



CITY OF KILLEEN

DEVELOPER FEES COLLECTIONS PROCESS AUDIT

Audit Report #24-02

A Report to the City of Killeen Audit Committee

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EXECUTIVE SUMMARY



AUDIT REPORT HIGHLIGHTS

Why Was This Audit Conducted?

The City Auditor performed this audit at the request of the Audit Committee to address concerns raised over the collection process for developer fees.

The City Auditor appreciates the cooperation of Development Services management and staff, Human Resources, Finance Department, and the City Attorney in the completion of this audit.

Developer Fees Collections Process Audit

Mayor and Council,

I am pleased to present this audit of the Developer Fees Collections Process.

Audit Objectives

The objectives of the audit were to: (1) assess the internal controls over Development Services' developer fees collections process; and (2) determine, if possible, the amount of developer fees not collected for the period under review.

Audit Results

The City Auditor's audit of Development Services' developer fees collections process identified several significant internal control weaknesses over the process, most notably the absence of standard operating procedures, lack of formal training, and operational silos, all of which were exacerbated by high turnover at the leadership level. Taken as a whole, these deficiencies contributed to a dysfunctional control environment that fostered pervasive inconsistencies in the documentation of project files and allowed for the non-collection of fees. We were not able to determine with certainty total fees not collected due to the lack of documentation. However, our analysis of Land Disturbance Permit fees and Construction Plan Review fees collected indicates that at least \$30,000 in fees for Construction Plan Reviews during the review period went uncollected. Further, although prior management at the division and department level were alerted to the issue in FY 2020, there was no evidence of corrective action taken at that time. At the time of the audit, current management had taken steps to address the issue, some of it prior to the audit, including the consolidation of both Planning and Engineering Divisions under Development Services, the transfer of all developer fee collections to Building Inspections, and the implementation of standard operating procedures to ensure all developer fees are collected and properly recorded prior to final project approval.

TABLE OF CONTENTS

INTRODUCTION	3
Background	3
FINDINGS AND RECOMMENDATIONS	7
Developer Fees by the numbers	7
Developer Fees not collected	9
How did this happen	10
What has been done	14
What else needs to be done	15
Recommendations:	16
VIEWS OF RESPONSIBLE OFFICIALS	17
OBJECTIVES, SCOPE AND METHODOLOGY	18
Objectives	18
Scope and Methodology	18
Statement of Compliance with Audit Standards	19

INTRODUCTION

The City Auditor conducted this audit at the request of the Audit Committee. The audit was requested due to concerns raised over the non-collection of certain developer fees.

The objectives of the audit were to: (1) assess the internal controls over Development Services' developer fees collections process; and (2) determine, if possible, the amount of developer fees not collected for the period under review. The scope of the audit focused on but was not limited to fees related to residential development projects approved for construction between FY 2019 and FY 2022.

Background

The general purpose of municipal fees is to allocate the cost of underlying services to the primary beneficiary of those services, in this case the developer, rather than to general tax revenue. The Texas Local Government Code, Chapter 9, Home-Rule Municipality delegates to Home-Rule cities the authority to assess fees, as appropriate to cover the cost of regulating.¹

Cost Recovery Study

In August 2000, the City Council authorized the outsourcing of a cost recovery study of developer fees charged for Planning services. The study concluded that the City was recovering approximately 14 percent of its Planning-related administrative costs through fees.

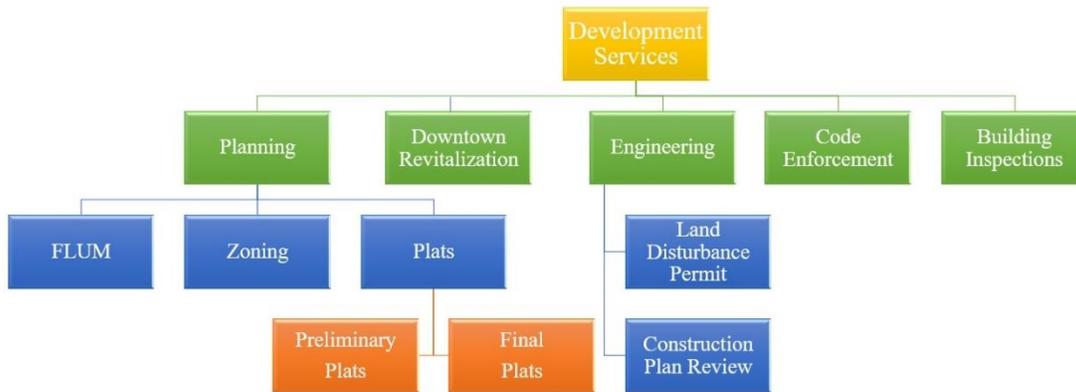
Since then, the City has amended its fee schedule on several occasions to increase certain fees, implement new fees, and in some cases eliminate fees. As of the implementation of its most recent fee amendment, which became effective October 1, 2023, management estimates its cost recovery of Development Services planning-related administrative costs at about 45 percent.

