

## **Community Redevelopment Agencies:**

**Surplus Balances in Lower-Income Housing  
Funds Are Overstated, Suggesting a Need  
for More Statewide Oversight and Direction**



March 1998  
97101

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# CALIFORNIA STATE AUDITOR

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March 11, 1998

97101

The Governor of California  
President pro Tempore of the Senate  
Speaker of the Assembly  
State Capitol  
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report concerning the status of excess surplus balances in the low- and moderate-income housing funds in the State's community redevelopment agencies. This report concludes that actual excess surplus balances in the low- and moderate-income housing funds are far less than reported and problems exist with the administration of community redevelopment. In addition, because the law does not provide clear guidance, redevelopment agencies do not utilize consistent methods to determine excess surplus balances, resulting in unreliable statewide information on the status of redevelopment funds that are mandated for affordable housing. Finally, the audit suggests that more stateside oversight may improve reporting of excess surplus balances and improve redevelopment agencies' compliance with statewide requirements regarding the set aside and spending of property tax increment revenue for affordable housing.

Respectfully submitted,

KURT R. SJOBERG  
State Auditor

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# Summary

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**Audit Highlights . . .**

**Community redevelopment agencies:**

- ☑ **Have excess surplus balances that are far less than reported.**
- ☑ **Fail to provide accurate and consistent information on amounts allocated and spent on low- and moderate-income housing.**

**State law does not provide for oversight of redevelopment by a state agency with the authority to enforce compliance with state requirements.**

**State Controller guidelines do not contain sufficient procedures for auditors to determine whether agencies' use of funds meet legal requirements.**



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## **Results in Brief**

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The Community Redevelopment Act gives California cities and counties the authority to establish community redevelopment agencies to revitalize their deteriorating and blighted areas. State law requires that a redevelopment agency set aside a designated amount of its property tax revenue to adequately supply affordable low- and moderate-income housing. The California Department of Housing and Community Development (department) must report each year on the status of the redevelopment agencies' low- and moderate-income housing funds. As of June 30, 1995, the department reported that 44 agencies had accumulated excess balances in their low- and moderate-income housing funds, totaling approximately \$51.7 million, that were subject to a mandated January 1, 1997, spending deadline.

Our audit finds that actual low- and moderate-income housing funds excess balances are far less than reported and there are problems with the administration of community redevelopment. Due to the lack of oversight, redevelopment agencies fail to provide accurate and consistent information on the mandated amount of property tax dollars they allocate and spend on low- and moderate-income housing. As a result, the department has no way of knowing how much mandated money has not been spent. Specifically, we found the following:

- The department reported 21 redevelopment agencies had excess balances in their low- and moderate-income housing funds greater than \$500,000. Of the 21 balances, 17 balances were overstated and one balance was understated.
- Only 12 of these 21 agencies actually accumulated excess balances with a combined total of approximately \$13.7 million.
- Inconsistency in how agencies report the availability of their funds is partly due to vague instructions in the law for calculating excess balances.

State law does not provide for the oversight of redevelopment by a state agency that has authority to enforce compliance with statewide policies regarding low- and moderate-income housing activities. Compliance depends on local legislative bodies' interpretations of the legal and regulatory requirements. However, our review of practices used by 51 redevelopment agencies shows that some do not comply with laws and regulations governing redevelopment activities. Specifically, we found the following:

- The redevelopment agencies of the cities of Hollister and Loma Linda do not ensure that their respective funds receive the designated amount of property tax dollars to provide housing for low- and moderate-income households.
- The Redevelopment Agency of the City of Fremont has not developed and implemented a system to properly allocate planning and administrative costs to its fund. The redevelopment agency could not support \$25,000 in costs for salary and benefits it charged to its fund in fiscal year 1995-96.
- The Culver City Redevelopment Agency did not follow the narrow restrictions of the law for spending designated low- and moderate-income housing funds outside an agency's territorial jurisdiction when it spent \$750,000 for housing outside its city limits.

Finally, the State Controller's Office guidelines for compliance audits of redevelopment agencies do not contain sufficient audit procedures to determine whether agencies use redevelopment funds to provide affordable housing as required by law.

## ***Recommendations***

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The Legislature should do the following:

- Clarify its intent for the treatment of the proceeds of bonds and other debt deposited in the low- and moderate-income housing funds when calculating excess surplus and amend the law to provide complete and specific requirements to the redevelopment agencies.
- Consider amending the California Government Code, Section 53895, which imposes fines on redevelopment agencies that do not file reports, to also include penalties for deficient or noncompliant reports.

- Consider amending the Health and Safety Code, Section 33080.1, to require the calculation for excess surplus low- and moderate-income housing funds to be included in agencies' audit reports and to be covered under the independent auditor's opinion on compliance with the laws and regulations governing redevelopment activities.
- Continue its efforts to require county auditors to provide redevelopment agencies the amount of property tax revenue allocated to the agencies and payments to other taxing-collecting entities deducted from the allocated taxes.
- Determine the extent of monitoring necessary to ensure satisfactory compliance with state policies to provide affordable housing through community redevelopment efforts, consider designating a state agency to oversee these efforts, and provide the authority to enforce the laws and regulations governing redevelopment activities.

The State Controller's Office should revise its *Guidelines For Compliance Audits of California Redevelopment Agencies* to include the critical tests and other audit procedures needed to determine whether a redevelopment agency complies with state policies regarding the production, improvement, or preservation of housing affordable to low- and moderate-income households.

After the law regarding the calculation of excess surplus is clarified, the State Controller's Office and the Department of Housing and Community Development should consider taking steps to further educate the redevelopment agencies about the law's intent and requirements.

### ***Agency Comments***

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We received comments from the Department of Housing and Community Development, the State Controller, and the 11 community redevelopment agencies for which we gave specific mention in the body of our report. The Department of Housing and Community Development and the State Controller agreed with our findings and recommendations. In addition, the agencies generally agreed with our findings. However, 6 of the redevelopment agencies disagreed with our conclusions regarding their compliance with the law that governs community redevelopment activities, and our conclusions on the adequacy of their internal accounting



controls over their agency's assets. We provide our comments to these and other concerns raised by the agencies after their respective responses.

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# *Introduction*

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## *Background*

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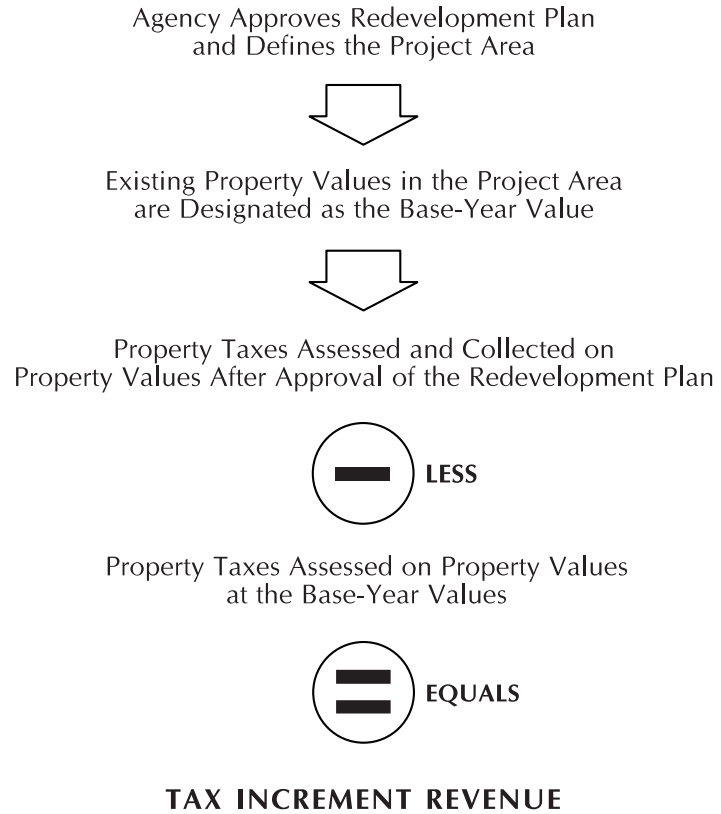
In 1945, the Legislature established redevelopment agencies in California with the Community Redevelopment Act, which gives cities and counties a mechanism to revitalize deteriorating and blighted areas in their communities. State law provides cities and counties the authority to activate a redevelopment agency. The territorial jurisdiction of a redevelopment agency is defined by law as the unincorporated territory of the county or the territory within the limits of the city that activates the agency. Initially, redevelopment was slow. But according to the State Controller's Office (SCO), as of June 30, 1996, 356 active agencies existed throughout the State with reported annual tax revenues of approximately \$1.5 billion.

Typically, a city council or board of supervisors acts as the governing board for these agencies. Rather than designating a state agency to provide oversight of redevelopment, the Legislature delegated to the local governing boards oversight to ensure that agencies comply with state policies and statutory requirements. The State requires that agencies submit annual financial reports to the SCO and reports of redevelopment activity to the Department of Housing and Community Development (department).

In redeveloping their communities, agencies identify blighted portions of their territorial jurisdiction and designate them as redevelopment project areas. Redevelopment activities are funded primarily by tax increment revenue. Tax increment revenue is that portion of property tax attributable to added property value resulting from redevelopment efforts.

**Figure 1**  
**Tax Increment Revenue**

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The Legislature has declared that providing an adequate supply of decent, safe, and sanitary housing affordable to people and households of all income levels is a fundamental purpose of redevelopment. The Senate Committee on Housing and Land Use reported that in response to criticism that redevelopment was destroying residential neighborhoods and replacing affordable housing with commercial and industrial development, the Legislature amended the law in 1976 to require redevelopment agencies to set aside 20 percent of their annual tax increment revenue to increase, improve, or preserve housing affordable to low- and moderate-income households. To ensure they spend the tax increment funds they set aside, the Legislature amended the law in 1988 to require redevelopment agencies to identify surplus funds and spend these funds by December 31, 1993, or transfer them to the county housing authority. In 1993, with the Community Redevelopment Law Reform Act, the Legislature required agencies to spend any surplus funds within a specific time period or face severe restrictions on their spending for nonhousing redevelopment activities.

### ***Excess Surplus Low- and Moderate-Income Housing Funds***

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The Health and Safety Code, Section 33334.12, states that agencies must identify excess surplus balances in their low- and moderate-income housing funds at the end of each fiscal year. An agency has an excess surplus balance when the unexpended and unencumbered balance in its fund exceeds the greater of \$1 million or the total tax increment revenue deposited in the fund during the previous four fiscal years. Funds are considered encumbered when they are committed to a legally enforceable contract or agreement. The first date an excess surplus could exist was July 1, 1994.

After determining its excess surplus, an agency must transfer the excess surplus to the county housing authority or another public housing agency within one year, or spend or encumber the excess surplus within an additional two years. Because of special transitional language in the 1993 act, an excess surplus balance identified on July 1, 1994, is subject to a January 1, 1997, spending deadline. Therefore, rather than 3 years, agencies have only 2-1/2 years to spend their first excess surplus balance. If an agency fails to use this balance for affordable housing within the required time period, it cannot spend or encumber any funds from any source, with few exceptions, such as existing obligations and administrative costs. To end such a restriction on spending for nonhousing purposes, an agency must spend its excess surplus plus an additional 50 percent of that amount from nonhousing funds on affordable housing.

In its annual report, *Redevelopment Housing Activities in California*, the department compiles excess surplus balances in agencies' low- and moderate-income housing funds. As of June 30, 1995, the department reported that for excess surplus balances with a January 1, 1997, spending deadline, 44 agencies had balances, totaling approximately \$51.7 million. Of those 44 agencies, 21 had accumulated balances greater than \$500,000 each, for an aggregate total of \$46 million.

### ***Scope and Methodology***

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At the request of the Joint Legislative Audit Committee, we conducted an audit of community redevelopment agencies' compliance with state law regarding the spending deadlines for excess surplus balances in low- and moderate-income housing funds. Specifically, we were asked to review

compliance with the January 1, 1997, spending deadline of 21 redevelopment agencies reported to have \$500,000 or more of excess surplus low- and moderate-income housing funds remaining as of June 30, 1995.

We reviewed relevant state laws, rules, and regulations. In addition, we reviewed the financial information the department used to determine the reported balances for the 21 agencies. We also interviewed representatives of the department to gain background on the issues surrounding the calculation for excess surplus balances submitted by agencies.

To determine whether the reported excess surplus balances for the 21 agencies still existed after the January 1, 1997, spending deadline, we first evaluated the accuracy of the calculations. We obtained the work sheets the department used to report the balances, requested that the 21 agencies provide their calculations of the balances along with audited financial statements and other schedules or records necessary to support the calculations, and attempted to verify the balances. Appendix A lists the agencies we surveyed and the methods they reported for calculating excess surplus.

To determine whether agencies correctly identified the unspent and unencumbered fund balances needed to calculate excess surplus, we compared amounts excluded from fund balances in the calculation work sheets to amounts from audited financial statements and other records provided by the agencies.

To identify different interpretations by the agencies of the requirement to exclude the proceeds of bonds or other debt from the fund balance when calculating excess surplus, and the effect of these different interpretations, we reviewed the information provided in response to a survey and conducted follow-up interviews.

To determine whether agencies appropriately allocate tax revenue and other income and receipts, charge expenditures, and report accumulated fund balances, we visited two agencies and performed tests of transactions and other records. We also tested allocations of tax increment revenue, interest, and other income to determine whether the funds had received their required allocations. We additionally determined whether the funds received their proportionate share of the proceeds from bonds or other debt. Moreover, we tested the two agencies' expenditures for planning and administrative costs and the direct costs of providing affordable housing to determine whether those costs met the restrictions of the law.

Further, we examined the agencies' excess surplus calculations to determine whether they computed them in accordance with the law.

To gain an understanding of the policies and procedures of agencies throughout the State regarding the accumulation, spending, and reporting of excess surplus balances in low- and moderate-income housing funds, we developed a questionnaire and surveyed the agencies with reported large balances and a sample of 32 additional agencies. We used our survey and follow-up contacts to obtain detailed descriptions of procedures these agencies used, along with supporting documentation, to ensure that their funds received the appropriate tax increment revenue, interest revenue, repayments of loans and advances, and proceeds from bonds or other debt.

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# *Chapter 1*

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## *Redevelopment Agencies and the Department of Housing and Community Development Incorrectly and Inconsistently Calculated Excess Surplus Balances*

### *Chapter Summary*

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Seventeen of the 21 excess surplus balances greater than \$500,000 reported by the Department of Housing and Community Development (department) were overstated and one was understated. Only 3 of the 21 balances were correct. While the department reported an aggregate balance of \$46 million for these 21 agencies, we determined their balances totaled only \$13.7 million. The department based its miscalculations on incomplete or inaccurate information provided by the redevelopment agencies. For example, 8 agencies did not complete the work sheet used to calculate excess surplus. Five others did not explain how they determined the fund balance they used in their calculations, and 10 agencies miscalculated their fund balances. The department recalculated many of the excess surplus balances using information from other reports and information it had accumulated from prior years. However, it did not verify the previously reported information with the agencies, and 18 of its recalculations also resulted in incorrect excess surplus balances.

In addition, widely different interpretations of the law requiring special treatment of the proceeds of bonds and other debt deposited in the funds contributed to the inconsistent and unreliable measurements of excess surplus balances in the funds. The department uses these calculations to compile annual reports on the status of the low- and moderate-income housing funds and the existence of excess surplus in those funds. The inaccurate, incomplete, or inconsistent information the agencies provide to the department makes this statewide information unreliable.

Based on the number of excess surplus calculations that were inaccurate or were not supported by financial information from agencies' audited financial statements, it appears that many of the agencies lacked basic understanding of the program provisions and local legislative bodies did not provide adequate





oversight. While the law provides penalties for agencies that do not file required reports, agencies that file deficient or noncompliant reports are not currently penalized.

***Reported Excess Surplus  
Balances Were Incorrect***

The department reported that 21 redevelopment agencies throughout the State had accumulated excess surplus balances greater than \$500,000 in their housing funds for a total of \$46 million. However, we determined that only 12 of those 21 agencies had actually accumulated excess surplus balances in their funds. The excess surplus for the 12 agencies totaled \$13.7 million, less than one-third the amount the department reported. See Table 1 for a comparison, by agency, of the excess surplus balances reported by the department and our calculation of the balances.

