

CITY AUDITOR'S REPORT



AUDIT OF SPECIAL IMPROVEMENT DISTRICTS ADMINISTRATION

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EXECUTIVE SUMMARY

At the request of the City Manager, this audit was conducted to determine whether the transactions of the City's special improvement districts (SID) were properly documented and the funds were used appropriately.

This report contains three audit issues and five recommendations to improve the administration of the City's improvement districts. Details of the audit issues, including findings, recommendations, and management responses can be found in the respective sections of the report. The following is a summary of the issues.

1. A review of the City's eight improvement districts indicated that there was a lack of transaction history for two construction funds. Without the fund history, it would be impossible to determine: (1) how the construction funds were spent; (2) the amounts of interest income earned; and (3) any unspent construction fund balances and their disposition.
2. There is a need for Finance to establish formal policy and procedures to ensure the City's administrative costs incurred for the improvement districts are properly authorized, documented, and applied in a consistent manner for reimbursement purposes.
3. Finance also needs to establish controls to ensure the bond fund balances of all inactive improvement districts are distributed in accordance with the law.

BACKGROUND

The City's special improvement districts (SID) were created to fund public improvements such as roads and sidewalks for the benefits of property owners within each improvement district. The improvement project costs were often financed by tax-exempt municipal bonds. Each parcel within an SID was levied an assessment, which could be paid by a lump-sum or installments.

Chapter 271 of the Nevada Revised Statutes (NRS 271) specifies the rules and regulations regarding the administration of improvement districts.

By the end of 2008, the City had seven active improvement districts as shown in the following table.

Special Improvement District	Bond Period	Original Assessment	Unbilled Assessment (as of 11/2008)	Number of Parcels with Balances
SID #54	1994-2014	\$2.96 million	\$0.54 million	84
SID #58	2002-2012	\$2.57 million	\$0.38 million	56
SID #59	2003-2013	\$1.53 million	\$0.14 million	20
SID #60	2002-2022	\$50.00 million	\$32.70 million	6,644
SID #61	2007-2017	\$4.13 million	\$2.63 million	18
SID #62	2007-2017	\$1.25 million	\$1.02 million	2
SID #63	2007-2017	\$12.73 million	\$11.50 million	14
	Total	\$75.17 million	\$48.91 million	6,838

City employees from several departments, including Finance and Public Works, were involved in administering the City's improvement districts. Finance's SID responsibilities included: coordinating with external assessment engineer, bond counsel, and billing contractor; processing assessments and debt servicing; banking, accounting, and reporting. Public Works' involvement included activities such as SID planning, cost estimation, and interaction with property owners.

AUDIT OBJECTIVES

This audit was conducted at the request of the City Manager. The audit objectives were to determine whether the SID transactions were properly documented and the SID funds were used appropriately.

SCOPE AND METHODOLOGY

This audit focused primarily on the active improvement districts with unbilled assessments. The audit was performed in accordance with generally accepted governmental auditing standards. Audit procedures included:

- Review the Nevada Revised Statutes;
- Interview management and staff responsible for administering the City's improvement districts;
- Review assessment ordinances;
- Review bond documents;
- Review transaction history and fund balances; and
- Benchmarking SID administration with other local governments.

FINDINGS AND RECOMMENDATIONS

The City Auditor's Office would like to thank the staff of Finance and Public Works for their cooperation and assistance during the audit. This audit identified issues management should address to improve controls over the administration of the City's improvement districts. These issues are summarized in the following sections. While other issues were identified and discussed with management, they were deemed less significant for reporting purposes.

1. CONSTRUCTION FUNDS

Criteria

- Adequate controls should be in place to ensure the bond proceeds used for improvement district construction are properly accounted for.

Condition

- The SID bond proceeds for each improvement district were allocated to different uses.

- For each SID, a small portion of the bond proceeds was used initially for purposes such as the following:
 - a. Bond issuance costs;
 - b. Deposit to Reserve Fund; and
 - c. Deposit to Administrative Fund.
- The remaining proceeds became construction fund for the improvement project.
- In addition to the bond proceeds, interest income from the construction fund was also available to fund the improvement project.
- To qualify for the bond's tax exemption status, interest earned by the unspent bond proceeds must be tracked to determine the rebate requirement as specified by the Internal Revenue Service.
- The rebate determination records must be retained until six years after the retirement of the last obligation of the bond issue.
- Constructions funds had been administered by the Public Works Department until 2006, when its Fiscal Division was transferred to the Finance Department.
- A review of the City's eight latest improvement districts indicated that there was a lack of transaction history for the following two funds:
 - a. Approximately \$2.5 million construction fund for SID #54 (bond period: 1994-2014);
 - b. Approximately \$1.2 million construction fund for SID #57 (bond period: 1999-2008).
- Without the construction fund history, it would be impossible to determine: (1) how the construction funds were spent; (2) the amounts of interest income earned; and (3) any unspent construction fund balances and their disposition.

