



AGENDA REPORT

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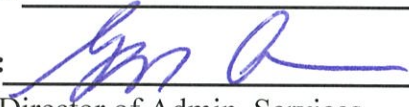
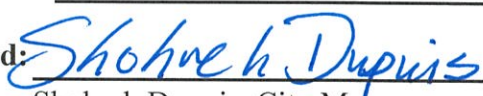
Meeting Date
December 14, 2021

**SUBJECT: CITIZENS' AUDIT REVIEW AND MEASURE LL OVERSIGHT COMMITTEE
REPORT ON THE RESULTS OF THE FISCAL YEAR 2019-20 AUDIT**

RECOMMENDATION: It is recommended that the City Council:

1. Receive and file the Citizens' Audit Review and Measure LL Oversight Committee Annual Report on the results of the audit for Fiscal Year 2019-20;
2. Consider implementing the Committee's recommendations;
3. Extend the current term of Committee members through June 30, 2022, allowing the Committee time to complete the Measure LL Report for Fiscal Year 2020-21 and participate in the selection of the City's financial auditor; and
4. Reaffirm the City Council's December 2016 decision to discontinue the Committee's oversight of Measure LL expenditures and submittal of an annual report after five years with the submittal of the FY 2020-21 Measure LL Report.

Appropriation: _____ **Fund Name:** _____

Submitted By:  **Approved:** 
Gavin Curran, Director of Admin. Services Shohreh Dupuis, City Manager

SUMMARY OF THE MATTER

The Citizens' Audit Review and Measure LL Oversight Committee ("Committee") is pleased to present its report on the results of the Review of the City's Comprehensive Annual Financial Report (CAFR) for the Fiscal Year Ended June 30, 2020, ("Report").

In addition to the Committee's presentation, staff is requesting that the City Council:

- 1) Extend the term of current Committee members to June 30, 2022. This extension will give the Committee the necessary time to complete the Measure LL Report for Fiscal Year 2020-21 and participate in the selection of the next City financial auditors; and
- 2) Reaffirm its decision to conclude the Committee's Measure LL audit and oversight responsibilities after five years and the issuance of the Fiscal Year 2020-21 Measure LL Report and change the committees name to Audit Review Committee then.

DISCUSSION

Committee Audit Report

In preparing the Report, the Committee reviewed the City's CAFR, the four audit compliance letters, and the auditors' findings for the fiscal year ended June 30, 2020. The Committee also formed a subcommittee that had additional discussions with City staff regarding the audit compliance letters and with the auditors without City staff being present.

**Citizen's Audit Review and Measure LL Oversight Committee Report on FY 2019-20 Audit
December 14, 2021
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The auditors expressed an "unmodified" opinion of the City's Fiscal Year 2019-20 financial statements, and did not identify any deficiencies in internal controls that would be considered material weaknesses. However, the auditors identified areas where internal controls could be improved, including receivables and payables, capital assets, accounts payable, beginning equity, and refundable project deposits. The City accepted and implemented the auditors' recommendations, and the City's response to each finding is included on pages 6 through 16 of the Report (Attachment 1).

In addition to implementing the City staff's response to the audit compliance letters, the Committee is requesting that the City Council consider the following recommendation:

Considering the recurring themes observed and identified by this Committee since its inception and in its audit review role, the Committee has identified that resource limitations around systems and staffing have played a consistent role in the recurrence of Significant Deficiencies and other minor discrepancies.

If City Council concludes that elimination of these recurring items is a priority, the Committee recommends that City staff management be asked to conduct a resource adequacy assessment to determine workload, span of control and responsibilities within the Finance function as well as in those parts of Community Development responsible for overseeing disposition of applicant deposits.

The objective would be to identify and assess various means to enhance staff capabilities, including but not limited to system enhancements and staff augmentation, and whether the benefits of providing such additional resources would be worth the added cost.

The Committee would like to thank the City for its efforts in keeping the citizens of Laguna Beach informed of the City's financial condition and hope the City Council and the residents of Laguna Beach will benefit from this Committee's work. We look forward to serving the interests of the community of Laguna Beach in the coming year.

Staff Recommendations

The term of the five Committee members expires on December 31, 2021. To allow the members time to complete the Fiscal Year 2020-21 Measure LL Report and participate in selecting the next financial auditors for the City, staff is requesting that the City Council extend the current term of the Committee members to June 30, 2022. The selection of new Committee members will occur in July 2022 during the City Council's regular selection schedule for members of commission, boards and committees.

Also, in 2016 the City Council approved Resolutions Nos. 16.028 and 16.102. These resolutions created the Measure LL Oversight Committee and affirmed the City Council's desire to discontinue the Committee's oversight of Measure LL expenditures after five years. The Fiscal Year 2020-21 Measure LL Report will represent that fifth and final report. When the final Measure LL report is presented to City Council in early 2022, and if reaffirmed by the City Council, a resolution will be submitted for City Council approval to formally remove the Measure LL oversight responsibilities and rename the Committee as the Audit Review Committee. Review of Measure LL expenditures would continue as part of Committee responsibilities under the annual audit review.

FINANCIAL ANALYSIS

There is no financial impact in receiving the Citizens' Audit Review and Measure LL Committee Audit Report. Funding may be necessary if the City Council implements the Committee's recommendations.

ATTACHMENTS

1. Committee Report (Pgs. 4-43)

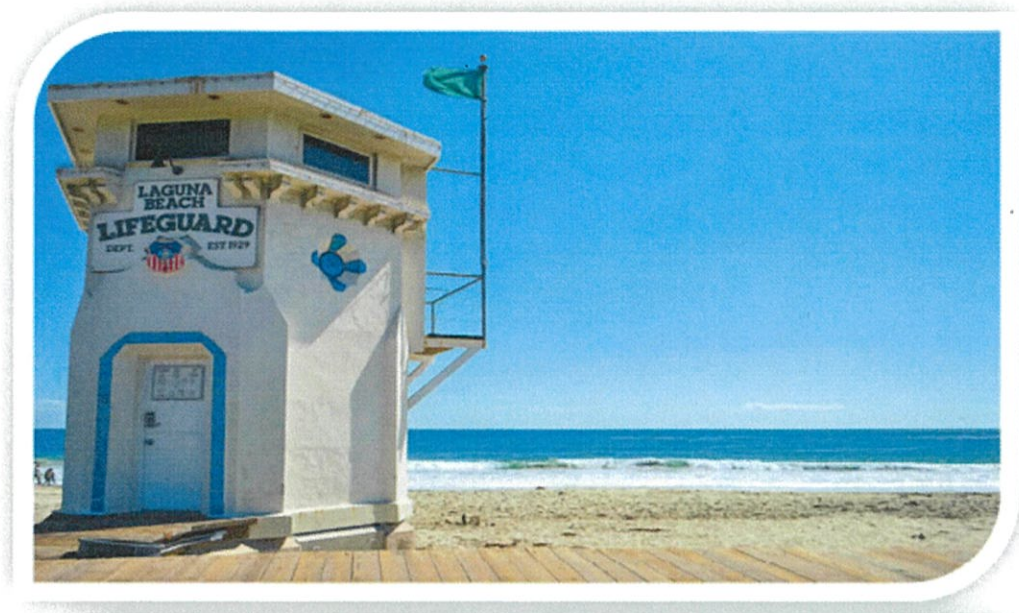
Report Prepared By:

Kris Ryan, Finance Manager

Coordinated With:

Citizens' Audit Review and Measure LL Oversight
Committee

**Report on the Results of the Review of the
Annual Financial Audit
For the Fiscal Year Ended June 30, 2020**



**Presented, 2021
To the Laguna Beach City Council**

**Mayor Bob Whalen
Mayor Pro Tem Sue Kempf
Councilmember Peter Blake
Councilmember Toni Iseman
Councilmember George Weiss**

**Report Prepared by
The Citizens' Audit Review and Measure LL Oversight Committee**

**Julian Harvey-- Chair
Peter Stevenson -- Vice-Chair
Glenn Gray
Matt Lawson
John Thomas**



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- IV. Review of The Annual Financial Audit, Audit Compliance Letters, Internal Control Weaknesses, Legal Compliance Issues; and Discussion with Auditors
- V. Interview of the Auditors
- VI. Conclusion – Auditors Unmodified Opinion
- VII. Recommendations and Observations

Attachments:

- A. Agreed-Upon Procedures Applied to Appropriations Limit Worksheet No. 6
- B. Report on Compliance and Other Matters and on Internal Controls
- C. Statement on Auditing Standards (SAS) 114
- D. Management Letter
- E. Memo from the City Manager to the City Council

I. EXECUTIVE SUMMARY

A. Conclusion – Auditors Unmodified Opinion

Audited by the accounting firm CliftonLarsonAllen LLP (CLA), the financial statements of the City of Laguna Beach (City) for the fiscal year (FY) ended June 30, 2020, comply with Generally Accepted Accounting Principles (GAAP), and received an unmodified opinion.

