

**CITY OF IRVINE, CALIFORNIA
AIR QUALITY IMPROVEMENT
SPECIAL REVENUE FUND**

FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2017

CITY OF IRVINE, CALIFORNIA
AIR QUALITY IMPROVEMENT SPECIAL REVENUE FUND

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For the year ended June 30, 2017

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INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor and
Members of the City Council
of the City of Irvine
Irvine, California

We have audited the accompanying financial statements of the Air Quality Improvement Special Revenue Fund of the City of Irvine, California (the City), as of and for the year ended June 30, 2017, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the City's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Air Quality Improvement Special Revenue Fund of the City of Irvine, California, as of June 30, 2017, and the changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements present only the Air Quality Improvement Special Revenue Fund and do not purport to and do not present fairly the financial position of the City of Irvine as of June 30, 2017, or the changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. Our opinion on the financial statements is not affected by this missing information.

Other Reporting Required by Government Auditing Standards

In accordance with Government Auditing Standards, we have also issued our report dated October 31, 2017, on our consideration of the Air Quality Improvement Special Revenue Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting and compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

White Nelson Dick Evans LLP

Irvine, California
October 31, 2017

CITY OF IRVINE
AIR QUALITY IMPROVEMENT SPECIAL REVENUE FUND

BALANCE SHEET

June 30, 2017

ASSETS:

Cash and investments	\$ 543,125
Interest receivable	906
Due from other governments	<u>83,875</u>

TOTAL ASSETS	<u>\$ 627,906</u>
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FUND BALANCE:

Restricted for air pollution reduction	<u>\$ 627,906</u>
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TOTAL FUND BALANCE	<u>\$ 627,906</u>
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See accompanying notes to financial statements.

CITY OF IRVINE
AIR QUALITY IMPROVEMENT SPECIAL REVENUE FUND

STATEMENT OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCE

For the year ended June 30, 2017

REVENUES:		
Motor vehicle fees		\$ 329,958
Investment income		<u>8</u>
TOTAL REVENUES		<u>329,966</u>
EXPENDITURES:		
Direct program		<u>587,384</u>
TOTAL EXPENDITURES		<u>587,384</u>
DEFICIENCY OF REVENUES UNDER EXPENDITURES		(257,418)
FUND BALANCE:		
Balance at June 30, 2016		<u>885,324</u>
Balance at June 30, 2017		<u>\$ 627,906</u>

See accompanying notes to financial statements.

CITY OF IRVINE
AIR QUALITY IMPROVEMENT SPECIAL REVENUE FUND

NOTES TO FINANCIAL STATEMENTS

June 30, 2017

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The accompanying financial statements present only the Air Quality Improvement Special Revenue Fund of the City of Irvine, California (the City), and do not include any other funds of the City. The City's basic financial statements are available at City Hall.

Basis of Accounting

The accompanying financial statements for the Air Quality Improvement Special Revenue Fund of the City of Irvine, California, have been prepared on the modified accrual basis of accounting. Generally, revenues are recognized when they become "susceptible to accrual", that is, measurable and available to finance expenditures of the current period. Revenues susceptible to accrual include motor vehicle fees and interest earnings on investments received within 60 days of year-end. Expenditures are recognized when the fund liability is incurred, if measurable.

Measurement Focus

The Air Quality Improvement Special Revenue Fund is accounted for on a spending or "financial flow" measurement focus. This means that generally only current assets and current liabilities are included on the balance sheet. The statement of revenues, expenditures, and changes in fund balance for the Air Quality Improvement Special Revenue Fund generally presents increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in net current assets.

Air Quality Improvement Special Revenue Fund

California Assembly Bill 2766 authorizes air pollution control districts to levy fees on motor vehicles. Fees are to be used to reduce air pollution. Under this program, the Department of Motor Vehicles collects the fees and subvenes the amounts to the South Coast Air Quality Management District (SCAQMD) for vehicles registered in the South Coast District. Forty cents of every dollar subvented to SCAQMD is proportionately allocated to the cities and counties in the South Coast District based upon population. The amounts attributable to the City of Irvine, California, are maintained in the City's Air Quality Improvement Special Revenue Fund.

CITY OF IRVINE
AIR QUALITY IMPROVEMENT SPECIAL REVENUE FUND

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

June 30, 2017

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

2. CASH AND INVESTMENTS:

The Air Quality Improvement Special Revenue Fund cash balance is pooled with various other City of Irvine, California, funds for deposit and investment purposes. Each fund's share of the pooled cash account is separately accounted for, and investment income is allocated to all participating funds based on the relationship of their average daily cash balances to the total of the pooled cash and investments. Information regarding the authorized types of deposits and investments, the type of risks (i.e., credit, interest rate, custodial, etc.), and other disclosures associated with the City's pooled cash and investments is included in the City's basic financial statements, which are available at City Hall.

3. FUND BALANCE:

The entire fund balance of the Air Quality Improvement Special Revenue Fund is classified as restricted fund balance since the external resource provider, SCAQMD, requires that the motor vehicle fees be used only to reduce air pollution.

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
of the City of Irvine
Irvine, 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 *Governmental Auditing Standards*, issued by Comptroller General of the United States, the financial statements of the City of Irvine, California (the City) including the Air Quality Improvement Special Revenue Fund (the AQMD), as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the AQMD's basic financial statements, and have issued our report thereon dated October 31, 2017.

