

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*

Honorable Mayor and  
Members of the City Council  
of the City of Costa Mesa  
Costa Mesa, 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, each major fund, and the aggregate remaining fund information of the City of Costa Mesa, California (the City), as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the City's basic financial statements and have issued our report thereon dated December 26, 2013.

**Internal Control Over Financial Reporting**

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described below, we identified certain deficiencies in internal control that we consider to be material weaknesses.

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. We consider the following deficiencies to be material weaknesses.



## **Internal Control Over Financial Reporting (Continued)**

### **Budget Approval/Unrecorded Transactions**

#### **Auditors' Comment**

The City has an arrangement with an outside organization to provide funding to the City for promotional activities without a written agreement. The arrangement allows for the payment of certain City-related promotional expenditures directly by the outside organization which results in City-related expenditures being incurred without formal budget approval by the City Council. The absence of not having budget approval of these expenditures and related revenue allows for a lack of accountability and could result in misuse of the funds provided by the outside organization. In addition, since the payments for these City expenditures are being paid directly by the outside organization, the expenditures and related reimbursement are not being recorded on the City's general ledger. We recommend that the City enter into a written agreement with this organization in which the City would receive the funding directly and expenditures and revenues for this program be approved by the City Council.

#### **Management's Response**

The City has had a close and informal working relationship with the outside organization with the intent of accomplishing certain promotional activities efficiently and effectively. The City recognizes the benefits to formalize this relationship in future activities and plans to prepare written agreements for CEO or Council approval as needed.

### **Purchasing Policies and Procedures**

During our testing of cash disbursements, we noted that the City did not follow the established purchasing policies and procedures. The purchasing policy requires the following procedures:

1. Purchases over \$1,000 are required to be done through a purchase requisition process, which includes issuance of the Purchase Order upon the receipt of the purchase requisition approved by the appropriate personnel.
2. Informal bids are required for purchases up to \$50,000.
3. Formal bids are required for contracts greater than \$50,000 and must be approved by City Council.
4. Bidding process may be exempt in some cases including "emergency" or "sole source" suppliers.
5. Formal professional service agreements must be reviewed and signed.

For the sample of cash disbursements we tested, we noted incidents where purchase orders were not issued for some purchases over \$1,000. Additionally, some purchases did not go through the required procurement process, and there was no documentation that those purchases were exempt from the bidding process. We also tested a contract that was greater than \$50,000, which required formal bidding and the City Council approval. In this instance, there was no documentation that formal bidding was performed nor that the City Council had approved the contract.

Failure to follow the established purchasing policies and procedures could result in misappropriation of assets. We recommend that management review its process for following these procedures and include additional steps, if needed, to allow for the proper functioning of the purchasing policies and procedures.

## **Internal Control Over Financial Reporting (Continued)**

### **Purchasing Policies and Procedures (Continued)**

#### Management's Response

The City's purchasing policies and procedures are in need of revision and some of the City staff need further training and awareness of the purchasing procedures. A temporary update to the Purchasing Policies & Procedures Manual was done in January 2010 by way of adding a "Forward" section. A complete update to the Manual is needed to ensure consistency with existing City ordinances and administrative regulations. In September 2013 the CEO created a Purchasing & Quality Control Committee led by the Finance Department and including a representative from each City department. The Committee's responsibilities are to revise the Manual, train staff and recommend ways to streamline the purchasing process.

#### **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 matters that we have reported to management and the City Council in a separate letter dated December 26, 2013.

#### **City of Costa Mesa's Responses to the Findings**

The City's responses to the findings 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.

#### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the City's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*White Nelson Dick Evans LLP*

Irvine, California  
December 26, 2013