

City of Laguna Beach

AGENDA BILL

No. **16**

Meeting Date: 04/20/2021

SUBJECT: CITIZENS' AUDIT REVIEW AND MEASURE LL OVERSIGHT COMMITTEE REPORT ON THE RESULTS OF THE FISCAL YEAR 2018-19 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, 2019, ("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, 2019. The Committee met and had discussions with city staff 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 2018-19 financial statements and did not identify any deficiencies in internal controls that would be considered material weaknesses. However, the auditors identified areas where internal controls could be improved, including receivables and payables, capital assets, accounts payable, beginning equity, and refundable project deposits. The City accepted and implemented the auditor's recommendations, and the City's response to each finding is included on pages 6 through 16 of the Report (Attachment A).

In addition to implementing staff response to the audit compliance letters, the Committee is requesting the City Council consider the following recommendations:

1. Deposits provided to Community Development held beyond five (5) years require regular analysis to determine their status. Specifically, this analysis should determine whether these deposits are revenue or whether they should be returned to the applicant (*Update: city staff is currently updating the procedures related to developer deposits*);

(Continued)

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 2018-19;
2. Consider implementing the Committee's recommendations; and
3. City staff recommends that the City Council maintain the current number of Committee members at five.

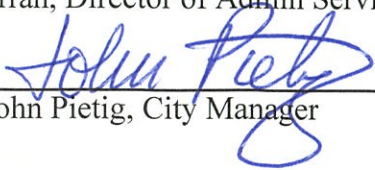
Appropriations Requested: \$ _____

Fund: _____

Attachments: 1) Committee Report (pgs. 3-39)

Submitted By: 
Kris Ryan, Finance Manager

Coordinated with: 
Gavin Curran, Director of Admin Services

Approved: 
John Pietig, City Manager

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Report on the Results of the Fiscal Year 2018-19 Audit

April 20, 2021

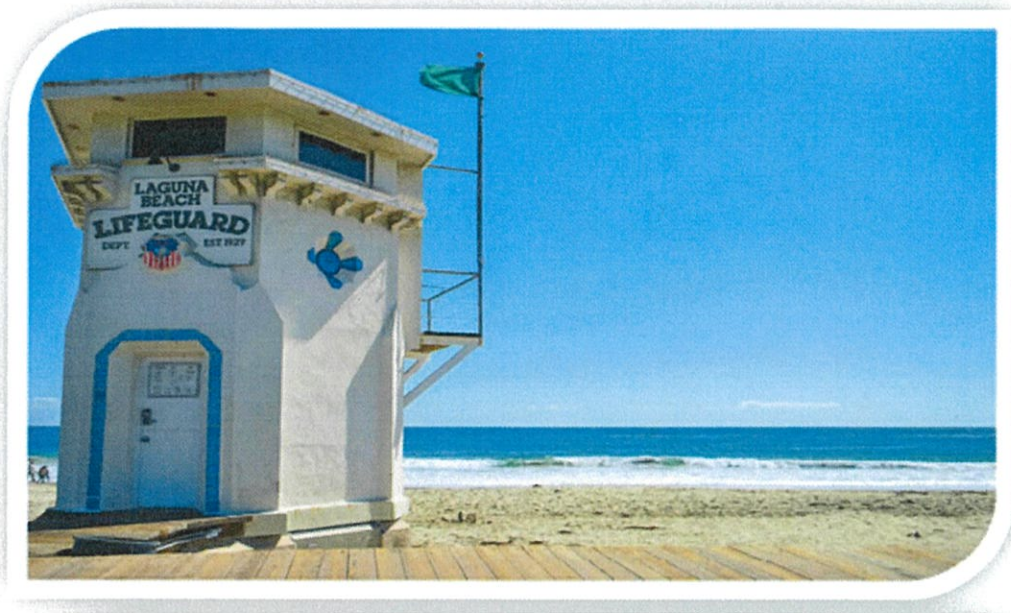
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2. Record bank reconciliation journal entries in a timelier manner (*Update: this issue has been resolved*);
3. Pursuant to Resolution 18.009 approved February 27, 2018, by the Laguna Beach City Council, it is recommended the Committee be included in the selection of the City's external financial auditors hired for the City Treasurer's Investment Report, as well as the audit City's Financial statements (*Update: In February 2020, the City Council requested an Agenda Item to select an entity outside the treasury function that will choose the auditing firm to conduct a review of the agreed-upon procedures applied to investments engagement on the next retention of the auditing firm*); and
4. The City embark on a systematic review of citywide processes and operations to not only correct the recurring issues but as an opportunity to improve and streamline operations. More broadly, this process should be a component of an internal philosophy of continuous improvement.

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

Finally, two Committee members resigned late last year, lowering the Committee's complement from seven members to five members. The term for the remaining five Committee members is set to expire later this year, on December 31, 2021. Interviews and appointments of the new Committee members are expected to occur shortly after that, in February of 2022. However, at five members, the Committee will improve its efficiency while maintaining its diversity of expertise. Therefore, City staff is recommending the City Council approve keeping the Committee at its current complement of five members. Resolution 18.009 established the membership limit for the Audit Review and Measure LL Oversight Committee of up to seven members. Therefore, a five member committee is allowed under the current resolution.

