

CITY OF STOCKTON
SINGLE AUDIT REPORT
FOR THE YEAR ENDED JUNE 30, 2011

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For The Year Ended June 30, 2011

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CITY OF STOCKTON

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For The Year Ended June 30, 2011**

SECTION I—SUMMARY OF AUDITOR’S RESULTS

Financial Statements

Type of auditor’s report issued: Unqualified

Internal control over financial reporting:

- Material weakness(es) identified? X Yes No
- Significant deficiency(ies) identified? X Yes None Reported

Noncompliance material to financial statements noted? X Yes No

Federal Awards

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

Internal control over major programs:

- Material weakness(es) identified? X Yes No
- Significant deficiency(ies) identified? X Yes None Reported

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? X Yes No

Identification of major programs:

CFDA#(s)	Name of Federal Program or Cluster
14.218	ARRA – Department of Housing and Urban Development – Community Development Block Grants/Entitlement Grants
14.239	Department of Housing and Urban Development – HOME Investment Partnership Program
16.710	ARRA – Department of Justice – Public Safety Partnership and Community Policing Grants
20.205	ARRA – Department of Transportation – Highway Planning and Construction Grants

Dollar threshold used to distinguish between type A and type B programs: \$1,055,611

Auditee qualified as low-risk auditee? Yes X No

SECTION II – FINANCIAL STATEMENT FINDINGS

Our audit disclosed material weaknesses, significant deficiencies, and instances of noncompliance material to the basic financial statements. We have communicated the material weaknesses and significant deficiencies, along with other matters, in a separate Memorandum on Internal Control dated November 17, 2012 which is an integral part of our audits and should be read in conjunction with this report.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Our audit disclosed the following findings and questioned costs required to be reported in accordance with section 510(a) of OMB Circular A-133.

Finding: SA2011-01 **Accurate Preparation of the Schedule Expenditures of Federal Awards**

CFDA Number: 14.218, 14.239 & 20.205
CFDA Title: ARRA - Community Development Block Grants/Entitlement Grants
 HOME Investment Partnership Grant
 Highway Planning and Construction Grants
Name of Federal Agency: U.S. Department of Housing and Urban Development
 U.S. Department of Transportation
Name of pass-through Entity: State of California, Department of Transportation (for CFDA #20.205)

Criteria: In accordance with the requirements of OMB Circular A-133, the City should report all Federal grant expenditures in the Schedule of Expenditures of Federal Awards (SEFA) accurately.

Condition: At the start of the Single Audit, the City provided a SEFA which included negative expenditures for one of the projects funded by Department of Transportation. In addition, for the programs funded by the Department of Housing and Urban Development, the City initially was unable to provide general ledger details to substantiate the amounts reported on the SEFA.

Effect: The City is not in compliance with the requirements of OMB Circular A-133 to prepare an accurate SEFA.

Cause: The City did not accurately account for all federally funded grants throughout the fiscal year due to its current accounting system set-up and policies to account for Federal grant expenditures.

Recommendation: The City should implement new policy, procedure and accounting system to ensure that expenditures for all Federal grants are reported accurately on the SEFA.

View of Responsible Official and Planned Corrective Actions:

Name of contact person: Vanessa Burke, Administrative Services Director, (209) 937-8908

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS (Continued)

Response: The City agrees with the finding. The negative expenditure appeared on an initial draft of the SEFA prior to the City’s efforts to get “its fiscal house in order”. This was a result of the City’s past practice of allocating expenditures incorrectly on multi funded projects and waiting until project completion (final year) to reconcile life to date expenditures and/or billing errors due to the wrong funding source percentage used or incorrect project number billed. Historically, the City at year end would move multi funded project expenditures from one funding source to another or between projects if eligible. The negative expenditures of \$56,141 was a result of correcting life to date expenditures (2002-2004) in order to match the revenue received and earned for the grant when no current year expenditure were incurred. These expenditures were either ineligible or overcharges to the project and were never moved to an alternate account and funding source.

The finding related to HUD occurred again prior to the City getting its “fiscal house in order”. The loan program had errors initially which were already disclosed by City staff to Council in a staff report on December 11, 2012, and therefore the Schedule of Expenditures of Federal Awards (SEFA) provided to the auditors did not include late transactions that were posted to the General Ledger to correct the loan activity.

After new management team was hired, the City was able to prepare an accurate SEFA for audit. Management understands the need to prepare accurate financial reports in accordance with the requirements of OMB Circular A-133. The City will provide additional training to ensure staff have a clear understanding of SEFA reporting requirements for the various programs. In addition, the City will review and revise its policies and procedures, as needed, establish responsibilities and define guidelines for periodic reconciliations of grant expenditure and expenditure monitoring.

Finding: SA2011-02 **Preparation of Federal Reimbursement Requests and Disallowed Costs**

CFDA Number: 16.710
CFDA Title: ARRA - Public Partnership and Community Policing Grants
Name of Federal Agency: U.S. Department of Justice

Criteria: In accordance with the requirements of OMB Circular A-133, the City should only be requesting federal reimbursements for actual costs incurred; and it should ensure all costs being submitted are allowable per the requirements of the grant agreement.

Condition: During our testing of expenditures charged to the COPS Hiring Recovery Program, we noted that the City had a total amount of \$56,131 in salary and fringe benefit expenditures charged to, and reimbursed by, the grant which were not allowable by the terms of the agreement because they exceeded the restrictions on specific fringe benefits and entry level salaries.

In addition, the City did not request the reimbursement of grant funds based on actual costs incurred. The total amount of money allotted for year two under the COPS Hiring Recovery Program was \$2,617,800. The City drew down \$2,615,120 during fiscal year 2011; however, it only had actual costs of \$2,422,593 which the City could substantiate. As a result, the City should not have requested and received reimbursement for the additional \$192,527 because the City could not substantiate these costs.

Questioned costs: Total questioned cost is \$248,658. See discussion above.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS (Continued)

Effect: The City charged, and was ultimately reimbursed, a total of \$248,658 of expenses which were not allowable per the terms of the COPS Hiring Recovery Program grant agreement.

