

City of Stockton

Stockton, California

Single Audit and Independent Auditors' Reports

For the Year Ended June 30, 2016



**City of Stockton
Single Audit Report
For the Year Ended June 30, 2016**

Table of Contents

	<u>Page</u>
Independent Auditors' Reports:	
Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	1
Report on Compliance for Each Major Federal Program; Report on Internal Control over Compliance; and Report on the Schedule of Expenditures of Federal Awards Required by the Uniform Guidance	3
Schedule of Expenditures of Federal Awards	7
Notes to the Schedule of Expenditures of Federal Awards	10
Schedule of Findings and Questioned Costs	11

This page intentionally left blank.



**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***

Independent Auditors' Report

To the Honorable Mayor and Members of City Council
of the City of Stockton
Stockton, 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 the City of Stockton, California (the "City"), as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated December 30, 2016.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the 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 the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the 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 Questioned Costs, 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 City's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs to be material weaknesses as items 2016-01, 2016-02, and 2016-03.

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 deficiencies described in the accompanying Schedule of Findings and Questioned Costs to be a significant deficiencies as item 2016-04.

To the Honorable Mayor and Members of City Council
of the City of Stockton
Stockton, California
Page 2

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 require to be reported under *Government Auditing Standards*.

The City's Response to Findings

The City's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. 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 and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the City'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 City's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

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

Santa Ana, California
December 30, 2016



REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM; REPORT ON INTERNAL CONTROL OVER COMPLIANCE; AND REPORT ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS REQUIRED BY THE UNIFORM GUIDANCE

Independent Auditors' Report

To the Honorable Mayor and Members of City Council
of the City of Stockton
Stockton, California

Report on Compliance for Each Major Federal Program

We have audited the City of Stockton, California's (the "City") compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the City's major federal programs for the year ended June 30, 2016. The City's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs.

Management's Responsibility

Management is responsible for compliance with the requirements of federal statutes, regulations, and the terms and condition of its federal awards.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the City's major federal programs based on our audit of the types of compliance requirements referred to above. 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; the audit requirements of Title 2 U.S. *Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirement for Federal Awards* (the "Uniform Guidance"). Those standards and the Uniform Guidance 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 on compliance for each major federal program. However, our audit does not provide a legal determination of the City's compliance.

Opinion on Each Major Federal Program

In our opinion, the City complied, in all material respects, with the types of 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, 2016.

Other Matters

The results of our audit procedures disclosed instances of noncompliance, which are required to be reported in accordance with Uniform Guidance and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2016-06 and 2016-07. Our opinion on each major federal program is not modified with respect to these matters.

The City's response to the noncompliance findings identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. The City's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control over Compliance

Management of the City is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the City's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, 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. *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.

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 material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified certain deficiencies in internal control over compliance, as described in the accompanying Schedule of Findings and Questioned Costs as items 2016-05 to 2016-07, that we consider to be significant deficiencies.

To the Honorable Mayor and Members of City Council
of the City of Stockton
Stockton, California
Page 3

The City's response to the internal control over compliance findings identified in our audit are described in the accompanying Schedule of Finding and Questioned Costs. The City's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Report on the Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

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, as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the City's basic financial statements. We have issued our report thereon dated December 30, 2016, which contained unmodified opinions on those financial statements. Our audit was conducted for the purpose of forming our opinions on the financial statements that collectively comprise the City's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the basic 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 basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain other procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditure of Federal Awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

The PwC Group, LLP

Santa Ana, California
March 28, 2017, except for the Schedule of Expenditures of Federal Awards
as to which the date is December 30, 2016

This page intentionally left blank.

City of Stockton
Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2016

Federal Grantor/Pass-Through Grantor Program Title	CFDA Number	Grant Award Number	Federal Expenditures	Amount Provided to Subrecipients
U.S. Department of Housing and Urban Development				
<i>Direct Program:</i>				
CDBG - Entitlement Grants Cluster:				
Community Development Block Grants/Entitlement Grants	14.218	B-15-MC-060026	\$ 4,008,073	\$ -
Community Development Block Grants/Entitlement Grants	14.218	B-14-MC-060026	322,040	322,040
Community Development Block Grants/Entitlement Grants	14.218	Program Income	386,402	-
Neighborhood Stabilization Program	14.218	B-08-MN-060009	620,843	-
Neighborhood Stabilization Program	14.218	B-11-MN-060009	770,829	-
Neighborhood Stabilization Program	14.218	Program Income	298,688	-
Total CDBG - Entitlement Grants Cluster			<u>6,406,875</u>	<u>322,040</u>
Emergency Solutions Grant Program	14.231	E-15-MC-060026	249,998	241,551
HOME Investment Partnership Program	14.239	M-15-MC-060221	804,048	-
HOME Investment Partnership Program	14.239	Program Income	201,031	-
Total HOME Investment Partnership Program			<u>1,005,079</u>	<u>-</u>
Total U.S. Department of Housing and Urban Development			<u>7,661,952</u>	<u>563,591</u>
U.S. Department of Justice				
<i>Pass-Through State of California Office of Emergency Services:</i>				
Violence Against Women Formula Grants	16.588	ST15-01-8019	188,975	-
<i>Direct Program:</i>				
Drug Court Discretionary Grants	16.585	2015-JV-FX-0004	31,475	-
<i>Direct Program:</i>				
Public Safety Partnership and Community Policing Grants	16.710	2011-UL-WX-0006	2,331,565	-
<i>Direct Program:</i>				
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2012-DJ-BX-1104	44,933	44,933
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2013-DJ-BX-1038	75,059	75,059
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2015-DJ-BX-0679	37,819	37,819
Total Edward Bryne Memorial Justice Assistance Grant Program			<u>157,811</u>	<u>157,811</u>
Total U.S. Department of Justice			<u>2,709,826</u>	<u>157,811</u>
U.S. Department of Transportation				
<i>Pass-Through State of California Office of Traffic Safety:</i>				
Highway Safety Cluster:				
State and Community Highway Safety	20.600	PT16139	231,413	-
State and Community Highway Safety	20.600	PT1533	125,069	-
Total Highway Safety Cluster			<u>356,482</u>	<u>-</u>
Minimum Penalties for Repeat Offenders for Driving While Intoxicated	20.608	AL1642	121,966	-
Minimum Penalties for Repeat Offenders for Driving While Intoxicated	20.608	AL1510	105,799	-
Total Minimum Penalties for Repeat Offenders for Driving While Intoxicated Grants			<u>227,765</u>	<u>-</u>

