting period. Governments should disclose (1) the ending balance of capital assets held for sale, with separate disclosure for historical cost and accumulated depreciation by major class of asset, and (2) the carrying amount of debt for which the capital assets held for sale are pledged as collateral for each major class of asset.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will improve financial reporting by providing users of financial statements with essential information about certain types of capital assets in order to make informed decisions and assess accountability. Additionally, the disclosure requirements will im-prove consistency and comparability between governments.

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STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCY

2024-01: **Accuracy of Bank Reconciliation**

Criteria:

Bank reconciliations are an important element of a City's internal control structure. In order to be an effective control, the book balance in the bank reconciliations should match the general ledger balance. Furthermore, the bank reconciliation should include any applicable reconciling items and general ledger cash accounts, such as payroll-related items.

Condition:

During our audit, we noted that there was variance of $1,232,897 between the June 30, 2024 general checking bank reconciliation and the City's general ledger. Upon further investigation, the City determined that the variance was due to a payroll accrual that was in the general ledger, but not reflected in the City's general checking bank reconciliation.

Effect:

If reconciling items are not properly included on the bank reconciliation each month, the balance of cash recorded in the City's general ledger may not be accurate. There is an increased risk that a material misstatement would not be presented, or detected and corrected on a timely basis.

Cause:

We understand that it is not the City's practice to include payroll reconciliation items on the bank reconciliation.

Recommendation:

We recommend that the City review reconciling items each month to ensure they are current, investigated and included or cleared from the bank reconciliation once the activity has been completed. In addition, the City should include all reconciling items and general ledger cash accounts on the bank reconciliation to ensure accuracy in the reconciliation process.

Current Status: See current year comment 2025-01.

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