***Table 1  
Agencies With Excess Surplus Balances  
of More Than \$500,000 as of June 30, 1995***

<b>Redevelopment Agency</b>	<b>Department Calculation of Excess Surplus at June 30, 1995</b>	<b>Auditor Calculation of Excess Surplus at June 30, 1995</b>
El Cajon	\$ 6,166,108	\$ 0
Culver City	4,878,001	0
Orange City	4,486,879	0
Indian Wells	4,107,550	3,773,917
Indio	3,673,702	0
Lynwood	3,045,372	0
Redondo Beach	2,441,859	742,621
Tustin	2,178,076	2,173,932
Palm Springs	1,929,572	0
San Ramon	1,840,487	0
Santee	1,743,822	1,407,413
Inglewood	1,576,995	1,576,995
Avalon	1,575,532	0
Montebello	1,273,710	228,389
Foster City	917,480	917,480
Coachella	898,715	968,931
Commerce	801,160	360,070
Walnut	747,379	724,071
Fremont	658,143	310,192
Madera	550,184	0
South San Francisco	539,231	539,231
<b>Totals</b>	<b>\$46,029,957</b>	<b>\$13,723,242</b>

  
*Most agencies with  
excess surplus balances  
greater than \$500,000  
eliminated their balances  
as required by law.*  


For excess surplus balances identified as of July 1, 1994, the law requires an agency to either decide to transfer the funds to a housing or other public authority by January 1, 1995, or spend or encumber the excess surplus funds by January 1, 1997. We determined that 10 of the 12 agencies that did have excess surplus funds had eliminated their surplus by the required deadline. Without detailed records of its expenditures and encumbrances we could not determine whether the Inglewood Redevelopment Agency had eliminated approximately \$15,000 of its \$1,576,995 balance before the January 1, 1997, deadline.

Further, the Walnut Improvement Agency did not meet the January 1, 1995, deadline when it transferred the remainder of its July 1, 1994, excess surplus, totaling \$732,662, to the Walnut Housing Authority in December 1996. According to the agency, it does not interpret the law to mean that the transfer had to take place by January 1, 1995. Rather, the agency believes the deadline to transfer the excess surplus funds to the housing authority was the same as the deadline to spend or encumber the funds, which is on or before December 31, 1996.

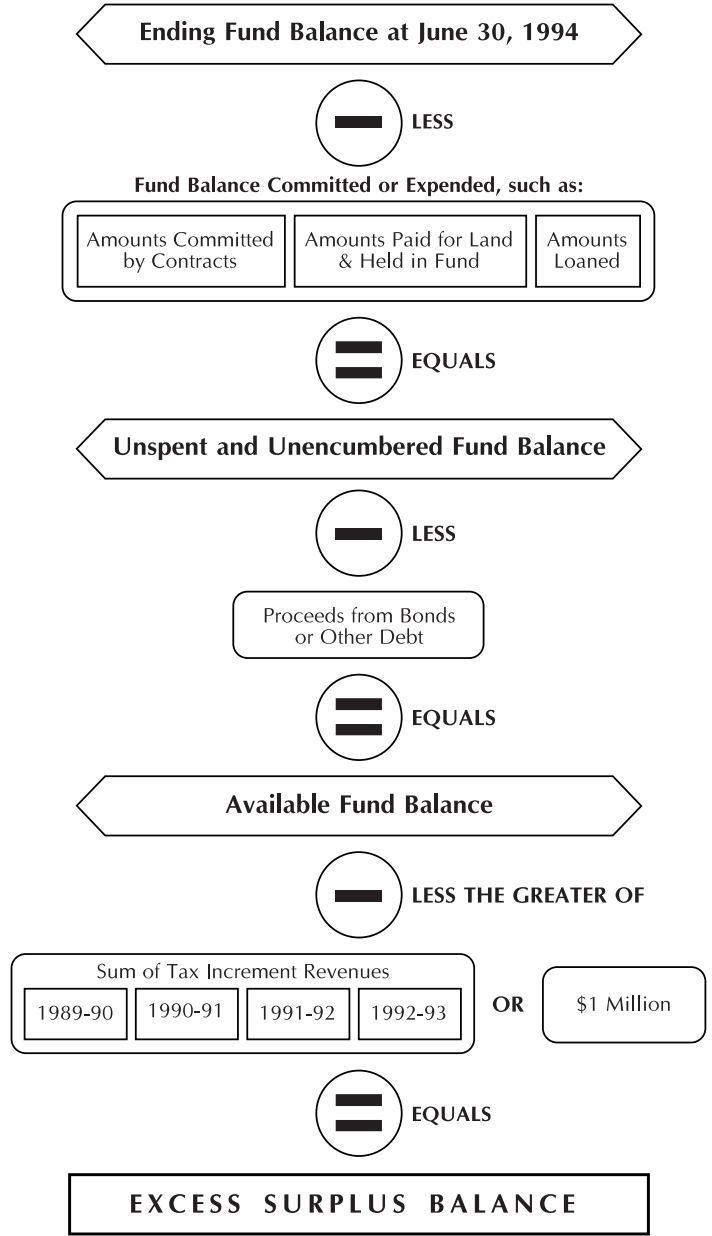
However, we believe the agency misinterpreted the requirement. The law provides separate deadlines for the options to either transfer an excess surplus balance to a housing or other public authority, or spend or encumber the balance.

Because it did not meet the January 1, 1995, deadline, under the requirements of the Health and Safety Code, Section 33334.12(e), the agency was prohibited from spending or encumbering any funds for nonhousing purposes, with the exceptions of its existing obligations and a limited amount of its administrative costs, until the excess surplus was eliminated in December 1996. However, because the agency believed its December 1996 transfer of excess surplus funds met the requirements of the law, it did not impose those sanctions.

When calculating excess surplus, the Health and Safety Code directs agencies to exclude amounts that have been expended but remain in the fund balance. Examples of these expenditures include loans and money agencies spend for land for future development of housing. In addition, an agency should exclude amounts encumbered by contract for future housing activities. Agencies should also exclude the proceeds from bonds or other debt in their fund balances when tax increment set-aside for low- and moderate-income housing has been pledged to repay the debt. They should treat the proceeds as if the debt had not been sold and the tax increment used to

repay the debt had been deposited in the fund. In Figure 2 we present an overview of the calculation.

**Figure 2**  
**Flow Chart of July 1, 1994, Excess Surplus Calculation**



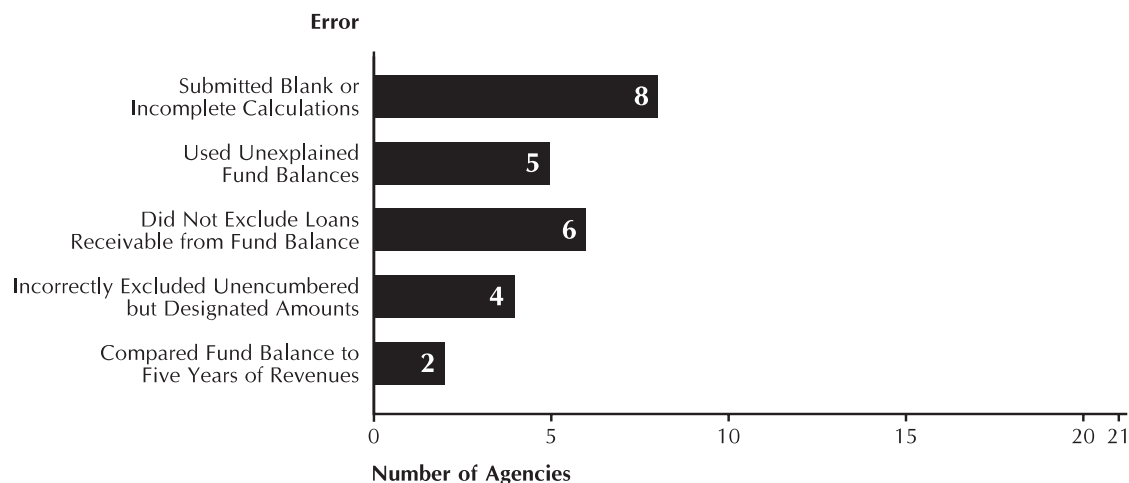
Excess Surplus Balance must be spent or encumbered by January 1, 1997, or else the agency ceases nonaffordable housing operations until an amount equal to 150 percent of surplus is spent on affordable housing.



***Many of the 21 Agencies Incorrectly Reported Information Used in Calculating Excess Surplus***

We found that many agencies provided either incomplete or incorrect information to the department. In some instances, agencies did not complete their excess surplus calculations. Others did not correctly identify their fund balances that were unspent or uncommitted to contracts or agreements. For 6 of the 21 agencies, the amounts they used to calculate excess surplus did not agree with amounts reported in their audited financial statements. To verify the excess surplus balances, we reviewed the department's calculations and found that it overstated balances for 17 agencies and understated the balance for one. For the remaining 3 agencies, the department correctly calculated the excess surplus balance. Based on the number of excess surplus calculations that were inaccurate or were not supported by information from the agencies' audited financial statements, it appears that many of the calculations submitted by the agencies to the department were not verified by the agencies' independent auditors.

We present a complete listing of the 21 agencies in Appendix B. Included in the appendix are the calculation errors we identified for the 18 agencies with incorrect balances. Figure 3 shows the number of agencies making specific errors. Some agencies made more than one type of error.

***Figure 3***  
***Errors Made by the 21 Redevelopment Agencies with Excess Surplus Balances Greater than \$500,000 in Their July 1, 1994, Excess Surplus Calculations***



  
*Some part of the responsibility for incomplete and inaccurate information can be attributed to the department's reporting form.*  


Some part of the responsibility for the incomplete and inaccurate information submitted by the agencies can be attributed to the reporting form the department used to collect both financial information and the July 1, 1994, excess surplus calculations. The first part of the form asked for information regarding the status and use of the low- and moderate-income housing funds. The second part contained the excess surplus calculation. Some agencies calculated excess surplus using the fund balance identified in the first part of the form. However, the fund balance from part one did not include amounts that were only designated to projects but not committed to enforceable contracts or agreements. Agencies usually designate funds for a project upon governing board approval and appropriate a portion of fund balance for the approved activity. The law states that amounts must be committed as a result of a legally enforceable contract or agreement before an agency may exclude them from the fund balance when calculating excess surplus. As a result, those agencies understated their fund balance and therefore understated their excess surplus balance. The department has since improved its form so that the fund balance agencies identify in the first part is the same fund balance they should use to calculate excess surplus.


Of the 18 agencies for which the department miscalculated excess surplus balances, 8 submitted blank or incomplete excess surplus calculations. For example, the El Cajon Redevelopment Agency (El Cajon) did not fill out the excess surplus calculation work sheet even though the \$8.5 million fund balance it reported indicated that it could have had an excess surplus balance. The department calculated El Cajon's excess surplus as \$6.2 million by comparing its reported fund balance to the previous four fiscal years' total tax increment revenue as reported by El Cajon in prior years. However, El Cajon did not report to the department that it had deposited the proceeds of bonds in its fund. Our recalculation, which excluded the bond proceeds from its fund balance, revealed that El Cajon did not have an excess surplus balance.

Five agencies provided no explanation for the fund balance they used to calculate their excess surplus. The City of Orange Redevelopment Agency (Orange), for example, reported an ending fund balance of \$8.9 million in the work sheets to report the status and use of the fund. However, in its work sheet to calculate excess surplus, Orange used an ending fund balance of \$4.4 million without explanation. In addition, the beginning fund balance Orange used in the status and use work sheet was

approximately \$2.3 million less than the ending fund balance it reported the prior fiscal year. According to its calculation, Orange did not have an excess surplus balance.

In contrast, the department used the ending fund balance reported by Orange from fiscal year 1992-93, along with revenue and expenditures information provided by Orange, to calculate an ending fund balance for fiscal year 1993-94 of \$12.5 million. From this, the department determined that Orange had accumulated an excess surplus as of July 1, 1994, of \$4.5 million. The ending fund balances are different, in part, because Orange incorrectly reported to the department that its fund balance contained bond proceeds of \$1.9 million when they actually totaled \$7.6 million. Because the department was not aware of the additional bond proceeds, it overstated Orange's fund balance and therefore its excess surplus.

In response to our request for additional information, Orange provided audited financial statements showing an ending fund balance of \$15 million. Using amounts from the audited financial statements and other records provided by the agency, we determined that Orange did not have an excess surplus balance for fiscal year 1993-94. The audited information the agency gave us differed from the revenues, expenditures, and fund balance amounts it provided to the department. Without the same information Orange gave us, the department could not have verified or correctly calculated the agency's excess surplus.

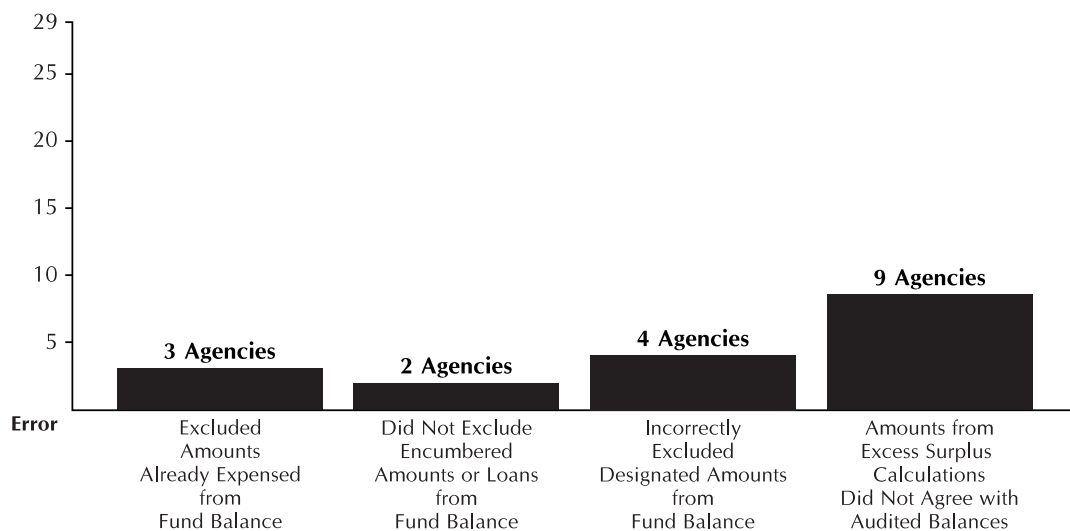
  
*Two agencies calculated their July 1, 1994, excess surplus balance using tax increment from the previous five fiscal years instead of four, thereby understating their excess surplus.*

Finally, in response to our survey, the redevelopment agencies for the cities of Tustin and El Cajon reported that they calculated their July 1, 1994, excess surplus by comparing their fund balance to the total tax increment revenue deposited in the fund during the previous five fiscal years. The El Cajon Redevelopment Agency reported that its financial consultant interpreted the law to mean that an agency should calculate excess surplus as of July 1, 1994, in this manner. However, the Health and Safety Code states that agencies should use the total tax increment from the previous four years. The code also states, "The first fiscal year to be included in this computation is the 1989-90 fiscal year, and the first date on which an excess surplus may exist is July 1, 1994." Based on the plain language of the law, we believe El Cajon's consultant misinterpreted the requirement. In response to our survey questionnaire, the two agencies reported that they still calculate their excess surplus balance using tax increment from the previous five fiscal years. By using five years rather than four, agencies will understate their excess surplus.

***Other Agencies Also Reported Incorrect Methods For Calculating Excess Surplus***

In addition to the 21 agencies with reported excess surplus balances over \$500,000, we surveyed 32 other agencies throughout the State to determine how they performed their excess surplus calculations. Of the 29 agencies that responded to our survey, 9 reported current methods that incorrectly identified the fund balance used to calculate excess surplus. As shown in Figure 4, similar to the 21 agencies we reviewed, these 9 committed errors in determining their fund balance because of the way they treated loans receivable, encumbrances, and amounts designated to housing projects but not committed as a result of contracts or agreements. Some of these agencies also committed more than one type of error.

***Figure 4***  
***Errors Made by 29 Redevelopment Agencies***  
***in Their Calculations of the July 1, 1994, Excess Surplus***



Because many agencies apparently misunderstand or have misinterpreted provisions, much of the data provided to the department is erroneous. Therefore, when the department recalculates excess surplus balances without verifying the accuracy of the information provided, it develops unreliable statewide information for its annual report.

***Some Agencies Do Not Use the Correct Amount of Tax Increment Revenue To Calculate Excess Surplus***

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Some agencies do not use the total amount of tax increment allocated to their low- and moderate-income housing fund when calculating excess surplus. These agencies first deducted debt-service payments or administrative fees charged by their county for collecting the taxes from the allocated tax increment and recorded the balance as revenue in their funds. As a result, when they compare recorded tax increment revenues to their fund balance they may overstate their excess surplus balance. For example, using this method the Redevelopment Agency of the City of Fremont underreported the tax increment revenue in its fund by approximately \$560,000 for fiscal years 1989-90 through 1993-94. Similarly, we found that the Poway Redevelopment Agency underreported its tax increment revenue by approximately \$125,000 for fiscal years 1992-93 through 1995-96 because it also recorded tax increment revenue after deducting administrative costs charged by the county.

***Interpretations of Vague Legal Requirements Result in Inconsistent Excess Surplus Calculations***

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◆  
*Excess surplus calculations can indicate whether agencies are accumulating rather than spending affordable housing funds.*

The law provides only vague instructions for calculating excess surplus. As a result, agencies are inconsistently reporting the availability of low- and moderate-income housing funds. As already mentioned, the law states that agencies should not count the proceeds from bonds or other debt when calculating excess surplus if tax increment revenue set-aside for low- and moderate-income housing is used to secure the debt. However, the law does not specify whether agencies should adjust fund balances using the unspent portion of proceeds or all of the proceeds deposited in the funds. Further, the law states that agencies should perform the excess surplus calculation as if the bonds or other debt had not been sold or incurred and the tax increment revenue used to pay the obligations deposited in the fund, but it is silent as to how agencies should treat income and expenditures related to the proceeds.


