

ASSOCIATION OF BAY AREA GOVERNMENTS

Review Report

July 1, 2012 through June 30, 2014



BETTY T. YEE
California State Controller

June 2015



BETTY T. YEE
California State Controller

June 2, 2015

Ezra Rapport, Executive Director
Association of Bay Area Governments
101 Eighth Street
Oakland, CA 94607

Dear Mr. Rapport:

Enclosed is the report of the State Controller's Office (SCO) review of the Association of Bay Area Governments' (ABAG) administrative and internal accounting controls. The review was conducted to assess the adequacy of the ABAG's controls to safeguard public assets and to ensure proper use of public funds.

Our review did not identify any significant deficiencies with the ABAG's administrative and internal accounting controls. However, we noted based upon the information provided, serious weaknesses in internal controls, in the ABAG's oversight of the ABAG Finance Authority for Non-Profit Corporations (Authority). We noted a lack of internal controls over the Authority's operations. In essence, the Authority's Director was given substantial authority and power in administering the Authority's operations—especially the financial aspects, which are the most critical in any organization. We also noted additional deficiencies; these are described in the Findings and Recommendations section of our report.

As a part of the review, we assessed various aspects of the ABAG's internal control components and elements mainly focusing on the ABAG's oversight of the Authority. This assessment was based primarily on Guidance from the General Accounting Office, Internal Control Management and Evaluation Tool. Of the 79 control elements evaluated pertaining to internal control components, we found:

- 29 control elements to be adequate
- 49 control elements to be inadequate
- One control element that was not applicable

The majority of internal controls considered inadequate (31 of 49) can be attributed directly to the ABAG's oversight of the Authority.

The results of our review and evaluation of the elements of internal control are included in this report as an Appendix. Our assessments of the elements were based on the conditions that existed during our review period of fiscal year (FY) 2012-13 and FY 2013-14. To the extent feasible, we made inquiries to assess whether the control deficiencies have been addressed since the conclusion of FY 2013-14.

It should be noted that the ABAG is taking these matters seriously. According to ABAG, prior to our review it responded to allegations of embezzlement by hiring a law firm that in turn engaged forensic consultants to conduct an internal investigation of the alleged embezzlement. The ABAG further states that it took immediate action to strengthen its oversight of all financial transactions performed by the Authority. Therefore, the ABAG should be commended for being proactive in determining the extent of the embezzlement and addressing the noted deficiencies. We would like to express our thanks to the ABAG staff and management, who were helpful throughout our review process.

As always, my staff and I are available to address your questions. You may contact Mr. Spalj, Chief, Local Government Audit Bureau by telephone at (916) 324-6984, or by email at mspalj@sco.ca.gov.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB/gj

cc: Susan Hsieh, Assistant Finance Director
Association of Bay Area Governments
Charles Adams, Interim Finance Director
Association of Bay Area Governments

Contents

Review Report

Introduction	1
Background	1
Objective, Scope, and Methodology	3
Conclusion	4
Views of Responsible Officials	4
Restricted Use	5

Findings and Recommendations	6
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Appendix—Evaluation of Elements of Internal Control

Attachment—ABAG’s Response to Draft Review Report

Review Report

Introduction

The State Controller's Office (SCO) reviewed the Association of Bay Area Governments' (ABAG) system of administrative and internal accounting controls for the period of July 1, 2012, through June 30, 2014 (fiscal year (FY) 2012-13 and FY 2013-14). As necessary, we expanded our testing to include prior-year transactions to follow up on issues identified through interviews of ABAG officials and through our review of the independent auditors' reports and other audit reports.

On February 12, 2015, we informed the ABAG that we would conduct a review of the ABAG's administrative and internal accounting controls.

Due to recent allegations of theft of \$1.3 million, we evaluated the ABAG's system of administrative and internal accounting controls to identify weaknesses that might have resulted in the alleged theft, determined if additional funds were missing, and provided recommendations.

The review focused on FY 2012-13 and FY 2013-14, unless issues came to our attention that necessitated expanding our work to prior and/or current periods.

The review was conducted under the Government Code section 12410, which requires the Controller to ". . . superintend the fiscal concerns of the state. The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provisions of law for payment."

Our review included an analysis of the administrative and financial internal controls and fiscal management practices of the ABAG, including the impact of any findings on selected local, state, and federal programs administered by the ABAG.

This report presents the results of findings and conclusions reached in our review of the ABAG's administrative and internal accounting controls system.

Background

The ABAG is a regional planning agency incorporating various local governments in the San Francisco Bay Area in California. The ABAG deals with land use, housing, environmental quality, and economic development. Non-profit organizations, as well as governmental organizations, can be members. All nine counties and 101 cities and towns of the San Francisco Bay region are voluntary members of the ABAG. The Bay Area is comprised of nine counties: Alameda, Contra Costa, Marin, Napa, San Francisco, San Mateo, Santa Clara, Solano, and Sonoma.

As an advisory organization, the ABAG has limited statutory authority. It is governed by its General Assembly, which consists of an elected official (delegate) from each city and county. The General Assembly

determines policy, adopts the annual budget and work program, and reviews policy actions taken or proposed by the organization's Executive Board. A majority of city and county votes are required for action.

The ABAG was formed in 1961. In 1970, it issued its Regional Plan, 1970-1990, the Bay Area's first comprehensive regional plan. The document outlined a regional open space plan, regional information systems and technology support, criminal justice and training, water policy and waste collection, and earthquake hazards and planning.

The ABAG is associated with such agencies and projects as the San Francisco Bay Trail and the San Francisco Estuary Partnership. The ABAG also works with other regional agencies, including the Metropolitan Transportation Commission, Bay Area Air Quality Management District, and San Francisco Bay Conservation and Development Commission, to promote sustainable development by working in partnership with city and county governments to establish both Priority Development Areas and Priority Conservation Areas. These local actions are intended to achieve a more efficient, equitable, and environmentally sustainable region.

The ABAG also manages the ABAG Finance Authority for Non-Profit Corporations (Authority) for its members throughout the State; the Authority issues debt only for projects located in member jurisdictions. The Authority is a Joint Powers Agency formed to help eligible nonprofits and other borrowers gain access to tax-exempt debt financing. The Authority simplifies the debt issuance process for both the borrower and the jurisdiction in which the borrower is located by issuing conduit tax-exempt bonds or certificates of participation to finance projects with demonstrated public benefit.

