

IMPERIAL BEACH FINANCES

A CITY UNDER STRESS

SUMMARY

Imperial Beach is a city of 26,000 people that bills itself as the “Most southwesterly city in the continental US.” To quote their website: “one of the last untouched beach towns in Southern California, we are known as Classic Southern California.”¹ It is also a city whose finances have been under stress for many years. It has been the subject of criticism by pundits and citizens, as well as San Diego County officials.

The City of Imperial Beach (City) has also become dependent upon its Redevelopment Agency (RDA) funds. The RDA’s tax increment funding² has provided over 10% of City employees’ salaries and has had a budget fully 50% as large as the City’s General Fund. As of February 1, 2012, State law dissolved the Imperial Beach RDA, along with all RDAs in California. The City became the Successor Agency, charged with winding down all of the affairs of the RDA. This placed additional stress on the City’s finances.

The 2012-2013 San Diego County Grand Jury (Grand Jury) received a citizen’s complaint that included a broad indictment of the City’s finances. The Grand Jury’s initial investigation included discussions with relevant officials and an informal audit of the City’s financial records. As a result of this preliminary investigation, the Grand Jury requested the San Diego County’s Office of Audits & Advisory Services (OAAS) conduct a formal audit. The purpose of the audit was to examine potential financial irregularities in the specific areas of outsourced attorney charges and employee time allocations related to RDA activities. The OAAS Audit is titled *Grand Jury Audit of the City of Imperial Beach’s Financial Records for Redevelopment Activities*³ (OAAS Audit).

The results of our investigations did not uncover any fraud. However, the investigation did uncover problems with accounting and administrative procedures. The time charging procedure has the potential for altered entries. There must be a segregation of charges of City administrative employee time and outsourced legal charges within and between various general fund accounts and RDA accounts. The Grand Jury’s recommendations include the findings and recommendations of the OAAS Audit. In addition, the Grand Jury found that the demise of redevelopment has hit Imperial Beach hard economically and we recommend and encourage the City take strong action to get their financial house in order.

¹ City of Imperial Beach Website, <http://www.imperialbeachca.gov/>.

² Tax Increment Funding is a method of funding RDAs defined in CA statute (constitutional amendment resulting from Proposition 18) that is the amount of property tax revenue over and above the baseline figure that the area would normally generate before redevelopment in the area began.

³ Grand Jury Audit of the City of Imperial Beach’s Financial Records for Redevelopment Activities, Report No. A13-011 dated April 2013.

INTRODUCTION AND BACKGROUND

The Grand Jury received a citizen's complaint alleging City officials' financial misbehavior. The complaint cited news articles, firsthand observations, and financial records that were obtained from the City's website or data requested from City officials. The complaint charged that, by using nontransparent and ethically suspect payments, City officials were not acting in the best interests of the citizens, and that they were manipulating the system for personal gain. The complainant's specific charges were too numerous and haphazard to efficiently address. The Grand Jury decided to concentrate on two aspects of the complaint: alleged excessive and unauthorized attorney fees and alleged misallocation of redevelopment expenses.

Ethics and Audit Standards

Charges of ethically suspect payments contained in the complaint were of concern to the Grand Jury. Ethics in government, audit standards, and transparency have long been of interest to the Grand Jury. The 2009-2010 San Diego County Grand Jury wrote a report⁴ reiterating this interest to all of the smaller cities of the County. The report included recommendations that they:

- Adopt a code-of-ethics defining and prohibiting fraud, waste, abuse and conflict-of-interest
- Adopt and apply Generally Accepted Government Audit Standards and/or Generally Accepted Accounting Principles (GAAP) internal controls and standards
- Adopt and implement fraud, waste, abuse and conflict-of-interest hotlines.

Imperial Beach responded to the report indicating that they did not have a formal code-of-ethics but City managers and officials (including the Mayor, City Council and City Manager) were required to take two hours of ethics training every two years. Moreover, they follow GAAP accounting principles and have an annual independent audit of their accounts as required by State law. Finally, they have an open-door management policy but currently have no hotlines. The City Council said they would consider the costs and benefits of implementing hotlines in the future.

Redevelopment Agency Background

The City formed the RDA in 1995 pursuant to the California Health and Safety Code as a separate legal entity. The RDA was responsible for the administration of redevelopment activities within the City. City staff prepared financial statements for the RDA and managed all the RDA's activities. The City Council members designated themselves as the RDA's Board of Directors.

