



January 9, 2009

Mr. Jack Broadbent, Executive Officer
Air Pollution Control Officer
Bay Area Air Quality Management District
939 Ellis Street
San Francisco, CA 94109

Dear Mr. Broadbent:

Final Report—Fiscal Review of the Bay Area Air Quality Management District's Carl Moyer Program, Lower-Emission School Bus Program, and AB 923 Funds.

The Department of Finance, Office of State Audits and Evaluations (Finance), has completed its fiscal review of the Bay Area Air Quality Management District's (District) Carl Moyer Program, Lower Emission School Bus Program, and AB 923 funds for July 1, 2006 through June 30, 2008.

The enclosed report is for your information and use. The District's response to the report findings and our evaluation of the response are incorporated into this final report.

In accordance with Finance's policy of increased transparency, this report will be placed on our website.

We appreciate the assistance and cooperation of your staff and management during our review. If you have any questions, please contact Mary Kelly, Manager, or Cheryl Lyon, Supervisor, at (916) 322-2985.

Sincerely,

David Botelho, CPA
Chief, Office of State Audits and Evaluations

Enclosure

cc: On following page

cc: Mr. Jeffrey McKay, Chief Financial Officer, Bay Area Air Quality Management District
Mr. Jack Colbourn, Director, Outreach and Incentives Division, Bay Area Air Quality
Management District
Ms. Linda Serdahl, Finance Manager, Bay Area Air Quality Management District
Mr. Damian Breen, Grants Manager, Bay Area Air Quality Management District
Mr. Jack Kitowski, Branch Chief, Mobile Source Control Division, California Air Resources
Board
Ms. Heather Arias, Manager, Incentives Oversight Section, California Air Resources Board
Mr. Tim Hartigan, Air Pollution Specialist, Incentives Oversight Section, California Air
Resources Board

FISCAL REVIEW

Bay Area Air Quality Management District
Carl Moyer Program
Lower-Emission School Bus Program
Assembly Bill 923

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

093900054

December 2008

MEMBERS OF THE AUDIT TEAM

Mary Kelly, CPA, CGFM
Manager

Cheryl L. Lyon, CPA
Supervisor

Staff

Daniel Jenkinson
Alexandria Tu

Final reports are available on our website at <http://www.dof.ca.gov>

You can contact our office at:

Department Of Finance
Office of State Audits and Evaluations
300 Capitol Mall, Suite 801
Sacramento, CA 95814
(916) 322-2985

The California Air Resources Board (Board) contracted with the Department of Finance, Office of State Audits and Evaluations (Finance), to perform a fiscal review of the Bay Area Air Quality Management District's (District) implementation of the Carl Moyer Program, the Lower-Emission School Bus Program, and the use of AB 923 funds for July 1, 2006 through June 30, 2008. Concurrent to this review, the Board also conducted a program audit of the District's Carl Moyer Program, Lower-Emission School Bus Program, and AB 923 funds. Because of this, Finance did not verify the programmatic validity of the projects reviewed.

Background

The District's mission is to achieve clean air and to protect public health and the environment. The District implements multiple clean-air programs supported by federal, state, and local funds. This review encompasses three programs funded by the state: the Carl Moyer Program (CMP), the Lower-Emission School Bus Program (LESBP) Retrofit and Replacement, and Assembly Bill 923 (AB 923) funds.

The objective of the CMP is to contribute to cleaner air by funding the incremental cost of replacing or retrofitting older engines with cleaner-than-required engines and equipment. Public or private entities that operate eligible engines or equipment within the District's jurisdiction participate by applying to the District for a grant. Examples of eligible engines and equipment include heavy-duty vehicles, marine applications, locomotives, agricultural pumps, forklifts, and auxiliary power units.

The primary purpose of the LESBP is to reduce school children's exposure to cancer-causing and smog-forming pollution. The LESBP achieves this through a Replacement Program and a Retrofit Program. The Replacement Program funds the replacement of older high-polluting school buses with new buses. The Retrofit Program funds the installation of Board-approved pollution control devices on diesel school bus engines.

AB 923 (Chapter 707 of the Statutes of 2004) provided two additional sources of funding for the CMP. By adjusting fees assessed on purchasers of new tires, the legislation resulted in approximately \$25 million for clean air programs in fiscal year 2005-06. AB 923 also provided air district governing boards with the authority to approve a \$2 increase in motor vehicle registration fees. This increase provides up to \$55 million annually to local air districts for four incentive programs: (1) the CMP, (2) the LESBP's Replacement Program, (3) light-duty accelerated vehicle retirement or repair programs, and (4) the Agricultural Assistance Program.