According to the ABAG, the Authority is a separate legal entity; however, there is very little distinction between the ABAG and the Authority. We did note that the Authority's financial information is not included in the ABAG's independent audit reports and the Annual Financial Transactions reports. However, we also noted that the Executive Director for the ABAG is also the Executive Director for the Authority, and the Finance Director for the ABAG is also the Chief Financial Officer for the Authority. In addition, the Authority entered into an "Agreement for Administrative and Related Service" with the ABAG for the purposes of carrying out its responsibilities. Further, the bylaws of the Authority permit the Board of Directors to delegate any of its powers. As such, the ABAG and the Authority agreed that the ABAG would:

- Provide fiscal and financial services;
- Attend Director meetings upon request or advise Directors during meetings upon request;
- Provide clerical and related services;
- Provide appropriate equipment and housing to the Authority and Directors as necessary for the conduct of Authority business;

- Aide and advise on legal, marketing, and other responsibilities related to the Authority;
- Represent the Authority, upon request, at any hearings, legal proceedings, or other meetings;
- Coordinate the interest of the Authority with the ABAG and other educational and related organizations;
- Review and draft contracts and general advice on matters related thereto;
- Perform such other duties as may, from time to time, be requested or delegated by the Board of Directors;
- Execute contracts by the Executive Director of the ABAG, or his designee, if and when requested or delegated by the Board of Directors; and
- Execute and deliver bank drafts by the Executive Director, Associate Executive Director, or Financial Officer of the ABAG.

Objective, Scope, and Methodology

The objective of this review was to evaluate the ABAG's system of administrative and internal accounting controls to ensure:

- Effectiveness and efficiency of operations;
- Reliability of financial reporting;
- Compliance with applicable laws and regulations; and
- Adequate safeguard of public resources.

To accomplish our objective, we performed the following procedures:

- Evaluated the ABAG's formal written internal policies and procedures;
- Conducted interviews with ABAG employees and observed ABAG business operations for the purpose of evaluating organization-wide administrative and internal accounting controls;
- Reviewed the ABAG's documentation and supporting financial records;
- On a limited basis, performed tests of transactions to ensure adherence with prescribed policies and procedures and to validate and test the effectiveness of controls; and
- Assessed various aspects of the ABAG internal control components and elements based primarily on guidance from the General Accounting Office, Internal Control Management and Evaluation Tool.

Conclusion

Our review did not identify any significant deficiencies with the ABAG's administrative and internal accounting controls. However, we noted based on the information provided, serious weaknesses in internal controls, in the ABAG's oversight of the ABAG Finance Authority for Non-Profit Corporations (Authority). We noted a lack of internal controls over the Authority's operations. In essence, the Authority's Director was given substantial authority and power in administering the Authority's operations—especially the financial aspects, which are the most critical in any organization. As such, the Director was provided with an opportunity to orchestrate and carry out the embezzlement as a result.

As a part of the review, we assessed various aspects of the ABAG's internal control components and elements, mainly focusing on the ABAG's oversight of the Authority. This assessment was based primarily on Guidance from the General Accounting Office, Internal Control Management and Evaluation Tool. Of the 79 control elements evaluated pertaining to internal control components, we found:

- 29 control elements to be adequate
- 49 control elements to be inadequate
- One control element that was not applicable

The majority of internal controls considered inadequate (31 of 49) can be attributed directly to the ABAG's oversight of the Authority. The results of our review and evaluation of elements of internal control are included in this report as an Appendix.

The ABAG should develop a comprehensive remedial plan to address its deficiencies related to the lack of oversight over the Authority's operations. The plan should identify the tasks to be performed, as well as milestones and timelines for completion. The ABAG Executive Board should require periodic updates at public meetings of the progress in implementing the remedial plan.

Views of Responsible Officials

We issued a draft report on May 15, 2015. Ezra Rapport, Executive Director, responded by email dated May 26, 2015. The ABAG offered responses to clarify or supplement other statements in Finding 1 and disagreed with Finding 2. The ABAG generally agreed with the remaining Findings and the Observation and is in the process of implementing our recommendations. The ABAG's response is included in this final review report as an attachment.

Restricted Use

This report is solely for the information and use of the ABAG and the SCO; it is not intended to be and should not be used by anyone other than these 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

June 2, 2015

Findings and Recommendations

Results of Analysis of ABAG's Administrative and Internal Control System

Our review did not identify any significant deficiencies with the ABAG's administrative and internal accounting controls. However, we noted based on the information provided, serious weaknesses in internal controls, in the ABAG's oversight of the Authority. We noted a lack of internal controls over the Authority's operations. In essence, the Authority's Director was given substantial authority and power in administering the Authority's operations—especially the financial aspects, which are the most critical in any organization. We found weaknesses in the ABAG's administrative and internal accounting controls system mainly pertaining to its oversight of the Authority, resulting in significant findings that should be addressed and corrected by the ABAG.

As a part of the review, we assessed various aspects of the ABAG's internal control components and elements mainly focusing on the ABAG's oversight of the Authority. This assessment was based primarily on Guidance from the General Accounting Office, Internal Control Management and Evaluation Tool. Of the 79 control elements evaluated pertaining to internal control components, we found:

- 29 control elements to be adequate
- 49 control elements to be inadequate
- One control element that was not applicable

The majority of internal controls considered inadequate (31 of 49) can be attributed directly to the ABAG's oversight of the Authority.

While we have made specific recommendations to address the findings described below, from a broader perspective, we recommend that the ABAG develop a comprehensive remedial plan to address the deficiencies related to the lack of oversight over the Authority's operations. The plan should identify the tasks to be performed, as well as milestones and timelines for completion. In addition, we recommend that the ABAG require periodic updates at ABAG Executive Board meetings of the progress in implementing the remedial plan.

**FINDING 1—
Lack of internal
controls over
administration of
ABAG affiliate,
ABAG Finance
Authority for Non-
profit Corporations**

The Association of Bay Area Governments (ABAG) offers a full range of programs to public and private borrowers in the municipal capital markets through its Financial Services unit. Within this unit is the ABAG Finance Authority for Non-profit Corporations (Authority), a Joint Powers Authority, which assists eligible non-profit corporations and other borrowers in obtaining financing. The Authority has designated the ABAG to act as the Authority's administrative agency. Through an agreement with the Authority, the ABAG provides management, administrative, accounting, and other support services to the Authority. The Authority pays the ABAG for these services. Although the ABAG

and Authority consider themselves separate and distinct entities, for all practical purposes they are basically the same organization. In general, the Authority merely assists its customers in obtaining financing and issuing bonds; the Authority then receives administrative fees for providing the service.

For a small portion of its bond transactions, the Authority provides additional services, through an agreement with the borrower, such as executing authorization to disburse funds from a trustee to a payee.

Recently, a former ABAG Director, who worked as the Public Finance Director and Authority Secretary, was charged by information with embezzlement of \$1.3 million from a customer's account that was held by a trustee. The embezzlement occurred from one of the three special tax bonds, wherein the Authority was designated to disburse the funds.