B. Recommendations

The Citizens' Audit Review and Measure LL Oversight Committee (Committee) recommends that:

Considering the recurring themes observed and identified by this Committee since its inception and in its audit review role, the Committee has identified that resource limitations around systems and staffing have played a consistent role in the recurrence of Significant Deficiencies and other minor discrepancies.

If City Council concludes that elimination of these recurring items is a priority, the Committee recommends that City staff management be asked to conduct a resource adequacy assessment to determine workload, span of control and responsibilities within the Finance function as well as in those parts of Community Development responsible for overseeing disposition of applicant deposits.

The objective would be to identify and assess various means to enhance staff capabilities, including but not limited to system enhancements and staff augmentation, and whether the benefits of providing such additional resources would be worth the added cost.

C. Observations

While the auditors identified the following six (6) significant deficiencies, it is important to note that at least two (2) of the items involved only a single transaction, and all were corrected before the completion of the Comprehensive Annual Financial Report (CAFR):

1. Significant Deficiencies

- a. Payment for the July 2020 Road Maintenance and Rehabilitation Program not being accrued
- b. Beginning equity worksheet did not agree to prior year-end financial statements
- c. Receivables for loan proceeds were mistakenly recorded twice due to an autogenerated journal entry by the accounts receivable system
- d. Payment for the operating lease of eight trolleys was recorded but not capitalized
- e. Revenues received after the 60-day availability period were recorded as receivables but not deferred
- f. Journal entries accurately recorded in the City's finance system but not properly translated on the worksheet to the auditor

2. Exemplary Performance: City Finance Staff

- a. Finance Department: A reflection of the professional work product put forward by the City's talented Finance staff, they received the Certificate of Achievement for Excellence in Financial Reporting award for the fiscal year ended June 30, 2019, representing the 5th consecutive year they received this recognition.
- b. Community Development Department: The Committee recognizes the tremendous work and effort needed to identify and implement a long-term solution to the issue of

accounting for deposits held for long periods. Recognizing the daunting task this challenge poses, Community Development demonstrated a willingness to examine options and address the problem.

3. Addition to Staff

- a. The Finance Department could provide more timely reporting and be better prepared for the City's annual audit if it employed additional resources.

D. Status Update on Prior-Year Committee Recommendations:

The following prior-year Audit Committee recommendations:

1. IMPLEMENTED. The City has made strides in implementing policies and procedures to ensure accuracy in the accounting of Capital Assets, Accounts Payable and in improving the timeliness of bank reconciliations. Although discrepancies were identified in the same categories during the audit of FY 18- '19, the errors were insignificant and involved a small number of transactions.
2. IMPLEMENTED. The increase in the thresholds for purchasing and asset tracking to \$1,000 and \$5,000 respectively has relieved valuable staff time to perform more critical functions.
3. IMPLEMENTED. The City formed a committee that has a role in the selection of the independent auditor to review the Treasury investment policy and investments. The objective of this previous recommendation is to install an entity outside of, or in conjunction with, the Treasury function in the review of the agreed-upon procedures of investments and monitor the results of that review.
4. NOT YET IMPLEMENTED. Council has yet to appoint an independent Investment Committee to help oversee the City's \$100 million portfolio invested in cash equivalents and short-term fixed-income investments. Members would be selected through the City's typical process for recruiting and vetting committee appointees, with the City Treasurer serving as Liaison. This new Committee will replace the City Treasurer's *ad hoc* Investment Committee to provide greater transparency and invaluable input from a group of talented, experienced residents with appropriate credentials (e.g., CFA, MBA in finance, etc.) and professional experience in fixed income investment management.

II. PURPOSE OF THE COMMITTEE & SCOPE FOR THIS REVIEW

As specified under "Qualifications of Appointed Public Member" in Resolution 18.009 of the City of Laguna Beach adopted February 27, 2018, this audit review committee is comprised of residents of the City of Laguna Beach, and the purpose of the Committee shall include, as specified in the adopted Resolution:

1. Participate in the selection of the City's external financial auditors
2. Review the results of the annual financial audit
3. Review any internal control weaknesses and legal compliance issues identified in the course of the annual financial audit and provide any necessary recommendations to the City Council
4. Review the expenditures of the Measure LL Fund annually and provide a subsequent public report to the City Council on the City's compliance with the ballot measure

Further, according to the best practices statement for Audit Committees of the Government Finance Officers Association:

An audit committee is a practical means for a governing body to provide much-needed independent review and oversight of the government's financial reporting processes, internal controls, and independent auditors. By effectively carrying out its functions and responsibilities, an audit committee helps to ensure that management properly develops and adheres to a sound system of internal controls, that procedures are in place to assess management's practices objectively, and that the independent auditors, through their review, objectively assess the government's financial reporting practices. An audit committee also provides a forum separate from management in which auditors and other interested parties can candidly discuss concerns.

The audit committee's responsibility is to provide independent review and oversight of a government's financial reporting processes, internal controls, and independent auditors. This is consistent with the purpose as specified in the adopted ordinance. Item #1, the selection of the City's external auditors, was completed before expanding this Committee's role. Therefore, there has not yet been the need or opportunity for the Committee to participate in the external financial auditor selection process. Item #4 has been addressed in separate reports on Measure LL dated February 27, 2018, June 4, 2019, October 13, 2020, and July 27, 2021.

Therefore, this report addresses duties 2 and 3 above:

- Review the results of the annual financial audit
- Review of internal control weaknesses and legal compliance issues identified during the annual financial audit and provided any necessary recommendations to the City Council.

III. METHODOLOGY

The full Committee held four meetings between June 2021 and October 2021, including creating a sub-committee to help draft this report. While these were open public meetings, no members of the community attended any of the meetings. It is also important to note that all meetings were held remotely via Zoom due to the pandemic.

A. Statements and Documents Reviewed

1. Certified Annual Financial Report including
 - a. The Basic Financial Statements
 - b. Fund Financial Statements
 - c. Proprietary Funds
 - d. Fiduciary Funds
 - e. Notes to Basic Financial Statements
2. Supplemental material contained in the Certified Annual Financial Report including:
 - a. The City Manager and Director of Administrative Services letter of transmittal to the City Council and Citizens of the City of Laguna Beach
 - b. Government Finance Officers Association Award
 - c. The Independent Auditor's Report, also known as the opinion letter Supplementary Information Section
 - d. Management's Discussion and Analysis
3. The Four (4) Audit Compliance letters for the fiscal year ended June 30, 2020.
 - a. Agreed-Upon Procedures Applied to Appropriations Limit Worksheet No.6

- b. Report on Compliance and Other Matters and on Internal Controls ("GAS" Letter)
 - c. SAS-114 Report
 - d. Management Letter (SAS 115)
4. The four (4) Audit Compliance letters for the prior fiscal year ended June 30, 2019.