Redevelopment agencies interpret differently the required treatment of the debt proceeds when calculating excess surplus. These various interpretations produce very different results, reducing the reliability of excess surplus as a measurement of the amount of available housing funds statewide. Further, the lack of reliable reporting hinders the State's ability to assure that



all agencies comply with its policy to promptly use tax increment funds to provide affordable housing for low- and moderate-income households.


The excess surplus calculation produces an indicator of the status of tax increment funds in each agency's low- and moderate-income housing fund. The department compiles these calculations into a report that provides information on the extent of funds for affordable housing that agencies are accumulating rather than spending. However, under current law, the indicator is based only on the tax increment revenue and related earnings deposited in the funds, which is then reduced by expenditures and encumbrances. Many agencies use future tax increment revenue as security for bonds or other debt. However, depending upon their interpretation of the law, some agencies exclude all funds related to bond proceeds and any related earnings from their excess surplus calculations, while other agencies exclude only the unspent portion of the proceeds.

Depending on the amount of proceeds from bonds or other debt deposited and remaining in their funds, the way agencies treat these proceeds can affect fund balances very differently and result in inconsistent calculations of excess surplus. An agency with a fund balance greater than the amount of unspent bond proceeds could potentially report an excess surplus if it calculated the balance using only the unspent portion of the proceeds, while the same agency would not report an excess surplus if it used the total amount of proceeds deposited in the fund in its calculation.


  
*We found the most significant factor in miscalculating excess surplus was the agencies' treatment of bond proceeds.*

We asked the 21 agencies with reported fiscal year 1993-94 excess surplus balances greater than \$500,000 to support their calculations. As stated earlier, 18 of these agencies' balances were not correctly calculated by either the agencies or the department. The most significant factor in miscalculating excess surplus was the agencies' treatment of the proceeds of bonds or other debt deposited in their respective funds. For example, 8 agencies that we determined did not have excess surplus balances had deposited debt proceeds in their funds but had not reduced their fund balance by the amount of those proceeds as required by law. Approximately \$28 million of the \$46 million excess surplus reported for these 21 agencies as of June 30, 1995, is eliminated when the proceeds of bonds or other debt is excluded from the fund balances.

We also found that 12 of the 21 agencies do not currently treat debt proceeds the same way when they calculate excess surplus. Some of these agencies assert their methods are correct by using interpretations of the requirement provided by



*Twelve of 21 agencies surveyed treat debt proceeds differently when making excess surplus calculations.*



their respective legal counsels and financial consultants. The 12 agencies reported that they treat the proceeds of bonds or other debt in one of four ways when calculating excess surplus:

- Thirty-three percent reduce the fund balance used to calculate excess surplus by the unspent portion of the debt proceeds remaining in the fund, following the manner the department believes correct;
- Twenty-five percent reduce the fund balance used to calculate excess surplus by the total amount of the debt proceeds deposited in the fund;
- Seventeen percent do not reduce the fund balance used to calculate excess surplus by debt proceeds deposited in the fund; and
- Twenty-five percent reported they account for the debt proceeds and the tax increment set-aside for low- and moderate-income housing in separate funds and calculate excess surplus using only the fund with the tax increment revenue.

Similarly, 8 of the 29 agencies that responded to our survey also reported different interpretations of the requirement to exclude the proceeds of debt from their fund balance when calculating excess surplus. For example, one agency accounted for its tax increment and bond proceeds in the same fund. It therefore developed a hypothetical fund balance to determine excess surplus. By eliminating bond proceeds and related interest earnings, it attempted to isolate the fund balance attributable to tax increment revenue and related interest earnings used in its calculations. However, we could not verify the fund balance because we could not determine whether the agency appropriately allocated expenditures to bond proceeds and tax increment revenue.

Because agencies do not fully disclose the treatment of bonds in the financial information they report, the department cannot distinguish whether the bond proceeds represent the unspent portion or the total proceeds. As a result, although it appears to comply with law, the information agencies report to the department does not always represent a true indicator of the status of the funds, or the tax increment revenue and debt proceeds available for affordable housing.

Although the law is not clear, the department believes it requires agencies to adjust their fund balance using the unspent portion of bond proceeds to calculate excess surplus. The California Office of Legislative Counsel agrees with the department's interpretation of the requirement. However, of the 12 agencies with bond proceeds in their fund balances, only 33 percent stated they performed their excess surplus calculation in a manner that conforms with the department and the Legislature's legal counsel. Without complete information regarding excess surplus balances and bond proceeds, the calculations do not provide a reliable indicator of the level of available tax increment housing funds and the State cannot measure the effectiveness of its policies regarding the prompt use of tax increment funds to provide affordable housing.

### ***Conclusion***

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Most of the excess surplus balances reported in the low- and moderate-income housing funds of the State's community redevelopment agencies were incorrectly calculated. Of the 21 agencies with reported excess surplus balances greater than \$500,000, 17 balances were overstated and 1 was understated as a result of inaccurate and incomplete calculations provided by the agencies. Because the financial information provided to the department is inconsistent and unreliable, the department overstated some balances when it recalculated them in an attempt to compensate for the agencies' errors and omissions. The department reported that balances for the 21 agencies totaled \$46 million. However, we determined that only 12 of the 21 agencies actually had excess balances in their funds, for a total of \$13.7 million, most of which was appropriately reduced by January 1, 1997. Our survey revealed that 9 of the additional 29 agencies responding also calculated excess surplus incorrectly. Further, redevelopment agencies throughout the State interpret the law differently, resulting in disparate calculations of excess surplus balances. Because the department relies on the agencies' calculations to compile statewide information, the State does not have reliable information to measure agencies' compliance with the State's policy to promptly use these funds to provide affordable housing for low- and moderate-income households.

## ***Recommendations***

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To improve the reliability of the excess surplus balances reported by redevelopment agencies, the Legislature should clarify its intent for the treatment of the proceeds of bonds and other debt deposited in agencies' low- and moderate-income housing funds when calculating excess surplus and amend the law to provide complete and specific requirements to the agencies. For example, if the Legislature intends for agencies to compute the excess fund balance attributable to unspent tax increment revenues and related income and reduce their fund balances using only the unspent portion of the proceeds, as the department and the California Office of Legislative Counsel interpret the current requirement, the law should be amended to state: "the unspent portion of the proceeds of the bonds or other indebtedness shall be excluded from the unspent or unencumbered amount in an agency's low- and moderate-income housing fund when determining whether an excess surplus exists." In addition, the law should instruct agencies as to the treatment of income or expenditures related to the proceeds.

After the law regarding the calculation of excess surplus is clarified, the State Controller's Office and the Department of Housing and Community Development should consider taking steps to further educate the agencies on the law's intent and requirements.

To improve the quality of information provided by community redevelopment agencies to departments responsible for compiling statewide reports, the Legislature should consider amending the California Government Code, Section 53895, which imposes fines on agencies that do not file reports, to also include penalties for agencies that submit deficient or noncompliant reports.

The Legislature should consider amending Section 33080.1 of the Health and Safety Code to require the calculation for excess surplus low- and moderate-income housing funds to be included in the agencies' audit report and to be covered under the independent auditor's opinion on compliance with the laws and regulations that govern redevelopment activities.

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# *Chapter 2*

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## *Current Oversight of Redevelopment Activities Does Not Ensure Compliance With Statewide Requirements*

### *Chapter Summary*

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Current law requires community redevelopment agencies to provide reports to the State Controller's Office (SCO) and the Department of Housing and Community Development (department). But the law does not provide oversight of redevelopment by an agency with the authority to enforce compliance with statewide requirements for low- and moderate-income housing activities. Oversight is provided primarily by the legislative bodies of communities conducting redevelopment activities and independent auditors who review their financial statements and compliance. As a result, compliance with statewide policies on community redevelopment depends on the local legislative bodies' interpretations of the legal and regulatory requirements.



Seven of the 51 redevelopment agencies we reviewed do not comply with state laws and regulations. For example, some agencies do not ensure that their low- and moderate-income housing funds receive all the mandated revenue. We also noted that one agency needs to improve its procedures to ensure that planning and administrative costs paid by its fund are necessary for, and directly related to, the production, improvement, or preservation of low- and moderate-income housing. Moreover, another agency did not follow the requirements of the law when spending low- and moderate-income housing funds outside its territorial jurisdiction.

We also noted that while the SCO has issued guidelines for compliance audits of California redevelopment agencies, the guidelines do not contain sufficient audit procedures to determine whether agencies use redevelopment funds to provide affordable housing according to state policies.

### ***Redevelopment Activity Is Not Overseen on a Statewide Level***

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Current law gives no state agency the authority to enforce compliance with statewide policy regarding low- and moderate-income housing activities. The Legislature defined state policy by declaring that decent housing and genuine employment opportunities for all residents are vital to the State's future peace and prosperity. The Legislature further declared that expanding the supply of low- and moderate-income housing is a fundamental purpose of redevelopment. The law and regulations governing redevelopment activities contain the requirements to ensure that redevelopment agencies meet the State's objectives. While the law requires redevelopment agencies to submit financial and compliance audit reports to the SCO, it does not mandate that the SCO review the reports. Further, the law delegates the responsibility to take corrective action on reported instances of noncompliance to the legislative bodies of the communities. Similarly, while the department has statutory authority to examine the records of housing authorities and redevelopment agencies, that statute does not give it the authority to enforce compliance with the legal or regulatory requirements for the production, improvement, or preservation of housing affordable to low- and moderate-income households.

  
*Lack of statewide oversight has contributed to agencies' misinterpretation of, and noncompliance with, state requirements.*  



Oversight of redevelopment activities is currently provided primarily by community legislative bodies, independent auditors who perform financial and compliance audits of redevelopment agencies, and by community members who take legal actions. As a result, individual redevelopment agency compliance with state policies depends on local legislative bodies' interpretations of the legal and regulatory requirements and financial and legal interpretations from the consultants who advise them. However, the lack of oversight by an agency with the authority to enforce compliance with state laws and regulations has contributed to misinterpretation and noncompliance with statewide requirements.

### ***Not All Agencies Set Aside Mandated Revenues for Low- and Moderate-Income Housing***


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We found that 3 of 51 redevelopment agencies failed to ensure that mandated funds were made available for affordable housing.

The Health and Safety Code, Sections 33334.2 and 33334.6, requires that a redevelopment agency set aside 20 percent of its tax increment revenue to produce, improve, or preserve housing that is affordable to low- and moderate-income households in the community. Prior to 1993, some counties deducted amounts they paid to other entities as a result of voluntary agreements to share the tax increment revenue, known as pass-through payments, before paying the tax increment revenue to the redevelopment agencies. As a result, some agencies calculated the set-aside using the net revenue paid to them rather than the gross revenue allocated by the county. In 1993, the Attorney General's Office opined that an agency should calculate the set-aside using the gross tax increment revenue. While most of the agencies we reviewed currently calculate the set-aside in accordance with the law, two have not ensured that their funds received all the tax increment they were entitled to in the past.



*While most agencies reviewed correctly calculated set-asides, two have not ensured that their funds received all of the tax increment revenue they were entitled to.*



For example, in response to our survey, the City of Hollister Redevelopment Agency (Hollister) reported that its low- and moderate-income housing fund has not received all of the tax increment revenue due to it in the past. Prior to the attorney general's 1993 opinion, Hollister calculated the 20 percent set-aside using the tax increment revenue after pass-through payments to other entities had been deducted. According to the city manager, during the four-year period beginning with fiscal year 1993-94, Hollister has repaid approximately \$480,000 to its fund and intends to repay all of the underallocation. However, the city manager further stated the city has not gathered all of the information necessary to confidently predict the total amount underallocated to the fund during the period prior to fiscal year 1993-94. As a result, we cannot predict when the city will complete the repayment.

Similarly, the City of Loma Linda Redevelopment Agency (Loma Linda) has a liability to pay its fund 20 percent of the difference between the gross and net tax increment revenue it received as of fiscal year 1993-94. However, Loma Linda reported that it has not been able to obtain from the county information necessary to reconcile the net tax increment revenue the agency has received and the pass-through payment amounts to the gross tax increment allocated to the agency. As a result, Loma Linda responded that it had not been able to determine the additional tax increment the agency's project areas owed to the fund. Under current law, county auditors are not required to provide gross property tax allocations and deductions to redevelopment agencies. Upon completion of our field work, however, Loma Linda presented evidence that it



has provided the full tax increment set-aside to its fund up to fiscal year 1994-95, and is taking steps to provide full set-aside for fiscal years 1995-96 and 1996-97.

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*State law specifies that interest or income earned on tax increment set-asides must be deposited into the fund and used for allowable purposes only.*  
—◆—

The Health and Safety Code, Section 33334.3, states that any interest or other income earned by tax increment set-aside for low- and moderate-income housing must be deposited in the fund and may only be used for allowable purposes described in the code. However, the Poway Redevelopment Agency (Poway) did not ensure that its fund received its share of interest income totaling \$32,949 earned by property tax collections before the county auditor allocated the taxes to the agency. For the five years we examined, rather than diverting 20 percent of interest income allocated by the county auditor into the fund, the agency deposited all of the interest into its debt-service fund. Using the agency's rate of return on investments from the investment pool in which it deposits its surplus funds, we determined that the fund lost additional interest earnings, totaling \$3,969, because the money was not available to the fund. The agency stated that it considered the interest income from the taxes a separate source of revenue from the tax increment revenue and did not allocate 20 percent of the interest income to the fund. As a result, Poway failed to make almost \$37,000 available for low- and moderate-income housing.



Poway also failed to compensate its fund for the loss of interest earnings on funds mistakenly used to pay bond debt. During fiscal years 1993-94 through 1995-96, the agency incorrectly calculated the fund's share of debt-service payments. For the three years, the fund overpaid its share of the debt by approximately \$149,000. In January 1996, the agency corrected the calculation errors and repaid the fund. However, Poway did not calculate and compensate the fund for lost interest earnings of \$6,900. The agency stated that it did not consider interest obligations at the time it corrected the debt-service calculations.

***Agencies Need To Ensure Only  
Appropriate Costs are Charged  
to the Low- and Moderate-Income  
Housing Fund***

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We found that some redevelopment agencies need to improve their controls to ensure that low- and moderate-income housing funds are spent according to the legal requirements. The Health and Safety Code, Section 33334.3, specifies that planning and administrative costs charged to the fund must be

necessary for the production, improvement, or preservation of low- and moderate-income housing and must be directly related to the programs and activities authorized by law.

  
*The law specifies that only planning and administrative costs necessary for the production, improvement, or preservation of low-income housing can be charged to the funds.*  



The Redevelopment Agency of the City of Fremont has not developed or implemented adequate procedures to ensure that its allocations of planning and administrative costs shared between the city and the agency meet the restrictions of the law. For example, employees' time spent on housing activities is charged to the fund using percentages developed during the budget process rather than actual time worked. However, according to the city finance director, during the budget process, the city housing office develops the allocation percentages using estimates of the amount of time that city housing office employees will work on low- and moderate-income housing activities based on experience and judgment and the amount of housing activity projected for the budget year. City housing office employees do not maintain records to differentiate the amount of time they work on low- and moderate-income housing activities as opposed to other activities. As a result, the city does not have the information necessary to charge the fund only for the costs of low- and moderate-income housing activities.

Using this process to allocate the costs of employees' salaries and benefits, at June 30, 1996, the city transferred \$25,000 in salary and benefits costs of the city housing development specialist to the fund. According to the housing office director, the city transferred the costs from the city's Community Development Block Grant (CDBG) program to make CDBG funds available to pay for consulting services. According to the housing office director, a portion of the costs of the housing development specialist could be moved to the fund because the housing development specialist had assumed some of the responsibilities of the housing manager position that was vacant during the year.


The housing development specialist estimated that he had spent approximately 30 percent of his time on low- and moderate-income housing activities during the year, and the \$25,000 amount transferred represented approximately 30 percent of his costs for fiscal year 1995-96. However, the housing development specialist allocated his time based on his recollection of the projects he had worked on during the year rather than actual hours worked on low- and moderate-income housing activities. Because it does not require employees to track the time they work on low- and moderate-income housing activities, the city cannot be certain that it charges to the fund only employee costs used to provide affordable housing, and

that the tax increment deposited in its fund is used, to the maximum extent possible, to defray the costs of low- and moderate-income housing activities in the community.

The Culver City Redevelopment Agency reported that it used \$750,000 in low- and moderate-income housing funds to pay a portion of the cost to rehabilitate a building that will be used to provide services and shelter for homeless veterans. These services include transitional and permanent housing, substance abuse programs, and job counseling. According to the agency's agreement with the nonprofit entity providing the services, the \$750,000 will be used to pay part of the cost to rehabilitate the building and guarantee that 23 beds at the facility are available for Culver City's homeless veterans. However, the rehabilitated building is outside Culver City at the Department of Veterans Affairs Medical Center in West Los Angeles. Because the law defines the territorial jurisdiction of a city redevelopment agency as the territory within the city limits, the agency expended its low- and moderate-income housing funds to rehabilitate a building outside the agency's territorial jurisdiction.



