

City of Monterey

Monterey, California

Single Audit and Independent Auditors' Reports

For the Year Ended June 30, 2016



City of Monterey

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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 *GOVERNMENTAL AUDITING STANDARDS***

Independent Auditors' Report

To the Honorable Mayor and Members of City Council
of the City of Monterey
Monterey, 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 Monterey, 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 16, 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.

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. 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 first paragraph of this section 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 consider to be significant deficiency as item 2016-001.

To the Honorable Mayor and Members of City Council
of the City of Monterey
Monterey, California
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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*.

The City's Response to Findings

The City's response to the 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 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 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 "The Pen Group, LLP". The signature is written in a cursive, flowing style.

Santa Ana, California
December 16, 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 Auditor's Report

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

Report on Compliance for Each Major Federal Program

We have audited the City of Monterey, 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 federal statutes, regulations, and terms and conditions of its federal awards 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; the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements 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.

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Other Matters

The results of our auditing procedures disclosed instances of noncompliance, which are required to be reported in accordance with the Uniform Guidance and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2016-004, 2016-006, and 2016-008. 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 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 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 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 weakness. However, we identified certain deficiencies in internal control over compliance as described in the accompanying Schedule of Findings and Questioned Costs as items 2016-002 to 2016-008 that we consider to be significant deficiencies.

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 Monterey
Monterey, 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, 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 16, 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 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 31, 2017, except for the Schedule of Expenditures of Federal Awards, which is as of December 16, 2016.

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

| Federal Grantor/Pass - Through Grantor/Program Title | Federal CFDA Number | Agency or Pass-Through Number | Federal Expenditures | Expenditures to Subrecipients |
|---|---------------------------|-------------------------------------|-------------------------|----------------------------------|
| U.S. Department of Housing and Urban Development: | | | | |
| <i>Direct Programs:</i> | | | | |
| <i>CDBG - Entitlement Grants Cluster:</i> | | | | |
| Community Development Block Grants / Entitlement Grants | 14.218 | B-11-MC-06-004 | \$ 26,349 | \$ - |
| Community Development Block Grants / Entitlement Grants | 14.218 | Program Income | 716,443 | 103,530 |
| Total U.S. Department of Housing and Urban Development | | | <u>742,792</u> | <u>103,530</u> |
| U.S. Department of Justice: | | | | |
| <i>Direct Program:</i> | | | | |
| Bulletproof Vest Partnership Program | 16.607 | | 4,959 | - |
| <i>Direct Program:</i> | | | | |
| Edward Byrne Memorial Justice Assistance Grant Program | 16.738 | 2014-DJ-BX-0063 | 13,525 | - |
| Total U.S. Department of Justice | | | <u>18,484</u> | <u>-</u> |
| U.S. Department of Transportation | | | | |
| <i>Pass-through the State of California Department of Transportation:</i> | | | | |
| <i>Highway Planning and Construction Cluster</i> | | | | |
| Highway Planning and Construction (Federal-Aid Highway Program) | 20.205 | ATPL-5086(034) | 128,253 | - |
| Total U.S. Department of Transportation | | | <u>128,253</u> | <u>-</u> |
| U.S. Department of Homeland Security | | | | |
| <i>Direct Program:</i> | | | | |
| Staffing for Adequate Fire and Emergency Response (SAFER) | 97.083 | EMW-2012-FH-00866 | 42,206 | - |
| Total U.S. Department of Homeland Security | | | <u>42,206</u> | <u>-</u> |
| Total Expenditures of Federal Awards | | | <u>\$ 931,735</u> | <u>\$ 103,530</u> |

City of Monterey
Notes to the 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 Monterey (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 Monterey Public Financing Authority

Note 2 – Summary of Significant Accounting Policies

Basis of Accounting

The activity of the City’s federal award programs are reported within the special revenue funds and capital projects funds of the City. The City utilizes the modified accrual basis of accounting for the special revenue funds and capital projects funds as described in Note 1 to the City’s basic financial statements. 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 200, 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 the City’s basic financial statements.

