

CITY OF COVINGTON, KENTUCKY

Single Audit Reports

Year Ended June 30, 2015

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CITY OF COVINGTON, KENTUCKY
Schedule of Expenditures of Federal Awards
Fiscal Year Ended June 30, 2015

Federal Grantor / Pass- Through Grantor / Program Title	Federal CFDA Number	Pass-Through Grantor's Number	Revenues	Expenditures
<u>U.S. Department of Housing and Urban Development</u>				
Section 8 Housing Choice Vouchers	14.871	KY-133-VO-0054-0F04	\$ 5,210,148	\$ 5,831,547
Community Development Block Grants/ Entitlement Grants	14.218	B-11-MC-21-0001	1,377,693	1,507,481
HOME Investment Partnership Programs	14.239	M-10-MC-21-0200	622,484	593,845
HOME Investment Partnership Programs	14.239	Loans Outstanding	-	128,717
			<u>622,484</u>	<u>722,562</u>
Economic Development Initiative - Special Project, Neighborhood Initiative and Miscellaneous Grants	14.251	B-10-SP-KY-0083	68,792	68,792
Total U.S. Department of Housing and Urban Development			<u>7,279,117</u>	<u>8,130,382</u>
<u>National Endowment for the Arts</u>				
Promotion of the Arts Grant to Organizations and Individuals	45.024	13-4292-7080	50,000	50,000
Total National Endowment for the Arts			<u>50,000</u>	<u>50,000</u>
<u>U.S. Department of Transportation</u>				
<i>Pass Through From Kentucky Transportation Cabinet</i> State and Community Highway Safety	20.600	AL-2014-09-00-00	23,851	23,851
<i>Pass Through From Kentucky Transportation Cabinet</i> Highway Planning and Construction - Streetscape Phase III	20.205	PO2 1200005121	150,425	150,425
Highway Planning and Construction - Russell Street Roadway Improvements	20.205	PO2 6251500001640	140,977	140,977
Highway Planning and Construction - River Front Commons	20.205	059 0008 004-008	35,881	35,881
Highway Planning and Construction - 6th Street Restoration	20.205	PO2 6251400003076	122,132	122,132
Highway Planning and Construction - Caroline Avenue	20.205	PO2 1300005873	131,733	131,733
			<u>581,148</u>	<u>581,148</u>
Total U.S. Department of Transportation			<u>604,999</u>	<u>604,999</u>
<u>U.S. Department of Justice</u>				
Paul Coverdell Forensic Sciences Improvement Grant Program	16.742	2014-CD-BX-0071	6,447	6,447
Bulletproof Vest Partnership Program	16.607	2013	5,931	5,931
Bulletproof Vest Partnership Program	16.607	2014	4,394	4,394
			<u>10,325</u>	<u>10,325</u>
<i>Pass Through From Kenton County</i> Edward Byne Memorial Justice Assistance Grant Program	16.738	2013-DJ-BX-0159	30,749	30,749
Total U.S. Department of Justice			<u>47,521</u>	<u>47,521</u>
<u>U.S. Department of Homeland Security</u>				
<i>Pass through From Kentucky Office of Homeland Security</i> Homeland Security Grant Program	97.067	PO2 09415000023961	76,396	76,396
Total U.S. Department of Homeland Security			<u>76,396</u>	<u>76,396</u>
<u>U.S. Department of Interior</u>				
<i>Pass through From Kentucky Heritage Council</i> Historic Preservation Fund Grants-In-Aid	15.904	N/A	19,563	19,563
Total U.S. Department of Interior			<u>19,563</u>	<u>19,563</u>
Total Federal Financial Assistance			<u>\$ 8,077,596</u>	<u>\$ 8,928,861</u>

Note 1 - Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards includes Federal grant activity of the City and is presented on the modified accrual basis of accounting. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, therefore, some amounts presented in this Schedule may differ from amounts presented in or used in the preparation of the basic financial statements.

Note 2 - Outstanding Notes

The community development loans outstanding at June 30, 2015 totaled \$5,380,958 under CFDA 14.218, \$2,414,113 under CFDA 14.228, and \$7,549,729 under CFDA 14.239.

