

LOCAL GOVERNMENT FINANCIAL REPORTING SYSTEM

Performance Audit



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LOCAL GOVERNMENT FINANCIAL REPORTING SYSTEM

SUMMARY

Our performance audit disclosed the following:

FINANCIAL EMERGENCIES ACT

Finding No. 1: Current law does not provide time frames within which entities must respond to requests for information by the Executive Office of the Governor (EOG) or the Commissioner of Education, or provide consequences for failure to respond.

Finding No. 2: Current law does not authorize EOG to release certain entities deemed to be in a state of financial emergency prior to 2004 when they have been determined not to need State assistance.

Finding No. 3: The condition specified in Section 218.503(1)(e), Florida Statutes, regarding a deficit fund balance or net assets balance has not been an effective indicator of a state of financial emergency.

COMMUNITY DEVELOPMENT DISTRICTS

Finding No. 4: Many community development districts (CDDs) are facing financial difficulties, indicating a potential need for parameters addressing the amount of bonds a CDD may issue.

Finding No. 5: Disclosure requirements for prospective purchasers within CDDs could be improved to ensure that such prospective purchasers are fully informed of current year and estimated future year assessments, monthly fees, and debt obligation repayment options.

LOCAL GOVERNMENT BOND ISSUES

Finding No. 6: Local governments did not always document conditions favoring the method of sale selected for bond issues.

Finding No. 7: Local governments did not always use a request for proposal or request for qualifications process when selecting financial advisors and bond counsel for bond issues.

FLORIDA DEPARTMENT OF FINANCIAL SERVICES

Finding No. 8: The Florida Department of Financial Services (DFS) needed to enhance its procedures to ensure that it properly notifies the Legislative Auditing Committee of all entities that fail to provide annual financial reports (AFRs).

Finding No. 9: DFS did not reconcile its database to the Special District Information Program's master list of special districts to ensure it had properly identified the population of special districts required to file AFRs.

Finding No. 10: DFS had inadequate policies and procedures regarding its certification (verification) process of AFRs. While auditors conducting financial audits of local governments are required to indicate whether the AFR is in agreement with the audit report, the level of agreement is not specified in the requirement. Also, current law does not provide time frames within which entities must respond to requests for information by DFS or provide consequences for failure to respond.

FLORIDA DEPARTMENT OF MANAGEMENT SERVICES, DIVISION OF RETIREMENT

Finding No. 11: The Florida Department of Management Services (DMS) needed to enhance its procedures to ensure timely contact of newly created local governmental entities, to obtain data on retirement systems or plans, and entities that change to the Florida Retirement System from a local plan.

Finding No. 12: DMS did not always withhold insurance premium tax moneys from entities when actuarial reports of police and firefighter retirement plans had not been State accepted.

OVERVIEW OF THE LOCAL GOVERNMENT FINANCIAL REPORTING SYSTEM

Finding No. 13: Current law requires the Florida State Board of Administration's Division of Bond Finance (Division) to publish a regular newsletter to the bond community and the general public; however, the

Division is no longer publishing a regular newsletter as the type of information formerly included in the newsletter is published by other entities and available on the Internet.

BACKGROUND

Section 11.45(2)(h), Florida Statutes, requires the Auditor General to conduct a performance audit of the local government¹ financial reporting system (System) at least every two years and to make recommendations to local governments, the Governor, and the Legislature as to how the reporting system can be improved and how program costs can be reduced. The “System” means any statutory provisions related to local government financial reporting and is intended to provide for the timely, accurate, uniform, and cost-effective accumulation of financial and other information that can be used by the members of the Legislature and other appropriate officials to accomplish the following goals:

- Enhance citizen participation in local government;
- Improve the financial condition of local governments;
- Provide essential government services in an efficient and effective manner; and
- Improve decision making on the part of the Legislature, State agencies, and local government officials on matters relating to local government.

FINDINGS AND RECOMMENDATIONS

Financial Emergencies Act

Part V of Chapter 218, Florida Statutes, comprises the Local Governmental Entity, Charter School, Charter Technical Career Center, and District School Board Financial Emergencies Act (Act). The purposes of the Act are to promote the fiscal responsibility of local governments, charter schools, charter technical career centers, and district school boards (applicable entities); assist applicable entities in providing essential services without interruption, and in meeting their financial obligations; and to assist applicable entities through the improvement of local financial management procedures.

Section 218.503(1), Florida Statutes, provides that applicable entities shall be subject to review and oversight by the Governor, the charter school or charter technical career center sponsor, or the Commissioner of Education, as appropriate, when any one of the following conditions occurs:

- (a) Failure within the same fiscal year in which due to pay short-term loans or failure to make bond debt service or other long-term debt payments when due, as a result of a lack of funds;
- (b) Failure to pay uncontested claims from creditors within 90 days after the claim is presented, as a result of a lack of funds;
- (c) Failure to transfer at the appropriate time, due to a lack of funds, taxes withheld on the income of employees; or employer and employee contributions for (i) Federal social security or (ii) any pension, retirement, or benefit plan of an employee;
- (d) Failure for one pay period to pay, due to a lack of funds, wages and salaries owed to employees or retirement benefits owed to former employees;

¹ The term “local government” refers to local governmental entities as defined in Section 218.31(1), Florida Statutes (i.e., county agencies, municipalities, and special districts).

- (e) An unreserved or total fund balance or retained earnings deficit, or unrestricted or total net assets deficit, as reported on the balance sheet or statement of net assets on the general purpose or fund financial statements, for which sufficient resources of the entity, as reported on the balance sheet or statement of net assets on the general purpose or fund financial statements, are not available to cover the deficit. Resources available to cover reported deficits include net assets that are not otherwise restricted by Federal, State, or local laws, bond covenants, contractual agreements, or other legal constraints. Fixed or capital assets, the disposal of which would impair the ability of the entity to carry out its functions, are not considered resources available to cover reported deficits.

The Act² requires applicable entities to notify the Legislative Auditing Committee (LAC) and either the Governor (for local governments) or the Commissioner of Education (all other applicable entities) when one or more of the conditions specified in Section 218.503(1), Florida Statutes, have occurred or will occur if action is not taken to assist the entity. Charter schools and charter technical career centers must also notify the sponsor.

Pursuant to Section 218.39, Florida Statutes, local governmental entities, charter schools, charter technical centers, and district school boards required to provide for an annual financial audit by an independent certified public accountant must submit a copy of the audit report to the Auditor General. Auditor General Rules require independent auditors conducting audits of these entities to indicate whether or not the entity met one or more of the conditions specified in Section 218.503(1), Florida Statutes. Section 11.45(7)(e), Florida Statutes, requires the Auditor General to notify the Governor or Commissioner of Education, as appropriate, and the LAC of any audit report reviewed which contains a statement that the entity met one or more of the conditions specified in Section 218.503(1), Florida Statutes.

Upon notification, the Governor (local governmental entities) or Commissioner of Education (district school boards), or their designees, are required to contact the entity to determine what actions have been taken by the entity to resolve or prevent the condition and determine if the entity needs State assistance to resolve or prevent the condition. If State assistance is needed, the entity is considered to be in a state of financial emergency. Section 218.503(3), Florida Statutes, authorizes the Governor and Commissioner of Education to implement a variety of measures to assist an entity in a state of financial emergency, ranging from providing technical assistance to the entity to establishing an oversight board to oversee the activities of the entity.

For charter schools and charter technical centers, the sponsor and the Commissioner of Education are required to contact the governing body of the entity to determine what actions have been taken to resolve or prevent the condition. The Commissioner of Education must determine whether the entity needs a financial recovery plan to resolve the condition and, if so, the entity is considered to be in a state of financial emergency. The Florida Department of Education is responsible for establishing guidelines for the development of financial recovery plans.

Pursuant to Section 218.504, Florida Statutes, the Governor or Commissioner of Education, as appropriate, has the authority to terminate all State actions provided the entity (a) has established and is operating an effective financial accounting and reporting system and (b) has resolved the conditions specified in Section 218.503(1), Florida Statutes. Cessation of State action cannot take place until none of the conditions in Section 218.503(1), Florida Statutes, exist. Exhibit A provides a history of the Act and descriptions of the circumstances surrounding entities that were determined to be in a state of financial emergency.

² Section 218.503(2), Florida Statutes.

Finding No. 1: Determination of Financial Emergency Status

Section 218.503(3), Florida Statutes, provides that upon notification that one or more of the conditions in subsection (1) have occurred or will occur if action is not taken to assist the local governmental entity or district school board, the Governor or his or her designee must contact the local governmental entity or the Commissioner of Education or his or her designee shall contact the district school board to determine what actions have been taken by the local governmental entity or the district school board to resolve or prevent the condition. The Governor or the Commissioner of Education, as appropriate, must determine whether the local governmental entity or the district school board needs State assistance to resolve or prevent the condition. If State assistance is needed, the local governmental entity or district school board is considered to be in a state of financial emergency.

When notified, EOG sends correspondence to local governmental entities requesting answers to a series of questions, including a description of the cause for the condition met, the actions that have been taken or are planned, the estimated time frame for resolution, and whether the entity believes State assistance is necessary to resolve the condition. Our review disclosed that while EOG timely contacted local governmental entities for which notifications were received, the entities contacted did not timely respond to EOG's requests. In many cases, EOG sends a follow-up request when the entity fails to respond; however, the entity does not always respond to the follow-up request. EOG provided a listing of 26 entities with unanswered requests as of October 6, 2010. For 8 of the 26 entities, the initial requests to the entities dated back to calendar year 2009, and requests for 7 additional entities were more than 6 months old. Untimely responses to follow-up requests has not been a concern for the Commissioner of Education, which, as previously noted, has only received notification of one district school board meeting a condition.

Various laws provide time frames within which entities must submit reports or other information to the State. For example:

- Sections 218.32(1)(e) and 218.39(8), Florida Statutes, require that annual financial reports and audit reports be submitted within 45 days after the audit report is delivered to the entity, but no later than 12 months after fiscal year end for entities required to have audits.
- Section 11.45(7)(b), Florida Statutes, requires entities to respond within 45 days of a request from the Auditor General for significant items omitted from audit reports.
- Section 218.38, Florida Statutes, requires entities to submit certain information to the Division of Bond Finance within 120 days after the delivery of any general obligation or revenue bonds sold by the entity.

In addition to providing time frames for providing reports or other information to the State, these laws also provide for consequences if entities fail to provide the report or information. The consequences for noncompliance of the above-noted laws involve reporting the entity to the LAC, who can take actions pursuant to Section 11.40(5), Florida Statutes. Section 218.503, Florida Statutes, does not currently provide a time frame within which entities must respond to either the Governor (for local governmental entities) or the Commissioner of Education (for district school boards) or consequences for failure to respond. Such provisions would help the Governor or the Commissioner of Education, as applicable, in determining what actions have been taken by the local governmental entity or the district school board to resolve or prevent the condition, and whether the local governmental entity or the district school board needs State assistance to resolve or prevent the condition.

