CITY OF SAN ANTONIO

P.O. Box 839966
SAN ANTONIO TEXAS 78283-3966

April 7, 2014

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Mike Gallagher
Councilman, District 10

SUBJECT: Audit Report of the Tax Increment Financing Program

Mayor and Council Members:

We are pleased to send you the final report of the audit of the Tax Increment Financing Program. This audit began in April 2013 and concluded with an exit meeting with department management in November 2013. Management's verbatim response is included in Appendix B of the report. The Department of Planning & Community Development and Finance Department management and staff should be commended for their cooperation and assistance during this audit.

The Office of the City Auditor is available to discuss this report with you individually at your convenience.

Respectfully Submitted,

Kevin W. Barthold, CPA, CIA, CISA
City Auditor
City of San Antonio

Distribution:
Sheryl L. Sculley, City Manager
Peter Zanoni, Deputy City Manager
Ben Gorzell, Chief Financial Officer
John M. Dugan, Director, Department of Planning and Community Development
Troy Elliott, Finance Director
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Donald Crews, Audit Committee Member
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CITY OF SAN ANTONIO

OFFICE OF THE CITY AUDITOR

Audit of the Tax Increment Financing Program

Project No. AU13-013

April 7, 2014

Kevin W. Barthold, CPA, CIA, CISA
City Auditor

Executive Summary

As part of our annual Audit Plan approved by City Council, we conducted an audit of the Department of Planning and Community Development (DPCD), specifically the Tax Increment Financing (TIF) program. The audit objective, conclusions, and recommendations follow:

Are there appropriate controls and governance structures in place to properly manage the Tax Increment Financing Program?

No, the City does not have appropriate governance structures in place to properly manage the TIF program. Specifically,

- Executive management has not assigned overall responsibility for ensuring the TIF program is in line with the City's overall strategic and operational goals and policies.

- Guidelines and criteria for governing the TIF program are not being managed in accordance with the TIF Manual adopted in 2008 and the Texas Tax Code.

Consequently the following operational control deficiencies were identified:

- Finance plans used to budget and anticipate future tax revenue collections have not been completely updated for the 23 active TIRZ since inception.

- Policies are not in place regarding Tax Increment Reinvestment Zone (TIRZ) administrative processes and procedures. Specifically:

    - Taxing entities were overbilled in at least one of the TIRZ districts.
    - Administrative fees have not been consistently deducted from the TIRZ accounts.
    - Disbursements are not supported with appropriate evidence indicating the originating invoice was reviewed and approved.

We recommend the Director of Planning and Community Development should:

A. Institute a TIF Governance Committee comprised of multiple stakeholders with the authority to make decisions on behalf of the City as to avoid conflicts in city goals and objectives. The committee should include stakeholders made up of 3 levels of decision making: Strategic (i.e. CoSA Executives); Tactical (i.e. Boards and City Leadership); and Operational (City staff) that provide oversight and direction of the TIF program.

B. Ensure appropriate controls are in place to effectively utilize, administer, and monitor the overall TIF program, to include:

    - Updating TIF Manual and submitting to City Council for approval as required.

- Updating project and finance plans for all TIRZ
- Updating controls over the collection of revenue (i.e. taxes and administrative fees) and over the disbursement process.
- Creation of internal policies and procedures over the administration of the TIF Program.

The Department of Planning and Community Development Management's verbatim responses are included in Appendix B.

