SANTA CLARA COUNTY

Audit Report

ROAD FUND

July 1, 2001, through June 30, 2005

JOHN CHIANG
California State Controller

July 2007

JOHN CHIANG
California State Controller

July 31, 2007

John V. Guthrie
Director of Finance
Santa Clara County
County Government Center, East Wing
70 West Hedding Street, 2nd Floor
San Jose, CA 95110

Michael Murdter
Road Commissioner
Santa Clara County
101 Skyport Drive
San Jose, CA 95110-1302

Dear Mr. Guthrie and Mr. Murdter:

The State Controller's Office (SCO) audited Santa Clara County's Road Fund for the period of July 1, 2001, through June 30, 2005. In addition, we audited Transportation Equity Act of the 21st Century (TEA-21) exchange moneys for the period of July 1, 2001, through June 30, 2005.

The county accounted for and expended Road Fund moneys in compliance with Article XIX of the California Constitution, the Streets and Highways Code, and the SCO's *Accounting Standards and Procedures for Counties* manual. However, we identified procedural findings affecting the Road Fund in this audit report.

The county accounted for and expended fiscal year (FY) 2001-02 through FY 2004-05 TEA-21 matching moneys in compliance with Article XIX of the California Constitution and Streets and Highways Code section 182.6.

If you have any questions, please contact Steven Mar, Chief, Local Government Audits Bureau, at (916) 324-7226.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB/vb:sm

cc: Grace Kong, Chief
Local Program Accounting Branch
Department of Transportation

Contents

Audit Report

Summary

The State Controller's Office (SCO) audited Santa Clara County's Road Fund for the period of July 1, 2001, through June 30, 2005 (fiscal year (FY) 2001-02 through FY 2004-05). The last day of fieldwork was June 15, 2006.

Our audit disclosed that the county accounted for and expended Road Fund moneys in compliance with Article XIX of the California Constitution, the Streets and Highways Code, and the SCO's *Accounting Standards and Procedures for Counties* manual, except for the procedural findings identified in this report.

In addition, we audited Transportation Equity Act of the 21st Century (TEA-21) exchange moneys for FY 2001-02 through FY 2004-05, at the request of the California Department of Transportation (Caltrans). The TEA-21-funded projects have been verified to be for road-related purposes and are eligible expenditures. The TEA-21 moneys received by the county were accounted for and expended in compliance with Article XIX of the California Constitution.

Background

We conducted an audit of the county's Road Fund in accordance with Government Code section 12410. The Road Fund was established by the county boards of supervisors in 1935, in accordance with Streets and Highways Code section 1622, for all amounts paid to the county out of moneys derived from the highway users tax fund. A portion of the Federal Forest Reserve revenue received by the county is also required to be deposited into the Road Fund (Government Code section 29484). In addition, the county board of supervisors may authorize the deposit of other sources of revenue into the Road Fund. Once moneys are deposited into the Road Fund, it is restricted to expenditures made in compliance with Article XIX of the California Constitution and Streets and Highways Code sections 2101 and 2150.

The Intermodal Surface Transportation Efficiency Act (ISTEA) of 1991 created a federal program designed to increase flexibility in federal funding for transportation purposes by shifting the funding responsibility to state and local agencies. The TEA-21 is a continuation of this program. The funds are restricted to expenditures made in compliance with Article XIX of the California Constitution. Caltrans requested that we audit these expenditures to ensure the county's compliance.

Objectives, Scope, and Methodology

The objectives of our audit of the Road Fund, and TEA-21 matching moneys were to determine whether:

- Highway users tax apportionments, and TEA-21 matching moneys received by the county were accounted for in the Road Fund, a special revenue fund;

- Expenditures were made exclusively for authorized purposes or safeguarded for future expenditure;

- Reimbursements of prior Road Fund expenditures were identified and properly credited to the Road Fund;

- Non-road-related expenditures were reimbursed in a timely manner;

- The Road Fund cost accounting is in conformance with the SCO's *Accounting Standards and Procedures for Counties* manual, Chapter 9, Appendix A; and

- Expenditures for indirect overhead support service costs were within the limits formally approved in the Countywide Cost Allocation Plan.