**Report on the Results of the Review of the
Annual Financial Audit
For the Fiscal Year Ended June 30, 2019**



**Presented, April 20, 2021
To the Laguna Beach City Council**

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

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

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



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I. EXECUTIVE SUMMARY

- A. **Conclusion – Auditors Unmodified Opinion:** Audited by the accounting firm White, Nelson, Diehl, and Evans LLP (WNDE), the financial statements of the City of Laguna Beach (City) for the fiscal year (FY) ended June 30, 2019, comply with Generally Accepted Accounting Principles (GAAP), and received an unmodified opinion.

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

1. Audit Compliance Letter Recommendations: The City implement staff responses to audit compliance letter comments. The City endeavor not only to establish the policies and procedures but also to ensure adherence thereto. The audit compliance letter comments fall into three categories: deficiencies in internal controls, significant deficiencies, and material weaknesses.¹ While the auditors did not identify any material weaknesses, which are items of the most significant concern, they highlighted issues that fell into the other categories. The following deficiencies in internal control were pointed out by the auditors and require the included corrective actions:
 - a. Deposits provided to Community Development held beyond five (5) years require regular analysis to determine their status. Specifically, this analysis should determine whether these deposits are revenue or whether they should be returned to the applicant.
 - b. To record bank reconciliation journal entries in a timelier manner.
2. Pursuant to Resolution 18.009 approved February 27, 2018, by the Laguna Beach City Council, it is recommended the Committee be included in the selection of the City's external financial auditors hired audit both the City Treasurer's Report, as well as the audit City's Financial statements.
3. In consideration of the fact that several significant deficiencies and weaknesses in internal controls highlighted in the FY 2018-19 audit completed by WNDE have been previously identified in recent audits, the Committee recommends the City embark on a systematic review of citywide processes and operations to not only correct the recurring issues but as an opportunity to improve and streamline operations. More broadly, this process should be a component of an internal philosophy of continuous improvement.

¹ WNDE described each as follows:

Deficiency in internal control: Exists when the design or operation of a control does not allow management or employees, in the normal course or performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis.

Significant deficiency: 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.

Material weakness: A deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented or detected and corrected on a timely basis.

C. Observations:

While the auditors identified the following five (5) significant deficiencies, it is important to note that at least two (2) of the items involved only a single transaction, and all were corrected before the completion of the Comprehensive Annual Financial Report (CAFR):

1. Significant Deficiencies
 - a. Staff prepared capital asset schedules must agree with the general ledger
 - b. An accounts payable check was incorrectly accrued back to the prior year
 - c. Beginning equity worksheet did not agree to prior year financial statements due to an autogenerated journal entry by the capital assets computer system
 - d. Receivables for loan proceeds were not recorded in the general ledger when funds were received
 - e. Compensated absences and claims payable schedules did not agree to the general ledger
2. Exemplary Performance: City Staff
 - a. Finance Department: A reflection of the professional work product put forward by the City's talented Finance staff, they received the Certificate of Achievement for Excellence in Financial Reporting award for the fiscal year ended June 30, 2019, representing the 5th consecutive year they received this recognition.
 - b. Community Development Department: The Committee recognizes the tremendous work and effort needed to identify and implement a long-term solution to the issue of accounting for deposits held for long periods. Recognizing the daunting task this challenge poses, Community Development demonstrated a willingness to examine options and address the problem.

D. Prior Year Recommendations: Follow-Up:

The following prior-year Audit Committee recommendations have not been implemented:

1. To date, the City has not brought forward a proposal to appoint an independent Investment Committee. The Audit Committee continues to recommend taking the necessary steps to replace the City Treasurer's Ad Hoc Investment Committee with a formal Investment Committee appointed by the City Council similar to other committees, commission, and boards.
2. To date, the City Treasurer continues to select the auditors to review the Treasury investment policy and investments. The Committee continues to recommend having an entity outside of the Treasury function choose the firm that will review the agreed-upon procedures of investments and monitor the results of that review.

II. PURPOSE OF THE COMMITTEE & SCOPE OR 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 the expenditures of the Measure LL Fund annually 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 assess management's practices objectively, and that the independent auditors, through their review, objectively assess the government's financial reporting practices.

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

Therefore, this report addresses duties 2 and 3 above:

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

III. METHODOLOGY

The full Committee held (9) times meeting between February 2020 and December 2020, including creating a sub-committee of committee members to help draft this report. While these were open public meetings, no members of the community attended any of the meetings. It is also important to note that aside from one in-person meeting at the beginning of the pandemic, the meetings were held remotely via Zoom.

A. Statements and Documents Reviewed

1. Certified Annual Financial Report including
 - a. The Basic Financial Statements
 - b. Fund Financial Statements
 - c. Proprietary Funds
 - d. Fiduciary Funds
 - e. Notes to Basic Financial Statements
2. Supplemental material contained in the Certified Annual Financial Report including:
 - a. The City Manager and Director of Administrative Services letter of transmittal to the City Council and Citizens of the City of Laguna Beach
 - b. Government Finance Officers Association Award
 - c. The Independent Auditor's Report also known as the opinion letter Supplementary Information Section

- d. Management's Discussion and Analysis
3. The Four (4) Audit Compliance letters for the fiscal year ended June 30, 2019.
 - a. Agreed-Upon Procedures Applied to Appropriations Limit Worksheet No.6
 - b. Report on Compliance and Other Matters and on Internal Controls ("GAS" Letter)
 - c. SAS-114 Report
 - d. Management Letter (SAS 115)
4. The Four (4) Audit Compliance letters for the prior fiscal year ended June 30, 2018.