Scope and Methodology

The Board engaged Finance to review the District's fiscal administration of the CMP, the LESBP, AB 923 funds, and the District's fiscal compliance with applicable laws, regulations, guidelines, and contract requirements. District processes for receiving, recording, and disbursing program funds; allocating administrative costs and earned interest; and meeting match funding requirements were analyzed. Schedules were created from the District's records to summarize amounts received and disbursed for the programs and funds from July 1, 2006 through June 30, 2008. Finally, site visits were conducted to interview program participants and review pertinent documents.

This review was not conducted in accordance with *Government Auditing Standards*, and did not include extensive testing of the District's internal control or the programmatic appropriateness of expenditures. Had additional procedures been performed, other matters might have come to our attention that would have been reported.

Analyses and Summary Schedules

Carl Moyer Program:

The following schedule illustrates CMP funds awarded and expended for program years 7, 8, and 9. The year 7 and 8 awards include regular and multi-district funding. The District expended funds after the end of the respective grant periods for year 7 multi-district, year 8 regular, and year 8 multi-district. See Observation 1 for details. Based on CMP funding guidelines, the District has until June 30, 2009 to expend the remaining year 9 project funds.

CMP Year	Fiscal Year Funds Awarded	Award Amount	Expenditures Within Grant Period	Balance as of End of Grant Period ¹	Expenditures After Grant Period	Balance as of June 30, 2008
7	2004-05	2,478,161	2,573,163	(95,002)	0	(95,002) ²
7 Multi-District	2004-05	988,628	636,038	352,590	257,590	95,000 ²
8	2005-06	10,318,307	9,570,884	747,423	764,677	(17,254) ²
8 Multi - District	2005-06	3,950,352	0	3,950,352	3,933,098	17,254 ²
9	2006-07	11,943,403	0	11,943,403	0	11,943,403

(1) Year 7 grant period ended June 30, 2007; Year 8 grant period ended June 30, 2008; Year 9 grant period ends June 30, 2009.

(2) Multi-district funds in year 7 and 8 were redirected and expended on regular CMP projects. Redirection was authorized by the Board.

Carl Moyer Program Administration:

The following schedule illustrates the CMP administration funds awarded and expended for program years 7, 8, and 9. The District has fully expended year 7 and 8 administration awards and has expended \$412,435 of the year 9 award. The administration expenses appropriately relate to CMP activities and are directly supported by timesheets as required by CMP guidelines.

CMP Year	Fiscal Year Funds Awarded	Administration Funds Awarded	Expenditures Within Grant Period	Remaining Administration Award
7	2004-05	57,364	57,364	0
8	2005-06	238,850	238,850	0
9	2006-07	628,600	412,435	216,165

Carl Moyer Program Match Requirements:

The following schedule illustrates the CMP match requirements and expenditures for program years 7 through 9. The District fully met match requirements for years 7 and 8 through in-kind contributions and by completing eligible projects funded with local-control funds. As of June 30, 2008, the District had a remaining year 9 match requirement of \$1,839,829.

CMP Year	Fiscal Year	Required District Match	Match Expenditures Within Grant Period	Remaining Match Requirement
7	2004-05	1,128,488	1,128,488	0
8	2005-06	1,619,320	1,619,320	0
9	2006-07	1,839,829	0	1,839,829

Carl Moyer Program Earned Interest:

The following schedule illustrates the District's allocation of interest earned on the cumulative unexpended balances of CMP funds during the review period. The District had a beginning balance of earned interest from prior CMP funding cycles. The District's interest calculation methodology is appropriate and allocations are materially correct and properly recorded. The District had not expended any CMP earned interest funds as of June 30, 2008.

Fiscal Year	Beginning Balance	Interest Earned	Expenditures	Ending Balance
2006-07	940,992	119,485	0	1,060,477
2007-08	1,060,477	639,099	0	1,699,576

Lower-Emission School Bus Program:

The following schedule illustrates LESBP Retrofit and Replacement Program funds expended during the review period. The District was not awarded LESBP Replacement or Retrofit Program funds during the current review period. However, the expenditures related to the 2005-06 awards were incurred during the current review period. The remaining Retrofit balance of \$1,298,356 as of June 30, 2008 was returned to the Board during fiscal year 2008-09.

