

APPROVED

**AUDIT ADVISORY BOARD REGULAR MEETING
CITY OF FORT LAUDERDALE
1st FLOOR CHAMBERS
MAY 28, 2015, 5:00 PM**

Board Member	Attendance	Cumulative Attendance	
		10/1/14 – 9/30/15	
		Present	Absent
Martin Kurtz, Chair	P	4	0
Richard Owen	A	2	2
Kimberly Jackson	P	3	1
D. Keith Cobb	A	0	1
Gregg McKee	P	1	0

Staff Present

Stanley Hawthorne, Assistant City Manager
Kirk Buffington, Director of Finance
Linda Logan-Short, Deputy Director of Finance
Mike Maier, Director, ITS
Pamela Winston, Senior Accountant
John Herbst, City Auditor
Marco Hausy, Assistant City Auditor III
Emilie Smith, Budget Manager
Laura Reece, Assistant Manager of CIP/Grants
Valerie Florestal, Budget Coordinator, ITS
Linda Blanco, Board Liaison

Other Attendees

Michelle Blackstock, Crowe Horwath

Call to Order

The Chairman called the meeting to order at 5:09p.m.

Roll Call

At the May 28, 2015 meeting, three (3) appointed members to the Board were present, allowing for a quorum.

Chairman Kurtz announced that they now have a full Board with two new members: Keith Cobb and Gregg McKee. Mr. Cobb was not present but Mr.

McKee was present and provided a brief description of his background which included work in Microsoft SAP, EOP Implementations, GL, and other software platforms. Chairman Kurtz stated Mr. McKee's knowledge will provide valuable input toward the ERP vendor selection.

Review of Meeting Minutes for Approval

Chairman Kurtz asked the Board members if they had any questions or comments regarding the March 5, 2015 Board minutes. Being none, a Motion was made by Kimberly Jackson, to approve the minutes, seconded by Gregg McKee. In a voice vote, the motion passed unanimously.

Chairman Kurtz asked whether there is any public input to be heard before entering into the agenda. Hearing none, he proceeded with the meeting.

Audit Findings and Responses - CAFR FY2014

Ms. Logan-Short reported there was one new audit finding which stemmed from the prior period restatement due to the fact that the Police and Fire Pension Board changed to Fiscal Year in June 2013. When the change to Fiscal Year occurred, we inquired of the Board's actuary, if there would be a fiscal impact to the City as a result of the change. They informed us there would not be an impact to the City and after approximately 1.5 years, it became apparent there was a miscommunication between the actuary and the City. The actuary seemed to be under the assumption that we had a prepaid and they would absorb that prepaid, but that is not what was communicated to the City. To correct this, we had to book a transaction, reducing the prepaid and booking the entry. And that transaction is what the audit finding is about. As of now, the Pension Board's fiscal years are now aligned with the City's fiscal year so this problem should not occur again and should not affect our implementation of GASB 68. Mr. McKee asked what the impact dollar amount was. Ms. Logan-Short replied it was \$10,223,809.

In order to remove the other audit finding that goes back to 2005, we have a project plan in place with temporary staff. Our payroll system database can hold the data in a particular screen, but some records are on paper, some records are in an old system and other records are in the new system. We will calculate every employee's time and update the database so all calculations will be made in that database going forward. This will also serve as a clean-up in preparation of the ERP. We expect to have this done by the end of the year.

With regard to IT Controls, Ms. Logan-Short reported that there are many issues with IT Controls. Mike Maier is sitting in the role of Chief Information Security Officer (CISO) and we have hired some security analysts but she is not sure where they are with correcting the internal control issues. They are issues that may not be corrected until after ERP is implemented.

FY2016 Budget Preparations and Revenue Estimates

Ms. Smith indicated that the City's revenue going into FY2016 looks favorable due to higher property taxes and fire assessment fees. Ms. Smith explained the budget process begins in early February. The Departments take a couple of months to compile their requests, which include revenue estimates, operating budgets, and their Capital Improvement Projects (5-year Community Investment Plan) which are due April 1st. Budget then takes their Revenue Estimates and meets with the Revenue Estimating Conference Committee of which Chairman Kurtz was a member this year. Budget looks for trends, history, anomalies, changes in service levels, and invite the Departments to have a conversation with them and the 4-member Revenue Estimating Committee. This process helps ensure that what they are projecting to happen is reasonable. The Budget team then reviews all departments' budget requests at a micro level. Once department budgets are finalized, they are presented to the City Manager and the Budget Advisory Board for their review.

