City of Killeen, TX

MANAGEMENT AUDIT

FINAL REPORT DATE

Thursday, August 31, 2017

McCONNELL & JONES LLP

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MJ
McCONNELL & JONES LLP
CERTIFIED PUBLIC ACCOUNTANTS

August 31, 2017

The Honorable Jose L. Segarra, Mayor
The Honorable Members of the City Council
City of Killeen, Texas

Dear Mayor Segarra and Members of the City Council:

McConnell & Jones LLP (MJ) is pleased to present the attached Final Report for the Management Audit of specific focus areas commissioned by the City of Killeen's (City) City Council.

Observations and recommendations included in the report will help the City address the public's questions regarding its financial condition and improve its overall financial management and control environment as it provides essential services to citizens throughout the community.

We applaud the efforts of City staff and management who worked tirelessly to provide data and context to enable us to successfully complete this management audit. Special thanks go out to the Audit Committee, City Auditor, City Attorney and City Manager for their assistance throughout this engagement.

Respectfully submitted,

Odysseus M. Lanier, Partner
McConnell & Jones LLP

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CITY OF KILLEEN
OFFICE OF THE CITY MANAGER

September 5, 2017

To Odysseus Lanier, Partner, McConnell & Jones LLP

Thank you for presenting your final Management Audit Report. Your recommendations will be very useful in creating a stronger financial environment for the City of Killeen. We appreciate your diligence in this effort to answer City Council's concerns. The organization and the public should be pleased to know that you found no evidence of fraud or abuse in your extensive review of a fifteen year period, encompassing Fiscal Years 2002 through 2017.

While I concur with the majority of your recommendations, I offer the following responses to some of your findings and conclusions.

CHAPTER 1—Executive Summary

This chapter contains a summary of the findings in Chapters 2 through 9, and therefore contains many of the same assertions that are addressed in detail below. Please see Management's response to each Chapter for detail.

CHAPTER 2—Financial Condition Analysis

No Management comments on this Chapter.

CHAPTER 3—Capital Outlays

Management agrees with the findings, with the exception of the following:

1. MJ states that it could not determine the specific causes of the 311 percent increase in General Fund capital outlay spending between FY 05 and FY 06, because the City could not provide detailed trial balance schedules. The City would like to clarify that MJ was provided all trial balance reports for all requested fiscal years but did not have the related audit work papers. MJ acknowledges that the documents were not required to be retained, though the City did have the documents for subsequent years. Subsequent to these fiscal years, the City Auditor began using a software program named Engagement that tracks and maintains that information, which is why it was available for subsequent years. City staff did request this information from the firm that performed the City's external audit for those years and the firm provided the relevant documents within its possession, which were then provided to MJ.

2. In reference to the 311 percent increase, every capital expenditure greater than $50,000 was approved by the City Council via Resolution, which is permanently retained, and can give insight into the reasons for the increase in capital expenditure spending between FY 2005 and FY 2006. A few of those expenditures are as follows:
    a. Police vehicle purchases totaling $672,671 approved by CCM/R 05-182R, 05-162R and 06-181R
    b. Fleet purchases totaling $390,967 for various general fund departments approved by CCM/R 06-73R and 06-121R
    c. Construction of the Andy K Wells Hike & Bike Trail in the amount of $460,318 approved by CCM/R 06-77R
    d. Various technology purchases totaling $214,305 approved by CCM/R 05-181R, 06-76R and 06-112R

Management agrees with the recommendations.

CHAPTER 4—Use of Bond Money

Management agrees with the findings.

Management agrees with the recommendations.

CHAPTER 5—Inter-fund Transfers

Management agrees with the findings.

Management agrees with the recommendations, with the following clarification:

1. Management plans to develop and implement policies governing inter-fund transfers, and the policies will distinguish between Operating Funds and Bond Funds and the different requirements that the Charter places upon the movement of funds between and among the two categories of funds.

CHAPTER 6—Pay Increases

Management agrees with the findings, with the exception of the following:

1. MJ misunderstood the timing of employee pay increases over two fiscal years. The timeline is as follows:
    a. In FY 2014, a 3% pay increase was granted to all City employees effective June 1, 2014. The budget was amended by $547,000 to fund the raises for the remaining four months of the fiscal year. The FY 2015 budget included $1,915,623 in funding to account for the full year's funding (12 months) of the FY 2014 3% pay increase.
    b. The City Manager's Message in the proposed FY 2015 budget book stated that a 5% civil service pay increase was included in the proposed budget, and this information was presented to Council during workshop discussions.

c. City Council requested and reached a consensus at the July 22, 2014 workshop to fund an additional 3% pay increase for civil service employees. When combined with the FY 2015 5% raise, the total FY 2015 civil service pay increase was 8%.

2. MJ notes an increase of 31 full time employees between fiscal years 2014 and 2015. This increase is over two fiscal years (24 months). All new positions are itemized with cost in the City Manager's Message in the proposed and adopted FY 2014 and FY 2015 budgets. Positions are approved by city council with adoption of the budget.
3. MJ states "Accordingly, we believe that the eight percent civil service employee pay increase in October 2014 did not align with the recommendation included in the consultant's compensation study and should have been five percent." The consultant can only offer a recommendation, and Council is not required to follow that recommendation. It is also important to note that the compensation study showed that police employees were 8% below market and fire employees were 13% below market.
4. MJ states "the specific percentage of the pay increase was not documented in minutes of the August 12, 2014 meeting." The consensus was reached at the July 22, 2014 workshop. Minutes are not made at workshop meetings, however, there is an audio recording of the workshop.
5. Management disagrees with the description of the AS400 System. The City's enterprise software system (Superion AS400) provides more than described and is electronic, not manual. The screens display each person's employment profile, current salary, and historical salary records and an accompanying explanation for changes in those records. Access is electronic, not manual.
6. Management notes that the four pay errors related to application of the three percent city-wide increase that were identified by MJ were caught and corrected during the subsequent pay cycle.

Management agrees with the recommendations, with the exception of the following:

1. The assignment of position control requires more study to determine whether it will be most effective in the human resources or finance department.

CHAPTER 7 - City/Owner Agreements

Management agrees with the findings, with the exception of the following:

1. MJ observed that four listed developers were used for more than 60% of the City/Owner agreements during the selected period of time and that they are responsible for a large portion of development city-wide during this time period as well. Management would clarify that developers are not chosen for City/Owner agreements based on preference or anything other than the fact that they own the property being developed that is subject to master plans requiring oversizing.
2. Management agrees that the City should assess the cost/benefit of the prospective City/Owner Agreement, and clarifies that it does conduct a cost/benefit analysis as indicated in the CCMR associated with each agreement. A Developer is required to delineate public benefits and provide discrete oversizing costs for the proposed project. A project evaluation is then performed by Public Works/Engineering staff, which includes vetting of all proposed unit costs and rates comparing other known project costs for similar work among local developers and bid tabulations from recent similar capital improvement projects. Staff also notes the generally accepted cost benefit of paying for oversizing at the time of private development rather than

allowing the developer to construct improvements at a lower service level and then tearing them out later to construct properly sized improvements needed for future development in conformance with the master plans.

Management agrees with the recommendations, with the exception of the following:

1. Management agrees that long-range planning is desirable, however, the City/Owner Agreement is difficult to fit into this process as the City does not control when private development will occur. Using only long-term planning would leave the City without the ability to obtain properly-sized infrastructure while recognizing significant cost savings if designed and constructed at the same time as the private development.
2. Management agrees that it is prudent to establish a dollar threshold that triggers an audit of the owner's financial records related to amounts expended under the Agreement, and will add that provision to future City/Owner Agreements once the threshold is established.
3. Management recognizes that the title "City/Owner Agreement" is misleading, and will recommend to the City Council that the title of the agreements be amended to clarify that they are Upsizing Agreements.

CHAPTER 8—Roadway Ownership

Management agrees with the findings, with the exception of the following:

1. While MJ states that the City does not include the costs of upgrading annexed county roads in its long-term planning, Management would clarify that the City does consider county roadways in its transportation master planning efforts. Upgrading costs are identified in the Transportation Master Plan; however, Management agrees that those costs should also be included in the formal annexation report.
2. MJ states that private roads are included in annexations at times. While this is true, Management would note that private roads retain their private status after annexation and do not become the property or responsibility of the City without further action by the private landowner and the City to convey a legal interest in the road to the City. Much as a privately-owned building would retain its private ownership upon annexation by the City, so too would a privately-owned roadway.
3. MJ delineates the two annexations that include annexation of county roadways as "roadway annexations." Management would clarify that most of the property annexed in these annexations does not consist of roadway. While the focus of this chapter is on the annexation of roadways, it is important to place the discussion in the correct context. The City does not set out to annex roadways in particular but to annex land. The purpose of annexation is twofold: 1) to control development and 2) to expand the City's tax base. Texas Local Government Code Sec. 43.106 now requires annexation of the entire width of county road if the City annexes any portion of the territory abutting the road. While the cost to upgrade and maintain a road is a factor in the annexation of the larger property, it is not the primary factor in the decision to annex, or not annex, property.
4. MJ states that staff adds or removes roadways based on the best knowledge of professionals performing the review. Management would like to clarify that any roadway that is annexed is included in an annexation ordinance which includes a legal description of the property and is approved by City Council.

5. Management would like to clarify that the Cityworks system currently captures maintenance by roadway.

Management agrees with the recommendations, with the exception of the following:

1. Large scale repairs and maintenance such as the recommended $1M threshold are considered capital maintenance, and would be handled as part of the CIP plan. Management agrees that the adoption of an annual work plan will aid in the transparency of street maintenance; however, deliberate discussions must be held to allow for the proper reaction to situations that arise. For example, in a hot and dry year excessive cracking will occur in the streets. It is necessary to adapt as conditions change and shift portions of maintenance dollars toward crack sealing to prevent contamination of the base structure of the roadway.
2. MJ notes that the City has not executed formal roadway annexation agreements, and recommends that the City do so. There is no legal requirement or practical reason to execute a roadway agreement separate from the annexation itself. Annexation of county roads follows a different process than when private roads are conveyed to the City by deed, dedication, or other agreement to memorialize the transfer. Once a public county roadway is annexed by the City, the ownership of the road and therefore the responsibility to maintain the roadway transfers from the County to the City without the need for a separate agreement between the City and anyone else related to the roadway. Once the transfer to the City has taken place, the former County road is placed in the City's roadway inventory along with all other City roads and its maintenance and reconstruction is analyzed and prioritized along with every other City road. The roadways annexed by the City in 2004 and 2008 were long ago placed in the City's inventory, assessed and largely improved.

CHAPTER 9—Post-Recall Period Spending

Management agrees with the findings.

Management agrees with the recommendations, and notes that it is has already complied with the following:

1. As soon as it was brought to the attention of the City Manager's Office that some City departments were using QuickBooks, it was immediately halted.

Respectfully Submitted,

Ronald L. Olson
City Manager, City of Killeen

EXECUTIVE SUMMARY

The City of Killeen (City) is established as a council-manager form of government. Under this form of government, the City's residents elect each of the seven city council members. The city council is responsible for legislative functions and appointing the city manager, city auditor and county judge. Legislative functions include setting the City's overall vision, establishing policy, passing local ordinances, establishing administrative offices, and adopting annual budgets. The mayor and all city council members serve two-year terms, with a three-consecutive-term limitation for each office. The city manager is responsible for the City's administrative functions; implementing City Ordinances; and hiring City staff. The mayor holds an elected position that presides over the city council, and is recognized as the head of the City of Killeen government for all ceremonial purposes and recognized by the Governor of Texas for purposes of military law. The mayor does not have an executive function or administrative powers.

Background

The City of Killeen experienced rapid growth during the past decade. According to the U.S. Census, the city's population grew from 86,911 residents in 2000 to 140,806 as of July 1, 2016. According to the Texas Water Development Board, the city's population growth is expected to continue with projections of 153,371 residents in 2020; 177,572 in 2030; 203,934 in 2040; and 283,732 in 2070. This growth is good for all citizens and the local economy. However, sustainable growth requires sound planning to ensure that adequate services are provided to all citizens. These services include, but are not limited to, providing utility, water, drainage and roadway infrastructure; maintaining public safety through fire and police; and providing parks and recreation services.

Providing these services to citizens requires significant revenues that are generated through property taxes, sales taxes and fees. Cities also use debt financing instruments such bonds and certificates of obligation (CO) as a method to finance capital improvement projects.

Events leading up to the audit

In May 2011, the City of Killeen voters exercised their right to hold a recall election of five city council members.[1] The recall election was held on November 8, 2011, and all five city council members were recalled.

In addition to the recall, the City experienced a period of significant turmoil and turnover within the ranks of the City's leadership, including the city manager, finance director, city auditor and various department directors. This period of volatility in the City's leadership fostered an environment of suspicion and mistrust in the community, which peaked with the City's unexpected $8 million shortfall in its proposed budget for FY 2016.

Transparency, trust and strong management principles are the foundation of effective government. Support for tax increases, bond issuances, and capital projects are affected by the community's perception of its city government. Bond agencies look at financial operations and management

[1] *Community members have the right to "recall" city council members when they are unhappy with decisions being made or actions being taken. A recall is a formal process whereby voters can hold a non-partisan election to remove individuals from the city council once the proper procedures are followed which starts with obtaining signatures equating to more than one-half the number of votes cast in the previous election.*

strategy to determine the City's bond rating, which influences interest rates paid on debt financing instruments such as bonds, CO's and bank loans.

In an effort to enhance transparency and help repair the City government's credibility, the city council authorized the city manager to contract with McConnell & Jones LLP (MJ) to conduct a thorough, risk-based analysis, targeting long standing issues, both before and after the recall election that were believed to have contributed to the City's current financial condition. The purpose of the audit was to determine if fraud, and/or gross mismanagement existed, and quantify, if applicable, the City's financial losses relative to identified incidents. The city council identified the following focus areas and periods as the scope of the management audit:

1. ***Capital Outlays (Scope Period FY 2006 – FY 2016):*** Conduct an analysis of the City's significant capital projects during the period FY 2006 through FY 2016 to determine if fraud and/or gross mismanagement exist, and determine the following:
   a) What were the reasons for the dramatic increase in spending?
   b) How were these capital projects financed (e.g., bond issuance, federal/state grants, general fund reserves)?
   c) Were there significant cost overruns (change orders due to renovations, etc.)?

2. ***Use of Bond Money (Scope Period FY 2002 – February 2017):*** Review the City's major bond issuances from FY 2002 to present to determine the following:
   a) Were bond funds spent legally and for the purpose for which the bonds were approved? (e.g., were idle funds used for other purposes)
   b) Were funds remaining after project completion, if any, used appropriately and legally?

3. ***Inter-Fund Transfers (Scope Period FY 2002 – FY 2017):*** Review the significant transfer of funds between the Enterprise Funds, Special Revenue Funds and the General Fund to determine the following:
   a) Were the transfers from restricted funds allowable and legal?
   b) Were the transfers authorized?
   c) Are the City's policies governing inter-fund transfers adequate to prevent the misuse or misallocation of restricted funds?

4. ***Pay Increases:*** Review the City's fiscal planning for the short-term funding and long-term impact of the three percent City-wide cost of living adjustment (COLA) and the eight percent pay adjustment for civil service (public safety) positions implemented in June 2014 and October 2014, respectively.

5. ***Analyze City/Owner Agreements (Scope Period FY 2002 – FY 2016):*** Review the City's City/Owner Agreements to determine if the City's participation is in keeping with best practices.

6. ***Private (Non-City) Roadway Ownership (Scope Period FY 2002 – FY 2016):*** Review City's participation, if any, in private (non-City owned) road way maintenance/improvement. Compare the City's roadway ownership and City's participation to best practices to assess the overall efficiency of the City's arrangements. [Comment: Although "Private" was used in the original

statement of work, council's intent was to focus on non-City owned roads, be they private or county-owned.]

7. ***Spending During Post Recall Period (Scope Period November 2011 – May 2012):*** Review significant expenditures during the six-month period without a fully seated city council to determine the following:

   a) Did city council ratify expenditures, as required?

   b) Is there any evidence of fraud or abuse of funds during the period?

