AUDITOR GENERAL

WILLIAM O. MONROE, CPA

CITY OF CAPE CORAL, FLORIDA

Operational Audit

For the Period October 1, 2000, Through March 31, 2005,

And Selected Actions Taken Prior and Subsequent Thereto

CITY OF CAPE CORAL, FLORIDA
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SCOPE

The Auditor General is authorized by State law to perform independent audits of governmental entities in Florida. Pursuant to Section 11.45(2)(a), Florida Statutes, the Legislative Auditing Committee, at its March 7, 2005, meeting, directed us to conduct an audit of the City of Cape Coral.

The scope of this audit included transactions during the period October 1, 2000, through March 31, 2005, and selected transactions taken prior and subsequent thereto, related to allegations concerning the City's water, sewer, and stormwater operations to determine whether such transactions were executed, both in manner and substance, in accordance with governing provisions of laws, ordinances, bond covenants, and other guidelines. In addition to the City's water, sewer, and stormwater operations, our audit included a review of the City's procedures for charging charter school expenses to the municipal charter school operated by the City.

Our audit did not extend to an examination of the City's financial statements. The City's financial statements for the fiscal year ended September 30, 2004, were audited by a certified public accounting firm, and the audit report is required to be filed as a public record with the City.

SUMMARY OF FINDINGS

The results of our operational audit of the City of Cape Coral are as follows:

Finding No. 1: The City had not maintained its accounting records on a current basis, or periodically reviewed them for completeness and accuracy.

Finding No. 2: Written policies and procedures necessary to assure the efficient and consistent conduct of accounting and business-related functions were not established in all cases.

Finding No. 3: The City had not provided for an adequate separation of duties in certain areas of operation, and had not provided for the proper safeguarding of blank checks.

Finding No. 4: The City did not consider all available net assets from prior fiscal years in adopting its 2003-04 or 2004-05 fiscal year budgets for the funds combined and reported as "Water and Sewer" and "Stormwater Utility," contrary to Section 166.241(2), Florida Statutes.

Finding No. 5: The City reported budget overexpenditures totaling approximately $39 million in 7 of the 27 funds reported as "Water and Sewer" and "Stormwater Utility," contrary to Section 166.241(2), Florida Statutes. Furthermore, budget-to-actual comparisons were provided to the City Council only through the 3rd quarter of the 2004 fiscal year.

Finding No. 6: Bank reconciliations were not always performed timely, were not adequately reviewed, and contained errors.

Finding No. 7: The City failed to timely report and remit unclaimed property to the Florida Department of Financial Services, contrary to Chapter 717, Florida Statutes.

Finding No. 8: The City did not prepare a financial analysis, including a calculation of the economic gain or loss, prior to issuing refunding debt totaling $53 million.

Finding No. 9: The City did not timely refund special assessments in excess of project costs for three completed utility expansion areas.

Finding No. 10: The City's methodology for determining contributions in aid of construction (CIAC) fees may not appropriately match fees charged to actual costs incurred and, as a result, may be subject to challenge by property owners.

Finding No. 11: The City does not have adequate controls in place to ensure that CIAC fees are timely collected.

Finding No. 12: City Council approved, via vote of City Council members rather than enactment of an ordinance, a change in CIAC fees established by ordinance, contrary to Section 166.041, Florida Statutes. Further, City staff's actions regarding CIAC and capital expansion fees charged regarding the North Loop CIAC project may have been contrary to the City Council's intentions.

Finding No. 13: Capital expansion fees and CIAC fees were not always expended in accordance with the City's Code of Ordinances and applicable case law.

Finding No. 14: The City did not always charge utility users appropriate fees or timely bill for services rendered.

Finding No. 15: Costs for shared administrative expenses from departments other than utilities were not always allocated to the Water and Sewer Fund and Stormwater Fund in a systematic and rational manner. In addition, some costs directly charged from other departments were not supported by documentation to evidence the basis for the direct charge.

Finding No. 16: Expenditures totaling $131,859 were not supported by documentation demonstrating the public purpose served.

Finding No. 17: The City did not select its bond counsel through a competitive selection process.

Finding No. 18: The City did not have written agreements with several bond professionals. Additionally, City practice and its procurement policies and procedures are contrary to Section 2-148 of the City's Code of Ordinances regarding required signatures on contracts.

Finding No. 19: The City did not properly monitor contracts for services to ensure contractors performed in accordance with terms of the contract.

Finding No. 20: The City did not fully comply with provisions of Section 287.055, Florida Statutes, in procurement of its contract for its utility expansion program. Additionally, invoices submitted for payment by the contractor were not adequately supported. Finally, the City's consultant hired to audit selected work authorizations relating to its utility expansion program included several findings and made several recommendations.

Finding No. 21: Although the City has taken some actions to reduce water loss, unaccounted for water remains in excess of 10 percent. Additionally, preliminary data from a water audit obtained by the City indicated several factors, including excessive service leaks, meter testing and replacement, and inconsistencies in meter size, that contributed to the City's unaccounted for water.

Finding No. 22: Some of the City's staff may have inappropriate access to information technology system resources. We also noted another deficiency in controls over the City's information systems.

Finding No. 23: The City has not prepared and executed a lease agreement for its charter school and the frequency and timing of billings to the charter school for services provided by the City were not addressed in Ordinance 41-04.

Finding No. 24: The City conducted discussions regarding the calculation of the charter school lease payments through a liaison rather than in a publicly noticed meeting.

This audit was conducted by Marilyn D. Rosetti, CPA. Please address inquiries regarding this report to James M. Dwyer, CPA, Audit Manager, via e-mail at jimdwyer@aud.state.fl.us or by telephone at (850) 487-9031.

This report, as well as other audit reports prepared by the Auditor General, can be obtained on our Web site at http://www.state.fl.us/audgen; by telephone at (850) 487-9024; or by mail at G74 Claude Pepper Building, 111 West Madison Street, Tallahassee, Florida 32399-1450.

FINDINGS AND RECOMMENDATIONS

Financial Management

Finding No. 1: General Accounting Records

An entity's accounting records reflect its fiscal condition at a given point in time and provide information that is used by the entity's management, such as financial position, fiscal year expenditures to date, budget-to-actual comparisons, and other information that can be utilized for decision-making. The trial balance report indicates the account totals at a given point in time for each of the City's accounts. This report should be generated periodically (e.g., monthly) during the fiscal year and reviewed for completeness and accuracy.

On April 1, 2005, we requested from the City the most recent trial balance report for the 2004-05 fiscal year for purposes of conducting our audit. On May 12, 2005, the City furnished a trial balance as of March 31, 2005. During the fiscal year, the City had not periodically generated trial balance reports for the purpose of reviewing completeness and accuracy of its accounting records. Except for reclassification of fixed asset purchases within the current fiscal year from expense accounts to asset accounts, the trial balance was represented to us to be current through March 31, 2005; however, we noted that it was not current for certain other transactions as of March 31, 2005. For example, the trial balance indicated that the City's balance in its primary bank account, which includes utility transactions, was ($20,017,036). However, as further discussed in finding No. 6, there were numerous journal entries that should have been made to the accounting records throughout the fiscal year that had not been made by May 12, 2005, including a $23,000,000 transfer dated February 2, 2005, from the City's State Board of Administration account to the primary bank account. The failure to generate and review periodic trial balances increases the likelihood that errors in the accounting records could occur and not be timely detected by management, limiting the City's decision-making and monitoring abilities.

Recommendation: The City should ensure that its accounting records are maintained on a current basis and are periodically reviewed for completeness and accuracy.

General Management Controls

Finding No. 2: Written Policies and Procedures

Written policies and procedures, which clearly define the responsibilities of employees, are essential to provide both management and employees with guidelines regarding the efficient and consistent conduct of City business and the effective safeguarding of City assets. In addition, written policies and procedures, if properly designed, communicated to employees, and effectively placed into operation, provide management additional assurance that City activities are conducted in accordance with applicable laws, ordinances, and other guidelines; and that City financial records provide reliable information necessary for management oversight. Written policies and procedures also assist in the training of new employees.

Adequate written procedures were not available to document controls over debt issuance, bank reconciliations and stale-dated checks, billing of fees and services to customers, tracking of contributions in aid of construction fees, and the allocation of certain costs. For some of these areas, the Financial Services Director indicated that the City's policies and procedures are in place through ordinances or resolutions. While ordinances and resolutions generally provide the authority for activities, they do not specify the positions that perform the work

or the methodology to be used. For example, the City's Code of Ordinances specifies that utility customers are to be billed monthly, but it does not indicate which employees are involved in the process or the timing and methodology relating to meter readings, generation of billings, and mailing of billings. Instances of noncompliance or inadequate management controls, which may have resulted, at least in part, from a lack of written procedures, are discussed in subsequent findings.

In correspondence dated June 7, 2005, the Financial Services Director indicated that the Financial Services Department is in the process of evaluating and hiring a consultant to write and standardize procedures within the Department.

Recommendation: The City should adopt comprehensive written procedures that are consistent with applicable laws, ordinances, and other guidelines. In doing so, the City should ensure that the written procedures address the instances of noncompliance and control deficiencies discussed in this report.

Finding No. 3: Separation of Duties and Safeguarding of Blank Checks

The City, to the extent possible with existing personnel, should separate duties so that no one employee has access to both physical assets and the related accounting records, or to all aspects of a transaction. Failure to adequately separate duties increases the possibility that errors or irregularities could occur and not be promptly detected. Our review of controls relating to water, sewer, and stormwater utility operations disclosed an inadequate separation of duties, as follows:

- Checks deposited by the City and returned from the bank due to insufficient funds (returned checks) are received by the Cashier Supervisor, who also notifies the customer of the returned check and requests settlement of the returned check by cash, cashier's check, or money order; and receives and processes the subsequent payment from the customer.
- The City has three cashier terminals that include cash drawers. The drawers are balanced to receipts recorded in the accounting records once each day. When a cashier leaves her post for lunch, the Cashier Supervisor utilizes the cashier's drawer and terminal if the lines at the other terminals are too long. As a result, should a drawer be short at the end of the day, and more than one employee has used the terminal and cash drawer, responsibility cannot be fixed.
- We observed that an employee, with authorization to access the vault within which blank checks are kept, loaned her vault keys to an employee without such authorization. Additionally, we observed that when blank checks were physically carried to the Information Technology Systems Department for printing, other blank checks were left unattended at an employee's desk.

Recommendation: The City should reassign the duties relating to returned checks to an employee that does not have access to cash. Additionally, the City should consider separate close-out procedures for instances in which more than one employee uses the same terminal and cash drawer. Finally, the City should establish procedures to ensure that blank checks are properly safeguarded.

Auditor General Clarification

In his response, the City Manager indicated disagreement with the recommendation related to returned checks and stated that the City modified its procedures for returned checks to include sending a copy of the returned check to another department for reversing the payment. However, this control is negated by allowing the Central Cashier to initially access the returned checks. Should the Cashier Supervisor fail to send the copy of the check and reverse the payment in the

accounting records, she could collect and retain the cash when the customer pays for the returned check and the City's records would continue to show the customer's account as "paid." The returned check would be a reconciling item only in the month within which the bank returned the check. Returned check records are still maintained by the Cashier Supervisor. We again recommend that returned checks be processed by someone that does not have access to cash.

Additionally, the City Manager indicated that since the City uses a "positive pay" system, bank tellers have access to the City's issue records and match those checks authorized by the City, thereby preventing unauthorized checks from being cashed. However, unauthorized checks could be cashed at establishments other than banks and the City would not be aware of the transaction until the establishment attempts to deposit the check. The point of our finding was that the City should ensure its procedures are followed.

Budgetary Controls

Finding No. 4: Budget Preparation

Section 166.241(2), Florida Statutes, states that the amount available from taxation and other sources, including amounts carried over from prior fiscal years, must equal the total appropriations for expenditures and reserves. Contrary to this law, the City, in preparing its 2003-04 and 2004-05 fiscal year budgets for the Water and Sewer Fund, the 23 other funds that are combined and reported as "Water and Sewer," the Stormwater Fund, and the 2 other funds that are combined and reported as "Stormwater Utility," did not consider all net assets available from prior fiscal years. For the 2003-04 fiscal year budget, the City considered only $41,493,267 of $131,484,365 ending net assets from the 2002-03 fiscal year. For the 2004-05 fiscal year budget, the City considered only $52,232,490 of $116,866,727 ending net assets from the 2003-04 fiscal year.

Net assets represent the City's net available resources. Although some portion of ending net assets may be restricted for specific purposes and not be available for immediate expenditure in the subsequent fiscal year, estimated prior year ending net assets should be carefully considered and included in the budget since the amount of such balances brought forward have a direct impact on the amount of additional funds to be raised to finance City operations. Failure to consider beginning net assets in preparing the budget diminishes the City's ability to determine appropriate increases or decreases in revenues or expenses that may be needed for the fiscal year for which the budget is adopted. If balances brought forward are significantly understated, the amount of revenue sources contemplated in the proposed budgets may be increased beyond those amounts necessary to carry out planned expenses.

Recommendation: The City should consider all available net assets from prior fiscal years in the preparation of the budget as required by Section 166.241(2), Florida Statutes.

Auditor General Clarification

In his response, the City Manager indicated that we suggested the City bring forward all prior year net assets, including invested in capital assets net of related debt. Amounts previously expended on capital assets would clearly not be available and we did not include such amounts in the finding above. Only restricted and unrestricted net assets were included in our calculations.

The City Manager also indicated that the language of the law underscores and supports the current methodology of budgeting used by the City. To the contrary, Section 166.241(2), Florida Statutes, requires the City to bring forward all amounts available from prior fiscal years and such amounts, along with amounts available from taxation and other sources, should equal total appropriations for

expenditures and reserves. The City Manager further indicated that the City includes in its budget all designated reserves established and adopted by City Council as well as all outstanding encumbrances as amounts carried over from prior fiscal years. However, of the $116,866,727 ending unrestricted and restricted net assets as of September 30, 2004, only $52,232,490 was brought forward to the 2004-05 fiscal year budget, whereas reported restricted net assets (reserves) for the prior year were $104,225,808. Therefore, the City did not bring forward all designated reserves and encumbrances.

The City Manager indicated that, in accordance with the City's financial policies, the City will not fund mainstream services with temporary or non-recurring revenue sources, and moneys required for bond reserves are not included in the budget. However, the law requires that amounts available from all sources be budgeted as expenditures or reserves. It does not place any limitations on those amounts, such as described by the City Manager.

The City Manager stated that we suggested that the requirements for counties and municipalities are the same. To the contrary, the Financial Services Director, in meetings between us and City staff, attempted to make this correlation and we indicated to him that the laws are different for counties and municipalities. Further, although the City Manager stated that the City requested documentation of legislative intent of this provision, we believe the law is clear and no further documentation of legislative intent is necessary. Since the City disagrees, the City should consider seeking an opinion from the Attorney General on this matter.

Finding No. 5: Budget Overexpenditures

Section 166.241(2), Florida Statutes, requires governing bodies of municipalities to adopt a budget each fiscal year, and provides that the budget must regulate expenditures of the municipality and that it is unlawful for any officer of a municipal government to expend or contract for expenditures in any fiscal year except in pursuance of budgeted appropriations. However, the law does not establish the level of detail at which budgeted appropriations are to be made.

The City's 2003-04 fiscal year budgets for the 27 funds reported as "Water and Sewer" and "Stormwater Utility" were established at the fund level. Our review of the City's accounting records disclosed budget overexpenditures for 7 of the 27 funds reviewed. These budget overexpenditures totaled $39,404,300, and ranged from $371,827 to $17,360,742. Some of the budget overexpenditures appeared to result from the City making extra principal payments on debt service. Although the City had available resources for the 2003-04 fiscal year to offset the overexpenditures, the City Council did not amend the budgets to ensure that expenditures did not exceed budgetary authority.

According to the National Advisory Council on State and Local Budgeting's *Recommended Budget Practices, A Framework for Improved State and Local Government Budgeting* (Government Finance Officers Association, 1998), "Regular monitoring of budgetary performance provides an early warning of potential problems and gives decision makers time to consider actions that may be needed if major deviations in budget-to-actual results become evident. It is also an essential input in demonstrating accountability."

Budget-to-actual comparisons were furnished to the City Council only through the 3rd quarter of the 2003-04 fiscal year. Additionally, the budget–to-actual comparisons were presented to the City Council for only two funds, neither of which were included in the seven funds for which we noted budget overexpenditures. As a result, City Council may not have been aware that such budget overexpenditures existed.

Recommendation: The City should ensure that future expenditures do not exceed budgetary authority. In addition, budget-to-actual comparisons for all funds budgeted should be prepared and submitted to City Council on a frequent basis.

Auditor General Clarification

In his response, the City Manager has chosen to define "expenditure" for purposes of Section 166.241(2), Florida Statutes, to mean decreases in net financial resources not properly classified as other financing uses and, therefore, the budgeting of debt service payments would not be required. Using his definition of expenditure for purposes of this law does not appear appropriate as it would exclude a municipality's obligation to appropriate moneys for the purchase of capital assets or debt service payments within proprietary funds, but require such appropriation in governmental funds. Although Section 166.241, Florida Statutes, does not include a definition of "expenditures," Florida law applicable to State planning, budgeting, and fiscal affairs generally defines an "expenditure" as a payment or the incurring of a legal obligation to disburse money (see Section 216.011(1)(m), Florida Statutes).

The City Manager also indicated that the overexpenditures in two funds related to capital expenditures. He further stated that as in most capital projects of this type, construction normally takes place over a period exceeding one fiscal year and that appropriations roll from year to year until the project is completed. While this is true, Section 166.241, Florida Statutes, requires that budgets be adopted annually and that it is unlawful for any officer of a municipality to expend or contract for expenditures in any fiscal year except in pursuance of budgeted appropriations. Unspent appropriations from prior fiscal years should have been available, and included in the 2003-04 fiscal year budget, to fund the 2003-04 fiscal year expenditures.

Regarding the reports provided to City Council, the City Manager stated that it has been the City's practice to furnish City Council with a financial performance report at the end of the first, second, and third quarters of the fiscal year and with the Comprehensive Annual Financial Report (CAFR) at year-end. At the beginning of the fiscal year, the Council budgeted a total of 27 funds. The reports received by them for the first, second, and third quarters included only 2 of the 27 funds, neither of which were the funds for which we noted overexpenditures. At fiscal year-end, the 27 funds were rolled into, and presented as, two funds in the CAFR. Therefore, the individual fund budget overexpenditures were not separately disclosed in the reports provided to the City Council.

Cash

Finding No. 6: Bank Reconciliations

An essential element of control over assets is the periodic comparison of such assets actually determined to be on hand with the recorded accountability for the assets. Because of the susceptibility of cash to loss, this is particularly important for cash on deposit with banking institutions. Accountability for such deposits is accomplished by the preparation, review, and approval of bank reconciliations as soon as possible after the receipt of monthly bank statements. In the event of a loss of cash, failure to reconcile bank accounts to the accounting records could result in a failure to detect and recover the loss.

We reviewed the December 2003 and March 2005 bank reconciliations for the City's operations bank account, which included water, sewer, and irrigation transactions. Our review of these reconciliations disclosed the following:

- The accounting records cash balance reported on the December 2003 bank reconciliation was $10,477,133, whereas the City's general ledger reported a cash balance of $32,144,433. The difference of approximately $21.6 million resulted from failure to record in the accounting records a December 1, 2003, transfer of $20.6 million from the City's operations bank account for debt service payments and other adjustments totaling approximately $1 million.

- The accounting records cash balance reported on the March 2005 bank reconciliation was $2,403,140, whereas the City's general ledger reported a cash balance of ($20,017,036). The difference of approximately $22.4 million resulted from the failure to record a February 2, 2005, transfer of $23 million from the City's State Board of Administration account to the operations bank account and other adjustments related to interest, voided permits, and returned checks. For example, on the bank reconciliation, the bank balance was increased for interest totaling $19,594 that had been received and deposited into the City's account from October 2004 through February 2005, thus overstating the bank balance.

- Several reconciling items indicated on the December 2003 bank reconciliation, such as deposit corrections, indicated that the bank was researching items that were dated four to six months earlier.

- Neither of the bank reconciliations reviewed were dated by the reconciler, and the March 2005 bank reconciliation was not submitted to us until May 26, 2005, the same date on which the employee's supervisor approved it. Additionally, the last bank reconciliation prepared prior to the March 2005 bank reconciliation was as of November 2004. In response to our inquiries as to why bank reconciliations had not been more timely performed, the Controller indicated that the accounting division had been understaffed, some employee duties had been reassigned, and other priorities had been placed ahead of bank reconciliations.

The lack of timely bank reconciliations, and resolution of reconciling items, and an apparent less-than-thorough review by supervisory personnel, as indicated above, increases the risk that errors or irregularities could occur without being promptly detected. Additionally, the failure to timely record transactions in the City's accounting records reduces its ability to adequately determine cash availability for decision-making purposes.

Recommendation: The City should enhance controls to provide for timely and accurate bank reconciliations, timely recording of cash transfers, and thorough review of bank reconciliations by supervisory personnel. Additionally, the City should ensure that all differences noted on bank reconciliations are appropriately and timely resolved and all journal entries relating thereto are properly prepared, reviewed, and approved.

Finding No. 7: Unclaimed Property

Sections 717.113 and 717.115, Florida Statutes, state that all intangible property and unpaid wages, including wages on unpresented payroll checks, that have not been claimed by the owner for more than one year after becoming payable are presumed unclaimed. Further, Sections 717.117 and 717.119, Florida Statutes, require that any person holding unclaimed property shall report such property to the Florida Department of Financial Services (FDFS) before May 1 of each year for the previous calendar year, and simultaneously deliver such property to the FDFS.

We were provided reports of stale-dated checks, along with remittances, submitted to FDFS prior to May 1, 2003, 2004, and 2005. However, we noted that checks totaling $61,489 and $276 included in the reports submitted in

2003 and 2004, respectively, should have been included in the reports submitted in 2002 and 2003, respectively. In addition, our review of the City's March 2005 bank reconciliation disclosed that stale-dated checks totaling $32,223 should have been reported and remitted to the FDFS as required by law. Of this amount, $534, $4,208, and $27,480 should have been remitted by May 1, 2003, 2004, and 2005, respectively.

