

**CITY OF LAKE WORTH'S SUB-REGIONAL
SEWER SYSTEM**

**Follow-up on Operational Audit
Report No. 2013-001**



MAYOR, COMMISSIONERS, AND CITY MANAGER

The City of Lake Worth's Mayor, Commissioners, and City Manager who served during the period August 2012 through May 2014 are listed below:

Mayor

Pam Triolo

City Commissioners

Scott Maxwell, Vice Mayor

Christopher McVoy

Andy Amoroso

Suzanne Mulvehill, to November 13, 2012

John Szerdi, from November 14, 2012

District

No.

1

2

3

4

4

City Manager

Michael Bornstein

The audit team leader was Stefanie Johnson, CPA, and the audit was supervised by Derek H. Noonan, CPA. Please address inquiries regarding this report to Marilyn D. Rosetti, CPA, Audit Manager, by e-mail at marilynrosetti@aud.state.fl.us or by telephone at (850) 412-2902.

This report and other reports prepared by the Auditor General can be obtained on our Web site (www.myflorida.com/audgen); by telephone (850) 412-2722; or by mail G74 Claude Pepper Building, 111 West Madison Street, Tallahassee, Florida 32399-1450.

**CITY OF LAKE WORTH'S SUB-REGIONAL SEWER SYSTEM
FOLLOW-UP ON OPERATIONAL AUDIT REPORT NO. 2013-001**

SUMMARY

This report provides the results of our follow-up procedures for each of the findings included in report No. 2013-001 and the City of Lake Worth's (City) response thereto. Our follow-up procedures to determine the City's progress in addressing the 6 findings and recommendations contained in report No. 2013-001 disclosed that, as of the completion of our follow-up procedures in May 2014, the City's actions adequately corrected 3 findings, partially corrected 2 findings, and had not corrected 1 finding.

BACKGROUND

The Auditor General is authorized by State law to perform audits of governmental entities in Florida. As directed by the Legislative Auditing Committee, we conducted an operational audit of the City of Lake Worth's Sub-regional Sewer System for the period October 1, 2005, through May 31, 2011, and selected actions taken prior and subsequent thereto through September 30, 2011. Pursuant to Section 11.45(2)(j), Florida Statutes, the Auditor General, no later than 18 months after the release of report No. 2013-001, must perform such appropriate follow-up procedures as deemed necessary to determine the City of Lake Worth's progress in addressing the findings and recommendations contained within that report.

STATUS OF REPORT NUMBER 2013-001 FINDINGS

Contracts

Finding No. 1: Contract Provisions

Previously Reported

Some contract terms were not sufficiently detailed as to the methodology for determining costs to be billed and paid by System Customers. Due to ambiguous contract provisions and various other deficiencies, City records were insufficient to permit a determination, in total, of amounts that should have been billed to System Customers.

We recommended that contracts with System Customers be renegotiated and redrafted with clear and concise detailed terms regarding costs to be charged and the methodologies to be used to calculate such costs.

Results of Follow-Up Procedures

The City's actions corrected this finding. New contracts with all System Customers were entered into on March 27, 2013. The new contracts specified the basis and methodology for the various costs to be billed and paid by System Customers. Additionally, the new contracts included a settlement of past claims, and System Customers timely paid or were paid, as applicable, agreed-upon settlement amounts.

Billing of Costs to System Customers

Finding No. 2: Renewal and Replacement Costs

Previously Reported

Renewal and replacement (R & R) costs for the two Regional and the Sub-regional Systems billed to System Customers were not always calculated properly and consistently, and City records did not always evidence the basis or methodology used to determine amounts billed to System Customers. In addition, an audit of the R&R Fund was not performed, contrary to the contracts between the City and System Customers.

We recommended that the City and System Customers negotiate the R&R provisions of the contracts, recalculate the billings for a reasonable period, and determine the amounts owed and payable by each entity. We also recommended that the City ensure that required annual audits of the R&R Fund are performed and audit reports furnished to System Customers.

Results of Follow-Up Procedures

The City's actions partially corrected this finding. The new contracts specified the basis and methodology for calculating R&R costs related to the Sub-regional System. The 2013-14 fiscal year Sub-regional R&R costs were calculated in accordance with the new contract and were consistent with the 2012-13 fiscal year Sub-regional R&R costs specified in the contract and charged to System Customers.