Budget staff sits with the City Commission for two days each year to discuss the priorities for the upcoming year; this is called our Commission Annual Action Plan. About 12 high priorities come out of that to be completed over the upcoming year or more. Tough decisions are made to decide with priorities will be chosen.

Ms. Smith distributed a copy of the *General Fund FY2016 Preliminary Budget Highlights (as of May 28, 2015)* which she mentioned changes daily. She then proceeded to provide a brief overview of each item on the list.

The total adopted budget last year was \$864MM for all funds. Most of them look very favorable with the exception of the sanitation fund, but we are expecting a payment from the Resource Recovery Board (RRB) program in the approximate amount of \$5MM, which should help support that fund in the next couple of years. A sanitation rate study will also be conducted this year. The building fund has very high permit revenue due to the uptick in building activity. Ms. Smith indicated they expect to finalize and balance everything by the third week of

June and send the budget to print by June 25th. The Commission should receive it in the first days of July and it should be on the July 7th Commission agenda.

Revenue Estimating Conference Committee

Chairman Kurtz stated the four members of the Revenue Estimating Conference Committee were himself, Bob Oelke (Budget Advisory Board member), Janette Smith (Treasurer), and Laura Reece (Assistant Manager of DIP/Grants). They met with department heads and discussed key line items in detail. There were not many changes but they reduced the net revenue by \$35,000 from \$306M, which tells us that the process is working.

Finance, Information Technology and City Auditor Budgets

Mr. Buffington reported on the Budget Modification Requests that are not in our base budget and what we perceive to be necessary to continue to provide services at the level that we are expected to. There are two funds within the Finance Department: General Fund that supports all accounting, and Utility Billing Service which is funded from the Water and Sewer Fund. The General Fund is at \$173,000 less than our previous year so we are keeping that as tight as possible. We have five Budget Modification Requests, 4 are for personnel (2 new positions in Procurement, 1 in Accounts Payable, 1 in Business Tax, 1 in the Water & Sewer Fund) and there is one request for a program. The program would allow us to do an actuarial audit of the General Employee's and our Police and Fire Pension Plan. They have never been done and should be done every five years. Both programs would cost approximately \$50,000 which is money well-spent. The ERP will be our biggest project in FY2016.

Mr. Maier reported he has hired 3 Security Analysts. From a security standpoint, there is a great deal of work to do internally for the City. He has received enough funding to manage City's firewall from external point of penetration. They are trying to educate the end users at this time, which is the weakest point of any system.

He mentioned that in 2012 he submitted a five-year IT Strategic Plan with 44 goals, of which only 14 are remaining. He mentioned various new technological advancements in Transportation and Mobility, Department of Sustainable Development, Police Department, and citywide. He also mentioned he has not increased his staff in three years and does not enough space in his department to accommodate his staff. He expressed his concern of other departments hiring their own IT staff because he does not have enough staff to properly serve

the departments. He also expressed that he does not want to continue providing end users with new programs if he doesn't have the staff to support them. He has requested \$3.5M for new personnel and equipment of which Ms. Smith indicated he will not receive the full requested amount. Lastly, Mr. Maier explained that his department will receive grant money this year from the Fire Department to expand EOC. We have begun to expand the data center in their Category 5 building. There is a great deal of back-end work that needs to be done by the same IT staff that are also providing end-user support.

Mr. Herbst reported that his budget is the same as last year except for an increase for pay increases anticipated for merit and COLA. They match what all the Management and Confidential folks do which is typically what is also in all our union contracts. We try to make sure that we are commensurate with the rest of the staff throughout the City. The increase from last year to this year is for the new Construction Auditor. Her first project was the Sixth Street Plaza Audit. She is also looking at the Aquatic Center project and some of the early invoices that came in for engineering design of that project. We expect to put an auditing contract out to bid for this because it is a \$32M - \$35M project beyond our scope to do an audit on the construction side of that. The bifurcated role of the Construction Auditor is to (1) be the point of contact for large construction project contracts; and (2) to do the audits of smaller City construction jobs. He mentioned their office space is too small to accommodate the new Construction Auditor who is working on the 5th floor and he is interested in acquiring a larger space in a different building. This year our office hired an external contractor for peer review since an internal quality review has not been done in 3 years. The review should begin in the next week or so and should be completed soon after that. We should be able to share the results of that review at our next Board meeting. Chairman Kurtz asked if Mr. Herbst feels his department is adequately staffed, to which Mr. Herbst replied "yes" considering how many gaping needs there are in the City from the operational and infrastructure perspectives. There may be a time when we may say that based on a change in landscape in the audit arena, we may need to staff up a little heavier. In fact, we see some changes in the horizon from the Auditor General that may require more analysis and staffing to fulfill those requirements.

