



### **Communication with Those Charged with Governance**

To Management, Mayor and City Council of  
City of Hondo

We have audited the financial statements of City of Hondo as of and for the year ended September 30, 2017, and have issued our report thereon dated January 15, 2018. Professional standards require that we advise you of the following matters relating to our audit.

#### **Our Responsibility in Relation to the Financial Statement Audit**

As communicated in our engagement letter dated May 26, 2017, our responsibility, as described by professional standards, is to form and express an opinion(s) about whether the financial statements that have been prepared by management with your oversight are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your respective responsibilities.

Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. Accordingly, as part of our audit, we considered the internal control of City of Hondo solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are also responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.

#### **Planned Scope and Timing of the Audit**

We conducted our audit consistent with the planned scope and timing we previously communicated to you.

#### **Compliance with All Ethics Requirements Regarding Independence**

The engagement team and others in our firm, as appropriate, have complied with all relevant ethical requirements regarding independence.

## **Qualitative Aspects of the Entity's Significant Accounting Practices**

### *Significant Accounting Policies*

Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by City of Hondo is included in Note A to the financial statements. There were no new accounting policies adopted and no changes in significant accounting policies or their application during 2017. No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

### *Significant Accounting Estimates*

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on 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 markedly from management's current judgments.

The most sensitive accounting estimates affecting the financial statements are:

1. Useful lives of depreciable assets
2. Allowance for uncollectible property tax and utility receivables
3. Net Pension Liability assumptions for mortality rates and investment returns

We evaluated the key factors and assumptions used to develop the estimates and determined that they are reasonable in relation to the basic financial statements taken as a whole and in relation to the applicable opinion units.

### *Financial Statement Disclosures*

Certain financial statement disclosures involve significant judgment and are particularly sensitive because of their significance to financial statement users. There are no sensitive disclosures affecting City of Hondo's financial statements.

### **Significant Difficulties Encountered during the Audit**

We encountered no difficulties in dealing with management relating to the performance of the audit.

### **Representations Requested from Management**

We have requested certain written representations from management in a separate letter dated January 15, 2018.

### **Disagreements with Management**

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter, which could be significant to City of Hondo's financial statements or the auditor's report. No such disagreements arose during the course of the audit.

## **Uncorrected and Corrected Misstatements**

For purposes of this communication, professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that we believe are trivial, and communicate them to the appropriate level of management. Further, professional standards require us to also communicate the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole and each applicable opinion unit. The following uncorrected financial statement misstatement's effects in the current and prior periods, as determined by management, are immaterial, both individually and in the aggregate, to the financial statements taken as a whole and each applicable opinion unit:

1. General Fund (and Governmental Activities) grant revenues are overstated by \$45,500 from the receipt of a USDA Grant payment recorded as revenue in the 2017 fiscal year but earned in the 2016 fiscal year.

In addition, professional standards require us to communicate to you all material, corrected misstatements that were brought to the attention of management as a result of our audit procedures. The following misstatements identified by us as a result of our audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole or applicable opinion units:

1. Reconcile accounts payable to the subsidiary ledger
2. Corrected cash reconciliations for erroneous reconciling items and posting errors

In addition, we assisted management in recording routine adjustments for depreciation, retirement, retiree insurance, and revenue accruals.

## **Management's Consultations with Other Accountants**

In some cases, management may decide to consult with other accountants about auditing and accounting matters. Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

## **Other Significant Matters, Findings, or Issues**

In the normal course of our professional association with City of Hondo, we generally discuss a variety of matters, including the application of accounting principles and auditing standards, operating and regulatory conditions affecting the entity, and operational plans and strategies that may affect the risks of material misstatement. None of the matters discussed resulted in a condition to our retention as City of Hondo's auditors.

During prior audit procedures, we became aware of opportunities for improvements. A listing of these findings and current status follows:

*Inadequate Financial Reporting*

In previous audits we discovered several significant adjustments that were not detected and corrected by management. Management did not have a routing closing process to reconcile items such as:

1. Pooled cash was not reconciled across all of the funds having a share in the pool.
2. Balances owed between funds were not reconciled and balanced.
3. Inventory was not reconciled to the financial statements.
4. The accounts payable open item report was not reconciled to the control account nor to accounts payable reported on the financial statements in each fund.
5. General accounts receivable and revenues (miscellaneous general fund revenues, recreation revenues, airport revenues, and other miscellaneous revenues) were not reconciled to underlying records.

Management should develop a comprehensive list of reconciliations and financial reporting duties to be performed on a routine basis and assign responsible individuals. Monitoring should be performed to ensure these functions are performed and individuals are held responsible.

