CITY OF CHICO, CALIFORNIA

SINGLE AUDIT REPORT
(OMB CIRCULAR A-133)

FOR THE FISCAL YEAR ENDED JUNE 30, 2013

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INDEPENDENT AUDITORS' 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
City of Chico, California

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Governmental Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Chico (the City), California, as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated March 11, 2014. Our report includes an emphasis of matter regarding the City's significant deficit fund equity in numerous funds, an emphasis of matter regarding the interfund receivable and payables between the General Fund, Private Development Fund, and the Capital Improvements capital project fund to reimburse deficit cash balances that were determined to be obligations of the General Fund, an emphasis of matter regarding the City's disclosure regarding significant financial stress and management's plan to address the City's current financial condition, and an emphasis of matter regarding the City's adoption of Governmental Accounting Standards Board (GASB) Statement No. 62 – *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, and GASB Statement No. 63 – *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as items 2013-01 and 2013-03 to be material weaknesses.

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A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as items 2013-02, 2013-04, 2013-05, 2013-06, 2013-07, 2013-08, 2013-09, and 2013-10 to be significant deficiencies.

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 instances of noncompliance or other matters that are required to be reported under *Government Auditing* Standards and which are described as items 2013-02 and 2013-10 in the accompanying Schedule of Findings and Questioned Costs.

City's Responses to Findings

The City's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. The City's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Vavrinek, Trine, Day & Co. LLP

Sacramento, California
March 11, 2014

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM; REPORT ON INTERNAL CONTROL OVER COMPLIANCE; AND REPORT ON SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS REQUIRED BY OMB CIRCULAR A-133

The Honorable Mayor and City Council
City of Chico, California

Report on Compliance for Each Major Federal Program

We have audited City of Chico's (the City) 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, 2013. The City's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of the City's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the City's compliance.

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, 2013.

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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 OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 2013-11 and 2013-12. Our opinion on each major federal program is not modified with respect to these matters.

The City's responses to the noncompliance findings identified in our audit are described in the accompanying schedule of findings and questioned costs. The City's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

Report on Internal Control Over Compliance

Management of the City is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the City's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified certain deficiencies in internal control over compliance, as described in the accompanying schedule of findings and questioned costs as items 2013-11 and 2013-12 that we consider to be significant deficiencies.

The City's responses to the internal control over compliance findings identified in our audit are described in the accompanying schedule of findings and questioned costs. The City's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

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

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component unit, each major fund and the aggregate remaining funding formation of the City as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the City's basic financial statements. We issued our report thereon dated March 11, 2014, which contained unmodified opinions on those financial statements. Our report includes an emphasis of matter regarding the City's significant deficit fund equity in numerous funds, an emphasis of matter regarding the interfund receivable and payables between the General Fund, Private Development Fund, and the Capital Improvements capital project fund to reimburse deficit cash balances that were determined to be obligations of the General Fund, an emphasis of matter regarding the City's disclosure regarding significant financial stress and management's plan to address the City's current financial condition, and an emphasis of matter regarding the City's adoption of Governmental Accounting Standards Board (GASB) Statement No. 62 – *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, and GASB Statement No. 63 – *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. Our audit was conducted for the purpose of forming 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 OMB Circular A-133 and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditure of federal awards is fairly stated in all material respects in relation to the financial statements as a whole.

Vavrinek, Trine, Day & Co. LLP

Sacramento, California
March 21, 2014

CITY OF CHICO, CALIFORNIA

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

FEDERAL GRANTOR PASS THROUGH GRANTOR PROGRAM TITLE	FEDERAL CFDA NUMBER	DIRECT OR PASS THROUGH IDENTIFYING NUMBER	FEDERAL EXPENDITURES
U. S. Department of Housing and Urban Development:			
Direct Programs:			
Community Development Block Grants (CDBG)/Entitlement Grants [1]	14.218	B-07-MC-06-0031	$ 798,174
Home Investment Partnerships Program	14.239	M-07-MC-06-0232	327,753
			1,125,927
Total Department of Housing and Urban Development			**1,125,927**
U. S. Department of Justice:			
Direct Program:			
Bulletproof Vest Partnership Program	16.607	N/A	1,803
Project Safe Neighborhoods:			
Federal Bureau of Investigation, Safe Streets Task Force	16.609	166E-SC-C37231	3,306
ARRA - Public Safety Partnership and Community Policing Grants:			
Citizens Option for Public Safety (COPS 09- ARRA) Program [1]	16.710	ARRA-2009RKWX0090	221,581
Edward Byrne Memorial Justice Assistance Grant Program:			
Justice Assistance Grant (JAG 09) Program	16.738	2009-DJ-BX-1185	3,531
Justice Assistance Grant (JAG 10) Program	16.738	2010-DJ-BX-1464	11,565
Justice Assistance Grant (JAG 11) Program	16.738	2011-DJ-BX-2365	17,701
Justice Assistance Grant (JAG 12) Program	16.738	2012-DJ-BX-0875	24,163
ARRA - Recovery Act - Edward Byrne Memorial Justice Assistance Grant (JAG) Program/Grants to Units of Local Government:			
Justice Assistance Grant (JAG 09- ARRA) Program	16.804	ARRA-2009-SB-B9-2362	24,443
Equitable Sharing Program	16.922	CA0040200	6,276
OCDETF (Crystal Ball) Program	16.PA-CAE-0369	PA-CAE-0369	6,318
			320,687
Total Department of Justice			**320,687**
U. S. Department of Transportation:			
Direct Program:			
Airport Improvement Program [1]	20.106	3-06-0041-29	2,996
Airport Improvement Program [1]	20.106	3-06-0041-31	197,915
Airport Improvement Program [1]	20.106	3-06-0041-32	107,672
Total Direct Programs:			308,583
Passed Through California Department of Transportation:			
Highway Planning and Construction:			
Congestion Mitigation Air Quality (CMAQ)	20.205	03-BUT-0-CHC/5037 (020)	1,910,490
Congestion Mitigation Air Quality (CMAQ)	20.205	03-BUT-0-CHC/5037 (019)	513,562
Salem Street @ LCC	20.205	BRLO-5037 (022)	51,623
Guynn Rd @ Lindo Channel	20.205	BRLO-5037 (023)	21,559
Pomona Rd @ LCC	20.205	BRLO-5037 (024)	31,465
Safe Routes to School	20.205	03-BUT-0-CHC/5037(025)	188,318
Total Passed Through California Department of Transportation:			2,717,017
Passed Through California Department of Parks and Recreation			
Recreational Trails Program:			
Bidwell Park Middle Trail Rehabilitation	20.219	NRT-CA-2009/RT-04-004	69,883
Total Passed Through California Department of Parks and Recreation:			69,883
Passed Through Town of Paradise:			
Alcohol Impaired Driving Countermeasures Incentive Grants I			
Avoid the Eight OTS Grant	20.601	AL1413	18,107
Total Passed Through Town of Paradise:			18,107
Total Department of Transportation			**3,113,590**

