1st District - Janet Nguyen 2nd District - John M.W. Moorlach, Vice Chairman 3rd District - Bill Campbell, Chairman 4th District - Shawn Nelson 5th District - Patricia C. Bates

OC Board of Supervisors'

Internal Audit Department

ORANGE COUNTY

6th Largest County in the USA

AUDIT OF LADERA RANCH COMMUNITY FACILITIES DISTRICTS

For Period Ending
November 30, 2009

Critical Impact Audit

The six (6) Community Facilities Districts (CFDs) for Ladera Ranch received principal bond proceeds totaling $287 million.

The six (6) Community Facilities Districts (CFDs) for Ladera Ranch received principal bond proceeds totaling $287 million. The objectives of our audit were to determine that: (1) the special tax rates charged to the CFD residents were properly calculated, and (2) bond proceeds were used only for authorized projects. In addition, we evaluated internal controls over processes for the Ladera Ranch CFDs.

We identified two (2) Critical Control Weaknesses, five (5) Significant Control Weaknesses, and six (6) Control Findings resulting in twenty-one (21) Recommendations where internal controls and processes need to be improved in the calculation of the special tax rate and to ensure that bond proceeds are used only for authorized projects. The critical control weaknesses relate to the Auditor-Controller Public Finance Accounting's method for the calculation of the special tax levy and for unexplained project costs for El Toro Branch Library of $803 thousand charged to the Ladera Ranch CFDs.

AUDIT NO: 2919
REPORT DATE: MARCH 7, 2011

Director: Dr. Peter Hughes, MBA, CPA, CIA
Deputy Director: Eli Littner, CPA, CIA
Senior Audit Manager: Alan Marcum, CPA, CIA
Senior Internal Auditor: Lisette Free, CPA, CFE

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ORANGE COUNTY BOARD OF SUPERVISORS'

Internal Audit Department

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RISK BASED AUDITING

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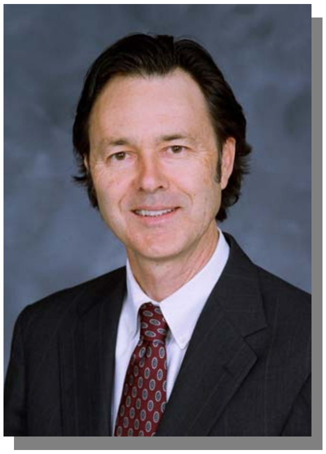
Letter from Dr. Peter Hughes, CPA

Transmittal Letter



Audit No. 2919 **March 7, 2011**

TO: David E. Sundstrom, Auditor-Controller
Robert J. Franz, Deputy CEO
Chief Financial Officer
Jess A. Carbajal, Director, OC Public Works

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

SUBJECT: Audit of Ladera Ranch Community Facilities Districts

We have completed an Audit of Ladera Ranch Community Facilities Districts (CFDs). We performed this audit in response to a directive by the County of Orange Audit Oversight Committee. Our final report is attached for your review.

Please note we have a structured and rigorous **Follow-Up Audit** process in response to recommendations and suggestions made by the Audit Oversight Committee (AOC) and the Board of Supervisors (BOS). As a matter of policy, our **first Follow-Up Audit** will begin at <u>six months</u> from the official release of the report. A copy of all our Follow-Up Audit reports is provided to the BOS as well as to all those individuals indicated on our standard routing distribution list.

The AOC and BOS expect that audit recommendations will typically be implemented within six months and often sooner for significant and higher risk issues. Our **second Follow-Up Audit** will begin at <u>six months</u> from the release of the first Follow-Up Audit report, by which time **all** audit recommendations are expected to be addressed and implemented.

At the request of the AOC, we are to bring to their attention any audit recommendations we find still not implemented or mitigated after the second Follow-Up Audit. The AOC requests that such open issues appear on the agenda at their next scheduled meeting for discussion.

We have attached a **Follow-Up Audit Report Form**. Your department should complete this template as our audit recommendations are implemented. When we perform our first Follow-Up Audit approximately six months from the date of this report, we will need to obtain the completed document to facilitate our review.

Letter from Dr. Peter Hughes, CPA

Each month I submit an **Audit Status Report** to the BOS where I detail any material and significant audit findings released in reports during the prior month and the implementation status of audit recommendations as disclosed by our Follow-Up Audits. Accordingly, the results of this audit will be included in a future status report to the BOS.

As always, the Internal Audit Department is available to partner with your staff so that they can successfully implement or mitigate difficult audit recommendations. Please feel free to call me should you wish to discuss any aspect of our audit report or recommendations.

Additionally, we will request your department complete a **Customer Survey** of Audit Services. You will receive the survey shortly after the distribution of our final report.

Attachments

Other recipients of this report are listed on the **OC Internal Auditor's Report** on page 7.

OC Internal Auditor's Report

Audit of Ladera Ranch Community Facilities Districts
Audit No. 2919

For the Period Ending
November 30, 2009

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Audit of Ladera Ranch Community Facilities Districts
Audit No. 2919

For the Period Ending
November 30, 2009

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OC Internal Auditor's Report

Audit Highlight

The six (6) Community Facilities Districts (CFDs) for Ladera Ranch received principal bond proceeds totaling $287 million. The objectives of our audit were to determine that: (1) the special tax rates charged to the CFD residents were properly calculated, and (2) bond proceeds were used only for authorized projects. In addition, we evaluated internal controls over processes for the Ladera Ranch CFDs.

We noted **two (2) Critical Control Weaknesses**, **five (5) Significant Control Weaknesses**, and **six (6) Control Findings** resulting in **twenty-one (21) Recommendations** where internal controls and processes need to be improved in the calculation of the Special tax rate and to ensure that bond proceeds are used only for authorized projects. The critical control weaknesses relate to the Auditor-Controller Public Finance Accounting's method for the calculation of the special tax levy and for unexplained project costs for El Toro Branch Library of $803 thousand charged to the Ladera Ranch CFDs.

Audit No. 2919 **March 7, 2011**

TO: David E. Sundstrom, Auditor-Controller
Robert J. Franz, Deputy CEO, Chief Financial Officer
Jess A. Carbajal, Director, OC Public Works

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

SUBJECT: Audit of Ladera Ranch Community Facilities Districts

OBJECTIVES

The Internal Audit Department conducted an audit of the six (6) Ladera Ranch Community Facilities Districts (CFDs). We included an evaluation of the adequacy and integrity of internal controls, compliance with department and County policies, and evidence of process efficiencies and effectiveness. Our audit was conducted in conformance with professional standards established by the Institute of Internal Auditors. Our audit objectives were to determine if controls were in place and working effectively over Ladera Ranch CFDs to ensure:

1. Special tax rates are calculated in accordance with pertinent governing documentation.
2. Bond proceeds are used for projects in compliance with pertinent governing documentation.

RESULTS

We audited the internal controls and processes over County Executive Office (CEO)/Public Finance's Ladera Ranch CFDs from the bond's inception date through November 30, 2009.

We identified **two (2) Critical Control Weaknesses**, **five (5) Significant Control Weaknesses**, and **six (6) Control Findings** resulting in **twenty-one (21) Recommendations** to enhance controls and processes as discussed in the *Detailed Findings, Recommendations and Management Responses* section of this report. See *Attachment A* for a description of Report Item Classifications. Based upon our audit, we noted:

- **Objective #1**: *Special tax rates are calculated in accordance with pertinent governing documentation.*

  Results: We found that the calculation method and internal controls need to be improved over the annual special tax levy calculation process. We noted **one (1) Critical Control Weakness** and **one (1) Significant Control Weakness** in the area of the special tax levy calculation and **two (2) Control Findings** in the areas of controls over monitoring special tax levy collections, and controls over notifying tax consultants of changes to parcel's information (See Finding Nos.1-7).

- **Objective #2:** Bond proceeds are used for projects in compliance with pertinent governing documentation.

- **Results:** We found that internal controls and processes need to be improved to ensure that bond proceeds for projects are used in compliance with governing documentation. We noted **one (1) Critical Control Weakness** in the area of project costs for the El Toro Branch Library charged to Ladera Ranch CFD, **four (4) Significant Control Weaknesses** in the areas of monitoring project costs and cash available for project costs, incomplete policy and procedures, missing approval for allocating costs between CFDs, and controls over transfers of bond proceeds from Ladera Ranch CFD funds, and **four (4) Control Findings** in the areas of administrative costs charged to incorrect funds, the use of anticipated interest earnings in the AFDA agreements and amendments, and AFDA amendments not signed (See Finding Nos. 8-21).

BACKGROUND

The Public Finance Division (CEO/Public Finance) is part of the County Executive Office (CEO) under the leadership and oversight of the Chief Financial Officer (CFO) and the Director CEO/Public Finance. The current CFO, Robert J. Franz, started with the County in January 2007 and the Director CEO/Public Finance Colleen Clark, started with the County in January 2010. CEO/Public Finance is primarily responsible for managing the County's public debt programs, including Community Facilities Districts (CFDs).

CEO/Public Finance Accounting (PFA) is one of the Auditor-Controller's Satellite Accounting Operations (Auditor-Controller PFA). Auditor-Controller PFA is primarily responsible for providing specialized accounting support/services in accordance with the complex needs of CEO/Public Finance. An Accounting Services Agreement is in place between CEO and Auditor-Controller. The Accounting Services Agreement was signed during the second quarter of calendar year 2008.

BOND PROCEEDS:

In order to provide a more flexible funding source to local governments, the State Legislature enacted the Mello-Roos Act (Act) in 1982. The Act permits landowners, upon receiving approval from a local government agency, to form a CFD to levy a special tax, and to authorize bonds secured by the special tax. As the properties in the CFD are developed and sold, new homebuyers assume the responsibility for paying the Mello-Roos special tax which is included on their property tax bills. The Act has been used by local governments to finance infrastructure in State communities to date. It has become one of the primary funding sources for constructing public facilities which are needed to serve development projects throughout the State.

The Ladera Ranch CFDs are designed to fund required infrastructure (e.g., roads, storm drains, fire stations, libraries, schools) to support current and future residential and commercial growth within land-based taxing regions called CFDs. Funds for CFDs' needs are generated through the issuance of bonds by each CFD.

Payment to investors of CFD bonds is made through special taxes levied on real property within the districts according to the Rate and Method of Apportionment of the Special Taxes approved by qualified electors of the CFD. The burden of the special taxes falls on the property owners within the districts. Debt service is secured by special tax liens on the property in each CFD. Failure to pay special taxes can result in judicial foreclosure. Auditor-Controller PFA provides accounting services for the Ladera Ranch CFD’s debt service, acquisition and construction activities.