Cause: The City misinterpreted the terms of the grant agreement and did not adhere to its stipulations, which included only drawing down funds for costs it actually incurred and for those which are allowable per the terms of the agreement.

Recommendation: The City should implement policies and procedures to ensure that only allowable costs are charged to the grant based on the terms of grant agreement. Additionally, it must also ensure only actual costs incurred are requested for reimbursement; and that reimbursement request should not be based on budgeted amounts. The City should contact the grantor to resolve any overdrawn reimbursement.

View of Responsible Official and Planned Corrective Actions:

Name of contact person: Erin Metler, Program Manager III, (209) 937-8886

Response: The City agrees with the finding. The Police Department has recently amended in December 2012 its Grant Administration Guideline which establishes new procedures to clarify the process for requesting reimbursement and the strict adherence to grant terms. The Guideline now requires that the claim draw down forms are reconciled and supported by the general ledger and approved by the Fiscal Affairs Manager prior to the draw down being initiated. This should prevent advancing funds in excess of allowable expenditures unless advances are authorized under the grant terms and conditions. The Guideline also address the process for requesting a grant amendment should the categories not match up properly with the City's compensation plan as in the case of the 2009 COPS Hiring Recovery Program. The Final Funding Memorandum for this grant was based on a compensation structure in place in 2008, and was not adjusted to reflect the significant changes to entry level Police Officer compensation rates after 2008.

The City has been in contact with the grantor and is working on final adjustments to the grant in an effort to close out the grant with the COPS Office. Staff worked with the grantor to reconcile this excess reimbursement with appropriate expenditures in the following fiscal year. To prevent this problem from occurring in the future the City issued in December 2012 an amended Grant Administration Guideline in Police Fiscal Affairs which includes a reconciliation of the draw down claims to the general ledger and a second level of review of those claims. The City also recently participated in a Grant Monitoring Visit from the COPS Office and received further guidance on this grant.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS (Continued)

Finding: SA2011-03 **Preparation of Program Income and Expenditures Reconciliation**

CFDA Number: 14.218
CFDA Title: ARRA - Community Development Block Grant/Entitlement Grant
Name of Federal Agency: Department of Housing and Urban Development

Criteria: In accordance with the requirements of OMB Circular A-102, program income should be used to help defray program costs prior to the City drawing down any additional grant funds. In order to ensure this occurs accordingly, the City should have an accounting mechanism in place which accurately tracks all the expenditures and program income generated from the grant proceeds.

Condition: During our testing of program income for the Neighborhood Stabilization Program (NSP), it was noted that the City was unable to provide a reconciliation of the program income used to defray expenditures incurred under the program during the fiscal year. A total of \$2,646,658 of program income was reported for fiscal year 2011. In addition, the City also had numerous journal entries to reclassify and correct balances to internally track the revenues and expenditures. However, the City could not reconcile the expenditures for the NSP.

Effect: The City is not properly tracking program income, and therefore cannot assure that accurate program income was being used to defray program costs under the grant agreement and compliance requirements.

Cause: The City experienced a high volume of staff turnover which contributed to the reconciliation of NSP program income and expenditures being overlooked.

Recommendation: The City should have an accounting mechanism in place which accurately tracks all the expenditures and program income generated from the Neighborhood Stabilization Program.

View of Responsible Official and Planned Corrective Actions:

Name of contact person: LaVerna Blanco, Program Manager II, (209) 937-8539

Response: The City only partially agrees with this finding as it relates to providing annual reconciliations of grant draws and activity. However, the nature of the program and related accounting is such that all outstanding loans are reported as deferred revenue until collected. This was a change in accounting method in the current year as previously reported in the City's June 30, 2011 Comprehensive Annual Financial Report. Thus any new loan expenditures are offset against program income in the current year (principal and interest repayments) and prior fund balance (accumulated principal and interest repayments) when no draws are made from federal funds. During fiscal year 2011, staff did not draw down any NSP grant entitlement funds. This was done intentionally to prevent drawing funds if there was program income available to defray costs. Staff has developed procedures to provide instructions on the proper treatment of NSP program revenues. In addition, staff is in the process of reconciling the Neighborhood Stabilization Program (NSP) program income collected from start of the program to current.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS (Continued)

Finding: SA2011-04

Direct Labor Allocations for Housing Activities

CFDA Number: 14.218 & 14.239

CFDA Title: ARRA - Community Development Block Grant/Entitlement Grant
HOME Investment Partnership Program

Name of Federal Agency: Department of Housing and Urban Development

Criteria: Payroll charges for Housing Activities are based on predetermined allocations. A large portion of Housing activities are funded with federal awards which are subject to Office of Management and Budget Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*. This regulation requires the use of contemporaneous time keeping records as a basis for charging direct labor costs to federal awards. The use of allocations is permitted if time studies conducted in accordance with requirements of A-87 are conducted and allocations are trued up.

Condition: During our testing of Housing Division payroll costs we noted that nine employees charged time to federally funded housing activities under the HOME Investment Partnership Program, and thirty six employees charged time to federally funded housing activities under the Neighborhood Stabilization Program. Per conversation with Housing staff, the allocation of payroll is based on an estimate of how much time each employee is going to spend working on Housing activities. We noted staff conducts two forms of time studies, but neither conforms to A-87 requirements. Further, we found no evidence that the time study results are used to true up allocations.

Questioned costs: Total amount of questioned compensation costs is \$1,330,706 for the ARRA – Community Development Block Grant/Entitlement Grant Program and \$155,755 for the HOME Investment Partnership Program.

Effect: The City is not in compliance with A-87 requirements and direct labor costs charged to federal programs may not be fair and equitable.

Cause: Lack of understanding of federal regulations and their application to direct labor charges to programs.

Recommendation: We recommend the City review Circular A-87 and employ those requirements as they relate to direct labor costs charged to federal award programs.