Upon inquiry, the Financial Services Director indicated that the amounts that were due to be remitted prior to May 1, 2003, and 2004, were not remitted due to an oversight and provided us a copy of the check issued to the FDFS dated June 10, 2005. Regarding the $27,480 that should have been remitted by May 1, 2005, the Financial Services Director indicated that the checks will be voided and reissued since the payees replied to letters sent by the City in April 2005. However, we are unaware of any authority within Chapter 717, Florida Statutes, for reissuance of stale-dated checks once they have been unpresented for more than one year. Pursuant to Section 717.117(3), Florida Statutes, the City may be subject to a penalty of $10 per day up to a maximum of $500 for failure to timely report unclaimed property to the FDFS.

Recommendation: The City should take appropriate action to report and deliver the $27,480 to the FDFS. Additionally, the City should enhance controls to ensure that stale-dated checks are timely reported and delivered to the FDFS in future years.

Debt Management

Finding No. 8: Debt Refinancing

In contracting for a utility expansion program in 1999, the City identified projects to be completed over a five year period. As of September 2004, the City had issued debt of at least $135.6 million to finance this five-year plan. In February 2005, the City issued refunding bonds totaling $53,285,000 to refund a portion of that debt. The City used the proceeds from the refunding bond issue ($51,605,335) and $28,397,507 from other available City funds (primarily from assessment collections and prepayments) to repay outstanding debt, totaling $80,002,862, associated with the utility expansion program. The repaid debt consisted of four State Revolving Fund loans from the Florida Department of Environmental Protection, one bank loan, and a commercial paper note.

According to the GFOA's publication, *An Elected Official's Guide to Debt Issuance* (2001), an issuer may consider refunding existing debt for three primary reasons: to reduce interest costs, to restructure debt service, and to eliminate old debt covenants that may have become restrictive. Most refundings are performed to take advantage of current interest rates that are lower than those rates on outstanding debt. However, issuers must exercise care in evaluating refunding opportunities because even though current rates may be lower than those on the issuer's outstanding debt, it is possible that a refunding would generate little or no present value savings due to the associated costs of the refunding issue. The costs of issuing debt are substantial. For example, the costs associated with the refunding bond issue, excluding future interest costs, were approximately $1.7 million. The costs associated with the issuance of the debt refunded by this bond issue were $1.8 million. Thus, the costs to the City for issuing debt to finance a portion of the utility expansion program were $3.5 million. While there could have been interest savings that might offset these costs, the City did not calculate the economic gain or loss on the refunding issue, or otherwise demonstrate whether such savings would be realized. The GFOA publication provides that regardless of the reason an issuer has for refunding, a cost-to-benefit analysis should be performed and must be weighed in making the decision.

We requested, but were not provided with, a financial analysis, including a calculation of the economic gain or loss, for this bond issue to determine how much it cost or benefited the City to issue the refunding bonds. Eighty-six percent of the debt refunded was comprised of State revolving fund loans. The stated interest rates on the revolving fund loans refunded ranged from 2.67 to 3.16 percent, whereas the interest rate of the refunding bonds was approximately 4 percent. Thus, it appears that the City may realize an economic loss from this transaction. Upon inquiry, the Financial Services Director indicated that the reason for issuing $53,285,000 of Wastewater and Irrigation Water Refunding Assessment Bonds in February 2005 was to change the security for the loans from net water and sewer revenues to special assessments. Special assessment revenue was used to pay off the loans since the loan proceeds paid for the capital improvements. As a result of changing the security to special assessments, the bonding capacity for the City's water and sewer system was increased by $53 million. However, it is not apparent why the City did not pledge special assessment revenues initially, thereby eliminating the need to refund these bonds at a later date. While we recognize that the purposes of the refunding issue were to change the security for the debt and increase bonding capacity, a calculation of the economic gain or loss is necessary to determining the cost of achieving those purposes.

Recommendation: The City should utilize a cost-to-benefit analysis, including calculation of economic gain or loss, prior to issuing any future refunding bonds and consider initially pledging revenues that will ultimately be used to pay bonded debt.

Auditor General Clarification

In his response, the City Manager reiterated the City's reasons for issuing the refunding bonds and disagreed with us that an economic gain or loss analysis should have been performed regardless of the reasons for refunding. In any prudent management decision, the cost of choosing one option over another should always be considered, including the pledging of revenues at debt issuance as well as the refunding of prior debt. The City Manager correctly asserted that original issue discount is not a true cost of issuance and is a function of the pricing. As bonds sold at a discount yield less immediate cash to the issuer, the difference is a cost to the City; thus, it was considered by us to be an immediate cost of issuing the bonds. We believe that, for the purpose of determining the costs associated with the decision to refund bonds, all costs, including the original issue discount, should be considered. The City Manager also indicated that the City requested, but was refused, a change in the pledged revenues for the SRF loans. During audit field work, we requested, but were not provided with, documentation to support this assertion. We noted that the City, in its 2005 fiscal year Comprehensive Annual Financial Report, did not disclose the economic gain or loss on two of the three refunding issues reported, including the issue discussed in this finding, contrary to Governmental Accounting Standards Board, Statement Nos. 7 and 23. Such information should have been disclosed in Note 11. The City Manager stated that the City will consider the potential cost/benefit of evaluating an economic gain or loss in similar circumstances.

Restricted Water, Sewer, and Irrigation Resources

Section 170.01, Florida Statutes, authorizes a municipality to levy special assessments for water, sewer, and irrigation construction or reconstruction on benefited real property. Additionally, pursuant to the Municipal Home Rule Powers Act (Chapter 166, Florida Statutes), municipalities are authorized to levy fees on users where such fees are related to the expansion of public facilities, the fees are no more than the municipality's costs incurred to benefit the users, and the fees are expressly earmarked and spent for the purposes for which they were charged. The City collects the following assessments and fees relating to its water, sewer, and irrigation systems to provide for the cost of the expansion of these systems:

- Chapter 2, Article II, Division 2, of the City's Code of Ordinances authorizes the charging of capital expansion fees, also referred to as impact fees, to all property owners connecting to the City's utility systems to be used for capital expansion of utility facilities. For existing improved property, the fee is due and payable at the time of application for service. For new construction in areas where utility service is currently available, the fee is due and payable at the same time the installation fee for the water meter is paid, but may be financed with annual installments for six years. For new construction in areas where utility service is not currently available, but where the property is within an approved five-year capital expansion program, the fee is due and payable upon application for a building permit. Proceeds are to be used solely for the cost of expanding the respective system and may not be used for the cost of operation, maintenance, repair, replacement, rehabilitation, renewal, or upgrading of the existing system to meet the service needs of existing users.

- Chapter 17, Article III, of the City's Code of Ordinances authorizes the levy of special assessments to finance the acquisition and construction of water and sewer improvements in assessment areas within the City. Assessment areas encompass properties specifically benefited by particular construction expansion projects. Special assessments must be computed in a manner that fairly and reasonably apportions the project cost among the parcels of property within the assessment area based upon objectively determinable assessment units. All parcels in an assessment area must pay whenever assessed regardless of whether or not the property has been improved, except that property owners may finance the payment of assessments up to 20 years. Proceeds of special assessments are used to finance the acquisition and construction of utility improvements within the assessment area.

- Chapter 19, Article III, of the City's Code of Ordinances authorizes the charging of contributions in aid of construction (CIAC), also known as betterment fees, to property owners connecting to the City's utility systems to pay for the cost of expansion of the applicable system. CIAC fees are primarily distinguished from special assessments in that they are one-time fees charged to properties that are not in an assessment area, but have City water, sewer, or irrigation services available. Property owners connecting to the City's utility systems will pay either a special assessment or a CIAC fee. Rates are pre-set and are charged on a square footage basis. CIAC fees are generally payable at the time of issuance of a permit for development on the property. However, CIAC fees to be paid for any parcel of land with development limited to clearing the land, filling the land, platting thereof or construction of roads, drainage facilities, or utility facilities, may be deferred and paid pursuant to a deferred payment agreement. A deferred payment agreement requires a proportional payment of the CIAC fee for each part of the parcel upon issuance of a building permit for such part, transfer of title to such part, or the passage of 15 years, whichever occurs first. For existing improved property, the fee is due and payable at the time of application for service. The City allows financing through annual installments over 15 years. Proceeds of all CIAC fees must be applied to the payment of the cost of expansion of the respective system.

Finding No. 9: Refunding of Special Assessments

During the audit period, the City completed utility expansions in four areas that were or will be primarily funded through special assessments. Once assessment amounts are determined, property owners may choose to pay the entire amount up front or pay the assessment in installments for up to 20 years. Refunds would only apply to amounts that had been prepaid by property owners, since future annual installments would be adjusted for those

property owners paying over a number of years. Based on discussions with City personnel and information provided regarding the costs of each of these projects, the final actual costs of the projects were less than those used to calculate assessments that were prepaid. The dates of final completion for the various assessment areas completed, and the dates on which refunds were issued, are as follows:

Assessment Area	Date of Final Completion*	Date of Refunds	Amount of Refunds
Pine Island Road Corridor	03/28/03	10/22/04	$170,934
Southwest 1	04/30/04	09/16/05	$695,224
Southwest 3	11/02/04	09/16/05	$720,640
Southwest 2	04/29/05	11/09/05	$986,460

***** Date used as "Final Completion" was obtained from the Program Master Schedule.

Although the final costs may not have been determinable by the dates of final completion noted above, they should have been determinable soon thereafter. In August 2005, we inquired as to why refunds had not been issued to property owners that prepaid assessments for the Southwest 1 and Southwest 3 areas. In response, the Financial Services Director indicated that, while the refunds have been calculated, they cannot be issued until the City has adjusted its records for all split and combined parcels within the assessment areas (See further discussion in finding No. 11). As indicated above, these refunds were issued the month following our inquiry.

In *Lake County v. Water Oak Management Corp.,* 695 So.2d 667 (Florida 1997), the Florida Supreme Court recited a two-prong test an assessment must satisfy in order to be considered a valid special assessment: (1) whether the services at issue provide a special benefit to the assessed property; and (2) whether the assessment for the services is properly apportioned. Thus, the assessment cannot exceed the benefit received. The City elected to apportion the assessment based on the final actual cost of each project, but collected payments based upon estimated costs. Because estimated costs exceeded actual costs in the above projects, the City should have promptly refunded the excess amounts collected in order to timely comply with the second prong of the above test.

Recommendation: To assure that assessments do not exceed benefits received by property owners, the City should timely issue refunds for any future assessments that exceed the final actual cost.

Auditor General Clarification

In his response, the City Manager contended that the City was not obligated to refund assessments that were based upon estimated costs collected from property owners in excess of the property owners' proportionate share of the improvement based upon actual costs. Therefore, the City asserted it had no obligation to timely refund these overpayments. In support of this proposition, the City cited Dryden v. Madison County, 727 So. 2d 245 (Fla. 1999), which holds that refunds may not be required if a special assessment was levied pursuant to a technically invalid ordinance but conferred a commensurate benefit upon the taxpayer and was enacted in good faith. The application of this case to the finding is unclear.

The City also contended Lake County v. Water Oak Management Corp., 695 So.2d 667 (Fla. 1997), cited in our Report for the proposition that assessments must be properly apportioned among the properties receiving the benefit, has "been distinguished" by City of Wintersprings [sic] vs. State, 776 So.2d 255 (Fla. 2001). However, Lake County is cited with approval in the City of Winter Springs case for exactly that proposition.

We continue to believe Florida case law clearly requires that special assessments be properly apportioned based on the benefits received and, therefore, the City is obligated to promptly refund excessive special assessments collected because of overestimated construction costs.

Finding No. 10: Determination of Contributions in Aid of Construction (CIAC) Fees

The City plans utility expansions several years in advance. A contributions in aid of construction (CIAC) area is established when City utilities are extended to an area outside a planned area of expansion. For example, as further discussed in finding No. 12, the City extended water and sewer utilities to the North Cape Industrial Park (Park), which was not included in the City's planned area of expansion. Thus, the Park, and all properties abutting the new utility lines, represented a CIAC area. The initial costs of the utility extension may be funded either by the City or by a third party (e.g., developer). If the extension is funded by a third party, the City refunds a portion of the CIAC fees collected to the third party.

Section 19-38 of the City's Code of Ordinances (Code), establishes contributions in aid of construction fees (previously known as "betterment fees"), and rates are pre-set and are charged on a square footage basis. CIAC fees are generally payable at the time of issuance of a permit allowing any development on the property and are based on the rates in effect at the time of permit issuance (unless the utility extension occurred prior to 1988, for which a different rate is charged). If properties are developed at the time of the utility extension, CIAC fees are due upon issuance of the utility permit. The Code provides that the CIAC rates are to be periodically examined to provide a uniform charge to those connecting to the utility systems, so that they reflect, as nearly as possible, the current costs of construction, as well as the cost of funding the unused portion of the system to the date of proposed development of each individual building site. Proceeds from CIAC fees may be applied only to the payment of the cost of expansion of the respective system and to the payment of any bonds to which such funds were pledged.

According to the City, CIAC fees are "in the nature of" special assessments. To be a valid special assessment, the assessed properties must be provided a special benefit and the cost must be properly apportioned among the properties assessed. The City, in response to our inquiries, indicated that the benefit to the properties is that they are allowed to utilize and connect to the City system and obtain water, wastewater, and non-potable water service. Further, the City indicated that the fee is fairly apportioned among the properties as the amount charged is based upon the property's fair share of the cost of the City's lines to which the property connects. However, the City also confirmed our understanding that CIAC fees charged to property owners within a specific CIAC area are not based on actual costs expended for the CIAC area's utility expansion. The City further explained that CIAC fees are a flat rate based on "current costs of construction" applied on a square footage basis. "Current costs of construction" was defined by the City as "the most recent cost incurred by the City for the construction of localized distribution and collection facilities. Typically, this would be determined utilizing the actual construction costs of the most recent utility expansion assessment area." The City further defined the portion of the rate applicable to "the cost of funding the unused portion of the system" to mean the cost to the City of maintenance and other expenses incurred for the localized distribution and collection facilities that are available, but not being used by the property that is going to connect to the system.

Although the properties charged CIAC fees are provided a special benefit, the City does not charge CIAC fees based upon the actual cost of the utility extension to the particular CIAC area. Rather, CIAC fees are generally calculated utilizing rates in effect at the time the property is developed or a utility permit is issued. Using the City's methodology, CIAC fees charged to a property owner may be higher than the actual costs incurred in

extending the utilities and the costs to maintain the unused portion of the system. Consequently, these fees may be subject to challenge by property owners as not being fairly apportioned. For example, a property owner of a 10,000 square foot parcel who developed his or her property in a CIAC area in 1992 would have paid $2,960 in water and sewer CIAC fees, while another property owner within the same CIAC area who developed his or her 10,000 square foot parcel in 1994 would have paid $6,202 in water and sewer CIAC fees, a difference of $3,242.

As the costs of the utility expansion are known for each of the CIAC areas, whether paid by the City or by the developer, and the payment for such expansion is currently funded by either the City or the developer, it is not apparent why the City does not charge the property owners a proportionate share of the actual costs, similar to the method used by the City within the planned areas of expansion.

Recommendation: The City should revise its methodology utilized for determination of CIAC fees to ensure that property owners in CIAC areas are paying only their proportionate share of the actual costs to extend utility services to their properties, including a determination of the costs to fund the unused portion of the system.

Auditor General Clarification

In his response, the City Manager indicated that we were advised numerous times that CIAC fees are not special assessments but are "service connection fees or charges and, as such, are not governed by any of the case law concerning special assessments." City staff had never previously referred to them as service connection fees. To the contrary, the City Attorney, through the Financial Services Director, provided a written response to our inquiry relating to the character of CIAC fees, in which she indicated that CIAC fees "are in the nature of special assessments." The written correspondence went on to justify the City's opinion regarding its satisfaction of the two-prong test for special assessments, (1) the special benefits test, as follows: "The provision of utility services has always been deemed to provide the requisite special benefit necessary for a valid special assessment" and (2) the fair apportionment to the properties test, as follows: "The fee is fairly apportioned among the properties, as the amount charged is based upon the property's fair share of the cost of the City's lines to which the development connects."

The City Manager also stated that there is no legal requirement that the amount of service connection fees be based upon actual cost of the utility extension to that area and the City, under its broad home rule powers, has determined that the imposition of CIAC fees in an amount that approximates the cost of current construction is a reasonable charge for those properties connecting to the existing system. This misstates applicable law because home rule authority does not grant the power to impose unauthorized fees or taxes. Assuming the CIAC fees are service connection fees, as the City now apparently contends, the validity of the fee must be determined using standards applicable to impact fees. See City of Zephyrhills v. Wood, 831 So.2d 223 (Fla. App. 2 Dist., 2002), stating "[i]mpact fees, which include connection fees, are the method by which a new user of a municipally-owned water or sewer system pays his or her fair share of the costs that the new use of the system involves." Similar to the special assessment fairly apportioned test, to be valid, impact fees must exhibit a reasonable connection between the expenditure of the fees collected and the benefits accruing to the new development. Under either test, the City may not collect more fees than it expends for the benefit of the persons subject to the CIAC fee.

The City Manager indicated that for many properties subject to CIAC fees, it may be difficult, if not impossible, to determine the exact cost of facilities used to service the property due to the length of time that has passed since the lines were initially installed and the City may not be able to determine which lines or portions of lines would be included to calculate the actual cost. The City has an obligation to demonstrate compliance with the above tests and may not credibly argue that

inadequate recordkeeping prevents compliance. We recommend the City determine whether it wishes to treat CIAC fees as either a special assessment or an impact fee, evaluate the CIAC fees under the appropriate tests, and maintain records appropriate to demonstrate compliance with applicable law.

Finding No. 11: Collection of CIAC Fees

As noted above, CIAC fees are generally payable at the time a permit is issued allowing development on the property, and are based on the rates in effect at the time of permit issuance. CIAC fees must be paid, or a financing agreement executed to pay annual installments or deferred payments, prior to issuance of a permit. Our review of the City's collection of CIAC fees disclosed the following:

- When a CIAC area is created, the City records, for each affected parcel, notes in the miscellaneous information section within the accounting system to indicate that CIAC fees should be collected. If a permit is issued for that parcel, personnel responsible for issuing permits must check for this miscellaneous information so that CIAC fees may be collected prior to issuance of the permit. There is no system edit in place to prevent a permit from being issued without collection of CIAC fees; therefore, if permitting personnel do not check for the information, a permit may be issued without collection of all required fees. Prior to April 2005, the City had not performed reconciliations between permits issued within a CIAC area and CIAC fees charged and collected to ensure that all CIAC fees that should have been collected were, in fact, collected. As of June 7, 2005, only two CIAC areas had been reconciled. The Financial Services Director indicated that two additional CIAC areas had been informally reviewed.

- When a parcel is either split into two or more parcels, or when parcels are combined, the County notifies the City of the change and the parcel identification numbers are changed. Although the changes in the City's records for parcel identification numbers are generally automated, the information regarding CIAC fees must be manually recalculated and transferred to the appropriate records of revised parcel numbers. As of May 14, 2005, the City was eight months behind in processing the changes due to split and combined parcels. If the miscellaneous information is not recorded, the personnel issuing permits are not aware of CIAC fees due and, as a result, CIAC fees may not be collected or the fees collected may not be in the proper amount.

- The City does not use unique codes to identify specific CIAC areas. Use of unique codes would assist the City in its efforts to perform reconciliations of permits issued to CIAC fees charged and collected.

We reviewed 40 parcels in CIAC areas to determine whether CIAC fees had been assessed and either collected or a financing agreement obtained. Of the 40 parcels, 3 had not been developed and, as a result, no CIAC fees were due. Of the remaining 37 parcels, the City had not collected CIAC fees on 1 parcel in Emerald Cove, and CIAC fees were paid up to 63 days after permits were issued on 3 parcels in the North Loop. For the Emerald Cove property, the City stated that CIAC fees, totaling $1,844, cannot be collected for this property because the statute of limitations has expired. In addition to the 40 parcels reviewed, we noted that several permits were issued within the Greystone Development prior to collection of CIAC fees or execution of financing agreements, including some that had not been paid as of the date of our review.

Recommendation: The City should implement system controls to prevent the issuance of permits without either collection of the required CIAC fees or execution of a financing agreement. In addition, the City should reconcile permits issued within CIAC areas to CIAC fees collected or receivable; collect CIAC fees from property owners for which permits have been issued, but fees have not been paid; and expedite efforts to update its records for split and combined parcels. Finally, the City should consider the use of unique identifying codes for specific CIAC areas to assist in the reconciliation of permits issued.

Finding No. 12: North Loop CIAC Project

CIAC rates and the methodology used to calculate CIAC fees have changed over the years. Prior to November 1989, CIAC fees were calculated on the basis of a standard eighty-foot residential building site or, for building sites of a different size, on the front footage of the parcel. In November 1989, Ordinance No. 63-89 amended the rates and the CIAC fees were calculated based on a standard 10,000 square foot residential building site (lot). For sites of a different size, the CIAC fees were adjusted up or down to the nearest whole equivalent lot. In May 1993, Ordinance No. 17-93 amended the rates and the CIAC fees were calculated on a square footage basis, with parcels of two acres or larger being calculated based on the greater of 200 linear feet from the property/right-of-way line abutting the system or 30 percent of the total property area. In July 1995, Ordinance No. 37-95 amended the rates with no changes to the methodology for calculating the CIAC fees.

The property owners within the North Cape Industrial Park (NCIP) requested to be connected to the City's water and sewer utility systems. Since the area was not included in the City's planned utility expansion at the time, the extension of the utilities to the NCIP represented a CIAC area, referred to by the City as the North Loop, and included all properties abutting the new utility lines. At the June 5, 2000, City Council meeting, the Council approved a motion "to require the occupants of the NCIP to connect to City utilities and pay a betterment fee. Those parcels developed before 1997 will be required to pay the betterment fee in effect at that time." Aside from the rates, no mention was made of the methodology to be used in calculating the CIAC fees or the rates to be paid by the other property owners that would benefit from the extension of utilities to the NCIP. Our review of the City's actions concerning CIAC fees and capital expansion fees charged for this project disclosed the following:

- While City Council has the authority to change CIAC rates or the method of calculation, these changes are required to be accomplished through enactment of an ordinance since the original fees were enacted via ordinance, pursuant to Section 166.041, Florida Statutes.
- Although City Council specified that CIAC fees for properties developed before 1997 would be charged the CIAC fee in effect at the time of the properties' development, the City calculated the fees for these property owners using the current methodology for calculating large parcels and applying the rates in effect at the time of development. It is not apparent that this was City Council's intent.
- The City also applied "rolled back" rates to the properties developed prior to 1997 for capital expansion fees; however, City Council action did not authorize or otherwise address a change in capital expansion fees for these property owners. Had the owners of the properties that were charged the rolled back rates been charged the rates in effect at the time of assessment, they would have paid $17,805 more in capital expansion fees.