**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**

INDEPENDENT AUDITORS' REPORT

To the Mayor and City Commissioners
City of Covington, Kentucky:

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 discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Covington, Kentucky ("City") as of and for the year ended June 30, 2015 and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated December 7, 2015, wherein we noted the City implemented Governmental Accounting Standards Board Statements No. 68, and 71 and the financial statements of Devou Properties, Inc. were audited by other auditors.

Internal Control over Financial Reporting

In connection with our engagement to audit the financial statements of the City, 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 finding 2015-001 described in the schedule of findings and questioned costs to be a material weakness.

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 in findings 2015-002 and 2015-003 described in the accompanying schedule of findings and questioned costs to be significant deficiencies.

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Compliance and Other Matters

In connection with our engagement to audit the financial statements of the City, 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 engagement, and accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matter that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and questioned costs as finding 2015-004.

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 result of that testing, and not to provide an opinion on the effectiveness of the City'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 City's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Clark, Schaefer, Hackett & Co.

Cincinnati, Ohio
December 7, 2015

**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**

INDEPENDENT AUDITORS' REPORT

To the Mayor and City Commissioners
City of Covington, Kentucky:

Report on Compliance for Each Major Federal Program

We have audited the City of Covington, Kentucky's (the "City") compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the City's major federal programs for the year ended June 30, 2015. 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 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, 2015.

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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 finding 2015-005 and 20015-006. 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 deficiencies in internal control over compliance, as described in the accompanying schedule of findings and questioned costs as findings 2015-005 and 2015-006 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 City as of and for the year ended June 30, 2015, and have issued our report thereon dated December 7, 2015, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. 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 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 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 financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United State 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.

Clark, Schaefer, Hackett & Co.

Cincinnati, Ohio
December 7, 2015

CITY OF COVINGTON, KENTUCKY
Schedule of Findings and Questioned Costs
Year Ended June 30, 2015

Section I – Summary of Auditors’ Results

Financial Statements

Type of auditors’ report issued:	Unmodified
Internal control over financial reporting:	
• Material weakness(es) identified?	Yes
• Significant deficiency(ies) identified not considered to be material weaknesses?	Yes
Noncompliance material to the financial statements noted?	Yes

Federal Awards

Internal control over major programs:	
• Material weakness(es) identified?	None
• Significant deficiency(ies) identified not considered to be material weaknesses?	Yes
Type of auditors’ report issued on compliance for major programs:	Unmodified
Any audit findings that are required to be reported in accordance with 510(a) of Circular A-133?	Yes
Identification of major programs:	
• CFDA 14.218 – Community Development Block Grants – Entitlement Grants	
• CFDA 14.239 – HOME Investment Partnerships Program	
• CFDA 14.871 – Section 8 Housing Choice Vouchers	
Dollar threshold to distinguish between Type A and Type B Programs:	\$300,000
Auditee qualified as low-risk auditee?	No

Section II – Financial Statement Findings

Finding 2015-001 – Material Weakness – Audit Adjustment

Condition: During the course of our audit, we identified misstatements that were not initially identified by the City’s internal control over financial reporting. 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 deficiency in operation exists when a properly designed control does not operate as designed. In this case, the internal controls over the preparation and review of the City’s financial statements did not operate as designed and we consider this a material weakness.

Effect: The audit adjustments were necessary to properly record receivables, deferred inflows of resources, fund balance classifications and net position.

Recommendation: We recommend the City enhance its internal controls over financial reporting with steps such as management analysis of the financials compared to prior years and improved internal communication to ensure the preparation of reliable financial statements in conformity with generally accepted accounting principles.

Management's Response: We agree with the auditors' comments, and the following actions have been taken or will be taken to improve the situation. Throughout the course of the audit, three main areas were identified to be significantly deficient in the design and operating effectiveness of its internal control environment, as such material adjusting entries were required. These areas include: GASB68 Pension funding, Neighborhood Stabilization residency information, and assignment of the use of inter-fund transfers. We have deemed it necessary to review the suite of internal controls surrounding each of these environments, and will make necessary adjustments as to enhance the effectiveness of the control environment. We plan to have remediated this issue prior to Q4 FY16.