As of February 1, 2012, the State dissolved the RDA and the City chose to become the Successor Agency. The Successor Agency is responsible for paying, performing, and enforcing existing obligations. They are also responsible for expeditiously winding down the affairs of the former RDA. As part of the winding down process, the Successor

⁴ Ethics in Government – Codes of Ethics, Internal Controls, Fraud Hotlines, 2009-2010 San Diego County Grand Jury Report.

Agency is required to prepare Recognized Obligation Payment Schedule (ROPS) for each six-month period of the fiscal year. ROPS discloses estimated payment obligations by amount and funding source. In addition, ROPS includes an administrative budget with estimated costs to manage the Successor Agency. The Successor Agency must submit each ROPS to the County Auditor and Controller (CAC), the State Controller's Office, and State Department of Finance (DOF) for review and approval.

The California Health and Safety Code outlines laws and regulations relating to the Agency's dissolution process and the Successor Agency's operations.

PROCEDURE

Following a review of the complaint materials and an interview with the complainant, the Grand Jury undertook an investigation that included:

- Review of relevant news articles
- Examination and categorization of complainant supplied financial data
- Examination of the City's website materials
- Budget materials and cost projections from the City's website
- Redevelopment Agency budgets and Successor Agency ROPS submissions
- Interview with the City Manager
- Examination of financial data provided by the City Manager in response to follow-up questions
- Independent financial statement and audit for Imperial Beach and Successor Agency.

As a result of the preliminary investigation, the Grand Jury decided that some aspects of the complaint had merit; i.e., involving nontransparent and/or administrative or ethically suspect dealings in certain budget areas. The Grand Jury then conducted a more thorough investigation. The Grand Jury asked OAAS to conduct a formal audit to investigate the accounting procedures for the City's General Fund and RDA. The audit focused on the City's finances in the "Non-departmental category" of general fund expenses involving redevelopment labor and professional service charges. The object of the audit was to determine if the RDA's labor and legal expenses were adequately supported and properly budgeted, recorded, and allocated. The scope of the audit included a review of the RDA's and City's labor and legal financial records for Fiscal Year (FY) 2010-11 and FY 2012-13 to date.

OAAS conducted the audit in conformance with the International Standards for the Professional Practice of Internal Auditing prescribed by the Institute of Internal Auditors as required by California Government Code, Section 1236. They performed the audit using the following methods:

- Evaluated City controls over processing labor expenses
- Reviewed and analyzed the process of allocating City shared labor cost to the RDA and Successor Agency
- Examined financial records for labor

- Investigated significant variances through inquiries to key City personnel, and review of supporting documentation
- Selected and reviewed supporting documentation for a judgmental sample of recorded labor and legal transactions to determine whether transactions were properly supported, approved, and recorded.

DISCUSSION

Summary of Results

Based on witness testimony, the Grand Jury became aware that allegations similar to those presented in the complaint have been considered by other agencies. Conclusions reached by the agencies indicate that the City may have “non standard” accounting systems and approval procedures but they are not fraudulent. As a result of the audit, the Grand Jury concluded that the City did not properly record and allocate, RDA labor and legal expenses. Our additional investigations, though limited to published budgets and audited financial reports, point to a city that must get its financial house in order to survive the transition away from its redevelopment-funding crutch.

Redevelopment in Imperial Beach

The City is, and has been, a city under economic stress. It is a small city with limited undeveloped land, limited commercial/tourism tax base, and static property tax rolls. The ongoing economic downturn and, more recently, last year’s State mandated dissolution of redevelopment agencies has adversely affected the City.

One reason given by the State for dissolution was that some RDAs were using the tax-increment funds, intended to fund development in blighted areas, to fund other city purposes. The City funded graffiti removal programs as well as other projects more correctly considered city maintenance or capital improvement projects with RDA funds. In recent years, the City had become dependent on the tax increment funds of its RDA for just over 10% of City employee salaries. Moreover, the RDA has a budget fully 50% as large as the City’s General Fund – the General Fund has been static for the last few years at about \$17M, as has the RDA’s budget at \$9M. Other City funds (sewer, storm water, capital improvement, etc.) total \$7.4M (see budgets and audited financial results available on the City’s website).¹

Since RDA dissolution, the City has been struggling with a ROPS process that involved arbitrary deadlines, changing submission requirements, and evolving definitions of Enforceable Obligations.⁵ Navigating the process has required the City to contract legal services in the field of redevelopment law. Their expenses in this area have tripled during the ROPS process. Likewise, City staff time devoted to redevelopment has increased significantly. For example, the City Manager time budgeted to RDA activities has increased from 50% to 70%; the Finance Director has doubled from 45% to 90 %. Costs of this type are not completely reimbursable under ROPS as RDA activities. The

⁵ Enforceable Obligations are valid and justifiable redevelopment charges that were contractually obligated by the RDA before dissolution, i.e. February 1, 2012.

law restricts the maximum allowable administrative costs to be 3% of anticipated funding from RPTTF⁶ or \$250,000, whichever is greater. Any costs above that amount must be borne by the City's General Fund.

