

**CITY OF SEDONA, ARIZONA
SINGLE AUDIT ACT REPORTS
YEAR ENDED JUNE 30, 2010**

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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Honorable Mayor and City Council
City of Sedona, Arizona
Sedona, Arizona

We have audited the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the City of Sedona, Arizona as of and for the year ended June 30, 2010, and have issued our report thereon dated February 2, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the City of Sedona, Arizona's internal control over financial reporting 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 City of Sedona, Arizona's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City of Sedona, Arizona's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

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 entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in item 2010-1 through 2010-3 in the accompanying schedule of findings and questioned costs to be material weaknesses.

Honorable Mayor and City Council
City of Sedona, Arizona

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the City of Sedona, Arizona's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The City of Sedona, Arizona's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the City of Sedona, Arizona's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of City Council, management of City, federal awarding agencies, state funding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

LarsonAllen LLP

LarsonAllen LLP

Mesa, Arizona
February 2, 2011

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS
THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133**

Honorable Mayor and City Council
City of Sedona, Arizona
Sedona, Arizona

COMPLIANCE

We have audited the City of Sedona, Arizona's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the City of Sedona, Arizona's major federal programs for the year ended June 30, 2010. The City of Sedona, Arizona's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the City of Sedona, Arizona's management. Our responsibility is to express an opinion on the City of Sedona, Arizona's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City of Sedona, Arizona's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the City of Sedona, Arizona's compliance with those requirements.

In our opinion, the City of Sedona, Arizona complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2010. However, the results of our auditing procedures disclosed an instance of noncompliance with those requirements, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as item 2010-4.

INTERNAL CONTROL OVER COMPLIANCE

Management of the City of Sedona, Arizona is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the City of Sedona, Arizona's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City of Sedona, Arizona's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified a certain deficiency in internal control over compliance that we consider to be a significant deficiency as described in the accompanying schedule of findings and questioned costs as item 2010-4. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

The City of Sedona, Arizona's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the City of Sedona, Arizona's responses and, accordingly, we express no opinion on the responses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Sedona, Arizona as of and for the year ended June 30, 2010, and have issued our report thereon dated REPORT DATE. Our audit was performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

Honorable Mayor and City Council
City of Sedona, Arizona

This report is intended solely for the information and use of the City Council, management of the City, federal awarding agencies, state funding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

LarsonAllen LLP

LarsonAllen LLP

Mesa, Arizona
February 2, 2011

**CITY OF SEDONA, ARIZONA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2010**

SECTION I – SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditor's report issued: *Unqualified*
 Internal control over financial reporting:

- Material weakness(es) identified? X yes no
- Significant deficiency(ies) identified? yes X none reported

Noncompliance material to financial statements noted? yes X no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? yes X no
- Significant deficiency(ies) identified? X yes none reported

Type of auditor's report issued on compliance for major programs: *Unqualified*

Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)? X yes no

Identification of major programs:

CFDA Numbers
16.803

Name of Federal Program or Cluster
Byrne Formula Grant

Dollar threshold used to distinguish between Type A and Type B programs: \$ 300,000

Auditee qualified as low-risk auditee? yes X no

CITY OF SEDONA, ARIZONA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED JUNE 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS

2010-1: Oversight of the Financial Reporting Process

Condition: The City does not have a system of internal controls that would enable management to conclude the financial statements and related disclosures are complete and presented in accordance with GAAP. As such, management requested us to prepare a draft of the financial statements, including the related footnote disclosures.

The audit firm proposed and the City posted to its general ledger accounts, journal entries to correct misstatements in long-term debt, transfers, fund balance and the GASB34 conversion entries. Long-term debt entries that were not properly recorded by the City include: 1) Principal and interest not recorded in the proper fund; 2) Principal payments in the business-type fund recorded as expenditures and not as reductions to bonds payable; and 3) Recording cash with trustee for governmental funds. These entries relate to internal controls over the year-end close-out process.

Criteria: The City should have controls in place to prevent and detect a material misstatement in the financial statements in a timely manner. Management is responsible for the accuracy and completeness of all financial records and related information. Their responsibilities include adjusting the financial statements to correct material misstatements.

Effect: No effect on the financial statements.

Cause: The City has not established controls to ensure that all accounts are adjusted to their appropriate year-end balances in accordance with GAAP. The City relies on the audit firm to prepare the annual financial statements, related footnote disclosures, and to verify balances are correct at year-end. However, they have reviewed and approved the annual financial statements and related footnote disclosures.

Recommendation: We recommend the City continue to evaluate its internal control processes to determine if additional internal control procedures should be implemented to ensure that accounts are adjusted to their appropriate year-end balances in accordance with GAAP. Additionally, we recommend that the City review these adjustments and modify year-end reconciling procedures in an effort to avoid similar adjustments next year.