*Using its interpretation of the law, one redevelopment agency spent \$750,000 outside its territorial jurisdiction without following strict legal requirements.*



The Health and Safety Code, Section 33334.3, requires that money in the low- and moderate-income housing fund be used to increase, improve, or preserve the supply of low- and moderate-income housing within the territorial jurisdiction of the redevelopment agency. Section 33334.17 of the Health and Safety Code allows an agency to use its low- and moderate-income housing funds outside its territorial jurisdiction by transferring funds to another adjacent or nearby agency if the agencies meet the 23 conditions in the law. One condition is that the receiving community must develop more dwelling units than the donor community would have developed with the funds. Further, other conditions restrict the use of such funds, address the eligibility requirements for agencies desiring to transfer housing funds to other communities, require that the department review the agreement for the transfer, and conduct public hearings to solicit comments on the transfer of funds.

The agency provided \$750,000 of its affordable housing funds to a nonprofit organization that operates the facility located outside its city limits. Instead of meeting the conditions contained in Section 33334.17, the agency provided the funds based on the much less restrictive provisions contained in Section 33334.2, which allows for spending housing funds outside a project area but within the agency's territorial jurisdiction. The agency based this use of funds on a finding by the agency's governing board that the expenditures were a benefit to the project area that generated them.


Even though the facility is outside the agency's boundaries, the agency's legal counsel says the project includes an enforceable and specific reservation of housing for Culver City homeless veterans and thus the project clearly expands the Culver City community's supply of affordable housing in compliance with the Health & Safety Code, Section 33334.2. The agency's counsel further stated that while Section 33334.17 contains provisions for expenditure of housing funds outside the territorial boundaries of a city, it has never been used by any city (including Culver City in this case) because of the infeasible conditions required by the section. According to the agency's counsel, Section 33334.17 does not state that it is the exhaustive authority for such expenditures, and in this case, as shown above, alternative legal authority exists.

However, we believe the agency's legal counsel misinterpreted these provisions because this facility is not within the agency's boundaries and failed to meet the requirements of the governing sections of the law. Section 33334.17 provides the exception to the requirement of Section 33334.3 to spend low- and moderate-income housing funds within the territorial jurisdiction of the agency. Because Section 33334.17 does not provide for an alternative method for transferring low- and moderate-income funds from one community to another, it is the sole statewide authority for using low- and moderate-income housing funds outside the agency's territorial jurisdiction.

***Some Agencies Do Not Have  
Adequate Controls Over  
Assets and Accounting Records***

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We found that not all agencies maintained adequate internal accounting controls to protect the assets of their funds and to ensure that revenues and expenditures are accurately recorded. For example, two agencies did not enter receivables in their funds' accounting records for loans made from the funds. In addition, as of June 30, 1996, one agency had not established a separate fund to account for the tax increment set-aside for low- and moderate-income housing, as required by law. Because of a lack of adequate accounting controls, the agencies have lost some assurance that they can track their funds' assets and report the financial information required by law.

  
*Because it did not record receivables for loans, one city cannot be assured that any amounts repaid will return to the low-income housing fund.*


The Redevelopment Agency of the City of Fremont did not record receivables for loans it provided to nonprofit developers and advances to the City of Fremont for loans made by the city totaling \$3.7 million. In addition, the agency did not accrue interest earned from the loans made from the fund. The agency

has provided low-interest loans, with repayment terms ranging from 30 to 42 years, to nonprofit developers of low- and moderate-income housing as part of its housing program.

According to the loan agreements, the borrowers are required to make annual repayments when their cash flow exceeds operating expenses and all other debt payments associated with the developments. The loan agreements also require the borrowers to make a final payment at the end of the loan term. However, the agency did not record the loans in its accounting records. State law requires that any interest earned and any repayments or other income from loans be accrued to, and deposited in, the low- and moderate-income housing fund and only be used for purposes prescribed for the fund. Because the agency has not recorded the loans or the associated interest income in its accounting records, it cannot assure that any amounts paid by the borrowers will be deposited in the fund as required by law.



*Because the agency does not monitor borrowers' ability to repay loans, it is not assured that payments, when available, will be forthcoming.*



We also found that the agency does not monitor the developers' ability to make the repayments. Only three of the six loan agreements we reviewed required the developer to submit the necessary financial documents that would allow the agency to determine whether the developer should have made an annual repayment. The terms of the loan agreements require the developers to make repayments when they have cash in excess of operating expenses and other debt payments associated with the developments. According to the agency, it inadvertently overlooked the monitoring of financial repayment capabilities because of staff turnover. Because it does not receive and review financial information regarding the operation of the developments, the agency cannot know whether the developers are complying with the terms of the agreements for repaying the loans.

We further noted two of the loans were provided by the City of Fremont with the agency advancing the funds from low- and moderate-income housing funds. However, the agency and the city did not execute agreements requiring that the city transfer repayments from the developer to the fund. Because the agency does not monitor the borrowers' ability to repay the loans and has not executed agreements with the city for repayment of the advances to the fund, it cannot ensure payment of loans, when available, will be forthcoming from the developers and appropriately deposited in the fund for future use. When we brought these conditions to the agency's attention, it responded that it would record the loans and accrued interest in the fund and develop procedures to monitor outstanding loans.

Additionally, the Tustin Community Redevelopment Agency (Tustin) reported that it has not recorded receivables totaling \$30,000 for rehabilitation loans it made to owner-occupied and rental units for low- and moderate-income residents. According to Tustin, some of the balances are forgivable, and it considered the amounts immaterial. Tustin reported that it records the loan obligations against the properties with the county recorder's office. While the absence of the receivables in the agency's accounting records is mitigated by the liens recorded against the properties, recording the loans with the county recorder's office will not necessarily ensure that any available repayments are appropriately deposited in the housing fund.

◆  
*One redevelopment agency failed to establish a separate low- and moderate-income housing fund as required by law.*

In response to our survey, the City of Inglewood Redevelopment Agency (Inglewood) reported that as of June 30, 1996, it had not established a separate fund to account for tax increment revenue set-aside for low- and moderate-income housing as required by law. Instead, it accounts for these funds in the various capital projects funds it administers. Inglewood reports the status of the set-aside funds as reserves of the balances of those capital projects funds. While state law requires that an agency hold set-aside tax increment in a separate low- and moderate-income housing fund until used, Inglewood's independent auditor did not include the agency's failure to establish a separate fund in the auditor's compliance report for fiscal year 1993-94. Holding set-asides in a separate fund provides a higher level of accountability. The independent auditor's compliance report accompanying the fiscal year 1995-96 financial statements indicated that Inglewood anticipated establishing a separate fund for the low- and moderate-income housing funds during the 1996-97 fiscal year. However, because Inglewood had not issued its fiscal year 1996-97 audit reports at the time of our review, we could not verify that it had established a separate fund for the set-asides.

***Nonprofit Corporations Offer Exemptions to Legal Requirements Regarding Low- and Moderate-Income Housing Programs***

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In 1992, the City of Montebello Redevelopment Agency formed a nonprofit corporation, the Montebello Housing Development Corporation, to administer low- and moderate-income housing activities paid by its fund. Employees of the City of Montebello perform all activities associated with the housing programs, and the agency oversees the corporation by approving its budgets. However, in a November 1992 report, the agency described

one of the benefits of having a nonprofit corporation administer housing programs as possible exemption from some legal requirements that would apply to a government agency if it carried out those activities. The possible exemptions listed in the report include public meeting laws, acquisition and relocation requirements, and public bidding and prevailing wage requirements. While nothing came to our attention to indicate that the agency was using the corporation to circumvent the laws and regulations governing redevelopment activities, it appears that using a nonprofit corporation to conduct low- and moderate-income housing activities paid by the fund could provide the opportunity for circumvention. In addition, our review of the law did not reveal a specific requirement that a nonprofit corporation that receives low- and moderate-income housing funds is required to comply with the same laws and regulations as the agency that provides the funds.

***Audit Guidelines Do Not Provide Adequate Assurance That Agencies Follow Requirements for Low- and Moderate-Income Housing Programs***

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*SCO guidelines do not contain sufficient procedures for auditors to determine whether agencies comply with requirements for spending or accumulating tax increment revenue earmarked for housing programs.*  
—◆—


The Health and Safety Code, Section 33080.1, states that redevelopment agencies must have an annual audit that results in an opinion on each agency's financial statements and its compliance with the laws and regulations governing community redevelopment activities. The SCO has developed guidelines to aid the auditors in performing these audits. However, the guidelines do not currently contain sufficient audit procedures to determine whether agencies comply with requirements regarding the set-aside, spending, or accumulation of tax increment revenue for low- and moderate-income housing.

For example, the audit guidelines do not require that auditors test expenditures to determine whether agencies use their low- and moderate-income housing funds only for purposes allowed by the law. In addition, the guidelines do not require auditors to determine whether agencies restrict their spending of low- and moderate-income housing funds for planning and administration to those costs necessary for and directly related to affordable housing in the community. Rather, the guidelines contain limited audit procedures to determine compliance with expenditures for specific nonhousing purposes, including the redevelopment or resale of acquired real property, public buildings or facilities, hazardous substance-release cleanup, and full payments to the Educational Revenue Augmentation Fund.

While the guidelines include some requirements to determine whether agencies set aside gross tax increment revenue for affordable housing and eliminate excess surplus balances in the low- and moderate-income housing fund, they are not adequately explained to assist the auditor in designing tests to determine compliance. For example, the guidelines do not specify the treatment of debt service or pass-through payments when determining the set-asides, nor do they adequately explain the complexities in calculating excess surplus. In addition, the guidelines state the compliance requirements but do not include audit objectives relating to these requirements, nor do they contain suggested procedures to assist the auditor in achieving the audit objectives.

The SCO audit guidelines state that they have been prepared to assist public accountants in developing an audit program that will allow the auditor to render an opinion on redevelopment agency's compliance with the laws, regulations, and administrative requirements governing its activities. However, the guidelines do not contain the necessary audit procedures to provide sufficient evidence to support such an opinion.

In addition, the SCO does not provide sufficient guidance to auditors regarding the required opinion on an agency's compliance with laws and regulations. Specifically, the sample compliance report for audits performed under Government Auditing Standards that is included in the guidelines does not contain an auditor's opinion on compliance as required by the law. The sample report is based on an audit meant to obtain reasonable assurance about whether an agency's financial statements are free of material misstatement. The audit work required to support such a report allows for a less detailed review than the audit work required to support an opinion on compliance with specific requirements. As a result, the SCO has not made clear the auditor's responsibility regarding compliance audits of redevelopment agencies. We found that 40 of the 49 compliance reports we reviewed did not contain an opinion on the agency's compliance with legal, regulatory, and administrative requirements.



*The SCO's task force has completed its project to improve redevelopment audits and plans to issue revised guidelines by April 30, 1998.*

The SCO says it is currently revising its guidelines. It has completed its task force work to obtain input for improving redevelopment agency audits and plans to issue revised guidelines by April 30, 1998. The SCO is working with the department to include audit procedures to review critical compliance items for low- and moderate-income housing.



## ***Conclusion***

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Currently, oversight of community redevelopment efforts to provide affordable housing is done primarily by the legislative bodies of the communities that conduct redevelopment activities. While the law requires that redevelopment agencies report financial transactions and housing production activity to the SCO and the department, it does not provide for oversight by a state agency with the authority to enforce compliance with statewide requirements for using redevelopment funds.

We found that agencies do not always comply with the requirements of the law to ensure that low- and moderate-income housing funds receive all of the required tax increment revenue and other income, or that the funds are only charged with costs in accordance with the law. In addition, because some agencies do not record as receivables low- and moderate-income housing funds they have loaned for housing programs, they cannot ensure repayment of loans or interest will be deposited in their funds. Finally, audit guidelines developed by the SCO are not adequate to determine whether agencies comply with the critical requirements regarding the setting-aside, spending, or accumulating of tax increment revenue for low- and moderate-income housing.

## ***Recommendations***

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The Legislature should determine the extent of monitoring necessary to ensure satisfactory compliance with the policies of the State concerning the production, improvement, and preservation of low- and moderate-income housing through community redevelopment efforts, up to and including designating a state agency to provide effective oversight, and provide the authority to enforce the laws and regulations.

The Legislature should amend the law to require county auditors to provide information to agencies regarding the gross tax increment allocated to them and payments to other taxing entities deducted from the allocated taxes.

To ensure that all low- and moderate-income housing activities are conducted in accordance with state policy, the Legislature should consider amending the Health and Safety Code to specify that any entity that receives low- and moderate-income housing funds, such as a nonprofit corporation, must follow the legal, regulatory, and administrative requirements that apply to the agency that provided the funds.

The State Controller's Office should revise its *Guidelines For Compliance Audits of California Redevelopment Agencies* to include the critical tests and other audit procedures needed to determine whether a redevelopment agency complies with state policies regarding the production, improvement, or preservation of housing affordable to low- and moderate-income households. The compliance guidelines should include the following:

- A description of the audit objectives;
- Recommended audit procedures;
- Sufficient explanatory language to aid the auditor in accomplishing the audit objectives and provide the evidence necessary to support the required auditor's opinion on the agency compliance with the laws and regulations that govern redevelopment activities; and
- A sample compliance audit report for audits performed in accordance with Government Auditing Standards that includes the auditor's opinion on the agency's compliance with the laws and regulations that govern redevelopment activities.

In addition to the other critical compliance requirements, the guidelines should also include the following:

- A review of deposits in, and expenditures from, an agency's fund to determine that they comply with the law;
- Procedures to determine whether an agency's expenditures for planning and administrative costs are limited to those costs that are necessary for, and directly related to, providing housing affordable to low- and moderate-income households; and
- Steps to verify the calculation of excess surplus in the funds using audited accounting records.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

A handwritten signature in black ink, reading "Kurt R. Sjoberg". The signature is written in a cursive style with a large, stylized initial "K".

KURT R. SJOBERG  
State Auditor

Date: March 11, 1998

Staff: Elaine Howle, CPA, Audit Principal  
Norm Calloway, CPA  
Claire Hur  
Tone Staten, CPA

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# Appendix A

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## *Current Methodology Reported by the Agencies To Calculate Excess Surplus*

Most of the agencies listed compare their unspent and unencumbered balance of the low- to moderate-income housing fund (fund) to the greater of \$1 million or the aggregate tax increment deposited into the fund for the four previous years. However, some agencies vary from the method required by the law to arrive at the fund balance used to calculate excess surplus. These variations are described below. Amounts described as designated are funds which are not encumbered through a legally enforceable contract but merely earmarked for a specific purpose.

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Agency	Current Methodology Used To Calculate Excess Surplus
1. Alameda	No variation.
2. Alhambra	No variation.
3. Anaheim	<b>The agency did not respond to our survey questionnaire.</b>
4. Arcadia	The agency has elected legal exception to setting aside tax increment and has no fund balance.
5. Avalon*	The agency reduces its fund balance by the total amount of bond proceeds deposited into the fund. However, the agency incorrectly deducts amounts that are designated for specific purposes from its fund balance when calculating excess surplus.
6. Cerritos	The agency has elected exception to setting aside tax increment up to fiscal year 1994-95 and had no fund balance at June 30, 1994.
7. Coachella*	The agency considers amounts encumbered when projects are approved by the legislative body even though the agency has not entered into legally enforceable contracts or agreements.
8. Commerce	For fiscal year 1993-94, the agency incorrectly reduced the fund balance by amounts designated for special purposes.
9. Compton	Before calculating excess surplus for fiscal year 1994-95 and 1995-96, the agency incorrectly increased its fund balance by the amount of excess surplus spent in the current year. Thus, the agency increased the available fund balance by \$138,155 in 1994-95 and by \$629,873 in 1995-96.

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\* We could not trace all fund amounts included in the calculation of fiscal year 1993-94 excess surplus to the audited financial statements provided by the agency. However, we substantially verified the agency's calculation of excess surplus using other financial information provided by the agency.