This report provides our answers to these questions based upon interviews, inquiries, and our review of the facts and supporting evidence. The report provides detailed schedules, analysis and recommendations for improvement where appropriate. This report is organized in the following sections:

Chapter 1 – Executive Summary – Contains a brief background about the City of Killeen, the purpose of the management audit, and summarizes our conclusions.

Chapter 2 – Financial Condition Analysis – Contains our analysis of the City's revenues, expenditures and fund balances between FY 2007 and FY 2016. This analysis is based upon financial information included in the City's Comprehensive Annual Financial Reports (CAFRs) and trial balance reports.

Detailed Discussion of the Seven Focus Areas:

Chapter 3 – Capital Outlays

Chapter 4 – Bond Money Usage

Chapter 5 – Interfund Transfers

Chapter 6 – Pay Increases

Chapter 7 – City Owner Agreements

Chapter 8 – Roadway Ownership

Chapter 9 – Post-Recall Period Spending

Summary of Audit Results and Conclusions

The City's $8 million budget shortfall presented to city council on June 30, 2016, was based on the budget preparation methodology and is not an actual monetary shortfall. The June 30, 2016 budget presentation was based on a projection that did not reduce anticipated expenditures to match anticipated revenues to balance the budget. This budget projection was developed using the same methodology applied in prior years under different leadership. This methodology budgeted a higher level of expenditures than revenues in anticipation of actual revenues being higher than anticipated, and actual expenditures being lower than anticipated.

Our analysis of the City's financial operations revealed that the City did not reduce the General Fund's operating expenditures to align with operating revenues generated each fiscal year. This deficit spending in the General Fund began in FY 2008 and continued through FY 2016. Between FY 2007 and FY 2016, operating expenditures in the City's General Fund exceeded operating revenues by $81.6 million before transfers in from Enterprise Funds. This deficit was reduced to $3.1 million after transfers in from Enterprise Funds. We noted that the City's General Fund budget deficit is attributable to the following major factors:

- ✓ The City budgeted for a deficit in its General Fund each years since at least FY 2003, which is similar to other cities. However, while most cities actual activities resulted in revenues exceeding expenditures, we noted that the City's actual activities resulted in expenditures exceeding revenues in FY 2007 through FY 2016.

- ✓ Expenditures related to governmental activities, specifically in public safety, doubled over the past 10 years. The majority of public safety expenditures are salaries and benefits for employees in the Fire and Police Departments. Annual increases in public safety expenditures were disproportionate to revenue increases in the General Funds in FY 2009, FY 2012, FY 2013 and FY 2016. Additional positions were hired in response to the City's population growth. The additional fire stations and police department headquarters were paid through bond funds and certificate of obligations, therefore these capital project expenditures do not contribute to the public safety expenditure increases within the General Fund.

- ✓ Outstanding debt for governmental activities increased dramatically over the past 10 years. The City's percentage of debt to total net position (including Governmental Funds and Enterprise Funds) has increased to 130 percent in FY 2016 from 49 percent in FY 2007. This debt increase is contributed to capital projects such as adding infrastructure; renovating facilities and new buildings.

- ✓ The City entered into grant agreements that required significant matching funds or commitments for future salaries. These decisions did not consider the long-term financial impact on the General Fund.

- ✓ The eight percent pay adjustment approved for civil service (public safety) employees in 2014 was not included in the FY 2015 budget and resulted in a $2.4 million budget amendment to cover the additional salary expenses incurred.

- ✓ The City's Fund Balance and Operating Reserves Fiscal Policy Statement adopted on September 27, 2011 is not clear on the formula and financial transaction types that should be used to calculate the required fund balance percentages. The policy states that the City will strive to maintain fund balances as a percent of operating expenditures. The policy also states that the City will avoid utilizing such assigned [funds assigned or committed for facilities replacement and equipment] or committed fund balances for operational expenditures.

  These statements imply that the total operating expenditures identified in the CAFR would be used as the amount to calculate operating expenditures. However, the CAFR operating expenditures section includes capital outlay and debt service payments that are not normally considered operating expenditures and would normally be identified on the CAFR as non-operating expenditures.

  The CAFR Statement of Net Position unrestricted fund balance includes deferred outflows of resources and deferred inflows of resources according to GASB requirements. This provides for the long-term financial obligations, including amounts identified as future pension obligations.

Because the policy is not clear and the CAFR includes non-operating expenditures in the operating expenditures line the fund balance amounts required to meet policy requirements using the CAFR operating expenditures' totals results in higher funds required to meet the City's policy.

The Finance Department calculates the fund balance percent of Enterprise Funds based on working capital which is current assets less current liabilities. The working capital formula results in less funds required to meet policy requirements. While this difference is usually less than one percent it demonstrates a need to clarify the City's fund balance policy to include the formula and specific transaction types that must be included in the formula.

Additionally, we noted the following with respect to the City's Enterprise Funds:

- ✓ Expenditures in Enterprise Funds increased and outpaced the increase in revenues.

The following is an accounting entry that does not impact the City's General Fund deficit but does have an impact on the Governmental Fund group's net position.

- ✓ GASB 68 required the city to recognize $53.1 million in Net Pension Liabilities. The adjusting entry resulted in the governmental activity's fund balance decreasing to $9 million in FY 2015 from $75 million in FY 2014.

Although the General Fund experienced deficits each year, **no instances of fraud or abuse came to our attention based on documents provided and tested by us for the seven focus areas of this audit.**

We noted that overall, City staff demonstrated a desire to perform their tasks in accordance with their assigned responsibilities and established polices. Many of the City's current staff began working for the City while it was a small municipality and have done their best to meet the growing demands associated with population growth and the respective service level requirements for its citizens. However, leadership in place during this growth period did not establish policies and procedures to accommodate the City's growing needs and responsibilities.

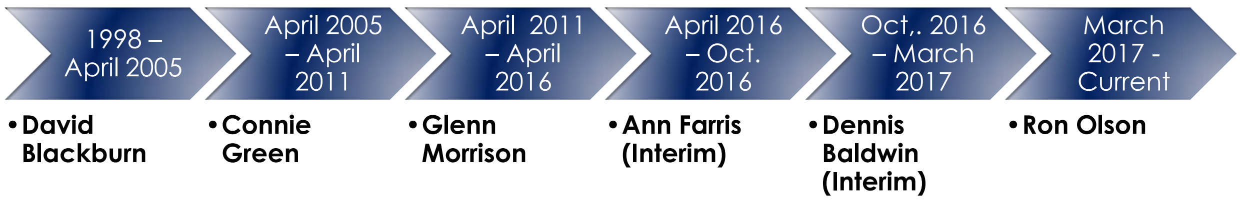
While we noted a weak internal control environment and a few instances of errors or non-compliance, overall City staff processed transactions in compliance with the City's existing policies.

City Leadership during the Audit Scope Period

In addition to different city council members and mayors governing the City during the audit scope period, the City has also had several different city managers and finance directors. Some of the city managers served as interim city manager before they were appointed to the position permanently. One city manager was the City's finance director for 10 years before becoming the city manager.

In any organization, when there is a change in leadership there is also a change in policy, procedures and processes. The City's frequent leadership changes follow these common practices. However, the number of changes that have occurred in a relatively short period of time created inconsistencies in focus, directives and processes. More significantly, the City is embroiled in a shroud of mistrust because of past management decisions and the departure of former employees under less than favorable circumstances; which has led to an overarching environment of internal and external mistrust. **Figure ES-1** on the following page provides a timeline of city managers and finance directors who served the City during the scope period of the management audit.

City Manager Historical Timeline



Finance Director Historical Timeline

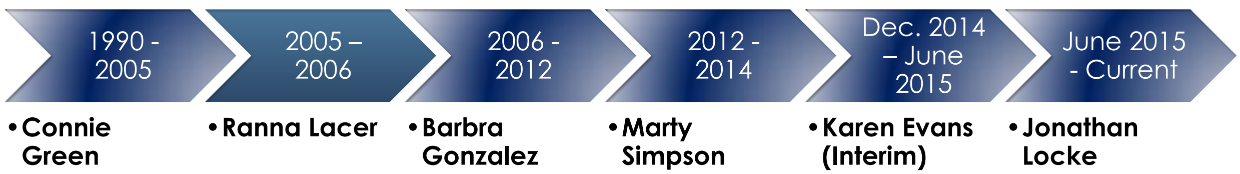


FIGURE ES-1 – City Leadership Timeline. *The City had six different city managers and six different finance directors during the management audit's scope period.*

Internal Control Environment

Internal controls are built around policies, people, processes and technology. Transparency and ethical culture is built upon the foundation of strong policies, enforcement of the policies and experienced, qualified staff. We noted an overall weak internal control environment that poses a risk that fraud could occur and possibly go undetected. In many instances, less than optimal internal controls, policies and processes that were in place many years ago have not been reviewed, strengthened or updated. For example:

Policies – Well-written policies must be in place to govern operations and decision making. The policies must define expectations and be detailed enough to provide criteria and basis for decisions. Additionally, all policies must be reviewed and updated on a regular basis. Well-written policies do not exist for most key functions and operations. As a result, we noted the following:

- ✓ Enterprise Funds to not have written policies to govern operations. Policies should be in place to describe allowable expenses and establish criteria for when Enterprise Funds can be transferred to other funds. Policies should also describe if it is appropriate to make loans to other funds, and under what terms and conditions loans are allowable.

- ✓ Debt policies do not exist to provide guidance to the City management with regard to how much debt can be incurred; under what conditions debt can be incurred; and how debt proceeds will be used and monitored.

- ✓ Salary payment policies did not exist to describe the effective date or period when employee pay increases will be applied and under what conditions, if any, retroactive pay increases will be allowed.

People – Organizations must have the right number of people employed to manage the transaction volume and provide for adequate segregation of duties. All people employed should possess the knowledge, skills and experience necessary to accomplish their assigned duties and responsibilities.

- ✓ While the scope of this audit did not include a staffing assessment we noted that there is a need for the City to assess its staffing levels, capabilities needs and current skills in order to implement the changes required to better manage the City's operations and enhance internal controls.

Processes – Processes must be in place to ensure accountability, completeness, accuracy, transparency, compliance and efficiency. Processes are dependent upon policies. We noted that the lack of written policies has created some processes/practices that could be considered questionable, including:

- ✓ Failure to maintain some documents and data according to state records retention requirements.

- ✓ Failure to document discussions with bond counsel regarding guidance obtained related to the appropriate use of bond proceeds for specific types of expenditures

- ✓ The City's Aviation Department maintaining a separate set of books (i.e., accounting system) outside of the City's SunGard financial system. The Aviation Department's uses this independent system to track expenses and issue monthly invoices to their customers. The Aviation Department also has payments mailed directly to them and then provides the City with high-level data to record the transactions in the City's financial system. The Aviation Department justified using the separate accounting system because, in the department's view, the City's finance staff had not set-up the financial system to meet the Aviation Department's needs.

  The Killeen Civic and Conference Center (KCCC), Volunteer Services, Senior Center and Cemetery also maintained a set of books outside of the City's SunGard financial system. Maintaining a set of books outside of the City's financial system is a significant weakness in internal controls.

- ✓ The Finance team frequently added new accounts to record transactions because they were not able to understand how former staff established and used certain accounts. This has led to convoluted recordkeeping and an unwieldy chart of accounts. It also poses a risk that manipulation of financial transactions could occur and go undetected.

- ✓ The City lacks policies to manage risks related to journal entries. We noted many journal entries in our testing sample were made without support documents such as purchase orders, receiving reports, payment vouchers, and reports of the pre-and post-journal entry account balances.

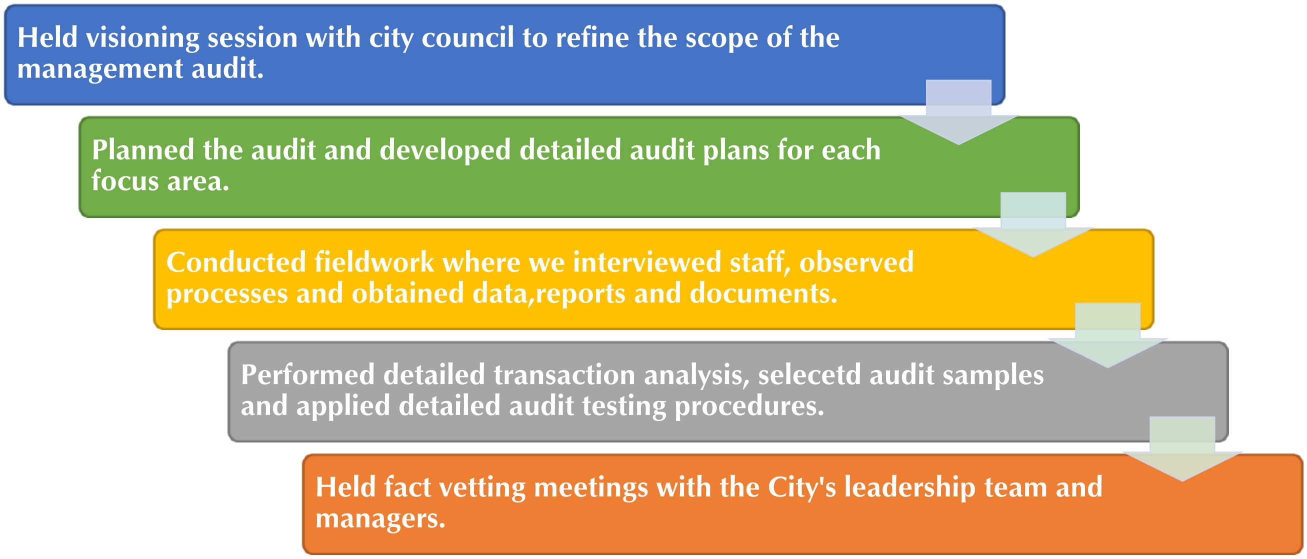
Technology – Technology includes hardware and software systems. Organizations must have the appropriate hardware and software in place to ensure that staff can effectively and efficiently complete their assigned tasks. Financial software must ensure completeness, accuracy and provide audit trails. Financial software must also be implemented so that adequate segregation of duties exists to prevent intentional manipulation of data. An organization must have adequate technology in place for staff to effectively and efficiently complete their tasks. Financial systems must also ensure that appropriate controls are in place to ensure transactions are recorded and maintained with complete audit trails. We noted the following with regards to the City's financial system:

- ✓ The City's financial system runs on an old platform (AS400) that has limitations on the amount of data that can be maintained.
- ✓ City staff do not fully utilize the capabilities of the City's financial system due to not having necessary training on the system. As a result City staff have created many "work-arounds" outside the financial system to complete necessary tasks. This includes maintaining electronic Excel spreadsheets outside of the system.
- ✓ While the City's financial system defines user roles, and has the capability of creating user roles so that appropriate segregation of duties exists, staff have not maximized its use of this capability. The City does not have a fully integrated Enterprise Resource Planning System (ERP) that addresses key City functions (i.e., Finance, Accounting, Procurement, Human Resources, Community Development and Public Works). As a result City staff needed to create electronic Excel spreadsheets outside of the finance system to complete necessary tasks.

Audit Methodology

We conducted this audit in accordance with the generally accepted government auditing standards (GAGAS). 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 for this audit provides a reasonable basis for our observations and conclusions based on our audit objectives.

We conducted the audit in the following steps and then prepared a draft report for management review and response.



Each chapter of this report contains the detailed audit methodology applied to accomplish the stated audit objectives. However, we applied the following methodology for each of the seven focus areas:

- ✓ Developed detailed risk assessments and audit plans for each focus area.
- ✓ Interviewed current and former City employees.
- ✓ Obtained and analyzed the City's Comprehensive Annual Financial Reports (CAFRs) for FY 2002 through FY 2016.
- ✓ Obtained and analyzed the City's detailed trial balance reports for FY 2002 through FY 2016.
- ✓ Reconciled the City's FY 2002 through FY 2016 detailed trial balances to the FY 2002 through FY 2016 CAFRs.
- ✓ Reviewed the City's budgets for FY 2010 through FY 2016.
- ✓ Obtained and analyzed transaction reports for each of the seven focus areas.
- ✓ Listened to audio tapes of city council workshops held during the focus area periods.
- ✓ Reviewed City Ordinances.
- ✓ Obtained and reviewed City and department policies and procedures.
- ✓ Selected judgmental samples for detailed audit testing procedures.
- ✓ Obtained and applied audit testing procedures to supporting documents, reports and data files.

