

City of Oakland Office of the City Auditor

**Measure K 2.5% Set-Aside
Performance Audit:
City of Oakland's Calculation of the
Set-aside for the KIDS FIRST!
Oakland Children's Fund**

July 14, 2009



**City Auditor
Courtney A. Ruby, CPA**

CITY OF OAKLAND



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July 14, 2009

OFFICE OF THE MAYOR
HONORABLE CITY COUNCIL
OAKLAND, CALIFORNIA

**RE: MEASURE K 2.5% SET-ASIDE FOR THE KIDS FIRST! OAKLAND
CHILDREN'S FUND PERFORMANCE AUDIT - THE CITY OWES KIDS
FIRST! \$647,000**

Dear Mayor Dellums, President Brunner and Members of the Council:

Attached is the performance audit of the Measure K 2.5% set-aside for the KIDS FIRST! Oakland Children's Fund (Fund). The primary objective of the audit was to determine whether the City of Oakland complied with the City Charter requirement to set aside 2.5% of the City's unrestricted general fund revenues for the Fund.

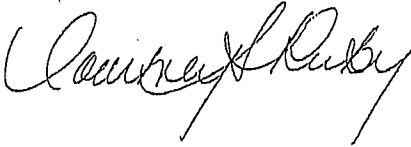
The audit found that the City:

- Underpaid the Fund by \$398,780 in fiscal years 2005-06 and 2006-07 as a result of not including certain unrestricted general fund revenues;
- Underpaid the Fund by \$248,640 in the true-up calculation for fiscal years 1997-98 through 2004-05 as a result of not classifying cable television franchise fees as unrestricted revenues;
- Lacks a formal policy and procedure for calculating the set-aside and reimbursing either the City or the Fund for any differences between the set-aside based on actual versus budgeted revenue; and
- Allocated interest income to the Fund in accordance with the process the City Administration uses to allocate interest to other City funds.

As guardians of the public trust, we need to be impeccable in our practices. This audit reinforces that the basic building blocks of fiscal management – the policies and procedures – must be in place, understood and enforced.

I would like to express my appreciation to the City Administration for their cooperation during our audit. A response from the Administration is included in the audit report.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Courtney A. Ruby".

COURTNEY A. RUBY, CPA
City Auditor

City of Oakland
Office of the City Auditor

Measure K 2.5% Set-Aside Performance Audit:
City of Oakland's Calculation of the Set-Aside for
the Kids First! Oakland Children's Fund

July 14, 2009

Table of Contents

| | |
|---|-----------|
| Introduction | 1 |
| Background | 1 |
| Audit Objectives, Scope, and Methodology | 2 |
| Audit Results: The City Owes the Kids First Fund \$647,000 | 4 |
| Kids First Fund Set-Aside Requirements | 4 |
| The City Administration did not include certain unrestricted general fund revenues in the calculation of the set-aside for fiscal years 2005-06 and 2006-07 | 5 |
| The City Administration did not include certain unrestricted general fund revenues in the calculation of the set-aside for fiscal year 2007-08 | 9 |
| The City Administration needs to develop and implement better internal controls to ensure that the set-aside calculations are correct | 10 |
| The City Administration did not include cable television franchise fees in the true-up calculation | 10 |
| The City Administration lacks a clear policy for reimbursing the Fund for any differences between the set-aside based on actual versus budgeted revenues | 12 |
| The City Administration correctly credited interest income to the Kids First Fund | 13 |
| Conclusion | 14 |
| Recommendations | 14 |
| City Administrator's Response | 17 |
| City Auditor's Response to the City Administrator's Response | 25 |

INTRODUCTION

The Office of the City Auditor has completed an audit of the City of Oakland's calculation of the set-aside for the KIDS FIRST! Oakland Children's Fund (Kids First Fund or Fund). The primary objective of the audit was to determine whether the City of Oakland (City) complied with the City Charter (Charter) requirement to set aside 2.5% of the City's unrestricted general fund revenues for the Fund.

Background

In 1996, Oakland voters passed an initiative called Measure K, which amended the Charter to provide additional funding for programs and services benefiting children and youth. The Charter requires the City to annually set aside 2.5% (set-aside) of unrestricted general fund revenues for the Fund. Monies set aside for the Fund are to be spent on services for children and youth below 21 years of age. Additionally, the Fund earns interest income on monies in the Fund. The set-aside and the interest income are the only two sources of revenue for the Fund. In November 2008, Oakland voters passed another Charter amendment that modifies the set-aside requirements. Effective July 1, 2009, and continuing through June 30, 2011, the City will be required to set aside 1.5% of annual total revenues (not limited to unrestricted general fund revenues). Beginning July 1, 2011, the City will be required to set aside 2.5% of annual total revenues.

The Set-Aside Process

The City Administration performs two sets of calculations to arrive at the set-aside amount. Prior to the beginning of the fiscal year, the City Administration calculates the amount of the set-aside based on budgeted unrestricted general fund revenues. During the fiscal year, the City Administration transfers the budgeted set-aside through installment payments to the Fund.

The second step in the set-aside process occurs after the end of the fiscal year when the actual unrestricted general fund revenues are known. The City Administration recalculates the amount of the set-aside based on actual unrestricted general fund revenues and compares this amount to the previously calculated set-aside amount based on budgeted revenues.

Use of the Set-Aside Monies

The Fund's Planning and Oversight Committee (POC) oversees a competitive Request For Proposals (RFP) process to award grants to non-

profit organizations and public agencies. Based on the RFP process, the POC makes funding recommendations for the City Council's approval. In fiscal years 2005-06 and 2006-07, the City Council approved nearly \$20.6 million in grants to various non-profit organizations and public agencies.

Objectives, Scope, and Methodology

The objective of the audit was to determine if the City Administration set aside the correct amount of money for the Fund. We assessed whether the City Administration credited the Fund with the correct amount of the set-aside and the correct amount of interest income.

The scope of the audit included the set-aside calculations and interest income allocations for fiscal years 2005-06 and 2006-07. In addition, we also reviewed the City Administration's 2006 true-up calculation. The City Administration recalculated the amount the City owed the Kids First Fund (Fund) for fiscal years 1997-98 through 2004-05. The City Administration performed this true-up calculation in response to the Office of the City Attorney's (City Attorney) legal opinions, which opined that the City Administration should have determined the set-aside amount based on actual rather than budgeted unrestricted general fund revenues. The City Attorney also opined that franchise fees needed to be included in the unrestricted general fund totals for calculating the set-aside. As a result of the true-up calculation, the City paid the Fund an additional \$3,288,032.

To determine if the City Administration set aside the correct amount of money for the Fund, we reviewed the Charter requirements, legal opinions, and prior audit reports that addressed the funding requirements. We also interviewed officials from the City Administration to determine how they calculated the set-aside, and reviewed their calculations. In addition, we reviewed and analyzed financial records from the City's Oracle financial system. We also judgmentally sampled revenue transactions to determine if the City Administration properly classified these general fund revenues as restricted and unrestricted.

To assess the accuracy of the amount of interest income credited to the Fund, we interviewed City Administration staff to determine how interest is allocated to the Fund. We also judgmentally selected one month of each fiscal year and tested the accuracy of the interest allocation to the Fund.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a

City of Oakland, Office of the City Auditor
Measure K 2.5% Set-Aside Performance Audit

reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT RESULTS
THE CITY OWES THE KIDS FIRST FUND \$647,000

The audit found that the City Administration did not include certain unrestricted general fund revenues in the calculation of the set-aside for fiscal years 2005-06 and 2006-07. As a result, the City underpaid the Kids First Fund by \$398,780 for fiscal years 2005-06 and 2006-07.

In 2006, the City Administration performed a true-up calculation to recalculate the amount the City owed the Kids First Fund for fiscal years 1997-98 through 2004-05. As a result of the true-up calculation, the City paid the Fund an additional \$3,288,032. The audit found that the City Administration did not classify cable television franchise fees as unrestricted revenues in the true-up calculation. As a result, the City underpaid the Fund by \$248,640, with respect to the true-up calculation.

The audit also found that the City Administration lacks a clear policy for reimbursing the Fund for any differences between the set-aside based on actual versus budgeted revenues. Specifically, the City Administration delayed crediting the Fund another \$652,931 from the recalculation of budgeted versus actual revenues for fiscal years 2005-06 and 2006-07.

The audit found that the City Administration allocated interest income to the Fund in fiscal years 2005-06 and 2006-07 in accordance with the process the City Administration uses to allocate interest to other City funds.

Kids First Fund Set-Aside Requirements

The Kids First Fund Charter amendment did not define several key terms that are used to calculate how much money should be set aside. For instance, the amendment did not define the term unrestricted general fund revenues. Similarly, the amendment did not define which of the City's general fund revenues are restricted or unrestricted.

The City Attorney has issued several legal opinions interpreting the Kids First Fund Charter amendment. In 1997, the City Attorney issued an opinion defining the term unrestricted general fund revenues. The City Attorney's 1997 opinion established that the unrestricted general fund revenues are limited to general fund

revenues, except for revenues subject to spending limits and from special taxes or cost recovery fees.

In 2003, in response to a request from the City Auditor, the City Attorney opined that the set-aside calculation should be based on actual unrestricted general fund revenues rather than budgeted revenues. Furthermore, in 2006, the City Attorney defined most franchise fee revenues as unrestricted. In the latter instance, the City Attorney opined that the City could properly categorize fees as restricted revenues only if the franchise agreements or legislation contain language that limits or restricts the use of the fees, or otherwise imposes restraints on the use of the fees.

The City Administration did not include certain unrestricted general fund revenues in the calculation of the set-aside for fiscal years 2005-06 and 2006-07

The City Administration has established a process for determining the amount of unrestricted general fund revenues. The City Administration uses the total revenues from the General Purpose Fund as the starting point for calculating the unrestricted general fund revenues. Then, the City Administration classifies all of the General Purpose Fund revenues as either unrestricted or restricted revenues. Examples of revenues that the City Administration has classified as unrestricted revenues include: property taxes, sales and use taxes, utility taxes, and franchise fees. Examples of revenues that the City Administration has classified as restricted revenues include: sales taxes with legal restrictions on their use, rents and concessions, grants, cable television franchise fees, the Oakland Raiders ticket surcharge, and sales of land, buildings, and equipment.

The City Administration subtracts the restricted revenues from total General Purpose Fund revenues. The difference equals the total of unrestricted general fund revenues. The City Administration multiplies this amount by 2.5% to determine the amount of the set-aside.

Exhibit 1 on the next page shows the City Administration's calculation of the unrestricted general fund revenue totals and the amount of the set-aside for fiscal years 2005-06 and 2006-07.

EXHIBIT 1

**THE CITY ADMINISTRATION'S CALCULATION OF THE UNRESTRICTED
GENERAL FUND REVENUES AND THE AMOUNT OF THE SET-ASIDE FOR
FY 2005-06 AND FY 2006-07**

| | FY 2005-06 | FY 2006-07 |
|---|-------------------|-------------------|
| All General Purpose Fund Revenues | \$476,458,416 | \$471,416,768 |
| Less: Restricted Revenues | \$69,344,989 | \$79,543,142 |
| Total Unrestricted General Fund Revenues | \$407,113,427 | \$391,873,626 |
| Multiplied by Set-Aside Percentage | x 2.5% | x 2.5% |
| Amount Due to the Kids First Fund | \$10,177,836 | \$9,796,841 |

The audit found that for fiscal years 2005-06 and 2006-07, the City Administration classified \$15,951,225 in revenues as restricted that it should have classified as unrestricted. The three categories of revenues the City Administration did not properly classify as unrestricted revenues are cable television franchise fees; rents; and proceeds from the sales of land, buildings and equipment.

The City Administration classified cable television franchise fee revenues as restricted, even though the City Attorney opined that a majority of these revenues are unrestricted. Specifically, in fiscal years 2005-06 and 2006-07, the City Administration classified \$3,524,574 in cable television franchise fees placed in the General Purpose Fund as restricted revenues. These revenues are unrestricted according to the City Attorney's opinion.

The City Attorney's opinion stated that most franchise fees are unrestricted revenues. Specifically, the City Attorney's opinion stated that franchise fees from Pacific Gas & Electric (PG&E), Alameda County Waste Management, and East Bay Municipal Utility District (EBMUD) are unrestricted revenues because the franchise fees have no restrictions on their use.