View of Responsible Officials and Planned Corrective Actions:

Name of contact person: Lorraine Islas, Program Manager III, (209) 937-8075 and Audrey Ogden, Administrative Analyst, (209) 937-8628

Response: This finding was previously reported in the Memorandum on Internal Control and staff responses for corrective action were provided. The City is in agreement with the finding and the recommendation. We brought this compliance issue to the attention of the audit firm at the beginning of the audit and asked for additional guidance in this area. We are aware of the OMB A-87 requirements and will be working with the Indirect Cost Plan consultant, City's Internal Auditor, budget, Human Resources and others in order to improve the activity based costing currently used by the City for charging payroll to Federal programs.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS (Continued)

Time sheet sampling was implemented in 2005. HUD has conducted other monitoring visits since we have implemented this system and we have received no findings or concerns from them on the issue. Upon completion of the sampling, the time sheets are reviewed and if a major discrepancy between the time sheet and the salary allocation is found, the staff person and/or their supervisor is asked to explain the differences. If there are no mitigating factors, then charges may be adjusted and allocations revised appropriately.

One area where improvement will be made is in reviewing the results of the quarterly time sheet sampling and adjusting the employee's salary costs each quarter to reflect the sampling results. In addition, the results will be reviewed annually, and used as a tool to justify or deny proposed salary allocations during preparation of the annual budget. As noted above, we previously reviewed the sampling and followed-up on major discrepancies. We are now reviewing all of the sampling results on a quarterly basis and adjusting the salary charges accordingly.

Finding: SA2011-05

Accuracy of PR-26 Form

CFDA Number: 14.218
CFDA Title: ARRA - Community Development Block Grant /Entitlement Grant
Name of Federal Agency: Department of Housing and Urban Development

Criteria: Financial reports should be accurate, and the City should be able to provide documentation supporting the amounts reported to the Department of Housing and Urban Development.

Condition: During our report testing, it was noted that in the PR-26 form submitted by the City, the City entered duplicate expenditures in the amount of \$439,528; resulting in an inaccurate report with overstated expenditures of \$439,528.

Effect: The City is not accurately reporting its financial status in the required report; therefore it is not in compliance with reporting requirements.

Cause: The City experienced a high volume of staff turnover during the fiscal year under audit and did not have sufficient resources available to perform a thorough enough review of the aforementioned submitted report to ensure all the information was accurate.

Recommendation: The City should implement policies to ensure that the information provided in its submitted reports is current, accurate and complete.

View of Responsible Official and Planned Corrective Actions:

Name of contact person: Lorraine Islas, Program Manager III, (209) 937-8075

Response: The City agrees with the finding. Staff inadvertently entered one of expenditure amounts twice on the PR26 report. Although the expenditure was listed twice, the City remained within HUD guidelines. The minimum and maximum percentages were well within HUD regulations both before and after the corrections were made.

It is important to note, this was only a typographical error in the Consolidated Annual Performance and Evaluation Report (CAPER) and did not affect the Federal Financial Report submitted quarterly to HUD, nor did it affect any draw down/reimbursement requests. The PR-26 has been revised and will be resubmitted. In addition, staff have updated procedures and included a reconciliation section to ensure the report balances and to prevent errors.

SECTION IV - STATUS OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS –
Prepared by Management

Financial Statement Prior Year Findings

Finding 2010-01 – Library Fund Accounts Receivable (Material Weakness)

CRITERIA

A material weakness is a deficiency, or 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.

CONDITION

The City did not have approximately \$3.4 million of accounts receivable representing uncollected fines, fees, and other charges for services recorded in the general ledger for the Library Fund. The accounting system used by the Library to account for and track the accounts receivable does not directly interface and upload into the City's accounts receivable module within the primary financial accounting and reporting system.

CAUSE

Based on observations and inquiry of City management, the error appears to result from the lack of routine reconciliations being performed between the decentralized subsidiary ledger utilized by the Library, and the City's accounts receivable module, as well as, inadequate monitoring and follow-up on outstanding accounts receivable balances.

EFFECT

The City was omitting financial transactions related to accounts receivable and revenue of the Library Fund from its financial statements. However, the City has recorded the related accounts receivable, allowance for doubtful accounts, and net revenue of approximately \$127,000 in the City's financial statements as of and for the year ended June 30, 2010.

RECOMMENDATION

The Library should implement procedures establishing specific control activities for the performance of routine reconciliation of accounts receivable between the Library Fund's subsidiary ledger and the City's general ledger. The Library should also establish monitoring procedures to ensure that the reconciliations are being performed on a timely basis, as well as, ensuring that a periodic analysis of the Library Fund's accounts receivable aging is conducted for identifying amounts that are no longer collectible.

CURRENT STATUS PREPARED BY MANAGEMENT

This issue was discovered as part of an internal audit. The City's new management teams has reviewed and analyzed the Library accounts receivable account balances for collectability and also reconciled the two systems. Allowances for doubtful accounts have been established and will be monitored quarterly on an ongoing basis. A quarterly review of the aging report will be completed by Library staff and Accounting. Procedures are in place to evaluate receivable activity to ensure that collection activity is within expectations.

**SECTION IV - STATUS OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS (Continued) –
Prepared by Management**

Finding 2010-02 – Cash Reconciliations (Significant Deficiency)

CRITERIA

A significant deficiency is a deficiency, or 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.

CONDITION

During our testing of the City's cash and investments, we noted that the reconciliation of the City's main checking account was not being performed monthly on a timely basis, resulting in unexplained and unidentified differences.

CAUSE

Based on our observations it appears that due to the lack of timely monitoring and oversight, bank reconciliations were not being timely reviewed to ensure their completeness and accuracy and to identify and determine the necessary follow-up of reconciling amounts and unexplained differences.

EFFECT

As of June 30, 2010, there were unidentified reconciling differences related to deposits in transit for the City's main checking account of approximately \$533,000.

RECOMMENDATION

The Administrative Services Department should improve upon the timeliness of performing bank reconciliations and strengthen the oversight and monitoring procedures, ensuring that complete and accurate reconciliations are being performed and there is timely follow-up to resolve any reconciling amounts and unexplained differences. Furthermore, all reconciling amounts should be clearly documented and supported.

