

City of Stockton

Stockton, California

Single Audit and Independent Auditors' Reports

For the Year Ended June 30, 2018



**City of Stockton
Single Audit Report
For the Year Ended June 30, 2018**

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**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, 2018, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated December 27, 2018.

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.

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. 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.

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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Questioned Costs that we considered to be significant deficiencies as items 2018-001 and 2018-002.

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

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are 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 responses were 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
March 26, 2019



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, 2018. 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, 2018.

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. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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.

To the Honorable Mayor and Members of City Council
of the City of Stockton
Stockton, California
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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, 2018, 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 27, 2018, 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.

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

Santa Ana, California
March 26, 2019, except for the Schedule of Expenditures of Federal Awards
as to which the date is December 27, 2018

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City of Stockton
Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2018

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-17-MC-060026	\$ 3,285,093	\$ 468,978
Neighborhood Stabilization Program	14.218	B-08-MN-060009	202,366	-
Neighborhood Stabilization Program	14.218	B-11-MN-060009	1,933	-
Total CDBG - Entitlement Grants Cluster			3,489,392	468,978
Emergency Solutions Grant Program	14.231	E-17-MC-060026	320,348	316,155
Total Emergency Solutions Grant Program			320,348	316,155
HOME Investment Partnership Program	14.239	M-17-MC-060221	320,267	-
Total HOME Investment Partnership Program			320,267	-
Total U.S. Department of Housing and Urban Development			4,130,007	785,133
U.S. Department of Justice				
<i>Pass-Through State of California Office of Emergency Services:</i>				
Violence Against Women Formula Grants	16.588	ST16-02-8019	87,804	31,051
Violence Against Women Formula Grants	16.588	ST17-02-8019	185,471	25,007
Total Violence Against Women Formula Grants			273,275	56,058
<i>Direct Program:</i>				
Drug Court Discretionary Grants	16.585	2015-JV-FX-0004	26,406	-
Public Safety Partnership and Community Policing Grants	16.710	2014-UL-WX-0004	689,411	-
Public Safety Partnership and Community Policing Grants	16.710	2014-UL-WX-0010	44,393	43,272
Total Public Safety Partnership and Community Policing Grants			733,804	43,272
<i>Pass-Through San Joaquin County District Attorney's Office:</i>				
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2014-DJ-BX-1110	24,830	9,829
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2015-DJ-BX-0679	161,154	115,940
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2016-DJ-BX-1007	132,097	59,737
Total Edward Byrne Memorial Justice Assistance Grant Program			318,081	185,506
Total U.S. Department of Justice			1,351,566	284,836
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	PT17127	142,969	-
State and Community Highway Safety	20.600	PT18141	389,450	-
Total Highway Safety Cluster			532,419	-

