

City of Laguna Beach
AGENDA BILL

17

No. 17

Meeting Date: 11/13/18

SUBJECT: CITIZENS' AUDIT REVIEW AND MEASURE LL OVERSIGHT COMMITTEE REPORT ON THE RESULTS OF THE FISCAL YEAR 2016-17 AUDIT

SUMMARY OF THE MATTER:

The Citizens' Audit Review and Measure LL Oversight Committee ("Committee") is pleased to present the report on the Results of the Review of the City's Comprehensive Annual Financial Report (CAFR) for the Fiscal Year Ended June 30, 2017 ("Report").

In preparing the report, the Committee reviewed the City's CAFR, the four audit compliance letters, and auditor findings for the fiscal year ended June 30, 2017. The Committee met with and had discussions with City staff, the City Treasurer, and the auditors. 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.

The auditors expressed an "unmodified" opinion of the City's Fiscal Year 2016-2017 financial statements and noted no material weaknesses in internal controls. The auditors did identify four internal control deficiencies and made four recommendations to improve the internal controls over payroll, capitalization of fixed assets, and refundable deposits. The City accepted and implemented the auditor's recommendations and the City's response to each finding is included on pages 8 through 12 of the report.

In summary, the Committee is requesting the City Council consider the following recommendations: 1) implement the City staff responses to the audit letter comments; 2) consider expansion of the Auditor's responsibilities to review internal controls; 3) consider developing formal procedures for public input regarding accounting or audit matters, such as a city hotline; 4) consider the auditor's recommendation of having the Treasury functions outside review of Agreed-Upon Procedures done annually rather than bi-annually and have an entity outside of the Treasury function select the firm that will conduct the review and monitor the results of the review.

RECOMMENDATION: The Citizens' Audit Review and Measure LL Oversight Committee recommends 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 2016-17; and 2) consider implementing the Committee's recommendations.

Appropriations Requested: \$ _____

Fund: _____

Attachments: Committee Report

Submitted by: Nancy Pauley
Nancy Pauley, Finance Officer
Coordinated with: Gavin Curran
Gavin Curran, Director of Admin Services

Approved: Stephen Gu
City Manager

Report on the Results of the Fiscal Year 2016-17 Audit

November 13, 2018

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

Citizens' Audit Review and Measure LL Oversight Committee

November 13, 2018

City Council Members
City of Laguna Beach

Re: Report from The Citizens' Audit Review and Measure LL Oversight Committee

This is a report from the newly formed Citizens' Audit Review and Measure LL Oversight Committee which is made up of appointed citizen volunteers. Our committee met several times to clarify our duties and understand the direction of the report. We met with staff and the auditors. A subcommittee was formed based on the information that was derived from the committee members and from public input. The subcommittee had a conference call with the auditors without staff and the following was the result of these efforts.

Summary

- Opinion: The auditors have expressed an "unmodified" opinion of the City's Fiscal Year 2016-2017 financial statements,
- Audit Compliance Letter comments: Four audit compliance letters accompany the audit with a number of comments and recommendations, which have been addressed, and which are more fully addressed in this report.
- Other Issues of note from the Comprehensive Annual Financial Report:
 - Sensitivity Analysis: Notes to the audit include an analysis of the sensitivity of changes in the CalPERS Discount Rate on the city's the net pension liability. The city's net pension liability (unfunded liability) for the year ended June 30, 2017 is \$59.6 million based on a discount rate of 7.65%. Note 14 includes a calculation of sensitivity of the net pension liability to changes in the discount rate which demonstrates that a one percent increase or decrease in the discount rate results in a change to the Laguna Beach Net Pension Liability of approximately \$30,000,000. The sensitivity analysis demonstrates volatility in the long-term obligations of the City due to factors that are outside its control, but that should be taken into consideration for prudent financial planning purposes. Note 14 further explains that CalPERS has voted to lower its discount rate from 7.5% to 7.0% over three years beginning in fiscal year 2018.
- Recommendations:
 - Implement the City staff responses to audit letter comments
 - Consider expansion of the Auditor's responsibility to review internal controls.
 - Consider developing formal procedures for public input regarding accounting or audit matters, such as a city hotline.
 - Consider the auditors' recommendation of having the Treasury function's outside review of Agreed Upon Procedures done annually rather than bi-annually. Also, we recommend that an entity outside of the Treasury function itself select the firm that will conduct the review and monitor the results of the review.

It should also be noted that the auditors commended the city staff for their responsiveness and The City of Laguna Beach for setting up a Citizens' Audit Review Committee saying that few cities do that.

The duties of this committee and the report itself are focused narrowly on the basic audit review responsibilities laid out in the resolution establishing the committee. Those responsibilities include: reviewing the results of the annual financial audit; and reviewing any internal controls and legal compliance issues identified in the course of the annual financial audit, and provide any necessary recommendations to the City Council.

However, in the process of this review, discussions of the committee, and input from the public, the observation was made that while formation of this committee is commendable, the focus is narrow, and there are other cities that have finance and/or investment committees that have broader scope.

Considering the talent in the Laguna Beach population that seems willing to work for the City at no cost, the City might want to consider investigation into the possible future formation of a citizens' finance committee and/or a citizens' investment committee.

At this time, we would like to thank the council for giving us the opportunity to conduct the first review of this kind and look forward to hearing your feedback after you review the complete report.

Submitted by:
The Citizens' Audit Review and Measure LL Oversight Committee

Anne McGraw, Chair

**Report on the Results of the Review of the
City's Comprehensive Annual Financial Report (CAFR)
For the Fiscal Year Ended June 30, 2017**

**Report Presented November 13, 2018
To the Laguna Beach City Council**

Mayor Kelly Boyd
Mayor Pro Tem Rob Zur Schmiede
Councilmember Steve Dicterow
Councilmember Toni Iseman
Councilmember Bob Whalen

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

Anne McGraw -- Chair
John Thomas -- Co-Chair
Julian Harvey
Matt Lawson
Charity Morsey
Deborah Schlesinger
Peter Stevenson

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Purpose of this Report: The purpose of this report is to convey to the City Council the results of the first review of the City's Comprehensive Annual Financial Report (CAFR) by the Citizens' Audit Review and Measure LL Oversight Committee.

Executive Summary:

- Opinion: The auditors have expressed an "unmodified" opinion of the City's Fiscal Year 2016-2017 financial statements,
- Audit Compliance Letter comments: Four audit compliance letters accompany the audit with a number of comments and recommendations, which have been addressed, and which are more fully addressed in this report.
- Other Issues of note from the Comprehensive Annual Financial Report:
 - Sensitivity Analysis: Notes to the audit include an analysis of the sensitivity of changes in the CalPERS Discount Rate on the city's the net pension liability. The city's net pension liability (unfunded liability) for the year ended June 30, 2017 is \$59.6 million based on a discount rate of 7.65%. Note 14 includes a calculation of sensitivity of the net pension liability to changes in the discount rate which demonstrates that a one percent increase or decrease in the discount rate results in a change to the Laguna Beach Net Pension Liability of approximately \$30,000,000. The sensitivity analysis demonstrates volatility in the long-term obligations of the City due to factors that are outside its control, but that should be taken into consideration for prudent financial planning purposes. Note 14 further explains that CalPERS has voted to lower its discount rate from 7.5% to 7.0% over three years beginning in fiscal year 2018.
- Recommendations:
 - Implement the City staff responses to audit letter comments
 - Consider expansion of the Auditor's responsibility to review internal controls.
 - Consider developing formal procedures for public input regarding accounting or audit matters, such as a city hotline.
 - Consider the auditors' recommendation of having the Treasury function's outside review of Agreed Upon Procedures done annually rather than bi-annually. Also, we recommend that an entity outside of the Treasury function itself select the firm that will conduct the review and monitor the results of the review.

Background:

At its December 16, 2016, meeting the City Council voted 5/0 to approve Resolution 16.102 establishing the Measure LL Fund and to create the Citizens' Measure LL Audit Oversight Committee.