[1] Denotes a major Federal Program

CITY OF CHICO, CALIFORNIA

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

FEDERAL GRANTOR PASS THROUGH GRANTOR PROGRAM TITLE	FEDERAL CFDA NUMBER	DIRECT OR PASS THROUGH IDENTIFYING NUMBER	FEDERAL EXPENDITURES
U.S. Environmental Protection Agency			
Direct Program:			
Brownsfield Assessment and Cleanup Cooperative Agreements	66.818	00T93301	655
Total Direct Program:			655
Total Environmental Protection Agency			**655**
U.S. Department of Energy			
Direct Program:			
ARRA - Energy Efficiency and Conservation Block Grant Program (EECBG)	81.128	ARRA-DE-SC0003464	51,509
Total Department of Energy			**51,509**
U. S. Department of Homeland Security			
Direct Program:			
Assistance to Firefighters Grant:			
Fire Safe-House Trailer	97.044	EMW-2010-FP-01990	16,721
FEMA AED's	97.044	EMW-2012-FO-06288	16,839
FEMA CAD Interface	97.044	EMW-2009-FO-06494	6,142
Total Department of Homeland Security			**39,702**
Total Expenditures of Federal Awards			**$ 4,652,070**

[1] Denotes a major Federal Program

CITY OF CHICO, CALIFORNIA

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

NOTE #1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Schedule of Expenditure of Federal Awards (the Schedule) includes expenditures of federal awards for the City of Chico, California.

B. Basis of Accounting

The accompanying Schedule of Expenditures of Federal Awards is presented using the modified accrual basis of accounting except for programs recorded in the City's enterprise funds, which are presented using the accrual basis of accounting, which is described in Note 1 to the City's basic financial statements. The information in this schedule is presented in accordance with the requirements of *OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations*.

NOTE #2 – 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 #3 – SUBRECIPIENTS

Of the Federal expenditures presented in the accompanying Schedule of Expenditures of Federal Awards, the City provided Federal awards to subrecipients as follows:

CFDA No.	City Program Title	Amount
14.218	Community Development Block Grants (CDBG) Entitlement Grants	$ 115,299
		$ 115,299

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS FOR THE FISCAL YEAR ENDED JUNE 30, 2013

NOTE #4 – CLUSTERS OF PROGRAMS

The schedule of expenditures of federal awards does not summarize clusters of programs. The following summarizes those programs that are part of a cluster:

Program Title	CFDA#	Pass Through Agency	Amount
CDBG - ENTITLEMENT GRANTS CLUSTER			
Community Development Block Grants/Entitlement Grants	14.218	N/A (Direct program)	$ 798,174
		Cluster Total	$ 798,174
JUSTICE ASSISTANCE PROGRAM (JAG) CLUSTER			
Edward Byrne Memorial Justice Assistance Grant Program	16.738	N/A (Direct program)	$ 56,960
ARRA – Edward Byrne Memorial Justice Assistance Grant (JAG) Program/Grants to Units of Local Government	16.804	N/A (Direct program)	24,443
		Cluster Total	$ 81,403
HIGHWAY PLANNING & CONSTRUCTION CLUSTER			
Highway Planning and Construction	20.205	Department of Transportation	$ 2,717,017
Recreational Trails Program	20.219	Department of Transportation	69,883
		Cluster Total	$ 2,786,900
HIGHWAY SAFETY CLUSTER			
Alcohol Impaired Driving Countermeasures Incentive Grants I	20.601	Town of Paradise	$ 18,107
		Cluster Total	$ 18,107

CITY OF CHICO, CALIFORNIA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

I. SUMMARY OF AUDITORS' RESULTS

FINANCIAL STATEMENTS

Type of auditors' report issued:	Unmodified
Unqualified, except for the discretely presented component units opinion unit, which was disclaimed	
Internal control over financial reporting:	
Material weaknesses identified?	Yes
Significant deficiencies identified?	Yes
Noncompliance material to financial statements noted?	Yes

FEDERAL AWARDS

Internal control over major programs:	
Material weaknesses identified?	No
Significant deficiencies identified?	Yes
Type of auditors' report issued on compliance for major programs:	Unmodified
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section	Yes

Identification of major programs

CFDA Numbers	Name of Federal Programs or Clusters
14.218	Community Development Block Grants (CDBG) Entitlement Grants
16.710	Public Safety Partnership and Community Policing Grants (includes ARRA)
20.106	Airport Improvement Program

Dollar threshold used to distinguish between Type A and Type B programs:	$ 300,000
Auditee qualified as low-risk auditee under OMB Circular A-133, Section 530?	Yes

II. FINANCIAL STATEMENT FINDINGS

The following findings represent significant deficiencies, material weaknesses, or instances of noncompliance related to the financial statements that are required to be reported in accordance with generally accepted government auditing standards:

FINDING 2013-01

COST ALLOCATION PLAN

Criteria:

Governmental entities that provide central services, such as accounting, human resources, legal, and city management services on behalf of other departments or cost centers should be allocated through a process to ensure that service costs are identified and assigned on a reasonable and consistent basis. The basis for the allocation of central service costs should be clearly documented and updated on a routine basis to ensure that costs incurred are appropriately allocated to benefiting cost centers (funds, departments, etc.) and justification can be supported.