Agency	Current Methodology Used To Calculate Excess Surplus
10. Corona	For fiscal year 1993-94, the agency reduced the fund balance by accounts payable and accrued liabilities. This treatment reduces the fund balance twice because it was already reduced when the payables and liabilities were entered on the financial records.
11. Culver City	The agency adjusts its fund balance for the total proceeds from bonds. However, the agency did not provide information sufficient to determine its current methodology to calculate excess surplus.
12. El Cajon*	The agency reduces its fund balance by the unspent portion of bond proceeds remaining in the fund. It then incorrectly compares the fund balance to the total of the previous five years (instead of four years) of tax increment revenues.
13. Fontana	The agency reduces its fund balance by the unspent portion of bond proceeds remaining in the fund.
14. Foster City	The agency accounts for tax increment set-aside for low- and moderate-income housing and the proceeds of bonds secured by tax increment in separate funds.
15. Hemet	The agency did not deduct amounts for notes receivable from its fund balance when calculating excess surplus.
16. Hollister	The agency incorrectly reduces the fund balance by the amount of outstanding bond principal that is secured by low- and moderate-income housing tax increment revenue.
17. Indian Wells	For fiscal year 1993-94, the agency did not exclude \$390,188 for loans receivable when calculating excess surplus.
18. Indio	The agency reduces the fund balance by the total bond proceeds deposited in the fund but did not exclude loans receivable.
19. Inglewood	The agency adjusts its fund balances for the excess surplus calculation as though bond proceeds were never deposited to the fund.
20. Irwindale	<b>The agency did not respond to our survey questionnaire.</b>
21. La Quinta	The agency accounts for tax increment set-aside for low- and moderate-income housing and the proceeds of bonds secured by tax increment in separate funds. The agency reduced its fund balance by amounts designated for specific purposes, which is incorrect.
22. Lake Elsinore	The agency was exempt from the requirement to set aside 20 percent of its tax increment revenue for low- and moderate-income housing until fiscal year 1995-96. As a result, its fund had no balance until June 30, 1996.
23. Lancaster*	The agency reduces the fund balance by the unspent portion of bond proceeds remaining in the fund.
24. Loma Linda	No variation.

\* We could not trace all fund amounts included in the calculation of fiscal year 1993-94 excess surplus to the audited financial statements provided by the agency. However, we substantially verified the agency's calculation of excess surplus using other financial information provided by the agency.

Agency	Current Methodology Used To Calculate Excess Surplus
25. Lynwood	The agency reduces the fund balance by the unspent portion of bond proceeds remaining in the fund.
26. Madera	The agency accounts for tax increment set-aside for low- and moderate-income housing and the proceeds of bonds secured by tax increment in separate funds. However, the agency does not deduct amounts that are reserved for encumbrances from its fund balance when calculating excess surplus.
27. Montebello	The agency does not deduct amounts encumbered, loans receivable, or restricted deposits from its fund balance when calculating excess surplus.
28. Norwalk	The agency reduces its fund balance by the unspent portion of bond proceeds remaining in the fund and calculates excess surplus by following the reporting form provided by the department. However, the agency incorrectly deducts designated amounts from the fund balance when calculating excess surplus.
29. Oakland	The fiscal year 1993-94 financial statements provided by the agency did not separately present the accounts of the fund. As a result, we could not verify the agency's calculation of excess surplus using audited financial information.
30. Ontario*	The agency accounts for tax increment set-aside for low- and moderate-income housing and the proceeds of bonds secured by tax increment in separate funds.
31. Orange*	The agency reduces the fund balance using the unspent portion of bond proceeds and the related interest earnings. However, the agency does not exclude amounts for encumbrances and loans receivable in its fund balance when calculating excess surplus, which is incorrect.
32. Oxnard	The agency's response was incomplete and lacked the detail to determine how it calculates excess surplus for the fund.
33. Palm Springs	The agency reduces the fund balance using the unspent portion of bond proceeds remaining in the fund.
34. Pittsburg	The agency reported a fund deficit of \$4.6 million as of June 30, 1996.
35. Rancho Mirage	The agency calculates excess surplus by following the reporting form provided by the department. For fiscal year 1993-94, the agency incorrectly reduced the fund balance by \$5.96 million designated for housing construction and rehabilitation. The corrected calculation resulted in no excess surplus for fiscal year 1993-94.
36. Redondo Beach	No variation.
37. Richmond	<b>The agency did not respond to our survey questionnaire.</b>
38. San Juan Capistrano*	The agency accounts for tax increment set-aside for low- and moderate-income housing and the proceeds of bonds secured by tax increment in separate funds.
39. San Mateo	No variation.

\* We could not trace all fund amounts included in the calculation of fiscal year 1993-94 excess surplus to the audited financial statements provided by the agency. However, we substantially verified the agency's calculation of excess surplus using other financial information provided by the agency.

Agency	Current Methodology Used To Calculate Excess Surplus
40. San Ramon*	The agency accounts for tax increment set-aside for low- and moderate-income housing and the proceeds of bonds secured by tax increment in separate funds. However, the agency does not exclude amounts for loans receivable in its fund balance when calculating excess surplus, which is incorrect.
41. Santa Clara*	No variation.
42. Santa Cruz*	The agency reduces its fund by the unspent portion of bond proceeds remaining in the fund and then follows the excess surplus reporting form provided by the department.
43. Santee*	No variation.
44. Signal Hill	The agency reduces the fund balance using total bond proceeds deposited in the fund. For fiscal year 1993-94, the agency incorrectly reduced its fund balance by accounts payable and accrued liabilities, totaling \$13,599.
45. South San Francisco	No variation.
46. Stanton	For fiscal year 1993-94, the agency did not deduct \$124,170 for advances to other funds when calculating excess surplus, which is incorrect.
47. Temecula	No variation.
48. Torrance*	The agency incorrectly deducted \$419,850 in designated amounts from its fund balance in the fiscal year 1993-94 excess surplus calculation. The agency also deducted \$730,000 of encumbrances; however, this amount was not supported by its audited financial statements.
49. Tustin	The agency incorrectly deducts the previous five years (instead of four years) of tax increment revenues from the available fund balance to determine its excess surplus.
50. Vallejo*	In fiscal year 1993-94, the agency incorrectly reduced its fund balance by \$125,000 of designated amounts.
51. Walnut	The agency did not deduct encumbrances of \$23,308 from its fund balance when calculating the July 1, 1994, excess surplus. The agency did not spend the fiscal year 1993-94 excess surplus and in December 1996, it transferred the remaining excess surplus balance to the housing authority.
52. Yorba Linda	No variation.

\* We could not trace all fund amounts included in the calculation of fiscal year 1993-94 excess surplus to the audited financial statements provided by the agency. However, we substantially verified the agency's calculation of excess surplus using other financial information provided by the agency.

# Appendix B

## *The Department of Housing and Community Development and Auditor Calculations of Excess Surplus for Agencies With Reported Balances Greater Than \$500,000*

	Agency	Excess Surplus as of June 30, 1995		Explanation for Differences In Excess Surplus Calculations
		Department Calculation	Auditor Calculation	
1.	El Cajon	\$6,166,108	\$ 0	Because the agency did not complete the work sheet, the department determined the excess surplus balance by using tax increment revenues supplied by the agency in previous reports. We noted that unspent bond proceeds of \$7.86 million eliminated any excess surplus; however, the agency did not report these to the department.
2.	Culver City	4,878,001	0	When the agency did not complete the excess surplus calculation, the department reduced the fund balance by \$1 million and reported the remaining amount as excess surplus. However, the department used incomplete information because the agency did not report other amounts used to eliminate the excess surplus, such as \$5.3 million for the total amount of bond proceeds deposited to the housing fund in 1990, \$325,000 for land purchased, and the \$744,718 loans-receivable balance.
3.	Orange	4,486,879	0	The numbers reported by the agency were not supported by audited financial statements and did not compare to balances the agency reported in the previous year. The department substituted numbers from other sources for its excess surplus calculation but was limited by the partial amount of bond proceeds reported by the agency. Deducting \$7.62 million for unspent bond proceeds, \$689,000 for land sold at less than fair market value, and \$351,000 for encumbrances from the fund balance eliminated the excess surplus.
4.	Indian Wells	4,107,550	3,773,917	Except for a minor correction, the department agreed with the agency's reported excess surplus calculation; however, neither entity deducted the loan amount of \$390,188 reported by the agency. This lowered the excess surplus to \$3.77 million, all of which was spent in the next two fiscal years.



	Agency	Excess Surplus as of June 30, 1995		Explanation for Differences In Excess Surplus Calculations
		Department Calculation	Auditor Calculation	
5.	Indio	3,673,702	0	Because the agency did not complete the work sheet, the department deducted \$1 million from the fund balance and reported the remaining balance as excess surplus. However, the agency did not report the loans receivable or the total amount of bond proceeds deposited in the housing fund. Deducting \$422,973 for loans and \$4 million for total bond proceeds eliminated the excess surplus.
6.	Lynwood	3,045,372	0	Because the agency did not complete the excess surplus calculation, the department deducted \$1 million from the balance and reported the remaining amount as excess surplus. However, unspent bond proceeds and related interest of \$3.06 million, which the agency failed to report, eliminated the excess surplus balance.
7.	Redondo Beach	2,441,859	742,621	The agency initially reported incorrect tax increment revenues that it adjusted in a subsequent work sheet. Although the department attempted to revise the revenues on the first work sheet, it did not have adequate information on the fiscal year 1992-93 revenues. We calculated the excess surplus using the revenues revised by the agency and determined that it spent the excess surplus in the following fiscal year.
8.	Tustin	2,178,076	2,173,932	We could not determine why the department adjusted the agency's excess surplus by \$4,144. The agency spent or encumbered the excess surplus by January 1, 1997.
9.	Palm Springs	1,929,572	0	The agency did not explain the fund balance it used to calculate its excess surplus and deducted designated funds of \$2.23 million. The department recalculated the excess surplus by adding back the designated funds and using the documented fund balance. In the calculation reported to us, the agency did not deduct the designated funds; instead, it deducted unspent bond proceeds of \$3.15 million which eliminated the excess surplus.

Agency	Excess Surplus as of June 30, 1995		Explanation for Differences In Excess Surplus Calculations
	Department Calculation	Auditor Calculation	
10. San Ramon	1,840,487	0	Although the agency attached an explanation to its excess surplus reporting form using a hypothetical fund balance without bond proceeds, the explanation did not show any excess surplus calculation. Additionally, the agency deducted the entire fund balance as designated funds and did not complete the rest of the work sheet. With this information, the department subtracted \$1 million from the \$2.84 million fund balance and reported \$1.84 million as the excess surplus. We appropriately deducted \$618,971 for loans and \$1.7 million for unspent bond proceeds, which eliminated the excess surplus.
11. Santee	1,743,822	1,407,413	Because the agency did not explain the fund balance it used to calculate excess surplus, the department used the fund balance from the work sheet for its calculation. The department also used tax increment revenues reported by the agency in previous years to perform the calculation; however, the agency had incorrectly reported prior-years' revenues after deducting debt-service payments. We therefore revised the fund balance and the revenues in our calculation of excess surplus. All the surplus was spent by January 1, 1997.
12. Inglewood	1,576,995	1,576,995	The agency incorrectly reduced its fund balance by \$2.51 million in designated funds and used inaccurate revenue amounts when calculating the excess surplus. Applying information from agency reports, the department recalculated the surplus using correct revenue amounts and deducting bond proceeds. We agreed with the department's calculation and determined that the agency had spent or encumbered most of the excess by January 1, 1997. However, we could not determine whether Inglewood spent or encumbered a balance of \$15,175.
13. Avalon	1,575,532	0	Because the agency incorrectly reduced its fund balance by \$2.84 million in designated funds and did not complete the excess surplus work sheet, the department recalculated the amount using revenues reported by the agency in prior years. However, the department used incomplete information in its calculation because the agency did not report the amount of total bond proceeds deposited to its fund. When we factored total bond proceeds of \$3.58 million into the calculation, Avalon did not have an excess surplus balance.

	Agency	Excess Surplus as of June 30, 1995		Explanation for Differences In Excess Surplus Calculations
		Department Calculation	Auditor Calculation	
14.	Montebello	1,273,710	228,389	Because the agency reported its ending fund balance as its excess surplus, the department subtracted four years of tax increment revenues from the agency balance and reported the remaining amount as excess surplus. However, the department was unaware of deductions for loans receivable, encumbrances, and deposits totaling \$1.15 million, because the agency did not report them. The surplus was spent in the following fiscal year.
15.	Foster City	917,480	917,480	The agency used an undocumented fund balance to calculate its excess surplus which the department corrected. We agreed with the department's calculation. The agency's financial statements indicated the excess surplus was spent in the following fiscal year.
16.	Coachella	898,715	968,931	The agency used an unspent and unencumbered fund balance of zero to report it had no excess surplus. Because the agency did not demonstrate how the zero excess surplus was calculated, the department recalculated the excess surplus using the \$2.15 million fund balance the agency reported in an accompanying work sheet. Using balances from audited financial statements, we determined that the agency's excess surplus balance was \$70,216 higher than the department's calculation. According to the agency's audited financial statements, it spent the excess surplus in the following fiscal year.
17.	Commerce	801,160	360,070	The agency reported no excess surplus balance because it reduced its fund balance by designated funds totaling \$2.95 million. The department added in the designated funds and used tax increment revenues reported by the agency in prior years to calculate an excess surplus balance of \$801,160. However, the department used expenditure amounts that differed from those reported by the agency. When we used the expenditures from the agency's audited financial statements and the tax revenues supplied by the department, we calculated an excess surplus of \$360,070. The surplus was spent in the following fiscal year.
18.	Walnut	747,379	724,071	The department overstated the excess surplus because it did not deduct encumbrances of \$23,308 from the fund balance. The Walnut Improvement Agency did not spend its excess surplus, but during December 1996, it transferred its excess surplus to the Walnut Housing Authority.

		<b>Excess Surplus as of June 30, 1995</b>		
<b>Agency</b>	<b>Department Calculation</b>	<b>Auditor Calculation</b>	<b>Explanation for Differences In Excess Surplus Calculations</b>	
19. Fremont	658,143	310,192	The department agreed with the agency's calculation; however, our site visit to Fremont revealed that the agency was reporting its tax increment revenues after county administrative charges were deducted and after bond debt had been paid. These errors caused the agency and the department to report a larger excess surplus than actual. The agency spent the excess surplus in the following fiscal year.	
20. Madera	550,184	0	For fiscal year 1993-94, the agency changed its method of reporting its low- and moderate-income housing funds by excluding bond proceeds from the fund balance it reported on the work sheet. As a result, the beginning balance reported by the agency was over \$1 million lower than the ending fund balance it reported in the previous year. By substituting the previous year's ending amount into the calculation, the department incorrectly determined that the agency had an excess surplus balance. However, when we used only the balances in the tax increment set-aside fund, we calculated that the agency had no excess surplus.	
21. South San Francisco	539,231	539,231	We agreed with both the department's and the agency's calculation of the excess surplus and determined that the surplus was spent or used for housing loans in the next two fiscal years.	

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*Agency's response to the report provided as text only:*

STATE OF CALIFORNIA  
BUSINESS, TRANSPORTATION AND HOUSING AGENCY  
980 9th Street, Suite 2450  
Sacramento, 95814-2719  
(916) 323-5401  
FAX (916) 323-5402

DEAN R. DUNPHY  
Secretary

March 3, 1998

Kurt R. Sjoberg, State Auditor  
Bureau of State Audits  
660 "J" Street, Suite 300  
Sacramento, CA 95814

Re: Bureau of State Audits Report Number 97101

Dear Mr. Sjoberg:

I am forwarding the Department of Housing and Community Development's response to the audit report titled "Community Redevelopment Agencies: Surplus Balances in Lower Income Housing Funds Are Overstated, Suggesting a Need for More Statewide Oversight and Direction." I appreciate the opportunity to respond to the report.

If you have any questions, please let me know.

Sincerely,

DEAN R. DUNPHY  
Secretary

Alcoholic Beverage Control  
Department of State Banking  
Department of Corporations  
California Highway Patrol  
California Housing Finance Agency

Department of Housing &  
Community Development  
Department of Motor Vehicles  
Department of Real Estate

Office of Real Estate Appraisers  
Stephen P. Teale Data Center  
Office of Traffic Safety  
Department of Transportation (Caltrans)

## **Department of Housing and Community Development Response to Audit Recommendation**

The Department has been aware of the problems associated with the current excess surplus formula, and the need for corrective action, for some time. As you may know, one of the recommendations from the 1997 report from the Senate-sponsored task force on "Redevelopment Agencies Affordable Housing Reports" called for a re-examination of the intent, definition, and use of the excess surplus provision.

We also believe the statute should be revised to provide greater clarity. In addition, the formula should be revised (where possible) to correct or eliminate some of the opportunities for abuse (noted below). We also believe the statute should include a self-enforcing mechanism for enforcing compliance with the statutory penalties for any agencies that fail to spend or encumber excess surplus funds within the statutory time frame. Authorizing the County Auditor, in which the agency is located, to withhold further tax increment revenue until the conditions and financial penalties of the statute have been met is one option.

We support the notion of providing further education concerning this requirement. The Department currently participates in annual training events on the reporting requirements of the law (including the excess surplus provisions) sponsored by the California Redevelopment Association and is very much interested in expanding these efforts. We believe educational efforts should also be extended to the current reporting process. The recent modifications the State Controller's Office has made to its audit guidelines, and legislation introduced to require agencies to provide the Department with copies of the independent audits (see SB 488), are critical to this effort. The latter will enable the Department to verify much of the information that is reported on our agency questionnaires.