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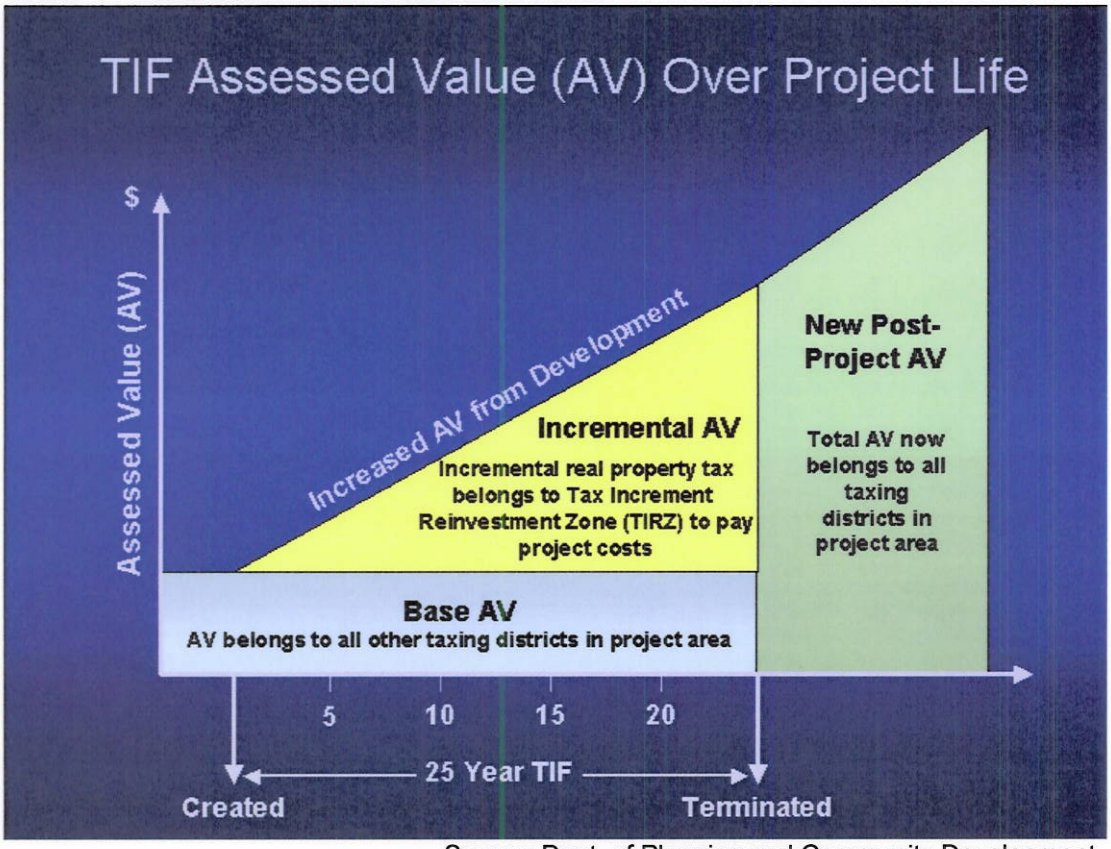
Background

Tax Increment Financing (TIF) is a special funding tool used by the City of San Antonio (City) to promote public and private investment in areas where little to no private sector investment is currently taking place. A portion of collected taxes are contributed to a fund that is used to help revitalize a designated area called a Tax Increment Reinvestment Zone (TIRZ).

Once a TIRZ has been established, the City enters into written interlocal agreements with all participating taxing entities to specify: (1) the conditions for payment of the tax increment into a tax increment fund, (2) the portion of the tax increment to be paid by each entity into the tax increment fund, and (3) the term of the interlocal agreement. As illustrated in Table 1 below, incremental real property taxes resulting from new construction, public improvements and redevelopment efforts accrue to the TIF fund. The funds are used to build and repair roads and infrastructure and rehabilitate historic facilities and existing vacant buildings. Currently managed by the Planning & Community Development Department (DPCD), the TIF program began in 1998.

Table 1 – Illustration of TIF Assessed Value



Source: Dept. of Planning and Community Development

A financing plan is developed to describe the projected and actual construction schedules, incremental value, tax collections and reimbursements. The Financing plan should be updated annually to bring projections in line with actual events of the preceding year.

The City administers the tax increment fund and is responsible for invoicing, collecting and depositing tax increment revenues from participating taxing entities. The City is also responsible for the investment, disbursement, and general accounting of funds. All increment tax funds should be reviewed to ensure compliance with provision of the project plan, financing plan, development and interlocal agreements.

