

CITY OF MODESTO, CALIFORNIA

Single Audit Reports

For the Fiscal Year Ended June 30, 2015



Certified
Public
Accountants

**CITY OF MODESTO, CALIFORNIA
SINGLE AUDIT REPORTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2015**

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CITY OF MODESTO, CALIFORNIA
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2015

Federal Grantor

Direct or Pass-through Grantor	CFDA		
Federal Program Title	Number	Grant/Project Number	Expenditures
U.S. Department of Housing and Urban Development			
Direct:			
Community Development Block Grants/Entitlement Grants	14.218	B-04-MC-060002	\$ 126
Community Development Block Grants/Entitlement Grants	14.218	B-08-MC-060002	56,467
Community Development Block Grants/Entitlement Grants	14.218	B-09-MC-060002	98,013
Community Development Block Grants/Entitlement Grants	14.218	B-10-MC-060002	2,809
Community Development Block Grants/Entitlement Grants	14.218	B-13-MC-060002	1,363,108
Community Development Block Grants/Entitlement Grants	14.218	B-14-MC-060002	168,900
Total Community Development Block Grants/Entitlement Grants			<u>1,689,423</u>
 Emergency Solutions Grant Program	 14.231	 E-14-MC-060002	 <u>126,054</u>
 Home Investment Partnerships Program	 14.239	 M-09-MC-060207	 681,350
Home Investment Partnerships Program	14.239	M-10-MC-060207	1,120,758
Home Investment Partnerships Program	14.239	M-11-MC-060207	836,289
Home Investment Partnerships Program	14.239	M-12-MC-060207	299,367
Home Investment Partnerships Program	14.239	M-13-MC-060207	49,987
Home Investment Partnerships Program	14.239	M-14-MC-060207	135,695
Total Home Investment Partnerships Program			<u>3,123,446</u>
 ARRA - Neighborhood Stabilization Program (Recovery Act Funded)	 14.256	 B-09-LN-CA-0053	 <u>413,747</u>
 Total U.S. Department of Housing and Urban Development			 <u>5,352,670</u>
U.S. Department of the Interior			
<i>Passed through the California Department of Parks and Recreation</i>			
Outdoor Recreation - Acquisition, Development and Planning	15.916	06-01740	<u>25,881</u>
 Total U.S. Department of the Interior			 <u>25,881</u>
U.S. Department of Justice			
Direct:			
ARRA - Public Safety Partnership and Community Policing Grants	16.710	2009-RJ-WX-0022	144,628
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2009 CK WX 0449	<u>43,857</u>
 Total U.S. Department of Justice			 <u>188,485</u>

See accompanying notes to schedule of expenditures of federal awards.

CITY OF MODESTO, CALIFORNIA
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
FOR THE FISCAL YEAR ENDED JUNE 30, 2015

Federal Grantor

Direct or Pass-through Grantor	CFDA		
Federal Program Title	Number	Grant/Project Number	Expenditures

U.S. Department of Transportation

Direct:

Airport Improvement Program	20.106	3-06-0153-35	\$ 280,551
Airport Improvement Program	20.106	3-06-0153-037	31,278
Airport Improvement Program	20.106	3-06-0153-038	858,404
Total Airport Improvement Program			<u>1,170,233</u>
Federal Transit - Capital Investment Grants	20.500	CA-03-0562	18,259
Federal Transit - Capital Investment Grants	20.500	CA-90-Y870	1,120,393
Total Federal Transit - Capital Investment Grants			<u>1,138,652</u>
Federal Transit - Formula Grants	20.507	CA-90-Y754	2,143
Federal Transit - Formula Grants	20.507	CA-90-Z064	2,092,791
Federal Transit - Formula Grants	20.507	CA-90-Y680	157,638
Federal Transit - Formula Grants	20.507	CA-95-X148	801,278
Federal Transit - Formula Grants	20.507	CA-95-X173	1,417,359
Federal Transit - Formula Grants	20.507	CA-95-X248	1,232,190
Federal Transit - Formula Grants	20.507	CA-90-Z030	3,887,367
Total Federal Transit - Formula Grants			<u>9,590,766</u>
Total Federal Transit Cluster			<u>10,729,418</u>