At its January 23, 2018, meeting, the City Council expanded the role of the Citizens' Measure LL Oversight Committee to include certain responsibilities related to the Comprehensive Annual Financial Report and changed the name of the committee to the Citizen' Audit Review and Measure LL Oversight Committee. Resolution 18.009 reflects these changes.

Purpose of the Committee and Scope of 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. Participating in the selection of the City's external financial auditors;
2. Reviewing 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. Reviewing annually the expenditures of the Measure LL Fund and providing a subsequent public report for distribution to the City Council

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. An audit committee also provides a forum separate from management in which auditors and other interested parties can candidly discuss concerns. 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 objectively assess management's practices, and that the independent auditors, through their own review, objectively assess the government's financial reporting practices.

It is the responsibility of the audit committee 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 above, selection of the City's external auditors was completed prior to expansion of the role of this committee, and item #4 was addressed in a separate report pertaining to Measure LL dated February 27, 2018.

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 in the course of the annual financial audit, and provide any necessary recommendations to the City Council.

Methodology:

The full committee met a number of times and a sub-committee was formed to draft this report.

Members of the public attended a number of these meetings and provided input.

The members of the committee reviewed the Certified Annual Financial Report including supplemental material and the Audit Compliance letters provided by the Auditors White Nelson Diehl Evans LLP. The committee also reviewed the audit plan for the White Nelson Diehl Evans LLP audit of the fiscal year ended June 30, 2017 and the four audit letters from the Vavrinek, Trine, Day and Co. LLP, the auditors for the prior fiscal year ended June 30, 2016. The subcommittee also discussed with the auditors the most recent review of Agreed Upon procedures pertaining to the Treasury function by Vavrinek, Trine, Day and Co. LLP and reviewed two examples of the Monthly City Treasurer's Report.

The committee met with staff and members of the audit firm, and members of the sub-committee had conversations with staff, the City Treasurer, and City Council liaison to the committee. A sub-committee also discussed the Audit Compliance letters and other issues with the auditors without city staff being present.

As this is the first review of the City's Comprehensive Annual Financial Report (CAFR) by the Citizens' Audit Review and Measure LL Oversight Committee, the committee also reviewed examples of reports by oversight committees from other cities and the subcommittee discussed the topic with the auditors.

In that regard, the auditors commended the City of Laguna Beach for setting up a Citizens Audit Review Committee saying few cities do so.

Findings:

The City's financial statements were audited by White Nelson Diehl.

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.
- The independent auditor concluded, based upon the audit, that there was a reasonable basis for rendering an unmodified opinion that the City's financial statements for the fiscal year ended June 30, 2017, were fairly presented in conformity with GAAP (generally accepted accounting principles.)

The Independent Auditors' Report includes the following Opinion:

- 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, 2017, 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.

In addition to the audit of the city's financial statements themselves, the auditors also provided four audit compliance letters, the purpose of which are explained in the attached January 17, 2017 memo.

Findings: Audit Compliance Letters

1. Agreed-Upon Procedures Applied to Appropriations Limit Worksheets

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, 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

This report is required to be issued for all audits performed in accordance with *Government Auditing Standards*. 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.

While the scope of the audit assignment does not include an opinion of the effectiveness of the City's internal control, the letter does distinguish between significant deficiencies and material deficiencies (which are considered more severe) and states that "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."

Excerpts from the letter:

Auditors Comments and Recommendations:

- a) Capital Assets – We (the auditors) – identified certain capital improvement projects, where construction was completed and the projects were placed in service; however, the asset value had not been transferred from the Capital Asset classification "Construction in Progress" (CIP) to the appropriate Capital Asset category (e.g. Infrastructure, improvements, etc.). We recommend that during the year, City departments review and/or determine if CIP projects are completed and the

Accounting Division is promptly notified to ensure accurate financial reporting and proper accounting of capital project inventory.

- *City Staff Response: Over the next year, the City Finance Staff will implement procedures to have City departments review the construction in progress projects listing and determine if the projects are completed and should be reclassified to the appropriate asset category.*
- b) Retentions Payable – "...we noted that the City records construction invoices at their net costs and does not record the liability for retentions payable. We recommend that the City record invoices at the gross amount with the retention recorded as a liability."
- *City Staff Response: The City Finance Staff will implement additional internal control procedures, including requiring City departments to provide annually to the Finance staff a list of open construction projects and related retentions payable at the end of the fiscal year.*
- c) Non-refundable Deposits – "The City collects deposits from developers and others that may not be refundable and are restricted to a specific purpose. We recommend the City record nonrefundable amounts received that are restricted to a specific purpose as revenue upon receipt and implement policies and procedures to allow tracking of the usage of these funds."
- *City Staff Response: The City Finance Staff has implemented the recommended change.*
- d) Bank Reconciliations – "...we noted that the bank reconciliations ending balances did not agree to the general ledger due to two main issues:
 - i) The general bank reconciliation reconciled the balances of cash and investments held in financial institutions to the City's Treasurer Report; however, the fair market value adjustment for investments was not recorded in the general ledger.
 - ii) The bank reconciliation for the recreation account showed a different balance than that reported in the general ledger since amounts received as of year-end for April through June recreation classes and services was recorded as a receivable instead of an increase to cash.
- *City Staff Response: The City Finance Staff has implemented the recommended change.*

It was noted that while the audit compliance letter stated "The City Finance Staff has implemented the recommended change", the actual wording of the letter did not include a specific recommended change. This was brought to the attention of the staff by the sub-committee, asking for clarification, and the staff response was:

The reason(s) we commented "The City Finance Staff has implemented the recommend changes" are:

- *For item #1: The response was intended to indicate that for FY 2017-18 staff will confirm that the adjustment to fair market is done prior to the start of audit fieldwork. Last year, this adjustment was done during fieldwork when the auditors were onsite.*
- *For item #2, as recommended by the Auditors, staff is now recording year-end recreation activity as an increase in cash and a deferred revenue. By making this change, the bank reconciliation for the recreation account does agree to the general ledger at year-end.*

Compliance and Other Matters:

- 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*."

The letter stated that certain other matters were reported in a separate letter ("the Management Letter") dated December 28, 2017 and described below.

3. SAS-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 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.

White Nelson Diehl Evans LLP practice has been to comply with the standard by making these communications in writing. For fiscal year 2017, the auditors sent the Council a letter during the planning phase of the audit (dated July 18, 2017) and have complied with the remainder of the reporting requirements with this letter issued with the CAFR.

Topics addressed in the letter include: Significant Audit findings; Qualitative Aspects of Accounting Practices including sensitive estimates; Difficulties Encountered in Performing the Audit; Corrected and Uncorrected Misstatements; Disagreements with Management; Management Representations; Management Consultations with Other Independent Accountants; Other Audit Findings or Issues; Other Matters; Upcoming Changes in Accounting Standards and Regulatory Updates; Procurement Rules under Uniform Guidance; Other Postemployment Benefit Standards; Restriction on Use;

Topics addressed in the letter with selected comments include:

- 1) Significant Audit findings
 - a) Qualitative Aspects of Accounting Practices including sensitive estimates;
 - i) Auditors noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus.
 - ii) All significant transactions have been recognized in the financial statements in the proper period.
 - iii) The financial statement disclosures are neutral, consistent, and clear.
 - b) Difficulties Encountered in Performing the Audit;
 - i) Auditors encountered no significant difficulties in dealing with management in performing and completing our audit.
 - c) Corrected and Uncorrected Misstatements;
 - i) The letter notes one uncorrected misstatement which Management has determined is immaterial, and four material misstatements that were corrected by management.
 - d) Disagreements with Management; None
 - e) Management Representations: Requested representations were provided by Management.
 - 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; None noted
- 2) Other Matters: Describes additional activities by auditors without expressing opinion.
- 3) Upcoming Changes in Accounting Standards and Regulatory Updates;
 - a) Procurement Rules under Uniform Guidance;
 - i) Commencing with the fiscal year 2018-2019 audits, auditors will request the written policies for all single audits and reviewing the procurement policies and procedures for compliance with the Uniform Guidance procurement rules.
 - b) Other Postemployment Benefit Standards;

- i) Starting with fiscal year ending June 30, 2018, governments are required to report a net OPEB (other postemployment benefits) liability or asset on the face of the financial statements.

