



**May 6, 2024**

**To:** Executive Committee  
**From:** Darrell E. Johnson, Chief Executive Officer  
**Subject:** Measure M2 Eligibility for the City of Buena Park

A handwritten signature in blue ink, appearing to read "Darrell E. Johnson", is written over the "From:" line of the memo.

**Overview**

The Orange County Transportation Authority's Internal Auditor issued results of an independent auditor's report related to the City of Buena Park's compliance with the Measure M2 requirements for fiscal year 2022-23. The independent auditor's report found that the City of Buena Park could not sufficiently support their use of Measure M2 Local Fair Share funds related to indirect labor charges thereby resulting in the use of the funds being disallowed. Based on this information, recommendations to address the independent auditor's report finding are presented.

**Recommendations**

- A. Seek reimbursement of \$387,576 from the City of Buena Park and find the City of Buena Park ineligible to receive Measure M2 net revenues for five years pursuant to Section 10.4 of Ordinance No. 3.
- B. Authorize the Internal Auditor to engage independent auditing services to apply agreed-upon procedures to review the City of Buena Park's Measure M2 Local Fair Share program and other expenditures for fiscal year 2023-24, fiscal year 2024-25, fiscal year 2025-26, fiscal year 2026-27, and fiscal year 2027-28 to enable the City of Buena Park to reestablish eligibility and authorize staff to deduct the review costs from any future net Measure M2 payments to the City of Buena Park.
- C. Authorize the Chief Executive Officer to negotiate and execute a settlement agreement with the City of Buena Park to formalize the required actions to reestablish eligibility and other terms.

***Background***

In July 2006, the Orange County Transportation Authority (OCTA) Board of Directors (Board) approved and adopted the Renewed Measure M (M2) Ordinance No. 3 (M2 Ordinance). The M2 Ordinance became effective on November 8, 2006, after voters approved the one-half cent sales tax for transportation improvements. OCTA is designated as responsible for administering M2 and ensuring that OCTA's commitment to voters is followed, including numerous specific requirements, safeguards, and transparency provisions.

The M2 Ordinance requires local jurisdictions to annually submit an expenditure report that details all M2 net revenues, interest earned, expenditures, and expenditures of earned interest. Local jurisdictions' expenditure reports are signed by their respective Finance Director, adopted by City Council/Board of Supervisors, and submitted to OCTA within six months of the local jurisdiction's fiscal year (FY) end.

Annually, the Audit Subcommittee (Subcommittee) of the Taxpayer Oversight Committee selects specific local jurisdictions for application of agreed-upon procedures (AUP) by OCTA's independent auditing firm. The AUP includes 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 the annual expenditure reports for accuracy. The independent auditing firm's report helps determine local jurisdictions' level of compliance with certain M2 Ordinance provisions.

For FY 2022-23, one of the local jurisdictions selected by the Subcommittee for review of the M2 Local Fair Share (LFS) program funding was the City of Buena Park (City). Crowe, LLP (auditors), OCTA's independent auditing firm, conducted interviews of City finance and program-related staff, and applied the AUP. The results of the effort were presented to the Finance and Administration Committee on April 24, 2024, and will be presented to the Board on May 13, 2024. The auditors reported one notable finding; the City could not provide sufficient support for its indirect LFS expenditures. As a result, the auditors disallowed a total of \$387,576.

This is not the first time that a city has had an AUP report finding noting a lack of reasonable methodology for determining indirect costs. To date, these findings have been related to the M2 eligibility requirement regarding maintenance of effort (MOE) involving local jurisdiction funds not M2 net revenues such as the LFS.

For these instances, the Board acted to:

- Find the local jurisdiction ineligible to receive or apply for net M2 revenues;
- Suspend payments to the local jurisdiction of net M2 revenues;
- Require the local jurisdiction to demonstrate supplemental investment of discretionary local funds for transportation equal to the amount of local discretionary investment that was short of the MOE benchmark identified as a condition of accessing suspended funds upon reinstatement of eligibility;
- Engage an independent auditing firm to apply AUP to verify MOE and supplemental investment of discretionary funds and deduct the costs related to the future review from any future net M2 payments to the local jurisdiction; and
- Authorize the Chief Executive Officer to negotiate and execute an agreement with the local jurisdiction outlining the process to re-establish eligibility.

OCTA continues to provide reminders and guidance through guidelines, eligibility workshops, and annual M2 Finance Director Workshops, stating that indirect costs must have a reasonable basis or methodology for cost allocation. Despite these efforts, there have been ineligibility determinations under similar circumstances.