The County of Orange issued the following six (6) bonds (See Attachment B) on behalf of the Ladera Ranch CFDs pursuant to the terms and provisions of the Mello-Roos Community Facilities Act of 1982 (Government Code section 53311, et seq.):

Bond Description	Aggregate Principal Amount	Maturity Date
Series A of 1999 Special Tax Bonds of CFD No. 1999-1 (CFD 99-1) issue date 10/29/99 (**Note Below**)	$ 22,620,000	August 2032
Series A of 2000 Special Tax Bonds of CFD No. 2000-1 (CFD 00-1) issue date 12/07/00 (**Note Below**)	30,200,000	
Series A of 2002 Special Tax Bonds of CFD No. 2001-1 (CFD 01-1) issue date 05/09/02 (**Note Below**)	32,985,000	
Series A of 2003 Special Tax Bonds of CFD No. 2002-1 (CFD 02-1) issue date 05/14/03	68,280,000	August 2033
Series A of 2004 Special Tax Bonds of CFD No. 2003-1 (CFD 03-1) issue date 04/07/04	57,185,000	August 2034
Series A of 2005 Special Tax Bonds of CFD No. 2004-1 (CFD 04-1) issue date 01/19/05	75,645,000	August 2034
Total	$286,915,000	
Note: Bonds for CFD 99-1, CFD 00-1 and CFD 01-1 were refunded in fiscal year 2005/2006 for $84,015,000 (2005 Series A) issue date 11/16/05.		

The County of Orange maintains two funds to account for each of the Ladera Ranch CFDs’ activities: 1) a debt service fund, and 2) an acquisition and construction fund (See Attachment C). The Ladera Ranch CFDs’ debt service funds are utilized to account for the bond’s proceeds for debt service activities (i.e., special taxes, interest, principal, redemption, reserve, rebate and administrative expenses). The Ladera Ranch CFDs’ acquisition and construction funds are utilized to account for the bonds’ proceeds for the required infrastructure and services (i.e., maintenance). The bonds’ Official Statements and Supplements to the Resolutions provides information concerning the issuance and sale along with the terms governing the bonds, specifically the process for receiving and transferring bond proceeds by the CFDs.

DEBT SERVICE PROCESS

Auditor-Controller PFA maintains Statement of Sources and Uses Reports for the debt service and acquisition and construction funds to track all expenditures and revenue activities within each CFD utilizing the general ledger as its source. The Statement of Sources and Uses Reports are submitted for supervisory review on an annual basis.

On a semi-annual basis, Auditor-Controller PFA debt service payments of interest and principal are made to the Trustees in accordance with the bonds' debt service schedules. For the debt service payments, Auditor-Controller PFA prepares a Payment Review and Approval form with the invoice (payment package) and forwards the payment package to CEO/Public Finance staff analysts for their review and approval. The Payment Review and Approval form documents a description of the payment, payment authorization, and evidence of the review and approval by CEO/Public Finance and Auditor-Controller PFA. CEO/Public Finance reviews the payment package to ensure costs agree to supporting documentation. Auditor-Controller PFA is responsible for ensuring CEO/Public Finance required approval is documented and invoices are mathematically correct before payments are processed. In addition, a senior accounting assistant for Auditor-Controller PFA performs a secondary review to ensure the legal authority to pay is accurate.

<u>Special Tax Levy Calculation and Apportionment Process</u>

On an annual basis, Auditor-Controller PFA prepares the Annual Tax Setting spreadsheet for each Ladera Ranch CFD to calculate the amount of the Special Tax Levy. The special tax levy includes bond principal and interest payments, administrative expenses including Treasurer-Tax Collector fees, and a credit for the interest earnings on bond proceeds. The principal and interest payments used in the calculation are those that are to be paid by the County to the Trustee in the following calendar year (i.e., the FY 09/10 special tax levy is to pay the debt service payments due in February 2010 and August 2010). In addition, the FY 09/10 special tax levy is reflected on the CFD taxpayers' bills due in November 2009 and February 2010 in the County's 2009-2010 Tax Bills. In addition, an analytical review is prepared to compare the current and prior year special tax levy for each CFD for reasonableness.

CEO/Public Finance contracts with a special tax consultant, David Taussig & Associates (DTA), to allocate the total amount of the special tax levy to the parcels within the CFD in accordance with the Rate and Method of Apportionment (RMA) stated in each of the CFDs Official Statements. DTA calculates the Assigned Special Tax using the maximum special tax rate based on the RMA for each parcel. The maximum special tax rate is escalated each fiscal year by two percent (2%) of the amount in effect for the previous fiscal year. After the calculation of the maximum special tax, the Assigned Special Tax may produce a greater amount of tax than is required to meet Auditor-Controller's PFA calculated special tax levy. Therefore, DTA will proportionately reduce all of the parcel tax levies accordingly. If the Assigned Special Tax is not sufficient to meet the total annual special tax after the allocation, DTA will follow the process as described in the RMA. DTA prepares an Annual Administration Report for each CFD allocating the annual special tax levy. The Ladera Ranch CFDs were proportionately reduced each fiscal year since the Assigned Special Tax (maximum) for the taxpayers' parcels was more than the Auditor-Controller PFA calculated total annual tax levy.

CEO/Public Finance prepares an Agenda Staff Report (ASR) in order for the Board of Supervisors to adopt a resolution levying the special taxes for the CFDs. Once adopted, the information on the Annual Administration Report is electronically provided to the Auditor-Controller/Property Tax Unit to upload the information into the Assessment Tax System in order to appear in the taxpayers' property tax bills.

ACQUISITION AND CONSTRUCTION PROCESS

Auditor-Controller PFA utilizes the acquisition and construction funds to pay the costs and expenses of acquisition and construction of certain public facilities necessary for the development of the CFDs.

Each bond has an accompanying Acquisition, Funding, and Disclosure Agreement (AFDA) in which its purpose is to "provide for funding the costs of formation of the District, the costs of issuance of bonds under the proceedings and for the acquisition and/or construction of certain public facilities, including bridges, pedestrian bridges, roadways, parks, storm drains, traffic signals, fire stations and equipment, a sheriff's substation and equipment and library facilities and equipment, and all related appurtenant work (the "Facilities") upon land, or which will benefit land, within the District." The AFDA is approved by the Board of Supervisors as part of the financing documents of the bonds (See Attachment D).

CEO/Public Finance initiates amendments to the AFDA as needed. An example is funding needs submitted to CEO/Public Finance for acquisition and construction projects identified by OC Public Works and/or developers. CEO/Public Finance works with Auditor-Controller PFA to determine the funding available for an amendment. Usually the AFDAs are amended to reallocate available funds (including interest income earned) to specific line items. Amendments to the AFDA are submitted to the Board of Supervisors for approval. In addition, Joint Community Financing Agreements may be in place to acquire and finance the acquisition and/or construction of a portion of facilities to be owned or operated by a public agency other than the agency that created the CFD (e.g., OC Fire Authority to fund fire stations and equipment).

Auditor-Controller PFA maintains Project Cost Reports for acquisition and construction funds to track all financing and facilities costs related to the CFD against approved AFDA amendments in addition to the Statement of Sources and Uses Reports maintained. At month-end, Auditor-Controller PFA records the revenues and expenditures listed in the general ledger for each fund on the Project Cost Reports (records based on project cost categories, interest earnings allocations and account balances for each fund). Project Cost Reports are submitted for supervisory review on an annual basis.

Disbursement of Funds

Disbursements may include acquisition and construction payments (i.e., services for construction, developers, consultants, and/or engineers) and other miscellaneous payments related to the project such as County departments' staff charges.

The disbursement of funds for acquisition and construction payments is similar to the debt service process. Auditor-Controller PFA prepares and forwards a payment package to CEO/Public Finance staff analysts for their review and approval. The Payment Review and Approval Form in the payment package documents a description of the payment, payment authorization, and evidence of the review and approval by CEO/Public Finance and Auditor-Controller PFA. CEO/Public Finance reviews the payment package to ensure costs are reasonable, relate to the appropriate projects, the required approvals from OC Public Works and/or district engineer are documented as needed, and project costs are allowable pursuant to the AFDA. Auditor-Controller PFA is responsible for ensuring required approvals are documented from CEO/Public Finance, OC Public Works, and/or the district engineer, invoices are mathematically correct, and project costs are within the parameters of the current AFDA before payments are processed.

In addition, a senior accounting assistant for Auditor-Controller PFA performs a secondary review to ensure the legal authority to pay is accurate. Auditor-Controller Central Claims Unit or OC Public Works Accounting is responsible for processing the payment once it is approved and received from Auditor-Controller PFA. Effective 7/1/09, Auditor-Controller Central Claims Unit or OC Public Works Accounting receives and approves payment requests, enters the information on the payment packages through CAPS+, and forwards the payment package to Auditor-Controller Check Writing Unit for disbursement of funds.

Construction/Developer Payments
Construction payments are made directly to contractors (construction payments) or made to the developers that manage construction contractors (developer payments). Construction and Developer Payments follow the same process as noted in the *Disbursement of Funds* section above with the following exceptions:

Construction Payments
OC Public Works Project Managers manage and track construction contracts, and inspect work-in-progress and completion of work to determine it is in accordance with contract specifications. Also, they review and approve the construction payment requests to ensure costs are in accordance with County Procedures, laws and regulations (Contract Policy Manual, Government Code, Public Contract Code, and contract specifications). The project managers for OC Public Works approve Monthly Progress Reports for construction and prepare a memorandum to Auditor-Controller PFA for further payment processing (see *Disbursing of Funds* section above).

Developer Payments
CEO/Public Finance contracts with an external third party District Engineer to provide the technical expertise in ensuring the work under the direction of the developer is accurate and completed as if OC Public Work had performed the construction. District Engineers provide a Final Acquisition Report that includes their conclusions to OCPW that documents eligible reimbursement costs are in accordance with the AFDA and lists any costs recommended for disallowance. The Final Acquisition Report includes a description of the District Engineer's standard procedures, analysis of compliance with the program, summary of the Developer's request for reimbursement, analysis of requested reimbursement amounts, summary and recommendation, comparison of the recommended reimbursement to the AFDA and a summary of CFD acquisition fund financial status.

OCPW reviews and approves the District Engineer's Final Acquisition Reports for developer payments and construction work per the County's procedures for construction and developer payments. They provide the Final Acquisition Report along with a memorandum from OCPW stating that OCPW concurs with the reimbursement request and that it has been adequately documented in accordance with the AFDA to the Auditor-Controller PFA for review and approval as noted in the *Disbursing of Funds* section above.

SCOPE

Our audit evaluated internal controls and processes over CEO/Public Finance's Ladera Ranch CFDs from the bonds' inception dates through November 30, 2009. Our audit conforms to the International Standards for the Professional Practice of Internal Auditing. Our methodology included inquiry, auditor observation and testing of relevant documents.

SCOPE EXCLUSIONS

We did not audit CEO/Public Finance's bond financing process or information technology controls. In addition, the controls over the Ladera Ranch CFDs were not audited in respect to the processes performed by the Assessor, Treasurer-Tax Collector, or the Auditor-Controller Property Tax Unit.

Management's Responsibilities for Internal Controls

In accordance with the Auditor-Controller's County Accounting Manual section S-2 - *Internal Control Systems*, "All County departments/agencies shall maintain effective internal control systems as an integral part of their management practices. This is because management has primary responsibility for establishing and maintaining the internal control system. All levels of management must be involved in assessing and strengthening internal controls. Control systems shall be continuously evaluated and weaknesses, when detected, must be promptly corrected." The criteria for evaluating an entity's internal control structure is the Committee of Sponsoring Organizations (COSO) control framework. Our audit of Ladera Ranch CFDs enhances and complements, but does not substitute for CEO/Public Finance's, Auditor-Controller PFA's, or OC Public Works continuing emphasis on control activities and self-assessment of control risks.

