

CITY OF CONROE, TEXAS

COMPLIANCE REPORT

FOR THE YEAR ENDED

SEPTEMBER 30, 2015



Hereford, Lynch, Sellars & Kirkham

Certified Public Accountants • A Professional Corporation

CITY OF CONROE, TEXAS
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CITY OF CONROE, TEXAS
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED SEPTEMBER 30, 2015

Federal Grantor	Federal CFDA #	Project Number	Grant Funds Expended	Pass-Through Amount to Subrecipients
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT				
<i>Community Development Block Grant</i>	14.218	B-14-MC-48-0038	\$ 315,065	\$ -
Passed Through Texas General Land Office:				
<i>Community Development Block Grant - Disaster Recovery - Ike 2.2 Grant</i>	14.228	13-255-000-7461	289,015	-
TOTAL U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT			604,080	-
U.S. DEPARTMENT OF JUSTICE				
<i>Bullet Proof Vest Partnership</i>	16.607	10050916	8,413	-
<i>Edward Byrne Memorial Justice Assistance Grant Program (JAG)</i>	16.738	2014-DJ-BX-0345	18,318	-
<i>Edward Byrne Memorial Justice Assistance Grant Program (JAG)</i>	16.738	2015-DJ-BX-0016	15,751	-
Total CFDA 16.738			34,069	-
TOTAL U.S. DEPARTMENT OF JUSTICE			42,482	-
U.S. DEPARTMENT OF TRANSPORTATION				
Federal Transit Cluster:				
<i>FTA 5309 Bus Livability Fund</i>	20.500	TX-04-0110-00	1,384,972	-
<i>FY 13 Section 5307 Urbanized Area Formula Fund</i>	20.507	TX-90-Y049-00	313,453	-
<i>FY 14 Section 5307 Urbanized Area Formula Fund</i>	20.507	TX-90-Y063-00	118,040	-
<i>FY 14 Section 5339 Bus and Bus Facility Funds</i>	20.526	TX-34-0006-00	134,707	-
Total Federal Transit Cluster			1,951,172	-
Passed Through TXDOT				
<i>Surface Transportation Program (STP) and Transportation Enhancement (TE)</i>	20.205	CSJ 0338-03-088	300,510	-
<i>Congestion Mitigation & Air Quality (CMAQ) - F07</i>	20.205	CSJ 0110-04-194	122,778	-
Total CFDA 20.205			423,288	-
<i>Job Access And Reverse Commute Program</i>	20.516	TX-37-092	141,050	-
Total Passed Through TXDOT			564,338	-
TOTAL U.S. DEPARTMENT OF TRANSPORTATION			2,515,510	-
U.S. DEPARTMENT OF HOMELAND SECURITY				
Passed Through the Texas Dept. of Public Safety's Division of Emergency Management:				
<i>Emergency Management Performance Grant</i>	97.042	15TX-EMPG-0470	37,047	-
GRAND TOTAL ALL FUNDING			\$ 3,199,119	\$ -

See accompanying notes to schedule of expenditures of federal awards.

CITY OF CONROE, TEXAS

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS FOR THE YEAR ENDED SEPTEMBER 30, 2015

Note 1. Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the City of Conroe, Texas. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The governmental fund types are accounted for using a current financial resources measurement focus. All federal grant funds were accounted for in a special revenue fund, a component of the governmental fund type or general fund. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. Operating statements of these funds present increases (i.e. revenues and other financing resources) and decreases (i.e. expenditures and other financing uses) in fund balance.

The modified accrual basis of accounting is used for the governmental fund types. This basis of accounting recognizes revenues in the accounting period in which they become susceptible to accrual (i.e. both measurable and available); and, expenditures in the accounting period in which the fund liability is incurred, if measurable.

Federal grant funds are considered to be earned to the extent of expenditures made under the provisions of the grant, and accordingly when such funds are received, they are recorded as deferred revenues until earned.

Note 2. Availability of Federal Grant Funds

The period of availability for federal grant funds for the purpose of liquidation of outstanding obligations made on or before the ending date of the federal project period extended 90 days beyond the federal project period ending date, in accordance with provisions in Section H. Period of Performance, Part 3 OMB Circular A-133 Compliance Supplement-June 2015.

