

To the Honorable City Council
of the City of Costa Mesa
Costa Mesa, California

We have audited the financial statements of the governmental activities, each major fund, and aggregate remaining fund information of the City of Costa Mesa (the City) for the year ended June 30, 2016. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you in our engagement letter dated February 1, 2016 and in our letter on planning matters dated May 31, 2016. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the financial statements. As discussed in Note 1 (i) to the financial statements, in fiscal year 2015-2016, the City implemented Governmental Accounting Standards Board (GASB) Statement No. 72, “*Fair Value Measurement and Application*”. GASB Statement No. 72 requires the City to use valuation techniques which are appropriate under the circumstances and are either a market approach, a cost approach or income approach. GASB Statement No. 72 establishes a hierarchy of inputs used to measure fair value consisting of three levels. Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Level 2 inputs are inputs, other than quoted prices included within Level 1, which are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs, and typically reflect management’s estimates of assumptions that market participants would use in pricing the asset or liability. GASB Statement No. 72 also contains note disclosure requirements regarding the hierarchy of valuation inputs and valuation techniques that were used for the fair value measurements. There was no material impact on the City’s financial statements as a result of the implementation of GASB Statement No. 72. As discussed in Notes 1(i), 14 and 24 to the financial statements, the City has recorded the net pension liability related to the Police 1% Supplemental Plan due to the early adoption of Governmental Accounting Standards Board’s (GASB) Statement No. 73, “*Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB 68, and Amendments to Certain Provisions of GASB 67 and 68.*” The adoption of these standards required retrospective application resulting in a \$703,205 reduction of previously reported net position of the governmental activities. No other accounting policies were adopted and the application of other existing polices was not changed during the year ended June 30, 2016. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Significant Audit Findings (Continued)

Qualitative Aspects of Accounting Practices (Continued)

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

The most sensitive estimates affecting the City's financial statements are as follows:

- a. Management's estimate of the fair value, the price that would be received to sell an asset in an orderly transaction between market participants, of investments is based on market values provided by outside sources.
- b. Management's estimate of the value of capital assets (infrastructure assets) is based on industry standards.
- c. The estimated useful lives of capital assets for depreciation purposes are based on industry standards.
- d. The annual required contributions, pension expense, net pension liability and corresponding deferred outflows of resources and deferred inflows of resources for the City's public defined benefit plans are based on actuarial valuations provided by outside resources.
- e. The annual required contribution and actuarial accrued liability for the City's Other Post-Employment Benefit Plan are based on certain actuarial assumptions and methods prepared by an outside consultant.
- f. The annual required contribution, pension expense and pension liability for the City's 1% Police Supplement Retirement Plan are based on certain actuarial assumptions and methods prepared by an actuary.
- g. Management's estimate of the claims payable liabilities related to general liability and worker's compensation claims are based on reports prepared by third-party administrators.

We evaluated the key factors and assumptions used to develop these estimates in determining that they were reasonable in relation to the financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were reported in Note 13 regarding the CalPERS defined benefit pension plans, Note 14 regarding the Police 1% Supplemental defined benefit plan, Note 16 regarding the City's other post-employment benefit plan, Note 19 regarding the claims payable, Note 22 regarding the recent changes in legislation affecting California Redevelopment Agencies, Note 23 regarding Successor Agency disclosure, and Note 24 regarding the restatement of prior year financial statements due to the implementation of GASB Number 73.

Significant Audit Findings (Continued)

Qualitative Aspects of Accounting Practices (Continued)

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. As a result of our audit related testwork, we proposed no corrections of the financial statements that, in our judgment, had a significant effect on the City of Costa Mesa's financial reporting process.

Disagreements with Management

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditors' report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated November 30, 2016.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Matters

We applied certain limited procedures to the management's discussion and analysis, the schedule of proportionate share of the net pension liability and the schedule of contributions – fire safety plans, the schedule of changes in the net pension liability and related ratios and the schedule of contributions – miscellaneous, police safety, and police 1% supplemental retirement plans, and the schedule of funding progress - other post-employment benefit plan, and budgetary comparison schedules for general and major special revenue funds, which are required supplementary information (RSI) that supplements the financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the individual major fund schedules, and combining and individual non-major fund financial statements and schedules (supplementary information), which accompany the financial statements but are not RSI. With respect to this supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the basic financial statements or to the basic financial statements themselves.

We were not engaged to report on the introductory section and statistical section, which accompany the financial statements but are not RSI. We did not audit or perform other procedures on this other information and we do not express an opinion or provide any assurance on them.

Restriction on Use

This information is intended solely for the use of the City Council and management of the City of Costa Mesa 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
November 30, 2016