Inherent Limitations in Any System of Internal Control

Because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. Specific examples of limitations include, but are not limited to, resource constraints, unintentional errors, management override, circumvention by collusion, and poor judgment. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or the degree of compliance with the procedures may deteriorate. Accordingly, our audit would not necessarily disclose all weaknesses in CEO/Public Finance's, Auditor-Controller PFA's, or OC Public Works operating procedures, accounting practices and compliance with County policy.

Acknowledgment

We appreciate the courtesy extended to us by CEO/Public Finance, Auditor-Controller Satellite Accounting Operations, and OC Public Works. If we can be of further assistance, please contact me directly or Eli Littner, Deputy Director at 834-5899 or Alan Marcum, Senior Audit Manager at 834-4119.

Attachments

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors
Members, Audit Oversight Committee
Thomas G. Mauk, County Executive Officer
Shaun Skelly, Senior Director of A-C/Accounting and Technology
Bill Castro, Director, A-C/Satellite Accounting Operations
Colleen Clark, Director, CEO/Public Finance
Suzanne Luster, Manager, CEO/Public Finance Accounting
Harry Persaud, Manager, Planned Communities/Planning/OC Public Works
Mary Fitzgerald, Manager, A-C/OC Public Works Accounting
Foreperson, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors

OBJECTIVE #1: *Special tax rates are calculated in accordance with pertinent governing documentation.*

Finding Nos. 1 - 3 – Method for Special Tax Levy Calculation Should be Improved (Critical Control Weakness)

The method used by Auditor-Controller PFA for calculating the annual special tax levy for all six of the Ladera Ranch CFDs was deficient resulting in inaccurate calculations. We compared Auditor-Controller PFA's special tax levy calculation to actual data (i.e., debt services schedules, actual interest earnings and actual administrative expenses) and identified the following three (3) issues:

A. Auditor-Controller PFA used incorrect debt service payment information when calculating the Special Tax Levy, resulting in bond service principal and interest payments being incorrectly applied **(See Recommendation No. 1)**.
   - For CFD 99-1, 00-1 and 01-1, the difference of $151,805 was due to Auditor-Controller PFA not adjusting the subsequent year's debt service payments when the refunding debt service schedules became available. Auditor-Controller PFA informed us that this was to increase the reserve at the time of refunding.
   - For CFD 03-1, the difference of $24,015 was due to Auditor-Controller PFA utilizing an amount not stated in the debt service schedule.
   - For CFD 04-1, the difference of ($80,934) was due to Auditor-Controller PFA utilizing debt service schedule's fiscal year amount for two consecutive years instead of the fiscal year applicable at the time the calculation was developed.

B. Auditor-Controller PFA used estimates for interest earnings instead of using actual prior fiscal year interest earnings on the debt service funds to reduce the tax amount. The estimates for the six CFDs interest earnings on an average were 26% or $1,537,000 less than actual interest earnings. In addition, their basis for the estimates was not supported.

   In addition, the Auditor-Controller PFA used estimates for administrative expenses in their calculation of the Special Tax Levy; however, the estimates are not based on actual costs or reasonable estimates as required. The estimates for the six CFDs administrative expenses on an average exceeded actual costs by 49% or $907,000. In addition, their basis for the estimates was not supported **(See Recommendation No. 2)**.

C. We found that the Auditor-Controller PFA management conducted no internal review of the annual special levy calculation to ensure the special tax levy was calculated accurately and that the calculation agrees to source documentation **(See Recommendation No. 3)**.

The Ladera Ranch CFDs Rate and Method of Apportionment of Special Tax Requirements (Requirements) define the Special Tax Requirement as the amount required in any fiscal year for the CFD to pay the sum of:

i. debt service on all outstanding bonds;
ii. periodic costs on the Bonds, including but not limited to, credit enhancement and rebate payments on the Bonds;
iii. reasonable Administrative Expenses;
iv. any amounts required to establish or replenish any reserve funds for all outstanding bonds; and
v. any amount required for construction of facilities eligible under the Act.

The Requirements further state that in arriving at the Special Tax Requirement, the CFD Administrator shall take into account the reasonably anticipated delinquent Special Taxes based on the delinquency rate for Special Taxes levied in the previous Fiscal Year and shall give a credit for funds available to reduce the annual Special Tax levy.

The Requirements also define Administrative Expenses within the Ladera Ranch CFDs as actual or reasonably estimated costs directly related to the administration of CFD.

Because of the essential importance of accurate Special Tax Levies, we are making the following recommendations:

Recommendation No. 1

We recommend Auditor-Controller PFA annually compare the debt service payments used in the calculation of the Special Tax Levy to the bonds' current debt service schedules to ensure the correct debt service payments are used.

Auditor-Controller Response:

Concur. PFA used current debt service schedules when computing the special tax levy for fiscal year 2005-06. These bonds were subsequently refunded in November 2005 resulting in new debt service schedules. The new debt service schedules were used in subsequent years. We agree that the tax levy calculation for the year following a refunding should consider the carryover fund balance that resulted from the refunding. This will be addressed in the policies and procedures that will be written to document the special tax levy calculation process (please see our response to Recommendation No. 2).

We agree that there were two instances where incorrect debt service payment information was used when calculating the special tax levy for Ladera Ranch CFDs 03-1 and 04-1. Although the two instances involved different Ladera Ranch CFDs and years, the net effect was a special tax levy undercharge of approximately $57,000. Although the Ladera Ranch CFD 04-1 undercharge was discovered shortly before the tax levy adoption by the Board, the CFD Administrator decided not to pull the ASR.

Recommendation No. 2

We recommend Auditor-Controller PFA use the actual or reasonable interest earnings and administrative expenses that are aligned with actual historical data and adjust the subsequent Special Tax Levy for the difference between actual and estimated interest earnings and administrative expenses for the prior years.

Auditor-Controller Response:

Concur. We will work with the CFD Administrator to prepare policies and procedures documenting the special tax levy calculation. These policies and procedures will address guidelines for budgeting interest earnings and administrative expenses. However, please note that budgets should be set to ensure interest earnings are not overestimated or that administrative expenses are not underestimated. If either of these were to occur, it could result in an inability to meet district expenses including debt service requirements and/or result in a reportable event.

We will also include provisions in these policies and procedures that addresses reasonable annual fund balance carryover amounts, infrastructure transfers, arbitrage rebate transfers, and reserve transfers so that any moneys left over at the end of the year (in excess of a reasonable carryover after transfers have been made) are used to offset the following year's special tax levy. The administrative policies and procedures to document the special tax levy calculation process will be submitted to the CFD Administrator in time to be reviewed and approved so that it can be used for the 2011-12 tax levy calculation process (July 31, 2011).

Recommendation No. 3
We recommend Auditor-Controller PFA management ensure a qualified and systematic supervisory review is provided and documented to enhance the integrity of the calculation of the Special Tax Levy.

Auditor-Controller Response:
Concur. PFA management will ensure a documented supervisory review is started with the 2011-12 special tax levy calculation process (July 31, 2011).

Finding No. 4 – Other CFD Special Tax Levy Calculations Require Additional Review (Significant Control Weakness)

Based on the discrepancies of the Special Tax Levy calculations noted in **Finding Nos. 1-3** for the six (6) Ladera Ranch CFDs, there is a need for Auditor-Controller PFA management to review the Special Tax Levy calculations for other CFDs to ensure they were calculated accurately and that the calculations agreed to source documentation.

Recommendation No. 4
We recommend that Auditor-Controller PFA management perform a review of all other Community Facilities Districts (an additional seventeen [17] CFDs) to determine if the calculation of the Special Tax Levy needs to be adjusted to ensure that debt service payments agree to source documentation and estimates used are aligned with actual historical data; specifically, for administrative expenses and interest earnings. In addition, at the conclusion of the review Auditor-Controller PFA management submit the review to the Internal Audit Department for their independent validation.

Auditor-Controller Response:
Concur. As part of the 2011-12 special tax rate setting process, we will ensure a second person compares debt service payments to the most current source documentation and documents their review. We will also ensure that interest earnings and administrative expenses are reasonably estimated and are consistent with management policies (which must be set). Further, we will ensure that any debt service fund carry over is in accordance with each CFD bond's tax certificate. The 2011-12 special tax rate setting process should be completed and available for review by Internal Audit by July 31, 2011.

Finding Nos. 5 & 6 – Controls over Notifying Tax Consultants of Changes to a Parcel's Information Needs Improvement (Control Finding)

We selected a sample of sixty (60) Ladera Ranch CFD parcels to determine that the special tax levy was accurately calculated based on the building's square footage stated on the CFDs' Annual Administration Reports.

We found four (4) out of the sixty (60) parcels selected for testing that the building square footage did not agree to the square footage on the Orange County Public Works' (OCPW) building permits.

For three (3) out of the four (4) parcels identified, an increase to the building's square footage required the parcels be classified to a new tax classification resulting in an increase to the special tax. For the remaining parcel identified, the change in the building's square footage did not result in a change to the tax classification; therefore, the special tax remained the same.

The Annual Administration Report for each CFD is prepared by David Taussig & Associates (DTA) whom serves as the special tax setting consultant for the CFDs. OCPW provides DTA with an electronic file that contains data pertaining to all the permits issued within each CFD. As a result, DTA reviewed the discrepancies with OCPW and it appears that DTA did not receive supplemental data for any amended building permits and/or the certificates of occupancy data were not always accurate.

As a result of our audit, DTA reviewed all Ladera Ranch CFDs and identified approximately 425 parcels for which the square footage identified on the building permit was different from the square footage identified on the certificates of occupancy. Out of the 425 parcels identified, DTA determined 38 parcels (including three [3] previously identified) resulted in a change to the special tax levy. DTA adjusted the building's square footage for the FY 2010-11 special tax levy resulting in correcting an undercharge to twenty-one (21) taxpayers' parcels totaling $4,085 and correcting an overcharge to seventeen (17) taxpayers' parcels totaling $5,755.

Recommendation No. 5

We recommend CEO/Public Finance make the appropriate corrections to the identified twenty-one (21) taxpayers' parcels that were undercharged and the seventeen (17) taxpayers' parcels that were overcharged.

Chief Financial Officer Response:

Concur. The identified amounts relate to the 2010-11 tax assessments. As a result of the audit finding, David Taussig and Associates was able to correct the levies on the identified parcels prior to distribution of the 2010-11 tax bills. Therefore no overcharge or undercharge occurred.

Recommendation No. 6

We recommend Orange County Public Works ensure internal controls and processes are in place to notify the tax setting consultants of supplemental data for any amended building permits and ensure the certificate of occupancy data is accurately stated.

