DEPARTMENT OF FINANCE

ARNOLD SCHWARZENEGGER, GOVERNOR

915 L STREET ■ SACRAMENTO CA ■ 95814-3706 ■ WWW.DOF.CA.GOV

July 31, 2007

Mr. Jack Broadbent, Executive Officer, Air Pollution Control Officer
Bay Area Air Quality Management District
939 Ellis Street
San Francisco, CA 94109

Dear Mr. Broadbent:

Final Report—Fiscal Review of the Bay Area Air Quality Management District's Carl Moyer Program, Lower-Emission School Bus Program, and AB 923 Funds.

Enclosed is the final report of the fiscal review of the Bay Area Air Quality Management District's Carl Moyer Program, Lower-School Bus Program, and AB 923 funds for July 1, 2002 through March 31, 2007. The district's response has been incorporated into the final report.

We appreciate the assistance and cooperation of your staff and management during our review. If you have any questions, please contact Mary Kelly, Manager, at (916) 322-2985.

Sincerely,

Original signed by:

Diana L. Ducay, Chief
Office of State Audits and Evaluations

Enclosure

cc: Ms. Catherine Witherspoon, Executive Officer, California Air Resources Board
Mr. Jack Kitowski, Branch Chief, Mobile Source Control Division, Air Resources Board
Ms. Lucina Negrete, Manager, Mobile Source Control Division, Air Resources Board
Mr. Jeff McKay, Chief Financial Officer, Bay Area Air Quality Management District

FISCAL REVIEW

Bay Area Air Quality Management District
Carl Moyer Program
Lower Emission School Bus Program
Assembly Bill 923

Prepared By:
Office of State Audits and Evaluations
Department of Finance

073900093

March 2007

DEPARTMENT OF FINANCE
ARNOLD SCHWARZENEGGER, GOVERNOR
915 L STREET ■ SACRAMENTO CA ■ 95814-3706 ■ WWW.DOF.CA.GOV

FISCAL REVIEW

Mr. Jack Broadbent, Executive Officer, Air Pollution Control Officer
Bay Area Air Quality Management District
939 Ellis Street
San Francisco, CA 94109

The California Air Resources Board (Board) contracted with the Department of Finance, Office of State Audits and Evaluations (Finance), to perform a fiscal review of the Bay Area Air Quality Management District's (District) implementation of the Carl Moyer Program, the Lower-Emission School Bus Program, and use of AB 923 funds for fiscal years 2002-03 through 2005-06.

Background

The District's mission is to achieve clean air, and to protect the public health and the environment. The District implements multiple clean-air programs supported by federal, state, and local funds. This review encompasses three programs funded by the state: the Carl Moyer Program (CMP), the Lower-Emission School Bus Program (LESBP), and AB 923 funds.

The objective of the CMP is to contribute to cleaner air by funding the incremental cost of replacing or retrofitting older engines with cleaner-than-required engines and equipment. Public or private entities that operate eligible engines or equipment within the District's jurisdiction participate by applying to the District for a grant. Examples of eligible engines and equipment include heavy-duty vehicles, marine applications, locomotives, agricultural pumps, forklifts, and auxiliary power units.

The primary purpose of the LESBP is to reduce school children's exposure to cancer-causing and smog-forming pollution. The LESBP achieves this through a Replacement Program and a Retrofit Program. The Replacement Program funds the replacement of older high-polluting school buses with new buses. The Retrofit Program funds the installation of Board-approved pollution control devices on diesel school bus engines.

Assembly Bill 923 (Chapter 707, Statutes of 2004) provided two additional sources of funding for the CMP. By adjusting fees assessed on purchasers of new tires, the legislation has resulted in approximately $25 million for clean air programs in 2005-06. AB 923 also provided air district governing boards with the authority to approve a $2 increase in motor vehicle registration fees. This increase provides up to $55 million annually to local air districts for four incentive programs: (1) the CMP, (2) the LESBP's Replacement Program, (3) light-duty accelerated vehicle retirement or repair programs, and (4) the Agricultural Assistance Program.

Scope and Methodology

The Board engaged Finance to conduct reviews of the District's fiscal administration of the CMP, the LESBP, and AB 923 funds, and the District's fiscal compliance with applicable laws,

regulations, guidelines, and contract requirements. District processes for receiving, recording, and disbursing program funds, allocating administrative costs and earned interest, and meeting match funding requirements were analyzed. Schedules were created from the District's records to summarize amounts received and disbursed for the programs and funds from July 1, 2002 through March 31, 2007. Finally, site visits were conducted to interview program participants and review pertinent documents.

