

**COMMUNICATIONS WITH THOSE CHARGED WITH GOVERNANCE UNDER SAS NO. 114**

To the City Council Members, and  
LaVonne Griffin-Valade, City Auditor  
City of Portland, Oregon

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 Portland, Oregon (the City) as of and for the year ended June 30, 2011, and have issued our report thereon dated January 25, 2012. Professional standards require that we provide you with the following information related to our audit.

**OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA, THE SINGLE AUDIT ACT, AND THE OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133**

Our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. Because of the concept of reasonable assurance and because we did not perform a detailed examination of all transactions, there is a risk that material errors, fraud, or other illegal acts may exist and not be detected by us.

In planning and performing our audit, we considered the City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our 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.

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 grants, 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. Also, in accordance with OMB Circular A-133, we examined, on a test basis, evidence about the City's compliance with the types of compliance requirements described in the "U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement" applicable to each of its major federal programs for the purpose of expressing an opinion on the City's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the City's compliance with those requirements.

**RESPONSIBILITIES UNDER GENERALLY ACCEPTED AUDITING STANDARDS (GAAS)**

The financial statements are the responsibility of management. Our audit was designed in accordance with GAAS, which provides for reasonable, rather than absolute, assurance that the financial statements are free of material misstatement. As a part of our audit, we obtained an understanding of internal control sufficient to plan our audits and to determine the nature, timing, and extent of testing performed.

We issued an unqualified opinion on the City's financial statements for the year ended June 30, 2011.

**OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS**

Our responsibility for other information in our Independent Auditor's Report and Financial Statements does not extend beyond the financial information identified in our report. We do not have an obligation to perform any procedures to corroborate other information contained in these documents. However, we have read the information and nothing came to our attention that caused us to believe that such information or its manner of presentation is materially inconsistent with the information or manner of its presentation appearing in the financial statements.

**PLANNED SCOPE AND TIMING OF THE AUDIT**

We performed the audit according to the planned scope previously communicated to you in the contract dated May 7, 2007, except in that the delivery of the audit was extended to January 25, 2012 to allow sufficient time for our review and testing of the City's financial statements as a result of delays in management's preparation and delivery of the draft CAFR to us.

**SIGNIFICANT ACCOUNTING POLICIES AND APPROPRIATENESS OF ACCOUNTING POLICIES**

The initial selection of and changes in significant accounting policies or their application, as well as any new accounting and reporting standards adopted during the year must be reported. Management has the responsibility for selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note I to the financial statements. Throughout the course of an audit, we review changes, if any, to significant accounting policies or their application, and the initial selection and implementation of new policies. These policies have been consistently followed during the year with the exception of the following timely and accurately implemented new standards. Management implemented the requirements of GASB No. 54 on fund balance reporting and governmental fund type definitions, and GASB No. 59, financial instruments omnibus.

## MANAGEMENT JUDGMENTS AND ACCOUNTING ESTIMATES

The preparation of financial statements requires the use of accounting estimates. Certain estimates are particularly sensitive due to their significance to the financial statements and the possibility that future events may differ significantly from management's expectations. Management's judgments and accounting estimates are based on knowledge and experience about past and current events and assumptions about future events. We apply audit procedures to management's estimates to ascertain whether the estimates are reasonable under the circumstances and do not materially misstate the financial statements. We believe management has selected and applied significant accounting policies appropriately and consistently with those of the prior year. Significant management estimates impacting the financial statements include the following:

- The depreciable lives of the City's fixed assets and infrastructure and related current year depreciation expense and end of year accumulated depreciation.
- The amount of compensated absence accrual at June 30, 2011.
- The amount of the allowance for uncollectible accounts at June 30, 2011.
- The amount of reserve for claims liability at June 30, 2011.
- The amount of accrued liabilities for the City's various other post employment benefits and retirement plans at June 30, 2011.

## FINANCIAL STATEMENT DISCLOSURES

The disclosures in the financial statements are consistent, clear and understandable. Certain financial statement disclosures are especially sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were:

- Disclosure of the reporting entity and significant accounting policies in Note 1 to the financial statements. This disclosure reports the operation under the governance of the elected City Council Members, as well as the more significant policies used by the City in the preparation of the financial statements.
- Disclosure of cash and investment details in Note III.A. to the financial statements. This disclosure provides the details of the amounts of cash and investments held in the various types of depositories and securities at year end as well as the details of the nature of the inherent risks the City is subject to.
- Disclosure of the City's long-term debt in Note III.I. to the financial statements. This disclosure provides the details of the amounts and types of debt outstanding at year end along with the repayment terms, significant covenants, and future maturities of principal and interest.

