

**CLERK & COMPTROLLER
PALM BEACH COUNTY
FINANCIAL REPORTING DEBT COMPLIANCE &
ADMINISTRATION AUDIT**



SHARON R. BOCK
Clerk & Comptroller
Palm Beach County

Division of Inspector General

Audit Services Unit

February 13, 2015



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The Honorable Sharon R. Bock, Esq.
Clerk & Comptroller

We conducted an audit of Financial Reporting Debt Compliance & Administration, which was included in the annual audit plan.

The objectives were to: perform a risk assessment to identify the risks and vulnerabilities impacting the debt compliance and administration processes, evaluate the overall effectiveness and efficiency and related internal controls to mitigate the risks, verify compliance with pertinent laws and regulations as well as established policies, and compare processes with accepted standards and best practices.

Our audit was neither designed nor intended to be a detailed study of every process, procedure, transaction or system in each area. Accordingly, the observations and recommendations included in this report are not all-inclusive.

Our audit indicated that the Clerk's Financial Reporting Debt Compliance team provides timely and accurate service to its core customers – Palm Beach County and County departments. The team effectively coordinated efforts with various federal agencies, paying agents, registrars, trustees, escrow agents, and other vendors who receive payments related to the requirements of bond covenants, loan agreements, or arbitrage and yield restrictions. The audit identified improvement opportunities related to further developing policies and procedures, enhancing management oversight of debt compliance responsibilities, and considering standard work requirements when next renegotiating the Clerk's arbitrage consultant contract.

We appreciate the cooperation of management and staff during the course of this audit.

Respectfully submitted,

Roger Trca CIG, CPA, CIA, MBA
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cc: Shannon Ramsey-Chessman, Chief Operating Officer Finance

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Executive Summary

An audit of Financial Reporting Debt Compliance & Administration was performed by the Clerk & Comptroller's Division of Inspector General. This regularly scheduled audit was included in the annual audit plan.

Financial Reporting is responsible for preparing financial statements that comply with state and federal laws and generally accepted accounting principles (GAAP). In addition, the department handles compliance with County bond covenants and loan agreement debt service payments, including invoices, debt service payment schedules, and statements from paying agents, registrars, trustees, and escrow agents.

For the fiscal year ending September 30, 2014, Financial Reporting administered payments for principal and interest defined by 86 individual bond covenants or loan agreements with an outstanding principal totaling \$1.2 billion. Debt service expenditures totaled \$93,440,498 in principal and \$44,276,746 in interest payments.

The objectives of this audit were to: perform a risk assessment to identify risks and vulnerabilities impacting the Debt Compliance & Administration processes, evaluate the overall effectiveness and efficiency of the processes and related internal controls to mitigate the risks, verify compliance with pertinent laws and regulations as well as established policies, and compare processes with accepted standards and best practices.

Our audit indicated that the Clerk's Financial Reporting Debt Compliance team provides timely and accurate service to its core customers – Palm Beach County and County departments. The team effectively coordinated efforts with various federal agencies, paying agents, registrars, trustees, escrow agents, and other vendors who receive payments related to the requirements of bond covenants, loan agreements, or arbitrage and yield restrictions. The audit identified improvement opportunities related to further developing policies and procedures, enhancing management oversight of debt compliance responsibilities, and considering standard work requirements when next renegotiating the Clerk's arbitrage consultant contract.

The report contains three observations and four recommendations.

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Introduction

Overall Conclusion

Overall, our audit disclosed that the Financial Reporting Debt Compliance team provides timely and accurate service to its customers – Palm Beach County and County departments. The team effectively coordinated efforts with various federal agencies, paying agents, registrars, trustees, escrow agents, and other vendors who receive payments related to the requirements of bond covenants, loan agreements, or arbitrage and yield restrictions.

The Financial Reporting Debt Compliance & Administration audit identified improvement opportunities related to further developing debt compliance policies and procedures, enhancing management oversight over debt compliance responsibilities, and considering standard work requirements when next renegotiating the Clerk's arbitrage consultant contract.

Objectives, Scope and Methodology

The Clerk's Audit Services Unit of the Division of Inspector General conducted an audit of Financial Reporting Debt Compliance & Administration. This regularly scheduled audit was included in the annual audit plan.