See accompanying Notes to the Schedule of Expenditures of Federal Awards.

City of Stockton
Schedule of Expenditures of Federal Awards (Continued)
For the Year Ended June 30, 2016

Federal Grantor/Pass-Through Grantor Program Title	CFDA Number	Grant Award Number	Federal Expenditures	Amount Provided to Subrecipients
U.S. Department of Transportation (Continued)				
<i>Pass-Through State of California Department of Transportation:</i>				
Highway Planning and Construction Cluster:				
HBP (Highway Bridge Program)McKinley Avenue Bridge	20.205	BRLO 5008(099)	584,125	-
AIRPORT WAY BEAUTIF PH 4	20.205	STPL-5008(112)	2,611	-
Safe Route > School Program Expansion	20.205	SRTSLNI-5008(121)	136,726	-
HARRISON ELEM SAFETY IMPROVEMENT	20.205	SRTSL-5008(119)	33,055	-
Harding Way/El Dr Trfc Sig	20.205	HSIPL-5008(128)	10,304	-
EVP System	20.205	HSIPL-5008(125)	18,348	-
BRT IV (MLK Jr Blvd)	20.205	CML-5008(123)	35,412	-
Filbert/Miner Traffic Sig	20.205	CML-5008(130)	16,681	-
Pershing Adaptive TCS	20.205	CML-5008(126)	11,508	-
Marh Ln Adaptive TCS	20.205	CML-5008(127)	55,774	-
Rapid Flashing Beacons C5	20.205	HSIPL-5008(124)	29,463	-
Cal St @ Wshngtn Trfc Sig	20.205	HSIPL-5008(131)	19,792	-
Montaubn/Swain Runabout	20.205	CML-5008(129)	33,065	-
Arch-Airport/B St Signal	20.205	HSIPL-5008(135)	23,360	-
Rapid Flashing Beacons C6	20.205	HSIPL-5008(133)	52,983	-
RESP Traffic Sig Cntrl	20.205	HSIPL-5008(137)	20,951	-
Traffic Sig Head Retrofit	20.205	HSIPL-5008(134)	15,121	-
West Lane Ped Access Imp	20.205	HSIPL-5008(136)	20,334	-
2014-15 St. Resurfacing	20.205	Cal-RecycleTRP5-14-51	1,176	-
ATP-Bike Mstr Plan Update	20.205	ATPLNI-5008(141)	303,328	-
ATP-Clvrs RI bike Ped Pth	20.205	ATPL-5008(143)	92,174	-
ATP-Fremont Sqr Sidewalk	20.205	ATPL-5008(140)	47,475	-
ATP-McKinley Elem Srts	20.205	ATPCML-5008(144)	65,736	-
ATP-Miner Ave Complete St	20.205	CML- 5008(145)	167,191	-
ATP-Safe Rts to Sch Plan	20.205	ATPLNI-5008(138)	97,038	-
ATP- San Joaquin Trail	20.205	ATPL-5008(139)	109,099	-
Tam O'Shanter /Castle Oaks	20.205	HSIPL-5008(136)	58,659	-
2012-13 Resurfacing Proj	20.205	STPL-5008(120)	50,446	-
2013-14 St. Resurfacing	20.205	STPL-5008(132)	2,431,378	-
2014-15 St. Resurfacing	20.205	STPL-5008(142)	14,839	-
Bus Rapid Transit Phase V	20.205	CML-5008(149)	1,906	-
Install/Upgrade Bike FAC	20.205	CML-5008(150)	1,179	-
Pre-EmpDev@ Filbert St/Xtown	20.205	HSIPL-5008(154)	2,824	-
Guardrail, Transition Rail	20.205	HSIPL-5008(152)	1,233	-
High Friction Treatment	20.205	HSIPL-5008(153)	2,336	-
CENTER/EL DORADO OVERPASS	20.205	BRLS-5008(103)	25,885	-
BENJAMIN HOLT/INGLWOOD TS	20.205	CML-5008(110)	7,836	-
DAVIS RD/WAGNER HEIGHT TS	20.205	CLM-5008(109)	7,025	-
WILSON WY,ADAPTIVE TCS	20.205	CML-5008(113)	263,623	-
CENTER/EL DORADO OVERPASS	20.205	BLRLS-5008(103)	11,613	-
FRENCH CAMP/I-5 RECONSTRUCTION	20.205	STPIMDL-5008(116)	170,402	-
Total Highway Planning and Construction Cluster:			5,054,014	-
Total U.S. Department of Transportation			5,638,261	-

See accompanying Notes to the Schedule of Expenditures of Federal Awards.