Condition:

Material Weakness – It was observed during the course of our audit that the City's cost allocation plan has not been updated by an external consultant since 2001. Although a variety of internal updates have taken place since 2001, the City has continued to base their cost allocation structure off the original plan plus large inflationary increases and reallocations. Clear documentation was not available to support the internal adjustments made since the original cost allocation plan.

The design of the cost allocation was not full cost recovery and therefore central service departments were able to charge time out to external departments and funds as well as allocate out budgeted central service costs. The direct charging of staff time and the cost allocation increased the risk that certain departments could potentially be double charged for services.

It was further observed during the course of our audit, that a second cost allocation plan entitled the “Private Development Cost Allocation Plan” was created in approximately FY2010. The purpose of this cost allocation plan was to allocate costs within the Community Development Department due to a shrinking workforce (and revenues) in that department that was not anticipated during the original cost allocation plan. This cost allocation plan was development internally in order to allocate costs associated with administrative employees who were allocated to the Private Development Fund to other funding sources including the Sewer, Airport, Transit, and other funds based on their work servicing these other department as these employees became shared resources. The plan was developed using internal estimates at the time of creation in FY2010. The City then estimated the percentage of time and a weighted benefit rate to be used to apply these employees time to benefiting cost centers. The plan has received minor updates however the underlying assumptions of the plan have not been reevaluated since the creation of the plan.

The Private Development Cost Allocation was being used rather than having these employees direct charge their time or incorporated into the regular cost allocation plan through an update process. This additional layer of cost allocation was created by the city in an attempt to solve the challenges associated by the initial cost allocation plan not being updated in a timely manner.

II. FINANCIAL STATEMENT FINDINGS

Context:

The condition noted above was for the Cost allocation plan approved in the budget by the City council pertaining to the 2013 fiscal year. The cost allocation plan allocates costs to various funds and departments, however does not allocate costs to any federal or state grant funded activities. The Private Development Cost Allocation was reviewed in fiscal year 2013 and noted to charge out a total of $189,648 in costs from the Private development fund to the Transportation, Sewer, Parking and Airport Funds of the City. Management brought concerns related to the Cost Allocation to our attention and the condition above was reviewed during the final audit fieldwork.

Cause:

The City's management did not identify and prioritize the timely update of the cost allocation plan and retain clear documentation for the adjustments made to the original cost allocation plan. City management also did not identify the risk and eliminate the ability for staff in central services departments from both billing time and having costs allocated through the annual cost allocation process creating the risk of double charges for services to benefiting cost centers.

The City's management further elected to create a new cost allocation plan (Private Development Cost Allocation) to allocate administration personnel of the Community Development department rather than using other available methodologies such as direct charge or utilization of the City's Personnel Allocation Worksheets in the budgeting process. The City's management has not retained clear documentation showing the performance of a re-evaluation of the assumptions underlying the cost allocation plan on a routine basis.

Effect:

The condition described above resulted in a cost allocation plan that may not accurately reflect the City's actual cost structure based on actual usage of city services that are allocated. The lack of a formal update to the cost allocation plan increases the likelihood of inaccuracies that may be contained in the cost allocation plan and certain funds, department or projects that receive allocated costs may have been over or under allocated costs. The structure of allowing employees in central service departments to direct charge time and to perform cost allocation increases the risk that certain benefitting cost centers may have been over or under allocated costs.

The condition described above results in a private development cost allocation plan that may not reflect the current usage of administrative Community Development personnel for other benefiting funds. This could result in an inaccurate or disproportionate allocation of Community Development costs to other funds during fiscal year 2013.

Recommendation:

We recommend that the City implement policies and procedures to ensure that the cost allocation plan utilized by the City of Chico is prepared and updated on a routine basis (every two to three years) to ensure that allocation of costs can be appropriately supported. We also recommend that any changes or modification of the plan are clearly and appropriately documented to be easily followed. We further recommend that the city consider the appropriateness of utilizing a hybrid approach of allowing the utilizing of both direct charging and cost allocation and develop policies and procedures to ensure the risk of double charging has been mitigated.

II. FINANCIAL STATEMENT FINDINGS

We further recommend that the City review the purpose of utilization of a private development cost allocation plan rather than utilization of alternative means such as the City's regular cost allocation plan, personnel allocation worksheets, or direct charging. We further recommend that any future utilization of the private development cost allocation plan have clear policies and procedures that require periodic updates and revisions to the assumptions of the plan.

Views of Responsible Officials and Planned Corrective Actions:

The City agrees with the recommendation as a plan to update a full cost allocation plan was in progress prior to the beginning of the audit. A full cost allocation plan was prepared by Wohlford Consulting and accepted for implementation by the City Council at its meeting on February 18, 2014. The new plan is a full cost recovery model. As a result, a hybrid approach is no longer being utilized. In addition, the City Council approved a new budget policy D.4., for the fiscal year 2013-14 budget that states: "City Manager will ensure the timely completion of appropriate cost allocation plans and user fee studies. Generally, these plans and studies should be completed every 2-3 years and reported to the City Council for review." In addition, the City's personnel allocation worksheets have been updated subsequent to the reorganization. As a result, the private development allocation has been eliminated.

FINDING 2013-02

DEVELOPMENT IMPACT FEE BORROWING

Criteria:

In accordance with Government Code Section 66006 (G), California local agencies that charge fees in connection with development projects are required to annually provide "A description of each interfund transfer or loan made from the account or fund, including the public improvement on which the transferred or loaned fees will be expended, and, in the case of an interfund loan, the date on which the loan will be repaid, and the rate of interest that the account or fund will receive on the loan."

Condition:

Significant Deficiency, Instance of Noncompliance – During the review of the interfund borrowing, it was noted that the Development Impact Fee Funds are borrowing resources from other Development Impact Fee Funds of the City as many of the Development Impact Fee Funds have negative cash positions and need to borrow cash at the end of the year to cover the negative position. Since these Development Impact Fee funds with negative balances will require multiple years in order to repay the resources borrowed from other Development Impact Fee Funds with positive positions, the funds are in substance performing long term borrowing from one another and have no formal borrowing agreements that meet the compliance requirement of Government Code Section 66006.