Our audit objectives were derived from the requirements of Article XIX of the California Constitution, the Streets and Highways Code, the Government Code, and the SCO's *Accounting Standards and Procedures for Counties* manual. To meet the objectives, we:

- Gained a basic understanding of the management controls that would have an effect on the reliability of the accounting records of the Road Fund by interviewing key personnel and testing the operating effectiveness of the controls;

- Verified whether all highway users tax apportionments, and TEA-21 matching moneys received, were properly accounted for in the Road Fund by reconciling the county's records to the State Controller's and Caltrans' payment records;

- Analyzed the system used to allocate interest and determined whether the interest revenue allocated to the Road Fund was fair and equitable by interviewing key personnel and testing a sample of interest calculations;

- Verified that unauthorized borrowing of Road Fund cash had not occurred by interviewing key personnel and examining the Road Fund cash account entries; and

- Determined, through testing, whether Road Fund expenditures were in compliance with Article XIX of the California Constitution and with the Streets and Highways Code, and whether indirect cost allocation plan charges were within the limits approved by the SCO's Division of Accounting and Reporting, County Cost Plan Unit.

We conducted the audit according to *Government Auditing Standards*, issued by the Comptroller General of the United States. We did not audit the county's financial statements. Our scope was limited to planning and performing audit procedures necessary to obtain reasonable assurance concerning the allowability of expenditures claimed for reimbursement. Accordingly, we examined transactions on a test basis to determine whether they complied with applicable laws and regulations and were properly supported by accounting records. We considered the county's internal controls only to the extent necessary to plan the audit.

Conclusion

Our audit disclosed that the county accounted for and expended Road Fund moneys in compliance with Article XIX of the California Constitution, the Streets and Highways Code, and the SCO's *Accounting Standards and Procedures for Counties* manual, except for the procedural findings described in the Findings and Recommendations section of this report.

We verified that the TEA-21-funded projects were for road-related purposes, and are eligible expenditures. The TEA-21 moneys received by the county were accounted for and expended in compliance with Article XIX of the California Constitution and the Streets and Highways Code.

Follow-up on Prior Audit Findings

Findings noted in our prior audit report, issued on October 31, 2002, have been satisfactorily resolved by the county.

Views of Responsible Officials

We issued a draft audit report on February 28, 2007. The County of Santa Clara responded on May 18, 2007, agreeing with the audit results except for Finding 1. The county's response is included in the final audit report as an attachment.

Restricted Use

This report is solely for the information and use of county management, the county board of supervisors, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

Schedule 1—
Reconciliation of Road Fund Balance
July 1, 2001, through June 30, 2005

	Amount
Beginning fund balance per county	$ 25,132,859
Revenues	41,309,553
Total funds available	66,442,412
Expenditures	(42,659,402)
Ending fund balance per county	23,783,010
SCO adjustment	—
Ending fund balance per audit	$ 23,783,010

Schedule 2—
Reconciliation of TEA-21 Balance
July 1, 2001, through June 30, 2005

	Amount
Beginning balance per county	$ 100,000
Revenues:	
TEA-21 matching funds	400,000
Total funds available	500,000
Expenditures:	
Construction	(464,930)
Ending balance per audit	$ 35,070

NOTE: The TEA-21 moneys have been accounted for and expended within the Road Fund.

Findings and Recommendations

FINDING 1— Understated rent in Road Fund properties

During FY 2001-02 through FY 2004-05, the county did not provide fair market value (FMV) to the Road Fund for the rental of four residences to the Housing Authority of Santa Clara County. During the above fiscal years, the Road Fund received $1 per year in rental income. County Roads Real Estate personnel calculated FMV of these properties at $6,850 per month, or $82,200 per year. The SCO audit period of four years multiplied by $82,200 equals the understated rent of $328,800.

Streets and Highways Code section 2150 restricts the use of Road Fund assets for road purposes. The Streets and Highways Code section supersedes Government Code section 25539.4 when Road Fund assets are involved. Government Code section 25539.4 "authorizes a county to lease real estate property at less than fair market value to provide affordable housing if there is a need for the housing and it is determined to be in the county's best interest." Affordable housing does not qualify as a road purpose.

Recommendation

The county should reimburse the Road Fund $328,800 less the costs for maintenance and remodeling for the understated rental of properties during FY 2001-02 through FY 2004-05. In addition, future rentals of Road Fund properties should be made at fair market value.

County's Response

Finding 1: Understated rent in Road Fund Properties

1. The finding is without merit because the County had no obligation to generate any revenue from these properties. The County's sole responsibility was simply to preserve the underlying real estate for its eventual use as part of the interchange project. Since the Roads Department is not in business of renovating houses and managing residential property, and does not have the staffing and expertise to do so, the Department would have simply boarded up the houses and left them vacant if not for the arrangement with the Housing Authority. . . .