Note 3. Loans Outstanding

The City of Conroe, Texas has received a loan guarantee from the Department of Housing and Urban Development under the Section 108 Loan Program for \$1,794,000. As of September 30, 2015, the City had a balance of \$868,000 on the loan guarantee.

HLSK

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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*

The Honorable Mayor and
Members of the City Council and Management of the
City of Conroe, Texas
P.O. Box 3066
Conroe, Texas 77305

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, the discretely presented component units, each major fund, and the aggregate remaining fund information of City of Conroe, Texas (City), as of and for the year ended September 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 February 22, 2016.

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 combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the City'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. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs as items 2015-001 and 2015-002 that we consider to be significant deficiencies.

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 Conroe, Texas' Response to Findings

The City's response to the 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 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 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.

Respectfully,

Hereford, Lynch, Sellars & Kirkham, P.C.

HEREFORD, LYNCH, SELLARS & KIRKHAM, P.C.
Certified Public Accountants

Conroe, Texas
February 22, 2016

HLSK

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133

The Honorable Mayor and
Members of the City Council and Management of the
City of Conroe, Texas
P.O. Box 3066
Conroe, Texas 77305

Report on Compliance for Each Major Federal Program

We have audited City of Conroe, Texas' (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 September 30, 2015. 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 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, City of Conroe, Texas, 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 September 30, 2015.

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. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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 discretely presented component units, each major fund, and the aggregate remaining fund information of the City, as of and for the year ended September 30, 2015, and the related notes to the financial statements, which collectively comprise the City's basic financial statements. We issued our report thereon dated February 22, 2016, 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 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 expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

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.

Respectfully,

Hereford, Lynch, Sellars & Kirkham, P.C.

HEREFORD, LYNCH, SELLARS & KIRKHAM, P.C.
Certified Public Accountants

Conroe, Texas
February 22, 2016

CITY OF CONROE, TEXAS**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED SEPTEMBER 30, 2015**

SECTION I – SUMMARY OF AUDITORS’ RESULTS	
FINANCIAL STATEMENTS	
1. Type of auditors’ report issued	Unmodified
2. Internal Control over Financial Reporting:	
a. Material Weakness(es) identified ?	No
b. Significant Deficiency(ies) identified that are not considered to be material weaknesses?	Yes, 2015-001 and 2015-002
3. Noncompliance material to the Financial Statements noted	No
FEDERAL AWARDS	
4. Internal control over major programs:	
a. Material Weakness(es) identified?	No
b. Significant Deficiency(ies) identified that are not considered to be material weaknesses?	None reported
5. Type of auditors’ report issued on compliance with major programs	Unmodified
6. Any Audit Findings Disclosed that are Required to be Reported in Accordance with Section 510(a) of OMB Circular A-133?	No
7. Identification Major Programs	Federal Transit Cluster and CFDA 20.205
8. Dollar Threshold Used to Distinguish Between Type A and Type B Federal Programs	\$300,000
9. Auditee Qualified as a Low-Risk Auditee?	Yes

CITY OF CONROE, TEXAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED SEPTEMBER 30, 2015

SECTION II –FINANCIAL STATEMENT FINDINGS

2015-001 HUMAN RESOURCE INTERNAL CONTROLS

Significant Deficiency in Controls

Criteria:

The human resources department is responsible for ensuring that employee pay rates are within the compensation range as approved by City Council.

Condition:

An employee of the City was identified as being paid above their position's maximum hourly City approved compensation range. The amount of overpayment appears to be immaterial. Even though this appears to be an isolated instance the lack control procedures warrants reporting the deficiency.

Questioned Cost:

None

Perspective Information:

None

Cause:

Only one individual performs a comparison of all City employees' compensation to the City's compensation schedule. The human resources department does not have a secondary internal control procedure in place to monitor that proper compensation is being applied to the related position.

Effect:

Lack of a secondary monitoring control could result in other City employees receiving excess compensation above the maximum allowed by City Council.

Recommendation:

We recommend that a second individual in human resources perform a review and approval of the placement of each employee on the City approved compensation scale. We also recommend that the City work with their software provider to implement an application control which will notify the user if any pay rate changes are outside the appropriate compensation range.

Views of Responsible Officials and Planned Corrective Actions:

See corrective action plan.