The District is participating in the fiscal year 2005-06 Replacement Program on a reimbursement basis. Therefore, the District seeks reimbursement from the Board once new buses are delivered to the school districts. As such, the District did not receive the remaining Replacement balance as of June 30, 2008.

Fiscal Year	Program	Award Amount	Expenditures as of June 30, 2008	Balance as of June 30, 2008
2005-06	Replacement	560,000	407,612	152,388
2005-06	Retrofit	2,395,000	1,096,644	1,298,356

Lower-Emission School Bus Program Earned Interest:

The following schedule illustrates the District's allocation of interest earned on the cumulative unexpended balances of LESBP fiscal year 2005-06 Retrofit Program funds during the review period. The District's interest calculation methodology is appropriate and the allocations are materially correct and properly recorded. The District had not expended any of the LESBP earned interest funds as of June 30, 2008. The total balance of \$168,876 was returned to the Board in two payments, one for \$102,931 during fiscal year 2007-08, and the other for \$65,945 during fiscal year 2008-09.

Fiscal Year	Program	Beginning Balance	Interest Earned	Expenditures	Ending Balance
2006-07	Retrofit	0	102,931	0	102,931
2007-08	Retrofit	102,931	65,945	0	168,876

Assembly Bill 923:

The following schedule illustrates the AB 923 funds received and expended from July 2005 (from fee collections beginning in May 2005) through June 30, 2008. The District has expended \$7,754,610 on projects, and the administration charges of \$701,146 (representing 2 percent of collections) are appropriate as allowed by statute. Finance compiled this information from the District's internal summary schedules and performed testing to verify the validity of receipts and earned interest amounts reported. However, testing of expenditure and administration charge data was not performed.

Total Receipts Through June 30, 2008	Total Expenditures Through June 30, 2008	Administration Charges	Balance as of June 30, 2008 (Excluding Interest)	Earned Interest Through June 30, 2008	Balance as of June 30, 2008 (Including Interest)
35,145,671	7,754,610	701,146	26,689,915	1,871,917	28,561,832

Review of the District's compliance with the CMP, LESBP, and AB 923 funds fiscal requirements resulted in the following observations:

Carl Moyer Program

Observation 1:

The District expended funds after the end of the respective grant periods. Specifically, \$257,590, \$764,677, and \$3,933,098 of CMP year 7 multi-district, year 8 regular, and year 8 multi-district funds were expended after the expiration of the grant periods, respectively.

The Health and Safety Code³ states that any funds reserved for a district are available for expenditure for a period not to exceed two years from the time of reservation. Funds not expended by that date shall revert back to the Board.

Recommendation:

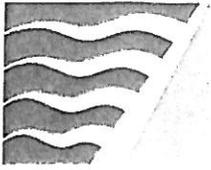
The District should institute policies and procedures to ensure projects are completed and funds expended within the respective grant periods. Final determination as to the treatment of the funds expended after the end of the grant period will be made by the Board.

The District's assistance and cooperation with our review was appreciated. If you have any questions regarding this report, please contact Mary Kelly, Manager, or Cheryl Lyon, Supervisor, at (916) 322-2985.

This report is a matter of public record and its distribution is not limited.

(3) Health and Safety Code section 44287(k)

BAY AREA AIR QUALITY
MANAGEMENT DISTRICT'S RESPONSE



**BAY AREA
AIR QUALITY
MANAGEMENT
DISTRICT**

December 23, 2008

David Botelho, CPA
Chief, Office of State Audits and Evaluations
Department of Finance
915 L Street
Sacramento, CA 95814-3706

RE: Draft Report - Fiscal Review of Bay Air Quality Management District (District) Carl Moyer Program (CMP), Lower Emissions School Bus Program (LESBP) and AB 923 Funds

ALAMEDA COUNTY
Tom Bates
(Secretary)
Scott Haggerty
Janet Lockhart
Nate Miley

CONTRA COSTA COUNTY
John Gioia
Mark Ross
Michael Shimansky
Gayle B. Uilkema

MARIN COUNTY
Harold C. Brown, Jr.