B. Committee Actions

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

IV. REVIEW OF ANNUAL FINANCIAL AUDIT

A. Summary

White Nelson Diehl Evans LLP audited the City's financial statements. The fiscal year ended June 30, 2019, was the third year of the three-year contract for auditing services between the City and White Nelson Diehl Evans LLP.

The City's letter of transmittal includes the following statements:

- As management, we assert that, to the best of our knowledge and belief, this financial report is complete and reliable in all material respects.
- Based upon the audit, the independent auditor concluded that there was a reasonable basis for rendering an unmodified opinion that the City's financial statements for the fiscal year ended June 30, 2019, were fairly presented in conformity with GAAP (generally accepted accounting principles.)

In addition to the audit of the City's financial statements themselves, the auditors also provided four audit compliance letters, the purpose of which is recapped below and more fully explained in the attached January 12, 2019 memo from the City Manager to the City Council.

B. Audit Compliance Letters

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

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

Committee Comment:

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

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

The accounting firm White, Nelson, Diehl, and Evans LLP (WNDE) submitted a letter to the City (highlighted above) dated January 28, 2020, entitled: "Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards." In this letter, WNDE described the scope of their audit included the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Laguna Beach (City) for the year ended June 30, 2019.

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

1. 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.
2. 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.
3. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

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

For Background, during the sub-committee's conferences with the auditors, the auditors explained that the comments in the GAS letter pertaining to management issues are considered more consequential than those in other Audit Compliance letters, and Resolution is expected. The issues identified in the audit for the fiscal year ended 6/30/2019 were not "material weaknesses." The auditors did identify a certain deficiency in internal control, which they considered a "significant deficiency."

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

Committee Comment:

Considering the scope of the audit's examination of internal control limited to the City's financial reporting, while WNDE did not identify any deficiencies in internal control which WNDE considered material weaknesses (which are more severe), they did identify a deficiency in internal control which WNDE

categorized as a significant deficiency. Specifically, WNDE's audit resulted in audit adjustments to the general ledger in the following categories:

Receivables and Payables

During the audit, the auditors noted schedules and reconciliations which did not reconcile to the general ledger at year end. Inquiry into these balances resulted in the City providing updated/revised detail schedules and adjustments. The auditors wrote: "...We recommend that the City thoroughly go through schedules and reconciliations periodically to ensure these misstatements are caught in a timely manner, this would prevent the possibility of materially misstated general ledger balances."

Further, during their review of road maintenance and rehabilitation program (RMRA) revenues, the auditors noted the City did not accrue the August 2019 payment, and the gas tax revenues July 2019 payment was accrued twice. Both required an audit adjustment.

Management's Response

The City will incorporate the auditors' recommendation to thoroughly review schedules and reconciliations prior to submittal to the auditors. Regarding the RMRA and gas tax revenue, staff will confer with the state before completing the audit schedules.

Receivables for Loan Proceeds not yet Drawn Down.

The auditors noted that drawdowns of loan proceeds were not properly accounted for in the receivable balances.

Management's Response

City Finance staff responded that this was likely an isolated error and that existing controls should prevent its recurrence. However, an additional step in the year-end process has been implemented to confirm any outstanding receivable balance through iBank.

Capital Assets

In their review of capital assets, the auditors identified three (3) areas requiring audit adjustments to correct the issues: (i) some detailed schedules did not agree to the general ledger; (ii) some assets that were added in a prior fiscal year were added again in the current fiscal year; and (iii) some asset classes were missing depreciation expense since they were not included in the City's capital asset software system. The auditors recommended the City develop policies and procedures surrounding capital assets to ensure the detailed schedules agree to the general ledger and that all asset classes have depreciation expense.

Management's Response

The City has a written policy related to capital assets and recognizes the importance of ensuring fixed assets agree to the general ledger and that depreciation expense is correctly calculated for all asset classes. Toward that end, all capital assets are added to the Fixed Asset System in the City's Financial System. Significant personnel turnover during the fiscal year under audit, however, resulted in the failure to complete the migration of tracked assets into the City's Financial System. A new financial system with greater functionality and capabilities will be coming online in the near future and promises to aid in this process and prevent the recurrence of this issue.

Committee Comment

Items (i) and (iii) were also identified in last year's financial audit (FY' 17-'18), and WNDE's recommendation in this category (Capital Assets) in their FY' 17-'18 audit was identical to the audit year addressed in this report (FY' 18-'19).

Accounts Payable

During their search for unrecorded liabilities, the auditors noted an expense and a payable for an invoice attributable to the next fiscal year. WNDE recommended the City develop policies and procedures to review invoices paid after FY end for accrual to the appropriate period.

Management's Response

Citing policies and procedures already in place to review invoices paid after year-end, City Finance asserted this single expense was merely an oversight and existing controls should prevent its recurrence.

Committee Comment

This item was also identified in last year's financial audit (FY' 17-'18), and WNDE's recommendation in this category (Accounts Payable) in their FY' 17-'18 audit was identical to the audit year addressed in this report (FY' 18-'19).

Beginning Equity

The auditors noted that beginning equity balances for each fund should agree to the prior year's financial statements and recommended that any adjustments and/or corrections be made prior to the audit to ensure that beginning equity agrees to the prior year's financial statements.

