

THE SURPLUS LINE ASSOCIATION OF
CALIFORNIA

NOVEMBER 30, 2020

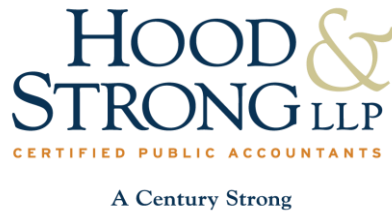


REPORT

TO

THE AUDIT COMMITTEE OF

THE BOARD OF DIRECTORS



March 5, 2021

THE AUDIT COMMITTEE OF
THE BOARD OF DIRECTORS
THE SURPLUS LINE ASSOCIATION OF CALIFORNIA
San Francisco, California

We are pleased to present this report related to our audit of the financial statements of **THE SURPLUS LINE ASSOCIATION OF CALIFORNIA (the Association)** as of November 30, 2020. This report summarizes certain matters required by professional standards to be communicated to you in your oversight responsibility for the Association's financial reporting process.

This report is intended solely for the information and use of the Audit Committee, the Board of Directors, and management and is not intended to be and should not be used by anyone other than these specified parties. It will be our pleasure to respond to any questions you have regarding this report. We appreciate the opportunity to continue to be of service to the Association.

Hood & Strong LLP

THE SURPLUS LINE ASSOCIATION OF CALIFORNIA
REPORT TO THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS

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THE SURPLUS LINE ASSOCIATION OF CALIFORNIA

REQUIRED COMMUNICATIONS

Generally accepted auditing standards (AU-C 260, *The Auditor's Communication With Those Charged With Governance*) require the auditor to promote effective two-way communication between the auditor and those charged with governance. Consistent with this requirement, the following summarizes our responsibilities regarding the financial statement audit as well as observations arising from our audit that are significant and relevant to your responsibility to oversee the financial reporting process.

Area	Comments
Our Responsibilities with Regard to the Financial Statement Audit	Our responsibilities under auditing standards generally accepted in the United States of America have been described to you in our arrangement letter dated December 29, 2020. Our audit of the financial statements does not relieve management or those charged with governance of their responsibilities, which are also described in that letter.
Overview of the Planned Scope and Timing of the Financial Statement Audit	We have issued a separate communication regarding the planned scope and timing of our audit and have discussed with you our identification of and planned audit response to significant risks of material misstatement.
Accounting Policies and Practices	<u>Preferability of Accounting Policies and Practices</u> Under generally accepted accounting principles, in certain circumstances, management may select among alternative accounting practices. In our view, in such circumstances, management has selected the preferable accounting practice. <u>Adoption of, or Change in, Accounting Policies</u> Management has the ultimate responsibility for the appropriateness of the accounting policies used by the Association. During fiscal 2020, the Association adopted Accounting Standards Update 2017-07 – Not-For-Profit Entities (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. The adoption of this update did not materially impact the Association. Significant accounting policies used by the Association are described in detail in the notes to the financial statements.

THE SURPLUS LINE ASSOCIATION OF CALIFORNIA

REQUIRED COMMUNICATIONS

Area	Comments
Significant or Unusual Transactions	We did not identify any significant or unusual transactions or significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.
Management's Judgments and Accounting Estimates	Summary information about the process used by management in formulating particularly sensitive accounting estimates and about our conclusions regarding the reasonableness of those estimates is in the attached Summary of Significant Accounting Estimates.
Audit Adjustments	Audit adjustments proposed by us and management and recorded by the Association are shown in the attached Summary of Recorded Audit Adjustments.
Uncorrected Adjustments	All uncorrected adjustments are summarized in the attached Summary of Uncorrected Adjustments. In addition, management omitted certain disclosures required by ASU 2016-14: Presentation of Financial Statements of Not-for-Profit Entities and ASU 2018-08: Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made, as management deemed them either insignificant or not applicable to the financial statements.
Disagreements with Management	We encountered no disagreements with management over the application of significant accounting principles, the basis for management's judgments on any significant matters, the scope of the audit, or significant disclosures to be included in the financial statements.
Consultations with Other Accountants	We are not aware of any consultations management had with other accountants about accounting or auditing matters, except for those with outside accountants engaged to provide monthly accounting services.
Significant Issues Discussed with Management	No significant issues arising from the audit were discussed or were the subject of correspondence with management.
Difficulties Encountered in Performing the Audit	We did not encounter any difficulties in dealing with management during the Audit.