The review was not conducted in accordance with Generally Accepted Government Auditing Standards, and did not include extensive testing of the District's internal control or the programmatic appropriateness of expenditures. Had additional procedures been performed, other matters might have come to our attention that would have been reported.

Analyses and Summary Schedules

Carl Moyer Program:

The following schedule illustrates CMP funds awarded and expended for program years 5, 6, 7, and 8. Years 7 and 8 awards include both project and administration funds.

Years 5 and 6 did not have an unexpended balance. While the District has until June 30, 2007 to expend year 7 project funds, only 5 percent of the funds had been expended at the time of our review.

Earned interest is comprised of two amounts: (1) $940,992 earned on year 1 through year 7 funds (prior to July 1, 2006) that was collected by the District but not allocated to the fund (see Observation 1 below), and (2) $16,287 collected and allocated to the CMP beginning July 1, 2006.

CMP Year	Fiscal Year	Award Amount	Expenditures Within Grant Period	Balance as of End of Grant Period[1]	Expenditures After Grant Period	Balance as of 3/31/2007 (Excluding Interest)	Earned Interest (Through 2nd Quarter 2006-07)
5	2002-03	1,894,911	565,308	1,329,603	1,329,603	0	0
6	2003-04	1,652,595	205,458	1,447,137	1,447,137	0	0
7	2004-05	2,478,161	119,747[2]	N/A[2]	N/A[2]	2,358,414	957,279
7 Admin.	2004-05	57,364	57,364	0	0	0	0
8[3]	2005-06	10,318,307	N/A	N/A	N/A	N/A	0
8 Admin.[3]	2005-06	238,850	N/A	N/A	N/A	N/A	0

(1) Year 5 grant period ended 6/30/05; Year 6 grant period ended 6/30/06; Year 7 grant period ends 6/30/07; Year 8 grant period ends 6/30/08.
(2) Expenditures shown are as of 3/31/07. It is not known what the Year 7 fund balance or expenditures will be as of 6/30/07.
(3) Year 8 awards were not received by the District as of 3/31/2007.

Carl Moyer Program Match Requirements:

The following schedule illustrates the CMP match requirements and expenditures for program years 5, 6, 7, and 8. The District met requirements for years 5 and 6 by completing eligible projects funded with local-control funds. At the time of our review the District had not reported match expenditures for years 7 or 8; however, the District has until June 30, 2007 and June 30, 2008, respectively, to meet the match requirements.

CMP Year	Fiscal Year	Required District Match	Match Expenditures Within Grant Period	Remaining Match Requirement
5	2002-03	947,456	967,200	0
6	2003-04	826,298	1,893,289	0
7	2004-05	1,128,488	0	1,128,488
8	2005-06	1,613,320	0	1,613,320

Lower-Emission School Bus Program:

The following schedule illustrates LESBP Replacement and Retrofit Program funds awarded and expended during the review period. The District met the fiscal and match requirements of the Replacement Program in 2002-03 and 2003-04. The District did not receive a 2004-05 Replacement Program award, and did not receive Retrofit Program awards in 2002-03, 2003-04, or 2004-05.

The District is participating in the 2005-06 Replacement Program and will seek reimbursement from the Board once new buses are delivered to the school districts. Because this is a reimbursed program, no funds are advanced to the District, and no interest is earned.

The District has received the 2005-06 Retrofit Program award. As of March 31, 2007 no expenditures have been made on these funds, however, the deadline for expenditure has not passed. The District is properly recording and allocating interest earned on the unexpended balance.

Award Year / Program	Grant Award	Total Expenditures	Earned Interest (Through 2nd Quarter 2006-07)	Balance
2002-03 Replacement Program	960,000	960,000	NA	0
2003-04 Replacement Program	900,000	900,000	NA	0
2005-06 Replacement Program	560,000	0	NA	560,000
2005-06 Retrofit Program	2,395,000	0	49,655	2,444,655

Assembly Bill 923:

The following schedule illustrates the AB 923 monies received and expended from inception of collections in May 2005 through March 31, 2007. The District's recording of AB 923 revenue was materially correct. The AB 923 fund has a balance of $19,557,462 (including interest) as of March 31, 2007. While the District's Board has approved specific projects, no AB 923 funds had been expended on projects as of March 31, 2007.

