



## City Encumbrance Carry Forward Audit - #882

### Executive Summary

#### *Why CAO Did This Review*

Pursuant to Section 5.10 of the Charter of the City of Jacksonville and Chapter 102 of the Municipal Code, we conducted an audit of the City encumbrance balances and associated budgets that were carried over at the end of the fiscal years 2019/20 and 2020/21.

According to the Governmental Accounting Standards Board (GASB), an encumbrance is a commitment of a budgeted expenditure (or appropriation) that is recorded in the accounting system before any actual expenditure or payment occurs. In other words, an encumbrance is a reservation of funds for a specific purpose or project, but the actual expenditure of the funds has not yet occurred. Encumbrances are used to ensure that funds are set aside and not overspent, and to provide information about the expected future financial obligations of the City. Once an encumbrance is recorded, it reduces the amount of available budget. The encumbrance remains in the accounting system until either the related goods or services are received and the encumbrance is closed, or until the encumbrance is canceled. An example of an encumbrance is with purchase orders. Once a purchase order is issued, there is an encumbrance for the full amount to prevent an area from overspending.

#### *What CAO Found*

We found instances where the encumbrances were not accurately carried forward, which resulted in overstated and understated budget capacity. Additionally, we found that encumbrances related to prior years that were closed or reduced were not properly released to fund balance. Specific issues noted included:

- Encumbrance carryforward issues related to the initial calculation caused by:
  - Invoices recorded in the new year prior to the carryforward not being properly accounted for in the carryforward.
  - Inaccurate totals for invoices charged to POs.
  - Un-invoiced receipt accrual expenses recorded in FY 2020/21 prior to the carryforward process that were not accounted for when calculating the carryforward amount.
- Purchase order balances carried forward were reduced without a reduction to budget.
- Failure to reduce budget capacity and encumbrances for invoices recorded in prior year after the carryforward process.
- No reduction in budget capacity for PO accruals recorded after the carryforward process.

#### *What CAO Recommends*

We recommend that the Accounting Division review their current carryforward process to ensure that it is accurately performed and to address the items noted above. This would include implementing checks and manual processes outside of the system as needed; however, the goal should be to make this process as automated as possible.



**Council Auditor's Office**

**City Encumbrance Carry Forward Audit**

**May 14, 2024**

**Report #882**

**EXECUTIVE SUMMARY**

**AUDIT REPORT #882**

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**OFFICE OF THE COUNCIL AUDITOR**  
Suite 200, St. James Building



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Report #882

Honorable Members of the City Council  
City of Jacksonville

**INTRODUCTION**

Pursuant to Section 5.10 of the Charter of the City of Jacksonville and Chapter 102 of the Municipal Code, we conducted an audit of the City encumbrance balances and associated budgets that were carried over at the end of the fiscal years 2019/20 and 2020/21.

According to the Governmental Accounting Standards Board (GASB), an encumbrance is a commitment of a budgeted expenditure (or appropriation) that is recorded in the accounting system before any actual expenditure or payment occurs. In other words, an encumbrance is a reservation of funds for a specific purpose or project, but the actual expenditure of the funds has not yet occurred. Encumbrances are used to ensure that funds are set aside and not overspent, and to provide information about the expected future financial obligations of the City. Once an encumbrance is recorded, it reduces the amount of available budget. The encumbrance remains in the accounting system until either the related goods or services are received and the encumbrance is closed, or until the encumbrance is canceled. An example of an encumbrance is with purchase orders. Once a purchase order is issued, there is an encumbrance for the full amount to prevent an area from overspending.

According to Section 106.414 of the Municipal Code, the Director of Finance and Administration is responsible for establishing an encumbrance system to track and document these obligations. If the outstanding encumbrance is still needed at the end of the fiscal year, then the encumbrance balance will be carried forward as part of the appropriation in the following year. If funds are released from an encumbrance that was carried forward to the following year, then those funds will become unappropriated funds in the following year's beginning fund balance. This is intended to prevent an area from having funds carried forward from one year to the next and then using the funds for a different purpose. This provides better budgetary controls to eliminate any advantages an area may have from not timely closing out purchase orders at year end.

**STATEMENT OF OBJECTIVE**

To determine whether the budget capacity associated with an encumbrance carry forward was accurate and that any unused budget capacity that was carried forward was properly released to fund balance.

