



# Agenda Report

March 25, 2019

**TO:** Honorable Mayor and City Council/Successor to Pasadena  
Community Development Commission

**THROUGH:** Finance/Audit Committee

**FROM:** Director of Finance

**SUBJECT: AUTHORIZATION TO AMEND CONTRACT WITH LANCE, SOLL  
& LUNGHARD LLP, CERTIFIED PUBLIC ACCOUNTANTS FOR  
AUDIT SERVICES FOR FISCAL YEAR 2019**

**RECOMMENDATION:**

It is recommended that the City Council:

1. Find that the proposed action is not a project subject to the California Environmental Quality Act (CEQA) as defined in Section 21065 of CEQA and Sections 15060 (c)(2), 15060 (c)(3), and 15378 of the State CEQA Guidelines and, as such, no environmental document pursuant to CEQA is required for the project; and
2. Authorize the City Manager to execute an amendment to contract 22,282 with Lance, Soll & Lunghard LLP, Certified Public Accountants (LSL), for a standard audit performed in accordance with *Government Auditing Standards* for fiscal year 2019 audits of the financial statements of the City and its operating companies, and to include audit services for the Housing Successor Agency and Foothill Workforce Development Board Financial Statements, in a total amount not to exceed \$203,117; and
3. Grant the proposed amendment an exemption from the Competitive Selection process pursuant to Pasadena Municipal Code Section 4.08.049(B), contracts for which the City's best interests are served.

## **EXECUTIVE SUMMARY:**

In the City's post-embezzlement environment and with the Tyler Munis implementation, the enhanced audit approach was valuable; however, staff believes that we are seeing a diminishing return for the enhanced audit both in the cost and time to perform the audit. Additionally, the City now has internal auditor staff, has completed citywide risk assessments, and has made numerous internal control improvements. Both staff and LSL believe that the audit findings for fiscal year 2018 would have been identified under a standard audit, which is based on an estimated 1,500 hours of auditor staff time. Therefore, staff recommends that the City Council extend the contract under a standard audit approach for the final, one-year option for fiscal year 2019.

## **BACKGROUND:**

Section 912 of the City Charter requires the City Council to employ a certified public accountant to examine the City's records, books, and inventories and report findings to the City Council.

In 2015, the City issued a Request for Proposals (RFP) that resulted in eight proposals. The RFP included a request for options for a standard audit and an enhanced audit. As a result, Lance, Soll & Lunghard (LSL) was awarded the contract for three years with two, one-year options with the more rigorous of their two options selected. On May 14, 2018, the City Council approved a one-year extension on the contract, continuing the enhanced audit, and requesting that staff return to City Council for discussion on the options available for the second, one-year option for fiscal year 2019.

There are three key concepts involved in financial statement audits: *fair presentation*, *reasonable assurance*, and *materiality*.

***Fair presentation:*** The auditor is responsible for rendering an opinion on whether the financial statements are *fairly presented*. Stated differently, the independent audit is an evaluation of the reliability of an entity's financial reporting, not an assessment of its economic well-being.

***Reasonable assurance:*** Costs should never exceed related benefits. Thus, the independent auditor's goal is to obtain *reasonable assurance* concerning the *fair presentation* of financial statements, not certainty. Consistent with this approach, auditors rely heavily on sampling rather than attempting to test each and every transaction.

***Materiality:*** Potential misstatements are virtually unavoidable; therefore, consistent with the concept of *reasonable assurance*, the possibility of a minimal degree of misstatement must be accepted. Thus the goal is for the financial statements to be free

from *material* misstatements (that is, misstatements that are significant enough to matter to the user of the financial statements or adversely affect their decisions).

It is possible to increase the *reasonable assurance* by requiring increased sample sizes. This can be done in two ways, just require more samples (Option 2), or require a lower *materiality* threshold (Option 3), which would also cause more samples to be selected. Lower *materiality* also means that auditors would review more transactions.

Government audits are performed in accordance with *generally accepted auditing standards* (GAAS), which are set by the American Institute of Certified Public Accountants (AICPA), and *generally accepted government auditing standards* established by the U.S. Government Accountability Office (GOA). These are robust standards and all of the options available to the City must be performed in compliance with these professional standards. Regardless of the level of sampling, numerous other procedures are performed in all audits. These include interviews with key staff members, third party independent confirmation of cash and investments, test calculations, review of City Council and Finance Committee minutes, communication with the Finance/Audit committee at the beginning and end of audits, searches for unrecorded liabilities, and numerous other audit tests.

The three options available for the last optional year under this contract are:

- Option 1: Revert to a standard audit where samples are selected from all transactions but may not include samples from every City fund. Cost: \$186,617 (Recommended);
- Option 2: Change to a less robust enhanced audit option where samples will be from every fund with sample size determined by the total number of individual transactions in each fund. This option is anticipated to require an extra 300 hours of auditor time. Cost: \$220,231;
- Option 3: Continue with the more robust methodology used for the last four years where LSL:
- Increased audit sample size beyond those required by professional audit standards by lowering the materiality threshold of all major funds by 25 percent and by calculating materiality for non-major funds;
  - Included samples of all individual transactions over each fund's materiality level;
  - Pulled samples from all funds;
  - Added approximately 600 hours of auditor time above the standard audit;
  - Cost \$254,749.

LSL has performed well as the City's auditor, and their pricing was competitive in comparison to the other proposers in 2015. LSL reaffirmed their originally proposed pricing for the final year of the contract (Appendix A). They have also proposed two additional services which are required, but were not part of the original RFP. The City is now required to submit a Housing Successor audit. This requirement came as part of the dissolution of redevelopment and was not included in the RFP. LSL has performed this audit at no additional cost since it became a requirement. LSL's proposal for this audit is for \$7,500.

The Foothill Workforce Development Board as a Joint Powers Authority, requires an annual audit. This requirement has been fulfilled during the timeframe that LSL has included all funds as part of their enhanced audit methodology. If the City reverts to a standard audit, a separate audit and opinion letter is required for the Foothill Workforce Development Board. LSL's proposal for this audit is \$9,000.

The savings of \$68,132 from reverting to a standard audit is reduced to \$51,632 after adding these two required services.

**COUNCIL POLICY CONSIDERATION:**

The City Council's strategic planning goal of maintaining fiscal responsibility and stability will be advanced through the retention of our present auditors for one additional year.

**ENVIRONMENTAL ANALYSIS:**

The action proposed herein is not a project subject to the California Environmental Quality Act (CEQA) in accordance with Section 21065 of CEQA and State CEQA Guidelines Sections 15060 (c)(2), 15060 (c)(3), and 15378. The authorization of a contract for auditing services is an organizational and administrative action that would not cause either a direct physical change in the environment or a reasonably foreseeable indirect physical change in the environment. Therefore, the proposed action is not a "project" subject to CEQA, as defined in Section 21065 of CEQA and Section 15378 of the State CEQA Guidelines. Since the action is not a project subject to CEQA, no environmental document is required.

**FISCAL IMPACT:**

The cost of a fiscal year 2019 standard audit and the additional required services is \$203,117. Funds for the fiscal year 2019 audit are included in the City's Operating Budget. The Rose Bowl Operating Company, the Pasadena Center Operating Company, and the Pasadena Community Access Corporation will pay for their respective audits.

Respectfully submitted,

  
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MATTHEW E. HAWKESWORTH  
Director of Finance

Prepared by:

  
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Controller

Approved by:

  
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STEVE MERMELL  
City Manager

Attachments: (2)

- 1) Taxpayer Protection Amendment Disclosure
- 2) Appendix A, LSL CPAs Quote for Audit Services