

CALENDAR ITEM

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**CONSIDER DIRECTING STATE LANDS COMMISSION STAFF TO PERFORM A FINANCIAL AUDIT OF THE CITY OF REDONDO BEACH'S MANAGEMENT OF GRANTED TIDE AND SUBMERGED LANDS**

**Trustee:**

City of Redondo Beach  
415 Diamond Street, P.O. Box 270  
Redondo Beach, CA 90277-0270

**Introduction:**

The City of Redondo Beach (City) is a trustee of sovereign tide and submerged lands granted by the Legislature pursuant to Chapter 57, Statutes of 1915 and as amended by Chapter 1555, Statutes of 1971.

The land uses authorized by the grant to the City include the traditional triad of public trust uses, including waterborne commerce, navigation and fisheries. The City's trust grant also allows other uses, such as marine oriented public recreation, commercial and industrial uses, open space and wildlife habitat uses, and uses which are necessarily incidental in the promotion and accommodation of public trust uses. The grant specifically requires that the State Lands Commission (Commission) approve any capital expenditure of public trust revenues proposed by the City which exceed \$250,000.

The Commission has the statutory responsibility to oversee the management of public trust lands and assets by legislative grantees who manage these lands, in trust, on behalf of the State. (Public Resources Code section 6301, *et. seq.*; *State of California ex rel. State Lands Commission v. County of Orange* (1982) 134 Cal App. 3d 20, 23).

At the April 23, 2014 Commission meeting, several Redondo Beach residents raised concerns about the City's management of its granted tide and submerged lands, alleging that the City is misusing tidelands funds. Upon hearing the concerns, the Chair of the Commission directed staff to report to the Commission at its June 19, 2014 meeting on the feasibility of conducting an audit of the City's use of tideland funds, with an emphasis on the City's use of Internal Service Funds (ISF) transfers.

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**STAFF ANALYSIS:**

Several Redondo Beach residents have alleged that the City is misusing tidelands funds by abusing ISF transfers and misappropriating collected self-insurance charges out of Harbor funds. ISFs are used in governmental accounting to allocate overhead costs of goods or services to other various city departments. Examples of ISF charges include Human Resources, Information Technology, and City Council functions. The concerns are that the City is overcharging overhead cost allocations to the Tidelands Fund instead of billing the City's General Fund.

In 2011, Commission staff received similar complaints alleging misuse of tidelands funds by improper ISF fund transfers. At that time, staff requested and received information from the City and had several discussions with City staff regarding the allocation of overhead charges. Staff's preliminary review of the ISF transfers did not indicate any erroneous actions on behalf of the City. However, these are issues of high complexity.

As part of its oversight duties pursuant to Public Resources Code section 6306, the Commission is responsible for reviewing granted lands financial information to ensure trustees are complying with the public trust and the applicable statutory trust grant. The Commission has the authority, though not the general duty, to institute an audit and review the administration of tidelands grants to determine whether the grantee is in compliance with the terms and conditions of its grant and all other applicable provisions of law concerning the granted lands.

The Commission currently has six auditors that primarily review and audit revenue generating oil, gas, and mineral leases. The audit unit also reviews and audits select high revenue generating surface leases. The audit unit's workload is based on annual audit plans, which take into account available resources, value of leases to be audited, and other monitoring priorities. The Commission has two attorneys who primarily work on granted lands issues and one granted lands specialist in the External Affairs Division.

Since the essential function of the Commission's audit staff is to audit oil, gas, and mineral leases for financial accuracy purposes and to ensure fair compensation for use and development of the State's resources, auditing the City of Redondo Beach would result in a redirection of staff from auditing high revenue generating oil and gas and surface leases. Auditing the City would also result in the redirection of legal and granted lands staff time and resources from other granted lands work.

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As the Commission has directed staff to explore and report on available options to address the complaints alleging misuse of tideland funds, staff proposes the following options for the Commission's discussion and consideration:

### Alternative 1: No Further Action at this Time

As mentioned above, in 2011, the Commission staff conducted a preliminary review of the allegations regarding the City's ISFs and did not find any evidence of maladministration concerning the tidelands trust. With the limited resources of the Commission and with previous reviews not uncovering any evidence that tidelands funds were misused, one alternative is to take no further action at this time. However, staff would continue to monitor the City's trust revenues and expenditures. This option would capitalize on the excellent working relationship that has developed between the City and Commission staff over the past few years while also ensuring staff continues to monitor the tideland trust funds over time. This alternative would have limited to no impact upon the expenditure of staff time and resources.

### Alternative 2: Review of Cost Allocation Plan for ISF Allocation Methods

The primary allegation against the City is that they are improperly allocating ISF charges. In 1997, an accountant was hired to review the City's cost allocation practices pursuant to the standards established by the American Institute of Certified Public Accountants. That report concluded that the then current practices were reasonable. In late 2007, Public Resources Management was commissioned by the City to prepare a cost allocation plan which included internal service cost allocations. The cost plan was approved by the City in March 2009. Suggested modifications to ISF charging practices were incorporated into the budgets for Fiscal Years 2009-2010 and 2010-2011. ISF allocations are adopted by the City Council every February, typically at the City's mid-year budget review. Allocations and methodologies are reviewed for conformity with Government Accounting Standards Board standards and financial best practices.