## **STATEMENT OF SCOPE AND METHODOLOGY**

Our audit scope focused on encumbrances carried forward from fiscal year (FY) 2019/20 to FY 2020/21 and from FY 2020/21 to FY 2021/22. Data was last pulled on December 31, 2022. Each of the two years had over \$400 million in encumbrance carryforwards (heavily impacted by funds for capital improvements) and we tested all carryforwards for both years since we did not utilize sampling in this audit. However, Finding 3 only related to carryforwards for non-all years funds, which had carryforwards that ranged from \$65 million to \$85 million.

To analyze the accuracy of encumbrance balances carried forward, we extracted all expense transactions within the audit scope from the financial system, including budgeted expenses, actual expenses, and encumbrances. Each encumbrance and actual expense transaction was matched with its corresponding purchase order number. We classified each transaction based on the information provided in the transaction action and description fields in the City's financial system.

For encumbrances carried forward, we recalculated the un-invoiced balance for all purchase orders (i.e., the encumbrance outstanding at year-end), verifying the accuracy of the carried forward amounts to the subsequent fiscal year.

We also examined budgetary transactions to identify any instances where the budget capacity in FY 2020/21 and FY 2021/22 was reduced in connection with any encumbrances that were carried forward and then subsequently reduced or closed. However, no such transactions were found in our population.

To ensure the accurate reduction of budget capacity, we calculated the required budgetary and encumbrances reduction in connection to transactions recorded after the carry-forward process in the following situations:

- For purchase orders with encumbrances carried forward that were subsequently closed or reduced via change order.
- For purchase orders with encumbrances carried forward that had actual expenses accrued to the prior year at the end of the period, specifically related to un-invoiced receipt accruals. This is a situation where an expense was paid in the subsequent year after the carry forward process, but the expense was accrued back and the carry forward should have been reduced.
- For purchase orders with encumbrances carried forward and actual expenses subsequently recorded in the prior year (excluding un-invoiced receipt accruals). This is a situation where an expense posted to the prior year after the carry forward process, which resulted in less encumbrance at year end meaning less should have been carried forward.

Note: un-invoiced receipt accruals are the recording of expenses incurred for goods and services received from suppliers but that have not been invoiced yet.

Lastly, we assessed whether any fund exceeded its budgetary capacity (available balance) after applying the necessary budgetary reductions described above.

## **REPORT FORMAT**

Our report is structured to identify Internal Control Weaknesses, Audit Findings, and Opportunities for Improvement as they relate to our audit objective(s). Internal control is a process implemented by management to provide reasonable assurance that they achieve their objectives in relation to the effectiveness and efficiency of operations and compliance with applicable laws and regulations. An Internal Control Weakness is therefore defined as either a defect in the design or operation of the internal controls or as an area in which there are currently no internal controls in place to ensure that management's objectives are met. An Audit Finding is an instance where management has established internal controls and procedures, but responsible parties are not operating in compliance with the established controls and procedures. An Opportunity for Improvement is a suggestion that we believe could enhance operations.

## **STATEMENT OF AUDITING STANDARDS**

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## **AUDITEE RESPONSES**

Responses from the auditee have been inserted after the respective finding and recommendation. We received these final responses from Marcia Saulo, City Comptroller, in a memorandum on May 10, 2024.

## **AUDIT CONCLUSION**

We found instances where the encumbrances were not accurately carried forward, which resulted in overstated and understated budget capacity. Additionally, we found that encumbrances related to prior years that were closed or reduced were not properly released to fund balance.

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## **AUDIT OBJECTIVE**

**To determine whether the budget capacity associated with an encumbrance carry forward was accurate and that any unused budget capacity that was carried forward was properly released to fund balance.**

## **Finding 1 – Encumbrance Carryforward Calculation Issues (Related to Initial Calculation)**

Section 106.414(b) of the Municipal Code states that the encumbered balance in an appropriation account at the end of the fiscal year will be carried forward and included in the appropriation account for the following fiscal year with the caveat that only the estimated amount of expenditures needed is carried forward. This means the amount carried forward must be calculated accurately to ensure there is enough budget capacity to meet future obligations. Further the section goes on to state that any amount carried forward that is not used (i.e., released when closing out the purchase order), must then fall to fund balance (i.e., deappropriate the excess amount). This is intended to maintain budget controls and remove the incentive for areas to not close purchase orders out at year end and utilize the funds for a different purpose.

