

**CITY OF COSTA MESA**  
**Costa Mesa, California**

**SINGLE AUDIT REPORT ON EXPENDITURES**  
**OF FEDERAL AWARDS**

Year ended June 30, 2018

**CITY OF COSTA MESA**  
**SINGLE AUDIT REPORT ON EXPENDITURES OF FEDERAL AWARDS**

Year ended June 30, 2018

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

**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***

**Independent Auditor's Report**

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, each major fund, and the aggregate remaining fund information of the City of Costa Mesa, as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the City of Costa Mesa's basic financial statements, and have issued our report thereon dated December 21, 2018.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the City of Costa Mesa'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 City of Costa Mesa's internal control. Accordingly, we do not express an opinion on the effectiveness of City of Costa Mesa's internal control.

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. However, as described in the accompanying schedule of findings and questioned costs, we identified deficiencies in internal control that we consider to be a material weakness, and significant deficiencies.

*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 entity's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and questioned costs as 2018-001 to be a material weakness.

*A significant deficiency* is defined to be 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 deficiencies described in the accompanying schedule of findings and questioned costs as items 2018-002, 2018-003 and 2018-004 to be significant deficiencies.

## **Compliance and Other Matters**


As part of obtaining reasonable assurance about whether City of Costa Mesa'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*.

## **City's Responses to Findings**

The City of Costa Mesa's responses to the finding identified in our audit are described in the accompanying schedule of findings and questioned costs. 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 of Costa Mesa'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.

A handwritten signature in blue ink that reads "Davis Fan" followed by a stylized flourish.

Irvine, California  
December 21, 2018

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

**Report on Compliance for Each Major Federal Program; Report on Internal Control Over Compliance; and Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance**

**Independent Auditor's Report**

**Report on Compliance for Each Major Federal Program**

We have audited the City of Costa Mesa's compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of City of Costa Mesa's major federal programs for the year ended June 30, 2018. The City of Costa Mesa's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

***Management's Responsibility***

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

***Auditor's Responsibility***

Our responsibility is to express an opinion on compliance for each of City of Costa Mesa's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about City of Costa Mesa's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of City of Costa Mesa's compliance.

### ***Opinion on Each Major Federal Program***

In our opinion, the City of Costa Mesa complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2018.

### **Report on Internal Control Over Compliance**

Management of City of Costa Mesa is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered City of Costa Mesa's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of City of Costa Mesa's internal control over compliance.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

### **Report on Schedule of Expenditures of Federal Awards Required by Uniform Guidance**

We have audited the financial statements of City of Costa Mesa as of and for the year ended June 30, 2018, and have issued our report thereon dated December 21, 2018 which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the

underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditure of federal awards is fairly stated in all material respects in relation to the financial statements as a whole.

*Davis Fan LLP*

Irvine, California  
December 21, 2018

CITY OF COSTA MESA  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
June 30, 2018