The Grand Jury has found evidence of the City's financial stress caused by dissolution in recent Successor Agency resolutions and ROPS submissions, including:

- Resolution No. SA-12-09: As part of the clawback⁷ procedure for requiring the City to repay unenforceable obligations from ROPS I, the City, under protest, made a payment to the CAC on July 12, 2012, of **\$372,115**. The payment will be the subject of future negotiations with the DOF.
- Resolution No. HA-12-12: The City Housing Authority, as successor to the RDA's housing element, passed a resolution to use bond proceeds to pay debt service for **\$533,092** that was due in November 2012. This payment was included in the City's ROPS II submission. DOF initially denied but later, in a letter⁸ describing results of a meet-and-confer reconciliation meeting, the DOF approved payment and actually "revised the item upward to \$626,526, to reflect the full shortfall in RPTTF from the ROPS II period." In the same letter, the DOF continued to deny RPTTF funding for \$2.1M for a housing loan as well as other amounts claimed by the Successor Agency in the original ROPS II submission.
- ROPS III for the period January 1 to June 30, 2013 shows an outstanding debt from redevelopment activities of **\$111M** and a **deficit of \$2.6M** in RDA expenses and debt service. The City issued a notice of insufficient funds to the CAC.
- ROPS 13-14A⁹ for the period July 1 to December 31, 2013 shows an outstanding debt of **\$40M** and a running **deficit of an additional \$1.5M**.

The total outstanding debt in ROPS 13-14A is \$40M. The Grand Jury concluded that the City may have to absorb some of the outstanding debt. The running deficit in the redevelopment accounts, \$4.1M in CY 2013 alone, however, has to be paid by some means.

The Grand Jury examined the following most recent independent audits:¹⁰

- *City of Imperial Beach and Imperial Beach Redevelopment Successor Agency Financial Statements* for the year ended June 30, 2012
- *Imperial Beach Redevelopment Agency Financial Statement* for the seven months ending at the date of dissolution, January 31, 2012.

⁶ Redevelopment Property Tax Trust Fund (RPTTF).

⁷ Clawback is a provision in a law or contract that limits or reverses a payment or distribution for specified reasons.

⁸ Letter from CA DOF to the City of Imperial Beach dated December 18, 2012. The letter reconciled the City's initial ROPS III submission, by approving RPTTF distribution for ROPS III totaling \$3,541,913.

⁹ For the fourth six-month ROPS period after dissolution, the ROPS numbering system was changed to include the applicable fiscal year.

¹⁰ Imperial Beach City Council Agenda, May 1, 2013 Item No.6.2 "Annual Financial Report of the City of Imperial Beach and Imperial Beach Redevelopment Successor Agency for the Year Ended June 30, 2012; and the Former Imperial Beach Redevelopment Agency for the Year Ended January 31, 2012. (0310-10)"

The most salient independent auditor comments, notes, and results pertaining to this study are quoted in the items below:

- “Management believes, in consultation with legal counsel, that the obligations of the former redevelopment agency due to the City are valid enforceable obligations payable by the successor agency trust under the requirements of the Bill (*AB1X26, the Dissolution Act*). The City’s position on this issue is not a position of settled law and there is considerable legal uncertainty regarding this issue. It is reasonably possible that a legal determination may be made at a later date by an appropriate judicial authority that would resolve this issue unfavorably to the City.”
- “As a result of our audit procedures, we noted one item that required a fund balance restatement. In the Project Fund (*an RDA Fund*), a fund balance restatement was made to adjust prior year expenditures.”
- “During the audit, we noted that the current format of the bank reconciliation makes reconciliation with the general ledger difficult and it lacked the proper approval. We recommend that the bank reconciliation format be changed to make reconciliation of these items easier and that they are reconciled to the general ledger for all funds. We also recommend that a proper system of checks and balances be followed of which approval would be required. A proper system would ensure that the bank statement is agreed to the general ledger on a monthly basis and approved in a timely manner.”
- “On June 14, 2012, Moody’s Investor Service (Moody’s) downgraded all California tax allocation bonds rated ‘Baa3’ and above. As such, the **Bonds’ (*Imperial Beach Tax Allocation Bonds*) insured rating was downgraded from ‘A3’ to ‘Ba1’ (*emphasis added*)** and underlying rating was downgraded from ‘A3’ to ‘Ba1’. According to Moody’s, all California tax allocation bond ratings remain on review for possible withdrawal.”
- As of June 30, 2012, the Successor Agency’s **total assets are \$25.2M compared to \$44.7M in liabilities**, for a total net assets deficit of (\$19.5M).
- Successor Agency Long Term Debt, as of June 30, 2012 is \$39.1M.