II. FINANCIAL STATEMENT FINDINGS

Context:

The borrowing mentioned above involved the Fire Protection Building and Equipment Fund borrowing $1,815,656 from the Community Park Impact Fee Fund, the Bidwell Park Land Acquisition Fee Fund Borrowing $1,450,000, $60,000, and $59,421 from the Street Maintenance Impact Fee Fund, Community Park Impact Fee Fund, and Zone I Neighborhood Parks Impact Fee Fund, respectively, the Administrative Building Impact Fee Fund borrowing $1,105,031 from the Police Protection Building and Equipment Impact Fee Fund, the Street Maintenance Impact Fee Fund borrowing $250,000 from the Zone I Neighborhood Parks Impact Fee Fund, the Street Facility Impact Fee Fund borrowing $156,874 from the Zone F&G Neighborhood Parks Impact Fee Fund, the Zone J Neighborhood Parks Impact Fee Fund borrowing $167,370 from the Zone B Neighborhood Parking Impact Fee Fund and the Bikeway Improvement Impact Fee Fund borrowing $145,889 from the Zone A Neighborhood Parks Impact Fee Fund for financial statement presentation to cover negative cash at the end of the year.

Cause:

The City performed various borrowings of resources for development from impact fee funds prior to accumulating the resources in the individual fund designed for that purpose and therefore have created negative cash balances in many of the impact fee funds. These negative cash balances require borrowing resources from other impact fee funds until sufficient resources are gathered to cover negative cash balances however these loans have not been formalized in accordance with Government Code Section 66006.

Effect:

The City may not be in compliance with the provisions of Government Code Section 66006 and may not be allocating or providing appropriate interest payments to the Development Impact Fee Funds that are loaning resources to other City Funds. Additionally, if future resources are not realized to repay the deficits in these funds, the City may be obligated to use its own resources to repay the deficits.

Recommendation:

We recommend the City review the cash borrowing that has occurred and ensure that formal agreements are established as necessary and include the required elements of Government Code 66006. We also recommend that the City implement policies and procedures to ensure any future loans meet the requirements.

View of Responsible Officials and Planned Corrective Action:

The City agrees with the recommendation and will implement policies and procedures to ensure that future interfund loans are approved and comply with legal requirements.

II. FINANCIAL STATEMENT FINDINGS

FINDING 2013-03

DEFICIT FUND POSITION

Criteria:

Governmental Accounting Standards requires that interfund loans only include amounts that are expected to be repaid within a reasonable time and that the borrowing fund should have the ability and intent to repay the loan in that reasonable time. The requirement also stipulates that if repayment is not expected within a reasonable time, the interfund balances should be reduced and the amount that is not expected to be repaid should be reported as a transfer.

Condition:

Material Weakness – During our review of the deficit fund balances of the City, we noted that the City has various funds in deficit fund balance or negative cash position including but not limited to the General Fund, Capital Improvements Fund, Capital Grants Fund, and other funds included in the remaining aggregate fund information. The City has historically not formulated a clear specific action plan in order to reduce the deficits which exist in each respective fund that has a significant deficit. Therefore no documentation was initially available in order to evaluate each individual funds ability and intent to repay the interfund borrowing.

A formal deficit reduction plan was presented by management and approved by the City Council in December, 2013. As part of the financial audit, an audit adjustment was ultimately made to transfer $13,100,891 from the General Fund to the Private Development Fund in the amount of $10,125,050 and the Capital Improvements Fund in the amount of $2,975,841 and a corresponding interfund loan was recognized. The interfund loan will be paid over time in accordance with the deficit reduction plan.

Context:

After the audit adjustment above, the condition still pertains to the General Fund Deficit of $7,665,415, the Capital Grants Fund in the amount of $1,933,118, various other nonmajor governmental funds of $5,479,258, and various internal services funds to the amount of $1,410,554.

Cause:

The City has allowed deficit fund positions to accumulate and has not put into place a formal procedure or plan to ensure that the borrowing funds have both the intent and ability to repay the resources. This lack of formal procedures and polices has allowed deficits to accumulate in certain funds for several fiscal years.

Effect:

The City is at risk that certain funds may ultimately not have the ability or intent to repay loans provided in previous fiscal years.

II. FINANCIAL STATEMENT FINDINGS

Recommendation:

The City should implement and follow procedures or a plan in order to address the deficit fund balances and negative cash balances that exist at the City. The City should implement procedures to ensure that all long term interfund borrowing (borrowing longer than one year) is governed by formal interfund loan agreements that have an appropriate level of authorization (i.e. City Council). The City should also implement policies and procedures to review funds that have annual operating losses or move to a deficit fund position annually and determine a course of action to prevent the accumulation of deficit fund balance.

View of Responsible Officials and Planned Corrective Action:

The City agrees with the recommendation. As stated in finding 2013-04, the City will implement policies and procedures to ensure that future interfund loans are approved and comply with legal requirements. In addition, the City Council approved a new budget policy D.1., Balanced Budget and Deficit Reduction Plan for the fiscal year 2013-14 budget that establishes a plan to reduce deficits and to structurally balance the City's budget. Specifically, budget policy D.1.g, states: "The City will refrain from allowing funds to fall into deficit positions or continuing growth in existing fund balance deficits. Annual fund deficits should be eliminated by transferring funds into the deficit fund to maintain the previous year's fund balance. The only exceptions to this are funds in which future revenues are estimated to be sufficient to cover current deficits (e.g., Development Impact Fee Funds and Capital Grants Funds)."

FINDING 2013-04

AUTHORIZED SIGNORS FOR EXPENDITURES

Criteria:

Government Auditing Standards note that management is responsible for implementing systems designed to achieve compliance with applicable laws and regulations; and for establishing and maintaining internal control to help ensure that appropriate goals and objectives are met; using resources efficiently, economically, effectively, and equitably, and safeguarding resources; following laws and regulations; and ensuring that management and financial information is reliable and properly reported.