THE SURPLUS LINE ASSOCIATION OF CALIFORNIA

REQUIRED COMMUNICATIONS

Area	Comments
Letter Communicating Control Deficiencies	We have separately communicated the control deficiencies identified during our audit of the financial statements, and this communication is included in the attached Communication and Related Recommendations – See Exhibit A.
Certain Written Communications Between Management and Our Firm	Copies of significant written communications between our firm and the management of the Association, including the representation letter and engagement letter provided to us by management, are available upon request.

THE SURPLUS LINE ASSOCIATION OF CALIFORNIA

SUMMARY OF SIGNIFICANT ACCOUNTING ESTIMATES

Accounting estimates are an integral part of the preparation of financial statements and are based upon management’s current judgment. The process used by management encompasses their knowledge and experience about past and current events and certain assumptions about future events. You may wish to monitor throughout the year the process used to determine and record these accounting estimates. The following describes the significant accounting estimates reflected in the Association’s November 30, 2020, financial statements:

Estimate	Accounting Policy	Management’s Estimation Process	Basis for Our Conclusions on Reasonableness of Estimate
Allowance for doubtful accounts	Accounts receivable are carried at original amount less an estimate for uncollectible receivables.	Management determines the allowance for doubtful accounts by using historical experience applied to an aging of accounts. No allowance was deemed necessary as all balances are expected to be collected.	We reviewed management's estimate noting the method and assumptions were reasonable, consistent with prior years, and in accordance with the applicable accounting principles generally accepted in the United States of America (GAAP) requirements.
Future obligations relating to pension and post-retirement benefits	The Association accounts for its pension and post-retirement benefit liabilities in accordance with current accounting pronouncements which require it to (a) recognize the overfunded or underfunded status of the pension and post-retirement benefits plans as an asset or liability in its statement of financial position and to recognize changes in that funded status in unrestricted net assets for a not-for-profit organization in the year in which the changes occur, and (b) measure the funded status of a plan as of the date of its year-end statement of financial position.	The Association obtains the valuation of the future obligations from an actuary. Annually, management prepares and reviews the accrual analysis for any changes along with ensuring the activity for the year is properly recorded through the accrual account.	We reviewed management's estimate noting the method and assumptions were reasonable, consistent with prior years, and in accordance with the applicable GAAP requirements.

THE SURPLUS LINE ASSOCIATION OF CALIFORNIA

SUMMARY OF SIGNIFICANT ACCOUNTING ESTIMATES

Estimate	Accounting Policy	Management's Estimation Process	Basis for Our Conclusions on Reasonableness of Estimate
Lives used for calculation of depreciation and amortization expense.	Depreciation is provided over the estimated service life of the respective assets, using the straight-line method.	Management estimates the useful life of fixed assets based on standard industry practices.	We reviewed management's estimate noting the method and assumptions were reasonable, consistent with prior years, and in accordance with the applicable GAAP requirements.

THE SURPLUS LINE ASSOCIATION OF CALIFORNIA

SUMMARY OF UNCORRECTED ADJUSTMENTS

During the course of our audit, we accumulated an uncorrected misstatement that was determined by management to be immaterial to the statements of financial position, results of operations, and cash flows and to the related financial statement disclosures. Following is a summary of that difference.