Sixth Street Plaza Audit

Mr. Hausy distributed copies of the 13-page Memo No. 14/15-01 from John Herbst to the City Commission relating to the Review of the Sixth Street Plaza Development Project. Chairman Kurtz stated that Mr. Herbst had many negative comments relating to the Sixth Street Plaza project. Mr. Herbst replied

that one of the things they had put on their audit work plan was to review the CRA's approved deals and this being one of them. He commented that all these things were done in a public way with discussion of the issues. The problems they encountered were that due diligence that should have been done on staff's side, was not being done. He said he raised concerns twice in the past when requests were made for more money; so the issues were not wholly unknown at the time.

The City has a building that they are partners in financing where the CRA's offices are located. The building has fallen into foreclosure which is stalled in court by a bankruptcy fund. We learned of this from an article in the South Florida Business Journal, and made the City Commission aware of it. We were asked to look into the history of the arrangement so we looked at the original RFP from 2000 and the agreement signed in 2003, as well as, the 2005 finance obtained and staff's actions during that whole period of time. He referred to the Overall Conclusion on page 2 of his memo which lists the various failures of the CRA related to this project. He then proceeded to elaborate on each of the four bulleted items.

There was poor project management from conception to completion. The City currently occupies approximately 70% of the building's space and has another 2 months left on the lease. We have had discussions with the bank regarding remaining on as a tenant. This problem is reflective of the lack of policy and procedures in place when dealing with project approvals and monitoring within the CRA.

ERP Selection Update

Ms. Logan-Short stated they have not selected a vendor for ERP yet. We have shortlisted to 3 vendors and are getting ready to do Best & Finals in the second week of June. We are looking at OneSolution with SunGuard, Cyber who uses Infor Lawson and Tyler Munis.

GASB Statements 67 & 68 Implementation Update

Ms. Logan-Short reported that the City will be contracting with an actuary to help with the 68 implementation. There are available funds in the budget for the implementation and she does not believe anything major will come from 68 report. When Ms. Logan-Short reviewed the 67 report, the Pension Boards have already implemented, GERS was over 100% funded and Police & Fire was not at 100% but mostly because of the fiscal year was not aligned. There was a large

accrual due from the City, but now that the plan's fiscal year is aligned with the City's fiscal year, we expecting the funding percentage for Police & Fire to increase. With the implementation of GASB 68, the Net Pension Asset goes away and the corresponding \$330M asset will be removed from the City's financial statements. We've already absorbed the shock of the impact by issuing the POBs, so the City's finances are in good standing. Once we do the calculations of the actuarial reports received last month, we will know the magnitude of the impact. We may not have the information by July but should definitely have it by the October Board meeting.

Other Business

None.

Communication to the City Commission

None.

The next meeting is scheduled for Thursday, July 30, 2015 (in 8th Floor Conf Rm).

The meeting was adjourned at 6:50PM.

[Minutes prepared by Linda Blanco, Board Liaison]

General Fund
FY 2016 Preliminary *Preliminary* Budget Highlights
As of May 28, 2015

Information is considered DRAFT and Subject to Change

Highlights of Revenue Changes to Date

- Increase in Property Tax Revenue – (estimated) \$9MM
- Increase in Franchise Fees and Utility Taxes - \$1.6MM
- Increase in State-Shared Revenues – (estimated) \$1.3MM
- Increase in Fire Rescue Transport & Inspection Fees - \$900k
 - Increase in Investment Earnings - \$610k
 - Increase in Fire Assessment Fees - \$500k
 - Increase in Code Fines and Lien Research - \$465k
 - Increase in Business Tax Revenue - \$300k
- Decrease in Red Light Camera Revenue - (\$1.6MM)
 - Decrease in Engineering Chargebacks - (\$1MM)
 - Decrease in Recreation User Charges - (\$650k)

Highlights of Expenditure Changes to Date

- Schlitterbahn Debt Service Payment - \$1.4MM
- Collective Bargaining Agreements - 1.7% COLA
 - OPEB Annual Contribution - \$1MM
 - Increase for Fleet Replacements - \$850k
- Increase for ITS Expenses (ERP System) - \$4.8MM
 - Decrease in Pension Expenses – (\$700k)
 - Decrease for Gasoline and Diesel - (\$440k)



CITY OF
FORT LAUDERDALE

City Auditor's Office

Memorandum No: 14/15-01

Date: April 29, 2015

To: Honorable Mayor and Commissioners

From: John Herbst, CPA, CGFO, CGMA
City Auditor

Re: Review of the Sixth Street Plaza Development Project

We have performed the procedures enumerated in the attached report, which were requested by the City of Fort Lauderdale Community Redevelopment Agency Board (the "CRA"), solely to assist in evaluating the Sixth Street Plaza development project. This engagement to apply agreed-upon procedures was performed in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of CRA management. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose. The procedures we performed and the results of these procedures are summarized in the report.

