

June 30, 2004

Debra K. Davenport, CPA
Auditor General
2910 North 44th Street Suite 410
Phoenix, AZ 85018

Dear Ms. Davenport:

Re: Auditor General's Recommendations to the Performance Audit of Gila County's
Transportation Excise Tax.

**RESPONSE TO THE OFFICE OF THE AUDITOR GENERAL'S FIRST
RECOMMENDATION**

Gila County will ensure that excise tax monies are used only for street and highway purposes and transportation projects.

With the assistance of the Gila County Attorney's office we will create a policy identifying the statutes and explanations of the expenditures that are appropriate uses of Road Fund monies. This will be approved by the Gila County Board of Supervisors and provided to the Public Works Division officials who are responsible for approving Road Fund expenditures. We anticipate this policy to be written and approved by September 30, 2004.

**RESPONSE TO THE OFFICE OF THE AUDITOR GENERAL'S SECOND
RECOMMENDATION**

The Auditor General's second recommendation is stated as follows:

2. Using the policy regarding appropriate uses of Road Fund monies, Gila County should determine the magnitude of the monies spent inappropriately and then reimburse the Road Fund accordingly with revenue from its General Fund or other unrestricted revenue sources.

Gila County's response addresses the Auditor General's second recommendation as two separate issues.

First issue: determine the magnitude of the monies spent inappropriately; and,

Second issue: reimburse the Road Fund accordingly with revenue from its General Fund or other unrestricted revenue sources.

MAGNITUDE OF MONIES SPENT INAPPROPRIATELY

Gila County agrees with the Auditor General's finding of some questionable expenditures in the amount of \$46,469 that do not meet the definition of street and highway purposes.

The results from the non-statistical sampling supports the Auditor General's assertion that Gila County's internal controls were weak prior to fiscal year 2003. Gila County became aware of this internal control weakness and took appropriate action to resolve this situation.

REIMBURSE ROAD FUND ACCORDINGLY WITH REVENUE FROM ITS GENERAL FUND OR OTHER UNRESTRICTED REVENUE SOURCES

As previously presented regarding the negligible expenditures inappropriately charged to the Road Fund (a.k.a. Public Works) for fiscal years 1998 through 2004, Gila County has over the same time period subsidized the Road Fund for \$1,761,889 which is significantly greater than the \$46,469 questioned by the Auditor General.

This subsidy was in the form of indirect costs associated with the Road Fund. The Federal Government has provided a procedure whereby indirect costs can be identified and allocated to direct costs that benefit from those indirect efforts. This procedure is provided by the Office of Management and Budget as the preferred method to determine indirect costs allowable under Federal Government Grants. This method is titled OMB Circular A-87. Over the past ten years, Gila County has contracted with an outside agency from the state of Washington to prepare an A-87 Cost Allocation Plan in accordance with the OMB Circular.

The indirect cost associated with the Road Fund as determined by the A-87 Cost Allocation method is presented in the following schedule for the fiscal years under review.

| Fiscal Year | Indirect Costs | | |
|-------------|---------------------|-------------------|---------------------|
| | Not Allocated | Allocated | Subsidized |
| 1998 | \$ 351,860 | \$ - | \$ 351,860 |
| 1999 | 416,393 | - | 416,393 |
| 2000 | 349,237 | - | 349,237 |
| 2001 | 437,760 | - | 437,760 |
| 2002 | 325,988 | 122,615 | 203,373 |
| 2003 | 418,222 | 415,000 | 3,222 |
| 2004 | 365,044 | 365,000 | 44 |
| Totals | <u>\$ 2,664,504</u> | <u>\$ 902,615</u> | <u>\$ 1,761,889</u> |

Gila County has not allocated the indirect costs attributable to the Road Fund for the years prior to 2002 and only a portion of the attributed indirect costs for the year 2002. Beginning with fiscal year 2003, Gila County began allocating all indirect costs attributed to the Road Fund.