CURRENT STATUS PREPARED BY MANAGEMENT

See response to Finding 2011-17 in our separately issued Memorandum of Internal Control report dated November 17, 2012, for current status on the bank reconciliation process. The prior year errors have been identified and corrected.

We agree with the finding and recommendations. As noted in our response to findings noted during the previous year's audit, we have given cash reconciliations a high priority. Staff developed procedures for daily posting of receipts to the general ledger and daily reconciliation of those receipts to bank statements and to the modules used for receipting. Non-cashiered cash activity, such as wire transfers in and out, are recorded in the general ledger and reconciled with bank records weekly. The new practices assist in identifying and correcting errors as they occur. Cash activity is monitored and reported to management daily. It should be noted that the activity of pooled investments and cash with fiscal agents, which represent approximately 97% of the City's cash holdings, are recorded in the general ledger and reconciled to source documents timely.

**SECTION IV - STATUS OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS (Continued) –
Prepared by Management**

Finding 2010-03 – Advances to Property Owners Reconciliation (Significant Deficiency)

CRITERIA

A significant deficiency is a deficiency, or 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.

CONDITION

During our testing we noted that the reconciliation between loans to property owners recorded in the general ledger and the loan balance amounts as reported by the third party administrator, were not being performed timely, resulting in unidentified reconciling amounts.

CAUSE

Based on our observations it appears that there were insufficient follow-up procedures performed related to unidentified reconciling amounts between the loans to property owners amounts reported by the third party administrator and the amounts recorded in the City's general ledger.

EFFECT

As of June 30, 2010, there were unidentified reconciling differences between the loan portfolio of the third party administrator and the City's general ledger of approximately \$1.3 million.

RECOMMENDATION

The Administrative Services Department should improve upon the completeness of the reconciliations between the third party administrator and the general ledger and strengthen the oversight and monitoring procedures, ensuring that complete and accurate reconciliations are performed and there is timely follow-up to resolve any reconciling amounts and unexplained differences. Furthermore, all reconciling amounts should be clearly documented and supported.

CURRENT STATUS PREPARED BY MANAGEMENT

Advances to Property Owners have been reconciled for the current year. The development of a reconciliation process is on-going due to the nature of the loan projects. Each loan project must be analyzed to ensure the project module agrees with the General Ledger and the third party administrator. These loans can be problematic in that loan amounts are reported at face value by the third party administrator and at net expended in the General Ledger. Reconciliation methodology has been to compare the list of loans provided by the third party administrator to the project module in the finance system; then identify any variances. Variances are then researched by the Housing and Accounting departments and adjustments made as necessary. This method was used to reconcile Advances to Property Owners to the General Ledger for fiscal 2010-2011. However, this method proved inaccurate. Reconciliation of Advances to Property Owners for 2011-2012, using a more detailed methodology, exposed an inherent weakness in the methodology developed for 2010-2011. The weakness being; if a project was not on the third party administrator list and had no current year expenditures, the project total could be excluded from the calculation.

SECTION IV - STATUS OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS (Continued) –
Prepared by Management

Current methodology is to complete a roll forward, by project, analysis of the general ledger accounts that make up the total loan balance; compare the calculated project balances to the third party administrator record and the project module. Using this methodology, staff discovered several loans omitted in the reconciliation of 2010-2011 Advances to Property Owners. The resulted in a correction of the 2010 – 2011 receivable balance of \$19,773 additional loans in CDBG Programs and \$1,910,056 additional loans in HOME Programs. These corrections include five small CDBG projects and three large HOME projects

Management believes the most current methodology, although cumbersome and labor intensive, will provide the most accurate analysis of the loan projects. Monthly analysis of Advanced to Property Owners will ensure that reconciling items are identified and processed in a timely fashion, eliminating further prior period adjustments.

Federal Award Prior Year Findings And Questioned Costs

Reference Number: 2010-04
Federal Catalog Number: 16.710
Federal Program Title: ARRA-Public Safety Partnership and Community Policing Grants (CHRP)
Federal Award Number: 2009RJWX0020
Calendar Year Awarded: 2009
Category of Finding: Activities Allowed or Unallowed
Federal Agency: Department of Justice

CRITERIA

CHAPTER 46--JUSTICE SYSTEM IMPROVEMENT SUBCHAPTER XII-E—PUBLIC SAFETY AND COMMUNITY POLICING; ``COPS ON THE BEAT" Sec. 3796dd.

Authority to make public safety and community policing grants

(b) Uses of grant amounts The purposes for which grants made under subsection (a) of this section may be made are—

- (1) rehire law enforcement officers who have been laid off as a result of State and local budget reductions for deployment in community oriented policing;
- (2) hire and train new, additional career law enforcement officers for deployment in community-oriented policing across the Nation;

OMB CIRCULAR A-87, "COST PRINCIPLES FOR STATE, LOCAL, AND INDIAN TRIBAL GOVERNMENTS".

The individual State/local departments or agencies (also known as operating agencies) are responsible for the performance or administration of Federal awards. In order to receive cost reimbursement under Federal awards, the department or agency usually submits claims asserting that allowable and eligible costs (direct and indirect) have been incurred in accordance with A-87.

SECTION IV - STATUS OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS (Continued) –

Prepared by Management

(d) Conform to any limitations or exclusions set forth in A-87, Federal laws, terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items.

2010 COPS HIRING RECOVERY PROGRAM (CHRP) GRANTS OWNER’S MANUAL

Funding under this program may be used to re-hire officers who were, at the time of application, scheduled to be laid off on a future date as a result of state, local or tribal budget cuts.

COPS Hiring Program Grant Award – Grant Terms and Conditions Section 13

All newly hired, additional officers (or an equal number of redeployed veteran officers) funded under CHRP must engage in community policing activities.