Recommendation: The Legislature should consider revising Section 218.503(3), Florida Statutes, to provide time frames within which entities must respond to requests for information by the Governor or the Commissioner of Education, and consequences for failure to respond.

Finding No. 2: Local Governmental Entities in a State of Financial Emergency

As mentioned in Exhibit A, prior to the enactment of Chapter 2004-305, Laws of Florida, an entity that met one or more of the conditions in Section 218.503(1), Florida Statutes, was considered to be in a state of financial emergency. According to EOG management, there were 39 local governmental entities (16 municipalities and 23 special districts) as of March 2011, that were declared to be in a state of financial emergency prior to the enactment of Chapter 2004-305, Laws of Florida. For 38 of those entities (all except the Town of Eatonville), State assistance has not been provided. These 38 entities are comprised of the following:

- Fourteen entities that continue to report meeting one or more of the conditions specified in Section 218.503(1), Florida Statutes, and, as such, pursuant to Section 218.504, Florida Statutes, EOG is unable to release these entities from their financial emergency status. Thirteen of the 14 entities continue to meet the condition specified in Section 218.503(1)(e), Florida Statutes (see further discussion in finding No. 3).
- Thirteen entities declared to be in a state of financial emergency prior to the enactment of Chapter 2004-305, Laws of Florida, have not met a condition specified in Section 218.503(1), Florida Statutes, since the enactment of Chapter 2004-305, Laws of Florida, and two other entities have not met a condition since the 2006-07 fiscal year but EOG had not, as of March 2011, released these entities from their financial emergency status. In response to our inquiry, EOG management indicated that no entities have been released from financial emergency status since November 2009 due to a shortage in staff needed to perform the analysis for release of the entities.
- Nine entities that have not submitted audit reports in several years or have reported issues that would prevent releasing the entities from financial emergency status.

Additionally, as mentioned in Exhibit A, although State assistance to the Town of Yankeetown ceased on September 13, 2006, and the Town has not been reported as meeting a condition specified in Section 218.503(1), Florida Statutes, through the 2008-09 fiscal year, EOG had not, as of October 2010, released the Town from its financial emergency status.

Recommendation: The Legislature should consider authorizing EOG to release entities deemed in a state of financial emergency prior to 2004 for which EOG determines that the entities do not need State assistance. EOG should determine whether the 15 entities that have not been reported as meeting a condition specified in Section 218.503(1), Florida Statutes, since the 2006-07 fiscal year and the Town of Yankeetown have established and are operating effective financial accounting and reporting systems and, if so, consider releasing them from their financial emergency status.

Finding No. 3: Section 218.503(1)(e), Florida Statutes

Under current law, the condition specified in Section 218.503(1)(e), Florida Statutes, is “an unreserved or total fund balance or retained earnings deficit, or unrestricted or total net assets deficit, as reported on the balance sheet or statement of net assets on the general purpose or fund financial statements, for which sufficient resources of the entity, as reported on the balance sheet or statement of net assets on the general purpose or fund financial statements, are not available to cover the deficit. Resources available to cover reported deficits include net assets that are not otherwise restricted by Federal, State, or local laws, bond covenants, contractual agreements, or other legal constraints. Fixed or capital assets, the disposal of which would impair the ability of the entity to carry out its functions, are not considered resources available to cover reported deficits.” Of the 280 local governmental entity notifications we provided to the LAC and the Governor since the enactment of Chapter 2004-305, Laws of Florida, through the 2007-08 local governmental entity fiscal year audits, 255 (91 percent) related to entities that met only the condition specified in Section 218.503(1)(e), Florida Statutes. Additionally, 92 percent of the charter schools that were

the subject of our notifications to LAC and the Commissioner of Education met only the condition specified in Section 218.503(1)(e), Florida Statutes.

The difference between assets and liabilities in governmental funds (used to report governmental activities) is “fund balance” and this difference in proprietary funds (used to report business-type activities) is “net assets.” Under current generally accepted accounting principles, fund balance is reported as reserved or unreserved and net assets are reported as restricted or unrestricted.³ Unreserved fund balance and unrestricted net assets are a measure of current available resources whereas reserved fund balance and restricted net assets represent resources already expended or are limited as to where they can be expended. It is important for an entity to maintain sufficient levels of unreserved fund balance and unrestricted net assets to ensure the entity can respond to emergencies or other unexpected occurrences. Declining unreserved fund balance/unrestricted net assets may indicate that an entity could have difficulty maintaining a stable revenue structure or providing an adequate level of services.

Pursuant to Section 11.45(8), Florida Statutes, the Auditor General, in consultation with the Board of Accountancy, adopts rules for the conduct of audits of local governmental entities, district school boards, charter schools, and charter technical career centers. Auditor General rules for audits conducted pursuant to Section 218.39, Florida Statutes, require the auditor to conduct a financial condition assessment of the entity. The rules also require the auditor to indicate in the management letter if such assessment identified deteriorating financial conditions, including a description of the conditions noted, and recommendations to resolve the conditions. Further, Section 218.39(5), Florida Statutes, requires the auditor to notify each member of the governing body of the entity when deteriorating financial conditions exist that may cause a condition described in Section 218.503(1), Florida Statutes, to occur if actions are not taken to address such conditions. For local governmental entities, optional financial condition assessment procedures and data are available on the Auditor General Web site for auditors to use if they so choose. One of the financial indicators included in these procedures is an evaluation of unreserved fund balance and unrestricted net assets. The indicator provides a five-year trend of this balance for the entity and a benchmark for similar entities for the most current year for which information is available.

As discussed in finding No. 1, EOG is required to contact the local governmental entity to determine what actions have been taken by the entity to resolve or prevent the condition and determine if the entity needs State assistance to resolve or prevent the condition. If EOG staff determines that State assistance is needed, the entity is considered to be in a state of financial emergency. Although EOG staff have not made a final determination for all notifications provided to date, according to EOG management, of the 177 local governmental entities for which the EOG has determined whether State assistance was needed since the enactment of Chapter 2004-305, Laws of Florida, only 2 were determined to need State assistance (i.e., to be in a state of financial emergency). Neither of the 2 entities (Town of Eatonville and the Town of Yankeetown; see Exhibit A) met the condition in Section 218.503(1)(e), Florida Statutes.

Entities that meet the conditions specified in Section 218.503(1)(a) through (d), Florida Statutes, are likely in the advanced stages of deteriorating financial condition and in a true financial crisis. However, those that meet only the condition specified in Section 218.503(1)(e), Florida Statutes, may or may not be facing a true financial crisis. As indicated above, the majority of notifications of entities meeting one or more of the conditions specified in Section 218.503(1), Florida Statutes, have been entities meeting the condition specified in paragraph (e). Meeting the condition specified in Section 218.503(1)(e), Florida Statutes, may indicate an entity is in need of State assistance; however, historical information indicates meeting this condition has not, in most instances, resulted in a determination

³ In March 2009, the Governmental Accounting Standards Board issued Statement No. 54, which provides new requirements for fund balance reporting. Statement No. 54 is effective for financial statements for periods beginning after June 15, 2010.

that State assistance was necessary. As such, it does not appear that it has been cost beneficial to include the condition specified in Section 218.503(1)(e), Florida Statutes, as one of the conditions requiring notifications of, and financial emergency determinations by, EOG given the effort required to make such notifications and determinations.

For those entities for which State assistance is not necessary, resolution of the condition remains with the entity's governing body. Since there is a requirement in law for auditors to notify the governing body of entities for which deteriorating financial conditions exist, and an unreserved or total fund balance or unrestricted or total net assets deficit could be considered indication of a deteriorating financial condition, it may be more appropriate to remove the condition currently specified in Section 218.503(1)(e), Florida Statutes, from the Act and instead require the auditor to consider this condition in determining whether the entity is experiencing deteriorating financial conditions pursuant to Section 218.39(5), Florida Statutes. Doing so would reduce the State resources currently used in providing the notifications, making contact with the entities, and determining whether State assistance is needed.

Recommendation: The Legislature should consider eliminating the condition specified in Section 218.503(1)(e), Florida Statutes, and revising Section 218.39(5), Florida Statutes, to require auditors to consider that condition in determining whether deteriorating financial conditions exist that are required to be discussed with the governing body.

Community Development Districts

The Legislature enacted the "Uniform Community Development District Act of 1980" (Act) authorizing a uniform procedure in general law to establish an independent special district as an alternative method to manage and finance basic services for community development. Community Development Districts (CDDs) are local units of special-purpose government created pursuant to Chapter 190, Florida Statutes, and are limited to the performance of those specialized functions contained in the Act. A CDD is created primarily for the purpose of financing, and then operating and maintaining, communitywide improvements in new communities, such as roads, sidewalks, landscaping, and community recreational facilities. CDDs also have broad authority to finance, acquire, construct, operate, and maintain public improvements, such as water management, water supply, sewer, and wastewater management, subject to the regulatory jurisdiction and permitting authority of all applicable governmental bodies. A landowner (usually a developer) petitions the local government to create a CDD with broad powers that enables the CDD to generate revenue. To finance the provision of these services, CDDs have the authority to borrow money and issue bonds, certificates, warrants, notes, or other evidence of indebtedness, to levy tax and special assessments, and to charge, collect, and enforce fees and other user charges.

Initial financing is typically accomplished through the issuance of tax-exempt revenue bonds⁴, with a corresponding imposition of special assessments on the owners of property within the development. Consequently, the burden of paying for the infrastructure is imposed on those buying land, housing, and other structures in the district, not on the other taxpayers of the county or municipality within which the district is located. As of January 15, 2010, there were 577 active Community Development Districts (CDDs) in Florida.

⁴ The Internal Revenue Service (IRS) has questioned whether certain bonds issued by the Village Center Community Development District (District) were issued by a political subdivision or on behalf of a state or local governmental unit and, thus, entitled to tax-exempt status. A resolution of this issue that is unfavorable to the District may result in the IRS questioning the tax status of bonds issued by other Florida CDDs.

Finding No. 4: Community Development Districts Bond Defaults

Section 190.016, Florida Statutes, authorizes CDDs to issue general obligation or revenue bonds as authorized by resolution or resolutions of the CDD board. Although the issuance of general obligation bonds is limited to 35 percent of the assessed value of the taxable property within the CDD, there is no limitation placed on the amount of revenue bonds CDDs may issue. Florida law does not provide for approval of the issuance of bonds by a State agency or other body. The majority of Florida CDDs issue revenue bonds, pledging special assessments on CDD property owners for repayment. As of September 30, 2009, Florida CDDs reported \$5.9 billion in total debt according to annual financial report information for 521 CDDs published by the Florida Department of Financial Services. Likely due to the recent housing market crisis, many CDDs are facing a financial crisis due to a lack of sufficient funds to make debt service payments on bonds or to pay obligations within 90 days. The lack of sufficient funds for newer CDDs appears to be primarily attributable to the failure of developers to provide funding. Developers are typically responsible for paying assessments on the unsold properties within a CDD and some have agreements with CDDs to fund operations of the CDD for a certain time period. If the developer is unable to sell properties within the CDD for an extended period of time, the developer may lack sufficient funds to make the required payments. Many developers have filed for bankruptcy protection.