The only franchise fee that is restricted is a portion of the cable television franchise fee. The City's contract with Comcast requires Comcast to pay an annual franchise fee of five percent of the company's annual gross revenues to the City. Two percent of the five percent cable television franchise fees are placed in a separate, interest-bearing Telecommunications Account under the sole control of the City Council, to be used for cable-related non-

City of Oakland, Office of the City Auditor
Measure K 2.5% Set-Aside Performance Audit

regulatory activities, including but not limited to funding public education and government-access programming. The City Attorney determined that these fees are restricted. The remaining three percent is placed in the General Purpose Fund. The City Attorney stated that this remaining three percent of the five percent cable television franchise fees is unrestricted.

The audit also found that the City Administration classified all of the revenues from the sales of land, buildings, and equipment as restricted revenues, even though some of these revenues had no restrictions on their use. In fiscal years 2005-06 and 2006-07, the City Administration classified \$19,621,117 in revenues from the sales of land, buildings, and equipment as restricted. However, the audit identified \$10,246,157 of these revenues that the City Administration should have classified as unrestricted.

The audit also found that the City Administration classified all revenues from rents and concessions as restricted revenues, even though some of these are unrestricted revenues. For fiscal years 2005-06 and 2006-07, the audit identified \$2,180,494 in revenues from rents that the City Administration classified as restricted that it should have classified as unrestricted. For instance, the City Administration classified rent revenues from the rents received from tenants of the City's buildings in Frank Ogawa Plaza as restricted. In fiscal years 2005-06 and 2006-07, these rents totaled approximately \$1,009,000 for the four leases we sampled. The revenues have no legal restrictions on how they can be spent. Accordingly, the City should have classified these revenues as unrestricted rather than restricted. The City Administration also classified revenues in the amount of \$756,814 received from the cities of Emeryville and Piedmont for fiscal years 2005-06 and 2006-07 as restricted. These cities pay the City to obtain library services for their residents. Again, these revenues have no restrictions on their use and the City Administration should have classified these revenues as unrestricted, rather than restricted.

For fiscal years 2005-06 and 2006-07, the audit identified a total of \$15,951,225 in revenues that the City Administration classified as restricted that it should have classified as unrestricted. The City Administration's misclassification of these revenues as restricted reduced the amount set aside to the Fund. Exhibit 2 on the next page shows the total of the revenues that the City Administration classified as restricted instead of unrestricted.

EXHIBIT 2
GENERAL FUND REVENUES MISCLASSIFIED AS RESTRICTED

| | | FY 2005-06 | FY 2006-07 | Total |
|---|--|--------------------|---------------------|---------------------|
| | Restricted Revenues per Exhibit 1 | (\$69,344,989) | (\$79,543,142) | |
| Unrestricted Revenues Misclassified as Restricted Revenues | Cable television franchise fees | \$1,701,021 | \$1,823,553 | \$3,524,574 |
| | Proceeds from the sales of land, buildings and equipment | 2,647,380 | 7,598,777 | 10,246,157 |
| | Rents | 1,055,850 | 1,124,644 | 2,180,494 |
| | Total | \$5,404,251 | \$10,546,974 | \$15,951,225 |
| | Revised Restricted Revenues | (\$63,940,738) | (\$68,996,168) | |

Exhibit 3 illustrates the set-aside calculation using the lower restricted revenue figures. The revised set-aside amount due to the Fund is greater than the City Administration's calculation of the set-aside due to the Fund shown in the last row of Exhibit 1.

EXHIBIT 3
**REVISED CALCULATION OF THE UNRESTRICTED GENERAL FUND
REVENUES AND THE AMOUNT OF THE SET-ASIDE FOR FY 2005-06 AND
FY 2006-07**

| | FY 2005-06 | FY 2006-07 |
|---|-------------------|-------------------|
| All General Purpose Fund Revenues | \$476,458,416 | \$471,416,768 |
| Less: | | |
| Revised Restricted Revenues | (63,940,738) | (68,996,168) |
| Total Revised Unrestricted General Fund Revenues | \$412,517,678 | \$402,420,600 |
| Multiplied by: | | |
| Set-Aside Percentage | x 2.5% | x 2.5% |
| Revised Amount Due to the Kids First Fund | \$10,312,942 | \$10,060,515 |
| Less: Amount Due to the Kids First Fund from Exhibit 1 | (10,177,836) | (9,796,841) |
| Additional Amount Due to the Kids First Fund | \$135,106 | \$263,674 |
| Combined Amount Due for Both Fiscal Years | | \$398,780 |

City of Oakland, Office of the City Auditor
Measure K 2.5% Set-Aside Performance Audit

As the exhibit on the previous page shows, the City owes \$398,780 to the Fund because the City Administration classified revenues as restricted that should have been classified as unrestricted.

Accordingly, we recommend that the City pay the Fund an additional \$398,780.

The City Administration did not include certain unrestricted general fund revenues in the calculation of the set-aside for fiscal year 2007-08

Although fiscal year 2007-08 was not in our audit scope, we determined that the City Administration improperly classified the same revenues in the fiscal year 2007-08 calculation of the set-aside as it had in previous years. Specifically, the City Administration classified the cable television franchise fees, all rent and concession revenues, and all revenues received from the sales of land, buildings, and equipment as restricted.

As of December 31, 2008, the City Administration had not calculated the set-aside for fiscal year 2007-08 based on actual revenues. Therefore, we recommend that when the City Administration calculates the set-aside for fiscal year 2007-08 based on actual revenues, it should include the cable television franchise fees in the unrestricted general fund revenue total. Furthermore, the City Administration should review the revenues from rents and the sales of land, buildings, and equipment to identify those revenues that are unrestricted and include them in the calculation of the set-aside.

By the completion of the audit, the City Administration calculated the set-aside based on actual revenues. In performing this calculation, City Administration staff stated that they classified the cable television franchise fees and certain rent revenues as unrestricted revenues. The City Administration did not classify any revenues from the sales of land, buildings, and equipment as unrestricted because the City Administration believes that all of these transactions should be classified as restricted.

We did not audit the City Administration's calculations; however, we will verify its calculations during our next Measure K audit of fiscal years 2007-08 and 2008-09. The City Administration's calculation of the set-aside based on actual revenues found that the City overpaid the Fund by \$278,290 when it calculated the set-aside based on budgeted revenues.

The City Administration needs to develop and implement better internal controls to ensure that the set-aside calculations are correct

The audit found that the City Administration needs to develop and implement better internal controls to ensure that the set-aside calculations are correct. Specifically, we found that the City Administration has not established written policies and procedures for calculating the set-aside. Furthermore, the City Administration has no formally-defined procedure for identifying which revenue transactions are restricted or unrestricted.

Therefore, we recommend that the City Administration develop a formal policy and procedure for calculating the set-aside. This policy and procedure should assign responsibility for calculating the set-aside and for reviewing the calculation for accuracy and compliance with the Kids First Fund Charter amendment, all legal opinions, and all City Council directives. Furthermore, the policy and procedure should clarify the definitions of restricted and unrestricted revenues. The policy and procedure should also establish a process for classifying revenues as either restricted or unrestricted.

The City Administration did not include cable television franchise fees in the true-up calculation

The City Administration performed a true-up calculation in 2006 to correct the set-aside calculations for fiscal years 1997-98 through 2004-05. The true-up calculation was to address the City Attorney's opinions stating that the City Administration should calculate the unrestricted general fund revenues based on actual rather than budgeted revenues and include franchise fees in the unrestricted general revenue total.

In 2006, the City Administration calculated the true-up and determined that the City owed the Fund an additional \$3,288,032. Of this total, the City Administration determined that \$1,672,735 was due to the difference between the set-aside based on actual compared to budgeted unrestricted general fund revenues. The remaining \$1,615,297 was due to the classification of franchise fees for PG&E, refuse collection, EBMUD, and other miscellaneous franchise fees as unrestricted revenues.

The City Administration reimbursed the Fund for the true-up in two annual installments. Specifically, the City Administration paid

City of Oakland, Office of the City Auditor
Measure K 2.5% Set-Aside Performance Audit

the Fund \$1,567,578 in fiscal year 2006-07 and \$1,720,454 in fiscal year 2007-08.

The audit found, however, that the City Administration did not classify cable television franchise fees as unrestricted revenues in calculating the true-up. Specifically, the audit found that the City Administration did not classify \$9,945,621 in cable television franchise fees that were placed in the General Purpose Fund as unrestricted revenues. The City Attorney's 2006 opinion stated that there is no restriction on the use of these revenues. Exhibit 4 below is a comparison of the City Administration's calculation of the true-up and the calculation of the true-up made by the Office of the City Auditor (City Auditor). The City Administration's calculation classifies cable television franchise fees as restricted revenues, and the City Auditor's true-up calculation classifies cable television franchise fees as unrestricted revenues.

EXHIBIT 4
COMPARISON OF THE CITY ADMINISTRATION'S TRUE-UP
CALCULATION AND THE CITY AUDITOR'S TRUE-UP CALCULATION

| | Total True-Up Amount for FY 1997-98 to FY 2004-05 |
|--|--|
| City Administration's true-up calculation | \$3,288,032 |
| City Auditor's true-up calculation | \$3,536,672 |
| Difference | \$248,640 |

As the exhibit above shows, the City Administration's true-up calculation is \$248,640 less than the City Auditor's calculation because the City Administration did not classify the cable television franchise fees as unrestricted revenues. By not classifying the cable television franchise fees as unrestricted revenues in the true-up calculation, the City underpaid the Fund by \$248,640.

To correct this omission, we recommend that the City Administration pay the Fund \$248,640.

The City Administration lacks a clear policy for reimbursing the Fund for any differences between the set-aside based on actual versus budgeted revenues

Annually, prior to the beginning of the fiscal year, the City Administration determines the set-aside for the Fund based on budgeted unrestricted general fund revenues. After the fiscal year ends and the annual financial audit is completed, the City Administration recalculates the set-aside based on actual unrestricted general fund revenues. If the initial set-aside amount is lower than the set-aside amount based on actual revenues, the City's general fund must reimburse the Fund for the difference. On the other hand, if the initial set-aside amount is higher than the set-aside amount based on actual revenues, the Fund owes the general fund the difference.

The City Administration performed this calculation for fiscal years 2005-06 and 2006-07. Exhibit 5 below shows the City Administration's calculations for the fiscal years 2005-06 and 2006-07.

**EXHIBIT 5
CITY ADMINISTRATION'S CALCULATIONS OF THE SET-ASIDE BASED ON
BUDGETED AND ACTUAL REVENUES FOR FISCAL YEARS 2005-06 AND
2006-07**

| Fiscal Years | Set-aside based on budgeted revenues | Set-aside based on actual revenues | Amount owed to the Kids First Fund | Amount owed to the General Fund |
|---------------------|---|---|---|--|
| 2005-06 | \$9,263,564 | \$10,177,836 | \$914,272 | |
| 2006-07 | \$10,058,181 | \$9,796,840 | | \$261,341 |
| Net Total | | | \$652,931 | |

As the exhibit illustrates, the general fund owes the Kids First Fund \$652,931. In addition, the Kids First Fund has not received any interest on these monies while the monies remain deposited in the general fund because the City Administration has not repaid the Kids First Fund in a timely manner.

Although the City Administration has calculated the set-aside based on actual revenues, the City Administration lacks a clear policy on when any adjustments should be repaid to the respective fund. The City's general fund did not reimburse the Fund for the

monies owed after fiscal years 2005-06 and 2006-07 until fiscal year 2008-09.

To address this problem, we recommend that the City Administration develop a written policy and procedure that clarifies when adjustments should be calculated and when the adjustments should be paid to the respective funds.

Furthermore, the Kids First Fund earns interest income on monies deposited in the Fund. However, the Kids First Fund Charter amendment and previous City Attorney's opinions have not addressed whether the Fund should earn interest on monies owed to the Fund, but not yet deposited to the Fund. For instance, should the City pay the Kids First Fund interest on the net amount of \$652,931 owed to the Fund for the two years?

Therefore, we recommend that the City Attorney opine on whether the City's general fund should pay interest income to the Fund on monies that are owed to the Kids First Fund.

At the completion of our audit, the City Administration requested the City Attorney to opine on whether the City's general fund should pay interest income to the Fund on monies that are owed to the Fund.

The City Administration correctly credited interest income to the Kids First Fund

The Kids First! Charter amendment requires that the City credit the Kids First Fund with interest income earned on the monies in the Fund. Exhibit 6 below shows the amount of interest credited to the Kids First Fund in fiscal years 2005-06 and 2006-07.