The Grand Jury concluded that the facts illustrated above identify problems that the City should correct in their accounting procedures. The results also indicate that the City is clearly struggling with the “wind-down” of redevelopment and will have to redirect funds from its General Fund to pay Successor Agency obligations.

OAAS Audit Findings

OAAS identified the facts, contained in Tables 1 through 3 below, related to the RDA’s and Successor Agency’s financial records reviewed during the audit:

Table 1. The RDA FY 2010-11 Records

Expense Description	Actual Amounts	Budget Amounts
Labor	\$331,311	\$1,137,109
Legal	\$71,094 ¹¹	\$75,000

Table 2. The RDA and Successor Agency FY 2011-12 Records

Expense Description	Actual Amounts (07/11-01/12)	Actual Amounts (02/12-06/12)	Total Actual Amounts	Budget Amounts (07/11-01/12)	ROPS I ¹² Amount (01/12-06/12)	Total Budget Amounts
Labor	\$700,377	\$88,172	\$788,549	\$619,488	\$1,314,578	\$1,934,066
Legal	\$58,026 ¹¹	\$65,872 ¹¹	\$123,898	\$43,750	\$140,000	\$183,750

Table 3. The Successor Agency FY 2012-13 Records

Expense Description	Actual Amounts (07/12-12/12)	ROPS II ¹² Amounts (07/12-12/12)	ROPS III ¹² Amounts (01/13-06/13)	Total Budget Amounts
Labor	\$217,510	\$665,637	\$600,510	\$1,266,147
Legal	\$37,631 ¹¹	\$140,000	\$80,000	\$220,000

The City allocated the labor cost of administrative employees to the RDA based on the budgeted allocation percentages. It charged labor costs of program employees directly to the RDA based on the actual time program employees spent on RDA activities.

The City started to track the actual time administrative employees spent on RDA activities and charged the time directly to the Successor Agency. However, for preparation of administrative budgets, the City continued to use budgeted allocation percentages. Table 4, below, presents the RDA's and the Successor Agency's budgeted labor allocation percentages for City employees working on both redevelopment and other City business.

¹¹ Amount represents legal services coded to the attorney services account.

¹² ROPS estimated amounts were used in lieu of budget amounts.

Table 4. Budgeted Labor Allocation Percentages

		FY 2011-12		FY 2012-13	
Position Description	FY 2010-11	07/11-01/12	02/12-06/12	07/12-12/12	01/13-06/13
Admin Intern	50%	50%	0%	0%	0%
Admin Secretary II	95%	75%	30%	20%	13%
Admin Secretary II	0%	40%	50%	25%	13%
Associate Planner	50%	50%	0%	0%	0%
Assistant City Manager	25%	0%	0%	0%	0%
Assistant Project Manager	100%	100%	0%	0%	0%
Building Compliance Specialist	30%	0%	0%	0%	0%
CIP Manager	100%	100%	20%	20%	20%
City Clerk	25%	25%	50%	50%	40%
City Manager	50%	50%	70%	70%	70%
City Planner	50%	50%	0%	0%	0%
Clerk Typist	0%	0%	50%	50%	15%
Code Compliance Officer	100%	0%	0%	0%	0%
Code Compliance Officer PT	10%	10%	0%	0%	0%
Community Development Director	50%	65%	75%	75%	75%
Council Members	200%	200%	0%	0%	0%
Deputy City Clerk	25%	25%	0%	0%	0%
Finance Director	45%	40%	90%	90%	90%
Finance Supervisor	30%	30%	50%	50%	10%
Graffiti Coordinator	100%	100%	0%	0%	0%
Facilities Supervisor	15%	15%	0%	0%	0%
Maintenance Worker I	100%	100%	0%	0%	0%
Mayor	50%	50%	0%	0%	0%
PW Inspector	100%	100%	0%	0%	0%
RDA Coordinator	100%	100%	75%	25%	0%
Sr. Accountant/Clerk Tech	30%	30%	20%	20%	0%