OC Public Works Management Response:

Concur. As a policy, OC Public Works' Building Inspectors must ensure that the square footage noted on the Building Plans match the square footage on the building permit prior to permit final and issuance of the Certificate of Occupancy. We reviewed the data provided to David Taussig and Associates (DTA) in conjunction with this audit, which included general permit data and specific reports from APPS. We found that the data included a variety of informational fields and data not related to the Ladera Community Facilities Districts. For example, permit data for solar panels was included that did not add to the livable square footage. OC Planning in collaboration with CEO/Public Finance and DTA will work to formalize a process for requesting the data and to develop a specific report that will meet the needs of both, and ensure that the data being provided to DTA is relevant and accurate.

Finding No. 7 – Special Tax Levy Collections are not Reviewed Following the Initial Year (Control Finding)

The Auditor-Controller Property Tax Unit provides Auditor-Controller PFA reports for the special taxes collected for each Ladera Ranch CFD. The Auditor-Controller PFA reviews the reports for the first year the special taxes are collected for a new CFD. However, the Auditor-Controller PFA does not review the reports of special taxes including Teeter collections (receipts) for each Ladera Ranch CFD after the first year to ensure that all special taxes levied were collected and accurately recorded to the proper Ladera Ranch CFD.

The County of Orange Accounting Manual, Number S-2, Internal Control Systems, Section 3.3, Authorization, Execution, and Recording of Transactions, states: "A system of authorization and record-keeping procedures is needed to provide effective accounting control over assets, liabilities, revenues, and expenditures. Independent evidence shall be maintained to document that authorizations are issued by persons acting within the scope of their authority and that transactions conform with the terms of the authorizations. Documentation shall provide an adequate audit trail. Transactions shall be accurate, timely, properly recorded, and properly classified. Computer system controls should be utilized to safeguard records and preserve data integrity."

The lack of an ongoing internal review process for the allocation of receipts following the initial year increases the risk that the special taxes and Teeter collections for the Ladera Ranch CFDs will be incomplete, inaccurate and/or untimely.

Recommendation No. 7

We recommend Auditor-Controller PFA perform a review to ensure that special taxes levied are collected (including Teeter) and accurately recorded to the appropriate CFD. In addition, the review should be documented.

Auditor-Controller Response:

Concur. Although there is no evidence that special taxes collections were ever inaccurately recorded in the wrong CFD, we agree that it is a good internal control procedure to review special tax collections and to document the review. We will implement this recommendation by July 31, 2011.

OBJECTIVE #2: *Bond proceeds are used for projects in compliance with pertinent governing documentation.*

Finding Nos. 8 & 9 – Unexplained El Toro Branch Library Costs Charged to Ladera Ranch CFDs (Critical Control Weakness)

The capital improvements for the El Toro Branch Library totaling $803,036 were charged to Ladera Ranch CFDs (starting February 2003 and ending May 2006), but the El Toro Branch Library is in Lake Forest which is not within the boundaries of Ladera Ranch.

The nearest boundary is located approximately seven (7) miles from the El Toro Branch Library.

The El Toro Branch Library capital improvements were reimbursed to the OC Public Library via journal vouchers approved by Auditor-Controller PFA management. There is no documented approval from CEO/Public Finance.

Government Code section 53326 (b), et seq. and the CFD's Engineers' Reports state that a community facilities district may provide for the purchase, construction, expansion or rehabilitation of any real or other tangible property with an estimated useful life of five (5) years or longer which is necessary to meet increased demands placed upon local agencies as the result of development or rehabilitation occurring in the district. The CFD's Engineers' Reports stated that specific library locations were to be determined as development proceeded.

No documentation was provided to support that the County determined the capital improvements for El Toro Branch Library were deemed necessary to meet the demands of the Ladera Ranch CFDs as development proceeded.

The CFD's AFDAs, Recital B, states in part: "The purpose of the District is to provide for funding the costs of formation of the District, the costs of issuance of bonds under the proceedings and for the acquisition and/or construction of certain public facilities, including bridges, pedestrian bridges, roadways, parks, storm drains, traffic signals, a fire station and equipment, a sheriff's substation and equipment and library facilities and equipment, and all related appurtenant work (the "Facilities") upon land, or which will benefit land, within the District."

Recommendation No. 8

We recommend CEO/Public Finance review and provide documentation to support the charge of the El Toro Branch Library capital improvement costs to the Ladera Ranch CFD's bond proceeds. Specifically, documentation in which the County determined that the capital improvements were deemed necessary to meet the increased demands. In addition, if the capital improvements were deemed necessary to meet the increased demands, CEO/Public Finance should ensure approval from the County Board of Supervisors.

Chief Financial Officer Response:
This finding needs further review. CEO/Public Finance and Public Finance Accounting have reviewed available documents related to expenditures from the Ladera Ranch CFDs for the El Toro Library. Additional research is being completed to obtain documentation to support payment of expenses for the El Toro Library from the Ladera CFDs. The Orange County Public Library Department (OCPL) was transferred a total of $1,128,754 from the CFDs which was applied to pay for capital costs at the El Toro Library and the Ladera Ranch Library. The OCPL also reimbursed DMB Ladera $600,000 for prior development fees. In addition, we have documented that $1.5 million was approved by the Board of Supervisors to establish a library at Ladera Ranch Elementary/Middle School, funded by developer fees reimbursable from Ladera CFD funds. We will work with County Counsel, Bond Counsel and the Library to determine if any funds need to be reimbursed to the CFDs or the developer.

Recommendation No. 9
We recommend CEO/Public Finance ensure project costs charged to the Ladera Ranch CFD's bond proceeds are authorized and the authorization documented regardless of the type of disbursement made (i.e., payment requests, journal vouchers, etc).

Chief Financial Officer Response:
Concur. CEO/Public Finance will work with Public Finance Accounting to implement procedures to ensure that all bond proceeds are maintained in a Public Finance controlled account and that appropriate documentation and approvals are in place prior to any release of bond proceeds from such accounts. These procedures will be in place by the next CFD bond issuance or July 31, 2011, whichever is sooner.

Finding Nos. 10 & 11 – Internal Controls over Monitoring Cash Available for Projects Need to be Improved (Significant Control Weakness)

Internal controls for monitoring cash available for the projects to ensure compliance with the AFDA needs to be improved. In the Project Cost Report that is used for monitoring cash available in the Acquisition and Construction Fund, we noted that the calculation of available project costs excludes the bond's costs-of-issuance and the calculation includes interest earned on bond proceeds twice. The Project Cost Report is distributed to CEO/Public Finance and developers.

The differences between cash-on-hand (See Attachment C) and CEO/Public Finance Accounting's calculation of available project costs as of November 30, 2009 are noted below:

	CFD 99-1	CFD 00-1	CFD 01-1	CFD 02-1	CFD 03-1	CFD 04-1
Cash-on-hand	$ 425,150	1,645,311	82,305	8,602,156	9,554,836	40,335,303
A-C's calculation of available project costs	2,413,722	4,217,226	1,058,516	12,601,241	16,359,955	50,618,664
Deficit	$(1,988,572)	(2,571,915)	(976,211)	(3,999,085)	(6,805,119)	(10,283,361)

There is a risk that cash may not be available to complete the required projects as stated in the AFDAs.

The CFDs Supplement to the Resolutions states that the Acquisition and Construction Fund shall be available to pay bond's costs-of-issuance.

The County of Orange Accounting Manual, Number S-2, Section 3.3, Authorization, Execution, and Recording of Transactions, states as follows: "A system of authorization and record-keeping procedures is needed to provide effective accounting control over assets, liabilities, revenues, and expenditures. Independent evidence shall be maintained to document that authorizations are issued by persons acting within the scope of their authority and that transactions conform with the terms of the authorizations. Documentation shall provide an adequate audit trail. Transactions shall be accurate, timely, properly recorded, and properly classified. Computer system controls should be utilized to safeguard records and preserve data integrity."

Recommendation No. 10

We recommend Auditor-Controller PFA revise the CFD Project Cost Reports to accurately reflect available funding.

Auditor-Controller Response:

Concur. This recommendation has been implemented.

Recommendation No. 11

We recommend CEO/Public Finance determine if the cash-on-hand will be sufficient to cover estimated project costs as stated in the Acquisition, Funding, and Disclosure Agreements.

Chief Financial Officer Response:

Concur. CEO/Public Finance will work with Public Finance Accounting to develop procedures to ensure that OC Public Works and the developer are provided a regular and accurate accounting of remaining available cash balances. These procedures will be in place by June 30, 2011.

Finding Nos. 12 & 13 – Internal Controls over Transfers of Bond Proceeds from Ladera Ranch CFD Funds Need to be Improved (Significant Control Weakness)

Internal controls over transfers of bond proceeds to other funds need to be improved. We found there are no written policies and procedures to account for monies transferred out of designated CFD funds. As a result of our testwork, it was found that $41,116 of the $99,000 transferred from debt service was utilized for costs not related to Ladera Ranch CFD.

There is a risk that the outstanding transfers are not accounted for and used in accordance with bond's purpose because the identify of the amounts transferred out may not be recalled due to the term of bonds (i.e., 30+ years), and changes in personnel.

We noted the following outstanding transfers to funds other than those designated for Ladera Ranch CFDs:

- Transfers from the acquisition and construction funds to Fund 112, County Infrastructure:

CFD	Transfer Amounts	Outstanding as of 11/30/09
CFD 99-1	2,301,650	77,407
CFD 00-1	150,000	150,000
CFD 01-1	5,832,315	141,790

- Transfers from the debt service fund to Fund 482, Special Mello-Roos Reserve:

CFD	Transfer Amounts	Outstanding as of 11/30/09
CFD 99-1	99,000	57,829

The County of Orange Accounting Manual, Number S-2, Section 3.3, Authorization, Execution, and Recording of Transactions, states as follows: "A system of authorization and record-keeping procedures is needed to provide effective accounting control over assets, liabilities, revenues, and expenditures. Independent evidence shall be maintained to document that authorizations are issued by persons acting within the scope of their authority and that transactions conform with the terms of the authorizations. Documentation shall provide an adequate audit trail. Transactions shall be accurate, timely, properly recorded, and properly classified. Computer system controls should be utilized to safeguard records and preserve data integrity."

Recommendation No. 12

We recommend Auditor-Controller PFA correct the $41,116 error in CFD 99-1.

Auditor-Controller Response:

Concur. The $41,116 error has been corrected.

Recommendation No. 13

We recommend Auditor-Controller PFA develop policies and procedures to ensure that monies transferred out of designated CFD funds are accurately accounted for.

Auditor-Controller Response:

Concur. We will update and/or prepare new policies and procedures by June 30, 2011.

Finding No. 14 – Missing Approval for Allocating Costs Between CFDs (Significant Control Weakness)

Auditor-Controller PFA split the bond proceeds ($2,182,139) between CFD 99-1 ($1,081,625) and CFD 00-1 ($1,100,514) for the construction of San Antonio Parkway – Phase 1 without the approval of the District Engineer. The District Engineer is hired to review developer requests for payments and ensure they are in compliance with the most current governing documents, such as corresponding Acquisition, Funding and Disclosure Agreement (AFDA).

On July 31, 2000 the Ladera Ranch Chief Financial Officer (CFO) requested an amendment to the AFDA for CFD 99-1. The Ladera Ranch CFO requested that the funding for the widening of San Antonio Parkway be reduced from $2,475,000 to $1,098,350 and stated that they anticipate that the unreimbursed widening costs would be included in subsequent Ladera Ranch CFDs. On September 12, 2000, Amendment No. 1 was issued for CFD 99-1 AFDA, reducing the project cost line item for the widening of San Antonio Parkway from $2,475,000 to $1,098,350.

