

CITY OF LOS ANGELES
CALIFORNIA

BOARD OF NEIGHBORHOOD
COMMISSIONERS

LINDA LUCKS
PRESIDENT

REV. DR. LEWIS LOGAN
VICE PRESIDENT

ESTHER CEPEDA
DANIEL GATICA
EUN SOOK LEE
MICHELE SIQUEIROS

BIANCA VITE
COMMISSION EXECUTIVE ASSISTANT
TELEPHONE: (213) 485-1360



ANTONIO R. VILLARAIGOSA
MAYOR

DEPARTMENT OF
NEIGHBORHOOD EMPOWERMENT

334-B EAST SECOND STREET
LOS ANGELES, CA 90012

TELEPHONE: (213) 485-1360
TOLL-FREE: 3-1-1
FAX: (213) 485-4608
E-MAIL: done@lacity.org

BONGHWAN KIM
GENERAL MANAGER

www.LACityNeighborhoods.com

DRAFT FOR PUBLIC REVIEW, 90 DAY PUBLIC COMMENT PERIOD

June 16, 2008

Neighborhood Council Community,

Re: **Proposed Changes in the Funding Program**

In a letter dated April 8, 2008, the Mayor directed this department to ensure that the neighborhood council funding program has the highest standard of accountability for the expenditure of public funds. In response to the Mayor's specific direction, the department has examined the processes of the funding program and has asked the Controller and the Treasurer for their input.

The neighborhood council funding program should emphasize autonomy of neighborhood council priorities in spending allocated City funds, but there should be firm, uniform, and fully implemented processes to track how City dollars are spent. In other words, as long as neighborhood councils spend their funds for purposes consistent with law and policy, they should be free to do so. But at no time, should there be any doubt about where every single dollar can be found, and accounted for.

We will be proposing some changes to the administration of the funding program, which will be the subject of a 90 day public comment period during which the neighborhood councils and others can provide input before a final decision is made. With this letter, the 90 day period is underway. Please let us know what you think!

Summary of Recommendations

Recommendation #1: The neighborhood council funding program should emphasize autonomy of neighborhood council priorities in spending allocated City funds, but there should be firm, uniform, and fully implemented processes to track how City dollars are spent. In other words, as long as neighborhood councils spend their funds for purposes consistent with law and policy, they should be free to do so. But at no time, should there be any doubt about where every single dollar can be found, and accounted for.

Recommendation #2: With the help of the Controller, the Treasurer, and the City Administrative Officer (CAO), the Department of Neighborhood Empowerment (DONE) should collaborate with the neighborhood councils to develop a uniform, informative, and user-friendly system of budgeting and accounting.

Recommendation #3: DONE should revise its petty cash procedures in a manner consistent with standard practice at nonprofit organizations. These practices might include a lower petty cash limit, the prompt rejection of "missing receipt" verification forms, spot audits, purchasing standardization, segregation of purchasing/cash handling responsibilities from bookkeeping responsibilities, and use of alternatives such as a checking account. A tiered level of authority is needed so that the larger dollar purchases are authorized by the president or full board. Stronger procedures are also needed to insure that neighborhood council boards receive regular treasurer reports, and that boards know the status of all their finances, including petty cash.

Recommendation #4: Building on DONE's successful policy of posting credit card transactions online, DONE should post petty cash reconciliation statements, and further develop standards that will help neighborhood council boards to be fully informed of their finances.

Recommendation #5: Recognizing that incomplete materials contribute to the serious backlog of audits, and that they take up excessive staff time to correct, DONE should implement a policy of routinely rejecting audit materials from neighborhood councils when they fail to meet DONE requirements. While this authority already rests with DONE, there has been a reluctance to turn back such submissions. DONE should also implement a more vigorous and uniform training program that includes a simplified training manual and a training DVD.

Recommendation #6: DONE should develop a clear policy that insures that neighborhood council boards have (a) authorized their annual budget and any interim changes to it, (b) approved all expenditures, (c) assured themselves that expenditures are authorized under their approved budget, and (d) approved the financial documents that are submitted to DONE for audit.

Analysis and Recommendations for Policy Change

We set out to identify improvements that can simplify, streamline and strengthen the overall neighborhood council funding program. We do not analyze individual neighborhood councils, most of which follow all established rules and procedures; rather we focus on how to ensure that the entire system can achieve the highest standard of fiscal accountability.

Background

The Department of Neighborhood Empowerment was established in the 1999 Charter to help create, support, and empower neighborhood councils. In 2002 the Citywide System of Neighborhood Councils (The Plan) was amended to allow certified

neighborhood councils to spend money on operating expenses and neighborhood improvement projects. The City appropriated \$50,000 annually to each neighborhood council. We now have 88 certified neighborhood councils responsible for nearly \$4.5 million per year.

