

# City of Merced

Merced, California

*Single Audit Report*

*For the year ended June 30, 2016*



**City of Merced**  
**Single Audit Report**  
**For the year ended June 30, 2016**

**Table of Contents**

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	<u>Page</u>
<b>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 <i>Government Auditing Standards</i> .....</b>	<b>1</b>
<b>Independent Auditors' Report on Compliance for Each Major Program and on Internal Control over Compliance Required by the Uniform Guidance .....</b>	<b>3</b>
Schedule of Expenditures of Federal Awards .....	7
Notes to the Schedule of Expenditures of Federal Awards.....	9
Schedule of Findings and Questioned Costs .....	11





**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**

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Merced, California (City), as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the City's basic financial statements and have issued our report thereon dated January 23, 2017.

**Internal Control Over Financial Reporting**

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

To the Honorable Mayor and Members of the City Council  
of the City of Merced  
Merced, California  
Page 2

### **Compliance and Other Matters**

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

### **Purpose of this Report**

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

A handwritten signature in black ink that reads "Badawi & Associates". The signature is written in a cursive, flowing style.

Badawi & Associates, CPAs  
Oakland, California  
January 23, 2017



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM  
AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE**

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

**Report on Compliance for Each Major Federal Program**

We have audited the City of Merced, California (City)'s compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the City's major federal programs for the year ended June 30, 2016. The City's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

***Management's Responsibility***

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

***Auditor's Responsibility***

Our responsibility is to express an opinion on compliance for each of the City's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

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

***Opinion on Each Major Federal Program***

In our opinion, the City, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2016.

### ***Other Matters***

The results of our auditing procedures disclosed two instances of noncompliance, which are required to be reported in accordance with the Uniform Guidance and which are described in the accompanying schedule of findings and questioned costs as items 2016-001 and 2016-002. Our opinion on each major federal program is not modified with respect to these matters.

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

### **Report on Internal Control Over Compliance**

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

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified certain deficiencies in internal control over compliance, as described in the accompanying schedule of findings and questioned costs as item 2016-001 and 2016-002 that we consider to be significant deficiencies.



To the Honorable Mayor and Members of the City Council  
of the City of Merced  
Merced, California  
Page 3

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

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

### **Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance**

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City, as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the City's basic financial statements. We issued our report thereon dated January 23, 2017, which contained unmodified opinions on those financial statements. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditures of Federal Awards is fairly stated in all material respects in relation to the basic financial statements as a whole.



Badawi & Associates, CPAs  
Oakland, California  
February 2, 2017, except for the schedule of expenditures  
of federal awards, which is as of January 23, 2017

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**City of Merced**  
**Schedule of Expenditures of Federal Awards**  
**For the year ended June 30, 2016**

Grantor Agency and Grant Title	Federal Catalog Number	Agency or Pass-Through Grantor's Number	Expenditures	Subrecipient Expenditures
<b>U.S. Department of Housing and Urban Development:</b>				
<i>CDBG Entitlement Grants Cluster</i>				
<i>Direct Program</i>				
Community Development Block Grant	14.218	B-12-MC-06-0044	\$ 475,621	\$ -
Community Development Block Grant	14.218	B-13-MC-06-0044	77,315	21,227
Community Development Block Grant	14.218	B-14-MC-06-0044	583,239	108,344
Community Development Block Grant	14.218	B-15-MC-06-0044	340,495	71,891
Community Development Block Grant	14.218	B-11-MN-06-0012	40,120	-
Subtotal CDBG Entitlement Cluster			<u>1,516,790</u>	<u>201,462</u>
<i>Passed through State of California Department of Housing and Community Development</i>				
HOME Investment Partnership	14.239	M12-MC060227	57,462	20,715
HOME Investment Partnership	14.239	M14-MC060227	71,786	34,957
HOME Investment Partnership	14.239	M15-MC060227	158,392	63,265
Subtotal CFDA 14.239			<u>287,640</u>	<u>118,937</u>
<b>Total U.S. Department of Housing and Urban Development</b>			<u>1,804,430</u>	<u>320,399</u>
<b>U.S. Department of Justice:</b>				
<i>Direct Program</i>				
Secure Our Schools	16.710	2011CKWX0025	11,431	-
COPS Hiring Program (CHP)	16.710	2012UMWX0029	118,147	-
Subtotal CFDA 16.710			<u>129,578</u>	<u>-</u>
<i>Direct Program</i>				
Justice Assistance Grant	16.738	2012-DJ-BX-1100	1,205	-
Justice Assistance Grant	16.738	2013-DJ-BX-0916	8,519	-
Justice Assistance Grant	16.738	2014-DJ-BX-1140	5,497	-
Justice Assistance Grant	16.738	2015-DJ-BX-0254	46,042	-
Subtotal CFDA 16.738			<u>61,263</u>	<u>-</u>
<b>Total U.S. Department of Justice</b>			<u>190,841</u>	<u>-</u>
<b>U.S. Department of Transportation:</b>				
<i>Federal Aviation Administration</i>				
<i>Direct Programs</i>				
Airport Improvement Program-Wildlife Hazard Assessment	20.106	03-06-152-21	27,992	-
Airport Improvement Program-Pavement Maintenance Construction	20.106	03-06-152-23	6,531	-
Subtotal CFDA 20.106			<u>34,523</u>	<u>-</u>