City of Stockton
Schedule of Expenditures of Federal Awards (Continued)
For the Year Ended June 30, 2016

Federal Grantor/Pass-Through Grantor Program Title	CFDA Number	Grant Award Number	Federal Expenditures	Amount Provided to Subrecipients
U.S. Department of Homeland Security				
<i>Direct Program:</i>				
Port Security Grant Program	97.056	EMW-2014-PU-00247-S01	484,475	-
Total U.S. Department of Homeland Security			484,475	-

See accompanying Notes to the Schedule of Expenditures of Federal Awards.

City of Stockton
Notes to Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2016

Note 1 – Reporting Entity

The financial reporting entity consists of the primary government, City of Stockton (the “City”), organizations for which the primary government is financially accountable, and other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity’s financial statements to be misleading or incomplete.

The City Council acts as the governing body and is able to impose its will on the following organizations, establishing financial accountability:

- The Stockton Public Financing Authority
- Fiduciary Component Unit:
 - Successor Agency of the Former Redevelopment Agency of the City of Stockton

Note 2 – Summary of Significant Accounting Policies

Basis of Accounting

Funds received under the various grant programs have been recorded within the special revenue and capital projects funds of the City. The City utilizes the modified accrual basis of accounting for the special revenue and capital projects funds. The accompanying Schedule of Expenditures of Federal Awards (the “Schedule”) is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations (CFR) Part 2, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the “Uniform Guidance”). Therefore, some amounts presented in the Schedule may differ from amounts presented in, or used in, the preparation of City’s basic financial statements.

Schedule of Expenditures of Federal Awards

The accompanying Schedule presents the activity of all federal financial assistance programs of the City. Federal financial assistance received directly from federal agencies, as well as federal financial assistance passed through the State of California, is included in the Schedule. The Schedule was prepared only from the accounts of various grant programs and, therefore, does not present the financial position or results of operations of the City.

City of Stockton
Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2016

Section I – Summary of Auditor’s Results

Financial Statements

Types of report the auditors issued on whether the financial statements audited were prepared in accordance with GAAP: Unmodified

Internal control over financial reporting:

- Material weakness(es) identified? 2016-01 to 2016-03
- Significant deficiency(ies) identified? 2016-04

Noncompliance material to financial statements noted? No

Federal Awards

Internal control over major federal programs:

- Material weakness(es) identified? No
- Significant deficiency(ies) identified? 2016-05 to 2016-07

Type of auditor’s report issued on compliance for major federal programs: Unmodified

Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? Yes - 2016-06
2016-07

Identification of major federal programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>	<u>Expenditures</u>
14.218	Community Development Block Grants	\$ 6,406,875
14.239	HOME Investment Partnership Program	1,005,079
97.056	Port Security Grant Program	484,475
	Total Expenditures of All Major Federal Programs	\$ 7,896,429
	Total Expenditures of Federal Awards	\$ 16,494,514
	Percentage of Total Expenditures of Federal Awards	47.87%

Dollar threshold used to distinguish between type A and type B programs: \$750,000

Auditee qualified as low-risk auditee under 2 CFR 500.520? No

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2016

Section II – Financial Statements Findings

A. Current Year Findings and Questioned Costs – Financial Statement Findings

Finding 2016-01 Internal Controls

Criteria:

Management is responsible for designing, implementing, and maintaining appropriate internal control over financial reporting and compliance.

Internal control is defined as a process implemented and monitored by the City Council, management, and other personnel. The Internal Control System should be designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Reliability of financial reporting;
- Effectiveness and efficiency of operations; and
- Compliance with applicable laws and regulations.

The Internal Control Framework would include establishing or enhancing guidance in the following areas:

- *Control environment* sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.
- *Risk assessment* is the entity's identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be managed.
- *Control activities* are the policies and procedures that help ensure that management directives are carried out.
- *Information and communication* systems support the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.
- *Monitoring* is a process that assesses the quality of internal control performance over time.

Condition:

The City is in the process of upgrading its administrative and financial services by adding qualified personnel; hiring consultants with certain expertise; contracting with professional accountants to provide both internal and external auditing; and, making appropriate and informed decisions. As part of the upgrading process, the City has established a document titled "Auditing Findings Response Tracking Report" (the "Report").

The Report displays findings identified by City management, State Gas Tax Audit, State Controller's Office (SCO) Audits, prior external audit firm, County Grand Jury Report and the City's Internal Auditor. The findings in the latest Report totaled 323 items as of December 2016 which has the same number of items as 2015.

Context:

See above condition for context of findings.

Effect:

The City must establish an effective system of internal controls that would provide reasonable assurance regarding achievement of the City's objectives. An effective system of internal control reduces, to an acceptable level, the risk of not achieving the City's objective and may relate to all three objectives presented above.

City of Stockton
Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2016

Section II – Financial Statements Findings (Continued)

A. Current Year Findings and Questioned Costs – Financial Statement Findings (Continued)

Finding 2016-01 Internal Controls (Continued)

Cause:

The City does not have detailed policies and procedures for its accounting systems that emphasize the need for proper review and approval for certain transactions that are susceptible to fraud.

Recommendation:

We recommend the City work closely with the Internal Auditors to design, implement and maintain its system of internal controls using the Internal Control Framework as outline above.