Passed through the California Department of Transportation

Highway Planning and Construction	20.205	10-107724L	235,499
Highway Planning and Construction	20.205	10-956975L	66,853
Highway Planning and Construction	20.205	10-957044L	215,337
Highway Planning and Construction	20.205	10-957051L	109,985
Highway Planning and Construction	20.205	10-957052L	609,877
Highway Planning and Construction	20.205	10-957053L	926,764
Highway Planning and Construction	20.205	10-957056L	5,866
Highway Planning and Construction	20.205	1000020579L-N	44,929
Highway Planning and Construction	20.205	1000020580L-N	3,530
Highway Planning and Construction	20.205	1000020600	12,913
Highway Planning and Construction	20.205	10-00020601	60,460
Highway Planning and Construction	20.205	1000020602L-N	20,902
Highway Planning and Construction	20.205	10-12000045L-O	24,644
Highway Planning and Construction	20.205	10-2000046L	19,555
Highway Planning and Construction	20.205	10-12000064L	12,159
Highway Planning and Construction	20.205	10-12000274L-N	31,175
Highway Planning and Construction	20.205	10-12000275L-N	65,536
Highway Planning and Construction	20.205	10-12000276L-N	93,973
Highway Planning and Construction	20.205	10-13000231L-N	880,319
Highway Planning and Construction	20.205	1013000085	10,731
Highway Planning and Construction	20.205	1014000174L-N	94,671
Highway Planning and Construction	20.205	1015000084L-N	6,708

See accompanying notes to schedule of expenditures of federal awards.

CITY OF MODESTO, CALIFORNIA
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
FOR THE FISCAL YEAR ENDED JUNE 30, 2015

Federal Grantor

Direct or Pass-through Grantor	CFDA		
Federal Program Title	Number	Grant/Project Number	Expenditures
U.S. Department of Transportation (continued)			
<i>Passed through the California Department of Transportation (continued)</i>			
Highway Planning and Construction	20.205	1014000040L-N	\$ 14,554
Highway Planning and Construction	20.205	10-956907L	29,486
Highway Planning and Construction	20.205	10-00020623L-N	1,398,433
Highway Planning and Construction	20.205	10-12000149L-N	91,239
Highway Planning and Construction	20.205	10-12000235L-N	88,523
Highway Planning and Construction	20.205	10-2000236L-N	139,363
Highway Planning and Construction	20.205	1014000109L-N	10,992
Highway Planning and Construction	20.205	00-12000075	356,589
Highway Planning and Construction	20.205	10-9569021	9,921
Total Highway Planning and Construction			<u>5,691,486</u>
<i>Passed through the University of California at Berkeley</i>			
State and Community Highway Safety	20.600	SC14262	25,789
<i>Passed through the California Office of Traffic Safety</i>			
State and Community Highway Safety	20.600	AL1444	18,044
State and Community Highway Safety	20.600	PT14113	24,111
State and Community Highway Safety	20.600	PT1579	38,402
State and Community Highway Safety	20.600	AL1520	13,996
Total State and Community Highway Safety			<u>120,342</u>
National Priority Safety Programs	20.616	PT1579	87,507
Total Highway Safety Cluster			<u>207,849</u>
Minimum Penalties for Repeat Offenders for Driving While Intoxicated	20.608	PT14113	29,829
Total U.S. Department of Transportation			<u>17,828,815</u>
U.S. Environmental Protection Agency			
<i>Passed through the California State Water Resources Control Board</i>			
Capitalization Grants for Clean Water State Revolving Funds	66.458	C-06-5175-210	13,395,939
Total U.S. Environmental Protection Agency			<u>13,395,939</u>
U.S. Department of Homeland Security			
<i>Passed through the Modesto Regional Fire Authority</i>			
Assistance to Firefighters Grant	97.044	DHS-13-GPD-044-000-99	83,733
Total U.S. Department of Homeland Security			<u>83,733</u>
Total Expenditures of Federal Awards			<u><u>\$ 36,875,523</u></u>

See accompanying notes to schedule of expenditures of federal awards.