- Disclosure of the City's commitments and contingent liabilities in Note IV.B. to the financial statements. This disclosure provides a description of the City's commitments and contingencies, including labor agreements, contractual commitments, and environmental remediation.
- Disclosure of the City's post retirement benefits in Note IV.C. This disclosure provides descriptions of the City's Other Postemployment Benefits (OPEB) Plans - Health Insurance Continuation, PERS Retirement Health Insurance Account, and Fire and Police Disability and Retirement Direct Subsidy Other Postemployment Benefits Plan.
- Disclosure of the City's employee retirement systems and pension plans in Note IV.D. This disclosure provides descriptions of State of Oregon Public Employees Retirement System, and the Fire and Police Disability and Retirement Plan.

### **SIGNIFICANT AUDIT ADJUSTMENTS MADE AND PASSED**

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management.

**Uncorrected Misstatements.** The following summarizes the impact of uncorrected misstatements in the fiscal year 2011 financial statements that were identified during the current year audit. Management has determined that the effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

**Cable Fund Classification** – It was determined the Cable fund should have historically been classified as an agency fund rather than a special revenues fund. As a result, fund balance reported in special revenue funds, and net assets of governmental activities, have been overstated by approximately \$6.3 million. A current year entry was made by management to record a Community Development expense in the amount of \$6.3 million to reduce the fund balance reported within the special revenue funds instead of restating prior year financial statements.

**Head Waters Apartment Fund** – Management reported the net book value of the assets of the Head Waters Apartment, totaling approximately \$12.1 million, as a current year Capital Contribution to the City. It was determined these assets should have been included in the accounts of the City since their initial construction in a prior year.

**Elizabeth Caruthers Park** – The assets associated with Elizabeth Caruthers Park and certain other assets totaling approximately \$9.3 million were likewise recorded as current year Capital Contribution to the City. It was determined these assets should have been included in the accounts of the City as of June 30, 2010.

**Unrecorded Cash Account** – During the confirmation process, it was determined the City had rights to funds totaling \$983,432 held by NY Mellon Bank relating to HUD Housing programs that had not been recorded by the City. Management has elected not to record the cash in the financial statements for the current year.

The uncorrected errors noted above, and the correcting entries made by management in the current year instead restating prior year financial statements, were determined by management to be immaterial, and we concur with management's assessment.

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**MAJOR ISSUES DISCUSSED WITH MANAGEMENT PRIOR TO OUR RETENTION**

There were no major issues, including the application of accounting principles, auditing standards or financial reporting, that were discussed with management in connection with our retention as the City's independent accountants.

**DISAGREEMENTS WITH MANAGEMENT**

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

**MANAGEMENT REPRESENTATIONS**

We requested and received certain representations from management that are included in the management representation letter dated January 25, 2012.

**MANAGEMENT CONSULTATION WITH OTHER INDEPENDENT ACCOUNTANTS**

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

**SERIOUS DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT**

We did not encounter any serious difficulties in terms of disagreements with management on the application of accounting principles, responding to our inquiries, or in the facilitation of our audit procedures. However, there was a delay in receiving the draft CAFR, compared to the originally agreed upon date that required a rescheduling of our staff to accommodate the City's revised timeline. Our understanding is that the delay was mainly caused by the additional time and effort required on the City's part for implementation of GASB 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, research regarding proper classification and reporting for the Cable fund, and for correct recognition of assets transferred from PDC to the Portland Housing Bureau, including those of the Headwaters Apartments.

**MATERIAL ERRORS OR FRAUD OR POSSIBLE MATERIAL ILLEGAL ACTS**

GAAS requires us, within the inherent limitations of the auditing process, to plan our audit to search for errors or irregularities that would have a material effect on the financial statements.

Our audit procedures included interviewing management and staff from several Bureaus to assess fraud risks that exist within the City and the potential for illegal acts. In addition, we modified our audit procedures to address the risks we found to exist. No material frauds or illegal acts were found as a result of the audit procedures we performed.

#### **AUDITOR INDEPENDENCE**

Auditor independence, in fact and appearance, is essential so that the public may justifiably perceive the audit process as an unbiased review of management's presentation of financial information.

At least annually, we will disclose to the City Council the nature of all relationships between Moss Adams and the City of Portland, Oregon, that, in our professional judgment, may reasonably be thought to bear on our independence.

We are not aware of any relationships between our Firm and the City of Portland, Oregon, for the year ended June 30, 2011, and through the date of this letter, that may reasonably be thought to impact our independence. Accordingly, relating to our audit of the financial statements of the City of Portland, Oregon, as of and for the year ended June 30, 2011, we confirm we are independent with respect to the City within the meaning of Rule 101 of the American Institute of Certified Public Accountants' Code of Professional Conduct, its interpretations and rulings.