Federal Grantor / Pass - Through Grantor / Program / Cluster Title	Catalog of Federal Domestic Assistance Number	Program Identification Number	Federal Expenditures	Amount Provided to Subrecipients
<u>United States Department of Housing and Urban Development</u>				
Direct Assistance:				
Community Development Block Grants (CDBG)	14.218	B-14-MC-06-0503	\$ 485,509	\$ -
	14.218	B-15-MC-06-0503	158,081	-
	14.218	B-16-MC-06-0503	270,948	-
	14.218	B-17-MC-06-0503	408,753	144,653
		Program income	30,000	-
Total CDBG Cluster			<u>1,353,291</u>	<u>144,653</u>
HOME Investment Partnerships Program	14.239	M-10-MC-06-0507	77,082	-
	14.239	M-11-MC-06-0507	4,754	-
	14.239	M-16-MC-06-0507	18,728	-
	14.239	M-17-MC-06-0507	25,077	-
		Program income	150,529	-
Total HOME Investment Partnerships Program			<u>276,170</u>	<u>-</u>
Total United States Department of Housing and Urban Development			<u>1,629,461</u>	<u>-</u>
<u>United States Department of Justice</u>				
Direct Assistance:				
Bulletproof Vest Partnership	16.607	n/a	56	-
Total United States Department of Justice			<u>56</u>	<u>-</u>
<u>United States Department of Homeland Security</u>				
Passed through the Governor's Office of Emergency Services:				
FEMA Fire Management Assistance Grant	97.046	USFS-BLM-NPS-FWS-BIA	38,675	-
Passed through the Orange County Sheriff Department:				
Emergency Management Performance Grant	97.042	059-00000	16,480	-
Total United States Department of Homeland Security			<u>55,155</u>	<u>-</u>
<u>United States Department of Transportation</u>				
Passed through California Department of Transportation:				
Citywide Safe Routes to School	20.205	SRTSLNI-5312(090)	14,450	-
Placentia Medians - Adams to Wilson	20.205	HSIP3-5312(092)	599,231	-
Bristol St. Medians- Baker to Newport	20.205	HSIP3-5312(093)	334,846	-
Harbor Blvd from 19th St to Wilson Improv	20.205	RPSTPLE-5312(099)	44,850	-
Bristol St and Bear St Rehabilitation	20.205	STPL-5312(100)	198,187	-
Total passed through California Department of Transportation			<u>1,191,564</u>	<u>-</u>
Passed through Orange County Transportation Authority:				
Placentia Ave Bicycle Signal	20.205	C-2-1891/CML-5312(095)	56,654	-
Total Highway Planning and Construction Cluster			<u>1,248,218</u>	<u>-</u>
Passed through California Office of Traffic Safety:				
Minimum Penalties for Repeat Offenders for Driving While Intoxicated	20.608	PT1728	12,132	-
Total Minimum Penalties for Repeat Offenders for Driving While Intoxicated	20.608	PT18032	83,378	-
			<u>95,510</u>	<u>-</u>
Passed through California Office of Traffic Safety:				
State and Community Highway Safety	20.600	PT1728	5,494	-
State and Community Highway Safety	20.600	PT18032	85,494	-
Total Highway Safety Cluster			<u>90,988</u>	<u>-</u>
Total United States Department of Transportation			<u>1,434,716</u>	<u>-</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 3,119,388</u>	<u>\$ 144,653</u>

See accompanying notes to schedule of expenditures of federal awards



**CITY OF COSTA MESA**

**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

Year ended June 30, 2018

(1) Summary of Significant Accounting Policies Applicable to the Schedule of Expenditures of Federal Awards

(a) Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards (the “Schedule”) includes the federal grant activity of the City of Costa Mesa (the City) under programs of the federal government for the year ended June 30, 2018. The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards. Because the Schedule presents only a selected portion of the operations of the City, it is not intended to and does not present the financial position, changes in net assets or cash flows of the City. The City did not use the 10% de minimis indirect cost rate as covered in section 200.414 of the Uniform Guidance.

(b) Summary of Significant Accounting Policies

Expenditures reported on the Schedule are reported on the modified-accrual basis of accounting for those grants that were recorded in governmental funds, and on the accrual basis of accounting for those grants that were recorded in proprietary funds. Such expenditures for part of the year are recognized following the cost principles contained in OMB Circular 87, Cost Principles for State, Local, and Indian Tribal Governments, and for part of the year contained in Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards wherein certain types of expenditures are not allowable or are limited as to reimbursement. Pass-through entity identifying numbers are presented where available.

