

Final Audit Follow-Up

As of December 31, 2013



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City Auditor

Audit of Selected Stormwater Activity

(Report #1302 issued December 12, 2012)

Report #1407

January 16, 2014

Summary

Applicable City departments have completed and/or resolved each of the 21 action plan steps established to address issues identified in audit report #1302, Audit of Selected Stormwater Activity. Five of those action plan steps were completed and/or resolved during the period covered by this follow-up report.

In audit report #1302, we reported the financial aspects of the City's stormwater function were, overall, properly and adequately managed and administered. Operating costs were generally proper, allowable and reasonable. For the most part, operating revenues, including stormwater fees and revenues for contractual services rendered the State and County, were received and properly accounted for by City staff. Capital project activities and expenditures were generally proper and reasonable.

Areas were identified where improvements and enhancements were needed. Those areas included (1) charging salaries to appropriate funding sources; (2) capitalizing costs; (3) transferring funds based on the most appropriate information and methodologies; (4) documenting debt service payment allocations; (5) assessing stormwater fees on applicable premises; (6) calculating billing factors for stormwater fees; (7) pledging stormwater revenues to pay debt; (8) addressing structures located on properties for which easements are acquired; (9) obtaining approvals for settlement agreements; (10) addressing the significant accumulation of undesignated construction funds; and (11) addressing the status of balances in specific stormwater funds.

Recommendations were made to address those areas.

Twenty-one action plan steps were developed to address the identified risks. Our initial follow-up engagement and report (#1321) showed that applicable City departments completed 16 of those 21 action plan steps as of March 31, 2013. This second and final follow-up engagement and report shows City management and staff successfully completed and/or resolved the five remaining action plan steps. Actions taken to complete/resolve those five steps included:

- Made appropriate changes to stormwater staff timekeeping practices such that salaries and overhead pertaining to stormwater capital projects are now capitalized.
- Completed research of available records and information to determine the support for allocation among various City funds (including Stormwater Fund) of certain debt service payments; while that research showed specific support for the actual allocation percentages used was not available, it showed the allocations were substantially correct and accurate.
- Determined appropriate (equitable) shares of contractual revenues received from the County for City work on the St. Marks Trail that should be recorded in the City's General Fund and Stormwater Fund; and made the appropriate accounting entries to record the respective shares in those funds.
- Enacted changes to City Commission Policy 224, Financing the Government, that effectively eliminated the inconsistency

between applicable bond resolutions/covenants and the City's stormwater ordinance.

- Requested and obtained an exemption to the policy limitation on accumulation of undesignated stormwater construction funds as part of the fiscal year 2014 budget.

We commend City management and staff for the timely completion and resolution of the action plan steps. We appreciate the cooperation and assistance provided by applicable City departments during this follow-up engagement.

Scope, Objectives, and Methodology

We conducted this audit follow-up in accordance with the International Standards for the Professional Practice of Internal Auditing and Generally Accepted Government Auditing Standards. Those standards require we plan and perform the audit follow-up to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit follow-up objectives.

Report #1302

The scope of report #1302 included selected financial activity within the Stormwater Operating Fund, Stormwater Construction Fund, Stormwater Grant Fund, and Stormwater Redevelopment Fund. The main focus was financial activity during the three and one-half year period Fiscal Year (FY) 2009 through mid-FY 2012. Activity within several City departments was addressed in our review.

The objectives were to determine:

- Whether operating costs were proper, allowable, reasonable, and adequately accounted for and supported.
- Whether the City received the stormwater operating revenues to which it was entitled and

whether those revenues were properly accounted for and used by the City.

- Whether stormwater capital project activities and expenditures were proper and appropriate, recorded and supported, and in accordance with controlling laws, rules, policies, and good business practices.
- The reasons for significant available undesignated funds within the Stormwater Construction Fund.
- The status and/or appropriate disposition of fund balances within the Stormwater Grant Fund and Stormwater Redevelopment Fund.

Various audit procedures were conducted to meet the stated audit objectives.

Report #1407

This is our second and final follow-up on action plan steps identified in audit report #1302. The purpose of this follow-up is to report on the progress and status of efforts to complete action plan steps due for completion as of September 30, 2013. To determine the status of the action plan steps, we interviewed staff, made observations, and reviewed relevant documentation.