The Securities Exchange Act Rule in Title 17, Section 240.15c2-12(b)(5)(i), Code of Federal Regulations, requires issuers or obligated persons to submit annual financial information and other continuing disclosure documents for public access electronically to the Municipal Securities Rulemaking Board (MSRB). The Rule also requires municipal bond issuers to file with the MSRB, within ten business days, notice of certain material events with respect to the securities being offered (bonds issued), such as principal and interest payment delinquencies, unscheduled draws on reserves or credit enhancements, bond calls, or failures to provide required financial information.

MSRB publishes the information on its Electronic Municipal Market Access (EMMA) Web site. Our review of 282 CDD audit reports submitted to us for the 2008-09 fiscal year, and our research on the MSRB's EMMA Web site of event notices posted through July 2010, disclosed the following:

- 81 (29 percent) had not paid bond principal, interest, or both, when due.
- 41 (15 percent) had to make debt service payments from bond reserves, which, in turn, created a deficit in the bond reserve fund, contrary to the bond indenture.
- 34 (12 percent) were involved in foreclosure proceedings in process (i.e., banks that loaned moneys to the developers for the purchase of the land on which to develop the CDD have filed foreclosure proceedings against the landowner/developer). For many of these CDDs, the CDD was dependent on funding from the developer or significant landowner.
- 22 (8 percent) were experiencing deteriorating financial conditions.
- 17 (6 percent) involved developers that had filed for bankruptcy protection.

Similar findings were included in our report No. 2010-113.

Our review of Texas law and correspondence from professional engineering staff with the Texas Commission on Environmental Quality (TCEQ)⁵ revealed that the TCEQ must approve most applications for bond issues by certain

⁵ TCEQ is responsible for the general supervision and oversight of districts and utilities, including the processing of petitions to create districts. Its bond review responsibilities involve evaluating the engineering and economic feasibility of all district bond issue applications.

types of districts in Texas⁶, whereas Florida has no approval requirement for bonds issued by CDDs. TCEQ staff also indicated that feasibility rules adopted in 1989, which ensure that district property taxes levied to pay district debt are limited because the rules limit the amount of bonds the district can issue at any one time, have been a major factor in low default rates in Texas. As noted above, Florida law does not establish parameters addressing the amount of revenue bonds that CDDs can issue at any one time and there is currently no oversight entity responsible for CDD bond issuances. Without an oversight entity approving and, when deemed prudent, limiting the amount of revenue bonds that CDDs are able to issue, there is limited assurance as to the feasibility of repayment to the bondholders.

Recommendation: The Legislature should consider amending Chapter 190 Florida Statutes, to establish parameters addressing the amount of bonds a CDD may issue and oversight responsibility for CDD bond issuances.

Finding No. 5: Disclosures to Prospective Homeowners Within CDDs

Section 190.009 Florida Statutes, requires CDDs to take affirmative steps to provide for full disclosure of information relating to public financing and maintenance of improvements to real property undertaken by a CDD. Such information is required to be made available to all existing residents, and all prospective residents of the CDD. The CDD is required to furnish each developer of a residential development within the CDD with sufficient copies of that information to provide to each prospective initial purchaser of property in that development. Any developer of a residential development within the CDD, when required by law to provide a public offering statement, must include a copy of such information relating to public financing and maintenance of improvements in the public offering statement. The disclosure documents and any amendments thereto are required to be filed in the property records of each county in which the CDD is located.

Section 190.048, Florida Statutes, requires that each contract for the initial sale of a parcel of real property and each contract for the initial sale of a residential unit within the CDD include, immediately prior to the space reserved in the contract for the signature of the purchaser, the following disclosure statement in boldfaced and conspicuous type that is larger than the type in the remaining text of the contract:

“THE (Name of District) COMMUNITY DEVELOPMENT DISTRICT MAY IMPOSE AND LEVY TAXES OR ASSESSMENTS, OR BOTH TAXES AND ASSESSMENTS, ON THIS PROPERTY. THESE TAXES AND ASSESSMENTS PAY THE CONSTRUCTION, OPERATION, AND MAINTENANCE COSTS OF CERTAIN PUBLIC FACILITIES AND SERVICES OF THE DISTRICT AND ARE SET ANNUALLY BY THE GOVERNING BOARD OF THE DISTRICT. THESE TAXES AND ASSESSMENTS ARE IN ADDITION TO COUNTY AND OTHER LOCAL GOVERNMENTAL TAXES AND ASSESSMENTS AND ALL OTHER TAXES AND ASSESSMENTS PROVIDED FOR BY LAW.”

While Section 190.048, Florida Statutes, requires this disclosure to be made to initial purchasers, it does not require it for subsequent purchasers of property within CDDs. Section 689.261, Florida Statutes, provides that a prospective purchaser of any residential property must be presented a disclosure summary with respect to ad valorem taxes, but does not address disclosure of assessments, monthly fees, or other debt obligation repayment options commonly associated with CDD properties. Most of the communitywide improvements within CDDs are financed with bonds with repayment terms of 30 years and the bonds are repaid with assessments collected from CDD property owners.

⁶ All debt secured by tax revenues must be approved by district voters. Except for bonds issued by river authorities or bonds sold to a state or Federal agency, the TCEQ must approve most district bonds.

Recent housing trends indicate that it is likely the initial purchaser of properties within CDDs will sell to other buyers before the bond repayment/assessment period expires. Consequently, it is important to ensure that subsequent purchasers are aware of the charges they can expect that are in addition to those expected for properties not in CDDs.

Other states, including Texas and California, provide for more disclosures to all potential purchasers in developments similar to Florida’s CDDs. For example, the State of California requires language to be in each contract for purchase of property in its CDDs that includes the following disclosures not required by Section 190.048, Florida Statutes:

- A statement that the property is subject to a special tax that is in addition to regular property taxes and any other charges, fees, special taxes, and benefit assessments on the parcel; if the prospective purchaser fails to pay taxes and assessments due on the property each year, the property may be foreclosed upon and sold.
- The maximum special tax(es) that may be levied against the parcel in the year of purchase and the amount of annual increase(s) thereafter.
- A statement that the special assessments will be levied each year until all the authorized facilities are built and all special revenue bonds are repaid.
- A list of authorized facilities that are being paid for by the special assessments, and by the money received from the sale of bonds that are being repaid by the special assessments.

The prospective purchaser must sign acknowledging that they have received and read the notice prior to entering into a contract to purchase property in the CDD.

Recommendation: The Legislature should consider amending Section 190.048, Florida Statutes, to require additional disclosures, such as a copy of the document creating the CDD, known current year and estimated future year assessments, a schedule of facilities not yet constructed or acquired, monthly fees, and debt obligation repayment options, and require the disclosures to be provided to all prospective purchasers (i.e., initial and subsequent) of property within CDDs.

Local Government Bond Issues

Section 218.38, Florida Statutes, requires local governments to furnish the Florida State Board of Administration’s Division of Bond Finance (Division) a complete description of new general obligation and revenue bonds, including advance notice of the impending sale of any new issues, and a copy of the final official statement, if any. The law also provides that certain information be provided to the Division within 120 days after delivery of the bonds.

Based on information obtained from the Division, we identified 42 local governments that issued 90 bonds during the 2008-09 fiscal year and sent a survey to each of these local governments requesting various information about the bond issue process. The 90 bond issues, comprised of 85 revenue and 5 general obligation bond issues, totaled more than \$6 billion as shown in the following tabulation:

Entity	Amount	Percentage
Counties	\$3,349,411,162	55
Municipalities	1,248,852,001	20
Special Districts	<u>1,515,695,000</u>	<u>25</u>
Total	<u>\$6,113,958,163</u>	<u>100</u>

Source: Surveys of Local Governments

The results of our survey are discussed in finding Nos. 6 and 7, as appropriate.

Finding No. 6: Method of Sale for Local Government Bond Issues

There are essentially three methods by which bonds are sold: competitive bids, negotiated sale, and private placement. In a competitive bid sale, the issuer solicits bids from underwriting firms and sells the bonds to the firm offering the lowest true interest cost bid. In a negotiated sale, an underwriting firm is selected early in the process and the underwriter assists the issuer in all steps. At the time the bonds are sold, the issuer negotiates a purchase price for the bonds with the underwriter. In a private placement (a type of negotiated sale), the issuer sells the bonds directly to investors without a public offering, although underwriting firms may be actively involved in placing the bonds on behalf of the issuer.

The Government Finance Officers Association (GFOA) recommends that state and local government bond issuers sell their debt using the method of sale that is most likely to achieve the lowest cost of borrowing while taking into account both short-range and long-range implications for taxpayers and ratepayers. Issuers should select a method of sale based on a thorough analysis of the relevant rating, security, structure, and other factors pertaining to the proposed bond issue. If the entity has in-house expertise, defined as dedicated debt management staff whose responsibilities include daily management of a debt portfolio, this analysis and selection could be made by the entity’s staff. However, in the more common situation where an entity does not have sufficient in-house expertise, this analysis and selection should be undertaken in partnership with a financial advisor. Due to the inherent conflict of interest, GFOA recommended that issuers not use a broker/dealer or potential underwriter to assist in the method of sale selection unless that firm has agreed not to underwrite that transaction.⁷ Failure to use an independent financial advisor can reduce public confidence in the bond sale process and local government officials, and may result in the governing body making decisions with respect to the debt issuance that are not in the best interest of the local government.⁸

The following tabulation provides a breakdown of the total amount issued by method of sale for the 90 bonds issued by the 42 local government survey respondents:

Method of Sale	Number of Issues	Amount Issued	Percentage
Negotiated (Including Private Placements)	59	\$5,098,517,198	83
Competitive	<u>31</u>	<u>1,015,440,965</u>	<u>17</u>
Totals	<u>90</u>	<u>\$6,113,958,163</u>	<u>100</u>

Source: Surveys of Local Governments

The survey responses from the 42 local government survey respondents disclosed the following:

- For 16 (27 percent) of the 59 issues sold by negotiated sale, the local government did not have documentation evidencing the conditions favoring a negotiated sale.
- For 13 (22 percent) of the 59 issues sold by negotiated sale, the local government did not obtain a financial or market analysis prepared by a qualified and independent financial advisor.
- For 25 (89 percent) of the 28 issues for which an underwriter assisted in selecting the method of bond sale, the same underwriter also underwrote the transaction.
- For 13 (14 percent) of the 90 issues, the local government did not use the services of an independent financial advisor and stated that it did not have qualified in-house staff with applicable expertise.