View of Responsible Officials and Planned Corrective Actions:

The City is in agreement with this finding and recommendation. The City Manager's Office asked the City Auditor's Office to conduct a more robust and improved risk assessment process. It was identified by new management as one of the City's 37 Strategic Initiatives. The City has since contracted out the Internal Auditor role to Moss Adams LLP, a reputable CPA firm, to conduct a full risk assessment and several reviews of the City's internal controls.

The internal auditors began an internal audit plan in November 2013. This internal audit plan was originally to take place over a minimum 18-24 month period and is continuing to take place into the current fiscal year. The result will be an evaluation and documentation of the City's design of internal controls, further recommendations to change internal controls, evaluation of new or revised policies and procedures, and training for senior management, City Council and staff on internal controls. That body of work has been prioritized based on those business cycles that are of highest risk to the City for material misstatement to financial reporting. The final result of the work will be implementation of new internal controls, new standards of operations, new policies, and subsequent testing to ensure they are working as planned. These actions should remediate this finding. Administrative Services has categorized all findings and is prioritizing action items with the greatest effect on the City's internal control structure to mitigate those areas of highest risk. As indicated in the above table, the City made significant progress in implementing effective internal controls and closed some of the findings.

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2016

Section II – Financial Statements Findings (Continued)

A. Current Year Findings and Questioned Costs – Financial Statement Findings (Continued)

Finding 2016-02 Accounting Manual

Criteria:

An Accounting Manual would aid the Administrative Services Department and the City in providing training for accounting personnel, communicating and providing a source of reference to approved policies, and maintaining consistency of recording financial transactions.

Condition:

During the performance of our audit for the year ended June 30, 2016, we noted that the City does not have an updated policies and procedures manual (Accounting Manual) which would define personnel roles and responsibilities, described appropriate procedures for recording significant transactions in finance and accounting systems, define and set procedures for management oversight and review, establish key internal controls, and ensure accounting and reporting requirements established by GAAP are followed.

Context:

See above condition for context of findings.

Effect:

Without the Accounting Manual, personnel responsible for the daily work and transactions do not have a clear understanding of their role and responsibilities or the accounting standards applicable to their function. In addition, the absence of standardized procedures has and will create inefficient and inconsistent processing of transactions. Absent clear guidance, delays in financial reporting occur as staffs are unaware of where to find the answers.

Cause:

The City has been in a two year long process of restructuring its management team and a significant amount of time and effort was required of the new team in preparing the Chapter 9 filings and catching up on the long overdue audits. Therefore, City management has not had sufficient time to focus on the development of a comprehensive accounting manual and it has not taken the highest priority.

Recommendation:

We recommend that the City develop a comprehensive Accounting Manual that would set the guidelines for recording significant transactions in the general ledger. In addition, Management should consider developing an Accounting Manual which includes at a minimum:

- Descriptions of functions each position performs
- Specific duties and responsibilities (desk procedures)
- Minimum required qualifications or standards
- Council/Management approved policies relating to specific transactions
- Procedures for processing of specific financial activities
- Appropriate monitoring and review controls

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2016

Section II – Financial Statements Findings (Continued)

A. Current Year Findings and Questioned Costs – Financial Statement Findings (Continued)

Finding 2016-02 Accounting Manual (Continued)

View of Responsible Officials and Planned Corrective Actions:

The City agrees with the finding and recommendation. The City also agrees that there has not been sufficient time or priority given developing the manual; although it was not due to the lack of understanding that the City needed to develop one. The City needed to focus on delivering accurate and timely financial reporting before it could focus on developing an accounting manual.

In some instances, the City has documented its accounting processes but has not finished due to work on the bankruptcy and the City's financial records and associated audits. With the largest burden on the Accounting Division for the implementation of the Plan of Adjustment and the new GASB Statements 68 and 71 on Pension Accounting, management and staff turned inward towards operational improvements, reviews of policies and procedures, and the establishment of better internal controls.

Now that the City has exited bankruptcy and is in the process of fully staffing the Accounting Division, the Accounting Division plans to begin drafting the Accounting Manual and work with the City's internal auditors to review and complete this project in 2017. The City will consider this recommendation in connection with the work it is currently performing as a result of the Risk Assessment and Internal Control Review by Moss Adams. The City will work on the first draft of the Accounting Manual in conjunction with work on improvements to the internal controls and revisions to policies and procedures which the City could then use for the development of a formal Comprehensive Accounting Manual.

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2016

Section II – Financial Statements Findings (Continued)

A. Current Year Findings and Questioned Costs – Financial Statement Findings (Continued)

Finding 2016-03 Accounting System

Criteria:

Reliable and updated financial systems are critical in producing accurate and timely financial statements.

Condition:

We evaluated the financial systems employed by the City in managing its overall fiscal operations, including processing of billings and payments, preparation of financial reports, budgets, and analysis of trends. These systems form the basis for all financial reporting that is critical to the decision making process, and ultimately, the basis for the financial stability of the City. We found that the systems employed by the City are outdated and are not adequate nor are appropriate for a City of this size and complexity. Specific deficiencies of the system employed include, but are not limited to:

1. Inability to automatically post activity from outsourced operations such as banking, loan servicer, parking, parking tickets, library and other auxiliary systems.
2. There is a sufficiently high volume of manually posted transactions to record daily financial activities due to the lack of integration. Manual entries are time consuming, subject to significant risk of error, and cause delays in monthly and year end close process.
3. Complex processes for the retrieval of data that is needed on a day-to-day basis. In addition, certain key reports used for budgeting and limited financial reporting contain unresolved errors in the data.
4. The library's accounting billing and AR system is not integrated into the City's GL. The City is only able to reconcile the two systems on an annual basis due to the time it consumes.