The City has collected and expended over $55 million in TIF funding over the past seven full fiscal years (October 2005 – September 2012). The process for administering the tax increment fund is currently monitored by DPCD with assistance from the Finance Department (Finance).

Audit Scope and Methodology

In order to gain an understanding of the overall TIF program, the audit team interviewed management and staff from both the DPCD and Finance. We performed walkthroughs and documented the initiation and administrative processes and internal controls associated with the creation and administration of a TIRZ within the TIF program. We obtained and reviewed copies of development agreements, financial plans, invoices, and other supporting documentation pertinent to the TIF program. In addition, we attended several TIRZ board meetings in order to observe the approval process of disbursements relating to completed projects.

Upon completion of our review of the TIF program processes, we determined whether internal controls critical to the effectiveness in safeguarding TIF monies were in place. Our primary criteria consisted of state and local laws, specifically the Chapter 311, *Tax Increment Financing Act,* of the Texas Tax Code. Our review was based on the assessment of the governance structure and internal controls associated with the TIF program. We did not test data from any information system, and so did not perform any assessment of data reliability or perform general and application control reviews of any information system.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit Results and Recommendations

A. TIF Program Lacks Appropriate Governance Structure

The City does not have appropriate governance structures in place to properly manage the TIF program.

- Executive management has not assigned overall responsibility for ensuring the TIF program is in line with the City's overall strategic and operational goals and policies.

- Guidelines and criteria for governing the TIF program are not being managed in accordance with the TIF Manual adopted in 2008 and the Texas Tax Code.

Without appropriate governance and structure in place, the City's overall strategic planning and budgeting of future tax revenues planned to support city services may be inaccurate due to outdated growth projections within specific geographic regions.

Recommendation:

The Director of Planning and Community Development should institute a TIF Governance Committee comprised of multiple stakeholders with the authority to make decisions on behalf of the City as to avoid conflicts in city goals and objectives. The committee should include stakeholders made up of 3 levels of decision making: Strategic (i.e. COSA Executives); Tactical (i.e. Boards and City Leadership); and Operational (City staff) that provide Oversight and Direction of the TIF program.

B. TIF Program Lacks Appropriate Administrative Controls

The TIF program, from the creation of a new TIRZ or project to the administrative procedures of distributing TIF monies, has not been reviewed or sufficiently monitored resulting in the following operational control deficiencies:

- Finance plans used to bring projections in line with actual events are not being updated annually as prescribed by the TIF manual.

- Participating jurisdictions in at least one of the TIRZ districts were found to have been overbilled. This occurred due to the lack of controls in the billing process that would ensure documents, such as interlocal agreements and other like contracts, are reviewed prior to invoicing collaborating partners.

- Administrative fees used to subsidize the City's operational expenditures of administering the TIF program have not been consistently deducted from the TIRZ funds. For some of the TIRZs, administrative fees have not been assessed

for the last three years. As of May 2013, not all TIRZ accounts have been appropriately adjusted.

- Disbursements are processed based on the assumptions that invoices had been thoroughly reviewed. If an invoice did not contain the appropriate supporting documentation upon submission to the City, there is no process in place to ensure the invoice will be appropriately reviewed and approved prior to disbursing TIF funding to the developer.

- Internal policies and procedures regarding basic processing of TIRZ transactions do not exist resulting in inconsistent processes, lack of internal controls, and insufficient knowledge and guidance of appropriate handling of public funding.

Due to the lack of administrative controls, TIF funding has not been sufficiently safeguarded thereby significantly increasing the City's risk of financial loss due to misappropriated tax based funding, as well as possible state tax law violations.