Condition:

Significant Deficiency – During the review of authorizations of cash disbursements and travel advances, we noted the following conditions:

- One Travel Advance that was not signed by an individual designated as an authorized individual on the City's Authorized Signor Listing.
- One Instance in which a Cash Disbursement Payment Authorization Form in the amount of $85,650 was not signed by an individual designated as an authorized individual on the City's Authorized Signor Listing.

Context:

The conditions were noted during the year of the City's disbursement process.

II. FINANCIAL STATEMENT FINDINGS

Cause:

The City did not ensure that policies and procedures were followed to ensure that the Travel Advance from and Payment Request forms were signed by an authorized individual at the City.

Effect:

The risk of improper disbursements increases when individuals outside of authorized individuals are allowed to make purchases or authorize transactions.

Recommendation:

We recommend that the City implement policies and procedures to ensure that the authorized signor listing is updated as necessary and that verification occurs to ensure that only authorized individuals approve the disbursement of City funds.

View of Responsible Officials and Planned Corrective Action:

The City agrees with the recommendation. The City has an extensive approval process for City expenditures. As a result, most payment requests can have four or more signatures approving a disbursement. In these cases, the transactions were approved; however, in some cases the authorized signor listing was not up-to-date due to significant changes in management and in some cases approval limits were exceeded. It should be noted that all payment requests were approved by managers and/or directors. The Finance Office has updated the authorized signor list and the list will be updated on an annual basis at the beginning of each fiscal year. In addition, the City is attempting to create a purchasing function that would enhance the internal controls over the purchasing and approval function.

FINDING 2013-05

PROCUREMENT POLICIES AND PROCEDURES

Criteria:

Government Auditing Standards note that management is responsible for implementing systems designed to achieve compliance with applicable laws and regulations; and for establishing and maintaining internal control to help ensure that appropriate goals and objectives are met; using resources efficiently, economically, effectively, and equitably, and safeguarding resources; following laws and regulations; and ensuring that management and financial information is reliable and properly reported.

II. FINANCIAL STATEMENT FINDINGS

Condition:

Significant Deficiency – During the review and understanding over the procurement process, the following conditions were noted related to procurement:

- *Procurement Cards* - We noted that procurement cards are issued to "Authorized User" rather than an individual person and that the City utilizes a check in/out system in certain instances. We further noted that there is not a card user agreement between the City and each individual procurement card user.
- *Sole Source Procurement* – We noted two instances in which sole source contracts for engineering services did not contain required documentation in accordance with the City's procurement policy documenting the exemption from competitive bidding. We noted that this requirement is in Administrative Policies and Procedures 15.1 Section VI.G.
- *Procurement Policies* – We noted that the procurement policies are scattered throughout the Administrative Policies and Procedures (AP&P) document and have not been updated recently and there is not one user friendly document to utilize for reviewing all procurement policies. We further noted that the city currently does not require competitive bids for any services deemed professional services (Engineering, consulting, etc.) unless required under a State or Federal procurement.
- *Splitting Purchases* – We noted three instances in which departments were splitting their purchases in order to circumvent the City's established procurement policies and purchased items limits without completing competitive bids for transactions under $1,000.
- *Contract Oversight* – We noted during our audit that significant procurement contract awards are not taken to the City Council for approval for any contracts and the City Council is not made aware of procurements that have been approved by City Personnel and the City Manager.

Context:

The conditions noted above were noted during review of the City's procurement process for fiscal year 2013.

Cause:

The City does not have policies and procedures to ensure adequate monitoring of the procurement requirements and to ensure that all procurements are in compliance with formal policies and procedures. The City's decentralized procurement process increases the risk associated with the procurement process.

Effect:

The risk associated with long complex procurement policies and multiple documents governing procurement policies increases the risk of noncompliance with the City's policy. The utilization of "Authorized User" on procurement cards rather than an individual's name increases the risk that the procurement card could be misused by City employees or other individuals as any individual carrying the card can utilize it. The effect of the circumvention of procurement policies and not obtaining sole source justification increases the risk that the City may not complete fair and competitive procurements which exposes the City to the risk of fraud and overpayment in its procurement processes.

II. FINANCIAL STATEMENT FINDINGS

Recommendation:

We recommend that the City implement policies and procedures to ensure that Procurement Cards are issued to individuals and that a user card agreement has been completed with that individual. We further recommend that the City implement policies and procedures in order to ensure that procurements are obtaining competitive bids where necessary and that procurement thresholds are not being circumvented by City personnel. We further recommend that the City consider reviewing its procurement policies and procedures to ensure that the Board has the opportunity to approve large contracts or are made aware of management awards of large contracts and competitive bidding should be required for all types of contracts (above a minimum threshold deemed appropriate) which is the best practice for governmental procurements.

View of Responsible Officials and Planned Corrective Action:

The City agrees with the recommendation. For years, the City has operated in a distributed purchasing process where departments are each responsible for their individual procurements. There is no central function to ensure up to date policies and procedures, strong internal controls, consistency in practices, and taking advantage of collaborative purchasing opportunities. The result is significant increase in risk exposure and likelihood of missing opportunities to save on purchases. City administration is recommending the establishment of a centralized purchasing function with the staffing level to consolidate purchasing activities, strengthening internal controls, and leveraging opportunities to improve the City's ability to obtain the best price and terms for purchases.

FINDING 2013-06

BANK RECONCILIATIONS & SIGNORS

Criteria:

Government Auditing Standards note that management is responsible for implementing systems designed to achieve compliance with applicable laws and regulations; and for establishing and maintaining internal control to help ensure that appropriate goals and objectives are met; using resources efficiently, economically, effectively, and equitably, and safeguarding resources; following laws and regulations; and ensuring that management and financial information is reliable and properly reported.

