



MOUNTAINS RECREATION & CONSERVATION AUTHORITY
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April 12, 2004

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Department of Finance
915 "L" Street
Sacramento, California 95814

**Response to Management Letter of March 24, 2004 Regarding
Proposition 12, 13, and 40 Bond Funds**

Dear Mr. Hull:

This letter, along with all of its attachments, constitutes the Mountains Recreation and Conservation Authority's (MRCA) response to your Management Letter.

The Authority requests that the Office of State Audits and Evaluations (OSAE) publish and distribute this letter and all its exhibits in any form and to any audience to which the Management Letter is published and/or distributed. [Note: this response, and that of the Santa Monica Mountains Conservancy, share a common set of exhibits, numbered 1 through 20.]

Although the Management Letter was addressed to the Authority's Executive Officer, the MRCA's Governing Board considers that, in the exercise of its fiduciary responsibilities, I should respond as the Chairperson of the Authority.

This correspondence will correct a number of mistakes and misperceptions evident in the Management Letter and provides additional materials that will help the Department of Finance and the public clearly understand that the Authority takes very seriously its fiduciary obligations to manage public funds with the same care and professionalism we employ in managing public land.

In fact, we take these duties so seriously that we have engaged the services of outside accountants and lawyers to provide their knowledgeable opinions on the issues you have broached, and we are supplying those opinions on the public record.

Finding 1: Lack of Operational Independence

Fiduciary Responsibilities of the Authority Board

The Management Letter discusses at great length issues involving alleged overlaps in the responsibilities of the Executive Officer and Staff Counsel, but almost completely ignores the fact that the MRCA is governed by a body of independent, accountable public officials. The Management Letter simply does not address the fact that it is the Authority Governing Board that sets policy, provides general oversight of all Authority operations, and makes the operative decisions. This failure to address the fundamental governance structure of the Authority creates a distorted picture of our agency and calls into question the validity of OSAE's conclusions.

An uninformed third party reading your letter might get a totally inaccurate impression that the MRCA is comprised solely of an Executive Officer and a Staff Counsel spending public funds, making decisions and wearing multiple hats with no supervision or oversight. As a matter of law and practice, the Executive Officer doesn't have an independent role. His duties are to "administer" decisions and policy that have been voted upon by the Governing Board (MRCA Joint Powers Agreement § 10.0). The Governing Board makes the decisions right down to approving the warrant register of transactions. The roles of the Executive Officer and Staff Counsel are prescribed by our governing documents and applicable State law, as is the role of the Authority's fiscal officer, treasurer and auditor, the existence and duties of whom are not mentioned in the Management Letter.

By the terms of the Mountains Recreation and Conservation Authority Joint Exercise of Powers Agreement (JPA) it is the Governing Board members who are the fiduciaries, and we intently carry out this obligation. The Authority board meets at least once monthly, and frequently twice or sometimes three times a month, as situations arise that require our attention. We do so in open and public meetings, held pursuant to the provisions of the Ralph M. Brown Act so that the public can have every confidence in the operations and mission of the Authority.

Independence of the Governing Board

The MRCA is legally and factually independent of any other entity. Our self-directed Governing Board consists of three members appointed by the parties to the Joint Powers Agreement (the Santa Monica Mountains Conservancy, Conejo Recreation and Park District, and the Rancho Simi Recreation and Park District) along with one public

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member. In addition to the separate entity provisions of the Joint Exercise of Powers Act (Government Code § 6500 *et seq.*), two Court of Appeal decisions have validated the independent structure of the Authority and its complete legal independence from the Santa Monica Mountains Conservancy (“SMMC”). See, *Cooper v. Mountains Recreation & Conservation Authority*, (1998) 61 Cal.App.4th 1115; and *Tucker Land Co. v. State of California*, (2001) 94 Cal.App.4th 1191. Thus, the Management Letter ignores the established law of the State of California: that the MRCA is legally independent and separate from the SMMC, which is governed by an altogether different body of public officials.

Separation of Fiscal and Policy Functions

The Management Letter does not adequately recognize that the Authority has a defined separation between its fiscal and policy-making functions. The General Manager of the Conejo Recreation and Park District (CRPD) serves as the Financial Officer of the MRCA (Joint Powers Agreement § 10.2). All of the actual financial transactions are carried out by CRPD staff; including receipts and deposits as well as disbursements.