The result of these overall system deficiencies is a significant degradation in efficiency of staff, who must utilize manual processes or other software products for the recording and reporting of routine financial activity, such as billings, personnel and payroll data, inventories, capital asset, depreciation, budgeting, etc.

Context:

See above condition for context of findings.

Effect:

Accounting records and useful data cannot be easily accessed by management and others needed in analysis of current and historical financial conditions of the City. The lack of integration of the City's subledger can cause the general ledger to be misstated.

Cause:

The City has a twenty plus year old outdated accounting system that needs to be updated.

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2016

Section II – Financial Statements Findings (Continued)

A. Current Year Findings and Questioned Costs – Financial Statement Findings (Continued)

Finding 2016-03 Accounting System (Continued)

Recommendation:

The City is strongly urged to begin the process of review of other software applications that are specifically designed for municipal entities and have the full functionality needed for a City of this size and complexity. These other software applications should be evaluated in light of their general acceptance in cities of this nature and size, the level of internal user support required to operate the software, the training required for users and the cost.

View of Responsible Officials and Planned Corrective Actions:

Management concurs that we need to replace our accounting system and review other software platforms and applications that can support the City based on its size and complexity. The City also agrees that it is problematic to retrieve data from the system in a variety of formats due to the age and limited capabilities of the current financial system.

The City Council approved an RFP on January 12, 2016, to obtain the services of an Enterprise Resource Planning (“ERP”) Consultant for the needs analysis. On January 24, 2017, Council approved moving forward with a different ERP consultant to assist the City in selection and implementation of a new financial system and also approved 11 new City positions to serve as the core project team. A software vendor contract is anticipated to be awarded by December 2017.

In the meantime, the City upgraded the HTE system to version 9.3 in August 2016 and began the process of evaluating potential improvements to processes and procedures made possible by this upgrade.

With an outdated financial system, it is neither cost effective nor technologically and operationally feasible at this time to achieve full automation within the subsidiary systems or sub-ledgers for library services and loans receivable and parking tickets. The City’s current financial system does not provide the capability to automatically post every single transaction carried on in the subsidiary ledgers or from other nonintegrated subsystems as it works in a batch environment. However, the City’s utility billing, accounts receivable and cash receipts subsidiary ledger modules are integrated with the City’s general ledger through automated system interfaces. These subsidiary ledgers account for the largest share of City revenues.

We agree reconciling the various systems is difficult and time-consuming, and that more efficient operations could be achieved with a new or fully upgraded financial system. Moss Adams also identified the interface of key data in its Report on General Computer Controls dated June 2014.

Management also concurs that regular reconciliation is an industry best practice that the City will continue to pursue and implement as an operational standard. Until the City operationalizes a new financial system, it will continue to operate in a partially manual mode without needed modern business analytics, processes or tools.

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2016

Section II – Financial Statements Findings (Continued)

A. Current Year Findings and Questioned Costs – Financial Statement Findings (Continued)

Finding 2016-04 Ability to Retain Qualified Accounting Personnel

Criteria:

In order to have effective accounting systems and internal controls, the City should retain qualified accounting personnel who have the skill, knowledge and experience to initiate, record and process the various transactional flows of the City. Having qualified accounting personnel is a key element to running a successful Accounting Department.

Condition:

During the fiscal year ended June 30, 2016, the City has lost significant accounting personnel within the department. The City's accounting personnel decreased more than 50% compared to the same year ended June 30, 2015, and the City has not been able to fill qualified personnel to desire positions.

Context:

See above condition for context of findings.

Effect:

Ineffective internal control to the financial statements can be caused by poor segregation of duties and lack of accounting personnel. The lack of the functional accounting department for the City can cause material weakness to the financial statements in the future.

Cause:

The City was not able to hire enough qualified personnel during the fiscal year.

Recommendation:

We recommend that the City hire qualified personnel for the Accounting Department, and also take necessary actions to retain its personnel.

View of Responsible Officials and Planned Corrective Actions:

Management agrees that qualified accounting personnel are essential to maintaining effective internal controls and accurate financial statements. The City completed a full evaluation and revision of the Accountant job description that incorporates more stringent minimum requirements for accounting educational coursework to attract a more focused and experienced professional workforce. The City also revised the test for the Accountant job classification with the same financial and analytical focus. A recent recruitment resulted in the hiring of five entry-level accountants who will begin employment mid-fiscal year. One vacancy remains with the recruitment expected to be completed in spring 2017.

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2016

Section II – Financial Statements Findings (Continued)

B. Prior Year Findings and Questioned Costs – Financial Statement Findings

Finding 2015-01 Internal Controls

Condition:

The City is in the process of upgrading its administrative and financial services by adding qualified personnel; hiring consultants with certain expertise; contracting with professional accountants to provide both internal and external auditing; and, making appropriate and informed decisions. As part of the upgrading process, the City has established a document titled “Auditing Findings Response Tracking Report” (the “Report”).

- The Report displays findings identified by City management, State Gas Tax Audit, State Controller’s Office (SCO) Audits, prior external audit firm, County Grand Jury Report and the City’s Internal Auditor. The findings in the latest Report totaled 323 items as of December 2015.

Recommendation:

We recommend the City work closely with the Internal Auditors to design, implement and maintain its system of internal controls using the Internal Control Framework as outline above.