Recommendation:

The Director of Planning and Community Development should ensure appropriate controls and governance structures are in place to effectively utilize, administer, and monitor the overall TIF program, to include:

- Updating TIF manual and submitting to City Council for approval.
- Updating project and finance plans for all TIRZ
- Updating controls over the collection of revenue (i.e. taxes and administrative fees) and over the disbursement process.
- Creation of internal policies and procedures over the administration of the TIF program.

Appendix A – Staff Acknowledgement

Sandy Paiz, CFE, Audit Manager
Kimberly Weber, CIA, CFE, CGAP, CRMA, Auditor in Charge
Christopher Moreno, CFE, Auditor

Appendix B – Management Response

CITY OF SAN ANTONIO

P.O. Box 839966
SAN ANTONIO TEXAS 78283-3966

March 21, 2014

Kevin W. Barthold, CPA, CIA, CISA
City Auditor
San Antonio, Texas

RE: Management's Corrective Action Plan for Audit of Planning & Community Development Tax Increment Financing Program

The Planning and Community Development Department and the Finance Department have reviewed the audit report and have developed the Corrective Action Plan below corresponding to report recommendations.

Recommendation					
#	Description	Audit Report Page	Accept, Decline	Responsible Person's Name/Title	Completion Date
1	***TIF Program Lacks Appropriate Governance Structure*** Institute a TIF Governance Committee comprised of multiple stakeholders with the authority to make decisions on behalf of the City as to avoid conflicts in city goals and objectives. The committee should include stakeholders made up of 3 levels of decision making: Strategic (i.e. COSA Executives); Tactical (i.e. Boards and City Leadership); and Operational (City staff) that provide Oversight and Direction of the TIF program.	4	Accept	John Dugan – Director of Planning and Community Development Troy Elliott – Director of Finance	Establishment of Governance Committee – *March 2014*

Action plan:
During 2013, the departments of Planning and Community Development, Finance, and the City Manager's Office met to manage priorities and strategize on issues related to the City's Tax Increment Financing ("TIF") program. The discussions were focused on managing current requests and issues as well as developing an overall strategic plan for the utilization of this development tool and determining the structure most effective for managing the program. Much focus was on the organization, management, function and effectiveness of the TIF Unit which is responsible for managing the program. As a result of this review, the TIF Unit was reorganized and staffed with qualified personnel who have the appropriate skill sets to manage the program. The new personnel includes a new Economic Development Manager who was recently hired (January 2014) after an extensive search who will manage the TIF Program and will be equipped to provide better oversight and clearer direction to staff with the support and focus of these departments.

Working collaboratively with the Planning and Community Development Department, the Finance Department also has recently hired a new dedicated Financial Manager who is tasked with updating the City's Tax Increment Reinvestment Zone ("TIRZ") Finance Plans and is supported by a pool of Finance Debt Officers. The Financial Manager position was created to provide support to the TIF Unit by assuming the task of comprehensively updating the Finance Plans for all of the existing TIRZ. The Finance Department provides financial expertise to various departments and programs throughout the City and the TIF Program is another opportunity to standardize these efforts.

In response to this audit, the Planning and Community Development Department in coordination with the City Manager's Office has proposed that the following City executives serve on the Strategic Level of the proposed Governance Committee:

1. Peter Zanoni, Deputy City Manager
2. Ben Gorzell, Chief Financial Officer
3. John Dugan, Director, Planning and Community Development Department
4. Troy Elliott, Director, Finance Department
5. Veronica Zertuche, Deputy City Attorney
6. Lori Houston, Director, Center City Development Office
7. Michael Taylor, Interim Assistant Director, Planning and Community Development Department

It is proposed that the Governance Committee will meet quarterly. Governance Committee meetings have been scheduled for the remainder of the year, with the first meeting scheduled for Friday, March 21, 2014. Other special meetings may be called to address issues and projects that arise outside of the scheduled meeting calendar. Those meetings will be scheduled as necessary.

The Governance Committee will provide strategic direction, assist with decision making and provide oversight and direction to the TIF Program. In addition, the Committee can explore the need for other committees or subcommittees needed as items are brought forward. The TIF Unit will staff the Governance Committee meetings and the City Attorney's Office and the Finance Department staff will attend and also be available to assist and present items to the Governance Committee as needed.

