



April 18, 2007

Mr. Barry Wallerstein, Executive Officer
South Coast Air Quality Management District
21865 Copley Drive
Diamond Bar, CA 91765

Dear Mr. Wallerstein:

**Final Audit Report—South Coast Air Quality Management District, Grant Contracts
G02-4022, G03-4027, G02-4033 and G03-4034**

Enclosed is the final report on our audits of the South Coast Air Quality Management District (District) grant contracts listed above. The Department of Finance, Office of State Audits and Evaluations, performed these audits of the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002 (Proposition 40) funds in response to the Governor's directive. The audits included a review of receipts, expenditures, internal control, and compliance with certain grant provisions.

As shown on the Statement of Revenue and Expenditures and discussed in the *Findings and Recommendations* section, the District did not fully expend grant funds within the statutory requirements. In addition, the District materially understated the expenditures for contract numbers G02-4022 and G03-4027, and materially overstated the revenue for contract number G02-4022 in its reports to the awarding agency. Although these were not the amounts recognized in the accounting system as of the end of the grant period, the awarding agency may have relied on this information when making program related decisions. Therefore, corrective action is necessary. In addition, findings pertaining to internal control and compliance weaknesses were identified. The District's response is included in the enclosed report.

We appreciate the District's assistance and cooperation with our audits. If you have any questions regarding this report, please contact Diana Antony, Manager at (916) 322-2985.

Sincerely,

Original signed by:

Diana L. Duca, Chief
Office of State Audits and Evaluations

Enclosure

cc: Ms. Catherine Witherspoon, Executive Officer, California Air Resources Board
Mr. Jack Kitowski, Branch Chief, Mobile Source Control Division, Air Resources Board
Ms. Lucina Negrete, Manager, Mobile Source Control Division, Air Resources Board
Mr. Patrick Pearce, Chief Financial Officer, South Coast Air Quality Management District
Mr. Chung Liu, District Executive Officer, Science and Technology Advancement Unit,
South Coast Air Quality Management District

South Coast Air Quality Management District
Proposition 40 Bond Programs
Grant Contracts G02-4022, G03-4027, G02-4033
and G03-4034

Prepared By:
Office of State Audits and Evaluations
Department of Finance

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The Department of Finance, Office of State Audits and Evaluations, performed audits of Proposition 40 Bond funds awarded to the South Coast Air Quality Management District (District). A Governor's directive required the Department of Finance to annually audit and report on the expenditures of these funds.

The Air Resources Board (Board) awarded grant contracts G02-4022 and G03-4027 in the amounts of \$8,148,088 and \$7,448,659, respectively, for the Carl Moyer Program. These grants were funded from Proposition 40 bond funds and covered the period June 26, 2003 through June 30, 2006.

The Board also awarded grant contracts G02-4033 and G03-4034 in the amounts of \$2,175,000 and \$2,030,000, respectively, for the Lower Emissions School Bus Program. These grants were funded from Proposition 40 bond funds and covered the period June 30, 2003 through December 31, 2005.

The objective of these audits was to determine the District's fiscal compliance with the aforementioned grants. We did not assess the efficiency or effectiveness of program operations or the quality of completed projects. The responsibility for financial reporting and compliance rests with the District.

This report is intended for the information and use of state and District management. However, this report is a matter of public record and its distribution is not limited.

STAFF:

Diana Antony, CPA
Manager

Jennifer Arbis
Supervisor

Mei Yip, CPA
Ife Maduchukwu, CPA
Issa Ndiaye



INDEPENDENT AUDITOR'S REPORT

Mr. Barry Wallerstein, Executive Officer
South Coast Air Quality Management District
21865 Copley Drive
Diamond Bar, CA 91765

We have audited the accompanying South Coast Air Quality Management District (District) *Statements of Revenue and Expenditures* (Statements) for the following grant contracts:

<u>Contract Number</u>	<u>Audit Period</u>	<u>State Awarding Agency</u>
G02-4022	June 26, 2003 to June 30, 2005	Air Resources Board
G03-4027	July 23, 2004 to June 30, 2006	Air Resources Board
G02-4033	June 30, 2003 to September 1, 2004	Air Resources Board
G03-4034	June 30, 2004 to December 31, 2005	Air Resources Board

These Statements were prepared from the District's records and are the responsibility of its management. Our responsibility is to express an opinion on the Statements based on our audits.

