

CITY OF COSTA MESA, CALIFORNIA
SINGLE AUDIT OF FEDERALLY ASSISTED
GRANT PROGRAMS

JUNE 30, 2012

CITY OF COSTA MESA

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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 City Council
City of Costa Mesa
Costa Mesa, California

We have audited 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, 2012, which collectively comprise the City of Costa Mesa's basic financial statements and have issued our report thereon dated December 14, 2012. We conducted our audit 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.

Internal Control Over Financial Reporting

Management of the City is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

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 over financial reporting 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 financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Costa Mesa's financial statements are free of 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 reported to management of the City in a separate letter dated December 14, 2012.

This report is intended for the information and use of management, the City Council, others within the City, federal awarding agencies and pass-through entities 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 14, 2012

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH
REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT
ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133 AND ON
THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

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

Compliance

We have audited the City of Costa Mesa's (the City) compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that could have a direct and material effect on each of the City's major federal programs for the year ended June 30, 2012. The City of Costa Mesa's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the City of Costa Mesa's management. Our responsibility is to express an opinion on the City of Costa Mesa's compliance based on our audit.

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 OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 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 the 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. Our audit does not provide a legal determination on the City of Costa Mesa's compliance with those requirements.

In our opinion, the City of Costa Mesa complied, in all material respects, with the 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, 2012. However, the results of our auditing procedures disclosed one instance of noncompliance with those requirements, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as Finding 2012-01.

Internal Control Over Compliance

Management of the City of Costa Mesa is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the City's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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'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.

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 deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

The City's response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the City's response and, accordingly, we express no opinion on the response.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental 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, 2012, which collectively comprise the City's basic financial statements, and have issued our report thereon dated December 14, 2012, which contained unqualified opinions on those statements. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is not a required part of the basic 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 basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements of the City 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 information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

This report is intended for the information and use of management, the City Council, others within the City, federal awarding agencies and pass-through entities 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

December 14, 2012, except to the date for the Schedule of Expenditures of Federal Awards, to which the date is January 8, 2013.

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
AND
SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

CITY OF COSTA MESA
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

For the year ended June 30, 2012

Federal Grantor / Pass - Through Grantor / Program / Cluster Title	Catalog of Federal Domestic Assistance Number	Program Identification Number	Federal Expenditures
<u>United States Department of Housing and Urban Development</u>			
Direct Assistance:			
Community Development Block Grant (CDBG)	14.218	B - 11 - MC - 06 - 0503	\$ 1,358,202
HOME Investment Partnerships Program	14.239	M - 11 - MC - 06 - 0507	544,252
ARRA -Homelessness Prevention	14.257	S - 09 - MY - 06 - 0503	<u>155,352</u>
Total United States Department of Housing and Urban Development			<u>2,057,806</u>
<u>United States Department of the Interior</u>			
Passed through California Department of Parks and Recreation: Outdoor Recreation, Acquisition, Development and Planning - Fairview Park Channel			
	15.916	RT - 30 - 014	<u>207,357</u>
<u>United States Department of Justice</u>			
Direct Assistance:			
Federal Asset Forfeiture	16.000	N/A	697,408
Bulletproof Vest Partnership Program	16.607	None	2,619
COPS Hiring Program	16.710	2010-UMWX-0035	<u>178,857</u>
Total United States Department of Justice			<u>878,884</u>
<u>United States Department of Transportation</u>			
Passed through California Department of Transportation:			
ARRA - Highway Planning and Construction	20.205	ESPLE-5312(071)	9,457
Highway Planning and Construction	20.205	RPSTPLE-5312(075) SRTSLNI-5312(078)	156,969 22,579
Passed through Orange County Transportation Authority:			
Highway Planning and Construction	20.205	C-0-1802	<u>402,517</u>
Total Highway Planning and Construction			<u>591,522</u>

(Continued)

See Independent Auditors' Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133 and the Schedule of Expenditures of Federal Awards (pages 3 and 4) and Notes to Schedule of Expenditures of Federal Awards (pages 7 and 8).

CITY OF COSTA MESA

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
(CONTINUED)

For the year ended June 30, 2012

Federal Grantor / Pass - Through Grantor / Program / Cluster Title	Catalog of Federal Domestic Assistance Number	Program Identification Number	Federal Expenditures
<u>United States Department of Transportation (Continued)</u>			
Passed through California Office of Traffic Safety: State and Community Highway Safety	20.600	PT 1125 20413	\$ 80,928 <u>59,205</u>
Total State and Community Highway Safety			<u>140,133</u>
Minimum Penalties for Repeat Offenders for Driving While Intoxicated	20.608	20413	57,495
Passed through City of Anaheim: Minimum Penalties for Repeat Offenders for Driving While Intoxicated	20.608	20656	<u>2,197</u>
Total Minimum Penalties for Repeat Offenders for Driving While Intoxicated			<u>59,692</u>
Total United States Department of Transportation			<u>791,347</u>
<u>United States Department of Energy</u>			
Direct Program: ARRA - Energy Efficiency and Conservation Block Grant	81.128	DE - SC0001495	<u>545,600</u>
<u>United States Department of Homeland Security</u>			
Passed through the City of Santa Ana: Non-Profit Security Program	97.008	2009-0019	<u>253,636</u>
Passed through the City of Anaheim: Homeland Security Grant Program	97.067	2009-0019 2010-0085	3,819 50,965
Passed through the City of Santa Ana: Homeland Security Grant Program	97.067	2009-0019	<u>33,835</u>
Total Homeland Security Grant Program			<u>88,619</u>
Total United States Department of Homeland Security			<u>342,255</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 4,823,249</u>

