

CITY OF HERCULES
SINGLE AUDIT REPORT
YEAR ENDED JUNE 30, 2017



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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 Members
of the City Council
City of Hercules
Hercules, 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 Hercules (the City), as of and for the year ended June 30, 2017, 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 31, 2018..

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.

Honorable Mayor and Members
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City of Hercules
Hercules, California

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a deficiency in internal control, described in the accompanying schedule of findings and questioned costs, as finding 2017-001, that we consider a significant deficiency.

Compliance and Other Matters

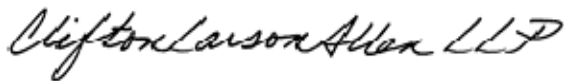
As part of obtaining reasonable assurance about whether the City's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect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

City of Hercules' Response to Findings

City of Hercules' response to the finding identified in our audit is described in the schedule of findings and questioned costs. City of Hercules' response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

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



CliftonLarsonAllen LLP

Roseville, California
January 31, 2018

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM; REPORT ON INTERNAL CONTROL OVER COMPLIANCE; AND REPORT ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS REQUIRED BY THE UNIFORM GUIDANCE

Honorable Mayor and Members
of the City Council
City of Hercules
Hercules, California

Report on Compliance for Each Major Federal Program

We have audited the City of Hercules' (the City) compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (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, 2017. The City's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards 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 the audit requirements of Title 2 *U.S. Code of Federal Regulations (CFR) 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.

Honorable Mayor and Members
of the City Council
City of Hercules
Hercules, California

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, 2017.

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 have not been identified.

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.

Honorable Mayor and Members
of the City Council
City of Hercules
Hercules, California

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, 2017 and the related notes to the financial statements, which collectively comprise The City's basic financial statements. We issued our report thereon dated January 31, 2018, 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.



CliftonLarsonAllen LLP

Roseville, California
January 31, 2018

CITY OF HERCULES
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2017

Federal Grantor/Pass-through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures	Expenditures to Subrecipients
<u>U.S. Department of Transportation</u>				
Passed through the State Department of Transportation:				
Highway Planning and Construction	20.205	TGR2DGL 5117 (011)	\$ 483,179	\$ -
Highway Planning and Construction	20.205	TGR2DGL 5117 (011)	83,150	-
Highway Planning and Construction	20.205	STPL 5117 (014)	678,857	-
Subtotal			<u>1,245,186</u>	<u>-</u>
Total U.S. Department of Transportation			<u>\$ 1,245,186</u>	<u>\$ -</u>
<u>U.S. Environmental Protection Agency</u>				
Passed through State of California Water Resources Control Board:				
Capitalization Grants for Clean Water State Revolving Funds	66.458	CS-060001	<u>\$ 5,509,461</u>	<u>\$ -</u>
Total U.S. Environmental Protection Agency			<u>\$ 5,509,461</u>	<u>\$ -</u>
Total Expenditures of Federal Awards			<u>\$ 6,754,647</u>	<u>\$ -</u>

See accompanying Notes to Schedule of Expenditures of Federal Awards.

CITY OF HERCULES
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2017

NOTE 1 BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards presents the activity of all federal awards programs of the City of Hercules for the year ended June 30, 2017. The information in this schedule is presented in accordance with the requirements of Title 2 *U.S. Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the schedule are reported on the modified accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Therefore, some amounts presented in the schedule may differ from amounts presented in, or used in the preparation of, the financial statements.

NOTE 3 CATALOG OF FEDERAL DOMESTIC (CFDA) NUMBERS

The program titles and CFDA numbers were obtained from the federal or pass-through grantor or the 2017 *Catalog of Federal Domestic Assistance*. When no CFDA number had been assigned to a program, the two-digit federal agency identifier and the federal contract number were used. When there was no federal contract number, the two-digit federal agency identifier and the word "unknown" were used.

NOTE 4 INDIRECT COST RATE

The City did not elect to use the 10 percent de minimis indirect cost rate as covered in 2 CFR §200.414.

NOTE 5 PASS-THROUGH ENTITIES' IDENTIFYING NUMBER

When federal awards were received from a pass-through entity, the schedule of expenditures of federal awards shows, if available, the identifying number assigned by the pass-through entity. When no identifying number is shown, the City determined that no identifying number is assigned for the program or the City was unable to obtain an identifying number from the pass-through entity.

