

# Capitola finances puzzled auditors

Capitola - 1990

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CAPITOLA — Auditors have offered a “qualified” opinion of Capitola’s finances, a finding the state Treasurer’s Office calls unusual for municipalities.

Hutchinson and Bloodgood, certified public accountants of Watsonville, issued that opinion of city financial statements for the year ending June 30, 1994, citing “uncertainties” in five areas. The audit, dated June 5, was released by city officials last week.

The uncertainties arise out of unresolved disputes over money that is owed to the city or by the city and the pending investigation into city handling of federal funds. The areas in question include:

- Municipal wharf finances.
- Accuracy of records for special assessment districts, which were formed to finance improvements such as sidewalks and streets.
- Accounting for proceeds of property that was bought with federal funds for low-income housing, and then sold.
- Transactions with the Soquel school district for a joint powers agency that runs a recreational program.
- The city’s default, or failure to meet conditions, of a \$10.2 million bond obtained in 1986.

This points out to a lender that unresolved issues exist, said Mike Machado, a partner in Hutchinson and Bloodgood.

All of these issues were detailed by the Sentinel in a special report seven weeks ago.



Westman



Hanna

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City Manager Susan Westman said the audit isn’t a surprise.

“I think that’s what everyone expected,” she said.

In private business, “qualified” opinions are issued when an irregularity is not cleared up, according to Jeffrey Scharf of Scharf Investments in Santa Cruz.

“It’s putting people who rely on an audit on notice that unresolved issues exist, and it’s a warning to them when dealing with the city on a financial matter,” he said.

For municipalities, such an audit is unusual, said Larry Kreig, attorney for the state Treasurer.

Orange County or some of the other municipalities in Southern California with bad investments may have received a similar designation on their reports, he said.

City Treasurer Glenn Hanna, the most vocal critic of Capitola’s financial practices, said a “qualified” opinion will make it “impossible and at best extremely difficult to borrow money,” he said.

“That remains to be seen,” said

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# Audit cites irregularities

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Vice Mayor Bob Garcia, adding that no decision has been made to even borrow funds.

City officials likely will have to explain the qualifications, but it shouldn't prevent the city from borrowing money, Westman said.

A financial recovery plan for the city is being prepared by Evensen Dodge Inc., of Costa Mesa. A firm representative is scheduled to report to council members this month. A workshop is tentatively set for Thursday. The plan is also scheduled to be discussed Aug. 24.

## Overspending and debt

Hanna said the Hutchinson and Bloodgood report paints a "dismal picture" of the city's financial state, adding, "It's the first one (audit) in a long time that makes any sense."

The audit, a snapshot of the city's finances at June 30, 1994, shows the city running a deficit of \$1.1 million on its \$6.2 million budget. The Redevelopment Agency ran a deficit of \$141,526 on a \$725,000 budget.

The city overspent in several areas. For example, in the general fund, \$13,500 was budgeted for debt principal, but \$77,000 was actually spent. No funds were budgeted for interest and fees on the debt, but \$90,800 was spent, the audit shows.

Westman and Mayor Margaret Fabrizio said they are reviewing the audit and its finding of deficit spending.

The audit also shows Capitola with about \$2.9 million in general fund assets and about \$2.2 million in liabilities.

"Clearly, at the time the city was solvent," Machado said.

Hanna, however, points out that the audit shows the city with only about \$400,000 in cash to cover the liabilities. The city does have about \$8 million in fixed assets such as property. The largest "short-term" liability is the city's debt to the Capitola Redevelopment Agency for \$1.5 million.

The city should be repaying the money as soon as possible, according to a May 8 letter from David Beatty, the Sacramento-based attorney for the Redevelopment Agency.

The financial plan will address the problem, Westman said.

A probe of records by city accountant Richard Standridge earlier this year revealed during the tenure of former city manager Steve Burrell, money was wrongfully transferred from the agency to the city coffers for several years.

Burrell resigned in October 1993 in the middle of the year being audited. Westman, who was planning director, filled in temporarily and was hired on a permanent basis in February 1994.

Audits for two previous years were performed by Maze & Associates of Walnut Creek, which resigned last year because of differences with Hanna, who says the firm didn't show sufficient diligence in uncovering the city's financial problems.

The Maze audits didn't mention any of the uncertainties cited by Hutchinson and Bloodgood.

"It's the first formal acknowledgment that the former accounting was in error," Hanna said of the new audit.

The City Council has asked the District Attorney's Office to determine whether any criminal or civil action should be taken against any party.

The audit, which was issued a year after the fiscal 1993-94 ended, was delayed while city staff dug through invoices and ledgers to determine what funds were spent where. The city wanted to put together accurate information for

the audit, said Westman.

"I'm just glad we have it," Garcia said.

The City Council will review the audit at a September meeting. The 1994-95 audit, which also is being done by Hutchinson & Bloodgood, may be ready at the same time, according to Westman.

## Why uncertainties exist

Some of the "uncertainties" in Capitola's finances stem from the \$10.2 million bond obtained in 1986. The money was supposed to be spent to refinance two earlier debts, build seven units of low-income housing on 38th Avenue, spruce up streets near 41st Avenue and buy a right-of-way for a loop road joining 41st Avenue with Capitola Road.

Instead, some of the bond proceeds were spent on projects not listed in the borrowing agreement, including \$1.45 million to buy property at Clares Street and Wharf Road.

City officials have since been asked to comply with the terms of the bond, but "appropriate corrective legal action(s) to remedy the default have not yet been determined," the audit said. The city owed \$8.77 million on the bond as of June 30, 1994.

The city's bond rating service, Standard and Poors issued a "credit watch" for the bond in April after learning the city was not in compliance. The status of the bond remains the same, Jeff Thiemann, S&P director, said Tuesday.

What the new audit means for the city remains unclear, he said, explaining that officials take each case on its own merits.

Another unresolved issue is accounting for \$150,000 awarded in 1981 by the federal Department of Housing and Urban Development to buy property on 38th Avenue for low-income housing. The housing was never built, and the city sold the land for \$277,000 with the money going to the general fund.

"It has not yet been determined whether or not the sale proceeds must be returned to the federal government; turned over to another agency; or retained by the city," said the audit.

HUD officials said Thursday the matter remains under review.

The city hasn't reached an agreement with the Soquel Elementary School District over a Joint Powers Agency that provides recreational, educational and day care services to the public. As of June 30, 1994, the city had recorded about \$125,000 in advances to the JPA, half of that sum coming from the school district. The school district questions whether it owes any money, however.

"The city may be entitled to full or partial reimbursement of these advances, however, collectibility is uncertain," the audit said.

Other uncertainties include how much money should have been in the wharf fund as of June 30, 1994 and the accounting of several special districts.

"The city may have used wharf proceeds incorrectly" to service debt, the audit said. The city eliminated a trust fund for wharf operations in violation of an agreement with the State Lands Commission, but it has since been re-established, the audit noted.

As for the special assessment districts, the audit noted certain funds have cash excesses or shortages although "special assessment funds generally should not contain significant cash balances."

Money to do the work in a special assessment district is obtained from bond issues. Bond payments are financed by special assessments that are collected with property taxes, with the city handling

the money.

Standridge soon will be looking at the areas that remain in question. He is helping the city establish a new accounting system, according to Westman.

The city staff has done a full internal accounting, according to Hutchinson and Bloodgood. For example, the city reviewed issues with the Redevelopment Agency and addressed them, Machado said.

"I think everything is open for public information," Machado said. "Certain items have not been completely analyzed yet, but they are in the process of being analyzed ... Each one will be resolved in due course."