2. Another reason the finding is without merit is that Government Code section 25539.4 expressly authorizes the County to lease real estate property at less than fair market value for affordable housing purposes notwithstanding any other provision of law. Government Code Section 25539.4 therefore takes precedence over Streets and Highways Code section 2150.

3. Although the draft audit report correctly notes that repair, ongoing maintenance and management costs would have reduced the net revenue to the County, it should also recognize that the arrangement with the Housing Authority transferred all risk from the County to the Authority. The Housing Authority assumed the responsibility of making the houses habitable and the many risks and responsibilities associated with owning and leasing residential property including maintenance and repairs, finding tenants, collecting rents, bringing necessary eviction actions, etc. Furthermore, all liability for the use and rental of the housing was

transferred from the County to the Housing Authority. If the Road Fund is to be held accountable for the loss of the rental income, all these duties, responsibilities and risks must be quantified and subtracted from the gross revenue.

4. These houses, after being made habitable by the Housing Authority, were used for low-income subsidized rental housing programs. If the Road Fund is to be held accountable for this rental income, the income should be established at the rate set for low-income subsidized rental housing programs over the period of time covered by the audit minus the duties, responsibilities and risks discussed above.

SCO's Comment

Upon review of additional documentation provided by the county, we will withdraw this finding from the audit report. We agree that the county relinquished its responsibilities to the Housing Authority for managing these properties. The Housing Authority used these properties for low-income housing and had an agreement with the county for a rental fee of one dollar annually. The Housing Authority assumed all of the management responsibilities and incurred all of the expenses pertaining to these properties. We also agree that the county did not incur any additional expenses for maintaining these properties, and would not until such time that it took these properties and used them as part of the interchange project.

While we concur with the county's comments to Finding 1, we take exception to their comment under item 2.

The county's comments that the finding is without merit because it had no obligation to generate any revenue from these properties, and that Government Code section 25539.4 takes precedence over Streets and Highways Code section 2150 is incorrect.

Streets and Highways Code section 2150 states, in part:

> All amounts paid to each county, out of the Highway Users Tax Fund shall be deposited in its road fund. The board may deposit in said fund any other money available for roads. All money received by a county from the Highway Users Tax Fund and all money deposited by a county in its road fund shall be expended by the county exclusively for county roads for the purposes specified in Section 2101 or for other public street and highway purposes as provided by law.

Government Code section 25539.4(a) states, in part:

> The Legislature recognizes that real property of counties can be utilized, in accordance with a county's best interests, to provide housing affordable to persons or families of low or moderate income. Therefore, notwithstanding any other provision of law, whenever the board of supervisors determines that any real property or interest therein owned, or to be purchased, by the county can be used to provide housing affordable to persons and families of low or moderate income, as defined by Section 50093 of the Health and Safety Code or as defined by the United States Department of Housing and Urban Development or its successors, and that this use is in the county's best interests, the county may sell, lease, exchange, quitclaim, convey, or

> otherwise dispose of the real property or interest therein at less than fair market value, or purchase an interest in the real property, to provide that affordable housing without complying with other provisions of this article.

Government Code section 25539.4 does not apply to county properties that may have been purchased using Highways Users Tax funds. Therefore, the county's assertion that Government Code section 25539.4 takes precedence over Streets and Highways Code section 2150 does not apply.

Streets and Highways Code section 2150 states that all moneys received from the Highway Users Tax Fund must be expended exclusively for county roads or for other street and highway purposes as provided by law. Because these funds were utilized to purchase the property, this section applies to the purchase and use of the property.

FINDING 2— Equipment depreciation factor not included

During FY 2000-01 through FY 2004-05, the county did not include a depreciation factor in the Road Fund equipment rates for non-road reimbursable work. These rental rates are used to bill other county departments and outside parties for non-road transactions.

The SCO's *Accounting Standards and Procedures for Counties* manual, Chapter 9, Appendix A, Section 32, requires a depreciation factor to recover all costs associated with performing non-road reimbursable work.

Recommendation

The county should establish and maintain a depreciation factor in the rental rates for Road Fund-owned equipment when billing other county departments and outside parties.

County's Response

> **Finding 2: Equipment Depreciation Factor not included**
>
> The Department has developed a methodology including depreciation as factor.