We conducted our audits in accordance with *Generally Accepted Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to provide reasonable assurance as to whether the Statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Statements. An audit also includes assessing the accounting principles used and significant estimates made by management. We believe that our audits provide a reasonable basis for our opinion.

The accompanying Statements were prepared, as described in Note 4, for the purpose of determining the District's fiscal compliance with the aforementioned contracts. The Statements are not intended to be a presentation of the District's total revenue and expenditures.

As noted in the *Findings and Recommendations* section of this report, the District lacked a review and reconciliation process for the annual report. As a result, the District's reported revenue and expenditures to the Board were inaccurate. Specifically, for grant number G02-4022, the revenue was overstated by \$11,753,293 and the expenditures were understated by \$1,138,209. For grant number G03-4027, the expenditures were understated by \$754,129.

In our opinion, except for the reporting error as discussed in the preceding paragraph, the *Statements of Revenue and Expenditures* present fairly, in all material respects, the reported

and audited revenue and expenditures for the contract numbers and periods specified in paragraph one, in conformity with accounting principles generally accepted in the United States of America.

Compliance

As part of obtaining reasonable assurance about whether the Statements are free of material misstatement, we performed tests of the District's compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of Statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audits, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance, as described in the *Findings and Recommendations* section of this report, that are required to be reported under *Generally Accepted Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered the District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the Statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the District's ability to record, process, summarize, and report financial data consistent with the assertions of management in the Statements. These reportable conditions are described in the *Findings and Recommendations* section of this report.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the Statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not disclose all reportable conditions that are also considered to be material weaknesses. However, the noted reportable conditions are not believed to be material weaknesses.

This report is intended solely for the information and use of State and District management, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Original signed by:

Janet I. Rosman, CPA
Assistant Chief, Office of State Audits and Evaluations
(916) 322-2985

August 11, 2006

STATEMENT OF REVENUE AND
EXPENDITURES

**South Coast Air Quality Management District
Carl Moyer Program
Grant Contract G02-4022
For the Period June 26, 2003 to June 30, 2005**

	<u>Reported</u>	<u>Audited</u>	<u>Difference</u>
Revenue:			
Proposition 40 Funds Advanced	\$19,901,381	\$8,148,088	\$11,753,293
Expenditures:			
Total Expenditures	<u>1,694,479</u>	<u>2,832,688</u>	<u>1,138,209</u>
Excess of Revenue Over Expenditures	<u>\$18,206,902</u>	<u>\$5,315,400</u>	<u>\$10,615,084</u>

The accompanying notes are an integral part of this statement.

STATEMENT OF REVENUE AND
EXPENDITURES

South Coast Air Quality Management District
Carl Moyer Program
Grant Contract G03-4027
For the Period July 23, 2004 to June 30, 2006

	<u>Reported</u>	<u>Audited</u>	<u>Difference</u>
Revenue:			
Proposition 40 Funds Advanced	\$7,448,659	\$7,448,659	\$ 0
Expenditures:			
Total Expenditures	<u>664,989</u>	<u>1,419,118</u>	<u>754,129</u>
Excess of Revenue Over Expenditures	<u>\$6,783,670</u>	<u>\$6,029,541</u>	<u>\$ 754,129</u>

The accompanying notes are an integral part of this statement.

STATEMENT OF REVENUE AND
EXPENDITURES

**South Coast Air Quality Management District
Lower Emissions School Bus Program
Grant Contract G02-4033
For the Period June 30, 2003 to September 1, 2004**

	<u>Claimed</u>	<u>Audited</u>	<u>Difference</u>
Revenue:			
Proposition 40 Funds Advanced	\$2,175,000	\$2,175,000	\$ 0
Expenditures:			
Total Expenditure	<u>1,929,207</u>	<u>1,929,207</u>	<u>0</u>
Excess of Revenue over Expenditures	<u>\$ 245,793</u>	<u>\$ 245,793</u>	<u>\$ 0</u>

The accompanying notes are an integral part of this statement.

