



CITY COUNCIL AGENDA REPORT

MEETING DATE: JUNE 1, 2010

ITEM NUMBER:

SUBJECT: COSTA MESA SENIOR CENTER AGREEMENT

DATE: MAY 27, 2010

**FROM: ADMINISTRATIVE SERVICES DEPARTMENT - RECREATION DIVISION
CITY MANAGER'S DEPARTMENT**

PRESENTATION JANA M. RANSOM, RECREATION MANAGER

BY:

FOR FURTHER INFORMATION CONTACT: Allan L. Roeder at (714) 754-5328

RECOMMENDATION:

Consider proposed language modification as approved by the Board of the Costa Mesa Senior Corporation regarding independent audits.

BACKGROUND:

At its regular meeting of May 4, 2010, the City Council considered a proposed agreement from the Senior Center Task Force for operation of the Costa Mesa Senior Center. The current Agreement between the City and the Costa Mesa Senior Corporation expires June 30, 2010. A copy of the staff report and the proposed agreement from the meeting of May 4, 2010 are attached as Exhibit A.

The City Council discussed the recommended Agreement at length (Minutes for the May 4, 2010 meeting have not been approved as of this writing – Action Minutes are attached as Exhibit B) and ultimately amended and approved the Agreement. The amendment to the Agreement related to the authority of the City to conduct a forensic audit of the funds provided by the City to the Senior Center Corporation. More specifically, the amendment reads as follows:

“At the City’s option and at City’s expense a forensic audit may be conducted during the term of this Agreement.”

The Board of Directors of the Senior Corporation subsequently considered the Agreement as amended by the City Council. At its regularly scheduled meeting of May 18, 2010, the Board unanimously rejected the language in the proposed amendment. The Board did approve substitute language in an effort to address the City’s concerns, as follows:

“The Costa Mesa Senior Corporation agrees that the City may contract with its independent auditor to perform an audit in accordance with generally accepted accounting principals (GAAP) of the Corporation’s financial statements. The City shall be responsible for all costs of this independent audit, including costs incurred by the Senior Center staff.”

A written communication from Board President Bruce Garlich to Mayor Mansoor (please refer to Exhibit C) addresses the basis for the Board's rejection of the amendment and the proposed substitute language.

As noted above, the current Agreement expires this month. Unless the existing Agreement is extended or a new Agreement entered into by the Senior Corporation and the City, financial support and City staff support for the Senior Center will not be authorized beginning July 1, 2010.

ANALYSIS:

Because the original staff report as attached provides a thorough analysis of the proposed changes to the recommended Agreement, this report will focus only on the subject of the audit amendments and alternatives available. Staff conducted a modest level of research to find two relatively simple operational definitions to help the City Council and the public understand the distinction between a forensic audit and an audit based on generally accepted accounting principles or GAAP.

Forensic Audit

A forensic audit is best defined as the application of auditing skills to situations that have legal consequences, usually for the investigation and prosecution of criminal acts such as embezzling or fraud. The objective of a forensic audit is to investigate cases of suspected fraud so as to prove or disprove the suspicions. If the suspicions are proven, the forensic auditor tries to identify the person(s) involved in the fraud, support the audit findings by evidence, and to present the evidence in disciplinary or criminal proceedings.

Forensic audits are sought by CEOs, chief financial officers or board members who suspect embezzlement within the company. In addition to identifying fraudulent activities, forensic audits can also identify misappropriation of assets (i.e. cash theft, inventory frauds, and misuse of assets). It can also detect fraudulent financial reporting (i.e. misapplication of accounting standards, omission of transactions, falsification of accounting records, etc.). This type of audit is a very specialized type of engagement and requires highly skilled experts known as forensic accountants that have experience not only of accounting and auditing techniques, but also of the relevant legal framework. Forensic auditors are not required to be a Certified Public Accountant (CPA).