4. Management Letter

Statement on Auditing Standards No. 115 requires the auditors 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. White Nelson Diehl Evans LLP 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 December 28, 2017, on the financial statements of the City. Our comments and recommendations are intended to improve the internal control or result in other operating efficiencies."

The Management Letter included several recommendations from White Nelson Diehl Evans LLP. Those included a recommendation to improve internal controls over the review of payroll employee changes, segregation of cash disbursement duties, adopt a capitalization policy and analyze outstanding deposit refundable deposits. These items are listed below. In each case, the City Staff response follows.

a) Segregation of Duties

- i) Payroll —...personnel assigned to prepare and process the payroll have access to the payroll database to make changes including pay rates and adding new employees. The personnel will document any changes in pay rates or the addition of new employees in a manual log that is reviewed and approved by an employee outside of the payroll process. However, given the manual nature of this log, it is possible for a change to be made and not be included in the log. We recommend the City utilize an employee change report generated from the payroll system during the review of payroll to ensure all employee changes can be reviewed by an employee outside of the payroll process.

- *City Staff Response: The Finance Division will implement additional internal control procedures including working with the finance system software developers to create a report that lists all employee changes and is reviewed by a manager outside of the payroll entry process.*

- ii) Cash Disbursements — "...personnel assigned to prepare and process checks also generate the positive pay file and sometimes mail out final, signed checks. The positive pay file is generated from the accounting system and includes the check number, vendor, and amount, which is electronically sent to the bank. The bank will only cash checks that are included on the positive pay file. We noted that the positive pay file can be edited for content after generation from the accounting system. To ensure proper segregation of duties, we recommend that personnel outside of the cash disbursement process generate and electronically send the positive pay file to the bank.

- *City Staff Response: Finance staff will implement additional internal control procedures including having a management employee outside of the cash disbursement and vendor entry process review the electronic positive pay file before it is sent to the bank.*

b) Capitalization Policy

- i) ...the City does not have a written capitalization policy. We recommend the City adopt a written capitalization policy establishing thresholds for what is considered a capital asset addition and what is considered an expense. In addition, the policy should detail the

procedures for additions and deletions of capital assets and the related documentation required.

- *City Staff Response: Over the next year, the Finance Division will review its procedures related to the recording of fixed assets and adopt a written capitalization policy establishing thresholds and procedures for additions and deletions of capital assets.*

c) Deposits

- i) 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. The auditors noted that some deposit balances are older than five years, which indicates that the deposit may need to be refunded or recognized as revenue. 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.

- *City Staff Response: Staff will review deposit balances annually and verify that old deposits have been refunded or adjusted accordingly.*

Findings: Discussions with Auditors and Sub-committee

Members of the Sub-Committee discussed with the auditors without city staff being present the Audit Compliance letters and a number of other issues.

A table of questions and answers follows:

Questions for auditors:	Response from Auditors:
1. Were staff responses to comments and recommendations in the management letters adequate?	Yes, and the auditors will continue to follow-up.
2. The auditor letter titled "Independent Auditors' Report on Internal Control Over Financial Reporting and On Compliance and Other Matters..." includes the statement in the second paragraph "In Planning and performing an 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 an opinion on the effectiveness of the City's internal control, 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." There is a similar statement in the "...Report on Agreed-Upon Procedures Applied to Appropriations Limit Worksheet No. 6" stating "...we make no representation regarding the sufficiency of the procedures described below..." The "management letter" includes similar language - "... we do not express an opinion on	Among other things the city could do if it wanted to do more would be to add a review of "Agreed Upon Procedures" to the scope of work. However, that would be uncommon. Generally, if the auditors saw a problem they would say so. This might be more applicable to smaller cities are generally more robust is attention to these issues. When asked about the auditors' sense of level of qualification of the staff, the auditors stated that was not a concern. The auditors also volunteered that the staff was very responsive to the auditors.

<p>the effectiveness of the City's control." Statements like these raise the question of whether the City should be doing more on control issues – relative to other cities our size.</p>	
<p>3. While the previous statements (in "b" above) regarding what the audit does not include, the SAS114 letter includes a number of comforting statements like "All significant transactions have been recognized in the financial statements in the proper period;" "The financial statement disclosures are neutral, consistent, and clear;" and regarding disagreements with management "We are pleased to report that no such disagreements arose during the course of our audit."</p>	<p>The auditors stated that the SAS114 letter is a powerful tool in that it is an opportunity for the auditors to express concerns if they have any.</p>
<p>4. Considering what is not included in the report, but the assurances in the SAS 114 report, do the auditors believe the City should be doing something different with respect to these issues? And, if that requires additional auditor involvement, how would that impact the cost of the audit to the City?</p>	<p>The auditors did not recommend additional work such as what is referenced above, but stated that the cost of such work, if requested would be relatively modest – a few thousand dollars.</p>
<p>5. While the SAS114 report contains a number of positive statements, it also states: "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." The committee requests clarification of this statement in terms of whether the scope of our review is intended to include a review of this letter.</p>	<p>The auditors stated it is okay to reference the SAS114 letter and its contents in a report.</p>
<p>6. As this is the first review by the Citizens' Audit Review and Measure LL Oversight Committee of Laguna Beach's annual financial audit and any internal control weaknesses and legal compliance issues identified in the course of the annual financial audit, please provide any appropriate input regarding the functions, roles, and relationship to outside auditors of Audit Committees with which the auditor is familiar. Also, in a quest to understand and establish "best practices" for this Audit Committee please provide guidelines as set forth by major public accounting firms. Such input shall include, as appropriate, written copies of best practices of the organizations cited.</p>	<p>The auditors commended the City of Laguna Beach for setting up a citizens Audit Oversight Committee saying few cities do that, and that best practice guidelines of the Government Finance Officers Association are as good a set of guidelines as they are aware of for that function.</p>
<p>7. The Government Finance Officers Association statement of Best Practices for Audit Committees makes a number of recommendations including</p>	<p>In the experience of the auditors, it would be uncommon for a Citizens Audit Oversight to engage outside</p>

<p>a recommendation that "The audit committee also should have access to the services of at least one financial expert" and that "The audit committee should be adequately funded and should be authorized to engage the services of financial experts, legal counsel, and other appropriate specialists, as necessary to fulfill its responsibilities." In the experience of the auditors, is this appropriate?</p>	<p>financial experts, legal counsel, and other appropriate specialists. Independent of the conversation with the auditors, the committee had agreed at its last public meeting that it would request outside assistance of the City Council only on an as needed basis.</p>
<p>8. The Government Finance Officers Association statement of Best Practices for Audit Committees also recommends that "All members of the audit committee should be members of the governing body" – which in this case would presumably mean members of the City Council. However, it also includes a footnote saying "The term "governing body" also is intended to encompass appointed bodies such as pension boards. Does the auditor believe the appointments comply with this best practice recommendation?</p>	<p>The auditors stated that an appointed committee was appropriate for this function.</p>
<p>9. The City of Laguna Beach has an extraordinary number of visitors yearly, which significantly impact both revenue to the city government and the cost to the city government of providing services to these visitors. Should future audits address this issue?</p>	<p>The auditors appreciated the issue but said they had never seen a city address the issue. If anything, they agreed it could be something of a cost accounting project.</p>
<p>10. Treasurer function: Since over \$100 million of liquid assets are under the sole control of the City Treasurer, please explain audit procedures, internal controls, and compliance issues regarding the city portfolio. We understand there is a separate audit of the portfolio under the control of the treasurer, and that it is conducted every two years. Is that correct? What is the relationship between that audit and the City audit (CAFR)? Is two years an appropriate interval for that audit?</p>	<p>As a matter of routine, the audit includes a check of compliance and confirms investments and bank reconciliations. That is a big portion of the audit function. There is a separate review of Agreed Upon procedures conducted by a different firm every two years. Asked if it was normal to have a different firm than the firm doing the audit do the review of Agreed Upon Procedures, the auditors said that was not normal, but that decision was within the jurisdiction of the City Treasurer. Asked if two-year intervals were appropriate, the auditors felt it should be done annually. They also stated the cost would normally be modest. The auditors did review the last review of Agreed Upon Procedures and noted nothing major.</p>
<p>11. Prior Year Audit – have recommendation from the prior year audit been adequately implemented?</p>	<p>Yes – the auditors stated that there was nothing that had not been followed up upon.</p>