Cause

- Inadequate controls to account for the construction funds of the older improvement districts.

Effect

- Potential violation of the federal tax exemption compliance requirements.

Recommendation

1. The Accounting Manager should instruct staff to retain the transaction history for each construction fund until six years after the retirement of the last obligation of its bond issue.

2. ADMINISTRATIVE COSTS REIMBURSEMENTS

Criteria

- The City's administrative costs incurred for its improvement districts should be properly documented and reimbursed in a timely manner.

Condition

- NRS 271.490(3) stipulates that, "If permitted by the ordinance authorizing the issuance of a bond, the assessments and any penalties, collection costs or interest not needed in any year to pay the principal and interest on the bonds may be used to pay the administrative costs of the municipality incurred in connection with the district and the collection of the assessments."
- However, most of the City's current SID bond ordinances are silent on administrative costs.
- Prior to 2007, the City had never requested administrative cost reimbursement from its improvement districts.
- Meanwhile, some SID had accumulated significant amounts of fund balances by the end of FY06/07, as shown in the following table:

Improvement District	Yearend Fund Balance
SID #60	\$6.1 million
SID #58	\$1.0 million
SID #54	\$0.9 million

- In 2007, Finance obtained a total of approximately \$1.42 million retroactive administrative cost reimbursements from its improvement districts, including \$1.24 million from SID #60.
- During the August 1, 2007 City Council meeting, the Finance Director reported that city staff involved in SID activities had been tracking their time since December 2006 to support the administrative cost reimbursement from improvement districts and would continue to do so.
- Nevertheless, most of the city employees who were involved in administering the City's improvement districts had not kept track of their time spent on SID activities.
- Without the actual timekeeping records, Finance had tried various methodologies to estimate the City's total administrative costs for improvement districts and to allocate the costs to individual SID.

- One method was based on the 1% administrative fund provided for by the SID bonds and assessment installments. Finance estimated that approximately \$375,000 and \$475,000 would be available for 2007 and 2008, respectively. However, the method was not adopted.
- Another estimation method was based on the percentages of staff time spent on SID activities. For 2008, Finance determined that 24 city employees (3.98 Full-time Equivalent) had been involved in SID activities and obtained a total of approximately \$568,000 administrative costs reimbursements for the City.
- Among the 24 employees, Finance estimated that four employees spent 40% to 100% of their time and twenty employees spent 1% to 20% of their time on SID activities.
- Without employees' timekeeping records, allocating the City's estimated total SID administrative costs could be based on different factors, such as SID fund balances or unpaid bond principals. However, Finance had not documented its allocation methodology to support the administrative costs allocated to the individual SID.
- In discussion with four local governments in Nevada of their improvement district administration, two entities required their employees to keep track time spent on individual improvement districts for administrative cost reimbursement purposes while the other two entities had adopted some formal estimation and allocation methodologies.

Cause

- Finance had not adopted a formal policy to determine the City's administrative costs reimbursement for SID.

Effect

- The City's administrative costs might not be consistently applied to its improvement districts.

Recommendation

1. The Finance Director should instruct staff to process reimbursement of the City's administrative costs for improvement districts on an annual basis.
2. The Finance Director should establish citywide policy and procedures to ensure the City's administrative costs incurred for improvement districts are properly documented and applied in a consistent manner for reimbursement purposes. City employees who are frequently and directly involved in improvement districts should account for their time spent on individual SID daily. City employees whose SID involvements are infrequent or indirect should report their time spent on SID activities to Finance quarterly.
3. The Finance Director should establish control to incorporate a provision for administrative costs reimbursement in the City's SID bond ordinances.

3. BOND FUNDS

Criteria

- Adequate controls should be in place to ensure all bond funds are properly accounted for.

Condition

- In addition to the currently active SID, the City had created other improvement districts in the past, including the following:

Improvement District	Bond Period	Amount	Number of Parcels
SID #48	1989 - 1999	\$1.7 million	66
SID #51	1991 - 2001	\$1.5 million	23
SID #57	1999 - 2008	\$1.3 million	12

- NRS 271.429 provides specific instruction regarding the distribution of the surplus amounts of the bond fund when all outstanding bonds and financial obligations related to an improvement district have been paid.
- The distribution includes: (1) transfer no more than \$25,000 from the bond fund to the surplus and deficiency fund; and (2) refund of surplus in excess of \$25,000 to the property owners.
- However, although SID #57's bond principal and interest had been fully paid off in FY03/04, it carried a fund balance of approximately \$70,000 during 2007. The entire amount was subsequently withdrawn to reimburse the City for its administrative costs.

Cause

- Inadequate controls for the distribution of surplus bond funds.