B. Committee Actions

- 1. The Committee and subcommittee met with and had conversations with:
 - a. Staff
 - b. Members of the audit firm CliftonLarsonAllen LLP
 - c. City Council liaisons to the Committee.
- 2. The subcommittee held one conference call regarding the audited financial statements, Audit Compliance letters, and other issues with the auditors without City staff being present.
- 3. The completed report was presented to the City Council and Laguna Beach community with the Committee's findings and recommendations.

IV. REVIEW OF ANNUAL FINANCIAL AUDIT

A. Summary

CliftonLarsonAllen (CLA) audited the City's financial statements. The fiscal year ended June 30, 2020, was the fourth year of the five-year contract for auditing services between the City and CLA. CLA acquired White Nelson Diehl Evans LLP and took over the auditing services contract in 2020. The audit partner and staff remained the same. The City's letter of transmittal includes the following statements:

- As management, we assert that, to the best of our knowledge and belief, this financial report is complete and reliable in all material respects.
- Based upon the audit, the independent auditor concluded that there was a reasonable basis for rendering an unmodified opinion that the City's financial statements for the fiscal year ended June 30, 2020, were fairly presented in conformity with GAAP (generally accepted accounting principles.)

In addition to the audit of the City's financial statements themselves, the auditors also provided four audit compliance letters, the purpose of which is recapped below and more fully explained in the attached May 24, 2021, memo from the City Manager to the City Council.

B. Audit Compliance Letters

- 1. Agreed-Upon Procedures Applied to Appropriations Limit Worksheet No.6

This report outlines specific procedures the auditors are required to do concerning the City's Appropriations Limit Calculation each year.

Committee Comment:

While the auditors clearly state that they were not engaged to and did not perform an audit, the objective of which would be the expression of an opinion of the Appropriations Limit Worksheet No. 6 and make no representation regarding the sufficiency of the procedures that they did perform, the auditors did perform three procedures as further described in their letter and found no exceptions.

2. Report on Compliance and Other Matters and on Internal Controls ("GAS" Letter)

CliftonLarsonAllen (CLA) submitted a letter to the City dated February 24, 2021, entitled: "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." In this letter, CLA described the scope of their audit included the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Laguna Beach (City) for the year ended June 30, 2020.

In terms of internal control, CLA clearly stated their audit was not designed to identify all deficiencies in internal control; rather, CLA only considered the City's internal control over its financial reporting. Subsequently, CLA's assessment of the City's internal control was used solely to provide opinions on the City's financial statements and not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Three key terms appear in the audit related to internal control, and CLA provided descriptions of each:

- a. 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.
- b. 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 City's financial statements will not be prevented or detected and corrected on a timely basis.
- c. 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.

Purpose: This report is required to be issued for all audits performed in accordance with *Government Auditing Standards (GAS)*. The standards require that the auditors disclose material issues of noncompliance as well as material weaknesses and significant deficiencies in internal control over financial reporting that might have come to the auditors' attention during the audit process.

For background, during the subcommittee's conferences with the auditors, the auditors explained that the comments in the GAS letter pertaining to management issues are considered more consequential than those in other Audit Compliance letters, and resolution is expected. The issues identified in the audit for the fiscal year ended 6/30/2020 were not "material weaknesses." The auditors did identify a certain deficiency in internal control, which they considered a "significant deficiency."

It should also be noted that the numbers in the final audited financial statement reflect corrections to any of the auditor comments that are numerical issues.

Committee Comment:

Considering the scope of the audit's examination of internal control limited to the City's financial reporting, while CLA did not identify any deficiencies in internal control which CLA considered material weaknesses (which are more severe), they did identify a deficiency in internal control which CLA categorized as a significant deficiency. Specifically, CLA's audit resulted in audit adjustments to the general ledger in the following categories:

Receivables

During our review of the Road Maintenance and Rehabilitation Program (RMRA) revenues, we noted the City did not accrue the July 2020 payment. After several revisions to journal entries provided, this resulted in an audit adjustment to increase receivables and revenues. This was caused by a lack of additional procedures to ensure the completeness of RMRA revenues recorded in the general ledger. We recommend the City properly review RMRA revenues to ensure the completeness of the revenue recorded in the general ledger.

Management's Response

The City has policies and procedures in place to ensure that revenues are recorded within the fiscal year. The Finance Staff did record twelve payments for the Fiscal Year 2019-20 (July 2019 – June 2020) for the road maintenance and rehabilitation program (RMRA). RMRA revenues are unique because the State Controller's Office considers the payment collected for July 2020 as a payment for Fiscal Year 2019-20. Next year, the Finance Staff will match the City's general ledger to the State Controller's Office RMRA annual report to ensure that the correct monthly payments are recorded.

Receivables for Loan Proceeds

The City has some loans for which the proceeds have not yet been drawn down, which are appropriately recorded as receivables. During our review of these receivables, we noted that drawdowns for the current year that had not yet been received as of year-end were accrued a second time in a separate receivable account and recorded as revenue. This resulted in an audit adjustment to reduce receivables and revenue in the Sewer Enterprise Fund and was caused by a lack of additional procedures to ensure that the receivables for loan proceeds were not double-counted. We recommend the City track the drawdown of loan proceeds throughout the year and reduce the receivable as proceeds are received. Any amounts outstanding as of year-end have already been included in the original receivable balance.

Management's Response

Management agrees that drawdowns of loan proceeds must be recorded as a reduction to the receivable when the funds are received. The City has been diligent in ensuring that all loans are properly recorded in the general ledger, and all drawdowns are accounted for. The receivable account that is used for the loan was correct at year-end. The separate receivable the auditors are describing was a result of the City accounts receivable system auto-generating a receivable when the Finance Staff created an invoice at the request of the lending institution. The Finance staff feels this error is an isolated incident and that existing internal controls should prevent this finding in the future.

Capital Lease

During the fiscal year 2019-2020, the City purchased eight trolleys through a capital lease, which should be recorded as long-term debt and capital assets in the Municipal Transit Enterprise Fund. The City did record the payment of the operating lease but did not record the capital assets. This resulted in an audit adjustment to record the capital assets, corresponding depreciation expense, long-term debt and reclassify the current year payments made as principal and interest. This was caused by a lack of a comprehensive review of the significant agreements to ensure appropriate financial reporting for year-end. We recommend the City implement policies and procedures to review all significant agreements at year-end to ensure they are correctly recorded in the General Ledger.

Management's Response

Management agrees with the finding. The Finance Staff did record the lease payments for the eight trolleys but agrees with the recommendation of the auditors recording the trolleys as capital assets of the City. To remedy the issue, the Finance Division will annually review long-term lease agreements with the auditors prior to the City audit to ensure they are recorded appropriately.

Committee Comment

Some of the discrepancies identified in this audit were pointed out in previous audits. The Committee identifies that while avoidable, these inconsistencies could have been corrected with additional training.

Journal Entries Provided During the Audit

During the audit process, we typically receive adjusting journal entries after year-end as part of the closeout of the general ledger. During our review, we noticed a few journal entries we received would have resulted in inaccurate general ledger balances. This was caused by a lack of additional review to ensure they achieve the desired balances prior to providing them for the audit process. We recommend the City thoroughly review journal entries prior to providing them for correcting audit issues.

Management's Response

The City does have policies and procedures in place to ensure that journal entries are thoroughly reviewed before posting in the general ledger. The Finance Staff did record all audit adjustments accurately in the general ledger. The journal entries being described are a result of the amounts on the spreadsheets being transposed as they are manually created by staff before being transmitted to the auditors for review. However, the adjustments were recorded correctly in the City's financial system. The Finance Staff will continue to thoroughly review journal entries prior to providing to auditors.

Committee Comment

This item was also identified in last year's financial audit (FY' 18-'19), and CLA's recommendation in this category (Accounts Payable) in their FY' 18-'19 audit was identical to the audit year addressed in this report (FY' 19-'20).

Beginning Equity

Beginning equity balances for each fund should agree to the prior year-end financial statements. During our review of beginning equity, we noted funds in which the beginning equity did not agree to the prior year audited financial statements. In addition, journal entries provided by City were incorrectly posted directly to the equity accounts and required an audit adjustment to reverse those effects. This occurred due to some current year entries recorded directly to equity and some prior year adjustments that were not reflected in the general ledger. We recommend the City properly review policies and procedures to ensure all adjustments are recorded at year-end and perform a review in the next fiscal year to verify ending equity agrees to the prior year audited financial statements.