**City of Merced**  
**Schedule of Expenditures of Federal Awards**  
**For the year ended June 30, 2016**

Grantor Agency and Grant Title	Federal Catalog Number	Agency or Pass-Through Grantor's Number	Expenditures	Subrecipient Expenditures
<b>U.S. Department of Transportation, Continued:</b>				
<i>Highway Planning and Construction Cluster</i>				
<i>Passed through State of California Department of Transportation</i>				
Highway Planning and Construction-CMAQ-Black Rascal Bike Path	20.205	CML- 5085(28)	323,542	-
Highway Planning and Construction-CMAQ-Bear Creek Bike Path	20.205	CML- 5085(29)	34,470	-
Highway Planning and Construction-CMAQ-Traffic Signal Synchronization	20.205	CML- 5085(35)	148,061	-
Highway Planning and Construction-CMAQ-Bike Shelters	20.205	CML- 5085(36)	5,925	-
Highway Planning and Construction-CMAQ Sidewalk Infill on El Redondo Dr	20.205	CML- 5085(38)	31,329	-
Highway Planning and Construction-CMAQ Sidewalk Infill on Carol Ave	20.205	CML- 5085(39)	7,471	-
Highway Planning and Construction-CMAQ Traffic Signal at Hwy 59/16 <sup>th</sup> St	20.205	CML- 5085(40)	11,349	-
Highway Planning and Construction-CMAQ Sidewalk Infill on Alexander Ave	20.205	CML- 5085(41)	13,896	-
Highway Planning and Construction-CMAQ Sidewalk Infill on Buena Vista Dr	20.205	CML- 5085(42)	161,401	-
Highway Planning and Construction-CMAQ Sidewalk Infill on Oleander Ave	20.205	CML- 5085(43)	770	-
Highway Planning and Construction-CMAQ R-turn at Hwy 59/16 <sup>th</sup> St	20.205	CML- 5085(44)	9,691	-
Highway Planning and Construction-Multi Use Path Crossing	20.205	ATPL- 5085(45)	4,865	-
Subtotal Highway Planning and Construction Cluster			752,770	-
<i>Highway Safety Cluster</i>				
<i>Passed through State of California Office of Traffic Safety</i>				
Selective Traffic Enforcement Program (STEP)	20.600	PT16118	10,406	-
Selective Traffic Enforcement Program (STEP)	20.616	PT1532	10,127	-
Subtotal Highway Safety Cluster			20,533	-
<i>Passed through State of California Office of Traffic Safety</i>				
AVOID the DUI Campaign	20.608	AL1509	30,302	-
AVOID the DUI Campaign	20.608	AL1634	14,127	-
Subtotal CFDA 20.608			44,429	-
<i>Passed through State of California High Speed Rail Authority</i>				
ARRA-High Speed Rail (HSR) Grant	20.319	HSR 11-10	194,131	-
Subtotal CFDA 20.319			194,131	-
<b>Total U.S. Department of Transportation</b>			<b>1,046,387</b>	<b>-</b>
<b>U.S. Department of Homeland Security</b>				
<i>Federal Emergency Management Agency</i>				
<i>Direct Program</i>				
Assistance to Firefighter Grant 2013	97.044	EMW-2013-FO-00747	47,331	-
Subtotal CFDA 97.044			47,331	-
<b>Total U.S. Department of Homeland Security</b>			<b>47,331</b>	<b>-</b>
<b>Total Expenditures of Federal Awards</b>			<b>\$ 3,088,989</b>	<b>\$ 320,399</b>

See accompanying Notes to Schedule of Expenditures of Federal Awards.