NAPA COUNTY
Brad Wagenknecht
(Vice-Chairperson)

SAN FRANCISCO COUNTY
Chris Daly
Jake McGoldrick
Gavin Newsom

SAN MATEO COUNTY
Carol Klatt

SANTA CLARA COUNTY
Erin Garner
Yoriko Kishimoto
Liz Kniss

SOLANO COUNTY
John F. Silva

SONOMA COUNTY
Tim Smith
Pamela Torliatt
(Chairperson)

Jack P. Broadbent
**EXECUTIVE
OFFICER/APCO**

Dear Mr. Botelho,

Thank you for your letter on December 18, 2008, regarding the fiscal review conducted by Department of Finance (DOF) on behalf of the California Air Resources Board (ARB) on the District's implementation of the CMP, LESBP and AB 923 funds. We would also like to thank and compliment you on the professional manner in which your staff conducted this fiscal review. In addition to performing their duties in a highly efficient matter, they provided us with valuable insight into the fiscal operations of our programs which will be reflected in our response.

In your draft report, you noted one observation that encompasses the three programs listed above. This observation pertains to the late expenditure of funds in the CMP after the two year time limit imposed by California Health and Safety Code Section 44287(k). In response to this observation, we offer the following comments:

- All payments made were to projects that will significantly reduce toxic particulate matter and nitrogen oxides in full compliance with the guidelines and goals for the CMP.
- All of the payments above were made with the full knowledge and advice of the oversight agency for the program, ARB.
- Additionally, based on instruction from ARB, partial expenditure of program funds (as was the case for the first payment listed in the observation) prior to the two year time limit, meets the CMP expenditure requirements.
- In the case of the second payment listed, the District acts through a proxy to expend funds from its CMP - Vehicle Buyback Program on a vehicle by a vehicle basis. The District contends that this constitutes expenditure of the funds and that the "late payment" in this case is a fund transfer to cover previously expended eligible funds under the CMP program prior to the two-year deadline.

We would therefore respectfully suggest that the draft observation be reworded to state that the District expended funds "past the required deadline" and not "inappropriately" as this could be misconstrued to mean that the District made ineligible payments under the grant terms. Additionally, based on the recommendation made in the draft report, the District has taken the following actions:

- A full-time Financial Analyst has been hired for all of the District's incentives programs. This will ensure greater accuracy, tracking, reconciliation and control over expenditures made by the Strategic Incentives Division; especially in the three programs reviewed by the DOF.
- Based on your recommendations, new sections have been added to the District's policies and procedures manuals for all three programs. These sections include monthly status checks on expenditures with the incentive program managers and daily reconciliations with the financial department under the guidance of the new financial analyst.

As part of the exit conference conducted by your staff on December 17, 2008, they noted significant improvement in the financial structures for the programs reviewed. We would like to thank you for that comment and assure you by implementing the measures you have suggested in your draft report that trend will continue. If you have any questions regarding this letter, please feel free to contact me or Jack Colbourn, Director of the Strategic Incentives Division at (415) 749-5041 or jcolbourn@baaqmd.gov.

Yours sincerely,



Jack P. Broadbent
Executive Officer /APCO

EVALUATION OF RESPONSE

The District's response to our draft report has been incorporated herein. Upon review of the District's response, we provide the following comments:

The District indicates that, "...partial expenditure of program funds prior to the two year time limit, meets the CMP expenditure requirements." The District also indicates that, "...the District acts through a proxy to expend funds from its CMP—Vehicle Buyback Program..."

We disagree with the District's interpretation. The Health and Safety Code states that any funds reserved for a district are available for expenditure for a period not to exceed two years from the time of reservation. Funds not expended by that date shall revert back to the Board. As such, the District has two years from reservation to expend the program funds, in their entirety. Our audit disclosed that funds were not expended by the District within the specified timeframes. Therefore, our finding and recommendation remains unchanged.

The District also requested rewording the observation to remove the word "inappropriately." We acknowledge the District's request and have revised the observation accordingly. However, we remind the District that although expenditures were incurred for eligible costs, program funds must be expended within the timeframe specified by the Health and Safety Code.

We commend the District on the recent improvements made to its grant program by implementing refined policies and increasing program oversight. Such improvements enhance the District's ability to operate an efficient and effective grant program. We encourage the District to continue its practice of periodically reviewing and revising its program. These efforts will aid the District in achieving its mission of cleaner air and protecting public health and the environment.