

SINGLE AUDIT REPORTS

CITY OF NASSAU BAY, TEXAS

For the Year Ended
September 30, 2012

CITY OF NASSAU BAY, TEXAS

SINGLE AUDIT REPORTS

For the Year Ended September 30, 2012

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**INDEPENDENT AUDITORS' 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**

February 22, 2013

To the Honorable Mayor and
City Council Members of the
City of Nassau Bay, Texas:

We have audited the financial statements of the governmental activities, the business-type activities, the discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Nassau Bay, Texas (the "City"), as of and for the year ended September 30, 2012, which collectively comprise the City's basic financial statements and have issued our report thereon dated February 22, 2013. We conducted our audit in accordance with generally accepted auditing standards 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

Management of the City is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the City'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's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City'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 a certain deficiency in internal control that we consider to be a material weakness.

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 combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency 2012-1 described in the accompanying schedule of findings and questioned costs to be a significant deficiency.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City’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’s response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the City’s response and, accordingly, we express no opinion on it.

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

BELT HARRIS PECHACEK, LLLP

Belt Harris Pechacek, LLLP
Certified Public Accountants
Houston, Texas



**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, AND THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

February 22, 2013

To the Honorable Mayor and
City Council Members of the
City of Nassau Bay, Texas

Compliance

We have audited the City of Nassau Bay, Texas' (the "City") 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's major federal programs for the year ended September 30, 2012. The City'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's management. Our responsibility is to express an opinion on the City'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'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's compliance with those requirements.

In our opinion, the City 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 September 30, 2012.

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Internal Control Over Compliance

Management of the City 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'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'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.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the business-type activities, the discretely presented component units, each major fund, and the aggregate remaining fund information of the City, as of and for the year ended September 30, 2012, and have issued our report thereon dated February 22, 2013, which contained unqualified opinions on those financial statements. Our audit was performed for the purpose of forming opinions on the financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for the purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

The purpose of this report is solely to describe the scope of our testing of compliance with the types of compliance requirements applicable to each of the City's major programs and our testing of internal control over compliance and the results of our testing, and to provide an opinion on the City's compliance but not to provide an opinion on the effectiveness of the City's internal control over compliance. This report is an integral part of an audit performed in accordance with Government Auditing Standards in considering the City's compliance with requirements applicable to each major program and its internal control over compliance. Accordingly, this report is not suitable for any other purpose.

BELT HARRIS PECHACEK, LLLP

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CITY OF NASSAU BAY, TEXAS
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
For the Year Ended September 30, 2012

No prior findings.

CITY OF NASSAU BAY, TEXAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended September 30, 2012

A. SUMMARY OF AUDIT RESULTS

1. The auditors' report expresses an unqualified opinion on the basic financial statements of the City of Nassau Bay, Texas.
2. No material weaknesses in internal control were identified by the audit of the basic financial statements.
3. A significant deficiency in internal control was identified by the audit of the basic financial statements.
4. No instances of noncompliance material to the basic financial statements were disclosed during the audit.
5. No significant deficiencies in internal control over major federal award programs were disclosed by the audit.
6. The auditors' report on compliance for the major federal award programs expresses an unqualified opinion.
7. No audit findings relative to the major federal award programs for the City are reported in Part C of this schedule.
8. The programs included as major programs included:

a. Community Development Block Grant	<u>CFDA Number</u> 14.228
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9. The threshold for distinguishing Type A and B programs was \$300,000.
10. The City did not classify as a low-risk auditee in the context of OMB Circular A-133.

CITY OF NASSAU BAY, TEXAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS, Continued
For the Year Ended September 30, 2012

B. FINDINGS – BASIC FINANCIAL STATEMENT AUDIT

Significant Deficiency:

2012-1. SEGREGATION OF DUTIES

Criteria

Proper segregation of duties reduces the risk of unauthorized actions.