Effect

- Potential violation of NRS.

Recommendation

1. The Accounting Manager should establish controls to ensure the fund balances of all inactive improvement districts are distributed in accordance with NRS 271.429.

MANAGEMENT RESPONSES

1. CONSTRUCTION FUNDS

Audit Recommendation 1.1

The Accounting Manager should instruct staff to retain the transaction history for each construction fund until six years after the retirement of the last obligation of its bond issue.

Management's Plan of Action

The Finance Director instructed the Accounting Manager to provide written notification to the Financial Analyst in charge of Bond Accounting and the Financial Analyst in charge of Capital Improvements Accounting instructing them to insure that for all SID Capital Improvement Funds and their related Bond Funds maintain all documentation supporting the accounting entries for at least ten years after the last SID Bond payment has been made.

The Finance Department will conduct annual training of its employees on the necessary record retention to insure that the City has not violated any Federal or State Statutes and regulations related to SID Capital Improvement Funds and SID Bond Funds. The annual training will be conducted within sixty days of the fiscal year end; this will also facilitate the annual audit conducted by the independent auditing firm. The Finance Department will have discussions with the City Clerks Office and the City Attorney's Office at least thirty days prior to conducting the annual training to insure that any changes in statutes and regulations are incorporated in the training.

The Finance Department will also conduct individualized training for any employees hired by the Department subsequent to the annual Department training. The Financial Analysts in charge of their respective areas will be responsible in insuring that their staff is trained within thirty days of their hire date.

In addition and as part of the annual training program, the Finance Department will conduct an inventory of all SID Capital Improvement Funds and Bond Funds accounting records on hand at the end of the previous fiscal year.

Target Completion Date

The Written notification to the Financial Analysts in charge of record keeping for CIP construction and Bond accounting will be completed by May 31, 2009.

The records retention training for the Department will be conducted and completed by July 31, 2009.

2. ADMINISTRATIVE COSTS REIMBURSEMENTS

Audit Recommendation 2.1

The Finance Director should instruct staff to process reimbursement of the City's administrative costs for improvement districts on an annual basis.

Management's Plan of Action

The Finance Director has instructed the Accounting Manager to process reimbursement of the City's administrative costs for special improvement districts within sixty days of the fiscal year ending June 30, 2009, and prior to the beginning of the annual audit conducted by the independent auditing firm.

In addition, the Finance Director has instructed the Accounting Manager to process quarterly reimbursement for the fiscal year beginning July 1, 2009. The quarterly reimbursement will be processed within thirty days of the end each fiscal quarterly period.

Target Completion Date

August 31, 2009 for the fiscal year ending June 30, 2009.

Audit Recommendation 2.2

The Finance Director should establish citywide policy and procedures to ensure the City's administrative costs incurred for improvement districts are properly documented and applied in a consistent manner for reimbursement purposes. City employees who are frequently and directly involved in improvement districts should account for their time spent on individual SID daily. City employees whose SID involvements are infrequent or indirect should report their time spent on SID activities to Finance quarterly.

Management's Plan of Action and Target Completion Dates

Finance Department will invite and conduct a meeting with various Departments to seek input on determining who should track time on an hourly basis and which employees should allocate time on a monthly basis, and what projects/activities/tasks should be tracked. This meeting will be conducted by May 31, 2009.

Projects and Grants: The Department will use this module and set up project/activities to be used by staff tracking time daily. The project/activity set-up will be completed by May 31, 2009.

The Finance Department will develop a policy and procedure for staff to track time worked on SID's by June 15, 2009.

Finance will also conduct individualized training to record time spent on SID projects and related activity for any employees hired by the Department subsequent to the annual Department training. The Financial Analysts in charge of their respective areas will be responsible in insuring that their staff is trained within thirty days of their hire date. In addition, the Finance Department will invite and instruct employees who are not in Finance to the annual training. Training will be completed by June 30, 2009.

Audit Recommendation 2.3

The Finance Director should establish control to incorporate a provision for administrative costs reimbursement in the City's SID bond ordinances.

Management's Plan of Action

The Finance Director will instruct the Accounting Manager and the Financial Analyst responsible for Bond Funds and related activity to review all SID bond ordinances prior to submission to the City Council.

Target Completion Date

Effective as of May 31, 2009

3. BOND FUNDS

Audit Recommendation 3.1

The Accounting Manager should establish controls to ensure the fund balances of all inactive improvement districts are distributed in accordance with NRS 271.429.

Management's Plan of Action

The Accounting Manager will instruct the Financial Analyst responsible for the bond fund to conduct a quarterly review to determine if any monies need to be distributed in accordance with NRS 271.429. A surplus and deficiency fund has been established and will be used in accordance to the statute.

Target Completion Date

Written notification will be given by May 31, 2009 instructing staff to complete this review annually on a quarterly basis.