Status:

Finding uncorrected, see current year finding 2016-01

Finding 2015-02 Accounting Manual

Condition:

During the performance of our audit for the year ended June 30, 2014, we noted that the City does not have an updated policies and procedures manual (Accounting Manual) which would define personnel roles and responsibilities, described appropriate procedures for recording significant transactions in finance and accounting systems, define and set procedures for management oversight and review, establish key internal controls, and ensure accounting and reporting requirements established by GAAP are followed.

Recommendation:

We recommend that the City develop a comprehensive Accounting Manual that would set the guidelines for recording significant transactions in the general ledger. In addition, Management should consider developing an Accounting Manual which includes at a minimum:

- Descriptions of functions each position performs
- Specific duties and responsibilities (desk procedures)
- Minimum required qualifications or standards
- Council/Management approved policies relating to specific transactions
- Procedures for processing of specific financial activities
- Appropriate monitoring and review controls

Status:

Finding uncorrected, see current year finding 2016-02

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2016

Section II – Financial Statements Findings (Continued)

B. Prior Year Findings and Questioned Costs – Financial Statement Findings (Continued)

Finding 2015-03 Accounting System

Condition:

We evaluated the financial systems employed by the City in managing its overall fiscal operations, including processing of billings and payments, preparation of financial reports, budgets, and analysis of trends. These systems form the basis for all financial reporting that is critical to the decision making process, and ultimately, the basis for the financial stability of the City. We found that the systems employed by the City are outdated and are not adequate nor are appropriate for a City of this size and complexity. Specific deficiencies of the system employed include, but are not limited to:

1. Inability to automatically post activity from outsourced operations such as banking, loan servicer, parking, parking tickets, library and other auxiliary systems.
2. There is a sufficiently high volume of manually posted transactions to record daily financial activities due to the lack of integration. Manual entries are time consuming, subject to significant risk of error, and cause delays in monthly and year end close process.
3. Complex processes for the retrieval of data that is needed on a day-to-day basis. In addition, certain key reports used for budgeting and limited financial reporting contain unresolved errors in the data.
4. The library's accounting billing and AR system is not integrated into the City's GL. The City is only able to reconcile the two systems on an annual basis due to the time it consumes.

The result of these overall system deficiencies is a significant degradation in efficiency of staff, who must utilize manual processes or other software products for the recording and reporting of routine financial activity, such as billings, personnel and payroll data, inventories, capital asset, depreciation, budgeting, etc.

Recommendation:

The City is strongly urged to begin the process of review of other software applications that are specifically designed for municipal entities and have the full functionality needed for a City of this size and complexity. These other software applications should be evaluated in light of their general acceptance in cities of this nature and size, the level of internal user support required to operate the software, the training required for users and the cost.

Status:

Finding uncorrected, see current year finding 2016-03

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2016

Section II – Financial Statements Findings (Continued)

B. Prior Year Findings and Questioned Costs – Financial Statement Findings (Continued)

Finding 2015-04 Allowance for Doubtful Accounts

Condition:

The City should remove all uncollectible accounts receivable amounts. The City has kept on its books for the past two fiscal years material amounts of uncollectible accounts receivable. Though the amounts have been reserved and are no longer showing as collectible, the subsidiary ledgers continue to be clogged with old data that ultimately won't be collected. This creates inefficiencies in city operations where sufficient difficulty already exists to extract system data. Compiling the receivable and aging information can take months for the revenue services division.

Recommendation:

We recommend that the City take necessary action to bring the delinquent accounts to City Council for authorization to remove all uncollectible accounts receivable amounts from their records and create policies and procedures for the criteria for when an amount is determined to be uncollectible.

Status:

The finding was resolved during fiscal year ended June 30, 2016.

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2016

Section III – Federal Awards Findings

A. Current Year Findings and Questioned Costs – Major Federal Award Program Audit

2016-05 Internal Control over Preparation of Schedule of Expenditures of Federal Awards

Information on the Federal Programs:

Edward Byrne Memorial Justice Assistance Grant Program (CFDA 16.738, U.S. Department of Justice, Award Number 2015-DJ-BX-0679)

Drug Court Discretionary Grant Program (CFDA 16.585, U.S. Department of Justice, Award Number 2015-JV-FX-004)

State of California Office of Emergency Services - Violence Against Women Formula Grants (CFDA 16.588, U.S. Department of Justice, Award Number ST15 01 80109)

Highway Planning and Construction (CFDA 20.205, U.S. Department of Transportation, passed through State of California Department of Transportation, Award Number BRLO 5008(099))

Criteria:

Under 2 CFR 200, Subpart F- Auditees, §200.510 Financial statements, the auditee must:

(b) "...also prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements which must include the total Federal awards expended as determined in accordance with §200.502 Basis for determining Federal awards expended. At a minimum, the schedule must:

- (1) List individual Federal programs by Federal agency. For a cluster of programs, provide the cluster name, list individual Federal programs within the cluster of programs, and provide the applicable Federal agency name. For R&D, total Federal awards expended must be shown either by individual Federal award or by Federal agency and major subdivision within the Federal agency.
- (2) For Federal awards received as a subrecipient, the name of the pass-through entity and identifying number assigned by the pass-through entity must be included.
- (3) Provide total Federal awards expended for each individual Federal program and the CFDA number or other identifying number when the CFDA information is not available. For a cluster of programs also provide the total for the cluster.
- (4) Include the total amount provided to subrecipients from each Federal program.
- (5) For loan or loan guarantee programs described in §200.502 Basis for determining Federal awards expended, paragraph (b), identify in the notes to the schedule the balances outstanding at the end of the audit period. This is in addition to including the total Federal awards expended for loan or loan guarantee programs in the schedule.
- (6) Include notes that describe that significant accounting policies used in preparing the schedule, and note whether or not the auditee elected to use the 10% de minimis cost rate as covered in §200.414 Indirect (F&A) costs."