Schedule of Expenditures of Federal Awards

The accompanying Schedule presents the activity of all federal awards programs of the City and, therefore, does not present the financial position or results of operations of the City. Federal financial assistance received directly from federal agencies, as well as federal financial assistance passed through the State of California Department of Transportation are included in the Schedule.

Catalog of Federal Domestic Assistance (CFDA) Numbers

The CFDA numbers included in the accompanying Schedule were determined based on the program name, review of grant contract information, and the Office of Management and Budget’s Catalog of Federal Domestic Assistance.

Indirect Cost Rate

The City elected to use the 10% de minimis cost rate.

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

Note 3 –Loans Receivables

The City’s loan programs funded by CDBG were in the amount of \$3,565,472 at June 30, 2016. There were new loans issued during the year ended June 30, 2016 in the amount of \$90,000. Loans made during the year were included in the Schedule of Expenditures of Federal Awards.

Note 4 – Subrecipients

During the year ended June 30, 2016, the City provided federal funds to the following subrecipients:

| <u>CFDA Number</u> | <u>Program Name / Subrecipient Names</u> | <u>Amount Provided to Subrecipients</u> |
|--------------------|--|---|
| 14.218 | Community Development Block Grants / Entitlement Grants: | |
| | Alliance on Aging, Inc. | \$ 11,170 |
| | Community Human Services | 13,170 |
| | Food Bank for Monterey County | 14,170 |
| | Interim, Inc. | 17,170 |
| | Josephine Kernes Memorial Pool | 7,170 |
| | Legal Services for Seniors | 8,670 |
| | Meals on Wheels of the Monterey Peninsula, Inc. | 7,670 |
| | The Salvation Army Monterey Peninsula Corps. | 17,170 |
| | Project Sentinel, Inc. | 7,170 |
| | Total Amount Provided to Subrecipients | <u>\$ 103,530</u> |

Note 5 – Long-Term Debt

At June 30, 2016, the outstanding balances for the federal loan programs were as follows:

| <u>Pass Through Entity</u> | <u>Loan Number</u> | <u>Amount</u> |
|---|--------------------|---------------------|
| California Energy Commission 1% Loan | 001-08-ECCA.1 | \$ 698,161 |
| California Energy Commission 3.95% Loan | 015-09-ECE-ARRA | 247,995 |
| State Water Resources Control Board 2.1% Loan | 13-831-550-110 | <u>3,171,875</u> |
| Total | | <u>\$ 4,118,031</u> |

City of Monterey
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 issued on whether the financial statements Audited were prepared in accordance with GAAP: Unmodified

Internal control over financial reporting:

- Material weakness(es) identified? None Reported
- Significant deficiency(ies) identified? 2016-001

Noncompliance material to financial statements noted? No

Federal Awards

Internal control over major federal programs:

- Material weakness(es) identified? No
- Significant deficiency(ies) identified? 2016-002 to 2016-008

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> |
|-----------------------|---|---------------------|
| | <i>CDBG - Entitlement Grants Cluster:</i> | |
| 14.218 | Community Development Block Grants / Entitlement Grants | \$ 742,792 |
| | Total Expenditures of All Major Federal Programs | <u>\$ 742,792</u> |
| | Total Expenditures of Federal Awards | <u>\$ 931,735</u> |
| | Percentage of Total Expenditures of Federal Awards | <u>79.72%</u> |

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

Auditee qualified as low-risk auditee in accordance with 2 CFR 200.520? Yes

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

Section II – Financial Statement Findings

A. Current Year Findings- Financial Statement

Finding 2016-001 Prior Period Adjustments

Criteria:

Effective internal control over financial reporting provides reasonable assurance for the completeness and accuracy of accounting records and proper year-end closing.