Management's Response

The City agreed with the finding. As a remedy, the Finance Division will now annually review its chart of accounts to validate that all balance sheet and income statement accounts are properly categorized. Further, an additional step has been included to review any adjustments to equity to ensure that beginning equity agrees to the prior year's financial statements.

Compensated Absences and Claims Payable

During their review of compensated absences and claims payable, the auditors noted the City's detailed schedules did not agree to the general ledger. This required audit adjustments and the auditors recommended policies and procedures be implemented to ensure general ledger balances are updated to agree to the current year schedules.

Management's Response

The City agreed with the finding, commenting that while policies and procedures are in place, the Finance Division's use of Microsoft Excel can occasionally lead to formula errors. Further, the City believes the variance involving Compensated Absences was a one-time occurrence and that existing procedures coupled with an annual review of spreadsheet formulas within the audit worksheets will prevent a recurrence.

Compliance

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

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

Committee Conclusions Regarding Internal Controls:

The audit committee notes that while the City's stated efforts in establishing more stringent policies and procedures are laudable, some of the identified discrepancies have recurred. Specifically, while the underlying causes were somewhat different, similar discrepancies identified via the audit related to Capital Assets and Accounts Payable recurred from the previous fiscal year. Further, the auditors' corresponding recommendations were brought forward during the last audit. It is important to note, however, that these discrepancies involved at times a single transaction. Considering the volume of work, while not ideal, these did not reflect a systemic problem or failure creates. However, the auditors pointed out the amount to approximately \$105,000, roughly one-tenth of one percent of the City's total cash of \$105 million. Moreover, the audit the \$105,000 discrepancy was correct and accounted for correctly.

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

3. *Statement on Auditing Standards (SAS) 114*

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

WNDE complied with this requirement by issuing a letter following their audit of the City for the fiscal year ended June 30, 2019. Specifically, the auditors sent the Council a letter during the planning phase of the audit dated May 3, 2019, in which they outlined their responsibilities under generally accepted auditing standards and provided information related to the planned scope and timing of the pending audit. The auditors have complied with the remainder of the reporting requirements with this letter issued with the Comprehensive Annual Financial Report.

- a. **Significant Audit Findings:** The auditors noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus, all significant transactions have been recognized in the financial statements in the proper period, and the financial statement disclosures are neutral, consistent, and clear.
- b. **Difficulties Encountered in Performing the Audit:** the auditors encountered no significant difficulties in dealing with management in performing and completing our audit.

- c. Corrected and Uncorrected Misstatements: "...the following material misstatements detected as a result of audit procedures were corrected by management":
- i. Adjust the general ledger receivable and payable accounts to agree with corresponding detail records.
 - ii. Record a reduction in a receivable account for loan proceeds drawn down during the fiscal year.
 - iii. Adjust the general ledger to agree with the capital asset detail records.
 - iv. Record depreciation expense for certain capital asset categories, such as infrastructure and contributed capital.
 - v. Record a decrease to accounts payable and expenditures for an invoice attributable to the next fiscal year.
 - vi. Adjust the beginning net position to agree to the prior year's audited financial statements.
 - vii. Adjust the general ledger compensated absences and claims payable accounts to agree with amounts in the corresponding detail records.
 - viii. Adjust the general ledger cash accounts to agree to the bank reconciliations.
- d. Disagreements with Management: None
- e. Management Representations: Requested representations were provided by management in its management representation letter dated January 28, 2020.
- f. Management Consultations with Other Independent Accountants: In some cases, management may decide to consult with other accountants to obtain a "second opinion" on certain situations. To the auditors' knowledge, there were no such consultations with other accountants.
- g. Other Audit Findings or Issues: The auditors noted that they discuss a variety of matters with the City each year prior to retention as the City's auditors. WNDE noted that these discussions occurred in the ordinary course of their professional relationship, and their responses were not a condition to their retention.

Upcoming Changes in Accounting Standards and Regulatory Updates

Issuance of Fiduciary Activities Statement No. 84, effective fiscal year ended June 30, 2020, with the objective of improving guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how these activities should be reported.

4. *Management Letter (SAS 115)*

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 January 28, 2020, on the financial statements of the City. Our comments and recommendations are intended to improve the internal control or result in other operating efficiencies."

"...we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control."

"Our consideration of internal control...was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified..."

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

Deposits

Auditors' Comment and Recommendation

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

Management's Response

The Finance Division is working with the Community Development Department to develop a procedure to review annually a sample set of developer deposits older than five years to verify if the deposit should be refunded, remain, or recognized as revenue. Also, the Finance Division is working with Community Development to perform a comprehensive review of developer deposits every five years. This review is expected to begin in the Fiscal Year 2019-20.

Committee Comment:

The recurrence of this item resulted in part to the Committee's Recommendation on this topic (Section I. Executive Summary: Recommendation #3). As highlighted earlier in this report, while Community Development has made strides in preventing the recurrence of this problem, a holistic examination of processes citywide with a philosophical commitment to continuous improvement is the broader objective.

Bank Reconciliations

Auditors' Comment and Recommendation

During our review of bank reconciliations, we noted that the bank reconciliations reconciling items were not properly recorded to the general ledger. Upon audit inquiry, the City determined that reconciling items on the bank reconciliation had not been recorded in the general ledger and an adjustment was required to correct the balance. To correct this comment, we recommend the City record all identified reconciling items in a timely manner to reduce the risk that errors or unrecorded transactions are not detected and corrected promptly.

