



MINUTES

HERCULES AD-HOC CITIZENS FINANCE ADVISORY COMMITTEE (CFAC)

September 27, 2012

City Hall Council Chambers Room

111 Civic Drive, Hercules, CA 94547-1771

Members Present

John Delgado, Vice-Mayor (arrived late), William Wilkins, Council Member

Hector Rubio, Chair, Virgilio de la Vega, Vice-Chair

Gabriel Naguit, Bill Shea, Stanley Tom, Committee Members

Staff Present

Steve Duran, Nicki Mastay, Liz Warmerdam

Guests Present

Chris Kelley, Ken Morrison

Meeting Called to Order: 6:39 PM

1. Public Comments

Ken Morrison stated that he was glad to see the item on the agenda.

2. Review Findings of State Controller's Review of Administrative and Internal Accounting Controls and Redevelopment Agency (Duran & Mastay)

Mastay received the final report from the State Controller's Office (SCO) dated September 2012. The administrative report reviewed the City's operations from January 1, 2007 through December 31, 2010. The report found that internal control deficiencies were serious, pervasive and in-effect non-existent. The report contains seven (7) findings and recommendations for clearing them. Including:

- The City Council failed to exercise oversight over the City's financial and operational activities.
- The City's contracts with four (4) school principals were vague in scope of services and whether such services were needed.
- The City exercised inadequate control over expenses charged to City issued credit cards by city officials and Council members.

- The City lacked proper approval for using bond funds to purchase five (5) real estate properties in the amount of \$44.1 million. Additionally, an absence of appraisals and other documentation for three (3) properties fail to establish the reasonableness of the \$32.7 million paid for these properties.
- Related party transactions between the City of Hercules and the Hercules Redevelopment Agency were not at arms-length transactions and lacked appraisals to determine current property values.
- The City had budget adjustments, revised revenue estimates and financing sources that were not recorded into the financial accounting system and may result in significant misstatement of the accounting records.
- The City's administrative Policy Manual has not been updated and is not current. Finance Director Mastay will work with the City's auditor, Gallina LLC to locate other internal control issues and clear the findings with the State Controller's Office. Should these findings remain open, they will negatively affect the City's ability to receive funding grants from State agencies.

The SCO's review of the RDA found serious mismanagement practices by the former City Manager and a lack of oversight by the City Council. The report contains ten (10) findings and recommendations for clearing them. Including:

- The former City Manager had a conflict of interest as principal and owner of NEO/AHSG engaged in questionable business practices, which received contracts without a competitive bid process; as a result payments of \$3.0 million made to NEO are questionable.
- The City charged unallowable costs to the Low and Moderate Income Housing Fund totaling \$1.4 million for mailbox program, gas valve program, lobbying charges, citywide beautification project, and notary services.
- The City charged the RDA's operating fund for administrative transfers and contract repayment of \$7.1 million in unallowable costs. It appears that these charges were arbitrary and based on the City's financial needs.
- Questionable property transfers were made from the RDA to the City. Several examples show that the City Council, acting as the RDA governing body, made decisions that primarily were for the benefit of the City, with little consideration of the benefit to the RDA.
- The City failed to pay \$6.0 million in the Supplemental Educational Revenue Augmentation Fund (SERAF).
- The RDA's five-year implementation plan was finalized and approved on January 14, 2010, after the deadline of December 31, 2009.
- The RDA's annual budget for FY2009-10 was incomplete, and the FY2010-11 budget was not approved by the governing body.
- The RDA did not maintain a housing database, which needs to be updated on an annual basis.
- The RDA's Annual Report to the Legislative Body was incomplete and did not include all required items.
- The RDA's annual independent financial audit report was missing the excess surplus calculation as required by the Health and Safety Code.

3. Status of County Review of Procedures (Mastay)

This item remains in progress; no update from the County.

Contra Costa County performed an audit of the City through 10/15/12; the review is part of a countywide review of audit controls and procedures for all cities within the county. The review includes the procedures for expenditures and the documents used for backup data.

The review is still in process and the City will respond when the list of open items is received.

4. Status of IRS Audit of 2007 RDA Bond (Mastay)

This item remains in progress; no update from the IRS.

The IRS audit is reviewing transactions using the proceeds of the Bonds, and to determine if the \$20 million used to purchase vacant lands, and expenditures towards the Sycamore North project are allowable costs. IRS is reviewing documentation for draw requests of bond funds.

Mastay is awaiting an open item list from the IRS which is not yet ready. No timetable was given by the auditor.

5. Status of State Controller's Office Asset Transfer Review (Mastay)

This item remains in progress. The final written report has not arrived at the City.

The auditor from the State Controller's Office had reviewed all assets of the RDA and its Affordable Housing program. The report is expected to disallow all transactions occurring after 1/31/11 and transferred to the RDA Successor Agency. This will result in the CalHFA debt cannot be repaid from RDA proceeds because it is a City of Hercules debt and not RDA debt.

The RDA Successor Agency chose to NOT accept the low-moderate income housing assets of the RDA, and opted for the County Housing Authority (CHA) to administer the program as allowed by the State Department of Finance (DOF); however, the CHA will not accept the assets. The homeowners remain in limbo without a governing agency to administer the program. The State's DOF is in contact with the CHA and attempting to have the County agency accept the assets.

6. Status of Audits for FY2010-11 by Gallina LLP (Mastay)

Gallina LLP is scheduled to complete the FY 2010-2011 audit by November 10 2012, and the FY2011-2012 audit by March 21, 2013. The schedule remains aggressive, but Gallina is aiming to complete the tasks as scheduled.

7. Review of Variance Report Format (Mastay)

Mastay distributed a sample variance report created by the Finance Department to provide timely financial data of the General Fund to the City Council and the Finance Subcommittee.

Discussion ensued among the members relating to the actual-to-budget figures on the document, and how the figures are generated. Stanley Tom asked about the numbers noted under the Encumbrances heading; Mastay explained that these are purchase orders and other committed expenses that are not yet paid when the report is printed.

The variance report includes a summary sheet of Total Revenues and Total Expenses, followed by a breakdown of the data showing amounts for Actuals, Budget, Year End Estimate, and Change from Fiscal Year Estimate; plus an itemized listing of the Account Activity occurring within the period.

The finance committee agreed that the variance report gives a concise snapshot of the City's finances and will be useful tool for the City Council while making financial decisions.

Meeting adjourned at 8:25 pm.

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