CITY OF CONROE, TEXAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED SEPTEMBER 30, 2015

SECTION II –FINANCIAL STATEMENT FINDINGS

2015-002 FEDERAL GRANT RECONCILIATION

Significant Deficiency in Controls

Criteria:

The City is required to report its expenditures of federal awards in accordance with the Federal Single Audit Act.

Condition:

During the past two years, the City has significantly increased its use of grant funds and the current accounting system is no longer providing timely and accurate information required to produce required information and reporting. The City should consider segregating grant awards into separate special revenue funds, which may make it easier to identify the matching receipts and expenditures for cost-reimbursement grants.

Questioned Cost:

None

Perspective Information:

The City's central accounting office does not have a grant accounting specialist with experience in preparing a Schedule of Expenditures of Federal Awards (SEFA).

Cause:

Individuals in multiple departments, whom do not have grant and accounting experience, are requested to provide a schedule of expenditures for the grants they manage. This information is then aggregated onto the SEFA with no reconciliation to the general ledger.

Effect:

This could result in a misstatement on the Schedule of Expenditures of Federal Awards.

Recommendation:

We recommend that the City assign the task of preparing the SEFA to an experienced individual with accounting experience related to grant awards and expenditures. The individual's duties would include reconciling the SEFA, the compliance reports submitted to the grant agencies and the City's general ledger to one another. As noted above, we recommend that the City setup special revenue funds to assist the City in the reconciliation process.

Views of Responsible Officials and Planned Corrective Actions:

See corrective action plan.

CITY OF CONROE, TEXAS

*SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED SEPTEMBER 30, 2015*

SECTION III –FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

None reported

CITY OF CONROE, TEXAS
SCHEDULE OF PRIOR FINDINGS
FOR THE YEAR ENDED SEPTEMBER 30, 2015

PRIOR YEAR FINDINGS

2014-001 DEBT NONCOMPLIANCE

Criteria:

The CIDC must comply with the Internal Revenue Code in order for tax-exempt bonds to remain tax-exempt.

Condition:

CIDC has determined that because of the sale of properties with proceeds of the CIDC's Sales Tax Revenue Bonds, Series 2008 ("2008 Bonds"), which were subsequently refunded by the proceeds of the CIDC's Sales Tax Revenue and Refunding Bonds, Series 2012("Series 2012"), that the proceeds of the redeemed 2008 Bonds and the outstanding 2012 Bonds were used in the trade or business of a nongovernmental person, as described in Section 141 of the Internal Revenue Code of 1986, as amended (the "Code"). In addition, CIDC has determined that the receipt of proceeds from the sale of properties may result in more than 10% of the debt service on the 2008 Bonds and Series 2012 Bonds as indirectly being secured by an interest in such property or payments in respect of such property, as described in Section 141 of the Code and Treas. Reg. 1.141-4. This may be true even though the 2008 Bonds were and the 2012 Bonds are secured and paid from sales and use tax revenues which constitute generally applicable taxes as described in Treas. Reg. 1.01004(e).

Questioned Cost:

Unknown

Perspective Information:

The CIDC has evolved over the years which have resulted in the original transaction surrounding the purchase and sale of CIDC properties to change.

Cause:

The 2008 Bonds and the 2012 Bonds may no longer qualify as tax-exempt bonds.

Effect:

CIDC may not be in compliance with the Internal Revenue Code and the Treasury Regulations that permit the bonds to be tax-exempt.

Recommendation:

We recommend CIDC modify its procedures to prevent this from occurring in the future as well as consulting their bond counsel and the IRS to resolve the current issue at hand.

Current Status:

The issuer is negotiating a closing agreement with the Internal Revenue Service through the Voluntary Closing Agreement Program (VCAP) and final approval by the agency is pending.

2014-002 SIGNIFICANT ESTIMATES IN SELF-FUNDED INSURANCE FUND – SIGNIFICANT DEFICIENCY

Criteria:

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of management's estimates.

Condition:

During discussions with the City's management and consultant, we noted the City was to receive an unknown amount of reimbursement from its aggregate stop loss insurance. The City had not estimated this amount but felt it could be of significance to the fund's net position.

Questioned Cost:

Unknown

Perspective Information:

During the fiscal year, the City experienced an unusually elevated volume of large claims.

CITY OF CONROE, TEXAS
SCHEDULE OF PRIOR FINDINGS
FOR THE YEAR ENDED SEPTEMBER 30, 2015

Cause:

Unknown.