12. Audit plan letter – We should review the Audit Plan Letter. Did the audit follow the audit plan? Does the audit conform to the plan?	Yes – the audit did conform to the audit plan.
13. Public input – The City (and the audit oversight committee) should establish procedures for the receipt, retention, and treatment of complaints regarding accounting, internal accounting controls, or auditing matters. Such procedures should specifically provide for the confidential, anonymous submission by employees of the government and by the public of concerns regarding questionable accounting or auditing matters. Can the auditors make suggestions about whether this is appropriate, and, if so, can the auditors make suggestions about how best to do this?	The auditors agreed it is appropriate for the city to have some procedures for public input regarding financial matters and that some cities have a hotline.
14. Would using an outside service for payroll provide a more secure process and alleviate the many reviews that the finance department have to do?	While there could possibly be benefits to having an outside service for payroll, the auditors stated it was uncommon since city payroll is complicated, especially the public safety payroll. They stated that some smaller cities use outside firms for this function.
15. Would reconciling the Recreation account weekly rather than monthly help keep it up to date?	Yes, but the auditors questioned whether the benefit would justify the cost.
16. Additional questions about Note 14 – Pensions.	There was additional conversation regarding Note 14, explaining the format for the presentation, differences between the safety cost sharing and miscellaneous plans, clarifying the rate of investment returns used in calculating unfunded pension obligations, and the sensitivity analysis in the footnote.

Findings: Other Issues of note from the Comprehensive Annual Financial Report

Net pension liability (unfunded liability):

- Current: The city's net pension liability (unfunded liability) for the year ended June 30, 2017 is \$59.6 million based on a discount rate of 7.65%. This represents an increase of approximately \$10.5 million from the prior year.
- Subsequent Events: Note 14 on Page 73 explains that CalPERS has voted to lower its discount rate from 7.5% to 7.0% over three years beginning in fiscal year 2018. Therefore, going forward, the unfunded liability is likely to increase over the next several years as CalPERS incorporates these lower rates of expected rate of return used to calculate the unfunded liability.

- Sensitivity Analysis: Note 14 on page 77 of the Comprehensive Annual Financial Report includes a calculation of sensitivity of the net pension liability to changes in the discount rate which demonstrates that a percent increase or decrease in the discount rate of as little as one (1%) percent results in a change to the Laguna Beach Net Pension Liability of approximately \$30,000,000. The sensitivity analysis demonstrates volatility in the long-term obligations of the City due to factors that are outside its control, but that should be taken into consideration for prudent financial planning purposes.

Other:

- Treasury Function: Since at times over \$100 million of liquid assets is under the sole control of the City Treasurer, the City's investment portfolio is a major focus of the audit. It was noted that a separate review of Treasury function Agreed Upon Procedures is conducted every two years and it is currently being conducted by an audit firm selected by the Treasurer and that is an audit firm different than the firm that conducts the Comprehensive Annual Financial Report. Further, the Treasurer is assisted by an Investment Committee appointed by the Treasurer.

Recommendations: Per the duties of the committee as outlined in the adopted resolution, "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."

1. Implement the City staff responses to audit letter comments
2. Consider expansion of the Auditor's responsibility to review internal controls.
3. Consider developing formal procedures for public input regarding accounting or audit matters, such as a city hotline.
4. Consider the auditors' recommendation of having the Treasury function's outside review of Agreed Upon Procedures done annually rather than bi-annually. Also, we recommend that an entity outside of the Treasury function itself select the firm that will conduct the review and monitor the results of the review.

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 will benefit from the work of this committee. We look forward to continuing to serve the interests of the community of Laguna Beach in the coming year.

Attachments:

Agenda Bill
Minutes
Resolution
Compliance Letter Memo
Compliance Letters
Government Finance Officers Association Best Practices

ATTACHMENTS

AGENDA BILL

12

No.

Meeting Date: 01/23/2018

SUBJECT: AUDIT REVIEW COMMITTEE

SUMMARY OF THE MATTER:

BACKGROUND:

On July 27, 2017, the City Council directed the City Manager to return with options to create an audit review committee whose primary responsibilities would be to participate in the periodic selection of the City's external financial auditors and to review the results of the annual financial report. On October 24, 2017, the City Council directed staff to check with the seven members of the Measure LL Audit Oversight Committee to ascertain whether they would be willing to add the responsibilities of an audit review committee to their responsibilities. At the same meeting, the City Council requested staff to develop a list of duties for an audit review committee.

DISCUSSION:

On December 11, 2017, staff met with the Citizens' Measure LL Audit Oversight Committee and confirmed that all seven members are willing to assume the additional responsibilities of an audit review committee. Staff believes this would be best and most efficiently accomplished by the creation of a Citizens' Audit Review and Measure LL Oversight Committee.

To develop the list of additional duties for a Citizens' Audit Review and Measure LL Oversight Committee, staff surveyed twenty-three Orange County cities regarding their respective audit committees and those committee's functions, membership, roles, meeting frequency, and relationship to external auditors. Staff also researched best practices as articulated by the U.S. Securities and Exchange Commission (SEC), the American Institute of Certified Public Accountants (AICPA), the Institute of Internal Auditors IIA, the Government Finance Officers Association (GFOA), and the Association of Local Government Auditors (ALGA), as well as guidelines set forth by major public accounting firms.

RECOMMENDATION: It is recommended that the City Council:

- 1) Add the responsibilities of an audit review committee to the duties of Citizens' Measure LL Oversight Committee; and
- 2) Adopt the attached resolution establishing the Citizens' Audit Review and Measure LL Oversight Committee.

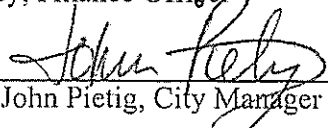
Appropriations Requested: \$None

Submitted By: 
Gavin Curran, Director of Administrative Services

Fund: _____

Coordinated with: 
Nancy Pauley, Finance Officer

Attachments: Resolution;
Application of Measure LL Committee Member

Approved: 
John Pietig, City Manager

Based on the results of the survey and research that was conducted, staff recommends establishing the following structure and duties for a Citizens' Audit Review and Measure LL Oversight Committee:

- Structure and Meetings: A seven-member committee, with two required meetings per year. Additional meetings will be scheduled as necessary.
- Membership, Terms, and Staff Support: The committee would be comprised of the residents who have already been appointed to serve on the Citizens' Measure LL Audit Oversight Committee, who will continue to serve for the remainder of their current terms. Thereafter, members will be appointed for five-year terms. The Finance Officer would serve as Staff Liaison to the committee, and the committee would have technical expertise as needed from the City's external auditors and relevant City staff.
- Role/Responsibilities:
 - Perform the duties assigned to the Citizens' Measure LL Audit Oversight Committee.
 - Participate in the selection of the City's external financial auditors.
 - 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.
 - Review the results of the annual financial audit and prepare a report for distribution to the City Council

For information only, the completed application for each member of the Measure LL Audit Oversight Committee is attached to this agenda bill.

FISCAL IMPACT:

There is no immediate financial impact associated with the recommended action. Staff will monitor needs on an ongoing basis and return to the City Council with a request if additional funds are needed.