Description	Effect—Increase (Decrease)				
	Assets	Liabilities	Net Assets	Revenue	Expense
Effect of prior year uncorrected adjustment			\$ 54,593		\$ (54,593)
Total effect	\$ -	\$ -	\$ 54,593	\$ -	\$ (54,493)

THE SURPLUS LINE ASSOCIATION OF CALIFORNIA

SUMMARY OF RECORDED AUDIT ADJUSTMENTS

Description	Effect—Increase (Decrease)				
	Assets	Liabilities	Net Assets	Revenue	Expense
To adjust Pension Liability and Retirement Benefit Obligation per valuation report as of year end		\$ (404,613)		\$ 404,613	
To true up net assets as of year end			\$ (505,488) 505,488		
Total effect	\$ -	\$ (404,613)	\$ -	\$ 404,613	\$ -



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March 5, 2021

THE AUDIT COMMITTEE OF
THE BOARD OF DIRECTORS
THE SURPLUS LINE ASSOCIATION OF CALIFORNIA
San Francisco, California

In planning and performing our audit of the financial statements of **THE SURPLUS LINE ASSOCIATION OF CALIFORNIA (the Association)** as of and for the year ended November 30, 2020 in accordance with auditing standards generally accepted in the United States of America, we considered the Association's internal control over financial reporting (internal control) as a basis for designing 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 Association's internal control. Accordingly, we do not express an opinion on the effectiveness of the Association'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 deficiency in design exists when (a) a control necessary to meet the control objective is missing, or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when a properly designed control does not operate as designed or when the person performing the control does not possess the necessary authority or competence to perform the control effectively.

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.

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.

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

A handwritten signature in black ink that reads 'Hood & Strong LLP'.

Following are descriptions of deficiencies in internal control that we identified during the current and prior year that we determined did not constitute either a significant deficiency or material weakness.

CURRENT YEAR CONTROL DEFICIENCIES

QuickBooks Premier 2015 Financial System

Observation

We noted that the QuickBooks Premier Accountant 2015 financial system is the current version utilized by the Association. We visited the vendor's website and determined that this version is no longer supported. Intuit has discontinued add-on services to its customer and critical security updates for version 2015. This means that customers are no longer provided notifications or assistance when updates are released.

Recommendation

We recommend that the Association convert or upgrade the QuickBooks financial system to a version that will receive support and updates from Intuit for the foreseeable future.

PRIOR YEAR CONTROL DEFICIENCIES

Preparation and Review of Monthly Accounting Reports

Observation

We noted that there was no physical evidence of review of the monthly accounting reports. These monthly reports include items such as journal entries, statements, reconciliations, and financial statements. Per discussion with management, although there is no evidence of review, the reviewer would follow up on any items on the packet that are unusual or suspicious.

Recommendation

We recommended that the Association establish policies and procedures to ensure there is physical evidence of review of the monthly accounting reports.

Current Year Update

We noted that these monthly accounting reports still don't show evidence of physical review. Therefore, we continue to make this recommendation.

Completeness and Cutoff of Expenses

Observation

We noted instances when expenses were not being recorded in the proper fiscal year, either partly or in whole, which led to the corresponding liabilities not being booked in the proper period. There are instances when expenses appear to be recorded based on when invoices are received instead of when the expense has been incurred.

Recommendation

We recommended that accounting personnel review invoices diligently to ensure that amounts are recorded in full based on when services and/or goods are provided rather than when invoices are received.

Current Year Update

Based on our testing, we noted expenses were recorded in the proper fiscal year, which resulted in corresponding liabilities being booked properly. Expenses appear to be recorded based on when they have been incurred rather than when the invoice was received. Therefore, we no longer make this recommendation.

Investment Policy

Observation

We noted an instance when a corporate bond was purchased at an amount greater than the limit imposed by the current investment policy.

Recommendation

We recommended that the Association review its investment policy when purchasing investments to determine compliance with it. It would also be beneficial to periodically review such limits to determine if any changes need to be made to existing policy.

Current Year Update

Based on our testing over investments, we noted that the Association is still purchasing investments at an amount greater than their investment policy allows. Therefore, we continue to make this recommendation.

Active Directory User Accounts

Observation

We noted that a few terminated employees still retained an active account in the Association's computer systems.

Recommendation

We recommend that the organization deactivate or remove any employee accounts immediately after their last day on the job. This reduces the possibility that access is not retained by unauthorized users who no longer work for the company. We suggested that organization implement a formalized termination process to include removal or deactivation of user accounts upon termination.

Current Year Update

Based on our testing over the Association's computer systems, noted no findings of terminated employees retaining an active account. Therefore, we no longer make this recommendation.