Moreover, the recent amendment to the Joint Powers Agreement (Section 11.7) establishes the position of an Assistant Financial Officer to whom all finance related MRCA employees report, and who is appointed by and reports to the General Manager of the Conejo District, therefore strengthening the independence of the two entities from a fiscal standpoint.

Further, from reading the Management Letter, you wouldn't know that MRCA's fiscal operations are regularly audited by independent auditors as required by law, with the results of those audits available to the public.

The Independent Auditors' Report for the 2001-2002 fiscal year, prepared by Moss, Levy & Hartzheim, CPAs, validated the financial statements of the Authority for that year and indicated that we operated in conformity with generally accepted accounting principles. A copy of that report is attached as EXHIBIT 1. While the audit of our 2002-2003 fiscal year is still in progress, we expect to receive the same finding upon its completion.

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Joint Powers Act

The fundamental shortcoming of this Management Letter, as we read it, is its failure to discuss, much less come to grips with, the Joint Exercise of Powers Act (Government Code § 6500 *et seq.*). Your letter does not refer to the Joint Powers Act, yet this law is the charter upon which the Authority was incorporated and under which it operates. Simply put, had OSAE utilized the applicable law and taken the governing documents of the Authority into account, the conclusions of the Management Letter should have been dramatically different.

As noted previously, the MRCA engaged outside Special Counsel to review the Management Letter, and attached hereto as EXHIBIT 2 is the opinion of Richards, Watson & Gershon, LLP.

In that opinion, the Richards Watson firm makes clear that the Joint Exercise of Powers Act and the MRCA's governing Agreement, to which the Conservancy is a party, specifically authorize, and in some cases require, many of the activities that were criticized, including use of facilities and equipment, sharing of employees, advances of funds, etc. A fair and accurate Management Letter must recognize those basic legal and reasonable operational facts.

Again, we must emphasize, honing in on the staff structure misses the most important point and that is the Governing Boards of both the Conservancy and the MRCA make the decisions, and these bodies are—legally and factually—*independent fiduciary boards*. They operate publicly and openly, and the members of each board are completely accountable for the operations of each agency.

We submit to you the fact that ministerial staff may carry out the mandates of the respective governing boards in a cooperative way, pooling resources and achieving operational efficiencies, perfectly testifies to the *merits* of the Joint Exercise of Powers Act as a way of focusing multiple resources and brain power for the common public good and simultaneously overcoming bureaucratic hurdles.

Joint Powers Agencies like the MRCA are the solution to the intrinsic "hurdles" of unresponsive and inefficient government. As the California League of Women Voters has said:

"The Joint Exercise of Powers Act is the basis for extensive contracting of any two or more governmental units to *share costs, avoid duplicate efforts, or secure better facilities.*" Guide to California Government. [Emphasis supplied.]

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As a consequence of the MRCA Joint Powers Agreement's objective, we are proud of the fact that we manage almost 50,000 acres of public parkland at no cost to the State of California. We were created so that agencies in the area sharing similar purposes could share costs and eliminate duplicative efforts. The Authority provides a superior quality of analytical and field resources upon which not only the SMMC relies, but also two other state conservancies, the California Resources Agency, and four other local government agencies. These public agencies contract with MRCA to provide everything from legal and property acquisition services to field operations and ranger services.

However, we certainly recognize that no government (or private) agency is perfect, and that there is no agency that cannot improve its operations. After carefully considering the Management Letter's criticisms, the MRCA is undertaking significant proactive steps to improve the perception of our fiscal oversight and independence. See EXHIBIT 3.

Prior Reliance by Department of General Services and Public Works Board on Legal Separation Between the MRCA and SMMC

The Management Letter also does not acknowledge that in two recent and significant transactions approved by the State Public Works Board and the Department of General Services (DGS), the legal independence of the SMMC from the MRCA was both acknowledged and relied upon by the State.

The Public Works Board approved, in March of 2003, the sale of a property known as Avatar located in the Western Santa Monica Mountains to California State Parks. Concern was raised by the Finance Department representative on the Public Works Board regarding liability associated with a pipeline located on the property. The Public Works Board approved the sale to State Parks based on an indemnity given to the State by the MRCA. If, as OSAE has alleged, the Authority were not a governmental entity separate from SMMC, the effect of this transaction would have been the State indemnifying itself.

