

*Proprietary & Confidential*  
PRELIMINARY REPORT

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# **CITY OF CUPERTINO**

## **SPECIAL REVENUE FUND PROCESS REVIEW**

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# Table of Contents

<b>I. Executive Summary</b>	<b>1</b>
A. Introduction	1
B. Summary of Observations and Recommendations	1
<b>II. Background, Scope, and Methodology</b>	<b>2</b>
A. Commendation	4
<b>III. Summary of Special Revenue Fund Expenditure Controls</b>	<b>5</b>
<b>IV. Summary of Testwork</b>	<b>6</b>
<b>V. Observations and Recommendations</b>	<b>8</b>
A. Process Documentation and Training	8
<b>VI. Additional Process Improvement Opportunities</b>	<b>9</b>
<b>VII. Process Map: Invoice Processing</b>	<b>11</b>

# I. EXECUTIVE SUMMARY

## A. INTRODUCTION

As part of the City of Cupertino's (the City's) fiscal year (FY) 24–25 internal audit program, Moss Adams LLP (Moss Adams) conducted a special revenue fund process review. The purpose of this engagement was to document the process used for special revenue fund accounting, identify gaps compared to best practices, and conduct testing of prior years' accounting. We conducted this engagement between August 2024 and April 2025 using a four-phased approach consisting of project initiation and management, fact-finding, analysis, and reporting.

## B. SUMMARY OF OBSERVATIONS AND RECOMMENDATIONS

Observations and recommendations are summarized below.

OBSERVATIONS AND RECOMMENDATIONS		
PROCESS		
1.	Observation	Processes and controls exist to ensure only allowable expenditures are recorded to special revenue funds, but some processes and controls are not well-documented. Gaps in documentation, staff knowledge, and training led to miscoding expenditures to a special revenue fund in FY24.
	Recommendation	<ul style="list-style-type: none"><li>• Verify the processes and controls that ensure only allowable expenditures are recorded to special revenue funds are well-documented and easily replicable.</li><li>• Conduct and document staff training on permitted uses of all special revenue funds.</li></ul>

## II. BACKGROUND, SCOPE, AND METHODOLOGY

Moss Adams conducted this special revenue fund process review for the City as part of its FY24–25 internal audit program. Special revenue funds are established to account for the proceeds of specific revenue sources that are legally restricted for expenditures for particular purposes. As of FY24–25, the City tracks 10 designated special revenue funds; some of these funds are grouped for Annual Comprehensive Financial Report (ACFR) purposes, as shown in the table below.

CITY OF CUPERTINO SPECIAL REVENUE FUNDS		
ACFR Grouping	Special Revenue Fund with General Ledger Fund Code	Purpose of Fund
<b>Storm Drain Improvement Special Revenue Fund</b>	210 Storm Drain Improvement	Accounts for the construction and maintenance of storm drain facilities, including drainage and sanitary sewer facilities. Projects are funded by the Capital Reserve.
	215 Storm Drain	Accounts for revenues from developers as a result of connections to the storm drainage sewer system.
<b>Environmental Management/Clean Creeks Special Revenue Fund</b>	230 Environmental Management/Clean Creek/Storm Drain	Accounts for activities related to operating the Non-Point Source Pollution Program. Revenues are from parcel taxes.
<b>Housing Development Special Revenue Fund</b>	260 Community Development Block Grant (CDBG)	Accounts for the Federal Housing and CDBG Program activities. CDBG is a federally funded program for housing assistance and public improvements.
	261 Housing and Community Development (HCD) Loan Rehab	Accounts for activities related to rehabilitation loans.
	265 Below Market Rate (BMR) Housing	Accounts for activities related to the BMR Housing Program. Revenues include BMR housing mitigation fees collected from developers to mitigate the impact of housing needs. Monies in this fund are governed by the program's rules.
<b>Transportation Special Revenue Fund</b>	270 Transportation	Accounts for the City's gas tax, vehicle registration fees, and grant revenues and expenditures related to the maintenance and construction of City streets. All revenue in this fund is restricted exclusively for street and road purposes, including related engineering and administrative expenditures.
<b>Traffic Impact Special Revenue Fund</b>	271 Traffic Impact	Accounts for development impact fees to ensure that new development and redevelopment projects pay their "fair share" to mitigate traffic impacts.