According to interviews we conducted, the Director was authorized to direct the release of funds earmarked for developers, record transactions, receive bank statements, and perform reconciliations. In August 2014, the Director prepared, authorized, and executed a certificate directing the trustee, Union Bank, to disburse funds from a customer's account to a vendor and a bank account the Director controlled. Prior to this transaction, the Director prepared a First Supplemental Indenture between the Authority and the trustee without the knowledge of the borrower. The document was signed by the Director as the Secretary of the Authority, and the ABAG's Chief Financial Officer as the Chief Financial Officer of the Authority. In effect, this replaced an expired agreement between the borrower and the Authority, and gave the Authority power to request disbursement of funds.

We found in our review of the ABAG that there was a lack of internal controls over the Authority's operations. In essence, the Authority's Director was given substantial authority and power in administering all of the Authority's operations—especially the financial aspects, which are the most critical in any organization. As such, the Director was provided an opportunity to orchestrate and carry out the embezzlement due to many factors, including the lack of proper oversight by the ABAG.

We noted the following:

- The ABAG, as the Authority's administrative agency, failed to provide adequate oversight over the Authority's functions. The lack of adequate oversight fostered an environment whereby the Director was able to defraud its customer and mismanage public funds.
- The ABAG substantially relied on the Director to carry out its responsibilities without sufficient segregation of duties, resulting in a lack of control over the Authority's activities.
- The Authority does not appear to have established policies and procedures for appropriate approval of its transactions. As mentioned above, the Director, without the ABAG's knowledge and approval, executed a First Supplemental Indenture that was a precursor and means to commit the fraudulent act of embezzling \$1.3 million. We reviewed the Authority's and the ABAG's meeting minutes and did

not find evidence of this transaction being presented to the Executive Committee for review and approval. According to the staff members interviewed, the \$1.3 million disbursement was solely prepared and executed by the Authority's Director.

- Lack of supporting documentation. According to an ABAG staff member interviewed, the Director did not retain supporting documentation of his requests for disbursement for the \$1.3 million from the Trustee. The Authority had to obtain a copy from the Trustee of what the Director had submitted to support the disbursement.
- Lack of proper documentation and transparency over accounting of bond transactions. Bond transactions, except for issuance disclosures, are not included in the Authority's accounting records and annual financial statements. It is not clear how the Authority accounts for bond funds under its control. Our review was limited to interviews conducted with ABAG staff members.
- The agreement between the ABAG and the Authority that provides management, administrative, accounting, and other support services to the Authority is not sufficient to ensure proper accounting and protection of public funds.

We were not provided access to the Authority's records and, therefore, we could not determine whether the embezzlement was an isolated incident or if there were other instances of financial malfeasance. Based on the results of the limited review and our assessment of the pervasive internal control weaknesses, it appears that the Authority was definitely vulnerable and at serious risk of such acts occurring more than once.

Recommendation

The ABAG should assume full control over the Authority's accounting, administrative, and operational activities. The ABAG should also fulfill its fiduciary responsibilities by engaging in complete and meaningful oversight over the Authority. The ABAG should also develop policies and procedures to ensure:

- Proper segregation of conflicting duties such as preparing or initiating transactions, authorizing, recording, reconciling, and maintaining custody of accounting records.
- Proper accounting, recording, and disbursement of the bond funds under the Authority's control.
- That the Authority complies with all the legal requirements when obtaining financing for its clients.
- That the Authority's accounting records and financial statements are included in the ABAG's official financial records.

The ABAG should also implement appropriate internal control measures to ensure proper review and approval of all of the Authority's significant financial transactions.

ABAG's Response

The Report's Introduction states: "Due to recent allegations of theft of \$1.3 million, [the SCO] evaluated the ABAG's system of administrative and internal accounting controls to identify weaknesses that might have resulted in the alleged theft . . ." The Report stated the SCO found there are "serious weaknesses" in ABAG's internal controls over the operations of the ABAG Finance Authority for Nonprofit Corporations (Authority). The Report recommends that ABAG develop a comprehensive remedial plan to address these weaknesses, that the plan include milestones and timelines and that periodic updates are provided at the ABAG Executive Board meetings of the progress in implementing the remedial plan.

We take this finding very seriously. In fact, prior to the SCO's review, ABAG and the Authority responded to the alleged embezzlement of proceeds from the Rincon Hill bond transaction by engaging the law firm of Orrick Herrington Sutcliffe LLP, who in turn engaged forensic consultants at FTI Consulting, Inc., to conduct an internal investigation of the embezzlement. We have asked that this investigation also include a review of existing internal controls and recommendations for improvement. ABAG and the Authority will consider these recommendations in the development of the remedial plan and accept the SCO's suggestion to include milestones and timelines in the plan.

In addition, ABAG management took immediate action to strengthen its oversight of all financial transactions performed by the Authority. We concur that the actions already initiated should be memorialized in a formal plan that includes the recommendations from our internal investigation. The Executive Director will continue to report to the ABAG Finance and Personnel Committee on remedial actions taken to strengthen oversight. The Finance and

Personnel Committee provides regular reports to the ABAG Executive Board and minutes of the Finance and Personnel Committee are submitted to the Executive Board and are made public.

The Report also recommends that ABAG "assume full control over the Authority's accounting, administrative and operational activities". ABAG will consider this recommendation in conjunction with the recommendations of its internal investigation.

ABAG offers the following to clarify or supplement other statements in Finding 1:

- a. The Background section of the Report states that nonprofit organizations can be members of ABAG. This is incorrect. Only cities, towns, counties and a city and county can be members of ABAG.
- b. The third paragraph on page 6 states: ". . . a former ABAG Director . . . was indicted". He was not indicted but was "charged by information".

c. The Report notes that the Authority does not appear to have established policies and procedures for its bond transactions. The Authority has always had established policies and procedures for bond transactions that include approval of all such transactions by the Authority's Executive Committee at a public meeting. For example, the Executive Committee's adoption on July 16, 2014 of Resolution 14-15, which authorized the execution of the First Supplemental Indenture for the Rincon Hill bond, was carried out in accordance with existing policies and procedures. As mentioned above, ABAG will be considering potential enhancements to ABAG's and the Authority's internal controls, including policies and procedures, following its internal investigation.

d. The Report notes that "the \$1.3 million disbursement was solely prepared and executed by the Authority's Director." This is incorrect. The disbursement request was signed by the Authority's Director and by ABAG's Finance Director in his capacity as the Chief Financial Officer for the Authority.

e. The Report notes that the examiners had to obtain a copy of the disbursement request for the \$1.3 million from the trustee bank because "the Director did not retain supporting documentation of his requests for disbursement for the \$1.3 million from the Trustee." ABAG now requires the ABAG accounting Department to retain supporting documentation for all requests for disbursement, and will consider additional remedial measures following the internal investigation.

f. The Report states that it is not clear how the Authority accounts for bond funds under its control. We concur that a documented protocol for accounting for bond funds under the control of the Authority does not exist. Written procedures will be established as part of ABAG's comprehensive plan to strengthen administrative and internal accounting controls.

g. The Report notes that records needed to determine whether there were other incidences of similar embezzlement were not made available to the SCO examiners. This is a factual statement. These documents were not made available to the SCO at that time due to the ongoing criminal investigation of the embezzlement and our internal investigation. ABAG and the Authority will publicly disclose any and all other embezzlements that may be uncovered.