Upon conducting a detailed recalculation of the encumbrances carried forward from FY 2019/20 to FY 2020/21 and from FY 2020/21 to FY 2021/22, we identified several issues that need to be addressed related to the initial calculation of the carry forward:

### **1. Encumbrances carried forward from FY 2019/20 to FY 2020/21:**

It appears that the encumbrances carried forward were understated by a net amount of \$8,248,469. This means less net funding was brought forward than should have been; however, some carry forwards were overstated which does mean in some instances the amount carried forward was more than was legally allowed. The following were factors identified as causing the issues:

- a. The encumbrances carried forward for 331 purchase order (PO) lines were understated by \$8,258,721 due to a calculation error that resulted from invoices expensed in FY 2020/21, prior to the FY 2019/20 carry forward process. These invoices expensed in FY 2020/21 incorrectly reduced the encumbrance balance to be carried forward from FY 2019/20 to FY 2020/21. To ensure accurate encumbrance carryforward calculations, invoices expensed in FY 2020/21, prior to the FY 2019/20 carryforward process, should not have reduced the carryforward amount.
- b. The encumbrances carried forward related to 38 purchase order lines were overstated by \$662,116 in total due to a calculation error that was attributed to inaccurate invoice totals charged to the PO in the Procurement System, as described in Finding 2.
- c. The encumbrances carried forward for 155 purchase order lines were understated by \$651,864 due to other unidentified factors. Further investigation would be required to determine the specific causes of these discrepancies.

### **2. Encumbrances carried forward from FY 2020/21 to FY 2021/22:**

It appears that the encumbrances carried forward were overstated by a net amount of \$3,094,542. This means more net funding was brought forward than was legally allowed. The following were factors identified as causing the issues:

- a. The encumbrances carried forward for 1,328 purchase order lines were overstated by \$14,008,643 in total due to a calculation error that was the result of un-invoiced receipt accrual expenses (i.e., accrued expenses booked for which an invoice had not yet been received but goods or services had been received) recorded in FY 2020/21 prior to the carryforward process that were not accounted for when calculating the carryforward amount. Therefore, the encumbrances for these accrued expenses did not need to be carried forward.

- b. The encumbrances carried forward for 387 purchase order lines were understated by \$11,311,479 due to a calculation error that resulted from invoices expensed in FY 2021/22, prior to the FY 2020/21 carry forward process. These invoices expensed in FY 2021/22 incorrectly reduced the un-invoiced purchase order balance to be carried forward from FY 2020/21 to FY 2021/22. To ensure accurate encumbrance carryforward calculations, invoices expensed in FY 2021/22, prior to the FY 2020/21 carryforward process, should not have reduced the carryforward amount.
- c. The encumbrances carried forward for 92 purchase order lines were overstated by \$1,878,304 due to a calculation error attributed to the inaccurate total for invoices charged to a PO in the Procurement System, as described in Finding 2.
- d. The encumbrances carried forward for 95 purchase order lines were understated by \$1,480,926 due to other unidentified factors. Further investigation would be required to determine the specific causes of these discrepancies.

Contrary to the guidance from the vendor for the City’s financial system, we observed in the City’s financial system that the Accounts Payable subledger for the new fiscal year is opened before the carryforward process is completed. Since invoices related to the new fiscal year are often posted to the new period before the encumbrance carryforward process is performed, this results in an incorrect encumbrance balance being carried forward to the next year.

We also observed that for FY 2020/21 the “Year-End Un-invoiced Receipt Accrual” process was run before the “Carry Forward Purchase Order Budgetary Control Balances” process in the City’s financial system. Per the vendor’s recommendation, the “Year-End Un-invoiced Receipt Accrual” process should be run after the “Carry Forward Purchase Order Budgetary Control Balances” process.

**Recommendation to Finding 1**

We recommend that the Accounting Division review their current budgetary control carryforward process to ensure that it is accurately performed. Consideration should be given to following the guidance provided by the vendor. In cases where any deviation from the recommended process occurs or discrepancies are identified, it is imperative for the Accounting Division to promptly make the necessary adjustments to the encumbrances carried forward to account for any issues caused by the deviation.