Condition

The City has an employee with the ability to print electronically signed checks, post adjusting journal entries, add/edit vendors, write-off accounts, and serve as the software administrator. Another employee has the ability to print electronically signed checks and add/edit vendors. There are multiple employees with the ability to add/edit vendors.

The City has four employees with the ability to edit payroll information (pay rates, routing numbers, hours, etc.) in the payroll software.

Effect

A lack of strong internal controls could cause a material misstatement or misappropriations of assets from being prevented, or detected and corrected, on a timely basis.

Cause

Due to the size of the City, employees perform duties across multiple functions with little segregation of duties in place to deter and detect unauthorized actions.

Recommendation

Only one employee should have the ability to add/edit vendor information upon approval by management. This employee should be independent of the financial reporting functions.

The City should segregate the duties of human resources and payroll reporting within the payroll software. The human resources function should have the ability to edit approved pay rates and update employee information. The payroll reporting function should only be able to perform the payroll related financial reporting within the software. Ideally, no individual employee should be able to perform both of these functions.

Due to the software administrator also overseeing the financial reporting functions, the City should establish a policy in which a management level employee outside of the finance function (City Manager is recommended) reviews a software change log for unusual activity.

CITY OF NASSAU BAY, TEXAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS, Continued
For the Year Ended September 30, 2012

Management's Response

Due to the City's size, it is often very difficult to achieve a complete and functionally effective segregation of duties. Across the board, the finance department strives to mitigate this problem by requiring review and oversight of activities and processes by multiple employees.

In response specifically to the concerns regarding payroll activities, the City has implemented a new internal process by which a bi-weekly Payroll Change Report is reviewed and approved by the city manager. This internal control change provides a mechanism by which the City is able diminish the potential for misstatement or misappropriation on a timely basis.

Regarding the similar situation in accounts payable, the City is constrained in its internal controls by the functionality, or lack thereof, of the existing accounting software. The software utilized by the City for its accounting functions does not currently have "change history" reporting functionality that would permit the City to generate a Vendor Change report. The City is exploring the possibility of limiting vendor changes and edits to users not permitted to otherwise have edit access to the Accounts Payable module. In response to this concern, the City will explore additional options with our current software vendor as well as continue with the existing internal controls: departmental purchase orders for items over \$200, departmental approval of invoices, finance director and senior accountant review of weekly accounts payable activities generated by accounts payable accountant, and the provision of a general City phone number for accounts payable activities instead of a direct line to the accounts payable accountant.

C. FINDINGS – FEDERAL AWARDS

None

CITY OF NASSAU BAY, TEXAS
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended September 30, 2012

Grantor/Program Title	CFDA Number	Grant/Contract Number	Expenditures
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT			
<i>Pass-through Office of Rural Community Affairs, an agency of the State of Texas</i>			
Community Development Block Grant	14.228	GLO-10-5254-000-5258	\$ 281,236
TOTAL DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT			<u>281,236</u>
DEPARTMENT OF COMMERCE			
<i>Direct Award</i>			
Economic Adjustment Assistance	11.307	08-79-04381	126,495
TOTAL DEPARTMENT OF COMMERCE			<u>126,495</u>
DEPARTMENT OF HOMELAND SECURITY			
<i>Pass-through Texas Department of Public Safety's Division of Emergency Management</i>			
Texas Department of Public Safety - Hazard Mitigation Grant	97.036	DR-1791-222	116,955
Emergency Management Performance Grants	97.042	12TX-EMPG-0365	26,939
TOTAL DEPARTMENT OF HOMELAND SECURITY			<u>143,894</u>
TOTAL FEDERAL AWARDS EXPENDED			<u>\$ 551,625</u>

CITY OF NASSAU BAY, TEXAS

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

For the Year Ended September 30, 2012

1. REPORTING ENTITY

The accompanying schedule of expenditures of federal awards presents the activity of all federal financial assistance programs of the City.

2. BASIS OF ACCOUNTING

The accompanying schedule of expenditures of federal awards is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.