SCO's Comments

The ABAG should be commended for taking these matters seriously and taking necessary action to remedy the situation. The ABAG is also considering our recommendation to assume full control over the Authority's accounting, administrative, and operational activities. This recommendation will be considered in conjunction with the recommendations of its internal investigation.

The report and the findings are strictly based on the information provided to us by ABAG staff. Therefore, we did not have or were not provided access to some of the information included in ABAG's response to the Draft Review Report. Our comments to the specific issues included in ABAG's response are as follows:

- a) Background information came directly from the ABAG's website and states "Only governmental and non-profit organizations are eligible to be ABAG members. Corporations and individuals cannot be members. Associate memberships are no longer offered." http://abag.ca.gov/overview//abag_members.html
- b) A statement regarding the former ABAG Director being indicted was based on the best information that was available to us. We will change the final report to indicate that the former ABAG Director was "charged by information."
- c) We inquired whether the Authority has a set of Administrative Policies and were informed that no sub-level administrative policies exist, only agency-wide policies for ABAG. If there are policies and procedures for the Authority, we were not provided with such policies and, therefore, were not able to perform a review. Given the complexity of the Authority's operations, it should have written policies and procedures for its activities.
- d) During the review, we were informed by ABAG staff that the \$1.3 million disbursement request was solely prepared by the Authority's director. We requested a copy of the disbursement request but were not provided with one. Therefore, we were not able to ascertain whether or not the disbursement request was signed by the Authority's Director and by ABAG's Finance Director in his capacity as the Chief Financial Officer for the Authority.
- e) The report specifically states that the Director did not retain supporting documentation of the disbursement request for the \$1.3 million from the Trustee and that the Authority had to obtain a copy from the Trustee of what the Director had submitted to support the disbursement.
- f) The ABAG agrees that a documented protocol for accounting for bond funds under the control of the Authority does not exist. According to the ABAG, written procedures will be established as part of the ABAG's comprehensive plan to strengthen administrative and internal accounting controls.
- g) The ABAG agrees that documents were not provided to the SCO to determine whether the embezzlement was an isolated incident. According to ABAG, this was due to the ongoing criminal investigation of the embezzlement and ABAG's internal investigation. In addition, ABAG stated during our review that the Authority does not receive any state funds and, therefore, the SCO does not have the authority to perform a review of the Authority. The ABAG and the Authority will publicly disclose any and all other embezzlements that may be uncovered.

The finding remains as stated except for a minor correction.

**FINDING 2—
Lack of
segregation of
duties in accounts
payable**

Proper segregation of duties ensures that funds and assets are properly recorded, protected, and appropriated. During our review of the ABAG's Finance Unit staff duties, we noted that incompatible functions are assigned to, and performed by, the accounts payable clerk. These functions include the ability to process invoices, make entries in the general ledger, and print checks for disbursement. In addition, we did not note sufficient compensating controls.

A lack of segregation of duties in accounts payable increases the risk of misappropriation.

Recommendation

The ABAG should separate responsibilities to reduce the risk of errors and fraud. Review and approval by a second person may be the most important compensating control activity.

ABAG's Response

We do not believe that a serious weakness in ABAG's internal accounting controls exist from lack of segregation of duties in the processing of accounts payable. Incompatible functions are not performed by the accounts payable clerk, but strict barriers such as denying access to all journals and reassignment of preparation of bank reconciliations are simply not feasible given the limited number of staff in the accounting department. Compensating controls exist in our strong system of review of AP journals, check registers, wire requests and bank reconciliations. We are pleased that the SCO examination did not find significant errors or fraud having occurred as a result of lack of segregation of duties.

SCO's Comments

A fundamental element of internal control is the segregation of certain key duties; we noted that such duties were not segregated with respect to the ABAG's processing of accounts payable. We noted that the accounts payable clerk was assigned too many incompatible duties. The accounts payable clerk was able to process invoices, make entries in the recordkeeping system, and print checks. This situation provides an opportunity and ability for a person to commit fraud by processing a fraudulent invoice, recording a false entry, and producing a live warrant. While the ABAG does have compensating controls, given the amounts and enormity of its transactions, management might not be able to detect fraudulent activity in a timely manner.

The basic idea underlying the segregation of duties is that no employee or group of employees should be in a position both to perpetrate and to conceal errors or fraud in the normal course of his or her duties. The goal is to prevent one person from having both access and responsibility for maintaining the accounts payable records.

We strongly recommend that the ABAG management separate these incompatible functions to reduce the risk of errors and fraud.

The finding remains as stated.

**FINDING 3—
Performance
evaluations not
performed in a
timely manner**

Our review of the staff performance evaluations log revealed that evaluations are not completed consistently. As noted in the table below, a significant number of staff evaluations were either missing or were completed over two months late.

Fiscal Year	Late	Missing	Total
2012-13	5 (8%)	38 (64%)	59
2013-14	26 (36%)	20 (27%)	73

According to the ABAG’s personnel policies, all staff members should be evaluated based on their competence, efficiency, adaptation, conduct, merit, and other job-related performance metrics annually on or about the staff member’s anniversary date.

An important element of internal control is an organization’s commitment to competence. It is crucial for an organization to demonstrate commitment to attract, develop, and retain competent individuals in alignment with the organization’s objectives. One of the tools commonly used is performance evaluation.

Recommendation

The ABAG Human Resources Department should ensure that all departments complete all of the past-due staff performance evaluations. It should also require that all departments conduct staff performance evaluations on a regular basis to determine if the knowledge, skills, and abilities of the staff members are sufficient to perform their respective functions, and monitor the evaluation process on a regular basis. Performance evaluation is an important tool that helps identify staff training needs.

ABAG’s Response

We concur with the Report’s findings and recommendation regarding timely completion of staff performance reviews. The Human Resources Director has been charged with the task to improve the system for monitoring the completion of staff performance reviews, the institution of positive and negative reinforcement devices, and the use of short form evaluations when appropriate.