CONDITION

During our testing of the activities allowed and unallowed compliance requirement, we noted that a police officer position being funded with COPS grant funds was not a new hire nor was the police officer identified on the City’s layoff list and scheduled to be laid off. Also, we identified another police officer whose salary and benefits were funded with COPS grant funds during FY 2009/10, yet the officer was on military leave beginning in November 2009. Pursuant to the City’s grant award and the COPS Hiring Recovery and Program Grant Terms and Conditions, COPS grant funds can only be used to rehire law enforcement officers who are scheduled to be laid off and used to hire new officers, both of which must engage in community policing activities.

QUESTIONED COSTS

\$194,835

RECOMMENDATION

Procedures should be designed and control activities implemented to ensure that all expenditures being charged to the COPS Grant program are reviewed, approved and determined to be allowable pursuant to the funding terms and conditions of the COPS program grant award, prior to the request and/or draw down of federal funds. Furthermore, the City should proactively and collaboratively work directly with the funding agency to determine the proper course of action to remedy the noncompliance.

CURRENT STATUS PREPARED BY MANAGEMENT

The Corrective Action Plan has been fully implemented for this finding. The questioned costs were removed from the grant account and replaced with allowable costs by staff working with granting agency to identify allowable replacement costs. A Grant Administration Guideline was also amended to establish additional internal control procedures than those currently in place. The Guideline establishes the roles and responsibilities of the Police Department’s personnel as it pertains to grant administration including a second level review of program expenditures for allowable in accordance with OMB A-87 cost principles prior to submission of the grant claims for reimbursement.

SECTION IV - STATUS OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS (Continued) –
Prepared by Management

Reference Number: 2010-05
Federal Catalog Number: 16.710
Federal Program Title: ARRA-Public Safety Partnership and Community
Policing Grants (CHRP)
Federal Award Number: 2009RJWX0020
Calendar Year Awarded: 2009
Category of Finding: Cash Management and Reporting
Federal Agency: Department of Justice

CRITERIA

OMB Circular A-133 Sec .105 – Internal Control Pertaining to the Compliance Requirements for Federal Programs

Internal control over Federal programs means a process--affected by an entity's management and other personnel--designed to provide reasonable assurance regarding the achievement of the following objectives for Federal programs:

- (1) Transactions are properly recorded and accounted for to:
 - (i) Permit the preparation of reliable financial statements and Federal reports;
 - (ii) Maintain accountability over assets; and
 - (iii) Demonstrate compliance with laws, regulations, and other compliance requirements;
- (2) Transactions are executed in compliance with:
 - (i) Laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on a Federal program; and
 - (ii) Any other laws and regulations that are identified in the compliance supplement; and
- (3) Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.

CONDITION

Based upon discussion and inquiry of program managers responsible for the draw down of federal funds and preparation and submission of quarterly reports, in conjunction with our testing, we noted that cash draw downs and the quarterly reports were not being reviewed and approved by someone independent of the preparation process.

QUESTIONED COSTS

There are no questioned costs.

RECOMMENDATION

Control activity procedures should be implemented establishing proper segregation of duties between the preparation and approval of the federal cash draw downs and quarterly reports. Segregation of duties should be designed and implemented sufficient to ensure that all federal cash draw downs and reports are independently reviewed and approved to mitigate the risk for potential noncompliance.

CURRENT STATUS PREPARED BY MANAGEMENT

The Corrective Action Plan has been fully implemented for this Finding. A Grant Administration Procedure is currently in place to provide guidance on the roles and responsibilities of the Police Department's personnel as it pertains to grant administration. A secondary review of required reports is included in this procedure and is actively in place.

SECTION IV - STATUS OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS (Continued) –
Prepared by Management

Reference Number: 2010-06
Federal Catalog Number: 16.710
Federal Program Title: ARRA-Public Safety Partnership and Community
Policing Grants (CHRP)
Federal Award Number: 2009RJWX0020
Calendar Year Awarded: 2009
Category of Finding: Reporting
Federal Agency: Department of Justice

CRITERIA

2010 COPS Hiring Recovery Program Grant Owner's Manual – Federal Financial Reports

Your agency is required to submit quarterly Federal Financial reports (FFR's) using Standard 425 (SF-425) within 30 days after the end of each calendar quarter. A Final SF-425 will be due in 90 days after the end of the grant period. This report reflects the actual cumulative federal monies spent, liquidated obligations incurred, and the unobligated balance of federal funds.

Cops Hiring Recovery Program Grant Terms and Conditions – 9

To assist the COPS office in the monitoring of your award, the grantee agrees to submit quarterly programmatic progress reports and quarterly financial reports in additions to any reports required by the Recovery Act. The grantee also agreed to submit all requested reports in a timely manner.

CONDITION

During our testing of City's completion and submission of the SF-425 quarterly report, we noted that the first quarter SF-425 report submitted by the City was rejected due to the use of an incorrect Data Universal Numbering System (DUNS) number. Furthermore, there was no evidence provided for us to determine whether a revised SF- 425 report for the first quarter was corrected and re-submitted.

QUESTIONED COSTS

There are no questioned costs.

RECOMMENDATION

Control and monitoring activities should be strengthened for identifying and ensuring required reports are accurately prepared and timely submitted as required by program guidelines.

CURRENT STATUS PREPARED BY MANAGEMENT

The City has submitted the SF-425 report for the first quarter as part of the second quarter submittal in January 2010 and is fully in compliance with its reporting for this grant. An amended Grant Administration Guideline is currently in place to provide guidance on the roles and responsibilities of the Police Department's personnel as it pertains to grant administration. Specifically, the responsible staff reviews the claims prior to submission to ensure accuracy.

SECTION IV - STATUS OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS (Continued) –
Prepared by Management

Reference Number: 2010-07
Federal Catalog Number: 16.804
Federal Program Title: ARRA-Edward Byrne Memorial Justice Assistance Grants (JAG)
Program/Grants to Units of Local Governments
Federal Award Number: 2009-SB-B9-0539
Calendar Year Awarded: 2009
Category of Finding: Reporting
Federal Agency: Department of Justice

CRITERIA

OMB Circular A-133 Sec .105 – Internal Control Pertaining to the Compliance Requirements for Federal Programs

Internal control over Federal programs means a process--affected by an entity's management and other personnel--designed to provide reasonable assurance regarding the achievement of the following objectives for Federal programs:

- (1) Transactions are properly recorded and accounted for to:
 - (i) Permit the preparation of reliable financial statements and Federal reports;
 - (ii) Maintain accountability over assets; and
 - (iii) Demonstrate compliance with laws, regulations, and other compliance requirements;
- (2) Transactions are executed in compliance with:
 - (i) Laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on a Federal program; and
 - (ii) Any other laws and regulations that are identified in the compliance supplement; and
- (3) Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.