The objectives of this audit were to:

- Perform a risk assessment to identify the risks and vulnerabilities impacting Debt Compliance & Administration processes,
- Evaluate the overall effectiveness and efficiency of the Financial Reporting Debt Compliance processes and related internal controls to mitigate the risks,
- Verify compliance with pertinent laws and regulations as well as established policies, and
- Compare processes with accepted standards and best practices.

In order to meet these objectives, we conducted interviews and reviewed departmental policies and procedures. We obtained key contracts in place. We identified the pertinent Florida Statutes and other laws and regulations. We gathered key performance volumes/metrics and relevant statistics. We performed a risk assessment of the debt compliance processes by documenting workflows and activities, identifying key risks, and evaluating the adequacy of the internal control environment to mitigate the risks identified. We conducted testing of internal controls and transactions. Testing performed covered the period from October 1, 2012 through September 30, 2014. In addition, we performed other procedures that were deemed necessary under the circumstances. This audit was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*.

Background

The Debt Compliance & Administration function is an integral role of Financial Reporting.

Primary Financial Reporting responsibilities include the following:

- Monitor County debt service requirements and compliance with bond covenants.
- Ensure timely payment of debt service in compliance with bond covenants.
- Ensure that all transactions of the Board of County Commissioners and the Clerk & Comptroller's Office are properly recorded in accordance with Generally Accepted Accounting Principles (GAAP).
- Maintain an accurate, complete set of financial records.
- Produce all required financial statements and reports to comply with state and federal laws and GAAP.
- Ensure that all financial statements are audited annually.
- Ensure accurate and timely reporting to all federal, state, and local agencies.

For fiscal year ended September 30, 2014, Financial Reporting administered payments for principal and interest defined by 86 individual bond covenants or loan agreements with an outstanding principal totaling \$1.2 billion, as summarized below. Debt service expenditures totaled \$93,440,498 in principal and \$44,276,746 in interest payments.

Bond Issue Type	Number of Issues	Face Amount at 9/30/14	Outstanding Principal at 9/30/14
General Obligation Bonds	10	\$362,940,000	\$163,630,000
Non-Ad Valorem Bonds	28	\$1,432,614,966	\$736,162,756
Notes and Loans	35	\$33,247,676	\$26,321,773
Palm Beach International Airport Revenue Bonds	3	\$146,085,000	\$98,435,000
Water and Sewer Revenue Bonds	6	\$289,422,733	\$180,525,823
WUD Loans	4	\$9,706,341	\$9,675,136
Totals	86	\$2,274,016,716	\$1,214,750,488

Financial Reporting requests wire transfers for most debt service payments and relies on the Clerk's Cash Management function through Wells Fargo Commercial Electronic Office (WF CEO) for initiating, approving, and confirming wire transactions. The department uses Microsoft Access and standard Microsoft applications (e.g., Excel, Word, and Outlook) for maintaining debt service payment schedules and generating reports of debt service payments.

Financial Reporting is led by Michael Florio - Manager, with a total of nine staff, three of which are partially dedicated to supporting the debt compliance and administration function.

Audit Team:

Charles Mansen, Senior Internal Auditor

Observations & Recommendations

The audit identified certain policies, procedures and practices that could be improved. The audit was neither designed nor intended to be a detailed study of every relevant system, procedure or transaction. Accordingly, the observations and recommendations presented in this report may not be all-inclusive of areas where improvement may be needed.

1. Written procedures require further development.

Numerous procedures governing the debt compliance processes were developed in recent months prior to the departure of a long-term employee who was responsible for the Clerk's debt service compliance. Certain procedures require further preparation, update or enhancement. Best practices in internal controls indicate that written procedures provide guidance to employees to ensure that processes are performed accurately and consistently in accordance with management's directives and objectives. In addition, written procedures help define responsibilities, pertinent laws and regulations, systems involved, and how they are updated and distributed.

Our audit identified opportunities to improve various existing procedures by ensuring inclusion of key elements such as: author, last revision date, purpose, positions/persons responsible for taking action and updating/approving procedures, and examples of relevant forms and documents required for support.

In addition, we noted the following examples as opportunities to further strengthen the debt compliance procedures.