¹ The City of Killeen is a home-rule city. Home rule cities have broad authority to take actions not specifically prohibited or preempted by the Texas Constitution, state, or federal law. Under home-rule authority, courts recognize that cities may adopt regulations to promote the general welfare and may assess a fee if the fee is regulatory and the amount is based on the cost of regulating.

Development Services houses five divisions, as shown in the chart below. The Planning and Engineering Divisions oversee the land development and infrastructure phase, also termed *horizontal* development, while Building Inspections oversees the building construction phase, also termed *vertical* development.

Developer Fees Reviewed

The focus of this audit was on developer fees collected for services rendered by the Engineering Division, with the primary focus being on Land Disturbance Permit and Construction Plan Review fees charged for reviews and inspections conducted by the Engineering Division.



Source: Development Services

Land Disturbance Permits and Construction Plan Reviews are described below:

Land Disturbance Permit Fee



Established by ordinance in 2007, a land disturbance permit is required before land disturbance activity, and after approval of the preliminary plat. Land disturbance is defined as clearing, grading or excavating that disturbs one or more acres of land area.

Construction Plan Review Fee



Established by ordinance in 2015, a construction plan review fee is required for submission of construction plans for all proposed infrastructure to be constructed for the property once preliminary plat is approved and the land is cleared.

Project Develop Process - Overview

The chart below illustrates a development project as it winds its way through the planning and building phases. While requests for FLUM and Zoning changes are included, they are not always required.



Source: Development Services

Statement of Compliance with Audit Standards

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. Those standards also require that we, as internal auditors, meet the criteria for independence. We believe that we met those independence standards, and that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

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FINDINGS AND RECOMMENDATIONS

The City Auditor’s audit found internal control weaknesses were the root cause of the non-collection of developer fees. Management had initiated corrective action prior to the audit.

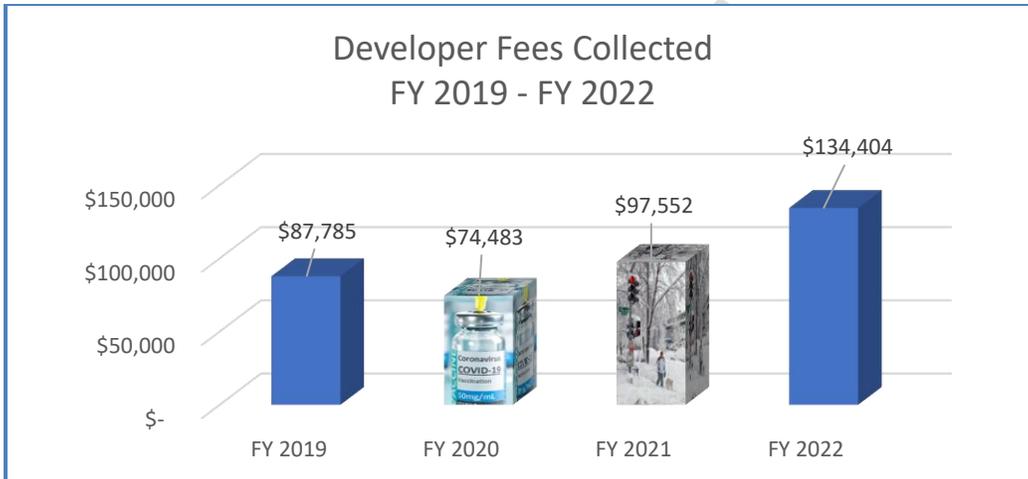
The City Auditor’s audit of Development Services’ developer fees collections process identified significant internal control weaknesses over the process, most notably the absence of standard operating procedures, lack of formal training, high turnover at the leadership level, and operational silos. Taken as a whole, these deficiencies contributed to a dysfunctional control environment that fostered pervasive inconsistencies in the documentation of project files and allowed for the non-collection of fees. We were not able to determine with certainty total fees not collected due to the lack of documentation. However, our analysis of Land Disturbance Permit fees and Construction Plan Review fees collected indicates an estimated \$30,000 in fees went uncollected for Construction Plan Reviews during the review period. While prior management was alerted to concerns over the collections process in FY 2020, there was no evidence of corrective action taken at that time. At the time of the audit, current management had already initiated corrective action, including the consolidation of both Planning and Engineering Divisions under Development Services, the transfer of all developer fee collections to Building Inspections, and the implementation of standard operating procedures to ensure all developer fees are collected and properly recorded prior to final project approval.

