



December 21, 2016

To the Honorable Mayor and Members of the City Council  
City of Santa Monica, California

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Santa Monica, California (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 and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information during our meeting with the Audit Subcommittee on April 19, 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 the notes to the financial statements. Statement of Governmental Accounting Standards (GASB Statement) No. 72 - *Fair Value Measurement and Application* was implemented in fiscal year 2015-16. The effect of this new accounting standard is discussed in Note 1 to the basic financial statements.

As described in Note 20 to the basic financial statements, the State of California passed Senate Bill 107 (SB 107) during fiscal year 2015-16, which changed the allowable interest rates on loans between the City and Successor Agency of the Former Redevelopment Agency. Additionally, the principal balance of one of the loans was revised upwards based on a review performed by the California Department of Finance and interpretation of SB107. The City recognized an extraordinary gain of \$324,614 as a result of this upwards valuation in principal, and a net extraordinary loss of \$8,107,400 as a result of the change in interest rate computation. The Successor Agency of the Former Development Agency recognized reciprocal losses and gains. These items are reported as extraordinary items because of their infrequent and unusual nature, and because the effect of the change in State law was outside of the control of City management.

As also described in Note 20 to the basic financial statements, various events occurred during fiscal year 2015-16 which resulted in the reporting of special items. These special items are categorized as such because of their infrequent and unusual nature, but unlike extraordinary items, the effect of special items is within the control of City management. The City's General Fund and Community Development Block Grant Fund (collectively referred to as Governmental Activities) forgave notes from both the Airport Fund and the Successor Agency of the Former Redevelopment Agency. The effect of the forgiveness of these loans resulted in the City's Governmental Activities reporting a loss of \$11,893,876, with the Airport Fund recognizing a gain of \$2,136,023 and the Successor Agency of the Former Redevelopment Agency recognizing a gain of \$9,757,853. The Big Blue Bus Fund (BBB) also sold land during fiscal year 2015-16 that was historically valued on BBB's books at \$11,468,462 for a sale price of \$19,950,000, resulting in a special gain of \$8,481,538 reported by BBB.



To the Honorable Mayor and Members of the City Council  
City of Santa Monica, California

As described in Note 9 to the basic financial statements, on July 9, 2015, the Santa Monica Public Financing Authority issued \$26,360,000 of Santa Monica Public Financing Authority Lease Revenue Refunding Bonds Series 2015, bearing interest from 3.00% to 5.00% with a final maturity of July 1, 2033. The bonds were issued to refund the Santa Monica Public Financing Authority Lease Revenue Series 2004 (Civic Center Parking Project) Bonds. The aggregate difference in debt service between the refunding debt and the refunded debt is \$9.0 million and resulted in an economic gain of \$4.4 million. The reacquisition price exceeded the net carry value of the old debt by \$70.0 thousand. The amount is being netted against the new debt and amortized over the remaining life of the new debt, which is equal to the life of the refunded debt.

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.

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 were:

Management's estimate of the net pension liability and the net other post-employment benefits (OPEB) obligation is based on actuarial standards utilized in the relating actuarial reports. We evaluated the key factors and assumptions used to develop the net pension liability and net OPEB obligation in determining that it is reasonable in relation to the financial statements taken as a whole.

The disclosure of Pollution Remediation in Note 4 to the basic financial statements discusses the City's obligation for pollution remediation costs. Multiple methods for estimating the value of the obligation are available under GASB Statement No. 49 – *Accounting and Financial Reporting for Pollution Remediation Obligations*, including measuring the obligation at current value, expected total outlays, or expected future cash flow. The City has elected to measure the liability using the expected cash flow method, and includes an additional 10% contingency for unforeseen costs. As of June 30, 2016, the City has estimated that its total obligation for pollution remediation is \$121,120,931, with \$12,897,596 of that amount expected to be paid out during fiscal year 2016-17.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosure(s) affecting the financial statements was (were):

As described in Note 16 to the basic financial statements, the city has a defined benefit pension plan which is part of the Public Agency portion of the California Public Employees Retirement System (CalPERS), an agent multiple employer plan administered by CalPERS. The City reported a net pension liability of \$386,760,127 as compared to \$367,309,150 in the prior year. This liability represents the net difference between the pension plan assets and the total pension liability.

