

City of Santa Fe, New Mexico

memo

Date: March 17, 2016
To: Chairman and Members of the City of Santa Fe Finance Committee
From: Oscar Rodriguez, Finance Director 
RE: Corrective action in response to the 2008 Parks Bond Program Special Audit

This memo transmits the actions take and/or contemplated in response to the Special Auditor's (Atkinson) findings and recommendations.

Overview

In its report that the State Auditor's Office released last month, Atkinson found four material weaknesses and five significant deficiencies in the way the city managed the 2008 parks bond program. Atkinson acknowledged the steps the city has already taken to strengthen its internal controls and procedures and made a number of recommendations corresponding to each finding. Below is a status report and plan of action addressing for each finding.

I am happy to report that almost all of the recommendations have already been implemented. The few that have not been completed will be completed by the end of this fiscal year as integral reforms within existing standard processes, like the annual operating and capital budget.

It is important to note that the two special audits that have been conducted on this program have moved the city organization to make major changes how it manages capital projects. As Atkinson noted, the reforms that were implemented in response to the REDW audit of last year represented major improvements in the city's oversight and budgetary controls.

- **Capital Projects Reporting Procedures** policy adopted July 1, 2015 instituted a new regimen of procedures for project file management standards, periodic project reporting, project close out, and assigned roles and responsibilities;
- **The Annual Debt Management and Post Issuance Policy** in effect since 2013 and reviewed by the Council in June 2015 assists in post issuance bond compliance efforts;

- **Resolution 2015-106 Adopting Best Practices and Standards to Help Guide the Management of the City's Finances** approved in November 2015 introduced many new requirements and financial management standards and affirms the requirement of the procurement code that each budgetary change that exceeds \$50,000 should be approved by the Council before it is executed, reversing the longstanding practice of bundling staff's actions and seeking Council ratification at the end of each quarter.
- The **Public Works Division** was reorganized into dedicated teams by function, such as the irrigation team, the maintenance team and so forth in August 2014. Previously each district was responsible for the overall maintenance of its district and had discretion over maintenance activities, making for a disparate maintenance program and standards. Teams are receiving training directed to their particular team expertise.

A major reform that the Council recently adopted, but was not highlighted by Atkinson, was the **FY 2015-2020 Capital Improvement Plan (CIP)**. Under this new process, all capital projects are planned, funded, and reported on a project-by-project basis every quarter from concept to close-out. Until then, there was no platform or venue for anybody to effectively monitor progress on the city's capital improvement program or, for that matter, any given capital project, whether implementation schedule or budget. With the adoption of its first CIP, which is a proven best practice among cities that have a lot of experience successfully managing complicated and extensive capital programs, Santa Fe put its capital project management processes on an entirely new track that will immediately enhance oversight and allow continuous improvement from project management to long-range financial planning and policy guidance.

Response to Atkinson's Findings

All of Atkinson's recommendations are either already implemented or on their way to completion.

Finding 001: Federal Bond Law Not Considered in Determination of Allowability of In-House Labor for the Construction and Related Labor Activities of Park Projects

Corrective Action:

- By May 30, implement as part of the City Council's annual review of the City's Debt Management Policy the auditor's recommendation to add to the Post Issuance Compliance Section a checklist noting the specific requirements called for, glossary of key terms, risk analysis of most likely activities, and specific explanation that operations and maintenance expenditures are not allowed.
- The City has already requested a written bond counsel opinion on the exposure it faces with regard to federal law for how it uses now and has in the past used tax-exempt bond proceeds and request recommendations for addressing it.

Finding 002: Time-keeping for Wages Paid from 2008 Bonds

Corrective Action:

- Already implemented. With *The Capital Projects Reporting Procedures* effective July 1, 2015, the City promulgated a new management policy requiring detailed time accounting for projects, including the specific work done by each individual. Along with this new requirement, the new policy also prescribes a standard record-keeping system for each project and a quarterly status report that will be presented to the Governing Body and posted on the City's web site. This first report will be presented as part of the CIP for Council approval in May.
- To further ensure compliance, Finance staff will provide training on this new policy to project managers in April as part of the process for preparing the CIP.

Finding 003: Cost Allocation Procedures - Timing

Corrective Action:

- Already implemented Auditor's recommendation with *Capital Projects Reporting Procedures* beginning July 1, 2015. The new project management policy now in place halts the practice of using suspense accounts for capital projects. All project costs, including workforce accounts, are now recorded in real time, and the control point is the budget formally appropriated for each specific project as part of an annual capital budget and the first year of the CIP. The new policy directs that deviations from the budget are addressed as budget adjustment requests for the specific project before, not after, proceeding.
- A new policy to account for legitimate indirect costs associated with capital projects will be presented as part of the upcoming operating budget.

Finding 004: Maintenance and Other Operating Expenditures Made From Bond Proceeds

Corrective Action:

- Already adjusted the General Ledger to correct omission of \$437,272 in capital improvements noted by Atkinson using the city's current capitalization standard of \$100,000. As a result, the total non-capitalizable expense has dropped from \$2,084,187 (7.05%) to \$1,646,915 (5.58%).
- An amendment to lower the threshold for capitalization to \$5,000 as recommended by Generally Accepted Accounting Practices (GAAP) will be presented this month to allow for Council action in April. Once this change is approved, staff will apply the new standard to the 2008 Park Bond Program to arrive at a new capitalization total for review by the External Auditor for inclusion in his opinion of the city's consolidated annual financial report (CAFR).