**EXHIBIT 6
INTEREST INCOME CREDITED TO THE FUND IN FISCAL YEARS 2005-06
AND 2006-07**

| Fiscal Year | Amount Credited to the Kids First Fund |
|--------------------|---|
| FY 2005-06 | \$320,466 |
| FY 2006-07 | \$355,745 |
| Total | \$676,211 |

The audit concluded that the City Administration allocated interest to the Kids First Fund in accordance with the process used to allocate interest income to all the funds participating in the City's

investment pool. As stated above, the City Attorney will need to opine on whether the City's general fund owes the Kids First Fund any additional interest that has resulted from the delay in crediting \$652,931 to the Fund.

CONCLUSION

The audit found that the City Administration underpaid the Kids First Fund by \$398,780 in fiscal years 2005-06 and 2006-07. In addition, the City Administration did not classify cable television franchise fees placed in the General Purpose Fund as unrestricted revenues in its 2006 true-up calculation. Consequently, the City Administration underpaid the Kids First Fund by \$248,640.

Furthermore, the City Administration lacks a formal policy and procedure for calculating the set-aside and reimbursing either the City or the Fund for any differences between the set-aside based on actual versus budgeted revenue.

RECOMMENDATIONS

The City Administration should:

RECOMMENDATION NO. 1: Pay the Kids First Fund \$398,780 to correct the set-aside calculation for fiscal years 2005-06 and 2006-07.

RECOMMENDATION NO. 2: Include the cable television franchise fees in the unrestricted general fund revenue total when calculating the set-aside for fiscal year 2007-08 based on actual revenues. Furthermore, the City Administration should review the revenues from rents and the sales of land, buildings, and equipment to identify those revenues that are unrestricted and include them in the calculation of the set-aside.

RECOMMENDATION NO. 3: Develop a formal policy and procedure for calculating the set-aside. This policy and procedure should assign responsibility for calculating the set-aside and for reviewing the calculation for accuracy and compliance with the Kids First Fund Charter amendment, all legal opinions and all City Council directives. Furthermore, the policy and procedure should clarify the definitions of restricted and unrestricted revenues and

establish a process for classifying revenues as either restricted or unrestricted.

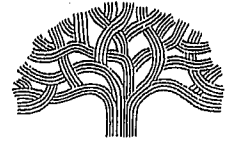
RECOMMENDATION NO. 4: Pay the Kids First Fund \$248,640 to correct the true-up calculation for fiscal years 1997-98 through 2004-05.

RECOMMENDATION NO. 5: Develop a written policy and procedure that clarifies when the City Administration should calculate and repay any monies owed to the Fund.

RECOMMENDATION NO. 6: Request the City Attorney to opine on whether the City owes the Kids First Fund any additional interest resulting from the delay in crediting \$652,931 to the Fund.

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April 24, 2009

Courtney Ruby
City Auditor
(Hand-Delivered)

Re: Management's Responses to the Final Draft of the Kids First! (Measure K) Audit Report

Dear Ms. Ruby

Management has reviewed the final draft of the Kids First! audit report received on April 13, 2009. We agree with some recommendations and require legal guidance on others in order to furnish our final response. The key outstanding question is whether proceeds from the Marriott property sale – as well as similar sales of property and land – should be treated as unrestricted revenues, as your audit maintains.

Our specific responses are detailed on the following pages. Please let us know if we can answer any questions or provide further documentation. We also would gladly have a face-to-face meeting with you or your staff to further discuss our responses.

Sincerely,

A handwritten signature in black ink, appearing to read 'Dan Lindheim', with a long horizontal stroke extending to the right.

Dan Lindheim
City Administrator

MANAGEMENT'S RESPONSES TO THE FINAL DRAFT OF THE KIDS FIRST! AUDIT REPORT

Recommendation No. 1

The City Administration should pay the Kids First! Fund \$398,780 to correct the set-aside calculation for the fiscal years 2005-06 and 2006-07.

Response

Management's calculation of the amount owed is \$163,409. (Please see "Attachment A" - Comparison of City Auditor's and Management's Calculations of Owed Amounts). We will include the amount owed in the FY 2009-11 budget.

The following items have reduced management's calculation as compared to the City Auditor's:

- **Proceeds from the Sale of Marriott:** We have treated the entire amount of proceeds (\$7,300,000) as restricted revenue, therefore deducting it from the revenue base. This resulted in the reduction of the amount owed by 2.5% of \$7.3 million, or \$182,500.

Management uses the following rationale to treat the above proceeds as "restricted":

1. Staff spoke with Stephen J. Gauthier of the Government Finance Officers Association (GFOA), who authored the "Blue Book" on Governmental Accounting, Auditing and Financial Reporting, and consulted Government Accounting Standards Board's (GASB) Statement #34 regarding the official definition of **restricted funds**.
2. Per GASB Statement #34, paragraph 34, restricted net assets can be defined as those net assets where constraints are placed on them either externally by creditors (such as through debt covenants), grantors, contributors, or laws and regulations of other governments; or by law through constitutional provisions or enabling legislation of the government itself. The term "enabling legislation" is defined in paragraph 34 as legislation that authorizes the government to assess, levy, charge, or otherwise mandate payment of resources (from external providers) including a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.
3. Proceeds from the Marriot property sale were used to repay a loan to the City by the Oakland Renaissance Associates (ORA). The loan to ORA originated in 1997; the \$7.3 million payment was a partial loan repayment against total loan receivables of \$20,746,748. ORA's payment was not a receipt of unrestricted revenue, but a reduction of the City's loan receivables. We have provided to your office: (i) copies of loan agreements; and (ii) accounting documents showing that the sale proceeds were used to pay off the loan.

Therefore, management maintains that proceeds from the sale of the Marriott property in FY 2006-07 were restricted as they were used to pay off debt related to that property. (The proceeds, therefore, fall in the "restricted" category of "assets where constraints are placed on them either externally by creditors (such as through debt covenants)", per GASB 34.

We also requested a formal legal opinion from the City Attorney's Office on the above item.

- **Rents received for building space at the Frank Ogawa Plaza:** Management maintains that these rent receipts are restricted because they pay for the costs necessary to maintain the building space, related debt service, and other necessary expenses. We have treated these rents (totaling \$1,358,018) as restricted revenue, therefore deducting it from the revenue base. This resulted in the reduction of the amount owed by \$33,950.
- **Payments from Emeryville and Piedmont for library services:** Management sees these payments as fees for services provided by Oakland to these other cities. Therefore, we maintain that payments received from these cities should be treated as restricted revenues, just like all other fees for services are treated for the purposes of calculating the Kids First set aside. Therefore, we have deduced these payments (totaling \$756,814) as restricted revenue, resulting in the reduction of the amount owed by \$18,920.

Recommendation No. 2

When the City Administration calculates the set-aside for fiscal year 2007-08 based on actual revenues, it should include the cable television franchise fees in the unrestricted general fund revenue total. Furthermore, the City Administration should review the revenues from rent and the sales of land, buildings, and equipment to identify those revenues that are unrestricted and include them in the calculation of the set-aside.

Response

Management concurs with this recommendation and has implemented the recommendation to include franchise cable fees as unrestricted funds in the Kids First! Fund calculation. Please see "Attachment B" ("FY 2007-08 Calculation of Mandatory "Kids First!" Transfer") for the FY 2007-08 calculation. This calculation has been shared with and approved by your office. The true-up calculation indicates that the General Fund **overpaid** Kids First **\$278,290** in FY 2007-08; this amount is owed by the Kids First! Fund to the General Fund.

Please note that the above computation of the true-up payment treated the following revenues as unrestricted:

- cost reimbursement received from the Oakland Base Reuse Authority, for municipal services provided by the City.
- revenues collected from the cities of Piedmont and Emeryville for use of Oakland Public Libraries
- rent received from tenants leasing units in Frank H. Ogawa Plaza.

In addition, staff is further reviewing, in consultation with the City Attorney's Office, actual revenues from rent and the sales of land, buildings, and equipment. If any such revenues are deemed "restricted", the owed amount may increase slightly.

Recommendation No. 3

The City Administration should develop a formal policy and procedures for calculating the set-aside. This policy and procedures should assign responsibility for calculating the set-aside and for reviewing the calculation for accuracy and compliance with the Kids First! Fund Charter amendment, all legal opinions and all City Council directives. Furthermore, the policy and

procedure should clarify the definition of restricted and unrestricted revenues and establish a process for classifying revenues as either restricted or unrestricted.

Response

Management concurs with this recommendation. We have already discussed with your office the timeline to develop the suggested guidelines, and specifics items that such guidelines should address. By September 2009, the Budget Office will develop an Administrative Instruction (AI) outlining a formal policy and set of procedures for calculating the set-aside. This AI will assign responsibility to the Budget Office for calculating the set-aside and for reviewing the calculation for accuracy and compliance with the Kids First! Fund Charter amendment, all legal opinions and all City Council directives. The AI will also define the meaning of restricted and unrestricted revenues, per the Government Accounting Standard Board (GASB) definition of restricted assets and based on legal opinions requested in this management's response letter. Lastly, the AI will establish a timeline for calculating the initial (based on budget) set-aside, transferring the budgeted amount, recalculating based on audited actual revenues, and transferring the under-paid amount (or collecting over-paid amount), along with applicable interest.

We look forward to sharing a draft of the AI with your office as well as the City Attorney's Office, for feedback before it is finalized.

Recommendation No. 4

The City Administration should pay the Kids First! Fund \$248,640 to correct the true-up calculation for fiscal years 1997-98 through 2004-05.

Response

Management concurs, and will include the amount owed in the FY 2009-11 budget.

Recommendation No. 5

City Administration should develop a written policy and procedures that clarifies when the City Administration should calculate and repay any monies owed to the Fund.

Response

Management concurs. This procedure will be included as part of the AI referenced in our response to Recommendation No. 3 above.

Recommendation No. 6

The City Attorney will need to opine on whether the City owes the Kids First! Fund any additional interest resulting from the delay in crediting \$652,931 to the Fund.

Response

Management has requested a legal opinion from the City Attorney's Office on this matter. We maintain that such interest charge should be applied to amounts both due to and due from the Kids First! Fund as a result of true-up calculations.

FY 2007-08 CALCULATION OF MANDATORY "KIDS FIRST!" TRANSFER*Note: The Kids First transfer is 2.5% of Unrestricted General Fund Revenues*

| | FY 2007-08 |
|--|---------------------|
| Actual Audited Revenue | \$455,221,386 |
| <u>Less Restricted General Purpose Fund Revenues:</u> | |
| Prop 172 Sales Tax (41313) | (2,616,383) |
| Service Charge Revenues | (44,069,467) |
| Add: Parking Meter Revenues in (453xx) | 9,600,494 |
| Add: Service Charges - Franchise Fees (416xx) | 12,514,693 |
| Add: Unrestricted Rents and Concessions (44219, 44419, 44519)* | 17,263 |
| Grants and Subventions (46xxx) | (4,647,185) |
| Sale of Land/Vehicles/Buildings (481xx) | 0 |
| Raiders Ticket Surcharge | (174,560) |
| Project-related Revenues | 0 |
| Loan Repayments | 0 |
| Operating Transfers | (25,695,366) |
| Net Unrestricted General Purpose Fund Revenues | \$400,150,875 |
| <u>Kids First 2.5% Funding Obligation (Actual)</u> | <u>\$10,003,772</u> |
| <u>Budgeted Transfers</u> | <u>\$10,282,062</u> |
| <u>Budget to Actual Adjustments Due to Kids First!</u> | <u>(\$278,290)</u> |

* Certain Rents & Concessions Revenue (44219, 44419, 44519) as "Restricted"
 (Excludes Oakland Army Base (44419) reimbursement to GPF for Municipal Services)

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**OFFICE OF THE CITY AUDITOR'S RESPONSE TO THE
OFFICE OF THE CITY ADMINISTRATOR'S RESPONSE**

To provide clarity and perspective, we are commenting on the Office of the City Administrator's (City Administrator) response to the Office of the City Auditor's (Office) audit report.