2004-05 Receipts	2005-06 Receipts	2006-07 Receipts (Through January 2007 Collections[4])	Total Receipts (Through January 2007 Collections[4])	Less Administration Charges[5]	Earned Interest (Through 2nd Quarter 2006-07)	Balance as of 3/31/2007
1,847,609	8,914,227	8,395,579	19,157,415	(55,925)	455,972	19,557,462

(4) Approximate two-month delay between collections by DMV and receipt of revenue by District is normal.
(5) Personnel, indirect, and travel costs.

Carl Moyer Program

Review of the District's compliance with the financial requirements of the CMP resulted in five observations:

1. The District earned $940,992 of interest on Year 1 (1998-99) through Year 7 (2004-05) funds but did not attribute this earned interest to the CMP fund and did not spend it on eligible projects as directed by guidelines. The District began properly recording interest beginning July 1, 2006, earning $16,287 through the second quarter of 2006-07.

   Recommendation:

   Allocate interest earnings to the CMP fund. Establish a plan and schedule to fund eligible projects; or conversely, return the funds to the Board.

2. Payments of $1,329,603 (70 percent) of the Year 5 award and $1,447,137 (88 percent) of the Year 6 award were made after the respective grant periods.

   Recommendation:

   Institute policies and procedures to ensure timely completion of projects.

3. The District filed the Year 5 Final Report one year late and filed the Year 6 Final Report five months late.

   Recommendation:

   Institute policies and procedures to ensure timely reporting.

4. The District has no established process to conduct reconciliations between program and accounting records. This lack of checks and balances raises the risk of error or fraud by accounting or program staff, inaccurate annual or final reports, and program year funding that may not be expended on a timely basis.

   Recommendation:

   Institute policies and procedures to reconcile program and accounting records on a regular basis and to record the results of the reconciliation process.

5. Program staff conduct cursory evaluations of applicant estimates and claims based on the staff's professional experience. There is no established process for the

substantive review of submitted information. The lack of review based on defined program criteria raises the risk of error or fraud by applicants or vendors, overpayments made to applicants, and a perception in the applicant and vendor community of lax project oversight by the District.

Recommendation:

Institute policies and procedures to conduct substantive reviews of applicant estimates and claims based on defined and documented criteria.

Lower-Emission School Bus Program

The District has a significant balance of unexpended funds remaining from Retrofit Program funds awarded in 2000-01. While 2000-01 was not included in the audit period, the review of the District's records disclosed the existence of these funds. Analysis resulted in two observations:

1. The District had an unexpended balance of $999,429 as of March 31, 2007 (excluding earned interest).

   Recommendation:

   Establish a plan and schedule to complete eligible projects and expend this balance timely; or conversely, return the funds to the Board.

2. The district earned Interest of approximately $285,078 on the unexpended balance through March 31, 2007, but did not attribute this earned interest to the LESBP fund or spend it on LESBP projects.

   Recommendation:

   Allocate interest earnings to the LESBP Retrofit fund. Establish a plan and schedule to fund eligible projects; or conversely, return the funds to the Board.

The District's assistance and cooperation with our review was appreciated. If you have any questions regarding this report, please contact Mary Kelly, Manager, at (916) 322-2985.

This report is a matter of public record and its distribution is not limited.

Original signed by:

Diana L. Ducay, Chief
Office of State Audits and Evaluations

March 30, 2007

District's Response

BAY AREA
AIR QUALITY
MANAGEMENT
DISTRICT
SINCE 1955

ALAMEDA COUNTY
Tom Bates
Scott Haggerty
Janet Lockhart
Nate Miley

CONTRA COSTA COUNTY
John Gioia
Mark Ross
(Chair)
Michael Shimansky
Gayle B. Uilkema

MARIN COUNTY
Harold C. Brown, Jr.

NAPA COUNTY
Brad Wagenknecht

SAN FRANCISCO COUNTY
Chris Daly
Jake McGoldrick
Gavin Newsom

SAN MATEO COUNTY
Jerry Hill
(Vice-Chair)
Carol Klatt

SANTA CLARA COUNTY
Erin Garner
Yoriko Kishimoto
Liz Kniss
Patrick Kwok

SOLANO COUNTY
John F. Silva

SONOMA COUNTY
Tim Smith
Pamela Torliatt
(Secretary)

Jack P. Broadbent
EXECUTIVE OFFICER/APCO

July 18, 2007

Janet I. Rosman, CPA
Assistant Chief
Department of Finance
Office of State Audits and Evaluations
300 Capitol Mall, Suite 801
Sacramento, CA 95814

Dear Ms. Rosman:

This letter constitutes the Bay Area Air Quality Management District's (District) response to the confidential Draft Report No. 073900093, Fiscal Review of the Bay Area Air Quality Management District's Carl Moyer Program, Lower-Emission School Bus Program, and AB 923 Funds (Report) dated March 2007 and prepared by the Department of Finance (DOF). The District appreciates this opportunity to provide a response to the Report.