Our review of billings to System Customers from April 2013 through April 2014 disclosed that the City properly billed the System Customers for the East Central Regional Water Reclamation Facility (ECRWRF) R&R costs. Because the Palm Beach County Joint Transmission Facility (PBCJTF) did not assess any R&R costs to the City, the City did not charge the System Customers for any PBCJTF R&R costs.

The new contracts required the City to engage an independent Certified Public Accountant (CPA) to perform an annual financial audit of the operational costs related to the Sub-regional System, including a report regarding the City's compliance with the contract. Pursuant to the new contracts, the report must be furnished to each member of the Member Board¹ on or before April 1 of each year. The City obtained an audit of the City's financial statements by an independent CPA, which included the Sub-regional System reported as a major fund; however, the scope of the audit did not include sufficient procedures for the CPA to determine the City's compliance with the terms of the new contracts. In May 2014, the City contracted with the CPA firm to perform an audit of the operational costs and provide the required report.

Finding No. 3: Other Pass-through Costs

Previously Reported

Contrary to contract provisions, the ECRWRF fleet reserve and debt costs were not always properly passed through to System Customers, and documentation supporting rates charged to Systems Customers was not always retained.

We recommended that the City ensure that Regional pass-through fixed costs are not included in the flow rate calculations to System Customers.

¹ The Member Board is comprised of one member representative for each System Customer, including the City.

Results of Follow-Up Procedures

The City's actions corrected this finding. The new contracts between the City and System Customers included definitions of each cost component. Section 2.3 (page 4) of the contracts stated that the ECRWRF R&R charges to the City were to be based on the City's reserve capacity in the ECRWRF and would include, but would not be limited to, debt service costs, ECRWRF R&R, and payments into the ECRWRF Catastrophic Reserve Fund. The contract between the City and ECRWRF provided that debt service costs would be billed to the City as pass-through fixed costs. However, ECRWRF billed the City for loan pass-through costs by including them in the flow charges, contrary to the agreement between the City and the ECRWRF. Thus, rather than a fixed cost, these costs were charged to the City as variable costs. Notwithstanding the billing methodology used by the ECRWRF to bill the City, the City calculated its portion (i.e., the City and its System Customers' portion) of the debt costs, backed these costs out of the flow, and passed them on to the System Customers as a pass-through fixed charge during the fiscal year-end true-up. The City, however, did not request support for the debt service costs from the ECRWRF prior to billing the System Customers. Upon our inquiry of the ECRWRF, we determined that the debt service costs used in the City's calculation were incorrect. While differences in amounts due to and from the System Customers were immaterial both individually and in aggregate, insofar as the ECRWRF Board has approved a bond issue estimated at \$111.98 million, the flow versus capacity billing methodology may yield significantly different calculations after the bonds are issued.

The contracts did not specifically address the ECRWRF fleet costs. As of May 2014, the City had no fleet costs; however, according to City and ECRWRF personnel, any future fleet costs would be included in estimated operating and maintenance (O&M) charges from the ECRWRF.

Finding No. 4: Flow Rate Calculations and Regional Systems Operating and Maintenance (O&M) Costs

Previously Reported

Amounts billed to System Customers for Regional O&M costs based on flow of effluent through the systems were not always calculated properly, and documentation supporting flow rate calculations was not always retained.

We recommended that the City recalculate the costs that should have been passed through, adjust the flow rates for all years, compare the revised amounts to System Customers' payments during those years, and that the differences be billed or credited, as applicable, to System Customer's accounts. We also recommended that the City provide System Customers with details of the recalculations.

Results of Follow-Up Procedures

The City's actions corrected this finding. As noted previously, settlement of past claims was included in the new contracts and we verified that the settlement amounts were timely paid to or received from the System Customers, as applicable. For periods subsequent to the March 27, 2013, contracts, our tests disclosed that the City calculated flow rate in accordance with the contracts and, subsequent to the end of the 2012-13 fiscal year, the City conducted a true-up reconciliation based on actual costs.

Finding No. 5: Flow Rate Calculations and Sub-regional System O&M Costs

Previously Reported

The City needed to improve its procedures for ensuring the reasonableness of budgeted amounts used as the basis for the Sub-regional O&M cost component of the flow rate calculations. Also, contrary to contract provisions, City

records did not evidence that budgets were provided to System Customers for any of the fiscal years we reviewed or that such budgets reflected estimated deficiencies and surpluses from prior fiscal years. In addition, contrary to contract provisions, the City did not provide for annual audits of operating costs by a CPA.