Condition:

During our audit, certain restatements of beginning balances were made in order to confirm with accounting standards generally accepted in the United States of America. Adjustments were as follows:

Government Wide Financial Statements

Governmental Activities and Business-Type Activities net position was restated from \$128,991,331 to \$112,542,270 and from \$11,901,347 to \$9,314,683, respectively due to various factors:

- 1) Reclassification of Presidio of Monterey Public Works Fund and Navy Service Fund from Business-Type Activities to Governmental-Activities to meet GASB Statement No. 34 requirements.
- 2) Restatements related to Net Pension Liabilities were made to be in compliance with GASB Statement No. 68 and No.71.
- 3) Restatements related to net OPEB obligation were made to correct the fund type described in 1).
- 4) Restatements related to unavailable revenue were made to recognize revenue based on full accrual basis accounting in accordance with GASB Statement No. 54 and No. 65.

Governmental Funds:

Governmental Funds fund balances were restated from \$127,835,200 to \$127,950,818 due to 1) fund type reclassification of Presidio of Monterey Public Works Fund, Navy Service Fund, Conference Center Facility District Capital Project Fund, and Conference Center Facility District Debt Service Fund, and 2) unavailable revenue corrections.

Proprietary Funds:

Proprietary Funds net positions were restated from \$19,158,240 to \$13,779,131 due to 1) fund type reclassification of Presidio of Monterey Public Works Fund, and Navy Service Fund, and 2) Net Pension Liabilities corrections.

Refer to City's Comprehensive Annual Financial Report Note 15 Prior Period Adjustments for details.

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

Section II – Financial Statement Findings (Continued)

A. Current Year Findings- Financial Statement (Continued)

Finding 2016-001 Prior Period Adjustments (Continued)

Cause:

The City was misinformed as to the reporting of fund types and the implementation of GASB Statement No.65. In addition, it was the first year of implementation of GASB Statement No.68 in FY14-15 and miscalculation occurred caused the restatements in FY15-16.

Effect:

The non-compliance with GASB Statements resulted in material misstatements in prior years and prior year adjustment in the current year.

Recommendation:

We recommend the City review GASB Statements more thoroughly to prevent future material prior period adjustments. We also recommend the City benchmark with similar size cities in order to ensure the City's financial records are comparable to the industry.

View of Responsible Officials and Planned Corrective Actions:

The City established the Presidio and Navy Services funds in 1998 and 2001 respectively and both have been classified Proprietary funds since that time. After further review with the City's current auditors, it was agreed that they are both more appropriately classified as Governmental Funds based on the current nature of the City's current contracts for services with the two agencies. Reclassification of these funds required an adjustment to beginning balances. Finance department staff will schedule a review all funds prior to June 30th of each fiscal year to ensure that they are appropriately classified.

FY2015/16 was the first year of implementation of GASB Statement No. 68 for the City. Finance department staff attended several trainings on the implementation of this complex new requirement and prepared the initial entry and adjustment to beginning balances required by the Statement in accordance with guidance available at that time. It was discovered after the FY14/15 audit that there was an error in the initial entries, requiring restatement of the beginning balances and staff has worked with the current auditors to correct the error and establish correct balances as of June 30, 2016. On an ongoing basis, the City will ensure that staff responsible for implementation of new GASB standards will carefully review GASB Statements and attend training on the subject matter prior to implementation, and all related entries will be reviewed thoroughly by Management.

Responsible person: Finance Director (Julie Porter)

Expected implementation date: Completed

B. Prior Year Findings – Financial Statement

No prior year findings were noted.

