

**INDEPENDENT AUDITOR'S 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***

To the Honorable Mayor and City Council  
City of Cupertino, California

We have audited, in accordance with the 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, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of City of Cupertino, California (City) as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated June 21, 2019.

**Internal Control Over Financial Reporting**

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

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 deficiency described in the accompanying schedule of findings and responses as 2018-001 to be a material weakness.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the accompanying schedule of findings and responses as 2018-002 to be a significant deficiency.

## **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether 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 Findings**

The City's response to the findings identified in our audit are described in the accompanying schedule of findings and responses. The City's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

## **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "Crowe LLP". The signature is written in a cursive, flowing style.

Crowe LLP

Costa Mesa, California  
June 21, 2019

CITY OF CUPERTINO, CALIFORNIA  
SCHEDULE OF FINDINGS AND RESPONSES  
YEAR ENDED JUNE 30, 2018

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**2018-001 – INFORMATION SYSTEM CONTROLS**

**Criteria:** Internal controls over information systems are a key component of an organization's control environment. Entities should have internal controls including policies and procedures regarding user access, change management, and back-up and recovery. Where adequate segregation of duties cannot be employed via system access restrictions, detective and monitoring review controls should be established that adequately mitigate such risks. Such controls enable entities to increase efficiency by reducing manual processes and improving the accuracy and quality of the data used across those information systems. Such controls are also important to prevent erroneous and fraudulent transactions or entry to systems.

**Condition:** We evaluated system access to the City's Active Directory as well as the financial reporting system, New World Systems (NWS). The Active Directory authenticates and authorizes all users and computers in a Windows domain type network—assigning and enforcing security policies for all computers and installing or updating software. For example, when a user logs into a computer that is part of a Windows domain, Active Directory checks the submitted password and determines whether the user is an authorized user. During our assessment of the City's information system controls, we noted the following:

**Financial Reporting System/Active Directory**

- There is one user in the Finance Department who maintains super user access. Super user access includes the ability to add/modify/delete user accounts as well as assign security privileges to user accounts. The City provided documentation to respond to the observation that consisted of queries and transaction logs, however the documentation was not able to completely mitigate the exposure observed at the time of the audit procedures.
- The City's information and technology (IT) and finance departments do not have a process to evaluate the propriety of changes to user access within the financial reporting system. For example the City's IT department did not remove access to information systems in a timely manner for terminated employees. It is the City's intent that user access is removed immediately at separation date. We tested the timeliness of removal for 11 employees with termination dates after 1/1/2018. Of those 11 employees:
  - 3 user accounts were deactivated between 2 and 4 days after termination date
  - 2 user accounts were deactivated between 83 and 88 days after termination.
  - 1 user account was deactivated 102 days after termination.

**Policies and Procedures**

- The City's information technology policies and procedures have not been recently updated to reflect the practices that are currently in use. The City recently began to review the IT policies and procedures but have not made document changes. For example, areas such as the disaster recovery plan and internet access and use monitoring policy, are no longer applicable to the City due to changes in hardware, software and/or management structure, yet are still presented therein.

**Cause:**

**Financial Reporting System/Active Directory**

- Super user access was granted to the individual, as management had not yet identified a position within the City, but outside the finance department, which could permanently fulfill this role.
- User access requests for the financial reporting system are informal, typically verbal or through email. The City does not have a mechanism for tracking when user access is changed. Within the financial reporting system, the City has not yet identified the key reports which should be utilized to evaluate changes made to user access. As such, the use of this informal process led to the delays in the user access change processing, as the City IT department was not timely notified of the requested changes.

**Policies and Procedures**

- With regard to the City's IT policies and procedures, there have been systematic changes to the City's disaster recovery plan, and other IT areas which have not yet been carried forward into the City's written policies.

**2018-001 – INFORMATION SYSTEM CONTROLS (Continued)**

**Effect:**

**Financial Reporting System/Active Directory**

Improper user access could result in fraudulent and/or unauthorized transactions being recorded in the City's financial reporting system, where management would not be able to detect such activity.

**Policies and Procedures**

Outdated policies and procedures may not provide the City a mechanism to restore critical information systems should there be a disaster recovery event. Further, in the event that key IT employees separate from the City, outdated policies and procedures may deter the City's ability to smoothly transition responsibilities to successors.

**Recommendation:**

**Financial Reporting System/Active Directory**

- The City should establish written policies and procedures which provide for the appropriate levels of user access based on the relative roles and responsibilities within the financial reporting system. A best practice is to provide the lowest level of access based on operational need. Further, we recommend the City perform a systematic review and maintain documentation of user's access rights within the financial reporting system, to ensure that a) there are not users with super user access who also have the ability to perform operational functions within the financial reporting system and b) users access roles are only for those functions which are necessary to perform in the normal course of business. Finally, we recommend that the City continue its efforts to implement a formal user access change to ensure that timely user access changes are processed.

