

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

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

Year ended June 30, 2019

CITY OF COSTA MESA
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Year ended June 30, 2019

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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

The Honorable Mayor and City Council
City of 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, 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, 2019, 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 13, 2019.

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 the City of Costa Mesa's internal control. Accordingly, we do not express an opinion on the effectiveness of the City of Costa Mesa'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 entity's financial statements will not be prevented or detected and corrected on a timely basis. 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.

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. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs as items 2019-001 and 2019-002 that we consider to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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 "David Sun CP".

Irvine, California
December 13, 2019

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

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

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 the City of Costa Mesa's major federal programs for the year ended June 30, 2019. 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 the 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 the 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, 2019.

Report on Internal Control Over Compliance

Management of the 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 the 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 the 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 the City of Costa Mesa as of and for the year ended June 30, 2019 and have issued our report thereon dated December 13, 2019 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.

A handwritten signature in blue ink that reads "David Sun CP". The signature is written in a cursive, flowing style.

Irvine, California
December 13, 2019

CITY OF COSTA MESA
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year Ended June 30, 2019

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	\$ 15,804	\$ -
	14.218	B-15-MC-06-0503	72,581	-
	14.218	B-16-MC-06-0503	232,316	-
	14.218	B-17-MC-06-0503	332,458	-
	14.218	B-18-MC-06-0503	446,551	161,324
		Program income	29,857	-
Total CDBG Cluster			<u>1,129,567</u>	<u>161,324</u>
HOME Investment Partnerships Program	14.239	M-12-MC-06-0507	39,011	-
	14.239	M-17-MC-06-0507	14,736	-
	14.239	M-18-MC-06-0507	12,144	-
		Program income	103,027	-
Total HOME Investment Partnerships Program			<u>168,918</u>	<u>-</u>
Total United States Department of Housing and Urban Development			<u>1,298,485</u>	<u>161,324</u>
<u>United States Department of Justice</u>				
Direct Assistance:				
Bulletproof Vest Partnership	16.607	n/a	19,668	-
Total United States Department of Justice			<u>19,668</u>	<u>-</u>
<u>United States Department of Treasury</u>				
Direct Assistance:				
Federal Asset Forfeiture	21.016	n/a	46,868	-
Total United States Department of Treasury			<u>46,868</u>	<u>-</u>
<u>United States Department of Homeland Security</u>				
Passed through the Orange County Sheriff Department:				
Emergency Management Performance Grant	97.042	n/a	14,446	-
Total United States Department of Homeland Security			<u>14,446</u>	<u>-</u>
<u>United States Department Agriculture</u>				
Passed through the Governor's Office of Emergency Services:				
Cooperative Fire Protection Agreement	10.703	USFS-BLM-NPS-FWS-BIA	76,318	-
Total United States Department of Agriculture			<u>76,318</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)	1,196	-
Placentia Medians - Adams to Wilson	20.205	HSIP3-5312(092)	39,019	-
Red Hill Avenue Median - McCormick to Bristol	20.205	HSIP3-5312(094)	279,075	-
Harbor Boulevard from 19th Street to Wilson Improvements	20.205	RPSTPLE-5312(099)	271,515	-
Fairview Road from Baker to Adams	20.205	HSIPL-5312(102)	63,000	-
Total passed through California Department of Transportation			<u>653,805</u>	<u>-</u>
Passed through Orange County Transportation Authority:				
Placentia Avenue Bicycle Signal	20.205	C-2-1891/CML-5312(095)	41,148	-
Total Highway Planning and Construction Cluster			<u>694,953</u>	<u>-</u>
Passed through California Office of Traffic Safety:				
Minimum Penalties for Repeat Offenders	20.608	PT1728	25,255	-
for Driving While Intoxicated	20.608	PT18032	80,694	-
Total Minimum Penalties for Repeat Offenders for Driving While Intoxicated			<u>105,949</u>	<u>-</u>
Passed through California Office of Traffic Safety:				
State and Community Highway Safety	20.600	PT1728	7,490	-
State and Community Highway Safety	20.600	PT18032	49,481	-
Total Highway Safety Cluster			<u>56,971</u>	<u>-</u>
Total United States Department of Transportation			<u>857,873</u>	<u>-</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u><u>2,313,658</u></u>	<u><u>\$ 161,324</u></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, 2019

(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, 2019. 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, 2019, payments to subrecipients consisted of the following:

Community Development Block Grant

B-18-MC-06-0503	\$ 161,324
Total	\$ <u>161,324</u>

CITY OF COSTA MESA
SUMMARY OF FINDINGS AND QUESTIONED COSTS
Year ended June 30, 2019

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?	No
• 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:	

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
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14.218	CDBG Cluster
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Dollar threshold used to distinguish between Type A and Type B programs:	\$750,000
Auditee qualified as a low-risk auditee?	No

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: 2019-001

Financial Health and Deficit Fund Equity

We noted certain deficit balances in the financial statements that warrant management’s attention. For the fiscal year ended June 30, 2019, the City reported a positive net position of \$28,658,066. However, after removing amounts that are restricted for specific purposes or invested in capital assets, the City reported a deficit unrestricted net position of (\$241,478,263). The unrestricted net position deficit is largely the result of the recent accounting standards that required the City to report net pension liabilities and total Other Post Employment Benefit (“OPEB”) liabilities. As of June 30, 2019, the City’s net pension liability and total OPEB liability were \$295,591,759 and \$53,202,676, respectively.