MINUTES
LAGUNA BEACH CITY COUNCIL
ADJOURNED AND REGULAR MEETING
January 23, 2018

An Adjourned and Regular Meeting of the City Council of the City of Laguna Beach was called to order on Tuesday January 23, 2018 in the City Hall, 505 Forest Avenue, Laguna Beach, California, Mayor Boyd presiding.

ROLL CALL

PRESENT: COUNCILMEMBERS: Dicterow, Iseman, Whalen, Zur Schmiede, Boyd

ABSENT: COUNCILMEMBERS:

Mayor Pro Tem Zur Schmiede led the Pledge of Allegiance.

In accordance with Government Code section 54952.2(b), the City Council voted unanimously to add an item to its closed session agenda, finding there is a need to take action that arose since the posting of the agenda for the meeting. Pursuant to Government Code section 54956.9(d)(2), the City Council will be conferring with its legal counsel concerning one item for which there is a significant exposure to litigation against the City.

CLOSED SESSION

Conference with Legal Counsel Regarding Anticipated Litigation (pursuant to Government Code section 54956.9(d)(4)): consideration of whether to initiate litigation – two items.

Conference Regarding Real Property Negotiations (pursuant to Government Code section 54956.8): one item – price and terms of payment for possible acquisition of Driftwood parcels (APN 656-191-40, 056-240-65, and 056-240-57) at County tax sale; property representative is County of Orange; City representative is John Pietig, City Manager.

Conference with Legal Counsel Regarding Existing Litigation (pursuant to Government Code section 54956.9(d)(1)): two items – (1) South Orange County Wastewater Authority v. Moulton Niguel Water District (Riverside County Superior Court Case No. RIC1721240); (2) Glover v. City of Laguna Beach (U.S. District Court Case No. 8:15-cv-01332).

9. COMMERCIAL PROPERTY MAINTENANCE

Direct staff to evaluate amending the Municipal Code to develop new standards and processes for commercial property maintenance and the feasibility of a commercial façade improvement program.

10. CITY TREASURER'S MONTHLY REPORT FOR DECEMBER 2017

Received and filed the City Treasurer's monthly report for December 2017.

11. REVIEW OF 9/80 CITY HALL SCHEDULE Review of the 9/80 work schedule.

This item was pulled by a member of the public after the consent calendar was approved.

Jennifer Zeiter pulled this item because she was concerned that City Hall was not open five days every week. She said there had been complaints from the public regarding the newly introduced 9/80 schedule.

City Manager John Pietig explained the 9/80 schedule.

Public Comments: Justin Carvin representing the Laguna Beach Municipal Employees Association said the City employees were in favor of continuing the 9/80 schedule.

Michael Morris, Laguna Beach resident, said he had conducted an unofficial online poll from residents and the new schedule did not appear to be "overly burdensome to the community."

Councilmember Comments: Councilmember Bob Whalen said that he supported the new schedule based on data and personal experience. He said the new schedule was important to retain and recruit qualified City staff.

Moved by Councilmember Whalen seconded by Mayor Pro Tem Zur Schmiede and carried unanimously 5/0 to receive and file the status report on the 9/80 work schedule for City Hall employees.

12. AUDIT REVIEW COMMITTEE Proposed options to create an Audit Review Committee.

City Manager John Pietig pulled this item in order to clarify that this was an ad hoc committee, and would not preclude the members from sitting on another committee

Public Comments: Michael Morris said he was concerned about how the committee was being formed. He discussed best practices for audit and oversight committees.

Councilmember Comments: Councilmember Bob Whalen said he would like to stagger the committee members' terms.

Councilmember Steve Dicterow said he had envisioned this to be a full-audit review committee.

Councilmember Toni Iseman said she believed the audit committee should be separate from the Measure LL committee.

Moved by Councilmember Whalen seconded by Mayor Pro Tem Zur Schmiede and carried unanimously 5/0 to add the responsibilities of an audit review committee to the duties of Citizens' Measure LL Oversight Committee; and adopt **Resolution No. 18.006** entitled "A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF LAGUNA BEACH, CALIFORNIA, ADDING THE RESPONSIBILITIES OF AN AUDIT REVIEW COMMITTEE TO THE DUTIES OF THE CITIZENS MEASURE LL AUDIT OVERSIGHT COMMITTEE AND ESTABLISHING A CITIZENS' AUDIT REVIEW AND MEASURE LL OVERSIGHT COMMITTEE" with the following amendment:

Section 6 of the Resolution shall read: Each member of the Citizens' Audit Review and Measure LL Oversight Committee shall be appointed for the remainder of the current Citizens' Measure LL Oversight Committee terms and thereafter; a two-year term for three members; and a three-year term for four members; and the City Council will review the Committee in one year.

REGULAR ORDER

13. PROPOSED REMOVAL OF THE RED IRONBARK TREE AT 485 HIGH DRIVE Proposal to remove decayed tree for public safety and plant a replacement tree.

Staff Report: Director of Public Works/Assistant City Manager Shohreh Dupuis gave a PowerPoint presentation. She said staff were recommending to remove the red ironbark tree and to plant a replacement tree.

Councilmember Toni Iseman asked about the prior condition of the tree and why it had deteriorated.

Director of Public Works/Assistant City Manager Shohreh Dupuis said there had been significant cutting of the roots when the property had been remodeled.

Public Testimony: Rubin Flores said he was concerned that the property owners had diminished the "garden" look of the neighborhood. He said he believed the tree was strong and should remain.

Ken Boden, property owner at 485 High Drive, said the tree was unhealthy and had a fungus, and he was concerned the tree could cause future damage to property or people.

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RESOLUTION NO. 18.009

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF LAGUNA BEACH, CALIFORNIA ADDING THE RESPONSIBILITIES OF AN AUDIT REVIEW COMMITTEE TO THE DUTIES OF THE CITIZENS MEASURE LL AUDIT OVERSIGHT COMMITTEE AND ESTABLISHING A CITIZENS' AUDIT REVIEW AND MEASURE LL OVERSIGHT COMMITTEE

WHEREAS, the City Council of the City of Laguna Beach recognizes the importance of transparency and accountability in the administration of public resources, and the City Council is ultimately responsible for ensuring that the City of Laguna Beach is meeting its internal control and financial reporting responsibilities; and

WHEREAS, the City Council recognizes the importance of an Audit Review Committee as it is considered a financial management best practice and will further the City's goals of transparency and accountability in the administration of public resources; and

WHEREAS, the City Council recognizes that the Citizens' Measure LL Audit Oversight Committee serves a similar purpose; and

WHEREAS, the City Council now desires to establish a Citizens' Audit Review and Measure LL Oversight Committee;

NOW, THEREFORE, THE CITY COUNCIL OF THE CITY OF LAGUNA BEACH HEREBY RESOLVES AS FOLLOW:

1. ESTABLISHMENT OF THE AUDIT REVIEW AND MEASURE LL OVERSIGHT COMMITTEE

The City Council of the City of Laguna Beach hereby establishes the City of Laguna Beach Citizens' Audit Review and Measure LL Oversight Committee.

2. PURPOSE

The Citizens' Audit Review and Measure LL Oversight Committee's primary

responsibilities will include:

- a) Participating in the selection of the City's external financial auditors; reviewing the results of the annual financial audit; reviewing 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.
- b) Reviewing annually the expenditures of the Measure LL Fund and providing a subsequent public report for distribution to the City Council

3. MEMBERSHIP AND APPOINTMENT

The Citizens' Audit Review and Measure LL Oversight Committee shall consist of up to seven members, initially to be composed of the current seven members of the Citizens' Measure LL Oversight Committee. The City Council will appoint members in the same manner provided for all other City commissions, boards, and committees.

4. QUALIFICATIONS OF APPOINTED PUBLIC MEMBER

Must be a resident of the City of Laguna Beach.

5. COMPENSATION

Members of the Citizens' Audit Review and Measure LL Oversight Committee shall serve without compensation.