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

*Moss Adams, LLP*

Eugene, Oregon  
January 25, 2012

**CITY OF PORTLAND  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2011**

**Section I - Summary of Auditor's Results - (continued)**

Identification of major programs (continued):

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
ARRA - 66.468	U.S. Environmental Protection Agency ARRA - Capitalization Grants for Drinking Water State Revolving Funds
ARRA - 81.128	U.S. Department of Energy ARRA - Energy Efficiency & Conservation Block Grant
	U.S. Department of Homeland Security Homeland Security Cluster:
97.008	Urban Areas Security Initiative
97.053	Citizens Corps Program
97.071	Metropolitan Medical Response System
97.073	State Homeland Security Program

Dollar threshold used to distinguish  
between type A and type B programs:      \$      3,000,000

Auditee qualified as low-risk auditee?        X   yes             no

**Section II - Financial Statement Findings**

**FINDING 2011-01 - Internal communication of financial reporting originating from provisions in Intergovernmental Agreements, Material Weakness in Internal Controls**

**Criteria:** Intergovernmental agreements (IGA) executed under Oregon Revised Statute 190 are used to create separate legal entities in some instances, memorialize joint activities conducted or services provided by the participating organizations, and document administrative obligations of the parties to the IGA. IGA's often result in events or transactions with financial reporting implications to the organizations involved.

**Condition:** During the City's financial statement close process, which included the implementation of Governmental Accounting Standards Board (GASB) No. 54 on fund balance reporting, City personnel discovered two IGA's with financial reporting implications that were not properly recognized in prior year financial statements. One IGA was identified that created the Mt. Hood Cable Regulatory Commission (Commission) in 1993, a separate legal entity made up of a County and several Cities, including the City of Portland, with the purpose of regulating and administering cable franchise agreements within the jurisdiction of the participating entities. A Cable Fund, reported as a special revenue fund, was created by the City to account for the resources and expenditures from all the participating entities except for the City of Portland. Given the resources reported within this fund were held on behalf of the Commission, the City determined the fund should have been classified as an agency fund.

CITY OF PORTLAND  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2011

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Section II – Financial Statement Findings – (continued)

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Another IGA originating from 2004 was discovered between the City the Portland Development Commission (PDC) regarding the acquisition and operation of the Headwaters Apartment complex that provided that the City would retain title and all the rights and obligations of ownership of the complex and PDC would operate the apartment. City personnel determined the assets governed by the agreement were not previously included in the financial statements of the City.

**Context:** The Mt. Hood Cable Commission's revenues and expenditures have totaled approximately \$5 million the last couple years, and net assets totaled \$6.5 million as of June 30, 2011. Individual fund and budgetary statements and schedules have been presented in the City's Comprehensive Annual Report every year since the Commission was created, and included in the aggregate remaining funds opinion unit as part of the City's annual audit.

The Headwater's Apartment Complex had a net book value of approximately \$12 million that was included in the City's current year additions to governmental activities capital assets.

**Cause:** The City's internal controls in prior years in the area of internal communications between management personnel within the various Bureaus were insufficient to identify provisions in IGA's with financial reporting requirements. In addition, the City does not currently have a database or other mechanism to track IGA's that are still active to periodically monitor them for financial reporting matters.

**Effect:** The fiscal year 2010 financial statements incorrectly reported the Cable Fund, with a fund balance of \$6.3 million, as a Special Revenue Fund. The capital assets of the Headwaters Apartment Complex, with a net book value of approximately \$12.1 million, were incorrectly excluded from the 2010 financial statements.

**Recommendation:** We recommend that the City review its internal communication processes with respect to intergovernmental agreements to enable appropriate personnel within the various Bureaus to identify provisions with legal and financial reporting requirements. In addition, we suggest the City consider development of a database of all active IGA's and a periodic monitoring process to assist with future compliance with any financial reporting requirements.

**Management Response:** Management responses will be included in a separately issued 'Management's Responses and Corrective Action Plans' document.

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Section III – Federal Award Findings and Questioned Costs

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None reported



**REPORT OF INDEPENDENT AUDITORS ON COMPLIANCE AND  
ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH OREGON MINIMUM AUDIT STANDARDS**

City Council  
City of Portland, Oregon

We have audited the basic financial statements of the City of Portland, Oregon (City) as of and for the year ended June 30, 2011 and have issued our report thereon dated January 25, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the provisions of the Minimum Standards for Audits of Oregon Municipal Corporations, prescribed by the Secretary of State. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement.