See Independent Auditors' Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133 and the Schedule of Expenditures of Federal Awards (pages 3 and 4) and Notes to Schedule of Expenditures of Federal Awards (pages 7 and 8).

CITY OF COSTA MESA

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

For the year ended June 30, 2012

1. GENERAL:

The accompanying Schedule of Expenditures of Federal Awards presents only the expenditures incurred by the City of Costa Mesa that are reimbursable under federal programs of federal financial assistance. For the purposes of this schedule, federal financial assistance includes both federal financial assistance received directly from a federal agency, as well as federal funds received indirectly by the City from a nonfederal agency or other organization. Only that portion of program expenditures reimbursable with such federal funds are reported in the accompanying schedule. Program expenditures in excess of the maximum federal reimbursement authorized or the portion of the program expenditures that were funded with state, local or other non-federal funds are excluded from the accompanying schedule.

2. BASIS OF ACCOUNTING:

The accompanying Schedule of Expenditures of Federal Awards is presented using the modified accrual basis of accounting for governmental funds and the accrual basis for proprietary funds, which is described in the Note 1 of the notes to the City's financial statements.

3. RELATIONSHIP TO COMPREHENSIVE ANNUAL FINANCIAL REPORT:

Amounts reported in the accompanying Schedule of Expenditures of Federal Awards agree to amounts reported within the City's Comprehensive Annual Financial Report.

4. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS:

Amounts reported in the accompanying Schedule of Expenditures of Federal Awards agree with amounts reported in federal financial reports.

5. CONTINGENCIES:

Under the terms of federal and state grants, additional audits may be requested by the grantor agencies and certain costs may be questioned as not being appropriate expenditures under the terms of the grants. Such audits could lead to a request for reimbursement to the grantor agencies

See Independent Auditors' Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133 and on the Schedule of Expenditures of Federal Awards (pages 3 and 4) and the Schedule of Expenditures of Federal Awards (pages 5 and 6).

CITY OF COSTA MESA

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
(CONTINUED)

For the year ended June 30, 2012

6. SUBRECIPIENTS:

During the fiscal year ended June 30, 2012, the City disbursed federal funds to the following subrecipients under the Community Development Block Grant program (CFDA #14.218):

	Amount <u>Disbursed</u>
Community Senior Services	\$ 39,615
Youth Employment Services	23,590
Council on Aging	8,085
Colette's Children's House	13,495
Serving People In Need	18,005
Alzheimer's Family Services	8,985
Community and Schools Collaboration	2,899
Women Helping Women	18,005
Costa Mesa Senior Corp	13,495
Mercy House	8,985
Project Independence	13,494
Elwyn	13,494
Fair Housing Foundation	<u>22,825</u>
Total disbursed to subrecipients	<u>\$ 204,972</u>

See Independent Auditors' Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133 and on the Schedule of Expenditures of Federal Awards (pages 3 and 4) and on the Schedule of Expenditures of Federal Awards (pages 5 and 6).

CITY OF COSTA MESA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For the year ended June 30, 2012

1. SUMMARY OF AUDITORS' RESULTS:

- a. The auditors' report expresses an unqualified opinion on the financial statements of the City of Costa Mesa.
- b. No significant deficiencies or material weaknesses in internal control over financial reporting are reported in this schedule.
- c. No instances of noncompliance material to financial statements of the City of Costa Mesa, which would be required to be reported in accordance with Government Auditing Standards, were disclosed during the audit.
- d. No significant deficiencies or material weaknesses in internal control over major federal award programs were disclosed during the audit.
- e. The auditors' report on compliance for the major federal award programs for the City of Costa Mesa expresses an unqualified opinion on all major federal programs.
- f. Audit findings that are required to be reported in accordance with Section 510(a) of OMB Circular A-133 are reported in this Schedule. See Finding Number 2012-01.
- g. The threshold used for distinguish between type A and type B programs was \$300,000.
- h. The programs tested as major programs were:

HOME Investment Partnership Program	CFDA No. 14.239
Outdoor Recreation, Acquisition, Development and Planning - Fairview Park Channel	CFDA No. 15.916
Federal Asset Forfeiture	CFDA No. 16.000
COPS Hiring Program	CFDA No. 16.710
ARRA - Energy Efficiency Conservation Block Grant	CFDA No. 81.128
Non-Profit Security Program	CFDA No. 97.008

- i. The City of Costa Mesa did not qualify as a low-risk auditee.