We are confident that the audited calculation of excess surplus funds performed by the Bureau was consistent with the methodology and assumptions used by the Department. It appears the Bureau's selection of agencies for audits was based upon agencies reported as having excess surplus funds in the Department's annual report.

We wish to point out that the Department's annual report is designed to track only those agencies determined to have excess funds, on the basis of the information they furnish. The report does not contain information on agencies that incorrectly report having excess surplus funds (which are subsequently corrected by the Department), or agencies that may inappropriately eliminate their excess surplus funds by overstating encumbered funds or the amount of debt proceeds in the fund balance.

While it is often possible for the Department to determine when an agency has calculated excess surplus funds incorrectly, we currently have no means for verifying whether agencies have inappropriately eliminated their excess surplus funds by overstating encumbrances or the amount of debt proceeds comprising the unencumbered balance.

The Department is concerned that the potential for agency error associated with overestimating encumbrances and debt proceeds is even more significant than the errors discovered by the Bureau with the agencies it selected for audits



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*Agency's response to the report provided as text only:*

WALNUT IMPROVEMENT AGENCY  
21201 La Puente Road  
Walnut, California 91789  
(909) 595-7543  
FAX (909) 595-6095

February 25, 1998

Kurt R. Sjoberg  
State Auditor  
660 J Street, Suite 300  
Sacramento, CA 95814

Dear Mr. Sjoberg:

The Walnut Improvement Agency is in receipt of that section of your draft report to the Joint Legislative Audit Committee which relates to our agency.

The Walnut Improvement Agency has reviewed this draft and does not contest the State Auditor's conclusion that we interpreted the deadline to be a different date.

Sincerely,

Jeffrey C. Parker  
Executive Director

JCP:wp

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*Agency's response to the report provided as text only:*

CITY OF EL CAJON  
City Manager  
200 East Main Street  
El Cajon, CA 92020  
(619) 441-1716

March 3, 1998

California State Auditor  
660 J Street, Suite 300  
Sacramento, CA 95814

Attn: Mr. Kurt R. Sjoberg

Dear Mr. Sjoberg:

Thank you for the opportunity to respond and provide input to your report entitled "Community Redevelopment Agencies: Surplus Balances in Lower Income Housing Funds Are Overstated, Suggesting a Need for More Statewide Oversight and Direction." Since receiving your letter dated February 25, 1998, Agency staff has been in contact with the Department of Housing and Community Development for clarification of the issues surrounding prior year reports submitted by the El Cajon Redevelopment Agency. As the result of this contact, the El Cajon Redevelopment Agency has successfully corrected deficiencies in prior years' reports. Revised Schedules HCD-C have been submitted for the fiscal years ending 6/30/94, 6/30/95, 6/30/96 and 6/30/97. Subsequent to the submittal of the revised reports, staff again contacted HCD.

It is my understanding as the result of this contact with the Department of Housing and Community Development that all outstanding concerns pertaining to incomplete reports and questions regarding a surplus of low and moderate income housing funds are now resolved.

As mentioned in your February 25, 1998, letter, these comments will be included in the final report to the Joint Legislative Audit Committee. This fact is very important as El Cajon has taken extreme measures to rectify the numerous and erroneous questions regarding our use of low and moderate income housing funds. I appreciate your willingness to provide El Cajon the opportunity to correct the previous submittals and the inclusion of our efforts in your report.

Should there be any question regarding material provided to the State Department of Housing and Community Development, please contact me.

Sincerely,

Bill Garrett  
City Manager

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*Agency's response to the report provided as text only:*

CITY OF ORANGE  
Economic Development Department  
230 East Chapman Avenue  
Orange, CA 92866-1506  
(714) 288-2580 / FAX (714) 288-2598

March 2, 1998

California State Auditor  
Bureau of State Audits  
660 J Street, Suite 300  
Sacramento, California 95814

Dear Mr. Sjoberg:

This letter is in response to your letter of February 25, 1998 regarding the report entitled "Community Redevelopment Agencies: Surplus Balances in Lower Income Housing Funds Are Overstated, Suggesting a Need for More Statewide Oversight and Direction," specifically with regard to the City of Orange Redevelopment Agency.

The discrepancy between the Bureau of State Audit's calculation of excess surplus and the calculation by City of Orange Redevelopment Agency for fiscal year 1993-94 was in part due to a misunderstanding of the information that was required to be included on the forms. The Agency contacted other sources for assistance and received faulty clarification with regard to the "Excess Surplus" section of the report.

This was the first year that excess surplus was calculated and definitive directions were not provided to agencies prior to preparation of the fiscal year 1993-94 report as to specific financial information to be used in the calculation of Excess Surplus (Schedule HCD-C, item 7). It was not clear that the "Adjusted L&M Fund Balance" in item 7a should be reconciled with the financial summary (Schedule HCD-C, items 1-5), in item 7b (an explanation of adjustments to fund balance). The Agency did not include funds that were solely the result of bond proceeds in the explanation of fund balance adjustments, although its calculation of Unencumbered Balance at the end of the Fiscal Year was correct. The lack of a correlation between the financial summary on page 1, items 1-5, and item 7 (1993-94 HCD-C) exacerbated the misunderstanding.

As a result of the Agency's response to the Low- and Moderate-Income Housing questionnaire and additional financial information provided to the Bureau of Audits in October of 1997, the Agency has been able to resolve the differences in calculation of excess surplus balances between the two agencies. The error in reporting beginning fund balance was corrected on the HCD-C report filed for fiscal year 1994-95.

California State Auditor  
Page 2  
March 2, 1998

It would be beneficial to the City of Orange Redevelopment Agency, and to all redevelopment agencies in the state, if a separate set of instructions were provided for completing the annual HCD Report. These instructions could be more comprehensive than the information provided on the HCD forms, and would be of particular benefit to those preparing and/or reviewing the report, especially those who have not done so previously. It would also enable redevelopment agencies to provide more accurate and comparable data for housing activities statewide.

If you have any further questions, please contact Diane Matthews at (714) 744-2259.

Sincerely,

Linda Boone  
Economic Development Director  
Assistant Executive Director

Q:EconDev:HsngQResp.doc

Agency's response to the report provided as text only:

CITY OF TUSTIN  
Office of the City Manager  
300 Centennial Way  
Tustin, CA 92780  
(714) 573-3010 FAX (714) 838-1602

February 26, 1998

Mr. Kurt R. Sjoberg  
State Auditor  
660 J Street, Suite 300  
Sacramento, CA 95814

**Subject: Tustin's Response to the State Auditor's Draft Report to the Joint Legislative Audit Committee**

Dear Mr. Sjoberg:

The purpose of this letter is to respond to your request for a response from the Tustin Redevelopment Agency on portions of a report prepared for by your office for the Joint Legislative Audit Committee. Materials we received from your office on February 25, 1998 included: a letter requesting Tustin's response to the result of an audit you have performed on Tustin's Redevelopment Agency's Housing Fund and excerpts from Chapter 1 and Chapter 2 of the draft report entitled Community Redevelopment Agencies: Surplus Balances In Lower Income Housing Funds Are Overstated, Suggesting A Need For More Statewide Oversight and Direction.

The actual financial audit upon which your conclusions and report are based was not included in the materials you sent to Tustin. This has put the City at a distinct disadvantage in trying to fully respond to the position you have taken when we do not have all the materials that should be available to us if we are asked to respond. It would have been more appropriate to send us the actual complete financial audit you performed, bring to our attention the matters in question, and request our response. ①\*

Frankly, we have found the contact we have had with representatives of your office on this project very unprofessional and unorganized. This is evidenced by the lack of a comprehensive set of written questions that each community would be asked to respond to, lack of specific written questions for a particular community based on the State's review of HCD reports, a lack of time for Tustin to adequately respond to the issues raised, and ever-changing and numerous phone queries to which Tustin was asked to respond. In general auditing procedures, where issues are brought forward, an agency generally has an opportunity to provide additional back-up information and a response to the issue before a conclusion is solidified. ②

The draft paragraphs we have been provided do not give any factual basis as to the issues you raise, the issue's importance, and most importantly the methodology used by your office in identifying and analyzing the issues. Instead, the report jumps to conclusions not based upon the aforementioned factual analysis. The issues you have raised in your draft report, as they pertain to Tustin, have very simple explanations and are of a minor nature. ①

\*California State Auditor's comments on this response begin on page 59.



The following are more specific comments in response to the materials you have asked us to respond to.

**Tustin's Response to draft Chapter 1**

Redevelopment Agencies and the Department of Housing and Community Development Incorrectly and Inconsistently Calculated Excess Surplus Balances.

- 3 The use of the word "finally" in the opening sentence is very non-professional. This type of editorializing is not in keeping with the standards of audit professionals. Your draft report states that "Tustin reported that they calculated excess surplus by comparing their fund balance to the total tax increment revenue deposited in the housing fund during the previous five fiscal years". Please be advised that your statement in this regard is not completely correct. In performing the excess surplus calculation Tustin used the tax increment for the previous five years *only* for Fiscal Year 1994-1995 (July 1, 1994 through June 30, 1995).
- 4

The reason the five preceding years for Fiscal Year 1994-1995 were used was in response to direction received from the accounting firm of Diehl, Evans and Company, LLP. In addition to direction received from them as the audit firm Tustin was using at the time of our first excess surplus calculation is their publication entitled Redevelopment Handbook. On page 19 of this publication is a discussion of the methodology for the calculation of excess surplus funds as required by AB 1290 Health and Safety Code Section 33334.12(g)(1). They offer the following direction.

*"...if 1989-90 is the first year to be included in the "excess surplus" computation, and if July 1, 1994 is the first date on which and "excess surplus" may exist under AB 1290, then apparently the authors of AB 1290 intended that the following five (not four) fiscal years be included in the initial AB 1290 computation: 1989-90, 1990-91, 1991-92, 1992-93, 1993-94. For Purposes of the "excess surplus" computations for the period July 1, 1994 to June 30, 1995 it is recommended that the five fiscal years prior to July 1, 1994 be used for calculating the excess surplus."*

- 3 Based upon the aforementioned direction, Tustin used the preceding five fiscal years in the excess surplus calculation for Fiscal Year 1994-1995. For all other fiscal years, we used only the previous four fiscal years in the excess calculation.

- 5 We take offense to the report's statement that "By using five years rather than four, agencies will understate their excess surplus". This statement certainly does not apply to Tustin and portrays Tustin as being deceitful. It has never been the intent of Tustin to understate our excess surplus, or for that matter, anything else regarding our municipal operations. Rather, the sole reason for Tustin using the previous five fiscal years in the calculation of excess surplus instead of four for

one year only was based upon direction received from a recognized leader in the field of public finance.

Broad and incorrect overgeneralizations could have been prevented in the report if representatives from the State Auditor's Office had reviewed the spreadsheets that were previously supplied to them that provide extensive detail about the financial standing of the Tustin Community Redevelopment Agency. In these documents we clearly denoted the methodology Tustin used in calculating excess surplus for Fiscal Year 1994-1995. For Fiscal Year 1994-95, and this year only, the preceding five fiscal years were used in the excess surplus calculation. If your staff had verified the excess calculation for all the other years it would have become evident that Tustin calculated its excess surplus using tax increment from the previous four fiscal years. The City did not make up the calculation methodology to reduce our excess surplus exposure. ④

In summary, although Tustin made what is now viewed by the State as an error in calculating its excess surplus for a single fiscal year the error was made because of incorrect direction given to Tustin by a leading public sector financial firm. In fact, based on our discussion with representatives from the State Auditor's Office, we have already gone back and run a revised excess surplus calculation (which was previously provided to your staff) which still shows that Tustin did not have any excess surplus funds in its Lower Income Housing Fund for any fiscal year (revised spread sheet attached). Since there are still no excess surplus funds, this entire matter should not even be noted in the report of the State Auditor to the Joint Legislative Audit Committee. ⑥

### **Tustin's Response to draft Chapter 2**

#### **Some Agencies Do Not Have Adequate Controls Over Assets and Accounting Records.**

The opening paragraph of this chapter seems to be contrary to Generally Accepted Accounting Principles and Reporting Standards for Redevelopment Agencies and California Reporting Requirements for Redevelopment Agencies. Your comments are based upon the results of a questionnaire that your staff prepared and was sent to redevelopment agencies for their completion. The survey was very limited in its scope, and from it information could not have been accurately obtained to assist you in determining the level of adequacy about accounting systems and the maintenance of records. The City of Tustin's Consolidated Annual Financial Report (CAFR) and the separate report of the Tustin Community Redevelopment Agency, both of which have been previously provided to the State, contain clean opinions from our independent auditors as to Tustin's financial controls and accounting records. Tustin has never received an audit Management Letter or comment that would even indicate that the Tustin Community Redevelopment Agency does not maintain adequate internal accounting controls. Unless, of course, that is exactly the intent of the writer of this particular report. ⑦

Mr. Kurt R. Sjoberg  
Response to State Auditor's Draft Report  
February 27, 1998  
Page 4

The tone of what little we have seen of the draft report is clearly written to convey the message that you choose to send. The draft report is in no way independent or objective. If some redevelopment agencies are lacking in controls or not making certain calculations the way you think they should be made, then agencies need to be given the courtesy to constructively respond, and those situations need to be corrected. The draft report does not even attempt to be helpful, constructive or objective in it's analysis or findings.

We welcome this opportunity to respond to your inquiry and look forward to having the Joint Legislative Audit Committee become aware of Tustin's history of appropriately using its Community Redevelopment Agency's Lower Income Housing Fund.

Sincerely,

William A. Huston  
City Manager

dave\rda\sjoberg response

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# Comments

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## *California State Auditor's Comments on the Response From the City of Tustin*

To provide clarity and perspective, we are commenting on the City of Tustin's (Tustin) response to our audit report. The numbers correspond to the numbers we have placed in the response.

- ① We did not conduct a financial audit, rather, our audit of the Tustin Community Redevelopment Agency (agency) was limited to a review of the agency's practices to deposit property tax income revenue and other income into their low- and moderate-income housing fund, an inquiry into their practices for spending those funds, and a review of their method of calculating excess surplus in their low- and moderate-income housing fund. Additionally, we verified the calculation and disposition of the \$2,178,076 excess surplus balance in the agency's fund at July 1, 1994, as reported by the Department of Housing and Community Development (department).

To accomplish these objectives, as with the 51 other agencies we reviewed, we sent the agency a 31-item questionnaire under a cover letter that explained the scope of our review, provided instructions for completing the questionnaire, highlighted the documents we requested the agency to return with the completed questionnaire, and identified a contact at our office to whom the agency could address any questions.

Finally, because our report was a draft at the time we requested the agency's response, and to ensure that we comply with confidentiality requirements contained in the California Government Code, Sections 8545(b) and 8545.1, we provided the agency only those portions of the draft report that directly related to the agency, along with chapter titles and introductory paragraphs to provide context.

In conclusion, we believe that the above-mentioned questionnaire, together with the interactions that resulted from our efforts to perform our audit tasks and the written materials transmitted to and from the agency during our review, should have been adequate to alert the agency as to the scope and

nature of our review. Further, the agency did not contact us during the response period to acquire any clarification it needed.

- ② We disagree that the agency did not have an opportunity to provide additional back-up information regarding our audit issues. In contrast, we made several attempts to obtain information from the agency regarding its methodology to calculate excess surplus and the status of the July 1, 1994, excess surplus, as reported by the department. We sent our questionnaire, cover letter, and request for documents to the agency on September 16, 1997, with a requested return date of September 29, 1997. The agency returned the questionnaire on October 3, 1997, but did not provide their July 1, 1994, excess surplus calculation. Although we requested additional information from the agency, we did not receive the information until November 20, 1997. Further, during the period from October 15 through November 20, 1997, we logged a total of 17 telephone conversations and facsimile transmissions in our attempts to obtain conclusive information regarding the agency's calculation and status of its July 1, 1994, excess surplus as well as the agency's current methodology for calculating excess surplus. Moreover, as part of those efforts, we contacted the city finance director, a senior project manager from the agency, and the assistant city manager.
- ③ We modified our report to specify that the agency used tax increment for the previous five years to calculate their July 1, 1994, excess surplus.
- ④ We believe the agency continues to lack a complete understanding of the requirement to calculate excess surplus. In its response to our report, the agency states that it has provided extensive detail about the financial standing of the agency that clearly denotes its methodology for calculating excess surplus for July 1, 1994, and other fiscal years. However, when we reviewed the details, we found that excess surplus calculations provided by the agency are inconsistent, unsupported by audited financial statements, and do not comply with the requirements of the law.

For example, in response to our survey questionnaire, the agency stated that it used the previous five years' tax increment revenue to calculate its July 1, 1994, excess surplus. Furthermore, the agency stated the methodology it currently uses is the same methodology it used to calculate its July 1, 1994, excess surplus. However, in the spreadsheets it provided to us, the agency used tax increment revenue from a four-year period rather than five.