Background

Organization and primary services. The City's stormwater utility was created in the late 1980s to provide stormwater management services within the City's incorporated limits. Some of the more critical stormwater management services include, but are not limited to, repair and maintenance of existing stormwater facilities and development and completion of capital projects to further enhance stormwater facilities and runoff control. Stormwater facilities include stormwater ponds, drains and drainage pipes, filters, and ditches. Curbs and gutters on City streets are also considered part of the City's stormwater infrastructure. The primary stormwater services are performed by three separate City units:

- Public Works Operations Division - Drainage Unit.

- Public Works Operations Division - Street Sweeping Unit.
- Underground Utilities Water Resources Engineering (WRE) Division – Stormwater Unit.

Other City departments providing key assistance in regard to the stormwater function include:

- Utility Business and Customer Services (UBCS) department that bills City residential and nonresidential customers applicable stormwater fees as part of the monthly utility billing process.
- Property Management Division that assists in acquisition of property (e.g., easements) needed for stormwater capital projects.
- Department of Management and Administration (DMA) that (1) oversees establishment of operating and capital budgets (including stormwater programs and activities) and (2) accounts for stormwater financial activities.

Revenues. The primary stormwater function is funded primarily from stormwater fees charged to and collected from City utility customers whose premises are within the City limits. For the period covered by our initial audit and as shown in **Table 1** and also noted in the initial audit report, over 98% of operating revenues came from those stormwater fees. Most of the remaining 2% of revenues came from the State of Florida and Leon County for stormwater services performed by City crews on State and County owned streets.

<u>Category</u>	<u>Amount</u>	<u>Percentage</u>
Residential Fees	\$21,818,286	45%
Nonresidential Fees	\$25,522,501	53%
Maintenance State and County Streets	\$739,205	1.5%
Interest and Miscellaneous	\$209,484	0.5%
TOTAL	\$48,289,476	100%

In addition to the noted operating revenues, the City receives funds from other governmental entities for stormwater capital improvements. Examples reported in the initial audit included (1) transfers from Blueprint 2000, (2) transfers from FAMU (to address drainage issues resulting from stormwater runoff coming from the FAMU campus), and (3) Federal grants.

Disbursements. In regard to the primary stormwater function, uses (disbursements) of stormwater operating and capital funds are accounted for through two City funds: (1) Stormwater Operating Fund and (2) Stormwater Construction Fund.

As shown in the initial audit report and again in **Table 2** that follows, the Stormwater Operating Fund is used to pay salary and payroll costs, operating expenses, and related administrative costs pertaining to the primary stormwater function. Annual operating excesses (operating revenues in excess of operating disbursements) are transferred to the Stormwater Construction Fund as one of the funding sources for stormwater capital projects.

TABLE 2 STORMWATER OPERATING FUND EXPENDITURES AND TRANSFERS FY 2009 through FY 2011 (3 years)		
<u>Category</u>	<u>Amount</u>	<u>Percentage</u>
Salary and payroll costs	\$14,737,195	31%
Operating expenses	\$2,211,740	4%
Allocated charges	\$9,224,814	19%
Transfers to the Stormwater Construction Fund	\$20,137,927	42%
Other transfers	\$1,977,181	4%
TOTAL	\$48,288,857	100%

TABLE 3 STORMWATER CAPITAL PROJECT EXPENDITURES FY 2009 through mid-August FY 2012 (3 years 10½ months)	
<u>Year</u>	<u>Amount</u>
FY 2009	\$5,891,162
FY 2010	\$5,919,662
FY 2011	\$11,210,979
FY 2012 as of mid-August	\$6,572,583
TOTAL	\$29,594,386
Represents an annual average of \$7,637,261 million	

The Stormwater Construction Fund accounts for monies used to finance stormwater capital projects. The sources of monies deposited into that fund are (1) transfers from the Stormwater Operating Fund as described in **Table 2** above and (2) funds received from other governmental entities as noted in the paragraph following **Table 1**. Activity within the Stormwater Construction Fund was described in the initial audit and again below in the following paragraphs and tables.