CITY OF CUPERTINO SPECIAL REVENUE FUNDS		
ACFR Grouping	Special Revenue Fund with General Ledger Fund Code	Purpose of Fund
Park Dedication Special Revenue Fund	280 Park Dedication	Accounts for the activity granted by the business and professions code of the State of California in accordance with the open space and conservation element of the City's General Plan. Revenues are restricted for the acquisition, improvement, expansion, and implementation of the City's parks and recreation facilities.
	281 Tree	Accounts for revenues from in-lieu tree replacement fees and tree damage and removal fees. The revenues are transferred to the Street Tree Maintenance Program to pay for new and replacement trees.

Our project objectives for this engagement included the following:

- Document the process used for special revenue fund accounting
- Identify gaps compared to best practices
- Conduct testing of prior years' accounting
- Develop actionable recommendations for consideration by management

This analysis was informed by staff interviews, document reviews, research on industry best practices, and testing of a sample of expenditure transactions. The study was conducted between August 2024 and April 2025, and consisted of four major phases:

1. **Project Initiation and Management:** This phase concentrated on comprehensive project planning and project management, including setting the scope, identifying staff to interview and documents to review, communicating the plan, and establishing a game plan for execution.
2. **Fact-Finding:** This phase included staff interviews, document reviews, research on industry best practices, and testing of a sample of expenditure transactions. We worked with City staff to obtain the most currently available information and insights.
  - **Staff Interviews:** We conducted interviews with six staff members. We included representation from City leadership and departments such as Public Works and Community Development.
  - **Document Review:** We reviewed documents, including policies and procedures, City resolutions and other regulatory documents, and prior reports pertaining to special revenue funds.
  - **Industry Best Practice Research:** Based on the opportunities for improvement identified, we conducted research to ascertain industry standards and best practices.
  - **Testing of Expenditure Transactions:** We obtained expenditure details for FY23–24, validated the completeness of the expenditure population, and judgmentally selected a sample of 22 transactions for testwork.

3. **Analysis:** This phase served as the assessment portion of the project. Based on the information gathered, we evaluated the importance, impact, and scope of our observations in order to draw conclusions and develop process recommendations.
4. **Reporting:** This phase concluded the project. We reviewed draft observations and recommendations with City leadership to validate facts and confirm the practicality of recommendations.

## A. COMMENDATION

Although the focus of the engagement was to identify areas that need improvement within the special revenue fund process, it is important to note the areas of strength that can be leveraged for further improvement within the City. The Moss Adams team would like to note the following commendation:

- **Commitment to Continuous Improvement:** In February 2024, the City was informed of an issue regarding the miscoding of transactions to the BMR Housing Fund, specifically transactions involving attorney fees. The City took immediate steps to implement additional controls for BMR fund invoice processing to prevent similar miscoding in the future. Additional controls included requiring a Director-level departmental review on invoices coded to the BMR fund. In addition, City staff conducted a review of all transactions processed to the BMR Housing Fund from 2019 to 2024, and Community Development held a number of meetings to educate department personnel on the process for recording and regulations related to BMR expenditures. These actions demonstrate a commitment to continuous process improvement and strengthening controls by Community Development and Finance.

We would like to commend City staff for their willingness to assist us in this assessment process. This commendation, coupled with our observation and recommendations, provide an overview of areas of strengths and weaknesses that can help improve operations and reduce risk at the City.

### III. SUMMARY OF SPECIAL REVENUE FUND EXPENDITURE CONTROLS

Accounts payable controls, budgeting controls, payroll controls, communication (particularly between departments and Finance), and staff education are critical to ensure that special revenue funds finance only the particular activities for which they are designated.