Management's Response

Management agrees with the finding. However, the journal entry to equity was to segregate out approximately \$3,437 of available funds for both our state and federal asset forfeiture accounts. As for the beginning equity, the Finance Division will review audit adjustments at

year-end to ensure they are recorded in the City's financial system and verify the equity beginning balances match the prior year audited financial statements.

Deferred Inflows of Resources, Unavailable Revenues

Governmental funds are presented using the current financial resources measurement focus and the modified-accrual basis of accounting. Their revenues are recognized when they become measurable and available. Measurable means that amounts can be estimated, or otherwise determined. Available means that the amounts were collected during the reporting period or soon enough thereafter to be available to finance the expenditures accrued for the reporting period. The City uses an availability period of 60 days for most revenues and uses an availability period of 180 days for grants. During our review of accounts receivable, we noted receivables that were received after the 60-day availability period but were not appropriately deferred as deferred inflows of resources, unavailable revenue. This resulted in an audit adjustment to decrease revenues and increase deferred inflows of resources, unavailable revenues. This was caused by a lack of review of the subsequent receipt of year-end receivables as part of the year-end closing process.

Also, the prior year balances for deferred inflows of resources, unavailable revenues, were received in fiscal year 2019-2020, but were not recorded as revenue. This resulted in an audit adjustment to reduce deferred inflows of resources, unavailable revenues, and increase revenues. This was caused by a lack of review of deferred inflows of resources, unavailable revenues during the year-end closing process.

Management's Response

The Finance Division does review revenues received as part of the year-end closing process. The revenues that were received after the 60-day availability period mostly consisted of transient occupancy taxes (TOT) that were deferred as part of the COVID-19 budget update. To ensure that revenues are properly recorded, the Finance Staff will review all receipts after the 60-day availability period and record them as unavailable revenues.

Compliance

A component of the GAS letter in achieving reasonable assurance whether the City's financial statements are free from material misstatement, CLA also tested the City's compliance with certain provisions of law, regulations, contracts, and grant agreements – noncompliance with which could have a material effect on financial statement amounts. The auditors found "...no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards."

The letter includes the statement "we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements" and, without expressing an opinion, further stated "our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*."

Committee Conclusions Regarding Internal Controls:

The audit committee notes that while the City's stated efforts in establishing more stringent policies and procedures are laudable, some of the identified discrepancies have recurred. Specifically, while the underlying causes were somewhat different, similar discrepancies identified via the audit related to Capital Assets and Accounts Payable recurred from the previous fiscal year. Further, the auditors' corresponding recommendations were brought forward during the last audit. It is important

to note, however, that these discrepancies involved, at times, a single transaction. Considering the volume of work, while not ideal, these discrepancies did not reflect a systemic problem or failure. However, the auditors pointed out the discrepancies amounted to approximately \$105,000, roughly one-tenth of one percent of the City's total cash of \$105 million. Moreover, the audit resulted in the \$105,000 discrepancy being accounted for correctly.

Notwithstanding that the upcoming financial audit will include assessing the City's performance related to its stated responses to the discrepancies outlined, the Committee's position is that the City endeavor to establish the policies mentioned in the audit procedures to ensure adherence to those policies.

3. Statement on Auditing Standards (SAS) 114

Statement on Auditing Standards No. 114 was issued to provide those charged with governance a direct communication link with the external auditors at the planning phase of the audit and the conclusion of the audit. The standard requires the auditors to communicate about eight different issues with those charged with governance. The standard does not require how this communication is provided so it is up to the auditors to choose how to comply.

CLA complied with this requirement by issuing a letter following their audit of the City for the fiscal year ended June 30, 2020. Specifically, the auditors sent the Council a letter during the planning phase of the audit dated June 10, 2020, in which they outlined their responsibilities under generally accepted auditing standards and provided information related to the planned scope and timing of the pending audit. The auditors have complied with the remainder of the reporting requirements with this letter issued with the Comprehensive Annual Financial Report.

- a. Significant Audit Findings: The auditors noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus, all significant transactions have been recognized in the financial statements in the proper period, and the financial statement disclosures are neutral, consistent, and clear.
- b. Difficulties Encountered in Performing the Audit: the auditors encountered no significant difficulties in dealing with management in performing and completing our audit.
- c. Corrected and Uncorrected Misstatements: "...the following material misstatements detected as a result of audit procedures were corrected by management":
 - i. Increase receivables and revenue for the July 2020 road maintenance and rehabilitation program payment received.
 - ii. Reduce receivables and revenue for a loan proceed drawdown that was already recorded in a separate receivable account.
 - iii. Record capital assets, depreciation expense, and long-term debt for a capital lease entered into during the fiscal year that was not recorded.
 - iv. Adjust the beginning net position to agree to the prior year's audited financial statements.
 - v. Adjust the general ledger claims payable account to agree amounts to the corresponding detail records.
 - vi. Reduce revenue and increase deferred inflows of resources, unavailable revenues, for governmental activity year-end receivables not received within the 60-day availability period.
- d. Disagreements with Management: None

- e. Management Representations: Requested representations were provided by management in its management representation letter dated February 24, 2021.
- f. Management Consultations with Other Independent Accountants: In some cases, management may decide to consult with other accountants to obtain a "second opinion" on certain situations. To the auditors' knowledge, there were no such consultations with other accountants.
- g. Other Audit Findings or Issues: The auditors noted that they discuss a variety of matters with the City each year prior to retention as the City's auditors. CLA noted that these discussions occurred in the ordinary course of their professional relationship, and their responses were not a condition to their retention.

4. Management Letter (SAS 115)

Statement on Auditing Standards No. 115 requires the auditors to communicate in writing material weaknesses and significant deficiencies in internal control that are identified during the audit process. The auditors are given the option to report other matters of internal control (i.e., "control deficiencies" or "best practices") either verbally or in writing. Clifton Larson Allen LLP (CLA) decided to issue their recommendations in writing in the City's management letter.

The Management Letter states:

"This letter does not affect our report dated February 24, 2021, on the financial statements of the City. Our comments and recommendations are intended to improve the internal control or result in other operating efficiencies."

"...we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing 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 not designed to identify all deficiencies in internal control that might be material weaknesses. 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..."

The Management Letter included recommendations from CLA regarding capitalization policy and deposits. These items are listed below. In each case, the City Staff response follows.

Deposits

Auditors' Comment and Recommendation

The City collects deposits from developers and others that are typically refundable upon satisfaction of certain City terms. In some cases, the depositor forfeits the deposit, which the City would then record as revenue. During our review of deposit payable accounts, we noted that some deposit balances are older than five years, which indicates that the deposit may need to be refunded or recognized as revenue. This comment is repeated from the prior year. We recommend the City analyze its outstanding deposits payable balances to determine the true balance of deposits payable that constitutes refundable deposits. The status of old deposits should be researched and adjusted if necessary.

Management's Response

The Community Development Department developed a plan for addressing the developer deposits older than five years to determine if they need to be refunded, remained, or recognized as revenue. Many deposits were reviewed and refunded in FY19-20. Due to the volume and complexity of reviewing developer deposits, staff will continue reviewing the deposits in FY20-21 to determine the appropriation action to take. The Community Development Department plans to have all developer deposits older than five years reviewed by June 2021.

Committee Comment:

The recurrence of this item resulted in part to the Committee's Recommendation on this topic (Section I. Executive Summary: Recommendation #3). As highlighted earlier in this report, while Community Development has made strides in preventing the recurrence of this problem, a holistic examination of processes citywide with a philosophical commitment to continuous improvement is the broader objective. Moreover, in their audit (Management 115 Letter) CLA recommended regular analysis of deposits by the Community Development Department to determine the status of deposits older than five (5) years and take appropriate action to either refund to the developer or record as revenue. As indicated earlier in our audit review, the Committee recognizes that the time and resource-intensive process recommended by CLA requires significant staff time. In the absence of that available time, the Committee recognizes the recurrence of this accounting challenge is highly likely.