**Auditee Response to Finding 1**

Agree                       Disagree                       Partially Agree

*We agree with the Council Auditor's findings. Many, if not all, of the issues are related to how ICloud (Oracle Fusion) handles dates. At the time of implementation, we were unaware of the importance of the various dates. As an example, the Expenditure Item Date (EID) on a Purchase Order (PO) triggers the invoice to be recorded in the period where the PO EID is set. Assuming*

*an October invoice is matched to a PO with an EID in September, ICloud will record the invoice in September for the Budgetary Control module.*

*Our experience with dates has led to an evolution of how we conduct the annual carry forward process. We have instituted policies so that the dates align across all of the relevant documents which will minimize the issues that will be carried forward in the future. As a further internal control, we will be implementing a rolling carry forward process starting with the first carry forward. By doing this, we will continuously monitor the carry-forward amounts and adjust them if necessary.*

*As an added measure to reduce human error, we process only prior-year invoices during the first couple of weeks of the new year.*

### **Finding 2 – Inaccurate Totals for Invoices Charged to POs (Related to Initial Calculation)**

During our review of purchase orders in the Procurement module of the City’s financial system, we identified discrepancies between the amount the module displayed as the total amount invoiced and the corresponding invoice detail section. We found this inconsistency for 221 purchase orders as of February 3, 2023. The cumulative net discrepancy amounted to \$3,438,299. Consequently, the displayed total amount invoiced was understated by \$3,438,299 as of February 3, 2023. This error type results in too much carry forward.

The carryforward process appears to rely on the Procurement module’s displayed totals to calculate the encumbrances balance to be carried forward. Therefore, if the total amount invoiced for a purchase order is incorrect, it is likely that the encumbrance amount carried forward for that specific purchase order will also be inaccurate. This finding resulted in errors in the calculation of encumbrance carryforward balances, which was discussed in detail in Finding 1 above.

### **Recommendation to Finding 2**

We recommend that the City takes corrective action to fix the inaccuracies in the invoiced totals for the identified purchase orders in the City’s financial system. Additionally, the City should investigate and determine the root cause of the issue that led to the discrepancies in the invoiced totals and should implement proper controls as necessary to prevent similar errors from occurring in the future. Until corrective action can be implemented in the system, this issue needs to be taken into account during the annual carry forward process to avoid the incorrect amount from being carried forward.

### **Auditee Response to Finding 2**

Agree                       Disagree                       Partially Agree

*Once we discovered that the PO life cycle did not represent the invoices being applied against a PO, we notified Oracle. We were told that the issue had been fixed. In the future, this should not be an issue.*

**Finding 3 – PO Balance Carried Forward Reduced Without a Reduction to Budget (Issue After Initial Calculation)**

Pursuant to Section 106.414(b), any amount carried forward that is not used (i.e., released when closing out the purchase order), must then fall to fund balance (i.e., deappropriate the excess amount). This is intended to maintain budget controls and remove the incentive of not closing purchase orders out at year end.

When purchase order (PO) un-invoiced balances were carried forward from FY 2019/20 to FY 2020/21, encumbrances and budgeted balances were increased in FY 2020/21 by the PO balance amount as they should have been. Then, after the encumbrances carry forward process was completed, some of the PO balances were closed or reduced via change order, releasing the respective encumbrance for those POs in FY 2020/21 as is normal. However, it appears that there was not a reduction in the budget for the amounts carried forward into FY 2020/21 that were released. We found this issue also occurred in FY 2021/22. Based on our detail testing, we found:

- **Carryforward from FY 2019/20 to FY 2020/21:** 1,749 PO lines were carried forward from FY 2019/20 to FY 2020/21 and subsequently had a reduction in encumbrances (via change orders or by closing the PO). The total reduction in PO balances (encumbrances) carried forward was \$9,258,188 in FY 2020/21. However, there was no reduction in budget capacity in FY 2020/21 for a corresponding amount as should have occurred. This caused the revised budget for FY 2020/21 to be overstated by \$9,258,188.
- **Carryforward from FY 2020/21 to FY 2021/22:** 1,052 PO lines were carried forward from FY 2020/21 to FY 2021/22 and subsequently had a reduction in encumbrances (via change orders or by closing the PO). The total reduction in PO balances (encumbrances) carried forward was \$7,229,202 in FY 2021/22. However, there was no reduction in budget capacity in FY 2021/22 for a corresponding amount as should have occurred. This caused the revised budget for FY 2021/22 to be overstated by \$7,229,202.