The City Administrator has fully concurred with five of the six recommendations in the audit report and partly concurs with the other recommendation. The only major disagreement is the amount that the City owes the Kids First Fund. The exhibit below compares the Office's calculation of the amount the City owes the Kids First Fund for fiscal years 2005-06 and 2007-08 and for the true-up calculation performed in 2006, to the City Administrator's estimate of the amount the City owes the Kids First Fund.

| Source | Amount owed for 2005-06 and 2006-07 | Amount owed for the 2006 true-up calculation | Total amount owed to the Kids First Fund |
|--------------------|---|--|--|
| City Auditor | \$398,780 | \$248,640 | \$647,420 |
| City Administrator | \$163,409 | \$248,640 | \$412,049 |
| Difference | \$235,371 | 0 | \$235,371 |

As shown in the exhibit above, the City Administrator's estimate of the amount owed for fiscal years 2005-06 and 2006-07 and for the 2006 true-up calculation, is \$235,371 less than the amount in the audit report.

In addition to this difference, the City Administrator has reduced the amount the City owes by another \$278,290. This adjustment is for the calculation of the set-aside based on actual revenues for fiscal year 2007-08. Although the audit report acknowledged the City Administrator's calculation in response to the audit recommendation, we did not adjust the report because the City Administrator's calculation was outside the scope of our audit. We did not audit this calculation and intend to do so at a later time.

The difference between the audit report and the City Administrator with regard to the amount the City owes the Kids First Fund for fiscal years 2005-06 and 2006-07 is due to the treatment of three revenue items. The three revenue items are \$7.3 million in revenues from the sale of the City's interest in the Marriott Hotel, \$1,358,018 in rent revenues from space the City owns in Frank Ogawa Plaza, and \$756,814 in revenues received from the cities of Emeryville and Piedmont. These revenues are payments from these cities to allow their residents to use Oakland libraries. As stated in the audit report, the Office believes that the above revenues are unrestricted, whereas, the City Administrator believes these revenues are restricted. The impact on the amount of money owed to the Kids First Fund is as follows: revenues received from the sale of City's interest in the Marriott Hotel (\$182,500); rent revenues from Frank Ogawa Plaza (\$33,950); and revenues received from the cities of Emeryville and Piedmont (\$18,920).

The Office has the following general comments with regard to the three revenue items mentioned above. Overall, the Office relied on previous City Attorney opinions in classifying revenues as either restricted or unrestricted. In 1997, the City Attorney opined that unrestricted general fund revenues are revenues in the general fund which are subject to appropriation at the discretion of the City Council. The unrestricted general fund excludes revenues derived from taxes imposed for a special purpose, fees for services provided which are based on cost reimbursement, and other dedicated revenues with restrictions upon their use. Furthermore, in 2006, the City Attorney opined that the City could properly classify fees as restricted revenues only if the franchise agreements or legislation contain language that limits or restricts the use of the fees, or otherwise imposes restraints on the use of the fees.

During the audit, we discussed the classification of these revenue items with staff from the City Attorney's office. The City Attorney staff agreed with our assessment that these revenues should be classified as unrestricted. Furthermore, City Attorney staff communicated to City staff that they needed to provide sufficient evidence of the restrictions if these revenues are to be classified as restricted.

The Office has the following specific comments with respect to the City Administrator's response to the three revenue items. In the City Administrator's comments on the sale of the City's interest in the Marriott Hotel, the City Administrator introduces criteria for assessing whether these revenues should be classified as restricted or unrestricted. Specifically, the City Administrator mentions GASB #34, which defines restricted net assets. We fail to see how the GASB pronouncement, as it relates to determining whether these revenues should be classified as restricted or unrestricted, differs significantly from the City Attorney's opinion. Furthermore, the City Administrator notes that \$7.3 million received from the sale of the City's interest in the Marriott Hotel was used to pay off debt from the property. The City deposited these proceeds in the General Purpose Fund and the proceeds were subject to appropriation by the City Council. In fact, the City Council funded various projects with the proceeds received from the sale of the City's interest in the Marriott Hotel. As noted above, the City Attorney's 1997 opinion specifically stated that unrestricted general fund revenues are those revenues subject to appropriation at the discretion of the City Council. Clearly, the City Council had discretion on how these revenues were spent. Therefore, our position stands that the proceeds from the sale of the City's interest in the Marriott Hotel should be classified as unrestricted revenues.

In regard to the rents received from property that the City owns in Frank Ogawa Plaza, the City Administrator disputes that these revenues should be classified as restricted because they pay for costs associated with building space, related debt service, and other necessary expenses. We disagree with the City Administrator's rationale for classifying these revenues as restricted. The City Attorney's 1997 opinion allows fees to be classified as restricted if they are cost-reimbursable. The City Attorney's opinion is referring to fees for municipal services which are required to be set based on the cost of the service. These fees cannot exceed the cost of providing the service. Fees set based on the cost of municipal services are contrasted by charging rents to tenants at Frank Ogawa Plaza. Rents charged at fair-market value are subject to market fluctuations and are not

City of Oakland, Office of the City Auditor
Measure K 2.5% Set-Aside Performance Audit

set according to the cost of providing building space maintenance and debt service coverage as a fee would be. We also have not been provided with any documentation that precludes the City Council from using Frank Ogawa Plaza property rent revenue at its discretion. Therefore, the rent charged on fair market value of the property does not meet the intent of the City Attorney's opinion and should be classified as unrestricted.

In regard to the payments received from the cities of Emeryville and Piedmont, the City Administrator's response notes that these revenues should be treated as restricted revenues because it is a fee for the cost of providing service to the residents of these other cities. Therefore, the City Administrator considers the fees, like other fees for service, are appropriately treated as restricted revenues. We disagree that contracts with Emeryville and Piedmont are the same as other fees for services. As noted above, municipal governments set fees based on the cost of providing service, where fees cannot exceed the cost of providing the service. The City negotiates the price of these agreements with the two jurisdictions. In fiscal years 2005-06 and 2006-07, the City of Emeryville paid a negotiated fixed amount. The City of Piedmont paid an amount calculated on a formula based on the total number of residents. However, residents from Piedmont use the library to varying degrees, so cost recovery based on the total number of residents rather than actual use is relatively imprecise. Since these revenues are not based on the cost of providing service, the library payments do not fit the cost-recovery model. Therefore, these revenues do not meet criteria for classifying them as restricted revenues.

CITY OF OAKLAND



CITY HALL • 1 FRANK H. OGAWA PLAZA • OAKLAND, CALIFORNIA 94612

Office of the City Administrator

(510) 238-3301
FAX (510) 238-2223
TDD (510) 238-2007

April 24, 2009

Courtney Ruby
City Auditor
(Hand-Delivered)

Re: Management's Responses to the Final Draft of the Kids First! (Measure K) Audit Report

Dear Ms. Ruby

Management has reviewed the final draft of the Kids First! audit report received on April 13, 2009. We agree with some recommendations and require legal guidance on others in order to furnish our final response. The key outstanding question is whether proceeds from the Marriott property sale – as well as similar sales of property and land – should be treated as unrestricted revenues, as your audit maintains.

Our specific responses are detailed on the following pages. Please let us know if we can answer any questions or provide further documentation. We also would gladly have a face-to-face meeting with you or your staff to further discuss our responses.

Sincerely,

A handwritten signature in black ink, appearing to read 'Dan Lindheim', with a long, sweeping horizontal stroke extending to the right.

Dan Lindheim
City Administrator

MANAGEMENT'S RESPONSES TO THE FINAL DRAFT OF THE KIDS FIRST! AUDIT REPORT

Recommendation No. 1

The City Administration should pay the Kids First! Fund \$398,780 to correct the set-aside calculation for the fiscal years 2005-06 and 2006-07.

Response

Management's calculation of the amount owed is **\$163,409**. (Please see "Attachment A" - Comparison of City Auditor's and Management's Calculations of Owed Amounts). We will include the amount owed in the FY 2009-11 budget

The following items have reduced management's calculation as compared to the City Auditor's:

- **Proceeds from the Sale of Marriott:** We have treated the entire amount of proceeds (\$7,300,000) as restricted revenue, therefore deducting it from the revenue base. This resulted in the reduction of the amount owed by 2.5% of \$7.3 million, or **\$182,500**.

Management uses the following rationale to treat the above proceeds as "restricted":

1. Staff spoke with Stephen J. Gauthier of the Government Finance Officers Association (GFOA), who authored the "Blue Book" on Governmental Accounting, Auditing and Financial Reporting, and consulted Government Accounting Standards Board's (GASB) Statement #34 regarding the official definition of **restricted funds**.
2. Per GASB Statement #34, paragraph 34, restricted net assets can be defined as those net assets where constraints are placed on them either externally by creditors (such as through debt covenants), grantors, contributors, or laws and regulations of other governments; or by law through constitutional provisions or enabling legislation of the government itself. The term "enabling legislation" is defined in paragraph 34 as legislation that authorizes the government to assess, levy, charge, or otherwise mandate payment of resources (from external providers) including a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.
3. Proceeds from the Marriot property sale were used to repay a loan to the City by the Oakland Renaissance Associates (ORA). The loan to ORA originated in 1997; the \$7.3 million payment was a partial loan repayment against total loan receivables of \$20,746,748. ORA's payment was not a receipt of unrestricted revenue, but a reduction of the City's loan receivables. We have provided to your office: (i) copies of loan agreements; and (ii) accounting documents showing that the sale proceeds were used to pay off the loan.

Therefore, management maintains that proceeds from the sale of the Marriott property in FY 2006-07 were **restricted** as they were used to pay off debt related to that property. (The proceeds, therefore, fall in the "restricted" category of "assets where constraints are placed on them either externally by creditors (such as through debt covenants)", per GASB 34.

We also requested a formal legal opinion from the City Attorney's Office on the above item.

- **Rents received for building space at the Frank Ogawa Plaza:** Management maintains that these rent receipts are restricted because they pay for the costs necessary to maintain the building space, related debt service, and other necessary expenses. We have treated these rents (totaling \$1,358,018) as restricted revenue, therefore deducting it from the revenue base. This resulted in the reduction of the amount owed by \$33,950.
- **Payments from Emeryville and Piedmont for library services:** Management sees these payments as fees for services provided by Oakland to these other cities. Therefore, we maintain that payments received from these cities should be treated as restricted revenues, just like all other fees for services are treated for the purposes of calculating the Kids First set aside. Therefore, we have deduced these payments (totaling \$756,814) as restricted revenue, resulting in the reduction of the amount owed by \$18,920.

Recommendation No. 2

When the City Administration calculates the set-aside for fiscal year 2007-08 based on actual revenues, it should include the cable television franchise fees in the unrestricted general fund revenue total. Furthermore, the City Administration should review the revenues from rent and the sales of land, buildings, and equipment to identify those revenues that are unrestricted and include them in the calculation of the set-aside.

Response

Management concurs with this recommendation and has implemented the recommendation to include franchise cable fees as unrestricted funds in the Kids First! Fund calculation. Please see "Attachment B" ("FY 2007-08 Calculation of Mandatory "Kids First!" Transfer") for the FY 2007-08 calculation. This calculation has been shared with and approved by your office. The true-up calculation indicates that the General Fund overpaid Kids First \$278,290 in FY 2007-08; this amount is owed by the Kids First! Fund to the General Fund.

Please note that the above computation of the true-up payment treated the following revenues as unrestricted:

- cost reimbursement received from the Oakland Base Reuse Authority, for municipal services provided by the City.
- revenues collected from the cities of Piedmont and Emeryville for use of Oakland Public Libraries
- rent received from tenants leasing units in Frank H. Ogawa Plaza.

In addition, staff is further reviewing, in consultation with the City Attorney's Office, actual revenues from rent and the sales of land, buildings, and equipment. If any such revenues are deemed "restricted", the owed amount may increase slightly.

Recommendation No. 3

The City Administration should develop a formal policy and procedures for calculating the set-aside. This policy and procedures should assign responsibility for calculating the set-aside and for reviewing the calculation for accuracy and compliance with the Kids First! Fund Charter amendment, all legal opinions and all City Council directives. Furthermore, the policy and

procedure should clarify the definition of restricted and unrestricted revenues and establish a process for classifying revenues as either restricted or unrestricted.