V. INTERVIEW OF AUDITORS

As described in the Purpose and Methods Sections herein, a subcommittee of the City of Laguna Beach Citizens' Audit Review and Measure LL Oversight Committee interviewed the CLA Partner in charge of the City audit, Kassie Radermacher, related to their FY' 19-'20 Financial Audit. Below is a summary of the topics discussed and the responses provided by the auditors.

- 1) "Some Developer deposit balances are older than five years, which indicates the deposit may need to be refunded or recognized as revenue."
 - a) Question - The above item was also identified in previous audits. How significantly did your audit consider this repeated and continuing issue to be?
 - b) Response - We considered this to be an "other matter", which is least significant. This is not uncommon for similar municipalities, especially during the pandemic.
 - c) Question - In your experience auditing municipal finance, is the retention of deposit balances beyond five years common?
 - d) Response – Yes, it is time-consuming to research each deposit, which typically is small amounts. Plus, researching these deposits has become more challenging during the pandemic.
 - e) Question - Since this is a recurring item, was management's response adequate in terms of addressing and preventing its recurrence?
 - f) Response - Yes, but it could be a case of the City lacking the resources to perform this function; however, we do not formally comment on personnel resources.

Government Accounting Standards Letter (GAS)

- 1) Capital Lease regarding the Trolleys was not properly recorded.
 - a) Question – How were they not recorded correctly?

- b) Response – The lease payment was entered in the Income Statement as an expense, but the asset and the corresponding lease liability was not recorded on the Balance Sheet
 - c) Question – Was this a significant error?
 - d) Response – We regard this as an "other matter", as city finance departments are becoming familiar with the new accounting standards regarding the treatment of capital leases.
- 2) Regarding the Road Maintenance and Rehabilitation program revenues, you noted the City did not accrue the July 2020 Payment (*August 2019 payment not accrued last year*).
- a) Question - Can you provide an opinion on the cause of this recurring item?
 - b) Response – The State of California dictates the accrual period, which in turn identifies how far into the next fiscal year revenue needs to be accrued; in this case, the July payment should have been accrued in the FYE 6/30 financials.
 - c) Question – Was this a significant error?
 - d) Response – This was not a significant error; however, since the City was familiar with this accounting nuance from last year, we regard this as an error rather than a misunderstanding.
- 3) Multiple Journal Entries
- a) Question - You noted there were several multiple journal entries. Is this a significant matter?
 - b) Response – Not a significant matter; however, the issue could be eliminated if the Finance Department followed a double-checking process more thoroughly. Correcting multiple journal entries slows down the audit process.
- 4) Deferred Inflows of Resources
- a) Question – Can you explain your concern?
 - b) Response – City revenue can be recorded within the fiscal year if the money is expected to be received within 60-days of the FYE. If the funds are expected to be received later than 60-days following the fiscal year-end, it should be recorded as Deferred Revenue with a corresponding A/R entry.
 - c) Question – Is this something the staff should have been aware of?
 - d) Response – Yes.
- 5) Beginning Equity not equaling prior FYE Equity
- a) Question – This appears to be a repeat item; your thoughts?
 - b) Response – This is a repeat item, which we think may be caused by the software program used, which is clumsy. Again, a more thorough process of double-checking should eliminate this error.
- 6) Receivables for loan proceeds
- a) Question – Please explain your concern?
 - b) Response – When the City issues debt and is expected to receive loan proceeds, it should record an A/R with a corresponding offset liability.
 - c) Question – Is this something the staff should have been aware of?
 - d) Response – Yes.
- 7) Material Weakness versus a Significant Deficiency and Other Matters
- a) Question - Please describe the essential differences between the three?
 - b) Response – A Material Weakness is serious because it may not be identified in time to prevent a reporting issue. A Significant Deficiency is less serious, and Other Matters are even less serious.

VI. CONCLUSION

The auditors have expressed an "unmodified" opinion of the financial statements for the City's fiscal year ended June 30, 2020. "In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City, as of June 30, 2020, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America."

VII. RECOMMENDATIONS & OBSERVATIONS

A. Current Recommendations

Considering the recurring themes observed and identified by this Committee since its inception and in its audit review role, the Committee has identified that limited staffing has played a consistent role in the recurrence of minor discrepancies and Significant Deficiencies. If the City concludes the elimination of these recurring items is a priority, the Committee recommends a resource assessment which could extend beyond resources dedicated to the Finance Division be conducted to determine workload, a span of control, and responsibilities with the objective of identifying opportunities to leverage systems and existing staff and whether the impacts of additional staffing would be appreciable and cost-effective considering the City's long-term goals. Finally, a staffing analysis would include an assessment of the rate and impacts of staff turnover and attrition.

B. Observations

While the auditors identified the following six (6) significant deficiencies, it is important to note that at least two (2) of the items involved only a single transaction, and all were corrected before the completion of the Comprehensive Annual Financial Report (CAFR):

1. Significant Deficiencies

- a. Payment for the July 2020 Road Maintenance and Rehabilitation Program not being accrued
- b. Beginning equity worksheet did not agree to prior year-end financial statements
- c. Receivables for loan proceeds were mistakenly recorded twice due to an autogenerated journal entry by the accounts receivable system
- d. Payment for the operating lease of eight trolleys was recorded but not capitalized
- e. Revenues received after the 60-day availability period were recorded as receivables but not deferred
- f. Journal entries accurately recorded in the City's finance system but not properly translated on the worksheet to the auditor

2. Exemplary Performance: City Staff

- a. Finance Department: A reflection of the professional work product put forward by the City's talented Finance staff, they received the Certificate of Achievement for Excellence in Financial Reporting award for the fiscal year ended June 30, 2019, representing the 5th consecutive year they received this recognition.
- b. Community Development Department: The Committee recognizes the tremendous work and effort needed to identify and implement a long-term solution to the issue of accounting for deposits held for long periods. Recognizing the daunting task this

challenge poses, Community Development demonstrated a willingness to examine options and address the problem.

3. Addition to Staff
 - a. The Finance Department could provide more timely reporting and be better prepared for the City's annual audit if it employed additional resources.

C. Prior Year Recommendations – Follow-Up:

The following prior-year Audit Committee recommendations:

1. The City has made strides in implementing policies and procedures to ensure accuracy in the accounting of Capital Assets, Accounts Payable, and in improving the timeliness of bank reconciliations. Although discrepancies were identified in the same categories during the audit of FY 18'- '19, the errors were insignificant and involved a small number of transactions. Recommendation implemented.
2. The increase in the thresholds for purchasing and asset tracking to \$1,000 and \$5,000 respectively has relieved valuable staff time to perform more critical functions. Recommendation implemented.
3. The City has formed a committee that has a role in the selection of the independent auditor to review the Treasury investment policy and investments. The objective of this previous recommendation is to install an entity outside of, or in conjunction with, the Treasury function in the review of the agreed-upon procedures of investments and monitor the results of that review. Recommendation implemented.
4. The City has not appointed an independent Investment Committee, replacing the City Treasurer's ad hoc Investment Committee. This important follow-through would provide greater transparency and invaluable input from a group of talented and experienced residents. Recommendation not yet implemented.

The members of The Citizens' Audit Review and Measure LL Oversight Committee thank the City for its efforts in keeping the citizens of Laguna Beach informed of the financial condition of the City, and we hope the City Council and the residents of Laguna Beach will benefit from the work of this Committee. We also thank the City Council liaison Councilmember Sue Kempf, the City Treasurer, auditors from CliftonLarsonAllen LLP, and especially City Finance staff for their assistance in the production of this report. The committee members look forward to continuing to serve the interests of the community of Laguna Beach in the coming year.