Condition:

Significant Deficiency – During the review and understanding of the City's cash management practices, the following conditions were noted:

- The City Bank Account and LAIF Account included several named authorized signors that are no longer employed at the City of Chico.
- The City of Chico did not perform timely review and completion of bank reconciliations of the City Bank Accounts. As of July 2013, the City had only completed bank reconciliations through August, 2012 and therefore was ten months behind on bank reconciliations.

Context:

The conditions noted above were noted during review of the City's cash management processes and procedures.

II. FINANCIAL STATEMENT FINDINGS

Cause:

The City did not initiate the timely removal of City staff from bank accounts after their departure from the City. The City also did not prioritize and ensure that procedures were in place to perform timely reconciliation of the bank statements.

Effect:

The individuals listed on the bank accounts after termination at the city may still retain the ability to access city resources until formally removed from the Bank Signors. This increases the risk that fraud or theft of city resources could potentially occur. The risk associated with the lack of timely reconciliation of the bank statements is that significant errors or fraud could persist and may not be detected or corrected on a timely basis until the completion of the bank statements or the year end close.

Recommendation:

We recommend that the City implement policies and procedures to ensure that City officials that terminate service from the city are immediately removed as authorized signors on all accounts of the City. We also recommend that the City implement policies and procedures to ensure that the bank accounts are reconciled on a timely basis, and no later than monthly.

View of Responsible Officials and Planned Corrective Action:

The City agrees with the recommendation. However, it should be noted that the delay to update authorized signors was mostly due to the high level of senior management turnover in the City as the City had changes in its City Manager, Assistant City Manager and Finance Director all within approximately seven months. In addition, the City designs its internal controls to ensure that no one person can initiate and approve a banking transaction, so the risk of fraud or theft was mitigated. The delay in reconciling bank statements in fiscal year 2012-13 was due to extenuating circumstances beyond normal workload issues. Unexpected redevelopment related audits from the Department of Finance as well as unexpected medical leaves of staff members in the Finance department redirected available staff efforts to other tasks. In addition, the City has mitigating controls in regards to cash. Daily, reports are run from the online Bank of America CashPro system showing previous day activity. Amounts are entered into an excel spreadsheet and compared to amounts recorded on Cash Deposit forms by internal staff as well as any Accounts Payable check totals reported. ACH and Deposit reports are delivered each day to internal staff to verify deposits and record any missing items (coin deposits, vault deposits, ACH deposits, etc.).

FINDING 2013-07

COMPUTER LOANS PROGRAM

Criteria:

Government Auditing Standards note that management is responsible for implementing systems designed to achieve compliance with applicable laws and regulations; and for establishing and maintaining internal control to help ensure that appropriate goals and objectives are met; using resources efficiently, economically, effectively, and equitably, and safeguarding resources; following laws and regulations; and ensuring that management and financial information is reliable and properly reported.

II. FINANCIAL STATEMENT FINDINGS

Condition:

Significant Deficiency – During our review over the City's computer loans program, it was noted that the City had relatively vague policies over the program allowing the City Staff to obtain a city loan for almost any electronic device. We noted that this was interpreted by City staff to allow loans to city employees for electronic devices such as laptops, tablets, cellular phones, projects, televisions including name brand items up to $2,500 and did not have to make clear justification of an educational or business related purpose. We noted one clear instance of noncompliance with the loan program in which an employee utilized the program in order to purchase gift cards from an electronics store. The City upon investigation noted that the gift cards appeared to be used for purchases not allowed by the computer loans program.

We did note that management suspended the program as of April, 2013.

Context:

There is a total amount of $49,391 in remaining loans to employees as of June 30, 2013. These loans are to be repaid over the loan term of 6 – 24 months depending on the original election of the employee.

Cause:

The City policies and procedures over the computer loan program were vague and were allowed to be interpreted to allow all electronic devices which lead to potential abuse of the program.

Effect:

The Computer Loans program policies and procedures were not clear and allowed for city resources to be utilized and tied up for loans for an employee benefit that may not have met the original goals of the program and allowed for potential abuse.

Recommendation:

We recommend that the City evaluate the goals of the Employee Loan program and if continued in the future that management put into place clear policies and procedures to govern the allowable devices and purposes for which employees can utilize the program.

View of Responsible Officials and Planned Corrective Action:

The City agrees with the recommendation. The City eliminated the Computer Loan Program in April 2013 and does not have the intent to reinstate the program.

II. FINANCIAL STATEMENT FINDINGS

FINDING 2013-08

DISASTER RECOVERY

Criteria:

Government Auditing Standards note that management is responsible for implementing systems designed to achieve compliance with applicable laws and regulations; and for establishing and maintaining internal control to help ensure that appropriate goals and objectives are met; using resources efficiently, economically, effectively, and equitably, and safeguarding resources; following laws and regulations; and ensuring that management and financial information is reliable and properly reported.

Condition:

Significant Deficiency – During our review over the information technology function at the City, we noted that the City's information technology structure involves significant risk that systems could not be recovered after a disaster event. This condition arises due to the fact that the City houses the financial server as well as other critical city systems at the City Hall Building. The City has a backup server located in the same location as the original server which both are served by a water-based sprinkler system that subjects the system to damage in the case of fire. The periodic backup tapes that are prepared by the Information Technology Division are also stored in the same administrative building. In the event of a significant disaster event, the City may not be able to recover the Finance system or other critical applications in a timely manner.

Context:

The City server, backup server, and backup tapes are all located and stored within the same physical location and therefore subject the City to information loss in a disaster event.

Cause:

The City has not developed a plan to utilize multiple locations to minimize the risk of loss in a disaster event.

Effect:

The City is exposed to the risk of loss of critical financial data and other critical applications in the case of a disaster event.

Recommendation:

We recommend that the City should implement policies and procedures to minimize the risk of data loss and delays in a disaster event. The City should formalize an updated disaster recovery plan incorporating changes to City backup policies.

View of Responsible Officials and Planned Corrective Action:

The City agrees with the recommendation. Current technology infrastructure is protected by a fire suppression system adequate for most fire needs, but not appropriate for sensitive electronic systems. Further, the City does not have a disaster recovery plan which would protect the City from a significant event. Until recently, backup practices did not ensure that backup systems would function properly when needed. The City will formalize a plan to protect systems and critical data.