As an initial matter, the District appreciated the professional manner in which the DOF staff conducted the audit, both during fieldwork, and post-fieldwork clarification discussions.

As you are aware, in addition to the California Air Resources Board (CARB) and DOF's audit, the Bureau of State Audits (BSA) conducted an audit and has released their final report on the District's implementation of the Moyer Program. During the course of the audits, CARB and the BSA staff shared with District staff some preliminary issues regarding the District's implementation of the Moyer Program. By a letter dated May 2, 2007 (May 2nd Letter) to Tom Cackette, Chief Deputy Executive Officer for CARB, the District outlined its plans to conduct a comprehensive review of its Moyer Program and to work with CARB to implement changes necessary to improve that program. The May 2nd Letter is included with this response to be incorporated in, and made a part of the District's response to the DOF audit of the Moyer Program.

The following are the District's responses to the observations in the DOF audit Report for the Moyer Program and Lower-Emission School Bus (LESB) Program:

Carl Moyer Program

1. Observation: Earned Interest Allocation

The District acknowledges the observation, and has formally allocated the $940,992 in interest to the Moyer Program through a board resolution dated May 2, 2007. Further, the District has set up a Moyer Program fund for year 7, and has allocated earned interest directly to the Moyer Program. The District is in the process of establishing a plan and schedule to fund eligible projects with the interest.

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2. Observation: Expenditure of Funds Within the Grant Period

The District acknowledges that there were expenditures of funds after the cut-off date for both years 5 and 6 of the Moyer Program in the amounts of $1,329,603 and $1,447,137, respectively. As outlined in the May 2nd Letter, the District will review the timeliness of distributions, and will develop processes to ensure that all
Moyer Program funds are disbursed within the time period as specified by the applicable Moyer Program Guidelines.

3. Observation: Final Report Submission Dates

The District acknowledges that the required Final Reports for Moyer Program years 5 and 6 were one year and five months late, respectively. The District is implementing measures to ensure that future reports are filed within the prescribed Moyer Program guidelines time period.

4. Observation: Reconciliation of Program and Accounting Records

The District concurs with the observation, and has reconciled the program and accounting records for Moyer Program year 7. The District has initiated project accounting of the Carl Moyer Program, that tracks the expenditures of individual projects.

5. Observation: Estimates and Claims Review

The District agrees that vendor estimates and claims should be monitored and verified. The District will establish a process for review of submitted information based on defined program criteria and will ensure that proper documentation is submitted with the claims. The Accounting Department will also monitor the payments to ensure that duplicate payments are not processed.

Lower-Emission School Bus Program

1. Observation: Unexpended LESBP Program Funds

The District acknowledges that there are unspent LESB Program funds in the amount of $999,429, which were allocated for the 2001-02 retrofit. The District is investigating eligible projects on which to expend the funds and will take appropriate action to complete fund expenditure

2. Observation: Earned Interest Allocation

The District acknowledges the observation, and has formally allocated the $267,261 interest to the LESB Program through a board resolution dated May 2, 2007. Further, the District has set up a LESB Program fund for year 2006-07, and allocated the interest earned directly to the LESB Program. The District has already initiated discussions with the ARB on the procedures to return the funds to the ARB should returns be required.

Conclusion:

In conclusion, the District appreciates this opportunity to provide a response to the DOF Report on the Moyer and LESB Programs. As set forth both in this letter and the accompanying May 2nd Letter to CARB, the District is committed to a comprehensive examination of its Moyer and LESB Programs, and will implement changes to strengthen aspects of these programs. The District's Moyer Program has been, and remains, an integral component of the District's efforts to continually improve air quality for the benefit of the residents of the Bay Area and beyond. The District appreciates and commends the DOF efforts to identify areas for improvement in the District's Moyer and LESB Programs.