STATEMENT OF REVENUE AND
EXPENDITURES

**South Coast Air Quality Management District
Lower Emissions School Bus Program
Grant Contract G03-4034
For the Period June 30, 2004 to December 31, 2005**

	<u>Claimed</u>	<u>Audited</u>	<u>Difference</u>
Revenue:			
Proposition 40 Funds Advanced	\$2,030,000	\$2,030,000	\$ 0
Expenditures:			
Total Expenditure	<u>1,806,927</u>	<u>1,806,927</u>	<u>0</u>
Excess of Revenue over Expenditures	<u>\$ 223,073</u>	<u>\$ 223,073</u>	<u>\$ 0</u>

The accompanying notes are an integral part of this statement.

NOTES TO THE STATEMENTS OF REVENUE AND EXPENDITURES

South Coast Air Quality Management District Grant Contracts G02-4022, G03-4027, G02-4033 and G03-4034

NOTE 1 Description of the Reporting Entity

The South Coast Air Quality Management District (District) was established pursuant to the Lewis Air Quality Management Act on February 1, 1977, commencing at Section 40400 of the Health and Safety Code of the State of California. The District encompasses all of Orange County, and parts of Los Angeles, San Bernardino, and Riverside Counties. The District operates a network of air monitoring stations, analyzes air quality data, and establishes maximum emission levels for stationary, commercial, and industrial facilities that are enforced through the District's permit system.

NOTE 2 Program Information

In 2002, voters approved the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act (Proposition 40), authorizing the sale of \$2.6 billion in general obligation bonds. Proposition 40 supports clean air, clean water, clean beaches, and natural ecosystems that can support both human communities and native fish and wildlife habitats. Various state agencies administer these programs, making grants to local governments and nonprofit organizations.

NOTE 3 Description of Grant Contracts

Grant Contract G02-4022 and G02-4027

The Air Resources Board (Board) awarded the District an \$8,148,088 Proposition 40 grant (G02-4022) for the period June 26, 2003 to June 30, 2005. The grant funded the Carl Moyer Program for fiscal year 2002-03. In addition, the Board awarded a \$7,448,659 Proposition 40 grant (G03-4027) for the period July 23, 2004 to June 30, 2006. The grant funded the same program for fiscal year 2003-04.

The Carl Moyer program funds the incremental cost of cleaner-than-required engines and equipment. Public or private entities that operate eligible engines or equipment in Orange County, and parts of Los Angeles, San Bernardino, and Riverside Counties can participate by applying directly to the District. Examples of eligible engines and equipment include heavy-duty on-road and off-road marine, locomotive, stationary agricultural pumps, forklifts, airport ground support equipment, and heavy-duty auxiliary power units.

Grant Contract G02-4033 and G02-4034

The Board awarded the District a \$2,175,000 Proposition 40 grant (G02-4033) for the period June 30, 2003 to September 1, 2004. The grant funded the implementation of the Lower Emissions School Bus Program for fiscal year 2002-03. In addition, the Board awarded a \$2,030,000 Proposition 40 grant (G02-4034) for the period June 30, 2004 to December 31, 2005. The grant funded the same program for fiscal year 2003-04.

The primary purpose of the Lower Emissions School Bus Program is to reduce school children's exposure to both cancer-causing and smog-forming pollution. Through a combined approach of replacing and retrofitting older, high-polluting school buses, the program will reduce emissions of both particulate matter and oxides of nitrogen. The program contains two components: (1) a school bus replacement and infrastructure component; and (2) a particulate matter retrofit component for diesel school buses.

NOTE 4 Summary of Significant Accounting Policies**A. Basis of Presentation**

The Statements were prepared from the District's accounts and financial transactions. The Statements summarize the Districts' reported revenue and expenditures submitted to the awarding agency for the aforementioned grants and their specified audit periods. The audit periods run from the contract effective dates through the contract end dates.

The Statements summarize the District's transactions pertaining to these grant contracts only, and are not intended to represent all of its financial activities.

B. Basis of Accounting

The District's governmental funds are maintained on the modified accrual basis and in accordance with the principles of fund accounting. Under the modified accrual basis, revenues are recorded as they become measurable and available, and expenditures are recorded at the time the liabilities are incurred. The Proposition 40 transactions were commingled with other funding sources in Fund 32. Therefore, the accounting staff maintained manual records of Proposition 40 transactions. These transactions were recorded on the cash basis during the year. At year end, accruals were recorded in the system.