Response

Management concurs with this recommendation. We have already discussed with your office the timeline to develop the suggested guidelines, and specifics items that such guidelines should address. By September 2009, the Budget Office will develop an Administrative Instruction (AI) outlining a formal policy and set of procedures for calculating the set-aside. This AI will assign responsibility to the Budget Office for calculating the set-aside and for reviewing the calculation for accuracy and compliance with the Kids First! Fund Charter amendment, all legal opinions and all City Council directives. The AI will also define the meaning of restricted and unrestricted revenues, per the Government Accounting Standard Board (GASB) definition of restricted assets and based on legal opinions requested in this management's response letter. Lastly, the AI will establish a timeline for calculating the initial (based on budget) set-aside, transferring the budgeted amount, recalculating based on audited actual revenues, and transferring the under-paid amount (or collecting over-paid amount), along with applicable interest.

We look forward to sharing a draft of the AI with your office as well as the City Attorney's Office, for feedback before it is finalized.

Recommendation No. 4

The City Administration should pay the Kids First! Fund \$248,640 to correct the true-up calculation for fiscal years 1997-98 through 2004-05.

Response

Management concurs, and will include the amount owed in the FY 2009-11 budget.

Recommendation No. 5

City Administration should develop a written policy and procedures that clarifies when the City Administration should calculate and repay any monies owed to the Fund.

Response

Management concurs. This procedure will be included as part of the AI referenced in our response to Recommendation No. 3 above.

Recommendation No. 6

The City Attorney will need to opine on whether the City owes the Kids First! Fund any additional interest resulting from the delay in crediting \$652,931 to the Fund.

Response

Management has requested a legal opinion from the City Attorney's Office on this matter. We maintain that such interest charge should be applied to amounts both due to and due from the Kids First! Fund as a result of true-up calculations.

SUMMARY OF MANAGEMENT'S OPINION AND CALCULATION

Management agrees that overall, the General Fund underpaid the Kids First! Fund for years beginning in FY 1997-98 and through FY 2007-08. However, compared to the City Auditor's calculation of \$647,420, we calculated the total to be \$133,759. The differences are summarized in Attachment "A" ("Comparison of City Auditor's and Management's Calculations of Owed Amounts"), and pertain to: (i) management's treatment of the Marriott property sale proceeds, rents for Frank Ogawa Plaza buildings, and revenues from Emeryville and Piedmont for library services as restricted revenues; and (ii) management's re-calculation of the FY 2007-08 set aside based on actual audited revenues.

Management recommends making the above owed payment to the Kids First! fund in Fiscal Year 2009-11; we have included this set aside in the FY 2009-11 proposed budget

Enclosures: "Attachment A" - Comparison of City Auditor's and Management's Calculations of Owed Amounts

"Attachment B" - FY 2007-08 Calculation of Mandatory "Kids First!" Transfer

Cc: Marianna Marysheva Martinez
Barbara Parker
Andrea Youngdahl
Joseph Yew
Cheryl Taylor

Kids First Audit - Comparison of City Auditor's and Management's Calculations of Owed Amounts

| | Recommendation #1 FY 2005-06 and FY 2006-07 | Recommendation #4 FY 1997-98 to FY 2004-05 True-Up | Recommendation #2 FY 2007-08 True-Up | TOTAL OWED |
|----------------------------------|---|---|---|---------------|
| City Auditor's Office | 398,780 | 248,640 | N/A | 647,420 |
| Less Marriott | 182,500 | | | |
| Less rents for Frank Ogawa Plaza | 33,950 | | | |
| Less library payments | 18,920 | | | |
| Management | 163,409 | 248,640 | (278,290) | 133,759 |

FY 2007-08 CALCULATION OF MANDATORY "KIDS FIRST!" TRANSFER*Note: The Kids First transfer is 2.5% of Unrestricted General Fund Revenues*

| FY 2007-08 | |
|--|----------------------|
| Actual Audited Revenue | \$455,221,386 |
| <u>Less Restricted General Purpose Fund Revenues:</u> | |
| Prop 172 Sales Tax (41313) | (2,616,383) |
| Service Charge Revenues | (44,069,467) |
| Add: Parking Meter Revenues in (453xx) | 9,600,494 |
| Add: Service Charges - Franchise Fees (416xx) | 12,514,693 |
| Add: Unrestricted Rents and Concessions (44219, 44419, 44519)* | 17,263 |
| Grants and Subventions (46xxx) | (4,647,185) |
| Sale of Land/Vehicles/Buildings (481xx) | 0 |
| Raiders Ticket Surcharge | (174,560) |
| Project-related Revenues | 0 |
| Loan Repayments | 0 |
| Operating Transfers | (25,695,366) |
| Net Unrestricted General Purpose Fund Revenues | \$400,150,875 |
| Kids First 2.5% Funding Obligation (Actual) | \$10,003,772 |
| Budgeted Transfers | \$10,282,062 |
| Budget to Actual Adjustments Due to Kids First! | (\$278,290) |

* Certain Rents & Concessions Revenue (44219, 44419, 44519) as "Restricted"
 (Excludes Oakland Army Base (44419) reimbursement to GPF for Municipal Services)

City of Oakland Office of the City Auditor

Measure K Performance Audit: The City Exceeded Required Funding for Children and Youth Services

May 29, 2008



City Auditor
Courtney A. Ruby, CPA

CITY OF OAKLAND



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May 29, 2008

OFFICE OF THE MAYOR
HONORABLE CITY COUNCIL
OAKLAND, CALIFORNIA

**RE: Performance Audit of Measure K: The City Exceeded Required Funding for
Children and Youth Services**

Dear Mayor Dellums, President De La Fuente and Members of the Council:

I am pleased to present a performance audit of the Measure K required level of appropriations for children and youth services. In 1996, the voters of the City of Oakland (City) passed Measure K, which promoted support for programs and services dedicated to the City's children and youth. The Measure specified, among other things, that the City put aside two and one half percent of the General Fund Unrestricted Revenues to create an additional source of funding for children and youth programs. The Measure also required the City to maintain appropriations for existing children and youth services at a prescribed level, which according to the Measure's provisions, was to be determined by the Office of the City Auditor.

The objectives of our audit were to: (1) respond to Measure K's mandate, which requires that 90 days following the end of each fiscal year through 2009-2010, the Office of the City Auditor shall calculate and publish the actual amount of the City of Oakland's appropriations for children and youth services, exclusive of expenditures mandated by state or federal law; (2) determine whether the City of Oakland has complied with the requirements of Measure K in its appropriations for children and youth services; and (3) assess the City's internal controls used to comply with Measure K.

Our audit found that the City exceeded required funding for children and youth services by \$1.2 million and \$4.5 million in fiscal years 2006 and 2007, respectively and is anticipated to exceed the required funding by over \$5.1 million in 2008.

A critical component of compliance is management's implementation of internal controls such as policies and procedures to ensure the City meets the mandates of the Measure each year. Our audit found that the City did not have a system in place to ensure the appropriate funding levels were met. However, in response to the audit's recommendations, the City has agreed to implement internal controls including policies

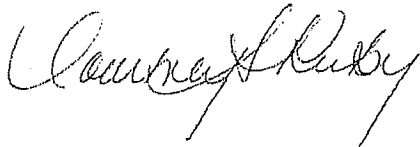
and procedures. Such policies and procedures would facilitate the City's compliance with Measure K by requiring annual compilation of appropriations for children and youth services and tracking compliance with Measure K's baseline percentage.

I believe that the City Administrator's commitment to implementing internal controls is an important step in creating an appropriate control environment. These controls will provide reasonable assurance that management's objectives to comply with Measure K will be met. As public servants I believe it is incumbent upon all of us to foster a sound internal control environment which will translate into increased public confidence.

I would like to express my appreciation to the City Administrator and her staff for their cooperation during our audit. A response from the City Administrator is included in the audit report.

I would also like to acknowledge Elizabeth Olivarez from my staff for her dedicated service in performing the audit of Measure K.

Respectfully submitted,

A handwritten signature in cursive script, reading "Courtney A. Ruby". The signature is written in dark ink and is positioned above the printed name.

COURTNEY A. RUBY, CPA
City Auditor

City of Oakland

Office of the City Auditor

Measure K Performance Audit:
The City Exceeded Required Funding
for Children and Youth Services

May 29, 2008

Table of Contents

| | |
|--|-----------|
| Executive Summary | i |
| Introduction | 1 |
| Background | 1 |
| Objectives, Scope, and Methodology | 3 |
| Audit Results | |
| <u>SECTION I</u> | |
| Appropriations Exceeded Measure K's Funding Requirements | 7 |
| Budgeted Appropriations from FY 2006 to FY 2008 | 7 |
| Table 1. Appropriations by Department or Agency | 8 |
| Table 2. Measure K's Baseline Requirement | 9 |
| Conclusion | 9 |
| <u>SECTION II</u> | |
| Internal Controls Would Facilitate Compliance | 10 |
| Benefits of Implementing Internal Controls | 10 |
| Conclusion and Recommendations | 11 |
| City Administrator's Response | 13 |
| City Auditor's Response | 15 |
| Appendix I | 17 |
| Appendix II | 19 |

EXECUTIVE SUMMARY

In 1996, the voters of the City of Oakland (City) passed Measure K, which promoted support for programs and services dedicated to the City's children and youth. The Measure specified, among other things, that the City put aside two and one half percent of the General Fund Unrestricted Revenues (the unrestricted general fund revenues) to create an additional source of funding for children and youth programs. The Measure also required the City to maintain appropriations for existing children and youth services at a certain level, which according to the Measure's provisions, was to be determined by the Office of the City Auditor (City Auditor). Our audit examined whether the City complied with the provisions of Measure K that required the City to maintain appropriations for children and youth programs and services at the level prescribed by the Measure.

As required by Measure K, the City Auditor determined, for fiscal year (FY) 1996, the Measure's prescribed level of appropriations to be 5.68 percent (referred to as the baseline percentage) of the unrestricted general fund revenues and the base amount to be \$11,891,650, below which appropriations should not fall. The baseline percentage represents Measure K's required level of appropriations for children and youth services during the 12-year life of the Measure. However, recently the Office of the City Attorney (the City Attorney) stated that the baseline percentage should be recalculated to reflect actual, not budgeted, unrestricted general fund revenues. The baseline percentage was recalculated, resulting in a decrease in the baseline percentage from 5.68 to 5.16.

Our audit found that the City's actual appropriations for children and youth services for FY 2006 to FY 2007 exceeded Measure K's required level of funding -- 5.16 percent of the unrestricted general fund revenues -- and for FY 2008, is projected to exceed Measure K's funding level. For instance at the end of FY 2006 and FY 2007, the City's appropriations exceeded Measure K's required level by nearly \$1.2 million and over \$4.5 million, respectively. The City's appropriations are projected to exceed Measure K's required level in FY 2008 by over \$5.1 million.

Although the City exceeded Measure K's required level of appropriations for children and youth services, we believe that the City would benefit from implementing internal controls, such as policies and procedures, to address the City's compliance with Measure K. Such policies and procedures would facilitate the City's compliance with Measure K by requiring annual compilation of appropriations for children and youth services and tracking compliance with Measure K's baseline percentage.

INTRODUCTION

The Office of the City Auditor has completed an audit of Measure K. The objective of the audit was to determine whether the City of Oakland complied with Measure K's required level of appropriations for children and youth services. The audit also assessed the internal controls, which the City relied on, to comply with Measure K.

Background

In 1996, the voters of Oakland, California passed Measure K, which was aimed at helping Oakland's children and youth to become healthy, productive, and honorable adults. Measure K specified two means for accomplishing its intent to support children and youth programs and services. First, Measure K called for the City to provide additional funding to support programs for Oakland's children and youth under age 21. Second, Measure K required the City to continue its level of financial support for the City's existing programs and services for children and youth, age 21 or less.

To provide for additional funding, Measure K required the City to annually put aside two and one half percent (the set-aside) of the unrestricted general fund revenues and create the "KIDS FIRST! Oakland Children's Fund" (Kids First Fund) to receive the set-aside. The Oakland Fund for Children and Youth (OFCY) administers the Kids First Fund within the City's Department of Human Services. OFCY awards grants through a competitive bid process to non-profit groups which operate programs and services for children and youth. The non-profit groups must serve youth that live in, attend school, or receive services in Oakland.

To ensure that the City continues its level of financial support for children and youth services, Measure K provided that the Kids First Fund was to be treated as an increase to the City's aggregate appropriations and expenditures for children and youth services. Therefore, Measure K prohibited the City from allowing the set-aside for Kids First Fund to result in a reduction of the "unrestricted general fund appropriations and expenditures" for children and youth services, below the amount appropriated ("the base amount") in FY 1995-96, the base year.¹ In effect, Measure K required the City to maintain ongoing financial support

¹ According to Section 14 of Measure K, the Kids First Oakland Children's Fund "shall be used exclusively to increase the aggregate City appropriations and expenditures for children and youth services. To this end, the City of Oakland shall not reduce the amount of unrestricted general fund appropriations and expenditures for eligible services in any of the twelve years during which funds are required to be set aside under this section below the amount so appropriated for the fiscal year 1995-1996 ("base amount")."