Sincerely,

Original signed by:

Jack P. Broadbent
Executive Officer/APCO

cc: Mr. Tom Cackette, Chief Deputy Executive Officer, CARB
Mr. Jack Kitowski, Branch Chief, CARB
Ms. Lucina Negrete, CARB
Mr. Stan Bajorina, Resources Agency

Enclosure

BAY AREA
AIR QUALITY
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SINCE 1955

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Jerry Hill
(Vice-Chair)
Carol Klatt

SANTA CLARA COUNTY
Erin Garner
Yoriko Kishimoto
Liz Kniss
Patrick Kwok

SOLANO COUNTY
John F. Silva

SONOMA COUNTY
Tim Smith
Pamela Torliatt
(Secretary)

Jack P. Broadbent
EXECUTIVE OFFICER/APCO

May 2, 2007

Tom Cackette
Chief Deputy Executive Officer
California Air Resources Board
1001 "I" Street
P. O. Box 2815
Sacramento, CA 95812

Dear Mr. Cackette:

As you know, the California Air Resources Board (CARB) staff is in the process of conducting its first-ever audit of the Bay Area Air Quality Management District's (District) implementation of the Carl Moyer Memorial Air Quality Standards Attainment Program (Moyer Program). As you also know, during the course of the audit, CARB staff shared with District staff some preliminary issues regarding the District's implementation of the Moyer Program. District staff appreciates this opportunity to outline a number of steps the District staff intends to take to address the issues identified by CARB staff. In taking these steps, District staff will continue to consult and cooperate with CARB staff to ensure that acceptable improvements are implemented in the District's Moyer Program.

Due to the nature of the issues identified by CARB staff, District staff believes that the best approach is to undertake a comprehensive review of the District's Moyer Program. This review will encompass every aspect of the programmatic, administrative, and financial aspects of the District's implementation of the Moyer Program. District staff has engaged and will engage consultants to assist with this review. This broad review will include:

(1) A review of all District Moyer Program projects currently under contract or committed for funding to confirm eligibility in accordance with CARB Moyer Program guidance;

(2) A review of all District Moyer Program "match" projects and funding to determine eligibility; and

(3) A review of all District Moyer Program procedures, processes and controls (including, but not limited to, outreach efforts, evaluation of applications and award of grants, file management, contracting, auditing, verification of project expenses, and timeliness of distributions) for adherence to CARB Moyer Program guidance, and, where appropriate, to best practices for grant program administration.

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District staff expects that the comprehensive reviews in each of these areas will result in recommendations for improvements in the District's Moyer Program. To the extent that the reviews of projects under contract or committed for funding and of match projects and funding identify projects and funding that do not meet Moyer Program requirements, District staff will work with CARB staff to expeditiously identify replacement projects and/or funding to meet the District's obligations under the Moyer Program. District staff expects that these broad reviews of the District's Moyer Program and implementation of anticipated recommendations for improvements will address all of the issues identified by CARB staff.

The District has already retained consultants to assist with the comprehensive review of the District's Moyer Program outlined above. Cindy Sullivan has agreed to assist with a review of Moyer Program projects currently under contract or committed for funding. If necessary, the District will retain additional consultants to assist with this review. In addition, the District has retained Gilbert and Associates to assist with a comprehensive review of the District's Moyer Program processes, procedures and controls. Gilbert and Associates previously assisted the District with a similarly comprehensive review of the District's financial processes, procedures and controls. Gilbert and Associates will review the District's compliance with CARB Moyer Program guidance, as well as provide recommendations for best practices for grant program administration. District staff anticipates seeking authorization from the District's Board of Directors to retain additional consultants to assist with implementing anticipated recommendations for improvements to the District's Moyer Program through computer hardware and software systems, as appropriate.

In addition to undertaking the comprehensive review of the District's Moyer Program and implementation of anticipated recommended improvements outlined above, District staff will take the following actions. First, the District will formally allocate interest earned to date to the Carl Moyer Program accounts maintained by the District. Second, the District will formally document its Board of Directors' approval of the receipt of all Moyer Program funds. Third, the District will develop and present to the District's Board of Directors a request for additional staff to assist in administering the District's Moyer Program. Fourth, based on the recommendations of its consultants, the District will develop and provide training in Moyer Program guidance and best practices for grants program administration for all existing and new staff involved with the District's Moyer Program.

District staff believes that the steps outlined above will significantly strengthen the District's Moyer Program. District staff hopes that CARB staff agrees and will consider these efforts and commitments as it finalizes its review of the District's Moyer Program.

Please let me know if you have any questions regarding this letter, or if I can provide additional assistance.

Sincerely,

Original signed by:

Jack P. Broadbent
Executive Officer/APCO