In November of 2003, the Conservancy made the single largest parkland acquisition in recent history of the State. The property was commonly known as the Ahmanson Ranch. The Authority acquired the Ahmanson Ranch from the Ahmanson Land Company and sold the Ranch to the SMMC in a concurrent transaction. The Department of General Services and the Public Works Board required the MRCA, in the property acquisition agreement, to indemnify the State from and against all liability for

hazardous materials and substances, and all liability for certain continuing obligations arising out of the Ahmanson Ranch Development Agreement, Air Quality Mitigation Agreement, Parks and Recreation Facilities Agreement, School Facilities Agreement, an agreement with the neighboring City of Hidden Hills and an agreement with a not-for-profit. In addition, DGS required the MRCA and SMMC to enter into an arms length License Agreement whereby the MRCA agreed to maintain the property. The State cannot have it both ways, taking advantage of MRCA's independence in some cases and denying the existence of it in others.

Effect on Federal Arbitration Rules

The Authority has retained independent counsel regarding this issue and it is discussed at length under Finding 2, but at this juncture, it is important to point out that p. 3 of OSAE's letter misstates the relevant legal standard.

It is not true under Federal law that MRCA must demonstrate that it "is an operationally independent grantee." The test is "related entity" not "operationally independent." The rules for determining "related entity" are thoroughly discussed below, but at this juncture suffice it to say they have to do with board member independence and control, not staff or office sharing.

Finding 2. Advance of Bond Funds

Independent or Related Entities

Reference has been made previously to the hiring of probably the leading attorney in the very narrow field of related-entity arbitration rules in California, Samuel Norber, Esq. His opinions as to the "related entity" question and Federal arbitration rules are attached as EXHIBITS 4 and 5. The Authority took the further cautionary step of engaging William L. Strausz, Esq. of Richards, Watson & Gershon, a prominent public agency finance lawyer, to peer-review Mr. Norber's opinions. Mr. Strausz's confirming letter is attached as EXHIBIT 6.

The conclusion is clear that MRCA and the Santa Monica Mountains Conservancy are not "related entities" within the standards set forth in the Internal Revenue Code and applicable regulations. Therefore, grants made by SMMC to the Authority are considered "spent" and need not be further tracked for arbitration purposes. Further, Mr. Norber's letter (EXHIBIT 5) makes it clear that other than a possible small arbitration

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rebate, there would be no adverse consequence to the bonds or the State's credit rating or anything else, *even if* the Authority and SMMC were considered "related entities."

The purpose of reviewing the related entity issue in this response is not to "re-litigate" if you will, the direction Resources Agency has given to the SMMC. Rather it is to show that the actions of MRCA (and the SMMC) were and are reasonable and undertaken in contemplation of a legal standard that has more than ample documentation from some of the most experienced practitioners in the field.

We recognize that the Agency and the Treasurer have applied a more conservative standard; therefore, to avoid any question, the Authority is returning unencumbered grant advances in accordance with the Resources Agency's request. The Management Letter's statements to the contrary are not true, and in light of the methodical approach demonstrated by the opinions of outside counsel, the inflammatory tone of Finding 2's second paragraph is just not warranted.

Advance Funds Have Been Returned

Following the November 2003 memorandum from the Resources Agency, the Authority Governing Board, in the exercise of its fiduciary duty, engaged special counsel Samuel Norber, Esq., and his opinion has been described above. Mr. Norber communicated directly with the State Treasurer's Office ("STO"), and the Resources Agency was kept abreast of these communications. Neither Mr. Norber nor the Authority have received a written response from STO, but on February 19, 2004, the Executive Officer took a telephone call from Assistant Secretary Don Wallace, who informed him that STO was taking a more conservative view, and that the November memorandum would have to be implemented. The Executive Officer indicated that this would happen, and in a follow-up e-mail to one sent by Deputy Assistant Secretary Elaine Berghausen on February 24, 2004, he described the procedures the Authority was undertaking to comply.