**CITY OF MODESTO, CALIFORNIA
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2015**

NOTE A – GENERAL

The accompanying Schedule of Expenditures of Federal Awards (Schedule) presents the activity of all federal award programs of the City of Modesto, California (City). The City reporting entity is defined in Note I.A to the City's basic financial statements. All federal awards received directly from federal agencies, as well as federal awards passed through other government agencies, are included in the Schedule.

NOTE B – BASIS OF ACCOUNTING

Expenditures of federal awards reported in the Schedule are recognized when incurred, which is consistent with the modified accrual basis of accounting used by the City's governmental funds and the accrual basis of accounting used by the City's proprietary funds, which are described in Note I.C to the City's basic financial statements.

NOTE C – SUBRECIPIENTS

Of the federal expenditures presented in the Schedule, the City provided federal awards to subrecipients as follows:

<u>Program Title</u>	<u>C DFA Number</u>	<u>Expenditures</u>
Community Development Block Grants/Entitlement Grants	14.218	\$ 181,449
Emergency Solutions Grant Program	14.231	123,972



Independent Auditor’s Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

City Council of the City of Modesto
Modesto, 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 Modesto, California (City), as of and for the fiscal year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the City’s basic financial statements, and have issued our report thereon dated January 27, 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 a significant deficiency.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as items 2015-001, 2015-002, 2015-003, 2015-004, 2015-005, 2015-006, and 2015-007 to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the accompanying schedule of findings and questioned costs as item 2015-008 to be a significant deficiency.

Compliance and Other Matters

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

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 them.

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 entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "Macias Gini E O'Connell LPA". The signature is written in a cursive style with a large, stylized "LPA" at the end.

Sacramento, California
January 27, 2016



**Independent Auditor’s Report on Compliance for Each Major Program;
Report on Internal Control Over Compliance; and Report on Schedule of
Expenditures of Federal Awards Required by OMB Circular A-133**

City Council of the City of Modesto
Modesto, California

Report on Compliance for Each Major Federal Program

We have audited the City of Modesto, California’s (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 fiscal year ended June 30, 2015. 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 laws, regulations, contracts, and grants applicable to its federal programs.

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; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 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.

Basis for Qualified Opinion on CFDA No. 14.239 Home Investment Partnerships Program

As described in the accompanying schedule of findings and questioned costs, the City did not comply with requirements regarding CFDA No. 14.239 Home Investment Partnerships Program as described in finding numbers 2015-009 for Reporting and 2015-010 for Special Tests and Provisions. Compliance with such requirements is necessary, in our opinion, for the City to comply with the requirements applicable to that program.

Qualified Opinion on CFDA No. 14.239 Home Investment Partnerships Program

In our opinion, except for the noncompliance described in the Basis for Qualified Opinion paragraph, 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 CFDA No. 14.239 Home Investment Partnerships Program for the fiscal year ended June 30, 2015.

Unmodified Opinion on Each of the Other Major Federal Programs

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 other major federal programs identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs for the fiscal year ended June 30, 2015.

Other Matters

The City's responses to the noncompliance 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 compliance and, accordingly, we express no opinion on the responses.

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 compliance 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 OMB Circular A-133, 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 identified certain deficiencies in internal control over compliance, as described in the accompanying schedule of findings and questioned costs as items 2015-009 and 2015-010, that we consider to be material weaknesses.

The City's responses to the internal control over compliance 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 compliance and, accordingly, we express no opinion on the responses.