Management's Response

Management agrees with the finding that some bank reconciling items were not recorded promptly in the general ledger. To improve this process and decrease the risk of errors or unrecorded transactions, the Finance staff will add an internal control to record bank reconciliation reconciling items in the period they are identified.

In response to the subcommittee's questions, the auditors stated they felt the management responses to the auditors' comments in the Management (SAS 115) Letter were adequate, and the level of detail in the answers was adequate. The auditors did note that they do not comment on the adequacy of responses unless they are notably deficient.

V. INTERVIEW OF AUDITORS

As described under the purpose and methodology sections of this review, the Committee and/or subcommittee met with and/or had conversations with the auditors. Topics discussed with the auditors included, and the questions and answers follow:

A. Management Letter

Deposits

"...some deposit balances that are older than five years, which indicates that the deposit may need to be refunded or recognized as revenue..."

1. The above item was also identified in the audit letters prepared last year. Did your audit estimate the approximate dollar amount of deposits older than five years old which should either be refunded to the applicant or recognized as revenue?

Response: Approximately \$490,000. Unknown how many deposits.

2. In your experience auditing municipal finance, is the retaining of deposit balances beyond five years common? (based on the response, might have a follow-up)

Response: This is a common issue in many municipalities. Mainly due to the intensive workload. The City has detailed information, included the address records. The software helps but ultimately requires an individual to reach out to the applicant.

3. Since this is a recurring item, was management's response adequate to address and prevent its recurrence?

Response: Yes, but City lacks resources to perform this function. We do not comment on personnel resources.

Bank Reconciliations

"During our review of bank reconciliations, we noted that the bank reconciliations reconciling items were not promptly recorded to the general ledger. Upon audit inquiry, the City determined that reconciling items on the bank reconciliation had not been recorded in the general ledger, and an adjustment was required to correct the balance. To correct this comment, we recommend the City record all identified reconciling items in a timely manner to reduce the risk that errors or unrecorded transactions are not detected and corrected promptly."

4. Explain how the failure to promptly record the reconciliations in the general ledger would have or could have avoided the need to correct the balance during the audit.

Response: When auditors received the documents, the reconciliations had not yet been completed.

5. While subtly different, a similar discrepancy was identified in last year's audit. Do you consider this a recurring discrepancy? Why, Why not?

Response: yes, similar year over year, but since last year they created a clear schedule showing how the balances / reconciling items agreed with the general ledger—also, fewer items not in agreement this year vs. last.

6. Was management's response adequate in addressing and preventing its recurrence?

Response: Yes.

B. Government Accounting Standards Letter

Receivables & Payables – 3 items

- 1) Schedules and reconciliations for receivable and payable accounts did not reconcile to the general ledger at year-end.
- 2) Road maintenance and rehabilitation program (RMRA) revenues, we noted the City did not accrue the August 2019 payment.
- 3) The gas tax revenues July 2019 payment was accrued twice.

1. Did your audit estimate the total dollar amount of these discrepancies?

Response: cannot quantify the reconciliations schedules because the City continually provided revised schedules which did not agree with documents preventing accurate dollar amount. RMRA: \$36,000. Gas tax: \$40,000. These amounted to significant deficiencies, but not material weaknesses. The Finance dept needs to ensure the schedules agree with the general ledger before providing it to the auditor. If an extra week is allowed, the audit goes much quicker.

2. What would move something from significant deficiency to material weakness?

Response: Dollar amount, number of discrepancies, recurrence.

3. Was management's response adequate in addressing the issues and preventing their recurrence?

Response: Yes.

4. Please describe the essential differences between a Material Weakness and a Significant Deficiency.

Response: Dollar amount, sensitivity, recurrence, frequency. Example: Bank Rec: Improvements have been made, moving it to "another matter" category.

Capital Assets – 3 items (2 repeats)

The auditors noted that some detailed schedules did not agree to the general ledger. Some asset classes were missing depreciation expenses since they were not included in the City's capital asset software system.

1. Regarding the 2 items that have recurred, do you have an opinion as to a particular process or the absence of a particular process that would prevent this from recurring?

Response: The end result needs to be that the schedules agree with the general ledger. Auditors pointed out that it is management's decision to address.

2. Are you able to elaborate on your opinion as to the reason it is recurring?

Response: Cannot comment as to why. Perhaps Gavin can provide insight. Auditors look at end result.

3. Was management's response adequate in addressing the issues and preventing their recurrence?

Response: Yes.

Different–

- some detailed schedules did not agree to the general ledger.

4. Was management's response adequate in addressing the issues and preventing their recurrence?

Accounts Payable (Repeat)

The City recorded an expense and a payable for an invoice attributable to the next fiscal year.

1. Regarding the 2 items that have recurred, do you think about a particular process or the absence of a particular process that would prevent this from recurring?
2. Are you able to elaborate on your opinion as to the reason it is recurring?
3. Was management's response adequate in addressing the issues and preventing their recurrence? Appropriate.

Beginning Equity

We noted funds in which adjustments to beginning equity occurred due to the automatic journal entries made by the accounting system when the City recorded capital assets in the subsidiary ledger. Beginning equity balances for each fund should agree to the prior year financial statements.

Please elaborate: the way the capital asset software works, when an asset is moved from one category to another, it creates an anomalous entry: Wants to classify it as equity. This requires a manual correction. Fairly new system – new finance manager took over when this came online. Now familiar with the system, so should avoid similar problems in the future. The City still has a threshold for capital assets: \$5,000. According to the auditors, this is not necessarily too low. The discrepancy involved a particular asset, large, at the end of FY – City makes payments to SOCWA (South OC Wastewater) annually for improvements. Contributed capital which the City is paying another entity. The City pays for wastewater capacity.