We also noted that two of the City’s Internal Service Funds did not have sufficient revenues to cover expenses during the year. The Self Insurance Worker’s Compensation and General Liability Internal Service Fund expenses exceeded revenues by \$1,181,914 during the year which increased the fund deficit to (\$4,670,953) at June 30, 2019. The Equipment Replacement Fund expenses exceeded revenue by \$796,404 during the year which resulted in deficit cash and subsequent borrowing from other City funds.

Recommendation

We recommend the City continue to evaluate solutions for improving the overall Unrestricted Net Position deficit caused by the pension and OPEB liabilities. Additionally, the City should evaluate the Internal Service Fund charges for services to ensure the charges to other city funds are sufficient to cover expenses in those shared services funds.

Management’s Comments Regarding Corrective Actions Planned

The City concurs with the auditor’s recommendation and is actively working on a funding plan to address the city-wide long-term obligations such as pensions and OPEB. In addition, the insufficient revenues in the internal service funds were identified by the Finance Department in early 2019 and the department has been working on a plan to fund those costs. The issues in these funds developed over many years and will take some time to resolve, however, we anticipate making significant improvements over the next fiscal year.

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)

Reference Number: 2019-002

Financial Accounting System

The City's financial accounting system has not been substantially upgraded in a number of years and the current version of the system is no longer supported by the vendor. The current system properly records accounting information; however, it can be time intensive and costly to retrieve certain information from the system in a format that is useful for management.

Additionally, during our prior year audit, we performed a review of the City's information systems (IT) internal controls. Of the four specific recommendations we communicated in the prior year, two were fully addressed by the City and one was partially addressed. The City should continue making improvements in IT controls in the following areas:

- a) The City does not have documented policies and procedures over IT general controls, including access management, change management, and data backup.
- b) The City does perform periodic reviews of user accounts; however, we noted that a recent review had not been performed for financial system access, which would include remote access.

Recommendations

We recommend the City evaluate options for upgrading or replacing the current accounting system to a system that is supported by the vendor and able to provide information to management in a timely and simple manner.

The City should also consider implementing the following controls over the IT area:

- a) Document policies and procedures over IT systems, including an access management policy, change management procedures, and data backup procedures. Implement a process for tracking changes to applications, to include tracking of the request, testing, and approvals.
- b) Continue performing periodic reviews of user access to sensitive systems, including active directory, financial system, and remote access. The review should include financial system access, including remote access.

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)

Management’s Comments Regarding Corrective Actions Planned

The City concurs with the auditor’s recommendations. During fiscal year 2018-19, the City Council dedicated funding in the IT Replacement Internal Service Fund for a new Enterprise Resource Planning (ERP) system. The new ERP system, when implemented, will replace the outdated financial software and bring additional internal controls and operational efficiency to financial reporting. The City has already contracted with a consultant to start the development of a Request for Proposal for an ERP system, however due to other system implementations that are ongoing, the ERP system is not scheduled to be replaced until 2022 at the earliest.

The IT Department is also in the process of writing the policies and procedures for IT systems, including an access management policy and change management procedures. Data backup policies will be posted on the IT Policy section of the City’s intranet beginning in December 2019. The department is creating procedures which will document the systemic reviews of user access to sensitive systems, including the active employee directory, financial systems, and remote access.

CITY OF COSTA MESA
SUMMARY OF FINDINGS AND QUESTIONED COSTS
(Continued)

Section III – Federal Award Findings and Questioned Costs

None noted.

CITY OF COSTA MESA
STATUS OF PRIOR AUDIT FINDINGS

Year ended June 30, 2019

There were four findings reported in the Single Audit Report for fiscal year 2017-2018. The status of those findings is as follows:

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.

Status

This finding has been resolved since no material audit adjustments or prior period adjustments were noted during the current year audit.

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.

We also noted that the City's Self Insurance Worker's Compensation and General Liability Internal Service Fund had a deficit equity balance at the end of year of (\$3,489,039). We noted that the City made efforts during the fiscal year to decrease the fund's deficit; however, a deficit balance still exists at year end.

Status

This finding is being repeated in the current year as finding 2019-01 since similar deficits remain in the current year.

CITY OF COSTA MESA
STATUS OF PRIOR AUDIT FINDINGS

(Continued)

Reference Number: **2018-003**

Financial Accounting System

The City's financial accounting system has not been substantially upgraded in a number of years and the current version of the system is no longer supported by the vendor. The current system properly records accounting information; however, it can be time intensive and costly to retrieve certain information from the system in a format that is useful for management.

Additionally, during our audit, we performed a review of the City's information systems (IT) internal controls. We noted the following areas where controls could be strengthened:

- a) The City does not have documented policies and procedures over IT general controls, including access management, change management, and data backup.
- b) The City does not provide initial (upon hire) security awareness training and training annually thereafter.
- c) The City does not perform a periodic review of user accounts to sensitive systems, including access to the network (and VPN) and financial software.
- d) The City has not performed a recent system recovery to ensure the backup process is adequate and working properly.

Status

Items b) and d) were resolved during the fiscal year ended June 30, 2019, and item c) was partially resolved. The unresolved items are being reflected in the current year finding 2019-002.

Reference Number: **2018-004**

Internal Controls over Cash Disbursements

During our review of purchasing controls, we noted the individuals who process disbursements in the accounting system also have the ability to add/modify vendor information. Additionally, the system allows budget overrides and once a budget override has been done for an expense 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.

Status

This finding was resolved during the fiscal year ended June 30, 2019.