II. FINANCIAL STATEMENT FINDINGS

FINDING 2013-09

INFORMATION TECHNOLOGY ACCESS REVIEW

Criteria:

Government Auditing Standards note that management is responsible for implementing systems designed to achieve compliance with applicable laws and regulations; and for establishing and maintaining internal control to help ensure that appropriate goals and objectives are met; using resources efficiently, economically, effectively, and equitably, and safeguarding resources; following laws and regulations; and ensuring that management and financial information is reliable and properly reported.

Condition:

Significant Deficiency – During our review over the information technology function at the City, we noted that access reviews to critical systems were not performed on a routine basis. Reviews of the system access to the financial system were being performed on an ad hoc basis when changes were made to individual employees however an overall review of access levels provided to employees was not performed.

IT access reviews should be performed on a periodic basis (i.e. quarterly, semiannually) to ensure that users are not provided with access rights that contradict their user role or that may create a risk of segregation of duties. The City should retain documentation of the results of these access reviews performed.

Context:

The condition above was noted in our review over the IT access roles at the City.

Cause:

The City has not developed policies and procedures to ensure that IT access reviews are performed on a periodic basis.

Effect:

The City is at risk that users may inadvertently have access to functions that contradict their user role and may create the risk of segregation of duties.

Recommendation:

We recommend that the city implement policies and procedures to perform user access reviews for critical IT applications such as the finance system and retain documentation of these reviews.

View of Responsible Officials and Planned Corrective Action:

The City agrees with the recommendation and will implement a periodic review of IT access rights to ensure the right people have access to critical systems. We intend to establish written policies and procedures strengthening review of access rights.

II. FINANCIAL STATEMENT FINDINGS

FINDING 2013-10

CAPITAL IMPROVEMENTS BUDGET VIOLATION

Criteria:

The City Council annually adopts a budget during its first meeting in July on a basis consistent with Generally Accepted Accounting Standards. The City Manager is authorized to transfer budget accounts between departments within any fund; however any revision that exceeds the appropriated expenditures of any fund requires approval by City Council. The City's legal level of budgetary control is the fund level.

Condition:

Significant Deficiency, Instance of Noncompliance – During our review over the City's budget to actual schedules presented in the financial statements, we noted that the budgetary schedule for the Capital Projects Fund was not presented to match the City Council approved budget. We noted that the Capital Projects Fund has a Fund Administration Department (Dept. 000) that was intended to operate as a clearing department in which fund administration costs charged to the department are charged out to capital projects. The City Council's approved budget shows the department as a net cost of $0 and does not show the department's true revenues and expenditures separately.

During the fiscal year 2012-13, the City was unable to charge all of the fund administration department costs out to capital projects during the year due to a lack of available projects with sufficient budgets to accommodate the level of allocated administrative costs. Therefore, this resulted in a compliance finding and over expenditure of the fund's budget by $785,929.

Context:

The condition noted above resulted in an over expenditure of the budget of $785,929 in the Capital Improvements Fund.

Cause:

The City's financial system and city staff monitored the budget at the account level (rather than department level) and did not perform timely and sufficient monitoring to ensure that the level of administrative costs in the department and fund were not in excess of the approved departmental budget.

Effect:

The City violated the annual approved budget by exceeding the approved expenditures by $785,929 in the fund. This over expenditure caused further increases in the negative fund balance in the Capital Improvements Fund.

Recommendation:

We recommend that the City ensure that for departments that are clearing or zero based budget departments, that the City ensure budget schedules are presented to reflect the total approved budget of the City Council. We further recommend that the budgets are closely monitored periodically to ensure that charges to the department aren't in excess of amounts that are allocable to other projects creating budget violations.

II. FINANCIAL STATEMENT FINDINGS

View of Responsible Officials and Planned Corrective Action:

The City agrees with the recommendation. Finance staff will provide new budgetary reports for Fund 400 (which functions as a capital overhead clearing fund) to Council to ensure that all appropriations have been clearly approved by Council.

III. FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS

The following findings represent significant deficiencies, material weaknesses, and/or instances of noncompliance including question costs that are required to be reported by OMB Circular A-133, section .510(a).

FINDING 2013-11

Program: Community Development Block Grant
CFDA No.: 14.218
Federal Agency: U.S. Department of Housing & Urban Development
Passed-through: N/A
Award Year: Fiscal Year 2012-2013
Compliance Requirement: Reporting

Criteria:

The *March 2013 OMB Circular A-133 Compliance Supplement* requires the following reports be submitted for the Community Development Block Grant Program:

Federal Financial Report– Recipients use the *Federal Financial Report (FFR) (SF-425/SF-425A (OMB No. 0348-0061)* as a standardized format to report expenditures under Federal awards, as well as, when applicable, cash status (Lines 10.a, 10.b, and 10c). References to this report include its applicability as both an expenditure and a cash status report unless otherwise indicated.

Federal Funding Accountability and Transparency Act - Aspects of the Federal Funding Accountability and Transparency Act (Pub. L. No. 109-282) (Transparency Act), as amended by Section 6202(a) of the Government Funding Transparency Act of 2008 (Pub. L. No. 111-252), that relate to subaward reporting (1) under grants and cooperative agreements. The requirements pertains to recipients (direct recipients) of grants or cooperative agreements who make first-tier subawards and contractors (i.e., prime contractors) that award first-tier subcontracts. There are limited exceptions as specified in 2 CFR part 170 and the FAR. The guidance at 2 CFR part 170 currently applies only to Federal financial assistance awards in the form of grants and cooperative agreements, e.g., it does not apply to loans made by a Federal agency to a recipient; however, the subaward reporting requirement applies to all types of first-tier subawards under a grant or cooperative agreement.

Condition:

Significant Deficiency - Instance of Non-Compliance – As a result of our audit during FY 2012-2013, VTD noted the following based on our testwork performed over subrecipient monitoring:

- The City did not have evidence of a submission of required Federal Financial Reports related to the CDBG Grant for Fiscal year 2012-2013.
- The City did not have evidence of submission of required Federal Funding Accountability and Transparency Act (FFATA) Reports. The City was required to submit a report related to the subaward of over $25,000 made associated with the Torres Shelter Project during FY2012-2013.