(c) Subrecipients

For the fiscal year ended June 30, 2018, payments to subrecipients consisted of the following:

**Community Development Block Grant**

B-17-MC-06-0503	<u>\$ 144,653</u>
Total	<u>\$ 144,653</u>

**CITY OF COSTA MESA**  
**SUMMARY OF FINDINGS AND QUESTIONED COSTS**

Year ended June 30, 2018

**Section I – Summary of Auditor’s Results**

***Financial Statements:***

Type of auditor’s report issued:	Unmodified
Internal control over financial reporting:	
• Material weakness(es) identified?	Yes
• Significant deficiency(ies) identified not Considered to be material weaknesses?	Yes
Noncompliance material to financial statements noted?	No

***Federal Awards:***

Internal control over major programs:	
• Material weakness(es) identified?	No
• Significant deficiency(ies) identified not Considered to be material weaknesses?	No
Type of auditor’s report issued on compliance for major programs:	Unmodified
Any audit findings disclosed that are required to be reported in accordance with Uniform Guidance?	No

Identification of major programs:

<b><u>CFDA Number(s)</u></b>	<b><u>Name of Federal Program or Cluster</u></b>
20.205	Highway Planning and Construction Cluster

Dollar threshold used to distinguish between Type A and Type B programs:	\$750,000
Auditee qualified as a low-risk auditee?	Yes

**CITY OF COSTA MESA**  
**SUMMARY OF FINDINGS AND QUESTIONED COSTS**

(Continued)

**Section II – Findings Relating to the Basic Financial Statements Reported in Accordance with Government Auditing Standards**

**Reference Number: 2018-001**

***Audit Adjustments and Prior Period Restatements***

As a result of audit procedures, we proposed certain material audit adjustments as well as prior period adjustments. The accounting standards requires management to develop an effective internal control structure to identify material transactions and properly report them in the general ledger.

**Recommendation**

To minimize auditor detected adjustments and prior period adjustments, the City should improve procedures to, whenever possible, identify adjustments in the reporting period in which the related transactions occurred. It is recognized that this is not always possible and on occasion, the City accounting procedures will identify adjustments in subsequent periods. However, this should be mitigated when possible.

**Management’s Comments Regarding Corrective Actions Planned**

The City concurs with the auditor’s recommendation that improvements to our year-end close procedures are necessary. In preparation for the next year-end close, the City will develop procedures to ensure all material transactions are recorded in the proper reporting period.

**Reference Number: 2018-002**

***Financial Health and Deficit Fund Equity***

For the fiscal year ended June 30, 2018, the Governmental Activities of the City reported a deficit unrestricted net position of (\$224,657,548). Overall, the total net position of the Governmental Activities of the City is \$28,063,057. The unrestricted net position deficit is largely the result of the recent implementation of GASB Statement No. 68 that required the City to report net pension liabilities, and this year’s implementation of GASB Statement No. 75 that required the City to report total OPEB liabilities. As of June 30, 2018, the City’s net pension liability and total OPEB liability were \$300,897,566 and \$53,432,728, respectively, of which the entire amounts are payable from Governmental Activities.





## CITY OF COSTA MESA

### SUMMARY OF FINDINGS AND QUESTIONED COSTS

(Continued)

#### **Section II – Findings Relating to the Basic Financial Statements Reported in Accordance with Government Auditing Standards (Continued)**

account, the system no longer alerts the user that the expense account is over budget. The City conducts reviews of the final warrant register to identify new vendors and budget overrides; however, ideally the City would utilize system controls to support proper segregation of duties and budget controls.

#### **Recommendation**

We recommend the City evaluate the procedures in place to add/modify vendors and create budget overrides and consider reassigning duties or implementing additional systems or process controls.

#### **Management's Comments Regarding Corrective Actions Planned**

The City concurs with this finding and has already taken steps to limit staff access to add/modify vendors.

The deficiency to create budget overrides was previously identified by management and this functionality was turned off prior to the start of the audit; however, the lack of internal controls was present during the period being audited. We believe we have adequately addressed this concern.

#### **Section III – Federal Award Findings and Questioned Costs**

None noted.

**CITY OF COSTA MESA**  
**STATUS OF PRIOR AUDIT FINDINGS**

Year ended June 30, 2018

There were no finding reported for fiscal year 2016-2017.