NOTE 5 Matching Funds

Grant contracts G02-4022 and G03-4027 required project and optional in-kind match of \$4,074,044 and \$3,724,330 respectively. Based on the matching funds requirements of the Health and Safety Code, Section 44287 (e), (h) and (j), the District met the match requirements.

Grant contracts G02-4033 and G03-4034 did not require the District to provide matching funds.

FINDINGS AND RECOMMENDATIONS

During our audits of grant contracts G02-4022, G03-4027, G02-4033 and G03-4034, we noted reportable internal control and compliance weaknesses requiring corrective action. The following recommendations, if implemented, will improve the District's fiscal control and accountability for grant funds.

FINDING 1 Inadequate Monitoring of Grant Funds

Conditions: The District did not fully expend the grant funds advanced for the Carl Moyer program as required. Specifically, Health and Safety Code Section 44287(k) states that funds are available to the district for a period of no more than two years. Funds not expended by June 30 of the second calendar year following the date of the reservation shall revert back to the state board.

The District claims that an agency can meet the statutory deadline to expend funds by "encumbering" the monies via an executed contract only. However, under the modified accrual basis, expenditures are recognized in the period in which goods or services are received or a liability is incurred. In this case, a signed contract is not an expenditure, since neither an expenditure nor a liability has been incurred, only a commitment to purchase.

Therefore, based on the audited expenditures in the Districts accounting records, the ending balance for contract number G02-4022 as of June 30, 2005 was \$5,315,400 and the ending balance for contract number G03-4027 as of June 30, 2006, was \$6,029,541. The District claims that of these amounts, \$504,969 for contract G02-4022 and the full balance for contract G03-4027 was committed to fully executed contracts.

In addition, the District did not fully expend the grant funds advanced for the Lower Emissions School Bus program as of the end of their respective contract periods. The ending balance for contract G02-4033 as of September 1, 2004 was \$245,793, and for contract G03-4034 as of December 31, 2005 was \$223,073.

Criteria: Section 44287(k) of the Health and Safety Code states that funds reserved for a district, "are available to the district for a period of no more than two years from time of reservation. Funds not expended by June 30 of the second calendar year following the date of the reservation shall revert back to the state board as of the June 30...."

Recommendations: Monitor grant activities to ensure that grant funds are spent within the statutory deadlines. Based on the Board's October 3, 2006 audit report for the same Carl Moyer grant periods noted above (same unexpended funds finding was noted), the District is required to submit quarterly progress reports indicating the status of unexpended funds. We recommend that the District comply with the Boards requirements to ensure full compliance with Section 44287(k) of the Health and Safety Code. The Board will make the final determination regarding the resolution of the final balances, and whether any amounts should be returned to the state.

FINDING 2 Weak Internal Controls

Conditions: During our review of the District's expenditures, we identified the following weaknesses:

- A. *Policies and procedures for Proposition 40 could be improved.* Although the District maintains general accounting policies and procedures, expanded policies should be developed to address specific Carl Moyer requirements. Lack of additional policies and procedures for unique Carl Moyer program requirements can lead to ineffective accounting control over Proposition 40 projects and expenditures. The current Carl Moyer guidelines now require the Districts to develop specific policies and procedures for the Carl Moyer program. It is our understanding that since the end of fieldwork date, the District has submitted draft procedures to the Board.
- B. *Lack of review and reconciliation process.* The Proposition 40 annual reports prepared by the Science and Technology Advancement Branch were not reviewed by the District's Finance Branch prior to submission to the Air Resources Board. The amounts reported were not based on the District's accounting system, and the expenditure cut-off dates for reporting were inconsistent for fiscal years 2002-03 and 2003-04. As a result, the District's reported revenue and expenditures to the Board were inaccurate. Specifically, for grant number G02-4022, the revenue was overstated by \$11,753,293 and the expenditure was understated by \$1,138,209. For grant number G03-4027, the expenditure was understated by \$754,129. However, the revenues and expenditures recognized in the accounting system were materially correct. The lack of a review and reconciliation process increases the risk that errors in the accounting and reporting of Proposition 40 funds and future Carl Moyer funds may not be detected in a timely manner. In addition, Proposition 40 projects and expenditures may not be accurately accounted for.