As shown in **Table 3** that follows, the City spent \$29.6 million through 68 individual stormwater capital projects during the period FY 2009 through mid-August FY 2012 (3 years and 10½ months); that represented an annual average of \$7.64 million.

In the initial audit we reported that, as of June 30, 2012, there were 53 active capital projects. As indicated in the initial audit and shown again in **Table 4** that follows, funds appropriated for those 53 active projects totaled \$78.8 million, with \$40.7 million of that amount expended or encumbered (committed/contracted) as of June 30, 2012. The remaining \$38.1 million was to be expended over the remaining lives of those projects.

TABLE 4 ALL ACTIVE STORMWATER CAPITAL PROJECTS As of June 30, 2012	
Total Active Projects	53
Total Appropriated (budgeted and designated)	\$78,774,486
Total Amount Expended (Note 1)	\$37,655,534
Total Amount Encumbered (Note 1)	\$2,999,820
Appropriated Balance (Represents Amounts Not Yet Expended or Encumbered on Active Projects)	\$38,119,132
Note 1:	Total expended and encumbered is \$40,655,354. Encumbrances represent commitments related to goods and services not yet received.

We also reported that, as of June 30, 2012, available funds within the Stormwater Construction Fund totaled \$58 million. As reported in the initial audit, of that amount:

- \$38.1 million was designated (appropriated) for active projects (see **Table 4** above).
- \$3 million was encumbered (committed/contracted) for active projects (see **Table 4** above).
- \$16.9 million was undesignated (available funds not yet designated/budgeted for specific capital projects).

Other Stormwater Activities. In addition to the primary stormwater function relating to repairing and maintaining existing stormwater facilities and developing and completing capital projects to enhance the City’s stormwater facilities and infrastructure, we also reviewed certain financial matters relating to other stormwater activities in the initial audit engagement. Those other activities pertained to (1) the Stormwater Grant Fund that was used to account for federal grants for disaster assistance (e.g., used to address drainage issues resulting from significant storms)

and (2) the Stormwater Redevelopment Fund, which accounts for fees collected from developers that elect to pay a fee in lieu of meeting certain environmental development requirements in regard to green space, slope retention, and stormwater ponds.

Previous Conditions and Current Status

In audit report #1302, we noted that, overall, financial aspects of the City’s stormwater function were being properly and adequately administered and managed. Operating costs were generally proper, allowable, and reasonable. For the most part, operating revenues were properly received and accounted for by the City. Capital project activities and expenditures were generally proper and reasonable.

Areas were identified where improvements and enhancements were needed. Those areas pertained to:

- Charging salaries to appropriate funding sources.
- Capitalizing salaries and overhead costs so as to reflect actual project costs.
- Transferring stormwater funds based on the most appropriate information and methodologies.
- Documenting debt service allocations.
- Assessing stormwater fees on all applicable premises.
- Calculating billing factors for stormwater fees.
- Pledging stormwater fees to pay debt for City bonds.
- Addressing structures located on properties for which easements are acquired.
- Obtaining approvals for settlement agreements.
- Addressing the significant accumulation of undesignated construction funds.
- Addressing the status of balances in the stormwater grant and redevelopment funds.

Twenty-one action plan steps were developed to address the identified issues. Of those 21 action plan steps, 16 were reported as completed in our initial follow-up report (#1321) for the period ending March 31, 2013. As shown below in

Table 5, the remaining five action plan steps have also been completed as of December 31, 2013.

The specific actions taken regarding those five action plans steps are described in further detail in **Table 5** that follows.

**Table 5
Action Plan Steps from Audit Report #1302
Due as of September 30, 2013, and Current Status as of December 31, 2013**