Finding 2015-002 – Significant Deficiency – Accounting Procedures

Condition: During our review of the City accounting and financial reporting processes, we noted the City does not have a comprehensive accounting procedures manual.

Effect: A manual of written procedures, instructions, and assignments of duties will prevent or reduce misunderstandings, errors, inefficient or wasted effort, duplicated or omitted procedures, and other situations that can result in inaccurate or untimely accounting records. A well-devised accounting manual can also help to ensure that all similar transactions are treated consistently, that accounting principles used are proper, and that records are produced in the form designed by management. A good accounting manual would aid in the training of new employees.

Recommendation: We recommend the City develop and utilize a comprehensive accounting procedures manual.

Management's Response: We agree with the auditors' comments, however, the City has continued to document procedures via memos from the Finance Director. In June of 2015, the City implemented Phase I of its new financial systems software to include the following modules: A/R, A/P, G/L, Purchasing, Bank Reconciliation, and Cash Receipts. In October of 2015, the City implemented a Fixed Assets module. The City anticipates completing the remaining portions of its systems upgrades by the end of Q3 FY16. Once the system upgrades have been implemented the City will formalize its accounting procedures in a new Desk Manual. The City's desk manual will be subject to an annual management review and all department personnel will be required to evidence their review of managerial updates to the policy.

Finding 2015-003 – Significant Deficiency – Tax Collection Processes

Condition: During our review of property and other taxes and license fees, we observed the following:

- The tax auditors have the access and ability to initiate and authorize transactions, record and process transactions, reconcile and report on the transactions, and authorize refunds which represents a lack of segregation of duties.
- We noted a lack of formal training resources and manuals, such as a formalized manual of written procedures, instructions, and assignments of duties and checklists for processes and auditing.
- Due to staffing and software implementation issues, work on notification and collection of outstanding delinquent tax filers has been inconsistent.

Effect: Without proper segregation of duties, the risk increases that errors or fraud could occur and not be detected within a timely basis. Formalized manuals and procedures assist with staff training and reduce misunderstandings, errors, duplicated or wasted efforts and other situations that can result in inaccurate or untimely accounting records.

Recommendation: We recommend the City find ways to segregate these duties or develop additional monitoring controls to mitigate risk. We also recommend additional training for staff and the development of formalized procedures and policies.

Management's Response: We agree with the auditors' comments, however, the City has made progress with respect to segregation of duties and policies and procedures to minimize the risk of fraud in Tax Collection. In February of 2015, the City hired a new Assistant Finance Director whose primary responsibility is to focus on tax revenue collection, provide oversight of those individuals collecting revenue for the City, and to help the City to focus on collecting outstanding delinquent taxes. In addition, the City has upgraded its financial software implementing a new Cash Receipts module; through continued focus on software upgrades the City is positioning itself to retire its legacy software.

Finding 2015-004 – Budgetary Noncompliance

Condition: As of June 30, 2015, we noted four funds had expenditures in excess of their budget ordinance appropriations.

Criteria: Kentucky Revised Statute (KRS) 91A.030 prohibits the expenditure of moneys except in accordance with a budget ordinance.

Effect: The City was not in compliance with Kentucky statutes.

Recommendation: We recommend the City monitor budgets and amend appropriations prior to incurring additional expenditures to ensure the funds are available and prevent fund deficits.

Management's Response: We agree with the auditors' comments and have implemented remedial efforts to prevent future non-compliance to KRS 91A.030. During 2015 the City implemented new financial management software which was expressly designed to ensure proper tracking of expenditures and amendments to appropriations. As of July 1, 2015, the City's Finance Director implemented a new work flow process using a Budget Re-appropriation form that requires detailed descriptions for re-appropriation of expenditures. This form is initiated by Department Directors and signed by the City Manager prior to an adjustment being made to budget line items in the City's financial system. Electronic, as well as paper records, for all adjustments are kept on an ongoing basis. We deem this finding to be appropriately re-mediated and no further action is deemed necessary.