Generally Accepted Auditing Standards (GAAS) Audit

GAAS are systematic guidelines used by an auditor when conducting audits on company finances, ensuring the accuracy, consistency and verifiability of auditor's action and reports. These are the standards used by an auditor when rendering an opinion on audited financial statements. GAAS is divided into these main sections:

General Standards – The auditor must have adequate technical training and proficiency to perform the audit. They must maintain independence in mental attitude in all matters related to the audit. And, the auditors must use professional care when performing the audit and preparing the report.

Standards of Fieldwork – The auditor must adequately plan the work, maintain sufficient understanding of the entity and its environment, including internal controls, assess risk of material misstatement whether due to error or fraud and to design the nature and timing of the audit procedures. The auditor must obtain sufficient appropriate audit evidence by performing audit procedures to render an opinion regarding the financial statements under audit.

Standards of Reporting – The auditor must state in the auditor’s report whether the financial statements are presented in accordance with GAAP. The auditor must identify in the auditor’s report those circumstances in which such principles have not been consistently observed in the current period in relation to the preceding period. The auditor must either express an opinion regarding the financial statements, taken as a whole, or state that an opinion cannot be expressed, in the auditor’s report.

The California Accounting Standards Board regulations require only a Certified Public Accountant (CPA) can render an opinion on audited financial statements in accordance with GAAS.

Generally Accepted Accounting Principles (GAAP)

GAAP are a common set of accounting principles, standards and procedures that companies use to compile their financial statements. GAAP are a combination of authoritative standards used to record and report accounting information. However, the Financial Accounting Standards Board (abbreviated FASB) is the main contributor to GAAP. It sets out the standard for managing accounts, preparing financial statements and accounting methods and techniques.

The GAAP principles include consistency, relevance, reliability and comparability:

- Consistency means that all information should be gathered and presented the same way across all periods. For example, a company cannot change the way they account for inventory from one year to the next without disclosing the information in the financial statements and having a valid reason for the change.
- Relevance means the information presented in the financial statements should be appropriate.
- Reliability means that the information presented in the financial statements is reliable and verifiable by and independent party.
- Comparability is the most important GAAP category. By ensuring comparability, a company’s financial statements and other documentation can be compared to similar businesses in the same industry.

Both the audit language as amended and approved by the City Council as well as the substitute audit language approved by the Senior Corporation Board accords the City the right to conduct an audit. Both the amended language approved by the City Council and the substitute language approved by the Senior Corporation Board require that the City pay for the cost of an audit. The Senior Corporation is already required to follow generally accepted accounting principles to satisfy the financial reporting requirements of the State of California to remain a qualified non-profit corporation.

Consequently, the outstanding issue is that of a forensic audit. If the City Council believes it is important to retain the right to conduct a forensic audit, it would be appropriate to also include language that addresses under what circumstances such an audit would be conducted. This might be addressed by incorporating clarifying language to the amendment approved on May 4, 2010. The suggested language would read as follows: **“At the City’s option and at the City’s expense and based on a sound factual basis giving rise to reasonable cause to believe that fraud, misappropriation or embezzlement has occurred, the City may conduct a forensic audit during the term of this Agreement.”**

ALTERNATIVES TO BE CONSIDERED:

- Accept the substitute language proposed by the Senior Center Corporation;
- Retain the amended language as previously approved by the City Council;
- Rescind the previously approved amendment; or
- Extend the existing agreement for 6 months and reconvene the Senior Center Task Force to reconcile the issue.

FISCAL REVIEW:

The fiscal impact of the Agreement is addressed in the original staff report which is attached as an exhibit.

LEGAL REVIEW:

The City Attorney's Office has reviewed and approved the Agreement as to form.

CONCLUSION:

The expiration of the existing Agreement makes it very important that action be taken on this item at this time. Staff did not include under "Alternatives" the seeking of a new operator given both the time constraints but more importantly, the success between the City and the Senior Corporation over the course of many years.

ALLAN L. ROEDER
CITY MANAGER

Distribution: Administrative Services Director
Recreation Manager

Attachments: [Exhibit A May 4, 2010 Staff Report/Agreement](#)
[Exhibit B May 4, 2010 Meeting Action Minutes](#)
[Exhibit C Letter – Board President Bruce Garlich](#)