



May 1, 2023

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

Overview

The Orange County Transportation Authority’s Internal Auditor has concluded an audit of the City of Cypress financials for fiscal year 2021-22 related to Measure M2. The audit found the City of Cypress lacked adequate documentation to support whether it had spent sufficient discretionary funds on streets and road purposes to meet the maintenance of effort requirement for the Measure M2 Ordinance. Based on this information, recommendations related to compliance with the Measure M2 Ordinance are presented.

Recommendations

- A. Find the City of Cypress an ineligible jurisdiction to receive or apply for net Measure M2 revenues.
- B. Suspend payments of net Measure M2 revenues to the City of Cypress until the City of Cypress can demonstrate compliance with Measure M2 eligibility requirements and the Board of Directors acts to find the City of Cypress an eligible jurisdiction.
- C. Require the City of Cypress to demonstrate supplemental investment of discretionary transportation funds equal to the amount of discretionary investment that was short of the maintenance of effort benchmark in the fiscal year 2021-22 (approximately \$1.38 million) as a condition of accessing suspended funds upon being found an eligible jurisdiction.
- D. Authorize the Chief Executive Officer to execute Amendment No. 5 to Contract No. C-8-1911 with Crowe, LLP to revise the scope of work, add an additional task to apply agreed-upon procedures to assess compliance with maintenance of effort expenditure requirements, extend the agreement through December 31, 2025, and authorize staff to deduct audit costs from any future net Measure M2 payments to the City of Cypress.

- E. Authorize the Chief Executive Officer to negotiate and execute a settlement agreement with the City of Cypress to correct and remedy the fiscal year 2021-22 audit issues and confirm required actions to become an eligible jurisdiction.

Background

The Measure M2 (M2) Ordinance outlines eligibility requirements that each local jurisdiction must continually satisfy to receive net revenues from the M2 Program, including local fair share, Senior Mobility Program, and awards through competitive programs. One of the requirements is that a local jurisdiction must continue to invest a certain level of discretionary revenues, such as general funds that support street and road activities, to be deemed eligible for any M2 funding. This requirement is rooted in the California Public Utilities Code (PUC) 180001 that enables local transportation authorities to seek voter approval for sales tax measures. The PUC states the intent of the legislature is that funds generated through a sales tax ordinance “shall supplement existing local revenues used for public transportation purposes and that local governments maintain their existing commitment of local funds for transportation purposes” (PUC 180200).

In the eligibility process, this requirement is referred to as the maintenance of effort (MOE) requirement and was also included in the original M2 program. Each jurisdiction is required to maintain a minimum level of local streets and roads discretionary expenditures. The minimum level was based on the average of general fund expenditures for local street maintenance and construction over the period of fiscal year (FY) 1985-86 through FY 1989-90. M2 used a similar benchmark and requires the amount to be adjusted for inflation every three years beginning in 2011 commensurate with overall growth of the local jurisdiction’s general fund revenues or growth in the construction cost index, whichever is lower.

The local jurisdiction demonstrates its commitment to comply with the required MOE through budgeting the appropriate level of discretionary funding as part of the local jurisdiction budget process. The local jurisdiction must also provide the Orange County Transportation Authority (OCTA) with an annual expenditure report to validate that the local jurisdiction has met the MOE commitment for each FY.

The OCTA Board of Directors (Board) makes a determination of eligibility annually based on the information that is provided by each jurisdiction and with support from the Taxpayer Oversight Committee (TOC), which is also charged with reviewing certain submittals. Following the annual eligibility cycle, the TOC directs the internal auditor to carry out audits to confirm that funds have been spent in accordance with the M2 Ordinance and that each jurisdiction had sufficient expenditures to meet the previously self-certified MOE requirement.

Every year, OCTA's Finance and Administration, Internal Audit, and Planning staff, as well as the TOC, have provided training on MOE process and cautioned local agencies that budgeting at or just above the required MOE amount may put the jurisdiction's M2 funds at risk if they end up not meeting the requirement due to disallowed costs.

At the direction of the TOC, the OCTA Internal Auditor utilizes OCTA's independent financial audit firm to conduct these audits and presented results of the audits to the Finance and Administration Committee on April 26, 2023, and will be considered by the Board on May 8, 2023. The audit of the City of Cypress (City) reported that the City lacked adequate documentation to support indirect costs charged to MOE, and if these unsupported costs were removed from MOE expenditures, the City would not meet its MOE requirement. This will impact the City's eligibility determination and the disbursement of net M2 revenues to the City. It should be noted that the City has provided a response to the audit that is also included in Attachment A.

Discussion

In June 2021, the City provided the required MOE certification that stated it budgeted sufficient expenditures for FY 2021-22, consistent with the following requirement:

“The Authority shall not allocate any net revenues to any jurisdiction for any fiscal year until that jurisdiction has certified to the Authority that it has included in its budget for that fiscal year an amount of local discretionary funds for streets and roads purposes, at least equal to the level of its maintenance of effort requirement.”