City of Oakland, Office of the City Auditor
Measure K Performance Audit: The City Exceeded Required Funding

for children and youth services, regardless of the set-aside for the Kids First Fund. Additionally, Measure K required the City Auditor to determine the base amount, i.e., the actual appropriations for children and youth services in 1996, the base year,² and annually adjust³ the base amount according to changes in the City's unrestricted general fund revenues.⁴

In October 1996 and January 1997, the City Attorney issued a legal opinion to the City Auditor concerning the implementation and interpretation of Measure K's base amount funding for children and youth services. Since Measure K required the City Auditor to determine the base amount in 1996 and annually adjust the base amount, the City Attorney's legal opinions of 1996 and 1997,⁵ as reaffirmed in January 2008, (See Appendix I) concluded that there were two base amounts. The first base amount, calculated to be \$11,891,650⁶ for base year 1996 by the City Auditor, constitutes a floor amount. The second base amount is a percentage of the City's unrestricted general fund revenues. For base year 1996, the City Auditor determined this percentage, the baseline percentage, to be 5.68 percent. According to a recent legal opinion,⁷ which the City Attorney issued to the City Auditor, Measure K's requirement of annual adjustments to the base amount should reflect the actual, rather than budgeted, revenues from the unrestricted general fund. In 1996 and 1998, the City Auditor did not use actual unrestricted general fund revenues that were required to be included in the calculation of the baseline percentage.⁸ Recently, the City Auditor recalculated the baseline

² Section 14 of Measure K states that not later than 90 days after the election which approves this section, the City Auditor shall calculate and publish the applicable base amount, specifying by department, program and services each amount included in the base amount.

³ Section 14 of Measure K states that the base amount shall be adjusted for each year after the base year of 1995-1996, based on calculations consistent from year to year, by the percentage increases or decreases in the aggregate City appropriations for the base year as estimated by the City Auditor.

⁴ In a legal opinion to the City Auditor, dated January 13, 1997, the City Attorney, in interpreting the language of Measure K, stated that to achieve consistency throughout this section and the entire initiative, the term "aggregate City appropriations" necessarily must be limited to unrestricted general fund.

⁵ According to the City Attorney's legal opinion to the City Auditor, dated October 18, 1996, the inclusion of the annual adjustment in the base amount, with the language stating that the City may not spend less than in FY 1995-1996 results in a base amount that is both a fixed percentage of the City's unrestricted general fund budget and a floor amount. This interpretation effectively makes the base amount not strictly an amount, but rather a fixed percentage of the City's budget with a minimum amount, a "floor" below which spending cannot go. The City Attorney in his legal opinion, dated January 13, 1997, reaffirmed his interpretations in the October 1996 opinion.

⁶ The base amount and baseline percent, calculated by the City Auditor for FY 1996, was adjusted in 1998 based on final year-end appropriations and other factors.

⁷ The City Attorney's legal opinion to the City Auditor, dated January 23, 2008, states that Measure K's "annual adjustment requirement signifies the electorate's intent that the City Auditor annual adjustments to the base amount reflect the actual, rather than the budgeted, appropriations and expenditures from the unrestricted general fund."

⁸ Franchise fee revenues from various sources should have been classified as unrestricted general fund revenues.

City of Oakland, Office of the City Auditor

Measure K Performance Audit: The City Exceeded Required Funding

percentage using actual unrestricted general fund revenues for FY 1996, and this resulted in decreasing the 5.68 baseline percentage to 5.16 percent. In his recent legal opinion,⁹ the City Attorney's stated that to comply with Measure K's required level of appropriations, i.e., the baseline percentage of the City's appropriations for children and youth services must be at least 5.16 percent of the aggregate appropriations from unrestricted general fund revenues. Since the City's total unrestricted general fund revenues are used to fund the City's total appropriations, the City's appropriations and unrestricted general fund revenues are the same. Thus to comply with Measure K's required level of appropriations, i.e., the baseline percentage, the City's appropriations for children and youth services must be at least 5.16 percent of the unrestricted general fund revenues.

Objectives, Scope, and Methodology

Audit Objectives

The objectives of our audit were to: (1) respond to Measure K's mandate, which requires that 90 days following the end of each fiscal year through 2009-2010, the Office of the City Auditor shall calculate and publish the actual amount of the City of Oakland's appropriations for children and youth services, exclusive of expenditures mandated by state or federal law; (2) determine whether the City of Oakland has complied with the requirements of Measure K in its appropriations for children and youth services; and (3) assess the City's internal controls used to comply with Measure K.

Audit Scope

The scope of our audit encompassed the review of appropriations data from City departments and agencies for three fiscal years, FY 2005-2006, FY 2006-2007, and FY 2007-2008. With regard to our review of the City's internal controls, the scope of our audit was limited to identifying those internal controls which the City uses to comply with Measure K's requirements for funding children and youth services -- the baseline percentage and the dollar base amount -- and assessing the effectiveness of those controls.

Audit Methodology

To establish the requirements for compliance with Measure K, we reviewed and analyzed Measure K's provisions that address appropriations for children and youth services, legal opinions from the City Attorney interpreting the provisions of Measure K, audit reports and documents of

⁹ The City Attorney's legal opinion dated, January 23, 2008, states that "to comply with Measure K's required level of appropriations, i.e., the baseline percentage of the City's appropriations for children and youth services must be at least 5.16 percent of the aggregate appropriations from unrestricted general fund revenues."

City of Oakland, Office of the City Auditor

Measure K Performance Audit: The City Exceeded Required Funding

prior reviews of Measure K, and literature describing the Oakland Fund for Children and Youth. We also obtained the views of City Administration officials.

To compile the City's total appropriations for children and youth services, we requested FY 2006 to FY 2008 appropriations data for children and youth services from all of the City's departments, agencies, or offices, and non-departmental organizations. The City's Budget Division disseminated our request to the City's departments and other units. We compiled and analyzed FY 2006 to FY 2008 appropriations data on children and youth services, which we received from six City departments and agencies and the Budget Division for several non-departmental organizations. (See Appendix II for detailed information on the appropriations of specific programs and services for FY 2005-2006, FY 2006-2007, and FY 2007-2008). We also reviewed revenue and other financial data from the City's Budget Division, and the City's Adopted Policy Budget for FY 2005-2007 and FY 2007-2009.

To determine the City's total appropriations for children and youth services, we included appropriations that were (1) for services and programs benefiting children and youth age 21 or less, (2) originally budgeted under Fund 1010, and (3) reported to us from the City's agencies, departments, offices, or non-departmental organizations in a prepared format. In our total calculation of appropriations, we excluded reported appropriations that were based on federal or private funding sources, or that did not originate from Fund 1010.¹⁰ We also interviewed officials from the Budget Division and departments or agencies providing appropriations data.

We used actual unrestricted general fund revenues to recalculate the FY 1996 baseline percentage and applied the recalculated baseline percentage to the actual unrestricted general fund revenues for FY 2006 and FY 2007 to determine Measure K's required appropriations for these fiscal years. For FY 2008, we used budgeted unrestricted general fund revenues since only budgeted totals are available. We also used final¹¹ budgeted appropriations for fiscal years 2006 and 2007, and budgeted appropriations for FY 2008 in our calculations to determine compliance with Measure K.

Our method of compiling the City's total appropriations for children and youth services was consistent with the City Auditor's 1997 and 1998 method of compiling appropriations for children and youth services. In these compilations, appropriations were included from children and youth

¹⁰ The source of funding for children and youth services is unrestricted general fund revenues, which is referred to as the General Purpose Fund or Fund 1010.

¹¹ Final budgeted appropriations here represent actual appropriations for children and youth services.

City of Oakland, Office of the City Auditor

Measure K Performance Audit: The City Exceeded Required Funding

programs and services that were (1) originally budgeted under Fund 1010 and (2) that covered youth age 21 or less. These compilations also excluded overhead costs. Overhead costs, typically, do not include the costs of direct services and are considered indirect costs. Indirect costs are not identifiable as a cost incurred for a direct activity of an organization or a particular service, such as children and youth services. The City Administration charges the General Purpose Fund (Fund 1010) for overhead costs related to the federal Head Start Program and has included these costs in its appropriations for children and youth services. We excluded these overhead costs from our calculation of appropriations for children and youth services, because these costs do not directly benefit children and youth services.

We verified the accuracy of over 80 percent of the appropriations data submitted by City agencies, departments, or offices and for non-departmental organizations. To verify the accuracy of the appropriations data, we compared reported appropriations from the departments, offices, or non-departmental organizations with those totals reported in the City's Adopted Policy Budget for FY 2005 to 2007, the final budgeted totals from the City's Budget Reporting and Analysis Support System (BRASS), financial reports from the City's Oracle System, or other financial reports provided by the Budget Division. Additionally, we spoke with the Budget Division officials with regards to appropriations from non-departmental organizations and officials from City agencies, departments, or offices that submitted appropriations data for children and youth services. We are reasonably assured that the appropriations we examined were accurate and calculated in accordance with the relevant provisions of Measure K.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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AUDIT RESULTS

SECTION I: APPROPRIATIONS FOR CHILDREN AND YOUTH SERVICES EXCEEDED MEASURE K'S FUNDING REQUIREMENT

Our review of the City's budgeted appropriations for children and youth services over the time period from FY 2006 to FY 2008 found that the City, not only complied with Measure K's required level of funding, but exceeded it. For example, in FY 2006, the City's appropriations for children and youth services totaled almost \$22.2 million and constituted 5.45 percent of the unrestricted general fund revenues, and thus exceeded Measure K's required level of funding --5.16 percent of the unrestricted general fund revenues. In terms of dollars, the City's FY 2006 appropriations for children and youth services exceeded Measure K's requirements by nearly \$1.2 million. Further, the City's appropriations for children and youth services exceeded Measure K's required funding by over \$4.5 million in FY 2007, and are projected to exceed Measure K's required funding in FY 2008 by at least \$5.1 million.

Budgeted Appropriations for Children and Youth Services from FY 2006 to FY 2008

Our review disclosed that the City's budgeted appropriations for children and youth services increased from FY 2006 to FY 2008 and exceeded Measure K's required level of funding in FY 2006 and FY 2007. Specifically, our analyses of the City's appropriations for children and youth services shows that these appropriations increased from almost \$22.2 million in FY 2006 to \$25 million in FY 2007 and are projected to increase to nearly \$26.4 million by the end of FY 2008 (See table 1).

City of Oakland, Office of the City Auditor
Measure K Performance Audit: The City Exceeded Required Funding

| Table 1. FY 2006 - FY 2008 Budgeted Appropriations for Children and Youth Services by Department or Agency and Non-departmental Organizations | | | |
|--|----------------------|----------------------|----------------------|
| Department/Agency/Office | FY 2005-2006 | FY 2006-2007 | FY 2007-2008 |
| Department of Human Services | \$ 567,016 | \$ 1,346,195 | \$ 1,273,089 |
| Fire Services Agency | \$ 115,351 | \$ 120,025 | \$ 124,177 |
| Oakland Public Library | \$ 4,532,190 | \$ 4,909,332 | \$ 5,303,478 |
| Oakland Museum of California | \$ 1,187,866 | \$ 1,330,230 | \$ 1,574,502 |
| Office of Parks and Recreation | \$ 10,342,950 | \$ 10,741,013 | \$ 12,259,593 |
| Police Services Agency | \$ 2,801,688 | \$ 3,167,160 | \$ 2,763,144 |
| Mayor & City Council | \$ 147,539 | \$ 1,004,881 | \$ 0.00 |
| Non-departmental Organizations | \$ 2,505,288 | \$ 2,386,180 | \$ 3,095,371 |
| Total Appropriations | \$ 22,199,888 | \$ 25,005,016 | \$ 26,393,354 |

Note: The total amounts were rounded down or up to the nearest dollar.

