Bond Funds Compliance Monitoring

Internal Audit

December 2014
Bernalillo County Internal Audit
Bond Funds Compliance Monitoring

Executive Summary

SUMMARY OF PROCEDURES

REDW performed an internal audit over bond fund compliance monitoring at Bernalillo County. Our internal audit focused on testing internal controls for various processes, including whether policies and procedures (P&P) over bond funds included monitoring functions and guidance on spending of proceeds.

We performed the following procedures:

- Obtained an understanding of operational procedures through reading relevant bond fund documentation and interviewing various personnel;
- Obtained an understanding of monitoring performed by the County to ensure bond fund requirements are complied with;
- Obtained an understanding of whether bond proceeds were used in a manner not outlined in original bond transcripts, and if so how these changes were communicated and assessed to determine the possible effect on the bond’s tax-exempt status;
- Tested a sample of outstanding bonds to determine if invested bond proceeds were segregated, and reserve funds were maintained at the level required, if applicable;
- Tested a sample of expenditures to determine if bond proceeds were spent as required for both eligible activity and timeliness; and,
- Tested a sample of outstanding bonds that required arbitrage calculations to determine if rebate calculations were completed and submitted timely.
SUMMARY OF OBSERVATIONS AND RECOMMENDATIONS

We found areas during the course of the audit where controls were functioning properly and established procedures were followed. Bond proceeds were monitored, and spent timely on eligible expenditures in accordance with requirements, which included the useful life limitation for capital expenditures. Debt capacity measures were met according to the County’s analysis for fiscal year 2013 and reserve funds were at the levels required. Additionally, arbitrage rebate calculations were submitted in accordance with requirements.

Significant high and moderate risk observations are presented below:

- **Investment of Bond Proceeds**—Bond tax certificates and transcripts include restrictions on the types of investments that bond proceeds can be invested in. There was not a process to ensure restrictions were considered when bond proceeds were invested. The County should consider implementing a process to monitor invested bond proceeds.

The lower risk observations are included in the attached detailed report.

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Further detail of our purpose, objectives, scope, procedures, observations, and recommendations are included in the internal audit report. In that report, management describes the corrective action taken for each observation.

We received excellent cooperation and assistance from the Finance Division during the course of our interviews and testing. We sincerely appreciate the courtesy extended to our personnel.

Albuquerque, New Mexico
February 2, 2015
# Bernalillo County Internal Audit
## Bond Funds Compliance Monitoring

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INTRODUCTION

We performed the internal audit services described below solely to assist Bernalillo County in evaluating the internal controls over selected processes relating to bond funds compliance monitoring. Our services were conducted in accordance with the Consulting Standards issued by the American Institute of Certified Public Accountants, Generally Accepted Government Auditing Standards, and the terms of our contract agreement for internal audit services. Since our procedures were applied to samples of transactions and processes, it is possible that significant issues related to the areas tested may not have been identified.

An entrance conference was held on December 15, 2014, at which time most items needed for the audit were requested and had been received. Fieldwork began the week of December 15, 2014. An exit conference was held on January 23, 2015, and final management responses were received on February 2, 2015.

Although we have included management’s responses in our report, we do not take responsibility for the sufficiency of these responses or the effective implementation of any corrective action.

PURPOSE AND OBJECTIVES

Our internal audit focused on evaluating whether processes were in place to monitor compliance with bond fund requirements and to determine if those processes were in compliance with policies and procedures (P&Ps), applicable regulations, and reflected best practices and sound internal controls. We evaluated the adequacy and reasonableness of the internal controls surrounding the bond funds to include monitoring functions and guidance on use of proceeds. We tested use of bond proceeds and expenditures to determine if spending requirements were met. Additionally, we tested for compliance with the County’s Debt Policy and Post Issuance Compliance Guidelines.
**SCOPE AND PROCEDURES PERFORMED**

In order to gain an understanding of the processes and operations surrounding the bond funds, we interviewed the following personnel:

- Denise Benavidez, Accounting Officer
- Emily E. Madrid, Special Projects Coordinator
- Cindy E. Torres, Accounting Officer

In order to understand policies and procedures over the bond funds we read relevant portions of:

- The Bernalillo County Debt Management Policy & Guidelines approved April 9, 2013; and,
- The Bernalillo County Post-Issuance Tax and Securities Compliance Guidelines for Bonds and related Exhibits dated April 1, 2013.

We performed the following testwork:

*Monitoring of Compliance with Bond Covenants:* We gained an understanding of the processes performed by the County to monitor compliance with bond requirements. We obtained a listing of outstanding general obligation (GO) and gross receipts tax (GRT) revenue bonds as of June 30, 2014 (total population of 22) and selected a judgmental sample of five, including the most recent issues of three GO bonds and two GRT bonds. We examined the tax certificate, transcript and supporting documentation, and tested each bond for compliance with bonds requirements related to use of proceeds and timeliness of expenditures. We also obtained the debt capacity calculations for fiscal year 2013 and verified the calculations were prepared according to requirements outlined in the County’s Debt Management Policy. We traced a sample of the five largest amounts from the debt capacity calculations, to the supporting documentation to ensure the amounts were accurate.

*Tracking and Use of Bond Proceeds:* We gained an understanding of how bond proceeds were tracked and segregated within SAP and from the sample of five bonds judgmentally selected above, we tested that the required reserve levels were maintained.