Action Plan Steps Due as of September 30, 2013	Current Status as of December 31, 2013
Ensure proper treatment and accounting of salary and related costs.	
<ul style="list-style-type: none"> • Work assignments of applicable WRE Division staff will be reviewed and a process established to charge their salary costs to the most appropriate funding sources. 	✓ Completed in a prior period.
<ul style="list-style-type: none"> • Salary and overhead costs pertaining to stormwater capital projects will be capitalized. 	✓ Appropriate changes have been made to stormwater staff timekeeping practices such that applicable salaries and overhead are now capitalized. Capitalization of those salaries and overhead commenced in October 2013. Accordingly, this action plan step has been completed.
Ensure proper transfers of stormwater funds.	
<ul style="list-style-type: none"> • A yearend true-up adjustment process will be implemented to determine if accounting adjustments are needed to amounts transferred to other City funds (Water, Sewer, and General Funds) based on proposed activity and costs. Adjustments will be made for material differences identified by that process. 	✓ Completed in a prior period.
<ul style="list-style-type: none"> • Transfers to the General Fund for work done by Public Works technical and administrative staff for the benefit of the stormwater function will be based on current and updated information. 	✓ Completed in a prior period.
<ul style="list-style-type: none"> • Unused maintenance project funds will be returned to the initial funding sources in amounts proportional to their respective initial contributions. 	✓ Completed in a prior period.
<ul style="list-style-type: none"> • The appropriate basis for the allocation of debt service paid on the Capital Series 2004 Bonds will be determined and documented. Verifications will be made that prior year debt service payments for those bonds were equitable and reasonable. 	✓ The City’s Capital Series 2004 Bonds were issued to provide funds for various purposes, one of which included improvements to various City buildings. Certain City Stormwater functions are housed in some of those buildings; therefore it is appropriate that the City’s Stormwater Fund share in the debt service payments made for that bond. The amount paid by the Stormwater Fund should be in proportion to the benefits received. In the initial audit we reported adequate and complete records

	<p>were not available to substantiate the logic or basis for the determination of the amounts paid by the Stormwater and other City funds.</p> <p>Applicable City staff completed research of available records and information to identify and determine the support for the allocation among various City funds (including the Stormwater Fund) of debt service payments on that bond. That research showed support was not available for the actual allocation percentages used. However, that research did show that the allocations are substantially correct and accurate. Accordingly, this issue is considered resolved.</p> <p><u>Audit recommendation:</u> City staff acknowledged that records should have been retained to support the rationale and logic used in allocation of debt service payments on the noted bond. We recommend appropriate efforts be made to retain such records for all subsequent bonds and related debt service payments.</p>
<p>Ensure proper operating revenues are received.</p>	
<ul style="list-style-type: none"> • Management will emphasize to staff the importance of properly coding premises within the PeopleSoft CIS as to the applicability of stormwater and fire services fees. 	<p>✓ Completed in a prior period.</p>
<ul style="list-style-type: none"> • Corrections will be made within the PeopleSoft CIS for the residential and non-residential premises identified by the audit as incorrectly not being assessed stormwater and/or fire services fees. 	<p>✓ Completed in a prior period.</p>
<ul style="list-style-type: none"> • System queries will be established and run periodically to identify newly established premises within the City’s incorporated limits that are billed basic City utilities (electric, water, sewer, and/or gas) but for which stormwater and fire services fees are coded as not applicable. Applicable staff will review the query results to verify the non-applicability of stormwater and/or fire services fees. Corrective actions will be taken if those reviews show either of those two fees is applicable. 	<p>✓ Completed in a prior period.</p>
<ul style="list-style-type: none"> • Staff will begin an evaluation of nonresidential premises, located within the City’s incorporated limits and not charged stormwater fees, for the purpose of verifying the non-applicability of those fees and correcting any instances where those fees are determined applicable. 	<p>✓ Completed in a prior period.</p>