Criteria: Generally accepted internal control procedures require a system of reconciliation and record keeping procedures adequate to provide effective tracking and accounting control over grant funds.

- Recommendations:
- A. Establish policies and procedures for the Carl Moyer Program to ensure effective accounting control over Proposition 40 funds.
 - B. The District's Science and Technology Advancement Branch and Finance Branch should periodically reconcile the list of Proposition 40 projects and related expenditures to ensure accuracy.

FINDING 3 Non-Compliance with Grant Requirements

Condition: The District did not submit final reports required by contracts G02-4033 and G03-4034. As a result, the Proposition 40 funds for the Lower Emission School Bus Program may not be accurately accounted for.

Criteria: Both contracts required the submission of final reports by November 1, 2004 and March 1, 2006, respectively.

Recommendations: Ensure compliance with the grant agreement by submitting the required final report to ensure adequate accounting of Proposition 40 funds.



South Coast Air Quality Management District

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March 23, 2007

Ms. Diana L. Ducay, Chief
California Department of Finance
Office of State Audits and Evaluations
300 Capitol Mall, Suite 801
Sacramento, CA 95814

**Re: Draft Audit Report – South Coast Air Quality Management District, Grant
Contracts G02-4022, G03-4027, G02-4033 and G03-4034**

Dear Ms. Ducay:

On behalf of the South Coast Air Quality Management District (SCAQMD), I want to thank you and your staff for the opportunity to submit the following comments regarding the Department of Finance's (DOF) Draft Audit of Proposition 40 Bond Programs – Grant Contracts G02-4022, G03-4027, G02-4033 and G03-4034. We hope these comments will be reflected in the DOF's final audit report. As always, my staff and I are available to address any of your questions or concerns.

FINDING 1 Inadequate Monitoring of Grant Funds

The District did not fully expend the grant funds advanced for the Carl Moyer program as required. Specifically, Health and Safety Code Section 44287(k) states that funds are available to the district for a period of no more than two years. Funds not expended by June 30 of the second calendar year following the date of the reservation shall revert back to the state board.

SCAQMD Response:

According to section 44287(k) of the Health and Safety Code, Moyer funds controlled by the District must be “expended” within two years from the time they are reserved. The District disagrees with the Department's finding that Moyer funds are “expended” only when the funds are paid to a contract recipient. The statutory language establishing the Moyer program makes it clear that funds are expended when a binding contract is made.

The District and other parties must follow the plain meaning of the statutory language establishing the program when determining a definition of “expended.” That language makes it clear that Moyer funds are expended when an award is made. One of the

provisions in the Moyer statute, Health and Safety Code section 44291(d), requires the state Air Resources Board to recapture Moyer funds *not yet awarded* when a District does not follow program criteria. One of those criteria, as the Department has pointed out, is that Districts must expend Moyer funds within two years. However, section 44291(d) states that the state board “shall not recapture funds already awarded to approved projects.” This language totally undercuts the Department’s position on the proper interpretation of the term “expended.” If the Department’s interpretation is correct, then the state board would be obliged to recapture any funds that have not been paid to a contract recipient within two years, even if a contract has been awarded. The quoted language of section 44291(d), however, expressly forbids recapturing funds when an award had been made. Thus, the Department’s interpretation of the word “expend” leads to a contradiction, namely that in certain situations the statute both requires and forbids the state board to recapture funds. For that reason, the Department’s interpretation must be rejected.

SCAQMD’s interpretation of the legislative intent is supported in CARB’s 2003 Carl Moyer Guidelines which require only that the funds reserved to a district be “obligated,” which the District has done, and which we interpreted to mean encumbered so as to be consistent with CARB guidelines. On pages 5-6 of the 2003 Guidelines, CARB states: “Districts must report project status including specific projects, state fund expenditures, additional funds obligated via contract or contracts in progress, and remaining funds that have not been obligated. Any funds not obligated by contract at the end of fiscal year are subject to reallocation as determined by the interpretation of Proposition 40 by the California Department of Finance.”