Attachments:

- A. Agreed-Upon Procedures Applied to Appropriations Limit Worksheet No. 6
- B. Report on Compliance and Other Matters and on Internal Controls
- C. Statement on Auditing Standards (SAS) 114
- D. Management Letter
- E. Memo from the City Manager to the City Council

ATTACHMENT A

Agreed-Upon Procedures Applied to
Appropriations Limit Worksheet No. 6

CITY OF LAGUNA BEACH, CALIFORNIA
APPROPRIATIONS LIMIT WORKSHEET NO. 6
WITH INDEPENDENT ACCOUNTANTS' REPORT
ON AGREED-UPON PROCEDURES
APPLIED TO APPROPRIATIONS
LIMIT WORKSHEET NO. 6
FOR THE YEAR ENDED JUNE 30, 2020



INDEPENDENT ACCOUNTANTS' REPORT
ON AGREED-UPON PROCEDURES APPLIED
TO APPROPRIATIONS LIMIT WORKSHEET NO. 6

To the Honorable Mayor and
Members of the City Council
of the City of Laguna Beach
Laguna Beach, California

We have performed the procedures enumerated below to the accompanying Appropriations Limit Worksheet No. 6 of the City of Laguna Beach, California for the year ended June 30, 2020. These procedures, which were agreed to by the City of Laguna Beach, California and the League of California Cities (as presented in the League publication entitled "Article XIII-B Appropriations Limit Uniform Guidelines") were performed solely to assist the City of Laguna Beach, California in meeting the requirements of Section 1.5 of Article XIII B of the California Constitution. The City of Laguna Beach's management is responsible for the Appropriations Limit Worksheet No. 6. The sufficiency of the procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

The procedures performed and our findings were as follows:

1. We obtained the completed Worksheet No. 6 for the year ended June 30, 2020, and compared the limit and annual adjustment factors included in that worksheet to the limit and annual adjustment factors that were adopted by resolution of the City Council. We also compared the population and inflation options included in the aforementioned worksheet to those that were selected by a recorded vote of the City Council.

No exceptions were noted as a result of our performing this procedure.

2. For the accompanying Appropriations Limit Worksheet No. 6, we added last year's limit to the total adjustments, and compared the resulting amount to this year's limit. We also recalculated the adjustment factor and the adjustment for inflation and population, and compared the results to the amounts on Worksheet No. 6.

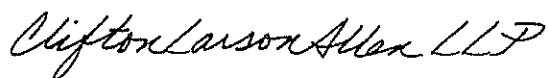
No exceptions were noted as a result of our performing this procedure.

3. We compared the prior year appropriations limit presented in the accompanying Appropriations Limit Worksheet No. 6 to the prior year appropriations limit adopted by the City Council for the prior year.

No exceptions were noted as a result of our performing this procedure.

This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. We were not engaged to, and did not, conduct an examination or review, the objective of which would be the expression of an opinion or conclusion, respectively, on the accompanying Appropriations Limit Worksheet No. 6. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you. No procedures have been performed with respect to the determination of the appropriation limit for the base year, as defined by the League publication entitled "Article XIII B Appropriations Limitation Uniform Guidelines".

This report is intended solely for the information and use of the City Council and management of the City of Laguna Beach, California and is not intended to be, and should not be, used by anyone other than these specified parties.



CliftonLarsonAllen LLP

Irvine, California
February 24, 2021

CITY OF LAGUNA BEACH
 APPROPRIATIONS LIMIT WORKSHEET NO. 6
 FOR THE YEAR ENDED JUNE 30, 2020

Appropriations limit for fiscal year ended June 30, 2019 (Note 2) \$ 60,554,676

Adjustment factors for the fiscal year ended June 30, 2020 (Note 2):

	<u>Inflation Factor (Note 3)</u>	<u>Population Factor (Note 4)</u>	<u>Combined Factor</u>	
	1.0385	1.0029	1.0415	x <u>0.0415</u>
Adjustment for inflation and population				2,513,019
Other adjustments (Note 5)				<u>-</u>
Total adjustments				<u>2,513,019</u>
Appropriations limit for fiscal year ended June 30, 2020				<u>\$ 63,067,695</u>

See accompanying Notes to Appropriations Limit Worksheet No. 6

CITY OF LAGUNA BEACH

NOTES TO APPROPRIATIONS LIMIT WORKSHEET NO. 6

FOR THE YEAR ENDED JUNE 30, 2020

1. PURPOSE OF LIMITED PROCEDURES REVIEW:

Under Article XIII B of the California Constitution (the Gann Spending Limitation Initiative), California governmental agencies are restricted as to the amount of annual appropriations from proceeds of taxes. Effective for years beginning on or after July 1, 1990, under Section 1.5 of Article XIII B, the annual calculation of the appropriations limit is subject to a limited procedures review in connection with the annual audit.

2. METHOD OF CALCULATION:

Under Section 10.5 of Article XIII B, for fiscal years beginning on or after July 1, 1990, the appropriations limit is required to be calculated based on the limit for the fiscal year 1986-87, adjusted for the inflation and population factors discussed at Notes 3 and 4 below.

3. INFLATION FACTORS:

A California governmental agency may adjust its appropriations limit by either the annual percentage change in the 4th quarter per capita personal income (which percentages are supplied by the State Department of Finance), or the percentage change in the local assessment roll from the preceding year due to the change of local nonresidential construction. The factor adopted by the City of Laguna Beach (the City) for fiscal year 2019-2020 represents the annual percentage change for per capita personal income.

4. POPULATION FACTORS:

A California governmental agency may adjust its appropriations limit by either the annual percentage change of the jurisdiction's own population, or the annual percentage change in population in the County where the jurisdiction is located. The factor adopted by the City for fiscal year 2019-2020 represents the annual percentage change in population for the County in which City is located.

5. OTHER ADJUSTMENTS:

A California governmental agency may be required to adjust its appropriations limit when certain events occur, such as the transfer of responsibility for municipal services to, or from, another governmental agency or private entity. The City had no such adjustments for the year ended June 30, 2020.

ATTACHMENT B

Report on Compliance and Other
Matters and on Internal Controls



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 City Council
of the City of Laguna Beach
Laguna Beach, 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, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Laguna Beach, California (the City), as of and for the year ended June 30, 2020, and the related notes to the basic financial statements, which collectively comprise the City's basic financial statements and have issued our report thereon dated February 24, 2021.

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 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 and therefore, material weaknesses or significant deficiencies may exist that were not 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 certain deficiency in internal control, described below, that we consider to be a significant deficiency.

Year-End Closing Procedures

Auditors' Comment and Recommendation

Sound internal control processes are required to ensure the books are closed and available for audit. For the year ended June 30, 2020, the audit detected several items in the accounting records that required adjustment including the following:

Receivables

During our review of road maintenance and rehabilitation program (RMRA) revenues, we noted the City did not accrue the July 2020 payment. After several revisions to journal entries provided, this resulted in an audit adjustment to increase receivables and revenues. This was caused by a lack of additional procedures to ensure the completeness of RMRA revenues recorded in the general ledger. We recommend the City properly review RMRA revenues to ensure the completeness of the revenue recorded in the general ledger.

Receivables for Loan Proceeds

The City has some loans for which the proceeds have not yet been drawn down, which are appropriately recorded as receivables. During our review of these receivables, we noted that drawdowns for the current year that had not yet been received as of year-end were accrued a second time in a separate receivable account and recorded as revenue. This resulted in an audit adjustment to reduce receivables and revenue in the Sewer Enterprise Fund and was caused by a lack of additional procedures to ensure that the receivables for loan proceeds were not double counted. We recommend the City track the drawdown of loan proceeds throughout the year and reduce the receivable as proceeds are received. Any amounts outstanding as of year-end have already been included in the original receivable balance.

Capital Lease

During fiscal year 2019-2020, the City purchased eight trolleys through a capital lease, which should be recorded as long-term debt and capital assets in the Municipal Transit Enterprise Fund. The City did record the payment of the operating lease but did not record the capital assets and long-term debt. This resulted in an audit adjustment to record the capital assets, corresponding depreciation expense, long-term debt, and reclassify the current year payments made as principal and interest. This was caused by a lack of a comprehensive review of the significant agreements to ensure appropriate financial reporting for year-end. We recommend the City implement policies and procedures to review all significant agreements at year-end to ensure they are correctly recorded in the General Ledger.