Furthermore, the City's appropriations for children and youth services exceeded that which was required by Measure K for all three fiscal years. For instance, in FY 2006, the City appropriated 5.45 percent of the actual unrestricted general fund revenues, which exceeded the required 5.16 baseline percentage (See table 2). At 5.45 percent of the unrestricted general fund revenues, reported at over \$407 million, FY 2006 appropriations for children and youth services represent nearly \$1.2 million in excess of that required by Measure K (See table 2).

Additionally, in fiscal year 2006-2007, the City's appropriations for children and youth services totaled \$25 million, representing 6.31 percent of the City's actual unrestricted general fund revenues of over \$396.4 million (See table 2). At 6.31 percent, the City's appropriations for children and youth services were well above Measure K's required 5.16

City of Oakland, Office of the City Auditor
Measure K Performance Audit: The City Exceeded Required Funding

baseline percentage and exceeded Measure K's required funding by over \$4.5 million.

| Table 2. Comparison of the City's Appropriations for Children and Youth Services to Measure K's Baseline Requirement – FY 2006 to FY 2008 | | | |
|--|---------------------|---------------------|---------------------|
| | FY 2005-2006 | FY 2006-2007 | FY 2007-2008 |
| Unrestricted General Fund Revenues | \$ 407,260,484 | \$ 396,438,312 | \$ 411,646,426 |
| Total appropriations | \$ 22,199,888 | \$ 25,005,016 | \$ 26,393,354 |
| Required appropriations at 5.16 percent | \$ 21,014,641 | \$ 20,456,217 | \$ 21,240,956 |
| Percent total appropriations of unrestricted general fund revenues | 5.45% | 6.31% | 6.41% |
| Appropriations above required 5.16% | \$ 1,185,247 | \$ 4,548,799 | \$ 5,152,398 |

Note: The total reported unrestricted general fund revenues for FY 2006 and FY 2007 are audited, actual totals. For FY 2008, these revenues are based on unaudited totals and are subject to change based on the results of FY 2008 audited totals. Differences in totals are due to rounding.

For FY 2007-2008, the City's appropriations for children and youth services are projected to total nearly \$26.4 million. The FY 2008 appropriations represent 6.41 percent of the City's budgeted unrestricted general fund revenues, reported at over \$411.6 million (See table 2). As with FY 2007 appropriations, the City's planned level of appropriations for children and youth services for FY 2008 is well above Measure K's required 5.16 baseline percentage, and reflects appropriations of over \$5.1 million in excess of that required by Measure K.

CONCLUSION

We found that the City's appropriations for children and youth services exceeded Measure K's required level of appropriations from the period FY 2006 to FY 2008. These appropriations exceeded Measure K's requirement by nearly \$1.2 million, over \$4.5 million, and over \$5.1 million, respectively for FY 2006, FY 2007, and FY 2008.

SECTION II: INTERNAL CONTROLS WOULD FACILITATE COMPLIANCE WITH MEASURE K

Although the City exceeded Measure K's required level of appropriations for children and youth services, we believe that the City would benefit from implementing internal controls, such as policies and procedures, to address the City's compliance with Measure K. Such policies and procedures would facilitate the City's compliance with Measure K by requiring annual compilation of appropriations for children and youth services and tracking compliance with Measure K's baseline percentage.

Benefits of Implementing Internal Controls

Officials from the City Administration, including the Department of Finance and Administration and the Budget Division, told us that the City did not have any policies and procedures to facilitate its compliance with Measure K. We were told that the City relied on its budgetary process to meet Measure K's required level of funding but that the City did not monitor its compliance with Measure K. Although the City's appropriations for children and youth services exceeded Measure K's funding requirement, during the period of our review, City officials, nevertheless, acknowledged that the City did not track, on a fiscal year basis, the level of appropriations for children and youth services. Thus, at the start of our review, they were not certain whether the City had met Measure K's required level of funding. For example, a City official told us that the City did not know whether it had been meeting Measure K's appropriation requirements over the years. Another official affirmed that the City did not have any written guidance or policies and procedures that required (1) adherence to the baseline percentage to comply with Measure K, (2) compilation of the total appropriations for children and youth services, and (3) tracking of the City's appropriations for children and youth services for compliance with Measure K.

The City would benefit from employing internal controls to facilitate its compliance with Measure K. Internal controls are a fundamental component of an organization's management that provides reasonable, though not absolute, assurance that management's objectives are being met. Internal controls consist of activities, such as policies, procedures, techniques, and mechanisms that provide management with a means to accomplish objectives, including compliance with applicable laws and regulations, such as Measure K. For example, the City's written policies and procedures could fully address its compliance with Measure K, affirming its policy to adhere to Measure K's required level of appropriations for children and youth services --- 5.16 percent of the

unrestricted general fund revenues and describing its procedures for compiling and tracking appropriations on an annual basis. These policies and procedures would also serve as guidance to City entities, such as departments, non-departmental organizations and others, that submit appropriations data on children and youth services. Such policies and procedures should address, among others: (1) reportable appropriations for children and youth services, such as those budgeted under Fund 1010, (2) the nature of reportable costs, such as those for programs or services benefiting children and youth age 21 or less, and (3) appropriations that are not reportable for children and youth services, such as Central Services Overhead. Compliance with this guidance would, in turn, provide the City with timely, reasonable assurance that the reported appropriations are likely to meet or exceed Measure K's required level of funding.

CONCLUSION AND RECOMMENDATIONS

Although the City complied with Measure K's required funding level, we believe that the City would benefit from implementing internal controls -- written policies and procedures. Such policies and procedures would facilitate the City's compliance with Measure K by requiring annual compilation of appropriations for children and youth services and tracking compliance with Measure K's baseline percentage.

We recommend that the City Administration take steps to establish and implement such internal controls -- policies and procedures -- to comply with Measure K's baseline percentage in its appropriations for children and youth services. These steps include maintaining an environment that supports a positive attitude towards internal controls and developing and implementing internal controls designed to address compliance with Measure K's required level of funding for children and youth services. These internal controls should be documented in writing, and at a minimum, should include the following:

- Policies that require adherence to Measure K's required level of appropriations -- 5.16 percent of the actual unrestricted general fund revenues;
- Procedures for compiling appropriations for children and youth services and programs from the City's agencies, departments, or offices and non-departmental organizations on an annual basis;
- Guidance on the nature or types of services and programs, age of youth, and costs that can be included in reportable appropriations together with costs or funding sources that must be excluded;
- Designation of personnel responsible for compiling and determining each department or agency's appropriations for children and youth services; and

Measure K Performance Audit: The City Exceeded Required Funding

- Designation of personnel responsible for compiling the City's total appropriations for children and youth services, determining whether the City has met Measure K's required level of appropriations, and tracking, on an annual basis, compliance with Measure K.



Inter-Office Memo

Office of the City Administrator

May 21, 2008

To: Courtney Ruby, City Auditor

From: Deborah Edgerly, City Administrator *DE*

Re: Response to Draft Measure K Audit Findings and Recommendations

I am pleased that your audit has confirmed that the City has complied with the provisions of Measure K by maintaining appropriations for children and youth programs above the level prescribed by the Measure. I do, however, offer the following comments in response to your draft report:

The draft report does not take into consideration the General Purpose Fund subsidy to the Head Start Program. The report states that appropriations based on federal or private funding sources or that did not originate in the General Purpose Fund were excluded from the calculation as were overhead costs that did not originate in the General Purpose Fund. As you are aware, the City currently provides a waiver for Head Start overhead charges of approximately \$1.4 million that would otherwise be recovered by the General Purpose Fund. Without this waiver, services provided by Head Start funding would have to be reduced in order to cover the overhead charges. Accordingly, the waiver has a direct impact (benefit) on children and youth services funding and I believe that the cost of this subsidy should be included in the appropriation calculation. 1

The draft report recommends that City Administration establish policies and procedures to comply with Measure K's baseline percentage in its appropriations for children and youth services and recommends development of internal controls for the calculation of future baseline amounts. Though I agree with the recommendation for development of policies and procedures to ensure compliance, the Measure K language clearly assigns responsibility to the City Auditor for calculating and publishing the amount of appropriations for children and youth services on an annual basis. I would, however, recommend that my staff work closely with the City Auditor's office to facilitate this analysis. 2

cc: William Noland
Sarah Schlenk
William Zenoni

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Comments

City Auditor's Response to the City Administrator's Response

To provide clarity and perspective, we are commenting on the Office of the City Administrator's (City Administrator) response to the Office of the City Auditor's (City Auditor) report on the City's compliance with Measure K's baseline funding requirements for children and youth services. The numbers below correspond with the numbers in the margin right of the City Administrator's response.

1. As stated on page 5 of the report, we considered the City's General Purpose Fund (Fund 1010) subsidy for the overhead costs of the federal Head Start program and concluded that the overhead costs covered by the subsidy should be excluded from the appropriations for children and youth services. We excluded these costs from our calculation because the costs in question are overhead costs and do not directly benefit children and youth services. When the baseline funding was initially determined in 1997 and 1998, the City Auditor did not include such overhead costs in the appropriations for children and youth services. Thus, the City Auditor's calculations in this report are consistent with the calculations used in the initial determination of the baseline funding requirements.
2. In agreeing with the City Auditor's recommendation to establish and implement policies and procedures to ensure compliance with Measure K, the City Administrator referred to the City Auditor's responsibility under Measure K for calculating and publishing the amount of appropriations for children and youth services on an annual basis. In this regard, the City Administrator recommended that her staff work closely with the City Auditor's office to facilitate this analysis. The City Auditor acknowledges its responsibility under Measure K, specifically, to calculate and publish the actual amount of appropriations for children and youth services within 90 days following the end of each fiscal year.

The City Auditor's obligation under Measure K, however, is independent of the City's mandate to comply with Measure K. Under Generally Accepted Government Auditing Standards, "Auditors and audit organizations must maintain independence so that their opinions, findings, conclusions, judgments, and recommendations will be impartial and will be viewed as impartial by objective third parties." As a result, the City Auditor's obligation under Measure K is not a function that can be

City of Oakland, Office of the City Auditor

Measure K Performance Audit: The City Exceeded Required Funding

regarded as interdependent with the functions the City carries out to comply with its mandate under Measure K. The City Auditor's role is to assess the City's compliance with Measure K and not to ensure that the City has complied with Measure K. Ensuring compliance with Measure K is a management function and an outcome of having effective internal controls. In assessing the City's compliance with Measure K, the City Auditor will examine the internal controls that the City has put in place to ensure these controls are operating effectively.

APPENDIX I

**CITY OF OAKLAND
CITY ATTORNEY'S OFFICE**

MEMORANDUM

TO: City Auditor Courtney Ruby
Elizabeth Olivarez

CC: City Administrator Deborah Edgerly

FROM: John A. Russo
City Attorney
Mark Morodomi
Kathleen Salem-Boyd

DATE: January 23, 2008

File No: CAO-990272

RE: **CITY BASELINE APPROPRIATIONS FOR CHILDREN AND YOUTH SERVICES
PURSUANT TO CITY CHARTER ARTICLE XIII, KIDS FIRST! OAKLAND
CHILDREN'S FUND**

In 1996, Oakland voters passed the Kids First! Oakland Children's Fund Initiative ("Kids First"), amending the City Charter and establishing an annual set-aside of 2.5% of the City's annual unrestricted general fund revenues to ensure increased funding for children and youth services. The Initiative established formulas to ensure that existing funding to children and youth services would not be reduced. This memorandum discusses these formulas and clarifies the City Attorney's advice regarding City Charter requirements.

You have requested clarification of the level of appropriations necessary to fulfill the Kids First! Charter mandate that "the City shall not reduce the amount of unrestricted general fund appropriations and expenditures for eligible [children and youth] services in any of the twelve years during which funds are required to be set aside...." (Oakland City Charter, Article XIII, Section 1300, paragraph 14).

Kids First requires that the City maintain funding for child and youth programs and services at a "base amount" that must not fall below the amount appropriated for the 1995-1996 fiscal year. The "base amount" calculation is performed by the City Auditor based on the formula identified in the Article XIII, Section 1300 of the City Charter and requires adjustment each year, "based on calculations consistent from year to year, by the percentage increase or decreases in aggregate City appropriations from the base year, as estimated by the City Auditor." The 2.5% Kids First set-aside is on top of continued, mandated base funding.

In January 1997, this office issued a legal opinion to the Office of the City Auditor relating to the implementation and interpretation of the Kids First base amount funding requirements. (Attached) Because the Charter requires annual adjustment of the base amount by the Auditor, the opinion concludes that there are two base amounts.