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 OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133

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 fiscal year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the City's basic financial statements. We issued our report thereon dated January 27, 2016, which contained unmodified opinions on those financial statements. Our audit was conducted for the purpose of forming 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 OMB Circular A-133 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 additional 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 expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

Macias Gini & O'Connell LLP

Sacramento, California

March 24, 2016

**CITY OF MODESTO, CALIFORNIA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2015**

Section I – Summary of Auditor’s Results

Financial Statements:

Type of auditor’s report issued:	Unmodified
Internal control over financial reporting:	
• Material weakness(es) identified?	Yes
• Significant deficiency(ies) identified?	Yes
Noncompliance material to financial statements noted?	No

Federal Awards:

Internal control over major federal programs:	
• Material weakness(es) identified?	Yes
• Significant deficiency(ies) identified?	None reported
Type of auditor’s report issued on compliance for major federal programs:	Unmodified for all major federal programs except for CFDA No. 14.239 Home Investment Partnerships Program, which was qualified.
Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133?	No

Identification of major federal programs:

CFDA Number	Name of Major Federal Program or Cluster
14.239	Home Investment Partnerships Program
20.106	Airport Improvement Program
20.205	Highway Planning and Construction
66.458	Capitalization Grants for Clean Water State Revolving Funds

Dollar threshold used to distinguish between type A and type B programs:	\$1,106,266
Auditee qualified as low-risk auditee	No

CITY OF MODESTO, CALIFORNIA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE FISCAL YEAR ENDED JUNE 30, 2015

Section II – Financial Statement Findings

Reference Number: 2015-001
Type of Finding: Material Weakness – Pollution Remediation Obligations

Criteria

Generally accepted accounting principles, specifically Governmental Accounting Standards Board (GASB) Statement No. 49, *Accounting and Reporting for Pollution Remediation Obligations*, require that pollution remediation obligations be presented as a liability in the financial statements.

Condition

The City had not previously presented a liability in its financial statements for the net recoveries it had collected over the years to pay for the remediation and legal costs incurred in pursuit of mitigating damages from the manufacturers of perchloroethylene, or PCE. In prior years, it was the City's practice to present any payments made from the collection of net recoveries as a special item in its financial statements.

Cause

The City was not fully aware of the requirements of GASB Statement No. 49.

Effect

This condition resulted in an audit adjustment to record the pollution remediation liability and decrease the beginning net position of the Water Fund by \$9,988,781, the Sewer Fund by \$10,914,776, and the business-type activities by \$20,903,557.

Recommendation

The City should account for subsequent payments made from the net recoveries it has collected as a reduction of the newly-created pollution remediation liability in accordance with GASB Statement No. 49.

Management Response/Corrective Action Plan

The City agrees with the finding and recommendation. The Finance Department will coordinate with the Utilities Department and City Attorney to review the requirements of GASB Statement No. 49 and implement the necessary adjustments each fiscal year.

CITY OF MODESTO, CALIFORNIA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE FISCAL YEAR ENDED JUNE 30, 2015

Section II – Financial Statement Findings (Continued)

Reference Number: 2015-002
Type of Finding: Material Weakness – Deferred Loans

Criteria

Generally accepted accounting principles, specifically GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, require that revenues not meeting the City’s availability criteria be deferred in the governmental fund financial statements as unavailable revenue (a deferred inflow of resources) and recognized as revenue in the government-wide financial statements.

Condition

The City was presenting unavailable revenue related to its deferred loans as unearned revenue (a liability) in the Housing and Community Development Fund and governmental activities financial statements.

Cause

The City was not fully aware of the requirements of GASB Statement No. 65.

Effect

This condition resulted in an audit adjustment to reclassify the unavailable revenue related to deferred loans from unearned revenue to unavailable revenue (a component of deferred inflows of resources) in the City’s Housing and Community Development Fund. Accordingly, this reclassification did not have an impact on the Housing and Community Development Fund’s beginning fund balance. However, in the government-wide financial statements, this adjustment increased the beginning net position of the governmental activities by \$28,677,805 to recognize the revenue associated with prior years.

Recommendation

The City should analyze the long-term assets of its governmental funds and for any related revenues that do not meet the City’s availability criteria, such amounts should be presented as unavailable revenue as a component of deferred inflows of resources in the governmental funds financial statements. The unavailable revenue should be recognized as revenue in the government-wide financial statements in accordance with GASB Statement No. 65.

Management Response/Corrective Action Plan

The City agrees with the finding and recommendation. The City will coordinate with the Community Economic Development Housing Urban Development division to analyze the deferred loans to ensure all requirements are being met related to the City’s availability criteria.