The City uses two law firms to provide legal services: Law Firm 1 for general litigation and Law Firm 2 for support on redevelopment law. Table 5 below shows payments made to these firms:

Table 5. Legal Payments

Fiscal Year	Reporting Period	Firm 1	Firm 2	Total Amount
FY 2010-11	Jul 1, 2010 – Jun, 2011	\$113,998	\$25,249	\$139,247
FY 2011-12	Jul 1, 2011 – Jan 31, 2012	\$89,671	\$47,432	\$137,103
FY 2011-12	Feb 1, 2012 – Jun 30, 2012	\$15,673	\$76,267	\$91,940
FY 2012-13	Jul 1, 2012 – Dec 31, 2012	\$3,546	\$74,274	\$77,820
		\$222,888	\$223,222	\$446,110

Reporting of Legal Expenses

The OAAS audit identified the following issues related to the recording of legal expenses:

Inconsistent Recording of Legal Services

Legal services related to the RDA dissolution and the Successor Agency operations are inconsistently recorded between the Attorney Services Account and the Professional Services Account. Specifically, OAAS tested 25 payments to outsourced legal counsel and RDA special counsel for \$240,896 (54% of total payments), 13 payments were related to the RDA dissolution and the Successor Agency operations. Seven of these 13 payments amounting to \$60,900 were coded to the Professional Services Account and six payments for \$63,071 were coded to the Attorney Services Account. According to City management, it is City practice to code legal services related to the RDA dissolution and Successor Agency operations to the Professional Services Account. However, after funding for the Professional Services Account was exhausted, services noted above were coded to the Attorney Services Account.

In the opinion of the Grand Jury, the City should implement a stronger accounting system. It should ensure that legal services, including legal assistance in the RDA dissolution and the Successor Agency operations, are consistently coded to the Attorney Services Account and professional services are coded to the Professional Services Account.

Since the Professional Services Account includes costs unrelated to contracted legal services, the current reporting system does not allow identifying total legal costs to the RDA and the Successor Agency.

Legal Services are Not Coded according to ROPS Reporting Requirements

The City's accounting system is not set up to separate legal services related to litigation actions and legal services related to general legal representation as required for ROPS reporting. HSC section 34171(b) classifies legal costs related to general legal representation as an administrative cost and requires reporting it as part of the

administrative budget, which has a cost allowance. HSC allows litigation expenses to be funded with tax increment funds outside the administrative budget allowance. Inadequate set up of City accounting system, and as a result, reporting of legal services, prevents the City from preparing accurate ROPS submissions in a timely manner.

Legal Services Were Incorrectly Coded to RDA Accounts

Of the 25 payments to City legal counsel and RDA special counsel tested by OAAS, two payments related to City operations for \$12,641 were incorrectly coded to RDA accounts. As a result, the RDA and Successor Agency expenses were overstated.

Specifically, the first payment was for legal assistance in establishing the Housing Authority (Authority). According to City management, it was proper for the RDA to pay for these services since a primary purpose for the Authority's establishment was to assist the RDA to implement its housing obligations under the California Community Redevelopment Law. Although the Authority was formed before the RDA's dissolution, the intent of its formation was to assume the RDA's housing assets, rights, and obligations after the dissolution. The City made the choice to establish the Authority and assume its responsibilities. Thus, the cost related to the Authority's formation should be coded to and paid by the City.

The second payment was for legal assistance in preparing RDA capital projects documentation rendered in February 2012. Since the City assumed management responsibilities over the former RDA's capital projects, costs related to these capital projects should be coded to, and paid by, the City. Further, OAAS noted that subsequent payments to the RDA special counsel regarding the matter noted above were coded to and paid by the City.

To improve their reporting processes for legal expenses, the Grand Jury recommends that the City:

- Make an adjusting journal entry to reclassify legal costs related to the RDA dissolution and the Successor Agency operations from the Professional Services Account to the Attorney Services Account
- Make an adjusting journal entry to reclassify legal costs related to City operations from the RDA and Successor Agency's accounts to City accounts
- Develop a process to ensure that legal services are recorded consistently and correctly
- Implement two accounts for recording legal services, one for legal services related to litigation and another for legal services related to general legal representation.