Summary Conclusions for the Seven Focus Areas

The scope of the management audit and resulting analysis and audit testing procedures focused on addressing the following questions or directives provided by city council in the scope of work and refined in the visioning session held with city council on March 21, 2017. The following summarizes our audit conclusions for each of the focus area questions.

Capital Outlays *(Scope Period FY 2006 – FY 2016):*

#	Question	Conclusion
1	Determine if fraud and/or gross mismanagement exists.	No instances of fraud and/or gross mismanagement came to our attention during the course of our work. However, capital outlay project accounting and reporting require strengthening to prevent or discourage fraud and/or gross mismanagement from occurring.
2	What were the reasons for the dramatic increase in spending?	We were unable to determine the specific causes of the 311 percent increase in General Fund capital outlay spending because the City could not provide the information necessary to conduct the analysis. We requested the detailed trial balances schedules for FY 2005 and FY 2006, which shows the account groupings that support capital outlay amount in question. These work papers would have allowed us to analyze the differences in the underlying accounts to isolate the causes of the variance. Without this detail, the reasons for the 311 percent increase cannot be determined. Finance staff could not provide an explanation of why the work papers could not be located. However, the City is not in violation of its records retention policy since the information was only required to be retained for three years after all audit issues had been resolved. As an alternative procedure, we performed a review of subsequent year General Fund capital outlay spending noting that such expenditures did not correspond to the City's definition of capital outlay, namely the acquisition; construction; renovation; and upgrade of streets, roads, buildings, communication systems, and public safety, drainage, solid waste, and various public works facilities. The General Fund capital outlay expenditures we examined for subsequent years consisted of equipment, furniture and fixture, and vehicles. It is not unusual for the General Fund to purchase these types of fixed assets.
3	How were these capital projects financed (e.g., bond issuance, federal/state grants, general fund reserves)?	Bonds comprise 87 percent of funds for capital outlay for bond-funded projects. From FY 2006 through FY 2016, certificates of obligation, general obligation bonds, and revenue bonds comprised 61 percent, 21 percent, and 18 percent of bonds issued, respectively. Passenger and customer facility charges comprise 68 percent of funding for non-bond projects. Bell County child safety fees comprise 12 percent of non-bond funded projects, while various contributions comprise 11 percent, and transfers from other funds comprise 8 percent of funding for non-bond projects.

#	Question	Conclusion
4	Were there significant cost overruns (change orders due to renovations, etc.)?	There were no significant cost overruns for the 12 projects in our sample. We selected also selected a sample of 8 change orders constituting 40 percent of the value of change orders for the projects selected. No exceptions were noted.

Use of Bond Money *(Scope Period FY 2002 – FY 2017):*

#	Question	Conclusion
1	Were bond funds spent legally and for the purpose for which the bonds were approved? (e.g., were idle funds used for other purposes)	We reviewed approximately $3.4 million in costs that were paid by bond funds between FY 2002 and February 2017 that did not appear consistent with the authorized purpose of the bond. Based on our further assessment of this amount, $3 million (89 percent) was deemed to be inconsistent with the purpose of the bond, $240,416 (7 percent) was consistent with the purpose of the bond, and $115,153 (3 percent) was undeterminable. To place the total $3.4 million in perspective, it represents approximately one percent of total bond expenditures during the scope period of $356.5 million. We evaluated all bond fund transfers greater than $30,000, identifying. $17 million in bond transfers. We deemed $13.4 million, or 78 percent of the transfers to be consistent with the purpose of the bond making the transfer. We noted $488,300, or 3 percent, that did not appear consistent, and $3.2 million, or 19 percent that were indeterminable. This analysis is presented in **Figure 4-17.** The City's process for approving bond transfers is to include the respective bond transfers in the fiscal year budget adoption or approve a budget amendment through an ordinance. Additionally, Section 71 of the city charter allows the city manager to initiate and approve transfers. We deemed transfers that were not approved or amended by a budget or not initiated by the city manager to be unapproved. The City's process for approving bond transfers is to include the respective bond transfers in the fiscal year budget adoption. Thus, if a transfer is not included in the respective fiscal year budget, we considered it to be an unapproved transfer. Of the $17 million bond transfers evaluated, we noted $14.5 million, or 85 percent, that were properly unapproved $2.4, or 14.3 percent that we deemed not properly approved, and $101,865 that were undeterminable. .We could not account for $3.2 million, as depicted in **Figure 4-15**, in funds transferred into two bond funds from the Aviation Passenger Facility Charge Fund #529. We noted funds being transferred into the bond funds but could not trace the transfer out of the Aviation Passenger Facility Charge Fund. Management represented that it could be a case of misclassification by City Finance staff employed at the time, but could not be certain since 97 percent of the

#	Question	Conclusion
		transfers occurred between FY 2005 and FY 2009. To put fund transfers into perspective, they do not represent an exchange of physical cash but a reassignment of claims on cash between or among funds on the City's books. We also noted that the City was in violation of its bond document retention requirements for bond fund 344-2012/CO (See **Figure 4-18**). We were unable to trace the initial proceeds of the bond fund to the investment statements because the statements were not available. According to the City's retention schedule, the investment statements should have been retained at least through August 2017.
2	Were funds remaining after project completion, if any, used appropriately and legally?	We noted two bond funds with total remaining balances of $488,300 that were transferred to other funds that did not appear to have a consistent purpose with the bond. These transfers were discussed in the previous objective.

Interfund Transfers *(Scope Period FY 2002 – FY 2017):*

#	Question	Conclusion
1	Were the transfers from restricted funds allowable and legal?	City Charter authorizes the city manager to initiate transfers. Therefore, transfers are not required to be approved by city council. For this reason, not all bond transfers are provided to city council for approval or informational purposes.
2	Were the transfers authorized?	Transfers from Enterprise Funds are allowable and legal under accounting principles. However, the City did not establish written policies to govern each Enterprise Fund's purpose, responsibilities, revenue generation and revenue usage. Therefore, there are no established policies and guidelines defining "allowable" expenditures for management to reference when making decisions related to authorizing interfund transfers.
3	Are the city's policies governing inter-fund transfers adequate to prevent the misuse or misallocation of restricted funds?	The City's policies governing interfund transfers are not adequate to prevent misuse or misallocation of restricted funds. However, no instances of misuse or misallocation came to our attention. The majority of interfund transfers were for franchise fees, indirect cost allocation, debt service and the Internal Service Fund (fleet replacement program). ➲ There are no specific restrictions regarding the type of transfers that can be made specified for individual funds. ➲ There are no policies and procedures establishing guidelines for authorizing, approving and managing

#	Question	Conclusion
		interfund transfers. ➲ There are no policies and procedures governing the Fleet Vehicle Program as a whole, or governing the accounting treatment for transactions within and outside the funds.

Pay Increases *(June 2014 and October 2014)*:

#	Question	Conclusion
1	Were the funding sources for the three percent pay increases identified (the initial six months and the following periods)? – What was the City's fiscal planning for the short-term and long-term impact of the three percent City-wide cost of living adjustment (COLA) implemented in June 2014? Were there fund transfers to cover the increase?	➲ The city manager presented a single dollar amount to city council for approval. However, no long-term budget impact was considered. The FY 2014 budget was amended to include $547,000, which was only sufficient to cover the marginal increase for the last four months of FY 2014. The General Fund and the four Enterprise Funds were the funding sources for the $547,000 increase. ➲ The City added $1.915 million in the FY 2015 budget for the pay increase. ➲ We estimated that the three percent COLA increase would result in an annual increase in base pay of $1.66 million.
2	What was the City's fiscal planning for the short-term and long-term impact of the eight percent pay adjustment for civil service positions implemented in October 2014?	The City conducted no long-term planning or analysis of the fiscal impact of the eight percent pay adjustment granted for civil service (public safety) positions in October 2014. ➲ City management did not separately quantify the fiscal impact of the eight percent civil service (public safety) employee pay adjustment in the annual FY 2015 budget submitted to city council. ➲ City management did not present the long-term impact of the eight percent civil service (public safety) employee pay adjustment to city council. ➲ The eight percent civil service (public safety) employee pay adjustment was absorbed into the City's pay plan and funded through a $2.43 million budget amendment approved by city council on September 22, 2015. ➲ Two council members expressed concerns opposing the pay adjustment during the July 22, 2014 special session, but their concerns were not addressed during that session.

#	Question	Conclusion
		➲ We estimated that the eight percent civil service (public safety) employee pay adjustment would result in an annual increase in base pay of $2.05 million.
3	Were staff pay increases paid retroactively?	Yes; staff pay increases were paid retroactively. ➲ The June 2014 city-wide three percent COLA increase was applied to the June 4, 2014 paycheck, which retroactively applies to the two weeks of service before June 2014. ➲ The eight percent civil service (public safety) employee pay adjustment approved for FY 2015 was applied only to the period of performance beginning October 1, 2014, and paychecks were prorated accordingly.
4	Were the budgeted funds for the three percent and eight percent increases used to hire additional FTE's?	The City did not designate separate budget line item for pay increases, therefore the answer to this question is no. However, we did note that the City's FTE's increased by an additional 31 FTE's during FY 2015.
5	Were there positions of job classification changes in addition to the pay increases?	No. City employees did not receive changes in job classification in addition to the pay increases. ➲ We identified one instance of a change in job classification during the period of the eight percent civil service employee pay adjustment. This individual's positions before and after this change were both non-civil service positions and, therefore, this change does not indicate a risk of using pay increase funds for changes to job classification or positions.

City/Owner Agreements *(Scope Period FY 2002 – FY 2016):*

#	Question	Conclusion
1	Is the City's participation in City Owner Agreements keeping with best practices?	The City's participation in City/Owner Agreements is based on Killeen Code of Ordinances Section 26-85 Agreements which governs the process. However, the City is not following the best practices listed below. ➲ Assessing the cost/benefit of the prospective City/Owner Agreement. ➲ Maintaining a better database of all City/Owner Agreements. ➲ Establishing criteria for auditing owner records.

#	Question	Conclusion
2	Did the City pay amounts over the existing approved city/owner agreements?	No, the City did not pay amounts over the original/existing approved City/Owner Agreements.
3	Is the volume of agreements disproportionally high?	The City executed 61 City/Owner Agreements from October 1, 2001 through September 30, 2016. This represents an average of four City/Owner Agreements being executed annually. Additionally, the City only incurred costs for less than 60 percent of the City/Owner Agreements executed. Based on these averages, we believe the number of City/Owner Agreements executed is not disproportionally high.
4	Were agreements applied evenly? Was there a pattern?	City/Owner agreements are open to all developers. We did note that there were primarily four developers that were used for more than 60 percent of the City/Owner Agreements that were executed from October 1, 2001 through September 30, 2016. These four developers included: (1) W& B Development; (2) the Purser Family; (3) Reeces Creek Development; and (4) RSBP Developers, Inc. These developers are members of the Killeen community and Chamber of Commerce and are responsible for a large portion of development in the City.

Roadway Ownership *(Scope Period FY 2002 – FY 2016):*

#	Question	Conclusion
1	Compare the City's private roadway ownership and City participation to best practices to assess the overall efficiency of the City's arrangements.	The City of Killeen does not have formal policies and procedures in place to monitor roadway ownership. City staff performs cursory reviews and adds or removes roadways based on the best knowledge of professionals performing the cursory review for roadway ownership and related maintenance plans. The City does not adequately assess county roadway annexations before requesting authorization from city council. We noted the City has not incorporated the following best practices into its roadway annexation processes: 1. Conduct formal operational due diligence on roadways considered for annexation and prepare formal operational due diligence reports. 2. Estimate the costs to upgrade the roadways to City standards, along with how and when the roadway upgrades will be funded. 3. Determine and provide estimates of the cost to maintain the annexed roadways, and include these costs in the annual budgeting process.

#	Question	Conclusion
		4. Execute formal roadway annexation agreements. 5. Include in the long-term capital improvement planning and budgeting process the nature, extent, timing and cost of upgrades necessary to convert annexed county roads to City standards. National best practices, as included in annexation studies conducted for the cities of San Antonio, Texas and Annapolis, Maryland, included the following: 1. Developing an annexation plan, including an inventory of current public services provided to the area and developing a service plan for the proposed annexation area, including the costs to provide such services. 2. Providing a multi-year analysis to determine long-term trends in revenues and expenditures. 3. Adopting different growth assumptions based on actual and current data. 4. Using conceptually rigorous, demand-driven or supply-driven methods to project growth in sales tax revenue based on actual and current sales or business establishment data. 5. Conducting a detailed marginal expenditure analysis for major cost drivers—such as public safety—in lieu of cost projections based on per capita estimates. 6. Including pension contributions, active and retiree health insurance, overtime and other premium pay when estimating salary-related expenditures. 7. Streamlining projections for minor revenues and expenditures by using per capita estimates.
2	At what point was the City authorized to spend money; were funds expended before the City owned the road?	The City assumes responsibility for the routine maintenance and repair of county roads at the time that they are annexed and ownership transfers to the City. However, we noted the City of Killeen spent $7,265 on chipseal maintenance for four roadways before conveyance of ownership. These four roads were conveyed to the City by Bell County in January 2008. However, the City incurred expenditures for maintaining the roads in FY 2007 and prior fiscal years. The actual amount of funds and resources expended on county roadways prior to conveyance of ownership could not be quantified because City staff do not track this information.
3	What are the monetary obligations for the roads?	The City does not incur costs for annexation. However, the City has future obligations to repair and maintain annexed county roadways and upgrade annexed roads to City standards. For example, the City has incurred significant capital outlays in relation to county roadways

#	Question	Conclusion
		that were annexed in FY 2004 and FY 2008. Those county road annexations included Trimmier Road and Stagecoach Road. Based on information City staff provided for our audit sample tested in the Capital Outlays chapter of this report, the City spent approximately $10.5 million to widen and reconstruct Trimmier Road and $17.9 million on a two-phased project for the reconstruction of Stagecoach Road.

Post-Recall Spending *(Scope Period November 2011 – May 2012):*

#	Question	Conclusion
1	Was an emergency declaration declared?	➲ The City did not declare an emergency declaration. However, the interim city manager issued instructions on how expenses over $50,000.01 were to be handled. ➲ One CCM/R approval occurred after the May 2012 election with 99 percent of CCM/R approvals occurring before the recall election. ➲ Declaring an emergency declaration when there are no council members seated is not a practice that is outlined in the City Charter or mandated by the State of Texas.
2	Did Council ratify expenditures, as required?	Yes. City council ratified post recall expenditures as required.
3	Is there any evidence of fraud or abuse of funds during the period?	➲ Based on the audit procedures we applied, we did not see indicators of fraud or abuse. ➲ We did note a weak internal control environment that could result in potential fraud going undetected. However, expenditure samples tested for the post-recall period indicate the necessary approvals and supporting documentation were present in accordance with City policy for vendor payments.
4	What is the process now? Are procedures, contingency plans and frameworks in place for the future?	➲ The City follows the existing Purchasing Department procurement processes that establish procurement methods and dollar thresholds for purchasing approval authority. ➲ There is neither a contingency plan nor framework in place in the event that a full city council is not seated.

Detailed observations for each of these areas are included in the respective chapters.

CHAPTER 2 – FINANCIAL CONDITION ANALYSIS

McConnell & Jones LLP (MJ) performed analysis of the City of Killeen's (the City) City's financial activities between FY 2007 and FY 2016 to identify the root causes of the budget shortfall presented to city council on June 30, 2016. Our analysis is based on information provided in the City's Consolidated Annual Financial Reports (CAFR) and trial balance files provided by the City. Trial balance reports provide the detailed transactions that become consolidated into the CAFR. We also obtained the City's fund balance polices to assess compliance.