We were not engaged to, and did not perform an audit, the objective of which would be the expression of an opinion on the specified elements, accounts, or items. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

EXECUTIVE SUMMARY

In May 2003, the CRA entered into an agreement with Sixth Street Plaza, Inc. (Sixth Street) for the development of office and retail space along the Sistrunk corridor. The CRA committed to provide assistance from two of its development incentive programs and to lease office space in the project upon completion.

During the project's lifespan, it experienced numerous cost increases and additional requests for funding. There is minimal documentation in the files we reviewed that show how or why the price tag increased so dramatically. Project cost increases were as follows:

Original Proposal, submitted January 2001	\$ 735,257
Staff Cost/Cash Flow Analysis, February 2002	\$ 1,598,008
Total Completed Project Costs	\$ 3,753,334
Total Project Cost Increase	\$ 3,018,077

Two circumstances make it especially difficult to evaluate the basis for the increases or to determine whether the funds were appropriately spent. First, the original Development Agreement and subsequent amendments between the Fort Lauderdale Community Redevelopment Agency and Sixth Street Plaza, Inc. did not contain a right to audit clause. Accordingly, the CAO was unable to review key elements that may have yielded a better understanding of the cost increases and flow of funds.

Second, given the length of time between the inception of the project and our review, the integrity and completeness of the files is uncertain, and several of the individuals involved are no longer employed by the CRA.

As a result, our scope was limited to a review of the information that was available to us and our findings and recommendations are based thereon.

The overall conclusion of our review is that the CRA:

- failed to adequately evaluate the original proposal and subsequent requests for funds,
- did not provide effective oversight and monitoring during construction,
- did not maintain its objectivity regarding the project's viability,
- and failed to document how its funds were spent.

The project lacked fundamental project management discipline, from risk assessment and establishing proper governance to detailed accounting of funds disbursement. Accordingly, there is no way to be certain that all of the funds put into this project were spent appropriately. The CRA needs to integrate a culture of fiscal discipline and accountability into its core mission of eliminating slum and blight.

The attached report provides our review methodology, conditions, criteria and recommendations.

cc: Lee R. Feldman, City Manager
Cynthia A. Everett, City Attorney
Jonda Joseph, City Clerk

**CITY OF FORT LAUDERDALE
CITY AUDITOR**

**Review of the Sixth Street Plaza Development Project with the Fort Lauderdale
Community Redevelopment Agency**

PURPOSE

The City Auditor's Office (CAO) was asked by the Fort Lauderdale Community Redevelopment Agency's (CRA) Board to review the Sixth Street Plaza project to determine how the \$1,166,334 in loans and grants provided to the developer were spent and accounted for.

The objectives for the review are:

1. Determine the nature of the underwriting and due diligence performed by CRA staff in support of the project.
2. Determine the sources and uses of funds for the project and the extent of monitoring and compliance that was conducted.
3. Determine if cost overruns and funding increases were documented and justified.

BACKGROUND

In an effort to stimulate economic growth within the Midtown Business District, the City issued in December 2000, an *Invitation to Submit Proposals for Providing Office Space for Certain City Offices in the Midtown Business District* for the development of a commercial office complex. On March 27, 2001, the City approved the proposal submitted by Sixth Street Plaza, Inc.

The project consisted of the design and construction of 8,000 square feet of new office space and the renovation of 14,000 square feet of existing retail and office space as well as site improvement consisting of parking, landscaping, utilities and other improvements as required by code.

The CRA executed the Development Agreement with Sixth Street on May 15, 2003, providing incentives from the CRA Midtown Strategic Investment Program (\$340,571) and the Low Interest Loan Program (\$57,619), for total assistance of \$398,190. The CRA also agreed to lease 6,000 square feet of office space at a rate of \$96,000 per year (\$16/sf). Sixth Street was required to obtain project financing approval from a Project Lender within six months of the agreement date, and to close on the loan within six months of the approval date.

Sixth Street experienced delays in obtaining financing and was unable to meet the timelines established in the Development Agreement. The First Amendment with the CRA, dated September 28, 2005, eliminated the performance bond requirement from the developer, deferred all payments for assistance until the project was completed, and revised the financing and construction schedules.