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

Section III – Federal Award Findings and Questioned Costs

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

2016-002 Internal Controls over Preparation of Schedule of Expenditures of Federal Awards

Information of the Federal Programs:

Community Development Block Grants / Entitlement Grants, (CFDA 14.218, U.S. Department of Housing and Urban Development, Award Number B-14-MC-06-004 and B-15-MC-06-004)

Bulletproof Vest Partnership Program, (CFDA 16.607, U.S. Department of Justice)

Highway Planning and Construction (Federal-Aid Highway Program), (CFDA 20.205, U.S. Department of Transportation, Passed through State of California, Department of Transportation (“CalTrans”), Award Number ATPL-5086(034))

Criteria:

According to 2 CFR 200.302 (a), “The state’s and the other non-Federal entity’s financial management systems, including records documenting compliance with Federal statutes, regulations, and the terms and conditions of the Federal award, must be sufficient to permit the preparation of reports required by general and program-specific terms and conditions; and the tracing of funds to a level of expenditures adequate to establish that such funds have been used according to the Federal statutes, regulations, and the terms and conditions of the Federal award.”

According to 2 CFR 200.302 (b), “The financial management system of each non-Federal entity must provide for the following:

(2) Accurate, current, and complete disclosure of the financial results of each Federal award or program in accordance with the reporting requirements set forth in § 200.327 Financial reporting and 200.328 Monitoring and reporting program performance.

(3) Records that identify adequately the source and application of funds for federally-funded activities. These records must contain information pertaining to Federal awards, authorizations, obligations, unobligated balances, assets, expenditures, income and interest and be supported by source documentation.”

Condition:

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

The City provided incorrect funding agreement number and did not break into entitlement and program income for the Community Development Block Grants program in the Schedule provided.

The expenditure for Edward Byrne Memorial Justice Assistance Grant program was restated from \$2,516 to \$4,959 during the audit.

The City used the incorrect matching percentage to calculate the Highway Planning and Construction (Federal-Aid Highway Program) and it resulted in the expenditure was restated from \$128,166 to \$128,253.

The City reported Presidio of Monterey Base Operations and Maintenance Contract in the amount of \$9,956,039 which should not be considered as a grant in the Schedule provided.

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

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

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

2016-002 Internal Controls over Preparation of Schedule of Expenditures of Federal Awards (Continued)

Questioned Costs:

None

Context:

See condition above for context of the finding.

Effect:

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

Cause:

Inadequate review process over the Schedule preparation process before the Schedule was provided for the audit.

Identification as a Repeat Finding, If Applicable:

Not applicable

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.

View of Responsible Officials and Planned Corrective Actions:

The Finance department will establish internal control procedures by May 31, 2017 to ensure that all expenditures of federal awards, grant agreements, grantors for the fiscal year are accurately reported on the Schedule of Expenditures of Federal Awards (SEFA). Beginning with the final SEFA prepared for the period ending June 30, 2016, the City has added a separate reporting line for CDBG program income, which has previously been reported on a combined basis with CDBG federal grants.

The City has historically included the reimbursable contract with the U.S. Department of the Army in the Schedule of Expenditures of Federal Awards. At the time the City entered into the contract with the US Army, it was a unique contract that was specifically authorized by legislation. The existing contract was subject to audit in accordance with FAR Subpart 42.1, Contract Audit Services and OMB circular A-133 and required the City to submit a copy of the annual audit report to the Contracting Officer. As such, the City has included the Base Operations and Maintenance Contract with the U.S. Army on the SEFA without a CFDA # to affirm that audit procedures had been applied in accordance with the contract requirements. Upon review by the City's current auditors, it was determined that as a service contract, it was not subject to the Single Audit and the City has removed Base Operations and Maintenance Contract with the U.S. Department of the Army from the SEFA for the period ending June 30, 2016. The contract will continue to be subject to audit as part of the City's annual financial audit.

Responsible person: Finance Director (Julie Porter)

Expected implementation date: Completed

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

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

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

2016-003 Cash Management – Internal Controls over Cash Management

Information of the Federal Programs:

Community Development Block Grants / Entitlement Grants, (CFDA 14.218, U.S. Department of Housing and Urban Development, Award Number B-14-MC-06-004 and B-15-MC-06-004)

Criteria:

Proper internal controls require adequate documentation which support amounts requested from reimbursement from federal warding agencies. Documentation should include a listing from the general ledger or a schedule detailing which checks/invoices comprise the amount being requested for reimbursement with proper approval for the draw.