CONDITION

Based upon discussion and inquiry of program managers responsible for preparing and submitting programmatic information to the County of San Joaquin (County) for inclusion in the Section 1512 quarterly reports required under the American Recovery and Reinvestment Act (ARRA), there is no secondary review of the compiled information by personnel independent of the preparation process. To ensure the completeness and accuracy of the information submitted to the County, and to mitigate the risk of errors from occurring during the compilation of the reports and potential noncompliance, an independent review should be performed by personnel independent of the preparation process.

QUESTIONED COSTS

There are no questioned costs.

RECOMMENDATION

Procedures should be designed and control activities implemented so that all reports are reviewed and approved by personnel independent of the preparation process that are knowledgeable of the program and the reporting requirements.

CURRENT STATUS PREPARED BY MANAGEMENT

The Corrective Action Plan has been fully implemented for this finding. An amended Grant Administration Guideline is currently in place to provide guidance on the roles and responsibilities of the Police Department's personnel as it pertains to grant administration. A secondary review of required reports is included in this procedure and is actively in place.

SECTION IV - STATUS OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS (Continued) –
Prepared by Management

Reference Number: 2010-08
Federal Catalog Number: 20.205
Federal Program Title: Highway Planning and Construction (HPC)
State Award Number and Project Number: 10-5008-M025 and STPLH-5008(069)
10-5008-M028 and STPLN-5008(072)
Calendar Year Awarded: 2004 and 2006
Category of Finding: Matching
Federal Agency: Department of Transportation
Pass Through Entity: California Department of Transportation

CRITERIA

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 on a timely basis.

OMB Circular A-133 Sec .105 – Internal Control Pertaining to the Compliance Requirements for Federal Programs

Internal control over Federal programs means a process--effected by an entity's management and other personnel--designed to provide reasonable assurance regarding the achievement of the following objectives for Federal programs:

- (1) Transactions are properly recorded and accounted for to:
 - (i) Permit the preparation of reliable financial statements and Federal reports;
 - (ii) Maintain accountability over assets; and
 - (iii) Demonstrate compliance with laws, regulations, and other compliance requirements;
- (2) Transactions are executed in compliance with:
 - (i) Laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on a Federal program; and
 - (ii) Any other laws and regulations that are identified in the compliance supplement; and
- (3) Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.

CONDITION

During our testing we noted that the federal matching percentages included in the City's invoices submitted to the California Department of Transportation (CalTRANS) to request reimbursement for project costs, were not in agreement with the percentages stipulated in the finance letters issued by CalTRANS. Of the 17 invoices submitted to CalTRANS for reimbursement of project costs that were tested, 5 of the invoices related to Federal Aid Project STPLN-5008(072) - (Hammer Lane) and STPLH-5008(069) - (Farmington/Mariposa Road). According to the most recent finance letters received from CalTRANS dated February 2, 2009 and March 4, 2010 for Federal Aid Project STPLN-5008(072) - (Hammer Lane) and STPLH-5008(069) - (Farmington/Mariposa Road), respectively, the federal matching fund percentages were 39.51% and 77.27%. The federal matching percentages used by the City on its invoices to CalTRANS were 34.10% and 68.42% Federal Aid Project STPLN-5008(072) - (Hammer Lane) and STPLH-5008(069) - (Farmington/Mariposa Road), respectively. As a result of using the incorrect federal matching percentages on its invoices to CalTRANS for the reimbursement of project costs, the City requested \$9,680 less in federal reimbursement than what the City could have claimed had the City used the proper federal matching percentages.

SECTION IV - STATUS OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS (Continued) –
Prepared by Management

QUESTIONED COSTS

There are no questioned costs.

RECOMMENDATION

Management responsible for administration of the Highway Planning and Construction program need to design and implement procedures to ensure that the most up-to-date federal matching percentages, as communicated by CalTRANS, are utilized in the preparation of invoices to maximize the City's reimbursable costs and so the City maintains its compliance with federal matching requirements.

CURRENT STATUS PREPARED BY MANAGEMENT

Both cited projects were reconciled with the final invoices as per the matching percentages in the most recent finance letters; therefore, there was no loss of federal funding. Nevertheless, management does agree with the recommendation, and has taken steps to improve the process. The first step is to ensure that reimbursement billing ratios are correctly established up front. Fiscal staff works closely with engineering staff to prepare requests for authorization (including finance letters) that accurately reflect available funding sources, amounts, and uses. If different funding ratios apply to different project phases, this is so noted. Drafts of these and other funding documents are reviewed and approved by Fiscal staff before being sent to Caltrans. Funding documents and invoices are scanned and organized electronically to be accessible to all involved parties. If additional funding is received after a capital project is already underway, the altered funding agreement and new request for authorization is routed to Fiscal staff for approval and invoicing integration. Reimbursement billing ratios are modified immediately upon approval of the altered funding document. To memorialize these current practices, a formal procedure is being developed, and additional personnel resources are being provided to the Fiscal Section to ensure compliance.

