

The Honorable Mayor and
Members of the City Council
of the City of Costa Mesa
Costa Mesa, California

In planning and performing our audit of the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the City of Costa Mesa (the City) as of and for the year ended June 30, 2014, in accordance with 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, 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 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 significant deficiencies or material weakness and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. We did not identify any deficiencies in internal control that we consider to be material weaknesses. However, as discussed below, we identified a certain matter involving the internal control and other operational matters that is presented for your consideration. This letter does not affect our report dated December 11, 2014 on the financial statements of the City. Our comment and recommendation, which have been discussed with appropriate members of management, is intended to improve the internal control or result in other operating efficiencies. Our comment is summarized as follows:

Cash Performance Bonds

Auditors' Comment

The City collects a cash performance bond when a permit is issued for construction work. This bond is a refundable deposit used to offset costs incurred by the City if damages occur to public property when the construction is in process. The permit is tracked by the public services department using an ACELLA Permits Plus software system and the deposit is recorded in the City's general ledger. When a permit is issued, a refund request form is sent to the finance department for validation along with the payment. After construction is completed and no damage has occurred, the inspector will close or finalize the permit in the Permits Plus software system and send the validated refund request form to finance after the City Engineer approves it. In the instance when damages occur, a refund would not be processed for payment and the deposit is kept by the City.

Cash Performance Bonds (Continued)

Auditors' Comment (Continued)

At June 30, 2014, when the permit report was reconciled to the general ledger, it was noted that the general ledger balance was higher than the Permits Plus software system report by \$293,433. The variance was attributed to two different issues: 1) permits were administratively closed or finalized and the refund request forms from the public services department were not submitted to the finance department for payment; and 2) there were permits issued and the cash payment was reported in the general ledger, however, the permit did not appear on any of the Permit Plus software system reports. We recommend that the City review the policies and procedure over cash performance bonds to ensure timely submission of refund requests forms to the finance department for permits finalized.

Management's Response

Staff from Finance and Public Services department met and reviewed the procedures over cash performance bonds. The following issues are identified and solutions proposed:

- Permits that were administratively closed are for projects that city has not received final completion notices from property owners. These payments represent valid cash performance bonds and should not have been closed. They have been changed to "open" status in the Permit Plus software system.
- Public Services department maintains a log of the refund requests submitted to Finance. Staff will reconcile this log with finance records to identify any missing refunds that should have been issued. Going forward, this log will be reconciled to finance records on a regular basis.
- Public Services staff will also review the older projects that have been finalized in Permit Plus software and identify whether the cash performance bonds should be released.

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 Nick Evans LLP

Irvine, California
December 11, 2014