The initial objective for performing this financial condition analysis was to determine causes of the projected $8 million budget shortfall presented to city council on June 30, 2016. However, our preliminary assessment determined that the $8 million budget shortfall discussed was a projection based upon a preliminary estimate of anticipated revenues and expenditures. This budget projection was developed using the same methodology applied in prior years under different leadership in the city manager's office. This methodology budgeted for a higher level of expenditures than revenues in anticipation of actual revenues being higher than anticipated and actual expenditures being lower than anticipated.

Budget projections are based on historical operational needs which do not always align with actual financial performance. Therefore, we analyzed the City's finances to see how well the City is managing its revenues and containing costs. Accordingly, we analyzed the following:

- ✓ All Governmental Funds - to provide the public and city council with an overview of the City's financial trends.
- ✓ General Fund – this is the primary fund used for City operations and reflects how effectively the City is managing its money in addition to providing a summary of the City's available reserves that can be used to support operations in the event that the City experiences a revenue shortfall.
- ✓ Enterprise Funds – these are the proprietary funds that are used to support operations provided to citizens on a fee-for-service basis.

This section of the report contains our analysis of the City's financial activities between FY 2007 and FY 2016.

CHAPTER HIGHLIGHTS

- No instances of fraud or abuse came to our attention based on documents provided by the City and that we tested.
- The City has adopted unbalanced, deficit budgets since FY 2008.
- The City's General Fund operating expenditures exceeded operating revenues every year since 2007. The total deficit spending during the 10 year period is $81.6 million. This was reduced to $3.1 after transfers from the Enterprise Funds.
- While the City maintains a healthy fund balance in its Governmental Funds almost half of this balances is restricted for specific purposes and cannot be used for general operating expenses.
- The City's transfers of Enterprise Funds to the General Fund are disproportionate to the percentage change in the respective Enterprise Fund's operating revenues.
- The City has entered into grant agreements for fire and police positions that require General Fund matching funds.

Overview

The City of Killeen has been among the fastest growing cities in the United States. The City's population increased to 143,000 in 2016 from 114,000 in 2007. This growth translates to a greater need to provide services to its citizens. While growth is a positive sign, it also poses challenges to fund the required infrastructure and services to support the growth.

The General Accounting Standards Board (GASB) determines how financial activities are reported. Major funds are funds whose revenues, expenditures/expenses, assets, or liabilities (excluding extraordinary items) are at least 10 percent of corresponding totals for all governmental or enterprise funds and at least five percent of the aggregate amount for all governmental and enterprise funds. Any other fund may be reported as a major fund if the government's officials believe that fund is particularly important to financial statement users. Non-major funds should be reported in the aggregate in a separate column.

The City reports its financial activities in four major fund groups that include revenues and expenses for the following funds:

1. Governmental Funds
    a. *General Fund* – the City's basic operating fund and accounts for everything not accounted for in another fund.
    b. *Debt Service Fund* – used to account for the repayment of the City's debt.
2. Enterprise Funds (Proprietary Funds) – used to account for activities financed primarily by revenues generated by the fund's activities.
    a. *Airport Funds (Also referred to as Aviation)*
    b. *Solid Waste Fund*
    c. *Water & Sewer Fund*
    d. *Drainage Utility Fund*
3. Internal Service Funds
    a. *Fleet Services*
4. Special Revenue Funds – used to report specific revenue sources that are limited to being used for a particular purpose, such as transportation aid. The City also uses these funds to report all of the financial activities associated with a single function (such as road maintenance) and classes of revenues (for example, all federal grants).
    a. *Hotel/Motel Occupancy Tax Fund*
    b. *22 Other Funds*

The City categorizes its financial transactions into three activity types as follows:

Governmental Activities – City functions that are principally supported by taxes and intergovernmental revenues. The City's governmental activities include:

- General Government
- Public Safety
- Public Works
- Community Services
- Community Development

Business-Type Activities (Enterprise Funds) – City functions that are intended to recover all or a significant portion of their costs through user fees and charges. The City business type activities include:

- Airport (also referred to as Aviation)
- Solid Waste
- Water & Sewer
- Drainage Utility

Component Unit – The City includes a separate legal entity in its report, the Killeen Economic Development Corporation. Although legally separate, this component unit is important because the City is financially accountable for it.

The City charges franchise fees to outside companies and Enterprise Funds for the use of City-owned streets, alleys, rights-of-way and easements. The fees are charged to build, improve and maintain City infrastructure. Enterprise Funds that pay a franchise fee as a percentage of their respective fund's revenues are:

- ✓ Solid Waste Fund
- ✓ Water & Sewer Fund

The City also captures certain costs and reallocates them to the Enterprise Funds in the form of indirect cost allocation (IDC) transfers. Funds charged the IDC are:

- ✓ Solid Waste Fund
- ✓ Water & Sewer Fund
- ✓ Drainage Utility Fund

Conclusions

The City's $8 million projected budget shortfall was based on the budget preparation methodology and is not an actual monetary shortfall. The June 30, 2016 budget presentation was based on a projection and the City had not reduced its anticipated costs to match anticipated revenues.

The City has not demonstrated sound fiscal management in that General Fund expenditures have outpaced General Fund revenues each year since FY 2008. As a result, the City's fund balance has decreased and debt has increased. While this overspending can be attributed to a lack of fiscal discipline, instances of fraud or abuse did not come to our attention during our financial analysis or our in-depth assessment of the seven focus areas within the scope of this management audit.

We noted that the City's General Fund budget deficit is attributable to the following major factors:

- ✓ The City budgeted for a deficit in its General Fund each year since at least FY 2003, which is similar to other cities. However, while most cities actual activities resulted in revenues exceeding expenditures, we noted that the City's actual activities resulted in expenditures exceeding revenues in FY 2007 through FY 2016.

- ✓ Expenditures related to governmental activities, specifically in public safety, doubled over the past 10 years. The majority of public safety expenditures are salaries and benefits for employees in the Fire and Police Departments. Annual increases in public safety expenditures were disproportionate to revenue increases in the General Funds in FY 2009, FY 2012, FY 2013 and FY 2016. Additional positions were hired in response to the City's population growth. The additional fire stations and police department headquarters were paid through bond funds and certificate of obligations, therefore these capital project expenditures do not contribute to the Public Safety expenditure increases within the General Fund.

- ✓ Expenditures in Enterprise Funds also increased and outpaced the increase in revenues.

- ✓ Outstanding debt for governmental activities increased dramatically over the past 10 years. The City's percentage of debt to total net position (including Governmental Funds and Enterprise Funds) has increased to 130 percent in FY 2016 from 49 percent in FY 2007. This debt increase is contributed to capital projects such as adding infrastructure; renovating facilities and new buildings.

- ✓ The City entered into grant agreements that required significant matching funds or commitments for future salaries. These decisions did not consider the long-term financial impact on the City's General Fund.

- ✓ The eight percent pay adjustment approved for civil service (public safety) employees in 2014 was not included in the FY 2015 budget and resulted in a $2.4 million budget amendment to cover the additional salary expenses incurred.

- ✓ GASB 68 required the city to recognize $53.1 million in Net Pension Liabilities. The adjusting entry resulted in the governmental activity's net position decreasing to $9 million in FY 2015 from $75 million in FY 2014.

- ✓ The City's Fund Balance and Operating Reserves Fiscal Policy Statement adopted on September 27, 2011 is not clear on the formula and financial transaction types that should be used to calculate the required fund balance percentages. Because the policy is not clear and the CAFR includes non-operating expenditures in the operating expenditures line the fund balance amounts required to meet policy requirements using the CAFR operating expenditures' totals results in higher funds required to meet the City's policy. The Finance Department calculates the fund balance percent based on working capital which is current assets less current liabilities. The working capital formula results in less funds required to meet policy requirements. While this difference is usually less than one percent it demonstrates a need to clarify the City's fund balance policy to include the formula and specific transaction types that must be included in the formula.

Analysis

The $8 million projected shortfall was a budget projection and not an actual monetary shortfall. However, the City did have a positive fund balance with unrestricted funds available to use for operations. Therefore, we analyzed the City's Governmental Funds, Enterprise Funds, debt ratio and budgets to determine the City's true financial condition. Our analysis is based on information presented in the City's Comprehensive Annual Financial Statements (CAFRs) and trial balances.

Within the CAFRs we specifically analyzed the following statements:

- ✓ Statement of Net Assets
- ✓ Balance Sheet
- ✓ Statement of Activities (Governmental Funds)
- ✓ Statement of Cash Flows (Enterprise Funds)
- ✓ Statement of Revenues, Expenses and Changes in Fund Net Assets

Our analysis is presented in the following order:

- ✓ Governmental Funds
  - Total Governmental Funds
  - General Fund
- ✓ Enterprise Funds
- ✓ Debt
- ✓ Budgets

Total Governmental Funds

Governmental Funds is the grouping that includes all of the City's fund accounts that are not Enterprise Funds, Special Revenue funds or Killeen Economic Development Corporation funds. The City's Governmental Funds includes the General Fund, bonds/debt service and capital projects in addition to several smaller funds. Governmental Funds represent all income and expenditures for City services such as police, fire and social services. It is important to note that the Governmental Fund group includes capital projects and debt service which are subject to volatility based upon the City's capital projects. Because many individuals tend to look at the Governmental Fund financial statements to see the City's financial results and the fund balance to determine financial solvency rather than look at the General Fund, we included Governmental Funds in this analysis.

The intent of analyzing the Governmental Fund group is to provide the public and city council with comparative analysis of the City's overall finances from FY 2007 through FY 2016. We have provided separate analysis of the General Fund later in this chapter to show the City's management of operational expenses and revenues.

The Statement of Revenues, Expenditures and Changes in Fund Balances provides an overview of the City's operating position and financing transactions. The City's total Governmental Fund expenditures were higher than revenues for six years between FY 2007 and FY 2016. **Figure 2-1** provides a comparison of the City's total Governmental Fund revenues and expenditures from FY 2007 through FY 2016. It is important to note that this comparison includes capital projects and debt payments.

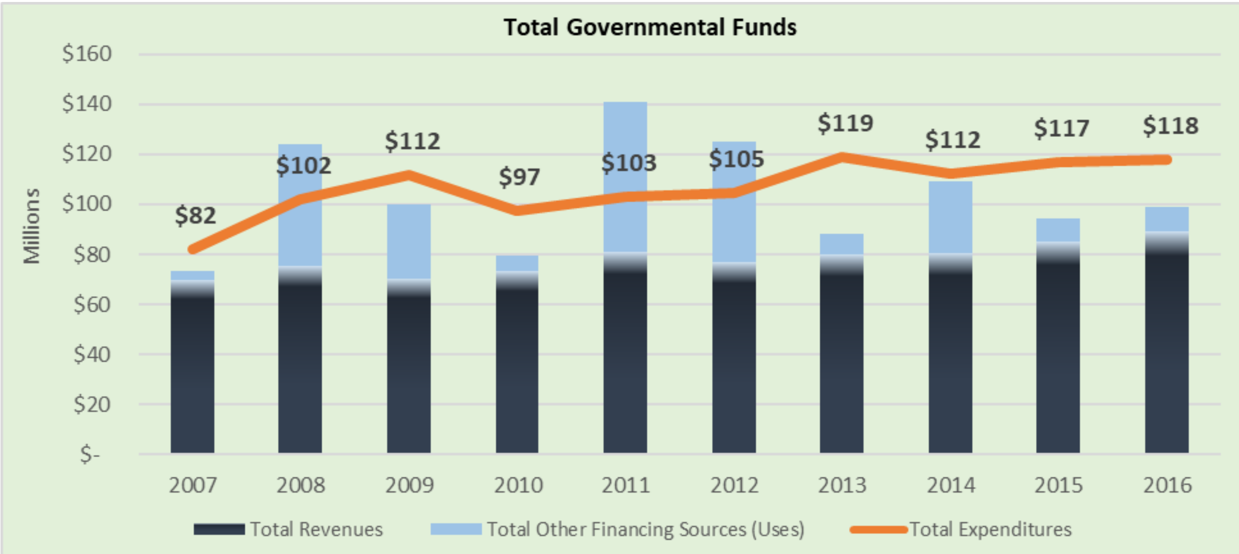


FIGURE 2-1 – City of Killeen Total Governmental Fund Revenues and Expenditures FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

The largest funding source for Governmental Funds is property and sales tax revenue. This is closely followed by intergovernmental revenue (transfers from Enterprise Funds). Both of these revenue sources are recorded in the General Fund which is a component of the Governmental Fund group. **Figure 2-2** provides a summary of the City's Governmental Fund revenue sources from FY 2007 through FY 2016.

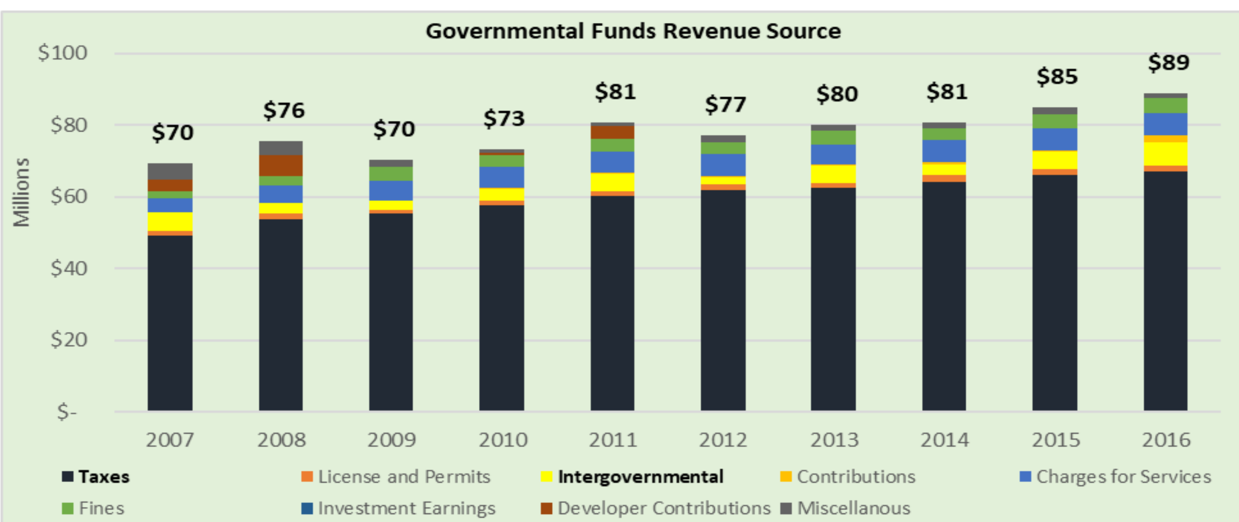


FIGURE 2-2 – City of Killeen Total Governmental Fund Revenue Sources FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

Public safety expenditures comprised the largest amount of the City's total Governmental Funds outlays. These expenses are recorded in the General Fund which is a component of the Governmental Fund group. Fiscal charges related to the City's debt was the second largest expense. **Figure 2-3** provides a summary of the City's total Governmental Funds expenditures from FY 2007 through FY 2016.