CITY OF STOCKTON
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Fiscal Year Ended June 30, 2011

Federal Grantor/ Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Grant Award / Pass-Through Identifying Number	Federal Expenditures
Department of Commerce Direct Program			
Public Safety Interoperable Communications Grant Program	11.555	0067-64000	<u>\$95,103</u>
Total Department of Commerce			<u>95,103</u>
Department of Housing and Urban Development Direct Programs			
Community Development Block Grants/Entitlement Grants	14.218	B-09-MC-060026	3,546,400
Community Development Block Grants/Entitlement Grants		B-10-MC-060026	645,563
Community Development Block Grants/Entitlement Grants - Program Income		Program Income	459,033
ARRA - Community Development Block Grants/Entitlement Grants		B-10-MY-060026	367,264
Community Development Block Grants/Entitlement Grants - Loan Balances		Loan Balances	21,987,106
Neighborhood Stabilization Program - Loan Balances		Loan Balances	5,373,286
Neighborhood Stabilization Program - Program Income		Program Income	<u>2,349,728</u>
Subtotal Community Development Block Grants/Entitlement Grants			<u>34,728,380</u>
Emergency Shelter Grants Program	14.231	S-10-MC-060026	<u>198,805</u>
Home Investment Partnership Program	14.239	M-99-MC-060221	298,650
Home Investment Partnership Program		M-00-MC-060221	37,445
Home Investment Partnership Program		M-06-MC-060221	241,934
Home Investment Partnership Program		M-07-MC-060221	1,119,280
Home Investment Partnership Program		M-08-MC-060221	652,759
Home Investment Partnership Program		M-09-MC-060221	100,721
Home Investment Partnership Program		M-10-MC-060221	65,423
Home Investment Partnership Program - Loan Balances		Loan Balances	29,716,875
Home Investment Partnership Program - Program Income		Program Income	<u>799,077</u>
Subtotal of Home Investment Partnership Program Grants			<u>33,032,164</u>
ARRA - Homelessness Prevention & Rapid Re-Housing Program	14.257	S-10-MY-06-0026	<u>681,761</u>
Subtotal Department of Housing and Urban Development Direct Programs			<u>68,641,110</u>
Department of Housing and Urban Development Pass-Through Program From:			
San Joaquin County+B121 Housing Authority			
Public Housing Drug Elimination Program	14.854	CA-024	<u>280,000</u>
Subtotal Department of Housing and Urban Development Pass-Through Program			<u>280,000</u>
Total Department of Housing and Urban Development			<u>68,921,110</u>
JAG Program Cluster			
Department of Justice Direct Programs			
Edward Byrne Memorial Justice Assistance Grant Program			
Edward Byrne Memorial Justice Assistance Grant	16.738	2010-DJ-BX-1460	210,000
Edward Byrne Memorial Justice Assistance Grant	16.738	2009-DJ-BX-0574	23,571
ARRA - Edward Byrne Memorial Justice Assistance Grant	16.804	2009-SB-B9-0539	<u>133,065</u>
Total JAG Program Cluster			<u>366,636</u>
Department of Justice Direct Programs			
Public Safety Partnership and Community Policing Grants	16.710		
COPS Law Enforcement Technology Grant		2008-CK-WX-0291	599,868
Methamphetamine Initiative		2009-CK-WX-0505	33,279
ARRA - COPS Hiring Recovery Program (CHRP)		2009-RJ-WX-0020	<u>2,422,593</u>
Subtotal Public Safety Partnership and Community Policing Grants			<u>3,055,740</u>
Congressionally Recommended Awards	16.753	2009-D1-BX-0312	<u>198,997</u>
Subtotal Department of Justice Direct Programs			<u>3,621,373</u>
Department of Justice Pass-Through Programs From:			
State of California Office of Emergency Services	16.588		
Violence Against Women Formula Grants		SU09-01-8019	111,611
Violence Against Women Formula Grants		LE09-02-8019	98,619
Violence Against Women Formula Grants		LE10-03-8019	<u>81,851</u>
Subtotal Violence Against Women Formula Grants			<u>292,081</u>
State of California Department of Corrections and Rehabilitation			
Juvenile Accountability Block Grant	16.523	CSA 182-10	<u>20,025</u>
San Joaquin County District Attorney's Office			
Edward Byrne Memorial Formula Grant Program	16.579	DC06-17-0390	<u>173,190</u>
Subtotal Department of Justice Pass-Through Programs			<u>485,296</u>
Total Department of Justice			<u>4,106,669</u>

(continued)

CITY OF STOCKTON
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Fiscal Year Ended June 30, 2011

Federal Grantor/ Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Grant Award / Pass-Through Identifying Number	Federal Expenditures
Department of Transportation Pass-Through Programs From:			
State of California Department of Transportation			
Highway Planning and Construction Grants	20.205		
Lincoln Street - BNSF Railroad		STPLR-7500 (069)	125,960
Safe Routes to School - Montezuma Elementary School		SRTS-5008 (088)	5,611
Safe Routes to School - Pilot Program		SRTS-5008 (089)	157,915
Traffic Signal Controller Update and Retiming		CML-5008 (098)	41,869
McKinley Avenue Bridge		BRLO-5008 (099)	5,801
Airport Way Corridor Project		RPSTPLE-5008 (077)	386,731
North Stockton I-5 Widening		HPLULN-5008 (079)	22,027
Bridge Maintenance		BPMP-5008(076)	335
ARRA - Airport Way Streetscape Beautification Phase 2		ESPL-5008 (092)	868,264
Bus Rapid Transit Phase II		CML-5008 (085)	132,929
2007-08 Street Overlay Project		RSTPL-508 (084)	779,122
2008-09 Street Overlay Project		STPL-5008 (086)	2,272,266
ARRA - 2009 Street Overlay Project		ESPL-5008 (087)	5,843,636
ARRA - 2009-10 Streetscape -Seal		ESPLSTP-5008 (091)	399,921
Airport Way at Oak, Park and Fremont		HSIPL-5008 (093)	84,693
El Dorado and MLK Traffic Signal Modification		CML-5008 (101)	18,160
Tam O'Shanter and Hammertown Project		CML-5008 (097)	76,780
Glacier Point Ansel Adams		HSIPL-5008 (102)	1,923
Hammer Lane and SR-99 Interchange and Widening		STPLN-5008 (072)	3,009,755
French Camp Road, I-5 Interchange and Matheny Road		NCPD-5008(059)-HPLUL-5008(081)- DEM112L-5008(082)	1,036,541
Davis Road Bridge		BRLS-5008 (055)	2,178,666
Subtotal Highway Planning and Construction Grants			<u>17,448,905</u>
State of California Office of Traffic Safety			
State and Community Highway Safety Grants	20.600		
Avoid the 10 DUI Campaign		AL0837	1,739
DUI Enforcement and Awareness Program		AL1016	101,980
OTS Sobriety Check Point Mini Grant		SC10420	17,568
AVOID Grant		AL1160	140,608
DUI Enforcement and Awareness Program		AL118	193,214
Click it or Ticket		CT11420	10,165
Subtotal State and Community Highway Safety Grants			<u>465,274</u>
Total Department of Transportation			<u>17,914,179</u>
Department of Energy Direct Program			
Energy Efficiency and Conservation Block Grant Program			
ARRA - Energy Efficiency and Block Grant	81.128	DE-EE0000886	802,810
Total Department of Energy			<u>802,810</u>
Department of Health and Human Services Direct Program			
Health Care and Other Facilities Grant Program	93.887	C76HF009996	4,287
Total Department of Health and Human Services			<u>4,287</u>
Department of Homeland Security Direct Programs			
Metropolitan Medical Response System	97.071	2007-0008, OES ID# 077-00000	7,980
Metropolitan Medical Response System		2009-0019, CAL EMA ID# 077-00000	66,645
Metropolitan Medical Response System		2008-2006, OES ID# 077-00000	35,973
Subtotal Department of Homeland Security Direct Programs			<u>110,598</u>
Department of Homeland Security Pass-Through Programs From:			
San Joaquin County Office of Emergency Services			
Homeland Security Grant Program			
Catastrophic Preparedness	97.067	2009-0019	12,605
Subtotal Department of Homeland Security Pass-Through Programs			<u>12,605</u>
Total Department of Homeland Security			<u>123,203</u>
Total Expenditures of Federal Awards			<u>\$91,967,361</u>