Recommendation: Should the City Council wish to authorize a change in the CIAC rates in the future, such change should be in the form of an ordinance, and City staff should ensure that City Council actions are implemented as intended. Also, the City should collect the proper capital expansion fee from any property owners that did not pay the correct fee.

Auditor General Clarification

In his response regarding City Council actions, the City Manager stated that it appears that Council decided to treat this project differently because of an agreement between the City and the NCIP in 1984 to extend utilities to that development. He also indicated that, "An argument can be made that the City did not actually change the rate for these parcels, what Council did was to interpret the ordinance so as to provide an equitable resolution of issues relating to the City's failure to extend the line according to the provisions of the 1984 agreement." Ordinance, as defined by Section 166.041(1)(a), Florida Statutes, means an official legislative action of a governing body, which action is a regulation of a general and permanent nature and enforceable as a local law. The point of our finding is not whether the City Council could have changed the rates for selected individual property owners. Instead, our point is that should the City Council choose to take such action, it must be accomplished through the enactment of an ordinance.

In his response regarding City staff actions, the City Manager stated, "The decision to allow those parcels developed before 1997 to pay the betterment fee that was in effect in 1997 was apparently based on the fact that, if the City had extended the line as agreed to in the 1984 agreement, the developed properties would have paid the fee in effect at that time." Given this reasoning, City staff did not, in fact, implement the City Council's intent in calculating the CIAC fees for these properties because while the rates applied were those in effect at the time of the property development, the methodology used to apply these rates was the one in current use, not the one used at the time the property was developed.

In his response regarding the application of "rolled back" rates for capital expansion fees, the City Manager acknowledged that although a Council member made a comment during the June 5, 2000, City Council meeting that the impact fees for these properties should be charged at the rates in effect when they were developed, no further action was taken by the City Council in this regard. He stated that "the comment stands as a record of intent by the Council since there was no discussion arguing against the recommendation. Staff did as they should at the time and charged the impact fees that were clearly intended to be charged by Council in accordance with their actions." Such action may have been the intention of one Council member; however, official actions of governing bodies require a majority vote. Section 4.16(c) of the City's Charter provides that no action of the Council shall be valid or binding unless adopted by the affirmative vote of four or more members of the Council. Therefore, a comment by one Council member with no further action would not constitute action of the governing body.

Finding No. 13: Use of Capital Expansion and CIAC Fees

Section 2-24.4 of the City's Code of Ordinances, indicates that capital expansion fees shall be used solely for the cost of expanding the respective system (i.e., water, sewer, or irrigation) for which the fees were collected, and may not be used for the cost of operation, maintenance, repair, replacement, rehabilitation, renewal, or upgrading of the existing system to meet the service needs of the existing users. Our review of a sample of capital expansion fee expenditures disclosed the following:

- The City borrowed approximately $1.4 million from water capital expansion fees for the construction of the current City Hall building. Although these funds were eventually restored, with interest, the

temporary use of these fees in this manner violated Section 2-24.4 of the City's Code of Ordinances. The Attorney General, in opinion No. AGO 91-94, in responding to an inquiry as to whether a city could borrow from its impact fee fund, stated that, ". . . a valid impact fee ordinance must include restrictions on the use of funds collected thereunder. The utilization of these funds for any other purpose would jeopardize the validity of the fee itself and expose the ordinance under which it is imposed to challenge." The Attorney General concluded that borrowing of the impact fees was not allowed.

- During the 2002 through 2005 fiscal years, the City used $2.15 million of water capital expansion fees for the Gator Slough irrigation expansion project. Contrary to Section 2-24.4, of the City's Code of Ordinances, the funds were used to expand a different system than that for which they were collected.

- During the 2002 through 2005 fiscal years, the City used $1.78 million of sewer capital expansion fees for new clarifiers for the Everest Parkway project, an existing system. In addition, during the 2004 fiscal year, the City used $31,287 of sewer capital expansion fees for design services to repair and replace the existing interconnection at the southwest water reclamation facility. These expenditures are defined as a cost of operation, maintenance, repair, replacement, rehabilitation, renewal, or upgrading of the existing system and not allowable pursuant to Section 2-24.4 of the City's Code of Ordinances. According to the City's Utility Manager, approximately $1.5 million of the $1.78 million was used to add clarification capacity and would, therefore, be considered an authorized use of capital expansion fees. However, no justification was provided for the remaining $311,287 of expenditures.

We also reviewed a sample of the expenditures of CIAC fees during the audit period. Section 19-38C of the City's Code of Ordinances requires that the CIAC fees shall be applied only to the payment of the cost of the expansion of the respective system (i.e., water, sewer, or irrigation). Our review disclosed the following:

- The City paid $130,544 from CIAC fees to property owners in the North Cape Industrial Park to retrofit the fire sprinkler systems within the property owners' buildings so that they could connect to the City's systems. CIAC fees are restricted for the purpose of expanding the utility systems to the CIAC area. Although City Council approved these expenditures, this did not constitute a cost of the expansion of the City's utilities, contrary to Section 19-38C of the City's Code of Ordinances. (Also see finding No. 16.)

- The City used $237,783 in CIAC fees to prepay special assessments for property owners that could not connect to the utility system until the abutting properties were able to connect. The City does not require property owners to pay special assessments until the property owner is able to connect to the system for which the assessment applies. When the assessment is eventually paid by the property owner, the funds are to be repaid to the CIAC fee account. The use of CIAC fee collections should be limited to the costs associated with the utility expansion of the property owners that paid such fees, and the borrowing of these funds for other purposes would be inappropriate for the reasons addressed in AGO 91-94, as discussed above.

Recommendation: The City should review all expenditures of capital expansion and CIAC fees for compliance with the City's Code of Ordinances. Also, the moneys inappropriately expended as noted above, along with any others identified by City personnel, should be restored to the respective fund(s). Further, the City should establish controls to ensure that future expenditures of these restricted funds are in accordance with the City's Code of Ordinances.

Auditor General Clarification

In his response regarding use of water capital expansion fees for irrigation projects, the City Manager indicated that irrigation capital expansion fees were not established by the City until January 1, 2005, and that the City did not impose irrigation capital expansion fees prior to that date and that the "costs of the irrigation improvements were allocated as a component of either the City's water or sewer system depending upon whether the inclusion of those costs within the respective system was appropriate." He further indicated that the costs of the Gator Slough irrigation expansion project were specifically considered in the calculation of the water capital expansion fees in effect during that period and provided documentation to support this fact. However, Section 2-24.4 of the City's Code of Ordinances, which relates to use of capital expansion fees, that was in effect from September 29, 1997, through January 1, 2005, limited the use of water capital expansion fees to expenditures related to that system. The water capital expansion fees used by the City on the Gator Slough irrigation project were not used to expand a water system, thus violating the terms of the Ordinance. Additionally, inclusion of the Gator Slough irrigation project within the calculation of water capital expansion fees did not, in itself, authorize the direct expenditure of those funds for the irrigation system given the language of Section 2-24.4 of the City's Code of Ordinances.

In his response regarding the Everest Parkway clarifier, the City Manager indicates that the secondary clarifier did in fact cost $1.782 million and provided a compilation of unsupported costs. During audit field work, we were provided a copy of the purchase order for the clarifier, totaling $1,494,600. We were not provided with documentation to support the remaining $287,400 either during field work or in the City's response.

In his response regarding the amounts paid to retrofit sprinkler systems in the North Cape Industrial Park, the City Manager stated that it is not accurate to state that the City actually paid the property owners to retrofit their system and that such payment was in violation of the ordinance. He stated that the City, instead of crediting the amount of betterment fees due for each property, required the property owners to pay the full amount of betterment and then sent each property owner a check representing the cost for each owner to retrofit the fire protection system. Whether the City accomplished the reimbursement of retrofitting the property owners' sprinkler systems via credit or payment issued from betterment fee funds, this was an inappropriate use of betterment fees and violates Section 19-38C of the City's Code of Ordinances.

In his response regarding using CIAC funds to pay assessments for property owners that could not connect to the system, the City Manager indicated that Section 19-38C of the City's Code of Ordinances does not restrict the use of CIAC funds to the costs associated with the utility expansion of the property owners that paid such fees. Section 19-38C of the City's Code of Ordinances states that CIAC fees shall be applied only to the payment of the cost of expansion of the respective system. These fees were not used for the cost of the expansion of the respective system; rather, they were used to pay special assessments incurred by property owners in an expansion unrelated to the expansion project that pertained to the CIAC fees. The clear language of the Ordinance establishes that the use of CIAC funds to pay these assessments was inappropriate. The City should have used an unrestricted source to fund this cause.

Revenues

Finding No. 14: Collection of User Fees

The City charges fees for water and sewer services and fees for services incidental to the operation of its water and sewer systems. According to the City's Comprehensive Annual Financial Report for the 2004 fiscal year, the

City collected $29.2 million in charges for water (including potable, or drinking water, and reclaimed water used for irrigation purposes) and sewer services. Our test of a sample of customers and the user fees charged for water, sewer, and irrigation services disclosed the following:

- For 3 of 13 accounts, we noted that the City failed to bill customers for sewer services received. The sewer hook-up dates for these accounts were May 14, 2003, January 8, 2004, and May 3, 2004, and sewer services followed soon thereafter. Upon inquiry, the Financial Services Director stated that the failure to properly bill these customers was due to operator error in setting up the account in the City's records. The Financial Services Director also furnished documentation supporting the back-billings, dated June 13, 2005, totaling $701, for these three accounts. According to the letters notifying the customer of the billings, the City's policy is to backbill for 12 months. As a result, the back-billings represented only 12 months of the non-billed periods, leaving $386 of sewer services unbilled. However, the City's 12-month back-billing policy, as established by the Financial Services Department, appears to be limited to problems associated with defective meters. Section 19-19A of the City's Code of Ordinances provides that when a customer has been overcharged or undercharged, an amount necessary to correct the error may be credited or billed to the customer as determined by the Financial Services Department.

- For two new utility accounts, the City charged the customers a $50 new account fee. The first billing for both new accounts was in June 2004; however, Ordinance No. 45-04, effective April 26, 2004, repealed the requirement for the $50 new account fee.

Recommendation: The City Council should amend Section 19-19A to require the Financial Services Department to credit or backbill customers, in full, when customers have been overcharged or undercharged, or the Financial Services Department should revise its policy to that effect. The City should also develop procedures, such as reconciliations, to detect instances in which a customer is receiving services but is not billed for such services. Additionally, the City should ensure that changes to rates or policies directed by the City Council are promptly implemented.

Auditor General Clarification

In his response, the City Manager stated that the language of the finding asserts that the City makes it a habit or implies that the utility billing group of the financial services department consistently does not charge the utility users appropriate fees or timely bill for services rendered. To determine appropriateness of billings, it is common and necessary for auditors to test transactions. The finding merely discloses the result of our tests, without reference to habits of, or the consistency of, the utility billing group in performing their duties. The City Manager also pointed out that the three accounts not billed for sewer services, out of 13 evaluated, represents less than .oo6 percent of all accounts. While our intention was not to estimate the total amount or number of failures to bill for service, the incidence of 3 such failures out of 13 evaluated would seem to indicate the possibility of more failures to bill than .006 percent of all accounts.

Regarding the policy for back-billing customers for only 12 months, the City Manager provided documentation from 1999 that indicates Council approved a 12-month back-billing for utility customers. This document was not provided to us during our audit field work; instead, we were provided with the Financial Services Department's Utilities Policies and Procedures Manual, dated August 22, 2001. Notwithstanding the additional documentation provided, we continue to recommend that City Council amend Section 19-19A of the City's Code of Ordinances to require the back-billing of customers in full.

Finding No. 15: Allocation of Costs

In its Recommended Practices, *Measuring the Cost of Government Service (2002)*, the Government Finance Officers Association (GFOA) recommends that governments calculate the full cost of the different services they provide. The full cost of a service encompasses all direct and indirect costs related to that service. Direct costs include the salaries, wages, and benefits of employees while they are exclusively working on the delivery of the service, as well as the materials and supplies, and other associated operating costs. Indirect costs include shared administrative expenses within a department and in one or more support functions outside a department (such as legal, finance, human resources, and information technology). These shared costs should be apportioned by some systematic and rational allocation methodology and that methodology should be disclosed, particularly in situations where costs are fully or partially recovered through user charges.

The City allocates direct and indirect costs from departments other than utilities to the Water and Sewer Fund and Stormwater Fund using various allocation methodologies. For indirect costs, the City allocates actual general fund costs from the second preceding year in the current year. For example, indirect costs allocated and transferred to the general fund from the Water and Sewer Fund and Stormwater Fund during the 2004 fiscal year are actual costs incurred in the 2002 fiscal year. During the 2004 fiscal year, direct costs for departments other than utilities (primarily Financial Services) that were paid by the Water and Sewer Fund and Stormwater Fund totaled $1,830,475 and $392,039, respectively. Additionally, indirect costs paid during the 2004 fiscal year (for 2002 fiscal year costs paid by the general fund) by the Water and Sewer Fund and Stormwater Fund totaled $2,301,968 and $774,688, respectively. Our review of the City's allocation of selected costs for the 2004 and 2005 fiscal years disclosed the following:

- ***Financial Services.*** The City directly charges the Water and Sewer Fund and the Stormwater Fund for certain positions (including accounting, budgeting, cashiers, and billing personnel) within the Financial Services Department that primarily are responsible for accounting for transactions recorded in these funds. The salaries and a portion of the operating costs for the Financial Services Department paid directly by the Water and Sewer Fund and Stormwater Fund for the 2004 fiscal year totaled $1,810,973 and $392,039, respectively. Although requested, we were not provided with documentation to support the direct allocation of the Financial Services Department costs to the Water and Sewer Fund or the Stormwater Fund. The Financial Services Director indicated that the allocations of personnel costs are based upon professional judgment due to the type of work assigned to each employee. The operating costs were prorated based on the ratio of the employees directly charged to the Water and Sewer Fund and Stormwater Fund, with the exception of envelopes and paper which are directly charged.

- ***Retiree Health Care Costs.*** For the 2004 fiscal year, the City allocated these costs based on the number of current employees (e.g., the number of employees directly charged to the Water and Sewer Fund as a percentage of total employees). Amounts allocated for the Water and Sewer Fund and Stormwater Fund were $233,206 and $110,461, respectively. An allocation based on the number of retirees would have been more appropriate, which the City did use for the 2005 fiscal year. Had the City allocated the 2004 fiscal year costs based on the number of retirees, and assuming the percentages of retirees for the 2004 fiscal year were the same percentages calculated for the 2005 fiscal year, the allocation of retiree health care costs would have been $70,665 less for the Water and Sewer Fund and $79,065 less for the Stormwater Fund than that allocated and transferred.

In addition to the allocation costs transferred, the City transferred additional moneys for retiree health care costs to the general fund. Upon inquiry, the Financial Services Director indicated that the extra transfers were for current retiree health care costs, that these costs had been overallocated to the Water and Sewer Fund by $295,000, and that the funds would be repaid to the general fund.

- ***Financial Services, Cashier's Office.*** In the City's Cashier's Office, there are three cashiers and one Cashier Supervisor. The City directly charges the salary of one of the cashiers to the Water and Sewer Fund along with a portion of other associated operating costs. In addition, the City allocated a portion of the operating costs of the Cashier's Office paid by the general fund to the Water and Sewer Fund based on the estimated number of transactions processed by fund. Upon inquiry, the Cashier Supervisor was able to print a report that indicated the total actual transactions. Based on the actual transactions, amounts allocated to the Water and Sewer Fund in the 2004 fiscal year would have been approximately $25,000 less than the amount allocated (aside from the amounts directly charged).

- ***Construction Costs/Feasibility Study.*** A feasibility study was prepared in 1999 by a consultant that estimated the construction costs for the City's 21-year utility master plan for utility improvements. The City divided the total estimated costs of $482,044,000 by 21 and allocated 2.5 percent, or $573,862, each in 2004 and 2005 to the Water and Sewer Fund for construction administration. A total of $3,195,501 was allocated for construction administration from the 2000 through the 2005 fiscal years. Since direct construction costs are charged to the Water and Sewer Fund (or appropriate assessment fund), and all potential administrative costs paid by the general fund are allocated annually to the Water and Sewer Fund, these additional allocations appeared to be duplicative. Upon inquiry, the Financial Services Director indicated that, prior to the 2000 fiscal year, not all costs were directly charged to an assessment project and that the 2.5 percent allocation corresponded with costs associated with an assessment project before a separate fund was established. The Financial Services Director stated that, beginning with the 2006 fiscal year, costs will be directly charged and these moneys will no longer be allocated. The Financial Services Director also stated that there is no documentation to support the percentage utilized. Further, he indicated that, although the allocation of these costs were valid in the first year utilized, the 2000 fiscal year, all allocations of these costs in subsequent years were inappropriate and that the amounts inappropriately allocated, totaling $2,695,501, would be repaid by the general fund over the same term that they were contributed.

- ***City Auditor.*** For the 2005 fiscal year, costs of this office were to be allocated based on actual audit hours incurred in the 2003 fiscal year. However, the City used estimated hours rather than actual hours, and part of the costs of the City Auditor's Office was directly charged to the Water and Sewer Fund in 2003. Although the amounts allocated to the Water and Sewer Fund were not double-counted, it appears that the City overallocated costs. The estimated hours for the Water and Sewer Fund were 511, whereas the actual hours were 126; total estimated hours were 2,856, and total actual hours were 3,512. As a result, the percentage that should have been used was 3.6 percent (126/3,512) whereas the actual percentage used was 17.89 percent (511/2,856). Including the $46,909 that was directly charged to the Water and Sewer Fund, the City overallocated a total of $58,022 to the Water and Sewer Fund. Similar discrepancies were noted regarding the Stormwater Fund where we calculated that the City overallocated $4,130.

- ***City Attorney.*** The 2004 fiscal year allocation of costs was based on the number of full-time employees, whereas the 2005 fiscal year allocation of costs was based on the percentage of expenditures. Neither

allocation method appears to be relevant to allocate costs of the City Attorney's Office. It appears more appropriate to allocate these professional services based upon the actual hours expended.

As previously stated, the allocation of shared costs should be apportioned using a systematic and rational allocation methodology. Based on our review of selected allocated costs, the City did not demonstrate that it always used a systematic or rational allocation methodology, resulting in overallocated costs to the Water and Sewer Fund and Stormwater Fund. Additionally, the City did not document its allocation of Financial Services costs directly paid by the Water and Sewer Fund and Stormwater Fund.

Recommendation: The City should evaluate the allocation methods used for each type of administrative cost to ensure that costs are allocated in a systematic and rational manner. In addition to the examples provided above, for any costs determined to be overallocated, the City should restore such funds to the Water and Sewer Fund or the Stormwater Fund.

Auditor General Clarification

In his response, the City Manager stated that the City has demonstrated that the basis of allocation has been reviewed annually with the goal of achieving a fair and equitable cost allocation. He also stated that professional judgment and estimation should be recognized as being not only rational but in many cases highly reliable. He further stated that the City's cost allocation was prepared in accordance with the Federal Office of Management and Budget, Circular A-87. Circular A-87, which applies to cost principles for allocating direct and indirect costs to Federally funded grants, indicates that allocated central services, which means central services that benefit operating agencies but are not billed to the agencies, should be allocated on some reasonable basis. The Circular also states that all costs and other data used to distribute the costs included in a cost allocation plan should be supported by formal accounting and other records that will support the propriety of the costs assigned. Therefore, if the City prepares its cost allocation plan in accordance with Circular A-87, the City should use a rational and systematic approach and should accumulate documentation, such as time records, to support professional judgments used.

The City Manager also discussed the allocation of costs of the City Attorney's office. He agreed that the most appropriate basis of allocation would be actual hours expended, but indicated that since this data was not recorded, another reasonable basis was selected. However, he did not provide an explanation as to why the bases chosen were reasonable. As noted in the finding, the City used percentage of full-time employees in 2004 and percentage of expenditures in 2005, neither of which bears any relationship to the duties/function of the City Attorney's office.

Finding No. 16: Unauthorized Expenditures

Expenditures of public funds must be authorized by applicable law or ordinance; reasonable in the circumstances and necessary to the accomplishment of authorized purposes of the governmental unit; and in pursuit of a public, rather than a private, purpose. Documentation of an expenditure, in sufficient detail to establish the authorized public purpose served, and how that particular expenditure serves to further the identified public purpose, should be present for payment of funds.

The Attorney General has indicated on numerous occasions that documentation of an expenditure must be in sufficient detail to demonstrate to the postauditor and the public the authorized public purpose served by such expenditure. Our audit disclosed expenditures totaling $131,859 for which the City's records did not clearly demonstrate the authorized public purpose served. Specifically, we noted expenditures of $130,544 for the retrofitting of fire sprinkler systems in buildings owned by five property owners in the North Cape Industrial Park

(see also finding No. 13); $837 for food expenses for a volunteer Canal Watch barbeque; and $478 for a refrigerator. Upon inquiry, the Financial Services Director pointed out that City Council approved the expenditures for retrofitting the fire sprinkler systems; that the expenditure for the volunteers was to show appreciation; and the refrigerator, purchased in July 2004, was for employees to use. However, the documentation supporting these expenditures did not demonstrate an authorized public purpose.

Recommendation: The City should ensure and document in its public records that expenditures serve an authorized public purpose, are reasonable, and necessarily benefit the City.