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, 2018

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:				
Safe Route > School Program Expansion	20.205	SRTSLNI-5008(121)	48,473	-
HARRISON ELEM SAFETY IMPROVEMENT	20.205	SRTSL-5008(119)	144,738	-
Harding Way/El Dr Trfc Sig	20.205	HSIPL-5008(128)	533,504	-
EVP System	20.205	HSIPL-5008(125)	528,537	-
BRT IV (MLK Jr Blvd)	20.205	CML-5008(123)	968,823	-
Filbert/Miner Traffic Sig	20.205	CML-5008(130)	(21,283)	-
Pershing Adaptive TCS	20.205	CML-5008(126)	525,073	-
March Ln Adaptive TCS	20.205	CML-5008(127)	1,212	-
Rapid Flashing Beacons C5	20.205	HSIPL-5008(124)	274,124	-
Cal St @ Wshngtn Trfc Sig	20.205	HSIPL-5008(131)	564,270	-
Montaubn/Swain Runabout	20.205	CML-5008(129)	(149,160)	-
2012-13 RESURFACING PROJ	20.205	STPL-5008(120)	(14,324)	-
Weber Ave Beaut Ph2 Con	20.205	RSTPL-5008(122)	(4,457)	-
Arch-Airport/B St Signal	20.205	HSIPL-5008(135)	146,989	-
Rapid Flashing Beacons C6	20.205	HSIPL-5008(133)	150,203	-
RESP Traffic Sig Cntrl	20.205	HSIPL-5008(137)	997	-
Traffic Sig Head Retrofit	20.205	HSIPL-5008(134)	37,269	-
West Lane Ped Access Imp	20.205	HSIPL-5008(136)	38,478	-
2013-14 St. Resurfacing	20.205	STPL-5008(132)	17,250	-
2015 LOCAL ST RESURFACING	20.205	TRP5-14-51 CAL-RECYCLE	(2,629)	-
ATP-Miner Ave Complete St	20.205	CML-5008(145)	78,630	-
ATP-McKinley Elem Srts	20.205	ATPCML-5008(144)	193,693	-
ATP-Safe Rts to Sch Plan	20.205	ATPLNI-5008(138)	67,834	-
Tam O'Shanter /Castle Oaks	20.205	HSIPL-5008(136)	283,251	-
2014-15 St. Resurfacing	20.205	STPL-5008(142)	76,609	-
BUS RAPID TRANSIT I-B	20.205	CML-5008(148)	5,236	-
Bus Rapid Transit Phase V	20.205	CML-5008(149)	17,396	-
Install/Upgrade Bike FAC	20.205	CML-5008(150)	3,989	-
THORNTON At HAMMER & LOWER	20.205	CML-5008(156)	93,908	-
ST RESURFACING FED-AID	20.205	STPL-5008(147)	3,120,919	-
BRIDGE REHAB/REPLACEMENT	20.205	BPMP-5008(157)	108,537	-
HAWK PED SIGNAL INSTALL	20.205	HSIPL-5008(151)	31,721	-
Pre-EmpDev@ Filbert St/Xtown	20.205	HSIPL-5008(154)	151,223	-
Guardrail, Transition Rail	20.205	HSIPL-5008(152)	15,413	-
HUNTER ST DIET/BIKE INSTAL	20.205	HSIPL-5008(155)	5,066	-
WST LN TRS CONTROL SYS	20.205	CML-5008(165)	2,123	-
High Friction Treatment	20.205	HSIPL-5008(153)	15,651	-
BRIDGE REHAB/REPLACEMENT	20.205	BPMP-5008(177)	4,160	-
HSIP 8 CONVT SIGNAL FR PED	20.205	HSIPL-5008(166)	9,277	-
HSIP 8 INSTALL GUARDRAILS	20.205	HSIP-5008(168)	20,309	-
HSIP 8 INSTALL PED XNG 9	20.205	HSIPL-5008(161)	18,759	-
HSIP 8 RAISED MED @ MLK	20.205	HSIPL-5008(167)	4,692	-
HSIP 8 RAISED MED @ PACIF	20.205	HSIPL-5008(164)	40,475	-
HSIP 8 RAISED MED @ EL DO	20.205	HRRRL-5008(163)	10,479	-
HSIP 8 ROAD DIET @ EL DO	20.205	HSIPL-5008(162)	5,175	-
LT TURN ADD @ VARIOUS LOC	20.205	CML-5008(169)	7,105	-
LINCOLN / 8TH ROUNDABOUT	20.205	CML-5008(176)	695	-
MARCH LN EBMUD BIKE & PED	20.205	CML-5008(179)	5,196	-
MONTAUBAN/HAMMERTOWN RND	20.205	CML-5008(174)	762	-
TAM O'SHANTER/KNICKERBOCK	20.205	CML-5008(173)	2,932	-
CENTER/EL DORADO OVERPASS	20.205	BRLS-5008(103)	51,424	-
WILSON WY, ADAPTIVE TCS	20.205	CML-5008(113)	(145)	-
Total Highway Planning and Construction Cluster:			8,240,581	-
Total U.S. Department of Transportation			8,773,000	-