Additionally, we found that the issues above helped contribute to three funds having further negative available balances in FY 2020/21 and nine funds having further negative available balances in FY 2021/22. Note that these funds had negative available balances before the issues we noted with the budget were taken into account. When taking into account the issues we noted, the negative balances went further negative by \$44,893 in FY 2020/21 and \$377,917 in FY 2021/22.

**Recommendation to Finding 3**

We recommend that the City implement a process to properly reduce any available budget capacity (budgetary and encumbrance balances as applicable) that resulted from releasing encumbrances that were carried over from a prior fiscal year. When a purchase order is closed or reduced via change order, the City should verify if the funds released were carried over from a prior fiscal year. If so, then the budgeted amount that was carried forward should also be properly reduced by the encumbrance amount being released so that these funds remain unspent and fall to fund balance in accordance with Municipal Code, Section 106.414 (b).

**Auditee Response to Finding 3**

Agree                       Disagree                       Partially Agree

*With the previous ERP accounting, we were able to run a report that would provide a listing of the carryforwards that needed to be adjusted. We have dedicated resources to this effort without success. However, we have managed to put several reports together to get at the encumbrance amount that needs to be recaptured.*

**Finding 4 – Failure to Reduce Budget Capacity and Encumbrances for Invoices Expensed in Prior Year After the Carryforward Process (Issue After Initial Calculation)**

Our audit identified issues related to the lack of reduction in budget capacity and encumbrances for purchase order (PO) invoices expensed after the carryforward process. In the process of carrying forward PO un-invoiced balances from FY 2019/20 to FY 2020/21, encumbrances and budgeted balances were increased in FY 2020/21 by the carried forward PO balance amount. However, in some instances new invoices were subsequently expensed in FY 2019/20 instead of being expensed in the new fiscal year (FY 2020/21). As a result, amounts carried forward were no longer needed to cover these invoices and thus the amount carried forward was overstated and should have been reduced. However, the encumbrances and budget capacity balances associated with these carried forward amounts were not reduced in FY 2020/21, which meant there was excess capacity in FY 2020/21. We also found a similar issue occurring in FY 2021/22.

Based on our testing performed, we found the following by fiscal year:

- **FY 2019/20 carryforward:** A total of 324 PO lines that were carried forward from FY 2019/20 to FY 2020/21 subsequently had invoices totaling \$1,356,495 expensed in the FY 2019/20 accounting period. However, budget and encumbrances carried forward into FY 2020/21 were not reduced by \$1,356,495 to account for those invoices.
- **FY 2020/21 carryforward:** A total of 74 PO lines that were carried forward from FY 2020/21 to FY 2021/22 subsequently had invoices totaling \$83,108 expensed in the FY 2020/21 accounting period. However, budget and encumbrances carried forward into FY 2021/22 were not reduced by \$83,108 to account for these invoices.

According to Section 106.414 of the Municipal Code, an encumbrance may be released if the funds are no longer needed to pay for any future obligations. The released funds may be encumbered again for a new obligation unless that appropriation was carried over from a prior fiscal year. If the funds released from an encumbrance were originally carried over from a prior fiscal year, the released funds should be unappropriated funds and included in the new fiscal year’s beginning fund balance.

**Recommendation to Finding 4**

We recommend that the City implement a business process to ensure the proper reduction of available budget capacity and encumbrance balances that are no longer needed in the new fiscal year that resulted from recording new invoices in the prior fiscal year. This process should be

designed in accordance with Section 106.414(b) of the Municipal Code, which requires compliance with the release of encumbrances carried over from a prior fiscal year.