Auditor General Clarification

In his response, the City Manager indicated that the City believes that it has, and continues to provide, sufficient documentation that its expenditures serve a valid public purpose and provided a reference to Attorney General Opinion No. 2005-02 in which the Attorney General stated that if an expenditure primarily or substantially serves a public purpose, the fact that the expenditure may also incidentally benefit private individuals does not violate the public purpose requirement. He also indicated that the refrigerator purchase was one of several provided for employees throughout City offices. We agree with the Attorney General's opinion and reiterate that the City should document in its public records the public purpose served. For example, the City should document why the purchase of several refrigerators for use by City employees primarily or substantially serves a public, rather than private, purpose. The City Manager also indicated that sufficient documentation exists to support the public purpose in retrofitting sprinklers in the North Cape Industrial Park, but did not provide such documentation.

Contractual Services

The City is responsible for establishing internal controls that provide assurance that the process of acquiring contractual services is effectively and consistently administered. As a matter of good business practice, procurement of services should be done using a competitive selection process to provide an effective means of equitably procuring the best quality services at the lowest possible cost. In addition, contractual arrangements for services should be evidenced by written agreements embodying all provisions and conditions of the procurement of such services.

Finding No. 17: Procurement of Contract for Bond Counsel

The Governmental Finance Officers Association (GFOA) recommends that issuers select bond counsel on the basis of merit using a competitive process. A competitive process using a request for proposals (RFP) or request for qualifications (RFQ) process permits issuers to compare qualifications of firms and select a firm or firms that best meets their needs. The RFP or RFQ should clearly describe the scope of services desired, the length of the engagement, evaluation criteria, and the selection process. The GFOA has developed a recommended practice for selecting financial advisors and underwriters that provides advice on setting up an objective RFP process, advice which is also generally applicable to the selection of bond counsel.

The current bond counsel contract is for five years, expiring on January 10, 2008, and was procured based on recommendations of the City Attorney and the Financial Services Director, not through an RFP. The written contract with the bond counsel provides compensation rates by type of bond issue plus out-of-pocket expenses. For the five debt issues we reviewed, bond counsel was paid $221,820 in fees and $16,847 in expenses for a total of $238,667. According to the Financial Services Director, the City's Code of Ordinances does not require that a bond counsel be selected by RFP.

Recommendation: Upon completion of the current bond counsel contract, the City should consider contracting with bond counsel through a competitive process.

Auditor General Clarification

In his response, the City Manager quoted a portion of the GFOA recommended practice discussed above, "The selection should not be driven solely by proposed fees. The experience of the firm with the type of transactions contemplated by the issuer is the most important factor in the selection of bond counsel." We do not dispute this practice. We did not state that the selection should be based on fees or the City should consider firms with no relevant experience. The City Manager also indicated that the City's bond counsel has been retained by the City since the late 1980's and indicated the firm's vast and relevant experience. We did not question the relevant experience of the firm selected by the City; however, it is a good business practice to periodically competitively select all firms providing professional services, including engineering firms, auditing firms, and legal firms.

The City Manager also stated that the City is at a loss to understand the meaning or the reason for including the information in the summary to support the finding and "We take exception to this clear inflation of the facts in the finding." It is unclear to us why this is considered by the City Manager to be an inflation of facts, as the amounts quoted are what the City paid for these services. The amounts included are intended simply to provide the reader with a quantification of costs relating to the issues discussed in the finding.

Finding No. 18: Written Agreements

As a matter of good business practice, contractual arrangements should be evidenced by written agreements embodying all provisions and conditions of the procurement of such services. The use of a formal written agreement protects the interests of the City, identifies the responsibilities of both parties, defines the services to be performed, and provides a basis for payment. Our audit disclosed the following:

- While payments to the financial advisor, the bond counsel, and the paying agents were supported by written agreements, the City did not provide written agreements to support the payments to other bond professionals, including the assessment counsel, the disclosure counsel, the underwriter's counsel, and the analytical contractors. These professionals were paid a total of approximately $104,657 from bond proceeds for the goods and services they provided. Although the Financial Services Director indicated that the City has contracts with the analytical contractors, copies were not provided for our review.

- For four contracts in excess of $20,000 that we reviewed, the City Manager or the Interim City Manager, not the Mayor, signed the contracts. Section 2-148 of the City's Code of Ordinances requires that all contracts in excess of $20,000 be executed by the Mayor and City Clerk, whereas the City's policy and procedure manual states, "The City Manager, the Procurement Manager, or their designee are the only individuals authorized to sign contracts on behalf of the City."

Recommendation: To provide adequate control of bond issuance costs, the City should require contracts with all bond professionals. Also, all contracts should be signed in accordance with the established ordinance and the City's policies and procedures manual should be updated to comply with established ordinances.

Auditor General Clarification

In his response, the City Manager indicated that he did not agree that the City did not have contracts with several bond professionals, as fees for their services were authorized by the City

Council in the bond resolution. While the bond resolution may authorize certain payments for services, to protect the interests of the City, written agreements should be used so that the service providers acknowledge the specific services to be provided, all circumstances related to the provision of the services, and the amounts to be paid for the services. The City Manager further stated that fees for bond professionals and contracts that have been signed by the City Manager or Interim City Manager were approved by City Council. This procedure is not in compliance with the City's ordinance.

Finding No. 19: Contract Monitoring

To ensure that contractors comply with applicable terms and conditions of the contract, and that the contractor's performance is effective in accomplishing the objectives established in the contract, effective monitoring procedures should be established. Our review of payments to contractors for services disclosed that the City made payments to contractors that did not perform in accordance with contract terms, as noted below:

- In March 2004, the City contracted with a firm to perform a comprehensive potable water audit for a lump sum fee of $47,180. The contract provided for deliverables consisting of a draft report and a final report to be submitted within 16 weeks and 20 weeks, respectively, from receipt of the purchase order. The purchase order was dated March 18, 2004; therefore, the draft report was due July 8, 2004, and the final report was due August 4, 2004. The contract provided for a lump sum payment, but provided that payments could be made based on City-established performance milestones. Although requested, we were not provided performance milestones established by the City. As of June 10, 2005, neither the draft nor the final report had been received from the contractor (the City later furnished a progress report from the contractor dated February 2, 2005), yet the City made payments totaling $30,431, from July 23, 2004, to March 18, 2005. In the absence of established milestones other than the dates of deliverables, payments should be based on the receipt and acceptance of the deliverables. The final report had still not been issued by March 15, 2006.

- In April 2004, the City contracted with a consulting firm, for a total of $29,500, to audit project records, billings, and applicable contractor records for one project included in the City's utility expansion program. The contract provided for a written audit report to be completed by June 30, 2004, with monthly invoices to be submitted based on percentage of completion. The consultant's July 1, 2004, invoice indicated that the audit was 80 percent complete and the City paid a total of $23,600. In August 2004, although the written report had not been received by the required submission date, the scope of audit work was expanded, and the contract amount increased to $48,700, to include other work authorizations issued for the utility expansion program. The revised date of completion on the expanded scope was "as soon as possible after completion of the agreed upon audit work." The written report was issued June 28, 2005.

Recommendation: The City should develop contract monitoring procedures to ensure that contractors perform in accordance with the terms of the contract. The City's contracts should establish definite due dates for deliverables. Unless another method for initiating payments is established in a contract, payments should not be made to contractors that have not provided the deliverables by the date specified within the contract.

Auditor General Clarification

In his response, the City Manager generally concurred with the finding but indicated that while the chronology identified in the first bullet of the finding is basically correct, all of the information which determined the decisions made by the manager with regard to payments and timing is not. The City manager did not cite any specific inaccuracies with the dates and facts presented in the finding and we do not discuss in the finding the decisions made by the manager other than the obvious approval of payments.

Finding No. 20: Contracts for Utility Expansion

Section 287.055, Florida Statutes, the Consultants' Competitive Negotiation Act, prescribes the selection procedures for the acquisition of certain professional services, including professional engineering services. Section 287.055, Florida Statutes, allows municipalities to award contracts by the use of either a competitive proposal selection process or a qualifications-based selection process pursuant to Sections 287.055(3), (4), and (5), Florida Statutes, for entering into a contract whereby the selected firm will subsequently establish a guaranteed maximum price and guaranteed completion date. Subsection (3) requires public announcement of the need and scope of the professional services, and certification by the City of qualified firms. Subsection (4) requires a further evaluation of firm qualifications and discussions with at least three firms about their qualifications. The City must then select no fewer than three firms, in order of preference, deemed to be the most qualified. Subsection (5) requires the City to conduct a detailed cost analysis of the professional services required considering the scope and complexity of the project and attempt to negotiate compensation with the highest ranked firm first at compensation which the City determines is fair, competitive, and reasonable and, should it be unable to successfully negotiate a contract, attempt to negotiate with the second highest ranked firm, etc.

The City entered into two contracts for utility expansion projects. The selected contractors were responsible for the overall management, coordination, design, and construction of the projects. The first contract, dated April 20, 1999, covered a five-year contract period. The second contract, dated September 10, 2004, does not define the contract term but rather stipulates the specific projects to be completed. Both contractors were chosen using a qualifications-based selection process. Our review of the City's actions regarding these contracts disclosed the following:

- Although requested, the City did not provide evidence that it certified the qualifications of the contractor prior to contract execution for the 1999 contract, contrary to Section 287.055(3)(c), Florida Statutes.
- Although requested, the City did not provide a detailed cost analysis, which the City is required to utilize in negotiating fair, competitive, and reasonable compensation, contrary to Section 287.055(5), Florida Statutes.
- The City executed the two contracts with the selected firms without first negotiating fair, competitive, and reasonable compensation as required by Section 287.055(5), Florida Statutes. Rather, the City executed contracts that allowed compensation to be determined at various stages during the terms of the contracts. This effectively precluded the City from negotiating contracts with lower ranked qualified firms if the compensation demands of the selected firm were excessive. As a result, it is not possible to determine whether the City selected the appropriate firm, taking into consideration both qualifications and cost.
- Neither contract established a guaranteed maximum price or guaranteed completion dates, contrary to Section 287.055(9)(c), Florida Statutes (2004; in 1999, subsection (10)(c)). Rather, contracts were

designed to be priced through the issuance of individual work authorizations for each major phase (program management services, design/engineering and preconstruction services, and construction services) for each year and expansion area, and work authorizations were issued throughout the contract period for the 1999 contract. The failure to specify a maximum price, which should have been negotiated prior to the execution of the contracts, limits the City's ability to determine the total estimated cost of the expansion projects. This, coupled with the City's failure to perform a detailed cost analysis, may have negatively impacted the City's ability to negotiate fair and reasonable compensation with the selected firm. The 1999 contract indicated that the anticipated cost of the entire project would be approximately $150 million, whereas the actual cost of the project was $162 million.

- Section 255.05(1)(a), Florida Statutes, requires any person entering into a formal contract with a city for the prosecution and completion of a public work, before commencing the work, to deliver to the public owner and record in the public records of the county where the improvement is located, a payment and performance bond with a surety insurer authorized to do business in Florida as surety. Although requested, the City could not provide documentation to evidence of payment and performance bonds for one work authorization totaling approximately $22 million. Additionally, for three other work authorizations, totaling $46.6 million, there was no record that the payment and performance bond had been publicly recorded.

- On August 16, 2002, the 1999 contract was partially assigned, with the City's approval, to another contractor. This partial assignment specified the work authorizations included in the assignment as well as "all other future Work Authorizations that are issued subsequent to the date of this Partial Assignment and Contract Amendment." It also referred to "Reserved Work" which "includes all remaining work exclusive of the Assigned Work" identified in the assignment agreement. However, we noted that the City executed a work authorization with the former contractor in September 2002 for work with a guaranteed maximum price of approximately $3.7 million. City personnel advised that the work authorization executed in September 2002 was "in negotiation and, therefore, was considered as 'Reserved Work' and excluded from the assignment." However, the assigned work included work authorizations issued subsequent to the date of the partial assignment and would be excluded from reserved work.

- Although the contracts provided for monthly invoices to be properly supported with documentation for payrolls, invoices, discounts, etc., the monthly contractors' invoices we reviewed were not sufficiently supported by detailed time records for hours charged or complete invoices detailing the costs to be reimbursed. In addition, requests for payments on behalf of subcontractors contained no supporting documentation of the materials and labor charges for which the subcontractor was requesting payment.

In April 2004, the City contracted with a construction cost control consultant to audit project records, billings, and applicable contractor records for the Pine Island Road Corridor utility expansion project (part of the 1999 contract). In August 2004, the scope of audit work was expanded to include other work authorizations issued pursuant to the 1999 contract. The consultant issued a report as of June 28, 2005, that noted many findings and made several recommendations.

Recommendation: The City should take steps to ensure compliance with Sections 287.055 and 255.05, Florida Statutes. The City should also verify all invoices submitted, and to be submitted, for payment by requesting adequate supporting documentation and, for any amounts overpaid, request a refund from the contractor. Finally, the City should consider all recommendations suggested by the contracted consultant.

Auditor General Clarification

In his response to our comment that the City did not provide us with evidence of compliance with the requirement of Section 287.055(3)(c), Florida Statutes, the City Manager provided details as to the evaluation process set forth in City Ordinances. However, the point of our comment was that no documentation was available to demonstrate such evaluation occurred. Specifically, the City did not provide evidence that the contractor was appropriately licensed as of the date of the City's evaluation.

The City Manager, in response to the applicability of Section 287.055(5)(a), Florida Statutes, stated that there is nothing in that section of the statute that requires the City to negotiate a guaranteed maximum price for all utility expansion assessment areas prior to the commencement of any work. As indicated in our comment, this requirement is contained in Section 287.055(9)(c), Florida Statutes. The City Manager also states that "if the City is required to negotiate the price of the entire project in year one, it is reasonable to expect that the contractor will demand a higher rate of compensation" because of the difficulty of estimating future material and labor costs. The City is not required to negotiate the price in year one, it is only required to negotiate a guaranteed maximum price to protect the City from excessive costs.

Regarding the performance bond which was not provided to us during audit field work, the City obtained the document and provided it with its response.

In his response regarding the partial assignment, the City Manager indicated that the City does not agree, but did not provide support for the City's position. As stated in the finding, the work authorization signed with the original contractor was not included in the stated "Reserved Work" and was dated after the date of the assignment. The assignment agreement indicated that all future work authorizations issued subsequent to the date of the assignment would be included in the assigned work. The basis for the City's disagreement is not apparent.

We continue to recommend that the City comply with the provisions of the Consultants' Competitive Negotiation Act.

Other Matters

Finding No. 21: Unaccounted for Water

The South Florida Water Management District (SFWMD) is charged with managing and protecting water resources of the region of the State that includes the City by balancing and improving water quality, flood control, natural systems and water supply. The City must submit monthly reports to SFWMD regarding its water usage. SFWMD reviews and approves the City's water use permits and requires implementation of leak detection programs by any utilities with unaccounted for water losses greater than 10 percent. The leak detection program must include water auditing procedures, and infield leak detection and repair program. The program description should include the number of labor hours devoted to leak detection, the type of leak detection equipment used, and an accounting of the water saved through leak detection and repair.

According to a schedule prepared by City personnel, the City's average annual unaccounted for water was 13.99 percent for the past 12 calendar years and the City has reported average unaccounted for water in excess of 10 percent for 11 of the past 12 calendar years, ranging from 11.67 to 17.82 percent. We inquired as to the City's leak detection program and the City furnished us a copy of an e-mail dated May 25, 2005, from the City's Utilities Manager to SFWMD listing various actions the City had taken over the past five years to reduce its unaccounted for water, including contracting with a consultant to conduct a comprehensive water audit. The City also indicated that SFWMD was aware of its potential unaccounted for water and has not, as of June 10, 2005, required a formal written leak detection program.

In reviewing a summary report of various water-related statistics for the 2004 fiscal year, we noted that unaccounted for water for September 2004 was reported at -5.02 percent, indicating that more water was billed than pumped. Upon inquiry, we were informed by City personnel that this was the result of billing errors related to the Lee County account with the City. We reviewed the entries in the City's accounting records relating to the Lee County account and found that the City billed the County for May, June, July, and August 2004, but the consumption of water for which the County was billed was much lower for these months than the months following. For example, the average billing to Lee County for the months of May through August 2004 was $7,780, whereas the billing for September 2004 was $172,419. The billings for the months of February through April 2005 averaged $50,719. It appears that the size of the meter, which determines the multiplier used to calculate water consumption, may have been incorrectly recorded in the City's accounting system and, as a result, water consumption was not billed correctly. The City's accounting system now correctly lists the meter as measuring in thousands of gallons.

In response to our inquiries regarding the City's contracted water audit, the City provided preliminary data that the contractor furnished to the City. Excerpts from the data furnished are as follows:

- The City is locating and repairing about 300 main and 1,000 service leaks per year. This number of service leaks and the associated manpower and expense requirements are excessive. The contractor recommended that the City develop an adequate budget to identify and replace the mains, rather than continue to repair, perhaps partially funded by revenue recovery from an improved meter accuracy maintenance program.
- The City's approximately 300 large meters (1.5 inches to 6 inches in size) were all tested for accuracy and 'flow-profiled' several years ago. The results were analyzed by the contractor and found to be thorough, but questionable as there were too many large meters over-registering. Meters generally under-register with age and use. The contractor recommended that the City select a small, valid sample of large meters for accuracy testing since only some of the inaccurate meters were replaced; but most were not (178 still on active meter list of the 250 which tested inaccurate, or 71 percent).
- The City has been working to reduce meter read errors and factoring problems associated with the correct fixed zeroes for respective meter sizes. The contractor recommended that the City standardize meter register heads; read and record full-scale meter register readings to avoid problems with zeroes and 100 vs. 1,000 gallon read and bill.

Recommendation: It appears that the City, while taking some actions to reduce water loss, should take additional steps including replacing rather than repairing dysfunctional meters, accelerate replacing meters identified as inaccurate, and ensure that meter registers are standardized to increase accountability and avoid under-billing for water usage. The City should also adopt a formal leak detection program.

Auditor General Clarification

In his response, the City Manager indicated that we asserted that 300 main and 1,000 service leaks are excessive, but that we did not provide support for that statement. This assertion was made by the City's consultant in the preliminary report. He further indicated a concern that the finding was built around an unfinished preliminary draft report by their consultant. As indicated in the finding, we relied not only on the preliminary report, but also the schedule provided to us by City personnel showing unaccounted for water over the past 12 calendar years. The City Manager acknowledged that the final report is still expected to indicate a 5 to 6 percent unaccounted for result and that the high percentage of unaccounted for water was a result of record keeping issues and failure to record all water usage.

Finding No. 22: System Access

Access to information technology systems should be controlled in a manner that permits authorized users to gain access only for purposes of performing their assigned duties and precludes unauthorized persons from gaining access. The access rules or profiles should be established in a manner that restricts employees from performing incompatible functions or functions beyond their responsibility and that enforces a separation of duties.

The City utilizes a public administration software package as its core financial system. We found that the access controls, as implemented for the financial system, allowed several Information Technology System (ITS) personnel to have very broad access to system resources. Specifically, we noted the following:

- Fifteen ITS employees have all-object authority which gives the user extensive authority over all resources on the system. All-object special authority essentially gives a user access to all functions on the system. Employees should only be given access to those functions necessary to perform assigned responsibilities.
- Fifteen ITS employees have direct access which allows the user to modify data tables without accessing the Utility Billing System. As a result, changes to the City's financial data could be made by these individuals without a record indicating the source of the change.
- Fourteen ITS employees have security administration access capability. This allows the user to set up user profiles and grant authority to selected objects.

Although we did not evaluate the specific duties and responsibilities of each ITS employee, typically one to three employees are given each type of authority or access described above. Allowing staff to have security administration duties, complete access to all system functions and resources, and update access to the production database, increases the risk that unauthorized activities may not be detected in a timely manner.

Our testing revealed a deficiency in controls over the City's information systems. Specific details of this deficiency are not disclosed in this report to avoid any possibility of compromising City information. However, the appropriate City personnel have been notified of the deficiency.

Recommendation: The City should review the duties of its ITS staff and remove, as appropriate, access capabilities that are unnecessary for the performance of assigned responsibilities. System administration functions provide a higher level of authority for system users and should be restricted to a limited number of individuals which actually need the function to perform their jobs.

Auditor General Clarification

In his response, the City Manager acknowledged and concurred with the finding. However, he indicated that the numbers of employees with specified access noted in the second and third bullets of our finding were fewer than indicated due to confusion arising from the City staff's explanation of the mechanics of the City's system to our auditors. The City Manager acknowledged that the actual numbers of employees with such access is excessive and will be reduced.

Finding No. 23: Cape Coral Charter School

In January 2004, the Lee County School Board (LCSB) granted the City a charter to operate a municipal charter school within the school district beginning July 1, 2005, serving students in grades K-5. The LCSB agreed to fund the school from moneys available to the LCSB for such purposes.

On April 12, 2004, City Council adopted Ordinance 41-04, created the Cape Coral Charter School Authority (the Authority), for the purpose of operating and managing all charter schools for which a charter is held by the City. The Ordinance further authorized the City to issue bonds, securities, or other forms of indebtedness allowed by law to finance the construction, renovation, remodeling, or operating of charter schools, providing that no indebtedness will ever be a general obligation of the City and no City ad valorem tax revenue shall ever be pledged for such indebtedness unless approved by a vote of the City electorate. Additionally, it authorized the City to require the Authority to use City departments and personnel for various services and charge a fee or fees for such services equal to the cost of providing such services.

The City purchased land and constructed a charter elementary school financed by a commercial paper note for which non-ad valorem revenues were pledged, and the charter school began operations for the 2005-2006 school year. The City is providing financial services, human resources support, computer technology, legal, and recording services to the school. According to the City's Financial Services Director, the City plans to bill the school monthly; however, the first billing to the school was not accomplished until December 2005 in order to provide cash flow to the school.

Our review of the City's actions for billing the school disclosed that the charter school is being billed for leasing the school facility based on interest expense and amortized issue costs on the commercial paper note. According to the Financial Services Director, as of February 1, 2006, the City is in the process of drafting a lease agreement between the City and the School, and that the City Council has decided to base the lease payments on the interest on the debt for only the first three years. Direct staff time expended and direct purchases of goods and services relating to charter school functions are charged to a project number set up for billing the school. According to the Financial Services Director, indirect overhead charges for providing services to the school will be calculated and billed at the end of the City's fiscal year and will be based on direct staff hours charged to the school as a percentage of total direct staff hours.