# City of Merced

## Notes to the Schedule of Expenditures of Federal Awards For the year ended June 30, 2016

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### 1. REPORTING ENTITY

The City of Merced (City) was incorporated in 1889 as a charter city. It has a council-manager form of government. The City Council is composed of six members-at-large elected to serve four-year terms, and the mayor who is elected to serve a two-year term. The City Council appoints the City Manager, City Attorney and Finance Officer. The financial reporting entity consists of: (1) the City; (2) organizations for which the City is financially accountable; and (3) organizations for which the nature and significance of their relationship with the City are such that exclusion would cause the City's financial statements to be misleading or incomplete. The following entities are component units of the City:

- The City of Merced Public Financing and Economic Development Authority
- The City of Merced Parking Authority

Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. In addition, component units can be other organizations for which the primary government's exclusion would cause the reporting entity's financial statements to be misleading or incomplete.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Basis of Accounting

Funds received under various grant programs have been recorded within the General, Special Revenue, Capital Projects, and Enterprise funds of the City. The City utilizes the modified accrual method of accounting for General, Special Revenue and Capital Projects funds and accrual basis of accounting for Enterprise funds. The accompanying Schedule of Expenditures of Federal Awards (SEFA) is presented in accordance with the requirements of the *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Therefore, some amounts presented in the Schedule of Expenditures of Federal Awards may differ from amounts presented in, or used in, the presentation of the City's basic financial statements.

#### Schedule of Expenditures of Federal Awards

The accompanying Schedule of Expenditures of Federal Awards presents the activity of all federal financial assistance programs of the City. Federal financial assistance received directly from federal agencies as well as federal financial assistance passed through the State of California is included in the Schedule of Expenditures of Federal Awards.

The Schedule of Expenditures of Federal Awards was prepared only from accounts of various grant programs and, therefore, does not present financial position or results of operations of the City.

# City of Merced

## Notes to the Schedule of Expenditures of Federal Awards For the year ended June 30, 2016

### 3. RELATIONSHIP TO FINANCIAL STATEMENTS

The amounts reported in the accompanying Schedule of Expenditures of Federal Awards agree, in all material respects, to amounts reported within the City's financial statements. Federal award revenues are reported principally in the City's financial statements as intergovernmental revenues in the General, Special Revenue, Capital Projects, and Enterprise funds.

### 4. PASS-THROUGH ENTITIES' IDENTIFYING NUMBER

When federal awards were received from a pass-through, the Schedule of Expenditures of Federal Awards shows, if available, the identifying number assigned by the pass-through entity.

### 5. OUTSTANDING LOANS OF FEDERAL FUNDS AT JUNE 30, 2016

The City administers federal award programs that fund revolving loans. The principal and interest payments collected are returned to the programs. The loans are not considered to have any significant continuing compliance requirements other than the requirement to repay the loans.

The City does monitor loans for income eligibility by reviewing:

- 1). Multi-Family Loans every 3 years, including profit and loss statements and repayment schedules.
- 2). Homeowner Rehabilitation Loans every 5 years.
- 3). First Time Homebuyer Loans every 5 years.

New loans that have been made during the fiscal year are included as part of the schedule of expenditures of federal awards.

The following is a summary of loan programs maintained by the City and their balance as of June 30, 2016.

Program Title	CFDA Number	Amount Outstanding	Prior Year Loans	New Loans
Community Development Block Grants/ Entitlement Grants	14.218	\$ 5,673,071	\$ 5,766,299	\$ 81,908
HOME Investment Partnership Program (1)	14.239	11,868,540	11,655,690	210,151
Community Development Block Grants/ State's Program and Non-Entitlement Grants in Hawaii	14.228	1,522,853	1,540,085	-
		<u>\$ 19,064,464</u>	<u>\$ 18,962,074</u>	<u>\$ 292,059</u>

(1) Prior Year Loan restated

### 6. INDIRECT COSTS

The City did not elect to use the 10% de minimis indirect cost rate as allowed under the Uniform Guidance, and currently does not charge any indirect costs to federal programs.