⁷ GFOA Best Practice: *Selecting and Managing the Method of Sale of State and Local Government Bonds* (1994 and 2007)

⁸ GFOA Best Practice: *Selecting Financial Advisors* (2008)

Section 218.385(1), Florida Statutes, requires all local government general obligation bonds and revenue bonds to be sold at public sale by competitive bids unless the governing body determines that a negotiated sale of such bonds is in the best interest of the issuer. Although the law requires that the resolution authorizing the negotiated sale include the specific findings as to the reasons requiring the negotiated sale, it does not require local governments to provide this information to the Division, or require the governing body to document the conditions favoring the selected method of sale. Further, despite the importance of using an independent financial advisor as discussed above, it does not require local governments to use a financial advisor. Nor does it prohibit the use of the underwriter of a bond issue in determining the method of sale for that bond issue. Failure to use the most appropriate sale method, or an independent financial advisor, may result in unfavorable issue terms or excessive bond issue costs.

Section 218.385(7), Florida Statutes, provides that the failure of a local government to comply with one or more provisions of Sections 218.385 or 218.38, Florida Statutes, shall subject the local government to the sanctions provided in Section 218.38(3), Florida Statutes. Section 218.38(3), Florida Statutes, requires the Division to report to the Legislative Auditing Committee (LAC) local governments that fail to provide information, and the LAC can take action pursuant to Section 11.40, Florida Statutes, to compel the local government to provide such information.

Recommendation: To promote public confidence in the bond sale process, and to ensure that an independent and adequate determination is made as to the best bond sale method, the Legislature should consider amending Section 218.385(1), Florida Statutes, to require local governments to use a financial advisor that is independent of the underwriter, or to otherwise demonstrate that the local governments have staff with sufficient expertise to act in a financial advisor capacity. To ensure that local governments adequately document and justify that a negotiated or private placement sale is the most appropriate type of sale, the Legislature should consider amending Sections 218.38 and 218.385, Florida Statutes, to require local governments to document the conditions favoring this type of sale and provide such documentation to the Division.

Finding No. 7: Selection of Bond Professionals

Various Florida laws provide guidelines that local governments are required to follow in the procurement of professional services. For example, Section 218.391, Florida Statutes, provides guidance for the selection of financial auditors, while Section 287.055, Florida Statutes, provides guidance on the acquisition of professional architectural, engineering, landscape architectural, surveying and mapping services. However, Florida law generally does not provide similar guidance regarding the procurement of financial and professional services for local government general obligation and revenue bond issues.

Governments typically employ a number of professionals to assist them in the bond process, primarily a financial advisor, an underwriter, and bond counsel. As discussed above, financial advisors can be used in determining the bond sale method and may have various other roles depending on which sale method is selected.⁹ The primary role of the underwriter in a negotiated sale is to market the issuer's bonds to investors. Assuming that the issuer and underwriter reach agreement on the pricing of the bonds at the time of sale, the underwriter purchases the entire bond issue from the issuer and resells the bonds to investors.¹⁰ Bond counsel renders an opinion on the validity of the bond offering, the security for the offering, and whether and to what extent interest on the bonds is exempt from

⁹ GFOA Best Practice: *Selecting Financial Advisors* (2008)

¹⁰ GFOA Best Practice: *Selecting Underwriters for Negotiated Bond Sales* (2008)

income and other taxation. The opinion of bond counsel provides assurance both to issuers and to investors who purchase the bonds that all legal and tax requirements relevant to the matters covered by the opinion are met.¹¹

GFOA recommends that issuers select financial advisors, underwriters, and bond counsel using a competitive process using a Request for Proposal (RFP) or Request for Qualifications (RFQ). Using a competitive process allows the issuer to compare the qualifications of proposers and to select the most qualified firm based on the scope of services and evaluation criteria outlined in the RFP or RFQ. A competitive process also provides objective assurance that the best services and interest rates are obtained at the lowest cost possible and demonstrates that marketing and procurement decisions are free of self-interest, personal, or political influences. Furthermore, a competitive process reduces the opportunity for fraud and abuse and is fair to competing finance professionals.¹²

The survey responses from the 42 local government survey respondents (see previous discussion under the heading **Local Government Bond Issues**) disclosed the following:

- For 10 (13 percent) of the 75 issues for which local governments used the services of an outside financial advisor, the local government did not use a formal RFP or RFQ to select the financial advisor.
- For 25 (42 percent) of the 59 issues sold by negotiated or private placement, the local government did not use a formal RFP or RFQ to select the underwriter.
- For 42 (47 percent) of the 90 issues, the local government did not use a formal RFP or RFQ to select the bond counsel.
- For 45 (50 percent) of the 90 issues, the local government did not enter into a written contract with the bond counsel selected¹³. Written contracts are necessary to describe the responsibilities of each party and to provide a basis for payment.

The majority of local government survey respondents that did not use a formal RFP or RFQ to select bond counsel, financial advisors, or underwriters stated that they used the same professionals as used in the past; selected them based on their qualifications, or familiarity with the entity or entity staff; or the bond professionals were selected by the entity's governing body or legal staff.

Recommendation: To ensure that qualified financial and professional services are acquired at the lowest possible cost consistent with the size, nature, and complexity of the bond issue, the Legislature should consider amending Section 218.385, Florida Statutes, to require local governments to select financial advisors and bond counsels using a competitive selection process whereby RFPs or RFQs are solicited from a reasonable number of professionals and, for negotiated bond issues, to use RFPs to solicit qualified underwriting firms to serve as the underwriter. Local governments should use written contracts with all bond professionals.

Florida Department of Financial Services

Section 218.32, Florida Statutes, requires that each local governmental entity that is determined to be a reporting entity, as defined by generally accepted accounting principles, and each independent special district as defined in Section 189.403, Florida Statutes, submit to the Florida Department of Financial Services (DFS) a copy of its annual

¹¹ GFOA Best Practice: *Selecting Bond Counsel* (1998 and 2008)

¹² GFOA Best Practice: *Selecting Financial Advisors* (2008); GFOA Best Practice: *Selecting Underwriters for Negotiated Bond Sales* (2008); GFOA Best Practice: *Selecting Bond Counsel* (1998 and 2008)

¹³ Based on the survey responses, written contracts were almost always used for financial advisors and underwriters.

financial report (AFR) for the previous fiscal year in a format prescribed by DFS.¹⁴ The AFR must include any component units, as defined by generally accepted accounting principles, and each component unit must provide the local governmental entity, within a reasonable time period, financial information necessary to comply with the AFR reporting requirements. For entities not required to provide for an audit pursuant to Section 218.39, Florida Statutes, the AFR is due to DFS by April 30 of the following year, whereas those entities required to provide for an audit must submit the AFR and audit report to DFS within 45 days after completion of the audit report, but no later than 12 months after the end of the fiscal year. AFRs provide local government revenue and expenditure information in more detail than is included in audit reports and is useful for detailed financial analysis. DFS has two primary reporting duties related to AFRs:

- If DFS does not receive a completed AFR from a local governmental entity within the required period, it must notify the Legislative Auditing Committee (LAC) of the local governmental entity's failure to comply with the reporting requirements. LAC may proceed in accordance with Section 11.40(5), Florida Statutes.
- DFS must, by December 1, file a verified report with the Governor, the Legislature, the Auditor General, and the Special District Information Program of the Florida Department of Community Affairs showing the revenues, both locally derived and derived from intergovernmental transfers, and the expenditures of each local governmental entity that is required to submit an AFR. The report must include, but is not limited to, the total revenues and expenditures of each local governmental entity that is a component unit included in the annual financial report of the reporting entity, and must include the amount of outstanding long-term debt for each local governmental entity.

DFS has established the Local Government Electronic Reporting system (LOGGER) for entities to file AFRs and to publish the AFR data reported on its Web site.

Finding No. 8: Reporting of Noncompliant Local Governments to LAC

Pursuant to Section 218.32, Florida Statutes, DFS notifies LAC of entities that fail to comply with the AFR reporting requirements. DFS notifications include entities that do not file the required AFR and those that file the AFR after the applicable deadlines (April 30 for unaudited entities and September 30 for audited entities). Our review of DFS's notifications to LAC for the 2007-08 fiscal year (dated May 27, 2009, for unaudited entities and January 13, 2010, for all others) disclosed that the following were not included on the 2007-08 fiscal year notifications made by DFS to LAC:

- Five entities (one municipality and four special districts) that did not meet the audit threshold and filed AFRs after the April 30, 2009.
- Four entities (one municipality and three special districts) that met the audit threshold and did not file an AFR by September 30, 2009.
- Four special districts that did not file an AFR by September 30, 2009, that were not included on the noncompliant report because DFS had not identified them as entities required to file an AFR (see additional discussion in finding No. 9).
- Two independent special districts that did not file AFRs. Although both of these districts were component units of a primary government (the primary government is the county or municipality within which the special district is located) and were included in the primary government's AFR as required by law, independent special districts must file a separate AFR as noted above. In response to our inquiry, DFS staff indicated that the LOGGER system does not flag independent special districts that are also component units

¹⁴ Pursuant to Section 218.32(1)(c), Florida Statutes, regional planning councils; local government finance commissions, boards, or councils; and municipal power corporations created as a separate legal or administrative entity by interlocal agreement under Section 163.01(7), Florida Statutes, are also required to submit an AFR and audit report to DFS. For purposes of this report, we limited our review to local governmental entities.

and, therefore, does not identify them as having to report independently and edit checks for discretely presented component units in LOGER certifies the component units along with the primary government, resulting in DFS not following up on those issues since the AFR was certified.

LAC cannot take appropriate action to compel local governmental entities to comply with the AFR reporting requirements unless these entities are properly reported to it.

Recommendation: DFS should enhance procedures to ensure that all known entities that fail to provide required AFRs on a timely basis are included in its notifications to the LAC. In doing so, DFS should revise its LOGER system to ensure all independent special districts comply with the separate filing requirement as set forth in Section 218.32, Florida Statutes.

Finding No. 9: Determination of Special Districts Required to Submit AFRs

For DFS to accurately report entities that fail to file AFRs, DFS must determine the population of entities required to file AFRs. The vast majority of local governmental entities (counties, municipalities, and special districts), in terms of number of entities, are special districts. Of the 2,004 local governmental entities determined to be a reporting entity for the 2007-08 fiscal year, 1,526 (76 percent) were special districts¹⁵. Every year a number of special districts are created, become inactive, or are dissolved. Therefore, the determination of special districts required to file an AFR should be made, at a minimum, annually.

Section 189.412, Florida Statutes, created the Special District Information Program (SDIP) within the Florida Department of Community Affairs. One of the responsibilities of the SDIP is to maintain a master list of independent and dependent special districts. The SDIP maintains its master list online and provides information for active, inactive, and dissolved special districts.

We compared DFS's database to the SDIP's master list of special districts for the 2007-08 fiscal year and identified the following differences:

- Forty-four entities that had been dissolved (24 prior to the 2007-08 fiscal year) according to SDIP were still in DFS's database, although none were included on DFS's notifications to LAC.
- Six entities included in DFS's database were not on SDIP's master list, although none were included on DFS's notifications to LAC.
- Four entities on SDIP's master list were not in DFS's database, all of which failed to provide AFRs for the 2007-08 fiscal year.
- Four entities in DFS's database as special districts were not special districts according to SDIP.
- Three entities were listed twice on DFS's database.