While Ordinance 41-04 stipulates that the City shall charge a fee or fees for services provided to the school equal to the cost of providing such services, the City's policies relating to the frequency and timing of billings for those costs are not addressed. As indicated above, billings for certain costs have not yet been implemented. As a result, we are unable at this time to make a determination as to the appropriateness of the partially implemented billing procedures.

Recommendation: The City Council should revise Ordinance 41-04 to address the frequency and timing of billings to the school for services provided by the City. In addition, the City should expedite the preparation and execution of the lease agreement.

Auditor General Clarification

In his response, the City Manager indicated our recommendation to amend Ordinance 41-04 to address the frequency and timing of billing to the school would be impractical as different services may require different billing schedules and the services offered by the City may change from time to time. Our recommendation was not intended to suggest that all billings be scheduled to occur at the same time. When we inquired as to whether City Council had approved the delay in billing the school for City services to begin December 2005, the Financial Services Director replied, "No the delay in billing was not approved by Council, why would it be?" We believe it would be prudent for the City Council to provide direction to City staff on what services will be billed to the school and the desired methods and frequency of billings.

Finding No. 24: Sunshine Law

Section 286.011(1), Florida Statutes (commonly referred to as the Sunshine Law), provides that all meetings of any board or commission of any State agency or authority or of any agency or authority of any county, municipal corporation, or political subdivision, except as otherwise provided in the Constitution of the State of Florida, at which official acts are to be taken are declared to be public meetings opened to the public at all times. Additionally, Section 286.011(2), Florida Statutes, states that minutes of a meeting of any such board or commission shall be promptly recorded and such records shall be open to public inspection.

We requested copies of the minutes of City Council meetings at which City Council members discussed and took action regarding the calculation of lease payments to be charged to the City's charter school. In response to our request, the Financial Services Director indicated that "With regard to the interest only lease payments, discussions were held with Council Members individually, not at a Council meeting, therefore, there are no minutes regarding the discussion." He further pointed to the fact that the lease payments were budgeted as interest-only in the City's budget. The City Council took action by formally adopting the budget in a public meeting.

The Attorney General, in the publication *Government-In-The-Sunshine Manual (Manual)* states that the Sunshine Law extends to the discussions and deliberations as well as the formal action taken by a public board or commission. The *Manual* further states that the Sunshine law is applicable to meetings between a board member and an individual who is not a member of the board when that individual is being used as a liaison between, or to conduct a de facto meeting of, board members, although it is permissible for staff to meet individually with Council members to provide information, or on an ad hoc basis. As noted by the Attorney General in Opinion No. 79-59, the spirit of the Sunshine Law requires official decisions to be made in public only after full and open discussion by board members. Since there was no public discussion of the lease payments to be charged to the school, it is not clear to us how the decision was made without violating the Sunshine Law.

Recommendation: The City should exercise caution in meetings between staff and Council members and ensure that violations of the Sunshine Law do not occur by using staff as liaisons among Council members to avoid full and open public discussions.

Auditor General Clarification

In his response, the City Manager indicated that the City strongly disagrees with the implication that a staff member has acted as a liaison with respect to the charter school lease payments and apparently bases his disagreement on the fact that the amount of lease payments has not yet been finally determined and will not be finally determined until the Charter School Authority and the City Council both finally approve a lease. However, on February 1, 2006, the Financial Services

Director stated in response to our inquiries, "the reimbursement was discussed numerous times with City Council whose decision it was to have the lease payments be interest on the debt only for three years." This response does not suggest that the amount of lease payments was unknown when we inquired. A delay on the City Council's part in approving the lease agreement does not render the Florida Sunshine Law inoperable.

OBJECTIVES

Our audit objectives for the scope of this audit were to:

- Document our understanding of the City's management controls relevant to the areas identified by specific allegations. Our purpose in obtaining an understanding of management controls and making judgments with regard thereto was to determine the nature, timing, and extent of substantive audit tests and procedures to be performed.
- Evaluate management's performance in administering its assigned responsibilities in accordance with applicable laws, ordinances, bond covenants, and other guidelines.
- Determine the extent to which the City's management controls promoted and encouraged the achievement of management's objectives in the categories of compliance with controlling laws, ordinances, bond covenants, and other guidelines; the economic and efficient operation of the City; the reliability of financial records and reports; and the safeguarding of assets.

METHODOLOGY

The methodology used to develop the findings in this report included the examination of pertinent City records in connection with the application of procedures required by generally accepted auditing standards and applicable standards contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

AUTHORITY

Pursuant to the provisions of Section 11.45(2)(l), Florida Statutes, I have directed that this report be prepared to present the results of our operational audit of the City of Cape Coral, Florida, for the period October 1, 2000, through March 31, 2005, and selected actions taken prior and subsequent thereto.

Respectfully submitted,

William O. Monroe

William O. Monroe, CPA
Auditor General

MANAGEMENT RESPONSE

The City Manager's response to our findings and recommendations is included in this report as Appendix A. The response, including attachments provided by the City with the response, may be viewed on the Auditor General's Web site.

APPENDIX A
MANAGEMENT RESPONSE

City of Cape Coral

May 3, 2006

William O. Monroe, CPA
Florida Auditor General
G74 Claude Pepper Building
111 West Madison Street
Tallahassee, Florida 32399-1450

Dear Mr. Monroe,

We are in receipt of the list of preliminary and tentative audit findings and recommendations for your operational audit of the:

City of Cape Coral, Florida
For the period October 1, 2000, through March 31, 2005,
and selected actions taken prior and subsequent thereto.

Pursuant to Section 11.45(4)(d), Florida Statutes, the attached written statement regarding the preliminary and tentative audit findings and any actual or proposed corrective actions shall serve as the City of Cape Coral's response required within thirty (30) days of receipt thereof.

If there are any questions related to the responses or request for additional information, please contact Mark C. Mason, CPA, Director of Financial Services at (239) 574-0491 or by e-mail at mmason@capecoral.net.

Sincerely,

Terry Stewart
City Manager

TM/mcm/shw(CM0506-074)

Enclosure

C: Eric P. Feichthaler, Mayor

City Manager's Office • City of Cape Coral • P.O. Box 150027 • Cape Coral, Florida 33915-0027
(239) 574-0447 • Fax (239) 574-0452 • www.capegov.org
Co-County Seat - Lee County, Florida

Following are detailed responses to each finding and recommendation included in the PRELIMINARY AND TENTATIVE FINDINGS for the City of Cape Coral, Florida. The preliminary and tentative findings and recommendations have been restated exactly as presented for clarity.

Finding No. 1: The City had not maintained its accounting records on a current basis, or periodically reviewed them for completeness and accuracy.

Recommendation: The City should ensure that its accounting records are maintained on a current basis and are periodically reviewed for completeness and accuracy.

Management's Response:

We acknowledge and concur with the Auditor General's observation and recommendation. The Accounting division is responsible for collection, analysis, and classification of all data relevant to the City's finances. To do so, the division maintains detailed data on each transaction that affects the City and the City's asset, liability, and equity accounts. We routinely engage in numerous individual transactions involving many separate accounts. There were several months where the monthly accounting periods were not closed on a timely basis.

We are committed to "Performance with Integrity". This philosophy has resulted in organizational and process changes, to ensure accounting records are maintained on a current basis, that include the following:

- **Reorganization of the accounting division.** The accounting division of the Financial Services Department reorganized with the addition of four accounting staff including two accountants and two accounting assistants. This reorganization has yielded immediate results through reallocation of personnel and modifying spans of control by providing direct supervision of the accounting processes and the results of those processes.

- **Changed the reporting dynamics.** The accounting assistants who maintain detailed data on transactions and prepare numerous journal entries are reporting directly to the accountants. This allows for a 2-level review for completeness and accuracy, and approval process of the journal entries by 1) the accountant and 2) the controller. In addition, the controller is reporting to the Financial Services Director that the closing of the monthly accounting periods are being accomplished within a designated time frame.

It should be noted that even though there were several months where the monthly accounting periods were not closed on a timely basis, the external auditors opined that the annual financial statements of the City of Cape Coral present fairly, in all material respects, the financial position of the City in conformity with U.S. generally accepted accounting principles. The Government Finance Officers Association of the United States has awarded a Certificate of Achievement for Excellence in Financial Reporting for the City of Cape Coral for its comprehensive annual financial report (CAFR) for the past 19 consecutive years.

In order to be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. Such reports must satisfy both accounting principles generally accepted in the U.S. and applicable legal requirements.

The reorganization of the division began in mid-2004 with the preparation of the FY 2005 budget well in advance of the Auditor General's performance audit by incorporating the appropriate staffing levels for the division that the City Council approved. During the course of the next eight months, following Hurricane Charlie and the completion of the CAFR, staff hired the additional personnel and changed the reporting dynamics that has resulted in numerous improvements in efficiencies in the division.

Finding No. 2: Written policies and procedures necessary to assure the efficient and consistent conduct of accounting and business-related functions were not established in all cases.

Recommendation: The City should adopt comprehensive written procedures that are consistent with applicable laws, ordinances, and other guidelines. In doing so, the City should ensure that the written procedures address the instances of noncompliance and control deficiencies discussed in this report.

Management's Response:

We acknowledge and concur with the Auditor General's observation and recommendation that procedures should be written. Many of the City's policies and procedures are in place through resolutions and ordinances, and Financial Management Policies in the areas of operating management, debt management, accounts management, financial planning and economic resources. At various times the City Council, the Budget Review Committee, and City Staff have conducted thorough reviews of such policies as part of an ongoing process of economic and financial analysis of the City.

We acknowledge that not all *detailed* procedures are written. The City operates in a constantly changing environment. Yesterday's policies and procedures may be inadequate to meet today's challenges. It is essential that we have clear lines of communication throughout the Financial Services Department. The Financial Services Department provides good communication, exchange of information, and changes in procedures through regularly scheduled weekly staff meetings, policy memos, documented procedures, and impromptu oral updates.

The Financial Services Department has proper segregation of duties. No one individual is able to *authorize* a transaction, *record* the transaction in the accounting records, and maintain *custody* of the assets resulting from the transaction. In addition, related accounting records are compared periodically through reconciliations, verifications, and analytical review.

Management has acknowledged that a comprehensive finance related policies and procedures manual is needed. City Council has approved the request to hire a consultant to write and standardize our procedures. In addition, City staff recognized the deficiencies in written procedures prior to the Auditor General's audit and crafted an appropriate RFP and sought outside support in drafting policies and procedures in compliance with federal, state and local laws as well as Generally Accepted Accounting Principals. The City Council recently approved a contract for the work following approval of a ranking for the services.

Finding No. 3: The City had not provided for an adequate separation of duties in certain areas of operation, and had not provided for the proper safeguarding of blank checks.

Recommendation: The City should reassign the duties relating to returned checks to an employee that does not have access to cash. Additionally, the City should consider separate close-out procedures for instances in which more than one employee uses the same terminal and cash drawer. Finally, the City should establish procedures to ensure that blank checks are properly safeguarded.

Management's Response:

We do not concur with the Auditor General's recommendation that returned checks should go to an individual who does not have access to cash. Checks deposited by the City and returned from the bank due to insufficient funds are mailed to the cashier's office. The cashier supervisor notifies the customer of the returned check and requests settlement of the returned check by cash, cashier's check or money order. We have modified the procedures to send a copy of the returned check to the specific department who will then reverse the payment from the appropriate account and add the service fee to the account. There is proper segregation of duties: the cashiers receive and record the funds, personnel from specific departments are reversing the payments, and an accounting assistant who does not have access to cash is doing the bank reconciliations.

The cashier's office used to be comprised of three (3) cashiers and only two (2) windows and terminals to service customers. At that time, two (2) cashiers shared one drawer and terminal and the other cashier had the other drawer and terminal. Responsibility and accountability was placed on both individuals that shared the drawer. We have not had any significant problems with the cashiers not being able to balance their cash receipts to the accounting records each day. If an error was made, management was concerned with how it happened, what caused the mistake, and how to correct and prevent it from happening in the future as opposed to finding whom to blame it on. As noted above, based upon the then policies in place, responsibility and accountability was shared by both individuals that has been considered an acceptable practice.

We are committed to ensuring all revenue collections are received, properly recorded, and deposited daily. To strengthen the control environment, we have increased the number of personnel in the cashier's office to four (4); one cashier supervisor and three cashiers. We have also increased the number of windows and terminals to service customers to three (3). This allows each cashier to have her own cash drawer. Each cashier balances her own drawer at a designated time throughout the day. When one drawer is being balanced only two (2) drawers are available for customers that come to the window. No payments are taken at the window of the drawer that is being balanced. On occasion the customer lines got long and the cashier supervisor utilized one of the cashier's drawers to serve a customer as quickly as possible. This happened when one of the cashiers was at lunch or on her scheduled break time and one cashier was balancing. The cashier supervisor is no longer sharing a cash drawer with one of the cashiers. We have further strengthened controls by assigning the cashier supervisor a 4th drawer to service a customer. The cashier supervisor and each cashier are responsible for their drawer and closing-out and balancing receipts to accounting records daily.

Finally, the City does have procedures to ensure blank checks are properly safeguarded. The blank checks are locked in the vault with a limited number of people having authorization to access the vault. The instance of an unauthorized employee having access to the vault and having blank checks on her desk was a one-time instance and is not standard practice. Also, this employee does not have access to the check signing machine and does not have the ability to issue a control pay record to the bank; and therefore could not process a check to be cashed. The City utilizes "positive pay", where the City transmits check issue information (e.g. check numbers and dollar amounts) to the bank. These electronic files are sent immediately after each accounts payable or payroll check processing cycle and whenever a manual check is processed. Bank tellers nationwide have access to the City's issue records and automatically match each item to be cashed against the City's "positive pay" file. Checks that match the file are cashed immediately. If an item does not match the issue file, a teller refers the check holder to an in-bank customer service representative for further directions and the City is notified. This method of safeguarding checks has been in place throughout the country for a number of years and has become the standard in the banking industry for insuring that unauthorized checks are not cashed.

Finding No. 4: The City did not consider all amounts available from prior years in adopting its 2003-04 or 2004-05 fiscal year budgets for the funds combined and reported as "Water and Sewer" and "Stormwater Utility," contrary to Section 166.241(2), Florida Statutes.

Recommendation: The City should consider all beginning net assets available from prior fiscal years in the preparation of the budget as required by Section 166.241(2), Florida Statutes.

Management's Response:

We do not concur with the Auditor General's findings or recommendations.

We do not agree with the statement that the City's FY 2004 and FY 2005 operating budgets were not prepared in compliance with Section 1664.241(2), Florida Statutes.

The statute section reads as follows:

> "(2) The governing body of each municipality shall adopt a budget each fiscal year. The budget must be adopted by ordinance or resolution unless otherwise specified in the respective municipality's charter. The amount available from taxation and other sources, including amounts carried over from prior fiscal years, must equal the total appropriations for expenditures and reserves. The budget must regulate expenditures of the municipality, and it is unlawful for any officer of a municipal government to expend or contract for expenditures in any fiscal year except in pursuance of budgeted appropriations."

It is the Auditor General staff's opinion that the underlined sentence requires the City to re-budget **all** available prior year net assets in support of an ensuing year's budget. The Auditor General's commentary in support of the finding opines that net assets represent the Cities net available resources. Nothing could be further from the facts of the issue. Net assets do not represent cash. In accounting vernacular, net assets represents total assets minus total liabilities and does not necessarily represent cash resources available to support the planned expenditures. Net assets has three main components, invested in capital assets, net of related debt (the terminology provides that the capital assets, i.e. pipes, buildings, and improvements are recorded less any debt and depreciation), restricted net assets which could include cash, receivables, net of any related restricted liabilities, and unrestricted net assets which is the net amount of remaining current and non-current unrestricted assets less any current and non-current liabilities. As can be seen, nowhere does this imply net cash available. In support of an annual operating budget, it would be irresponsible to utilize an estimated value of net assets as a cash revenue source to carry out planned operations and expenditures.

In addition, the language of the law underscores and supports the current methodology of budgeting used by the City. The City does in fact adopt a balanced budget annually that includes all designated reserves established and adopted by City Council as well as all outstanding encumbrances which would be and are classified as amounts carried over from prior fiscal years. Although asked for from the Auditor General's staff for some type of authoritative documentation, i.e. legislative intent supporting their position, none was provided.

As appropriate, the City does re-budget cash balances in support of the planned expenditures in order to minimize rate increases in the Water & Sewer Fund as well as the Stormwater Fund. However, the City's Financial Policy #7 (see Budget on City Website) states, 'that the City will not fund mainstream municipal services with temporary or non-recurring revenue sources'. In addition, the City's financial policies as well as bond covenants require certain reserves be established for repairs/replacements that are not budgeted unless necessary for expenses.

While not formally stated in the findings report, Florida Statute Section 129.03(3)(b) has been referenced during conversations with representatives of the Auditor General's Office. This particular statute section governs the preparation and adoption of the budget for county governments and specifically references utilization of fund balances. While the Auditor General's Office has suggested that the requirements are the same for counties and municipalities, the language in the statutes for municipalities and counties are clearly different.

The City does not concur with the findings. Unless there is substantive documentation of the legislative intent that supports the Auditor General staff's position with regard to its opinion, we do not recommend following the course of action in the recommendation since the City has and continues to evaluate all available sources of revenue to include existing cash balances, when appropriate, for inclusion in the annual budget.

Finding No. 5: The City reported budget overexpenditures totaling approximately $39 million in 7 of the 27 funds reported as "Water and Sewer" and "Stormwater Utility," contrary to Section 166.241(2), Florida Statutes. Furthermore, budget-to-actual comparisons were provided to the City Council only through the 3rd quarter of the 2004 fiscal year..

Recommendation: The City should ensure that future expenditures do not exceed budgetary authority. In addition, budget-to-actual comparisons for all funds budgeted should be prepared and submitted to City Council on a frequent basis.

Management's Response:

We do not concur with the Auditor General's findings.

The findings of this section reference the underlined Section 166.241(2), Florida Statutes as identified below:

> "(2) The governing body of each municipality shall adopt a budget each fiscal year. The budget must be adopted by ordinance or resolution unless otherwise specified in the respective municipality's charter. The amount available from taxation and other sources, including amounts carried over from prior fiscal years, must equal the total appropriations for expenditures and reserves. The budget must regulate expenditures of the municipality, and it is unlawful for any officer of a municipal government to expend or contract for expenditures in any fiscal year except in pursuance of budgeted appropriations."

The Auditor General's staff has implied that in FY 2004, seven of the 27 funds reported as "Water and Sewer" and "Stormwater Utility" and established at the fund level by City Council were over-expended. The finding also goes on to reference regular monitoring of budget performance and preparation of budget to actual comparisons. Each component of this finding will be addressed individually.

In determining that the funds were over-expended, the Audit General's staff prepared a spreadsheet in which the budgeted expenditures were compared to actual expenditures, i.e. cash transactions. Additionally, there were various adjustments made to arrive at a budget to actual variance. The City does acknowledge that the mathematical calculations within the spreadsheet were correct but does not agree with the methodology used or that the funds were over-expended.

The Auditor General's staff's spreadsheet categorized, in five of the seven funds from the balance sheet, principal payments on outstanding debt as expenditures. This is contrary to accepted Generally Accepted Accounting Principles as identified below. The basic question here is whether or not a principal payment is an expenditure and does it require an appropriation?

Florida Statutes do not define what an expenditure is. Therefore, the normal course of action is to go to the next authoritative level, General Accepted Accounting Principles (GAAP). What is an expenditure? As defined by *Governmental Accounting, Auditing, and Financial Reporting Blue Book, 2005 Edition* (recognized as second tier authoritative guidance for GAAP) as published by the Government Finance Officer's Association, expenditures are "Decreases in net financial resources not properly classified as *other financing uses*." The definition of "other financing uses" is "Decrease in current financial resources that is reported separately from expenditures to avoid distorting expenditure trends. The use of the *other financing uses* category is limited to items so classified by GAAP." Bond refunding and redemptions are classified as *other financing uses* and not as expenditures for the purpose of budgeting in Enterprise funds.

In the following three funds, the early redemption of outstanding special assessment bonds was made.

1. Fund 421 Green Wastewater Fund:
   Special Assessment Bonds totaling $5.8 million were redeemed
   Budget Variance $5,657,702 (as calculated on the audit spreadsheet)
2. Fund 422 Orange Wastewater Fund
   Special Assessment Bonds totaling $19,010,000 were redeemed
   Budget Variance = $17,360,742 (as calculated on the audit spreadsheet)
3. Fund 423 Orange Irrigation Fund
   Special Assessment Bonds totaling $1,970,000 were redeemed.
   Budget Variance = $1,952,047 (as calculated on the audit spreadsheet)

Two additional funds identified as being over-expended were Fund 446 & 447 in the amount of $9,737,220 and $3,829,504 respectively. Similar to the "over-expended" funds identified above, the City repaid State Revolving Fund Pre-Construction Loans for Southwest 3 Sewer and Irrigation Projects. The loans were repaid utilizing commercial paper proceeds as authorized by City Council.

If the principal payments were not expenditures, were appropriations required? Budgeting guidelines provided within *Governmental Accounting, Auditing, and Financial Reporting Blue Book 2005 Edition,* states that "debt covenants typically already provide adequate control over balances and spending related to the debt service making an appropriation budget superfluous." Additionally, the bond covenants related to the these particular bonds only require the City to budget and appropriate legally available non ad valorem funds to pay the bonds in the event the special assessment are inadequate to cover the required annual debt service payments. It is apparent that this audit report does fully recognize that there were available resources to support the transactions and therefore was not required to budget and appropriate legally available non ad valorem revenues which would have triggered the need to budget and appropriate the necessary expenditures. Based on the above and that it is a practice dictated by both GAAP and Budget guidelines as well as the debt resolution covenants that provide guidance as to what the City is required to do with redemptions and refundings, the City does not consider any of these funds to have had expenditures in excess of appropriations.

The expenditures made in the remaining two funds were related to capital expenditures.

The first fund was Southwest 4 Fund 406. A budget was created and approved by City Council for the utility extension area known as Southwest 4 in both FY 2003 and FY 2004. The budgets were established in Fund 448. The FY 2004 budget was $3 million. In late FY 2004, expenditures of $371,827 were incurred and recorded in Fund 406 rather than in Fund 448 as budgeted. The City does acknowledge that there was a disconnect between the budget and accounting functions; however, City Council appropriated funds for Southwest 4 and the expenditures were made in accordance with that authorization. A copy of the City's final budget ordinance for FY 2004 has been attached. The fund in question is circled on Page 8 of the ordinance (See Attachment 5-1).