6. TERM OF MEMBERSHIP

Each member of the Citizens' Audit Review and Measure LL Oversight Committee shall be appointed for the remainder of the current Citizens' Measure LL Oversight Committee terms. Thereafter, three positions will be appointed for two-year terms, and four positions will be appointed for three-year terms.

7. TIME AND PLACE OF MEETINGS

The Citizens' Audit Review and Measure LL Oversight Committee will meet at least

1 twice annually and shall hold other meetings on an as-needed basis. Meetings of the
2 Citizens' Audit Review and Measure LL Oversight Committee shall comply with
3 applicable requirements of the Brown Act.

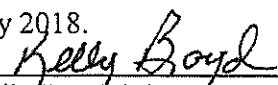
4 8. CONFLICT OF INTEREST

5 Current members of Citizens' Audit Review and Measure LL Oversight Committee
6 terms, are not designated filers for the Statement of Economic Interests form (Form
7 700) for the remainder of their current terms. Thereafter, all new and existing members
8 of the Citizens' Audit Review and Measure LL Oversight Committee are subject to the
9 requirements of the Conflict of Interest provisions of the Laguna Beach Municipal
10 Code and the conflict of interest laws of the State of California. All members shall be
11 designated filers for the Statement of Economic Interests form (Form 700) required by
12 the California Fair Political Practices Commission.
13

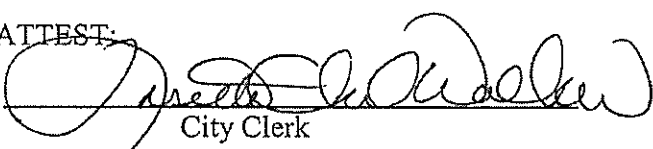
14 9. SUPERSEDE AND REPLACE RESOLUTION 18.006

15 This resolution is intended to supersede and replace Resolution 18.006 adopted by the
16 City Council on January 23, 2018.
17

18 ADOPTED this 27th day of February 2018.

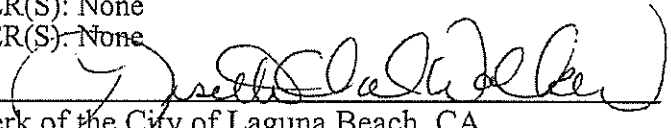
19 
Kelly Boyd, Mayor

20 ATTEST:

21 
City Clerk
22

23 I, LISETTE CHEL, City Clerk of the City of Laguna Beach, California, do hereby
24 certify that the foregoing Resolution No. 18.009 was duly adopted at a Regular Meeting of the
City Council of said City held on February 27, 2018, by the following vote:

25 AYES: COUNCILMEMBER(S): Dicterow, Iseman, Whalen, Zur Schmiede, Boyd
26 NOES: COUNCILMEMBER(S): None
ABSENT: COUNCILMEMBER(S): None

27 
City Clerk of the City of Laguna Beach, CA
28



City of Laguna Beach

MEMORANDUM

Date: January 17, 2017
To: John Pietig, City Manager
From: Nancy Pauley, Finance Officer
Subject: Audit Compliance Letters

Agreed-Upon Procedures Applied to Appropriations Limit Worksheets

This report outlines specific procedures the auditors are required to do in relation to the City's Appropriations Limit Calculation each year. The auditors reviewed and compared the 2015-2016 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 XIIB, which requires that the annual appropriations limit calculation be reviewed as part of the local government's annual financial audit.

Management Letter

Statement on Auditing Standards No. 115 requires the auditors 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. VTD decided to issue their recommendation(s) in writing in the City's management letter.

Report on Compliance and Other Matters and on Internal Controls

This report is required to be issued for all audits performed in accordance with *Government Auditing Standards*. 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. Since no such matters came to their attention, there are no findings/recommendations included in this report.

SAS-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 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.

VTD's practice has been to comply with the standard by making these communications in writing. For fiscal year 2016, the auditors sent the Council a letter during the planning phase of the audit (last Spring) and have complied with the remainder of the reporting requirements with this letter issued with the Comprehensive Annual Finance Report.

CC: Gavin Curran, Director of Finance & IT

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, 2017

WHITE NELSON DIEHL EVANS LLP
Certified Public Accountants & Consultants

**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, 2017. 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.

This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. 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, 2017, 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.

We were not engaged to, and did not, perform an audit, the objective of which would be the expression of an opinion on the accompanying Appropriations Limit Worksheet No. 6. Accordingly, we do not express such an opinion. 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 Limit 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.

White Nelson Dick Evans LLP

Irvine, California
December 28, 2017

CITY OF LAGUNA BEACH
 APPROPRIATIONS LIMIT WORKSHEET NO. 6
 FOR THE YEAR ENDED JUNE 30, 2017

Appropriations limit for fiscal year ended June 30, 2016 (Note 2) \$ 52,211,270

Adjustment factors for the fiscal year ended June 30, 2017 (Note 2):

Inflation Factor (Note 3)	Population Factor (Note 4)	Combined Factor		
1.0537	1.0099	1.0641	x	0.0641

Adjustment for inflation and population 3,346,742

Other adjustments (Note 5) -

Total adjustments 3346742

Appropriations limit for fiscal year ended June 30, 2017 \$ 55,558,012

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, 2017

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 2016-2017 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 2016-2017 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, 2017.

WHITE NELSON DIEHL EVANS LLP
Certified Public Accountants & Consultants

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, 2017, 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 December 28, 2017, on the financial statements of the City. Our comments and recommendations are intended to improve the internal control or result in other operating efficiencies.

Our comments with our recommendations for improvement are summarized as follows:

Segregation of Duties

Auditors' Comment and Recommendation

Payroll

During our review of the payroll process, we noted that the personnel assigned to prepare and process the payroll have access to the payroll database to make changes including pay rates and adding new employees. The personnel will document any changes in pay rates or the addition of new employees in a manual log that is reviewed and approved by an employee outside of the payroll process. However, given the manual nature of this log, it is possible for a change to be made and not be included in the log. We recommend that the City utilize an employee change report generated from the payroll system during the review of payroll to ensure all employee changes can be reviewed by an employee outside of the payroll process.

Cash Disbursements

During our review of the cash disbursement process, we noted that the personnel assigned to prepare and process checks also generate the positive pay file and sometimes mail out final, signed checks. The positive pay file is generated from the accounting system and includes the check number, vendor, and amount, which is electronically sent to the bank. The bank will only cash checks that are included on the positive pay file. We noted that the positive pay file can be edited for content after generation from the accounting system. To ensure proper segregation of duties, we recommend that personnel outside of the cash disbursement process generate and electronically send the positive pay file to the bank.

Management's Response

Payroll:

The Finance Division will implement additional internal control procedures including working with the finance system software developers to create a report that lists all employee changes and is reviewed by a manager outside of the payroll entry process.

Cash Disbursements:

The Finance Division will implement additional internal control procedures including having a management employee outside of the cash disbursement and vendor entry process review the electronic positive pay file before it is sent to the bank.

Capitalization Policy

Auditors' Comment and Recommendation

During our review of capital assets, we noted that the City does not have a written capitalization policy. We recommend that the City adopt a written capitalization policy establishing thresholds for what is considered a capital asset addition and what is considered an expense. In addition, the policy should detail the procedures for additions and deletions of capital assets and the related documentation required.

Capitalization Policy (Continued)

Management's Response

Over the next year, the Finance Division will review its procedures related to the recording of fixed assets and adopt a written capitalization policy establishing thresholds and procedures for additions and deletions of capital assets.

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. 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

Staff will review deposit balances annually and verify that old deposits have been refunded or adjusted accordingly.

City's Responses to Findings

The City's responses to the findings identified in our audit are described above. The City's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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.

White Nelson Hill Evans LLP

Irvine, California
December 28, 2017

WHITE NELSON DIEHL EVANS LLP
Certified Public Accountants & Consultants

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, 2017. 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 July 18, 2017. 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 other existing policies was not changed during the year ended June 30, 2017. 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. Management's estimate of the fair value of investments is based on quoted prices in an active market. When quoted prices in active markets are not available, fair values are based on evaluated prices received by a third party service provider.
- b. Management's estimate of the value of capital assets (infrastructure assets) is based on industry standards.
- c. The estimated useful lives of capital assets for depreciation purposes are based on industry standards.