**Policies and Procedures**

- We recommend that the City update its policies and procedures to reflect current conditions and establish a process to ensure periodic review occurs. IT policies should be reviewed and approved by management or those charged with governance on a periodic basis.

**Management's Response and Planned Corrective Action:** Management agrees with the auditors' recommendation with points of emphasis. The City's Business Systems Analyst was transferred from the Innovation and Technology department to the Administrative Services department in April 2018. The position maintained administration rights (the ability to initiate system user-access changes); however, the City ensured the following:

- The Business Systems Analyst was never granted access or ability to enter transactions in the New World ERP system (NWS).
- NWS-generated control log reports were created on May 21, 2018, indicating (1) the Business Systems Analyst position had not transacted in the system during FY 2017-18, (2) the "NWS" user profile had not transacted in the system in FY 2017-18, and (3) all user-access changes made by the Business Systems Analyst were clearly identified and time-stamped.
- The Business Systems Analyst did/does not have physical access or custody to City assets.

As of June 29, 2018, administration rights/access has been removed from the Business Systems Analyst in Finance.

Although written policies and procedures have been drafted, it does not appear that a City-wide cognizance or adherence to said policies and procedures has been achieved. Currently, Finance staff is collaborating with members of the Innovation and Technology (I&T) Department to update and revise the policies and procedures to ensure controls are implemented, operating effectively, and monitored appropriately.

Upon the anticipated termination of an employee, the City's Human Resources Division is currently requesting from I&T that all user access be removed and any other City property or City access belonging to the employee be returned prior to termination date.

CITY OF CUPERTINO, CALIFORNIA  
SCHEDULE OF FINDINGS AND RESPONSES  
YEAR ENDED JUNE 30, 2018

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**2018-002 – VENDOR CREATION AND PAYMENT PROCESS**

**Criteria:** Internal controls over procurement are a key component of an organization's control environment. An integral part of a strong control environment surrounding the disbursements process is for entities to design and implement internal controls relating to its vendor creation process. The entity must ensure that every vendor utilized has a legitimate business purpose and that vendor selection has complied with all applicable laws and regulations. In addition, entities should also establish policies and procedures regarding key transaction cycles that promote segregation of duties.

**Condition:** We evaluated the internal controls surrounding the City's vendor creation process during the audit and determined that the City's established processes have opportunities for improvement, specifically over the process of reviewing new vendor creation and segregation of duties between the vendor creation and vendor payment processes. Based on the City's procurement policy, the City requires form approvals by the designated supervisor or the purchasing officer to establish new vendors. We selected and reviewed twenty City vendors and noted however, that the City did not have a standardized or formalized vendor creation approvals prior to the initiation of the City's processing for vendor payment in the financial system. In addition, we were unable to review documentation of management's review performed to ensure that vendors are valid before establishing within the financial system. From the vendor payment standpoint, the Accountant I/II and Account Clerk I/II in the Finance Department also had the ability to create a vendor in the financial system but also had the ability to process vendor payments. While the City had identified an additional control to review the vendor master file in place quarterly as well as review of accuracy as part of the established disbursement process (i.e. review of check registers), these controls were not designed to review for fictitious vendors in detail.

**Cause:** The lack of segregation of duties between the vendor creation and vendor payment process increases the risk that an unapproved vendor could be established and paid. Further, the current vendor creation process does not require formal approvals to be documented within the financial system.

**Effect:** Although the City's Finance Department reviews and approves vendor disbursements prior to the outflow of resources, the ability for the above individuals to create and pay new vendors increases the chances that an inappropriate vendor could be paid.

**Recommendation:** We recommend that the City segregate the ability to create a vendor from the ability to process vendor payments. Further, we recommend that the City require approvals for vendor creation to be embedded within the financial system prior to processing vendor payments. Lastly, we recommend that the City consider a full vendor validation for all City vendors to ensure that the vendors captured in the City's financial system have been properly vetted and approved.

**Management's Response and Planned Corrective Action:** Management agrees with the auditors' finding with points of emphasis. In order for a vendor payment to occur, invoices must be created and approved by two separate individuals within the City's Enterprise Resource Planning (ERP) system. Although the City's disbursements are reviewed and authorized by multiple personnel prior to the outflow of funds; the City's ERP system does not have the capability to establish an approval process for the creation of a new vendor. Segregation of duties is of extreme importance to the City. Effective July 1, 2018, the employee responsible for creating new vendors and also responsible for processing payments will not have the ability to create an invoice (or initiate a payment) in the system. In addition, effective July 1, 2018 the vendor master file and all related changes are maintained and reviewed on a quarterly basis. This review is explicitly designed to review for fictitious vendors. Effective July 1, 2019, vendor creation and EFT enrollment forms will be required to be completed by the originating Department/Division prior to creation in the system. Lastly, the City is currently finalizing a comprehensive purchasing policy that incorporates key controls and procedures over the City's procurement and purchasing. Management will continue to evaluate staffing resources in order to implement the auditors' recommendations noted above.