Contrary to Tustin's assertion that we did not properly review spreadsheets it provided us, we did review them and noted that the tax increment set-asides, expenditures, encumbrances, and fund balances in the spreadsheets that contain the agency's calculations of excess surplus **do not support** the excess surplus balances contained in the spreadsheets. For example, in the March 3, 1998, spreadsheet attached to Tustin's response to our report, the amount shown as deposited during the previous four years is \$2,112,334, while the deposits for the four years add up to \$2,651,257. Furthermore, the spreadsheet shows zero excess surplus, while a calculation using the figures in the spreadsheet reveals an excess surplus balance of \$1,261,121.

Further, we found that while the fund balance in the July 1, 1994, excess surplus calculation the agency provided to the department agreed with audited balances, the fund balance in the July 1, 1994, excess surplus calculation the agency provided to us in a spreadsheet dated November 14, 1997, was approximately \$857,000 less than the audited fund balance. Moreover, while the spreadsheet the agency used to calculate its July 1, 1994, excess surplus indicates that the agency correctly used the tax increment revenue for four fiscal years rather than five, we noted that it used the wrong four fiscal years.

Finally, while the spreadsheet that Tustin included with its response to our report, dated March 3, 1998, used the correct four-year period to calculate excess surplus, the agency incorrectly used the total of tax increment and interest income to calculate excess surplus. The Health and Safety Code specifies that the calculation of excess surplus shall be made using only the tax increment revenue, excluding interest income.

- ⑤ Tustin states that it takes offense to our statement that "By using (tax increment for) five years rather than four years agencies will understate their excess surplus". Tustin further states that our statement ". . . certainly does not apply to Tustin and portrays Tustin as being deceitful". Our statement is intended merely to characterize the effect of any agency using tax increment revenue from five years rather than four years when calculating excess surplus.
- ⑥ Tustin is incorrect; in fact, as shown in Appendix B, we determined that as of June 30, 1995, the agency had an excess surplus balance of \$2,173,932.

- ⑦ We believe Tustin is incorrect when it implies that we used the results of our questionnaire to conclude its internal accounting controls are inadequate. As stated on page 29 of our report, we address only the agency's controls over loans receivable. While Tustin implies that we did not provide an opportunity for it to constructively respond, we have only reported information that Tustin provided to us. In addition, we documented conversations regarding the agency's procedures for tracking loans receivable on October 15 and October 17, 1997. Further, we transmitted a facsimile of the language from our draft report to the city finance manager for his review. He confirmed the accuracy of the draft report's language, signed and dated the copy February 4, 1998, and returned the document to us.

Finally, while Tustin does not believe the agency lacks adequate internal controls over its assets, it does not dispute the fact that it has not recorded the loans receivable in its accounting records. Without an entry of the loans in its official accounting records, the agency has lost some assurance that the loaned funds, if repaid, and any earned interest, will be returned to the fund as required by law.

Agency's response to the report provided as text only:

CITY OF FREMONT  
City Administration  
39100 Liberty St.  
P.O. Box 5006  
Fremont, CA 94537-5006  
(510) 494-4800 FAX (510) 494-4257

March 3, 1998

Mr. Kurt R. Sjoberg  
California State Auditor  
Bureau of State Audits  
660 J Street, Suite 300  
Sacramento, California 95814

Dear Mr. Sjoberg:

Thank you for the opportunity to respond to your audit report, conclusions and recommendations for community redevelopment agencies. We appreciate the time your staff spent with us in your review of our Redevelopment Agency's financial reporting methods and practices. Our responses are contained in this letter and have also been copied on the diskette you included with the draft report.

**Summary - Results in Brief**

**Response:** The Redevelopment Agency of the City of Fremont recognizes the importance of charging only those planning and administrative costs directly related to low- and moderate-income housing activities to that fund. For those costs incurred only for that purpose and without a shared component with other activities, the process is straightforward in that they are charged directly to the fund. For those costs (primarily staff costs) incurred in support of a number of activities, the issue is more complex. We agree it is prudent to keep more formal records substantiating the amount of time worked on low- and moderate-income housing activities and, to that end, we will begin to do so.

Following is a recap of total expenditures from the low- and moderate-income housing fund, the amount of those expenditures that were incurred for planning and administrative activities, and the amount of planning and administrative expenditures that consist of staff costs (salary and benefits) for 1994/95, 1995/96 and 1996/97:

TOTAL EXPENDITURES	
1994/95	\$2,815,000
1995/96	1,414,000
1996/97	3,947,000



PLANNING AND ADMINISTRATIVE COSTS

(included in above amounts)

1994/95	\$ 257,000
1995/96	303,000
1996/97	364,000

PLANNING AND ADMINISTRATIVE STAFF COSTS

(included in above amounts)

1994/95	\$ 104,000
1995/96	105,000
1996/97	159,000

In 1995/96, a portion (\$25,000) of the housing development specialist's salary and benefits was transferred to the low- and moderate-income housing fund because the housing manager's position, which is allocated 100% to the fund, was vacant for a portion of 1994/95 and all of 1995/96. It was filled again in 1996/97. During 1995/96, the Redevelopment Agency was still actively engaged in low- and moderate-income housing activities, even though the housing manager position was vacant. In evaluating how those duties were performed, it was determined the housing development specialist had reallocated his work effort to allow the low- and moderate-income housing projects to continue on track and he was actually spending less time on his other job assignments. The transfer of a portion of his salary and benefits to the low- and moderate-income housing fund was an attempt to recognize this change in his work effort during 1995/96, until such time as the new housing manager was on board. In the future, we will better document the rationale for this type of decision.

**Chapter 1 - Some Agencies Do Not Use the Correct Amount of Tax Increment Revenue To Calculate Excess Surplus**

**Response:** Although in the past the Redevelopment Agency of the City of Fremont recorded tax increment revenues "net" of the administrative fee charged by Alameda County, this practice has been changed in 1997/98. As a result, all future tax increment revenues will be recorded at their full amount and the associated administrative fees will be recorded as expenditures, to ensure that the excess surplus calculation will not be overstated.

**Chapter 2 - Agencies Need to Ensure Only Appropriate Costs Are Charged to the Low- and Moderate-Income Housing Fund**

**Response:** The Redevelopment Agency of the City of Fremont recognizes the importance of charging only those planning and administrative costs directly related to low- and moderate-income housing activities to that fund, in accordance with the requirements of Section 33334.3 of the Health and Safety Code. For those costs incurred only for that purpose and without a shared component with other activities, the process is straightforward in that they are charged directly to the fund. For those costs (primarily staff costs) incurred in support of a number of activities, the issue is more complex.

The Redevelopment Agency of the City of Fremont uses a percentage allocation method to distribute salaries, based on each employee's work assignment. During each year's budget process, these percentages are reviewed based on work actually performed in the prior year and

anticipated to be performed in the coming year. For example, the housing manager's work assignment is related solely to low- and moderate-income housing activities and, as a result, 100% of his/her salary and benefits is charged to the low- and moderate-income housing fund. However, for employees who have multiple assignments, we agree it is prudent to keep more formal records substantiating the amount of time worked on low- and moderate-income housing activities and, to that end, we will begin to do so. This should provide the necessary information to ensure the fund is appropriately charged for the administrative costs of low- and moderate-income housing activities.

Following is a recap of total expenditures from the low- and moderate-income housing fund, the amount of those expenditures that were incurred for planning and administrative activities, and the amount of planning and administrative expenditures that consist of staff costs (salary and benefits) for 1994/95, 1995/96 and 1996/97:

TOTAL EXPENDITURES		
1994/95		\$2,815,000
1995/96		1,414,000
1996/97		3,947,000
PLANNING AND ADMINISTRATIVE COSTS		
(included in above amounts)		
1994/95		\$ 257,000
1995/96		303,000
1996/97		364,000
PLANNING AND ADMINISTRATIVE STAFF COSTS		
(included in above amounts)		
1994/95		\$ 104,000
1995/96		105,000
1996/97		159,000

With respect to the portion of the housing development specialist's salary and benefits transferred to the fund in 1995/96, the housing manager's position was vacant for a portion of 1994/95 and all of 1995/96. It was filled again in 1996/97. During 1995/96, the Redevelopment Agency was still actively engaged in low- and moderate-income housing activities, even though the housing manager position was vacant. In evaluating how those duties were performed, it was determined the housing development specialist had reallocated his work effort to allow the low- and moderate-income housing projects to continue on track and he was actually spending less time on his other job assignments. The transfer of a portion of his salary and benefits to the low- and moderate-income housing fund was an attempt to recognize this change in his work effort during 1995/96, until such time as the new housing manager was on board. In the future, we will better document the rationale for this type of decision.

## **Chapter 2 - Some Agencies Do Not Have Adequate Controls Over Assets and Accounting Records**

**Response:** The report findings refer to six loans. As of June 30, 1996, the Redevelopment Agency of the City of Fremont had four loans to non-profit developers with outstanding balances, and only one of those loans was recorded as a receivable. For the other two loan agreements, no amounts had been advanced to the developers. This information has been conveyed to Bureau of State Audits staff, who concur. All of the loans that have outstanding balances have now been recorded in the Agency's accounting records.

Of the four outstanding loans, only one had accrued interest receivable at June 30, 1996, and it was recorded at that date, with a corresponding deferral of revenue. The remaining three loans have interest accruals beginning on July 1, 1996, October 1, 1997 and January 1, 1998, respectively. The accrued interest and related deferral of revenue are in the process of being recorded in the Agency's accounting records.

The projects funded by the four loans with outstanding balances have been completed and have begun operations. However, it is projected to be several years, if ever, before any of them begin to generate sufficient cash to require repayment of the loans to the Agency. The Agency could have structured its financial support for these projects as more traditional grants, which would not require the same sort of monitoring. Instead, the Agency opted for a more innovative approach, with the expectation that any loan repayments, including interest, it receives would provide additional resources that would not otherwise be available to fund low- and moderate-income housing activities.

Because the Agency has only recently begun to enter into these types of loans to facilitate the development of low- and moderate-income housing, procedures for monitoring these loans to ensure compliance with the terms of the loan agreements are still in the process of being developed. Procedures will be in place by the end of the 1997/98 to ensure that adequate, ongoing monitoring occurs. The areas that will be specifically monitored include the following:

- Compliance with agreements
- Submission of annual reports
- Calculations of excess cash to determine if/when repayment is required
- Deposit of all repayments to the fund for future use

In addition, for those loans that do not now require the developer to submit the necessary financial documents so that the Agency can monitor compliance, we are determining how best to proceed with modifications to those loan agreements to ensure the necessary information will be provided to the Agency. We anticipate this will be complete by the end of 1997/98.

Because funding low- and moderate-income housing projects in this manner is a relatively new undertaking for us, we appreciate your comments and observations. They will be very helpful as we develop and review our procedures in this area.

Finally, for two of the loans reviewed, the actions taken by the City of Fremont and the Redevelopment Agency of the City of Fremont authorizing the loan agreements made provisions

for a signed contract between the City and the Redevelopment Agency to ensure that loan repayments would be made to the Redevelopment Agency for deposit in the low- and moderate-income housing fund. Although there was a time lag between the action of the governing boards and the execution of the documents, those contracts have now been prepared and signed.

\* \* \* \* \*

We would appreciate receiving a copy of the report when it is issued. If you have questions or need additional information, please contact Harriet V. Commons, Financial Services Director (510/494-4775), or me.

Yours very truly,

Jan C. Perkins  
City Manager, City of Fremont  
Executive Director, Redevelopment Agency

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Agency's response to the report provided as text only:

POWAY REDEVELOPMENT AGENCY  
13325 Civic Center Drive  
Mailing Address: P.O. Box 789  
Poway, CA 92074-0789  
(619) 748-6600, 695-1400

Don Higginson, Chair  
Jay Goldby, Vice Chair  
Mickey Cafagna, Board Member  
Bob Emery, Board Member  
Betty Rexford, Board Member

*Transmitted via Facsimile, Federal Express and First Class Mail*

March 2, 1998

Kurt R. Sjoberg  
State Auditor  
660 J Street, Suite 300  
Sacramento, CA 95814

Dear Mr. Sjoberg:

I am responding to your letter of February 25, 1998, concerning the report "Community Redevelopment Agencies: Surplus Balances in Lower Income Housing Funds Are Overstated, Suggesting the Need for More Statewide Oversight and Direction." As requested, we are responding to the section you've forwarded which mentions the Agency, as found on Page 1-1. A more detailed response is attached to this letter as Exhibit "A."

Briefly, we are suggesting the elimination of the entire, one sentence reference to the Poway Redevelopment Agency. The use of Poway does not support the conclusion being made by the chapter in which the reference is found or the report overall. Poway has never had an excess surplus balance to report, as confirmed by your staff after an exhaustive audit. As a result, Poway has never added to the reported Statewide problem of a "overstated" surplus balances. These results were not affected by the "under reporting" of tax increment by Poway as referenced in the report. If the Legislative intent is to confirm the accuracy of agencies' reporting of excess surplus, if applicable, and to cause agencies to expend Housing Fund monies in a timely manner, using Poway as an example is simply misleading.

①\*

Your careful consideration of these comments is appreciated. If you have any questions or comments about this matter, you may contact Warren Shafer directly at (619) 679-4249.

Sincerely,

James L. Bowersox  
Executive Director

cc: Warren H. Shafer, Assistant Executive Director  
Pamela R. Colby, Redevelopment Project Administrator  
Norm Callaway, Bureau of State Audits

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\*California State Auditor's comments on this response begin on page 71.

## Exhibit "A"

The Poway Redevelopment Agency appreciates the opportunity to comment on the referenced section of the Auditor's report. We are also pleased the report confirms the Agency has never had an excess surplus balance. You have asked the Agency to comment on Page 1-1 of the February 1998 draft report, "Community Redevelopment Agencies: Surplus Balances Are Overstated, Suggesting a Need for More Statewide Oversight and Direction."

Accordingly, the following modifications are recommended:

~~"...As a result, when they compare recorded tax increment revenues to their fund balance they may overstate their excess surplus balance." Similarly, we found that the Poway Redevelopment Agency underreported its tax increment revenue by approximately \$125,000 for fiscal years 1992-93 through 1995-96, because it also recorded tax increment revenue after deducting administrative costs charged by the County."~~

The report states that the some agencies under-report their tax increment when performing their excess surplus calculation. However, this does not automatically result in the overstatement of an excess surplus balance. To illustrate this point, one may look to Poway. The Agency's method of reporting tax increment has never affected the accuracy of the Agency's excess surplus balance, because Poway has never come close to having an excess surplus balance in its Housing Fund. Accordingly, the Agency has never contributed to the statewide "overstatement" of "surplus balances."

Inclusion of the amount of the Agency's "under reported" tax increment of "approximately \$125,000" is provided without the benefit of any context. The \$125,000 figure included in the report amounts to only 1.3% of the Agency's total Housing Fund revenues during the subject time frame (FY 1992/93 - 1995/96). However, as presented, there is the implication of a significant issue. It must also be said that the Agency's method of reporting tax increment has had no effect on the Agency's fund balance, as the County's administrative cost is a legitimate Housing Fund expense.

The report's conclusion, as reflected in the title, is not supported by inclusion of Poway. It would appear more appropriate to use an example where an agency's calculation resulted in a material impact. Using Poway as an example in this manner, we believe, is misleading. Therefore, we request that the reference to the Poway Redevelopment Agency be eliminated from the Report entirely.

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# Comments

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## *California State Auditor's Comments on the Response From the Poway Redevelopment Agency*

To provide clarity and perspective, we are commenting on the Poway Redevelopment Agency's (Poway) response to our audit report. The numbers correspond to the numbers we have placed in the response.

- ① We disagree with Poway's position that its underreporting of tax increment revenue in its low- and moderate-income housing fund is irrelevant to the conclusions of our report. As stated on page 10 of our report, cumulative tax increment revenue is the indicator used to measure excess surplus. Underreporting those revenues because an agency first deducts debt service payments or county administrative costs results in an inaccurate calculation, and as such, has statewide implications on the integrity of the annual report compiled by the Department of Housing and Community Development. However, because we recognize that Poway has not reported an excess surplus balance, we have modified our report to state that underreporting tax increment revenue **may** overstate excess surplus.



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Agency's response to the report provided as text only:

CITY OF HOLLISTER  
375 Fifth Street  
Hollister, CA 95023

March 2, 1998

Kurt R. Sjoberg, State Auditor  
Bureau of State Audits  
660 J Street, Suite 300  
Sacramento, CA 95814

RE: Response to draft report entitled "Community Redevelopment Agencies: Surplus Balances In Lower Income Housing Funds are Overstated, Suggesting a Need for More Statewide Oversight and Direction"

Attn: Elaine Howle

Dear Elaine,

I have reviewed the draft copies of portions of your report which relate to the City of Hollister, and their past and present actions and future intentions with relation to handling of the housing set a side for the Hollister Redevelopment Agency.