The next fund was Southwest 2 Irrigation Fund 444. This fund was established to record the capital construction costs of extending irrigation services to the utility extension area known as Southwest 2. Funding for this project was initially established by City Council in FY 1999. The capital construction project was finalized in FY 2006. The total project costs included program management fees, design costs, and construction costs. The total appropriations for the project were $13,214,581 and capitalized costs equaled $11,810,848. The actual construction contract was approved by City Council on November 3, 2003.

As in most capital projects of this type, capital construction normally takes place over a period exceeding one fiscal year. Accordingly, capital budgets are generally adopted on a life-of-the-project basis and capital projects commonly do not have annual appropriated budgets but instead operate using life-of-the-project basis budgets. Clearly, the total appropriations authorized by City Council were not over-expended when applying a common practice of budgeting using life-of-the-project basis since the appropriations roll from year to year until the project is completed. The City's own Charter recognizes this method of budgeting as follows:

> **Article VII Financial Procedures Section 7.10. Lapse of appropriations.**
> Every appropriation, except an appropriation for a capital expenditure, shall lapse at the close of the fiscal year to the extent that it has not been expended or encumbered. An appropriation for a capital expenditure shall continue in force until the purpose for which it was made has been accomplished or abandoned; the purpose of any such appropriation shall be deemed abandoned if three (3) years pass without any disbursement from or encumbrance of the appropriation.

The second component of this finding focused on regular monitoring of budgetary performance. It has been the practice of the City to furnish City Council with a Financial Performance report at the end of the first, second, and third quarters of the fiscal year with the Comprehensive Annual Financial Report being provided at year-end following the completion of the annual audit. The focus of the quarterly reports is primarily upon the operational funds of the City and not the various utility extension funds that roll up into the Water & Sewer Fund at year end.

The finding indicated that if, in fact, the individual funds had been reported that City Council would have been aware of the funds being over-expended, when in fact this would not have been the case. The quarterly reports focus upon the revenues and expenditures of the funds not the cash balances or other balance sheet items. The transactions related to principal payments, as noted above being a balance sheet item, do not affect revenue and expenditures accounts but only balance sheet accounts related to cash and bonds payable.

Also, the City already ensures that expenditures do not exceed budgetary authority as well as provides the City Council with a budget-to-actual report on the operating funds and governmental capital project funds.

Finding No. 6: Bank reconciliations were not always performed timely, were not adequately reviewed, and contained errors.

Recommendation: The City should enhance controls to provide for timely and accurate bank reconciliations, timely recording of cash transfers, and thorough review of bank reconciliations by supervisory personnel. Additionally, the City should ensure that all differences were noted on bank reconciliations are appropriately and timely resolved and all journal entries relating thereto are properly prepared, reviewed, and approved.

Management's Response:

We acknowledge and concur with the Auditor General's recommendation. There were several months where the bank reconciliations were not properly reconciled. When it became apparent that the accounting assistant responsible for preparing the bank reconciliations was not properly reconciling the accounts, an evaluation including discussion of the bank reconciliation process was performed. Shortly thereafter, this accounting assistant resigned. The remaining accounting staff worked together as a team to re-construct all the bank reconciliations from October 1, 2004 through September 30, 2005 in accordance with established policies and procedures. During the process of performing the twelve bank reconciliations a number of process improvements were made that has created efficiencies in the preparation of the reconciliations. The bank accounts have been properly reconciled from bank balance to general ledger balance with proper supporting documentation for reconciling items.

We are committed to "Performance with Integrity". This philosophy has resulted in organizational and process changes, to ensure bank reconciliations are properly reconciled in a timely manner, that include the following:

- **Reorganization of the accounting division.** The accounting division of the Financial Services Department reorganized with the addition of four accounting staff including two accountants and two accounting assistants. As part of this reorganization, the bank reconciliation process has been included as a function of Treasury Management supported by both a Treasury Accountant and Accounting Assistant.

This reorganization has yielded immediate results through reallocation of personnel and modifying spans of control by providing direct supervision of the process and the results of those processes.

- **Changed the reporting dynamics.** As noted above, the bank reconciliation process became part of the cash and treasury management function through the reorganization. The accounting assistant who performs the bank reconciliations is reporting directly to the debt/treasury accountant. This allows for a 2-level review and approval process of the bank reconciliations by 1) the debt/treasury accountant and 2) the controller. In addition, the controller is reporting to the Financial Services Director that bank reconciliations are being accomplished within a designated time frame.

- **Enhanced internal controls surrounding the bank reconciliation process.** A new accounting assistant has been hired to perform the bank reconciliations effective October 1, 2005. The accounting assistant responsible for performing the bank reconciliations does not have access to cash. We have gone from monthly to daily reconciliation to ensure items are discovered and researched timely. We have refined the bank reconciliation process to ensure the bank accounts are properly reconciled from the bank balance to the general ledger balance with supporting documentation on a timely basis.

Finding No. 7: The City failed to timely report and remit unclaimed property to the Florida Department of Financial Services (FDFS), contrary to Chapter 717, Florida Statutes.

Recommendation: The City should take appropriate action to report and deliver the $27,480 to the FDFS. Additionally, the City should enhance controls to ensure that state-dated checks are timely reported and delivered to the FDFS in future years.

Management's Response:

We acknowledge and concur with the Auditor General's recommendation. Accounting personnel corresponded with personnel from the FDFS via telephone and e-mail. The FDFS confirmed that since the City performed due diligence as required by Florida Statutes by mailing notices again in April 2006 to individuals and vendors that had not claimed the warrants written in 2003, that the City could still void the 2003 checks and reissue new checks to the payees that responded to the notices. The checks that were not reissued were reported to the FDFS in the May 1, 2006 Annual Report of Property Presumed Abandoned. The FDFS also confirmed that a penalty will not be assessed for failure to timely report unclaimed property to the FDFS since the City performed its due diligence in mailing notices as noted in the attached e-mails (See Attachment 7-1).

Controls have been enhanced in this area as a result of the reorganization of the accounting division and the change in reporting dynamics. On a quarterly basis the accounting assistant will provide an outstanding check list to the accounts payable supervisor and payroll coordinator to review and determine if the payment is still valid. An accounting assistant who does not have access to cash and is not part of the accounts payable process is responsible for preparing the Annual Report of Property Presumed Abandoned. This report will be reviewed by the debt/treasury accountant and signed off on by the Controller. This process will ensure that the City is reporting unclaimed property to the FDFS before May 1 of each year, and simultaneously delivering such property to the FDFS.

In closing, the City of Cape Coral understands the importance and continuously seeks to improve our processes. We consider it a high priority.

Finding No. 8: The City did not prepare a financial analysis, including a calculation of the economic gain or loss, prior to issuing refunding debt totaling $53 million.

Recommendation: The City should utilize a cost-to-benefit analysis, including calculation of economic gain or loss, prior to issuing any future refunding bonds and consider initially pledging revenues that will ultimately be used to pay bonded debt.

Management's Response:

We do not concur with the finding. The finding asserts that the City did not prepare a financial analysis prior to the issuance of the $53,285,000 Wastewater and Irrigation Water Refunding Assessment Bonds (Southwest 1, Pine Island Road, and Southwest 3 Areas), Series 2005 including a calculation of an economic gain or loss.

The City refunded existing SRF debt, Commercial Paper Obligations and a Bank loan associated with the above assessment areas referenced in the title of the Series 2005 bonds. In doing so, the City is required in its bond resolution, specifically Resolution 04-05, to state the reasons for the refunding. Such reasons are typically based upon a financial analysis of either generating savings from the existing debt (which would include a calculation of a minimum amount of economic gain) or another financial analysis such as the restructuring of debt to remove restrictive bond covenants, which in fact was done. Specifically, Section 1.04 of the Resolution, items (C) and (D), are indicative of the financial analysis of the reasons for the refunding. Item (C) states that "the Issuer (the City of Cape Coral) anticipates having various infrastructure needs and requirements related to the System in the future which will need to be acquired, constructed and equipped in order to maintain and protect the health, safety and welfare of the citizens of the Issuer." Item (D) states that "The Issuer deems it to be in the best interest to refinance all or a portion of the Prior Indebtedness in order to provide the City with greater flexibility and capacity with respect to its financing of the Future Utility Capital Requirements through the issuance of additional indebtedness secured by the Net Revenues of the System."

A financial analysis was performed to determine that refunding the debt would and did in fact free up debt capacity in the utility system. The maximum annual debt service for the water and sewer system debt secured by net revenues and impact fees was $10,066,958 prior to the refunding. The refunding reduced this maximum annual debt service to $6,346,869, eliminating $3,720,089 from maximum annual debt service which is used to calculate the amount of additional bonds that are permitted under the bond covenants.

Additionally, the capacity analysis that was performed by the City's Financial Advisor in 2004 based on the 2003 Net Water and Sewer Revenues Including Impact Fees showed capacity of $102,190,000 based on that test and then current market conditions. This was prior to the SRF refunding. As a follow up to the original financial analysis, the City's Financial Advisor reran the capacity analysis in 2005 after the refunding and showed that the 2004 Net Water and Sewer Revenues Including Impact Fees produced capacity of $192,850,000 based on the new SRF debt service and current market conditions at that time. Capacity based upon net water and sewer revenue and impact fees was increased by $90,660,000 in 2005 due to the refunding and the market conditions at that time.

Within the body of the discussion prepared by the Auditor General's staff to support the finding, the Auditor General's staff provided information related to the Government Finance Officer's Association's (GFOA) publication, *An Elected Official's Guide to Debt Issuance (2001)*, that an issuer may consider refunding debt for three primary reasons: to reduce interest costs, to restructure debt service, and to eliminate old debt covenants that may have become too restrictive. The Auditor General's staff goes on to say that 'most refundings are performed to take advantage of current interest rates that are lower than those rates on outstanding debt. However, issuers must exercise care in evaluating refunding opportunities because even though current rates may be lower than those on the issuer's outstanding debt, it is possible that a refunding would generate little or no present value savings due to the associated costs of the refunding issue.' We agree with respect to the fact that most refundings, **but not all**, are performed to take advantage of current interest rates that are lower than the rates on the outstanding debt and that issuers must exercise care in evaluating refunding opportunities to insure that the

refunding generates sufficient present value savings to be economically beneficial to the issuer. However, as stated in the GFOA's referenced publication, some refundings are performed for reasons other than taking advantage of current interest rates. The interest rate on the outstanding bonds was not the reason for the specifically identified refunding except in a peripheral manner.

The refunding of the SRF debt was undertaken to remove restrictive covenants associated with the primary pledge of net water and sewer revenue which has already been demonstrated in the reduction in the maximum annual debt service and the resulting debt capacity increase to the utility system. The Auditor General's staff asserts that an economic gain or loss analysis should have been performed. We respectfully disagree. The financial analysis of the enhanced capacity generated was sufficient reason to refund the SRF notes, bank loan and commercial paper in light of the low interest rate environment as well as the avoidance of a utility rate increase to all utility customers that would have been required by the utilization of general system capacity for special assessment projects. Due to the recent explosive growth in the City, the City's significant Utility Facility Expansion needs were not known at the time that the prior loans were entered into with the pledge of the net water and sewer revenues instead of special assessments. It was determined that it would not be fair and equitable to all utility customers to put in place a higher rate increase than required because the debt capacity needed for system expansion was being utilized for special assessment projects. Also, it should be pointed out that although there was an increase in interest rates from 2.67% to 3.16% on debt service to 4.0% over the life of the assessment, the final interest rate was less than the 5.5% to 5.75% that was initially charged on the special assessments based on the necessary conservative original assumptions.

In addition to the fact that the City could not know that the unprecedented and significant growth would occur which would require the use of all of its water and sewer debt capacity, the SRF can only make a certain amount of loans secured by special assessments and they could not make any additional loans secured by special assessments at the time of the initial borrowing and at the time of the refunding. Both the City and the City's Financial Advisor contacted SRF prior to the refunding to request that the pledge on the SRF loans be changed to special assessments. The contact at SRF who spoke with the City's Financial Advisor stated that SRF had no more capacity for special assessment loans at that time, and that they could only make additional loans secured by special assessments once outstanding loans were paid off. They also stated that they had no way of knowing when the loan payoffs would occur as they are often repaid early from the prepayment of assessments. Also, in discussions with SRF by the Financial Services Director, they also advise that when we discussed changing the pledge two years ago, that they consulted with their bond counsel at the time that we made the requests to change the pledge to special assessments and that their bond counsel (which are the SBA's bond attorneys) stated that it would be an arbitrage issue. In any event, we are expecting confirmation regarding the discussions from SRF in a form of a letter. When received, it will be forwarded to you.

Also, the Auditor General's office asserts that 'the costs associated with the refunding bond issue, excluding future interest costs, were approximately $1.7 million.' In actuality, the costs of issuance for the Special Assessment Bonds which refunded the SRF loans and the other loans were $1,051,155.37. The state appears to have included the net original issue discount in their calculation of the costs of issuance however this is not a cost of issuance to the City. It is a function of the pricing (the bonds were priced at an overall discount in that some coupons are lower than the yield to maturity) which allows the City to achieve the lowest overall interest cost by maximizing investor demand.

The City already considers a cost-to-benefit analysis on all refundings and will consider the potential cost/benefit of evaluating an economic gain or loss in similar circumstances. Now that the City's special assessment programs have become more accepted and known in the market, the City will, when possible, issue special assessment bonds for projects secured by special assessments. The City will recommend not using SRF loans for special assessment projects in the future unless such SRF loans are secured by special assessments due to the unprecedented capital demands on the City's water and sewer system which requires that its net revenues be utilized for system-wide projects.

Finding No. 9: The City did not timely refund special assessments in excess of project costs for three completed utility expansion areas.

Recommendation: To assure that assessments do not exceed benefits received by property owners, the City should timely issue refunds for any future assessments that exceed the final actual cost.

Management's Response:

We do not concur with the Auditor General's findings or recommendations.

Under applicable Florida law, a local government is not required to allow for prepayments of special assessments for capital projects. *See §197.3632(10)(b)(3), Florida Statutes.* If prepayments are authorized, a local government may, but is not required to, reduce the prepayment amount for parcels in the assessment area by the pro rata share of the financing costs attributable to each particular parcel of real property in the assessment area. *See §197.3632(8)(b), Florida Statutes.*

Notwithstanding the above Florida law, the City desired to provide its citizens the opportunity to avoid financing costs (or perhaps finance the cost themselves by alternative means) by implementing a prepayment system. This prepayment system has evolved over time and varies from project to project depending on the availability of interim/permanent financing and the intent of the City to finance the construction costs at the lowest possible interest rates (given the volatility of the municipal debt market), again for the benefit of the citizens. The specific system for prepayment has been detailed in each of the implementing resolutions for the assessments areas. One of the terms of the earlier prepayment systems was that if the property owner chooses to prepay their assessment, they specifically assume the risk of non-refund if (1) the actual capital cost of the utility facilities is less than the estimated capital cost upon which the prepayment was computed, or (2) assessments will not be imposed for the full number of years anticipated at the time of such prepayment.

Moreover, in the event prepayments are authorized and paid, a local government is not necessarily required to refund prepayments of special assessments for capital projects in excess of the actual construction costs of such projects under certain conditions. *See Dryden vs. Madison County, 727 So. 2d 245 (Fla. 1999).*

However, in the instant case, the City's policy with respect to the Pine Island Road, Southwest 1, Southwest 3 and Southwest 2 Assessment Areas has been to provide refunds to the owners of real property who prepaid such assessments in the event that the actual construction costs of the improvements financed thereby are less than the estimated costs. Before the City can issue a refund, there are certain considerations that the City must balance in order to assure that the refund is sent in the appropriate amount to the appropriate party. Initially, a refund cannot be issued until the City has updated its records for all subdivided and combined parcels in the assessment area as of the refund date since each subdivision or combination of parcels results in a reallocation of each assessment (irrigation, water or wastewater) for such parcel. Once the amount of refund attributable to each parcel is determined, the proper recipient of the refund must be determined if the property or any portion of it has been transferred or sold. As indicated in Finding No. 11, the City is eight months behind in the processing changes due to subdivided and combined parcels (primarily due to the recent hot real estate market in Florida) and that has impacted the timely issuance of the refunds in these assessment areas.

Since there is no requirement under Florida law that requires refunds of excess prepayments, there is no standard under Florida law that can be applied to conclude that 8 months is unreasonable under these circumstances. The case cited in your finding contains no such standard and, in fact, is not even a case involving special assessments for capital projects since it relates only to special assessments for fire protection services. Furthermore, such case has been distinguished by more recent cases. We would suggest that *City of Wintersprings vs. State, 776 So. 2d 255 (Fla. 2001)* be a better citation for referencing current Florida law involving special assessments for capital projects.

Finding No. 10: The City's methodology for determining contributions in aid of construction (CIAC) fees may not appropriately match fees charged to actual costs incurred and, as a result, may be subject to challenge by property owners.-.

Recommendation: The City should revise its methodology utilized for determination of CIAC fees to ensure that property owners in CIAC areas are paying only their proportionate share of the actual costs to extend utility services to their properties, including a determination of the costs to fund the unused portion of the system.

Management's Response:

We do not concur with the findings and recommendations.

The preliminary and tentative findings suggest that for property subject to CIAC fees, the City should charge each property a proportionate share of the actual costs of construction of the facilities, similar to the manner in which the City calculates utility special assessments. As we have stated numerous times to the Auditor General's staff, the City's Contribution In Aid of Construction Fees are not special assessments as defined by Florida Statute. They are actually service connection fees or charges and, as such, are not governed by any of the caselaw concerning special assessments. There is no legal requirement that the amount of service connection fees be based upon actual cost of the utility extension to that area.

Furthermore, with many properties subject to the City's CIAC, it may be very difficult, if not impossible, to determine the exact cost of facilities used to service the property due to at least a couple of factors. One, in areas where the properties are being connected to lines that were originally installed by GAC, those costs may not be readily discernable due to the length of time that has passed since those lines were initially installed. Also, those lines were purchased by the City in the mid-70's through the issuance of a general obligation bond. Arguably, the bond issuance costs, debt service paid over the years, etc. could also be included in the calculation of actual costs. Second, for any given piece of property, it may be difficult, it not impossible, to determine which lines or portions of lines would be included to calculate the actual cost. There are no defined geographic areas for CIAC fees like there are for utility special assessment areas. Properties may be connected to collection and distribution lines that were constructed at different times by different entities. A recent report conducted for the City by Hartman & Associates determined that the amount of CIAC charged by the City is, in their expert opinion, too low. The City is currently considering that recommendation, but has not yet amended the ordinance in this respect.

In CIAC areas, the property owner derives a benefit not enjoyed by property owners in utility special assessment areas. In CIAC areas, the property owner does not have to pay anything until he or she is ready to develop the property. In assessment areas, the assessment is imposed and is due and payable on all properties, whether they are developed or not.

The preliminary and tentative findings suggest that the City's CIAC fees "…may be subject to challenge by property owners as not being fairly apportioned." "Apportionment," however, relates to how the total amount of an assessment is divided among the benefited properties in an assessment area; it has nothing to do with whether the total actual cost of the improvements is higher or lower than the amount charged to the property owner.

The City, under its broad home rule powers, has determined that the imposition of CIAC fees in an amount that approximates the cost of current construction is a reasonable charge for those properties connecting to the existing system.

Finding No. 11: The City does not have adequate controls in place to ensure that CIAC fees are timely collected.

Recommendation: The City should implement system controls to prevent the issuance of permits without either collection of the required CIAC fees or execution of a financing agreement. In addition, the City should reconcile permits issued within CIAC areas to CIAC fees collected or receivable; collect CIAC fees from property owners for which permits have been issued, but fees have not been paid; and expedite efforts to update its records for split and combined parcels. Finally, the City should consider the use of unique identifying codes for specific CIAC areas to assist in the reconciliation of permits issued.

Management's Response:

We acknowledge and concur with the Auditor General's observation and recommendation.

Bullet Point # 1 – We agree with the Auditor General's staff that certain controls with regard to the HTE system are not in place to ensure that CIAC fees will be collected at the time of issuance due to certain failings in the software when it was originally purchased. It is also acknowledged that staff has not pursued, as of the date of the audit, to update the system using unique codes for CIAC areas. However, staff is evaluating and putting in place changes to the system that will allow for both a control identifier for all CIAC areas and a unique code identifying specific CIAC areas that will allow for evaluation, as are performed with all fees, the CIAC due for a particular area when a permit is issued. In addition, we certainly acknowledged that reconciliations were not performed on the CIAC areas since we informed them of this fact at the beginning of there audit with the exception of one area, therefore I disagree however that there was none performed prior to April 2005 since the Financial Services Director performed one of the reconciliations on Emerald Cove himself prior to the Auditor General's staff beginning the audit. All areas have been reconciled to date.

Bullet Point # 2 – We generally agree with the summary associated with the point regarding splits and combines and the affect on the miscellaneous information in the HTE system. We do acknowledge that the City is eight months behind, however, it is also a procedural action on the part of the permitting function to check with the Customer Billings Services division of Financial Services for an evaluation of the property for potential CIAC. Until we are caught up with the splits and combines due to the incredibly active real estate market and the 160,000 lots in the city, this will continue to be a procedural action to insure that the appropriate CIAC fees are calculated for collection.

Bullet Point # 3 – As stated in Bullet Point # 1 where it has already been identified that unique codes are not used, we are in the process of evaluating the use of the a two part code that first uniquely identifies and area as CIAC and second a CIAC area. This should be put in place within the next several months.

With respect to the forty parcels reviewed, we recognize that CIAC fees on three parcels were collected following the issuance of a permit and this resulted from the items identified above with respect to specific codes, however they were collected. As noted, the City has rendered a legal opinion regarding the inability to collect on one parcel in Emerald Cove that was missed in the amount of $1,844 due to the statute of limitations expiring for the collection. We are not aware of any of the Greystone properties that have not been paid to date, since we provided all the payment of CIAC fees to you and include them again as part of this document as Attachment 11-1. In analyzing the Greystone development, there is one property that CIAC fee has not been collected for because it is vacant and permit request has not yet been submitted for. It would appear for the commentary of the finding that of the 37 parcels, 3 were collected late, 1 was not collected and 33 were collected when the permit was issued. Whereas we recognize that it was not 100% collection at time of issuance 89% collected on time and in the correct amount is an excellent rate of collection within the current permitting environment and the system that has been in place for some time.