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, 2018

Federal Grantor/Pass-Through Grantor Program Title	CFDA Number	Grant Award Number	Federal Expenditures	Amount Provided to Subrecipients
National Endowment for the Humanities				
<i>Pass-Through State of California State Library:</i>				
Library Services and Technology Act (LSTA) Grant	45.310	40-8698	4,340	-
Total National Endowment for the Humanities			<u>4,340</u>	<u>-</u>
Department of Homeland Security				
<i>Direct:</i>				
Port Security Grant Program	97.056	EMW-2017-PU-00690	57,920	-
Total Department of Homeland Security			<u>57,920</u>	<u>-</u>
Total Expenditures of Federal Awards			<u>\$ 14,316,833</u>	<u>\$ 1,069,969</u>

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

City of Stockton
Notes to the Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2018

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.

Indirect Cost Rate

The City has not elected to use the 10 percent de-minimis indirect rate as allowed under the Uniform Guidance.

City of Stockton
Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2018

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? No
- Significant deficiency(ies) identified? 2018-001, 2018-002

Noncompliance material to financial statements noted? No

Federal Awards

Internal control over major federal programs:

- Material weakness(es) identified? No
- Significant deficiency(ies) identified? None reported

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

Identification of major federal programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>	<u>Expenditures</u>
14.239	HOME Investment Partnership Program	\$ 320,267
20.205	Highway Planning and Construction Program	8,240,581
	Total Expenditures of All Major Federal Programs	\$ 8,560,848
	Total Expenditures of Federal Awards	\$ 14,316,833
	Percentage of Total Expenditures of Federal Awards	59.80%

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, 2018

Section II – Financial Statements Findings (Continued)

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

Finding 2018-001 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 Condition above for context of the finding.

Cause:

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

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.

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2018

Section II – Financial Statements Findings (Continued)

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

Finding 2018-001 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.

Management View and Corrective Action Plan:

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.

On January 24, 2017, Council approved moving forward with an ERP consultant to assist the City in selection and implementation of a new financial system and approved 11 new City positions to serve as the core project team. The City received seven (7) bids in December 2017 and has extensively evaluated those bids. Contract negotiations have commenced with Vendor 1 and the current project team is close to finalizing the contract with Vendor 1. A software vendor contract is anticipated to be recommended for City Council action in April 2019. In the meantime, the City upgraded the HTE system to version 9.1.18.3 in January 2019 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, development permits 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, 2018

Section II – Financial Statements Findings (Continued)

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

Finding 2018-002 Preparation of Schedule of Expenditures of Federal Awards

Criteria:

Pursuant to § 200.303 *Internal Controls under Uniform Guidance Title 2 Grants and Agreement, Part 200 Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, Subpart D – Post Federal Award Requirements:*

The City must:

- (a) Establish and maintain effective internal control over the Federal award that provides reasonable assurance that the non-Federal entity is managing the Federal award in compliance with Federal statutes, regulations, and the terms and conditions of the Federal award. These internal controls should be in compliance with guidance in “*Standards for Internal Control in the Federal Government*” issued by the Comptroller General of the United States or the “*Internal Control Integrated Framework*”, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).
- (b) Comply with Federal statutes, regulations, and the terms and conditions of the Federal awards.
- (c) Evaluate and monitor the non-Federal entity's compliance with statutes, regulations and the terms and conditions of Federal awards.
- (d) Take prompt action when instances of noncompliance are identified including noncompliance identified in audit findings.
- (e) Take reasonable measures to safeguard protected personally identifiable information and other information the Federal awarding agency or pass-through entity designates as sensitive or the non-Federal entity considers sensitive consistent with applicable Federal, state, local, and tribal laws regarding privacy and obligations of confidentiality.