SCO's Comment

Our recommendation was implemented. We will follow up on this matter during the next audit.

FINDING 3—High equipment variance

The FY 2004-05 Annual Road Report (ARR) presented a variance of (57.56%) for the equipment clearing account. The equipment variance represented an overdistribution of $960,986 to the road projects. Further research indicated that the equipment rental rates for FY 2004-05 were overstated and were based on the prior year's costs.

The SCO's *Accounting Standards and Procedures for Counties* manual, Chapter 9, Appendix A, Section 16, prescribes the method used in the development and operation of the equipment clearing account. According to Section 24, the acceptable range for the equipment variance should be +/-10%.

Recommendation

The county should analyze its equipment clearing account and update the equipment rental rates for FY 2006-07 based on a three-year average of costs. In addition, the county should monitor the equipment variance on a quarterly basis.

County's Response

> **Finding 3: High Equipment Variance**
>
> The Department has started a quarterly review of equipment rates and associated cost distribution. The equipment rates are being updated during the year based on the variance.

SCO's Comment

Our recommendation was implemented. We will follow up on this matter during the next audit.

Attachment— County's Response to Draft Audit Report

County of Santa Clara

Roads and Airports Department

101 Skyport Drive
San Jose, California 95110-1302
(408) 573-2400

May 18, 2007

Paul R. Criss, Chief, Financial-Related Audits Bureau
California State Controller
P. O. Box 942850
Sacramento, CA 94250-5874

Subject: **Draft Audit Report – Santa Clara County Road Fund July 1, 2001 through June 30, 2005**

Dear Mr. Criss:

The following comments are provided in response to the Findings and Recommendations contained in the subject draft audit report:

Finding 1: Understated rent in Road Fund Properties

1. The finding is without merit because the County had no obligation to generate any revenue from these properties. The County's sole responsibility was simply to preserve the underlying real estate for its eventual use as part of the interchange project. Since the Roads Department is not in the business of renovating houses and managing residential property, and does not have the staffing and expertise to do so, the Department most likely would have simply boarded up the houses and left them vacant if not for the arrangement with the Housing Authority. That would have been an entirely reasonable course of action given that the houses were not habitable and were slated to be demolished as part of the interchange project.

2. Another reason the finding is without merit is that Government Code section 25539.4 expressly authorizes the County to lease real estate property at less than fair market value for affordable housing purposes notwithstanding any other provision of law. Government Code section 25539.4 therefore takes precedence over Streets and Highways Code section 2150.

3. Although the draft audit report correctly notes that repair, ongoing maintenance and management costs would have reduced the net revenue to the County, it should also recognize that the arrangement with the Housing Authority transferred all risk from the County to the Authority. The Housing Authority assumed the responsibility of making the houses habitable and the many risks

and responsibilities associated with owning and leasing residential property including maintenance and repairs, finding tenants, collecting rents, bringing necessary eviction actions, etc. Furthermore, all liability for the use and rental of the housing was transferred from the County to the Housing Authority. If the Road Fund is to be held accountable for the loss of the rental income, all these duties, responsibilities and risks must be quantified and subtracted from the gross revenue.

4. These houses, after being made habitable by the Housing Authority, were used for low-income subsidized rental housing programs. If the Road Fund is to be held accountable for this rental income, the income should be established at the rate set for low-income subsidized rental housing programs over the period of time covered by the audit minus the duties, responsibilities and risks discussed above.

We have recently learned that Caltrans has begun the process of formally canceling the interchange project. Once the properties are declared surplus, the County will dispose of them at fair market value in accordance with the Government Code.

Finding 2: Equipment Depreciation Factor not included

The Department has developed a methodology including depreciation as a factor.

Finding 3: High Equipment Variance

The department has started a quarterly review of equipment rates and associated cost distribution. The equipment rates are being updated during the year based on the variance.

John V. Guthrie
Director of Finance
Santa Clara County
County Government Center, East Wing
70 West Hedding Street, 2nd Floor
San Jose, CA 95110

M. J. Murdter
Michael Murdter
Road Commissioner
Santa Clara County
101 Skyport Drive
San Jose, CA 95110-1302

cc: Jane Decker, Deputy County Executive
Kathy Kretchmer, Deputy County Counsel
TA, MB, JR, RB, RJ, DC

State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874

http://www.sco.ca.gov

S06-RFA-007