



RON GALPERIN
CONTROLLER

September 13, 2017

Honorable Eric Garcetti, Mayor
Honorable Members of the City Council of the City of Los Angeles

SUBJECT: FISCAL YEAR 2016-17 AUDIT ENGAGEMENT LETTER

Attached to this transmittal is the fiscal year 2016-17 Audit Engagement letter for the City's Financial and Single Audits from the City's external auditor, Macias, Gini & O'Connell LLP (MGO). The Audit Engagement letter is required under current American Institute of CPAs (AICPA) and Government Accountability Office (GAO) guidelines as part of communications with those charged with governance of the entity being audited. The letter communicates:

- The responsibilities of the auditor under generally accepted auditing standards;
- The responsibilities of City management;
- The audit objectives and scope; and
- The audit procedures to be applied.

I have signed as the authorized representative of the City with the understanding that the letter will be communicated to the Mayor and Council for review.

If you have any questions, please contact Matthew Crawford, Director of Financial Analysis and Reporting at (213) 978-7300 or Matthew.Crawford@lacity.org.

Sincerely,

A handwritten signature in black ink, appearing to read 'Ron Galperin', written over a white background.

RON GALPERIN
City Controller

Attachments



August 21, 2017

To the Members of the City Council and Management of the
City of Los Angeles

We are pleased to confirm our understanding of the services we are to provide the City of Los Angeles (City) for the year ended June 30, 2017.

We will audit the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information, including the related notes to the financial statements, which collectively comprise the basic financial statements, of the City as of and for the year ended June 30, 2017. Accounting standards generally accepted in the United States of America (GAAP) provide for certain required supplementary information (RSI), such as management's discussion and analysis (MD&A), to supplement City's basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. As part of our engagement, we will apply certain limited procedures to the City's RSI in accordance with auditing standards generally accepted in the United States of America. These limited procedures will consist 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 will not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance. The following RSI is required by GAAP and will be subjected to certain limited procedures, but will not be audited:

- 1) Management's Discussion and Analysis
- 2) Schedule of Employer Contributions- Pensions
- 3) Schedule of Changes in the Net Pension Liability and Related Ratios
- 4) Actuarial Methods and Assumptions Used to Determine Employer Contribution Rates
- 5) Schedules of Funding Progress for Other Postemployment Benefits Healthcare Plans
- 6) Condition Rating for City Bridges
- 7) Comparison of Needed-to-Actual Maintenance/Preservation Costs

We have also been engaged to report on supplementary information other than RSI that accompanies the City's financial statements. We will subject the following supplementary information to the auditing procedures applied in our audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America, and we will provide an opinion on it in relation to the financial statements as a whole:

- 1) Schedule of Expenditures of Federal Awards in a separate written report accompanying our auditor's report on the financial statements or in a report combined with our auditor's report on the financial statements
- 2) Combining and Individual Fund Financial Statements and Schedules

The City's Comprehensive Annual Financial Report (CAFR) will also include introductory and statistical sections prepared by the City that will not be subjected to the auditing procedures applied in our audit of the financial statements, and for which our auditor's report will not provide any opinion or any assurance.

In addition to our audit of the basic financial statements of the City, we will also perform and report on the following separately:

- 1) Compliance audits (Single Audit) in accordance with U.S. Office of Management and Budget (OMB) Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance)
- 2) Audit of the financial statements of the Sewer Construction and Maintenance Fund (SCM), an enterprise fund of the City, in accordance with GAAP
- 3) Review of SCM's compliance with its debt service terms, covenants, provisions, or conditions
- 4) Audit of the financial statements of the Municipal Improvement Corporation of Los Angeles (MICLA), a component unit of the City, in accordance with GAAP
- 5) Audit of the financial statements of the Mobile Source Air Pollution Reduction Trust Fund in accordance with guidelines issued by the South Coast Air Quality Management District
- 6) Agreed upon procedures to perform a review of the GANN Appropriations Limit
- 7) Audit of the rates developed for each Cost Allocation Plans (CAP) and the application of CAP rates. We will render an opinion on each of the following components of CAP: (1) Central Services; (2) Fringe Benefits; (3) Departmental Administration and Support; and (4) Departmental Compensated Time Off (paid leave)
- 8) Attestation of the Service Organization Controls (SOC 1) relevant to user entities' internal control over financial reporting, in accordance with GAAP