SCO’s Comments

The ABAG agrees with SCO and is in the process of implementing our recommendation.

The finding remains as stated.

**FINDING 4—
Bank
reconciliations not
performed in a
timely manner**

Timely bank reconciliation provides the necessary control mechanism to help protect an entity's cash by uncovering irregularities such as unauthorized bank withdrawals. Timely monthly preparation of bank reconciliations would assist in the regular monitoring of the ABAG's cash flows.

Bank reconciliation is an important monthly task for the ABAG's accounting department because it:

- Compares the ABAG's general ledger against its bank statement to check for any irregularities or overcharges;
- Provides ABAG management a good financial oversight from month to month; and
- Provides information regarding misclassified and/or missing funds.

It is also essential, and that the duties of issuing payments and reconciliation are separated and that bank reconciliation statements are reviewed and approved by upper management at least once a month and reviewed by an external auditor at least once a year.

In our review of the ABAG's bank reconciliation process and procedures for the period of July 1, 2012, through June 30, 2014, we noted that the majority of reconciliations were not performed, reviewed, and finalized on a timely basis. The ABAG's written procedures state that bank reconciliations should be prepared within 30 to 45 days from the last day of the previous month. During FY 2012-13, the ABAG completed the monthly reconciliation on time only twice, with the remaining 10 months late. There was also no evidence of when a review and final approval was completed. The majority of the bank reconciliations were missing elements such as the preparer's name, date prepared, and date reviewed. In addition, we noted that in FY 2013-14, management went as long as 148 and 86 days without reviewing and approving reconciliations for the month of October and December 2013, respectively.

The bank reconciliations provided to us indicated a lack of timeliness, which results in insufficient controls over the ABAG's cash accounts because staff might not detect errors or fraud in a timely manner.

Recommendation

We recommend that the ABAG implement procedures to ensure that bank reconciliations, are completed, reviewed, and approved in a timely manner. The bank reconciliations should be signed and dated by the preparer and the reviewer.

ABAG's Response

We concur with the Report's finding that timely bank account reconciliation is important. We took steps to modify the bank reconciliation system so that performance in FY2013-14 was improved over FY2012-13. We are in the process of finalizing further modifications to the bank reconciliation process.

SCO's Comments

The ABAG agrees with SCO and is in the process of finalizing further modifications to the bank reconciliation process.

The finding remains as stated.

**FINDING 5—
Inadequate
Travel Advance
Policy and Lack
of Accounting
Procedures**

During our limited review of the ABAG travel expenditures, we noted that the ABAG did not have a comprehensive travel policy and accounting procedures for travel advances. Without these policies and procedures, the ABAG is at risk of misuse of funds.

For example, we found an instance of an unsupported travel advance in FY 2012-13. The staff travel claim statement and adequate receipts were not on file for review. In addition, the staff travel advance request was submitted and approved a month prior to the travel date for a conference meeting. The request was approved on September 20, 2012, for a trip from November 7, 2012, to November 9, 2012. Per the ABAG's Travel Request Instructions, "The Travel Request should be submitted five (5) days prior to the planned trip."

A written comprehensive travel policy and procedures would help safeguard the ABAG from misuse of travel money because it would allow the ABAG to track and account for its travel expenditures. The ABAG has Executive Director's administrative policies related to travel, but it lacks detailed procedures relating to travel advance activities.

Recommendation

The ABAG should update its administrative policies related to travel and establish written accounting procedures for travel advances. The travel policy and accounting procedures should require that a request and approval process be followed, prompt submission of receipts and documentation after travel has occurred, return of unused travel advance funds, accounting of travel advances as an advance to employee, and subsequent recording to an expense account once travel cost has been incurred.

ABAG's Response

We concur with the Report's finding that ABAG's policy and procedure for accounting for travel advances are not comprehensive. While the risk of fraud or abuse is low because of the low number of travel advances, this does not obviate the need for improved policies and procedures. We are committed to documenting and enforcing a more comprehensive policy or eliminating travel advances altogether.

SCO's Comments

The ABAG agrees with SCO and is committed to documenting and enforcing a more comprehensive policy or eliminating travel advances altogether.

The finding remains as stated.

**OBSERVATION—
Lack of Contract
Information
Tracking System**

During our review, we found that the ABAG had limited information regarding its contract activities. Through interviews with the ABAG's personnel, we noted that the agency's contract process is decentralized to individual programs and that there is no centralized listing of contracts awarded by the agency. The agency does not have an efficient way to identify the number of contracts currently in effect and the amount of funds associated with those contracts.

The ABAG management relies on program information to report on agency activities to the State and local government agencies. For example, the ABAG makes regular progress reports to various State departments to provide accountability and to seek reimbursement. A contract information tracking system would help the ABAG accurately govern its contract commitments and provide oversight. It would also give ABAG management the ability to access and evaluate contract information to make important decisions. Failure to maintain contract—related information affects the ABAG's ability to effectively manage its contracts and collect reimbursement from grantors in a timely manner.

Recommendation

The ABAG should develop a centralized contract tracking system to ensure that contract information is widely accessible and accurate.

ABAG's Response

We appreciate the observation in the Report that a contract information tracking system will be beneficial to our operations. ABAG's programs comprise funding from members, federal, state, and local agencies. Due to the uniqueness of each program, we have been maintaining contract information according to each program's specific needs and provisions in grant/funding agreements. For example, some contract files and related program information are required to be kept for 30 years. While the process and system in place have been working, in the spirit of upgrading our various systems and going paperless, we have been searching for a comprehensive information system that will meet all of our diverse needs. Our objective is to implement a robust system that can interact with other financial systems, so as to increase our overall efficiency.

SCO's Comments

The ABAG is in the process of searching for a comprehensive information system to meet its diverse needs and to interact with other financial systems.

The observation remains as stated.

Appendix— Association of Bay Area Governments Evaluation of Elements of Internal Control

Internal Control Elements		YES	NO	COMMENTS
Control Environment				
A1. Integrity and Ethical Values				
a.	Are code of conduct and other policies regarding acceptable business practice, conflicts of interest, or expected standards to ethical and moral behavior established and communicated to all ABAG management and employees?		X*	Ethical standards were not properly established to all ABAG management due to lack of oversight. Please see Finding 1 for further detail.
b.	Is the reasonable management attitude of "Tone at the Top" established and communicated to ABAG management and staff?		X*	ABAG management relied completely on the Authority Director and did not provide enough oversight. Please see Finding 1 for further detail.
c.	Is everyday interaction with vendors, clients, auditors, and other parties based on honesty and fairness?		X*	The former ABAG Authority Director embezzled \$1.3 million from the customers' Special Tax Bond account held with the trustee.
d.	Is appropriate remedial action taken in response to non-compliance?	X		
e.	Is management appropriately addressing intervention or overriding established controls?	X		
A2. Commitment to Competence				
a.	Is management identifying and defining the tasks required to accomplish particular jobs and fill various positions?		X*	ABAG management did not adequately staff the Authority, which did not allow for proper segregation of duties.
b.	Does the ABAG conduct appropriate analysis of the knowledge, skills, and abilities needed to perform job assignments?		X	Please see Finding 3 for further detail.