As a first step towards strengthening the governance structure, the TIF Unit in conjunction with the City Attorney's Office and the Finance Department will develop an outline of proposed duties for the Governance Committee and provide background information on existing TIRZ including the status of Finance and Project Plans, legal agreements and reporting requirements. Staff will also report on the performance of each TIRZ and begin to establish standard reporting metrics that will enable the Governance Committee to compare TIRZ across the City and make recommendations as to the effectiveness of continued City support.

Recommendation

#	Description	Audit Report Page	Accept, Decline	Responsible Person's Name/Title	Completion Date
2	***TIF Program Lacks Appropriate Administrative Controls*** Ensure appropriate controls and governance structures are in place to effectively utilize, administer, and monitor the overall TIF program, to include: ➢ Updating TIF manual and submitting to City Council for approval. ➢ Updating project and finance plans for all TIRZ ➢ Updating controls over the collection of revenue (i.e. taxes and administrative fees) and over the disbursement process. ➢ Creation of internal policies and procedures over the administration of the TIF program.	4	Accept	John Dugan – Director of Planning and Community Development Troy Elliott – Director of Finance	TIF Guidelines to include internal policies – November, *2014;* Project and Finance Plan Updates – Ongoing; Controls over collections and distributions- *June, 2014;*

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Action plan:

1. The TIF Unit will update the TIF Guidelines and incorporate TIF policies and procedures and present them to the Governance Committee for their review and approval. It is anticipated that this process will take approximately eight to twelve months.

   Proposed tasks are as follows:
   a. Review existing policy
   b. Incorporate TIF policies and procedures
   c. TIF Unit proposed revisions
   d. Interdepartmental review and revisions (Finance Department, City Attorney's Office, Center City Development Office)
   e. Present to Governance Committee
   f. Final Revisions
   g. City Council Consideration

2. The Finance Department with assistance from the Planning and Community Development Department's TIF Unit has continued the process of updating the TIRZ Finance Plans. Since 2013, two Finance Plan updates have been completed and one additional plan is finalized and pending review and approval by the Governance Committee, TIRZ Board, and City Council. The new format for the Finance Plan updates includes an update to the developer's construction plan, expenses, reimbursements and carrying costs as well as updating taxable values, interest earnings, and grants pertaining to each TIRZ. Each Finance Plan is being reconciled with the City's SAP system by year and will be maintained in a consistent format. The Finance Plan updates have not previously been maintained at this level of diligence and will provide the City with important information to analyze the financial impact of the TIF Program and its effect on the General Fund and Debt Service Fund for the life of each TIRZ.

   In order to continue the updates to the TIRZ Finance Plans, the TIF Unit has developed a draft priority list for updating the plans which will be presented to the Governance Committee for review and approval in March/April 2014. This list will represent the order of priority in which each TIRZ Finance Plan which will comprehensively be updated by the Finance Department with information coordinated and provided by the TIF Unit. The TIF Unit will update each TIRZ Project Plan once it receives a substantially completed Finance Plan and in coordination with the Finance Department. As the Finance and Project Plans for each TIRZ are updated, they will be presented to the Governance Committee, TIRZ Boards, and subsequently to City Council for review and consideration.

3. The TIF Unit in coordination with the Finance Department will review current TIRZ collection and disbursement procedures and will develop a draft policy on TIRZ collections and disbursements by June, 2014.

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We are committed to addressing the recommendations in the audit report and the plan of actions presented above.

Sincerely,

John Dugan, Director
Planning and Community Development

Date 3/21/2014

Troy Elliott, Director
Finance

Date 3-21-14

Peter Zanoni, Deputy City Manager
City Manager's Office

Date 3-21-14

Ben Gorzell, Chief Financial Officer
City Manager's Office

Date 3/21/14

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