Developer Fees by the numbers

Prior to FY 2023, all developer fees, including those related to permits and plans submitted to the Engineering Division were collected by the Planning Division at the Municipal Court Annex. Because Planning was not set up to take payments by credit card, Planning staff took payments by check only, which were recorded manually in a receipts book. Deposits were then transported to Utility Collections for deposit.

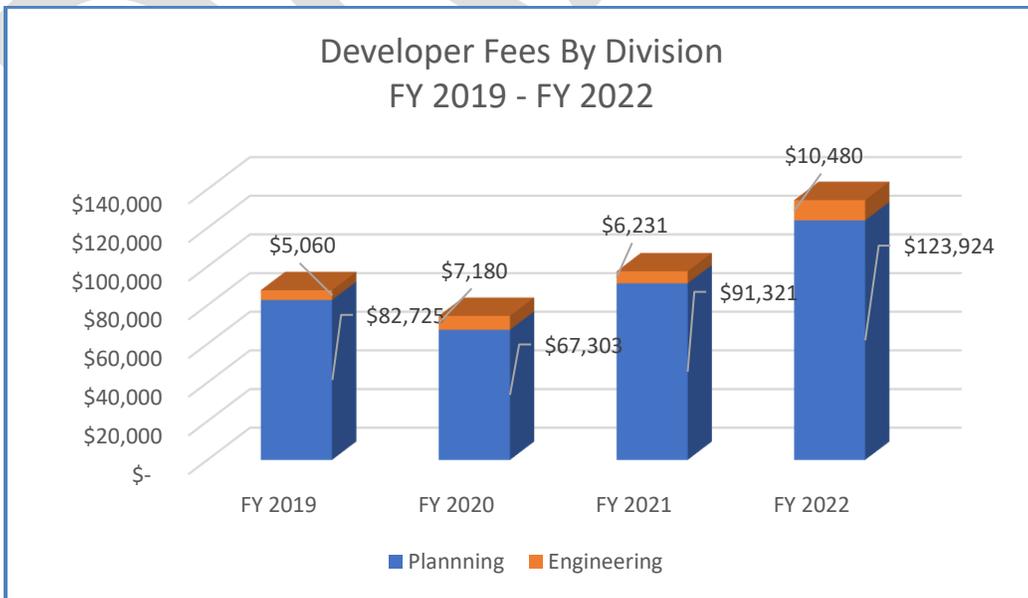
Fees Collected

We reviewed the receipts books for FY 2019 through FY 2022, including but not limited to payments for zoning and FLUM requests, preliminary and final plats, land disturbance permits, construction plan reviews, and various inspections. Developer fee revenue for the period totaled \$394,224, for an average of about \$100,000 annually.



Source: Development Services – Planning Division

The overwhelming majority of those fees, \$365,273 related to Planning Division activities, while \$28,951, or 7 percent overall were attributed to fees related to Engineering Division activities.