- A Payables procedure for preparing and posting electronic funds transfers through the Advantage Financial System is used for general guidance within various departments (e.g., Payables, Payroll, and Financial Reporting). Financial Reporting does have its own written procedure for the approval and processing of debt service payments though an updated and more comprehensive procedure is recommended specific to the processing and posting of debt service payments.

- Procedures for creating Microsoft Excel debt issue spreadsheets for new bonds and loans direct employees to use active debt issue spreadsheets to edit as needed. This may result in overwriting a current debt issue spreadsheet if not saved properly, thereby requiring re-creation of the information. Blank templates should be considered when creating new debt issue spreadsheets.
- The procedure for reconciling paying agent bank statements directs a single fiscal year-end reconciliation and does not identify the steps to perform. Paying agent bank statements are received monthly, quarterly, annually, or only when there is activity. Any potential errors or irregularities would not be identified until year end.
- The "Annual Variable Rate Debt and Loan Updates" procedure states that variable interest rate debt schedules need to be updated for the new year interest rate; however, three-month LIBOR interest rates on HUD variable rate loans are reset on a monthly basis, not as an annual interest rate.

Recommendation:

- A. Continue efforts to document debt compliance procedures to address the gaps highlighted above and ensure inclusion of key elements (e.g., author, preparation date, purpose, ownership/update responsibilities, and examples of supporting documentation).

Management Responses:

- A. Financial Reporting will be updating the Debt Service Manual to include the above recommendations so that each written procedure will provide a narrative of the purpose for the procedure, the responsibilities of each member of staff with assigned duties related to each procedure, the physical location of workpaper files and directory navigation for the electronic files and other supporting documentation. The Debt Service Manual will be reviewed annually and updated when revisions have taken place. In addition:
 - The Manual will contain an updated and more comprehensive procedure specific to the processing of debt service payments and the posting of MD Documents as they pertain to Financial Reporting.
 - A spreadsheet template for new active debt will be created to avoid any existing

spreadsheet from being accidentally overwritten. The templates created will be made for the various types of ad-valorem and non ad-valorem bond issuances, as well as for HUD and USDA loan repayment schedules.

- Although paying agent bank statements are received throughout the year at different intervals, payments specific to any one debt issuance are made only twice per year in which receipts and disbursements to and from the paying agent account are made the same day. As a result, outstanding wires in transit are not typically observed. This procedure has since been updated where paying agent bank statements are now reviewed and reconciled upon receipt to ensure any potential irregularities are detected at the earliest possible date.
- All HUD variable rate loan payments are invoiced and paid using the specified three month rolling LIBOR rate. The minimal differences observed between the invoiced amount and calculated amount in the loan repayment schedules have had no effect on the loan amount paid. This procedure has been updated to use the three-month LIBOR rate to ensure the highest degree of accuracy between future invoiced amounts and the calculated amounts for variable rate loans.

Target Completion Date: 9/30/15

2. Opportunities exist to enhance management oversight over debt compliance activities.

Opportunities exist to strengthen management oversight and performance monitoring of debt compliance processes and results. Enhanced review and monitoring would assist in ensuring that Clerk and County objectives are satisfied that involve monitoring compliance with bond covenants and ensuring timely payment of debt service. To ensure a balanced perspective on this observation, it is important to note that our testing of the timeliness and accuracy of debt service payments did not identify any exceptions.

County PPM CW-F-080 states the Clerk & Comptroller's office is responsible for ensuring compliance with debt covenants applicable to Finance and to make debt service payments in a timely manner. Additionally, the Clerk's 2014 strategic goals include:

- Measure performance and use that data to drive decision making.

- Create and maintain a dashboard of key indicators for review at Executive Committee meetings.

We identified the following observations during the audit.

- Performance measures and benchmarks have not been established by management to monitor the timeliness and accuracy of debt service payments.
- Debt service payments are monitored via Microsoft (MS) Excel spreadsheets and a MS Access County debt database by staff. Staff manually input relevant data into both the Excel debt issue spreadsheets and into the MS Access County debt database, which is inefficient. Management is planning to discontinue usage of the MS Access County debt database as it is not providing incremental value. Further, management is planning to implement an Advantage debt management module in 2016. There was no sign-off or indication of management review of the MS Access reports.
- There was no evidence of supervisory review or signoff of:
 - manual disbursement and JVA (journal voucher accounting) debt service transactions and postings to the Advantage financial system,
 - the accuracy and completeness of debt service payment information prior to releasing it to Integrity Public Finance Consulting LLC for calculating arbitrage rebate and yield reduction amounts, and
 - bond and loan interest payment accruals and adjustments (prepared by the Investments Department) to ensure posting to the general ledger.