As indicated in the letter from Richards, Watson & Gershon attached as Exhibit 2, the advance of grant funds from SMMC to MRCA was not prohibited by any of the bond acts at issue. Further, the Joint Exercise of Powers Act specifically permits such advances from one member entity to a joint powers authority such as MRCA, without limit on the source of funds. See Government Code § 6504, clause (c) "advances of public funds may be made for the purpose set forth in the agreement" In the judgment of the granting agency and the grantee, such advances were necessary for the efficient completion of the grant projects and acquisitions on terms favorable to the

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people of the State of California. The Management Letter does not find otherwise with regard to MRCA acquisitions, only that some other, but not all, State bond agencies handle the process differently. Thus, the advances were in compliance with the provision of the State Contract Manual quoted in the Management Letter. Nonetheless, to avoid any question of a failure to comply with the State's procedures, the Authority's Governing Board has directed that the Authority return unencumbered advanced grant funds.

The Berens-Tate Consulting Group has now completed their work in detailing the actual expenditure dates of bond advances, as was requested by Resources Agency, and that information will be transmitted to the STO.

As of this date \$2,610,039.71 in advanced grant funds have been returned. We expect that at least an additional \$2,300,000.00, representing all of the unencumbered advanced grant funds will be returned within the month once outside counsel have completed their review of each grant. Outside counsel is reviewing each grant advance to ensure that the Authority does not incur breach of contract liabilities by returning encumbered funds.

MRCA Is Not Accepting Any Further Funds in Advance of Need

The statement on page 4 of the Management Letter that "neither the Conservancy nor Authority plan to substantially change the current advancing procedures" is factually incorrect as shown by the return of advanced funds. Moreover, the Authority is not requesting any further funds in advance of need, nor do we believe such funds would be forthcoming from SMMC. We understand that SMMC will be requesting the deposit of purchase money directly into escrow for future acquisitions. This conclusion in the Management Letter should be changed.

Implementing New Procedures

The Management Letter recommends procedures that have been discussed above relating to advance of funds and escrows and we have indicated our agreement to be responsive to such recommendations. The letter also states that the Authority and SMMC should develop and implement procedures "that will ensure the continued tax-exempt status of the bonds." That last phrase is deceptive and misleading. As counsel has made very clear, (See Norber, EXHIBIT 5) the only thing at issue is rebate amounts that the Authority may owe back if as a result of advances there is net positive arbitrage.

In layman's terms, any money that was made by investing at higher rates than the interest paid on the bonds must be returned to the Federal Government. It is not a question of the bonds losing their tax-exempt status. Of course, given the interest spread as shown on the chart in EXHIBIT 7, it is unlikely that there is any positive arbitrage. So, while we don't want to characterize the issue as not being important, the wording in the letter implies the existence of possible consequences that don't exist. The phrase about bond jeopardy should be deleted from the Management Letter.

Finding 3. Grant Overhead Costs

Overhead Costs Were Calculated According to a Documented Cost Allocation Plan and Generally Accepted Accounting Principles

In 2000 the Authority adopted a Cost Allocation Plan, also considered and endorsed by the Conservancy (see SMMC Minutes, Dec. 4, 2000, EXHIBIT 8). The independent accounting firm of Quezada, Godsey & Co prepared this plan. The Quezada firm looked at historical cost data and from that calculated a realistic and supportable cost allocation plan. The accounting firm informed the Authority that, for accuracy, the cost allocation plan should be applied across all Authority transactions and grants, except those cases where precluded by law. None of the State bond acts at issue here prohibit the application of a cost allocation plan or the charge of overhead by grantees.

It is highly misleading, to the point of being a distortion, to compare MRCA with entities like the Coastal Conservancy and Wildlife Conservation Board, and then to conclude that MRCA's overhead was 350 times that of these agencies. This is like comparing Apples to Oranges.

Take three prominent examples: The State Coastal Conservancy (SCC), Wildlife Conservation Board (WCB), and Department of Fish and Game (DFG) each have very significant support appropriations from Bond Funds. In the current fiscal year Propositions 12, 40, and 50 provide almost 45% of the SCC support budget (\$3,692,000). In the case of WCB, over 72% (\$4,762,000) of their support appropriation is from Props. 40 and 50. (See *Governor's Budget*, p. R-102 and R-84.) The WCB amount is no doubt understated because of the services they receive from Department of Fish and Game. (DFG does the analysis of land acquisition project desirability according to an extensive criterion for each project [Conceptual Area Plan Land Acquisition Evaluation] that is done first at the DFG Regional level and then evaluated by DFG staff in Sacramento. The evaluation is then forwarded to WCB to act upon.)