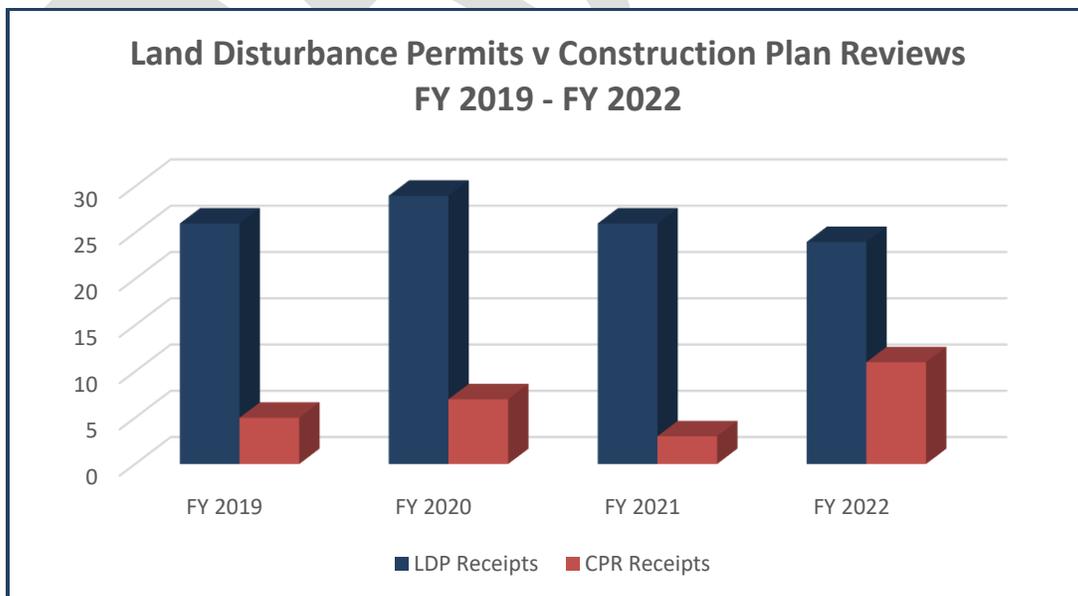
Source: Development Services – Planning Division

Developer Fees not collected

To determine developer fees not collected, we first attempted to identify which developer fees were not collected through a review of the project case files, focusing on subdivision residential projects. However, the inconsistencies in documentation maintained in the files were such that we were unable to determine with certainty which fees went uncollected.

We then turned to ratio analysis of fees paid per the receipts books to arrive at an estimated figure for uncollected fees. It was there that we noted a large disparity between payments received for Land Disturbance Permits as compared to payments received for Construction Plan Reviews. Specifically, the number of payments for Land Disturbance Permits far outnumbered those for Construction Plan Reviews.

While some of that disparity might be explained by timing differences in a particular year, over time one would expect to see something approaching a one-to-one ratio between the two fees. If anything, one would expect to see more Construction Plan Reviews than Land Disturbance Permits because not all development projects require the latter. Instead, we found the opposite to be true, as shown in the chart below.



Source: Development Services – Planning Division

While it is not clear when the trend started, it appeared to reach its apex in the FY 2020 and FY 2021 time frame. Current management corroborated the analysis, in part stating that it appeared in the past some developers were simply proceeding with construction without first submitting construction plans. In total, there were 115 payments for Land Disturbance Permits recorded during the period compared to 29 Construction Plan Reviews, for a difference of 86. Based on that disparity, we estimated approximately \$30,000 in Construction Plan Review fees went uncollected.