Based on the above information, one alternative would be for Commission staff to review and analyze the cost allocation plan that was approved by the City in March 2009, as well as any and all changes or amendments to the plan, and the City Council staff reports adopting the yearly ISF allocations. This would provide staff the materials necessary to determine whether the City has adopted an allocation method that is appropriate and reasonable. This option makes optimal use of limited staff resources while concurrently addressing the primary concern of the citizens of the City. This option also takes into account the fact that in previous preliminary reviews, staff has not uncovered any information that would warrant a large scale financial audit. This

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alternative is estimated to take a total of 60 hours of staff time: 20 hours of legal staff time; 10 hours of granted lands staff time, and 30 hours of audit staff time.

### Alternative 3: Detailed Financial Review

A detailed financial review would require Commission staff to interview City staff and acquire information pertaining to allocation methodology for all ISF charges to the tidelands fund. The previous two years electronic files of tidelands revenue and cost transactions would then be collected and analyzed to determine if the information is reasonable. The information would also be analyzed to evaluate whether the alleged improper charges had occurred, without applying the rigorous examination required during a comprehensive financial audit. Commission staff estimates that a detailed financial review of the City's financial information and practices, with a special emphasis on the ISF's, would require approximately 560 hours of audit staff time and an additional 180 hours of legal and granted lands staff time.

### Alternative 4: Comprehensive Financial Audit

The scope of a comprehensive financial audit would include a more complete examination and evaluation of the City's financial records and accounting procedures, including an analysis of revenues and expenditures for an approximately two-year period ending June 30, 2014. A full financial audit would be conducted in accordance with generally accepted auditing standards. These standards require that staff obtain reasonable assurance about whether the financial documents provided by the City are free of material misstatement and provides in depth examination of evidence supporting the amounts disclosed in the financial statements. Commission staff would analyze thousands of documents and transactions and review cost allocation methodologies in depth to determine whether those costs are reasonable for managing the City's granted lands and properly allocated through ISF accounting. It is estimated that a comprehensive financial audit would take approximately six months with two dedicated audit staff working approximately 2000 total hours. It would also require hundreds of hours of legal and granted lands staff time. This timeframe is an approximation and the actual time and resources required for such a comprehensive audit may vary.

Since the essential function of the Commission's audit staff is to audit oil, gas, and mineral leases for financial accuracy purposes and to ensure fair compensation for use of the State's resources, conducting an audit of the Redondo Beach administration of its tidelands trust would result in a redirection of staff from auditing revenue generating leases for a significant period of time. An audit would also result in the redirection of legal and granted lands staff time and resources from other granted lands work. Taking

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into account the previous financial reviews performed by Commission staff in 2004 and 2011, and the cooperativeness of the City with the Commission, staff does not believe such a comprehensive financial audit is justified at this time.

The foregoing summary of alternatives is not exhaustive, but is intended to provide a range of options and strategies for the Commission's consideration and discussion.

**OTHER PERTINENT FACTS:**

1. In 2004, Commission staff conducted a financial review investigation (audit) of the City's granted tide and submerged lands trust fund accounts. The audit was in response to a complaint from a Redondo Beach citizen alleging a number of illegal activities by the City, including the misuse of tideland trust revenues for non-trust purposes. The scope of the Commission's review included an analysis of revenues and expenditures for a five-year period ending June 20, 2004.
2. The Commission staff's findings were presented to the Commission on June 26, 2006, and December 14, 2006. The Commission staff found that the evidence uncovered at that time did not warrant further action by the Commission relating to the specific allegations. However, the review did lead staff to uncover several separate areas within the management of the City's granted tide and submerged lands that needed to be addressed. To rectify these issues, the Commission and City entered into an agreement entitled the "Agreement Regarding the Harbor Center Project and Kincaid's Restaurant Lease" (Agreement). The Agreement, which was amended by the Commission on September 20, 2013, addresses the Harbor Center Project, a hotel, retail and parking complex project on lands acquired by the City using tideland trust funds, and a lease with Kincaid's restaurant, which is located on the Redondo Beach Pier. The agreement set out a framework to address outstanding issues that were not necessarily in violation of the grant, but required further attention.
3. The staff recommends that the Commission find that directing staff to perform a financial review or audit does not have a potential for resulting in either a direct or a reasonably foreseeable indirect physical change in the environment, and is, therefore, not a project in accordance with the California Environmental Quality Act (CEQA).

Authority: Public Resources Code section 21065 and California Code of Regulations, Title 14, sections 15060, subdivision (c)(3), and 15378.

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**RECOMMENDED ACTION:**

It is recommended that the Commission:

**CEQA FINDING:**

Find that directing staff to perform a financial review or audit of the City of Redondo Beach's management of granted tide and submerged lands is not subject to the requirements of CEQA pursuant to California Resources Code of Regulations, Title 14, section 15060, subdivision (c) (3), because the subject activity is not a project as defined by Public Resources Code section 21065 and California Code of Regulations, Title 14, section 15378.

**AUTHORIZATION:**

Direct staff to review and analyze the cost allocation plan that was approved by the City in March 2009, as well as any and all changes or amendments to the plan, and the City Council actions adopting the yearly Internal Service Fund allocations to determine consistency with the City's trust grant responsibilities and report back to the Commission by December 31, 2014.