Audit Objectives

The objective of our audit is the expression of opinions as to whether the City's financial statements are fairly presented, in all material respects, in conformity with GAAP and to report on the fairness of the supplementary information referred to in the second paragraph when considered in relation to the financial statements as a whole. The objective also includes reporting on—

- 1) Internal control over financial reporting and compliance with provisions of laws, regulations, contracts, and award agreements, noncompliance with which could have a material effect on the financial statements in accordance with *Government Auditing Standards*.
- 2) Internal control over compliance related to major programs and an opinion (or disclaimer of opinion) on compliance with federal statutes, regulations, and the terms and conditions of federal awards that could have a direct and material effect on each major program in accordance with the Single Audit Act Amendments of 1996 and Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).

The *Government Auditing Standards* report on internal control over financial reporting and on compliance and other matters will include a paragraph that states that (1) the purpose of the report is solely to describe the scope of testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance, and (2) the report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. The Uniform Guidance report on internal control over compliance will include a paragraph that states that the purpose of the report on internal control over compliance is solely to describe the scope of testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Both reports will state that the report is not suitable for any

other purpose. If during our audit we become aware that the City is subject to an audit requirement that is not encompassed in the terms of this engagement, we will communicate to management and those charged with governance that an audit in accordance with U.S. generally accepted auditing standards and the standards for financial audits contained in *Government Auditing Standards* may not satisfy the relevant legal, regulatory, or contractual requirements.

Our audit will be conducted in accordance with auditing standards generally accepted in the United States of America; the standards for financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; the Single Audit Act Amendments of 1996; and the provisions of the Uniform Guidance, and will include tests of accounting records, a determination of major program(s) in accordance with the Uniform Guidance, and other procedures we consider necessary to enable us to express such opinions. We will issue written reports upon completion of our Single Audit. Our reports will be addressed to the City Council of the City. We will make reference to KPMG, LLP's audit of the Department of Water and Power (DWP), Brown Armstrong's audit of the Los Angeles City Employees' Retirement System (LACERS), and Simpson & Simpson's audits of the Los Angeles Fire and Police Pension System (LAFPP) and the Department of Water and Power's Retirement Plan and Retiree Health Benefits Fund in our report on your financial statements. We cannot provide assurance that unmodified opinions will be expressed. Circumstances may arise in which it is necessary for us to modify our opinions or add emphasis-of-matter or other-matter paragraphs. If our opinions on the financial statements or the single audit compliance opinions are other than unmodified, we will discuss the reasons with you in advance. If, for any reason, we are unable to complete the audit or are unable to form or have not formed opinions, we may decline to express opinions or issue reports, or we may withdraw from this engagement.

Audit Procedures—General

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit will involve judgment about the number of transactions to be examined and the areas to be tested. 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 will plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether from (1) errors, (2) fraudulent financial reporting, (3) misappropriation of assets, or (4) violations of laws or governmental regulations that are attributable to the government or to acts by management or employees acting on behalf of the government. Because the determination of abuse is subjective, *Government Auditing Standards* do not expect auditors to provide reasonable assurance of detecting abuse.

Because of the inherent limitations of an audit, combined with the inherent limitations of internal control, and because we will not perform a detailed examination of all transactions, there is a risk that material misstatements or noncompliance may exist and not be detected by us, even though the audit is properly planned and performed in accordance with U.S. generally accepted auditing standards and *Government Auditing Standards*. In addition, an audit is not designed to detect immaterial misstatements or violations of laws or governmental regulations that do not have a direct and material effect on the financial statements or major programs. However, we will inform the appropriate level of management of any material errors, any fraudulent financial reporting, or misappropriation of assets that come to our attention. We will also inform the appropriate level of management of any violations of laws or governmental regulations that come to our attention, unless clearly inconsequential, and of any material abuse that comes to our attention. We will include such matters in the reports required for a Single Audit. Our responsibility as auditors is limited to the period covered by our audit and does not extend to any later periods for which we are not engaged as auditors.