The City has a work around system of controls for collection of CIAC as noted in bullet point number 2 and recognizes that unique codes and getting up to date on the splits and combines will resolve the comments. In addition, since the City informed the Auditor General's staff that reconciliations were not performed and were

now being performed, it appears that the recommendation is somewhat redundant. The City has been and continues to move towards a more automated system for splits and combines and has contracted with an outside agency to write the program for updating the system with the splits and combines.

Finding No. 12: City Council approved, via vote of City Council members rather than enactment of an ordinance, a change in CIAC fees established by ordinance, contrary to Section 166.041, Florida Statutes. Further, City staff's actions regarding CIAC and capital expansion fees charged regarding the North Loop CIAC project may have been contrary to the City Council's intentions.

Recommendation: Should the City Council wish to authorize a change in the CIAC rates in the future, such change should be in the form of an ordinance, and City staff should ensure that City Council actions are implemented as intended. Also, the City should collect the proper capital expansion fee from any property owners that did not pay the correct fee.

Management's Response:

We do not concur with the finding.

Bullet Point # 1and # 2 – The North Cape Industrial Park represents a somewhat unique situation. From a review of the minutes and supporting documentation, it appears that Council decided to treat this project differently because of an agreement between the City and the NCIP in 1984 (See Attachment 12-1) to extend utilities to that development. The decision to allow those parcels developed before 1997 to pay the betterment fee that was in effect in 1997 was apparently based on the fact that, if the City had extended the line as agreed to in the 1984 agreement, the developed properties would have paid the fee in effect at that time (which in some instances may have been long before 1997). Council's actions, therefore, were a compromise arising out of the City's failure to extend the line in accordance with the provisions of the 1984 agreement. An argument can be made that the City did not actually change the rate for these parcels, what Council in substance did was to interpret the ordinance so as to provide an equitable resolution of issues relating to the City's failure to extend the line according to the provisions of the 1984 agreement.

Bullet Point # 3 – With respect to the assertion that the City "rolled back" capital expansion rates we disagree. Attached please find the verbatim minutes of the meeting that was held relative to the discussion on the North Cape Industrial Park (See Attachment 12-2). During the discussion, one Councilmember made a comment that the impact fees at the time should be charged. Although a formal vote was not taken on this comment, the comment stands as a record of intent by the Council since there was no discussion arguing against the recommendation. Staff did as they should at the time and charged the impact fees that were clearly intended to be charged by Council in accordance with their actions.

With respect to the recommendations, staff will recommend to City Council that they consider adding a provision in the ordinance to allow for credits and other equitable adjustments as they deem appropriate and as the need arises.

Finding No. 13: Capital expansion fees and CIAC fees were not always expended in accordance with the City's Code of Ordinances and applicable case law.

Recommendation: The City should review all expenditures of capital expansion and CIAC fees for compliance with the City's Code of Ordinances. Also, the moneys inappropriately expended as noted above, along with any others identified by City personnel, should be restored to the respective fund(s). Further, the City should establish controls to ensure that future expenditures of these restricted funds are in accordance with the City's Code of Ordinances.

Management's Response:

We do not concur with the Auditor General's findings with the exception of one item contained in the narrative supporting the finding. Following are responses to the specific citations provided by the Auditor General's audit staff:

Bullet Point # 1: We concur with the comment that Impact Fees should not have been borrowed to use for non-utility expansion purposes and that such borrowing is in violation of existing policy provided in the City's Code of Ordinances. As noted, this was a one time transaction that has not been repeated. In addition, although the City promptly paid the impact fees back with interest, we do understand the importance of utilizing the impact fees for the purpose for which they were collected.

Bullet Point # 2: The Preliminary and Tentative Findings assert that during Fiscal Years 2002 through 2005, $2.15 million of water capital expansion fees were improperly used toward the Gator Slough irrigation expansion project. These findings mistakenly assert that this was contrary to the provisions of Section 2-24.4 of the City's Code of Ordinances.

During the period Fiscal Years 2002 through 2005, the City did not impose a separate irrigation capital expansion fee for the funding of the various improvements to the City's irrigation program. Rather, the costs of the irrigation improvements were allocated as a component of either the City's water or sewer system depending upon whether the inclusion of those costs within the respective system was appropriate. In particular, the cost of the Gator Slough irrigation expansion project was specifically considered in the calculation of the water capital expansion fees in effect during the period in question (See attached calculation of impact fees labeled Attachment 13-3). The ordinances in effect at that time also authorized that water and wastewater capacity expansion fees could be utilized to fund the cost of irrigation capital expansion, to the extent that they are related to the water and sewer improvement program Section 2-24.4 Ordinance 71-97 (ordinance existing during the period in question). See language following for the specific sections as provided previously.

> **Sec. 2-23. Use of proceeds.**
>
> (a) The proceeds accumulated by reason of the establishment of a utility capital expansion fee can be used only for the capital expansion of utility facilities. Said proceeds may not be used for improving, updating, or bringing the present system into compliance with any change in laws, but may be used for valid purposes along with other types of revenues or matching funds.
>
> **Sec. 2-24.1. Purpose.**
>
> (a) This section is intended to address the need for additional capital funds to support the orderly expansion of the city's water system, wastewater system, and dual water irrigation/fire protection system to meet the burdens imposed by new users. It provides for the funding of such capital needs by imposing fees upon new users of the city's utilities systems that are reasonably commensurate with the burdens currently imposed or reasonably anticipated to be imposed on those systems. (Ord. 71-97, 9-29-97)
>
> **Sec. 2-24.4. Separate capital expansion fee trust funds for water and sewer fees and use of fees collected.**
>
> 3. Trust funds may also be used to retire revenue bonds issued for the above-stated capital improvements to the water, sewer and the dual water irrigation/fire protection systems. (Ord. 48-85, §1, 6/17/85; Ord. 71-97, 9/29/97)

On November 8, 2004, the City adopted Ordinance 137-04, which imposed a separate irrigation capital expansion fee for the funding of the irrigation program and incorporated the language of Section 2-24.4, which is asserted to have been violated in the Preliminary and Tentative Findings. That ordinance and those changes did not become

effective until January 1, 2005. Therefore, the expenditure of the proceeds toward the Gator Slough was under the previous version of the ordinance and authorized by it. Following the ordinance amendment's effective date, capital expansion fees for the funding of irrigation improvements have been maintained in a separate trust fund and used only for irrigation purposes in accordance with Section 2-24.4 of the City's Code of Ordinances.

Bullet Point # 3: It is unclear how the Auditor General's staff has determined that adding a secondary clarifier to a utility plant does not qualify as an expansion of the system. The bullet point asserts first that the expenditures did not qualify even though the Utility Manager stated that they did. The secondary clarifier did in fact cost $1.782 million as provided by the cost summary and associated general ledger backup provided in attachment 13-1 contrary to comments provided by City Staff.

Also, with respect to the $31,287, this represented a 59% share of the cost of the total design associated with the interconnect repair and replacement that was attributable to future growth of the plant and was determined to be such by qualified engineers associated with the project. Without taking into account the future expansion of the plant, the interconnect would have had to be reconstructed a second time to add the necessary capacity for the plant expansion that will be taking place over the next three years. We have attached the documentation (see attachment 13-2) supporting the breakdown between the plant rehabilitation and plant improvements that was attached to the agenda item approved by the City Council.

Bullet Point # 4: The North Cape Industrial Park presents a unique set of circumstances. The City, back in September of 1984, entered into an agreement with the developer concerning the provision of utilities to that project. A copy of that agreement is attached (See Attachment 12-1). Under that agreement, the City was obligated to install a water line within a certain time period and at a certain cost. There are also provisions in that agreement that require the City to credit and repay the Developer for betterment fees attributable to the line that is collected from other users and the Developer was also to be entitled to a credit for assessments or betterment fees collected from tap-ins to the line from outside the industrial park. Some sixteen (16) years later, in June of 2000, the City Manager addressed City Council concerning the extension of the North Loop water line and he asked for guidance on how to levy betterment fees for the North Cape Industrial Park properties. The Council was presented with several options at that meeting. A copy of the memo detailing those options is attached (See Attachment 12-2). After discussion at a regular meeting, Council voted to approve Option Number 4. Option Number 4 proposed a special program to offset the cost to the residents of converting their sprinkler systems to be compatible with the waterline being installed by the City. The proposal suggested that the cost to the business owner of the retrofit could be used as a credit against the amount of betterment fees due. In the last paragraph of the City Manager's memo, he states that he believes the City should work with the existing business owners in the North Cape Industrial Park to gain them as customers on the City's system and prevent a more costly conversion in the future. It appears that this approval of a credit against betterment fees due represents a compromise of potential claims arising out of the 1984 agreement. As such, it is not accurate to state that the City actually paid the property owners to retrofit their system and that such payment was in violation of the ordinance. The City, instead of crediting the amount of betterment fees due for each property, required the property owners to pay the full amount of betterment and then sent each property owner a check representing the cost for each owner to retrofit their fire protection system.

Bullet Point # 5: Section 19-38.C. does not restrict the use of CIAC funds to the costs associated with the utility expansion of the property owners that paid such fees. The restriction is a general one and states that such funds may be applied "…only to the payment of the cost of expansion of the respective system…" The CIAC funds in this instance were used to pay for expansion of the City's utility system. Thus, AGO 91-94 is clearly distinguishable. AGO 91-94 involved the borrowing of funds from a water and sewer impact fee account to provide additional operating funds for the City of Hialeah. Presumably, those operating expenses were totally unrelated to the expansion of the utility system. That is not the situation here, since the funds were in fact used to pay for the expansion of the City's utility system.

In summary, the recommendation to the finding asserts that the City should review all expenditures of Capital Expansion Fees and CIAC fees for compliance with the City's Code of Ordinances. As provided above, the City

already does this on a transaction by transaction basis with the exception of a one-time event that has not been repeated.

Finding No. 14: The City did not always charge utility users appropriate fees or timely bill for services rendered.

Recommendation: The City Council should amend Section 19-19A to require the Financial Services Department to credit or backbill customers, in full, when customers have been overcharged or undercharged, or the Financial Services Department should revise its policy to that effect. The City should also develop procedures, such as reconciliations, to detect instances in which a customer is receiving services but is not billed for such services. Additionally, the City should ensure that changes to rates or policies directed by the City Council are promptly implemented.

Management's Response:

We do not concur with the language of the finding. The language asserts that the City makes it a habit or implies that the utility billing group of the financial services department consistently does not charge the utility users appropriate fees or timely bill for services rendered. As in any type of utility system, there is a certain error rate that is strictly human error that is understandable. Whereas the City would certainly desire to have 100% perfection every day, it is not unreasonable to expect errors periodically such as were found during the audit. As such, and as shown below, less than 1% error rate monthly is understandable and like all errors that are discovered, an analysis of why, how and when it occurred and the appropriate evaluation of procedures to prevent it from occurring again is standard practice.

Bullet Point 1: The Auditor General's office has asserted that the policy for backbilling 12 months was established by the Financial Services department although they were informed that this was a policy adopted by City Council. See attachment 14-1, indicating that on September 7, 1999, the City Council adopted said policy via Consent Agenda as well as the consent agenda item summary supporting the item. In the summary, it states that 'the policy revision is in conformance with the City's efforts to enhance service to its utility customers.' We do not contest the calculation of lost revenue on the three accounts identified since we provided it to the Auditor General and fully recognize that the backbilling of 12 months may be insufficient to realize all revenues that were not recorded for failure to reconcile the accounts. The City has implemented a weekly reconciliation of accounts to insure that all accounts are billed appropriately. It should be pointed out that the three accounts not billed for sewer out of the 13 evaluated represents less than .006 percent of all accounts (49,000).

Bullet Point 2: The Auditor General's staff has noted that two accounts (out of several hundred new accounts that were created) were charged the old new account fee of $50 when the customer opened an account. The timing of said fee occurred at the changeover when the customer service reps were used to charging a fee over and over and simply forgot about the deposit. Training for collection of the deposits did occur prior to the changeover with all representatives and as noted above, human error can sometimes occur in these instances. The collection of the new account fee although incorrect did not deter the customer or cause the system to not work since there are criteria in place for collecting the deposit in the first place. The collection of said fee occurred during the change over period for collection of deposits and new account fees that occurred in the last week of April 2004 following adoption of the resolution establishing the deposits. It should also be noted that upon discovery following an evaluation of new accounts, the fees were credited to the customers.

With respect to the recommendations associated with the above findings, staff will prepare an analysis associated with credits/backbilling for customers for Council's consideration. Procedures have already been developed for reconciling accounts to billings. And as for the last recommendation, City staff already insures that all policies directed by City Council are promptly implemented.

Finding No. 15: Costs for shared administrative expenses from departments other than utilities were not always allocated to the Water and Sewer Fund and Stormwater Fund in a systematic and rational manner. In addition, some costs directly charged from other departments were not supported by documentation to evidence the basis for the direct charge.

Recommendation: The City should evaluate the allocation methods used for each type of administrative cost to ensure that costs are allocated in a systematic and rational manner. In addition to the examples provided above, for any costs determined to be overallocated, the City should restore such funds to the Water and Sewer Fund or the Stormwater Fund.

Management's Response:

We do not concur with the Auditor General's findings or recommendations.

This report asserts that the City has failed to allocate direct and indirect costs to the Water and Sewer and Stormwater Fund in a systematic and rational manner. We do not concur with this finding in that the City has demonstrated that the basis of allocation has been reviewed annually with the goal of achieving a fair and equitable cost allocation. As stated in the annual budget document for the Full Cost Allocation Plan, the Cost Allocation was prepared in accordance with the Federal Office of Management and Budget Circular A-87, the recognized authority on cost allocations utilized by the Federal Government and Contractors doing business with the Federal Government. This is a federally recognized systematic and rational manner of allocating indirect costs. The determination of the "correct" basis of allocation can be very subjective based on the rationale of an individual making that determination. The findings also indicated that the use of professional judgment was inappropriate; when in fact, professional judgment and estimation should be recognized as being not only rational but in many cases highly reliable. Generally Accepted Accounting Principles recognize professional judgment as substantive support for estimates with regard to contingent liability reporting in an entity's financial statements. In addition, Generally Accepted Auditing Procedures recognize professional judgment with respect to audit procedures. As such, professional judgment has been determined to support numerous types of estimates in preparing budgets as well as financial statements and can and should be extended to evaluations associated with cost allocations when appropriate.

With regard to the direct costs charged to these two enterprise funds, the costs questioned were primarily associated with the staff of the Financial Services Department. There were 61 employees authorized within the Financial Services Department in FY 2004 and 65 in FY 2005. Within Accounting, Budget, and Cashiers Office, 3 of these positions were directly charged to these funds. Within the Customer Billing Services Divisions, six (6) Field Service Representatives who are directly responsible for "turn-ons" and "turn-offs" for utilities were allocated 100% to the Water & Sewer Fund as is appropriate. For the remaining 26 employees within Customer Billing Services, a portion of the costs of 12 employees were charged to the Water & Sewer Fund as related to their servicing of utility accounts to include the amount of time spent in completing account documentation for customer hookups, daily billings, and customer service.

Staff within the Financial Services Department, provides direct benefit to the activities within these two funds and the allocation of time and direct charges were based on the professional judgment of the present and past Financial Services Directors. The use of professional judgment is not uncommon and if reasonable, is not unacceptable.

It is recognized that utilization of payroll records or, for lack of a better word, a time and billing system, would provide substantially more accurate data associated with the percentages designated for the charge backs, however, one must also weigh the cost/benefit associated with keeping such records and the payroll costs associated with same. The professional judgment used in determining the relevant percentages to charge back was based upon the number of transactions as well as the size and type of fund that the staff was responsible for. This methodology is a fairly simple one to use and in evaluating responses from the individuals involved, the percentages used were reasonably accurate.

The second part of this finding relates to the indirect cost allocation for central service costs. The cost allocation plan has been prepared in-house since the mid to late 1990's. In preparing the allocation, the primary components are 1) the cost and 2) the basis of allocation. Prior to FY 2006, the plan was prepared using the final costs of the last closed fiscal year. For example, the cost allocated in FY 2004 and FY 2005 was the actual cost of FY 2002 and FY 2003 respectively. However, in 2006, the plan was prepared using a forecasting method based upon the budget with gross up of costs occurring at that end of the year based upon actual. This insured a more timely approach to both revenue and expenditure recapture.

It has been City staff's practice to annually evaluate the allocation basis to ensure that the costs are being reasonably distributed. The underlying assumptions of the plan are continually challenged. Staff has asked the questions, "Is the basis reasonable?" "Is there another allocation method or basis that is more appropriate?" This fact is evidenced by the findings in this report that the basis of allocation was changed for both Retiree Health Care Costs and the services of the City Attorney's office. The working environment of this governmental entity is very dynamic and capturing the data to utilize in preparing the allocations can be difficult to extract from the various departments with the exception of utilizing a question and answer format in making determinations of time spent on any one department. Therefore, not only was the reasonableness of the allocation basis evaluated but also the availability of data.

Financial Services does agree that the most appropriate basis of allocation of the costs associated with the services provided by the City Attorney's as well as the City Auditor's office would be actual hours expended. However, as this data was not recorded by the City Attorney's office, another reasonable basis was selected. When evaluating the actual hours expended, one must evaluate to what extent that the hours should be segregated. For example, it is certainly reasonable to assume that if either of the offices spent time specific to the funds in question, then that time could be charged directly or the hours could be accumulated for chargeback. However, let's assume that the City attorney's office works on an ordinance that covers all funds/departments of the City such as the procurement ordinance. If the office maintained a record of hours, how then would it be divided among all departments and/or funds? The reality here is making a determination of cost vs. benefit and to what extent should the record keeping go to insure full and justifiably exact chargebacks for services performed. Thus the use of a reasonable basis associated with the City Attorney's office as to the number of full time employees.

In being fair and reasonable, it was recognized that the reimbursement to the general fund was considerably lower than the costs being expended on behalf of the enterprise funds. This was particularly true with the cost of retiree health care insurance premiums. As stated in this report, an additional interfund transfer was included in the annual budgets in order to recoup the current costs being incurred. During the period of FY 2000 to FY 2004, the number of full time equivalent employees was used to allocate the retiree health care premiums being paid by the general fund. In FY 2005, the number of retirees was utilized. A revised calculation was made for the period of FY 2000 to 2004 and has been attached (See Attachment 15-1). Based on the revised calculations, there was an overpayment made by the Water and Sewer and underpayment by the Stormwater Fund. Repayments will be made for a period of 6 years, the same period over which the calculation was made based on full-time equivalents rather than retirees. The repayments are scheduled to begin in FY 2006 and will end in FY 2011.

One unique component of the full cost allocation was the inclusion of a reimbursement for Construction Costs/Feasibility Study which was charged solely to the Water and Sewer Fund. This component was added in the FY 2000 plan based on a feasibility study completed in 1999 by an outside consultant. This item was eliminated from the FY 2006 allocation plan prior to the review of the Auditor General's Office. The general fund will be repaying the Water and Sewer Fund $449,250.16 on annual basis through FY2011 for the total amount of $2,695,501.

While the City does have systematic and rational methods for allocation in place, beginning in FY 2007 only those employees in Financial Services that are 100% allocable to Water & Sewer will be directly charged. These employees will include the 6 Field Service Reps, Customer Service Supervisor, and 4 Utility Billing Clerks. All other employees will be charged 100% to the general fund with appropriate costs being recovered through the indirect cost allocation plan.

Finding No. 16: Expenditures totaling $131,859 were not supported by documentation demonstrating the public purpose served.

Recommendation: The City should ensure and document in its public records that expenditures serve an authorized public purpose, are reasonable, and necessarily benefit the City.

Management's Response:
We do not concur with the finding.

The first question that begs to be asked is, 'what constitutes sufficient documentation to support the expenditure to demonstrate to the postauditor and the public the authorized public purpose served by such expenditure?'

When evaluating an expenditure for reasonableness, an auditor would first ask the question is this reasonable, and within a government environment, is the public purpose served. In the absence of a specific law within the Florida Statute or the State Constitution that specifically states that a particular action is defined as a public purpose such as, expenditures for economic development to attract and retain business enterprises, Section 166.021(9)(a-c), it falls on the Florida Statute and the State Constitution that provides Home Rule Powers to a municipality. The second question has more to do with substance over form. The determination of a public purpose is established by the municipality.

With respect to the items identified by the Auditor General's staff, sufficient documentation does exist, however the question is who decides what is sufficient documentation? For example, the barbeque for the Canal Watch program has occurred each year since 2001. The program was established in 1995 for the purpose of providing additional staffing on a volunteer basis to test canal waters, provide information on canal depths and help clean the canals periodically for the four hundred (400) miles of waterways in the City. It is common practice in government to show appreciation to volunteer groups that have volunteered their time in support of the municipality's programs. In other words, substance over form in that this has been and continues to be a practice of the City and supported by the City for the public purpose that it is.

With respect to the refrigerator, again, sufficient documentation does exist. The question again is who decides what is sufficient documentation of the public purpose? On the purchase order it states $437 for a refrigerator split between parks and recreation and water & sewer utility. In discussion with the Auditor General's staff, the comment was that they don't believe a refrigerator constitutes a public purpose since at the State offices, if someone wants a refrigerator, they must purchase it themselves. However, there are several refrigerators in City Hall, even one used by the Auditor General's Staff in Financial Services that was not questioned. In the response to the Auditor General's staff, it was stated that the refrigerator was for employees use. It should be noted that this would not have been necessary on the Purchase Order to support a public purpose, since there are four other refrigerators in City Hall serving the same purpose which has been determined to be a practice acceptable to the legislative body as a public purpose. The City has determined that it is a valid public purpose to provide certain benefits to employees, such as refrigerators that encourages and supports productivity in the work place. This again serves as substance over form in that the City Council has determined that providing refrigerators in the buildings serves as a public purpose as a benefit to employees.