*"No" has been checked due to the ABAG's oversight of the Authority.

Internal Control Elements		YES	NO	COMMENTS
	c. Is the ABAG providing training and counseling in order to help employees maintain and improve their job competence?		X	Without consistent performance evaluations, it is difficult to ascertain the type of training and counseling necessary to provide to ABAG employees.
A3.	Audit Committee			
	a. Does the ABAG have an audit committee that is appropriate for the size and nature of the entity?		X	The ABAG has included in its Roster List (January 2015) a standing Finance and Personnel Committee. Listed among its main functions is to study and submit to the executive board the following: <ul style="list-style-type: none"> • The annual audit of financial affairs for the ABAG, required by Article XI of the bylaws, and audits for funding agencies. • The financial and budgetary status of the ABAG and reports to the General Assembly as required by Article XI of the bylaws. The Finance and Personnel committee studying and submitting the above document to the Executive Board, for all intents and purposes, does not constitute an audit committee. Accordingly, the ABAG does not have an audit committee.
	b. Are members of the audit committee independent from the ABAG management?		X	Please refer to A3.a
	c. Do audit committee members have sufficient knowledge, experience, and time to serve effectively?		X	Please refer to A3.a
	d. Does the audit committee meet regularly to set policies and objectives, review the ABAG's performance, and take appropriate actions; and are minutes of such meetings prepared and signed on timely basis?		X	Please refer to A3.a
	e. Do the members of the audit committee regularly receive the information they need to monitor management's objectives and strategies?		X	Please refer to A3.a
	f. Does the audit committee review the scope and activities of the internal and external auditors?		X	Please refer to A3.a
	g. Does the audit committee meet privately with the Chief Financial Officer/and or accounting officers, internal auditors, and external auditors to discuss the reasonableness of the financial reporting process, the system of internal control, significant comments or recommendations, and management performance?		X	Please refer to A3.a
	h. Does the audit committee take actions as a result of its audit findings?		X	Please refer to A3.a

*"No" has been checked due to the ABAG's oversight of the Authority.

Internal Control Elements		YES	NO	COMMENTS
A4.	Management Philosophy and Operating Style			
a.	Is management conservative in accepting risks, and does management move carefully and proceed only after careful evaluation?		X*	ABAG management did not properly evaluate the Authority’s operations and accepted too much risk by allowing one person to run the program.
b.	Are procedures or activities in place to regularly educate and communicate to management and employees the importance of internal controls and to raise the level of understanding control?		X*	We found no evidence that management effectively communicated the importance of internal control to Authority staff, which helped foster the environment that allowed a former ABAG Director to embezzle \$1.3 million.
c.	Is personnel turnover in key functions at an acceptable level?	X		
d.	Does management have a positive and supportive attitude towards internal control and audit functions?		X*	ABAG management relied too much on the Authority Director and did not provide enough oversight. Please see Finding 1 for further detail.
e.	Are valuable assets and information safeguarded from unauthorized access or use?		X*	The Authority Director embezzled \$1.3 million from the clients’ trust fund. Please see Finding 1 for further detail.
f.	Are there frequent interactions of senior management and operation management?		X*	There was not sufficient oversight over the Authority’s activities. Please see Finding 1 for further detail.
g.	Is management attitude appropriate towards financial, budgetary and other operational reporting?	X		
A5.	Organizational Structure			
a.	Is the ABAG’s organizational structure appropriate for its size and the nature of its operation?		X*	There was a lack of sufficient staffing at the Authority, which was inappropriate given its size and the nature of its operations.
b.	Are key areas of authority and responsibility defined and communicated throughout the organization?		X*	There was too much authority and responsibility assigned to the Authority Director. Please see Finding 1 for further detail.
c.	Have appropriate and clear reporting relationships been established?		X*	We found that the agreement between the ABAG and the Authority that provides management, administrative, accounting, and other support services to the Authority did not establish appropriate and clear reporting relationships.
d.	Does management periodically evaluate the organization’s structure and make changes as necessary in fluctuating conditions?		X*	ABAG management did not periodically perform an evaluation of the Authority nor did they make necessary changes to create a proper control environment.
e.	Does ABAG employ an appropriate number of employees, particularly		X	Please refer to A5.d

*“No” has been checked due to the ABAG’s oversight of the Authority.

Internal Control Elements		YES	NO	COMMENTS
A6.	Assignment of authority and responsibility			
	a. Is the ABAG appropriately assigning authority and delegating responsibility to the proper personnel to deal with organizational goals and objectives?		X*	The ABAG delegated too much authority and responsibility to the Authority's Director. Please see Finding 1 for further detail.
	b. Does each employee know how his or her work interrelates to others in the way in which authority and responsibility are assigned, and how duties are related concerning internal control?	X		
	c. Is delegation of authority appropriate in relation to the assignment of responsibility?		X	Please refer to A6.a
A7.	Human Resources policies and practices			
	a. Are policies and procedures established for hiring, training, and promoting employees and management?	X		
	b. Are background checks conducted on candidates for employment?	X		
	c. Are employees provided the proper amount of supervision?		X*	The ABAG lacked oversight over the Authority's Director. Please see Finding 1 for further detail.
Risk Assessment				
B1.	Establishment of Entity-wide Objectives			
	a. Are there entity-wide objectives that were established by management?	X		
	b. Are entity-wide objectives clearly communicated to all employees, and does management obtain feedback signifying that communication has been effective?	X		
	c. Is there a relationship and consistency between the department's operational strategies and the District-wide objectives?	X		
	d. Is there an integrated management strategy and risk assessment plan that considers the entity-wide objectives and the relevant sources of risk from internal management factors and external sources, and that establishes a control structure to address those risks?		X*	The ABAG management did not establish the proper control structure to address the various internal and external risks they were exposed to by the Authority.

*"No" has been checked due to the ABAG's oversight of the Authority.