Section III – Federal Award Findings (Continued)

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2016

A. Current Year Findings and Questioned Costs – Major Federal Award Program Audit (Continued)

2016-05 Internal Control over Preparation of Schedule of Expenditures of Federal Awards (Continued)

Condition:

During our reviewing of the Schedule of Expenditures of Federal Awards (“Schedule”) provided by the City, we noted the following:

The City reported the incorrect CFDA #, award period, and award amount in the Schedule provided for the Drug Court Discretionary Grant Program. The City also reported the incorrect award number and amount for the Edward Byrne Memorial Justice Assistance Grant Program.

The City reported an award amount less than federal expenditures in the Schedule provided for the Violence Against Women Formula Grant and Highway Planning and Construction.

Questioned Cost:

No questioned costs over \$25,000 noted.

Context:

See condition above for context of the finding.

Effect:

The federal expenditure amounts, funding agreements number and grantor information provided to federal audit clearinghouse may be inaccurate, leading to potential noncompliance with reporting requirements and incorrect identification of major programs.

Cause:

There was a lack of communication between departments to Finance to correctly identify the funding sources and the status of the programs. The departments did not provide the grant agreements to Finance for verification.

Identification as a Repeat finding, If Applicable:

Not a repeat finding.

Recommendation:

We recommend the City establish and follow appropriate internal control procedures to ensure that all expenditures of federal awards, grant agreements, grantors for the fiscal year are accurately reported in the Schedule.

Views of Responsible Officials and Planned Corrective Actions:

The City released a preliminary SEFA to the auditors for review which included certain grant information that was not yet validated by departments. In the future, finance staff will assist in verifying the grant information and finalize the SEFA before releasing it to the auditors. We will also modify the format of the SEFA worksheet distributed to the department staff to include more detailed information on the grants such as funding agreement numbers, funding periods, federal expenditures, local match expenditures, and grantor information. Furthermore, the City recently updated the grant administration policy on June 30, 2016 which provides guidance in the implementation of a grant coordination process that will encourage communication between departments.

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2016

Section III – Federal Award Findings (Continued)

A. Current Year Findings and Questioned Costs – Major Federal Award Program Audit (Continued)

Finding 2016-06 Reporting – Internal Control and Compliance over Reporting

Information on the Federal Program:

Community Development Block Grants / Entitlement Grants, (CFDA 14.218, U.S. Department of Housing and Urban Development, Award Numbers B-14-MC-060026, and B-15-MC-060026)

HOME Investment Partnerships Grant, (CFDA 14.239, U.S. Department of Housing and Urban Development, Award Number M-15-MC-060221)

Port Security Grant Program, (CFDA 97.056, U.S. Department of Homeland Security, Award Number EMW-2014-PU-00247-S01)

Criteria:

Pursuant to the OMB June 2016 Compliance Requirements for CFDA 14.218 Community Development Block Grants / Entitlement Grants and CFDA 14.239 HOME Investment Partnerships Program - *Performance Reporting*, HUD 60002, *Section 3 Summary Report, Economic Opportunities for Low-and Very Low – Income Persons*, (OMB No. 2529-004)³ – Each recipient that administers covered public and Indian housing assistance, regardless of the amount expended, and each recipient that administers covered housing and community development assistance in excess of \$200,000 in a program year must submit HUD 60002 information using the automated Section 3 Performance Evaluation and Registry (“SPEARS”) System (24 CFR sections 135.3(a)(1) and 135.90).

Pursuant to the U.S. Department of Housing and Urban Development Schedule for Submission of 2015 Section 3 Reports, Form HUD 60002, grantees must submit Section 3 Reports at the same time they submit annual performance reports. For example, entitlement communities that receive CDBG, HOME, ESG, etc., Section 3 reports should be submitted into the Integrated Disbursement and Information System (IDIS) at the same time they submit CAPERS, (i.e., 90-days after the end of their program year). All Section 3 reports must be submitted electronically via IDIS. Paper copies, pdf attachments or other methods of transmitting Form HUD 60002 will not be accepted.

Pursuant to the Federal Financial Report (“FFR”) and Final Payment Request or ASAP Draw instructions, obligations and expenditures must be reported on a quarterly basis through the FFR (SF-425, OMB Approval number 0348-0061) and must be filed electronically using PARS. An FFR report must be submitted quarterly, within 30 days of reporting period end, throughout the period of performance, including partial calendar quarters, as well as for periods where no grant award activity occurs. Future awards and fund drawdowns may be withheld if these reports are delinquent, demonstrate lack of progress, or are insufficient in detail. In addition, the final FFR and payment request are due no later than 90 days after the end of the project/budget.

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2016

Section III – Federal Awards Findings (Continued)

A. Current Year Findings and Questioned Costs – Major Federal Award Program Audit (Continued)

Finding 2016-06 Reporting – Internal Control and Compliance over Reporting (Continued)

Condition:

During our audit, we noted that for CDBG and HOME programs, Form HUD 60002 was submitted on October 18, 2016, which was not within 90 days after the end of the City’s program year.