Status: Management made great effort this year to address this finding and performed all of the reconciliations listed above. Although, we detected significant corrections to cash, these primarily related to closing out the problematic, prior pooled cash system that was not implemented properly. Management has posted the correcting entries from the audit and has successfully reconciled subsequent months. This matter is considered resolved.

*Pooled Cash*

Pooled cash utilizes one account at the bank that is shared by multiple funds to facilitate transactions between funds, simplify accounts payable, reduce the number of monthly reconciliations required, and maximize investment potential by minimizing checking account balance requirements. The City is currently using pooled cash but it also has 20 individual accounts for other purposes. Many of these accounts could be consolidated into pooled cash to maximize the benefits of pooled cash. In addition, many of the errors we identified as part of the audit were partially caused by these other accounts not being pooled (i.e. payments were made from or deposits were made to the wrong bank account). Management should consolidate as many bank accounts into pooled cash as possible to maximize the benefit of pooled cash and simplify daily processing of transactions to reduce errors.

Status: Management has worked with Incode to start fresh by implementing a new pooled cash system. Management has also slowly been closing bank accounts and incorporating them into the new pooled cash. This matter is considered resolved.

*Comparison of Utility Consumption to Sales*

A key operating indicator for utility services, particularly in water service, is a comparison of supply entering the system and consumption billed to customers. This indicator can reveal inefficiencies in the delivery system, potential billing errors, or unbilled consumption. It did not appear this comparison was being performed for the water or electric systems. Consider adding this comparison to monthly reports to Council.

Status: Management now includes this information in the quarterly financial packets. This matter is considered resolved.

### Unclaimed Funds

The City maintains a fund called Unclaimed Funds. Presumably this fund holds uncleared utility deposit payments and vendor checks. The turnover in management has resulted in a loss of knowledge about the fund and what is included in it. Management should research the unclaimed funds and the balances that it holds to ensure compliance with Texas escheat laws. The costs of maintaining the City's unclaimed funds may outweigh the benefits.

Status: Management has identified as much of the unclaimed balance as possible and has made effort to notify the individuals. The City is awaiting the prescribed time before next steps are taken. This matter is considered resolved.

### Incode Permissions

During audit procedures we noted opportunities to restrict employee access in Incode to strengthen internal control. For example, restrict utility clerk access to account adjustments to a supervisor. This would require approval before any adjustments are made. The City has a good paper review process, but it does not prevent someone from making fraudulent or erroneous adjustments by bypassing the paper process. Management should review employee setup in Incode and restrict permissions as much as possible without compromising their ability to perform their assigned duties.

Status: Management feels the paper review process reduces the risk to an acceptable level, and that the operational inefficiencies of tightening permissions further outweigh the benefits of the strengthened controls. Management's evaluation is reasonable and we consider the matter closed.

### Journal Entry Review

We noted several adjusting journal entries that were made backwards, were duplicates, or should have been recorded differently. We found documentation of these entries to be sufficient; however we did not see any evidence of review of these journal entries before they were posted. Management should implement a review process to help reduce the error rate in the adjusting journal entries.

Status: Management has developed a journal entry form to document the entry prior to posting and to document review and approval. This matter is considered resolved. However, it is important to note that the absence of a Finance Director has limited the review capabilities of entries the Assistant Finance Director makes.

### Permit Process

The City utilizes Incode to prepare permits, which are printed and signed by appropriate personnel before payment. These paper permits are then moved to City Hall to await payment. Opportunities exist for permits to leave City Hall without payment. Rather than have physical signatures, management should consider utilizing Incode to restrict printing of the permit until payment is applied. This could eliminate the need for physical signatures, provide better long-term storage of approval history and permits, and allow anyone with access to Incode from any location to print a permit upon payment. Thus, payments could be accepted at any City location without the need to transfer paper files. In addition, we noted that permit clerks were able to override the fee calculations in Incode. Management should review situations where overrides are necessary, correct the appropriate Incode calculations, and restrict access to overrides to prevent abuse or error.

Status: Permits are now created and kept in Incode. City Hall may accept payments, apply them to the permit, and print them at City Hall. This matter is considered resolved.

During audit procedures, we became aware of another opportunity for improvement with the following suggestion:

*Investments*

The City currently utilizes a sweep from checking accounts that is making bank reconciliations more difficult than the interest earnings may be worth. In addition, investment returns from traditional local government investment pools, such as Texpool, are now competitive with the sweep and beating the City's certificate of deposit portfolio. Local government investment pools provide security and liquidity. Now that the City has a pooled cash system with more funds participating, the City should consider reducing the checking balance, investing the excess and eliminating the sweep to simplify the bank reconciliation process.

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.

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

Respectfully,

A handwritten signature in black ink that reads "Armstrong, Vaughan & Associates, P.C." The signature is written in a cursive, flowing style.

Armstrong, Vaughan & Associates, PC  
January 15, 2018