We recommended that the City ensure that proposed budgets used as a basis for billing System Customers for Sub-regional System O&M costs are reasonable and provided to System Customers as required by contract provisions, and that budgets reflect surpluses and deficiencies from prior fiscal years. We also recommended that the City develop systematic and rational methodologies for allocating direct and indirect costs to the Regional Sewer Fund and enhance its procedures to maintain adequate documentation to support all expenditures and allocations of direct and indirect costs. In addition, we recommended that the City ensure that expenditures are accurately recorded. We further recommended that the City ensure that required annual audits are performed and copies of the audit reports are provided to System Customers.

Results of Follow-Up Procedures

The City's actions partially corrected this finding. The new contracts included a rate calculation worksheet that showed how the O&M rate would be determined. Budgeted amounts were to be recorded in this worksheet to calculate the flow rate. After completion of the annual audit, the budgeted amounts were to be compared with actual expenses and a true-up performed. For the 2012-13 fiscal year, the budgeted amounts exceeded actual recorded expenditures by \$360,306. This surplus was mainly attributable to four line items (PBCJTF flow expenses, professional services, supplies, and repairs and maintenance) in the budget. In accordance with the new contracts, the City performed the true-up and refunded the excess amounts paid to the System Customers. The surpluses for these items were taken into consideration when the new budget for the following fiscal year was determined, contributing to a \$219,295 reduction in budgeted amounts for these items for the 2013-14 fiscal year.

For the period August 1, 2012, through April 9, 2014, the City incurred \$9,901,661 in Sub-regional System expenses. We tested \$3,181,734 of these expenses to determine whether they were recorded for the correct amounts and related only to the Sub-regional System. Our tests disclosed the following:

- The City incurred \$8,802,155 in non-salary direct expenses. We tested 65 items totaling \$2,207,372 and noted that 3 items totaling \$31,030 were not charged to the Sub-regional System in the correct amounts. These items, consisting of hand-held radios, pole overload blocks, and interest for the ECRWRF loan, were overcharged to System Customers in the amounts of \$10, \$1,267, and \$3,280, respectively, for a total overcharge of \$4,557. Documentation for 2 items totaling \$916, including an electric bill for a local lift station and a service call, did not pertain to the Sub-regional System. In addition, documentation was not sufficient to evidence that 3 items totaling \$5,460, including a crane, small equipment and tools, and training, related solely to the Sub-regional System.
- We reviewed salaries totaling \$358,226 that were charged to the Sub-regional System. Budgeted salaries for six City employees working on the Sub-regional and Local Sewer Systems were allocated based on percentages estimated by the City's Utilities Director. However, City records did not evidence the basis upon which the allocation percentages were established for these employees, consisting of a maintenance supervisor, life station foreman, an electrician, and three mechanics. The City stated that the allocations were in accordance with the Lake Worth Sub-regional Sewer System – FY 2013 Calculations and Line Item Budget Breakdown, which were the basis for the Settlement Agreement reached by all parties in March 2013. The line item detail tab showed 2.5 full-time equivalent employees included in Sub-regional salary expenditures; however, the budget detail did not list position titles of the employees. Consequently, City records did not evidence that the System Customers agreed that salaries and benefits of specific employees would be included in the Sub-regional System billings.
- We reviewed indirect costs totaling \$741,280, consisting of insurance and administrative costs allocated to the Sub-regional System. The City correctly allocated insurance premiums for the 2012-13 and 2013-14 fiscal

years, and administrative costs for the 2012-13 fiscal year. However, the administrative costs included in the rate calculation for the 2013-14 fiscal year were over-allocated in the amount of \$9,579. The City indicated that the amount would be corrected during the 2013-14 fiscal year true-up.

The new contracts require that the City’s independent CPA firm perform an annual financial audit of the operational costs related to the Sub-regional System together with a report as to the City’s compliance with the contract, with a copy of the audit report furnished to each member of the Member Board on or before April 1 of each year. The City received an audit report from an independent CPA for the City; which included the Sub-regional System as a major fund; however, the scope of the audit did not include sufficient procedures for the CPA to determine the City’s compliance with the terms of the new contracts. In May 2014, the City contracted with the CPA firm to perform an audit of the operational costs and provide the required report.