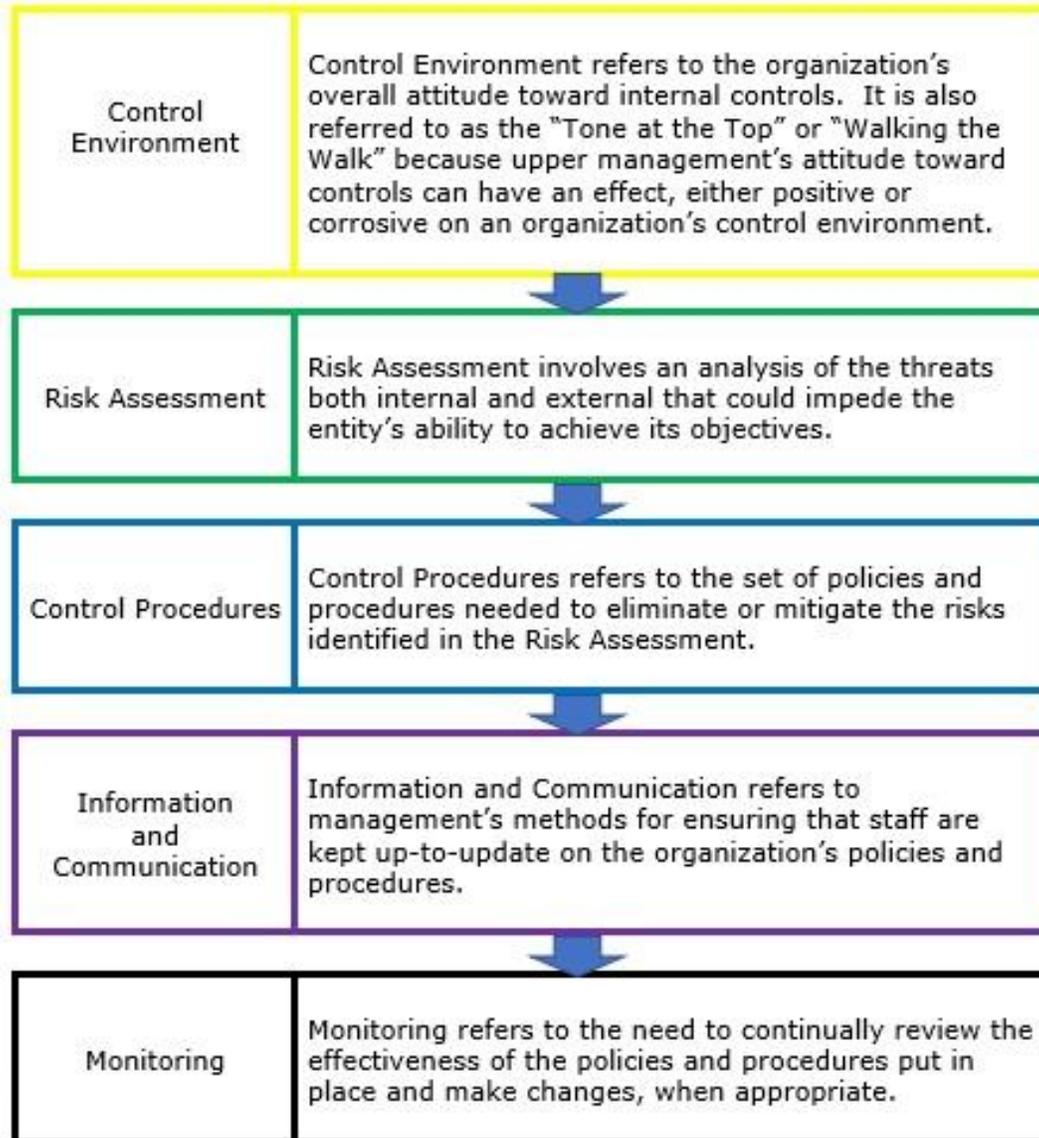
It should be noted that this is a rough estimate, and should be considered a conservative estimate, as it assumes that all Land Disturbance Permit fees were appropriately collected during period. It should also be noted that the variance in the two fees began to moderate in FY 2022 and had reached equilibrium in the first quarter of FY 2024, where Land Disturbance Permits and Construction Plan Reviews were at a one-to-one ratio.

How did this happen

The failure to collect fees was attributed to a breakdown in the internal control system, primarily due to a failure in leadership at both the division and department levels. There was no particular event that caused this, but rather a confluence of factors. These included the lack of standard operating procedures, the lack of a formal training regimen, and impact of operational silos, all of which were exacerbated by high turnover at the leadership level. The end result was a dysfunctional control environment that fostered inconsistencies in the documentation of project files and allowed for fees to go uncollected.

Internal Control System

Internal controls can be defined as a system designed to minimize an entity's risks, protect their assets, ensure the accuracy of their records, and ensure adherence to policies, rules, regulations, and laws. In 1985, the first conceptual model for an internal control system was created, which defined the following five components essential to a well-functioning system of internal controls:



Source: Government Accountability Office - "Greenbook"

Our review of the developer fees collections process indicated a breakdown in virtually all of these internal control components. What follows is an analysis of some of the significant events and problems encountered during the review and how they relate to specific components of the internal control system.

The Silo Effect

In FY 2017, the decision was made to pull Engineering staff involved in the development process out of the Municipal Court Annex on Avenue D and relocate them to the Public Works facility on W.S. Young. The decision made sense organizationally because Engineering fell under

Public Works at the time. Functionally, however, the decision was counterproductive in that Engineering staff work together with Planning staff throughout development life cycle.