Internal Control over Financial Reporting

In planning and performing our audit of the AQMD financial statements, we considered the City's internal control over financial reporting (internal control) as it relates to the AQMD 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 related to AQMD. Accordingly, we do not express an opinion on the effectiveness of the City's internal control related to AQMD.

Our consideration of internal control was for the limited purpose described in the preceding paragraph 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. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and a significant deficiency.

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. We consider the deficiency described in the accompanying schedule of findings and responses, as Finding 2017-001, to be a material weakness.

Internal Control over Financial Reporting (Continued)

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. We consider the deficiencies described in the accompanying schedule of findings and responses, as Finding 2017-002 and 2017-003, to be a significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the AQMD's financial statements are free from material misstatements, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, including Assembly Bill 2766 (AB 2766) Chapter 1705 (Health and Safety Code Sections 44220 through 44247), noncompliance with which could have a direct and material effect on the determination of the AQMD's 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 of Irvine's Responses to Findings

The City's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. The City's responses were not subjected to the auditing procedures applied in the audit of the AQMD 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's internal control or on compliance related to AQMD. 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 related to AQMD. Accordingly, this communication is not suitable for any other purpose.

White Nelson Dick Evans LLP

Irvine, California
October 31, 2017

CITY OF IRVINE
AIR QUALITY IMPROVEMENT SPECIAL REVENUE FUND

SCHEDULE OF FINDINGS AND RESPONSES

For the year ended June 30, 2017

Finding 2017-001 – Material Weakness - Revenue Recognition

Governmental funds are accounted for on the modified accrual basis. As such, revenues are recognized only when they are measurable and available. Availability is defined as being collected within the current period or within 60 days after year-end. Those accrued revenues that are not available are recorded on the balance sheet as a deferred inflow of resources. We noted that the revenue related to a certain material receivable balance in the City’s Capital Project Improvement Fund was recorded as both unearned revenue and a deferred inflow of resources on the balance sheet which resulted in an understatement of fund balance. The cause for this duplication was an incorrect prior period adjustment made in fiscal year 2015-16. We recommend that a more thorough review of capital project related reimbursements occur during the year-end closing process to ensure the accuracy of the revenue recognition related to specific capital projects.

City’s Response

This was an isolated event involving a construction project with complicated cooperative agreements as well as amendments with several other agencies. Going forward all projects with multiple agreements that involve more than one agency are subject to an additional review by Fiscal Services before any billings and/or reimbursements are recorded.

Finding 2017-002 – Significant Deficiency - Construction in Progress

We identified certain capital improvement projects, where construction was completed and the projects were placed in service as of the end of the fiscal year; however, the asset values had not been transferred from the capital asset classification, “Construction in Progress” (CIP), to the appropriate capital asset category (e.g. infrastructure, improvements, etc.). As a result, the commencement of depreciation of the capital assets was delayed and the asset category balances in the capital asset note disclosures as of the end of the fiscal year were misstated. The City does perform an annual process in November each year to identify completed capital projects and has the City Council formally accept the projects as being complete. It is at this time that City adjusts the related CIP balances. Unfortunately, this practice can cause timing issues with generally accepted accounting principles. An important part of financial reporting is ensuring the accuracy of capital asset classifications and appropriately estimating the use of those capital assets in the form of depreciation expense. As these projects are completed and placed in service, the assets should be transferred to the appropriate capital asset category and depreciation of the capital assets should commence pursuant to the City’s depreciation policy. We recommend that the City consider moving the timing of their annual analysis process for formally accepting the completion of capital projects to July or August so that it can coincide with the year-end financial closing process to ensure that accounting for the completed capital projects is done in accordance with generally accepted accounting principles.

CITY OF IRVINE
AIR QUALITY IMPROVEMENT SPECIAL REVENUE FUND

SCHEDULE OF FINDINGS AND RESPONSES
(CONTINUED)

For the year ended June 30, 2017

Finding 2017-002 – Significant Deficiency - Construction in Progress (Continued)

City's Response

Fiscal Services follows an established capitalization practice where all Construction in Progress (CIP) projects are not capitalized or transferred into the appropriate capital asset category until the City Council approves the project closure. After discussion with the auditor, White Nelson Diehl Evans, staff will update the capital asset policy to include a section on the timing of the transfer of projects categorized as construction in progress to coincide with the requirements of generally accepted accounting principles.

Finding 2017-003 – Significant Deficiency – Contributed Capital Assets

We noted that two current year additions to the capital asset classification, Land, should have been recorded in prior years. These two additions represented the second and third installments relate to a long-term existing agreement whereby the third party was obligated to contribute land to the City for affordable housing. The Fiscal Services Division only identified the existence of this unrecorded land as a result of monitoring the minutes of recent council meetings in which discussions occurred about transferring this contributed land to the Irvine Community Land Trust. We recommend that the City departments responsible for monitoring activity related to multi-year agreements affecting City assets and obligations such as the one identified above, improve their communications with the Fiscal Services Division to ensure the timely and accurate recording of events involving the multi-year agreements.

City's Response

Fiscal Services has a standard procedure in place with Public Works to receive all donations of land, streets, parks, and other capital assets as a result of development. Staff will issue direction to guide the other departments on the proper procedure and processes for accepting and notifying Fiscal Services of the donation of capital assets.