Subject: MANAGEMENT LETTER – BIG BEAR VALLEY PARK AND RECREATION DISTRICT FOR THE FISCAL YEAR ENDED JUNE 30, 2008

We have completed an audit of the Big Bear Valley Park and Recreation District (District) governmental funds, for the fiscal year ended June 30, 2008 and have issued our report thereon dated April 28, 2009. In planning and performing our audit of the financial statements of the District’s governmental funds as of and for the year ended June 30, 2008, in accordance with auditing standards generally accepted in the United States of America, we considered the District’s internal control over financial reporting (internal control) 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 District’s internal control. Accordingly, we do not express an opinion on the effectiveness of the District’s internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. However, as discussed below, we identified deficiencies in internal control that we consider to be material weaknesses or significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity’s ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles (GAAP) such that there is more than a remote likelihood that a misstatement of the entity’s financial statements that is more than inconsequential will not be prevented or detected by the entity’s internal control.
A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We believe that the following deficiencies constitute a material weakness:

**Material Weakness #1 - The overall accounting and internal controls related to the Special Activities account are not adequate.**

Good business practice dictates that an organization comply with the policies, laws, and regulations that govern its business operations.

1) All revenue, including federal grants and private donations, and expenditure activity should be properly recorded in FAS.

2) Treasury Regulations, Subchapter A, Sec. 1.6041-1 general rule requires an information return for payments of $600 or more. Under these requirements, information is reported to the Internal Revenue Service (IRS) and Form 1099-MISC, *Miscellaneous Income* should be furnished for each person paid at least $600 in rents, services, prizes and awards and other income payments.

3) EMACS procedures state that an employee is required to submit and complete an Employee Reimbursement Form to claim employee expense reimbursement for work-related reimbursements and travel.

4) All payment documents must be approved by persons with signing authority.

The processes over handling and accounting for the receipt and disbursement of cash for recreational activities could be improved. Currently, the Big Bear office is using a special activities checking account for the deposit of all revenues received, including grant funding and donations, and the payment of expenditures incurred for the District's programs and recreational activities. The account had a balance of $22,707 and ($4,666) at June 30, 2008 and June 30, 2007, respectively. Our audit of the Special Activities account disclosed the following deficiencies:

1A) The gross revenue and all expenditures for park programs and recreational activities are not being recorded in the financial accounting system (FAS).

   1. During fiscal year 2008, the District generated $596,758 in cash receipts and $274,419 in expenditures in the Special Activities account.

   2. The District deposited $294,966 from the Special Activities account into the Clearing account that transferred to the County Treasury and was recorded as revenue in FAS. The expenditures made from the Special Activities account were not recognized in FAS.

1B) Revenue from federally funded programs and private donations are not being reported in FAS.

   1. The District is the subrecipient of Community Development Block Grants (CDBG). CDBG funding was received from the following organizations:

      i. The Soroptimist International of Big Bear Valley, $22,088
      ii. The Hummingbird Project, $5,300
2. Donations from private citizens exceeded $15,000.

2A) Instructor services rendered for program and recreational activities that exceeded $600 were paid out of the checking account and a 1099-MISC form was not provided by the District for the services rendered. The cost of services rendered requiring a 1099-MISC form was approximately $90,000.

2B) Service contracts were not submitted to the Purchasing Agent to be properly approved prior to executing the contracts with the service providers.

3A) The Special Activities Account was used to reimburse employees for various expenses, including:
   1. gasoline
   2. mileage
   3. golf fees
   4. supplies
   5. parking
   6. cameras
   7. clothing
   8. food

4A) Invoices for special activity expenditures were paid without any evidence of management approval (i.e., initials and date).

The District personnel at the Big Bear office did not have a familiarity with County policies, as they relate to internal controls and purchase contract procedures. If the District does not improve its business practices by gaining an understanding of the County’s policies and procedures, then the District will continue to be adversely impacted by the following:

1) Revenue and expenditure transactions will not be properly recorded in FAS, which may result in the financial statements being materially misstated.

2) The District will be in violation of Internal Revenue Code Section 6721, which states:
   "A person who is required to file information returns but who fails to do so by the due date for the returns is subject to a penalty of $50 for each return with respect to which such a failure occurs, up to a maximum of $250,000 in any calendar year".

3) Employee reimbursements that are not processed through EMACS may not be properly reported on the employees' W-2's.