**CITY OF HERCULES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2017**

Section I – Summary of Auditors' Results

Financial Statements

1. Type of auditors' report issued: Unmodified
2. Internal control over financial reporting:
- Material weakness(es) identified? _____ yes x no
 - Significant deficiency(ies) identified? x yes _____ none reported
3. Noncompliance material to financial statements noted? _____ yes x no

Federal Awards

1. Internal control over major federal programs:
- Material weakness(es) identified? _____ yes x no
 - Significant deficiency(ies) identified? _____ yes x none reported
2. Type of auditors' report issued on compliance for major federal programs: Unmodified
3. Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? _____ yes x no

Identification of Major Federal Programs

CFDA Number(s)

66.458

Name of Federal Program or Cluster

Capitalization Grants for Clean Water State
Revolving Funds

Dollar threshold used to distinguish between
Type A and Type B programs:

\$ 750,000

Auditee qualified as low-risk auditee?

_____ yes x no

**CITY OF HERCULES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED JUNE 30, 2017**

Section II – Financial Statement Findings

2017-001

REVENUE RECOGNITION

Type of Finding

Significant Deficiency in Internal Control Over Financial Reporting

Criteria: Accounting standards generally accepted in the United States of America state that non-exchange revenues that carry purpose restrictions should be reported as revenue when received and net position be reported as restricted.

Condition: During the audit it was determined that the City had not properly recorded all revenues received in a prior period.

Cause: The City had reported \$5.2 million as unearned revenue in a prior period that should have been reported as earned.

Effect: The City understated the net position of the Private Purpose Trust Fund by \$5.2 million at the beginning of the current fiscal year

Recommendation: The City should review unearned revenue accounts to confirm that criteria for recognizing revenue has not been met.

Management Response: In FY14-15, the City reported a \$5.2 million from the Redevelopment Property Tax Trust Fund (RPTTF) as unearned revenue. The City made the error originally and classified the revenue as unearned rather than as earned revenue. This error has been corrected in the FY16-17 Financial Statements. The City will review unearned revenue balances as part of its year-end closing process to ensure that revenue recognition has not been met for amounts reported as unearned

**CITY OF HERCULES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED JUNE 30, 2017**

Section III – Findings and Questioned Costs – Major Federal Programs

Our audit did not disclose any matters required to be reported in accordance with 2 CFR 200.516(a).



SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS YEAR ENDED JUNE 30, 2017

Finding 2016-001

Capital Asset Additions and Depreciation

Recommendation

We recommend that the City adopt policies and procedures to provide for a more thorough review of capital asset expenditures / expenses. This review should include reviewing supporting documentation for both assets that are capitalized, as well as a review of potential expenditures / expenses that could potentially be capitalized to ensure that expenditures / expenses are properly capitalized in accordance with City policy. Additionally, we recommend that the city adopt policies and procedures to review capital assets under construction to ensure they are placed into service timely and depreciated in accordance with City policy. This process may include performing documented inquiries with public works and or have public works perform a review of all construction projects to represent that projects are ongoing or have been placed in service during the fiscal year. For all construction projects that have been placed in service a notice of completion should be obtained. As part of the year end closing process the City should prepare a capital asset roll forward schedule documenting all capital asset additions, dispositions and transfers for construction projects placed into service. Capital asset additions should be reconciled to the proper expenditure / expense account within the trial balance. Capital asset dispositions should be supported by documentation for the sale, exchange, transfer, abandonment or donation of the asset, along with the calculation of the gain or loss associated with the disposition. Capital assets under construction should be tracked by project, with a detail listing of all expenditures / expenses that have been added to the project during the fiscal. Capital asset placed in service during the fiscal year should have a reconciliation to the total capital expenditures / expense for the project along with documentation for the notice of completion and what depreciable capital asset category the asset is transferred to, such as infrastructure or buildings and improvements. These procedures should be performed by the appropriate staff and reviewed by the Director of Finance.

Status

Implemented in the current year.

Finding 2016-002
Accounts Receivable

Recommendation

The City should establish policies and procedures to identify match cash receipts with accounts receivable in a timely manner. Additionally, the City should establish procedures to review accrual and long outstanding receivables and a follow up process to determine if there continues to be a properly valued receivable.

Status

Implemented in the current year.

Signature:  Title: Finance Director