The Charter reformers who created DONE did not envision that this agency would also provide fiscal oversight to a neighborhood council funding program. As the agency closest to the neighborhood councils, DONE was the obvious candidate for this role. But DONE has had to stretch its resources to carry out its responsibility for helping promote the work of neighborhood councils, while also acting as fiscal overseer of a sprawling system of neighborhood council funding. Despite the growth of the funding program since 2002 the size of the DONE accounting staff has not increased.

The dual responsibility of enhancing the autonomy of neighborhood councils while acting as their fiscal overseer has at times created a conflict between DONE's roles as supporter of neighborhood councils and as "cop." This ambivalent or contradictory mission has made it difficult for DONE to ensure the integrity of the neighborhood council funding program. Furthermore, there has been a wide belief that the City should be cautious in its oversight of neighborhood councils, so as not to interfere with their independence.

In its yearlong review of the neighborhood council system, the Neighborhood Council Review Commission (NCRC) declared that DONE should principally emphasize its supportive role with neighborhood councils. However, the NCRC also noted that DONE is best situated to make certain that City funds provided to neighborhood councils are accounted for, and to do this DONE should work with neighborhood councils to devise and implement transparent systems for handling City monies.

When DONE identifies a deficiency in the transactions or records of a neighborhood council, it already has some authority to take corrective action. This authority includes:

- Requiring the neighborhood council to take mandatory supplemental training;
- Demanding that the neighborhood council submit a corrective action plan;
- Placing the neighborhood council on formal probation;
- Suspending or revoking a neighborhood council's access to funds;
- Recommending decertification to BONC; or
- Filing a criminal report with LAPD.

While these sanctions may seem impressive, the lack of a hierarchical model in the neighborhood council system make it difficult to match the sanctions to the needed reforms. The neighborhood council funding program is unlike any other fiscal process at City Hall. City budget and accounting systems do not neatly fit the requirements of neighborhood councils. Furthermore, as the 88 neighborhood councils became certified, each one developed a somewhat different system of budgeting and accounting. This diversity of accounting methods complicates the auditing workload of

DONE, and greatly reduces the ability of City policymakers to see how public funds are being spent.

Volunteer neighborhood councils have no employees, and their board members have varying levels of accounting and budgeting skill. Unless addressed, this situation has the potential to undermine the autonomy of neighborhood councils by raising doubts about how City funds are handled.

Some of the problems we identify in our analysis below are not new. But we propose addressing them in a more comprehensive way than has ever been done since the program began. The proposed actions include making procedural changes in the way both DONE and the neighborhood councils conduct business; making changes in some of the banking practices related to petty cash and credit card transactions; and instituting major systemic changes in the accounting, budgeting, and reporting processes used by DONE and the neighborhood council treasurers.

DONE has already taken two immediate actions to increase transparency and to prevent new problems from arising. In December of last year, we directed that all neighborhood council expenditures that were done by credit card be posted on the website. This decision will allow neighborhood council stakeholders and others to help DONE identify financial problems as they develop. The second decision was taken in June 2008, to impose a limit of \$500 per month for the withdrawal of cash, in preparation for developing a long-term policy on petty cash.

Recommendation #1: The neighborhood council funding program should emphasize autonomy of neighborhood council priorities in spending allocated City funds, but there should be firm, uniform, and fully implemented processes to track how City dollars are spent. In other words, as long as neighborhood councils spend their funds for purposes consistent with law and policy, they should be free to do so. But at no time, should there be any doubt about where every single dollar can be found, and accounted for.

Budget and Accounting

Each neighborhood council is expected to adopt a budget as the basis for its spending program. Those budgets are plans, and they should serve as an element of fiscal control, as well as a way of describing the purposes and accomplishments of neighborhood council programs.

Neighborhood council expenses generally fit one or more of the following broad budget categories: (1) operating expenses that enable a neighborhood council to conduct its business; (2) outreach expenses that allow the neighborhood council to engage its stakeholders; and (3) community improvement projects. But within these general categories, there is insufficient uniformity and detail. It is often difficult to identify programs and outcomes, and some spending is not easily traced to the budget or the neighborhood council board authorization. As the Controller's 2006 audit noted, "The budgets submitted by NCs are not performance based and serve little purpose."

In addition, two new programs will expand the neighborhood council funding program and add to the volume and complexity of accounting and budgeting work of DONE. A new donation ordinance will allow neighborhood councils to accept and spend donated funds, and a proposed "Neighborhood Purpose" grant program will permit neighborhood councils to give grants of up to \$5,000 to individual 501©(3) organizations and public schools.