<ul style="list-style-type: none"> • The ERU billing factor for nonresidential premises will be revised to comply with City ordinances (rounded to the nearest tenth). 	<ul style="list-style-type: none"> ✓ Completed in a prior period.
<ul style="list-style-type: none"> • A process will be implemented to equitably allocate contractual revenues, received from the County for work on the St. Marks Trail, to the General Fund and Stormwater Operating Fund. 	<ul style="list-style-type: none"> ✓ Public Works staff determined the appropriate (equitable) amounts of contractual revenues, received from the County for work on the St. Marks Trail, that should be recorded in the City’s General Fund and in the City’s Stormwater Fund. For recent semiannual periods the appropriate amounts (shares) have been properly recorded in each fund based on those determinations. Accordingly, this action plan step is considered completed. <p><u>Audit Recommendation:</u> The current process used by Public Works is to initially record all of the applicable revenues in the City’s General Fund and then, through subsequent accounting adjustment, transfer the appropriate share of those revenues to the City’s Stormwater Fund. While Public Works staff have effectively completed that process, the transfers of the applicable share to the City’s Stormwater Fund for the past few semiannual periods have not occurred until subsequent to (and as a result of) our audit inquiry. We recommend Public Works staff enhance the current process to ensure the appropriate transfers are timely made.</p>
<p>Ensure proper use of stormwater revenues.</p>	
<ul style="list-style-type: none"> • Appropriate action will be taken to eliminate the inconsistency between applicable bond resolutions/covenants and the City’s stormwater ordinance. 	<ul style="list-style-type: none"> ✓ As explained in the initial audit, bond resolution and covenant language that provides for pledging of stormwater fees to meet debt obligations on City water and sewer bonds was not consistent with Section 21.556 of the City’s Code of Ordinances, which provides that stormwater fees cannot be used for purposes other than the stormwater program. Applicable City staff met and made the determination that a use of stormwater fees to meet debt obligations for water or sewer bonds should be considered a “loan” that would necessitate repayment to the stormwater fund (by the water or sewer fund as applicable). It was interpreted that such loans would not violate the intent of the noted City ordinance as the water and sewer funds would ultimately pay the water and sewer debt. Based on this interpretation, applicable changes were proposed to and authorized by the City Commission to City Commission Policy 224, Financing the Government. Those changes authorized by the City Commission on December 11, 2013, effectively addressed the noted inconsistency through incorporation of appropriate clarifying language. Accordingly, this action plan step is completed.

Ensure proper administration of stormwater capital projects.	
<ul style="list-style-type: none"> • Standard agreements for obtaining easements for City projects will be modified so that all property owner rights in the applicable real estate, including improvements, are identified and extinguished. Assistance will be obtained from the City Attorney’s Office in this matter. 	<ul style="list-style-type: none"> ✓ Completed in a prior period.
<ul style="list-style-type: none"> • Appropriate levels of approval will be obtained for settlement agreements that provide for payment of City funds in amounts in excess of applicable real estate and procurement policy thresholds. Each settlement agreement will be handled on a case by case basis and all “quasi” real estate transactions will be subject to approvals as required by Real Estate Policy 136 and applicable procurement policy. 	<ul style="list-style-type: none"> ✓ Completed in a prior period.
<ul style="list-style-type: none"> • Retainage on construction contracts will be withheld in amounts prescribed by applicable State statutes. 	<ul style="list-style-type: none"> ✓ Completed in a prior period.
<ul style="list-style-type: none"> • Appropriate notification will made to all applicable City departments and offices as to statutory retainage requirements for construction contracts. Appropriate language for use in bid/proposal documents will be provided. 	<ul style="list-style-type: none"> ✓ Completed in a prior period.
Ensure proper accounting and disposition of fund balances.	
<ul style="list-style-type: none"> • The accumulation of undesignated construction funds and applicable circumstances will be brought to the City’s Financial Viability Target Issue Committee for discussion and direction. 	<ul style="list-style-type: none"> ✓ It was reported in the initial audit that the accumulation of undesignated funds in the Stormwater Construction Fund was a violation of City Commission Policy 224, Financing the Government. Specifically, undesignated funds as of that audit in the amount of \$16.9 million represented 29 percent of the collective sources of capital available for stormwater projects, which exceeded the three percent threshold established by that policy. As reported, one significant factor contributing to the accumulation of undesignated construction funds was the lack of finalization of Federal requirements and regulations that will impact the City’s decision as to the prioritization of Stormwater Pollution Reduction Program (SPRD) projects. Specifically, City management has determined it prudent to not designate much of the available funds for SPRD projects until those regulations and requirements are finalized, as those regulations and requirements will likely impact the priority of those projects. To address this technical violation of City policy while applicable Federal requirements and regulations are being finalized, City management requested and the City Commission approved an exemption to the “three percent” limitation on accumulation of stormwater