Significant Audit Findings (Continued)

Qualitative Aspects of Accounting Practices (Continued)

Sensitive Estimates (continued):

- d. 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.
- e. The annual required contribution and actuarial accrued liability for the City's Other Post-Employment Benefits Plan are based on certain actuarial assumptions and methods prepared by an outside consultant.
- f. 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, Note 17 regarding related party transactions, and Note 19 regarding the restatement of prior year financial statements.

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.

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. The attached schedule contains an uncorrected misstatement of the financial statements. Management has determined that its effect is immaterial, both individually and in the aggregate, to the financial statements taken as a whole. In addition, the following material misstatements detected as a result of audit procedures were corrected by management:

- Record retentions payable and corresponding expense for amounts due to vendors that have not yet been paid.
- Record a change in investments and investment income for the fair value adjustment for investments as of year-end.
- Record a decrease to accounts receivable and an increase to cash for recreation amounts received as of year-end.
- Record revenue for amounts received that were previously recorded as a deposit liability, which represent nonrefundable balances restricted to a specific purpose.

Significant Audit Findings (Continued)

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 December 28, 2017.

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 funding progress - other post-employment benefit plan, 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. 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.

Other Matters (Continued)

We were engaged to report on the consolidating general fund financial statements, individual general fund sub-fund budgetary comparison schedules, 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.

Upcoming Changes in Accounting Standards and Regulatory Updates

Procurement Rules under Uniform Guidance

The Uniform Guidance has different procurement rules than those previously required by the Circular A-133. Due to the work required by non-federal entities to implement these new rules, a two-year grace period was given. In May 2017, an additional one-year grace period was given. Beginning July 1, 2018, non-federal entities will be required to comply with all of the Uniform Guidance procurement rules. Included in these new rules is the requirement for written policies and procedures.

Commencing with the fiscal year 2018-2019 audits, auditors will request the written policies of the non-federal entity for all single audits and reviewing the procurement policies and procedures for compliance with the Uniform Guidance procurement rules.

Other Postemployment Benefit Standards

In June 2015, the Government Accounting Standards Board (GASB) issued Statement No. 75, "Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions". The scope of this Statement addresses accounting and financial reporting for postemployment benefits other than pension (other postemployment benefits or OPEB) that is provided to the employees of state and local governmental employers. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures for defined benefit and defined contribution plans. This Statement requires governments to report a net OPEB liability or asset on the face of the financial statements. The City is required to implement this Statement in fiscal year ending June 30, 2018.

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.

White Nelson Dick Evans LLP

Irvine, California
December 28, 2017

City of Laguna Beach
 Waived Journal Entry
 June 30, 2017

DESCRIPTION	DEBIT (CREDIT)				
	ASSET	LIABILITY	FUND BALANCE	REVENUE	EXPENDITURE
<i>General Fund</i>					
Revenue				447,062	
Fund Balance			(447,062)		
<p><i>The city had non-refundable deposits originally recorded in an agency fund. These deposits represent restricted revenue. In the current year the City recognized these as revenue; however, they were received in prior years and should have been revenue upon receipt. This waived journal entry removes the revenue recognized in the current year and shows it as an addition to fund balance as of the beginning of the year.</i></p>					
TOTAL WAIVED JOURNAL ENTRY	-	-	(447,062)	447,062	-
OVERALL FUND BALANCE EFFECT					-

WHITE NELSON DIEHL EVANS LLP
Certified Public Accountants & Consultants

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

The Honorable Mayor and
Members of the City Council
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, 2017, 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 December 28, 2017.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion 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

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

Capital Assets

We identified certain capital improvement projects, where construction was completed and the projects were placed in service; however, the asset value had not been transferred from the Capital Asset classification "Construction in Progress" (CIP) to the appropriate Capital Asset category (e.g. Infrastructure, improvements, etc.). As a result, approximately \$9.7 million of CIP projects were reclassified to various asset categories. An important part of financial reporting is ensuring the accuracy of capital asset classifications. As these projects are completed, the assets should be transferred to the appropriate capital asset category and depreciation of the capital assets should commence. We recommend that during the year, City departments review and/or determine if CIP projects are completed and the Accounting Division is promptly notified to ensure accurate financial reporting and proper accounting of capital project inventory.

Retentions Payable

During our search for unrecorded liabilities, we noted that the City records construction invoices at their net costs and does not record the liability for retentions payable. Retentions are only recorded as an expenditure once they have been paid. This resulted in an adjustment to recognize approximately \$280,000 of expenses, the corresponding liability, and an increase to the capital asset balance. We recommend that the City record invoices at the gross amount with the retention recorded as a liability. This will result in correctly stating the balance of the construction in progress asset and the related accrued liability for retentions.

Non-refundable Deposits

The City collects deposits from developers and others that may not be refundable and are restricted to a specific purpose. Such funds were originally recorded as deposits payable. Given the non-refundable nature of these amounts, they are more appropriately recorded as revenue upon receipt and then tracked as to the restricted purpose. This resulted in an adjustment to recognize the revenue of approximately \$450,000 of deposits. We recommend the City record nonrefundable amounts received that are restricted to a specific purpose as revenue upon receipt and implement policies and procedures to allow tracking of the usage of these funds.

Bank Reconciliations

During our review of bank reconciliations, we noted that the bank reconciliations ending balances did not agree to the general ledger due to two main issues:

- The general bank reconciliation reconciled the balances of cash and investments held in financial institutions to the City's Treasurer Report; however, the fair market value adjustment for investments was not recorded in the general ledger.
- The bank reconciliation for the recreation account showed a different balance than that reported in the general ledger since amounts received as of year-end for April through June recreation classes and services was recorded as a receivable instead of an increase to cash.

Management's Response

Capital Assets:

Over the next year, the City Finance Staff will implement procedures to have City departments review the construction in progress projects listing and determine if the projects are completed and should be reclassified to the appropriate asset category.

Retentions Payable:

The City Finance Staff will implement additional internal control procedures, including requiring City departments to provide annually to the Finance staff a list of open construction projects and related retentions payable at the end of the fiscal year.

Non-refundable Deposits:

The City Finance Staff has implemented the recommended change.

Bank Reconciliations:

The City Finance Staff has implemented the recommended change.

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 December 28, 2017.

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.

White Nelson Dick Evans LLP

Irvine, California
December 28, 2017

<http://www.gfoa.org/audit-committees>



Government Finance Officers Association

Audit Committees

Type:

Best Practice

Background:

Three main groups are responsible for the quality of financial reporting: the governing body,¹ financial management, and the independent auditors. Of these three, the governing body must be seen as "first among equals" because of its unique position as the ultimate monitor of the financial reporting process.² 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. An audit committee also provides a forum separate from management in which auditors and other interested parties can candidly discuss concerns. 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 objectively assess management's practices, and that the independent auditors, through their own review, objectively assess the government's financial reporting practices.³

Recommendation:

GFOA makes the following recommendations regarding the establishment of audit committees by state and local governments:

- The governing body⁴ of every state and local government should establish an audit committee or its equivalent;
- The audit committee should be formally established by charter, enabling resolution, or other appropriate legal means and made directly responsible⁵ for the appointment, compensation, retention, and oversight of the work of any independent accountants engaged for the purpose of preparing or issuing an independent audit report or performing other independent audit, review, or attest services.⁶ Likewise, the audit committee should be established in such a manner that all accountants thus engaged report directly to the audit committee. The written documentation establishing the audit committee should prescribe the scope of the committee's responsibilities, as well as its structure, processes, and membership requirements. The audit committee should itself periodically review such documentation, no less than once every five years, to assess its continued adequacy;⁷
- Ideally, all members of the audit committee should possess or obtain a basic understanding of governmental financial reporting and auditing.⁸ The audit committee also should have access to the services of at least one financial expert, either a committee member or an outside party engaged by the committee for this purpose. Such a financial expert should through both education and experience, and in a manner specifically relevant to the government sector, possess 1) an understanding of generally accepted accounting principles and financial statements; 2) experience in preparing or auditing financial statements of comparable entities; 3) experience in

applying such principles in connection with the accounting for estimates, accruals, and reserves; 4) experience with internal accounting controls; and 5) an understanding of audit committee functions;⁹