The donation ordinance has been approved by the Council and signed by the Mayor, but the program has not yet been rolled out to the neighborhood councils. The Office of the Treasurer is still completing a Request for Proposal (RFP) process to select a financial institution that will participate in the donation program.

Both programs will require changes in the systems of budgeting and accounting used for the neighborhood council funding program. The grant program will require DONE staff to review proposed grants, process checks to grant recipients, track the grants, post them monthly to the website, report them as required to the Controller, and possibly audit grant recipients. The donation program will require that DONE staff review and track donor disclosure forms, monitor bank account activity, audit expenditures, and post donations.

To increase transparency of the neighborhood council funding program, DONE will soon begin posting neighborhood council budgets on line.

Recommendation #2: With the help of the Controller, the Treasurer, and the CAO, DONE should collaborate with the neighborhood councils to develop a uniform, informative, and user-friendly system of budgeting and accounting.

Expenditures

Neighborhood councils now have three ways to spend their City funds:

- *Warrant:* Neighborhood councils can request the City to pay a vendor by warrant. DONE accounting staff insures that the paperwork is in order, that the expenditure is within budget, and that the expenditure is within other guidelines before DONE asks the Controller to cut the check. The warrant system provides the highest level of fiscal accountability and control.

DONE staff recently met with the Controller's Office about the neighborhood council funding program. To deliver faster service to neighborhood councils, the Controller will assist DONE in streamlining the warrant payment process. We also will be evaluating the feasibility of issuing checking accounts to neighborhood councils as a way to reduce or eliminate the volume of Controller-issued advance payments.

- *Credit Card:* Neighborhood councils can purchase a good or service using a City-issued credit card. The credit card system provides a lesser degree of direct

oversight than warrants. Unlike warrants, DONE's involvement in credit card purchases occurs after the financial transaction takes place. DONE lacks real-time information about the transaction.

DONE has recently started posting end-of-month bank statements of neighborhood council credit card transactions on the DONE website. Our Funding Unit is also working with the bank card company to modify their procedures in order to flag credit card transactions that exceed certain thresholds, develop more comprehensive monthly statements, and establish protocols that would prevent excessive ATM cash withdrawals.

- *Petty Cash:* Neighborhood councils can pay a vendor out of petty cash (also called an "imprest account"), which the neighborhood council treasurer periodically replenishes by making ATM cash withdrawals using the City credit card. Payment by petty cash is convenient for small purchases of an immediate nature. But DONE's level of fiscal control over petty cash is low, and the transactions carry insufficient transparency and accountability. Neighborhood councils are allowed to maintain a petty cash account with a \$500 limit. DONE's policy allows a treasurer to withdraw a maximum of \$500 per 30-day cycle, but there is currently no process to prevent withdrawals that exceed the limit. While we develop a policy on petty cash, DONE has implemented a requirement that the bank not allow any cash withdrawal beyond \$500 per month.

In the nonprofit world, the size of a petty cash fund might vary from as little as \$100 to \$1,000 depending on the size of the organization. We would expect that an organization with an annual budget of \$50,000 would have a small petty cash fund for incidental expenses, especially when the neighborhood council has the ability to make purchases by warrant and credit card.

It is also standard practice among nonprofits that there be a separation of responsibilities for cash custody, bookkeeping, and purchasing. In neighborhood councils, these responsibilities often rest with the same person, the treasurer. We are evaluating policy alternatives that would separate these functions, but if they cannot be split, it will be even more important that DONE staff implement other controls, and develop the capacity to conduct field audits and spot checks.

The staff of DONE are working with the bank that issues neighborhood council credit cards to improve the information contained in their statements, and to identify alternative ways to electronically cap and control monthly petty cash withdrawals. A policy is also needed that establishes thresholds of authorization that increase as the dollar amount of financial transactions increase. For example, a treasurer could be authorized to make expenditures up to \$250, the Board president could be required to approve expenditures between \$250 and \$500, and the full board could be required to approve expenditures over \$500. Related to this, there is a need for a policy for certain red-flag purchases to be approved by the entire board (e.g.,

gasoline purchases, mileage reimbursement, and large food purchases.) A separate issue that needs to be addressed is the commingling of City funds with non-City funds. While DONE can issue bulletins reminding neighborhood councils that such practice is forbidden, DONE currently lacks the capacity to audit and enforce these requirements in the field.

Recommendation #3: DONE should revise its petty cash procedures in a manner consistent with standard practice at nonprofit organizations. These practices might include a lower petty cash limit, the prompt rejection of "missing receipt" verification forms, spot audits, purchasing standardization, segregation of purchasing/cash handling responsibilities from bookkeeping responsibilities, and use of alternatives such as a checking account. A tiered level of authority is needed so that the larger dollar purchases are authorized by the president or full board. Stronger procedures are also needed to insure that neighborhood council boards receive regular treasurer reports, and that boards know the status of all their finances, including petty cash.