Without proper reconciliation of special districts in its database to SDIP's master list, DFS cannot ensure complete and accurate reporting regarding special districts that fail to file AFRs.

Recommendation: To identify special districts that should be added or deleted in its database, and ensure that the population of special districts required to file AFRs is properly identified, DFS should reconcile its database to SDIP's master list at least annually.

¹⁵ This determination was made by us for purposes of providing notification to LAC of entities that did not file an audit report pursuant to Section 218.39, Florida Statutes.

Finding No. 10: Revenues, Expenditures, and Debt Reported on Local Government AFRs

As previously noted, DFS must annually file a verified report with the Governor, the Legislature, the Auditor General, and the SDIP showing the revenues, expenditures, and the amount of outstanding long-term debt for each local governmental entity that is required to submit an AFR. The verified report is made available on the DFS Web site for all users of the information, including the general public.

DFS' Certification Process

For DFS to file a “verified” report, DFS has created an AFR certification policy whereby DFS reconciles AFR data with the audit report data, or the data element worksheet if no audit was required.¹⁶ If the reconciliation does not disclose any discrepancies or the discrepancies are resolved upon inquiry by DFS staff, the AFR is updated to a “certified” status, and the LOGER system includes the AFR information in the system-generated report that is filed with the specified parties. If an AFR does not have a “certified” status, the LOGER system does not include the information in the verified report.

For the verified report that was due on December 1, 2009, for the 2007-08 fiscal year AFRs, DFS established a cut-off date of November 12, 2009. Of the 1,930 AFRs received by DFS as of November 12, 2009, 424 (22 percent) were not certified and not included in the report. Of the 424, 43 remained uncertified as of April 9, 2010. This may have resulted because DFS had not established written policies and procedures relating to the certification process, including time frames for completing reconciliations or following up on unanswered inquiries of local governmental entities, or materiality thresholds that prompt inquiry of local governmental entities for differences noted in reconciliations. In addition, our review of 70 AFRs (10 of the 43 AFRs that were not certified as of April 9, 2010, and 60 of the 381 AFRs that were certified subsequent to November 12, 2009) disclosed that DFS certification procedures needed improvement, as follows:

- ***Unexplainable Omissions.*** Twenty entities filed an AFR and audit report and were identified as having “no questioned items.” The number of days between the date DFS received the AFR and audit report, and the November 12 cut-off date, ranged from 16 to 302 days, an average of 97 days. An additional 16 entities had issues that appeared resolved by the cut-off date. DFS records did not indicate why these items were not certified by the November 12 cut-off date and included in the verified report.
- ***Untimely Reconciliations.*** DFS did not timely resolve issues that arose during the certification process, as follows:
 - Eight entities were not contacted to resolve reconciling differences between the AFRs and the audit reports until after the cut-off date. For these entities, DFS had received both the AFR and audit report from 16 to 265 days prior to the cut-off date.
 - Eight entities submitted an audit report subsequent to the cut-off date, but correspondence provided indicated the request for the audit was not made until after the cut-off date. The AFRs for these entities were received by DFS from 62 to 264 days prior to the cut-off date.
- ***Insignificant Reconciling Issues.*** Three entities with reconciling issues were contacted by DFS, but the reconciling issues involved DFS questioning differences of less than two percent between revenues or expenditures reported on the AFR and the audit report. DFS had not established thresholds for determining when to question differences, which may have resulted in DFS staff expending unnecessary effort on insignificant reconciling issues.

¹⁶ The data element worksheet contains balance sheet information collected for unaudited entities. Section 218.32(1)(e), Florida Statutes, requires DFS to provide this information to the Auditor General for use in our report of significant financial trends and findings of local governments.

The instances noted above resulted in the untimely certification of AFRs, exclusion of AFR data from the verified report, and unnecessary delays in information being made available on the DFS Web site. Users of this information, including the Legislature, State agencies, and the public, do not have the most current and complete financial data available if DFS does not certify AFRs timely.

DFS's Requests for Information

During our review, we noted several instances in which entities did not timely respond to DFS requests for information to resolve reconciling issues. For example, five entities included in our review did not respond to DFS requests from three months to more than one year after the DFS request dates. As discussed in finding No. 1, various laws provide time frames within which local governmental entities must provide reports or other information to the State or be reported to LAC for possible action pursuant to Section 11.40(5), Florida Statutes. However, current law does not provide a time frame within which local governmental entities must respond to DFS requests for information regarding AFRs, nor does current law provide a mechanism for DFS to compel local governmental entities to timely respond to DFS requests. Such provisions would help ensure that DFS timely obtains information needed to prepare a complete and accurate verified report.

Auditor Assurances

Pursuant to Section 218.32(1)(d), Florida Statutes, each local government that is required to provide for an audit in accordance with Section 218.39(1), Florida Statutes, must submit the AFR with the audit report to DFS. Section 218.39(4), Florida Statutes, requires that the audit report include a management letter. The management letter must include a statement¹⁷ as to whether or not the AFR filed with DFS is in agreement with the audit report for the current audit period and, if not, explain any significant differences. The purpose of these requirements is to provide some assurance as to the reliability of the unaudited AFR information. However, the assurance provided by the management letter statement is limited because the level of assurance is not specified and, as a result, auditors may apply the requirement to the total revenues, expenditures, and long-term debt reported on the AFR, which would not provide assurance as to amounts reported at the fund or account level. Because of the limited assurance provided by the management letter statement, DFS staff have expended a significant amount of effort comparing AFRs to audited financial statements. Such comparisons are part of DFS's certification process, and have disclosed numerous instances in which the management letter statement indicated that the AFR and audited financial statements were materially in agreement; however, differences existed at the fund or account level. If the auditors' management letter statement provided assurance at the fund and account level, the reconciliation currently performed by DFS staff would no longer be necessary.

Recommendation: DFS should establish policies and procedures regarding its certification process, and enhance its procedures to ensure the more timely and complete reporting of AFR information on its Web site and in verified reports to the Governor, the Legislature, the Auditor General, and the SDIP. The Legislature should consider revising Section 218.32, Florida Statutes, to provide time frames within which entities must respond to DFS requests for information, including audit reports, and consequences for failure to respond. The Legislature should also consider revising Section 218.32, Florida Statutes, to require auditors to state in the management letter whether the AFR substantially agrees with the audited financial statements at an appropriate level.

¹⁷ Required by Chapter 10.550, Rules of the Auditor General for Local Governmental Entity Audits.

Florida Department of Management Services, Division of Retirement
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Part VII of Chapter 112, Florida Statutes, provides for the operation and funding of public employee retirement systems and plans, and requires each system and plan to have regularly scheduled actuarial reports prepared and certified by an enrolled actuary. The frequency of the actuarial reports is to be at least every three years commencing from the last actuarial report of the plan or system, and the actuarial report is to be furnished to the Florida Department of Management Services, Division of Retirement (DMS), within 60 days after receipt from the actuary. Additionally, actuarial impact statements of proposed changes to local retirement systems are to be furnished to DMS. Upon receipt of the actuarial report or actuarial impact statement, DMS is to acknowledge such receipt, but must review and comment on each retirement system's or plan's actuarial valuations at least on a triennial basis. DMS maintains a database to track local retirement systems plans and its review activities related to those plans.

Finding No. 11: DMS Database of Municipalities and Special Districts

Section 112.665(1)(a), Florida Statutes, requires DMS to gather, catalog, and maintain complete, computerized data information on all public employee retirement systems or plans in the State. Using our database of local governments that have submitted audit reports to us, we identified four municipalities that were created by referendum during the 2005, 2006, and 2007 fiscal years and inquired of DMS staff if those entities had been surveyed to determine if they had adopted a pension plan or had joined FRS. In response to our inquiry on May 21, 2010, DMS management advised that none of the four municipalities created in 2005 and 2006 had been surveyed to determine if they had adopted a pension plan or had joined FRS. DMS management also advised that they do not routinely survey local governments to obtain information about changes or additions to retirement plans. Subsequent to our inquiry, DMS management indicated that surveys were sent to all municipalities listed in the Florida League of Cities' directory and to all special districts on SDIP's master list requesting information regarding employee retirement systems or plans.

Recommendation: DMS should implement procedures to survey, or otherwise contact entities that change to the FRS to determine if local plans are still in effect and any newly created entity to obtain data on all public employee retirement systems or plans as soon as possible after the creation of the entity.

Finding No. 12: Insurance Premium Tax Distributions

Excise taxes on property insurance premiums levied by the State under Chapters 175 and 185, Florida Statutes, are designated to fund local government public safety (police and firefighter) pension benefits. Sections 175.121 and 185.10, Florida Statutes, provide that, for a municipality or a special fire control district, as applicable, and its police or firefighter's retirement fund to participate in the distribution of insurance premium tax moneys, all provisions in Chapters 175 and 185, respectively, must be complied with annually, including State acceptance of actuarial valuations pursuant to Part VII of Chapter 112, Florida Statutes.

We selected 50 retirement plans for which DMS approved distribution of insurance premium tax moneys in August and September of 2009. For 11 (22 percent) of the 50 retirement plans tested, DMS had not State accepted the actuarial report for the plans within the past three years, contrary to Part VII of Chapter 112, Florida Statutes. At the time the distributions were approved, actuarial reports for 5 (45 percent) of the 11 retirement plans had never been State accepted; the actuarial report for one of the retirement plans had not been State accepted since 1997; and, the others were last State accepted between 1999 and 2002. DMS completed the State acceptance process for all 11 of these retirement plans from 9 to 317 days after the dates on which the distribution of insurance premium tax moneys

were approved. DMS staff indicated that these actuarial reports were part of a backlog that has been completely eliminated.

In response to our inquiry as to why insurance premium tax distributions were made to the 11 entities, DMS staff indicated that insurance premium tax distributions are approved unless DMS has determined that the actuarial valuation should not be State accepted. While we agree that entities should not be penalized for the untimely review of actuarial reports by DMS, Sections 175.121 and 185.10, Florida Statutes, do not provide exceptions to the State acceptance requirement.

Recommendation: DMS should continue its efforts to ensure that actuarial reports are timely reviewed. Additionally, DMS should ensure that insurance premium tax distributions are not approved unless the actuarial reports for the retirement plans have been State accepted in accordance with Part VII of Chapter 112, Florida Statutes.

Overview of the Local Government Financial Reporting System

As discussed in the Background section of this report, the local government financial reporting system is defined as any statutory provisions related to local government financial reporting. There are numerous statutory provisions that require local governmental entities to file various reports with the Auditor General and State agencies and provisions requiring State agencies to report to other State agencies, the Governor, the Legislature, or other party.