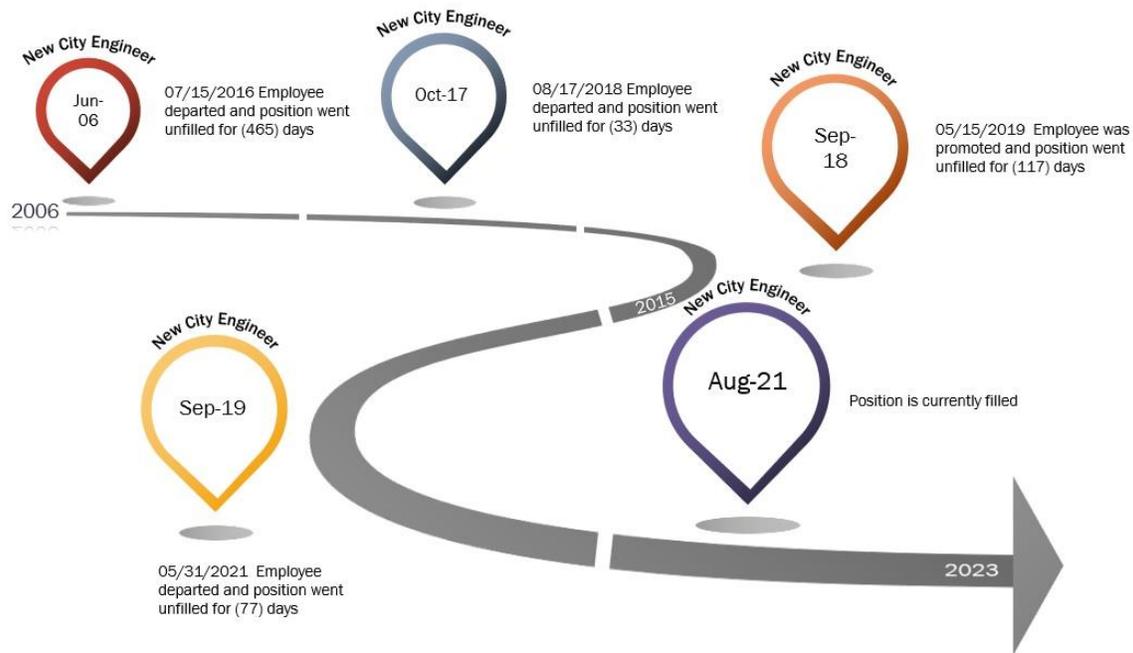


While the impact of the silo effect has been muted somewhat in the age of instant messaging and videoconferencing, it does nonetheless pose a challenge in terms of the fourth component of the internal control system, *Information and Communication*. Staff that were previously down the hall were now on the other side of town, creating the need to take steps to ensure the continuity of operations. Staff commented during the audit that the development process was more efficient when both Planning and Engineering staff were co-located.

The *Monitoring* component of the internal control system requires that whenever there are significant changes to the control environment, the system should be re-evaluated to identify any new risks and implement additional procedures, if necessary. The relocation of Engineering staff from the Municipal Court Annex to Public Works would certainly qualify as a significant change to the control environment.

High Turnover – Tone at the Top

The separation of Engineering staff from Planning staff ushered in a period of high turnover at the leadership level, where the division saw four City Engineers come and go in as many years. While it was likely coincidental to the move, the rapid turnover came at a crucial time, during which the Engineering Division should have been re-assessing its Risk environment, based on the relocation of staff and developing or strengthening internal controls over the fee collection process accordingly.



Source: Human Resources

Turnover was not confined to the leadership level, as there was turnover at the staff level as well, though not as dramatic. However, the failure to address the challenges posed by both the physical and organizational changes going on at the time lies with management at the both the division and department levels. The disruption in continuity due to the frequent changes in leadership during the period were likely a contributing factor.

Standard Operating Procedures and File Maintenance

At the time of the audit, the Engineering Division did not have fully developed standard operating procedures (SOP) in place for managing and documenting project files. According to staff, several City Engineers and Interim City Engineers had worked on developing SOPs during their brief tenures, but none were fully developed or implemented. SOPs relate to the third component of the internal control system, *Control Procedures*. These are the policies and procedures designed to eliminate or reduce the risks identified in the *Risk Assessment*.

The lack of procedural guidance for staff was evident in the review of the project files, which reflected pervasive inconsistencies in file documentation. The inconsistencies ranged from a few well-organized

and well-documented project files to project files with almost no documentation.