Our procedures will include tests of documentary evidence supporting the transactions recorded in the accounts, and may include tests of the physical existence of inventories, and direct confirmation of receivables and certain other assets and liabilities by correspondence with selected individuals, funding sources, creditors, and financial institutions. We will request written representations from the City Attorney as part of the engagement. At the conclusion of our audit, we will require certain written representations from you about your responsibilities for the financial statements; schedule of expenditures of federal awards; federal award programs; compliance with laws, regulations, contracts, and grant agreements; and other responsibilities required by generally accepted auditing standards.

Audit Procedures—Internal Control

Our audit will include obtaining an understanding of the government and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing, and extent of further audit procedures. Tests of controls may be performed to test the effectiveness of certain controls that we consider relevant to preventing and detecting errors and fraud that are material to the financial statements and to preventing and detecting misstatements resulting from illegal acts and other noncompliance matters that have a direct and material effect on the financial statements. Our tests, if performed, will be less in scope than would be necessary to render an opinion on internal control and, accordingly, no opinion will be expressed in our report on internal control issued pursuant to *Government Auditing Standards*.

As required by the Uniform Guidance, we will perform tests of controls over compliance to evaluate the effectiveness of the design and operation of controls that we consider relevant to preventing or detecting material noncompliance with compliance requirements applicable to each major federal award program. However, our tests will be less in scope than would be necessary to render an opinion on those controls and, accordingly, no opinion will be expressed in our report on internal control issued pursuant to the Uniform Guidance.

An audit is not designed to provide assurance on internal control or to identify significant deficiencies or material weaknesses. However, during the audit, we will communicate to management and those charged with governance internal control related matters that are required to be communicated under AICPA professional standards, *Government Auditing Standards*, and the Uniform Guidance.

Audit Procedures—Compliance

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we will perform tests of the City's compliance with provisions of applicable laws, regulations, contracts, and agreements, including grant agreements. However, the objective of those procedures will not be to provide an opinion on overall compliance and we will not express such an opinion in our report on compliance issued pursuant to *Government Auditing Standards*.

The Uniform Guidance requires that we also plan and perform the audit to obtain reasonable assurance about whether the auditee has complied with federal statutes, regulations, and the terms and conditions of federal awards applicable to major programs. Our procedures will consist of tests of transactions and other applicable procedures described in the *OMB Compliance Supplement* for the types of compliance requirements that could have a direct and material effect on each of the City's major programs. The purpose of these procedures will be to express an opinion on the City's compliance with requirements applicable to each of its major programs in our report on compliance issued pursuant to the Uniform Guidance.

Other Services

We will also assist in preparing the financial statements and related notes of SCM and MICLA in conformity with GAAP based on information provided by you. In addition, we will assist in preparing the City's Single Audit report, including the schedule of expenditures of federal awards and related notes, in accordance with GAAP and the Uniform Guidance. These non-audit services do not constitute an audit under *Government Auditing Standards* and such services will not be conducted in accordance with *Government Auditing Standards*.

We will also provide tax preparation services to MICLA by assisting in the preparation of the Federal form 990, California form 199, and RRF-1 Annual Registration Renewal Fee Report. A separate letter outlining the nature and scope of our services will be provided by us to the responsible City party(ies).

We will perform the services in accordance with applicable professional standards. The other services are limited to the preparation of the financial statements and related notes, as previously defined. We, in our sole professional judgment, reserve the right to refuse to perform any procedure or take any action that could be construed as assuming management responsibilities.

Management Responsibilities

Management is responsible for (1) establishing and maintaining effective internal controls, including internal controls over federal awards, and for evaluating and monitoring ongoing activities, to help ensure that appropriate goals and objectives are met; (2) following laws and regulations; (3) ensuring that there is reasonable assurance that government programs are administered in compliance with compliance requirements; and (4) ensuring that management and financial information is reliable and properly reported. Management is also responsible for implementing systems designed to achieve compliance with applicable laws, regulations, contracts, and grant agreements. You are also responsible for the selection and application of accounting principles; for the preparation and fair presentation of the financial statements, schedule of expenditures of federal awards, and all accompanying information in conformity with GAAP; and for compliance with applicable laws and regulations (including federal statutes) and the provisions of contracts and grant agreements (including award agreements). Your responsibilities also include identifying significant contractor relationships in which the contractor has responsibility for program compliance and for the accuracy and completeness of that information.