Was management's response adequate in addressing the issue and preventing its recurrence?

Response: Yes.

Compensated Absences and Claims Payable

During our review of compensated absences and claims payable, we noted that the detailed schedules and calculations provided by the City did not agree to the general ledger.

1. Was management's response adequate in addressing the issue and preventing its recurrence?

Response: Yes.

2. Regarding Compensated Absences and Claims Payable, are these discrepancies you noted in your audit common among municipalities audited by your firm?

Response: Not common, but it does happen on occasion.

3. Other Matters: Not significant, areas noted during the audit that could lead to operational improvements.
4. Did not note any non-compliance; audit did not cover all laws/regulations a city had to follow.

VI. CONCLUSION

The auditors have expressed an "unmodified" opinion of the financial statements for the City's fiscal year ended June 30, 2019. "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, 2018, 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."

VI. RECOMMENDATIONS

A. Status of prior years' accepted recommendations:

1. The City has made strides in implementing policies and procedures to ensure accuracy in the accounting of Capital Assets Accounts Payable and in improving the timeliness of bank reconciliations. Although discrepancies were identified in the same categories during the audit of FY' 18-'19, the errors were insignificant and involved a small number of transactions.
2. While the City agreed to raise the thresholds for purchasing and asset tracking to \$1,000 and \$5,000, respectively, the timing of the decision required waiting until the new fiscal year started before implementation. FY' 19-'20 should reflect these changes.
3. To date, the City has not brought forward a proposal to appoint an independent Investment Committee. The Audit Committee continues to recommend taking the necessary steps to replace the City Treasurer's Ad Hoc Investment Committee with a formal Investment Committee appointed by the City Council similar to other committees, commission, and boards.
4. To date, the City Treasurer continues to select the auditors to review the Treasury investment policy and investments. The Committee continues to recommend having an entity outside of the Treasury function select the firm that will review the agreed-upon procedures of investments and monitor the results of that review.

B. Current Recommendations

1. Audit Compliance Letter Recommendations: The City implement staff responses to audit compliance letter comments, and that the City endeavor not only to establish the aforementioned policies and procedures but to ensure adherence thereto. The audit compliance letter comments fall into three categories: deficiencies in internal controls, significant deficiencies, and material weaknesses.² While the auditors did not identify any material weaknesses, which are items of the highest concern, they highlighted issues that fell into the other categories. The following

deficiencies in internal control were pointed out by the auditors and require the included corrective actions:

- a. Deposits provided to Community Development held beyond five (5) years require regular analysis to determine their status. Specifically, this analysis should determine whether these deposits are revenue or whether they should be returned to the applicant.
- b. To record bank reconciliation journal entries in a timelier manner.
- c. Pursuant to Resolution 18.009 approved February 27, 2018, by the Laguna Beach City Council, it is recommended the Committee be included in the selection of the City's external financial auditors hired for the City Treasurer's Report, as well as the audit City's Financial statements.
- d. In consideration of the fact that several significant deficiencies and weaknesses in internal controls highlighted in the FY' 18-'19 audit completed by WNDE have been previously identified in recent audits, the Committee recommends the City embark on a systematic review of citywide processes and operations to not only correct the recurring issues but as an opportunity to improve and streamline operations. More broadly, this process should be a component of an internal philosophy of continuous improvement.

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

Attachments:

- Attachment A: Agreed-Upon Procedures Applied to Appropriations Limit Worksheet No.6
- Attachment B: Audit Compliance Letters
- Attachment C: Report on Compliance and Other Matters and on Internal Controls
- Attachment D: Management Letter

ATTACHMENT A

GANN Limit Worksheet

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, 2019

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, 2019. 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, 2019, 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
January 28, 2020

CITY OF LAGUNA BEACH
 APPROPRIATIONS LIMIT WORKSHEET NO. 6
 FOR THE YEAR ENDED JUNE 30, 2019

Appropriations limit for fiscal year ended June 30, 2018 (Note 2) \$ 58,008,120

Adjustment factors for the fiscal year ended June 30, 2019 (Note 2):

	<u>Inflation Factor (Note 3)</u>	<u>Population Factor (Note 4)</u>	<u>Combined Factor</u>	
	1.0367	1.0069	1.0439	x <u>0.0439</u>
Adjustment for inflation and population				2,546,556
Other adjustments (Note 5)				<u>-</u>
Total adjustments				<u>2,546,556</u>
Appropriations limit for fiscal year ended June 30, 2019				<u>\$ 60,554,676</u>

See accompanying Notes to Appropriations Limit Worksheet No. 6

CITY OF LAGUNA BEACH

NOTES TO APPROPRIATIONS LIMIT WORKSHEET NO. 6

FOR THE YEAR ENDED JUNE 30, 2019

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 2018-2019 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 2018-2019 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, 2019.

ATTACHMENT B

Report on Compliance and Other Matters and on Internal Controls

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

The Honorable 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, 2019, 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 January 28, 2020.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a certain deficiency in internal control, described below, that we consider to be a significant deficiency.