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DFG provides substantial support for the other entities that actually make land acquisitions from Props. 12, 40, and 50. The *Governor's Budget* reports (p. R-82) that in the current fiscal year, DFG had only \$766,000 of Bond Fund capital outlay (all from Prop. 12), but turn to pp. 65-66 of the *Governor's Budget* and you find that DFG was appropriated **\$10,789,000** of Propositions 12, 40, and 50 Bond Funds to **support** the Department, *i.e.*, personnel and operating expenses.

Bond Funded support appropriations for just these three agencies, totals **\$19,243,000** in this fiscal year alone for personnel and operating expenses.

To put this in perspective, this represents **\$2,024,316 more of Bond Funds spent on personnel and operating expenses of SCC, WCB, and DFG, than the total land acquisition grants MRCA received from the Conservancy.**

We don't for a moment suggest that there is anything wrong with these expenditures, we know better than most that it takes money to support a Bond Funded land acquisition program. The point of this comparison is merely to point out: One way or another, Bond Funds pay those costs and the Authority is no less efficient than any other similar agency.

Moreover, by making an invidious comparison between the granting practices of SMMC and SCC and WCB, the Management Letter admits that there is nothing that legally prohibits grantees charging overhead costs. If WCB allows overhead in "isolated cases" and SCC "occasionally" then the number of times is irrelevant to the legality thereof.

Our method of allocating costs across all our programs is consistent with the law and generally accepted accounting principles. The attached letter from Macias, Gini & Company, LLP certified public accountants (EXHIBIT 9) supports this point, and states unequivocally that the Authority's cost allocation plan is valid and consistent with OMB Circular A-87.

The Management Letter recommends the return of indirect costs charged to the Avatar grant. This overhead was charged pursuant to the MRCA's Cost Allocation Plan. The grant application submitted to the Resources Agency stated that the Avatar acquisition (also known as the Upper Los Angeles Watershed Western Acquisition) was a joint Proposition 12 and 13 project. The amount billed to the Resources Agency, namely \$5,922,000, was the amount requested in the grant application. The grant application stated that the total project cost would be \$9,000,000. Neither Proposition 13 nor the grant agreement prohibits the charging of cost allocation to a project. The escrow closing statement sent on two occasions to Elaine Berghausen of the

Resources Agency indicated total purchase consideration to be \$8,130,000. The Resources Agency was put on notice of the application of cost allocation to the project in 2001 and did not object. The MRCA recognizes that the grant guidelines consider overhead charges to be ineligible Proposition 13 project costs and in response thereto has reallocated the cost allocation to the Proposition 12 component of the entire project. Such an allocation is supported by the MRCA's cost allocation procedures. Please see the attached EXHIBIT 11. The entire \$5,922,000 has been allocated to the purchase consideration.

Finding 4. Administrative Services Contract

The Administrative Services Contract is Legal

This contract is valid. It bears the approval stamp of the Legal Office of the Department of General Services and there was no conflict of interest in its execution. The contract was signed on behalf of MRCA by its Chairperson, not by a staff member with *ex officio* duties. The project representative for MRCA was not a state employee. MRCA has performed pursuant to the contract; there is no reason for cancellation thereof.

The discussion of the policy questions raised by OSAE is best left for the Conservancy's response.

The Attorney General opined on this very section with respect to a joint powers agency of which the State Personnel Board is a member, ruling that Cooperative Personnel Services (the joint powers authority of which the State Personnel Board was a member) could provide examination, training, and management consulting services for its members (including the State Personnel Board). (See 83 Ops. Cal. Atty. Gen. 8.) In that opinion, the Attorney General followed well-settled case law to conclude that a contract very similar to the contract at issue here was valid.

Unallowable Costs Were Detected by MRCA Auditors Before Questions Were Raised by OSAE

It is invalid to assert (p. 8), "We found that the Conservancy failed to detect or question certain unallowable expenditures . . ." and the next page is wrong as well when it says, "corrective actions were not undertaken after we raised these concerns, indicating that they might not otherwise have been detected and corrected." This implies that nobody was looking at this billing until DOF raised the questions—and this is just not true. The

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fact is that *MRCA's independent auditors discovered and questioned these expenses five months before they were discovered by DOF*. The attached letter from Moss, Levy & Hartzheim (EXHIBIT 10) shows that the questionable billings were already under review as a result of an August 11, 2003 letter from MRCA's auditors. The expenses were first questioned by the Department of Finance's auditor Yolanda Wesson in an email dated January 23, 2004. As a result of MRCA's independent auditor's questions, the MRCA created detailed explanations for each charge, revised our billing for the contract, submitted the Executive Director's personal checks to accounting for reimbursement, and submitted our revised invoice to the State.