The first base amount is the floor amount, which is based on the actual appropriations for children and youth services during the base year. On June 29, 1998, the Auditor reported the floor amount of \$11,891,650 for the 1995-1996 base year. The second base amount is a percentage of the City's appropriations from the unrestricted general fund that is to be calculated by the Auditor each year based on increases or decreases in the aggregate City appropriations from the base year.^{1 2} The annual adjustment requirement signifies the electorate's intent that the Auditor adjusts base amounts annually to reflect the actual, rather than budgeted, appropriations and expenditures from the unrestricted general fund. To simplify the annual calculation required under the Charter, the Auditor's June 1998 report identified the minimum fixed percentage of base amount appropriations as at least 5.68%. In Fiscal Years 1996 and 1998, the Auditor did not use actual appropriations of unrestricted revenues that were required to be included in the calculation of the baseline percent. Recent recalculation of the percentage by the Auditor resulted in a decrease of the baseline percent from 5.68 percent to 5.16 percent of appropriated unrestricted general fund revenues. Thus, to comply with Measure K's required level of appropriations, i.e., the baseline percentage, the City's appropriations for children and youth services must be at least 5.16 percent of the aggregate appropriations from unrestricted general fund revenues.

The City must appropriate the greater of the first base amount and the second base amount. In every year that Kids First is in effect, the City must continue funding the minimum fixed percentage of the City's actual appropriations from the unrestricted general fund (the second base amount). In no event may base funding for child and youth services fall below the 1995-96 floor amount \$11,891,650 (the first base amount).

¹ The Auditor informs this office that, during the base year and in every year since, the amount of the unrestricted general fund revenues has been equal to annual aggregate appropriations of unrestricted general fund revenue. However, if the amount of annual appropriations from the unrestricted general fund revenues does not equal the unrestricted general fund revenues, the Charter requires that the amount of aggregate appropriations must be used to calculate of the base amount for that fiscal year. NOTE: The base year percentage and base year floor amount were calculated based on unrestricted general fund revenues rather than aggregate appropriations. Because these amounts were equal during the base year, the calculations of the base floor and base percentage amounts are accurate and require no adjustment.

² This calculation also does not include "funds granted to the City by private agencies or appropriated by other public agencies and received by the City." (Section 300, paragraph 14.)

APPENDIX II

BUDGETED APPROPRIATIONS FOR CHILDREN AND YOUTH SERVICES BY CITY AGENCY, DEPARTMENT, OR OFFICE AND NON-DEPARTMENTAL ORGANIZATIONS, FY 2006 – 2008

| Department of Human Services | Appropriations for Children and Youth Services | | |
|---|---|---------------------|---------------------|
| Service/Program | FY 2005-2006 | FY 2006-2007 | FY 2007-2008 |
| Youth Services Unit (78251) | \$ 180,532 | \$ 189,016 | \$ 197,404 |
| OFCY Administration | -0- | -0- | \$ 52,812 |
| Head Start Fringe Benefit Costs | -0- | \$ 765,823 | \$ 618,629 |
| Summer Food Program & A Safe Walk to School Program (78111) | \$ 86,484 | \$ 91,356 | \$ 104,244 |
| City School Partnership | \$ 300,000 | \$ 300,000 | \$ 300,000 |
| TOTAL | \$ 567,016 | \$ 1,346,195 | \$ 1,273,089 |

| Fire Services Agency | Appropriations for Children and Youth Services | | |
|--|---|---------------------|---------------------|
| Service/Program | FY 2005-2006 | FY 2006-2007 | FY 2007-2008 |
| Safety Education: Fire Safety Education Coordination | \$ 87,091 | \$ 90,575 | \$ 94,198 |
| Material & Supplies | \$ 5,200 | \$ 5,400 | \$ 5,600 |
| Health Fair Staff | \$ 6,949 | \$ 7,286 | \$ 7,245 |
| Material & Supplies | \$ 3,500 | \$ 3,700 | \$ 3,900 |
| Fire Prevention Sworn Staff | \$ 5,211 | \$ 5,464 | \$ 5,434 |
| Prevention Staff | \$ 1,200 | \$ 1,200 | \$ 1,200 |
| Material & Supplies | \$ 6,200 | \$ 6,400 | \$ 6,600 |
| TOTAL | \$ 115,351 | \$ 120,025 | \$ 124,177 |

APPENDIX II
(Continued)

| Oakland Public Library | Appropriations for Children and Youth Services | | |
|--|---|---------------------|---------------------|
| Service/Program | FY 2005-2006 | FY 2006-2007 | FY 2007-2008 |
| Main Library Children's Room | \$ 248,760 | \$ 262,752 | \$ 357,912 |
| Bookmobile | \$ 68,117 | \$ 70,782 | \$ 47,231 |
| Children's Book Budget | \$ 58,785 | \$ 88,533 | \$ 27,475 |
| Children's Cataloging | \$ 117,107 | \$ 123,692 | \$ 152,440 |
| Children's Acquisitions | \$ 79,310 | \$ 87,491 | \$ 111,249 |
| Youth Age 21 or Less Direct Public Service | \$ 2,250,662 | \$ 2,408,187 | \$ 2,544,963 |
| Youth Age 21 or Less Book Budget | \$ 90,446 | \$ 136,135 | \$ 42,248 |
| Youth Age 21 or Less Cataloging | \$ 180,072 | \$ 190,199 | \$ 234,403 |
| Youth Age 21 or Less Acquisitions | \$ 121,954 | \$ 134,532 | \$ 171,065 |
| Graphic / Publicity | \$ 80,540 | \$ 106,817 | \$ 120,468 |
| Second Start/Literacy | \$ 29,359 | \$ 59,157 | \$ 49,488 |
| Main Library & Branches | \$ 156,036 | \$ 186,406 | \$ 191,998 |
| General Administration - Personnel & OSM | \$ 1,051,042 | \$ 1,054,649 | \$ 1,252,538 |
| TOTAL | \$ 4,532,190 | \$ 4,909,332 | \$ 5,303,478 |

APPENDIX II

(Continued)

| Mayor & City Council | | Appropriations for Children and Youth Services | | |
|---|-------------------|--|--------------|--|
| Service/Program | FY 2005-2006 | FY 2006- 2007 | FY 2007-2008 | |
| Mayor - Oakland Longfellow Elementary School Grant | \$ 12,539 | -0- | -0- | |
| Mayor - Oakland School for the Arts | \$ 135,000 | \$ 150,000 | -0- | |
| Priority Project Funds- Oakland Zoo Grant | -0- | \$ 250,000 | -0- | |
| Priority Project Funds - Chabot Space & Science Center Grant | -0- | \$ 300,000 | -0- | |
| Priority Project Funds - Oakland Asian Cultural Center | -0- | \$ 100,000 | -0- | |
| Priority Project Funds - Edna Middle School Workshop "The Crucible" Grant | -0- | \$ 3,636 | -0- | |
| Priority Project Funds - Cesar Chavez Education Center Grant | -0- | \$ 10,000 | -0- | |
| Priority Project Funds - Glenview Elementary PTA Grant | -0- | \$ 6,245 | -0- | |
| Priority Project Funds - Elijah Muhammad Education Foundation Grant | -0- | \$ 25,000 | -0- | |
| Priority Project Funds - Alameda Co. Office of Education Grant | -0- | \$ 20,000 | -0- | |
| Priority Project Funds - Oakland Potter House Grant | -0- | \$ 15,000 | -0- | |
| Priority Project Funds - Oakland School for the Arts Grant | -0- | \$ 125,000 | -0- | |
| TOTAL | \$ 147,539 | \$ 1,004,881 | -0- | |

Note: Appropriations are actual expenditures based on budgeted amounts. Actual expenditures for FY 07-08 will be determined at year end and reflected in the City Auditor's next report on Measure K.

APPENDIX II
(Continued)

| The Oakland Museum | Appropriations for Children and Youth Services | | |
|-------------------------------|---|---------------------|---------------------|
| Service/Program | FY 2005-2006 | FY 2006-2007 | FY 2007-2008 |
| General School Programs | \$ 259,999 | \$ 289,521 | \$ 345,683 |
| Community Youth Programs | \$ 176,396 | \$ 198,027 | \$ 233,403 |
| Museum School Partnership | \$ 159,118 | \$ 178,748 | \$ 209,936 |
| School Tour Programs | \$ 132,530 | \$ 146,559 | \$ 174,274 |
| Exhibits/Curatorial Offerings | \$ 459,823 | \$ 517,375 | \$ 611,206 |
| TOTAL | \$ 1,187,866 | \$ 1,330,230 | \$ 1,574,502 |

APPENDIX II
(Continued)

| Office of Parks, Recreation | Appropriations for Children and Youth Services | | |
|--|---|----------------------|----------------------|
| Service/Program | FY 2005-2006 | FY 2006-2007 | FY 2007-2008 |
| Adult Sports and/or Community Sports | \$ 94,965 | \$ 58,097 | \$ 94,147 |
| After School Sports/Programs | \$ 618,897 | \$ 838,593 | \$ 1,073,842 |
| Aquatics - Boating | \$ 120,403 | \$ 127,091 | \$ 181,833 |
| Aquatics-Pools | \$ 1,064,390 | \$ 1,178,421 | \$ 1,160,320 |
| Automated Systems | \$ 213,654 | \$ 172,692 | -0- |
| Ballfields | \$ 62,489 | -0- | \$ 68,072 |
| Camps | \$ 84,144 | \$ 86,316 | \$ 220,386 |
| Central Administration | \$ 1,836,428 | \$ 1,925,973 | \$ 2,513,497 |
| Central Reservations | \$ 37,245 | \$ 43,930 | \$ 52,817 |
| Cultural Arts | \$ 917,646 | \$ 695,870 | \$ 943,028 |
| Contract Management | \$ 1,035,496 | \$ 1,038,962 | \$ 1,460,701 |
| Davies Tennis and Citywide Tennis | \$ 28,662 | \$ 30,394 | \$ 70,837 |
| Malonga Casquelourd Center for the Arts | \$ 89,547 | \$ 31,890 | -0- |
| Recreation Centers and Programs | \$ 4,056,868 | \$ 4,426,024 | \$ 4,420,113 |
| Self-Sustaining Programs | \$ 82,116 | \$ 86,760 | -0- |
| TOTAL | \$ 10,342,950 | \$ 10,741,013 | \$ 12,259,593 |

APPENDIX II
(Continued)

| Non-departmental Organizations | Appropriations for Children and Youth Services | | |
|---------------------------------------|---|---------------------|---------------------|
| Service/Program | FY 2005-2006 | FY 2006-2007 | FY 2007-2008 |
| Raider's Surcharge | \$ 581,964 | \$ 544,033 | \$ 160,000 |
| Oakland School for the Arts | \$ 500,000 | \$ 500,000 | \$ 350,000 |
| Chabot Space & Science Ctr. | \$ 180,000 | \$ 180,000 | \$ 595,000 |
| Safe Passages | \$ 102,903 | \$ 109,980 | \$ 150,000 |
| Mayor's Summer Job Program | \$ 282,715 | \$ 157,654 | -0- |
| Street Outreach | \$ 96,698 | \$ 99,077 | -0- |
| Public Art Grants | \$ 761,008 | \$ 795,436 | \$ 785,371 |
| Peralta Hacienda Historic Park | -0- | -0- | \$ 180,000 |
| Oakland Asian Cultural Center | -0- | -0- | \$ 100,000 |
| Symphony in Schools | -0- | -0- | \$ 100,000 |
| City/County Collaboration | -0- | -0- | \$ 675,000 |
| TOTAL | \$ 2,505,288 | \$ 2,386,180 | \$ 3,095,371 |

POLICE SERVICES AGENCY

| Police Services Agency | Appropriations for Children and Youth Services | | |
|-------------------------------|---|---------------------|---------------------|
| Service/Program | FY 2005-2006 | FY 2006-2007 | FY 2007-2008 |
| Police Activities League | \$ 446,220 | \$ 457,506 | \$ 487,746 |
| CLASS | \$ 1,948,776 | \$ 2,282,022 | \$ 1,837,554 |
| Cadets | \$ 257,952 | \$ 271,572 | \$ 269,556 |
| Cadets Supervisor | \$ 148,740 | \$ 156,060 | \$ 168,288 |
| TOTAL | \$ 2,801,688 | \$ 3,167,160 | \$ 2,763,144 |

Note: Appropriation numbers throughout these schedules were rounded up or down.