CITY OF MODESTO, CALIFORNIA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE FISCAL YEAR ENDED JUNE 30, 2015

Section II – Financial Statement Findings (Continued)

Reference Number: 2015-003
Type of Finding: Material Weakness – Gas Taxes

Criteria

Generally accepted accounting principles, specifically GASB Statement No. 33, *Accounting and Reporting for Nonexchange Transactions*, require that government-mandated nonexchange transactions be recognized as revenue in the financial statements when received, unless required to be used in a subsequent period.

Condition

The City was presenting gas tax revenue as unearned revenue in its Special Gas Tax Street Improvement Fund (other governmental fund) and governmental activities financial statements.

Cause

The City was not fully aware of the requirements of GASB Statement No. 33.

Effect

This condition resulted in an audit adjustment to eliminate the unearned revenue and increase the beginning fund balance of the Special Gas Tax Street Improvement Fund and the beginning net position of the governmental activities by \$12,575,507.

Recommendation

The City should account for the receipt of gas taxes and other similar government-mandated nonexchange transactions as revenue when received in accordance with GASB Statement No. 33.

Management Response/Corrective Action Plan

The City agrees with the finding and recommendation. The City will move forward on recording the gas tax revenues based on the requirements defined under GASB Statement No. 33.

CITY OF MODESTO, CALIFORNIA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE FISCAL YEAR ENDED JUNE 30, 2015

Section II – Financial Statement Findings (Continued)

Reference Number: 2015-004
Type of Finding: Material Weakness – Reimbursement Agreement

Criteria

Generally accepted accounting principles require that agreements to receive/pay an agreed-upon amount be presented as a receivable/payable in the financial statements.

Condition

The City had not previously presented a receivable or a payable for a reimbursement agreement between the City and Successor Agency (Private-Purpose Trust Fund) associated with the obligations for the repayment of the 2008 Lease Revenue Bonds. In prior years, payments made on the reimbursement agreement were accounted for in operations.

Cause

The City was not fully aware of generally accepted accounting principles.

Effect

This condition resulted in an audit adjustment to record the receivable in the governmental activities and the payable in the Successor Agency and increase and decrease, respectively, net position by \$17,247,750.

Recommendation

The City should account for subsequent payments made from the Successor Agency to the City as a reduction of the newly-created receivable and payable in accordance with generally accepted accounting principles.

Management Response/Corrective Action Plan

The City agrees with the finding and recommendation. The City will ensure all future payments related to the Successor Agency to the City are reducing the receivable and payable associated with the reimbursement agreement.

CITY OF MODESTO, CALIFORNIA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE FISCAL YEAR ENDED JUNE 30, 2015

Section II – Financial Statement Findings (Continued)

Reference Number: 2015-005
Type of Finding: Material Weakness – Debt Refunding

Criteria

Generally accepted accounting principles, specifically GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, require that in a debt refunding the difference between the reacquisition price and the net carrying amount of the old debt should be reported as a deferred outflow of resources or a deferred inflow of resources and recognized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter.

Condition

During fiscal year 2014, an interest payment on debt being refunded was included in the refunding transaction as the refunding occurred prior to the date the interest was due, and the City incorrectly accounted for that amount titled “bond refunding contribution” as a deferred inflow of resources. In addition, the City accounted for the underwriters’ discount as a bond discount.

Cause

The City was not fully aware of the requirements of GASB Statement No. 65.

Effect

This condition resulted in an audit adjustment to eliminate the “bond refunding contribution” and bond discount and increase the beginning net position of the Water Fund and business-type activities by \$4,783,179.

Recommendation

The City should account for debt refunding transactions in accordance with GASB Statement No. 65. Specifically, the difference between the reacquisition price and the net carrying amount of the old debt should be reported as a deferred outflow of resources or a deferred inflow of resources and recognized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter.

Management Response/Corrective Action Plan

The City agrees with the finding and recommendation. The City will implement the recommendation made by the auditors.

