

**STATE CONTROLLER'S REPORT: FINDINGS REGARDING THE BOARD OF EQUALIZATION'S ACCOUNTING AND ADMINISTRATIVE CONTROLS**

The purpose of this communication is to address client inquires regarding recent print media news on the mandated State Controller audit and findings report of the State Board of Equalization (BOE). The Controller's report from November 2015 is titled: *Review Report: Internal Accounting and Administrative Control Review (July 1, 2013 through April 30, 2015)*. To begin with, please note that allocations of purely local revenues (Bradley-Burns, Transactions and Use Tax, and Transit District Tax) are not affected by the issues identified in the Controller's report. The following includes background from the Controller's report and MuniServices' research to provide the framework for client inquires. This policy update is organized as follows:

- Background and Issue
- The Eleven (11) State Controller Findings: Concerns for Local Government
- What this Means for Local Government: Revenues Impacted and Not
- State Controller Findings Regarding Reallocations
- Reallocating of the Funds

MuniServices is an Associate Member of the California State Association of Counties (CSAC) and especially thanks CSAC staff Geoffrey Neill for the assistance in capturing the nuances of this issue. We are continuing conversations with stakeholders to better understand the full implication behind the findings. Please contact your respective MuniServices Client Manager for additional information.

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**BACKGROUND AND ISSUE**

**Background and issue:** In November 2015, the State Controller's Office (SCO) audited the BOE and found issues, including a material lack of internal controls and a misallocation of several different taxes, including sales tax, use taxes, and diesel fuel taxes. The focus of the review are the BOE's State Retail Sales Tax Fund (RSTF), Office Revolving Fund (ORF), accounts receivable cycle, and apportionment and allocation processes for the period of July 1, 2013, through April 30, 2015. ([http://www.sco.ca.gov/Files-AUD/11\\_2015saa\\_ca\\_boardofequalization\\_internal\\_cntrl.pdf](http://www.sco.ca.gov/Files-AUD/11_2015saa_ca_boardofequalization_internal_cntrl.pdf))

**Review objectives:** Determine whether the BOE has adequate internal accounting and administrative controls over certain financial operations and activities, specifically the RSTF, the ORF, the accounts receivable cycle, and the apportionment and allocation processes, to safeguard the State against theft, abuse, or losses; and the BOE is complying with applicable laws, rules, regulations, policies, and procedures.

**Authority:** The review authority comes from the California Government Code (GC) section 12410, which states, "The Controller shall superintend the fiscal concerns of the state."

**ELEVEN (11) FINDINGS: CONCERN FOR LOCAL GOVERNMENT**

The report outlines: a) eleven (11) major findings, b) the SCO's recommendation for each finding, c) the BOE's response, and d) the SCO's comments in response to the BOE.

1. Inadequate internal accounting and administrative controls to appropriately allocate money in the RSTF
2. Quarterly true-up of RSTF inaccurately adjusts fund allocations
3. Sales tax on diesel fuel is being improperly allocated in the RSTF
4. DMV Use Tax is being allocated to the RSTF
5. FTB Use Tax is being improperly allocated to the RSTF
6. RSTF accounts receivable balance is inaccurate
7. ORF receivables not collected in a timely manner



8. Claims not scheduled for prompt reimbursement to the ORF
9. Improper use of office revolving funds and lack of supporting documentation
10. Inadequate controls over salary advances
11. Inadequate controls over travel advances and reimbursement claims

The SCO noted that the control weaknesses, detailed in Findings 1 through 5, contribute to the increasing fund balance of the RSTF, inaccurate adjustments during the quarterly true-ups, improper allocations of DMV and FTB Use Taxes, and improper allocations of the additional sales tax on diesel fuel. In addition, the BOE's RSTF accounts receivable balance is inaccurate, as noted in Finding 6. Findings 7 through 11 could lead to waste, abuse, and the misappropriation of funds.

#### **WHAT THIS MEANS FOR LOCAL GOVERNMENT**

First, as part of their effort to improve internal controls and correct calculations, the BOE is significantly updating their technology systems. Transferring all of the information into the new system is an enormous task and, while it is intended to produce more accurate results, it will also take an unknown but significant amount of time to implement and could conceivably uncover allocation errors not yet identified. The BOE has drafted a plan to correct their allocation issues, their internal controls, and their auditing and reporting procedures to avoid any future problems of this sort. That plan is being reviewed by SCO and the Department of Finance. The Legislature has also requested an audit of the BOE.

**Revenues not impacted:** It was clarified this week that purely local allocations (Bradley-Burns, Transactions and Use Tax, and Transit District Tax) are not affected by these issues identified in the CRO report. The BOE sent too much money to the RSTF, where it accumulated over time. The excess funds were never distributed to local governments, so the correction will direct the excess revenues back to the state's General Fund.

**Revenues impacted:** Also clarified is the State General Fund, Proposition 172, 1991 Realignment, 2011 Realignment, and the Fiscal Recovery Fund will be impacted. At the time of print we are working with CSAC to identify what the effect will be on locals of the Fiscal Recovery Fund misallocation, since the bonds are paid off and the only thing left to do is repay locals for some lost revenue.

#### **SCO FINDINGS REGARDING REALLOCATIONS**

Four of the SCO's findings will result in reallocations. Some of the errors benefited the state's General Fund at the expense of some or all other funds, while others erred in the opposite direction. Some errors affected all funds that receive sales tax revenues, while others only affected one or two funds. The audit notes that in several cases, the errors extend beyond the period the audit covered, so the SCO estimates of how much money was misallocated do not reflect the entire problem. Also, in two cases, the SCO was able to identify that errors were being made, but because the correct information was not available to them, they were not able to identify either which funds were over-allocated or by how much. For these errors, it is not known which funds received too much or too little revenue, nor was the SCO able to provide an estimate of the amount of money involved.

It is not currently known how much money has been misallocated, or what the net result will be when they are corrected. However, the net result of the known estimates would result in a reallocation of funds from local agencies to the state General Fund.

#### **REALLOCATING OF THE FUNDS**

All involved agencies, including the Department of Finance, have expressed a desire to reallocate funds in a way that minimizes fiscal impacts on all affected agencies. The BOE has not given an indication of when the amounts might be known. The SCO audit found inaccurate adjustments during the quarterly true-ups, leading to misallocations in following years. These withholdings have already begun and will affect the funds received by counties in at least the current fiscal year and next fiscal year.