See 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 and Independent Auditors' Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133 and on Schedule of Expenditures of Federal Awards (pages 1 through 4).

CITY OF COSTA MESA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(CONTINUED)

For the year ended June 30, 2012

2. FINDINGS RELATING TO FINANCIAL STATEMENTS:

There were no significant deficiencies or noncompliance material to the financial statements which were disclosed by the audit of the financial statements of the City of Costa Mesa for the year ended June 30, 2012.

3. FINDINGS AND QUESTIONED COSTS RELATING TO MAJOR FEDERAL AWARDS:

Finding Number 2012-01

Major Program

U.S. Department Housing and Urban Development - HOME Investment Partnerships Program (CFDA No. 14.239), Grant Identification Number: M-11-MC-06-0507

Criteria

24 CFR Part 92, Subpart k (92.502(c)(3)) states that HOME funds in the local account of the HOME Investment Trust Fund must be disbursed before requests are made for HOME funds in the United States Treasury account.

Condition

The results of our program income test work indicated the City does not exhaust its own funding available in their HOME Investment Trust Fund account before requesting draw downs from the HUD.

Effect

The City may be penalized or fined for its noncompliance with program compliance requirements.

Cause

It was a practice of the City to report program income to HUD in the IDIS system at the end of the year instead of when it was received. When the City applied program income at the end of June 30, 2012, there were not enough program expenditures to offset the program income received during the year which resulted in a large program income balance at year end. Also, the City received a lot more program income this year than in any other year.

See 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 and Independent Auditors' Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133 and on Schedule of Expenditures of Federal Awards (pages 1 through 4).

CITY OF COSTA MESA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(CONTINUED)

For the year ended June 30, 2012

3. FINDINGS AND QUESTIONED COSTS RELATING TO MAJOR FEDERAL AWARDS
(CONTINUED):

Finding Number 2012-01 (Continued)

Questioned Cost

Questioned cost is equal to the program income balance on hand at the end of June 30, 2012, which was \$145,660.

Recommendation

We recommend that the City establish procedures to ensure program income received related to the HOME Program are used before the City draws down funds from HUD. The performance of these procedures should be documented to ensure compliance with the monitoring and review programs.

Management's Response

The City has taken the necessary steps to implement procedures to ensure program income is used before drawing down funds from HUD.

See 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 and Independent Auditors' Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133 and on Schedule of Expenditures of Federal Awards (pages 1 through 4)

CITY OF COSTA MESA

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

For the year ended June 30, 2012

FINDINGS RELATING TO FINANCIAL STATEMENTS:

Finding Number 2011-01

Condition

The City has procedures in place to annually identify infrastructure projects that qualify as capital assets of the City. As a year-end closing procedure, Finance personnel meet with Public Services Department staff to discuss the various infrastructure projects that occurred during the year and to identify capital projects. During discussions this year, the Finance Department was informed that \$18.2 million of capital projects that had been previously capitalized by the City did not meet the criteria of consideration as an asset of the City. These projects previously identified as capital asset of the City are owned and maintained by CalTRANS.

The \$18.2 million of previously capitalized capital projects included \$12.5 million in depreciable assets (i.e. infrastructure) and \$5.7 million in construction in progress. The City recorded a prior period adjustment in the financial statements for the year ended June 30, 2011 to adjust for this information that was provided to the Finance Department this year.

It was also noted that certain infrastructure additions identified during the current year appeared to have been associated with the replacement of previously acquired infrastructure assets. No deletions were recorded in the capital assets records with respect to these replacements. It is likely that the net book value of the deleted assets was immaterial. Future procedures should include a consideration of such deletions were warranted.

Audit adjustments included reclassifying \$1.0 million of maintenance projects (\$260,000 in 2011 and \$840,000 in 2010) that did not meet capitalization requirements and the reclassification of \$2.1 million of projects listed as construction in progress that were in service as of June 30, 2011.

See 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 and Independent Auditors' Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133 and on Schedule of Expenditures of Federal Awards (pages 1 through 4).

CITY OF COSTA MESA

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
(CONTINUED)

For the year ended June 30, 2012

FINDINGS RELATING TO FINANCIAL STATEMENTS (CONTINUED):

Finding Number 2011-01 (Continued)

Recommendation

Discussions between personnel from the Finance Department and the Public Services Department should be enhanced to ensure that only infrastructure projects that qualify as City capital assets are capitalized. When agreements or other documents exist that address project ownership, these documents should be provided to the Finance Department to assist the Finance Department in its determination of asset ownership. The Finance Department should add additional questions to their annual inquiries or develop an internal form that would identify pertinent information to help ensure capital assets are properly accounted for. These additional questions should address the removal of existing capital assets that have been replaced, ensure projects meet the capitalization criteria and are not maintenance activities, and they should address if an asset is substantially complete and in-use as of June 30th. For significant asset replacements, a consideration should be made to record deletions for the replaced assets.

Current Status

The finding has been corrected.

See 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 and Independent Auditors' Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133 and on Schedule of Expenditures of Federal Awards (pages 1 through 4).