The City met the MOE requirement through the submittal of the self-certification of intent to meet the MOE based on their FY 201-22 budget. The City's MOE benchmark for FY 2021-22 was \$3,607,878. The next submittal related to MOE was the expenditure report to verify that the budgeted amount was actually spent. The City Council approved the expenditure report through a resolution on November 14, 2022, and submitted it to OCTA on December 7, 2022. According to the expenditure report that was submitted, the City spent \$3,892,903 in discretionary revenues toward streets and roads-related costs to meet the MOE requirement.

However, the audit identified \$632 in ineligible direct charges, and the City could not provide documentation to confirm that any of the indirect costs allocated to MOE were based on a reasonable methodology. After the removal of ineligible direct costs and unsupported indirect costs, the City's shortfall from the MOE benchmark amounted to \$1,381,048. The City, in its response to the audit, disagreed with the finding noting that the allocation methodology that was used has been used for 30 years and is fair and reasonable and was not found

non-compliant in prior audits. In the internal audit staff report, it is noted that indirect costs were reviewed in audits in FY 2012-13 and FY 2016-17 and reported no exceptions. For the FY 2007-08 audit, no indirect costs were identified, and City staff confirmed no indirect costs were charged.

In addition, since those audits were conducted, there were audit findings for FY 2017-18 that led to ineligibility based on similar circumstances for the Cities of Santa Ana and Stanton for MOE. Since that finding of ineligibility, OCTA sent letters and emails and provided guidance through guidelines and the annual M2 Finance Director Workshops that indirect costs must have a reasonable basis or methodology for cost allocation.

The City has indicated that it could not produce the original allocation methodology that is being applied. The City only provided spreadsheets indicating the allocation of budgeted costs from various internal service funds and could not produce support for how the allocation percentages were derived or demonstrate that the allocations represented actual costs (rather than budgeted amounts). The City acknowledged that its documentation and method of allocating costs could be improved. After deducting these unverifiable expenditures, the City would not meet the MOE requirement for FY 2021-22.

Under this circumstance, the following M2 Ordinance requirement applies:

“A determination of non-eligibility of a jurisdiction shall be made only after a hearing has been conducted and a determination has been made by the Authority’s Board of Directors that the jurisdiction is not an eligible jurisdiction.”

Because the audit determined that the City did not provide sufficient verifiable expenditures to meet the MOE requirement, and in order to be consistent with the requirements of the M2 Ordinance and comply with the intent of the authorizing state statute, it is recommended that the Board find the City ineligible to receive Measure M2 revenues. Specific recommendations include:

- Find the City ineligible to receive or apply for net M2 revenues;
- Suspend payments to the City of net M2 revenues;
- Deduct audit costs for any future audits related to this eligibility finding from any future net M2 payments to the City;
- Require the City to demonstrate supplemental investment of discretionary transportation funds equal to the amount of discretionary investment that was short of the MOE benchmark in FY 2021-22 (approximately \$1.38 million) as a condition of accessing suspended funds upon being found an eligible jurisdiction, and
- Authorize the Chief Executive Officer to negotiate and execute an agreement with the City outlining the process to re-establish eligibility.

Based on these recommendations, subject to Board approval, net M2 payments would be suspended until the City can re-establish eligibility. The funds will be held in reserve until such a time that the City has re-established eligibility. The City will be required to demonstrate through a future OCTA audit that it has met the MOE required for FY 2022-23, plus made up for the underrun in MOE expenditures from FY 2021-22. Based on discussions with the City, the City may need more than one year to make up for the underrun. If an additional audit of FY 2023-24 is required in order to validate that the entire underrun amount has been expended, then an audit shall be conducted. Costs incurred for audits required to determine eligibility will be paid for by the City through a reduction in M2 revenues. The M2 Ordinance and eligibility guidelines do not include precise terms and conditions related to re-establishing eligibility. Therefore, staff will return to Board and seek further direction if the City has not re-established eligibility after two years. In the interim, OCTA will work with the City to enter into an agreement that details specific requirements and timeframes for submittals to support timely re-establishment of the City's eligibility.

Summary

A recent audit indicated that the City of Cypress did not meet Measure M2 eligibility requirements. Recommendations are presented to find the City of Cypress ineligible to receive net Measure M2 funds given the audit report and to remain consistent with the Measure M2 Ordinance.

Attachment

- A. Crowe, LLP, Certified Public Accounts, Independent Accountants' Report on Applying Agreed-Upon Procedures – City of Cypress

Prepared by:

Adriann Cardoso
Department Manager,
Capital Programming
(714) 560-5915

Approved by:

Kia Mortazavi
Executive Director, Planning
(714) 560-5741