In November 2005, Sixth Street received a \$1,450,000 loan from Regent Bank (Regent), secured by a first mortgage on the properties. Concurrently, they also received a \$300,000 loan from the South Florida Regional Planning Council (SFRPC), secured by a second mortgage. The initial funding from Regent, SFRPC and the CRA totaled \$2,148,190. Compared to the proposed construction budget of \$1,598,000, the project should have had more than adequate capital.

From the onset, the project experienced significant delays and cost overruns. Sixth Street submitted two change orders to Regent totaling \$698,760, and received two additional loans in 2006 and 2007 from Regent, equaling \$837,000. Between 2007 and 2009, Sixth Street also came back to the CRA seeking amendments to the Development Agreement for either additional funding or for the early release of funds. They received three loans from the CRA totaling \$697,990, secured by a third mortgage, and an additional grant for \$70,154.

When all of the original loans and grants, and the subsequent loans and grants are added up, **Sixth Street received a total of \$3.75 million** for the redevelopment of Sixth Street Plaza.

During the initial stages of the construction, Regent provided monitoring services over the construction draws; Sixth Street, through its related-party construction company, Airam Construction, (*the owner/developer is also the construction contractor*) submitted a monthly application and certification for payment request to the assigned bank project manager along with the construction budget. The bank also used the services of an outside inspector who issued monthly reports regarding the project's progress as another monitoring tool. After the bank project manager reviewed all documents and approved payment, Regent would transfer the funds to the Sixth Street operating account.

Once Regent's funds and those of South Florida Regional Planning Council were fully disbursed, Regent no longer received the monthly request for funds from Sixth Street and its role became that of a conduit between the CRA and Sixth Street. Regent simply held the loan and grant funds from the CRA and would disperse the money upon written request from the CRA, directly to Sixth Street's construction account. In September 2009, the CRA retained Landmark Title Services to oversee the disbursement of the final \$250,000 loan. This was to satisfy the CRA Board's requirement that the loan be used to clear the liens from subcontractors and unpaid taxes against the property,

The CRA moved into the Sixth Street Plaza offices after completion and has a lease agreement through 2016. The CRA is paying an above-market rate for its space under the assumption that the higher lease price would provide Sixth Street with sufficient cash flow to support the project. It was suggested by the CRA Director at the time that paying higher rates would jumpstart the office market in the area, but there was no rationale provided to justify that statement. No examples were provided from other cities where following that course of action led to the outcome described. The present value of the CRA's excess rent payment (the amount paid above the market rate) was estimated by staff to be as much as \$581,947.

Notwithstanding the CRA's above-market rental payments, Sixth Street has struggled to find tenants and has been unable to meet its financial obligations. As a result, Regent began foreclosure proceedings, with an expected final date of May 5, 2015.

SCOPE AND METHODOLOGY

The CAO reviewed the original Development Agreement and subsequent amendments between the Fort Lauderdale Community Redevelopment Agency and Sixth Street Plaza, Inc. Unfortunately, the agreements do not contain a *right to audit* clause. Accordingly, the CAO was not able to review certain documents, such as the construction account used to receive and disburse funds received from the city, limiting the scope of work the CAO could perform.

The CAO was granted access to the Regent Bank loan file. This review was conducted with the assistance of the court-appointed receiver for the foreclosure of Sixth Street Plaza. CAO also reviewed the project file between the CRA and Landmark Title Services.

In addition, CAO:

- Reviewed CRA meeting videos, agendas, and documentation.
- Interviewed Alfred Battle, former Director of the CRA, now Deputy Director of Sustainable Development.
- Interviewed Landmark Title Services principals.
- Traced receipts and disbursements for all funds.
- Determined which agency/entity was responsible for monitoring the funds and the project at specific points in the process.
- Reviewed documentation related to project including, but not limited to, the original development agreement, lease agreement, all subsequent amendments to the original development agreement, Regent Bank's Mortgage and subsequent Modification of Mortgage, and budgets and monthly invoice submissions to Regent Bank.

Our approach to evaluating internal control is guided by framework established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). COSO is a joint initiative of five private sector organizations, dedicated to providing thought leadership to executive management and governance entities on critical aspects of organizational governance, business ethics, internal control, enterprise risk management, fraud, and financial reporting.

The COSO internal control framework consists of five interrelated components derived from the way management runs a business. These components provide an effective framework for describing and analyzing the internal control system implemented in an organization.

The five components are the following:

Control environment: The control environment sets the tone of an organization and is the foundation for all other components of internal control. Control environment factors include the integrity, ethical values, management's operating style, delegation of authority systems, and the processes for managing and developing people in the organization.

Risk assessment: A precondition to risk assessment is the establishment of objectives, and thus risk assessment is the identification and analysis of relevant risks to the achievement of assigned objectives.