The System Worked: MRCA Received No Unauthorized Reimbursements

No system is impervious to the human error of a temporary employee making a billing mistake. However, the system did prevent MRCA from receiving and retaining any reimbursement for questioned billings.

While Billing Mistakes Were Made, Most of What DOF has Questioned Were Appropriate Communications Charges

The questionable charges were submitted to our internal accounting department incorrectly as a result of a temporary employee working as the Executive Officer's secretary while his regular assistant was on leave. This temporary employee did not follow our internal controls for submitting expenses. The employee was given the Executive Officer's personal MasterCard number for use in these situations, and she neglected to use it for the personal expenses. When charges were presented to the Executive Officer that were questionable or outside of the allowable limit, he requested backup and submitted personal checks as reimbursement to the Authority.

The expenses incurred by the Executive Officer for long-distance telecommunication charges from Mexico were proper communication charges for e-mail, internet, and telephone calls back to California doing the State's business, supervising sensitive negotiations and the preparation of the board meeting materials for SMMC's April 28, 2003 meeting, the agenda for which contained a number of high-profile projects (EXHIBIT 12). The Executive Director attempted to find an alternatively cheaper means of communication (See attached memo from Simon Maguire, Network Project Manager EXHIBIT 13). Backup for these telecommunication charges were submitted as per the hotel's invoice, unfortunately for everybody, this invoice, though the best we have, is not

in the detail that U.S. hotels typically provide, and in the detail that DOF is used to seeing. The Executive Officer submitted a personal check for partial reimbursement for these charges.

These communications charges are valid business expenses. It's an example of dedication to one's job that the Executive Officer conducted state business even while taking personal leave time to chaperone his son's spring break vacation. However, the Executive Officer has decided, on his own, to reimburse the total amount challenged by OSAE, even though it represents an unreasonable demand for him to bear the cost of doing public business. His personal letter is attached as EXHIBIT 14.

Billing Did Not Circumvent Proper Procedures

The Management Letter says (p. 9), "All State agencies are required to submit this detail for their own expenditures but because the payment was to a contractor (Authority), the costs were paid without this detail and without question." This statement is wrong and DOF knows, or should know that it is wrong. As stated above, **none of the questioned billings were reimbursed to MRCA.**

- A contract billing was submitted on June 27, 2003 for \$152,381 pursuant to the DGS approved contract.
- Only \$7,250 of that contract was paid on September 4, 2003. None of the questioned billings was reimbursed as part of this small initial payment.
- On February 3, 2004, a revised billing of \$83,573.85 was submitted and the majority of questioned expenditures were removed.
- On February 17, 2004, a revised billing for \$66,473 was submitted. No questioned expenditure was included in this billing.
- On February 23, 2004, the MRCA received a check from the SMMC in the amount of \$76,323.85.
- On March 23, 2004, the MRCA provided a check to the SMMC in the amount of \$9,850.61, which reflected the overpayment by the SMMC to the MRCA.

- The total net amount reimbursed to the MRCA by the SMMC for this contract is \$66,473.

While it is true that the State Travel Claim form was not attached, such a form is not required and would not be appropriate for billings on an MRCA contract. The claim under an MRCA contract is not to the state, but to MRCA, from which MRCA pays (or does not pay) on its own forms, and then submits a reimbursement request to the State as a vendor under the administrative services contract. This procedure is wholly correct and typically used where other state agencies have similar contracts with MRCA. The Management Letter implies that some lump sum "travel" amount is billed without particulars. This is not true; travel detail is provided, including itinerary and original ticket stub or credit card billings.

This level of detail is consistent with the level of detail submitted pursuant to other contracts with state agencies. For example, the level of detail submitted by MRCA under the administrative services contract is the same as submitted by MRCA's urban affairs specialist working under contract to the California Resources Agency when she billed travel for attendance at SMMC meetings as the Resources Secretary's designee as a voting member of the SMMC Board. This is true also of the level of detail submitted by the MRCA's environmental program manager working under contract to the Resources Agency when he billed travel to MRCA and MRCA was reimbursed by Resources Agency pursuant to its contract. (EXHIBITS 15 and 16 show sample billings from these sources that were paid by the California Resources Agency.)