The reason behind the decision to begin allocating those indirect costs attributed to the Road Fund in fiscal year 2002 was due to County Management identifying expenditures being made to provide services to constituents within Gila County's three Districts that were outside the definition of street and highway purposes. Gila County recognized during fiscal year 2001 that expenditures were being charged to the Road Fund that would be considered inappropriate.

At this time County Management decided to consolidate three Road Fund departments into one and create three new departments separate from road efforts. The following three departments were consolidated into 510 Consolidated Roads. These three departments were 511 Road Department – District One, 512 Road Department – District Two, and 513 Road Department – District Three.

The three new departments are 541 Constituent Services 1, 542 Constituent Services 2, and 543 Constituent Services 3. These three departments were created to accumulate expenditures that would not be considered allowable under the Road Fund. However, these three newly created departments remained under the Road Fund during fiscal year 2002 and were funded through partial identification of indirect costs attributed to the Road Fund as identified under the OMB A-87 Cost Allocation Plan. Based on the type of expenditures being made by the County Supervisors on behalf of their constituents, County Management decided to move those departments out of the Road Fund to the General Fund in fiscal year 2003 and to charge the Road Fund for its total indirect costs identified in the OMB A-87 Cost Allocation Plan.

RESPONSE TO THE OFFICE OF THE AUDITOR GENERAL'S THIRD RECOMMENDATION

Gila County is implementing steps to demonstrate the impact that the Transportation Excise Tax is having on helping solve transportation problems.

Gila County is working with the Arizona Department of Transportation on an update of the County-wide transportation plan. The study is expected to begin in the fall of 2004. We will provide a schedule once it has been finalized.

Gila County needs to take steps to ensure it can demonstrate the impact of the excise tax through proper recordkeeping. The revenues are identified individually at this time but until now the expenses were not identified separately. We will begin identifying projects in the Capital Improvement Program to be identified out of the Excise Tax. Gila County is implementing a new financial accounting software program that will enable more efficient project tracking that will track labor, material, equipment and other associated costs. This will enable us to track expenses such as contracted and non-contracted road projects and general road maintenance.

A portion of the Excise Tax will be used to repay the state funded H.E.L.P. loan for the Fossil Creek project completed in June, 2004. There are other state funded H.E.L.P. projects planned that will use Excise Tax Revenue in the future. Major construction and paving maintenance projects will be identified in the budget planning process each fiscal year out of the Excise Tax revenue. The Public Works Division is creating new policies and procedures to track expenditures identified to the various road projects in Gila County to show the impact of the Excise Tax and other Road Fund monies.

CONCLUSION

Gila County agrees to further establish more questionable expenditures on our own. We will create an internal audit procedure and present it to Dot Reinhardt at the Attorney General's Office when our plan is ready. This will occur by mid December 2004.

Gila County has two proposals to deal with the Auditor General's findings regarding expenditures that did not meet the definition of street and highway purposes. We will also use one of these methods once we perform an internal audit and determine the extent of our findings.

1. Gila County will charge the Road Fund for indirect costs in the amount of \$1,761,889 and reimburse the Road Fund for the inappropriately spent monies.

Or

2. Gila County was deemed to have acted in good faith through subsidizing the Road Fund in the amount of \$1,761,889 by not charging indirect costs attributed to the Road Fund for the years 1998 through 2002. With the understanding that the deferred indirect costs would have more than offset any incidental expenditures deemed not to meet the definition of street and highway purposes.

This good faith is also evidenced by Gila County becoming aware of the inappropriate use of Road Fund monies during fiscal year 2001 and the correction of this problem through the consolidation of three road departments into one and the creation of three new departments under the General Fund to accumulate those expenditures deemed inappropriate road expenditures.

Sincerely,

John F. Nelson
Gila County Manager

By: _____
Jacque Griffin
Assistant County Manager

JG:sc

CC: José M. Sanchez, Chairman of the Board of Supervisors