We noted that expenditures are posted against special revenue funds by the City in the following ways:

- Accounts payable/invoice processing
- Quarterly allocation of Citywide costs (cost allocation)
- Payroll
- Transfers between funds (transfers out)

A summary of controls within each of these processes is described in the table below. In addition, a map of the invoice processing process is included in [Section VII](#) of this report.

EXPENDITURE SOURCE	DESCRIPTION OF CONTROLS
Invoice Processing	<p>Invoices are processed and coded at the department level and subject to three levels of review after coding: departmental supervisor review (at the individual invoice level), AP review (at the individual invoice level), and Finance Manager review (at the payment batch level). See <a href="#">Section VII</a> of this report for a process map.</p> <p>Additionally, expenses are budgeted by fund annually and budget-to-actuals are monitored by departments as well as by Finance. Within the invoice coding process, the system compares the expense that the department is trying to encumber against the budget for that string. Finance override is needed for transfers between account strings within each fund; departments cannot transfer budgeted amounts between funds or exceed budgeted encumbrances.</p>
Cost Allocation	<p>A Cost Allocation Plan is created by Finance to allocate Citywide central service and administrative expenses to departments/funds based on a number of allocation formulas/bases. Cost allocation expense is posted quarterly. Finance reviews and updates allocation formulas periodically to ensure that allocations are fair and not charged to funds that cannot be used for administrative expenses.</p>
Payroll	<p>Employee timesheets are reviewed and approved by supervisors prior to payroll processing. Each employee's time is designated to a fund (or funds) during the annual budgeting process, based on employee job duties. Payroll budget-to-actuals are monitored by departments as well as by Finance.</p>
Transfers Out	<p>In most cases, transfers are included within budget modification resolutions, which are prepared by Finance and approved by City Council.</p>

## IV. SUMMARY OF TESTWORK

Moss Adams obtained expenditure detail for FY24, validated the completeness of the expenditure population, and judgmentally selected a sample of 22 transactions for testwork. This sample included 17 transfer and expenditure transactions, three payroll transactions, and two cost allocation transactions. A summary of testwork results by special revenue fund grouping is presented below.

CITY OF CUPERTINO SPECIAL REVENUE FUNDS				
ACFR Grouping	Special Revenue Fund with General Ledger Fund Code	Summary of Expenditure and Transfer Testwork	Summary of Payroll Testwork	Summary of Cost Allocation Testwork
Storm Drain Improvement Special Revenue Fund	210 Storm Drain Improvement	We judgmentally selected and tested one transfer and two expenditure transactions posted to these funds during FY24. Transfers and expenditures were supported by documentation and approvals. Transactions appeared allowable based on Municipal Code 3.36.010 and 3.36.170 and associated City resolutions.	We noted no payroll expenses posted to these funds during FY24.	We noted no quarterly cost allocations allotted to these funds during FY24.
	215 Storm Drain			
Environmental Management/Clean Creeks Special Revenue Fund	230 Environmental Management/Clean Creek/Storm Drain	An agreed upon procedure (AUP) engagement is completed each year by an independent third party to assess the allowability of expenditures, including payroll transactions, posted to this fund. We reviewed the most recent four years of finalized AUP reports and noted no exceptions. Expenditure allowability is guided by Municipal Code 3.38.010 and 3.38.160.		
Housing Development Special Revenue Fund	260 Community Development Block Grant	We judgmentally selected and tested one transfer and four expenditure transactions posted to funds 260 and 265 during FY24. We noted no expenditures or transfers out from fund 261 during FY24. Transfers and expenditures were supported by documentation and approvals. Four of five transactions appeared allowable based on the CDBG Annual Action Plan and the BMR Housing Mitigation Program Procedural Manual. For one of five transactions tested, additional narrative information was required from Finance and Community Development	We judgmentally selected one FY24 payroll transaction for testwork. We verified that the employee timesheet was approved, and labor allocated between funds 260 and 265 appeared reasonable based on employee's approved Personnel Action Form. We noted no payroll	We traced the FY24 cost allocation allotted to fund 265 to the Cost Allocation Plan provided by Finance. We noted no cost allocated to funds 260 or 261. We noted that allocated costs appeared reasonable, and we confirmed that the BMR Housing Mitigation Program Procedural Manual allows
	261 Housing and Community Development (HCD) Loan Rehab			
	265 Below Market Rate (BMR) Housing			