- All members of the audit committee should be members of the governing body. To ensure the committee's independence and effectiveness, no governing body member who exercises managerial responsibilities that fall within the scope of the audit should serve as a member of the audit committee;
- An audit committee should have sufficient members for meaningful discussion and deliberation, but not so many as to impede its efficient operation. As a general rule, the minimum membership of the committee should be no fewer than three;¹⁰
- Members of the audit committee should be educated regarding both the role of the audit committee and their personal responsibility as members, including their duty to exercise an appropriate degree of professional skepticism;
- It is the responsibility of the audit committee to provide independent review and oversight of a government's financial reporting processes, internal controls and independent auditors;¹¹
- The audit committee should have access to the reports of internal auditors, as well as access to annual internal audit work plans;
- The audit committee should present annually to the full governing body a written report of how it has discharged its duties and met its responsibilities. It is further recommended that this report be made public and be accompanied by the audit committee's charter or other establishing documentation;
- The audit committee should establish procedures for the receipt, retention, and treatment of complaints regarding accounting, internal accounting controls, or auditing matters. Such procedures should specifically provide for the confidential, anonymous submission by employees of the government of concerns regarding questionable accounting or auditing matters.¹² The audit committee also should monitor controls performed directly by senior management, as well as controls designed to prevent or detect senior-management override of other controls¹³;
- The audit committee should be adequately funded and should be authorized to engage the services of financial experts, legal counsel, and other appropriate specialists, as necessary to fulfill its responsibilities¹⁴; and
- In its report to the governing body, the audit committee should specifically state that it has discussed the financial statements with management, with the independent auditors in private,¹⁵ and privately among committee members,¹⁶ and believes that they are fairly presented, to the extent such a determination can be made solely on the basis of such conversations.

Committee:

Accounting, Auditing, and Financial Reporting

Notes:

¹ For the purposes of this recommended practice, the term governing body should be understood to include any elected officials (e.g., county auditor, city controller) with legal responsibility for overseeing financial reporting, internal control, and auditing, provided they do not exercise managerial responsibilities within the scope of the audit. The term "governing body" also is intended to encompass appointed bodies such as pension boards.

² *Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees*, Overview and Recommendations.

³ Securities and Exchange Commission (SEC) Regulation 33-8220, Background and Overview of the New Rule and Amendments.

⁴ For the purposes of this recommended practice, the term "governing body" should be understood to include any other elected officials (e.g., county auditor, city controller) with legal responsibility for overseeing financial reporting, internal control, and auditing, provided they do *not* exercise managerial

responsibilities within the scope of the audit. The term governing body also is intended to encompass appointed bodies such as pension boards.

⁵ Nothing in this recommended practice should be interpreted so as to limit the full governing body from exercising ultimate authority.

⁶ Sarbanes Oxley Act, Section 301.

⁷ *Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees*, Recommendation 4.

⁸ *Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees*, Recommendation 3. Continuity typically is a positive factor in achieving this goal, a fact that should be kept in mind when considering the appropriate length of service for audit committee members.

⁹ Sarbanes-Oxley Act, Section 407.

¹⁰ In certain limited instances, as noted later, the audit committee will need to meet privately to achieve its goals. If the audit committee constitutes a majority of the governing body, such private meetings may be hampered by sunshine laws and similar open meetings legislation.

¹¹ SEC Regulation 330-8220, Background and Overview.

¹² Sarbanes Oxley Act, Section 301.

¹³ *Internal Control Integrated Framework: Guidance on Monitoring Internal Control Systems* (Discussion Document of the Committee of Sponsoring Organizations COSO, 2007), page 10.

¹⁴ Nothing in this recommended practice should be interpreted so as to limit the full governing body from exercising ultimate authority.

¹⁵ It is important that the audit committee be able to meet privately with the independent auditors, as needed, to ensure a full and candid discussion. Governments are urged to amend sunshine laws and similar open meetings legislation to permit such encounters in these limited circumstances.

¹⁶ It is important that audit committee members be able to meet privately among themselves, as needed, to ensure a full and candid discussion. Governments are urged to amend sunshine laws and similar open meetings legislation to permit such an encounter in these limited circumstances.

Approved by GFOA's Executive Board:
October 2008

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Citizens' Audit Review and Measure LL Oversight Committee

November 13, 2018

City Council Members
City of Laguna Beach

*Ann McGRAW
11/17*

Re: Report from The Citizens' Audit Review and Measure LL Oversight Committee

This is a report from the newly formed Citizens' Audit Review and Measure LL Oversight Committee which is made up of appointed citizen volunteers. Our committee met several times to clarify our duties and understand the direction of the report. We met with staff and the auditors. A subcommittee was formed based on the information that was derived from the committee members and from public input. The subcommittee had a conference call with the auditors without staff and the following was the result of these efforts.

Summary

- Opinion: The auditors have expressed an "unmodified" opinion of the City's Fiscal Year 2016-2017 financial statements,
- Audit Compliance Letter comments: Four audit compliance letters accompany the audit with a number of comments and recommendations, which have been addressed, and which are more fully addressed in this report.
- Other Issues of note from the Comprehensive Annual Financial Report:
 - Sensitivity Analysis: Notes to the audit include an analysis of the sensitivity of changes in the CalPERS Discount Rate on the city's the net pension liability. The city's net pension liability (unfunded liability) for the year ended June 30, 2017 is \$59.6 million based on a discount rate of 7.65%. Note 14 includes a calculation of sensitivity of the net pension liability to changes in the discount rate which demonstrates that a one percent increase or decrease in the discount rate results in a change to the Laguna Beach Net Pension Liability of approximately \$30,000,000. *30M*
The sensitivity analysis demonstrates volatility in the long-term obligations of the City due to factors that are outside its control, but that should be taken into consideration for prudent financial planning purposes. Note 14 further explains that CalPERS has voted to lower its discount rate from 7.5% to 7.0% over three years beginning in fiscal year 2018.
- Recommendations:
 - Implement the City staff responses to audit letter comments
 - Consider expansion of the Auditor's responsibility to review internal controls.
 - Consider developing formal procedures for public input regarding accounting or audit matters, such as a city hotline.

- Consider the auditors' recommendation of having the Treasury function's outside review of Agreed Upon Procedures done annually rather than bi-annually. Also, we recommend that an entity outside of the Treasury function itself select the firm that will conduct the review and monitor the results of the review.

It should also be noted that the auditors commended the city staff for their responsiveness and The City of Laguna Beach for setting up a Citizens' Audit Review Committee saying that few cities do that.

The duties of this committee and the report itself are focused narrowly on the basic audit review responsibilities laid out in the resolution establishing the committee. Those responsibilities include: reviewing the results of the annual financial audit; and reviewing any internal controls and legal compliance issues identified in the course of the annual financial audit, and provide any necessary recommendations to the City Council.

However, in the process of this review, discussions of the committee, and input from the public, the observation was made that while formation of this committee is commendable, the focus is narrow, and there are other cities that have finance and/or investment committees that have broader scope.

Considering the talent in the Laguna Beach population that seems willing to work for the City at no cost, the City might want to consider investigation into the possible future formation of a citizens' finance committee and/or a citizens' investment committee.

At this time, we would like to thank the council for giving us the opportunity to conduct the first review of this kind and look forward to hearing your feedback after you review the complete report.

Submitted by:
The Citizens' Audit Review and Measure LL Oversight Committee

Anne McGraw, Chair