It is also important to note that this interpretation of the Carl Moyer legislation is not inconsistent with other state-provided accounting definitions, as evidenced by Government Code Section 16304 – *Availability of appropriations; encumbered appropriations; exemptions* which states, “An appropriation shall be available for encumbrance during the period specified therein, or, if not otherwise limited by law, for three years after the date upon which it first became available for encumbrance.” This code section goes on to further state, “As used in this code and in every other statute heretofore or hereafter enacted, the term “unexpended balance” shall be construed to mean “unencumbered balance.” In addition, definitions provided by the DOF in their Glossary of Terms document, revised in December 2004 (www.dof.ca.gov/fisa/bag/dofgloss.htm), defines the term “appropriation” as an “authorization for a specific agency to make expenditures and incur liabilities from a specific fund for a specific purpose and is usually limited in amount and period of time which the expenditure is to be incurred.” DOF has also defined “expenditure” to represent the amount of an appropriation used for goods and services ordered, whether paid for or not. In other words, under DOF definitions, an agency can meet the statutory deadline to expend appropriated funds by encumbering the monies, which is defined by DOF to mean “a commitment of part or all of an appropriation,” as expressed in documents such as Board letters, purchase orders, and contracts.

It is our belief, based on the 2003 Carl Moyer Air Quality Standards Attainment Program Guidelines adopted by CARB and the legislative language contained in Health and Safety Code section 44291(d) that when the state legislature appropriated Carl Moyer Program funds, it intended to give the district's two full years to award the funds and issue contracts. Therefore, the SCAQMD fully complied with statutory requirements by committing all funds for years 5 and 6 within the two-year deadline.

Finally, we have also established a backup list of Carl Moyer qualified projects, funded from our Clean Fuels Fund, so that these projects can be substituted for any returned Carl Moyer funds in an expedited manner.

FINDING 2 Weak Internal Controls

- A. Policies and procedures for Proposition 40 could be improved.*
- B. Lack of review and reconciliation process*

SCAQMD's Response:

- A. At the time of the audit, separate Policies and Procedures for this specific grant program were not required under CARB's Carl Moyer Program. Instead the SCAQMD followed its well established Policies and Procedures for Procurement, for Contracting, and other internal controls which have been audited annually by independent CPA firms as part of their OMB Circular A-133 Report on Compliance and on Internal Control. In addition, these policies and procedures and internal controls have been reviewed in detail by Region IX of the Environmental Protection Agency, as part of Section 105 grant program review, as well as by state agencies such as the California Air Resources Board and the Department of Transportation, Audits and Investigations section. The District provided to the DOF the SCAQMD's Board adopted Procurement Policy and Procedure and our Procurement Guide. However, as required by CARB's new guidelines released on January 6, 2006, the District has developed a specific "Policies and Procedures Manual" for the administration of the Carl Moyer Program. This manual was approved by the SCAQMD's Governing Board on October 6, 2006, and was subsequently submitted to CARB before the required date of November 15, 2006.
- B. Staff at the Technology Advancement Office (TAO) provided, at CARB's request, with reports regarding Board approved Carl Moyer projects, executed contracts, progress of projects, current expenditures, annual operation status of the projects, etc. This CARB requested information represented the most updated status of the projects. These reports differ from the reports generated by Finance, as Finance's reports reflect grant dollars received, invoices paid and contract awards (encumbrances), whereas TAO's program status report to CARB reflects the most updated status of the projects. Had the DOF looked at the differences between the program reports to CARB (which were consistent with our

understanding of the grant requirements, see response to Finding 1) and the accounting records, it would have found that the actual expenditures plus the contract awards (encumbrances) equaled the amount of the grants. However, in response to this finding, the SCAQMD has strengthened its reporting procedures by establishing a monthly reconciliation process between program staff and Finance to ensure that the status of the program regarding obligation of funds, execution of contracts, and expenditures are properly reported. Furthermore, the quarterly reports will now require the approval of the Executive Officer before being forwarded to CARB.

FINDING 3 Non-Compliance with Grant Requirements

The District did not submit final reports required by contracts G02-4033 and G03-4034. As a result, the Proposition 40 funds for the Lower Emission School Bus Program may not be accurately accounted for.