Control activities: Control activities are the policies and procedures that help ensure management directives are carried out. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties.

Information and communication: Information systems play a key role in internal control systems as they produce reports, including operational, financial and compliance-related information, that make it possible to run and control the business.

Monitoring: Internal control systems need to be monitored—a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities or separate evaluations. Internal control deficiencies detected through these monitoring activities should be reported upstream and corrective actions should be taken to ensure continuous improvement of the system.

OBJECTIVE 1

Determine the nature of the underwriting and due diligence performed by CRA staff in support of the project.

Condition

The CRA's project files were reviewed and staff interviewed to determine what procedures were in place to evaluate development proposals. We noted the following:

1. There is no evidence that a formal underwriting of the original proposal was performed using established criteria for approval.
2. The business plan submitted by the applicant was meager, lacking a detailed market demand analysis, marketing plan, construction budget, and cash flow projections.
3. There is no evidence of an independent verification of the construction cost budget.
4. There is no documentation of the developer's capacity to undertake the work.
5. There was no formal risk assessment performed by management.
6. There is no analysis supporting the purported cost increases.
7. There was no financial review to determine if the development's cash flow could support the additional bank and CRA debt taken on by Sixth Street.

This applies to both the initial development agreement and grant approval, as well as to subsequent loan and grant funding requests.

The fiscal analysis performed by CRA staff in 2002 that is in the files appears primarily geared to determining how much CRA assistance would be necessary to make the project viable. Several scenarios were run with varying combinations of grant funds and above-market rental payments to try to get to a net operating income/debt service ratio that would be acceptable to a lender. The vacancy rate used in the analysis was unsupported, as noted by the developer's statement that "*There is no historical data (market studies or comparative rents) available for*

the corridor that I know of. The purpose of this project is to help create a Class B market where none presently exists” and therefore appears to have been highly optimistic.

We did not see evidence of similar detailed analysis having been performed on the initial submittal in 2001, as a basis for awarding the project to Sixth Street in the first place. For example, the construction budget in the Sixth Street proposal was \$735,257. The construction budget in the February 2002 staff analysis was \$1,598,008. There is no explanation of what increased or why. When compared with the as-built cost of \$3.75 million, it is clear that all of the early projections were dramatically underestimated. In addition, the original proposal contained a cash flow statement for a single year. It is only the CRA analysis from 2002 that shows a 15 year projection.

Significantly, the CRA’s analysis shows that even under aggressive assumptions regarding vacancy rates, and using an extremely low budget for construction, the development was projected to generate barely enough cash flow after operations to service its debt.

Finally, there is no documentation observed in the files supporting the ability of the project to service the additional \$1,534,990 in loans it took on as construction progressed. Had further analysis been performed, it would have been clear that the project was likely to default.

Criteria

The relevant principles of the COSO Risk Assessment Activities include:

“The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed”

“The organization considers the potential for fraud in assessing risks to the achievement of objectives”

“The organization identifies and assesses changes that could significantly impact the system of internal control”

Cause

The CRA did not develop written policies or procedures to effectively evaluate proposals from developers. There are no established criteria defining thresholds for project viability, debt service coverage, working capital, etc. Awareness of the risk of failure was not present. Expansion of the project’s costs and debt service requirements received minimal review.

Impact

The CRA undertook the project without clearly determining whether it was financially feasible. The numerous requests for additional funding, combined with the present foreclosure, clearly demonstrate that this development was not viable from the onset. The failure to rigorously evaluate the original proposal, as well as the multiple subsequent requests for funding, has placed the CRA in a position where it stands to lose the \$697,990 in loans it made to the project.

Recommendation

CRA management needs to develop written policies, procedures, and criteria to effectively review proposals from developers. Staff needs to have sufficient training and expertise in methods for conducting this review. These procedures should include at a minimum:

- Formal criteria and thresholds that the project must achieve to warrant funding.
- A business plan with a detailed budget and timeline for construction.
- A market analysis showing demand and comparable rents.
- Proforma cash flow statement in sufficient detail to permit an objective evaluation of the risks and likelihood for success of the project.
- Credit and background checks of the principals involved.
- Review of prior projects of similar size/scope successfully completed by the applicant.
- Additional funding requests, cost increases, and change orders should receive the same level of scrutiny, analysis, documentation, and risk assessment as the initial proposal.

OBJECTIVE 2

Determine the sources and uses of funds for the project and the extent of monitoring and compliance that was conducted.