CITY OF MODESTO, CALIFORNIA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE FISCAL YEAR ENDED JUNE 30, 2015

Section II – Financial Statement Findings (Continued)

Reference Number : 2015-006
Type of Finding: Material Weakness – Governmental Fund Long-Term Liability

Criteria

Generally accepted accounting principles, specifically GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*, states that matured liabilities (i.e., liabilities that normally are due and payable in full when incurred) should be reported as governmental fund liabilities.

Condition

The City was reporting the unfunded portion of loans approved by the City to fund third parties in its Successor Redevelopment Housing Agency Fund (other governmental fund) that were not due and payable at fiscal year-end.

Cause

The City was not fully aware of the requirements of GASB Interpretation No. 6.

Effect

This condition resulted in an audit adjustment to eliminate the unfunded portion of the approved loans payable and increase the beginning fund balance of the Successor Redevelopment Housing Agency Fund by \$575,000.

Recommendation

The City should only report governmental fund liabilities that are normally due and payable in full when incurred in accordance with generally accepted accounting principles.

Management Response/Corrective Action Plan

The City agrees with the finding and recommendation. The City will implement the recommendation made by the auditors.

CITY OF MODESTO, CALIFORNIA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE FISCAL YEAR ENDED JUNE 30, 2015

Section II – Financial Statement Findings (Continued)

Reference Number: 2015-007
Type of Finding: Material Weakness – Other Prior Period Adjustments

Criteria

Generally accepted accounting principles require that assets, liabilities, revenues and expenditures/expenses be recognized in the period the transaction occurs in accordance with the basis of accounting for each fund type.

Conditions

During fiscal year 2015, the City identified a number of errors in its June 30, 2014 compensated absences, accounts payable, receivables, and property held for resale balances.

Causes

The compensated absences error was due to a miscalculation; the accounts payable and receivables errors were due to improper cutoff; and the property held for resale errors were the result of the accounting department not being informed of the sale of those properties.

Effects

These conditions resulted in the City adjusting the beginning net position/fund balances of its opinion units/funds as follows:

<u>Opinion Units</u>	<u>Compensated Absences</u>	<u>Accounts Payable</u>	<u>Receivables</u>	<u>Property Held for Resale</u>
Governmental activities	\$ 2,330,638	\$ (915,984)	\$ 34,045	\$ (784,000)
Business-type activities	-	-	26,037	(630,000)
General Fund	-	(111,616)	-	-
Housing and Community Development Fund	-	(805,437)	-	-
Capital Grants Fund	-	1,069	-	-
Other governmental funds	-	-	34,045	(784,000)
Bus Fund	-	-	26,037	-
Other enterprise funds	-	-	-	(630,000)
Internal service funds	2,330,638	-	-	-

Recommendation

The City should implement procedures to ensure that all transactions are recorded in the proper period at fiscal year-end. Such procedures should include timely communication between project managers and the accounting department related to the sale of property held for resale. Financial information should be reviewed at year-end for completeness and reasonableness of account balances. Immaterial errors detected in a current period that relate to a prior period may be reported as current year activity.

Management Response/Corrective Action Plan

The City agrees with the finding and recommendation. The City will review immaterial errors to ensure these are captured as current year activities and only account for material adjustments associated with the prior year.

CITY OF MODESTO, CALIFORNIA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE FISCAL YEAR ENDED JUNE 30, 2015

Section II – Financial Statement Findings (Continued)

Reference Number: 2015-008
Type of Finding: Significant Deficiency – Cash Flows Statements

Criteria

Generally accepted accounting principles, specifically GASB Codification Section 2450, *Cash Flows Statements*, establishes standards for cash flow reporting. GASB requires that a statement of cash flows classify cash receipts and payments according to whether they stem from operating, noncapital financing, capital and related financing, or investing activities, and it provides definitions of each category. Information about investing, capital, and financing activities not resulting in cash receipts or payments in the period is required to be provided separately. The primary purpose of a statement of cash flows is to provide relevant information about the cash receipts and cash payments that should help financial report users assess (a) an entity's ability to generate future net cash flows, (b) its ability to meet its obligations as they come due, (c) its needs for external financing, (d) the reasons for differences between operating income (or net income if operating income is not separately identified on the operating statement) and associated cash receipts and payments, and (e) the effects on the entity's financial position of both its cash and its noncash investing, capital, and financing transactions during the period.