Journal Entries Provided During the Audit

During the audit process, we typically receive adjusting journal entries after year-end as part of the closeout of the general ledger. During our review, we noticed a few journal entries we received that would have resulted in inaccurate general ledger balances. This was caused by a lack of additional review to ensure they achieve the desired balances prior to providing them for the audit process. We recommend the City thoroughly review journal entries prior to providing them for correcting audit issues.

Year-End Closing Procedures (Continued)

Auditors' Comment and Recommendation (Continued)

Our audit resulted in audit adjustments to the general ledger, which are as follows (continued):

Beginning Equity

Beginning equity balances for each fund should agree to the prior year financial statements. During our review of beginning equity, we noted funds in which the beginning equity did not agree to the prior year audited financial statements. In addition, journal entries provided by City were incorrectly posted directly to the equity accounts and required an audit adjustment to reverse those effects. This occurred due to some current year entries recorded directly to equity and some prior year adjustments that were not reflected in the general ledger. This comment is repeated from the prior year. We recommend the City properly review policies and procedures to ensure all adjustments are recorded at year-end and perform a review in the next fiscal year to verify ending equity agrees to the prior year audited financial statements.

Deferred Inflows of Resources, Unavailable Revenues

Governmental funds are presented using the current financial resources measurement focus and the modified-accrual basis of accounting. Their revenues are recognized when they become measurable and available. Measurable means that amounts can be estimated, or otherwise determined. Available means that the amounts were collected during the reporting period or soon enough thereafter to be available to finance the expenditures accrued for the reporting period. The City uses an availability period of 60 days for most revenues and uses an availability period of 180 days for grants. During our review of accounts receivable, we noted receivables that were received after the 60-day availability period but were not appropriately deferred as deferred inflows of resources, unavailable revenue. This resulted in an audit adjustment to decrease revenues and increase deferred inflows of resources, unavailable revenues. This was caused by a lack of review of the subsequent receipt of year-end receivables as part of the year-end closing process.

Also, the prior year balances for deferred inflows of resources, unavailable revenues, were received in fiscal year 2019-2020, but were not recorded as revenue. This resulted in an audit adjustment to reduce deferred inflows of resources, unavailable revenues, and increase revenues. This was caused by a lack of review of deferred inflows of resources, unavailable revenues during the year-end closing process.

Management's Response

Receivables:

The City has policies and procedures in place to ensure that revenues are recorded within the fiscal year. The Finance Staff did record twelve payments for the Fiscal Year 2019-20 (July 2019 – June 2020) for the road maintenance and rehabilitation program (RMRA). RMRA revenues are unique because the State Controller's Office considers the payment collected for July 2020 as a payment for Fiscal Year 2019-20. Next year, the Finance Staff will match the City's general ledger to the State Controller's Office RMRA annual report to ensure that the correct monthly payments are recorded.

Year-End Closing Procedures (Continued)

Management's Response (Continued)

Receivables for Loan Proceeds:

Management agrees that drawdowns of loan proceeds must be recorded as a reduction to the receivable when the funds are received. The City has been diligent in ensuring that all loans are properly recorded in the general ledger and all drawdowns are accounted for. The receivable account that is used for the loan was correct at year-end. The separate receivable the auditors are describing was a result from the City accounts receivable system auto-generating a receivable when the Finance Staff created an invoice at the request of the lending institution. The Finance staff feels this error is an isolated incident and that existing internal controls should prevent this finding in the future.

Capital Lease:

Management agrees with the finding. The Finance Staff did record the lease payments for the eight trolleys but agrees with the recommendation of the auditors recording the trolleys as capital assets of the City. To remedy the issue, the Finance Division will annually review long-term lease agreements with the auditors prior to the City audit to ensure they are recorded appropriately.

Journal Entries Provided During the Audit:

The City does have policies and procedures in place to ensure that journal entries are thoroughly reviewed before posting in the General Ledger. The Finance Staff did record all audit adjustments accurately in the General Ledger. The journal entries being described are a result of the cover sheets being transposed as they are manually created by staff. However, the adjustments were recorded correctly in the City's financial system. The Finance Staff will continue to thoroughly review journal entries prior to providing to auditors.

Beginning Equity:

Management agrees with the finding. However, the journal entry to equity was to segregate out approximately \$3,437 of available funds for both our state and federal asset forfeiture accounts. As for the beginning equity, the Finance Division will review audit adjustments at year-end to ensure they are recorded in the City's financial system and verify the equity beginning balances match the prior year audited financial statements.

Deferred Inflows of Resources, Unavailable Revenues:

The Finance Division does review revenues received as part of the year-end closing process. The revenues that were received after the 60-day availability period mostly consisted of transient occupancy taxes (TOT) that were deferred as part of the COVID-19 budget update. To ensure that revenues are properly recorded, the Finance Staff will review all receipts after the 60-day availability period and record them as unavailable revenues.

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*.

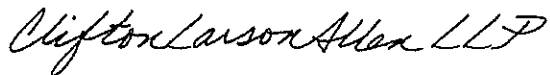
We noted certain other matters that we have reported to management and the City Council in a separate letter dated February 24, 2021.

City's Response to Finding

The City's response to the finding identified in our audit is described above. 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 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

Irvine, California
February 24, 2021

ATTACHMENT C

Statement on Auditing Standards
(SAS) 114



The Honorable City Council
of the City of Laguna Beach
Laguna Beach, California

We have audited the financial statements of the governmental activities, business-type activities, the discretely presented component unit, each major fund, and aggregate remaining fund information of the City of Laguna Beach, California (the City) as of and for the year ended June 30, 2020. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards* as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated June 10, 2020. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended June 30, 2020. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

The most sensitive estimates affecting the City's financial statements were as follows:

- a. The annual required contributions, pension expense, net pension liability and corresponding deferred outflows of resources and deferred inflows of resources for the City's public defined benefit pension plans with CalPERS are based on actuarial valuations provided by CalPERS.

Significant Audit Findings (Continued)

Qualitative Aspects of Accounting Practices (Continued)

Sensitive Estimates (continued):

- b. The Other Post-Employment Benefit Plan (OPEB) expense, total OPEB liability, and corresponding deferred outflows of resources and deferred inflows of resources for the City's OPEB plan are based several key assumptions that are set by management with the assistance of an independent third-party actuary. These key assumptions include anticipated investment rate of return, health care cost trends, mortality and certain amortization periods.
- c. Management's estimate of the claims payable liabilities related to general liability and workers' compensation claims are based on estimates by the claims administrators.

We evaluated the key factors and assumptions used to develop these estimates in determining that they were reasonable in relation to the financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were reported in Note 6 regarding the City's claims payable, Note 11 regarding the City's other post-employment benefits plan, Note 14 regarding the CalPERS defined benefit plan, and Note 17 regarding related party transactions.

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit other than the final closing of the books for the audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements.

In addition, the following significant misstatements detected as a result of audit procedures were corrected by management:

- Increase receivables and revenue for the July 2020 road maintenance and rehabilitation program payment received.
- Reduce receivables and revenue for a loan proceed drawdown that was already recorded in a separate receivable account.
- Record capital assets, depreciation expense, and long-term debt for a capital lease entered into during the fiscal year that was not recorded.

Significant Audit Findings (Continued)

Corrected and Uncorrected Misstatements (Continued)

In addition, the following significant misstatements detected as a result of audit procedures were corrected by management (continued):

- Adjust the beginning net position to agree to the prior year audited financial statements.
- Adjust the general ledger claims payable account to agree amounts to the corresponding detail records.
- Reduce revenue and increase deferred inflows of resources, unavailable revenues, for governmental activity year-end receivables not received within the 60-day availability period.