Additionally, the City provides other post-employment benefits (OPEB) based on agreements with various bargaining units. The City reported \$10,431,582 in net OPEB obligation as compared to \$10,323,773 in the prior year. This represents the balance of the unfunded annual required contributions. Beginning in fiscal year 2017-18, the City will be required to report the unfunded actuarial accrued liability on the face of the financial statements which as of July 1, 2015, the latest valuation date, was \$27,848,131.



To the Honorable Mayor and Members of the City Council  
City of Santa Monica, California

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 trivial, and communicate them to the appropriate level of management. No misstatements were found.

### ***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 auditor's 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 December 21, 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 schedules of revenues, expenditures and changes in fund balance – budget and actual for the general fund, special revenue source fund, and the low and moderate income housing assets fund, the schedule of changes in net pension liability and related ratio, the schedule of contributions – pension plans, and the OPEB funding information, which are required supplementary information (RSI) that supplements the basic 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.



To the Honorable Mayor and Members of the City Council  
City of Santa Monica, California

We were engaged to report on the combining and individual fund statements and schedules, 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 financial statements or to the financial statements themselves.

#### New Auditing Standard No. 130

This new auditing standard is effective for financial periods ending on or after December 15, 2016; for most California municipalities it is effective for the period July 1, 2016 through June 30, 2017 and future periods thereafter. The standard allows CPA firms to issue an opinion on the financial statements conformity with generally accepted accounting principles, as well as an opinion on the operating effectiveness of internal controls over financial reporting through an integrated audit. This standard does not change the objectives of a financial statement audit, it only enhances the value and scope of a financial statement audit and increases the level of assurance provided by CPA firms on financial controls. Municipalities should look to perform an integrated audit for more assurance on the operating effectiveness of internal controls over financial reporting.

#### New Accounting Standards

The following new Governmental Accounting Standards Board (GASB) pronouncements were effective for fiscal year 2015-2016 audit:

*GASB Statement No. 72, Fair Value Measurement and Application.*

*GASB Statement No. 76, The Hierarchy of Generally accepted Accounting Principles for State and Local Governments.*

*GASB Statement No. 79, Certain External Investment Pools and Pool Participants.*

The following Governmental Accounting Standards Board (GASB) pronouncements are effective in the following fiscal year audit and should be reviewed for proper implementation by management:

Fiscal year 2016-2017

*GASB Statement No. 73, Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement No. 68, and Amendments to Certain Provisions of GASB Statement Nos. 67 and 68.*

*GASB Statement No. 74, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans.*

*GASB Statement No. 77, Tax Abatement Disclosures.*

*GASB Statement No. 78, Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans.*

*GASB Statement No. 80, Blending Requirements for Certain Component Units-an amendment of GASB Statement No. 14.*



CPAs AND ADVISORS

To the Honorable Mayor and Members of the City Council  
City of Santa Monica, California

GASB Statement No. 82, *Pension Issues an Amendment of GASB Statements No. 67, No. 68, and No. 73.*

Fiscal year 2017-2018

GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions.*

GASB Statement No. 81, *Irrevocable Split Interest Agreements.*

**Restriction on Use**

This information is intended solely for the use of the City Council and management of the City of Santa Monica, California, and is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

A handwritten signature in black ink that reads "Lance, Solt &amp; Lughard, LLP". The signature is written in a cursive, flowing style.

Brea, California



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*

To the Honorable Mayor and Members of the City Council  
City of Santa Monica, 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 Santa Monica, California (the City), as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated December 21, 2016.

#### **Internal Control over Financial Reporting**

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

#### **Compliance and Other Matters**

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



CPAs AND ADVISORS

To the Honorable Mayor and Members of the City Council  
City of Santa Monica, California

**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'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 City's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Lance, Solt & Lughard, LLP*

Brea, California  
December 21, 2016