Finding No. 6: Public Records Requests

Previously Reported

The City had not established adequate procedures to ensure that public records requests were addressed timely and appropriately, and notification was provided for records that did not exist or were otherwise unavailable.

We recommended that the City revise its procedures to require, when applicable, notification of requestors that public records requested are not available, and to specify a time frame within which public records requests should be completed.

Results of Follow-Up Procedures

The City’s actions did not correct this finding. While the City enacted a new public records policy on June 5, 2014, the new policy did not establish a time frame within which public records requests should be completed and did not address notification of requestors when records are unavailable.

OBJECTIVES, SCOPE, AND METHODOLOGY

Pursuant to Section 11.45(2)(j), Florida Statutes, no later than 18 months after the release of a report on the audit of a local government, we must perform appropriate follow-up procedures as we deem necessary to determine the audited entity's progress in addressing the findings and recommendations contained within our previous report. Pursuant to Section 11.45(3)(a), Florida Statutes, we conducted an audit of the City's Sub-regional Sewer System and issued report No. 2013-001. The objectives of this audit were to determine the extent to which the City has corrected, or is in the process of correcting, deficiencies disclosed in our report No. 2013-001 and included transactions, as well as events and conditions, occurring from August 2012 through May 2014.

This follow-up audit was conducted in accordance with applicable generally accepted government auditing standards. Those standards require that we plan and perform the follow-up 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.

For those activities and functions included within the scope of our follow-up audit, our audit work included, but was not limited to, communicating to management and those charged with governance the scope, objectives, timing, overall methodology, and reporting of our audit; obtaining an understanding of the activities and functions; exercising professional judgment in considering significance and audit risk in the design and execution of interviews, tests, analyses, and other procedures included in the audit methodology; obtaining reasonable assurance of the overall sufficiency and appropriateness of the evidence gathered in support of our audit findings and conclusions; and reporting on the results of the audit as required by governing laws and auditing standards.

The scope and methodology used to develop the findings in this report are described in Exhibit A. Our audit included the examination of pertinent City records and transactions, inquiry of City and ECRWRF personnel, observation of procedures in practice, and additional follow-up procedures as appropriate. Unless otherwise indicated in this report, records and transactions were not selected with the intent of projecting the results, although we have presented for perspective, where practicable, information concerning the relevant population value or size and quantifications relative to the items selected for examination.

An audit by its nature does not include a review of all records and actions of City management, staff, and vendors, and as a consequence, cannot be relied upon to identify all instances of noncompliance, fraud, waste, abuse, or inefficiency.

AUTHORITY

Pursuant to the provisions of Section 11.45(2)(j), Florida Statutes, I have directed that this report be prepared to present the results of our follow-up procedures regarding findings and recommendations included in report No. 2013-001, operational audit of the City of Lake Worth's Sub-regional Sewer System.



David W. Martin, CPA
Auditor General

MANAGEMENT'S RESPONSE

Management's response is included as Exhibit B.

**EXHIBIT A
AUDIT SCOPE AND METHODOLOGY**

Scope (Topic)	Methodology
Finding No. 1, Contract Provisions	Reviewed and evaluated contract provisions to determine whether the new contracts were written with clear and concise detailed terms regarding costs charged and methodologies used to calculate such costs.
Finding No. 2, Renewal and Replacement (R&R) Costs	Reviewed methodologies and calculations for billing System Customers for Sub-regional System R&R costs. Determined whether management obtained the required annual financial audit of the Sub-regional System operational costs and provided the report to System Customers.
Finding No. 3, Other Pass-through Costs	Reviewed the methodologies included in the contracts for all cost components and determined whether all items billed to System Customers were calculated in accordance with the contract.
Finding No. 4, Flow Rate Calculations and Regional Systems Operating and Maintenance (O&M) Costs	Reviewed Regional costs included in the flow rate calculations to determine whether rates were calculated in accordance with the contract and whether any differences between budgeted and actual costs in excess of reserve requirements were paid to or received from the regional facilities. In addition, reviewed the settlement of the past claims provision included in the contract and verified that the settlement amounts were paid to or received from the customers, as applicable.
Finding No. 5, Flow Rate Calculations and Sub-regional System O&M Costs	Reviewed budgets used as a basis for billing System Customers for Sub-regional System O&M costs, determined whether budgets reflected surpluses and deficiencies from prior fiscal years, and determined whether those budgets were provided to System Customers. Reviewed methodologies and calculations for billing System Customers for Sub-regional System O&M costs and determined whether administrative, insurance, and information system support costs were allocated using a systematic and rational method. Determined whether O&M Sub-regional costs were billed to System Customers in accordance with contract terms and tested expenditures recorded in the Sub-regional Sewer Fund to verify that expenditures were recorded in the correct amounts and sufficiently documented to evidence relation to the Sub-regional System. Reviewed support and payments for the true-ups performed in March 2013 and May 2014.
Finding No. 6, Public Records Requests	Reviewed the City’s new public records policy to determine whether it contained provisions related to timeliness of providing copies of requested public records, and notification to requestors when requested public records are unavailable.

