NOVATO FIRE PROTECTION DISTRICT
MEMORANDUM ON INTERNAL CONTROL
FOR THE YEAR ENDED JUNE 30, 2019
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MEMORANDUM ON INTERNAL CONTROL

To the Board of Directors of
the Novato Fire Protection District
Novato, California

In planning and performing our audit of the basic financial statements of the Novato Fire Protection District (District) as of and for the year ended June 30, 2019, 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 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 District’s internal control. Accordingly, we do not express an opinion on the effectiveness of the District’s internal control.

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 District’s financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. 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. Given these limitations during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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.

This communication is intended solely for the information and use of management, Board of Directors, others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

Pleasant Hill, California
November 7, 2019
GASB PRONOUNCEMENTS OR PRONOUNCEMENTS NOT YET EFFECTIVE

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

EFFECTIVE FISCAL YEAR 2019/20:

GASB 84 – Fiduciary Activities

The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported.

This Statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities.

This Statement describes four fiduciary funds that should be reported, if applicable: (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private-purpose trust funds, and (4) custodial funds. Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria.

GASB 90 – Majority Equity Interests—an amendment of GASB Statements No. 14 and No. 61)

The primary objectives of this Statement are to improve the consistency and comparability of reporting a government’s majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units. It defines a majority equity interest and specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government’s holding of the equity interest meets the definition of an investment. A majority equity interest that meets the definition of an investment should be measured using the equity method, unless it is held by a special-purpose government engaged only in fiduciary activities, a fiduciary fund, or an endowment (including permanent and term endowments) or permanent fund. Those governments and funds should measure the majority equity interest at fair value.

For all other holdings of a majority equity interest in a legally separate organization, a government should report the legally separate organization as a component unit, and the government or fund that holds the equity interest should report an asset related to the majority equity interest using the equity method. This Statement establishes that ownership of a majority equity interest in a legally separate organization results in the government being financially accountable for the legally separate organization and, therefore, the government should report that organization as a component unit.
This Statement also requires that a component unit in which a government has a 100 percent equity interest account for its assets, deferred outflows of resources, liabilities, and deferred inflows of resources at acquisition value at the date the government acquired a 100 percent equity interest in the component unit. Transactions presented in flows statements of the component unit in that circumstance should include only transactions that occurred subsequent to the acquisition.

**EFFECTIVE FISCAL YEAR 2020/21:**

**GASB 87 – Leases**

The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments’ financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments’ leasing activities.

**GASB 89 – Accounting for Interest Cost Incurred before the End of a Construction Period**

The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period.

This Statement establishes accounting requirements for interest cost incurred before the end of a construction period. Such interest cost includes all interest that previously was accounted for in accordance with the requirements of paragraphs 5–22 of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which are superseded by this Statement. This Statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund.

This Statement also reiterates that in financial statements prepared using the current financial resources measurement focus, interest cost incurred before the end of a construction period should be recognized as an expenditure on a basis consistent with governmental fund accounting principles.
EFFECTIVE FISCAL YEAR 2021/22:

GASB 91 – Conduit Debt Obligations

The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This Statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures.

This Statement also addresses arrangements—often characterized as leases—that are associated with conduit debt obligations.

This Statement requires issuers to disclose general information about their conduit debt obligations, organized by type of commitment, including the aggregate outstanding principal amount of the issuers’ conduit debt obligations and a description of each type of commitment. Issuers that recognize liabilities related to supporting the debt service of conduit debt obligations also should disclose information about the amount recognized and how the liabilities changed during the reporting period.
\textbf{NOVATO FIRE PROTECTION DISTRICT}
\textbf{MEMORANDUM ON INTERNAL CONTROL}

\textbf{STATUS OF PRIOR YEAR MATERIAL WEAKNESS}

\textbf{2018 – 001 Finance Division Staffing}

\textit{Criteria:} Adequate staffing of the District’s financial functions is essential to ensure data are processed, recorded timely and reported in a meaningful way. Permanent staff at appropriate levels is needed to provide for good checks and balances and ensure data accuracy is maintained at a high level.

\textit{Condition:} Since November 2017 the position of Accounting Specialist has been vacant leaving the Finance Division with two full-time employees (Director of Finance and Contracts Administrator/Accounts Payable). While staff closed the District’s books in current year with minimal adjustments, the additional workload shared by them due to the vacancy is significant. In addition, the Director of Finance is scheduled to retire in March 2019, which will leave the District without a professional who is knowledgeable in governmental accounting.

\textit{Cause:} The Accounting Specialist resigned in October 2017. The District’s recruitment efforts did not result any viable candidates. With the vacant Accounting Specialist position, the workload was distributed between the Contracts Administrator/Accounts Payable, and the Finance Director. This additional workload caused a lack of segregation of duties.

\textit{Effect:} The above condition does not allow for adequate internal controls. For example, due to lack of other accounting staff, when entering bank deposits, the Director of Finance enters the entry into the financial system, releases the entry for approval and logs in to approve the same entry.

\textit{Recommendation:} We understand that the District is currently looking for a replacement for the retiring Director of Finance. We recommend that the District should also fill the vacant position of Accounting Specialist with someone who is knowledgeable in governmental accounting. This will allow the District to better segregate various financial functions and provide the check and balances that is appropriate.

\textit{Fiscal Year 2017/18 Management Response:} The District will hire a new Finance Director on December 1, 2018. Effective that date, this will allow for an immediate and sufficient separation of duties between the two Finance Directors. One Finance Director will enter the transactions and the other will approve the transactions, which are now currently performed by the incumbent Finance Director alone. The District will then begin the recruitment process in January 2019 to hire an additional full time Finance Division employee to complement the incoming Finance Director based upon the skills required. Upon hiring the new Finance Division employee, separation of duties would be transitioned and maintained during this period and after the retirement of the outgoing Finance Director in March 2019.
Status of Prior Year Material Weakness

Current Year Status: The District hired a new Finance Director in December 2018. The new Finance Director worked with the incumbent Finance Director for 4 months and immediately took on tasks while training to achieve a separation of duties and ensure a smooth transition of responsibilities. The District began the recruitment process for a Senior Accountant position in January 2019 to replace the previous Accounting Specialist position that had been vacant since October 2017. In May 2019, the District hired a Senior Accountant with a BS degree in Accounting and experience in governmental accounting, having worked for the City of Novato, County of Marin, and Ross Valley Sanitation District. In the interim, the District had been utilizing a part-time contractor for payroll services, and now has a full-time position to process payroll and benefits. This position also performs many of the day-to-day accounting tasks previously handled by the Finance Director and Contracts Administrator, including bank deposits and accounts payable. There is now separation of duties between Purchasing and Accounts Payable, since the Contracts Administrator is no longer issuing the PO to the vendor, entering the invoice for payment, and issuing the check. There is also a more robust review process. For example, the Finance Director, who previously entered and approved deposits and reconciled the bank accounts, now approves bank deposits entered in the County of Marin’s financial system (MUNIS) by the Senior Accountant and also reviews the account reconciliations. The timeliness of the transaction processing has improved, and the secondary review reduces risk of errors or potential for fraud. There is also a backup person in the event another staff member is ill or on vacation to maintain critical and time-sensitive accounting functions such as payroll, banking functions, and vendor payments.