	<p>construction funds as part of the fiscal year 2014 operating and capital budget. Accordingly, this issue is considered resolved.</p> <p><u>Audit recommendation:</u> City management should continue to monitor the accumulated balance of undesignated funds within the Stormwater Construction Fund to ensure those funds are designated and used for authorized and appropriate purposes in as timely a manner as is reasonable and possible.</p>
<ul style="list-style-type: none"> • The \$909,449 balance in the Stormwater Grant Fund will be returned to the Deficiencies Fund. 	<ul style="list-style-type: none"> ✓ Completed in a prior period.
<ul style="list-style-type: none"> • Appropriate adjusting entries will be made to provide correct and updated accountings for the various “fee in lieu of” stormwater redevelopment programs. 	<ul style="list-style-type: none"> ✓ Completed in a prior period.
<ul style="list-style-type: none"> • Staff will be reminded of the importance of tracking and accounting for resources available for the City’s Deficiencies Fund and Redevelopment Fund. 	<ul style="list-style-type: none"> ✓ Completed in a prior period.

Table Legend:

- Issue to be addressed from the original audit.
- ✓ Issue addressed and completed or otherwise resolved.

Conclusion

Table 5 above shows each of the 21 action plan steps established to address issues identified in our initial audit have been completed and/or resolved. Sixteen of those steps were completed/resolved as of March 31, 2013, as reported in our initial follow-up report (#1321). The five remaining steps completed/resolved during the period covered by this second (and final) follow-up engagement involved the following:

- Capitalization of salary and overhead costs pertaining to stormwater capital projects. (*Capitalization of those costs commenced in October 2013, the start of the current fiscal year.*)
- Documenting the appropriate basis for allocation of certain bond payments to applicable City funds. (*Research by City staff showed support was not available for the actual allocation percentages used; however, that research did show the allocations are substantially correct and accurate.*)
- Crediting the Stormwater Operating Fund for an appropriate share of contractual revenues received from the County for work performed by the City on the St. Marks Trail. (*Staff has determined the appropriate share and made appropriate adjusting entries to ensure the Stormwater Operating Fund is properly credited that amount.*)
- Addressing the inconsistency between City bond resolutions/covenants and the City's stormwater ordinance. (*Appropriate policy changes to address the inconsistency were proposed by City management and authorized by the City Commission on December 11, 2013.*)
- Addressing the limitation on the accumulation of undesignated construction funds. (*A policy exemption was recommended by City management and authorized by the City Commission as part of the FY 2014 budget.*)

Notwithstanding the successful completion and resolution of these five action plan steps, we made

additional recommendations for management to consider in regard to subsequent activities relating to three of those steps.

We commend City management and staff for the timely completion and resolution of the action plan steps. We appreciate the assistance and cooperation from the various City departments during this audit follow-up.

Appointed Officials' Responses

City Manager:

I am pleased with the results of this follow-up audit of selected stormwater activity. These results continue to mirror the organization's commitment to improving internal controls and accountability. I would like to thank the audit staff for their thorough review and the various City staff for their implementation of the action plan.

City Attorney:

The City Attorney's Office appreciates the thoroughness and professionalism exhibited throughout this audit process by all departments involved. The City Attorney's Office worked closely with the Treasurer-Clerk's office, the Stormwater Division, the Property Management Office, and your office to develop a plan to resolve the contradiction in the City's stormwater regulations and bond resolutions/covenants and then to implement the plan, including the City Commission's recent amendment to the City's financial policies. We also worked closely with the Property Management Division, and now have procedures in place to make sure that easements obtained by the City ensure clear ownership of structures within the easements and the right to demolish such structures if needed.

City Treasurer-Clerk:

We appreciate the efforts of the City Auditor to work with us to improve the financial procedures of the City. We are very pleased that all of the action plan steps have been completed, and we believe that the implementation of these action steps will further enhance the financial management of the City.

Copies of this final audit follow-up #1407 or audit report #1302 may be obtained from the City Auditor's website (<http://talgov.com/auditing>) or via request by telephone (850 / 891-8397), by FAX (850 / 891-0912), by mail or in person (Office of the City Auditor, 300 S. Adams Street, Mail Box A-22, Tallahassee, FL 32301-1731), or by e-mail (auditors@talgov.com).

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