### ***Discussion***

Continued investment in Orange County's transportation improvements is the cornerstone of M2. However, the specific type of funding, M2 net revenues through the LFS, is the critical distinction with the matter at hand. The difference between previous AUP report findings related to MOE and the City's finding is the specific funding utilized: local discretionary revenues versus M2 net revenues. The M2 MOE requires local jurisdictions to continue to invest a certain level of local revenues, such as general funds that support streets and road activities, to be deemed eligible to receive any M2 net revenues. The M2 LFS program provides 18 percent of M2 net revenues to eligible local jurisdictions for use on allowable transportation planning and implementation activities. OCTA, as the M2 administrator, is accountable to the taxpayers on uses of M2 revenues. This is the first instance where there has been a finding of disallowed expenditures for actual M2 net revenues that have been provided to a local jurisdiction under the M2 LFS program; as such, there is no precedent to address this, and the measures taken to address the MOE issues with other local jurisdictions do not apply.

The auditors' AUP report along with the City's response is included as Attachment A; specifically, the finding pertains to Procedure 8. The City reported indirect expenses for LFS, which are an allowable use. When inspecting these expenditures, the auditors "...requested the City to provide the documented methodology used to support the labor cost allocations..." However, "...the City was unable to provide such documentation. It was noted that allocation percentages for each employee were based on the Public Works managerial assumption of the time being spent on each account and was not based on historical or current data. As such, sufficient information was not available to confirm these costs as fair and reasonable." The auditors found that "...the entirety of these allocations, except for the allocated salary of one Street Maintenance Superintendent... were not deemed allowable per the [M2] Ordinance. The total disallowed was \$387,576."

The M2 Ordinance includes specific language to address safeguards related to the unauthorized use of M2 net revenues. Section 10.4 of the M2 Ordinance (Attachment B) states:

"No Net Revenues shall be used by a jurisdiction for other than transportation purposes authorized by the Ordinance. Any jurisdiction which violates this provision must fully reimburse the Authority for the Net Revenues misspent and shall be deemed ineligible to receive Net Revenues for a period of five (5) years."

The unsupported expenditures identified in the auditor's finding are not authorized by the M2 Ordinance. OCTA staff has carefully reviewed, considered, and consulted with legal counsel on how to address this matter. To ensure OCTA maintains compliance with the M2 Ordinance and continues to uphold public trust, staff recommends the Board adhere to the provisions of Section 10.4 of the M2 Ordinance by:

- Seeking reimbursement from the City for the disallowed indirect expenditures in the amount of \$387,576 (to be paid to OCTA by June 30, 2024) and,
- Finding the City ineligible to receive M2 net revenues for a period of five years, which would also exclude the City from participating in M2 competitive programs.

Since the City is ineligible, OCTA will not be allocating M2 net revenues to the City. For previous M2 ineligibility findings involving other jurisdictions, the Board has suspended payments and held funds in reserve for that local jurisdiction. Although this situation is different, the City is expecting that the estimated amounts, specifically for the LFS and Senior Mobility Program, be withheld within

the source programs and be released to the City once it has reestablished eligibility and demonstrated it was fulfilling M2 eligibility requirements throughout the five-year ineligibility period. This can be verified through future AUP reviews of FY 2023-24, FY 2024-25, FY 2025-26, FY 2026-27, and FY 2027-28 expenditures. Costs incurred for these reviews can be paid for by the City through a reduction in future M2 net revenues.

During the period of ineligibility, M2 net revenues the City has received to date can still be utilized. Further, the City has requested to incur M2-eligible expenditures at risk and be able to apply the expense to future M2 net revenues. Should the City choose to do so, these expenditures must be clearly identified in accounting records and included in annual M2 expenditure report submittals.

Pending Board action on this item, OCTA will work with the City to enter into a settlement agreement that details the specific requirements and time frames for submittals to support the re-establishment of the City's eligibility. OCTA is committed to delivering the M2 promises made to voters and does not take this responsibility lightly. This includes adhering to the safeguards in the M2 Ordinance which ensure transparency and accountability of taxpayer dollars.

### ***Summary***

A recent report conducted by an independent auditing firm disallowed the City's FY 2022-23 indirect LFS expenditures due to insufficient support. The M2 Ordinance has specific language related to funds used for unauthorized purposes. Recommendations to address the auditor's report finding are presented.

**Attachments**

- A. Crowe, Independent Accountants' Report on Applying Agreed-Upon Procedures, City of Buena Park
- B. Orange County Local Transportation Authority Ordinance No. 3, Safeguards of Use of Revenues Excerpt, Pages 5-6

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