Oversight

To monitor and control credit card transactions and related petty cash expenditures, DONE primarily relies on the following three measures:

- *Quarterly audits* are DONE's main line of oversight. At the end of each quarter, every neighborhood council must submit an itemized statement of expenditures for the quarter, together with all original receipts. The statement should list the items purchased with the City credit card, the amount of each purchase, and where the expenditures were approved in the neighborhood council's budget.

Ideally, DONE should review the quarterly audit material before it releases additional funds to the neighborhood council, but we have a large and growing audit backlog. Contributing to our backlog, some neighborhood councils submit audit materials that are incomplete and take excessive staff time to reconcile.

DONE is taking a series of steps to address the audit backlog. We recently reassigned staff to temporarily help pre-screen audit materials for our auditor. Deficient materials are being returned to the neighborhood council. We are also taking steps to eliminate the problem of excessive missing receipt affidavits. When the treasurer of a neighborhood council has trouble maintaining its own financial records, DONE proposes to begin mandating that the neighborhood council use its own funds to hire a DONE-approved temporary accounting service.

Over the years, DONE has created a series of programs, procedures, controls, and information bulletins to train, guide and oversee the neighborhood council boards, and their treasurers. But recognizing that treasurers are volunteers, we plan to summarize this information in a simple treasurer's guide. We will also be examining

alternatives that provide more efficient and convenient training to board treasurers. This includes developing a training tape or DVD.

- *On-site monitoring* can include a surprise cash-count of the neighborhood council's petty cash till and a review of its accounting ledgers. Although this is a standard practice in City departments where petty cash is used, and it is standard in the nonprofit industry, DONE is not currently able to do on-site monitoring because of workload priorities in other accounting areas. We are, however, in the process of modifying the duties and responsibilities of Neighborhood Empowerment Analysts (NEA) (formerly Project Coordinators) to aid DONE accounting staff in monitoring neighborhood council funding activity. We do not intend for NEAs to become accountants or detectives, but as DONE's only regular contact with neighborhood councils, it make sense to have them trained to understand the financial plans of their liaison assignments, to spot check neighborhood council records, and refer irregularities to DONE accountants for follow-up.
- *Online review* currently involves posting all monthly credit card statements of neighborhood councils on the DONE website. This is an innovation DONE implemented in December 2007 to promote transparency. Only bank statements are currently posted. No petty cash transactions are posted at this time, but we are working to do so. We are also training NEAs to be able to scan these petty cash postings, and refer irregularities to a DONE accountant for follow-up. Finally, we also are working with the financial institution that handles the City-issued credit cards to develop more detailed reports.

Recommendation #4: Building on DONE's successful policy of posting credit card transactions online, DONE should post petty cash reconciliation statements, and further develop standards that will help neighborhood council boards to be fully informed of their finances.

Recommendation #5: Recognizing that incomplete materials contribute to the serious backlog of audits, and that they take up excessive staff time to correct, DONE should implement a policy of routinely rejecting audit materials from neighborhood councils when they fail to meet DONE requirements. While this authority already rests with DONE, there has been a reluctance to turn back such submissions. DONE should also implement a more vigorous and uniform training program that includes a simplified training manual and a training DVD.

Neighborhood Council Board Funding Responsibility

Finally, we sometimes have difficulty determining whether neighborhood council expenditures are approved by their boards. We also find that some neighborhood council boards are not regularly updated on the status of their budget and expenditures. We need to develop and enforce a clear policy for how neighborhood council boards

approve expenditures, and how boards approve the audit materials that are submitted to DONE by their treasurers.

Recommendation #6: DONE should develop a clear policy that insures that neighborhood council boards have (a) authorized their annual budget and any interim changes to it, (b) approved all expenditures, (c) assured themselves that expenditures are authorized under their approved budget, and (d) approved the financial documents that are submitted to DONE for audit.

It is important that we receive comments from as many board members and stakeholders as possible on how to improve the funding program. DONE, along with the Board of Neighborhood Commissioners (BONC), will be organizing a number of community meetings for this purpose. We will also be requesting time on all neighborhood council board meeting agendas to solicit feedback. You may also forward your comments via email to Kevin McNeely at (done.funding@lacity.org). Please be sure to reference the **proposed funding program policy** in your response. We look forward to receiving your thoughtful comments on improving this very important resource for neighborhood councils throughout the city.

Sincerely,



BongHwan Kim
General Manager

CC: Antonio R. Villaraigosa, Mayor
Laura N. Chick, City Controller
Joya C. De Foor, City Treasurer