4) There would be no appropriate supporting documentation to indicate that District's finances are being properly managed.
Recommendation
Based on the nature of the deficiencies discovered, we recommend that the District proceed with the following corrective actions:

- **Discontinuance of the Special Activities Account**
  The District should immediately discontinue the use of the special activities checking account and begin processing expenditures using payment vouchers (PV) submitted to the Accounts Payable Section for payment. Furthermore, all cash receipts should be deposited directly into the District's Clearing account so that the revenue can be transferred into the County Treasury. Implementing these changes will help ensure that all of the District's accounting activity is recorded in FAS and the financial statements will not be misstated.

- **Purchase Contracts for Service Providers**
  The District needs to adhere to the policies and procedures in the County's Policy Manual, Section 11-05SP2, by submitting the contracts for service providers to the Purchasing Agent for the appropriate approval and processing. Complying with the policies and procedures outlined in the County's Policy Manual will help ensure that the District obtains the required level of approval prior to executing the purchase contracts.

- **Approval for vendor invoices**
  Management must initial and date all payment documents prior to submitting them to Accounts Payable. Management's formal review and approval of vendor invoices will reduce the risk of unauthorized purchases and vendor payments.

- **Petty Cash Account**
  The District should request a cash increase for the Petty Cash account to pay for miscellaneous expenses or charges incurred while performing official County business. The guidelines set forth in the County’s Internal Control and Cash Manual should be used for executing Petty Cash transactions.

Management's Response

1) All revenue will be recorded in FAS with the elimination of the Special Activity Account.
2) With the elimination of the Special Activity Account, all payments to “instructors” will be done through FAS thereby prompting issuance of 1099 forms by the Auditor/Controller-Recorder.
3) Employee Reimbursement Forms will become standard procedure in all cases where employees are being reimbursed.
4) All payment documents will be approved by persons with signing authority.
2B) All Service contracts have been brought into compliance and will be kept up to date and monitored by administrative staff.

Management will initial and date all payment documents prior to submission to Accounts Payable.

District administration will not need to increase petty cash account.

Management Response Summary

The District will comply with each stated recommendation toward the elimination of existing deficiencies noting the following exceptions to findings:

The Big Bear Valley Recreation and Park District and several other Districts have been using the Special Activity Account system for over 25 years. This system has been audited at least six times that I am aware of and during that time deficiencies and/or recommendations were not presented by audit staff. Over the past 2 years the District has significantly improved the reconciling process for revenue/cash deposits. The District did not change or invent new ways of doing business that the county was unaware of, and in fact has streamlined what we thought were past unsafe practices including the reconciliation of donations to our various programs.

To provide one example, the District (and all other Park Districts) has never provided 1099 forms to instructors, despite the District Manager questioning every previous auditor on why this practice did not take place. The management letter seems to be drafted in a tone which suggests that this and several other previously audited "standard" practices were a result of managements disinterest or inexperience when in fact the very contract provided by the county and governing the instructor class program (this contract has been in existence for 25 years as well) stipulates “The Instructor shall be solely responsible for properly reporting all monies as a result of work done for the District, to the State and Federal Governments. District shall have no responsibility for reports of income for tax purposes.”

The District is prepared to close the Special Activities Account as of June 22, 2009 while needed assistance with the following concerns:

1. Method and procedure for payment to recreation class instructors – though payments $3,000 and below will be paid via Low Value/Payment Request method.
2. Method and procedure for refunding rental deposits and program participants.

Auditor's Response

In the management letter for the FY 2004 audit, the Internal Audits Division documented deficiencies and recommendations regarding closure of the Special Activities Account. The recommendations were not implemented. Nonetheless, the current Management response addresses actions that have been implemented, as well as planned actions to correct the deficiencies noted in the audit finding.
Material Weakness #2 - The Big Bear Sports Ranch purchase was not recorded in the Financial Accounting System (FAS).

The District purchased a sports ranch to provide various recreational activities for the residents of Big Bear Lake. The overall purchase included land, a hockey rink, basketball courts, tennis courts, a dining hall, dormitories, and a swimming pool. The District received $2,500,000 in Proposition 12 grant funding from the State to finance the sports ranch purchase. However, the funding for the purchase and the related capital expenditures were not recorded in FAS.

All financial transactions, including those related to major capital purchases, are required to be recorded in FAS so that the accounting records and financial statements are complete and accurate in accordance with generally accepted accounting principles.

Since the Proposition 12 grant funding was directly submitted by the State to the escrow company associated with purchase, the transaction was never recorded in FAS by the department. The District’s financial statements could be materially misstated if significant transactions are not being properly recorded in the financial accounting records.