We selected certain statutory provisions to determine whether the provision was still relevant and, if so, whether revisions were needed to make the information or the process more efficient and effective. In our review, we made inquiries with the various individuals that were the recipients of the specified reports to determine if the report was still useful, contained appropriate information, was in a desired format, etc. For the provisions selected, most of the reports required to be filed are posted to Web sites and accessible to all. None of the individuals questioned indicated that they do not need the reports they receive from the local governmental entities or State agencies. However, below we discuss a provision that could be eliminated.

Finding No. 13: Florida State Board of Administration's Division of Bond Finance Newsletter

Section 218.37(1)(f), Florida Statutes, requires the Florida State Board of Administration's Division of Bond Finance (Division) to issue a regular newsletter to issuers, underwriters, attorneys, investors, and other parties within the bond community and the general public containing information of interest relating to local and State bonds and authorizes the Division to charge fees for subscriptions to the newsletter. Through inquiry with Division management, we determined that the Division is no longer publishing the newsletter due to a lack of resources and availability of the same information at no cost on the Internet. For example, the Municipal Securities Rulemaking Board's EMMA Web site (discussed in finding No. 4) provides extensive information relating to bond issues, including an educational section and an extensive glossary of terms relating to bonds.

Recommendation: The Legislature should consider repealing Section 218.37(1)(f), Florida Statutes, to no longer require the Division to issue a newsletter.

PRIOR AUDIT FOLLOW-UP

Except as discussed in the preceding paragraphs, the Executive Office of the Governor, Florida Department of Financial Services, and Florida Department of Management Services had taken corrective actions for finding Nos. 5 through 10 included in our report No. 2009-014.

OBJECTIVES, SCOPE, AND METHODOLOGY

The Auditor General conducts audits of governmental entities to provide the Legislature, Florida's citizens, public entity management, and other stakeholders unbiased, timely, and relevant information for use in promoting government accountability and stewardship and improving government operations.

We conducted this performance audit from August 2009 to November 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

This performance audit's overall objective was to determine the accuracy, efficiency, and effectiveness of the System in achieving its goals. This included:

- Documenting our understanding of managements controls relevant to the operations of selected State agencies with local government financial reporting system administrative responsibilities. 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.
- Evaluating selected State agency managements' performance in administering assigned local government financial reporting system responsibilities in accordance with applicable laws, rules, and other guidelines.
- Determining the extent to which selected State agencies' management controls promoted and encouraged the achievement of management's control objectives in the categories of compliance with controlling laws, rules, and other guidelines; the economic and efficient administration of the assigned functions; and the safeguarding of assets.
- Evaluating the adequacy and appropriateness of local government financial reporting system laws related to the scope of this audit.

This performance audit focused on certain activities performed by the Executive Office of the Governor, Florida Department of Financial Services, Florida Department of Management Services, and local governmental entities. This performance audit also focused on evaluating law requirements relating to audits of housing authorities and the extent of oversight of housing authority audits regarding compliance with required filing and reporting requirements. We also interviewed recipients of selected reports from the System to determine if the reports are useful, needed to be eliminated, or need any statutory revisions to improve their usability or effectiveness.

Our audit also included a determination whether management of the Executive Office of the Governor, Florida Department of Financial Services, and Florida Department of Management Services had taken corrective actions for finding Nos. 5 through 10 of our report No. 2009-014.

Specific scope and audit procedures applied relative to this audit were:

Financial Emergencies Act

Determined whether the Executive Office of the Governor (EOG) took adequate corrective actions for finding No. 10 in our report No. 2009-014, and evaluated the effectiveness of current law in identifying entities meeting one or more of the conditions specified in Section 218.503(1), Florida Statutes, and the subsequent determination of whether such entities need State assistance.

In conducting our audit, we:

- Obtained an understanding of the procedures and processes used by EOG: (1) to track notifications from us pursuant to Section 11.45(7)(e), Florida Statutes, of entities reported as meeting one or more of the conditions specified in Section 218.503(1), Florida Statutes, and (2) to determine whether such entities were in need of State assistance.
- Obtained a list of entities EOG determined needed State assistance, and for each entity:
 - Determined the entity's fiscal year to which the notification applied, the condition(s) met, the date on which the entity was determined to need assistance, and identified what criteria or other circumstance was the key to EOG's determination.
 - Determined what State assistance EOG determined the entity needed, obtained any documentation of agreements between EOG and the entity, and noted the date EOG formally released the entity from a state of financial emergency.
 - Reviewed documentation of the State assistance provided and determined if the terms of the agreement were followed by the entity and EOG.
- For all entities reported as meeting one or more of the conditions specified in Section 218.503(1), Florida Statutes, included in our notifications to EOG for the 2003-04, 2004-05, 2005-06, and 2007-08 fiscal years, we determined the condition(s) met and whether EOG determined if the entity needed State assistance.
- For 10 entities reported as meeting one or more of the conditions specified in Section 218.503(1), Florida Statutes, included in our notifications to EOG during the 2009 calendar year, we determined whether EOG timely contacted the entity to determine what actions had been taken to resolve the condition(s).

Community Development Districts

Identified CDDs that reported serious financial difficulties arising from the housing crisis and evaluated whether changes in law should be recommended to alleviate these difficulties or prevent them from occurring in the future. We also evaluated whether changes to law were necessary regarding impact fee credits and disclosures to prospective homeowners of CDDs regarding annual special assessments that have been, or could be, imposed by the CDD.

In conducting our audit, we:

- Identified CDDs that reported serious financial difficulties in 2008-09 fiscal year audit reports filed with us or in event notices filed with MSRB through July 2010.
- Researched other states (California, Colorado, and Texas) to determine if they have experienced the same financial difficulties with CDDs as Florida.
- Researched laws of other states (California, Colorado, and Texas) governing their CDDs.
- Interviewed Florida State Board of Administration, Division of Bond Finance management for input on recommended law changes governing CDDs.

Local Government Bond Issues

Determined whether local governments are using a financial advisor that is independent of the underwriter and maintaining documentation evidencing the conditions favoring the type of sale selected, including a financial or market analysis prepared by a qualified and independent financial advisor.

Determined whether local governments are selecting financial advisors and bond counsels using a competitive selection process and, for negotiated bond issues, using RFPs to solicit qualified firms to serve as the underwriter.

In conducting our audit, we:

- Surveyed local governments that issued long-term debt during the 2008-09 fiscal year to request information concerning:
 - Method of sale selected.
 - Documentation, if any, used to support selected method of sale.
 - Method of selecting financial advisors.
 - Method of selecting bond counsel.
 - Method of selecting underwriters.

Florida Department of Financial Services

Determined whether the Florida Department of Financial Services (DFS) took adequate corrective actions for finding Nos. 5, 6, and 7 in our report No. 2009-014, and evaluated the accuracy of the report provided in December 2009 pursuant to Section 218.32(2), Florida Statutes, showing total revenues and expenditures, and the amount of long-term debt, for each local governmental entity.

In conducting our audit, we:

- Obtained an understanding and prepared a narrative description of DFS's control activities as they relate to AFR filings.
- Determined what percentage (or number) of entities filed their AFRs electronically for the 2007-08 fiscal year.
- Reviewed Department of Financial Services Rule 69I-51.003, Florida Administrative Code, as it relates to finding No. 5 in our report No. 2009-014.
- Determined whether DFS reported to the Legislative Auditing Committee (LAC) all known entities that were reported on the governing authority's AFR, that failed to provide the required AFR for the 2007-08 fiscal year.
- Compared a list of entities not required to file an audit report for the 2007-08 fiscal year that had filed AFRs by September 30 to the list of entities for which balance sheet information was provided to us pursuant to Section 218.32(1)(e), Florida Statutes. Determined whether DFS contacted those entities that did not provide balance sheet information to provide technical assistance to assist them with proper completion and filing of the AFR.
- Compared the list of entities that submitted an AFR by the cut-off date used by DFS to prepare the December 2009 report required by Section 218.32(2), Florida Statutes, to those included on the report submitted. For those entities not included in the report, we determined why they were excluded.

Florida Department of Management Services, Division of Retirement

Determined whether the Florida Department of Management Services, Division of Retirement (DMS) took adequate corrective actions for finding Nos. 8 and 9 in our report No. 2009-014, and reviewed DMS's responsibilities as they relate to distributions of the insurance premium tax to municipalities and special fire control districts and the reporting of municipalities and special fire control districts that fail to provide requested information.

In conducting our audit, we:

- Obtained an understanding and documented DMS's procedures for review of actuarial reports and impact statements.
- Evaluated DMS's procedures and systems and determined whether they:
 - Established a prioritization of actuarial reports and impact statements to ensure that reviews were performed in a timely manner.
 - Adopted standards or requirements regarding the level of review needed to determine compliance with Chapter 112, Florida Statutes.
 - Were sufficiently linked in the DMS's database (i.e., information in each table linked to other tables so that staff were not manually recording the same data into different tables or modules).
 - Ensured that new retirement plans that came into existence, or plans that no longer exist, were added to or deleted from the tracking system, as applicable.
- Determined how DMS identified entities that need to be added to or deleted from their database.
- Tested 20 actuarial reports and impact statements received during the 2009 calendar year to determine whether DMS notified the local governments in a timely manner that it had received their actuarial report and impact statements.
- Determined whether and when DMS prioritized its backlog of actuarial report and impact statement reviews based on the triennial review schedule provided for in Section 112.63(2), Florida Statutes. Compared 20 retirement plans on the prioritized list to the reports subsequently reviewed by DMS staff and contracted actuaries.
- Determined whether DMS had established a tracking system for its correspondence to ensure timely monitoring and follow-up.
- Tested 10 letters DMS sent to local governments requesting information and determined whether DMS indicated the consequences for failure to provide the requested information as provided for in law and rule. For those entities that failed to contact DMS or provide the requested information, we:
 - Determined whether DMS reported those noncompliant entities (municipalities and special districts) to the Florida Department of Revenue and the Florida Department of Financial Services as required by Section 112.63(4), Florida Statutes.
 - Determined whether DMS reported those special districts that did not respond to DMS's request for information to the Florida Department of Community Affairs as required by Section 112.673(4)(b), Florida Statutes.
- Tested 50 police and firefighter retirement plans for which DMS had approved insurance premium tax distributions during the 2009 calendar year to determine whether DMS had "State accepted" the actuarial reports for the plans in at least one of the previous three fiscal years as required by Section 185.10(2), Florida Statutes.

- Examined 20 retirement plan files reviewed by DMS or its contracted actuaries during the 2009 calendar year and determined if the results of the actuary's reviews were documented, and if documented, whether the documentation was in the format required by DMS procedures.
- Based on audit reports submitted to us, selected 15 special districts and 15 municipalities that had non-FRS pension plans and:
 - Determined the plan year and date submitted for the most recent actuarial report submitted to DMS.
 - Determined whether DMS, or its contractors, had reviewed a plan from the entity within the past three fiscal years.
 - Determined whether DMS, or its contractors, followed the standard review program developed by DMS in conducting the review.