CITY OF CUPERTINO SPECIAL REVENUE FUNDS				
ACFR Grouping	Special Revenue Fund with General Ledger Fund Code	Summary of Expenditure and Transfer Testwork	Summary of Payroll Testwork	Summary of Cost Allocation Testwork
		in order to support allowability. This is not considered an exception. See the <a href="#">Additional Process Improvement Opportunities</a> section for a recommendation related to this sample.	expenses posted to fund 261 during FY24.	for administrative costs to be charged to the fund.
<b>Transportation Special Revenue Fund</b>	270 Transportation	We judgmentally selected and tested five expenditure transactions posted to this fund during FY24. Expenditures were supported by documentation and approvals. Expenditures appeared allowable based on Municipal Code 14.02.010 and 14.02.080.	We judgmentally selected one FY24 payroll transaction for testwork. We verified that the employee timesheet was approved, and labor allocated to fund 270 appeared reasonable for the selected sample based on employee job title.	We traced the FY24 cost allocation allotted to fund 270 to the Cost Allocation Plan provided by Finance. We noted that allocated costs appeared reasonable, and we confirmed that Municipal Code 14.02.080 allows for administrative costs to be charged to the fund.
<b>Traffic Impact Special Revenue Fund</b>	271 Traffic Impact	We noted no expenditures or transfers out from this fund during FY24. Further testwork was not considered necessary.		
<b>Park Dedication Special Revenue Fund</b>	280 Park Dedication	We judgmentally selected two transfers and two expenditure transactions posted to these funds during FY24. Transfers and expenditures were supported by documentation and approvals. Transactions appeared allowable based on Municipal Code 13.08.060, 14.05.030, and 14.05.100.	We noted no payroll expenses posted to these funds during FY24.	We noted no quarterly cost allocations allotted to these funds during FY24.
	281 Tree			

# V. OBSERVATIONS AND RECOMMENDATIONS

Based on the input gathered from interviews, document review, and review of expenditure transactions as well as comparisons to best practices, we prepared the following observation and recommendation.

## A. PROCESS DOCUMENTATION AND TRAINING

1.	Observation	Processes and controls exist to ensure only allowable expenditures are recorded to special revenue funds, but some processes and controls are not well-documented. Gaps in documentation, staff knowledge, and training led to miscoding expenditures to a special revenue fund in FY24.
	Recommendations	<ul style="list-style-type: none"><li>• Verify the processes and controls that ensure only allowable expenditures are recorded to special revenue funds are well-documented and easily replicable.</li><li>• Conduct and document staff training on permitted uses of all special revenue funds.</li></ul>

Accounts payable controls, budgeting controls, payroll controls, communication, and staff education are critical to ensure that special revenue funds finance only the particular activities for which they are designated. Interviewees reported that controls are in place and that special revenue fund expenditures are reviewed by individuals with knowledge to assess their allowability. In cases where expenses are allocated between funds, interviewees reported that allocation is consistent.

However, in FY24, the City experienced an incident involving the coding of unallowable expenditures to a special revenue fund. This incident indicated a gap in internal controls and a lack of staff training related to permissible uses of the BMR fund.

The City took steps to correct the miscoding and implement additional controls for the BMR fund as a result of this discovery. Additional controls included the following:

- A Director-level review is required on each BMR invoice, which is checked manually by Finance.
- Additional education was given to Community Development personnel regarding permissible uses of BMR funds.