**Auditee Response to Finding 4**

Agree                       Disagree                       Partially Agree

*We believe that by implementing a rolling carry forward, this issue will be resolved since the process will take a look at both Encumbrances and Expenditures.*

**Finding 5 – No Reduction in Budget Capacity for PO Accruals Recorded After the Carryforward Process (Issue After Initial Calculation)**

When purchase order (PO) un-invoiced balances were carried forward from FY 2019/20 to FY 2020/21, encumbrances and budgeted balances were increased in FY 2020/21 by the PO balance amount being carried forward. After the encumbrances carry forward process was completed in FY 2019/20, the Accounting Division ran the “Create Un-invoiced Receipt Accruals” process in the City’s financial system which moved some of the PO expenses back to the prior year. The “Create Un-invoiced Receipt Accruals” process reduced expenses in FY 2020/21 and increased expenses in FY 2019/20. Since expenses were transferred out of FY 2020/21, the balance carried forward was no longer needed in FY 2020/21 to cover those expenses. Therefore, budget capacity balances needed to be reduced in FY 2020/21 because that budget capacity was only authorized for expenses of that specific PO.

Based on our detail testing, we found 133 PO encumbrance lines that were carried forward from FY 2019/20 to FY 2020/21 and subsequently had expenses accrued back to FY 2019/20 totaling \$8,926,575. However, budget capacity was not reduced by \$8,926,575 in FY 2020/21 for the excess carryforward. This means that there was more budget capacity available in these funds for other purposes in FY 2020/21 than should have been.

According to Section 106.414 of the Municipal Code, an encumbrance may be released if the funds are no longer needed to pay for any future obligations. The released funds may be encumbered again for a new obligation unless that appropriation was carried over from a prior fiscal year. If the funds released from an encumbrance were originally carried over from a prior fiscal year, the released funds should be unappropriated funds and included in the new fiscal year’s beginning fund balance.

**Recommendation to Finding 5**

We recommend that the City implement a process to properly ensure there is not extra budget capacity created from accruing PO expenses back to the prior year. When expenses related to a purchase order are moved back to the prior period, the City should verify if the expenses accrued were for a PO balance that was carried forward from a prior year. If that was the case, then the budgeted amount that was carried forward should be properly reduced by the amount being accrued back to the prior year.

**Auditee Response to Finding 5**

Agree                       Disagree                       Partially Agree

*We believe that by implementing a rolling carry forward, this issue will be resolved since the process will take a look at both Encumbrances and Expenditures. We also believe there are training opportunities for Departments on invoice follow up once good/services have been received.*

**Opportunity For Improvement 1 – Adjust Frequency of the “Create Un-invoiced Receipts Accruals” Process**

During our audit, we identified an opportunity for the City to potentially reduce the frequency of the "Create Un-invoiced Receipt Accruals" process in the financial system. This process records expenses for products and services that have been recorded in the Procurement module as received, but an invoice has not been received yet at the end of the period. Currently, this process is executed on a monthly basis. However, discussions with the Accounting Division revealed that the process does not consistently run smoothly, and efforts are being made to resolve the associated issues with the vendor’s support.

Currently, other accrual processes, such as payroll accruals, are performed only at the end of the year while others are performed on a quarterly basis. Considering these factors, we propose that the City reassess the frequency of running the "Create Un-invoiced Receipt Accruals” process and consider transitioning it to a quarterly or annual basis.

By reducing the frequency of this process, the City will decrease the time and effort expended on this task, as running the process less frequently will alleviate the burden on resources involved in its execution. Also, given the existing issues encountered with the process, decreasing the number of occurrences will minimize the potential for system-related problems and related complications.

**Recommendation to Opportunity For Improvement 1**

We recommend that the City evaluate the feasibility and potential advantages of adjusting the “Create Un-invoiced Receipt Accruals" process to operate on a quarterly or annual basis. This change will allow for improved efficiency and mitigate the risks associated with the current monthly execution.

**Auditee Response to Opportunity For Improvement 1**

Agree                       Disagree                       Partially Agree

*We have changed the timing of the Receipt Accrual process to take place prior to the carry forward. Currently we continue to run the process on a monthly basis. We are open to further evaluation of the feasibility and potential advantages of adjusting the process to operate on a quarterly or annual basis.*

We appreciate the assistance and cooperation we received from the Finance and Administration Department throughout the course of this audit.

Respectfully submitted,

*Kim Taylor*

Kim Taylor, CPA  
Council Auditor

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