We obtained the bond expenditure detail (July 2013 through November 2014) and selected a random statistical sample of 22 expenditures (based on 90% Confidence Level (CL) and 10% Tolerable Deviation (TD) from a total population of 2235 expenditures). We determined:

- If bond proceeds were spent on capital, or other eligible/allowable expenditures;
- That requisitions for use of bond proceeds included details on project costs incurred;
- For all requests to use bond proceeds after April 2013, if proper approval by the Deputy County Manager of Finance (DCMF) or delegate was obtained;
- If capital expenditures were in compliance with the useful life limitations; and,
- If arbitrage rebate calculation requirements were monitored and submitted, if required.
**Timely Expenditure of Bond Proceeds:** We obtained a listing of outstanding GO and GRT revenue bonds excluding refunded bond issues as of June 30, 2014 (total population of 14) and selected a judgmental sample of five bonds issued prior to fiscal year 2011 to test if the spending requirements were met including at least five percent of bond proceeds were committed within six months after issuance, and at least 85% of all bond proceeds were spent within three (3) years of issuance. Additionally, if proceeds were not spent timely, we determined whether the County requested arbitrage calculations to determine if rebate payments would be required.

**OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES**

We identified the following weaknesses relating to the Bernalillo County’s processes:

1) **Investment of Bond Proceeds**

Bond tax certificates and transcripts include restrictions on the types of investments that bond proceeds can be invested in. Investment restrictions for the 2013 GO bond series of $17.8 million stated that no more than five percent of bond proceeds could be invested in federally insured deposits or obligations guaranteed by the United States. Based on the investments held by the County as of June 30, 2014, listed in the Comprehensive Annual Financial Report, the County had investments in Certificates of Deposit, the Federal Farm Credit Agency and Federal Mortgage Acceptance Corp which could be deemed as unallowable. Although the majority of the County’s investments were in allowable investments, there was not a process to ensure that the restrictions were considered when bond proceeds were invested. Cash proceeds from bond issues are provided to the Treasurer and invested with all other cash on hand at the County. Additionally, it appears that the County does not segregate the investments to facilitate monitoring or confirmation that investments are in allowable investment types.

**Potential Risk: Moderate**—Without proper segregation of invested bond proceeds, the County does not have controls in place to properly monitor to ensure that investment restrictions are complied with. This could lead to bond proceeds invested in ways that are not allowed by the tax Certificate and result in negative impact to the tax-exempt status of the bonds.

**Recommendation:** The County should consider implementing a process to monitor invested bond proceeds. This could be accomplished through segregated investments or an analysis of investments to ensure an adequate amount of money is invested allowable types of investments to cover the total dollar value of bond proceeds included in the County’s pooled investments.

**Management’s Response**

Management agrees with the auditors’ recommendation. The Treasurer’s Office, Finance Division and the Investment Advisor met to discuss how to address the implementation of segregating bond proceeds. The next step is to review the Investment Policy for potential updates to address allowable investments for which bond proceeds are to be invested, utilize the Investment Advisor’s system to segregate bond proceeds, and create a procedure for the Treasurer’s Office to ensure allocation of interest is properly recorded to the bond proceed funds. This implementation will be effective beginning in fiscal year 2016.
2) Use of Bond Proceeds and Department Guidance

The bond process impacts several departments and divisions within the County. The documented P&Ps in place for those impacted are not comprehensive to cover all responsibilities, provide guidance or allow them to understand and ensure compliance with all bond requirements. It is also critical to ensure all necessary communication across departments is completed timely. A comprehensive listing of all departments and positions that affect the bond process was also not available.

Potential Risk: Low—Without proper guidance and clear understanding of who is responsible for each critical task, County personnel may not complete or monitor key requirements of bond issues which could affect the tax-exempt status or cause other noncompliance issues.

Recommendation: The County should consider modifying the debt policy to cover all department and division responsibilities including who is responsible for each part of the process, what required timing needs to be met, and what reporting and monitoring should occur throughout the life of the bond. This should include specific guidance by position for responsibilities in monitoring critical tasks outside of the Finance Division such as completing typical bond requirements and timelines for submitting required information. Departments that are responsible for spending bond funds on capital projects should monitor timeliness of expenditures and communicate expected delays to facilitate monitoring of arbitrage requirements. The Treasurer’s Office should communicate how bond proceeds are invested to facilitate monitoring of investment restrictions. Training should be developed and occur every few years to include guidance of how different departments rely upon one another to ensure all bond requirements are met, as well as explain allowable expenditures and how changes to use of bond proceeds should be requested and documented.

Management’s Response

Management agrees with the auditors’ recommendation. The following processes and procedures are currently being drafted to clarify and give guidance to employees to improve completing and monitoring bond requirements to ensure compliance with the Debt Management Policy and Post Issuance Compliance Guidelines. The Finance Division is working on developing policies and procedures to identify stakeholders. The Finance Division will compile each respective process and create guidance using the County’s inProcess system which will be available to all employees through the Bernalillo County intranet. These plans are expected to be completed within the next six months. Over the past few years the County has provided training on bond uses and spending requirements. The County expects to hold additional bond training for departments annually to educate new employees about the bond process and to refresh current employees of any changes. Revisions to all practices will be reviewed and updated as needed to ensure that processes and procedures are current.

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This report is intended for the information and use of Bernalillo County management, the audit committee, members of the Board of Commissioners of Bernalillo County and others within the organization. However, this report is a matter of public record, and once accepted its distribution is not limited.
We discussed and resolved other minor observations with management and received excellent cooperation and assistance from the Finance Division during the course of our interviews and testing. We sincerely appreciate the courtesy extended to our personnel.

Albuquerque, New Mexico
February 2, 2015