While we commend the City for these corrective actions related to the BMR fund, the City should also consider the following:

- Where the City has processes and controls in place for special revenue funds that ensure only allowable expenditures are recorded, the City should verify that the processes and controls are well-documented and easily replicable. This is particularly important for manual controls. When processes and controls are not well-documented, there is a risk of inconsistent practices by City personnel and knowledge loss during staff turnover.
- The City should provide staff training related to each special revenue fund, including instructions on permissible uses of funds. The City should record or document this training and store it in a central location as well as require departmental and Finance staff to participate in this training.

## VI. ADDITIONAL PROCESS IMPROVEMENT OPPORTUNITIES

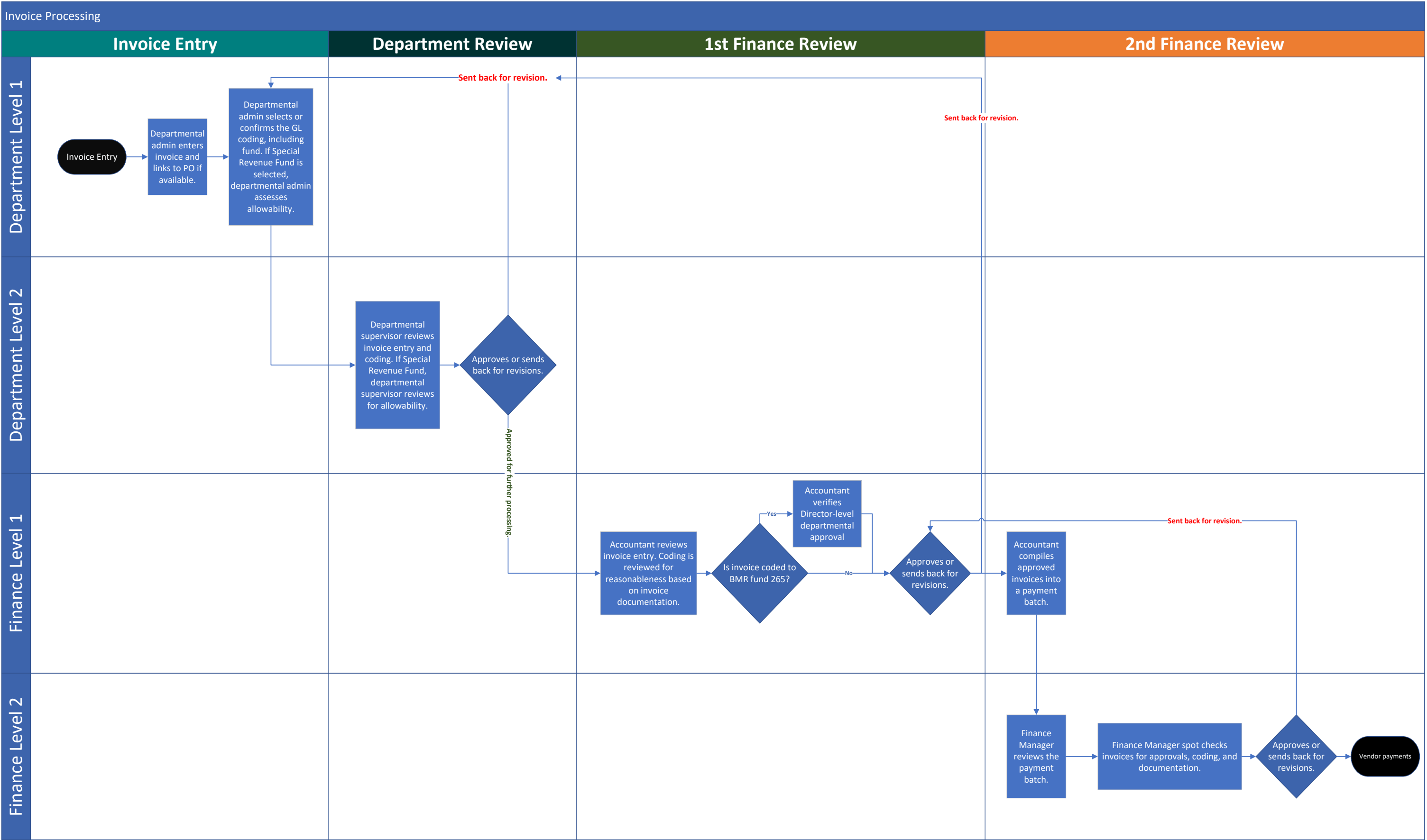
Moss Adams identified the following two opportunities for process improvement as a result of this review.

