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Contact: Jacob Roper
916-445-2636

Controller's Audits Find Lack of Internal Controls, Misspent Redevelopment Funds in Hercules

SACRAMENTO – State Controller John Chiang today released findings of two audits of the City of Hercules that questioned nearly \$50 million in charges to the redevelopment funds, and found almost no internal and accounting controls in the City.

“Weak oversight and poor management practices invited self-dealing, nepotism, and other public trust abuses that crippled Hercules’ fiscal health,” said Chiang. “But part of any recovery process is to understand what went wrong, and my audits not only break down those transgressions but offer a path forward.”

The redevelopment audit, which looked at redevelopment agency (RDA) records from July 1, 2005, through June 30, 2010, found the former City Manager/Executive RDA Director engaged in questionable business practices including:

- The arbitrary and capricious awarding of loans that appear to be gifts of public funds
- Steering more than \$3 million towards a consulting company run by his family
- Misuse of public funds that produced little public benefit but heavily contributed to turning what were multi-million dollar surpluses at the beginning of his tenure into multi-million dollar budget deficits near the time of his resignation

The City has filed a lawsuit to recover those amounts.

The audit also found \$1.4 million of questionable spending from the RDA’s housing fund. Dollars in that fund only can be used to increase and improve affordable housing in the area. But the City unlawfully took money from this fund to cover “administrative” costs without any documentation showing what services were provided or how they improved the supply of affordable housing.

Other unallowable charges to the housing fund include:

- \$222,170 for mailboxes
- \$26,400 for lobbying services
- \$18,848 for “beautification projects”

Also found were \$32.8 million in questionable property transfers and purchases. The City/RDA acquired real estate, but now cannot produce any pertinent documents, such as appraisals, that could be used to determine whether these properties were purchased at fair market value. The City/RDA could not even provide the names of the contracting parties to these transactions to determine whether these were related-party transactions.

Audit findings also show that bond funds were unlawfully used to purchase property outside of city limits and that proper legal authorization necessary to proceed with many of these land acquisitions cannot be produced.

The second audit, which looked at the City’s administrative and internal accounting controls for the years 2007 through 2010, found the City had little or no internal controls during that time period. In one example of poor control, the auditors found a vague set of contracts with local school principals. The City paid nearly \$200,000 to four principals for “professional services” without showing why those services were necessary or outside the scope of a principal’s regular responsibilities. One principal billed the City for attending a school ceremony. Another billed the City for politically-related activities, which is an obvious abuse of taxpayer dollars.

The audit also assessed various aspects of the City’s internal control components and elements in accordance with standards adopted by the American Institute of Certified Public Accountants. Of the 74 control elements evaluated pertaining to internal control components, the audit found only seven, or roughly 9%, were considered adequate.

During the time period reviewed, Hercules’ internal control failures allowed the following waste, spending abuses, and fiscal mismanagement to occur:

- Misuse of city-issued credit cards to pay for travel, lodging and meals that appear excessive and did not serve the public’s interests. In one case, a city official charged expenses for two hotel rooms in two different cities on the same night for a one-day trip. In another instance, a room was booked at a luxury resort and spa for \$299 per night, when the government rate was \$84 per night.
- The City failed to record budget appropriation adjustments, revised revenue estimates or other financing sources in its financial and accounting systems. This exposed Hercules to increased and wholly-preventable risk of budget overruns.
- Numerous contracts were executed without competitive bid that raised questions about potential conflicts of interest and favoritism.

“While millions of Californians and the city governments that serve them suffered immense hardships during the Great Recession, Hercules’ compounded its struggles with self-inflicted wounds,” said Chiang. “For Hercules, its troubles were as grounded in a crisis of accountability and governance as it was in trying to cut spending down to reduced levels of revenue.”

The City’s response to each finding is included in the audit reports.

The [City's Redevelopment Agency audit](#) and the [City's internal control audit](#) are available on the Controller's website at www.sco.ca.gov. The City’s response to each finding is included in the audit reports.

The audits released today follow two separate audits completed earlier this year: an audit of state and federal expenditures and an audit of the City’s Gas Tax Fund. During the first seven months of the audit process, city officials were largely uncooperative, failed to provide requested documents, and often missed scheduled meetings. This led to significant delays in completing the audits. However, in recent months city officials made improved efforts to cooperate with auditors and, to the extent that information could be found, provide the necessary documentation to complete the audits.

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