Recommendation
Management must comply with the County’s accounting policies by ensuring that all supporting documentation for capital asset purchases is submitted to General Accounting for the appropriate processing. Consistently complying with the County’s accounting policies will serve to prevent the financial statements from being materially misstated and will help ensure that the accounting information in the financial statements is being reported in accordance with GAAP.

Management’s Response
District management was under the assumption that Real Estate Services was the responsible party for transaction recordation. With direction that this responsibility is the District’s, administrative staff will perform this function in any future case.

Auditor’s Response
Management response addresses planned actions to correct the deficiency noted in the audit finding.

We consider the following deficiencies to be significant deficiencies in internal control.

Significant Deficiency #1 - Bank reconciliations were not being performed.

The District has 3 bank accounts, which include the Clearing Account, Special Activities Account, and the Petty Cash Account. The accounting records for these accounts were not being reconciled to the bank statements.
The Internal Control and Cash Manual (January 2008), Chapter 9 – Bank Accounts, states that departments are to reconcile their records to the bank statements each month.

The District personnel in the Big Bear office considered the reconciliation summary produced by their Quicken system to be an appropriate bank reconciliation. However, the reconciliation summary did not show evidence that the check register was reconciled to the monthly bank statement. The bank reconciliation is a key element in providing assurance as to the integrity and accuracy of the financial records. By not properly performing the monthly bank reconciliations, the District’s exposure to accounting errors and the misappropriation of cash assets is significantly increased.

**Recommendation**

The District Manager needs to ensure that the District staff is consistently following the policies outlined in the County’s Internal Control and Cash Manual when performing the duties related to the District’s bank accounts, which include performing timely and accurate bank reconciliations. Furthermore, management should review the monthly bank reconciliations to help ensure that cash transactions are properly recorded in the accounting records.

**Management’s Response**

District administration disagrees with the statement that the accounting records are not reconciled to the bank statements. In fact they are reconciled on a monthly basis by the Assistant Regional Manager and reviewed by the Regional Manager. Regardless, the District will be switching to the Quick Books system on July 1, 2009 so that we are using a system which is compatible with County FAS.

The Regional manager will ensure that staff is following County’s Internal Control and Cash Manual.

Clearing account and petty cash account will be reconciled with bank statements. A/C-R has provided a sample reconciliation form which will be used; records of reconciliation will be kept on file at the District office.

**Auditor’s Response**

The District did not provide evidence of a bank reconciliation during the course of the audit. Nevertheless, Management’s response addresses planned actions to correct deficiencies noted in the audit finding.
Significant Deficiency #2 - The District lacks appropriate segregation of duties for their accounting functions.

The Assistant District Manager at the Big Bear office has full autonomy over most of the District's accounting functions, which include the following duties:

1) recording transactions in the Quicken accounting system
2) depositing the cash receipts into the District's bank account at Union Bank
3) maintaining custody of the prenumbered, blank checks
4) issuing checks as an authorized check signer on the bank account

Proper segregation of duties is an essential part of the control environment. Strong internal controls require the segregation of authorizing transactions, recording financial information, and maintaining custody of assets.

The District Manager was not aware that the Assistant District Manager was performing incompatible job functions. Therefore, the conflicting duties were not appropriately segregated among the District personnel. When various job functions are not properly segregated, the risk of committing and concealing fraudulent financial activity increases. In addition, this weakness in the control environment also prevents errors from being detected in a timely manner.

Recommendation
The District should establish an appropriate segregation of duties among the District staff. Ideally, the responsibilities of authorizing, recording, and custody should be delegated to individual staff members. However, if staffing limitations prevent segregating these functions, then management should implement mitigating controls to reduce the risk of unintentional errors and fraudulent financial reporting.

Management's Response
District will confer with Special District's Budget/Fiscal Division regarding segregation of duties, and will comply with their recommendations with consideration of the limited number of positions available.

Final note: BBVRPD administrative staff looks forward to complying/correcting audit findings and subsequent meetings to solve the minor issues associated with closing the Special Activities Account. Thank you for your time and interest in helping our District to comply with County policies and procedures. We truly appreciate your time and assistance.

Auditor's Response
Management response addresses planned actions to correct deficiencies noted in the audit finding.
This communication is intended solely for the information and use of management, the Audit Committee, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,

Larry Walker
Auditor/Controller-Recorder

By: Howard M. Ochi
Chief Deputy Auditor

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