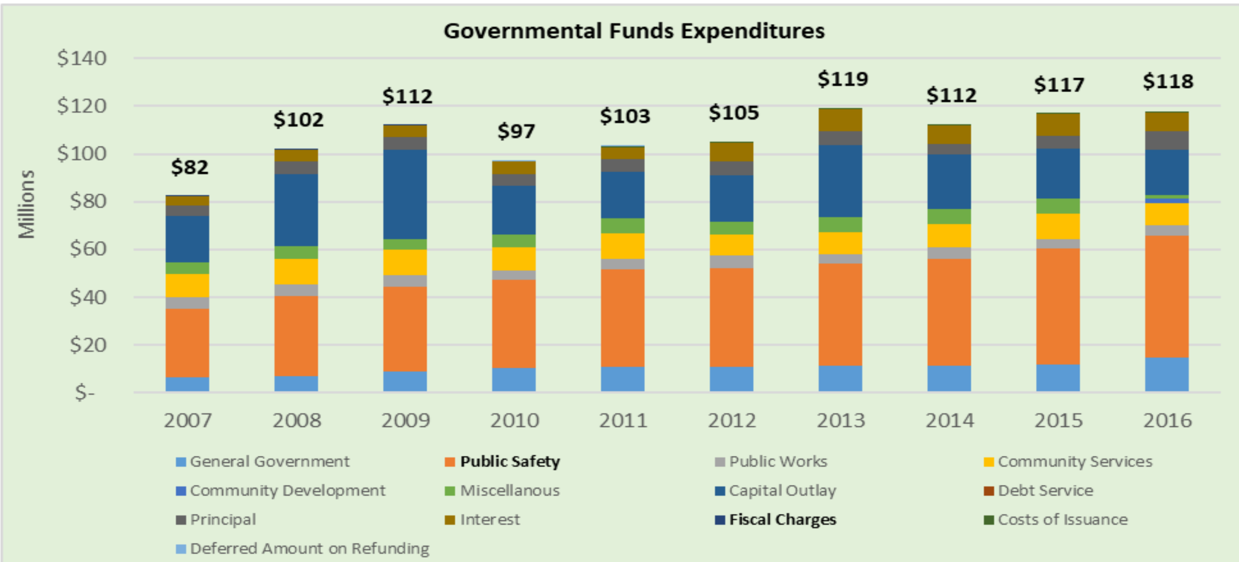


FIGURE 2-3 – City of Killeen Total Governmental Expenditures FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

Fund balances represent the difference between revenues and expenditures accumulated over the years. Fund balances contain amounts that are set aside that can only be used for specific financial obligations while undesignated or unassigned funds represent discretionary amounts that the City has available to spend as needed.

The City's total Governmental Fund balance decreased 60 percent from FY 2007 to FY 2016; from $51 million in FY 2010 to $32 million in FY 2016. This decrease is a reflection of the City's capital projects.

GASB 54 changed fund balance classifications for governmental funds. The City adopted GASB 54 for the FY 2011 financial reporting year. Therefore, the terms used from FY 2007 – FY 2010 are different than those used for FY 2011 – FY 2016. For example, until FY 2010, the Governmental Fund's fund balance available for spending was termed "Unreserved Undesignated." In FY 2011, with the implementation of GASB 54, fund balance available for discretionary spending was renamed "Unassigned Fund Balance." Although the terminology changed in addition to some changes in accounting treatment, the result is that the fund balance includes funds that are:

- ✓ Dedicated and cannot be used for purposes other than the designated purpose. For the purposes of consistency in this chapter, we will refer to these as "restricted funds."
- ✓ Unreserved and can be used for discretionary purposes. For the purposes of consistency in this chapter we will refer to these as "unassigned funds."

Figure 2-4 provides a comparative summary of the City's fund balance from FY 2007 to FY 2016. This chart accounts for the GASB 54 changes by showing the unreserved undesignated and unreserved designated amounts in green for FY 2007 – FY 2010 and the unassigned fund balance also in green for FY 2011 forward. We intentionally used the same color for these designations because regardless of the naming convention, they represent funds available for discretionary use.

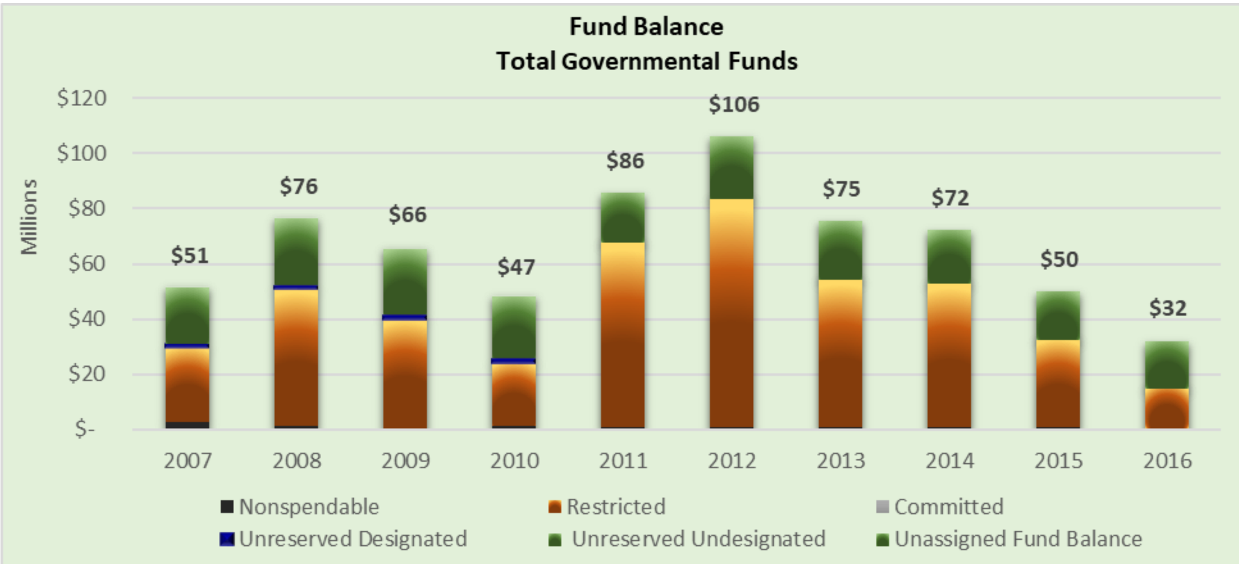


FIGURE 2-4 – City of Killeen Governmental Funds Fund Balance Composition FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

Looking at fund balance totals can provide the reader or decision maker with a false perception if they are looking only at the total fund balance. Restricted amounts represent funds that the City has available, but are set aside to pay specific future obligations. In most instances these funds are contractually obligated.

The unassigned fund balance is available for other uses; therefore, financial decisions should be made based on this amount and not the total fund balance.

The total restricted fund balance fluctuated each year and ranged from a low of $14 million in FY 2016 to a high of $38 million in FY 2011. This is a result of the City's capital project initiatives. **Capital projects comprise the largest amount of restricted funds each year followed by debt service.**

Figure 2-5 provides a summary of Governmental Fund restricted fund balance amounts by purpose for FY 2007 through FY 2016.

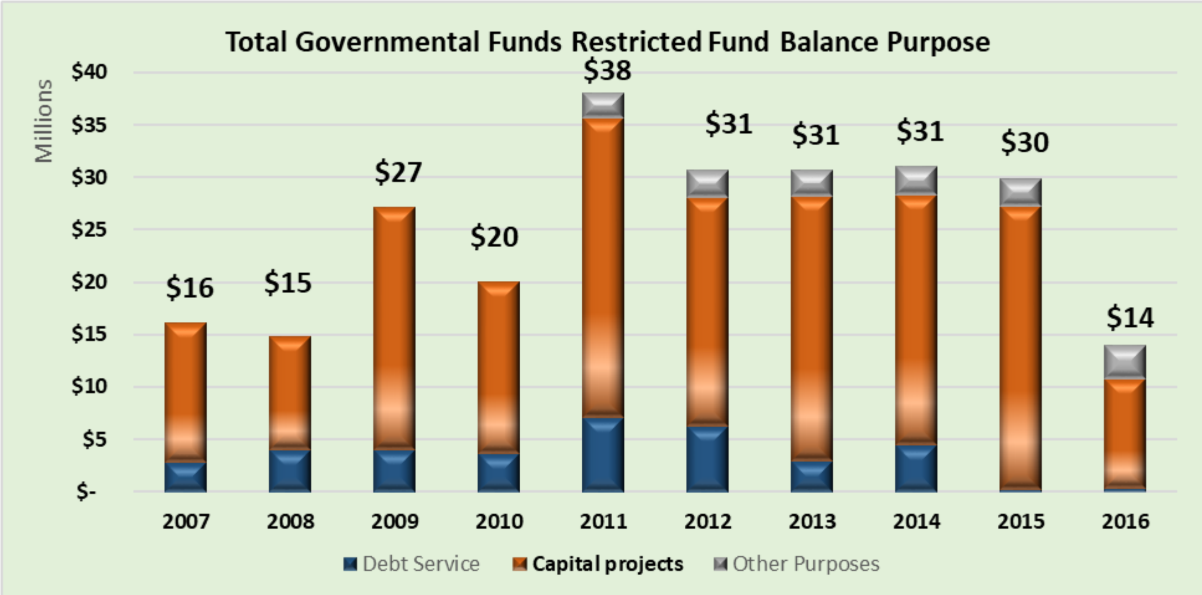


FIGURE 2-5 – City of Killeen Governmental Fund's Fund Balance Composition FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

While the City's FY 2016 Governmental Funds capital outlay expenditures levels are the same as FY 2007, expenditures reached $30 million or more in FY 2008, FY 2009 and FY 2013. **Figure 2-6** provides a summary of the City's Governmental Funds capital outlay expenditures between FY 2007 and FY 2016. These amounts will not agree with **Figure 3-2** in Chapter 3- Capital Outlay because the Capital Outlay chapter includes both Governmental and Enterprise Fund capital outlay whereas **Figure 2-7** reflects capital outlay only from Governmental Funds.

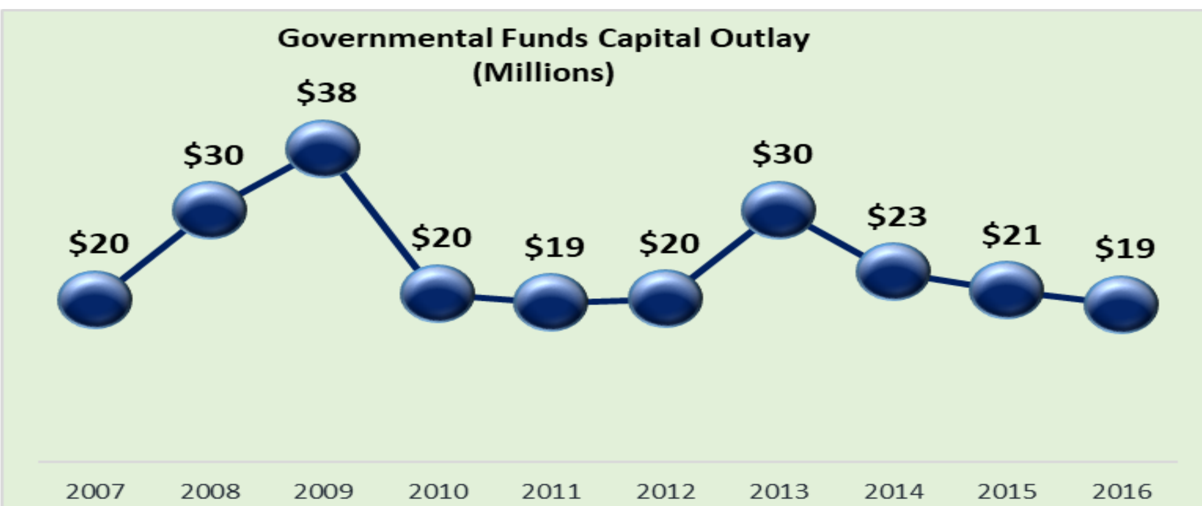


FIGURE 2-6 – City of Killeen Governmental Fund Capital Outlay Expenditures FY 2007 through FY 2016
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

General Fund

The City's General Fund includes general operating revenues and expenditures and is the largest fund within the Governmental Funds group. This is the major fund that accounts for the City's general operations. Accordingly, we also performed an analysis of the City's General Fund activities.

The City's General Fund has operated at a deficit since FY 2007. Property and sales tax revenues comprise the City's largest revenue source while charges for services comprise the second largest source. We compared the City's operating revenues to total expenditures to show the shortfall between operational revenues and expenditures. **Figure 2-7** provides a comparison of operational revenue and expenditures from FY 2007 through FY 2016.

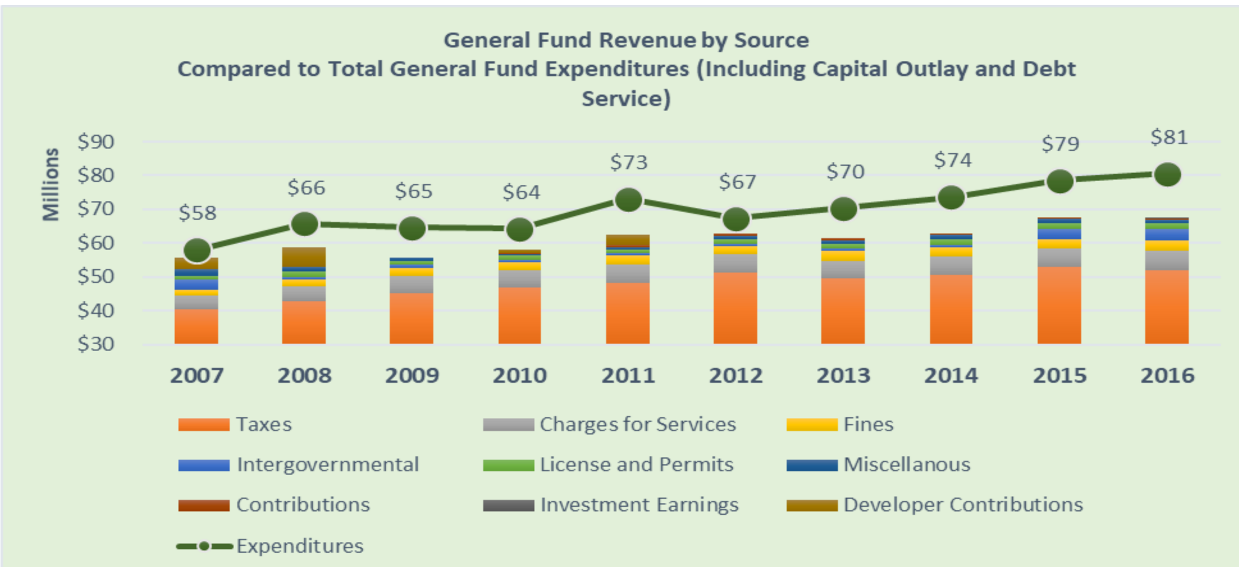


FIGURE 2-7 – City of Killeen General Fund Total Expenditures and Operational Revenues FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

The City funds operations through a variety of revenue sources. However, the goal is to align operational expenditures with revenues from taxes, fines and miscellaneous revenues associated with operations. This alignment prevents the City from requiring other funding sources such as loans to satisfy General Fund expenditures.

We analyzed the Statement of Revenues, Expenditures and Changes in Fund Balances to identify indicators of what funding sources were used to supplement General Fund revenues. The analysis shows that General Fund revenues were largely supplemented by transfers from Enterprise Funds, which generate revenue from franchise fees and indirect cost allocations. We also noted that the City transferred the following Certificate of Obligation (C.O.) and bond funds into the General Fund:

- ✓ $1,083,775 from C.O. Bonds in FY 2008
- ✓ $1,646,585 from Fund 341 PTF 190/2410 Construction Bond in FY 2012 to pay for a division's operating expenses.
- ✓ $213,365 from C.O. 2014 in FY 2014 (reimbursement of expenses incurred in FY 2013)

Even with the Enterprise Fund transfers into the General Fund and other financing sources, the City did not generate enough General Fund revenue to cover operating expenditures each year, except FY 2007 and FY 2012. **The City's cumulative deficit spending in the General Fund, including all revenue sources, was $3.1 million from October 1, 2006 to September 31, 2016; an average of $350,000 per year.** The General Fund deficit without these transfers would have been $81.6 million over the period from FY 2007 to FY 2016. This represents the amount of the General Fund's fund balance that was used to cover its general operating expenditures. Transfers from the Water & Sewer Fund (W&S) were the City's largest source of additional revenue for the General Fund, followed by transfers from the Solid Waste Fund. **Figure 2-8** provides a summary of additional revenue sources for the General Fund compared to General Fund expenditures from FY 2007 through FY 2016.