**Compliance**

As part of obtaining reasonable assurance about whether the City's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, grants, including provisions of Oregon Revised Statutes as specified in Oregon Administrative Rules OAR 162-010-0000 to 162-010-0330, as set forth below, noncompliance with which could have a direct and material effect on the determination of financial statement amounts:

- The use of various depositories to secure the deposit of public funds.
- The requirements relating to debt.
- The requirements relating to the preparation, adoption and execution of the annual budgets for fiscal years 2011 and 2012.
- The requirements relating to insurance and fidelity bond coverage.
- The appropriate laws, rules and regulations pertaining to programs funded wholly or partially by other governmental agencies.
- The requirements pertaining to the use of revenue from taxes on motor vehicle use fuel funds.
- The statutory requirements pertaining to the investment of public funds.
- The requirements pertaining to the awarding of public contracts and the construction of public improvements.

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 test disclosed no instances of noncompliance that are required to be reported under Minimum Standards for Audits of Oregon Municipal Corporations, prescribed by the Secretary of State, except those noted below.

### **Expenditures in Excess of Appropriations**

The results of our tests disclosed two instances of noncompliance relating to over expenditures of budgeted appropriations that is described in Note II.B. of the City's financial statements.

### **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 determining our auditing procedures for the purpose of expressing our opinion 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 was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control 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 discussed below, we identified one 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 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 following deficiency in the City's internal control to be a material weakness:

The City's processes and internal controls over intergovernmental agreements (IGA's) that were created in prior years is not sufficient to know if all active agreements with financial and legal reporting obligations are known by appropriate management personnel. As a result, a cable regulatory commission, created through an IGA in 1993 as a separate legal entity, was not properly reported as a separate legal entity. In addition, certain capital assets, identified in an IGA from 2004 to be constructed and thereafter operated by the Portland Development Commission but owned by the City, were not properly capitalized and recognized in the financial statements of the City.

A significant deficiency is a deficiency, or 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 did not note any significant deficiencies as part of the current year engagement.

The above matters are reported in further detail in the Schedule of Findings and Questioned Costs included in a separately bound report with the City's Single Audit reports. Further, additional best practice observations and recommendations were included in a letter issued separately to management.

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This report is intended solely for the information of City of Portland, Oregon's management, and State of Oregon and is not intended to be and should not be used by anyone other than those specified parties.

A handwritten signature in black ink, appearing to read "James C. Layarott". The signature is written in a cursive style with a large initial 'J'.

For Moss Adams LLP  
Eugene, Oregon  
January 25, 2012



**CITY OF PORTLAND**  
OFFICE OF MANAGEMENT AND FINANCE  
Sam Adams, Mayor  
Jack D. Graham, Chief Administrative Officer

Richard F. Goward, Jr., CFO  
Bureau of Financial Services  
1120 S.W. Fifth Avenue, Rm. 1250  
Portland, Oregon 97204-1912  
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February 27, 2012

EXHIBIT D

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To: LaVonne Griffin-Valade, City Auditor

From: Rich Goward, Jr., Chief Financial Officer

On January 25, 2012, you provided us with the findings in the Schedule of Findings and Questioned Costs (SFQC) prepared by the City's outside financial auditors, Moss Adams LLP, for the fiscal year ended June 30, 2011.

In response to your request for a corrective action plan, we provide the following management response to the finding:

**FINDING 2011-01 – Internal communication of financial reporting originating from provisions in Intergovernmental Agreements, Material Weakness in Internal Controls**

**Recommendation:** We recommend that the City review its internal communication processes with respect to intergovernmental agreements (IGAs) to enable appropriate personnel within the various Bureaus to identify provisions with legal and financial reporting requirements. In addition, we suggest the City consider development of a database of all active IGA's and a periodic monitoring process to assist with future compliance with any financial reporting requirements.

**Management Response:** Management agrees with the recommendations from the auditors. Further, an initial review has been made of the current processes and procedures. Based on this information, an existing but dormant IGA-database and related processes will be re-examined. Additionally, communications are planned to enlist support from each bureau to facilitate their support in documenting and timely and accurately reporting for all IGAs.

Completion Date: June 30, 2012

OMF Contact People: City Controller, Sr. Operations Accounting Supervisor

CC: Jack Graham, Chief Administrative Officer  
Drummond Kahn, Director, Audit Services Division  
Fiona Earle, Principal Management Auditor, Audit Services Division  
Jane Kingston, City Controller, OMF  
Andrew Scott, Manager, Financial Planning Division, OMF  
Sheila Black-Craig, Team Lead, Grants Administration, OMF

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