Disagreements with Management

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditors' report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated February 24, 2021.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Matters

We applied certain limited procedures to management's discussion and analysis, the schedule of proportionate share of the net pension liability - safety plan, the schedule of contributions - safety plan, the schedule of changes in the net pension liability and related ratios - miscellaneous plan, the schedule of contributions - miscellaneous plan, the schedule of changes in the total OPEB liability and related ratios, and the schedule of revenues, expenditures and changes in fund balance - budget and actual for the general fund, which are required supplementary information (RSI) that supplements the basic financial statements.

Other Matters (Continued)

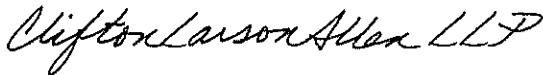
Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the consolidating general fund financial statements, individual general fund sub-fund budgetary comparison schedules, major capital projects fund budgetary comparison schedule, combining and individual nonmajor fund financial statements and budgetary comparison schedules (supplementary information), which accompany the basic financial statements but are not RSI. With respect to this supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the basic financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the basic financial statements or to the basic financial statements themselves.

We were not engaged to report on the introductory and statistical sections, which accompany the basic financial statements but are not RSI. We did not audit or perform other procedures on this other information and we do not express an opinion or provide any assurance.

Restriction on Use

This information is intended solely for the information and use of City Council and management of the City, and is not intended to be, and should not be, used by anyone other than these specified parties.



CliftonLarsonAllen LLP

Irvine, California
February 24, 2021

ATTACHMENT D

Management Letter



To the Honorable City Council
of the City of Laguna Beach
Laguna Beach, California

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Laguna Beach, California (the City) as of and for the year ended June 30, 2020, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing 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 City's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. 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. As discussed below, we identified certain matters involving the internal control and other operational matters that are presented for your consideration. This letter does not affect our report dated February 24, 2021, on the financial statements of the City. Our comment and recommendation is intended to improve the internal control or result in other operating efficiencies.

Our comment with our recommendation for improvement is summarized as follows:

Deposits

Auditors' Comment and Recommendation

The City collects deposits from developers and others that are typically refundable upon satisfaction of certain City terms. In some cases, the depositor forfeits the deposit, which the City would then record as revenue. During our review of deposit payable accounts, we noted that some deposit balances that are older than five years, which indicates that the deposit may need to be refunded or recognized as revenue. This comment is repeated from the prior year. We recommend the City analyze its outstanding deposits payable balances to determine the true balance of deposits payable that constitutes refundable deposits. Status of old deposits should be researched and adjusted if necessary.

Management's Response

The Community Development Department developed a plan for addressing the developer deposits older than five years to determine if they need to be refunded, remained, or recognized as revenue. Many deposits were reviewed and refunded in FY19-20. Due to the volume and complexity of reviewing developer deposits, staff will continue reviewing the deposits in FY20-21 to determine the appropriation action to take. The Community Development Department plans to have all developer deposits older than five years reviewed by June 2021.

City's Response to the Finding

The City's response to the findings identified in our audit is described above. 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.

This communication is intended solely for the information and use of management, the City Council, and others within the City, and is not intended to be, and should not be, used by anyone other than these specified parties.



CliftonLarsonAllen LLP

Irvine, California
February 24, 2021

ATTACHMENT E

Memo from the City Manager to the
City Council



City of Laguna Beach
MEMORANDUM

Date: May 24, 2021
To: City Council
From: John Pietig, City Manager
Subject: Comprehensive Annual Finance Report and Audit Compliance Letters

Dear City Council Members,

This Letter serves to transmit the Comprehensive Annual Financial Report (CAFR) for the Year Ended June 30, 2020 (CAFR), along with each of the required four audit letters. The City's financial statements have been audited by CliftonLarsonAllen LLP and comply with Generally Accepted Accounting Principles (GAAP) and received an unqualified opinion.

Four audit letters accompany the CAFR. The *Management Letter and Report on Internal Control over Financial Reporting and on Compliance with other Matters Letter* provide an assessment of the City's internal controls over the financial reporting. The *GANN Limit Letter* provides an assessment of the City's compliance with the GANN limit, and the *Statement of Auditing Standards (SAS) No 114 Report* meets an audit requirement to confirm direct communication of the audit results to the City Council.

The letters noted seven findings that included: continuing the City's effort toward a timely refund of community development deposits; the necessity to make corrections to revenue accruals; corrections to an iBank loan payment; recording the lease of seven trolleys as a capital asset; and the need to correct staff-prepared Microsoft Excel worksheets so that it agreed to the general ledger. None of these items are considered material misstatements and each issue was addressed during the audit before the release of the financial statements.

The following sections provide more details regarding each audit letter and discuss the findings identified during the audit in greater detail. If you have any questions, please contact Gavin Curran. A copy of this same information has also been provided to the Citizens' Audit Review and Measure LL Oversight Committee.

MANAGEMENT LETTER

Statement on Auditing Standards No. 115 requires the auditors to communicate in writing material weaknesses and significant deficiencies in internal control that are identified during the audit process. The auditors are also given the option to report other matters of internal control (i.e., "control deficiencies" or "best practices") either verbally or in writing. CliftonLarsonAllen LLP decided to issue their recommendation(s) in writing in the City's management letter.

This management letter did not identify any material weaknesses to our internal controls but did include one procedure the auditors recommended for improvement. The recommendation was to regularly analyze community development deposits to determine the status of deposits older than five years and take the appropriate action to refund or record as revenue. The Community Development Department and Finance Staff have implemented a plan to perform a comprehensive analysis of developer deposits and determine if older deposits should remain, be refunded, or recognized as revenue. The Finance staff anticipates having all developer deposits older than five years reviewed by June 30, 2021.

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS

This report is required to be issued for all audits performed in accordance with Government Auditing Standards (GAS). The standards require that the auditors disclose material issues of noncompliance as well as material weaknesses and significant deficiencies in internal control over financial reporting that might have come to the auditor's attention during the audit process. A significant deficiency is a single weakness in internal controls associated with financial reporting that is less severe than a material weakness yet important enough to merit attention by the auditors.

The auditors reported no material weaknesses. However, this year's GAS letter included six significant deficiencies to internal controls that were corrected during the audit and before the CAFR was completed. Those significant deficiencies included 1) a payment for the July 2020 Road Maintenance and Rehabilitation Program not being accrued, 2) a receivable for a loan proceed mistakenly recorded twice due to an autogenerated journal entry by the accounts receivable system, 3) payment for the operating lease of eight trolleys recorded but not capitalized, 4) beginning equity worksheet not agreeing to prior year financial statements, 5) journal entries accurately recorded in the City's finance system but not properly translated on the worksheet to the auditor, and 6) revenues received after the 60-day availability period recorded as receivables but not deferred. The Finance staff has implemented several changes to correct the deficiencies as indicated in the management response of the GAS letter, including a secondary review of accounts receivables after all year-end closing entries are posted, a reconciliation comparing schedules and journal entry worksheets to the general ledger prior to providing to auditors, and a thorough review of all revenues received after the 60-day availability period.

AGREED-UPON PROCEDURES APPLIED TO APPROPRIATIONS LIMIT WORKSHEET

This report outlines specific procedures the auditors are required to do concerning the City's Appropriations Limit Calculation each year. The auditors reviewed and compared the 2019-20 limit and annual adjustment factors that were adopted by resolution by the City Council. This report is necessary to meet Section 1.5 of Article XIII B, which requires that the annual appropriations limit calculation be reviewed as part of the local government's annual financial audit. No findings were noted.

STATEMENT ON AUDITING STANDARDS (SAS) NO. 114 REPORT

Statement on Auditing Standards No. 114 was issued a few years ago to provide those charged with governance a direct communication link with the external auditors at the planning phase of the audit and the conclusion of the audit. The Letter is required to meet this requirement.

CC: Shohreh Dupuis, Assistant City Manager
Gavin Curran, Director of Administrative Services
Citizens' Audit Review and Measure LL Oversight Committee