Transfer of RDA Expenses in FY 2010-11

In FY 2010-11, the City transferred a total of \$1.7 million of RDA expenses, including \$916,518 in labor cost, and \$20,234 in miscellaneous cost, from the RDA non-housing funds to the City's General Fund. According to City management, the transfer of expenses was done in accordance with the City Services Reimbursement Agreement (CSRA). The CSRA is a loan agreement between the City and the Agency and does not

justify the transfer of expenses from the RDA to the City. As a result, the City understated the RDA's expenses in FY 2010-11 by \$1.7 million.

In March 2013, the DOF questioned the \$1.7 million transfer in its review of the RDA's cash balances available for distribution to the taxing entities. The DOF concluded that the City did not provide sufficient documentation to validate the transfer and the RDA's cash balances should be adjusted by \$1.7 million. However, after the "Meet and Confer"¹³ process, the DOF reversed its determination. The DOF indicated that the date of the transfer was not within the scope of the DOF review. Further, the DOF stated that the California State Controller's Office has the authority to clawback assets that were inappropriately transferred to the City. Since these transfers are still in question, the City should consider restating its financial statements for FY 2010-11.

City Shared Labor Cost Was Not Allocated to the Successor Agency

OAAS found that the City did not allocate shared labor costs of the administrative employees to the Successor Agency for the period of February 1 through June 30, 2012. The City comingled labor costs related to the redevelopment activities with City records. As a result, the Successor Agency's labor expenses reported in FY 2011-12 were understated. According to City management, the legislation was not clear on how expenses should be reported after the RDA's dissolution.

Based on the audit results, the Grand Jury concluded:

- In order to properly track costs, City expenses related to the redevelopment activities should be allocated to the Successor Agency.
- The City should identify labor costs related to the redevelopment activities for the period of February 1 through June 30, 2012 and make an adjusting journal entry to transfer this cost from the City's General Fund to the Successor Agency fund.

Lack of Controls Over the Time Sheet Approval Process

City employees complete electronic time sheets in a commercial time accounting system. Supervisors approve time sheets by sending an approval email to the payroll administrator. OAAS noted that employees might make unauthorized adjustments to time, after supervisors have approved, but prior to payroll processing the approved time sheets. As a result, an employee's labor expenses may be in error. The current application cannot electronically approve time sheets.

Electronic approval of time sheet records and automated controls that prevent time adjustments after supervisor's approval is an integral part of a strong system of internal controls. The City should implement an employee timekeeping system that provides for electronic approval of time sheets.

¹³ "Meet and Confer" refers to the administrative procedure for adjudicating disputes between the RDA and the DOF.

Other Audit Findings

City Shared Labor Cost Was Allocated Based on the Estimated Records

Prior to July 1, 2012, the City based the allocation of shared labor cost of administrative employees to the RDA and Successor Agency on the budgeted allocation percentages for each position. Every year, City management determined budgeted allocation percentages based on estimating the prior year's time spent by the administrative employees on RDA activities. As a result, actual time spent on RDA activities could vary from the estimated time. The City shared labor cost would be incorrectly allocated to the RDA or the Successor Agency. Based on the audit, the Grand Jury believes that the City should instead allocate actual time spent on RDA activities and conduct a periodic study of time allocated for shared cost employees. The Grand Jury believes that use of estimated labor costs rather than actual time allocated labor costs for shared labor is not a proper accounting procedure. The City should update its time charging system and approval procedure to allow required segregation of labor costs to the Successor Agency.

ROPS I and ROPS II Include Unqualified Enforceable Obligations

The OAAS audit found that ROPS I and ROPS II include unqualified Enforceable Obligations related to labor cost. Specifically, ROPS I includes \$75,000 in the Housing Agreement and \$200,000 in the CSRA. ROPS II includes \$90,000 in the Housing Agreement and \$240,000 in the CSRA.

The Housing Agreement is a contract between the Imperial Beach Housing Authority and the City. Since the Successor Agency is not a party to this agreement, the claimed amount does not constitute an Enforceable Obligation. Further, the CSRA is a loan agreement between the Successor Agency and the City. Therefore, the claimed amount does not constitute an Enforceable Obligation.

The DOF mistakenly approved some Enforceable Obligations in ROPS I and ROPS II. They were subsequently funded by the County Auditor and Controller. The DOF later denied these obligations in ROPS III.