Finding 5. Consistency with Bond Acts

Outside Counsel Has Found All Grants to Be Consistent With Bond Purposes and Intent

In the exercise of its fiduciary obligations, the MRCA Governing Board has engaged outside counsel of Richards, Watson & Gershon, LLP, to review the grants MRCA received that were questioned in the Management Letter. The opinion of counsel is attached as EXHIBIT 2. This opinion gives unqualified approval to each grant as being consistent with Bond Act purposes and intent.

Because the grants were for a valid public purpose and consistent with the Bond Acts, there is no legitimate reason to cancel them, and to do so would be resisted by the MRCA on the basis that all terms and conditions of these valid contracts have been complied with by MRCA.

To the extent that DOF has raised non-legal, but park planning questions regarding the River Center Improvements grant, we shall leave the explanation of that grant to the SMMC, while noting that MRCA has fulfilled its end of the bargain.

Finding 6. Grant Contracting and Procedures Should be Improved

Improved Grant and Accounting Procedures Are Being Implemented

There is rarely a system that cannot be improved upon and that is why the MRCA is aggressively implementing improved grant accounting procedures. We appreciate the suggestions OSAE has made in this regard. Had the other portions of the Management Letter been as tightly focused, there would have been no need for this extended response.

EXHIBIT 3 details the improved organizational and accounting procedures now being implemented by MRCA and SMMC. These are extensive and represent a good faith commitment on the part of MRCA to address those legitimate concerns raised in your Management Letter.

Recording of Funds Was Done According to Local Agency Investment Fund Regulations

With respect to recording of grant funds issue, the Management Letter on p. 12 faults the MRCA for its lump sum investment in Local Agency Investment Fund (LAIF). LAIF is the safest and most convenient place to invest grant proceeds, but LAIF does not permit individual grant accounts. While the funds from each advance are technically combined, each project is separately tracked in the accounting system by project code, so there is no loss of accountability and the interest earned on each project can be tracked by project code. The alternative to this modern computer based tracking is to invest commercially with banking institutions that have FDIC insurance limits of \$100,000 per institution. This would mean many accounts (ten different banks per each million of investment). MRCA will work with its financial advisors to determine an appropriate investment system that gives accountability, yet does not involve such a cumbersome process.

Since 2002, American Express Cards Have Been Subject to
a More Rigorous Control System

As shown in EXHIBIT 17, since October 18, 2002, use of AmEx cards has been subject to a rigorous control system. There may have been individual examples of documentation failure, but on a systemic basis compliance has been good. The Management Letter (p. 12) identifies "several" instances where the only supporting documentation was the AmEx bill. We note that the word "several" is defined as "more than two but fewer than many," Merriam-Webster's Collegiate Dictionary, 11th ed. We continue to aim for zero errors.

MRCA is moving to the Cal-Card System That Will Provide Even
More Purchasing Accountability

The MRCA is implementing the Cal-Card system that provides greater accountability than the current American Express card system. The Cal-Card program is administered by U.S. Bank and is similar to a Visa card account. It is widely used by state agencies and local government entities. The Cal-Card system allows multiple levels of controls, including dollar limits on single purchases for each user, a monthly limit for each user, as well as a control system on the type of vendor each card holder is allowed to use. Internally, an appointed Cal-Card administrator can monitor the Cal-Card account on a daily basis. All MRCA users will have a pre-approved spending limit per single transaction, and all card holders will be required to turn in a weekly summary of their purchases as well as all receipts. The Cal-Card program does not charge an annual fee for cardholders, and is therefore a more cost-efficient credit card program than American Express.

Outside Counsel and Accountancy Firm Agree That Improved
Procedures Will Provide Appropriate Safeguards

As mentioned before, the MRCA Governing Board has retained outside legal counsel, and an outside accountancy firm to, among other things, review the adequacy of the organizational and procedural changes made by MRCA and SMMC as outlined in EXHIBIT 3.

- The unqualified opinion of Richards, Watson & Gershon, LLP, as to the legal adequacy of the organizational changes and procedures is contained in EXHIBIT 18.

- The unqualified opinion of the outside accountancy firm of Macias, Gini & Company, LLP as to the adequacy of the MRCA's and SMMC's improved accounting safeguards and procedures is attached as EXHIBIT 19.

