JOHN CHIANG
California State Controller

September 22, 2010

Pedro Carrillo
Interim City Administrator
City of Bell
6330 Pine Avenue
Bell, CA 90201

Dear Mr. Carrillo:

Enclosed is the report of the State Controller's Office audit of the City of Bell's administrative and internal accounting controls system. The audit was conducted at your request for an assessment of the adequacy of the city's controls to safeguard public assets and to ensure proper use of public funds.

Our audit found that, because the control deficiencies were so serious and pervasive, the City of Bell's internal control system was virtually non-existent. All of the city's financial activities and transactions evolved around one individual—the former Chief Administrative Officer (CAO)—who for all intents and purposes had complete control and discretion over how city funds were to be used. There is no evidence of any oversight by members of the Bell City Council, most of whom received additional compensation and/or loans as a result of actions authorized by the CAO. Under this environment, the potential for waste, fraud, abuse, and misappropriation of public funds is extremely high.

Based on a review of a very limited sample of transactions, we identified the following conditions that suggest possible intentional abuse and misuse of city funds (Finding 1):

- The Bell City Council approved exorbitant salary and benefits for the former CAO without any accountability for performance. The former CAO continued this process by allowing enormous salaries for other chief administrative staff.

- More than $93,000 in city funds was used to repay the former CAO's personal loans, apparently without any authorization or justification of public benefit, which constitutes a gift of public funds.

- Approximately $1.5 million in loans were made to members of the Bell City Council, city officials, and city employees at the sole discretion of the former CAO and without any justification of public benefit, which again constitutes a gift of public funds.

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- Payments were made to a contractor, who was also acting as the city's "Director of Planning Services." Payments continued even after the contract had expired in June 1997. The contractor also charged the city a 10% administrative fee (profit) for any subcontractor he hired, which raised questions about conflict-of-interest with his role of the Director of Planning Services. Total payment to two firms owned by the contractor was in excess of $10.4 million from January 1995 through June 2010. In effect, the Director oversaw many subcontractors of the city, each garnering him a 10% administrative fee (profit).

- The city in May 2009 purchased real property for $4.8 million from a trust established by a former Bell mayor who paid $480,000 for it in 1981. There was no documentation available to show what the property was to be used for, how the property was selected, and cost analyses to justify the purchase amount. The store on the acquired site has been vacated and there has not been any activity on this site.

In addition, we found the city mismanaged its voter-approved Measure A bond funds (Finding 2) as follows:

- The city issued $50 million in general obligation bonds for Measure A without any documented plan and timeframe to utilize the proceeds and apparent need for the funds.

- The 2007 series of bond proceeds of $35 million had the former CAO assume the role of fiscal agent. As such he had total control and discretion over how bond funds were to be used. As of August 31, 2010, approximately $11.5 million of the $35 million had been spent. Given the questionable practices of the former CAO identified in other sections of this report, the risk for improper use of bond funds is very high.

- The amount of 2007 series of bond issuance ($35 million) was far in excess of the amount that was needed and thus unnecessarily increased the city's costs of borrowing. In addition, the surplus funds inexplicably were deposited in a non-interest-bearing checking account which, assuming an interest factor of 2% per annum, resulted in interest losses of approximately $1.7 million as of August 31, 2010.

- Rather than depositing increased property tax proceeds in a separate Debt Service Trust Account as specified in the city's paying agent agreement with the U.S. Bank National Association, the funds were deposited in the General Fund, which artificially inflated the General Fund cash balance. Under the former CAO's employment agreement with the city, his salary increases were contingent on a positive cash position in the General Fund. Again, at least in appearance, this practice could be self-serving.

We also found the Bell City Council exceeded its authority in increasing assessments and taxes without voter approval (Finding 3). Specifically, we found that:

- The Bell City Council improperly increased the assessment of the Sanitation and Sewerage System District without voter approval. The estimated amount of overcharge is $621,737 for FY 2007-08 through FY 2009-10.

- The city improperly used $1,143,618 in funds from four assessment districts (Sanitation and Sewerage System, Refuse Collection, Recycling and Integrated Waste Management, and Landscape and Lighting) to pay for portions of payments to the former CAO and the Assistant CAO for regular and holiday pay, and pay in lieu of vacation. The California Constitution stipulates that charges against assessment districts must be directly related to services provided to the districts.

- Other unauthorized increases in pension assessment and business license taxes have had the effect of reducing General Fund pension obligations or enhancing General Fund revenues, which in turn provided greater flexibility to increase compensation. At least in appearance, this raised the question of whether the decisions to increase assessments and taxes were motivated by personal gain considerations. The amount of the unallowable pension assessment is $2,934,144 for FY 2007-08 through FY 2009-10. The estimated overcharge to the business license taxes is $2,105,441 for calendar years 2000 through 2010.

We recommend the City of Bell takes immediate action to institute a system of business policies, processes and procedures that will provide proper checks and balances over public assets and public funds. The city should take other measures to refund unallowable excess amounts of assessments and taxes collected and, to the extent possible, recoup any inappropriate payments or loans. Furthermore, the Director of Planning Services should be a city employee to avoid conflict of interest and save the city money. In addition, as certain matters disclosed in this report suggest possible intentional misuse of public funds that may involve collusive practices, we will provide copies of this report to all appropriate law enforcement agencies for consideration of additional investigation and possible legal action.

The above findings were discussed with the City of Bell management during an audit exit conference on September 16, 2010. In its response, included as Attachment E of this report, the city did not dispute any of the findings contained in this report but offered legal theories suggesting that at least some of the increases in the Sanitation and Sewerage assessments and business license taxes were justifiable and that these matters require further legal review. These are legal issues that the city ultimately must address with the citizens or the businesses that paid the higher assessments and taxes.

If you have any questions, please contact Jeffrey V. Brownfield, Chief, Division of Audits, at (916) 324-1696.

Sincerely,

Original signed by:

JOHN CHIANG
California State Controller

cc: The Honorable Edmund G. Brown, California Attorney General
The Honorable Steve Cooley, Los Angeles County District Attorney
Andre Birotte Jr., U.S. Attorney, Central District of California