Local Governmental Entity Audit-related Requirements

Evaluated local governmental audit-related requirements as they relate to audits of housing authorities.

In conducting our audit, we:

- Prepared a schedule for the 2005-06, 2006-07, and 2007-08 fiscal years showing the following information for each housing authority:
 - Whether the authority provided for an audit pursuant to Section 421.091(a), Florida Statutes.
 - Whether the authority filed an audit with us pursuant to Section 421.091(a), Florida Statutes.
 - Whether the amount of revenues or expenditures reported for the authority would have met the Section 218.39, Florida Statutes, audit threshold.
 - Whether the authority met the Federal or Florida single audit thresholds and, if so, whether the authority's audit appeared to have been conducted in accordance with the Federal and State single audit requirements, as applicable.
 - The number of audit report findings.
- Contacted United States Department of Housing and Urban Development personnel and inquired as to the frequency of the Department's audits of housing authorities.

Overview of the Local Government Financial Reporting System

Evaluated selected statutory provisions that are included in the local government financial reporting system to determine whether such provisions are still relevant, including those requiring State agencies or local governments to prepare reports. For selected reports, we determined whether the reports are useful, need to be eliminated, or whether any statutory revisions are needed to improve their usability or effectiveness.

In conducting our audit, we:

- Interviewed appropriate individuals that receive reports from local governmental entities and determined:
 - What is done with the report.
 - If the report provided useful information.
 - If the report is redundant (the same report is required from more than one entity).

- If the requirement to file the report needs to be eliminated or revised.

AUTHORITY

Pursuant to the provisions of Section 11.45(2)(h), Florida Statutes, I have directed that this report be prepared to present the results of our performance audit of the local government financial reporting system.



David W. Martin, CPA
Auditor General

MANAGEMENT'S RESPONSE

Managements' responses are included as Exhibit B.

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EXHIBIT A
FINANCIAL EMERGENCIES ACT - HISTORICAL INFORMATION

Prior to 2004, the Local Governmental Entity, Charter School, Charter Technical Career Center, and District School Board Financial Emergencies Act (Act) applied only to local governmental entities. District school boards, charter schools, and charter technical career centers were made subject to the Act in 2004, 2006, and 2009, respectively. Also prior to 2004, any entity that met one or more of the specified conditions was considered to be in a state of financial emergency. For many entities reported prior to 2004, auditors indicted that while the entity was technically in a state of financial emergency (i.e., by definition in law), the entity was not facing a true financial crisis. Since the enactment of Chapter 2004-305, Laws of Florida, the Governor or Commissioner of Education, as applicable, determines whether entities meeting one or more of the specified conditions are in a state of financial emergency.

Local Governmental Entities. According to the Executive Office of the Governor (EOG), there are 39 local governmental entities reported prior to the enactment of Chapter 2004-305, Laws of Florida, that are still considered as being in a state of financial emergency because they continue to meet one or more of the conditions specified in Section 218.503(1), Florida Statutes (see additional discussion in finding No. 13). Since the enactment of Chapter 2004-305, Laws of Florida, through the 2007-08 local governmental entity fiscal year, we have provided 280 notifications to LAC and EOG, relating to 177 local governmental entities reported as meeting one or more conditions specified in Section 218.503(1), Florida Statutes.

According to EOG management, only four local governmental entities have been determined to need State assistance to resolve a condition met, or prevent the meeting of, a condition specified in Section 218.503(1), Florida Statutes. The entities and the circumstances surrounding the actions taken are as follows:

- **City of Miami.** In 1996, the City advised the Governor that a financial emergency existed where the health, safety, and welfare of the citizens of Miami were threatened and that, without assistance to address a critical shortage of funds, essential services such as police and fire protection could not be assured. Although the auditors that conducted the City's 1994-95 fiscal year annual financial audit did not indicate whether or not the City was in a state of financial emergency, they noted that the City had a very difficult financial year and recommended that the City implement operating efficiencies and financing plans to cover various deficits in enterprise and internal service funds. Our review of the City's audited financial statements disclosed that the City reported total unreserved fund balance/retained earnings deficits of \$34,278,000 and \$117,946,000, for the 1993-94 and 1994-95 fiscal years, respectively. On October 11, 1996, the Governor issued Executive Order No. 96-318 providing for the early release of local option gas tax, municipal revenue sharing, and half-cent sales tax revenues to the City. Simultaneously, EOG and the City entered into a contract wherein the City agreed to, among other things, an arrangement that would provide for an oversight board to run the City's operations. On March 19, 2002, after the City met the requirements for the cessation of State action and final action by the oversight board, the Governor released the City from its financial emergency status.
- **City of Opa-locka.** At September 30, 2000, the City had reported deficits in several funds and had failed to transfer retirement contributions to the State due to a lack of funds. Thus, the auditors indicated in the management letter, dated December 12, 2001, that the City was in a state of financial emergency. On February 28, 2002, the City notified the Governor's Office that it was in a state of financial emergency. EOG determined that the City was in need of State assistance as indicated in Executive Order No. 02-125 issued by the Governor on April 26, 2002. On May 21, 2002, EOG and the City entered into a State and Local Agreement wherein the City agreed to provide to EOG for review and approval: (1) a five-year financial recovery plan, (2) the City's budget, (3) monthly revenue and expenditure reports, and (4) a financial integrity ordinance setting forth procedures to be followed for financial affairs. The agreement also prohibited the City from entering into financial or contractual obligations that were not specifically authorized in the annual budget or the agreement and provided a mechanism for EOG staff to conduct, or cause to be conducted, audits, examinations, or studies of the City as deemed necessary. EOG enlisted

EXHIBIT A (CONTINUED)
FINANCIAL EMERGENCIES ACT - HISTORICAL INFORMATION

assistance from several State agencies to provide technical assistance to the City in formulating its financial recovery plan. On August 23, 2005, after the City met the requirements for the cessation of State action and final action by the oversight board, the Governor released the City from its financial emergency status.

- **Town of Eatonville.** At its July 31, 2002, Council meeting, the Town Council adopted Resolution 2002-38, declaring a state of financial emergency; however, the Town did not notify the EOG or the LAC. In connection with our operational audit of the Town, we requested the basis for the resolution and the Mayor indicated that the Town was not in a state of financial emergency. During that audit, we noted that the Town had not made required contributions for the 2000-01 fiscal year for its employee retirement plan due to a lack of funds; therefore, we concluded that the Town met one of the specified conditions for financial emergency and we recommended that the Town notify EOG and LAC (our report No. 2004-178, finding No. 5, issued April 2004). The auditors for the Town's 2001-02 fiscal year annual financial audit, issued May 25, 2004, also indicated that the Town met the same condition and noted that the Town's financial condition was deteriorating as indicated through its use of restricted funds for operations. On July 6, 2004, EOG and the Town entered into a State and Local Agreement wherein the Town agreed to provide to EOG for review and approval: (1) the Town's budget; (2) various financial documents, including monthly statements of revenues and expenditures, balance sheets, accounts receivable and payable, and bank account reconciliations; and (3) a financial integrity ordinance. The Town was also prohibited from entering into financial or contractual obligations that were not specifically authorized in the annual budget or the agreement and provided a mechanism for EOG staff to conduct, or cause to be conducted, audits, examinations, or studies of the City as deemed necessary. As of January 2011, State action has not ceased and, therefore, the Governor had not formally released the Town from its financial emergency status.
- **Town of Yankeetown.** On July 12, 2006, the Governor issued Executive Order No. 06-163 declaring a financial emergency due to the failure to transfer at the appropriate time retirement contributions due to inaccessible funds. The Town Council had been unable to muster a quorum to conduct business because three of the five Council members had resigned. The Governor created a Financial Emergency Board to oversee activities of the Town and appointed seven members to serve on the Board. The Executive Order also provided for technical assistance from other agencies to support the Board. The Board completed its work on September 13, 2006, and EOG management indicated that no State assistance has been provided since September 13, 2006; however, as of January 2011, the Governor had not formally released the Town from its financial emergency status.

District School Boards. District school boards became subject to the Act with the enactment of Chapter 2004-305, Laws of Florida. Additionally, Chapter 2009-3, Laws of Florida, established Section 1011.51, Florida Statutes, which provides a minimum level for district school boards' unreserved general fund balance. If a district school board's unreserved general fund balance is projected to fall during the fiscal year below three percent of projected general fund revenues, the superintendent is required to notify the school board and the Commissioner of Education. If the unreserved general fund balance is projected to fall below two percent of projected general fund revenues, the superintendent is required to notify the school board and the Commissioner of Education must determine whether the school board has a plan that is reasonably anticipated to avoid a financial emergency. If it is determined that the school board does not have a sufficient plan, the Commissioner is required to appoint a financial emergency board to oversee the activities of the school board and operate consistent with the requirements, powers, and duties specified in Section 218.503(3), Florida Statutes. During the 2008-09 fiscal year, Jefferson County District School Board notified the Commissioner of Education that its unreserved general fund balance was projected to fall below two percent of the projected general fund revenues. On April 22, 2009, a financial emergency board was appointed to oversee the District's activities. According to Florida Department of Education personnel, no other district school board has been officially determined to be in a state of financial emergency pursuant to the Act.

EXHIBIT A (CONTINUED)
FINANCIAL EMERGENCIES ACT - HISTORICAL INFORMATION

Charter Schools and Charter Technical Career Centers. Charter schools became subject to the Act with the enactment of Chapter 2006-190, Laws of Florida, and charter technical career centers became subject to the Act with the enactment of Chapter 2009-214, Laws of Florida. Since the enactment of Chapter 2006-190, Laws of Florida, we have provided 168 notifications to LAC and the Commissioner of Education relating to 109 charter schools/charter technical career centers reported as meeting one or more conditions specified in Section 218.503(1), Florida Statutes, through the 2007-08 fiscal year. As noted above, upon notification, the Commissioner of Education must determine if the entity needs a financial recovery plan to resolve the condition and, if so, the entity is considered to be in a state of financial emergency. Of the 168 notifications provided to the Commissioner of Education through the 2007-08 fiscal year, none of the entities were determined to need a financial recovery plan to resolve the condition. Therefore, none were considered to be in a state of financial emergency.

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EXHIBIT B
MANAGEMENT'S RESPONSES



RICK SCOTT
GOVERNOR

STATE OF FLORIDA
Office of the Governor

THE CAPITOL
TALLAHASSEE, FLORIDA 32399-0001

www.flgov.com
850-488-7146
850-487-0801 fax

May 27, 2011

Mr. David Martin, Auditor General
111 West Madison Street
G-74 Pepper Building
Tallahassee, FL 32399-1450

Re: Performance Audit of the Local Government Financial Reporting System

Dear Mr. Martin:

In compliance with Section 11.45(4)(d), Florida Statutes, the Executive Office of the Governor is pleased to provide the following response to your preliminary audit finding and recommendation specific to this office contained in the above referenced report.