Management is also responsible for making all financial records and related information available to us and for the accuracy and completeness of that information. You are also responsible for providing us with (1) access to all information of which you are aware that is relevant to the preparation and fair presentation of the financial statements, (2) access to personnel, accounts, books, records, supporting documentation, and other information as needed to perform an audit under the Uniform Guidance, (3) additional information that we may request for the purpose of the audit, and (4) unrestricted access to persons within the government from whom we determine it necessary to obtain audit evidence.

Management's responsibilities include adjusting the financial statements to correct material misstatements and confirming to us in the management representation letter that the effects of any uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements as a whole.

Management is responsible for the design and implementation of programs and controls to prevent and detect fraud, and for informing us about all known or suspected fraud affecting the government involving (1) management, (2) employees who have significant roles in internal control, and (3) others where the fraud could have a material effect on the financial statements. Management's responsibilities include

informing us of your knowledge of any allegations of fraud or suspected fraud affecting the government received in communications from employees, former employees, grantors, regulators, or others. In addition, management is responsible for identifying and ensuring that the government complies with applicable laws, regulations, contracts, agreements, and grants. Management is also responsible for taking timely and appropriate steps to remedy fraud and noncompliance with provisions of laws, regulations, contracts, and grant agreements, or abuse that we report. Additionally, as required by the Uniform Guidance, it is management's responsibility to evaluate and monitor noncompliance with federal statutes, regulations, and the terms and conditions of federal awards; take prompt action when instances of noncompliance are identified including noncompliance identified in audit findings; promptly follow up and take corrective action on reported audit findings; and prepare a summary schedule of prior audit findings and a separate corrective action plan. The summary schedule of prior audit findings should be available for our review prior to completion of fieldwork.

Management is responsible for identifying all federal awards received and understanding and complying with the compliance requirements and for the preparation of the schedule of expenditures of federal awards (including notes and noncash assistance received) in conformity with the Uniform Guidance. Management agrees to include our report on the schedule of expenditures of federal awards in any document that contains and indicates that we have reported on the schedule of expenditures of federal awards. Management also agrees to include the audited financial statements with any presentation of the schedule of expenditures of federal awards that includes our report thereon. Management's responsibilities include acknowledging to us in the written representation letter that (1) management is responsible for presentation of the schedule of expenditures of federal awards in accordance with the Uniform Guidance; (2) management believes the schedule of expenditures of federal awards, including its form and content, is stated fairly in accordance with the Uniform Guidance; (3) the methods of measurement or presentation have not changed from those used in the prior period (or, if they have changed, the reasons for such changes); and (4) management has disclosed to us any significant assumptions or interpretations underlying the measurement or presentation of the schedule of expenditures of federal awards.

Management is also responsible for the preparation of the other supplementary information, which we have been engaged to report on, in conformity with GAAP. Management agrees to include our report on the supplementary information in any document that contains, and indicates that we have reported on, the supplementary information. Management also agrees to include the audited financial statements with any presentation of the supplementary information that includes our report thereon. Management's responsibilities include acknowledging to us in the written representation letter that (1) management is responsible for presentation of the supplementary information in accordance with GAAP; (2) management believes the supplementary information, including its form and content, is fairly presented in accordance with GAAP; (3) the methods of measurement or presentation have not changed from those used in the prior period (or, if they have changed, the reasons for such changes); and (4) management has disclosed to us any significant assumptions or interpretations underlying the measurement or presentation of the supplementary information.

Management is responsible for establishing and maintaining a process for tracking the status of audit findings and recommendations. Management is also responsible for identifying and providing report copies of previous financial audits, attestation engagements, performance audits, or other studies related to the objectives discussed in the Audit Objectives section of this letter. This responsibility includes relaying to us corrective actions taken to address significant findings and recommendations resulting from those audits, attestation engagements, performance audits, or studies. Management is also responsible for providing management's views on our current findings, conclusions, and recommendations, as well as your planned corrective actions, for the report, and for the timing and format for providing that information.