Condition:

During our testing, we noted that three out of five samples selected for testing were missing supporting documents attached to the drawdown requests. The supporting documents were provided and re-printed after our requests. In addition, the indication of review prior to submission was missing. We also noted that one out of the five sample selected for testing was not prepared timely (the drawdown request was submitted in February 2016 for June 2015 expenditures).

Questioned Costs:

None

Context:

Statistically sampling was performed to draw sample selections. See condition above for context of the finding.

Effect:

The lack of a review process might result in noncompliance with the grant requirements for the City. The delay in the preparing for the drawdown requests resulted in the difficulty in reconciling the financial data from HUD Integrated Disbursement and Information System (“IDIS”) to the City’s accounting system and could result in noncompliance with the grant requirements.

Cause:

The City does not have sufficient monitoring procedures in place to ensure the reimbursement requests are being reviewed for accuracy and documented properly for timely submission.

Identification as a Repeat Finding, If Applicable:

Not applicable

Recommendation:

We recommend the City establish a formal policy to adopt a second review procedures, checklist, and timeline over federal grants drawdown requests in order to ensure the drawdown requests are submitted timely with proper approval and supporting documents.

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

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

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

2016-003 Cash Management – Internal Controls over Cash Management (Continued)

View of Responsible Officials and Planned Corrective Actions:

The Housing Programs Office will prepare a written procedure to review and approve revenue and expenditure reporting into HUD's Integrated Disbursement and Information System (IDIS). The procedure will be coordinated with the Finance Department; it will require monthly review of the City's financial system (Eden) Revenue and Expenditure Detail reports to confirm Community Development Block Grant receipts and expenditures are documented prior to reporting in IDIS. The procedure will require all IDIS revenue and expenditure reporting to be prepared and submitted by the Accounting Assistant with approval by the Administrative Analyst/Housing. Reporting and approval will not be conducted by a single employee.

IDIS reporting for revenue and expenditures will generally be prepared and submitted on a quarterly basis. The interval between IDIS reports will not exceed three months.

Responsible person: Housing and Property Manager (Rick Marvin)

Expected implementation date: June 1, 2017

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

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

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

2016-004 Eligibility – Internal Controls and Compliance over Eligibility – CDBG Rental Unit

Information of the Federal Programs:

Community Development Block Grants / Entitlement Grants, (CFDA 14.218, U.S. Department of Housing and Urban Development, Award Number B-14-MC-06-004 and B-15-MC-06-004)

Criteria:

The City of Monterey's Housing and Property Management Division administers and manages a variety of programs, each of which are subject to specific income eligibility criteria. Income eligibility for these programs is determined by comparisons with the U.S. Department of Housing and Urban Development (HUD) income limits currently in effect at the time of program application. The current income limits, adjusted for household size, are published on the City's website.

Pursuant to the City of Monterey Inclusionary Ordinance Rents Chart based on 2015 HCD Income Data, the income of \$45,600 should be charged with the rent of \$1,002.

Condition:

During our testing, we noted that one of one rental unit selected for testing did not have the tenant income evaluation supporting documents (out of the one rental unit). In addition, we noted that the rental unit selected for testing was not charged correctly. The tenant income was \$48,100 with the monthly rent of \$1,100.

Questioned Costs:

None

Context:

100 percentage of population was tested. See condition above for context of the finding.

Effect:

The lack of income eligibility review and rental charges review resulted in the City is not in compliance with the program requirements.

Cause:

The City does not have sufficient monitoring procedures in place to ensure the program/management company performed the income evaluation prior to signing the lease agreement with the tenant and charge the rent correctly.

Identification as a Repeat Finding, If Applicable:

Not applicable

Recommendation:

We recommend the City establish a formal policy to adopt review procedures over eligibility requirement to ensure the City is in compliance the program requirements.