Inaccurate Data Were Reported on the ROPS I and ROPS II Reconciliation Schedules

After each ROPS reporting period, the Successor Agency is required to reconcile actually paid obligations with the estimated obligations reported on a previous ROPS. As listed in Table 6 below, the audit found that actual payments reported on ROPS I and ROPS II reconciliation schedules do not agree with the actual financial records.

Table 6. Reconciliation of Enforceable Obligations

Expense Description	Financial Records (02/12-06/12)	ROPS I Reconciliation (01/12-06/12)	Financial Records (07/12-12/12)	ROPS II Reconciliation (07/12-12/12)
Labor	\$88,172 ¹⁴	\$1,337,496	\$217,510	\$436,826
Litigation	\$26,016 ¹⁵	\$76,510	\$354,612 ¹⁵	\$70,343

¹⁴ Amount is misstated.

¹⁵ Amount is an estimate determined by OAAS through review of payments made to the City Legal Counsel and RDA Special Counsel.

According to City management, the Successor Agency reported obligations that were approved by DOF and funded by the CAC as actual payments on ROPS I and ROPS II reconciliation schedules. City management stated that it was their understanding that legislation at that time did not require reporting actual amounts from their financial records on the reconciliation schedule.

FACTS AND FINDINGS

Fact: The City pays just over 10% of its personnel labor costs from redevelopment funds.

Fact: The City's redevelopment budget is equivalent to slightly more than 50% of its General Fund.

Finding 01: The City continues to be dependent on tax increment redevelopment funds for a substantial amount of its operating budget.

Fact: The City inconsistently recorded its outsourced legal-service costs related to RDA dissolution and Successor Agency operations between the Attorney Services Account and the Professional Services Account.

Fact: The City does not record outsourced legal services costs in a manner required by ROPS reporting requirements.

Finding 02: The City often records legal services costs incorrectly to the RDA, the Successor Agency and/or City accounts.

Fact: The City based shared labor costs on estimated time records.

Finding 03: The RDA's administrative costs for shared labor are inaccurate.

Fact: The DOF mistakenly approved some Enforceable Obligations in ROPS I and ROPS II that were subsequently funded by the CAC. The DOF later denied these obligations in ROPS III.

Fact: The City has understated its RDA expenses in FY2010-11 by \$1.7M.

Fact: The City comingled shared labor costs related to redevelopment activities with the City's General Fund.

Fact: Actual payments reported on the City's ROPS I and ROPS II reconciliation schedules did not agree with actual financial records.

Finding 04: The City's ROPS I and ROPS II submissions were inaccurate.

Finding 05: Inadequate accounting, and especially incorrect reporting of shared labor costs, prevented the City from preparing accurate and timely ROPS submissions.

Fact: The City's timekeeping system does not currently allow employee time sheets to be electronically approved by a supervisor.

Fact: Employees may make unauthorized adjustments to time sheets after supervisor's approval, but prior to payroll processing.

Finding 06: The City timekeeping system and procedures are flawed and they are open to altered entries.

Fact: An independent audit for the period ending Jan 31, 2012 noted that "the current format of the bank reconciliation makes reconciliation with the general ledger difficult and it lacked the proper approval."

Fact: An independent audit for the period ending Jan 31, 2012, stated the City made an RDA fund balance restatement to adjust prior year's expenditures.

Finding 07: The City's accounting procedures regarding RDA funds were flawed.

Fact: On June 14, 2012, the Tax Allocation Bonds insured rating was downgraded from 'A3' to 'Ba1'.

Fact: As of June 30, 2012, the Successor Agency's Long Term Debt, was \$39.1M.

Fact: The DOF has continued to deny RPTTF funding for many items claimed by the Successor Agency on its ROPS submissions.

Finding 08: There is no guarantee that RPTTF funds will be sufficient to repay the Successor Agency's debt.

Fact: As of June 30, 2012, the Successor Agency's total assets were \$25.2M compared to \$44.7M in liabilities, for a total net assets deficit of (\$19.5M)

Fact: The City, under protest, made a payment in July 2012 of \$372,115 to the CAC as part of the clawback of unqualified Enforceable Obligations in ROPS I.

Fact: The City, using bond proceeds, made a Housing Authority debt service payment in November 2012 of \$533,092.

Fact: The City's ROPS III submission shows an outstanding debt for redevelopment activities of \$111M and a payment deficit of \$2.6M.

Fact: The City's ROPS 13-14A submission shows an outstanding debt for redevelopment activities of \$40M and a payment deficit of \$1.5M.