We reviewed project files for 33 completed subdivision developments and noted one or more missing applications in 26 of the 33 project files. Further, only four of the project files had proof of payment in the form of scanned receipts in the files. We did find checklists in several of the files, as some evidence of internal controls. However, the checklists were not consistently maintained. For example, some items on the checklists were marked as "NA," while others were left blank, begging the question as to whether unmarked steps were not applicable or not completed.

Wake-up Call Unheeded

In FY 2020, both department and division management were alerted in writing to problems with the collections process, in particular with non-collection of fees for Construction Plan Reviews. There is no evidence that department or division management took any corrective action at that time to address the concerns raised. Management's failure to act in this instance speaks again to the first component of the internal control system, i.e., "Tone at the Top." In this case, the message conveyed to employees, whether intended or not, appeared to be one of indifference regarding collection efforts. Not surprisingly, the problems continued unabated through FY 2020 and into FY 2021 until changes occurred in management at both the department and division levels.

What has been done

Development Services had already taken corrective action in some areas, and is currently taking corrective action in others, as follows:

- In late FY 2021, the Engineering Division was brought under Development Services, effectively eliminating the organizational silo, although Engineering staff are still physically located at the Public Works facility.
- In the first quarter of FY 2023, the Development Services Executive Director consolidated all fee collections under Building Inspections, which is tied into the financial management system, and can accept credit card payments, as well as checks.

- In the second quarter of FY 2023, Development Services coordinated with the Finance Department to establish separate revenue accounts for certain developer fees, including Land Disturbance fees and Construction Plan Review fees, which will allow for better tracking and enhanced transparency.
- In the first quarter of FY 2024, Development Services implemented My Government Online (MGO) permitting software to bring the permit application process online for permits issued by Building Inspections. Development Services and IT are currently working to expand the online permitting process to include Planning and Engineering permits in the second quarter of FY 2024. This should significantly enhance controls over the collection of developer fees.
- The City Engineer is currently implementing a more robust onboarding curriculum for Engineering staff, as well as developing SOPs, and implementing project checklists.

What else needs to be done

The above-mentioned actions appear sufficient to address the internal control weaknesses over the fee collection process cited in this report. However, management should also establish a process for monitoring its newly established controls to ensure they are achieving their intended outcome. Of particular concern is ensuring the healthy lines of communication between the divisions involved in the development process, including Building Inspections which now collects all fees on behalf the Planning and Engineering Divisions.

Finally, as mentioned in the introduction, in FY 2000 the City commissioned an independent cost recovery study of its developer fee structure. Management should consider the benefit of conducting another independent study to determine the cost recovery rate of the current fee structure.

Recommendations:

We recommend the Executive Director, Development Services:

1. Ensure the internal controls over the collection and recording of developer fees are monitored on a regular basis to evaluate their effectiveness and make changes where appropriate.
2. Consider commissioning an updated independent cost recovery study to determine the cost recovery rate of the current fee structure.

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VIEWS OF RESPONSIBLE OFFICIALS

Copies of the draft report were provided to the Executive Director of Development Services, the Assistant Director of Development Services, and the City Engineer. They agreed with the findings and recommendations, and their input during the audit is reflected throughout the report.

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OBJECTIVES, SCOPE AND METHODOLOGY

Objectives

The objectives of the audit were to: (1) assess the internal controls over Development Services' developer fees collections process; and (2) determine, if possible, the amount of developer fees not collected for the period under review.

Scope and Methodology

The scope of the audit focused on but was not limited to fees related to residential development projects approved for construction from FY 2019 through FY 2022.

To address the audit objectives, we:

- ▶ Held discussions with key personnel, including the Executive Director of Development Services, the Assistant Director of Development Services, the City Engineer, Engineering staff, Director of Building Inspections, Building Inspections Clerk Supervisor, Planning staff, the City Attorney, and the Finance Department's Budget Director.
- ▶ Obtained Letters of Release from the Engineering Division for subdivision residential projects approved during the review period.
- ▶ Reviewed and analyzed project files for residential subdivision projects closed during the review period.
- ▶ Obtained and analyzed Planning Division receipts books for all receipts recorded during the review period.
- ▶ Obtained from Human Resources information on management and staff turnover in the Engineering Division.
- ▶ Conducted research on all fee-related ordinances passed since 2000.

Statement of Compliance with Audit Standards

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. Those standards also require that we, as internal auditors, meet the criteria for independence. We believe that we met those independence standards, and that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

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