Information is necessary for the City to carry out internal control responsibilities to support the achievement of its objectives. Management obtains or generates and uses relevant and quality information from both internal and external sources to support the functioning of internal control. Communication is the continual, iterative process of providing, sharing, and obtaining necessary information. Internal communication is the means by which information is disseminated throughout the organization, flowing up, down, and across the entity. It enables personnel to receive a clear message from senior management that control responsibilities must be taken seriously. External communication is twofold: it enables inbound communication of relevant external information and provides information to external parties in response to requirements and expectations.

Condition:

While obtaining our understanding of the preparation of the Schedule of Expenditures of Federal Awards (“SEFA”), we noted the following:

1. Public Works Department fails to take responsibility and ownership in reconciling the grant expenditures and report properly in the SEFA.
2. Public Works Department fails to provide grant-related supporting documents to the Administrative Services Department.

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2018

Section II – Financial Statements Findings (Continued)

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

Finding 2018-002 Preparation of Schedule of Expenditures of Federal Awards (Continued)

Context:

See Condition above for context of the finding.

Cause:

There was a lack of communication between the Public Works Department and Accounting Department to correctly prepare the SEFA.

Effect:

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

Recommendation:

We recommend that 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 SEFA.

Management View and Corrective Action Plan:

Public Works Management's view is that the department does take responsibility and ownership for its grant expenditures, and is not aware of any non-compliance. Management does agree that there should be improvements in communication between Public Works (PW) and Administrative Services Department (ASD). PW management will coordinate with ASD to establish procedures that ensure all PW expenditures of federal grants are reported accurately in the SEFA, and will dedicate resources to make available all grant-related documents to ASD, as needed, for SEFA audits.

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2018

Section II – Financial Statements Findings (Continued)

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

Finding 2017-001 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 open findings in the latest report total 145 as of June 2017.

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 was resolved during the year ended June 30, 2018.

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2018

Section II – Financial Statements Findings (Continued)

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

Finding 2017-002 Accounting Manual

Condition:

During the performance of our audit for the year ended June 30, 2017, 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 was resolved during the year ended June 30, 2018.

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2018

Section II – Financial Statements Findings (Continued)

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

Finding 2017-003 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 has not been resolved. See Finding 2018-001.

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2018

Section II – Financial Statements Findings (Continued)

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

Finding 2017-004 Ability to Retain Qualified Accounting Personnel

Condition:

During the fiscal year ended June 30, 2017, the City has tried to hire qualified personnel, but have not been able to retain all qualified personnel.

Recommendation:

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

Status:

Finding was resolved during the year ended June 30, 2018.

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2018

Section III – Federal Awards Finding and Questioned Costs

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

No current year findings and questioned costs noted.

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

2017-005 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-16-MC-060221)

Condition:

During our testing of the City’s internal control over tenant eligibility at multi-family projects, we tested 369 units in five separate rental projects. We noted a total of 26 tenants whose income limit were over the low-income threshold in three rental projects. The City was unable to provide the support for calculation of the rent charged to these tenants. Furthermore, pursuant to 24 CFR 92.252(i) – Over-income tenants, these tenants must pay rent, lesser of the amount payable by the tenant under State or local law or 30 percent of the family’s adjusted income. We noted that all 26 tenants are paying less than the required amount per 24 CFR 92.252(i).

Recommendation:

We recommend the City develop a formal policy to monitor and review the income level and rent requirement for all new and existing tenant.

Status:

Finding was resolved during the year ended June 30, 2018

City of Stockton
Schedule of Findings and Questioned Costs (Continued)
For the Year Ended June 30, 2018

Section III – Federal Awards Finding and Questioned Costs

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

2017-006 Reporting – Internal Control and Compliance over Reporting

Information on the Federal Program:

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

Condition:

During our audit, the City was not able to provide the proof of submission of the Form HUD 60002 for the HOME program.

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.

Status:

Finding was resolved during the year ended June 30, 2018

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