With respect to the expenditures for the retrofitting of sprinklers in the North Cape Industrial Park, we believe that sufficient documentation exists to support the public purpose. Finding # 13, Bullet Point # 4, provides additional information in support of this.

As such, the City believes that it has and continues to provide sufficient documentation that supports and ensures that its expenditures serve a valid public purpose and are reasonable and will necessarily benefit the City. In addition, we provide an updated AGO opinion 2005-02, wherein the Attorney General was asked to opine whether county funds could be used to pay for educational courses for volunteer firefighters to obtain state certification as EMTs. The Attorney General refused to render an opinion on the appropriateness of the

expenditure and stated that if an expenditure primarily or substantially serves a public purpose, the fact that the expenditure may also incidentally benefit private individuals does not violate the "public purpose" requirement. The determination of whether an expenditure of municipal funds fulfills a municipal purpose is one that the City Council, as the legislative body of the City, must make. The City disputes this finding to the extent that it implies that such expenditures were not for a public purpose.

Finding No. 17: The City did not select its bond counsel through a competitive selection process.

Recommendation: Upon completion of the current bond counsel contract, the City should consider contracting with bond counsel through a competitive process.

Management's Response:

We do not concur with the finding.

This preliminary and tentative finding states that the GFOA recommends that issuers select bond counsel on the basis of merit using a competitive process. The preliminary and tentative finding further states that the current bond counsel contract is for a period of five years and was procured based on recommendations of the City Attorney and the Financial Services Director, not through an RFP. The finding then lists the amount of fees paid to the City's current bond counsel for five different debt issues.

The GFOA recommended practice for selecting bond counsel also suggests five factors that issuers should consider when selecting bond counsel. The recommendation states:

> The selection should not be driven solely by proposed fees. The experience of the firm with the type of transactions contemplated by the issuer is the most important factor in the selection of bond counsel.

Nabors, Giblin & Nickerson has been the City's bond counsel since the late 1980's. For a period of nine years (1993-2002) the City's contracts and contract renewals with that firm provided for no increase in the fees charged for representation of the City in the issuance of bonds. During their tenure as bond counsel, the firm has been extensively involved in the City's development of Home Rule Assessment Ordinances and numerous bond financings and refinancings to obtain more favorable rates. The firm's expertise in finding innovative solutions towards financing infrastructure improvements is well-known throughout the state of Florida. The firm has extensive institutional knowledge of the City's history with utility and other assessments and is therefore uniquely qualified to handle the type of transactions the City is involved in. In addition, Florida law exempts Attorneys from the RFP process.

With regard to the comment regarding fees paid to bond counsel for five different issues, the City is at a loss to understand the meaning or the reason for including the information in the summary to support the finding. The fact that the fees were paid is irrelevant to the procurement of a bond counsel since they would have been paid regardless of who the bond counsel was representing the City. We take exception to this clear inflation of the facts in the finding. Also, the summary implies that bond counsel fees would have been lower if we had done an RFP. The primary question that begs to be asked is, 'Based upon what evidence would this implication be made?' Since the best practice for selection of a bond counsel clearly indicates that the selection should not be based solely upon fees, it would appear that the implication has little value in supporting the finding.

Although we appreciate the Auditor General's staff's suggestion that we use the RFP process in the selection process, we will evaluate the cost/benefit as well as the circumstances at the time when the contract is up for evaluation.

Finding No. 18: The City did not have written agreements with several bond professionals. Additionally, City practice and its procurement policies and procedures are contrary to Section 2-148 of the City's Code of Ordinances regarding required signatures on contracts.

Recommendation: To provide adequate control of bond issuance costs, the City should require contracts with all bond professionals. Also, all contracts should be signed in accordance with the established ordinance and the City's policies and procedures manual should be updated to comply with established ordinances.

Management's Response:

We do not concur with the first sentence of the Finding and concur with the second sentence of the finding.

Bullet Point # 1 – This bullet point addresses the first sentence of the finding in that the City did not have written agreements with several bond professionals. We do not agree with the content or the finding, as these fees for services are authorized by City Counsel in the Bond Resolution, which is adopted prior to each transaction. The Bond Resolution authorizes the costs to be paid from bond proceeds and delegates to the City Manager the authority to approve all of the terms and provisions of the transaction within certain parameters.

In addition to this documentation, there are other mitigating circumstances as follows. The City contracts with Nabors Giblin Nickerson (NGN). NGN serves as both assessment counsel and bond counsel. Therefore, the fee structure serves for both purposes. In addition, for each assessment, NGN provides written documentation of the fees that will be charged pursuant to the contract with NGN. As for underwriter's counsel, as was explained to the Auditor General staff, the City does not contract for the service. The underwriter contracts for the service for underwriter's counsel and the underwriter's counsel fees are distributed from the underwriter's expenses portion of the bond proceeds. By having the underwriter's counsel prepare the preliminary and final official statements in addition to preparing other documents for the underwriters, this reduces the number of attorneys involved in the transaction and thus reduces the cost of the transaction to the City. With respect to a contract for underwriters, this is a required part of any sale and is called the Bond Purchase Agreement (BPA). The BPA serves as the final contract on the pricing of the bonds. As for analytical contractors, they were used a couple of times for Advance Refundings of water & sewer issues. An RFP is issued for the service by the Financial Advisor and a determination is made by the issuer and the Financial Advisor as to the firm which will provide the best service for the specific type of refunding. Generally, these amounts are less than $3,000 for an issue and their fees are authorized by City Counsel in the Bond Resolution to be incurred as a necessary service related to the transaction.

Bullet Point # 2 – The current Purchasing Ordinance does say that Mayor and Clerk are to sign all contracts. Contracts that have been signed by the City Manager or Interim City Manager were approved by City Council and the action taken by Council was to authorize the City Manager to sign which is clearly their prerogative.

With respect to the recommendations, clearly the information provided in bullet point # 1 obviates any need for written contracts since they are already provided for. In addition, it has been demonstrated that adequate control is already in place to control bond issuance costs. Also, the provision in the purchasing ordinance is being amended to remove the language requiring the Mayor and Clerk to sign all agreements over $20,000.

Finding No. 19: The City did not properly monitor contracts for services to ensure contractors performed in accordance with terms of the contract.

Recommendation: The City should develop contract monitoring procedures to ensure that contractors perform in accordance with the terms of the contract. The City's contracts should establish definite due dates for deliverables. Unless another method for initiating payments is established in a contract, payments should not be made to contractors that have not provided the deliverables by the date specified within the contract.

Management's Response:

The City acknowledges and concurs with the Findings and Recommendations with the exception of Bullet Point # 1.

Bullet Point # 1: The contract was monitored throughout. The chronology identified in the comments is basically correct but all of the information which determined the decisions made by the manager with regard to payments and timing is not.

The consultant worked with City staff on and off for months and months trying to obtain data and rectify alleged inaccuracies with the data provided. Because of this there were several versions and iterations of draft reports provided over many months. The consultant continued to work trying to rectify the alleged data inaccuracies to no avail. So the final report will indicate as one of the recommendations that further investigation of the data sets is needed and assumes certain losses for now. Because of the level of effort required, the amount of time expended and deliverables provided by the consultant, the manager made partial payments on a percentage-of-completion basis. The work effort expended by the consultant went far beyond what was anticipated and the schedule was substantially extended as a result of the consultant's determination to rectify alleged errors in the City's data. The contract was monitored throughout by the manager and continues to be with the final report scheduled for delivery in the next two weeks. Additional monitoring procedures are not necessary with regard to this contract. The consultant has not requested additional funds which would be warranted based on the additional effort required.

Contracts are monitored by each project manager. We recognize that the need for training in managing contracts and will be scheduling such training. It is each project manager's responsibility to evaluate payment requests against deliverables or in the absence of such terms, on a percentage-of-completion basis or such other terms as agreed upon.

Finding No. 20: The City did not fully comply with provisions of Section 287.055, Florida Statutes, in procurement of its contract for its utility expansion program. Additionally, invoices submitted for payment by the contractor were not adequately supported. Finally, the City's consultant hired to audit selected work authorizations relating to its utility expansion program included several findings and made several recommendations.

Recommendation: The City should take steps to ensure compliance with Sections 287.055 and 255.05, Florida Statutes. The City should also verify all invoices submitted, and to be submitted, for payment by requesting adequate supporting documentation and, for any amounts overpaid, request a refund from the contractor. Finally, the City should consider all recommendations suggested by the contracted consultant.

Management's Response:

Bullet Point # 1 - The Florida Statute section referenced is provided below:

287.055(3)(c) Any firm or individual desiring to provide professional services to the agency must first be certified by the agency as qualified pursuant to law and the regulations of the agency. The agency must find that the firm or individual to be employed is fully qualified to render the required service. Among the factors to be considered in making this finding are the capabilities, adequacy of personnel, past record, and experience of the firm or individual.

The City's process for certifying qualified firms is outlined in Chapter 2 Article VII Division 1 Section 2-144(i)(3)(c). This section details the process for the competitive negotiation of professional services and the use of the Selection Advisory Committee (SAC). The SAC has been established for the purpose of evaluating (certifying) firms who express interest in contracting with the City on specific projects. The SAC is tasked with reviewing various proposals and ranking the firms as outlined below:

The SAC shall determine and prepare a "shortlist" of the highest ranked firms. The short-listing of firms shall be based on the SAC's ability to differentiate qualifications applicable to the scope and nature of the request for proposals. Such determination shall be based on, but not necessarily limited to:

1. The proposer's demonstrated understanding of the city's requirements and plans for meeting those requirements;
2. The professional qualifications and related experience of the personnel assigned to the project;
3. The prior experience and references of the proposer;
4. The prior experience, if any, that the proposer has had with the City of Cape Coral;
5. The size and organizational structure of the proposer.

Recommendations are provided to City Council.

As can be seen from the above, the SAC's role within the City's Procurement Ordinance meets the language of Sec. 287.055(3)(c), F.S. In fact, many of the provisions in the City's Procurement Ordinance are taken verbatim from Section 287.055, F.S.

As requested in May 2005, the City did provide copies to the Auditor General's staff of the minutes from the SAC Meetings in which the contractors were selected. Through the City's processes, the City did certify the contractors as being qualified based on the evaluation of the firms' capabilities; adequacy of personnel, past record, and experience of the firm or individual.

Bullet Points # 3 and # 4 – Section 287.055(5)(a), Fla. Stat. states that the agency shall negotiate a contract with the most qualified firm for professional services at compensation which the agency determines is fair, competitive, and reasonable. There is nothing in that section of the statute that requires the City to negotiate a guaranteed maximum price for all utility expansion assessment areas prior to the commencement of any work. If the City is required to negotiate the price of the entire project in year one, it is reasonable to expect that the Contractor will demand a higher amount of compensation, since it is difficult, if not impossible to try to predict what the market will be for labor and materials five years from now. The City decided to use a master agreement and negotiate each segment of the project separately since this approach would better enable the City to determine if the GMP for any phase of the project was fair, competitive and reasonable. If the City is unable to reach agreement on a GMP for any phase of the project, then the City has the right, under both contracts to terminate the agreement for its convenience. The City could then decide to either undertake negotiations with the second ranked firm, or, if a sufficient amount of time has passed since the original selection, the City could re-advertise and go through the entire selection process again.

Bullet Point # 5 – The City acknowledges that there were three work authorization performance bonds that were not recorded with the Clerk of Court. As for the one performance bond that the auditors stated could not be provided, see attachment 20-1 for said performance bond.

Bullet Point # 6 – The City does not acknowledge or agree with the Auditor General staff's opinion regarding the partial assignment and the timing of work authorization issues. It is clearly their opinion of what was assigned work authorizations and reserved work, one in which we do not agree as provided in the commentary.

As stated above, the findings regarding Sections 287.055 and 255.05, Florida Statutes do not apply in this situation and therefore, taking steps to ensure compliance does not apply. We agree that all invoices paid and to be paid from the contractor should provide adequate support to support the payment. With respect to the recommendation that the City should consider all recommendations suggested by the contracted consultant, we do not agree and can provide the substantiation and support provided in our response to the contracted consultant. Those items we did agree with were implemented however those not agreed with were presented to City Council with reasoning and support. Therefore we do not recommend to the City Council that any of the recommendations suggested by the contracted consultant, other than those already taken under advisement and implemented, be considered for implementation.

Finding No. 21:. Although the City has taken some actions to reduce water loss, unaccounted for water remains in excess of 10 percent. Additionally, preliminary data from a water audit obtained by the City indicated several factors, including excessive service leaks, meter testing and replacement, and inconsistencies in meter size, that contributed to the City's unaccounted for water.

Recommendation: It appears that the City, while taking some actions to reduce water loss, should take additional steps including replacing rather than repairing dysfunctional meters, accelerate replacing meters identified as inaccurate, and ensure that meter registers are standardized to increase accountability and avoid under-billing for water usage. The City should also adopt a formal leak detection program.

Management's Response:

We do not concur with the finding. The recommendations will be forthcoming in the results from the water audit.

The Utility Manager has only been in this position since 2004 and since that time initiated the water audit. The Utility Manager can not speak for others involved with water losses up to twelve years old. Recommendations from this finding are "old news". The City will take additional actions to reduce unaccounted for water once the results are in so as to spend our customer's money wisely. The completed water audit will be forthcoming shortly which will address this finding and others in more detail. Based on the results of the audit the city will continue its "field" leak detection program including adding the irrigation system this next year as well as implementing other recommended cost effective measures. Money has already been established in next year's budget for field leak detection.

Bullet Point # 1 - The consultant preparing the water audit is not a "contractor" and does not know specifically what causes leaks in Cape Coral. The Auditor General's Staff has asserted that 300 main and 1,000 service leaks are excessive however there is no support for this supposition. The City has approximately 700 miles of water mains and 50,000 services and based on the size of the utility and conditions of the physical environment the number of leaks do not appear excessive. As a matter of fact the "Final" Water Audit Report will show the City of Cape Coral grades very high at 1.3 on a scale of 1 to 12 with 1 being the most ideal score for unaccounted for water. The City has budgeted $7.5 million over three years to replace old galvanized pipe and associated services to further reduce leaks and improve service in the water distribution system. Engineering design is in progress. The City will continue to replace the older polytube water services with the new schedule 80 pvc services as needed and is considering a more aggressive change-out program.

Bullet Point # 2 – It appears that this bullet point has jumped the gun using information from a preliminary draft of the water audit. When the "final" water audit report is in and based on those recommendations the City will be begin Phase II implementation. It is anticipated that a meter change-out program for both small and large meters that will be based on actual field testing results will be initiated. It is necessary that the first item of business will be to conduct actual field testing in order to establish when it is cost effective to replace meter(s). A preliminary draft of an audit can not provide that information nor is it prudent to run out and begin implementation of something that has not been finalized.

Bullet Point # 3 – The City has been working on reducing large meter read errors due to different register heads. Mostly this has to do with training personnel in the field to read the meters correctly due to the size of the meters as well as accurately entering in the meter register in the billing system. The City is in fact working towards electronic read meters for standardization of the system.

It appears that this finding was built around an unfinished **"preliminary"** draft report, the results of which have created a negative finding that would not otherwise have existed. As stated above, recommendations regarding this finding are "old news". In fact, as part of the "final" report, it will show that actual remaining unaccounted for water is in the 5% - 6% range. Record keeping and how the calculation was performed insofar as not recording all known water usage created the higher than 10% unaccounted for water in the first place.

Finding No. 22: Some of the City's staff may have inappropriate access to information technology system resources. We also noted another deficiency in controls over the City's information systems.

Recommendation: The City should review the duties of its ITS staff and remove, as appropriate, access capabilities that are unnecessary for the performance of assigned responsibilities. System administration functions provide a higher level of authority for system users and should be restricted to a limited number of individuals which actually need the function to perform their jobs.

Management's Response:

We acknowledge and concur with the Auditor General's observation and recommendations.

Following are responses to the specific bullet points supporting the Auditor General's finding and recommendation.

- *"Fifteen ITS employees have all object authority which gives the user extensive authority over all resources on the system. All-object special authority essentially gives a user access to all functions on the system. Employees should only be given access to those functions necessary to perform assigned responsibilities."*

We concur. A report we ran on May 17, 2005 for the audit review showed 15 IT users with IBM "ALLOBJ" authority on the AS/400. This authority allowed these individuals access to all H.T.E. modules basically so that they could help any user with problem resolution. It should be noted that there were internal controls in place to show that any transactions performed by these users would show up on audit trails generated by the H.T.E system.

We agree that providing "ALLOBJ" access to this number of users is unnecessary and we have reduced the number of users to three.

- *"Fifteen ITS employees have direct access which allows the user to modify data tables without accessing the Utility Billing System. As a result, changes to the City's financial data could be made by these individuals without a record indicating the source of the change."*

This finding is not correct although the confusion arose in our not explaining properly the mechanics of the IBM security system to the audit team in May of last year.

We provided a report titled "Data File Utility" that purportedly listed the employees having access to the IBM DFU – Data File Utility feature. This report listed ITS employees having various User Classes. Five (5) employees had the "SECOFR" User Class, six (6) had the "SECADM" User Class, and four (4) employees had the "PGMR" User Class. The report lists these 15 employees as having DFU capability.

However, in order to have access to the DFU function, an employee must have the following three assignments: "ALLOBJ" authority, the "SECOFR" User Class, and "Limit Capabilities" set to "*NO". Reviewing both reports, five (5) users had the ALLOBJ and SECOFR assignments. These users also had "Limit Capabilities" set to "*NO". The report provided is in error since we should have applied the exclusion rules explained above which would have resulted in 5 names, not 15.

We do agree with the finding that we don't need 5 users with this authority, however, and have reduced the number of employees to three. It should be noted, however, that even DFU transactions can be analyzed using IBM diagnostic tools.

- *"Fourteen ITS employees have security administration access capability. This allows the user to set up user profiles and grant authority to selected objects.""*

Taking the count of SECOFR & SECADMIN users on the report provided to the audit team last year, we come up with eleven (11) ITS individuals who had this authority. Whether eleven or fourteen, we concur – this is too high a count. We have reduced the number of SECADM users to two. Both of these individuals support the help desk where they frequently have to reset user passwords due to users locking themselves out of the database, etc.

We concur with the overall findings, although in terms of DFU capability the audit report is much higher than reality due our providing an inaccurate query report.

We have significantly reduced the number of individuals with broad access as described above. In terms of the exposure at the time of the audit, we stress again that the IBM system audit trails are capable of tracking any transactions made including DFU changes which the H.T.E enterprise system itself would be unable to catch.

Finding No. 23: The City has not prepared and executed a lease agreement for its charter school and the frequency and timing of billings to the charter school for services provided by the City were not addressed in Ordinance 41-04.

Recommendation: The City Council should revise Ordinance 41-04 to address the frequency and timing of billings to the school for services provided by the City. In addition, the City should expedite the preparation and execution of the lease agreement.

Management's Response:

We concur with the first part of the finding and do not concur with the second part of the finding.

The lease agreement between the City and the Charter School Authority has been prepared and approved and executed by the Charter School Governing Board. Furthermore, the proposed lease agreement and the ordinance approving it have been sent to the City Council and scheduled for public hearing this month.

With respect to the Audit recommendation that the City Council should revise Ordinance 41-04, which established Chapter 26 of the City Code of Ordinances, to address the frequency and timing of billings to the

school for services provided by the City, that recommendation would appear to be impractical. Section 26-1 of the City Code of Ordinances specifically provides that the purpose of Chapter 26 of the City Code of Ordinances is "to effectuate and to implement the charter school contract that has been entered into between the City of Cape Coral and the Lee County School District, as same may hereafter be amended." Although Section 26-17 provides that the City has the right to require the Charter School Authority to use City departments and personnel for services and that the City shall charge a fee or fees for such services that is equal to the cost of providing the service(s), it would be impractical to expect the City to ordain the frequency of the billing for each service or services, as may be rendered from time to time. Different services may require different billing schedules. The services offered by the City may change from time to time. To require the adoption of local legislation in the form of a City ordinance each time a new service is added, a service is altered, or the billing schedule is proposed for alteration would promote inefficiency due to the time involved in holding the required public hearing and first reading (introduction). Such a requirement would run contrary to the flexibility that Section 26-17 would otherwise offer in that it is clearly not intended to be an all-inclusive, static list of the service(s) to be provided.

Finding No. 24: The City conducted discussions regarding the calculation of the charter school lease payments through a liaison rather than in a publicly noticed meeting.

Recommendation: The City should exercise caution in meetings between staff and Council members and ensure that violations of the Sunshine Law do not occur by using staff as liaisons among Council members to avoid full and open public discussions.

Management's Response:

To the extent that the Auditor General's Office recommends that the City, including staff members, should be careful to ensure that Sunshine Law violations do not occur and to ensure that no staff member acts as a liaison among City Council members, the City is in full agreement that all employees and officials of the City should take care to fully adhere with the spirit and intent of the Sunshine Law as well as its literal language.

The City strongly disagrees with the implication in Finding No. 24 that a staff member has acted as a liaison in possible violation of the Sunshine Law with respect to the issue of the charter school lease payments. If Finding No. 24 expresses confusion as to the manner in which the amount of the lease payments by the Charter School Authority to the City for Charter Elementary School South was determined, the answer is quite simple: the amount has not yet been finally determined. The Finding seems to have been based on a misunderstanding of the information provided to the Auditor by Mr. Mason, the City Financial Services Director. The minutes of the City Council meetings that were previously supplied by Mr. Mason in response to the Auditor's request indicate the staff's explanation (as provided to Council at public meetings) of the Charter School Budget as approved by the Charter School Authority and by the City Council at a public meeting and of the financing mechanism for the charter school. These minutes are responsive to the Auditor's request for minutes of Council meetings where the amount of the lease payments was discussed.

The amount of the lease payments will not be finally determined, however, until the Charter School Authority and the City Council both finally approve a lease. As stated with respect to Finding No. 23 above, the proposed lease has been approved and executed by the Charter School Governing Board and is scheduled for consideration by Council at an upcoming public meeting. The minutes of that meeting would appear to be the minutes that are sought by the Auditor with respect to "the minutes of City Council meetings at which City Council members discussed and **took action** regarding the calculation of lease payments to be charged to the City's charter school." (Emphasis supplied.) The City would be happy to provide the Auditor with a copy of the minutes of such meeting, after it has occurred, to supplement the minutes previously provided.