Finding 09: The City's redevelopment deficits, shown in the ROPS submissions and audited financial statements, are evidence of the City's growing fiscal stress.

RECOMMENDATIONS

The 2012-2013 San Diego County Grand Jury recommends that the Imperial Beach Mayor, City Council, and City Manager should:

- 13-83: Update the City's timekeeping system and approval procedure to allow required segregation of labor costs to the Successor Agency.**
- 13-84: Immediately implement accounting procedures that accurately segregate all cost types (notably labor and outsourced legal expenses) between the General Fund, Successor Agency funds, and other City funds.**
- 13-85: By the end of Calendar Year (CY) 2013, institute a time study that should be performed on a periodic basis, to allocate time spent on RDA activities.**
- 13-86: By the end of CY 2013, improve the City accounting system for legal expenses as follows:**
- **Make an adjusting journal entry to reclassify legal cost related to the RDA dissolution and the Successor Agency operations from the Professional Services Account to the Attorney Services Account.**
 - **Make an adjusting journal entry to reclassify legal costs related to City operations from the RDA and Successor Agency's accounts to City accounts.**
 - **Implement two accounts for recording legal services, one for legal services related to litigation and another for legal services related to general legal representation.**
 - **Develop a process to ensure that legal services are recorded correctly.**
- 13-87: By the end of CY 2013, restate financial statements for FY 2010-11.**
- 13-88: By the end of CY 2013, identify labor costs related to RDA activities for the period of February 1 through June 30, 2012 and make an adjusting journal entry to transfer this cost from the City's General Fund to the Successor Agency fund.**
- 13-89: Develop a timekeeping system or work with their current vendor's system support to automate the time sheet approval process and to implement automated controls that prevent employees from adjusting time sheets after supervisor's approval.**
- 13-90: Begin immediately to increase the accuracy of their ROPS submission procedures to comply with DOF requirements.**
- 13-91: Consider getting help from their State representatives or County resources in the ROPS submission and settlement process.**

REQUIREMENTS AND INSTRUCTIONS

The California Penal Code §933(c) requires any public agency which the Grand Jury has reviewed, and about which it has issued a final report, to comment to the Presiding Judge of the Superior Court on the findings and recommendations pertaining to matters under

the control of the agency. Such comment shall be made *no later than 90 days* after the Grand Jury publishes its report (filed with the Clerk of the Court); except that in the case of a report containing findings and recommendations pertaining to a department or agency headed by an elected County official (e.g. District Attorney, Sheriff, etc.), such comment shall be made *within 60 days* to the Presiding Judge with an information copy sent to the Board of Supervisors.

Furthermore, California Penal Code §933.05(a), (b), (c), details, as follows, the manner in which such comment(s) are to be made:

- (a) As to each grand jury finding, the responding person or entity shall indicate one of the following:
 - (1) The respondent agrees with the finding
 - (2) The respondent disagrees wholly or partially with the finding, in which case the response shall specify the portion of the finding that is disputed and shall include an explanation of the reasons therefor.
- (b) As to each grand jury recommendation, the responding person or entity shall report one of the following actions:
 - (1) The recommendation has been implemented, with a summary regarding the implemented action.
 - (2) The recommendation has not yet been implemented, but will be implemented in the future, with a time frame for implementation.
 - (3) The recommendation requires further analysis, with an explanation and the scope and parameters of an analysis or study, and a time frame for the matter to be prepared for discussion by the officer or head of the agency or department being investigated or reviewed, including the governing body of the public agency when applicable. This time frame shall not exceed six months from the date of publication of the grand jury report.
 - (4) The recommendation will not be implemented because it is not warranted or is not reasonable, with an explanation therefor.
- (c) If a finding or recommendation of the grand jury addresses budgetary or personnel matters of a county agency or department headed by an elected officer, both the agency or department head and the Board of Supervisors shall respond if requested by the grand jury, but the response of the Board of Supervisors shall address only those budgetary or personnel matters over which it has some decision making authority. The response of the elected agency or department head shall address all aspects of the findings or recommendations affecting his or her agency or department.

Comments to the Presiding Judge of the Superior Court in compliance with the Penal Code §933.05 are required from the:

<u>Responding Agency</u>	<u>Recommendations</u>	<u>Date</u>
Mayor, City of Imperial Beach	13-83 through 13-91	8/26/13
City Manager, City of Imperial Beach	13-83 through 13-91	8/26/13
City Council, City of Imperial Beach	13-83 through 13-91	8/26/13