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

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

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

2016-004 Eligibility – Internal Controls and Compliance over Eligibility – CDBG Rental Unit (Continued)

View of Responsible Officials and Planned Corrective Actions:

The unit in question requires a foundation repair and it will be sold to a qualified low-income first time homebuyer after it is repaired. The repair does not prevent occupancy and the Housing Programs Office determined the unit should be temporarily rented until such time as the repair is completed and the unit is ready to be sold.

The Housing Programs Office will immediately work with the property manager to establish a schedule to review income tenant income eligibility and require move-out, consistent with the rental agreement, if tenant is not income eligible. If the current tenant is not income eligible, the unit will be re-leased to low-income qualified household and rent will be adjusted to comply with low-income rent requirements.

The Housing Programs Office will establish written procedures for reviewing income eligibility for the unit. The procedures will require income documentation to include most recent tax filings and employment pay documents, and will require a second review and authorization before entering into a rental agreement. The written procedure will be established by May 1, 2017.

Responsible person: Housing and Property Manager (Rick Marvin)

Expected implementation date: May 1, 2017

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

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

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

2016-005 Procurement and Suspension, and Debarment – Internal Control over Verification Against the System for Award Management (“SAM”)

Information of the Federal Programs:

Community Development Block Grants / Entitlement Grants, (CFDA 14.218, U.S. Department of Housing and Urban Development, Award Number B-14-MC-06-004 and B-15-MC-06-004)

Criteria:

Suspension and Debarment, Non-Federal entities are prohibited from contracting with or making subawards under covered transactions to parties that are suspended or debarred. “Covered transactions” include those procurement contracts for goods and services awarded under a nonprocurement transaction (e.g., grant or cooperative agreement) that are expected to equal or exceed \$25,000 or meet certain other criteria as specified in 2 CFR section 180.220. All nonprocurement transactions entered into by a recipient (i.e., subawards to subrecipients), irrespective of award amount, are considered covered transactions, unless they are exempt as provided in 2 CFR section 180.215.

When a non-Federal entity enters into a covered transaction with an entity at a lower tier, the non-Federal entity must verify that the entity, as defined in 2 CFR section 180.995 and agency adopting regulations, is not suspended or debarred or otherwise excluded from participating in the transaction. This verification may be accomplished by (1) checking the System for Award Management (SAM) Exclusions maintained by the General Services Administration (GSA) and available at <https://www.sam.gov/portal/public/SAM/> (Note: The OMB guidance at 2 CFR part 180 and agency implementing regulations still refer to the SAM Exclusions as the Excluded Parties List System (EPLS)), (2) collecting a certification from the entity, or (3) adding a clause or condition to the covered transaction with that entity (2 CFR section 180.300).

Condition:

During our testing, we noted that one out of two vendors selected for testing did not have documentation on verifying the vendor against the SAM to ensure that the vendors were not suspended or debarred from federally-funded purchases. We also noted that one out of two vendors selected for testing was checked one day after the grant awarded.

Questioned Costs:

None

Context:

100 percent of population was tested. See condition above for context of the finding.

Effect:

Without verifying whether vendors are suspended or debarred from working on federally-funded projects prior to the contract awarded, the City could be contracting with vendors that are prohibited from working on federally-funded projects.

Cause:

The City does not have a formal policy to require departments to perform suspension or debarment over vendors that the City makes contracts with federally-funded projects.

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

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

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

2016-005 Procurement and Suspension, and Debarment – Internal Control over Verification Against the System for Award Management (“SAM”) (Continued)

Identification as a Repeat Finding, If Applicable:

Not applicable

Recommendation:

We recommended the City establish proper internal control procedures to monitor compliance requirements to ensure vendors are not suspended or debarred from federally-funded purchases.

View of Responsible Officials and Planned Corrective Actions:

The City's Master Bid Specification templates include Debarment and Suspension Certifications to be completed by vendors. The Housing Programs office will utilize these templates and certifications for all covered transactions expected to equal or exceed \$25,000.