Condition

The City was not properly reporting many of the cash receipts and payments, as well as noncash transactions, made during the year in its cash flows statements. The City was reporting items such as gains and losses and prior period adjustments at the same amounts reported in its operating statements, which are prepared on the accrual basis of accounting.

Cause

The City used an Excel workbook that had been used in previous years that linked directly to its operating statements without adjusting the workbook to convert some full accrual amounts to cash amounts.

Effect

This condition resulted in a significant number of revisions to the City's cash flows statements in order to present them in accordance with GASB requirements.

Recommendation

While using a tool, such as an Excel workbook, is very beneficial to preparing cash flow statements, the City should provide additional training to staff on the preparation of cash flows statements, including how to convert accrual based balances to cash receipts and disbursements, in order to present cash flows statements in accordance with generally accepted accounting principles.

Management Response/Corrective Action Plan

The City agrees with the finding and recommendation. The City will ensure key staff members who are involved in the preparation and review of the cash flow statements receive adequate training to ensure they fully understand the preparation of the cash flow statements.

CITY OF MODESTO, CALIFORNIA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE FISCAL YEAR ENDED JUNE 30, 2015

Section III – Federal Award Findings and Questioned Costs

Reference Number: 2015-009
Type of Finding: Material Weakness and Material Instance of Noncompliance
Category of Finding: Reporting
Federal Program Title: Home Investment Partnerships Program
Federal Catalog Number: 14.239
Federal Agency: U.S. Department of Housing and Urban Development
Federal Award Numbers and Years: M-14-MC-060207 / 2014-15; M-13-MC-060207 / 2013-14;
M-12-MC-060207 / 2012-13; M-11-MC-060207 / 2011-12;
M-10-MC-060207 / 2010-11; M-09-MC-060207 / 2009-10

Criteria:

24 CFR Sections 135.3(a)(1) and 135.90

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 Section 3 Summary Reporting System.

Condition:

The City did not submit the required HUD 60002 information.

Cause:

Due to management changes, reorganization and staff shortage, the City fell behind on filing the HUD 60002. In addition, HUD required the report to be filed in a new web-based system.

Effect:

Key line items containing critical information of Form HUD 60002 are not submitted to HUD on a timely basis.

Questioned Costs:

There are no questioned costs.

Context:

This report is required to be submitted to HUD annually.

Recommendation:

We recommend that the City develop controls and procedures to ensure that required reports are submitted when due.

Management Response and Corrective Action:

As mentioned above due to management changes, reorganization and staff shortage, the City fell behind on filing the HUD 60002 for FY 2015. In addition, HUD required the report to be filed in a new web-based system, which required a setup and a staff designation. The City has been able to set up the City of Modesto as a grantee and assigned a staff member to complete the reporting, however the designated staff member has left the City, and we will have to go through the process to designate another staff member to complete the report. In addition, there is a threshold requirement of \$200,000, and there is only one project that will fall under the reporting process. Staff is collecting the information and will submit the report as soon as we can get access to the system.

CITY OF MODESTO, CALIFORNIA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE FISCAL YEAR ENDED JUNE 30, 2015

Section III – Federal Award Findings and Questioned Costs (Continued)

Reference Number: 2015-010
Type of Finding: Material Weakness and Material Instance of Noncompliance
Category of Finding: Special Tests and Provisions
Federal Program Title: Home Investment Partnerships Program
Federal Catalog Number: 14.239
Federal Agency: U.S. Department of Housing and Urban Development
Federal Award Numbers and Years: M-14-MC-060207 / 2014-15; M-13-MC-060207 / 2013-14;
M-12-MC-060207 / 2012-13; M-11-MC-060207 / 2011-12;
M-10-MC-060207 / 2010-11; M-09-MC-060207 / 2009-10

Criteria:

24 CFR Sections 92.209(i), 92.251(f), and 92.504(d)

During the period of affordability (i.e., the period for which the non-Federal entity must maintain subsidized housing) for HOME assisted rental housing, the participating jurisdiction must perform on-site inspections to determine compliance with property standards and verify the information submitted by the owners no less than (a) every 3 years for projects containing 1 to 4 units, (b) every 2 years for projects containing 5 to 25 units, and (c) every year for projects containing 26 or more units.

