



**April 26, 2023**

**To:** Finance and Administration Committee

**From:** Darrell E. Johnson, Chief Executive Officer

Janet Sutter, Executive Director  
Internal Audit Department 

**Subject:** Orange County Local Transportation Authority Measure M2  
Agreed-Upon Procedures Reports, Year Ended June 30, 2022

### **Overview**

Crowe LLP, an independent accounting firm, has applied agreed-upon procedures related to Measure M2 Local Fair Share funds provided to seven cities, and Senior Mobility Program funds provided to four cities, for the fiscal year ended June 30, 2022. Local Fair Share program reports include observations of ineligible maintenance of effort expenditures, indirect charges lacking a reasonable methodology, reporting errors, and funded projects not reflected in Seven-Year Capital Improvement Program plans. Senior Mobility Program audits include observations relating to late submission of monthly reports, reporting errors, failure to allocate interest, and verification of participant eligibility.

### **Recommendations**

- A. Direct staff to monitor implementation of recommendations by cities.
- B. Direct staff to review observations with legal counsel and develop recommendations for Board of Directors' consideration related to the City of Cypress' compliance with the Measure M2 Ordinance and Eligibility Guidelines.

### **Background**

Annually, the Audit Subcommittee (Subcommittee) of the Taxpayers Oversight Committee selects a sample of local jurisdictions receiving Measure M2 (M2) funding for audit to determine the local jurisdictions' level of compliance with provisions of the M2 Ordinance. For the fiscal year (FY) ended June 30, 2022, the Subcommittee selected the seven cities for review of Local Fair Share (LFS)

program funding, and four cities for review of Senior Mobility Program (SMP) funding. The agreed-upon procedures (AUP) applied for these reviews were approved by the Subcommittee.

The LFS program is a formula-based allocation provided to eligible jurisdictions for use on allowable transportation planning and implementation activities. Since the LFS program is intended to augment, not replace, existing transportation expenditures, each jurisdiction is required to maintain a minimum level of local street and roads expenditures to conform to a defined maintenance of effort (MOE) requirement. MOE expenditures are required to conform to State Controller's Office Gas Tax Guidelines (Guidelines). Cities are required to submit copies of their Seven-Year Capital Improvement Plan (CIP), reflecting projects that will be funded with LFS.

The SMP funds local community transportation services for seniors. This program provides 80 percent of the funding allocation, and participating local jurisdictions provide a 20 percent match. Seniors must be age 60 or older to be eligible to participate in the program. A cooperative agreement, along with a written Service Plan, is executed between the local jurisdiction and the Orange County Local Transportation Authority (OCLTA) to outline requirements of the program and to describe services to be provided. Cities are required to submit monthly SMP activity reports within 30 days of month end.

All M2 revenues, interest earned on net revenues, expenditures, and expenditures of earned interest are required to be reflected on an annual Expenditure Report. The Expenditure Report requires certification by the respective city's finance director and must be adopted by the city council and filed with OCLTA within six months of FY end.

### ***Discussion***

Crowe LLP (auditors), made site visits to each of the selected cities, conducted interviews of city finance and program-related staff, and applied the AUPs, including testing of expenditures for compliance with program requirements, review of indirect costs for adequate support and reasonableness, testing to ensure allocation of interest, and testing of annual Expenditure Reports for accuracy.

### **Agreed-Upon Procedures: LFS Program Funds**

The auditors examined the cities of Cypress, Irvine, Laguna Beach, Los Alamitos, Rancho Santa Margarita, San Juan Capistrano, and Villa Park. No observations resulted from the audits of Rancho Santa Margarita and San Juan Capistrano.

Auditors identified reporting errors on the Expenditure Reports submitted by five cities and identified projects not listed in the Seven-Year CIP of one city. At two cities, the auditors identified expenditures that were not properly classified as MOE expenditures; however, after removal of the ineligible amounts, the cities continued to meet the minimum MOE requirement.

Four cities lacked adequate documentation to support indirect costs allocated to MOE. Without sufficient documentation to support how allocation methodologies were derived, auditors are unable to determine that the allocation of these costs is fair and equitable, as required. At three cities, if indirect costs were removed from total MOE expenditures, the cities continue to meet the minimum MOE requirement. However, if indirect charges by the City of Cypress (Cypress) are removed from total MOE expenditures, Cypress no longer meets the minimum MOE requirement of \$3,607,878. The shortfall would amount to \$1,381,048.

Cypress responded to the finding and indicated that management believes the current process for allocating internal service charges is documented and represents a fair and reasonable allocation of costs. Auditors, and the Internal Audit Department (Internal Audit), disagree with this statement. Cypress only provided excel spreadsheets indicating allocation of budgeted costs from various internal service funds and could not produce, after multiple requests, support for how the allocation percentages were derived or demonstrate that the allocations represented actual costs (rather than budgeted amounts).

Cypress also asserted that the methodology for allocating indirect costs has been used for 30 years and has been accepted and audited by OCLTA. Internal Audit has reviewed three prior audits from FY 2007-08, FY 2012-13, and FY 2016-17. In FY 2007-08, auditors did not identify indirect costs charged to MOE and city staff confirmed indirect costs were not charged. During the FY 2012-13 audit, auditors identified indirect costs charged to MOE and tested a sample of \$35,861 of those charges and reported no exceptions. In the FY 2016-17 audit, auditors also identified indirect costs charged to MOE and tested a sample of \$171,324 of those charges and reported no exceptions.

Cypress acknowledged that its documentation and method of allocating costs can be improved and pointed out that its indirect costs represent more than 45 percent of its MOE benchmark. Cypress stated that the documentation standard for determining if indirect costs are fair and reasonable "does not appear clear and obvious". In response, it should be noted that OCLTA provides regular guidance to cities, both in writing and through annual workshops. After two cities were found ineligible following audits of their MOE for FY 2017-18, OCLTA took additional steps to notify cities by sending a letter to all city managers and a detailed email to all city finance directors. Cities were reminded

that MOE expenditures must conform to Guidelines and were urged to thoroughly review MOE expenditures against Guidelines before closing their books each year.

A summary of all findings and city management responses can be found at Attachment A, and the detailed reports, along with written management letters, can be found at Attachment B.

Agreed-Upon Procedures: SMP Funds

The auditors examined the cities of Anaheim, Garden Grove, Huntington Beach, and Santa Ana.

Auditors identified errors in reporting of direct and indirect expenditures in Expenditure Reports submitted by two cities and another city did not allocate interest to the SMP fund, as required. Two cities were found to have submitted one or more monthly reports beyond the required timeframe of 30 days after month-end. Auditors also noted that participant age is not being verified at one city.

A summary of all findings and city management responses can be found at Attachment C, and the detailed reports, along with written management letters, can be found at Attachment D.

***Summary***

The auditors have completed agreed-upon procedures related to M2 LFS and SMP funds provided to 11 cities for the FY ended June 30, 2022.

***Attachments***

- A. Summary of Results of Agreed-Upon Procedures Reports Orange County Local Transportation Authority Measure M2 Local Fair Share for the Year Ended June 30, 2022
- B. Orange County Local Transportation Authority Measure M2 Local Fair Share Agreed-Upon Procedures Reports Year Ended June 30, 2022
- C. Summary of Results of Agreed-Upon Procedures Audits Orange County Local Transportation Authority Measure M2 Senior Mobility Program for the Year Ended June 30, 2022
- D. Orange County Local Transportation Authority Measure M2 Senior Mobility Program Agreed-Upon Procedures Reports Year Ended June 30, 2022

**Prepared by:**



Janet Sutter  
Executive Director, Internal Audit  
714-560-5591