On March 26, 2001, the District Engineer recommended that San Antonio Parkway – Phase 1 (widening) costs ($2,182,139) be charged to CFD 99-1 in accordance with the current AFDA for CFD 99-1 as noted in the Final Acquisition Report 99-1-3. However, it appears that the District Engineer was not aware of Amendment No. 1 to the AFDA since the Final Acquisition Report references the original AFDA.

In response to our recommendation, the Auditor-Controller PFA on November 11, 2010 received written authorization from the current district engineer to split the costs between the two CFDs.

Recommendation No. 14

We recommend CEO/Public Finance develop and implement policies and procedures to ensure the district engineer has the most current governing documents and require that written authorization with justification is received from the district engineer before any changes by staff are made to the district engineers' prior written authorization.

Chief Financial Officer Response:

Concur. Public Finance Accounting received verbal approval from the District Engineer of record at the time the expenses were paid. Because the expenses for Antonio Parkway in CFD 99-1 were limited by a September 2000 AFDA Amendment, which the District Engineer did not take into account, Public Finance Accounting prudently paid only the amount authorized by the AFDA. CEO/Public Finance on November 11, 2010, obtained written documentation from the District Engineer for CFD 2000-1 confirming that the remaining expenses for Antonio Parkway Widening were appropriately charged to CFD 2000-1. Policies and procedures will be developed by July 31, 2011 to ensure that any changes to the District Engineer's initial recommendation are confirmed in writing prior to payment of expenditures and that the District Engineer has the most current governing documents.

Finding No. 15 – Policies and Procedures Were Not Complete (Significant Control Weakness)

During our audit, we found that written policies and procedures for the administration and accounting of CFDs need to be developed and/or improved in the following areas:

- Special tax levy calculation and apportionment process.
- Practices to ensure compliance with governing documentation.
- Debt service process to track expenditures and revenue activities.
- Oversight roles and responsibilities for management.
- Identification of CFD process objectives, risks and internal controls in place to mitigate or prevent the risks from occurring.

The Chief Financial Officer (CFO) and the Auditor-Controller have an Accounting Services Agreement for the Auditor-Controller PFA to provide professional accounting services for CEO/Public Finance. Included in this Agreement is the requirement that the Auditor-Controller PFA develops accounting policies and procedures and develops and maintains accounting related internal controls.

Policy and procedural manuals are a set of written instructions that document a recurring activity. The development and use of policy and procedural manuals are an integral part of a successful quality assurance system as it provides personnel with the information to perform their duties properly, facilitates consistency in the quality and integrity of an end-result, and ensures compliance with governing documentation.

The development and use of policy and procedural manuals minimizes variation and promotes quality through consistent implementation of a process, even if there are temporary or permanent personnel changes. Policy and procedural manuals can be used as a part of a personnel training program, since they should provide detailed work instructions.

It minimizes opportunities for miscommunication and can address quality control concerns. When historical data are being evaluated for current use, policy and procedural manuals can also be valuable for reconstructing project activities when no other references are available. In addition, policy and procedural manuals can be used as checklists by reviewing management for monitoring quality assurance.

The benefits of policy and procedural manuals are reduced work effort, along with improved comparability and credibility.

Properly documented and effectively communicated operational policies and procedures along with the identification of risks and internal controls will significantly enhance the administration and accounting of CFDs.

Recommendation No. 15

We recommend that Auditor-Controller PFA improve policy and procedures to be followed for the CFD process. Documented policy and procedures should be reviewed and approved by management and current versions need to be readily accessible for reference by personnel responsible for the CFD process.

Auditor-Controller Response:
Concur. All updated and/or new policies and procedures for CFD processes will be written and submitted to management for approval by September 30, 2011. Those policies and procedures needed for the 2011-12 tax levy calculation process will be written first (by July 31, 2011).

Finding Nos. 16 - 18 – Internal Controls over Monitoring Project Costs Need to be Improved (Control Finding)

Internal controls need to be improved over monitoring project costs to ensure that project costs stay within the allowable cost categories as stated in the Acquisition, Funding and Disclosure Agreement (AFDA).

Auditor-Controller PFA manually prepares Project Cost Reports and Statement of Sources and Uses to monitor project costs and ensure allowable costs do not exceed the AFDA. We found that project costs are not recorded on the Project Cost Reports and Statement of Sources and Uses at the time costs are approved; but rather sometime later after costs are posted to the general ledger and the vendors are paid. This results in a risk that the project costs may exceed the allowable cost category per the AFDA.

We found that supervisors in Auditor-Controller PFA review the monthly Project Cost Reports and Statement of Sources and Uses on an annual basis. However, their reviews are not documented to evidence accountability. The infrequency and lack of documented evidence of the review increases the risk that CFD transactions are not recorded in the proper accounting period and/or incorrectly posted to cost accounts, and errors may not be detected timely.

County of Orange Accounting Manual, Number S-2, Internal Control Systems, Section 3.3, Authorization, Execution, and Recording of Transactions, states as follows: "A system of authorization and record-keeping procedures is needed to provide effective accounting control over assets, liabilities, revenues, and expenditures. Independent evidence shall be maintained to document that authorizations are issued by persons acting within the scope of their authority and that transactions conform with the terms of the authorizations. Documentation shall provide an adequate audit trail. Transactions shall be accurate, timely, properly recorded, and properly classified. Computer system controls should be utilized to safeguard records and preserve data integrity." In addition, Section 4.2.1, Review, states as follows: "Review internal control systems on an ongoing basis to determine whether controls are operating as intended and are effective."

Recommendation No. 16
We recommend Auditor-Controller PFA record project costs on the Project Cost Reports and Statement of Sources and Uses at the time costs are approved rather than after payment has been made to ensure costs do not exceed the most recently approved AFDA.

Auditor-Controller Response:
Concur. This recommendation has already been implemented.

Recommendation No. 17
We recommend Auditor-Controller PFA complete a reconciliation between the Project Cost Reports and Statement of Sources and Uses to the general ledger on a regular basis to ensure all project costs that should have been recorded were recorded correctly.

Auditor-Controller Response:
Concur. This reconciliation will be completed semi-annually. The first reconciliation will be completed by July 31, 2011.

Recommendation No. 18
We recommend Auditor-Controller PFA supervisors perform and document their supervisory reviews of Project Cost Reports, Statement of Sources and Uses, and the reconciliation to the general ledger.

Auditor-Controller Response:
Concur. We will perform and document supervisory review of the semi-annual reconciliation. The first reconciliation will be completed by July 31, 2011.

Finding No. 19 – Administrative Costs Are Incorrectly Charged to the Acquisition and Construction Fund (Control Finding)

Administrative costs are applied directly as acquisition and construction costs in the construction fund instead of being classified as administrative costs in the debt service fund. We noted Single Audit Fees and County-Wide Cost Allocation (CWCAP) Charges were directly charged to specific line cost categories while at other times they were netted against interest income earned within the acquisition and construction fund as noted below:

Description	99-1	00-1	01-1	02-1	03-1	04-1	Total
Single Audit Fees netted against interest income	$6,935	1,153	-	16,114	-	20,360	**44,562**
CWCAP Charges netted against interest income	-	-	-	59,376	19,013	-	**78,389**
Single Audit Fees charged to a specific line item against the AFDA	-	-	-	1,212	-	-	**1,212**
CWCAP charges charged to a specific line item against the AFDA	-	-	13,956	54,744	35,078	14,883	**118,661**
Total Administrative Costs	**$6,935**	**1,153**	**13,956**	**131,446**	**54,091**	**35,243**	**242,824**

This results in an understatement of administrative costs in the debt service fund which are included in the special tax levy calculation. In addition, this results in an overstatement of project costs in the acquisition and construction fund.

The Supplement to the Resolution for the CFDs, Section 1.1, defines administrative expenses as "the administrative costs with respect to the calculation and collection of the Special Taxes, or costs otherwise incurred by the County staff on behalf of the District in order to carry out the purposes of the District as set forth in the Resolution of Formation, the fees and expenses of the Paying Agent and any fees for credit enhancement for the Bonds or any Parity Bonds which are not otherwise paid as Costs of Issuance."

The Supplement to the Resolution for the CFDs, Section 3.2, states in part, "The Treasurer shall transfer the amount on deposit in the Special Tax Fund on the dates and in the amounts set forth in Sections 3.3 to 3.9 below, in the following order of priority, to: (1) The Administrative Expense Account of the Special Tax Fund in an amount needed to pay Administrative Expenses when due."

Recommendation No. 19
We recommend Auditor-Controller PFA charge administrative costs to the debt service fund and transfer administrative costs claimed in the acquisition and construction fund to the debt service fund.

Auditor-Controller Response:
This finding needs further review. We will consult with County Counsel and/or Bond Counsel to determine if there is any prohibition against paying limited administrative expenses from the acquisition and construction fund. If it is not allowable, we will ensure the debt service funds reimburse the acquisition funds. We anticipate having an answer to this question before the 2011-12 tax levy calculation process (July 31, 2011).

Finding No. 20 – Acquisition, Funding and Disclosure Agreement (AFDA) and Amendments Include Anticipated Interest Earnings (Control Finding)

The AFDA and amendments include anticipated interest earnings on bond proceeds that may or may not be realized. For example, CFD 04-1 anticipated interest earnings are $4 million.

Acquisition, Funding and Disclosure Agreement, Section 3 Deposit and Use of Series A of 2003 Bond Proceeds, Subsection (c), states: "Allocation of Interest Earnings. The District intends to invest amounts on deposit in the Acquisition and Construction Fund in investments which it is permitted by law to make. Interest earnings realized on amounts in each Account of the Acquisition and Construction Fund will remain in such Account until disbursed in accordance with the Fire Authority Agreement or transferred by the Auditor-Controller. Earnings on amounts in the County Facilities Account shall not be deemed to reduce or partially fulfill the amount of the Company's financial obligations related to the County Facilities or other facilities required by the Development Agreement."

There is a risk that anticipated earnings will not be realized (specifically in an economic downturn) to meet financial obligations, resulting in the County having to subsidize program costs due to contractual agreements.

Recommendation No. 20

We recommend CEO/Public Finance only include actual interest income earned when initiating an AFDA amendment to ensure financial obligations are met without the County having to subsidize costs.

Chief Financial Officer Response:

Concur. All future AFDA amendments will include only actual interest earned.

Finding No. 21 – Acquisition, Funding and Disclosure Agreement (AFDA) Amendments Not Signed (Control Finding)

We tested all AFDA Amendments for the CFDs and found that the following six (6) out of the ten (10) amendments issued were not signed as executed by the County of Orange Public Finance Manager.

- CFD 99-1 – AFDA Amendment No. 2
- CFD 00-1 – AFDA Amendment No. 1
- CFD 01-1 – AFDA Amendment No. 1
- CFD 02-1 – AFDA Amendment No. 1
- CFD 02-1 – AFDA Amendment No. 2
- CFD 04-1 – AFDA Amendment No. 1

Contracts/agreements should be signed by those authorized to enter into agreements between the County and another party. Without a properly executed amendment, there is a risk that no legal binding agreement exists.