In the absence of any staff members who were involved in the past handling of the housing set-a-side funds for the Hollister Redevelopment Agency, it has taken significant time to research the past actions. At this time I have found information which indicates that the practice from the formation of the Agency during the 1982/83 fiscal year until the 1992/93 fiscal year was to allocate the housing set-a-side on the basis of 20% of net income after negotiated pass-through payments had been deducted. Contrary to your report, the City has in the four fiscal years beginning in 1993/94 repaid approximately \$480,000 of the under allocation and intends to continue to repay until the entire under allocation repaid. It is my intention to completely audit the agency allocation of housing set-a-side funds to insure that the full appropriate allocation is made. ①\*

There are no actions by the Agency's board to support, and current actions by the Agency do not support your statement that "Hollister does not believe that the Attorney General's opinion requires it to pay the fund 20 percent of the difference between net and gross tax increments for prior periods". The reported statement by the prior Agency Finance Director that "the Agency does not intend to pay the amount until the specific issue is resolved legally" is not supported by any Agency board action or current actions by the Agency. The Agency is committed to fully complying with the applicable regulations, and are taking steps to fully fund any prior deficiencies.

If you have any questions, please contact me.

Sincerely

George Lewis  
Executive Director,  
Hollister Redevelopment Agency

City Attorney 636-4306	City Clerk 636-4304	City Manager 636-4305	Finance 636-4301	Management Services 636-4324	Personnel 636-4308
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Fax (408) 636-4310 • TDD Line Only (408) 636-4319

\*California State Auditor's comments on this response begin on page 75.

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# *Comments*

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## *California State Auditor's Comments on the Response From the City of Hollister*

To provide clarity and perspective, we are commenting on the City of Hollister's (Hollister) response to our audit report. The numbers correspond to the numbers we have placed in the response.

- ① Based on updated information provided by Hollister, we modified the text of our report to reflect the statements of the city manager.

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Agency's response to the report provided as text only:

CITY OF LOMA LINDA  
25541 Barton Road  
Loma Linda, CA 92354-3160  
(909) 799-2800 FAX (909) 799-2890

March 3, 1998

Kurt R. Sjoberg, State Auditor  
Bureau of State Audits  
660 J Street, Suite 300  
Sacramento, Ca 95814

Dear Mr. Sjoberg:

The following comments are in response to your request to respond in writing to the draft excerpts of your special redevelopment agencies audit report as the report applies to the City of Loma Linda and its Redevelopment Agency.

Based upon my review of your draft comments with the City's and Redevelopment Agency's Auditor, I must take exception to your statement that the Loma Linda Redevelopment Agency is one of three agencies that "failed to ensure that mandated funds were made available for affordable housing". As your draft report notes in the last sentence of Chapter 2, page 2-1 "under current law, county auditors are not required to provide gross property tax allocations and deductions to redevelopment agencies". Your above noted comment and particularly your usage of the relatively inflammatory language "failed to ensure" is somewhat perplexing given your own observation with regard to county reporting responsibilities in this area. Your comment is further interesting in that according to the Health and Safety Code, each redevelopment agency is to set-aside 20 percent of the tax increment allocated to it, and as reported, the County of San Bernardino does not voluntarily provide this information and has, in the past, not been responsive to our auditor's request for this information. ①\*

Having no power over the County of San Bernardino, the City's Redevelopment Agency cannot "ensure" the full set-aside. Nevertheless, please be advised that through the City's initiative, pass through amounts for fiscal years 1992-93, 1993-94 and 1994-95 were obtained from the County Auditor-Controller's office this past year and appropriate adjustments to set-aside Funds for these years were included in the Agency's 1996-97 Audit (refer ②)

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\*California State Auditor's comments on this response begin on page 79.

Page Two

to attached Note 13). Additionally, pass through amounts for fiscal years 1995-96 and 1996-97 have now been obtained and appropriate adjustments for these years will be incorporated in the 1997-98 audit.

In view of the foregoing, it is requested that alternative language not including the statement "failed to ensure" be developed and substituted in your final report with regard to the Loma Linda Redevelopment Agency. Finally, it is requested that your comments/observations be expanded to recognize the City's/Redevelopment Agency's efforts to obtain the subject information from the County, the adjustments that have been made to date and the remaining adjustments to be included in the Agency's fiscal year 1997-98 audit.

Sincerely,

Reviewed/Approved,

W. Tom Parker  
Director of Finance

Peter R. Hills  
Interim City Manager

c: City Manager  
Auditor

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# Comments

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## *California State Auditor's Comments on the Response From the City of Loma Linda*

To provide clarity and perspective, we are commenting on the City of Loma Linda's (Loma Linda) response to our audit report. The numbers correspond to the numbers we have placed in the response.

- ① While we disagree with Loma Linda's exception to our statement that Loma Linda failed to ensure that mandated funds were made available for affordable housing, we are pleased to note that the agency has taken the initiative to acquire the information necessary to make the proper adjustments to its low- and moderate-income housing fund.
- ② Based on the updated information Loma Linda provided in its response, we modified our report to recognize the action Loma Linda is taking to fully provide the required tax increment set-aside to its low- and moderate-income housing fund.



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Agency's response to the report provided as text only:

CITY OF CULVER CITY  
Administrative Office  
9770 Culver Boulevard  
Culver City, CA 90232-0507  
Tel: 253-6000 Fax: 253-6010

Jody Hall-Esser  
Chief Administrative Officer and Executive Director  
Culver City Redevelopment Agency

March 3, 1998

Kurt R. Sjoberg, State Auditor  
Bureau of State Audits  
660 J Street, Suite 300  
Sacramento, CA 95814

Re: Culver City New Directions Project Contribution

Dear Mr. Sjoberg:

My staff, Agency Counsel and I have read the draft State Auditor's February 1998 Report which is, in part, critical of the Culver City Redevelopment Agency's use of Housing set-aside funds to support the New Directions project on the grounds of the Sepulveda Veterans Administration complex in West Los Angeles.

This Report was requested by the California State Legislature on the specific subject of Excess Surplus Balances in redevelopment agency affordable housing funds, and was required to be limited to the State Auditor's admitted function of observing and reporting facts. Instead, the report has ventured far afield in subject matter, such as dealing with the Culver City homeless veteran housing expenditures. In addition, instead of requesting legal opinions from Legislative Counsel or the Office of the Attorney General, the State Auditor has chosen to base the report on questionable legal conclusions which are regrettably unsupported, erroneous, and misstate applicable law and the plain language of the statutes themselves. (1)\*

According to the State Auditor, the Culver City Redevelopment Agency "provided the funds based on the much less restrictive provisions contained in Section 33334.2, which allows for spending housing funds outside a project area but within the agency's territorial jurisdiction." In fact, the quoted statute (Section 33334.2) nowhere mentions a limitation of expenditures to an agency's territorial jurisdiction. The words "territorial jurisdiction" are not even mentioned in that statute, which instead contains the following criteria: (1)

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\*California State Auditor's comments on this response begin on page 85.

“(a) ... [Housing set-aside funds] shall be used by the agency for the purposes of increasing, improving, and preserving the community’s supply of low- and moderate-income housing....”

“(g) “The agency may use these funds inside or outside the project area. ... upon a resolution of the agency and the legislative body that the use will be of benefit to the project.”

Here, the creation of 23 beds earmarked for Culver City homeless veterans clearly satisfies the requirement that these funds increase and improve the community’s supply of low-income housing. The required findings of benefit were properly made and are “final and conclusive as to the issue of benefit to the project area” under Section 33334.2(g).

According to the State Auditor, Section 33334.17, which provides a means of spending housing set-aside funds in another city, and which has never been used by any city because of its unfeasible and convoluted requirements, “is the sole statewide authority for using low- and moderate-income housing funds outside the territorial jurisdiction of the agency.” In fact, nowhere in that statute is there any language or wording to the effect that it is the exclusive means of using these funds in another city. This conclusion is offered without any citation of support, and is simply a mis-statement of the plain language of Section 3334.17. Section 33334.2, the authority used by Culver City, provides ample alternate authority for the expenditure of the fund in question, and does not restrict expenditures to the territorial jurisdiction of the Agency.

①

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According to the State Auditor, another statute, Section 33334.3, requires that the building containing the housing which is the subject of the expenditure be located within the agency’s territorial jurisdiction. In fact, that section contains no such requirement. It is housing for the people of a community which is to be increased, improved and preserved. Nowhere does that section require the building in which those people are to be housed be located in the agency’s territorial jurisdiction. All that is required is that housing be provided for people from the community. Again, the subject expenditure clearly increases and improves low-income housing for the people of Culver City, specifically homeless veterans within the territorial jurisdiction of the community (the City of Culver City).

Homeless veterans within the territorial jurisdiction of the community now have guaranteed access to 23 more beds than would be the case in the absence of the crucial program; the project, as a whole, provides over 150 formerly homeless veterans with substance abuse problems, both transitional and permanent housing. New Directions also provides comprehensive job training and other self-sufficiency support services to project clients. This project was a joint effort between the cities of Los Angeles, Santa Monica, Beverly Hills and Culver City, and the U.S. Department of Housing and Urban Development and U.S. Veterans Administration, and has successfully proven that regional solutions can be forged to regional problems.

I trust these comments will serve to either hasten changes to the draft Report or will at least be included, verbatim, as a response to Report findings. If any reader has any questions regarding this matter, they are encouraged to contact Steve Wagner, Housing Manager, at (310) 253-5780, or Murray O. Kane, Agency General Counsel, at (213) 452-0121.

Sincerely,

Mrs. Jody Hall-Esser  
Executive Director, Culver City Redevelopment Agency  
Chief Administrative Officer, City of Culver City

cc: Honorable Chair and Agency Members  
Mark Winogrand, Assistant Executive Director  
Steve Wagner, Housing Manager  
Murray O. Kane, Agency General Counsel

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# Comments

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## *California State Auditor's Comments on the Response From the City of Culver City*

To provide clarity and perspective, we are commenting on the City of Culver City's (Culver City) response to our audit report. The numbers correspond to the numbers we have placed in the response.

- ① The City of Culver City is wrong. We based our conclusion regarding Culver City's misinterpretation of provisions of the Health and Safety Code not only on our review of the statutes but also on the opinion of our legal counsel. As such, we still believe, as we stated on page 27 of our report, that Culver City has misinterpreted the requirements of the Health and Safety Code, Sections 33334.2 and 33334.17. Culver City points to the Health and Safety Code, Section 33334.2, in support of its transfer of funds for a housing facility outside its territorial jurisdiction. However, according to our legal counsel, Section 33334.2 does not support such a transfer. Our legal counsel further concluded that a redevelopment agency may not expend low- and moderate-income housing funds outside its territorial jurisdiction without following the statutory requirements of the Health and Safety Code, Section 33334.17. Finally, our legal counsel states that the interplay between Sections 33334.3 and 33334.17 clearly reflects the legislative intent that funds would only be transferred from one community to another if the requirements of Section 33334.17 are met. Otherwise, the requirements of Section 33334.3, subdivision (c), apply and an agency may not expend low- and moderate-income housing funds outside its territorial jurisdiction.

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*Agency's response to the report provided as text only:*

INGLEWOOD CALIFORNIA  
One Manchester Boulevard  
Inglewood, California 90301-1750  
FAX (310) 412-8737

Office of  
Nick D. Rives  
Finance Director

Telephone: 310/412-5257

February 25, 1998

Kurt J. Sjoberg  
State Auditor  
Bureau of State Audits  
660 J Street, Suite 300  
Sacramento, CA 95814

Dear Mr. Sjoberg,

This letter is in response to the draft copy of your report entitled, "Community Redevelopment Agencies: Surplus Balances in Lower Income Housing Funds are Overstated, Suggesting a Need for More Statewide Oversight and Direction." The City of Inglewood did establish a Low/Moderate Income Housing Fund in FY 96/97 and moved all monies reserved for this purpose into this fund. An audited financial statement was not available due to the fact that our fiscal year ended on September 30, 1997, and will not be completed until late March.

If you have any further question regarding this matter, please contact Jeff Muir, Financial Reporting Manager at (310) 412-5634.

Sincerely,

Nick D. Rives  
Finance Director

NDR:JSM

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*Agency's response to the report provided as text only:*

CITY OF MONTEBELLO  
1600 W. Beverly Boulevard  
Montebello, CA 90640  
(213) 887-1200

March 2, 1998

VIA FEDERAL EXPRESS

Mr. Kurt R. Sjoberg  
Bureau of State Audits  
660 J Street, Suite 300  
Sacramento, CA 95814

Dear Mr. Sjoberg:

I have reviewed your report dated February 25, 1998, concerning an audit of the Montebello Redevelopment Agency's activities. The only change that we have made concerns the Montebello Housing Development Corporation (MHDC) Board of Directors. The MHDC, per their by-laws, appoint their own Board of Directors, and the Redevelopment Agency provides no influence concerning these appointments. The appropriate changes were made on the disk, which is enclosed.

①\*

Sincerely,

Richard Torres  
Executive Director  
Montebello Redevelopment Agency

RT:elv

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\*California State Auditor's comments on this response begin on page 91.

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# *Comments*

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## *California State Auditor's Comments on the Response From the City of Montebello*

To provide clarity and perspective, we are commenting on the City of Montebello's (Montebello) response to our audit report. The numbers correspond to the numbers we have placed in the response.

- ① Based on Montebello's response to our report, we modified the text.

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Response to the report provided as text only:

KATHLEEN CONNELL  
CONTROLLER OF THE STATE OF CALIFORNIA

Sacramento: 300 Capitol Mall, Suite 1850, Sacramento, CA 95814 (916) 445-2636

Mailing Address: P.O. Box 942850, Sacramento, CA 94250

Los Angeles: 600 Corporate Pointe, Suite 1150, Culver City, CA 90230 (310) 342-5678

March 3, 1998

Mr. Kurt R. Sjoberg  
State Auditor  
660 J Street, Suite 300  
Sacramento, CA 95814

Dear Mr. Sjoberg:

I appreciate the opportunity to review and comment on the portion of your draft audit report concerning the State Controller's Guidelines for Compliance Audits of California Redevelopment Agencies.

The State Controller's Office is aware of the issues identified in your report. In August 1997, I convened a technical working group at the request of Senator Barbara Lee, Chair of the Senate Committee on Housing and Land Use, to examine methods to improve audits of California's redevelopment agencies. The working group's recommendations, some of which require legislation, were conveyed to Senator Lee in a letter dated February 4, 1998 (attached).

The working group's proposed legislative changes were incorporated into Senate Bill 488(Lee), as amended February 19, 1998. The amendments will improve the quality of redevelopment agency audits by requiring that these audits be conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States, as well as the California State Controller's compliance audit guidelines. These legislative modifications will also eliminate inconsistencies between statutory requirements and the actual practices of independent auditors when rendering "opinions" on California's redevelopment agencies compliance with laws and regulations.

To implement the working group's recommendations, my office recently issued a draft version of updated, statewide compliance audit guidelines for redevelopment agencies. A copy of these draft audit guidelines was provided to your staff. (1)\*

In the coming months, we will be working closely with the California Society of Certified Public Accountants and other public and private entities to ensure that our draft guidelines are reasonable and workable and that the audit results will meet the needs of the prospective users. We welcome any comment or suggestions from your office. (1)

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\*California State Auditor's comments on this response begin on page 95.

The State Controller's Office shares your concern regarding incorrect and inconsistent calculations of excess surplus balances by the redevelopment agencies and the Department of Housing and Community Development which results from unclear statutes. However, we do not have the basis to fully evaluate and comment on this issue because you did not share with us the portion of the draft report discussing this finding, presumably in recognition of the fact that the State Controller's Office was not responsible for any of the errors or inconsistencies. As alluded to in your recommendation, if legislation is enacted to clarify the excess surplus calculation, the State Controller's Office will appropriately modify the audit guidelines which should, through the independent auditors, educate the redevelopment agencies on the legislative requirements. If formalized training is needed, the Department of Housing and Community Development should be the state agency responsible for the administration of this function.

If you have questions, please contact Carol Nebel, Chief, Division of Audits, at (916) 322-2423.

Sincerely,

KATHLEEN CONNELL  
State Controller

KC:CN:dl

Attachment

cc: Howard A. Sarasohn, Chief Deputy State Controller, Administration  
State Controller's Office  
Julie Bornstein, Chief Deputy State Controller, External Affairs  
State Controller's Office  
Carol Nebel, Chief, Division of Audits, State Controller's Office

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# *Comments*

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## *California State Auditor's Comments on the Response From the California State Controller's Office*

To provide clarity and perspective, we are commenting on the California State Controller's Office (SCO) response to our audit report. The numbers correspond to the numbers we have placed in the response.

- ① We have reviewed the SCO's draft revision of its audit guidelines for compliance audits of California community redevelopment agencies. While the SCO has improved the value of the guidelines as an oversight tool for agency compliance by adding audit procedures regarding low- and moderate-income housing funds, and by proposing changes to the law that require auditors to meet the minimum audit requirements contained in the guidelines, we believe the SCO can further improve the audit guidelines. We will provide our specific comments and suggestions in a separate letter to the SCO.



cc: Members of the Legislature  
Office of the Lieutenant Governor  
Attorney General  
State Controller  
Legislative Analyst  
Assembly Office of Research  
Senate Office of Research  
Assembly Majority/Minority Consultants  
Senate Majority/Minority Consultants  
Capitol Press Corps