

**The Association of Bay Area Governments and
ABAG Finance Authority for Nonprofit Corporations
Internal Investigation and Forensic Review
Internal Controls Observations and
Recommendations**

Issued by:



O R R I C K



December 15, 2015

Orrick, Herrington, & Sutcliffe, LLP and FTI Consulting, Inc. (together “the Investigative Team”) were retained to review the events surrounding defalcations by Clarke Howatt and to conduct testing to determine if other thefts had taken place. In connection with that review, below is a list of recommended remedial measures. This document is intended to provide ABAG and FAN with a list of remedial measures that will improve the control environment and reduce the risk of theft in the future by enhancing and strengthening internal processes.

I. GENERAL

1. **Advice and Routine Training:** FAN should consider retaining a Municipal Advisor (as defined in Section 15b of the Securities Exchange Act) to serve as a resource to internal personnel and the Executive Committee to support current knowledge of municipal finance principles and processes relating to administration of special tax districts. Meetings with the Municipal Advisor could occur on a regular basis, such as quarterly, semi-annually, or annually and on an as needed basis. In addition, FAN should provide periodic training relating to municipal finance matters, conducted by the Municipal Advisor or another qualified third party.
2. **Documentation of Controls:** ABAG and FAN policies, procedures, guidelines, and checklists, including those referred to herein, should be documented, approved by the ABAG Legal Counsel and/or FAN General Counsel, and saved in a central location. Such documents should be reviewed and updated periodically.
3. **Related Consultants:** FAN should consider retaining a consultant with a background/expertise in CFDs (Mello-Roos financings) and assessment districts (1913/1915 Act financings) who can advise on administration, recordkeeping and accounting procedures related to FAN’s role in connection with these districts.

II. RECORDKEEPING

4. FAN should enhance its document retention policy to specify how long bank account statements and other documentation relating to bond transactions should be maintained.
5. Statements relating to all bond bank accounts for CFDs and assessment districts (including trustee and deposit accounts) should be delivered directly to and maintained by the accounting department, specifically the individual performing reconciliations on these statements. The person who maintains these accounts should not have signature authority over the accounts. Statements should be kept in an organized fashion that permits timely/efficient access when needed.
6. The accounting department should receive a breakdown of tax collections from the service provider (e.g. NBS) and the amounts collected for debt service, administrative fees and costs.

III. ADMINISTRATION OF CFDS AND ASSESSMENT DISTRICTS

7. FAN should establish internal written guidelines for administering real property improvement districts, including Community Facilities Districts (Mello-Roos financings) and Assessment Districts (1913 Act/1915 Act financings). These guidelines should affirm the

public purpose of the district and should include a list of considerations for FAN in administering the district, such as:

- a. preserving the creditworthiness of the district and the bonds;
- b. considering the tax burden on owners in the district;
- c. preparing the district to withstand negative market conditions;
- d. minimizing year-over-year fluctuations in tax assessments; and
- e. collecting administrative fees and costs to support effective administration of the district.

IV. DEPOSIT AND TRUSTEE BANK ACCOUNTS

These recommendations relate to all bond deals and related accounts where FAN has control over or input into disbursements or transfers, such as CFDs and Assessment Districts.

8. ABAG and/or FAN should maintain a Transaction Account List and Signature Authority of all accounts relating to the bond transaction containing key information, including: account number, account name, description/purpose, signature authority, and date opened. This document should be maintained internally and shared with the Trustee/Financial Institution.
9. Modifications to the Transaction Account List and Signature Authority should require two signature approvals from 1) the ABAG Finance Director/FAN CFO and 2) the ABAG Legal Counsel and/or FAN General Counsel or ABAG Executive Director/FAN President. The second approver/signature should not be someone who is listed as a signatory on the accounts.
10. Within 30 days of the closing of the bond transaction, FAN should establish a List of Approved Payees who may receive disbursements from accounts relating to the transaction (including Trustee or deposit accounts).
 - a. The list should include the business name, address, bank account number, contact name, and phone number of each payee.
 - b. The initial list should be prepared by or under the direction of the Finance Director. The accounts payable department should review each party on the list and verify the information. Following the verification performed by accounts payable, the list should be reviewed and approved by the Finance Director and one of the following: CFO, Deputy Director, or Executive Director.
 - c. Modifications or additions to the List of Approved Payees should follow the same process.

11. FAN should document its internal process in a Policy on Bond Disbursements and Transfers to require two signature approvals for all requests to disburse or transfer funds from accounts (including Trustee and Deposit accounts). The written Policy should include the following:
 - a. Two signatures should be required, one from the requestor (e.g. Finance Director) and one from an Approving Party (e.g. CFO or CFO's delegate).
 - b. The Approving Party should complete an Approval Procedures Checklist (see Recommendation No. 13 below), which should be maintained internally along with the disbursement request and supporting documentation (e.g. invoices).
12. FAN should document an Approval Procedures Checklist, which should include the following steps:
 - a. Ensure the intended recipient of the disbursed funds is included in the List of Approved Payees and the bank account information on the requisition matches the information contained in the List of Approved Payees.
 - b. Verify that amounts on the requisition are supported by invoices provided by the payee.
 - c. Ensure completeness of the requisition package, including that schedules referred to within the documents are attached.
 - d. Verify the request is described in sufficient detail.
13. FAN should maintain non-Trustee accounts relating to a bond transaction (such as custody or deposit accounts) at the same institution as the Trustee.
14. Non-Trustee accounts, such as custody or deposit accounts, should be treated and accounted for in the same manner as other FAN bank accounts (e.g. Bank of the West). For example, bank reconciliations should be performed by the FAN accounting department on a regular and timely basis. These accounts should be included in FAN's books and records (audited financial statements).