Finding on Local Governmental Entities in a State of Financial Emergency: Thirteen entities declared to be in a state of financial emergency prior to the enactment of Chapter 2004-305, Laws of Florida, and two other entities have not met a condition since the 2006-07 fiscal year but EOG had not, as of March 2011, released these entities from their financial emergency status.

Recommendation: EOG should determine whether the 15 entities that have not been reported as meeting a condition specified in Section 218.503(1), Florida Statutes, since the 2006-07 fiscal year and the Town of Yankeetown have established and are operating effective financial accounting and reporting systems and, if so, consider releasing them from their financial emergency status.

Response: We concur with the recommendation. We have begun gathering the information needed to contact the affected entities identified by the auditors to determine their eligibility for release from financial emergency status. Hereafter, we will analyze the entities in financial emergency status on an annual basis to determine which entities should be considered for release.

If you have any questions or need additional information, please contact Kim Mills, Director of Auditing, at (850) 922-4637.

Sincerely,

A handwritten signature in blue ink that reads "Melinda Miguel".

Melinda Miguel
Chief Inspector General

cc: Mike Prendergast, Chief of Staff

**EXHIBIT B (CONTINUED)
MANAGEMENT'S RESPONSES**



CHIEF FINANCIAL OFFICER
JEFF ATWATER
STATE OF FLORIDA

May 31, 2011

Mr. David W. Martin
Auditor General
State of Florida
Claude Pepper Building
111 West Madison Street
Tallahassee, Florida 32399-1450

Dear Mr. Martin:

Pursuant to Section 11.45(4)(d), Florida Statutes, the enclosed responses are provided for the preliminary and tentative audit findings included in the Auditor General's Performance Audit of the Department of Financial Services, Local Government Financial Reporting System.

If you have any questions or would like to discuss the matter further, please contact Alan Sands, Audit Director, at (850) 413-4962.

Sincerely,

A handwritten signature in blue ink, appearing to read "Jeff Atwater".

Jeff Atwater

JA:Sc

Enclosure

FLORIDA DEPARTMENT OF FINANCIAL SERVICES
Ned Luczynski • Inspector General
Division • Office of Inspector General
200 East Gaines Street • Tallahassee, Florida 32399-0312 • Tel. 850-413-3112 • Fax 850-413-4973
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AFFIRMATIVE ACTION • EQUAL OPPORTUNITY EMPLOYER

EXHIBIT B (CONTINUED)
MANAGEMENT'S RESPONSES



CHIEF FINANCIAL OFFICER
JEFF ATWATER
STATE OF FLORIDA

MEMORANDUM

TO: Ned Luczynski, Inspector General

FROM: Christina Smith, Director
Division of Accounting and Auditing

DATE: May 19, 2011

SUBJECT: Audit Response to Preliminary and Tentative Findings –
Local Government Financial Reporting System Performance Audit

Below are the Division's responses to the Preliminary and Tentative Findings from the Local Government Financial Reporting System Performance Audit.

Finding No. 8: Reporting of Noncompliant Local Governments to LAC

The Florida Department of Financial Services (DFS) needed to enhance its procedures to ensure that it properly notifies the Legislative Auditing Committee of all entities that fail to provide annual financial reports (AFRs).

Recommendation: DFS should enhance procedures to ensure that all known entities that fail to provide required AFRs on a timely basis are included in its notifications to the LAC. In doing so, DFS should revise its LOGER system to ensure all independent special districts comply with the separate filing requirement as set forth in Section 218.32, Florida Statutes.

Response: The Department concurs. The enhancement in DFS procedures will not require a revision of LOGER, but will ensure that all independent special districts comply with Section 218.32, Florida Statutes.

Finding No. 9: Determination of Special Districts Required to Submit AFRs

DFS did not reconcile its database to the Special District Information Program's master list of special districts to ensure it had properly identified the population of special districts required to file AFRs.

EXHIBIT B (CONTINUED)
MANAGEMENT'S RESPONSES

Recommendation: To identify special districts that should be added or deleted in its database, and ensure that the population of special districts required to file AFRs is properly identified; DFS should reconcile its database to SDIP's master list at least annually.

Response: The Department concurs. DFS has completed its initial reconciliation between the Department of Community Affairs' Special District data base and the one used by the Bureau of Local Government's LOGER system. This reconciliation will continue on a monthly basis.

Finding No. 10: Revenues, Expenditures, and Debt Reported on Local Government AFRs

DFS had inadequate policies and procedures regarding its certification (verification) process of AFRs. While auditors conducting financial audits of local governments are required to indicate whether the AFR is in agreement with the audit report, the level of agreement is not specified in the requirement. Also, current law does not provide time frames within which entities must respond to requests for information by DFS or provide consequences for failure to respond.

Recommendation: DFS should establish policies and procedures regarding its certification process, and enhance its procedures to ensure the more timely and complete reporting of AFR information on its Web site and in verified reports to the Governor, the Legislature, the Auditor General, and the SDIP. The Legislature should consider revising Section 218.32, Florida Statutes, to provide time frames within which entities must respond to DFS requests for information, including audit reports, and consequences for failure to respond. The Legislature should also consider revising Section 218.32, Florida Statutes, to require auditors to state in the management letter whether the AFR substantially agrees with the audited financial statements at an appropriate level.

Response: The Department concurs. DFS will strengthen its existing procedures related to the AFR certification process. DFS will consider proposing an amendment to Section 218.32, Florida Statutes.

EXHIBIT B (CONTINUED)
MANAGEMENT'S RESPONSES



RICK SCOTT
Governor

DEPARTMENT OF MANAGEMENT
SERVICES

JOHN P. MILES
Secretary

4050 Esplanade Way | Tallahassee, Florida 32399-0950 | Tel: 850.488.2786 | Fax: 850.922.6149

May 26, 2011

Mr. David W. Martin, CPA
Auditor General
G74 Claude Pepper Building
111 West Madison Street
Tallahassee, FL 32399-1450

Dear Mr. Martin:

Pursuant to Section 11.45(4)(d), Florida Statutes, this is our response to your report, *Local Government Financial Reporting System*. The report contained two preliminary and tentative findings and recommendations for the Department of Management Services, Division of Retirement. Our response corresponds with the order of the preliminary and tentative findings and recommendations contained in the draft report.

If further information is needed concerning our response, please contact Steve Rumph, Inspector General or John Davis, Audit Director, at 488-5285.

Sincerely,

A handwritten signature in cursive script that reads "John P. Miles".

John P. Miles
Secretary

Attachment

cc: David Faulkenberry, Deputy Secretary
Brett Rayman, Chief of Staff
Sarabeth Snuggs, Director of Retirement

EXHIBIT B (CONTINUED)
MANAGEMENT'S RESPONSES

Mr. David W. Martin
May 24, 2011
Page 2

**Department of Management Services' Response to the Auditor
General's Preliminary and Tentative Report, Local Government
Financial Reporting System.**

Finding 11: DMS Database of Municipalities and Special Districts

Section 112.665(1)(a), Florida Statutes, requires DMS to gather, catalog, and maintain complete, computerized data information on all public employee retirement systems or plans in the State. We identified four municipalities that were created by referendum during the 2005, 2006, and 2007 fiscal year and inquired of DMS staff if those entities had been surveyed to determine if they had adopted a pension plan or had joined FRS. DMS management advised that none of the four municipalities had been surveyed to determine if they had adopted a pension plan or had joined FRS. DMS management also advised that they do not routinely survey local governments to obtain information about changes or additions to retirement plans.

Recommendation:

DMS should implement procedures to survey, or otherwise contacts entities that change to the FRS to determine if local plans are still in effect and any newly created entity to obtain data on all public employee retirement systems or plans as soon as possible after the creation of the entity.

DMS Response:

Currently DMS annually reviews (1) the Municipal Directory maintained by the Florida League of Cities and (2) the Official List of Special Districts maintained by the Department of Community Affairs for any newly created cities or special districts. If the city or district has created a new defined benefit pension plan, we enter the information into our database and begin monitoring it for compliance with Chapter 112, Florida Statutes. Moreover, all newly created defined benefit plans are required by law to submit actuarial valuations to DMS. The required information on new plans, not identified during the reviews above, may be obtained from the actuarial valuations and added to the actuarial database. This information is used to prepare the Florida Local Government Retirement Systems Annual Report.

Of the four new municipalities noted in Finding 11, two had enrolled in the FRS and were properly identified on the annual report as FRS participating employers. The other two cities identified by the Auditor General have not created defined benefit plans and neither city is subject to an actuarial review by DMS.

As part of a process that has been ongoing since 2009, enhancements have been made in the actuarial database. One of the standard reports available in the database makes it

EXHIBIT B (CONTINUED)
MANAGEMENT'S RESPONSES

Mr. David W. Martin
May 24, 2011
Page 3

possible for us to better identify plans that have terminated and/or switched to the FRS, thereby improving the accuracy of the actuarial data. The database tracks and identifies those plans which have not submitted an actuarial valuation so that we may contact the plans to determine their status. In May 2010, the Department implemented procedures for contacting those plans using this report.

Finding 12: Insurance Premium Tax Distributions

DMS did not always withhold insurance premium tax moneys from entities when actuarial reports of police and firefighter retirement plans had not been State accepted.

Recommendation:

DMS should continue its efforts to ensure that actuarial reports are timely reviewed. Additionally, DMS should ensure that insurance premium tax distributions are not approved unless the actuarial reports for the retirement plans have been State accepted in accordance with Part VII of Chapter 112, Florida Statutes.

DMS Response:

DMS has and continues to use all available resources to ensure timely actuarial reviews of pension plans. In order to accomplish this objective, DMS maintains two internal actuary positions and has a contract with an external actuarial firm to supplement its internal review capacity. To this end, DMS eliminated its backlog of actuarial reviews prior to the end of 2009 as recognized by the Auditor General.

As indicated in the audit finding, the Auditor General sampled data for 50 police and firefighter retirement plans for which distribution was made during the period of August and September 2009. Of the 50 plans sampled, the Auditor General identified 11 plans for which distribution of insurance premium tax moneys was approved yet had not been state accepted under Part VII of Chapter 112, Florida Statutes. Of the 11 identified plans, 6 were part of the backlog that DMS eliminated prior to the end of 2009. The other 5 had been reviewed within the preceding 3-year period, but had not yet been state accepted. Therefore, the data sampled did not reflect the most recently completed reviews for those plans.

Since the elimination of the backlog, a decrease in funding has limited the department's use of the external actuarial firm. Potentially, this could lead to a re-occurrence of the backlog. To minimize the likelihood of release of tax moneys to plans that have not been state accepted pursuant to Part VII of Chapter 112, Florida Statutes, DMS will assign a higher priority to actuarial reviews of police and firefighter plans (350 of the 490 plans). Concurrent with this action, DMS will ask the Legislature to revise Chapter 175 and 185, Florida Statutes to allow the distribution of funds when the lack of a current review is not the fault of the plan.