Recommendations:

- A. Consider development of key performance measures linked to debt compliance objectives to enable comparison of actual with desired results.
- B. Enhance management oversight and review of debt compliance activity and implement sign offs and/or acknowledgement of review of key transaction activity and reports.

Management Responses:

- A. The feasibility of creating a new dashboard of performance measures and benchmarks will be considered to assist with helping improve monitoring of the timeliness and accuracy of debt service payments and other related key indicators.

Target Completion Date: 9/30/15

- B. The MS Access County Debt database is a replication of the existing MS Excel debt payment schedules and has been used to create specialized reports for departments and staff members other than those within Financial Reporting or the Clerk & Comptroller's Office. The creation of these specialized reports for external departments is unrelated to ensuring the timeliness, accuracy and completeness of actual debt service payments. To maintain the highest degree of oversight possible, the procedure for processing debt service payments will now require signed approval by management prior to delivery of the supporting documentation to the Revenue and Cash Management and/or Payables Departments.

Signed management review and approval of debt service payments prior to the processing and posting of documents in Advantage will be incorporated in the new written procedures.

Considering there is already a considerable amount of management oversight in the form of regular and periodic reviews of fund analyses for all fund types performed by staff, including capital project and debt service funds which directly impact the computation of arbitrage, further detailed management review of the data prior to submission to Integrity Consulting is likely unnecessary and not an effective use of management's time. Management is included on all communications involving the delivery of the reports and documentation provided to Integrity Consulting. Management does perform a general review of the documentation provided to Integrity to help verify the documentation provided was as needed and requested.

Creation of the monthly investment pool accruals and adjustments is initiated in the Investments Department and is subsequently reviewed by the Investments Manager prior to any JVA being created in Advantage. The JVA is then reviewed, approved and submitted in Advantage by Financial Reporting. This procedure will be revised to include further review and approval of the JVA by management in Financial Reporting prior to posting.

Target Completion Date: 9/30/15

3. The arbitrage consultant contract terms should be re-evaluated prior to renewal.

A contract between the Clerk & Comptroller and Integrity Public Finance Consulting LLC for arbitrage rebate consulting and advisory services was executed in 2007 and extended through November 30, 2015. Based on our review of the contract as well as other guidance on best practices for contract development, certain optional services that would require additional fees were detailed in the contract with the Clerk & Comptroller of Palm Beach County that best practice guidance indicated may be considered as standard services (at no incremental fees).

The Clerk's responsibility for the arbitrage contract is outlined in County PPM CW-F080. Contracted responsibilities are defined by the PPM, which include annual analysis of all County debt, arbitrage rebate calculations, yield restriction calculations, and technical support on an ad-hoc basis.

Examples of optional services that could be negotiated as standard services include:

- Application of universal cap rules, which is required by the IRS, to prevent allocation of investment principal that exceeds the total face value of bonds.
- Transferred proceeds calculations due to advance refunding transactions. Advance refunding bonds are frequently issued by the County to take advantage of lower interest rates.
- Allocation of bond proceeds invested in commingled funds. The County and the Clerk's Investments Department use a cash pooling process for bond proceeds and debt service funds to maximize investment income.
- Yield restriction analysis was included in the contract as both optional services and standard services for all County bond issues.
- No provision for IRS representation was included in the contract scope of work.

Recommendation:

- A. Review the Clerk's arbitrage consultant contract prior to renewal and consider these highlighted items as opportunities to include certain optional fee-based services as standard services.

Management Response:

- A. Prior to completion of this audit, the arbitrage consulting contract with Integrity Consulting was extended for an additional one year term to maintain uninterrupted compliance over arbitrage in accordance with all County PPMs and IRS rules and regulations. Prior to the expiration of this contract extension, all current and prospective services to be included in the next contract will be carefully evaluated for need, applicability, best practices and cost-benefit.

Target Completion Date: 11/30/15