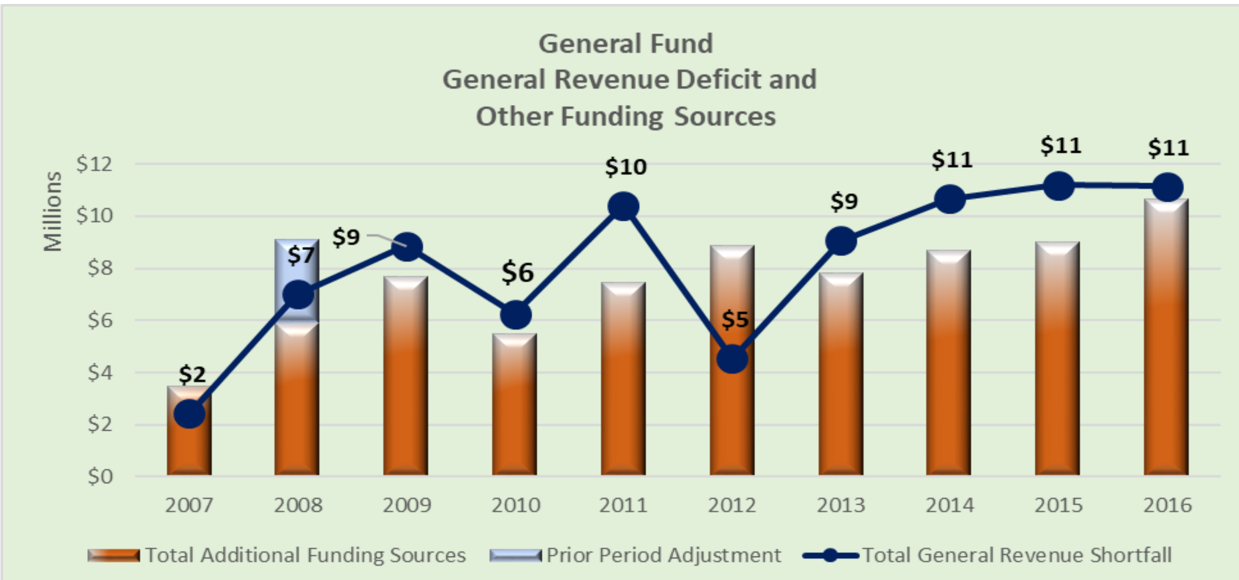


FIGURE 2-8 – City of Killeen General Fund With Additional Funding Sources Compared to Annual Deficits FY 2007 through FY 2016. *The difference between the funding sources and the deficit amount (blue line) represent amounts where the City did not generate enough revenues to cover its general operating expenditures and had to use its fund balance.*
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

The City's General Fund receives interfund transfers from Enterprise Funds, which consist primarily of franchise fees and indirect cost allocations totaling $5 million to $14 million a year from FY 2007 through FY 2016 for all Enterprise Funds. We analyzed the changes in each Enterprise Fund's annual operating revenues and the amount transferred into the General Fund. **The City's transfers of Enterprise Funds to the General Fund are disproportionate to the percentage change in the respective Enterprise Fund's operating revenues. Figure 2-9** compares the annual change in Enterprise Fund revenues to the annual change in transfers from Enterprise Funds to the General Fund.

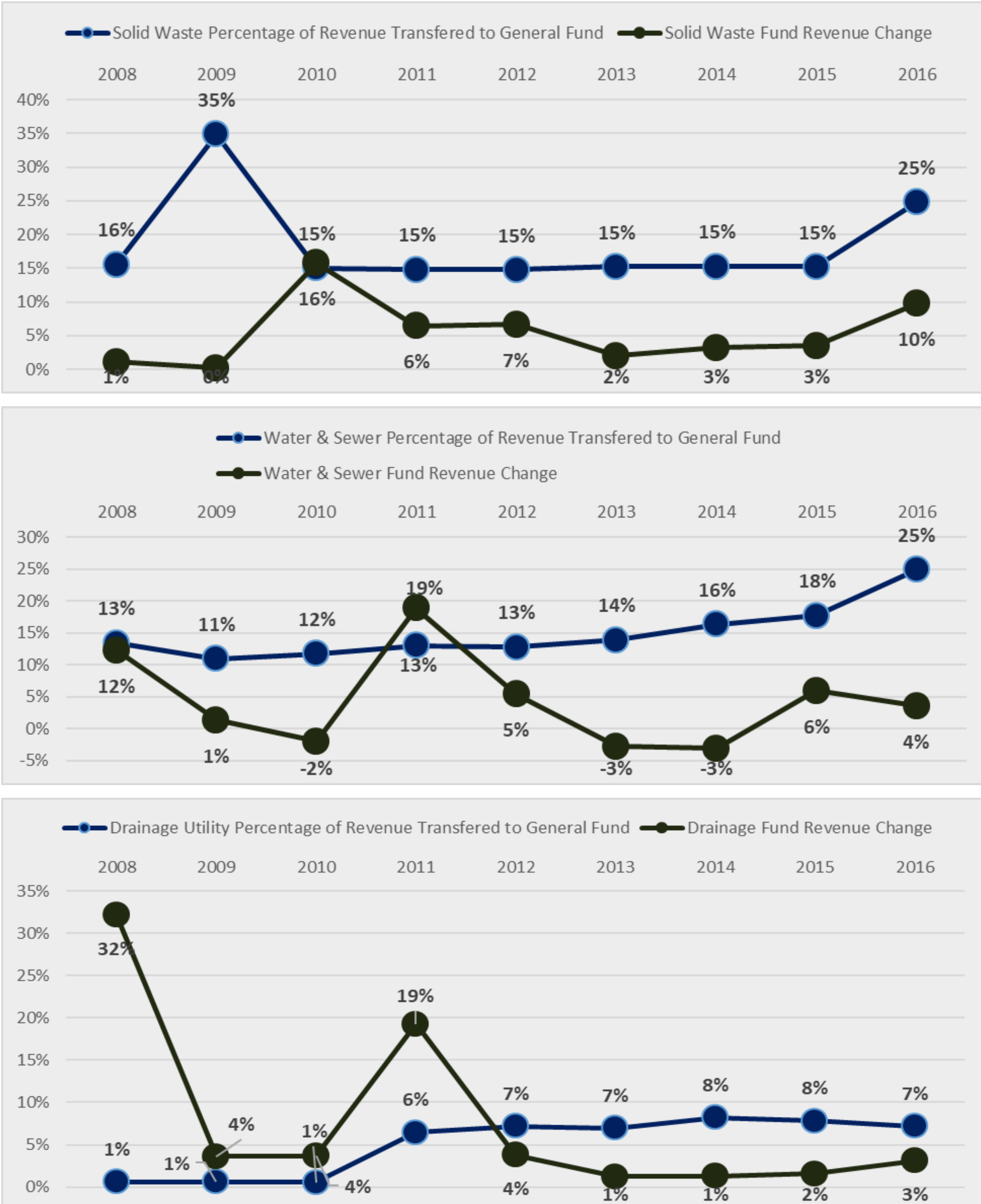


FIGURE 2-9 – Comparison of Percentage Change in Enterprise Fund Revenue to the Percentage Change in Transfers to the City's General Fund.
Source: McConnell & Jones LLP's calculations from data included in the City of Killeen Comprehensive Annual Financial Report for respective years.

As previously stated, prudent fiscal management ensures that costs are contained so that operating expenditures do not exceed operating revenues. Comparing the City's General Fund operating revenues to operating expenditures shows that these costs were not contained. **The City's General Fund operating expenditures were $81.6 million higher than operating revenues, cumulatively, over the last 10 years. The cumulative deficit is $3.1 million after transfers in from the Enterprise Funds. Figure 2-10** provides a comparison of the City's General Fund operating revenues and expenditures by year for FY 2007 through FY 2016.

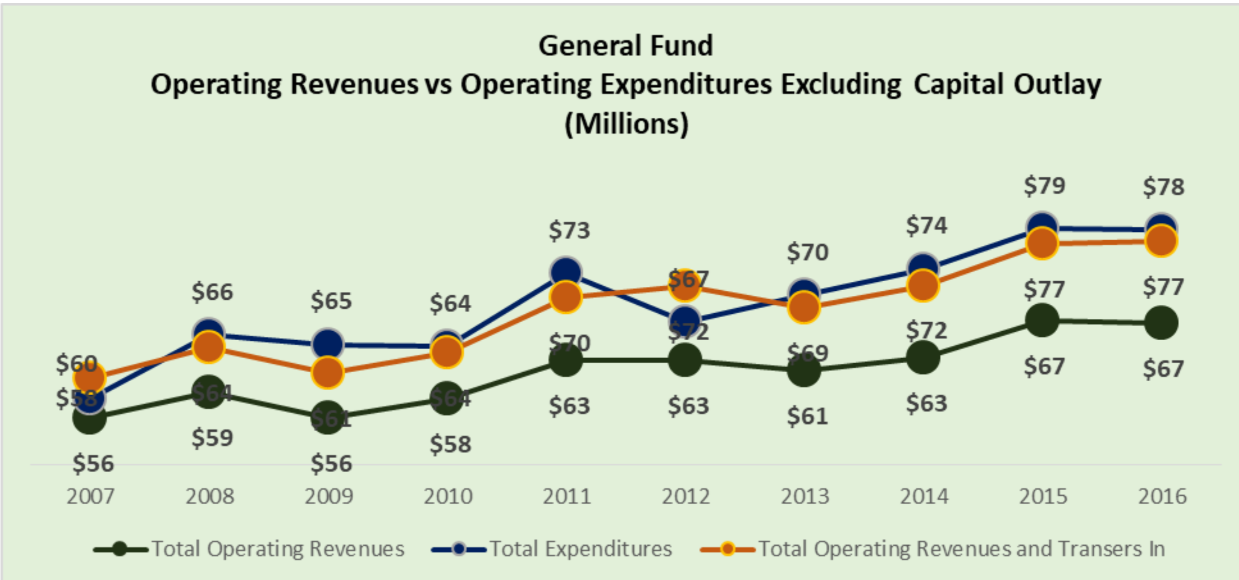


FIGURE 2-10 – City of Killeen General Fund Revenues and Expenditures FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

Financial decisions that have had a significant impact on the City's General Fund's operating expenditures and fund balance include:

- ✓ COLA and pay increases approved in 2014 - $3.7 million annual impact.
- ✓ Capital projects paid with General Fund revenues
  - – FY 2011 - Bunny Trail in the amount of $1,003,036.03 (CCM/R 11-038R Goodnight Ranch).
  - – FY 2013 - The Landing at Clear Creek, Phase 3 in the amount of $360,366.68 (CCM/R 13-119R/130120R.)
- ✓ Grant funds for salaries to hire additional police and fire positions that require City matching funds. While receiving grant funds result in additional funding sources, the City must carefully evaluate the long-term obligations before committing to the terms and conditions of grant awards.
  - – **Community Oriented Police Services (COPS) Grant #2010UMWX0301.** A three-year grant awarded on September 13, 2010 and ending August 31, 2013. This grant award was for $1,806,230 annually to fund10 full-time officer positions. This grant required the City to retain the 10 additional full-time officer positions for a minimum of 12 months

after the conclusion of federal (grant) funding for each position. This grant did not require annual matching funds.

- **Staffing Adequate Fire & Emergency Response (SAFER).** Grant award totaled $4,443,404 for full-time fire personnel. This grant does not require annual City matching funds but will require the City's General Fund to absorb the personnel costs once the grant funds are exhausted.
- Additional grants requiring a total of $1,859,452 in annual General Fund matching dollars. These grants are detailed in the table below.

Department	Award Number	Award Period	Program	Items Awarded	Federal	State	Local - City
Police	2014-UM-WX-0056	09/01/2014 to 08/31/2017	2014 Community Oriented Policing Services	12 Officers	$1,500,000	$0-	$834,218
Police	2015-UM-WX-0120	09/01/2015 to 08/31/2018	2015 Community Oriented Policing Services	13 Officers	1,625,000	0	829,884
Police	2017-KilleenP-S-1YG-0018	10/01/2016 to 09/30/2017	2017 Selective Traffic Enforcement Program	Salaries	0	$117,291	36,803
Police	2916401	09/01/2015 to 09/30/2017	Crisis Assistance Program	Services & Supplies	0	39,947	3,713
Police	HSTS02-16-H-SLR856	04/01/2016 to 12/31/2018	Law Enforcement Officer Reimbursement Program	Salaries	320,430	0	97,589
Total Police		**Total**			**$3,445,430**	**$157,238**	**$1,802,207**
Fire	EMW-2015-FO-05713	06/30/2016 to 06/29/2017	Assistance to Firefighters	81 SCBAs	$572,449	-	$57,245
Total Fire Department					**$572,449**	**$0**	**$57,245**
Total General Fund Matching Grants					**$4,017,879**	**$157,238**	**$1,859,452**

Source: Grant schedule provided by the City of Killeen Finance Department August 2017.

The long-range fiscal impact of the police and fire grants will require the General Fund to absorb an additional cumulative $7.5 million in annual expenditures by FY 2021. **Figure 2-11** provides a summary of grant-funded positions that the General Fund will need to absorb.

Fiscal Year	Police		Fire		Total	
	Annual Salary Funding	Total Positions Funded	Annual Salary Funding	Total Positions Funded	Annual Salary Funding	Total Positions Funded
FY2017	$ 1,262,472	35	$ 2,198,111	37	$ 3,460,584	72
FY2018	$ 1,262,169	35	$ 1,537,876	37	$ 2,800,045	72
FY2019	$ 755,125	35	$ 38,806	37	$ 793,931	72
FY2020	$ 251,063	35	$ 38,806	37	$ 289,869	72
FY2021	$ 117,291	35	$ 38,806	37	$ 156,097	72
Total	**$ 3,648,121**	**35**	**$ 3,852,405**	**37**	**$ 7,500,526**	**72**

FIGURE 2-11 – Grant Funded Positions and Salaries Requiring Future General Fund Resources.
Source: Grant schedule provided by the City of Killeen Finance Department August 2017.

Over the 10-year period, the annual expenditures for public safety almost doubled to $50 million in FY 2016 from $28 million in FY 2007. The salaries and related payroll expenditures account for the majority of public safety expenditures. Total expenditures for other services grew at a slower rate. **Figure 2-12** presents the General Fund's major operating expenditures from FY 2007 through FY 2016.

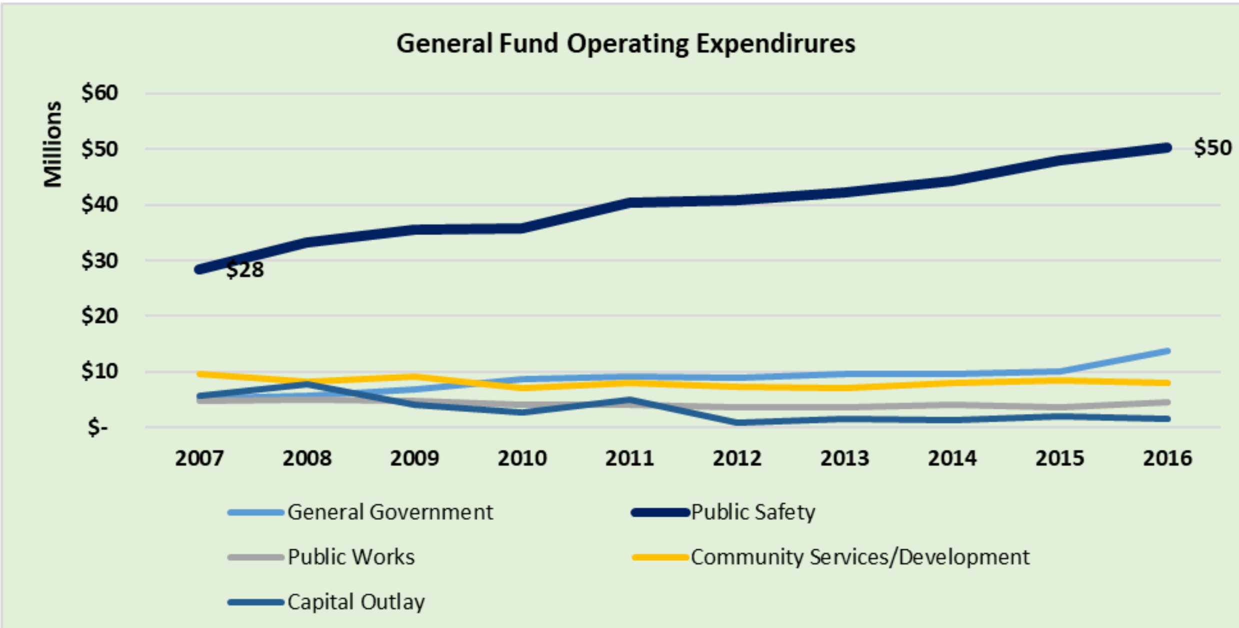


FIGURE 2-12 – City of Killeen General Fund Operating Expenditures FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

Public safety's percentage increase in operating expenditures has been higher than the percentage increase in operating revenue for the General Fund in four of the previous 10 years. **Figure 2-13** compares the annual percentage increase in public safety expenditures to the percentage increase in General Fund revenue from FY 2007 through FY 2016.