Effect:

The self-funded insurance fund's statement of net position may be materially misstated since an estimate for the aggregate stop loss reimbursement receivable and related revenue has not been recorded.

Recommendation:

We recommend the City implement procedures to ensure that estimates surrounding stop loss reimbursements be recorded as of the City's fiscal year end.

Current Status:

The City implemented procedures in FY 14-15 to compare actual monthly claim history to the aggregate stop loss limit utilizing report data provided by the City's third party insurance advisers. The workpaper substantiates the amount to be recorded as an aggregate stop loss reimbursement receivable and related revenue, if claims exceed the aggregate limit each year.

2014-003 LACK OF RESERVE IN SELF-FUNDED INSURANCE FUND – SIGNIFICANT DEFICIENCY

Criteria:

The City's consultants recommended an adequate reserve be present in the self-funded insurance fund. The City's Financial Management Policy as of January 23, 2014 does not address a reserve for the self-funded insurance fund.

Condition:

During discussions with the City's management and consultant, we noted the City did not have a reserve in the self-funded insurance fund. Additionally, the City's budgeting process does not facilitate the accumulation of a reserve nor does its Financial Management Policy address mitigating the risks of being self-insured with an adequate reserve.

Questioned Cost:

The City's consultant indicated the fund should have at least \$1.6 million dollars in reserves.

Perspective Information:

The City's self-funded insurance fund has shown a negative trend in net position. The fund has been established for 9 years. The fund has had a positive change in net position 5 of the 9 years. General fund transferred fund balance it had segregated for self-funded insurance during 2010; otherwise, the fund would have suffered a loss during that year as well.

Cause:

The cause appears to be a consistent trend of the revenues in the fund not meeting the demand of claims as well as the City's budgeting process and policy not being configured to build a reserve in the fund.

Effect:

The City has not mitigated the risk of having a self-funded insurance fund nor has it built reserves in the fund as recommended by its consultants.

Recommendation:

We recommend the City adopt and implement policies and procedures to ensure the self-funded insurance fund has an adequate and funded reserve. Additionally, we recommend the City assign fund balance in the general fund during the current year (\$1.6 million) and commit fund balance in future years in the amount the consultants feel is necessary to adequately fund the reserve. Once the self-funded insurance fund has built the adequate reserve then the assignment/commitment of fund balance would be removed from the general fund.

Current Status:

The City's budget preparation process for FY 15-16 addressed the fund's shortfall by increasing City employee and retiree premiums, increasing the City's contribution per full-time employee from \$8,580 to \$10,195 (increase of 19%), rebidding the health insurance contract, and modifying benefits to include a third plan option.

CITY OF CONROE, TEXAS
CORRECTIVE ACTION PLAN
FOR THE YEAR ENDED SEPTEMBER 30, 2015

CURRENT YEAR FINDINGS

2015-001 HUMAN RESOURCE INTERNAL CONTROLS

Contact Person:

Andre Houser
Director of Human Resources

Response:

A City employee was identified as being paid above the maximum pay scale for their position. In the past, this would not have been possible. The previous version of our HR related software allowed us to input the pay scale, and would not allow anyone to be paid beyond the pay scale range.

The newer version of HR related software no longer has this feature. We were aware that we could not put in the pay scale, but did not realize an employee could be paid outside the pay scale range allowed.

We have implemented the following control procedures to prevent a future occurrence:

1. Whenever a pay change form is sent to a supervisor at the time of annual review, we will now put the maximum allowable pay on the form for verification; and
2. All pay changes are now reviewed by two people in the HR department. Both individuals will check the current pay scale as a part of their review process.

Estimated Date of Completion:

September 30, 2016

2015-002 FEDERAL GRANT RECONCILIATION

Contact Person:

Kathleen Richey
Accounting Manager

Response:

The City will work with Transportation Grants staff and the Goodman Corporation to analyze the use of different special revenue funds for each grant. The City will also assign the Sr. Accountant to be the grants liaison. The City will provide a budget for training regarding SEFA and grant accounting to the Sr. Accountant. The accountant will be responsible for reconciling compliance reports to the general ledger as well as coordinating the preparation of grant budgets with staff.

Estimated Date of Completion:

September 30, 2016