Section III – Federal Award Findings and Questioned Costs

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Finding 2015-005 – CFDA 14.871 Section 8 Housing Choice Vouchers

Condition: The City did not submit its unaudited financial information, for the fiscal year ended June 30, 2014, until March 2015. The City's audited submission is currently in the IPA disagrees status.

Criteria: 24 CFR 5.801, *Uniform Financial Reporting Standards*, require unaudited financial statements to be submitted 60 days after the fiscal year end, and audited financial statements to be submitted no later than 9 months after the fiscal year end.

Cause: The City experienced turnover in key positions during the prior fiscal year, which caused the oversight in financial reporting.

Effect: The City was not in compliance with reporting requirements.

Recommendation: We recommend the City implement procedures to ensure personnel are knowledgeable with reporting requirements of federal awards.

View of Responsible Officials: Based on the review of 24 CFR §5.801 and prior experience with HUD Section 8 Housing Choice Voucher administration (HUD), the city deems city-wide financial data to not be required for submission to HUD; however, program-specific periodic GAAP financials submission has been identified to be a requirement. Per 24 CFR §5.801, program compliance requirements include a fixed schedule of reporting both unaudited GAAP financials and audited GAAP financials. Management agrees with the auditor finding and asserts the program oversight in this regards have been addressed as to allow for compliance in the future. The senior accounting manager has provided remediate training to accounting staff on the compliance requirements as prescribes by 24 CFR §5.801; additionally, a compliance calendar tracking tool will be implemented during FY2016 as to provide tracking on compliance and reporting requirements in accordance with federal and external-party funding specifications.

Finding 2015-006 – CFDA 14.218 Community Development Block Grants – Entitlement Grants

Condition: The first and fourth quarter Federal Cash Transaction Reports (FCTR) included errors related to receipts and disbursements. Information was sometimes reported on the cash basis, while at other times on the accrual basis. Also, certain receipts and disbursements were improperly included or excluded altogether. Finally, in a specific instance, a disbursement was included in the 4th quarter report which was actually related to another grant.

Criteria: The City must file quarterly the FCTRs via IDIS as required by HUD. These reports must be supported by underlying data to verify that the data was accumulated and summarized accurately in accordance with the reporting requirements.

Cause: Internal controls and processes related to the filing of reports were not properly designed or implemented.

Effect: The City was not in compliance with reporting requirements.

Recommendation: The City should establish formal policies and procedures to ensure FCTRs are properly supported by accurate documentation, are presented on a consistent basis of accounting and reviewed prior to submission.

View of Responsible Officials: We agree with the auditor's comments and the following actions have been or will be taken to remediate the finding. We have identified the periods in which the reporting of CDBG funds via the FCTR are most prone to inconsistent application of accounting theory. We will design and implement effective internal controls for this process; the tenets of our design will be to document an observable process on the initiation, recording, processing, and review of these reports. Based on our efforts and our collaboration with CDBG program managers, we will remediate this finding and will provide sufficient and appropriate evidence, in the future, that all funds are being reviewed and reported on a consistent accrual basis.

Section IV – Schedule of Prior Year Findings and Questioned Costs

Finding 2014-001 – Material Weakness – Prior Period Adjustment

The City restated its beginning fund balance in the General Fund and beginning net position in the Medical Self Insurance Fund to correct errors made in prior years in the due to/due from accounts between these funds.

Status: No prior period adjustment noted. However, there were material audit adjustments noted in Finding 2015-001.

Finding 2014-002 – Significant Deficiency – Accounting Procedures

The City lacked a comprehensive accounting procedures manual.

Status: Repeated as Finding 2015-002.

Finding 2014-003 – Significant Deficiency – Tax Collection Processes

The City lacked segregation of duties within its tax software, lacked formal training resources and manuals, and succession planning for retire-eligible personnel.

Status: Repeated as Finding 2015-003.

Finding 2014-004 – CFDA 14.871 Section 8 Housing Choice Vouchers

The City did not submit its unaudited financial information for the fiscal year ended June 30, 2013 until July 2014, which was rejected by HUD, and then resubmitted in December 2014. The City still hadn't submitted the audited financial information.

Status: Repeated as Finding 2015-005