Finding 005: Unallowable Non-payroll Costs Charged to Bonds

Corrective Action:

- Already implemented through **Resolution 2015-106** Atkinson's recommendation to put in place specific policies and procedures to make employees aware of and understand the types of costs that may be applied to internally constructed capital assets and those that are not eligible for bond funding. Project managers and support staff, including those from Finance, have alerted to the seriousness of this error through a special email from the Finance Director this month. They will all also be reminded of this at the yearly capital budget training session in April.

Finding 006: Design of Time Sheets and Accounting Systems for Bonds

Corrective Action:

- Already implemented the Auditor's recommendation to add to the Internal Auditor's risk profile the review of reports that are required by the city new *Capital Projects Reporting Procedures* policy. This policy has also been amended to include ADA considerations, cultural reviews and anticipated irrigation needs to the planning phase requirements. It now also requires a photograph of the project each year from start to close-out as part of the interim performance reporting requirement called for in this new policy.
- Internal accounting procedures now also include the standard practices followed by the State Board of Finance to oversee the state's capital program, including the reconciliation of project spreadsheets to City financial records on an ongoing basis and the creation of a single Capital Project Fund for each bond.

Finding 007: Procurement Test Work

Corrective Action:

- Next month, the Chief Procurement Officer will call a mandatory training session for all staff involved with capital project management to review the Atkinson's findings and the related purchasing regulations, as recommended by Atkinson.
- Also as recommended by Atkinson, the Procurement Office has begun a campaign to increase efficiency in purchasing for capital projects through "blanket purchase orders" and/or indefinite quantity price agreement. Progress on this objective will be reported periodically through a performance indicator inserted in the Monthly Financial Performance Report.
- Also as recommended by Atkinson, the Procurement Office will compile a detailed list of potential conflicts among staff members who are involved with the procurement process. Procurement will also amend its procurement code to (1) require any city employee who is in a potential conflict of interest to file an affidavit declaring the conflict and acknowledging what is required by city policy to address the conflict and (2) that he/she must stand completely out of the procurement process associated with the conflict, including the

initiation and execution of purchase orders and the receipt of the goods or services from the conflicted vendor and his/her competitors.

Finding 008: Unreasonable Budget Increases

Corrective Action:

- Already implemented the Auditor's recommendation to implement policies governing multiple capital project programs funded by a single bond, like the 2008 Park Bond Program, to strengthened budgetary control. A formal close-out procedure was instituted as part of the July 1, 2015 **Capital Projects Reporting Procedures Policy**. This will ensure that costs are not allocated to projects after all planned tasks have been completed. The new **5-year CIP** is another major reform that will improve transparency and strengthen oversight. It imposes the requirement of a periodic report on the progress on both individual projects and their related bond program, which will bring all budget increases to the attention of all interested parties. The newly approved **Resolution 2015-106 Adopting Best Practices and Standards to Help Guide the Management of the City's Finances** is yet another measure that will help strengthen budgetary control. It calls for, among other things, all pre-construction costs to be paid through cash, not bond proceeds, to ensure that all projects included in future bond programs be fully defined and costed.

Finding 009: Unspent Proceeds

Corrective Action:

- As recommended by Atkinson, staff has prepared for submission to the Governing Body in March a budget adjustment request that will re-program the balance of the proceeds to projects from the implementation plan in time for the construction season. It is anticipated that, if approved, this reprogramming will result in all of the remaining balance of the bond proceeds being efficiently invested in parks and trails improvements as envisioned in 2008 when the voters approved the bond program.

I am available to answer any questions you may have.

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DISCLOSURE OF SPECIAL AUDIT BY
THE OFFICE OF THE STATE OF NEW MEXICO AUDITOR

On February 26, 2016, the State of New Mexico Office of the State Auditor released its City of Santa Fe 2008 and 2010 Parks Bonds Special Audit (“Special Audit”) related to the City of Santa Fe, New Mexico General Obligation Bonds, Series 2008 (the “2008 Bonds”) and the City of Santa Fe, New Mexico General Obligation Bonds, Series 2010 (the “2010 Bonds”). The Special Audit relates to the expenditure of proceeds from the 2008 Bonds and 2010 Bonds and whether the City exceeded the 5% cap in Treasury Regulation Section 1.148-6(d)(3)(ii)(A)(5) governing working capital expenditures related to the capital projects financed with the proceeds of the 2008 Bonds and the 2010 Bonds. The City believes that its internal policy of only capitalizing costs over \$100,000 in contravention of its stated policy of capitalizing costs over \$5,000 contributed to the incorrect calculation of amounts spent on working capital. The City is in the process of reviewing its expenditures related to the 2008 Bonds and 2010 Bonds and does not believe that the amounts spent on working capital exceeded the 5% limit. The City will post an update regarding the results of this review when it is completed.

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