We brought this to the attention of CEO/Public Finance and as of April 27, 2010 all the amendments were signed by the new CEO/Public Finance Director.

Recommendation No. 21

We recommend that the Chief Financial Officer develop a process to ensure that CFDs Acquisition, Funding and Disclosure Agreement (AFDA) Amendments are properly executed (signed).

Chief Financial Officer Response:

Concur. CEO/Public Finance will establish a procedure to ensure that all AFDA amendments are tracked through the signature process to conclusion. This process will be in place by March 31, 2011.

ATTACHMENT A: Report Item Classifications

For purposes of reporting our audit observations and recommendations, we will classify audit report items into three distinct categories:

Critical Control Weaknesses:
A serious audit finding or a combination of Significant Control Weaknesses that represent critical exceptions to the audit objective(s) and/or business goals. Management is expected to address "Critical Control Weaknesses" brought to their attention immediately.

Significant Control Weaknesses:
Audit findings or a combination of Control Findings that represent a significant deficiency in the design or operation of internal controls. Significant Control Weaknesses generally will require prompt corrective actions.

Control Findings:
Audit findings concerning internal controls, compliance issues, or efficiency/effectiveness issues that require management's corrective action to implement or enhance processes and internal controls. Control Findings are expected to be addressed within our follow-up process of six months, but no later than twelve months.

ATTACHMENT B: Estimated Sources and Uses for Ladera Ranch CFDs

	CFD 99-1	CFD 00-1	CFD 01-1	CFD 02-1	CFD 03-1	CFD 04-1
Sources:						
Principal Amount of Bonds	$ 22,620,000	30,200,000	32,985,000	68,280,000	57,185,000	75,645,000
Less: Original Issue Discount	(111,608)	(92,605)	(70,205)	(82,714)	(140,240)	(12,691)
Total Sources	**$ 22,508,392**	**30,107,395**	**32,914,795**	**68,197,286**	**57,044,760**	**75,632,309**
Uses:						
Underwriter's Discount	**$ 373,230**	**430,350**	**461,790**	**813,215**	**714,813**	**900,176**
Debt Service Fund						
Capitalized Interest	1,112,169	1,213,840	433,211	779,720	981,532	2,021,099
Reserve Account	2,262,000	2,776,875	2,953,800	6,278,498	5,299,037	6,681,327
Administrative Account	-	-	75,000	75,000	75,000	75,000
Subtotal Debt Service Fund	**3,374,169**	**3,990,715**	**3,462,011**	**7,133,218**	**6,355,569**	**8,777,426**
Acquisition and Construction Fund						
Acquisition and Construction	18,249,193	25,326,330	28,655,994	59,860,853	49,604,378	65,524,707
Costs of Issuance	511,800	360,000	335,000	390,000	370,000	430,000
Subtotal A&C Fund	**18,760,993**	**25,686,330**	**28,990,994**	**60,250,853**	**49,974,378**	**65,954,707**
Total Uses	**$ 22,508,392**	**30,107,395**	**32,914,795**	**68,197,286**	**57,044,760**	**75,632,309**

Source: Ladera Ranch CFD Official Statements

ATTACHMENT C: Ladera Ranch CFD Schedules for Debt Service Funds and Acquisition and Construction Funds

ATTACHMENT C: Ladera Ranch CFD Schedules for Debt Service Funds and Acquisition and Construction Funds

Debt Service Activity	CFD 99-1	CFD 00-1	CFD 01-1	CFD 02-1	CFD 03-1	CFD 04-1
Bond proceeds	$ 3,374,169	3,990,715	3,462,011	7,133,218	6,355,569	8,777,426
Principal payments	(1,860,000)	(2,390,000)	(1,940,000)	(1,665,000)	(895,000)	(1,615,000)
Interest payments	(12,440,631)	(13,597,688)	(11,956,105)	(22,582,725)	(16,444,787)	(16,965,849)
Interest income	679,982	651,662	508,028	1,652,025	1,329,801	1,573,209
Special Taxes Collected	12,990,920	14,580,922	13,428,094	22,284,904	15,138,762	14,770,540
Teeter Apportionment	319,337	315,888	338,463	599,629	924,682	1,397,381
Administrative Expenses	(402,345)	(334,661)	(328,578)	(275,305)	(233,451)	(287,187)
Refunding payments	(2,336,576)	(2,882,758)	(3,107,646)	-	-	-
Transfers (to)/ from other funds	(57,829)	-	-	-	-	-
Cash Balance as of 11/30/09	**$ 267,027**	**334,080**	**404,267**	**7,146,746**	**6,175,576**	**7,650,520**

Source: General Ledgers

Acquisition & Construction Activity	CFD 99-1	CFD 00-1	CFD 01-1	CFD 02-1	CFD 03-1	CFD 04-1
Bond Proceeds	$ 18,760,993	25,686,330	28,990,994	60,250,853	49,974,378	65,954,707
Cost of Issuance	(349,986)	(317,796)	(294,421)	(385,271)	(328,895)	(382,133)
Interest Income	1,338,618	1,770,012	1,370,902	4,222,734	5,964,482	10,493,008
Project Costs	(19,247,068)	(25,343,235)	(29,843,380)	(55,486,160)	(46,055,129)	(35,730,279)
Transfers (to)/ from other funds	(77,407)	(150,000)	(141,790)	-	-	-
Cash Balance as of 11/30/09	**$ 425,150**	**1,645,311**	**82,305**	**8,602,156**	**9,554,836**	**40,335,303**

Source: General Ledgers

ATTACHMENT D: Schedule of Acquisition, Funding and Disclosure Agreement (AFDA) Project Budgets and Actual Project Costs

CFD 99-1 AFDA Description	AFDA Original (Budget)	AFDA Amendments (Budget) #1	 #2	Actual Project Costs
Board Approval Date	10/19/99	09/12/00	01/30/07	
Onsite and Offsite Transportation Improvements (including, without limitation, rough grading for roadways and traffic improvements)				
Grading for Roadways - Crown Valley, Antonio, Sienna, Benjamin, O'Neil and all streets within or serving Ladera Ranch Planned Community	$ 2,640,000	4,500,000	4,876,805	4,872,440
Street Improvements - Widening Antonio from Crown Valley to Benjamin, Oso Parkway Improvements	2,475,000	1,098,350	2,341,000	1,108,940
Crown Valley Bridge	6,000,000	6,000,000	5,776,140	5,876,406
Antonio Parkway	2,000,000	2,000,000	2,000,000	2,000,000
Storm Drain Facilities				
Major Storm Drains	4,400,000	4,100,000	4,100,000	4,108,424
Public Facilities				
Sheriff Facilities	81,250	81,250	81,250	-
Fire Authority	1,000,000	1,000,000	1,000,000	1,056,615
Library Facilities	220,400	220,400	220,400	224,243
Contingency	183,350	-	-	-
Total	**$ 19,000,000**	**19,000,000**	**20,395,595**	**19,247,068**

Source: CFD 99-1 AFDA Exhibit A, corresponding amendments, and general ledgers.

ATTACHMENT D: Schedule of Acquisition, Funding and Disclosure Agreement (AFDA) Project Budgets and Actual Project Costs (continued)

CFD 00-1 AFDA Description	AFDA Original (Budget)	Amendment #1	Actual Project Costs
Board Approval Date	11/07/00	01/30/07	
Onsite and Offsite Transportation Improvements (including, without limitation, rough grading for roadways and traffic improvements)			
Grading for Roadways - Crown Valley, Antonio, Sienna, Benjamin, O'Neil and all streets within or serving Ladera Ranch Planned Community	$ 6,500,000	7,150,000	7,150,000
Street Improvements - Widening Antonio and Oso Parkway Improvements and all streets within or serving Ladera Ranch Planned Community	7,000,000	9,551,000	7,187,826
Crown Valley Bridge	2,800,000	3,080,000	3,083,770
Traffic Signals - Crown Valley Pkwy (4), Antonio Parkway and Windmill Avenue (1)	625,000	-	-
Antonio Parkway	2,000,000	2,000,000	2,000,000
Storm Drain Facilities			
Major Storm Drains	2,145,000	2,145,000	2,145,000
Public Facilities			
Sports Park	2,250,000	2,475,000	2,475,000
Fire Authority	1,000,000	1,000,000	1,061,639
Sheriff Facilities	150,000	150,000	-
Library Facilities	240,000	240,000	240,000
Contingency	1,290,000	-	-
Total	**$ 26,000,000**	**27,791,000**	**25,343,235**

Source: CFD 00-1 AFDA Exhibit A, corresponding amendment, and general ledgers.

ATTACHMENT D: Schedule of Acquisition, Funding and Disclosure Agreement (AFDA) Project Budgets and Actual Project Costs (continued)

CFD 01-1 AFDA Description	AFDA Original (Budget)	Amendment #1	Actual Project Costs
Board Approval Date	04/23/02	01/30/07	
Onsite and Offsite Transportation Improvements (including, without limitation, rough grading for roadways and traffic improvements)			
Grading for Roadways - Antonio Widening, Crown Valley Bridge abutment and all streets within or serving Ladera Ranch Planned Community	$ 7,400,000	7,400,000	7,400,000
Street Improvements - all streets within or serving Ladera Ranch Planned Community	7,835,000	6,814,443	6,716,427
Widening of Crown Valley Parkway within the City of Mission Viejo	-	5,000,000	5,500,000
Crown Valley Parkway Bridge	500,000	55,203	58,361
Traffic Signals - Antonio Parkway	400,000	142,981	142,982
Antonio Parkway	5,190,631	5,382,315	5,382,315
Storm Drain Facilities			
Major Storm Drains	3,000,000	1,048,551	1,048,551
Public Facilities			
Sports Park	2,250,000	2,475,000	2,469,498
Fire Authority	800,000	800,000	817,037
Sheriff Facilities	112,500	112,500	-
Library Facilities	300,000	300,000	308,209
Contingency	867,863	-	-
Total	$ 28,655,994	29,530,993	29,843,380

Source: CFD 01-1 AFDA Exhibit A, corresponding amendment, and general ledgers.