SCAQMD's Response:

SCAQMD staff has submitted all the information to CARB regarding the status of the Lower-Emission School Bus Program. All the buses have been delivered and are in operation. As a result of grants G02-4033 and G03-4034, a total of 31 new CNG school buses were granted to public school districts for replacement of pre-1987 buses. All the buses were delivered on time and are in operation. During the same time period the SCAQMD also funded an additional 55 new CNG school buses with its own funds, which are in operation. SCAQMD will submit formal reports to CARB for the program.

Again, thank you for the opportunity to submit our comments regarding the DOF's Draft Audit of Proposition 40 Bond Programs – Grant Contracts G02-4022, G03-4027, G02-4033 and G03-4034. Please feel free to call me at 909-396-2100 if you have any questions regarding our responses or require any additional information.

Sincerely,

Original signed by:

Barry Wallerstein, D.Env
Executive Officer

CSL/RP

EVALUATION OF RESPONSE

The South Coast Air Quality Management District's (District) response to the draft audit report dated March 23, 2007 has been reviewed and incorporated into the final report. We acknowledge the District's willingness to implement corrective actions for two of the three findings identified herein. If implemented, the corrective actions will strengthen the District's accounting and administrative controls over Proposition 40 bond funds and reduce the risk that errors or irregularities affecting the financial statements could occur and remain undetected.

The District disagreed with Finding 1, "*Inadequate Monitoring of Grant Funds*." Specifically, the response states, "The statutory language establishing the Moyer program makes it clear that funds are expended when a binding contract is made." The District further states that the language makes it, "clear that Moyer funds are expended when an award is made." The District refers to Government Code Section 16304, Department of Finance's (Finance) Glossary of Accounting and Budgeting Terms (revised in December 2004), Health and Safety Code Section 44291(d), and the 2003 Carl Moyer Program Guidelines.

The District refers to Finance's "Glossary of Accounting and Budgeting Terms" and the Government Code Section 16304 to define expenditures, encumbrances, and appropriations. Finance's glossary and Government Code Section 16304 is used for governmental accounting and budgeting purposes and does not establish uniform accounting guidance as claimed by the District. In fact, accruing expenditures and liabilities for encumbrances (i.e. unperformed contracts) is not consistent with Generally Accepted Accounting Principles (GAAP). Although state agencies accrue encumbrances as expenditures, at year end state agencies must identify in their year end reports to the Office of the State Controller the amount which was accrued for encumbrances. The encumbrance amounts are deducted from the accrued expenditures and shown as a reservation of fund balance for GAAP financial statement presentation.

Health and Safety Code Section 44287(k) clearly states that funds reserved for a district are available for no more than two years from time of reservation. Funds not *expended* by June 30 of the second calendar year following the date of the reservation shall revert back to the Air Resources Board (Board). This is consistent with the program's overall goal of achieving early emission reductions by requiring projects (engines) to be funded and in operation within a specified timeframe. By not expending funds, the District is unable to achieve the intended program emission reductions. As noted in the Board's October 3, 2006 audit report, by not expending the funds within the two year timeframe, "two-thirds of the anticipated emission reductions, over 300 tons per year of NOx and approximately 15 tons per year of PM, have not yet been achieved."

The District also makes reference to Section 44291(d) of the Health and Safety Code, which states that the Board "shall not recapture funds already awarded to approved projects." Although this section can be more clearly defined by the Board, it does not define an expenditure as an encumbrance as claimed by the District. Legislative intent may have been to allow "active" contracts that had unexpended balances after the two year timeframe to continue

within a reasonable completion date; however, as the program administering agency, the Board is responsible for program legal definitions and legislative intent. The District should work with the Board to determine allowable time frames for these instances. The Board's intent for requiring the District to expend the funds within the two year deadline is explicit in the Board's October 3, 2006 audit report. However, because of the over-arching importance of emission reduction in California, the Board has decided not to recapture the Proposition 40 funds not expended by the District and is requiring the District to submit quarterly progress reports indicating the status of unexpended funds.

Our finding and recommendation remains unchanged. It is recommended that the District comply with the Boards requirements to ensure full compliance with Health and Safety Code Section 44287(k) and to ultimately achieve the goals of emission reduction.