**City of Merced**  
**Schedule of Findings and Questioned Costs**  
**For the year ended June 30, 2016**

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**Section I - Summary of Auditor's Results**

**Financial Statements**

Types of auditors' report issued on whether financial statements audited were prepared in accordance with GAAP: Unmodified

Internal control over financial reporting:

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

Any noncompliance material to the financial statements noted No

**Federal Awards**

Internal control over major programs:

- Material weakness(es) identified? No
- Significant deficiency(ies) identified? Yes

Type of auditor's report issued on compliance for major programs Unmodified

Any audit findings disclosed that are required to be reported in accordance with section 200.516(a) Yes

Identification of major programs:

CFDA Number(s)	Name of Federal Program or Cluster	Expenditures
14.218	CDBG Entitlement Cluster	\$ 1,516,790
	<b>Total Expenditures of All Major Federal Programs</b>	<b>\$ 1,516,790</b>
	<b>Total Expenditures of Federal Awards</b>	<b>\$ 3,088,989</b>
	<b>Percentage of Total Expenditures of Federal Awards</b>	<b>49%</b>

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

Auditee qualified as low-risk auditee under section 200.520? Yes

**City of Merced**  
**Schedule of Findings and Questioned Costs, Continued**  
**For the year ended June 30, 2016**

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**Section II - Current Year Findings**

**A. Current Year Findings - Financial Statement Audit**

No financial statement findings in the current year.

**B. Current Year Findings and Questioned Costs - Major Federal Award Program Audit**

**2016-001 Procurement, Suspension and Debarment, Control Activities (Significant Deficiency) and Compliance**

**Program:**

Community Development Block Grant (CFDA Number 14.218, U.S. Department of Housing and Urban Development, Direct Program, Award Numbers B-12-MC-06-0044, B-13-MC-06-0044, B-14-MC-06-0044, B-15-MC-06-0044)

**Criteria:**

Per 2 CFR Section 180.300, when a non-federal entity enters into a covered transaction with an entity at a lower tier, the non-federal entity must verify that the entity is not suspended or debarred or otherwise excluded. This verification may be accomplished by checking the *Excluded Parties List System (EPLS)* maintained by the General Services Administration (GSA), collecting a certification from the entity, or adding a clause or condition to the covered transaction with that entity.

**Condition:**

During the performance of the audit, we noted that the City did not perform procedures over suspension and debarment requirements for all subaward transactions.

**Cause:**

The City's procedures for suspension and debarment only encompass construction contracts funded through federal programs, and as a result such procedures were not performed for subrecipient agreements. The City relied on a subrecipient agreement template that was believed to include all regulatory language required by the grant, however the clause for debarment and suspension is not included as part of the subrecipient agreement template.

**Context and Effect:**

The City may pass through funds to a subrecipient that is suspended or debarred by a federal agency and require repayment of such funds to the grantor.

**Questioned Costs:**

No questioned costs were noted.

**Recommendation:**

We recommend that the City implement policies and procedures over suspension and debarment requirements for subrecipient agreements for federal awards.

**View of Responsible Officials and Planned Corrective Action:**

The City Housing Department will update policies and procedure regarding suspension and debarment requirements for subrecipient agreements. In addition, all subrecipient agreements and professional service contracts executed on or after January 1, 2017 will include the appropriate suspension and debarment requirements.