ATTACHMENT D: Schedule of Acquisition, Funding and Disclosure Agreement (AFDA) Project Budgets and Actual Project Costs (continued)

CFD 02-1 AFDA Description	AFDA Original (Budget)	AFDA Amendments (Budget) #1	AFDA Amendments (Budget) #2	AFDA Amendments (Budget) #3	Actual Project Costs
Board Approval Date	04/29/03	01/30/07	05/20/08	09/29/09	
Onsite and Offsite Transportation Improvements (including, without limitation, rough grading for roadways and traffic improvements)					
Street Improvements – Crown Valley Parkway - Bridge to Antonio Parkway (all 6 lanes); Antonio Parkway widening - Crown Valley Parkway to Windmill Avenue; Sienna Parkway - Crown Valley Parkway to Windmill Avenue; O'Neil Drive - Crown Valley Parkway to Cecil Pasture Road; Roanoke Street; Flintridge Avenue; Weldon Heights; First Street; Second Street; Third Street; Main Street; Mercantile Way; Windmill Avenue; Cecil Pasture Road; and all streets within or serving Ladera Ranch Planned Community	$ 16,505,203	25,917,631	18,517,631	18,617,764	18,588,859
Street Improvements – Offsite Street Improvements:					
Crown Valley Bridge	8,094,797	8,094,797	8,094,797	8,374,067	8,374,067
Antonio Parkway	6,550,000	6,550,000	6,950,000	6,617,773	6,617,773
Avenida La Pata Widening & Antonio Widening	-	-	7,000,000	10,000,000	2,741,196
Utilities					
Dry Utilities	2,750,000	2,750,000	2,750,000	2,750,000	2,102,895
Horno Detention Basin	8,000,000	6,707,572	6,707,572	6,707,572	6,707,572
Storm Drains	5,000,000	8,200,000	8,200,000	7,697,824	7,697,824
Public Facilities					
Fire Authority	2,000,000	2,000,000	2,000,000	2,000,000	1,804,538
Library Facilities	600,000	600,000	600,000	600,000	351,436
Contingency	5,500,000	500,000	500,000	500,000	500,000
Total	$ 55,000,000	61,320,000	61,320,000	63,865,000	55,486,160

Source: CFD 02-1 AFDA Exhibit A, corresponding amendments, and general ledgers.

ATTACHMENT D: Schedule of Acquisition, Funding and Disclosure Agreement (AFDA) Project Budgets and Actual Project Costs (continued)

CFD 03-1 AFDA Description	AFDA Original (Budget)	AFDA Amendments (Budget) #1	 #2	Actual Project Costs
Board Approval Date	03/16/04	08/21/07	09/29/09	
Onsite and Offsite Transportation Improvements (including, without limitation, rough grading for roadways and traffic improvements)				
Street Improvements - Crown Valley Parkway, Antonio Parkway widening, Antonio Wildlife Corridor Bridge widening and all streets within or servicing Ladera Ranch Planned Community	$ 28,950,000	28,950,000	26,350,000	22,678,841
Crown Valley Parkway Bridge	2,000,000	2,000,000	2,000,000	2,000,000
Remainder of Antonio Parkway	6,500,000	6,500,000	6,293,813	6,293,813
Antonio Parkway Widening	-	-	4,000,000	265,034
Utilities				
Dry Utilities	2,450,000	2,450,000	2,462,653	2,462,653
Horno Detention Basin	1,000,000	2,061,200	2,061,156	2,139,298
Storm Drains	1,200,000	10,122,000	10,122,000	9,506,206
Public Facilities				
Fire Authority	2,000,000	2,000,000	2,000,000	-
Sports Park	-	700,000	660,980	660,980
Contingency	5,504,378	500,000	500,000	48,304
Total	**$ 49,604,378**	**55,283,200**	**56,450,602**	**46,055,129**

Source: CFD 03-1 AFDA Exhibit A, corresponding amendments, and general ledgers.

ATTACHMENT D: Schedule of Acquisition, Funding and Disclosure Agreement (AFDA) Project Budgets and Actual Project Costs (continued)

CFD 04-1 AFDA Description	AFDA Original (Budget)	Amendment #1	Actual Project Costs
Board Approval Date	12/21/04	05/20/08	
Onsite and Offsite Transportation Improvements (including, without limitation, rough grading for roadways and traffic improvements)			
Crown Valley Parkway (Mission Viejo JCFA)	$ 4,500,000	9,523,000	7,750,251
Ortega Highway Widening - Antonio Parkway to Calle Entradera, Ortega Highway/I-5 Interchange Improvements and Avery Parkway/I-5 Interchange Improvement (Caltrans JCFA)	27,000,000	45,638,000	15,091,500
Water Improvements (SMWD JCFA)	5,740,000	6,345,410	4,572,858
Street Improvements - Crown Valley Parkway, Oso Parkway Widening, Antonio Wildlife Corridor Bridge widening and all major roadways and collector streets within or serving Ladera Ranch Planned Community	5,600,000	9,380,000	2,098,409
Antonio Parkway Widening	5,200,000	1,263,000	1,262,427
Phase I Avenida La Pata Extension	7,000,000	-	-
Storm Drain Facilities	11,000,000	2,157,000	2,156,919
Dry Utilities	3,275,000	3,275,000	2,797,915
Total	**$ 69,315,000**	**77,581,410**	**35,730,279**

Source: CFD 04-1 AFDA Exhibit A, corresponding amendment, and general ledgers.

ATTACHMENT E: Auditor-Controller Responses

ORANGE COUNTY AUDITOR-CONTROLLER

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12 CIVIC CENTER PLAZA, ROOM 200
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SANTA ANA, CALIFORNIA 92702-0567

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AUDITOR-CONTROLLER

JAN E. GRIMES
DIRECTOR
CENTRAL ACCOUNTING OPERATIONS

WILLIAM A. CASTRO
DIRECTOR
SATELLITE ACCOUNTING OPERATIONS

PHILLIP T. DAIGNEAU
DIRECTOR
INFORMATION TECHNOLOGY

March 3, 2011

TO: Peter Hughes, Director
Internal Audit Department

SUBJECT: Response to Ladera Ranch Community Facilities Districts Audit No. 2919

We reviewed the draft audit report dated February 24, 2011, prepared by the Internal Audit Department, covering the audit of Ladera Ranch Community Facilities Districts for the period ending November 30, 2009.

Our responses to the recommendations made in the draft audit report that relate to Public Finance Accounting are attached.

Please call Suzanne Luster, Public Finance Accounting Manager (834-3362), or Shaun Skelly, Chief Deputy Auditor-Controller (834-2458), if you have any questions regarding our responses.

Thank you.

for
David E. Sundstrom
Auditor-Controller

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Attachment

cc: Thomas G. Mauk, County Executive Officer
Bob Franz, Chief Financial Officer
Shaun Skelly, Chief Deputy, Auditor-Controller
Bill Castro, Director of Satellite Accounting Operations, Auditor-Controller
Colleen Clark, Director, CEO/Public Finance
Suzanne Luster, Manager, CEO/Public Finance Accounting

Internal Audit Department
Audit of Ladera Ranch Community Facilities Districts
For the Period Ending November 30, 2009

Finding No. 1-3 – Method for Special Tax Levy Calculation Needs to be Improved (Critical Control Weakness)

Recommendation No. 1
We recommend Auditor-Controller PFA annually compare the debt service payments used in the calculation of the Special Tax Levy to the bond's current debt service schedules to ensure the correct debt service payments are used.

Auditor-Controller Response
Concur. PFA used current debt service schedules when computing the special tax levy for fiscal year 2005-06. These bonds were subsequently refunded in November 2005 resulting in new debt service schedules. The new debt service schedules were used in subsequent years. We agree that the tax levy calculation for the year following a refunding should consider the carryover fund balance that resulted from the refunding. This will be addressed in the policies and procedures that will be written to document the special tax levy calculation process (please see our response to Recommendation No. 2).

We agree that there were two instances where incorrect debt service payment information was used when calculating the special tax levy for Ladera Ranch CFDs 03-1 and 04-1. Although the two instances involved different Ladera Ranch CFDs and years, the net effect was a special tax levy undercharge of approximately $57,000. Although the Ladera Ranch CFD 04-1 undercharge was discovered shortly before the tax levy adoption by the Board, the CFD Administrator decided not to pull the ASR.

Recommendation No. 2
We recommend Auditor-Controller PFA use the actual or reasonable interest earnings and administrative expenses that are aligned with actual or historical data and adjust the subsequent Special Tax Levy for the difference between actual and estimated interest earnings and administrative expenses for the prior year.

Auditor-Controller Response
Concur. We will work with the CFD Administrator to prepare policies and procedures documenting the special tax levy calculation. These policies and procedures will address guidelines for budgeting interest earnings and administrative expenses. However, please note that budgets should be set to ensure interest earnings are not overestimated or that administrative expenses are not underestimated. If either of these were to occur, it could result in an inability to meet district expenses including debt service requirements and/or result in a reportable event. We will also include provisions in these policies and procedures that addresses reasonable annual fund balance carryover amounts, infrastructure transfers, arbitrage rebate transfers, and reserve transfers so that any moneys left over at the end of the year (in excess of a reasonable carryover after transfers have been made) are used to offset the following year's special tax levy. The administrative policies and procedures to document the special tax levy calculation

Ladera Response-2/23/11 Page 1 of 5

ATTACHMENT E: Auditor-Controller Responses (Continued)

Internal Audit Department
Audit of Ladera Ranch Community Facilities Districts
For the Period Ending November 30, 2009

process will be submitted to the CFD Administrator in time to be reviewed and approved so that it can be used for the 2011-12 tax levy calculation process (July 31, 2011).

Recommendation No. 3
We recommend Auditor-Controller PFA management ensure a qualified and systematic supervisory review is provided and documented to enhance the integrity of the calculation of the Special Tax Levy.

Auditor-Controller Response
Concur. PFA management will ensure a documented supervisory review is started with the 2011-12 special tax levy calculation process (July 31, 2011).

Finding No. 4 – Other CFD Special Tax Levy Calculations Require Additional Review (Significant Control Weakness)

Recommendation No. 4
We recommend that Auditor-Controller PFA management perform a review of all other Community Facilities Districts (an additional 17 CFDs) to determine if the calculation of the Special Tax Levy needs to be adjusted to ensure that debt service payments agree to source documentation and estimates used are aligned with actual historical data; specifically, for administrative expenses and interest earnings. In addition, at the conclusion of the review Auditor-Controller PFA management submit the review to the Internal Audit Department for their independent validation.

Auditor-Controller Response
Concur. As part of the 2011-12 special tax rate setting process, we will ensure a second person compares debt service payments to the most current source documentation and documents their review. We will also ensure that interest earnings and administrative expenses are reasonably estimated and are consistent with management policies (which must be set). Further, we will ensure that any debt service fund carry over is in accordance with each CFD bond's tax certificate. The 2011-12 special tax rate setting process should be completed and available for review by Internal Audit by July 31, 2011.

Finding No. 7 – Special Tax Levy Collections are not Reviewed Following the Initial Year (Control Finding)

Recommendation No. 7:
We recommend Auditor-Controller PFA perform a review to ensure that special taxes levied are collected (including Teeter) and accurately recorded to the appropriate CFD. In addition, the review should be documented.

Auditor-Controller Response
Concur. Although there is no evidence that special taxes collections were ever inaccurately recorded in the wrong CFD, we agree that it is a good internal control

Ladera Response-2/23/11 Page 2 of 5

ATTACHMENT E: Auditor-Controller Responses (Continued)

Internal Audit Department
Audit of Ladera Ranch Community Facilities Districts
For the Period Ending November 30, 2009

procedure to review special tax collections and to document the review. We will implement this recommendation by July 31, 2011.

Findings Nos. 10 – Internal Controls over Monitoring Cash Available for Projects Needs to be Improved (Significant Control Weakness)

Recommendation No. 10
We recommend Auditor-Controller PFA revise the CFD Project Cost Reports to accurately reflect available funding.