Year-End Closing Procedures

Auditors' Comment and Recommendation

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

Receivables and Payables

During the audit, we were provided with schedules and reconciliations for receivable and payable accounts that did not reconcile to the general ledger at year end. The investigation into these balances resulted in revised detail schedules and audit adjustments. In addition, some correcting entries were provided that were already included in the general ledger balance and required reversal. We recommend that the City thoroughly go through schedules and reconciliations periodically to ensure these misstatements are caught in a timely manner, this would prevent the possibility of materially misstated general ledger balances.

Also, during our review of road maintenance and rehabilitation program (RMRA) revenues, we noted the City did not accrue the August 2019 payment. In addition, the gas tax revenues July 2019 payment was accrued twice. An audit adjustment was required to recognize the revenue and receivable for RMRA and reduce the revenue and receivable for gas tax.

Receivables for Loan Proceeds not yet Drawn Down

The City has some loans for which the proceeds have not yet been drawn down, which are appropriately recorded as receivables. During our review of these receivables, we noted that drawdowns for the current year were not accounted for in the receivable balances. We recommend the City record drawdowns of loan proceeds as a reduction to the receivable when the funds are received.

Capital Assets

During our review of capital assets, we noted the following: (1) some detail schedules did not agree to the general ledger, (2) some assets that were added in a prior fiscal year were added again in the current fiscal year, and (3) some asset classes were missing depreciation expense since they were not included in the City's capital asset software system. Audit adjustments were needed to correct these issues. We recommend the City develop policies and procedures surrounding capital assets to ensure the detail schedules agree to the general ledger and that all asset classes have depreciation expense.

Accounts Payable

During our search for unrecorded liabilities, we noted that the City recorded an expense and a payable for an invoice attributable to the next fiscal year. We recommend the City develop policies and procedures to review all invoices paid after year-end for accrual to verify they are recorded in the appropriate accounting period.

Year-End Closing Procedures (Continued)

Auditors' Comment and Recommendation (Continued)

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

Beginning Equity

Beginning equity balances for each fund should agree to the prior year financial statements. During our review of beginning equity, we noted funds in which adjustments to beginning equity occurred due to the automatic journal entries made by the accounting system when the City recorded capital assets in the subsidiary ledger. We recommend the City review these adjustments and make any necessary corrections prior to the audit to ensure that beginning equity agrees to the prior year financial statements.

Compensated Absences and Claims Payable

During our review of compensated absences and claims payable, we noted that the detail schedules and calculations provided by the City did not agree to the general ledger. Audit adjustments were necessary to record the current year balance. We recommend the City implement policies and procedures to ensure that general ledger balances are updated to agree to the current year schedules.

Management's Response

Receivables and Payables:

Management agrees that a reconciliation comparing Finance staff prepared audit scheduled to the general ledger should be done before providing the schedules to the auditors to ensure the accuracy of the detailed schedules. However, the Finance Division did anticipate needing to make correcting adjustments to the general ledger due to the investigation of several receivable and payable items at year-end.

The Finance staff will incorporate the auditor's recommendation to thoroughly review the Finance staff prepared schedules and reconciliations before submitting to the auditors. The Finance staff will also add an internal control of confirming the road maintenance and rehabilitation (RMRA) and Gas Tax revenue with the State before completing the audit schedules.

Receivables for Loan Proceeds not yet Drawn Down:

Management agrees that drawdowns of loan proceeds must be recorded as a reduction to the receivable when the funds are received. The City has been diligent in ensuring that all loans are properly recorded in the general ledger and all drawdowns are accounted for. The Finance staff feels this error is an isolated incident and that existing internal controls should prevent this finding in the future. However, the Finance staff will add an additional step in the year-end process to confirm with IBank, through email or letter, the outstanding receivable balance.

Year-End Closing Procedures (Continued)

Management's Response (Continued)

Capital Assets:

Management has developed a written policy for capital assets and continues to ensure that fixed assets agree to the general ledger and depreciation expense is correctly calculated for all asset classes. The Finance staff has been diligent in making sure that all capital assets are added to the Fixed Asset System in the City's Financial System. However, with significant turnover during the fiscal year, migrating assets tracked in Microsoft Excel into City's Financial System was not completed. The Finance staff does anticipate this project to be completed in FY 2019-20. Also, the City will be exploring a new financial software system in the coming year to replace the existing financial system with an emphasis on better capabilities to manage fixed assets.

Accounts Payable:

The City has policies and procedures when reviewing all invoices paid after year-end for accrual. The Finance staff manually reviews hundreds of transactions that occur after year-end to confirm if they need to be accrued to the prior year. The Finance Division feels this one expense was an oversight and is confident that the existing internal controls should prevent this from occurring in the future.

Beginning Equity:

Management agrees with the finding. To remedy the issues, the Finance Division will annually review its chart of accounts to validate that all balance sheet and income statement accounts are properly categorized and including in the year-end closing procedures a step to review any adjustments to equity to ensure that beginning equity agrees to the prior year financial statements.

Compensated Absences and Claims Payable:

Management agrees with the finding. The City does have policies and procedures in place when completing the year-end closeout. The Finance Division produces all schedules using Microsoft Excel that can occasionally lead to formula errors in the report. The Finance Division feels the variance with the Compensated Absences was a one-time occurrence and is confident that existing procedures, coupled with an annual review of spreadsheet formulas within the audit worksheets, will prevent this from occurring in the future.

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 January 28, 2020.