See Accompanying Notes to Schedule of Expenditures of Federal Awards

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CITY OF STOCKTON

**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For The Year Ended June 30, 2011**

NOTE 1-REPORTING ENTITY

The Schedule of Expenditure of Federal Awards (the Schedule) includes expenditures of federal awards for the City of Stockton, California and its component units as disclosed in the notes to the Basic Financial Statements.

NOTE 2-BASIS OF ACCOUNTING

Basis of accounting refers to *when* revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements, regardless of the measurement focus applied. All governmental funds and agency funds are accounted for using the modified accrual basis of accounting. All proprietary funds are accounted for using the accrual basis of accounting. Expenditures of Federal Awards reported on the Schedule are recognized when incurred.

NOTE 3-DIRECT AND INDIRECT (PASS-THROUGH) FEDERAL AWARDS

Federal awards may be granted directly to the City by a federal granting agency or may be granted to other government agencies which pass-through federal awards to the City. The Schedule includes both of these types of Federal award programs when they occur.

NOTE 4 - SUBRECIPIENTS

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

<u>CFDA Number</u>	<u>Program Name</u>	<u>Amount Provided to Subrecipients</u>
14.218	Community Development Block Grants/Entitlement Grants	\$467,778

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**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**

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

We have audited the financial statements of the City of Stockton as of and for the year ended June 30, 2011, and have issued our report thereon dated November 17, 2012. We conducted our audit in accordance with generally accepted auditing standards 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.

Internal Control over Financial Reporting

Management of the City of Stockton is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies reported in our separately issued Memorandum on Internal Control dated November 17, 2012, as described in the accompanying Schedule of Findings and Questioned Costs, Section II – Financial Statement Findings to be material weaknesses: 2011-1, 2011-2, 2011-3, 2011-4, 2011-5, 2011-6, 2011-7, 2011-8, 2011-9, 2011-10, 2011-11 and 2011-12.

A significant deficiency is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies reported in our separately issued Memorandum on Internal Control dated November 17, 2012, as described in the accompanying Schedule of Findings and Questioned Costs, Section II – Financial Statement Findings, to be significant deficiencies: 2011-13, 2011-14, 2011-15, 2011-16, 2011-17, 2011-18, 2011-19, 2011-20, 2011-21, 2011-22, 2011-23, 2011-24, 2011-25, 2011-26, 2011-27, 2011-28, 2011-29, 2011-30, 2011-31, 2011-32, 2011-33, 2011-34, 2011-35, 2011-36 and 2011-37.

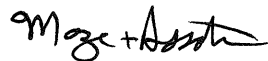
Compliance and Other Matters

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

We have also issued a separate Memorandum on Internal Control dated November 17, 2012 which is an integral part of our audits and should be read in conjunction with this report.

The City’s responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the City’s response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of City Council, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



November 17, 2012

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE
WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL
EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL
OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

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

Compliance

We have audited City of Stockton's compliance with the types of compliance requirements described in the *OMB Circular A-133 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, 2011. 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. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of City's management. Our responsibility is to express an opinion on the City's compliance based on our audit.

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. 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. Our audit does not provide a legal determination of the City's compliance with those requirements.

As described in items SA2011-03 and SA2011-04 in the accompanying schedule of findings and questioned costs, the City did not comply with requirements regarding program income and expenditures reconciliation and allowable costs that are applicable to its Community Development Block Grant/Entitlement Grant Program and HOME Investment Partnership Program. Compliance with such requirements is necessary, in our opinion, for the City to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the City complied, in all material respects, with the 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, 2011. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items SA2011-01, SA2011-02 and SA2011-05.

Internal Control Over Compliance

Management of the City is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the City's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance 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.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

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 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. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items SA2011-03 and SA2011-04 to be material weaknesses.

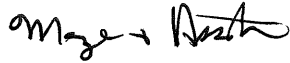
A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items SA2011-01 and SA2011-02 to be significant deficiencies.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the City as of and for the year ended June 30, 2011, and have issued our report thereon dated November 17, 2012. Our audit was performed for the purpose of forming our opinions on the financial statements that collectively comprise the City's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

The City's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the City's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of management, City Council, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, appearing to read "Mayer & Roth".

January 23, 2013

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