Date	Lender	Type	Amount
May 2005	Ft Lauderdale CRA	Midtown Strategic Investment	\$ 340,571.00
May 2005	Ft Lauderdale CRA	Low Interest Loan Program	57,619.00
Nov 2005	Regent Bank	Original loan	1,450,000.00
Nov 2005	So Fl Reg Plan Council	Original loan	300,000.00
Dec 2006	Regent Bank	Additional loan	456,289.00
Aug 2007	Regent Bank	Additional loan	380,711.00
May 2007	Ft Lauderdale CRA	Amendment #2 – loan	228,144.50
June 2007	Ft Lauderdale CRA	Amendment #3 – grant	70,154.00
June 2009	Ft Lauderdale CRA	Amendment #4 – loan	219,846.00
Aug 2009	Ft Lauderdale CRA	Amendment #5 – loan	<u>250,000.00</u>
Total			\$3,753,334.50

Summary of funding by source:

Ft Lauderdale CRA	\$1,166,334
Regent Bank	\$2,287,000
South Florida Regional Planning Council	\$ 300,000

Condition

The monitoring of the construction draws by the CRA was nonexistent during the initial phase of construction financing and inadequate at best during the later stages. Based on file reviews, we observed that all of the funds held by Regent were disbursed to Sixth Street/Airam Construction. However, without access to the Sixth Street construction account, it is not possible to determine what those funds were spent on. While Sixth Street was drawing down on its loan from Regent Bank and the South Florida Regional Planning Council, Sixth Street/Airam Construction submitted monthly invoices to the bank's project manager. The project manager also received a monthly inspection report from an outside consultant hired by Regent. In the payment requests we were able to review within our limited access, we did not note any supporting documentation from subcontractors showing amounts paid for material, labor, permits, professional services, etc. During this period, the CRA did not receive any documentation indicating the amount of funds drawn down, what they were spent for, and supporting material for those dispersals. Accordingly, the CAO cannot reconcile the amounts provided to Sixth Street with actual project-related expenses.

Once the \$2.6 million in Regent and SFRPC loans were fully disbursed, Sixth Street requested and received the CRA funds. Regent acted as the disbursing agent for all funds, including those of the CRA. However, Regent was not obligated to continue the monitoring practices it had established with Sixth Street at the start of the project after its funds were drawn down. Instead, Regent disbursed the funds to Sixth Street upon written requests from the CRA Executive Director/City Manager.

During this timeframe, we found no record in the file of Sixth Street/Airam Construction submitting detailed monthly invoices and budgets to the CRA. As a result, \$916,334 of City funds, whether loans or grants, were disbursed without adequate support. The CRA changed its approach with the Fifth Amendment to the Development Agreement, which provided Sixth Street with an additional \$250,000 low interest loan. The CRA hired an outside title services company, Landmark, to monitor and manage the disbursement of funds and required "itemized lists of obligations, invoices and other documents...prior to any of the third loan payment being disbursed by Title Company".

Criteria

The relevant principles of the COSO framework for Monitoring Activities include:

"The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning"

"The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate"

While Regent Bank monitored its loans and that of South Florida Planning Council, and the CRA hired a title services company to monitor the final \$250,000, close to \$1 million in CRA dollars were disbursed with minimal oversight. There was limited communication between the various

parties and the construction company was permitted to submit monthly invoices without supporting documentation from subcontractors.

Cause

The CRA did not have in place sufficient requirements or procedures to effectively monitor the expenditure of funds for its programs.

- There was no right to audit clause included in the contract.
- Until the Fifth Amendment, there was no requirement that Sixth Street submit invoices, timesheets, cancelled checks or other evidence in support of their funding requests.
- There was no review by the CRA of construction draws submitted to Regent Bank.
- There was inadequate review of draw requests submitted to the CRA.
- There was no analysis performed to document how previous funds were spent before agreeing to increase the amount of loan and grant funding to support the project.
- There was no monitoring of debt service or tax payments by Sixth Street after project completion.

Impact

The City is unable to determine how \$916,334 (the unmonitored portion) of CRA funds were spent. The project had an initial proposed construction budget of \$735,257. By February 2002, the budget was up to \$1,598,008. The final cost was \$3.75 million. There is no documentation in the CRA files supporting how the construction costs increased by \$3 million dollars, or 400%.

Recommendation

1. Ensure that all agreements entered into by the City/CRA include a *right to audit* clause where appropriate.
2. Require appropriate documentation to substantiate reimbursement of expenses.
3. Develop procedures to provide effective oversight over the disbursement of funds.
4. Incorporate ongoing monitoring into program requirements to determine whether the developer has fallen behind on payments to other senior lenders, subcontractors, utility providers or taxing authorities.