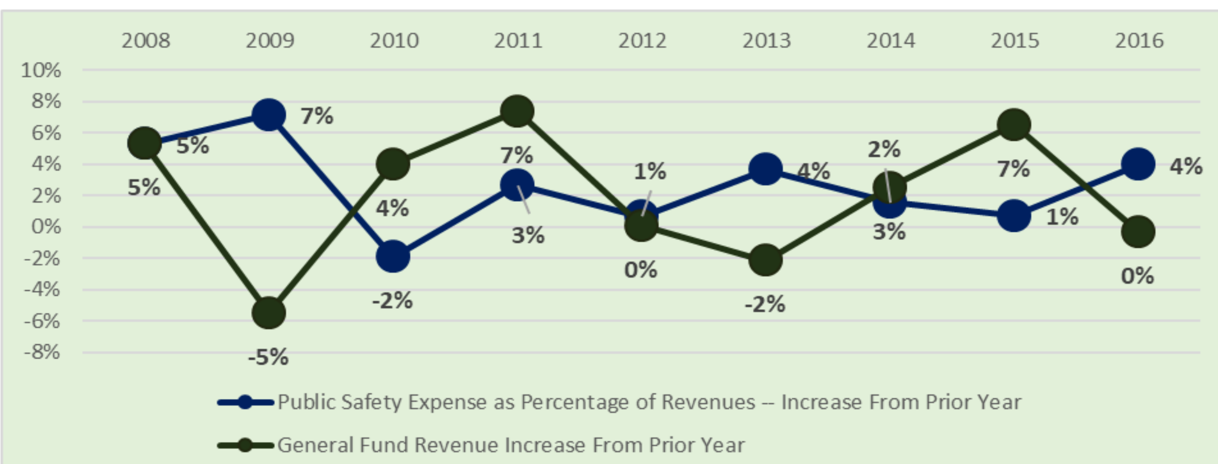


FIGURE 2-13 – City of Killeen General Fund Operating Expenditures FY 2007 through FY 2016.
Source: McConnell & Jones LLP's calculation from information included in the City of Killeen Comprehensive Annual Financial Reports for respective years.

Capital outlays also had an impact on the City's General Fund expenditures. We analyzed General Fund capital outlay expenditures from FY 2008 through FY 2016 as part of the Capital Outlay focus area (Chapter 3 of this report). We noted that most General Fund capital outlays were neither bond-related nor did they correspond to the definition of capital outlay as described in the City's financial policies: *...improvements that exceed $50,000 and have useful lives exceeding one year...Examples include water and wastewater line replacement, street resurfacing, building construction and renovation, major software and hardware projects, and park improvements.* Rather, we noted that the expenditures were closely aligned with the definition of fixed assets costing $5,000 or more rather than the definition of capital outlay described in the City's financial policies.

The General Fund's capital outlay expenditures decreased each year from a high of $7.8 million in FY 2008 to $1.5 million in FY 2016. **Figure 2-14** provides a summary of the General Fund's capital outlay expenditures from FY 2007 through FY 2016.

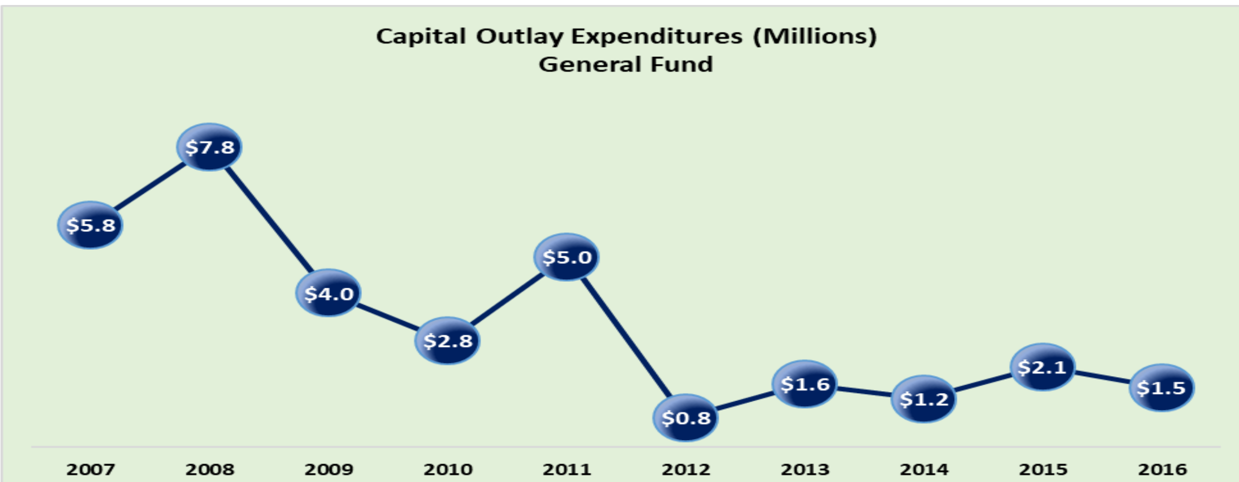


FIGURE 2-14 – City of Killeen General Fund Capital Outlay Expenditures FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

The fund balance in the General Fund declined to $18 million in FY 2016 from $22 million in FY 2007 as a result of continuous deficit spending. Additionally, during this period the General Fund balance went from highs of $24 million in FY 2008 and FY 2012, respectively, to a low of $18 million in FY2016. **Figure 2-15** graphically depicts the fluctuation in the General Fund's fund balance from FY 2007 through FY 2016.

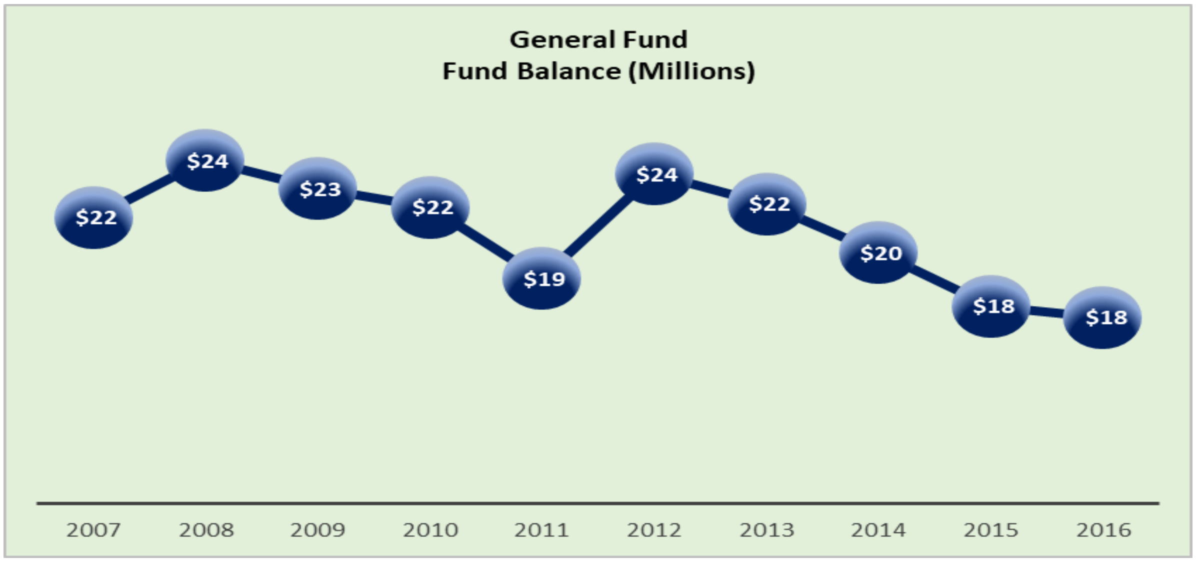


FIGURE 2-15 – City of Killeen General Fund Balance FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Reports for respective years.

While the General Fund's fund balance has decreased $3.1 million since FY 2006, almost all of the funds are unrestricted and are available for use as needed for operations. **Figure 2-16** provides a summary of the designation of the General Fund's fund balance. This chart accounts for GASB 54 changes by showing the unreserved undesignated and unreserved designated amounts in green for FY 2007 – FY 2010, and the unassigned fund balance in green for FY 2011 forward. We intentionally used the same color for these designations because regardless of the naming convention, they represent funds available for use at the City's discretion.

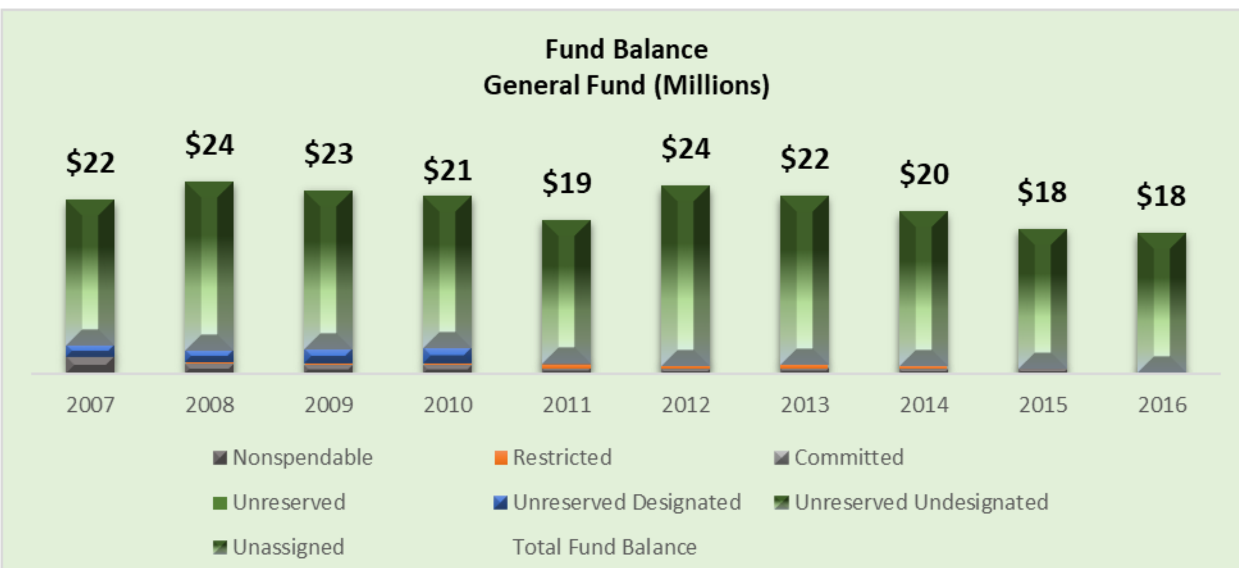


FIGURE 2-16 – Composition of the City of Killeen General Fund's Fund Balance FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

Enterprise Funds

The City's Enterprise funds are used to record revenues and expenditures associated with providing specific services that are supported by the revenue generating activities. These funds are:

- ✓ Airport Funds (also referred to as Aviation)
- ✓ Solid Waste Fund
- ✓ Water & Sewer Fund
- ✓ Drainage Utility Fund

Since revenue generating activities are distinct to the respective purposes of the enterprise funds, we analyzed each fund separately.

Airport Fund

The City's Airport Fund operating expenditures have operating exceeded its operating revenues by a total of $28,625,305 from FY 2007 through FY 2016. The Airport Fund's operating revenues have remained around $4 million each year and dropped to $3.7 million in FY 2016, while operating expenses increased to $8 million in FY 2016 from $6 million in FY 2007. **Figure 2-17** summarizes operating revenues and expenditures for the Airport Fund from FY 2007 through FY 2016.

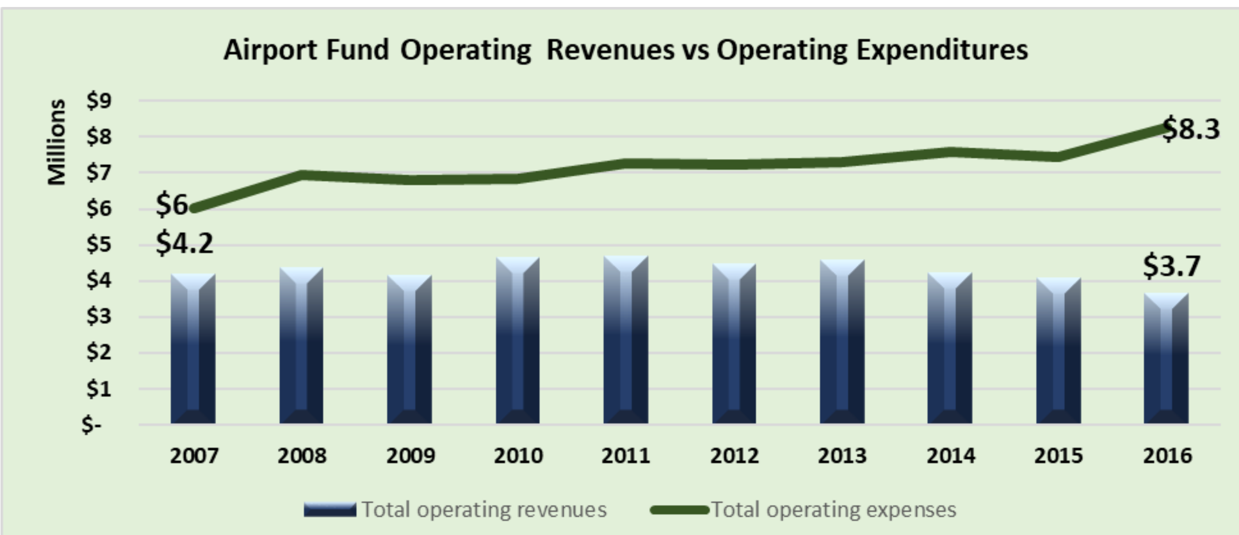


FIGURE 2-17 – City of Killeen Airport Fund Operating Revenues and Operating Expenditures FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

The Airport Fund received a total of $22,284,414 in capital contributions from developers and other sources from FY 2007 through FY 2016. These contributions, in addition to a $3.5 million grant in FY 2008, helped support the Airport Fund expenditures to prevent operational losses in four of the last 10 fiscal years. **Figure 2-18** compares the Airport Fund's total revenues to operating expenditures from FY 2007 through FY 2016.

