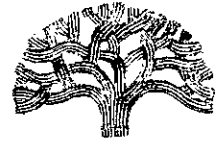


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July 14, 2009

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.

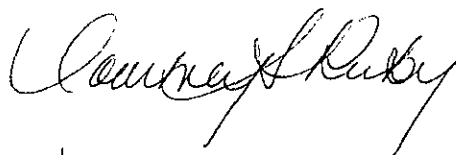
The audit found that the City:

- 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 black ink, appearing to read "Courtney A. Ruby". The signature is written in a cursive, flowing style.

COURTNEY A. RUBY, CPA  
City Auditor

**City of Oakland**  
**Office of the City Auditor**

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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**

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## 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.

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### 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.

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### **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

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-

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)	
<b>Unrestricted Revenues Misclassified as Restricted Revenues</b>	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
	<b>Total</b>	<b>\$5,404,251</b>	<b>\$10,546,974</b>	<b>\$15,951,225</b>
	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)
<b>Additional Amount Due to the Kids First Fund</b>	<b>\$135,106</b>	<b>\$263,674</b>
<b>Combined Amount Due for Both Fiscal Years</b>		<b>\$398,780</b>

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.

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**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

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**

	<b>Total True-Up Amount for FY 1997-98 to FY 2004-05</b>
<b>City Administration's true-up calculation</b>	\$3,288,032
<b>City Auditor's true-up calculation</b>	\$3,536,672
<b>Difference</b>	\$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**

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

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.

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**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**

<b>Fiscal Year</b>	<b>Amount Credited to the Kids First Fund</b>
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*

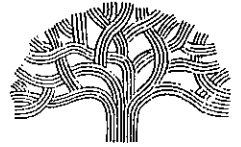
establish a process for classifying revenues as either restricted or unrestricted.

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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Office of the City Administrator

(510) 238-3301  
FAX (510) 238-2223  
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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". The signature is fluid and cursive, 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.



## 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)	136,759

**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	
<b>Actual Audited Revenue</b>	<b>\$455,221,386</b>
<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)
<b>Net Unrestricted General Purpose Fund Revenues</b>	<b>\$400,150,875</b>
<b>Kids First 2.5% Funding Obligation (Actual)</b>	<b>\$10,003,772</b>
<b>Budgeted Transfers</b>	<b>\$10,282,062</b>
<b>Budget to Actual Adjustments Due to Kids First!</b>	<b>(\$278,290)</b>

\* 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

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.

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