Internal Control Elements		YES	NO	COMMENTS
B2.	Risk Identification			
	a. Is management appropriately and comprehensively identifying risk using various methodologies?		X*	Please refer to B1.d
	b. Are there mechanisms in place to anticipate, identify, and react to routine events or acts that affect achievement of objectives?	X		
	c. Do adequate mechanisms exist to identify risks to the entity arising from external factors?	X		
	d. Is management assessing other factors that may contribute to or increase the risk to which the entity is exposed?		X*	Please see Finding 1 for further detail.
	e. Is management identifying risks entity-wide and for each significant activity level of the entity?		X*	Please see Finding 1 for further detail.
B3.	Risk Analysis			
	a. After risks to the ABAG have been identified, does management undertake a thorough and complete analysis of the possible effect?	X		
	b. Has management developed an approach for risk management and control based on how much risk can be prudently accepted?	X		
Control Activities				
C1.	Policies and Procedures (General Applications)			
	a. Do appropriate procedures, techniques, and mechanisms exist with respect to each ABAG's activities?		X*	Please see Finding 1 for further detail.
	b. Are the control activities identified as necessary in place and being applied?		X*	Please see Finding 1 for further detail.
	c. Are control activities regularly evaluated to ensure that they are still appropriate and working as intended?		X*	Please see Finding 1 for further detail.

*"No" has been checked due to the ABAG's oversight of the Authority.

Internal Control Elements		YES	NO	COMMENTS
C2.	Common Categories of Control Activities			
	a. Are top level reviews made of actual performance relative to budgets, forecasts, and prior periods?	X		
	b. Do managers review performance reports?		X	Please see Finding 3 for further detail.
	c. For information processing, are varieties of controls in place for performing check accuracy, completeness, and authorization of transactions?		X*	Please see Finding 1 for further detail.
	d. Are controlled items periodically counted and compared to amounts shown on control records?	X		
	e. For performance indicators, does management compare different sets of data and investigate differences?	X		
	f. Are duties properly segregated among different people to reduce the risk or error or inappropriate actions?		X	Please see Finding 2 for further detail.
	g. Are administrative and operation policies in writing, current, and do they set clear procedures for compliance?		X	Please see Finding 5 for further detail.
Information and Communication				
D1.	Information			
	a. Are mechanisms in place to obtain relevant information on legislative or regulatory developments and program, budget, or economic changes?	X		
	b. Is information provided to the right people in sufficient detail and on time to enable them to carry out their responsibilities efficiently and effectively?		X*	The Authority did not provide sufficient information to ABAG management, which resulted in lack of oversight over Authority's activities. Please see Finding 1 for further detail.

*"No" has been checked due to the ABAG's oversight of the Authority.

Internal Control Elements		YES	NO	COMMENTS
	c. Is development or revision of information systems based on the strategic plan linked to the entity’s overall strategy, and is it responsive to achieving entity -wide objectives?		X*	Please refer to D1.b
	d. Does management support the development of necessary information systems and show its support by committing appropriate resources.	X		
D2.	Communications			
	a. Does management ensure that effective internal communications occur?	X		
	b. Does management ensure that effective external communication occurs regarding issues with serious impact on programs, projects and other activities?	X		
	c. Does the ABAG employ various forms and means of communicating important information with employee and others?	X		
	d. Does the ABAG manage, develop, and revise its information systems in an effort to continually improve usefulness and reliability?	X		
Monitoring				
E1.	On-going monitoring			
	a. Does management have a strategy to ensure that ongoing monitoring is effective and will trigger separate evaluations?		X*	Please see Finding 1 for further detail.
	b. Do ABAG personnel, in the process of performing their regular duties, obtain information about whether internal control is functioning properly?		X*	Please see Finding 1 for further detail.
	c. Are communications from external parties corroborated with internally generated data and able to indicate problems with internal control?	X		

*“No” has been checked due to the ABAG’s oversight of the Authority.

Internal Control Elements		YES	NO	COMMENTS
d.	Is there appropriate organizational structure and supervision to help provide oversight of internal control functions?		X*	Please see Finding 1 for further detail.
e.	Are data recorded by information and financial systems periodically compared with physical assets and discrepancies?	X		
f.	Are the entity's auditors regularly providing recommendations for improvements in internal control, and is management taking appropriate follow-up action?	X		
g.	Are meetings with employees used to provide management with feedback on whether internal control is effective?		X*	Please see Finding 1 for further detail.
h.	Are employees' regularly asked to state explicitly whether they comply with the ABAG's code of conduct?		X	ABAG employees were not asked about their compliance with the code of conduct except during the new-employee orientation.
E2.	Separate evaluation			
a.	Are the scope and frequency of separate internal control evaluations appropriate for the entity?		X*	Please see Finding 1 for further detail.
b.	Are the methodologies for evaluating the entity's internal control logical and appropriate?		X*	Please see Finding 1 for further detail.
c.	If the evaluations are conducted by the ABAG Auditor's Office, does the office have sufficient resources, ability, and independence?			Not applicable to ABAG. ABAG does not have an Auditor's Office.
d.	Are deficiencies found during separate evaluations promptly resolved?		X*	Please see Finding 1 for further detail.
E3.	Reporting deficiencies			
a.	Are there means of obtaining reports of deficiencies from both internal and external sources?	X		
b.	Is there ongoing monitoring of internal controls?		X*	Please see Finding 1 for further detail.

*"No" has been checked due to the ABAG's oversight of the Authority.

Internal Control Elements		YES	NO	COMMENTS
c.	Are deficiencies reported to the person directly responsible and to a person at least one level higher?	X		
d.	Are the identified transactions or events investigated to determine causes and correct problems?	X		

*"No" has been checked due to the ABAG's oversight of the Authority.

**Attachment—
ABAG's Response to Draft Review Report**

ASSOCIATION OF BAY AREA GOVERNMENTS

Representing City and County Governments of the San Francisco Bay Area



May 26, 2015

Mr. Mike Spalj, Chief
Local Government Audits Bureau
California State Controller's Office
Division of Audits
P.O. Box 942850
Sacramento, CA 94250-5874

Dear Mr. Spalj:

On behalf of Association of Bay Area Governments (ABAG), I sincerely thank the State Controller's Office, Division Chief Mr. Jeffrey V. Brownfield and your team for the Review Report on ABAG's administrative and internal accounting controls. Attached is ABAG's response to the Report's findings and recommendations.

As noted in ABAG's response, we will be moving forward to address all the recommendations in the Report. Where necessary and appropriate, we have also provided clarifications regarding some of the findings in the Report.

We sincerely appreciate your support and valuable recommendations. If you have any questions about our response, please feel free to contact the Interim Finance Director, Charles Adams.