Responsible person: Housing and Property Manager (Rick Marvin)

Expected implementation date: May 1, 2017

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

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

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

2016-006 Reporting – Internal Controls and Compliance over Reporting

Information of the Federal Programs:

Community Development Block Grants / Entitlement Grants, (CFDA 14.218, U.S. Department of Housing and Urban Development, Award Number B-14-MC-06-004 and B-15-MC-06-004)

Criteria:

Pursuant to the OMB June 2016 Compliance Requirements for CFDA 14.218 Community Development Block Grants / Entitlement Grants - *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, Public Housing Authorities must submit Section 3 Reports by January 10th of each year following the completion of their agency’s fiscal cycle or calendar year. All other HUD 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 in SPEARS 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 SPEARS. 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, the quarterly FFR are due no later than 30 days after the end of the quarter.

Condition:

During our audit, we noted that the City did not file quarterly FFR and HUD 60002, *Section 3 Summary Report, Economic Opportunities for Low- and Very Low- Income Persons* for the year ended June 30, 2016.

Questioned Costs:

None

Context:

See condition above for context of the finding.

Effect:

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

Cause:

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

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

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

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

2016-006 Reporting – Internal Controls and Compliance over Reporting (Continued)

Identification as a Repeat Finding, If Applicable:

Not applicable

Recommendation:

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

View of Responsible Officials and Planned Corrective Actions:

In Program Year 2015 and 2016, the Housing Program Office has focused on addressing CDBG timeliness spending challenges and completing agreements necessary to initiate construction of a low-income senior rental housing project on land purchased with CDBG funds. Successful completion of these two projects is a priority of the City and HUD. This focus resulted in the Housing Program Office missing Section 3 and Federal Financial Reporting SP-425 (FFR) reporting.

By May 31, 2017 the Housing and Property Manager and Administrative Analyst will work with the Assistant Finance Director in the Finance Department staff to prepare and submit FFR reports for Program Year 2015 and Program Year 2016 Qtr 1, Qtr 2 and Qtr 3.

The Housing Programs Office will establish policy and procedures to specify compliance with Section 3 reporting at the same time as the submission of the annual CAPER report. The Housing Program Office is currently requesting Section 3 reporting from grantees executing construction projects in preparation of filing the Section 3 report in SPEARS in September 2017.

Responsible person: Housing and Property Manager (Rick Marvin)

Expected implementation date: May 31, 2017

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

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

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

2016-007 Subrecipient Monitoring – Internal Control over Subrecipient Monitoring

Information of the Federal Programs:

Community Development Block Grants / Entitlement Grants, (CFDA 14.218, U.S. Department of Housing and Urban Development, Award Number B-14-MC-06-004 and B-15-MC-06-004)

Criteria:

Pursuant to Code of Federal Regulation §200.331 Requirements for pass-through entities.

All pass-through entities must:

(d) Monitor the activities of the subrecipient as necessary to ensure that the subaward is used for authorized purposes, in compliance with Federal statutes, regulations, and the terms and conditions of the subaward; and that subaward performance goals are achieved. Pass-through entity monitoring of the subrecipient must include:

(1) Reviewing financial and performance reports required by the pass-through entity.

(2) Following-up and ensuring that the subrecipient takes timely and appropriate action on all deficiencies pertaining to the Federal award provided to the subrecipient from the pass-through entity detected through audits, on-site reviews, and other means.

(3) Issuing a management decision for audit findings pertaining to the Federal award provided to the subrecipient from the pass-through entity as required by §200.521 Management decision.

Condition:

During our testing, we noted that eight of twelve Quarterly Reporting submitted by the subrecipients did not have any indication of City's review.

Questioned Costs:

None

Context:

Statistically sampling was performed to draw sample selections. See condition above for context of the finding.

Effect:

The lack of subrecipient monitoring may lead to noncompliance with the compliance requirements.