NO.	CATEGORY	PROCESS IMPROVEMENT RECOMMENDATION
1	Allowability of Expenditures	<p>For one of five expenditure samples tested for Fund 265, we were unable to confirm the allowability of the expenditure transaction based on a review of the BMR Housing Mitigation Program Procedural Manual, section 2.2.2 Permitted Use of Fees, and the invoice documentation. For this sample, additional narrative information was obtained from Community Development to substantiate the connection between the expenditure and the list of permitted fees.</p> <p>Section 2.2.2.A, Permitted Use of Fees, states, “Affordable housing mitigation fees deposited into the BMR AHF shall only be used for the provision of affordable housing in Cupertino.” Section 2.2.2.B lists example uses of the fund’s revenue. Some of these include land acquisition, new construction, substantial rehabilitation, BMR program administration, and down payment assistance. Section 2.2.2.C notes that a portion of the BMR AHF will be targeted to specific target populations.</p> <p>The invoice we reviewed as part of our expenditure sample included expenses related to the Haven to Home and Rotating Shelter Car Park programs. Expenses invoiced included case management, indirect administration costs, ready-to-cook food, insurance, car repair, and registration.</p> <p>Per inquiry with Community Development, “These programs [Haven to Home and Rotating Shelter Car Park] provide intensive case management and social services for the unhoused with the ultimate goal of helping them to secure permanent housing...[T]hese programs assist extremely low income and homeless persons find permanent housing, which makes it a qualified service that assist[s] in the provision of affordable housing.”</p> <p>While we accept Community Development’s explanation for these expenditures, we observe that some ambiguity exists in the link between the tested expenditures (e.g., ready-to-cook meals) and the “provision of affordable housing” as outlined in Section 2.2.2.A. Where ambiguity exists between permitted use of special revenue fees and City expenditures, we recommend the following:</p> <ul style="list-style-type: none"> <li>• Obtain and document City Attorney review of the proposed expenditure or expenditure category.</li> <li>• If appropriate, consider revising the BMR Housing Mitigation Program Procedural Manual to clarify permitted use of fees.</li> </ul>

NO.	CATEGORY	PROCESS IMPROVEMENT RECOMMENDATION
2	Roles and Responsibilities	<p>The City's Accounts Payable Processes and Procedures specify that City departments are responsible for coding invoices to appropriate budget line items (including fund number) that correspond to expenditures. Finance is responsible for verifying that general ledger accounts (including fund) appear appropriate.</p> <p>During the fieldwork portion of this engagement, we noted that Finance had difficulty identifying a complete list of departmental points of contact with whom we could discuss the process for posting expenditures to special revenue funds. While we were ultimately able to identify and connect with departmental points of contact, we recommend Finance maintain the following information centrally for each special revenue fund:</p> <ul style="list-style-type: none"> <li>• Regulatory documentation, such as Municipal Code section or City resolution, that guides the use of each special revenue fund</li> <li>• Department responsible for managing each special revenue fund</li> <li>• Position or person within department responsible for ensuring that invoices coded to special revenue funds adhere to regulatory requirements and restrictions</li> </ul>

## VII. PROCESS MAP: INVOICE PROCESSING

We mapped the invoice processing workflow to illustrate review and approval controls that occur during invoice processing. See next page.





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