Sincerely,

Ezra Rapport
Executive Director

Enclosure: Response to SCO Findings and Recommendations

cc: Charles Adams, Interim Finance Director



ASSOCIATION OF BAY AREA GOVERNMENTS
RESPONSE TO FINDINGS AND RECOMMENDATIONS OF
STATE CONTROLLER OFFICE
REVIEW REPORT

We appreciate the State Controller's Office (SCO) providing the Association of Bay Area Governments (ABAG) an opportunity to review and respond to the draft of the SCO's Review Report ("Report") of its review of ABAG's system of administrative and internal accounting controls for the period of July 1, 2012 through to June 30, 2014. We understand that this response will be included in the final Review Report when it is released to the public.

ABAG Response to General Findings and Finding 1: The Report's Introduction states: "Due to recent allegations of theft of \$1.3 million, [the SCO] evaluated the ABAG's system of administrative and internal accounting controls to identify weaknesses that might have resulted in the alleged theft . . ." The Report stated the SCO found there are "serious weaknesses" in ABAG's internal controls over the operations of the ABAG Finance Authority for Nonprofit Corporations (Authority). The Report recommends that ABAG develop a comprehensive remedial plan to address these weaknesses, that the plan include milestones and timelines and that periodic updates are provided at the ABAG Executive Board meetings of the progress in implementing the remedial plan.

We take this finding very seriously. In fact, prior to the SCO's review, ABAG and the Authority responded to the alleged embezzlement of proceeds from the Rincon Hill bond transaction by engaging the law firm of Orrick Herrington Sutcliffe LLP, who in turn engaged forensic consultants at FTI Consulting, Inc., to conduct an internal investigation of the embezzlement. We have asked that this investigation also include a review of existing internal controls and recommendations for improvement. ABAG and the Authority will consider these recommendations in the development of the remedial plan and accept the SCO's suggestion to include milestones and timelines in the plan.

In addition, ABAG management took immediate action to strengthen its oversight of all financial transactions performed by the Authority. We concur that the actions already initiated should be memorialized in a formal plan that includes the recommendations from our internal investigation. The Executive Director will continue to report to the ABAG Finance and Personnel Committee on remedial actions taken to strengthen oversight. The Finance and Personnel Committee provides regular reports to the ABAG Executive Board and minutes of the Finance and Personnel Committee are submitted to the Executive Board and are made public.

The Report also recommends that ABAG "assume full control over the Authority's accounting, administrative and operational activities". ABAG will consider this recommendation in conjunction with the recommendations of its internal investigation.

ABAG offers the following to clarify or supplement other statements in Finding 1:

- a. The Background section of the Report states that nonprofit organizations can be members of ABAG. This is incorrect. Only cities, towns, counties and a city and county can be members of ABAG.
- b. The third paragraph on page 6 states: ". . . a former ABAG Director . . . was indicted". He was not indicted but was "charged by information".
- c. The Report notes that the Authority does not appear to have established policies and procedures for its bond transactions. The Authority has always had established policies and procedures for bond

transactions that include approval of all such transactions by the Authority's Executive Committee at a public meeting. For example, the Executive Committee's adoption on July 16, 2014 of Resolution 14-15, which authorized the execution of the First Supplemental Indenture for the Rincon Hill bond, was carried out in accordance with existing policies and procedures. As mentioned above, ABAG will be considering potential enhancements to ABAG's and the Authority's internal controls, including policies and procedures, following its internal investigation.

- d. The Report notes that "the \$1.3 million disbursement was solely prepared and executed by the Authority's Director." This is incorrect. The disbursement request was signed by the Authority's Director and by ABAG's Finance Director in his capacity as the Chief Financial Officer for the Authority.
- e. The Report notes that the examiners had to obtain a copy of the disbursement request for the \$1.3 million from the trustee bank because "the Director did not retain supporting documentation of his requests for disbursement for the \$1.3 million from the Trustee." ABAG now requires the ABAG accounting Department to retain supporting documentation for all requests for disbursement, and will consider additional remedial measures following the internal investigation.
- f. The Report states that it is not clear how the Authority accounts for bond funds under its control. We concur that a documented protocol for accounting for bond funds under the control of the Authority does not exist. Written procedures will be established as part of ABAG's comprehensive plan to strengthen administrative and internal accounting controls.
- g. The Report notes that records needed to determine whether there were other incidences of similar embezzlement were not made available to the SCO examiners. This is a factual statement. These documents were not made available to the SCO at that time due to the ongoing criminal investigation of the embezzlement and our internal investigation. ABAG and the Authority will publicly disclose any and all other embezzlements that may be uncovered.

ABAG Response to Finding 2: We do not believe that a serious weakness in ABAG's internal accounting controls exist from lack of segregation of duties in the processing of accounts payable. Incompatible functions are not performed by the accounts payable clerk, but strict barriers such as denying access to all journals and reassignment of preparation of bank reconciliations are simply not feasible given the limited number of staff in the accounting department. Compensating controls exist in our strong system of review of AP journals, check registers, wire requests and bank reconciliations. We are pleased that the SCO examination did not find significant errors or fraud having occurred as a result of lack of segregation of duties.

ABAG Response to Finding 3: We concur with the Report's findings and recommendation regarding timely completion of staff performance reviews. The Human Resources Director has been charged with the task to improve the system for monitoring the completion of staff performance reviews, the institution of positive and negative reinforcement devices, and the use of short form evaluations when appropriate.

ABAG Response to Finding 4: We concur with the Report's finding that timely bank account reconciliation is important. We took steps to modify the bank reconciliation system so that performance in FY2013-14 was improved over FY2012-13. We are in the process of finalizing further modifications to the bank reconciliation process.

ABAG Response to Finding 5: We concur with the Report's finding that ABAG's policy and procedure for accounting for travel advances are not comprehensive. While the risk of fraud or abuse is low because of the low number of travel advances, this does not obviate the need for improved policies and

procedures. We are committed to documenting and enforcing a more comprehensive policy or eliminating travel advances altogether.

ABAG Response to Observation: We appreciate the observation in the Report that a contract information tracking system will be beneficial to our operations. ABAG's programs comprise funding from members, federal, state, and local agencies. Due to the uniqueness of each program, we have been maintaining contract information according to each program's specific needs and provisions in grant/funding agreements. For example, some contract files and related program information are required to be kept for 30 years. While the process and system in place have been working, in the spirit of upgrading our various systems and going paperless, we have been searching for a comprehensive information system that will meet all of our diverse needs. Our objective is to implement a robust system that can interact with other financial systems, so as to increase our overall efficiency.

This response to the draft report provides an overview of ABAG's actions to date and anticipated remedial actions, as well as a specific response to many statements in the Report. ABAG will consider all factual findings and recommendations included in the Report, and reserves the right to supplement its response, including to correct factual inaccuracies not specifically mentioned here.

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

<http://www.sco.ca.gov>