**EXHIBIT B
MANAGEMENT’S RESPONSE**



MAYOR’S OFFICE

7 North Dixie Highway · Lake Worth, Florida 33460 · Phone: 561-586-1600

September 8, 2014

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

Dear Mr. Martin:

The City is in receipt of your follow-up preliminary audit results for the City of Lake Worth’s Sub-regional Sewer System, dated August 12, 2014.

The preliminary audit results disclosed that, as of the completion of the follow up procedures in May 2014, the City had adequately corrected 3 findings, partially corrected 2 findings and had not corrected 1 finding contained in report No. 2013-001.

BILLING OF COSTS TO SYSTEM CUSTOMERS

Finding No. 2: The new contracts required the City to engage an independent Certified Public Accountant (CPA) to perform an annual financial audit of the operational costs related to the Sub-regional System, including a report regarding the City’s compliance with the contract. Pursuant to the new contracts, the report must be furnished to each member of the Member Board on or before April 1 of each year. The City obtained an audit of the City’s financial statements by an independent CPA, which included the Sub-regional System reported as a major fund; however, the scope of the audit did not include sufficient procedures for the CPA to determine the City’s compliance with the terms of the new contracts.

City Response

- The City agrees with the auditors’ finding that the City did not meet the time requirement to perform an annual financial audit of the operational costs related to the Sub-regional System, including a report regarding the City’s compliance with the contract. The City has now included this audit requirement in the contract for the City’s annual financial audit. Going forward, the required audit mentioned above will be issued to the members by April 1 of each year.

Finding No. 5: Non-salary direct expenses charged to the Sub-regional System were not always applicable to the Sub-regional System, recorded in the correct amounts, or documented as pertaining to the Sub-regional System. Also, City records did not evidence the basis upon which salary and benefit expenses were allocated to the Sub-

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

Page 2 of 2

regional System, or that system customers agreed that salaries and benefits of specific employees would be included in their billings. In addition, administrative costs included in the rate calculation for the 2013-14 fiscal year were over-allocated. Finally, the City did not obtain a financial audit of the operational costs related to the Sub-regional System, contrary to its contracts with system customers.

City Response

- The City will develop more procedures to maintain and ensure adequate documentation to support all expenditures and allocations being charged to the Sub-regional System.

PUBLIC RECORDS

Finding No. 6: The City had not established adequate procedures to ensure that public records requests were addressed timely and appropriately, and notification was provided for records that did not exist or were otherwise unavailable.

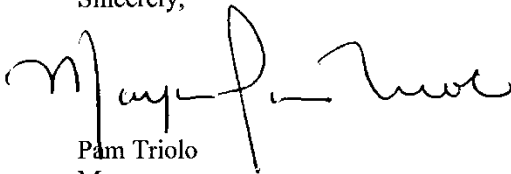
City Response

- On August 20, 2014, the City updated its policy on public records requests. The policy is written in compliance with Chapter 119 of the Florida Statutes.

In conclusion, the City as the owner/operator of the Sub-regional System bears the responsibility of ensuring that the System operates in a safe and effective mode. The City has discharged this operational responsibility in a professional manner. The Sub-regional System assets have been maintained and improved over the years.

The City has resolved the dispute with the System customers. All of the customers' contracts have been renegotiated and the City has developed and is maintaining closer communications with the customers concerning budget and capital plans. The unresolved findings listed above will be corrected in FY 2014.

Sincerely,



Pam Triolo
Mayor
City of Lake Worth