OBJECTIVE 3

Determine if cost overruns and funding increases were documented and justified.

Condition

The budget increased substantially without adequate documentation of why. The CRA files did not contain evidence supporting increased construction costs. There were no payroll reports, subcontractor labor invoices, material invoices, etc. showing the before and after prices. The two change orders, totaling \$698,760, presented to Regent Bank were not well documented. There is a line item budget for construction costs that shows increases in various categories, but without rationale or justification. There is no evidence that the change orders were reviewed or approved by the CRA. It is unclear whether the information regarding the cost overruns, change orders and additional loans from Regent Bank was shared with the CRA in a timely manner. The Application for Payment and Certification delineates the distributees and the CRA is not listed as a recipient.

The documents submitted as part of the CRA agenda package when Maria Freeman requested additional funds were sparse, lacking any direct evidence demonstrating which costs had increased and by how much.

In emails dated June 16, 2008 and July 6, 2009, the CAO raised concerns regarding the repeated requests for funding by the developer, questioning the viability of the project and the wisdom of investing more funds in a venture that was already experiencing the likelihood of default. CRA staff responded that "I think it is correct to characterize the project as having a high probability of defaulting on its obligations to Regent Bank and the South Florida Regional Planning Council if we do not allow the Developer to use some of our funds to help finish the project and cover the increased costs with additional funding" and "it is also not prudent to attempt to respond to the Developer's request as a matter of protecting the CRA's financial interest based on past financial contributions to the project".

Criteria

The City of Fort Lauderdale's Procurement Manual provides many reasons why a change order is permissible:

"A change order is defined as a written order to a contractor approved by the City, authorizing a revision of an underlying agreement between the City and a contractor that is directly related to the original scope of work or an adjustment in the original contract price or the contract time directly related to the original scope, issued on or after the effective date of the contract."

"Generally, change orders are changes that affect the price or quantity of the original purchase order, changes to a purchase order may also be required when:

- There are required changes in quantities or specifications.
- Procurement Division corrects any misinterpretations and inadvertent errors.
- Vendor has submitted notification of change prior to shipment.

- Vendor name change.
- Extension of service is required (i.e. rental, temporary help, etc.)”

Additionally, the relevant principles of the COSO framework for Control Activities include:

“The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable risks”

“The organization deploys control activities through policies that establish what is expected and procedures that put policies in place”

These principles require in part that the organization develop controls to mitigate business risk, deploy those controls, establish responsibility and accountability for executing those policies, and take corrective action in a timely manner.

Cause

The CRA did not have in place policies or procedures to effectively control the expenditure of funds for its programs to ensure that it achieved its goal of eliminating slum and blight.

Additionally the lines of authority and responsibility were never clarified for this project. The multiple funding sources confused the matter and made it easier to ignore good procurement practices. However, it clearly was the responsibility of the CRA to ensure that actions taken with respect to the expenditure of its funds were properly documented and reviewed.

Finally, the CRA staff failed to maintain their objectivity with respect to the project. As observed in emails from the CAO to the CRA in 2008 and 2009, they appear to view their role as project advocates rather than as stewards of the CRA’s funds.

Impact

As a result of the failure to re-analyze the project’s viability in light of the cost increases, the CRA will likely have to write off the \$697,990 in loans it made to the project. That is money that could have come back to the CRA to be reinvested in other projects to support continued revitalization in the Northwest-Progresso-Flagler Heights area.

Recommendation

The CRA needs to develop policies and procedures to ensure effective oversight of its programs, establish responsibility and accountability for executing those policies, and take corrective action in a timely manner.

Project management/advocacy needs to be separated from compliance monitoring. These functions have goals which may be at odds with each other and are therefore incompatible.

Auditor Note: During our review it also came to our attention that communication between the CRA and the Finance Department was limited. The Finance Department had no mechanism in place to alert them when the first payment is due from Sixth Street (February 1, 2016). We also discovered two non-related CRA loans on the books of which CRA staff were unaware.

APPENDIX

1. Invitation to Submit Proposals for Providing Office Space for Certain City Offices in the Midtown Business District
2. Sixth Street Plaza, Inc. Lease Proposal
3. CRA staff's cash flow analysis scenarios
4. CRA staff's estimate of excess rent payments
5. Examples of Application and Certification for Payment to Regent Bank
6. Lease Agreement extract
7. Development Agreement
8. First Amendment to Development Agreement
9. Second Amendment to Development Agreement
10. Third Amendment to Development Agreement
11. Fourth Amendment to Development Agreement
12. Fifth Amendment to Development Agreement
13. CRA Meeting July 7, 2009 minutes approving the Funding Request and Fifth Amendment