Auditor-Controller Response
Concur. This recommendation has been implemented.

Findings Nos. 12 & 13 – Internal Controls over Transfers of Bond Proceeds from Ladera Ranch CFD Funds (Significant Control Weakness)
As a result of our test work, it was found that $41,116 of the $99,000 transferred from debt service was utilized for costs not related to Ladera Ranch CFD.

Recommendation No. 12
We recommend Auditor-Controller PFA correct the $41,116 error in CFD 99-1.

Auditor-Controller Response
Concur. The $41,116 error has been corrected.

Recommendation No. 13
We recommend Auditor-Controller PFA develop policies and procedures to ensure that monies transferred out of designated CFD funds are accurately accounted for.

Auditor-Controller Response
Concur. We will update and/or prepare new policies and procedures by June 30, 2011.

Finding No. 15– Policies and Procedures Were Not Complete (Significant Control Weakness)

Recommendation No. 15
We recommend that Auditor-Controller PFA improve policy and procedures to be followed for the CFD process. Documented policy and procedures should be reviewed and approved by management and current versions need to be readily accessible for reference by personnel responsible for the CFD process.

Auditor-Controller Response
Concur. All updated and/or new policies and procedures for CFD processes will be written and submitted to management for approval by September 30, 2011. Those

Ladera Response-2/23/11 Page 3 of 5

ATTACHMENT E: Auditor-Controller Responses (Continued)

Internal Audit Department
Audit of Ladera Ranch Community Facilities Districts
For the Period Ending November 30, 2009

policies and procedures needed for the 2011-12 tax levy calculation process will be written first (by July 31, 2011).

Finding Nos. 16-18 – Internal Controls over Monitoring Project Costs Need to be Improved (Control Finding)

Recommendation No. 16
We recommend Auditor-Controller PFA record project costs on the Project Cost Reports and Statement of Sources and Uses at the time costs are approved rather than after payment has been made to ensure costs do not exceed the most recently approved AFDA.

Auditor-Controller Response:
Concur. This recommendation has already been implemented.

Recommendation No. 17
We recommend Auditor-Controller PFA complete a reconciliation between the Project Cost Reports and Statement of Sources and Uses to the general ledger on a regular basis to ensure all project costs should have been recorded were recorded correctly.

Auditor-Controller Response:
Concur. This reconciliation will be completed semi-annually. The first reconciliation will be completed by July 31, 2011.

Recommendation No. 18
We recommend Auditor-Controller PFA supervisors perform and document their supervisory reviews of Project Cost Reports, Statements of Sources and Uses, and the reconciliation to the general ledger.

Auditor-Controller Response
Concur. We will perform and document supervisory review of the semi-annual reconciliation. The first reconciliation will be completed by July 31, 2011.

Finding No. 19 – Administrative Costs are Incorrectly Charged to the Acquisition and Construction Fund (Control Finding)

Recommendation No. 19
We recommend Auditor-Controller PFA charge administrative costs to the debt service fund and transfer administrative cost claimed in the acquisition and construction fund to the debt service fund.

Auditor-Controller Response:
This finding needs further review. We will consult with County Counsel and/or Bond Counsel to determine if there is any prohibition against paying limited administrative expenses from the acquisition and construction fund. If it is not allowable, we will

Ladera Response-2/23/11 Page 4 of 5

ATTACHMENT E: Auditor-Controller Responses (Continued)

Internal Audit Department
Audit of Ladera Ranch Community Facilities Districts
For the Period Ending November 30, 2009

ensure the debt service funds reimburse the acquisition funds. We anticipate having an answer to this question before the 2011-12 tax levy calculation process (July 31, 2011).

ATTACHMENT F: Chief Financial Officer Responses

County Executive Office

Memorandum

March 3, 2011

TO: Dr. Peter Hughes, CPA, Director
Internal Audit Department

FROM: Robert J. Franz
Chief Financial Officer

SUBJECT: Chief Financial Officer Responses to Audit of Ladera Ranch Community Facilities Districts

Attached are the final responses to your recommendations for the Chief Financial Officer related to the Audit of the Ladera Ranch Community Facilities District.

Should you require any additional information or clarification, please contact Colleen Clark at 834-5969.

Attachment

cc: Thomas G. Mauk, County Executive Officer
Colleen Clark, Director CEO/Public Finance
David Sundstrom, Auditor-Controller
Jess Carbajal, Director, OC Public Works
Suzanne Luster, Manager, CEO/Public Finance Accounting

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INTERNAL AUDIT
DEPARTMENT

ATTACHMENT F: Chief Financial Officer Responses (Continued)

ATTACHMENT F: Chief Financial Officer Responses

Recommendation No. 5
We recommend CEO/Public Finance make the appropriate corrections to the identified twenty-one (21) taxpayers' parcels that were undercharged and the seventeen (17) taxpayers' parcels that were overcharged.

Chief Financial Officer Response:
Concur. The identified amounts relate to the 2010-11 tax assessments. As a result of the audit finding, David Taussig and Associates was able to correct the levies on the identified parcels prior to distribution of the 2010-11 tax bills. Therefore no overcharge or undercharge occurred.

Recommendation No. 8
We recommend CEO/Public Finance review and provide documentation to support the charge of the El Toro Branch Library capital improvement costs to the Ladera Ranch CFDs bond proceeds. Specifically, documentation in which the County determined that the capital improvements were deemed necessary to meet the increased demands. In addition, if the capital improvements were deemed necessary to meet the increased demands, CEO/Public Finance should ensure approval from the County Board of Supervisors.

Chief Financial Officer Response:
This finding needs further review. CEO/Public Finance and Public Finance Accounting have reviewed available documents related to expenditures from the Ladera Ranch CFDs for the El Toro Library. Additional research is being completed to obtain documentation to support payment of expenses for the El Toro Library from the Ladera CFDs. The Orange County Public Library Department (OCPL) was transferred a total of $1,128,754 from the CFDs which was applied to pay for capital costs at the El Toro Library and the Ladera Ranch Library. The OCPL also reimbursed DMB Ladera $600,000 for prior development fees. In addition, we have documented that $1.5 million was approved by the Board of Supervisors to establish a library at Ladera Ranch Elementary/Middle School, funded by developer fees reimbursable from Ladera CFD funds. We will work with County Counsel, Bond Counsel and the Library to determine if any funds need to be reimbursed to the CFDs or the developer.

Recommendation No. 9
We recommend CEO/Public Finance ensure projects costs charged to the Ladera Ranch CFDs bond proceeds are authorized and the authorization documented regardless of the type of disbursement made (i.e., payment requests, journal vouchers, etc).

Chief Financial Officer Response:
Concur. CEO/Public Finance will work with Public Finance Accounting to implement procedures to ensure that all bond proceeds are maintained in a Public Finance controlled account and that appropriate documentation and approvals are in place prior to any release of bond proceeds from such accounts. These procedures will be in place by the next CFD bond issuance or July 31, 2011, whichever is sooner.

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ATTACHMENT F: Chief Financial Officer Responses (Continued)

Recommendation No. 11
We recommend CEO/Public Finance determine if the cash-on-hand will be sufficient to cover estimated project costs as stated in the Acquisition, Funding, and Disclosure Agreements.

Chief Financial Officer Response:
Concur. CEO Public Finance will work with Public Finance Accounting to develop procedures to ensure that OC Public Works and the developer are provided a regular and accurate accounting of remaining available cash balances. These procedures will be in place by June 30, 2011.

Recommendation No. 14
We recommend CEO/Public Finance develop and implement policies and procedures to ensure the district engineer has the most current governing documents and require that written authorization with justification is received from the district engineer before any changes by staff are made to the district engineers' prior written authorization.

Chief Financial Officer Response:
Concur. Public finance Accounting received verbal approval from the District Engineer of record at the time the expenses were paid. Because the expenses for Antonio Parkway in CFD 99-1 were limited by a September 2000 AFDA Amendment, which the District Engineer did not take into account, Public Finance Accounting prudently paid only the amount authorized by the AFDA. CEO/Public Finance, on November 11, 2010, obtained written documentation from the District Engineer for CFD 2000-1 confirming that the remaining expenses for Antonio Parkway Widening were appropriately charged to CFD 2000-1. Policies and procedures will be developed by July 31, 2011 to ensure that any changes to the District Engineer's initial recommendation are confirmed in writing prior to payment of expenditures and that the District Engineer has the most current governing documents.

Recommendation No. 20
We recommend CEO/Public Finance only include actual interest income earned when initiating an AFDA amendment to ensure financial obligations are met without the County having to subsidize costs.

Chief Financial Officer Response:
Concur. All future AFDA amendments will include only actual interest earned.

Recommendation No. 21
We recommend that the Chief Financial Officer develop a process to ensure that CFDs Acquisition, Funding and Disclosure Agreement (AFDA) Amendments are properly executed (signed).

Chief Financial Officer Response:
Concur. CEO/Public Finance will establish a procedure to ensure that all AFDA amendments are tracked through the signature process to conclusion. This process will be in place by March 31, 2011.

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ATTACHMENT G: OC Public Works Management Response

ORANGE COUNTY
OC PublicWorks
Our Community. Our Commitment.

Jess A. Carbajal, Director
300 N. Flower Street
Santa Ana, CA

P.O. Box 4048
Santa Ana, CA 92702-4048

Telephone: (714) 834-2300
Fax: (714) 834-5188

Memorandum

DATE: December 21, 2010

TO: Dr. Peter Hughes, CPA, Director, Internal Audit Department

FROM: Jess A. Carbajal, Director, OC Public Works

SUBJECT: Response Draft Report on Ladera Ranch Community Facilities Districts, Audit No. 2919

I am pleased to provide OC Public Works' response to the Internal Audit Department's Draft Report on Ladera Ranch Community Facilities Districts, Audit No. 2919. Our response has been reviewed and approved by the County Executive Office.

While there were no material weaknesses of significant issues, we will work to implement the Internal Audit Department's recommendation as indicated in our following response.

Recommendation No. 6: We recommend Orange County Public Works ensure internal controls and processes are in place to notify the tax setting consultants of supplemental data for any amended building permits and ensure the certificate of occupancy data is accurately stated.

OC Public Works Response: Concur. As a policy, OC Public Works' Building Inspectors must ensure that the square footage noted on the Building Plans match the square footage on the building permit prior to permit final and issuance of the Certificate of Occupancy. We reviewed the data provided to David Taussig and Associates (DTA) in conjunction with this audit, which included general permit data and specific reports from APPS. We found that the data included a variety of informational fields and data not related to the Ladera Community Facilities Districts. For example, permit data for solar panels was included that did not add to the livable square footage. OC Planning in collaboration with CEO Public Finance and DTA will work to formalize a process for requesting the data and to develop a specific report that will meet the needs of both, and ensure that the data being provided to DTA is relevant and accurate.

If you have any questions regarding OC Public Works' response to the Internal Audit Department's recommendation, or require additional information, please contact me at (714) 667-3217 or Mary Fitzgerald, Manager of Accounting Services at (714) 834-5338.

Thank you

c: Thomas G. Mauk, County Executive Officer
Alisa Drakodaidis, Deputy CEO, OC Infrastructure
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