Questioned Costs:

No questioned costs were noted as a result of procedures performed.

III. FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS

Context:

Through client inquiry and testwork of specific requirements related to Reporting, it was noted that no submissions were made of either the Federal Financial Report or the FFATA Report.

Effect:

As a result of the instance of non-compliance noted above, the City's appears to have not submitted required reports to the granting agency in accordance with the reporting requirements associated with the Community Development Block Grant.

Cause:

The City did not have policies and procedures to ensure that all required reports were submitted in accordance with the Community Development Block Grant requirements.

Recommendation:

We recommend the City implement policies and procedures to ensure that the required reports associated with the Community Development Block Grants are completed and submitted in accordance with the grant requirements.

View of Responsible Officials and Planned Corrective Action:

The City will implement policies and procedures to ensure that all required reports associated with the Community Development Block Grants are completed and submitted in accordance with the grant requirements. Due to the timing of the finding, the City will work with HUD to attempt to file the reports for fiscal year 2013-14, even if they're considered late.

III. FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS

FINDING 2013-12

Program: Airport Improvement Program
CFDA No.: 21.106
Federal Agency: U.S. Department of Transportation
Passed-through: N/A
Award Year: Fiscal Year 2012-2013
Compliance Requirement: Special Tests and Provisions

Criteria:

The Airport Enterprise Fund must follow *Policies and Procedures Concerning the Generation and Use of Airport Revenue*, issued February 16, 1999 (64 FR 7695), contains definitions of airport revenue and unlawful revenue diversion; provides examples of airport revenue; and describes permitted and prohibited uses of airport revenue. The policy can be obtained from FAA's Airports Federal Register Notices Page at http://www.faa.gov/airports/resources/publications/federal_register_notices/.

The Final Policy requires that reimbursements for capital and operating costs of the airport made by a government entity, both direct and indirect, be supported by adequate documentary evidence. Adequate documentation consists of underlying accounting records and corroborating evidence, such as invoices, vouchers and cost allocation plans, to support all payments of airport revenues to other government entities. If this underlying accounting data is not available, the Final Policy allows reimbursement to a government entity based on audited financial statements, if such statements clearly identify the expenses as having been incurred for airport purposes consistent with the Final Policy statement. In addition, the Final Policy provides that budget estimates are not a sufficient basis for reimbursement of government entities. Budget estimates are just that – estimates of projected expenditures, not records of actual expenditures. Therefore, budget estimates cannot be relied on as documentary evidence to show that the funds claimed for reimbursement were actually expended for the benefit of the airport.

Indirect cost allocation plans, however, may use budget estimates to establish pre-determined indirect cost allocation rates. Such estimated rates must, however, be adjusted to actual expenditures in the subsequent accounting period.

Condition:

Significant Deficiency - Instances of Non-Compliance –We noted that the City of Chico charged overhead costs to the Airport fund through two cost allocation plan methodologies. The City's regular cost allocation plan has not been updated by an outside consultant since 2001. The plan has had a variety of internal updates since the initial creation of the plan through large inflationary increases and reallocations. Clear documentation was not available to support the internal adjustments and reallocations made since the original cost plan. The cost allocation plan is adopted through the budget and is not subsequently updated to ensure that the estimates are updated to actual in subsequent accounting periods.

III. FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS

The City also has an internal cost allocation plan to allocate charges associated with other administrative personnel in the Community Development Department (CDD). This plan was created in fiscal year 2010 in order to allocate salaries of administrative personnel in the CDD to other benefiting funds and departments. The plan is based off of estimates of the amount of time that CDD personnel assist the other benefiting funds. This plan has not had subsequent updates to the formula and methods used. The underlying estimates of time spent or budgeted amount of time to be spent on benefiting departments or funds is not updated to actual amounts in the subsequent accounting period to ensure only appropriate amounts are charged. Therefore clear documentation was not available to ensure that these charges were appropriate and supported to be charged to the benefiting funds and departments.

Questioned Costs:

No questioned costs were identified as a result of the procedures performed.

Context:

Through review of costs charged to the Airport Enterprise Fund, it was noted that a total of $113,739 was charged related to the City's cost allocation plan for fiscal year 2012-13. A total amount of $9,529 was charged through the CDD Allocation of administrative costs to the Airport Enterprise Fund for fiscal year 2012-13.

Effect:

The expenditure of airport revenues related to the City's cost allocation plans noted above may not be appropriately supported. This could result in further noncompliance and result in fines or penalties from the Federal Aviation Administration related to the potential revenue diversion.

Cause:

The City did not have policies and procedures in place to ensure that the cost allocation plans were updated on a routine and periodic basis and to ensure that allocated cost were appropriately supported. The City also did not ensure that the cost allocation plan's charges were reviewed to ensure they reflected actual costs rather than budgeted costs.

Recommendation:

We recommend the City perform an update of the cost allocation plans to ensure that they are appropriately supported and ensure that the charges to the airport fund are appropriate based on the benefits to the Airport to comply with Federal Aviation Administration Regulations.

View of Responsible Officials and Planned Corrective Action:

The City has implemented a new cost allocation plan in fiscal year 2013-14 that ensures that indirect costs charged to the Airport Fund are based on an equitable plan that appropriates costs that are tied to the benefits received. In addition, the City Council has approved a plan to transfer over $800,000 to the Airport Fund to cover an existing cash deficit in part caused by indirect costs charged to the Airport for which revenue did not exist. It is the City's position that the transfer will pay for these past indirect costs. The City does not believe Airport revenue was used to pay for indirect costs in fiscal year 2012-13 due to its deficit position.

CITY OF CHICO, CALIFORNIA

SUMMARY SCHEDULE OF PRIOR YEAR FINDINGS
YEAR ENDED JUNE 30, 2013

Summarized below is the current status of all audit findings reported in the prior year audit's schedule of audit findings and questioned costs.

None reported.