During our audit, we noted that two out of the four quarterly FFRs for the Port Security Grant Program were submitted after report due date.

Questioned Cost:

No questioned costs over \$25,000 noted.

Context:

See condition above for context of the finding.

Effect:

The delay in filing the report resulted in the City not being in compliance with the compliance requirement.

Cause:

The City did not have sufficient monitoring control over the reporting requirements.

Identification as a Repeat finding, If Applicable:

Not applicable

Recommendation:

We recommend that the City establish a comprehensive policies and procedures and specify the deadlines for all required reporting for all City employees to follow.

We also recommend the City establish a review and approval process for all required federal reports to ensure completeness and accuracy of the financial information included in all reports.

Views of Responsible Officials and Planned Corrective Actions:

Staff acknowledges that the Section 3 report was 18 days late. The report must be submitted via SPEARS, an automated registry system. Staff requested access to the system well in advance of the due date, but the log-in information was not provided in time. Staff have registered in the system and the report has been added to the Housing Monthly Task List to ensure we submit future reports on time.

In addition, the City recently updated the grant administration policy on June 30, 2016 which strengthens the grant coordination process. This policy establishes practices, procedures, guidelines and responsibilities for compliance with grant requirements for all departments to ensure timely financial reporting. Training will be provided to staff once the grant coordination process is designed and implemented by the City Manager’s Office.

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2016

Section III – Federal Award Findings (Continued)

A. Current Year Findings and Questioned Costs – Major Federal Award Program Audit (Continued)

2016-07 Eligibility - Internal Control and Compliance over Eligibility Determination

Information on the Federal Programs:

HOME Investment Partnerships Grant, (CFDA 14.239, U.S. Department of Housing and Urban Development, Award Number M-15-MC-060221)

Criteria:

Pursuant to the OMB June 2016 Compliance Requirements for CFDA 14.239 HOME Investment Partnerships Program – *Eligibility for Individuals*, only low-income or very low-income persons, as defined in 24 CFR section 92.2, can receive housing assistance (24 CFR section 92.1). Therefore, the participating jurisdiction must determine if each family is income eligible by determining the family’s annual income, including all persons in the household, as provided for in 24 CFR Section 92.203. Participating jurisdictions must maintain records for each family assisted (24 CFR section 92.508).

HOME-assisted units in a rental housing project must be occupied only by households that are eligible as low-income families and must meet certain limits on the rents that can be charged. The requirements also apply to the HOME-assisted non-owner-occupied units in single-family (1-4 unit) housing purchased with HOME funds. The maximum HOME rents, which include utilities or the utility allowance, are the lesser of: the fair market rent for comparable units in the area, as established by HUD under 24 CFR section 888.111, or a rent that does not exceed 30 percent of the adjusted income of a family whose annual income equals 65 percent of the median income for the area as determined by HUD with adjustments for the number of bedrooms. In rental projects with five or more units there are additional rent limitations. Twenty percent of the HOME-assisted units must be occupied by very low-income families and meet one of the following rent requirements: (1) the rent does not exceed 30 percent of the annual income of a family whose income equals 50 percent of the median income for the area, as determined by HUD, with adjustments for larger or smaller families; or (2) the rent does not exceed 30 percent of the families adjusted income (24 CFR sections 92.216 and 92.252).

Condition:

During our testing of the City’s internal control over new tenant eligibility at multi-family projects, we noted that the City monitors the eligibility of the new tenants who moved in to those HOME-assisted units during the year by reviewing the unit status report provided by the property management. Per regulatory agreements between the City and the borrower of the HOME loans, the City relies on the borrower to verify and monitor the household income level of the tenants.

During our testing of the City’s compliance with the maximum HOME rent requirement, 5 out of 42 different multi-family projects were tested to determine whether the borrowers are charging rents that exceed the allowable HOME rent limit. We noted that there were 51 very-low income tenants in rental projects with five or more HOME assisted units that are charged with rent that exceeds the maximum rent threshold.

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2016

Section III – Federal Award Findings (Continued)

B. Current Year Findings and Questioned Costs – Major Federal Award Program Audit (Continued)

2016-07 Eligibility - Internal Control and Compliance over Eligibility Determination (Continued)

Questioned Cost:

No questioned costs over \$25,000 noted.

Context:

See above condition for contexts of finding.

Effect:

The City could be improperly using HOME Investment Partnership Grant federal funds for ineligible families, which could potentially cause the City to lose federal funding for that program.

Cause:

The monitoring controls are lacking to enforce income level eligibility requirements are being met.

Recommendation:

We recommend that the City ensures that staff knowledgeable with program eligibility requirements properly review and approve application forms when determining a family's income eligibility. We also recommend the City develop a formal policy to monitor the review of all new and existing tenant income levels that are residing in HOME-assisted units performed by the property management.

Views of Responsible Officials and Planned Corrective Actions:

Staff monitor tenant income and eligibility annually and periodically. The borrowers are required to submit forms documenting this information which is reviewed by staff. If rents or income is not in line with the agreements, staff contact the borrower for justification which includes information regarding tenant rent subsidies, income increases, changes to designated "floating" HOME units.

In response to the concerns raised during the audit, staff have determined that it would be beneficial to modify our monitoring process by updating the tenant verification forms to capture additional information including subsidy types and actual tenant rent contribution amounts.

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2016

Section III – Federal Award Findings (Continued)

B. Prior Year Findings and Questioned Costs – Major Federal Award Program Audit

No federal award findings were noted for the year ended June 30, 2015.