Condition:

The City did not perform inspections for the fiscal year ended June 30, 2015.

Cause:

Due to management changes and reorganization, staff did not perform inspections.

Effect:

Property standards might not be met and/or needed repairs might not be completed timely.

Questioned Costs:

There are no questioned costs.

Context:

The City is required to perform inspections no less than (a) every 3 years for projects containing 1 to 4 units, (b) every 2 years for projects containing 5 to 25 units, and (c) every year for projects containing 26 or more units. The City subsidizes affordable housing projects with HOME funds on projects that range from 1 to 76 units.

Recommendation:

We recommend that the City develop controls and procedures to identify those units on which housing quality inspections are due and to ensure that the required inspections of units are performed as outlined above.

Management Response and Corrective Action:

The City did not monitor HOME units for the fiscal year ended June 30, 2015 due to management changes, reorganization and staff shortage. City staff has developed a monitoring schedule for the current fiscal year. City staff communicated with their HUD Community Development Representative in regards to this issue.

**CITY OF MODESTO, CALIFORNIA
STATUS OF PRIOR YEAR FINDING AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2015**

Reference Number: 2014-01
Type of Finding: Material Weakness – Construction in Progress

Criteria

In accordance with accounting principles generally accepted in the United States of America, the capitalization of an asset shall occur when the asset is substantially complete and ready for its intended use.

Condition

During our construction in progress testing, we noted six projects that should have been capitalized in the prior fiscal year as no project activity occurred during fiscal year 2013-14. The six projects in question are the Dale/Kiernan Intersection, Virginia Corridor Phase III, ARRA Street Overlay ADA Ramp, Parking Garage Projects, CAD Computer Aid Dispatch, and Downtown Affordable Housing Land Acquisition, representing a \$16.2 million total improvement capital asset.

Cause

Per discussion with management, projects are not closed until the project manager submits the closing documents to the Finance Department, which verifies the completion of the project. The City leaves projects in the open status through a warranty period of about one year to adjust the capitalized cost for any additional expenses. Upon receipt of the closing document, the Finance Department is authorized to move the project from Construction In Progress (CIP). Upon further discussion, the City recognizes this is a wide-spread concern for all CIP projects, and the City will address this issue in an adjustment to the fiscal year 2015 financial statements.

Effect

Failing to capitalize a completed project in a timely manner overstates CIP and understates depreciation expense as projects should be moved out of CIP and subsequently depreciated shortly after completion.

Recommendation

We recommend that the City review project activity a month prior to fiscal year-end and investigate those projects that have experienced minimal expenditure activity in the past year for possible completion. These projects should then be removed from CIP and capitalized.

Management Response/Corrective Action Plan

The City will modify the existing Capital Project Closure form to implement a warranty period identifier, which will require all departments to submit a closure form once the project is completed and in service based on the Council acceptance date. The warranty period identifier will be used to justify the need to reopen the project in the future if there are any warranty issues identified through the warranty period end date. Additionally, the Accounting division will be reviewing all active capital projects semi-annually and any projects with minimal to no activity will be reviewed by the project manager to determine if the project should be capitalized.

Current Year Status

During the year, the City reviewed its capital assets in an effort to address this condition and implement the recommendation, and as a result adjusted its June 30, 2014 capital assets balances for errors identified via decreases to the beginning net position of the Water Fund by \$972,654, Sewer Fund by \$5,477,852, other enterprise funds by \$206,774, business-type activities by \$5,970,727, internal service funds by \$467,125, and governmental activities by \$3,402,733 and increasing the beginning net position of the Bus Fund by \$686,553. As no capital projects that were in CIP at June 30, 2015 were determined to be substantially complete and in use, this recommendation is considered implemented.