Cause:

The City does not have sufficient monitoring procedures in place to ensure the subrecipient monitoring is properly performed.

Identification as a Repeat Finding, If Applicable:

Not applicable

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

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

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

2016-007 Subrecipient Monitoring – Internal Control over Subrecipient Monitoring (Continued)

Recommendation:

We recommend the City establish a formal policy over review procedures on subrecipient monitoring to ensure the City is in compliance the grant requirement.

View of Responsible Officials and Planned Corrective Actions:

The Housing Program Office has drafted a Community Services Subrecipient Monitoring Plan. The draft plan includes: Pre-monitoring questions; Remote (desk) monitory review form; and On-site monitoring review form. The monitoring plan will be completed prior to July 1, 2017 and it will be used to review Program Year 2017 community service subrecipients.

Responsible person: Housing and Property Manager (Rick Marvin)

Expected implementation date: July 1, 2017

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

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

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

2016-008 Special Tests and Provision – Internal Control and Compliance over Citizen Participation Plan

Information of the Federal Programs:

Community Development Block Grants / Entitlement Grants, (CFDA 14.218, U.S. Department of Housing and Urban Development, Award Number B-14-MC-06-004 and B-15-MC-06-004)

Criteria:

Pursuant to the OMB June 2016 Compliance Requirements for CFDA 14.218 Community Development Block Grants / Entitlement Grants *Special Tests and Provisions – Citizen Participation*, the provisions of 24 CFR sections 570.302 and 91.105 with respect to following the citizen participation plan are waived to allow the jurisdiction to provide no fewer than 15 calendar days for citizen comment, rather than 30 days, for its initial NSP submission (section II.B.4 of NSP 3 Notice, 75 FR 64328).

Condition:

During our audit, we noted that the City cannot provide the proof of publication for its Citizen Participation Plan (the “Plan”). In addition, the Plan was adopted back in 1988 without any revision or update since then.

Questioned Costs:

None

Context:

See condition above for context of the finding.

Effect:

No proof of publication for the City’s Citizen Participation resulted in noncompliance. In addition, the outdated Plan might not fit in the current program needs.

Cause:

The City did not have comprehensive policies and procedures to ensure all program compliance requirements are met.

Identification as a Repeat Finding, If Applicable:

Not applicable

Recommendation:

We recommend that the City establish a comprehensive grant management policy to ensure all compliance requirements are met.

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

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

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

2016-008 Special Tests and Provision – Internal Control and Compliance over Citizen Participation Plan

View of Responsible Officials and Planned Corrective Actions:

The Housing Programs office has prepared an amendment to update the Citizen Participation Plan. The Amendment draft will be published for a 30-day review on Friday March 31, 2017. The Amendment will be reviewed for comment and recommendation by the Planning Commission on April 11, 2017 and reviewed for adoption by the City Council on May 2, 2017. Notice of the 30-day review will be published April 1, 2017 in a local newspaper, the Monterey County Herald.

Responsible person: Housing and Property Manager (Rick Marvin)

Expected implementation date: May 2, 2017

City of Monterey
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

2015-001 Activities Allowed or Unallowed, Allowable Costs/Cost Principles, Cash Management

Program:

Presidio Municipal Services Agency, (CFDA 99.Unknown, U.S. Department of Army, Passed through the Presidio Municipal Services Agency, Award Number DABT67-97-R-0015)

Condition:

The Defense Contract and Audit Agency performed an independent audit on the City of Monterey's Presidio Municipal Service Agency Accounting System. The results of the audit reported noncompliance with required accounting system criteria resulting in deficiencies in areas of preparing reimbursement claims and accumulating and segregating costs.

Recommendation:

The City of Monterey has responded to the audit findings and has developed a plan of corrective action. The City of Monterey is working with the Presidio's contracting office to implement their corrective action plan. It was recommended that the City should continue its efforts to correct their noncompliance with applicable regulations discussed above.

Status:

Finding was resolved during the year ended June 30, 2016.