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 Dickerson LLP

Irvine, California
January 28, 2020

ATTACHMENT C

Statement on Auditing Standards (SAS) 114

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

We have audited the financial statements of the governmental activities, business-type activities, the discretely presented component unit, each major fund, and aggregate remaining fund information of the City of Laguna Beach, California (the City) as of and for the year ended June 30, 2019. 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 May 3, 2019. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended June 30, 2019. 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 contributed capital is based on amounts provided by the third party that constructed the improvements.
- 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 Other Post-Employment Benefit Plan (OPEB) expense, total OPEB liability, and corresponding deferred outflows of resources and deferred inflows of resources for the City's OPEB plan are based several key assumptions that are set by management with the assistance of an independent third-party actuary. These key assumptions include anticipated investment rate of return, health care cost trends, mortality and certain amortization periods.
- 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, and Note 17 regarding related party transactions.

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

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

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

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

- Adjust the general ledger receivable and payable accounts to agree amounts to the corresponding detail records.
- Record a reduction in a receivable account for loan proceeds drawn down during the fiscal year.
- Adjust the general ledger to agree amounts to the capital asset detail records.
- Record depreciation expense for certain capital asset categories, such as infrastructure and contributed capital.

Significant Audit Findings (Continued)

Corrected and Uncorrected Misstatements (Continued)

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

- Record a decrease to accounts payable and expenditures for an invoice attributable to the next fiscal year.
- Adjust the beginning net position to agree to the prior year audited financial statements.
- Adjust the general ledger compensated absences and claims payable accounts to agree amounts to the corresponding detail records.
- Adjust the general ledger cash accounts to agree to the bank reconciliations.

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 January 28, 2020.

Management Consultations with Other Independent Accountants

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

Other Audit Findings or Issues

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

Other Matters

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

Other Matters (Continued)

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

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

The Governmental Accounting Standards Board (GASB) issued Statement No. 84, *Fiduciary Activities* (Statement), which is effective for the City's fiscal year ended June 30, 2020. Due to the significant nature of this Statement, GASB has also issued Implementation Guide No. 2019-2, *Fiduciary Activities*, to clarify, explain, and elaborate the requirements of this Statement. The objective of the Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. Implementation of this Statement could require significant time from staff to identify the City's fiduciary activities, to analyze current activity in the City's agency funds and recharacterize those activities into a custodial fund or another City fund depending upon whether the activity is custodial in nature or related to a City's own-source revenue activity, and, to potentially modify the chart of accounts structure in the City's general ledger for fiduciary activities to accommodate the newly-required statement of changes in fiduciary net position for all fiduciary activities.

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
January 28, 2020

ATTACHMENT D

Management Letter

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

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Laguna Beach, California (the City) as of and for the year ended June 30, 2019, 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 January 28, 2020, 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:

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

The Finance Division is working with the Community Development Department to develop a procedure to review annually a sample set of developer deposits older than five years to verify if the deposit should be refunded, remain, or recognized as revenue. Also, the Finance Division is working with Community Development to perform a comprehensive review of developer deposits every five years. This review is expected to begin in the Fiscal Year 2019-20.

Bank Reconciliations

Auditors' Comment and Recommendation

During our review of bank reconciliations, we noted that the bank reconciliations reconciling items were not promptly recorded to the general ledger. Upon audit inquiry, the City determined that reconciling items on the bank reconciliation had not been recorded in the general ledger and an adjustment was required to correct the balance. To correct this comment, we recommend the City record all identified reconciling items in a timely manner to reduce the risk that errors or unrecorded transactions are not detected and corrected promptly.

Management's Response

Management agrees with the finding that some bank reconciling items were not recorded promptly in the general ledger. To improve this process and decrease the risk of errors or unrecorded transactions, the Finance staff will add an internal control to record bank reconciliation reconciling items in the period they are identified.

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 Dick Evans LLP

Irvine, California
January 28, 2020

THIS CONCLUDES THE CITY'S STAFF REPORT

**At the March 28, 2017, City Council meeting
the City Council directed staff to distribute
Appeal Agenda Bills two weeks in advance
of the City Council meeting.**

**EVERYTHING BEYOND THIS PAGE
WAS RECEIVED AFTER THE AGENDA BILL
WAS DISTRIBUTED AND IS NOT PART
OF THE STAFF REPORT**

From: Parisi, Laura CT
Sent: Thursday, April 15, 2021 11:44 AM
To: McKay, Ann Marie CC
Cc: LauraParisiCPA@cox.net
Subject: April 20, 2021 City Council Meeting, Agenda Item 16
Attachments: Audit Committees GFOA.pdf

I strongly recommend that you consider following the guidelines set by the Government Finance Officers Association for Audit Committees when determining the committee size and the potential background of new committee members. Specifically, there are members of the community that have the experiences identified by the GFOA;

- *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*

I was a member of a similar committee for 10 years and have been considered a Subject Matter Expert. My experience as a former municipal auditor and preparer of governmental financial reporting as well as the education required to obtain my Certified Public Accountant license were utilized and I considered necessary to performing my responsibilities on that committee.

Thank you for your consideration and service,

Laura Parisi, CPA, CCMT, CFIP

City Treasurer

City of Laguna Beach

(949)497-0327

lparisi@lagunabeachcity.net





BEST PRACTICES

Audit Committees

Establish audit committees, made up of appropriate audit committee members, that are responsible for review, oversight, establishing procedures, and providing a written report.



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

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.

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 33-8220, Background and Overview. 

11. SEC Regulation 330-0220, 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.