Management agrees to assume all management responsibilities relating to the financial statements, schedule of expenditures of federal award, related notes, and any other non-audit services we provide. Management will be required to acknowledge in the management representation letter our assistance with preparation of the financial statements and related notes for SCM and MICLA, and the City's schedule of expenditures of federal awards, and related notes and that you have reviewed and approved these financial statements, the schedule of expenditures of federal awards, and related notes prior to their issuance and have accepted responsibility for them. Further, management agrees to oversee the non-audit services by designating an individual, preferably from senior management, with suitable skill, knowledge, or experience; evaluate the adequacy and results of those services; and accept responsibility for them.

Engagement Administration, Fees, and Other

Assistance from the City

We understand that the City's employees will prepare all cash, accounts receivable, or other confirmations we request and will locate any documents selected by us for testing.

Data Collection Form

At the conclusion of the engagement, we will complete the appropriate sections of the Data Collection Form that summarizes our audit findings. It is management's responsibility to electronically submit the reporting package (including financial statements, schedule of expenditures of federal awards, summary schedule of prior audit findings, auditors' reports, and corrective action plan) along with the Data Collection Form to the federal audit clearinghouse. We will coordinate with you the electronic submission and certification. If applicable, we will provide copies of our report for you to include with the reporting package you will submit to pass-through entities. The Data Collection Form and the reporting package must be submitted within the earlier of 30 calendar days after receipt of the auditors' reports or nine months after the end of the audit period, unless a longer period is agreed to in advance by the U.S. Department of Housing and Urban Development.

Report Copies

We will provide copies of our reports to the City; however, management is responsible for distribution of the reports and the financial statements. Unless restricted by law or regulation, or containing privileged and confidential information, copies of our reports are to be made available for public inspection.

Audit Documentation

The audit documentation for this engagement is the property of Macias Gini & O'Connell, LLP (MGO) and constitutes confidential information. However, subject to applicable laws and regulations, audit documentation and appropriate individuals will be made available upon request and in a timely manner to the U.S. Department of Housing and Urban Development or its designee, a federal agency providing direct or indirect funding, the U.S. Government Accountability Office, or the California State Controller's Office for purposes of a quality review of the audit, to resolve audit findings, or to carry out oversight responsibilities.

We will notify management of any such request. If requested, access to such audit documentation will be provided under the supervision of MGO personnel. Furthermore, upon request, we may provide copies of selected audit documentation to the aforementioned parties. These parties may intend, or decide, to distribute the copies or information contained therein to others, including other governmental agencies.

The audit documentation for this engagement will be retained for a minimum of seven years after the report release date or for any additional period requested by the the U.S. Department of Housing and Urban Development or the California State Controller's Office. If we are aware that a federal awarding agency, pass-through entity, or auditee is contesting an audit finding, we will contact the party(ies) contesting the audit finding for guidance prior to destroying the audit documentation.

Upon expiration of the seven-year period, MGO will be free to destroy our records related to this engagement. However, MGO does not keep any original client records, so we will return those to management at the completion of the services rendered under this engagement. When records are returned to management, it is management's responsibility to retain and protect the records for possible future use, including potential examination by any government or regulatory agencies. By your signature below, you acknowledge and agree that upon expiration of the seven year period Macias Gini & O'Connell LLP shall be free to destroy our records related to this engagement.

Engagement Partner

James V. Godsey is the engagement partner and is responsible for supervising the engagement and signing the reports or authorizing another individual to sign them.

Fees

Our fees are outlined in the Second Amendment of the Contract # C-124148.

Additional major Single Audit programs (exceeding twenty programs) due to changes in risk assessment or additional major programs are identified:

- 1) \$13,000 for each additional major program.
- 2) To be determined upon receipt of June 30, 2017 Schedule of Expenditures of Federal Awards.

Independence

Professional and certain regulatory standards require us to be independent, in both fact and appearance, with respect to the City in the performance of our services. Any discussions that the City representatives have with professional personnel of MGO regarding employment could pose a threat to our independence. Therefore, you agree to inform us prior to any such discussions so that we can implement appropriate safeguards to maintain our independence.

General

Government Auditing Standards require that we provide the City with a copy of our most recent external peer review report and any letter of comment, and any subsequent peer review reports and letters of comment received during the period of the contract. Our 2015 peer review report accompanies this letter.