**City of Merced**  
**Schedule of Findings and Questioned Costs, Continued**  
**For the year ended June 30, 2016**

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**Section II- Current Year Findings (Continued)**

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

**2016-002 Pass-through Entity Responsibilities, Information and Communication (Significant Deficiency) and Compliance**

**Program:**

Community Development Block Grant (CFDA Number 14.218, U.S. Department of Housing and Urban Development, Direct Program, Award Numbers B-12-MC-06-0044, B-13-MC-06-0044, B-14-MC-06-0044, B-15-MC-06-0044)

**Criteria:**

Per OMB Circular No. A-133 Subpart D *Federal Agencies and Pass-Through Entities .400 Responsibilities* (d)

- (1), A pass-through entity shall identify federal awards made by informing each subrecipient of the CFDA title and number, award name and number, award year, if the award is R&D, and name of Federal Agency. When some of this information is not available, the pass-through entity shall provide the best information available to describe the Federal award.
- (4) Ensure that subrecipients expending \$500,000 or more in Federal awards during the subrecipient’s fiscal year have met the audit requirement of OMB Circular No. A-133 for that fiscal year.
- (5) Issue management decision on audit findings within six months after receipt of the subrecipient’s audit report and ensure that the subrecipient takes appropriate and timely corrective action.

Per 2 CFR Section 200.331 *Requirements for pass-through entities,*

- All pass through entities must ensure that every subaward is clearly identified to the subrecipients as a subaward and includes the following information at the time of the subaward and if any of these elements change, include the changes in subsequent award information...Required information includes... (xi) CFDA Number and Name; the pass-through entity must identify the dollar amount made available under each Federal award and the CFDA number at time of disbursement.
- Evaluate each subrecipient’s risk of noncompliance with Federal statutes, regulations, and the terms and conditions of the subaward for purposes of determining the appropriate subrecipient monitoring described in paragraphs (d) and (e) of this section.

**Condition:**

During the performance of the audit, we noted the following matters:

- The City did not include the CFDA number of the Community Development Block Grant program in the subaward documentation for all subrecipient agreements effective during the fiscal year.
- The City currently only obtains audit reports from subrecipients as part of the application process for grant awarding purposes. However there are no processes in place to verify whether a subrecipient had an audit in accordance with OMB Circular No. A-133 when it was required and issuing management decisions on audit findings.
- The City does perform on-site monitoring for all subrecipients, and performs follow up visits for problematic subrecipients, however the City did not document a formal evaluation on each subrecipient’s risk of noncompliance with program requirements.

**City of Merced**  
**Schedule of Findings and Questioned Costs, Continued**  
**For the year ended June 30, 2016**

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**Section II- Current Year Findings (Continued)**

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

**2016-002 Pass-through Entity Responsibilities, Information and Communication (Significant Deficiency) and Compliance (Continued)**

**Cause:**

The City believed that the subrecipient agreement template that is used included all regulatory language required by the grant, however the subrecipient agreement template only included the program name and did not include the CFDA number of the program. The City's policies and procedures for postaward pass-through entity responsibilities focused on monitoring the activities of the subrecipients, but did not encompass the responsibilities with regard to verifying subrecipients met the audit requirements of OMB Circular No. A-133 and management decision requirements. The requirement to perform a formal evaluation on each subrecipient's risk of noncompliance with program requirements to determine the level of monitoring to be performed by the City is relatively new and was not timely captured by the City's internal control over compliance for the program.

**Context and Effect:**

The City was not in full compliance with the pass through entity responsibilities under OMB Circular No. A-133 and 2 CFR Section 200.

**Questioned Costs:**

No questioned costs were noted.

**Recommendation:**

We recommend that the City implement policies and procedures over subrecipients to be in full compliance with pass-through entity responsibilities under OMB Circular No. A-133 and 2 CFR Section 200.

**View of Responsible Officials and Planned Corrective Action:**

The City Housing Department will update policies and procedures to be in compliance with pass-through entity responsibilities as follows:

- 1). Include the CFDA number on all subrecipient agreements and professional service contracts. All agreements and contracts executed on or after January 1, 2017 will include the CFDA number.
- 2). All subrecipients will be required to submit the federally required audit to the City prior to execution of the agreement and during the term of the agreement.
- 3). Include a formal risk assessment procedure. The revised policies and procedures will be included with the adoption of the 2018 HUD Annual Action Plan. The formal risk assessment procedures will begin on July 1, 2017.

**City of Merced**  
**Schedule of Findings and Questioned Costs, Continued**  
**For the year ended June 30, 2016**

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**Section III- Prior Year Findings**

**A. Prior Year Findings - Financial Statement Audit**

No financial statement findings in the prior year.

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

No prior year findings or questioned costs.