Lastly, should the City elect to establish the “full oversight” of the financial statement preparation, we suggest management establish effective review policies and procedures, including but not limited to, the following functions: reconciling general ledger amounts to the draft financial statements; review of all supporting documentation and explanations for journal entries proposed by us and approve the entries; review the adequacy of financial statement disclosures by completing a disclosure checklist; review and approval of schedules and calculations supporting the amounts included in the notes to the financial statements; apply analytic procedures to the draft financial statements; and perform other procedures considered necessary by management.

**CITY OF SEDONA, ARIZONA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED JUNE 30, 2010**

SECTION II – FINANCIAL STATEMENT FINDINGS (CONTINUED)

2010-2: Court

Condition: The City Court did not maintain proper segregation of duties. The Administrator was involved in the cash receipting and depositing processes, reconciled the bank accounts and signed checks.

Criteria: The City should maintain proper segregation of duties.

Effect: The design of the internal controls over financial reporting could affect the ability of the City to record, process, summarize and report financial data consistently with the assertions of management in the financial statements. In addition, this lack of segregation of duties may result in the City's inability to prevent/detect material misappropriation of City assets.

Cause: The City had turnover resulting in improper segregation of duties.

Recommendation: We recommend the Court establish segregation of duties policies related to collection, depositing, reconciliation and check signing procedures in order to maintain adequate internal controls over these processes.

2010-3: Homeowners' Assessment Taxes

Condition: The City did not have sufficient controls over accumulating and reporting nonexchange revenues and receivables under the definitions of GASB 33. The City also has not established and implemented a policy for uncollectible accounts and bad debts for these revenues.

Criteria: The City has a developer agreement that includes a provision to collect Homeowners' Assessment Taxes in lieu of CFD taxes on certain units within the development. Homeowners' Assessment Taxes may not have been collected for all years required by the developer agreement.

Effect: An adjustment of \$126,124 was necessary in order to properly state revenues and receivables for unbilled amounts.

Cause: The City has not established controls to ensure that Homeowners' Assessment Taxes are collected for all years required by the developer agreement.

Recommendation: We recommend the City establish and implement internal control procedures to ensure that revenues and receivables are collected and recorded.

Management Response: The City has already started enforcement of required reporting from the developer per the development agreement section: 6.8(b)1 – Developer agrees to cause sufficient information to be provided to City to substantiate the payments made upon deeding and annual assessments on an annual basis, commencing one year after conveyance of the first Unit.

CITY OF SEDONA, ARIZONA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED JUNE 30, 2010

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

2010-4

CFDA Number, Title and Award Number:

16.803 – Byrne Formula Grant Program

Grantor:

U.S. Department of Justice

Award Period:

July 1, 2009 to June 30, 2010

Condition: Four of twelve required financial reports were not submitted by the 15th of the following month as required under the grant agreement.

Criteria: The A-133 compliance supplement requires cities to submit the SF-269, Financial Status Report, but leaves the establishment of timeliness criteria to the pass-through entities. The grant agreement with the Arizona Criminal Justice Commission specifically states the financial reporting due dates throughout the year as the 15th of each following month.

Questioned Costs: None.

Possible Asserted Effect: The Arizona Criminal Justice Commission could suspend or delay funding.

Recommendation: The City should ensure that all financial reports are submitted according to the reporting schedule provided in the grant agreement.

Management Response: The City concurs with this recommendation and will establish a policy to ensure that all financial reports are submitted timely.

SECTION IV – SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

2009-2

CFDA Number, Title and Award Number:

16.710 – Community Oriented Policing Services Grant Program

Grantor:

U.S. Department of Justice

Award Period:

December 26, 2007 through December 25, 2010

Condition: No *Excluded Parties List System (EPLS)* check was being performed on vendors that the City made purchases with greater than \$25,000.

Status: Nothing came to our attention in the current year testing.

**CITY OF SEDONA, ARIZONA
 SUPPLEMENTARY SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
 YEAR ENDED JUNE 30, 2010**

Grantor Agency	Federal CFDA Number	Pass-through Grantor's Number	Expenditures
U.S. Department of Justice			
Passed through Arizona Criminal Justice Commission			
Community Oriented Policing Services Grant Program	16.710	2008CKWX0318	\$ 138,756
Byrne Formula Grant Program	16.803	DC-09-021	513,626
Total U.S. Department of Justice			<u>652,382</u>
U.S. Department of Housing and Urban Development			
Passed through the Arizona Department of Commerce:			
Community Development Block Grant	14.228	147-08	<u>167,078</u>
TOTAL FEDERAL AWARDS			<u><u>\$ 819,460</u></u>

(1) This schedule was prepared using the modified accrual basis of accounting.

(2) The City did not pass-through any funds to subrecipients.