Finding 7. Legal Costs and Loans

Legal Costs and Loans Were Appropriately Charged to Bond Funds

Outside counsel has reviewed each of the legal charges against Bond Funds and has concluded that those costs were appropriately charged. None can be considered as "ongoing litigation." See opinion of Richards, Watson & Gershon, LLP, EXHIBIT 2.

Indeed, in the case of Ramirez Canyon, the entire value of a significant gift to the State of the former Barbra Streisand Estate (valued in 1993 at \$14.5 million), one of the most beautiful venues in the entire Santa Monica Mountains, would have been lost but for the expenditure of Bond Funds on attorney fees related to the Coastal Permit and subsequent litigation challenging that permit. Public access to public resources being an indubitable purpose of the Bond Funds, it is especially striking to find OSAE questioning this expense. It should be noted that the Attorney General's Office did not represent SMMC initially because of a potential conflict between the interests of the Coastal Commission and SMMC. Hiring counsel was beyond the ability of SMMC's meager support appropriation, so it was either a Bond Fund grant to MRCA, or lose the litigation—and the public access—by default.

Unwarranted Criticism of Tucker Property Loan

The Management Letter criticizes a loan to the MRCA (which is legally authorized by Public Resources Code § 33204(d)) on the basis that no other agency so acted. Probably true, but no other state agency has so innovatively sought and acquired parkland. These 1,518 acres of wildlife habitat in the last developable open space within the City of Los Angeles was acquired by MRCA for a total of \$14,000,000, fully \$4,000,000 below the value of the notes and deeds of trust on the property. It is no criticism that SMMC acted to award the loan to MRCA where, perhaps, other agencies would have stayed their hand—and lost the open space. The MRCA has been at the vanguard of park and open space agencies in implementing new and innovative techniques for bringing open space into the public domain.

Project Planning and Design Grants

As we have seen above, proper bond act planning and implementation costs of over \$19 million for salaries and operating expenses in the current fiscal year were budgeted to the Bond Funds, and that was just for SCC, WCB, and DFG.

Either state employees provide this function, or it is done by grantees or outside contractors. The Management Letter doesn't find fault with the quality of work done by MRCA employees when they are implementing Conservancy grants. Indeed, in light of this the MRCA has always been recognized within the profession for its work (the testimony of the U.S. National Park Service to this effect is just the latest recognition of the value of this agency as an innovator in the field, see EXHIBIT 20), and it would be hard to argue that any other entity has more expertise.

The MRCA has a comparative advantage in this field. While employees are hired according to ability, the MRCA is not part of the civil service system and its personnel do not have a legally vested interest in their continued employment, *i.e.*, they are "at-will" employees. This provides the Authority flexibility to manage and control its workforces and costs consistent with the workload and thereby avoid the difficulties of laying-off state employees.

Conclusion

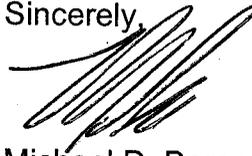
The MRCA Governing Board vigorously asserts the propriety of its implementation of the grants and contracts as awarded by SMMC under the Bond Acts.

The Board also recognizes that constant improvement is essential to being an effective and responsive instrument for the people we serve. We honestly appreciate the efforts of the Office of State Audits and Evaluations, and where they have been constructive in their criticisms such recommendations have—in conjunction with our own internal review—led to the changes in organizational structure and procedures that have been described above and in the exhibits.

We are pleased to report that the sum total of these implementations have led our outside law firm and outside accountancy firm to give the unqualified opinions that they have as to the propriety of accounting procedures and practices.

Mr. Samuel E. Hull, CPA
April 12, 2004
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Sincerely,

A handwritten signature in black ink, appearing to read "Michael D. Berger". The signature is stylized with several overlapping, sweeping lines.

Michael D. Berger
Chairperson

Copy to: MRCA Governing Board members
SMMC members
Mike Chrisman, Secretary for Resources
Don Wallace, Assistant Secretary
Elaine Berghausen, Deputy Asst. Secretary
Tex Ward, Financial Officer, MRCA
Joseph T. Edmiston, Executive Officer, MRCA
Rorie Skei, Chief Deputy Executive Officer, MRCA
Laurie Collins, Staff Counsel, MRCA
Reva Feldman, Chief Operating Officer, MRCA