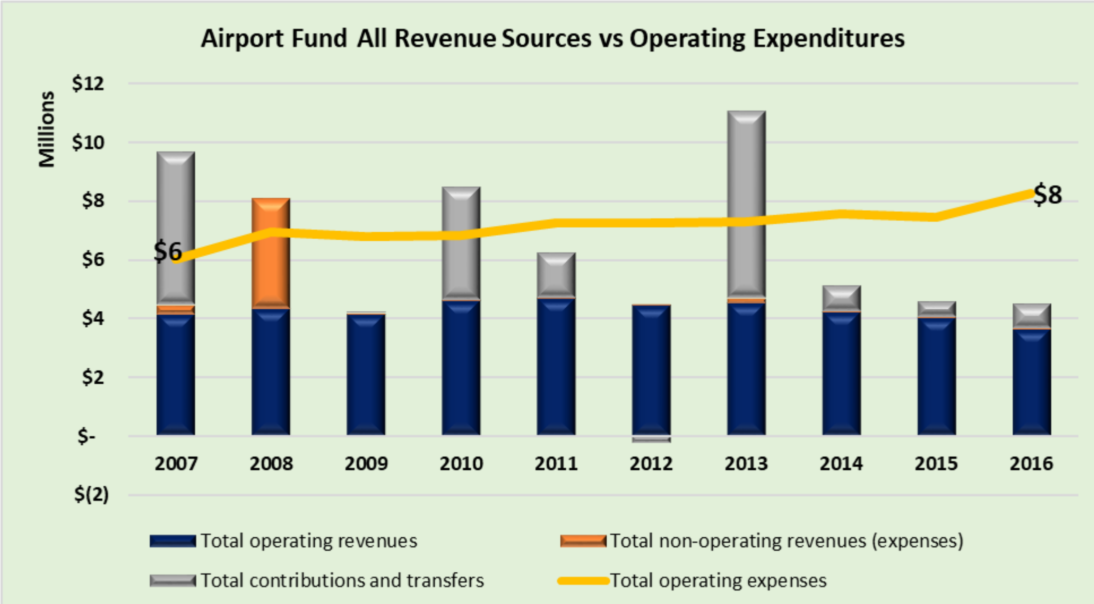


FIGURE 2-18 – City of Killeen Airport Fund Revenues and Operating Expenditures FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

Airport Fund operating expenditures exceeded all revenues by an average of $2 million to $3 million a year, except in FY 2008 and FY 2016. **Figure 2-19** provides a summary of the Airport Fund's operating losses each year from FY 2008 through FY 2016.

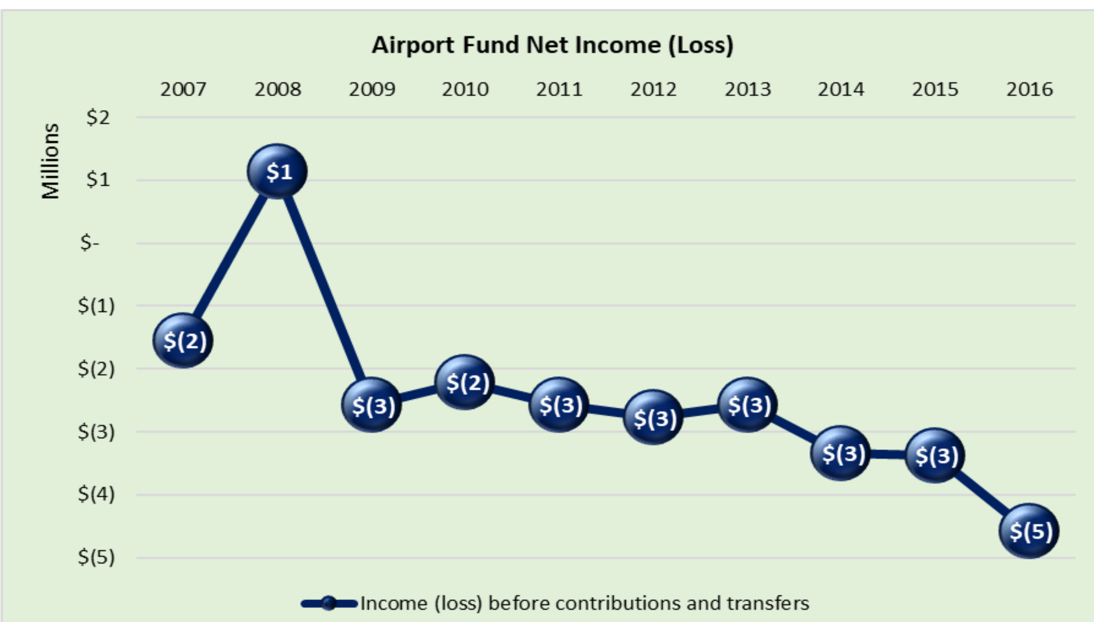


FIGURE 2-19 – City of Killeen Airport Fund's Annual Operating Losses FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Statements for respective years.

Net position for Enterprise Funds represents the difference between total assets and total liabilities. It is similar to fund balance for governmental funds. . The Airport Fund's net position decreased to $69 million in FY 2016 from $81 million in FY 2007. Furthermore, the Airport Fund's net position is comprised primarily of capital assets and no unrestricted funds as of FY 2016. **Figure 2-20** depicts the Airport Fund's net position from FY 2007 through FY 2016.

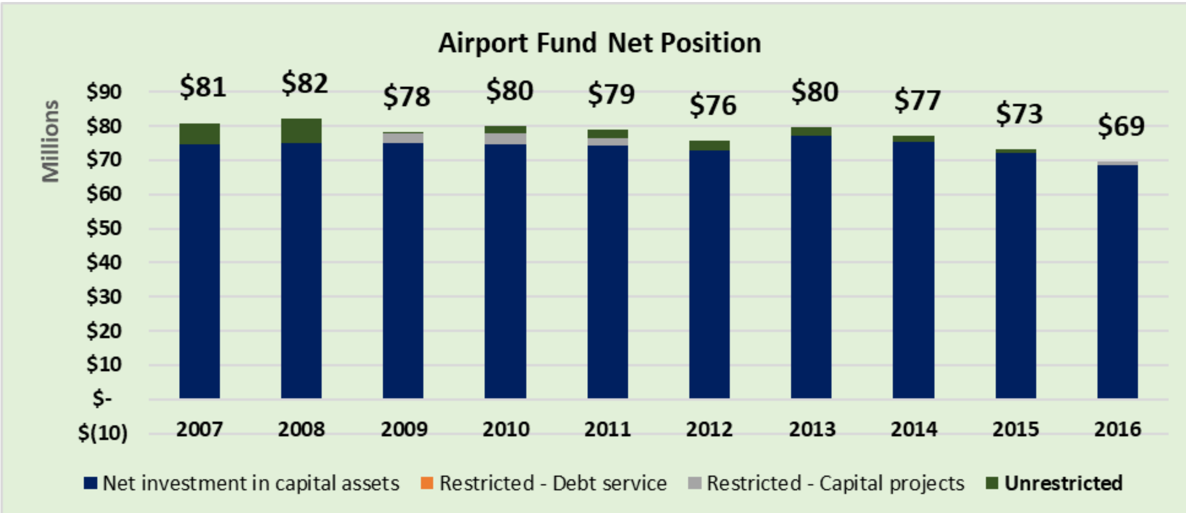


FIGURE 2-20 – City of Killeen Airport Fund's Net Position FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

Solid Waste Fund

Operating revenues in the City's Solid Waste Fund have exceeded operating expenditures by $23,291,728 from FY 2007 through FY 2016. The Solid Waste Fund's operating revenues have steadily increased to $17.6 million in FY 2016 from $11.5 million in FY 2007, while operating expenses increased to $13.2 million in FY 2016 from $9.5 million in FY 2007. **Figure 2-21** depicts operating revenues and expenditures for the Solid Waste Fund from FY 2007 through FY 2016.

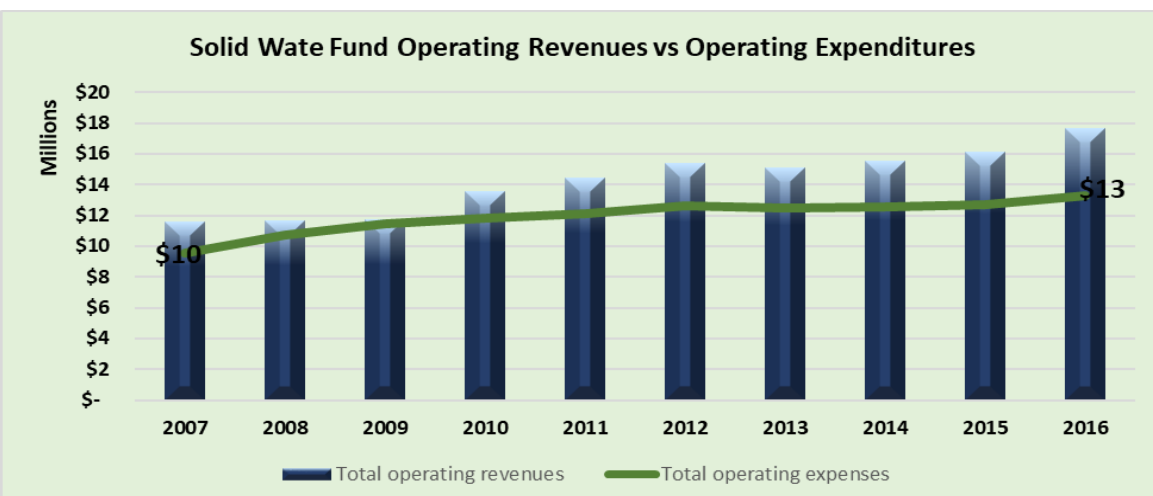


FIGURE 2-21 – City of Killeen Solid Waste Fund Operating Revenues and Operating Expenditures FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

The Solid Waste Fund received additional revenues from sales of capital asset, investment earnings, and leases. Additionally, the fund incurred interest expense related to debt and transferred franchise fees and indirect cost payments to the General Fund. **Figure 2-22** compares the Solid Waste Fund's revenues to operating expenditures from FY 2007 through FY 2016.

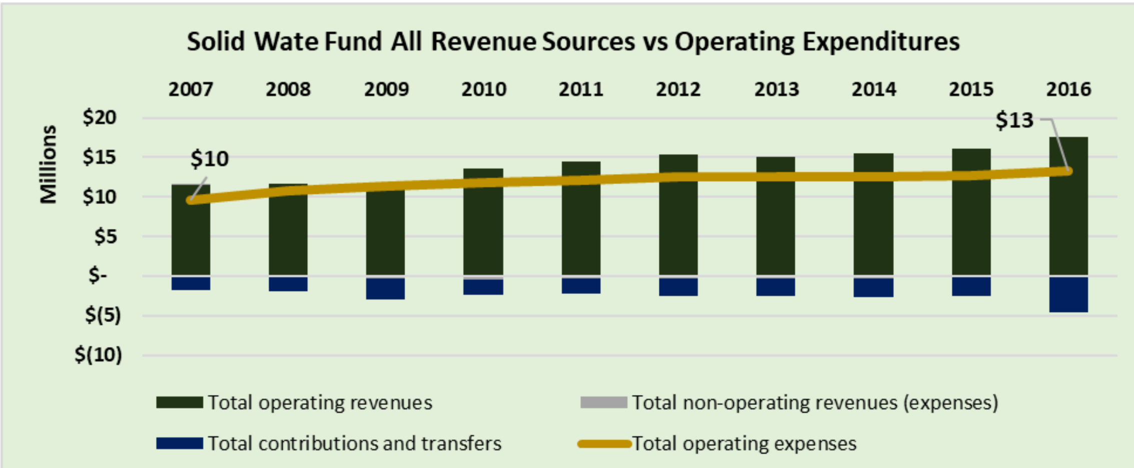


FIGURE 2-22 – City of Killeen Solid Waste Fund Revenues and Operating Expenditures FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

Operating revenues exceeded operating expenditures in the Solid Waste Fund each year. However, the $25.4 million in transfers out from FY 2007 through FY 2016 caused the fund's net position to decrease $2.87 million from FY 2008 to FY 2016. Additionally, a $0.5 million prior period adjustment in FY 2007 and a $3 million change in accounting principle to account for pension liabilities caused the Solid Waste's net position to decrease to $4.1 million in FY 2016 from $10.2 million in FY 2007. Solid Waste's net position does not contain unrestricted funds available for use at the City's discretion. Consequently, t**his situation places the Solid Waste Fund in a position of not having available resources to cover operating expenditures in an emergency, or if a lack of available resources for normal operating expenditures in fiscal years in which operating revenues do not equal or exceed operating expenditures. Figure 2-23** depicts the net position of the Solid Waste Fund from FY 2007 through FY 2016.

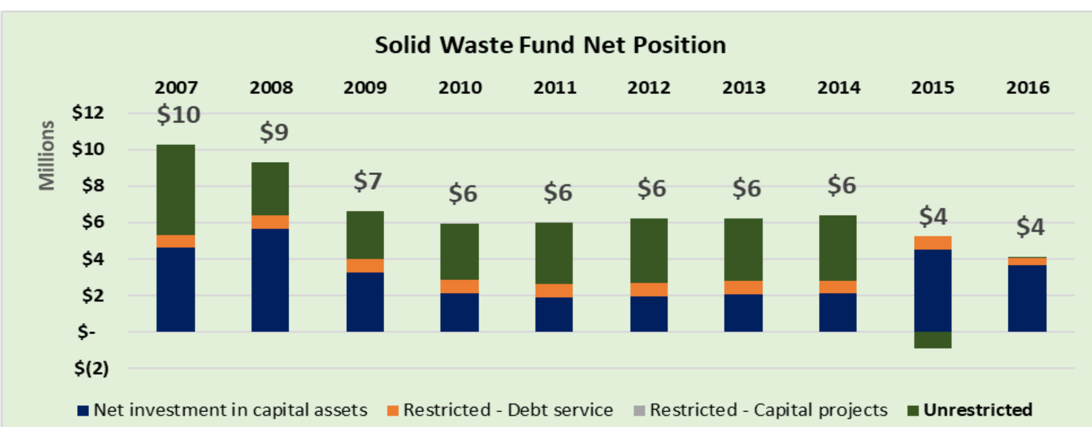


FIGURE 2-23 – City of Killeen Solid Waste Fund's Net Position FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

Water & Sewer Fund

Operating revenues for the City's Water & Sewer Fund have exceeded operating expenditures by $82,703,194 from FY 2007 through FY 2016. The Water & Sewer Fund's operating revenues have steadily increased to $38.8 million in FY 2016 from $26.8 million in FY 2007, while operating expenses increased to $31.2 million in FY 2016 from $19.9 million in FY 2007. The Water & Sewer Fund received $25.1 million in developer capital contributions and additional revenues from investment earnings. Additionally the fund incurred interest expense related to debt and also transferred franchise fees and indirect cost payments to the City's General Fund. **Figure 2-24** compares the Water & Sewer Fund's revenues to operating expenditures from FY 2007 through FY 2016.

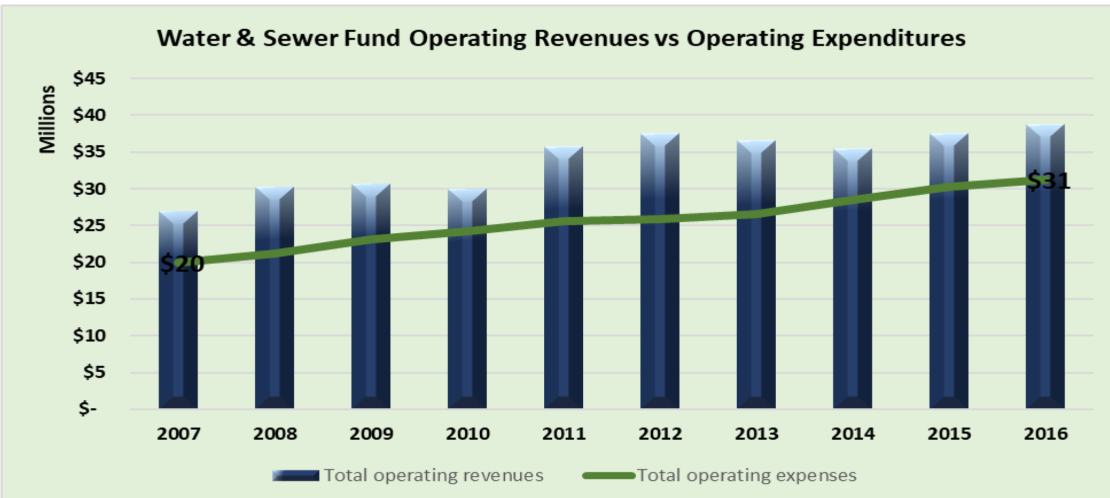


FIGURE 2-24 – City of Killeen Water & Sewer Fund Operating Revenues and Operating Expenditures FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

The Water & Sewer Fund received $25.1 million in capital contributions from developers and additional revenues from investment earnings. Additionally, the fund incurred interest expense related to debt and also transferred franchise fees and indirect cost payments to the City's General Fund. **Figure 2-25** compares the Water & Sewer Fund's revenues to operating expenditures from FY 2007 through FY 2016.

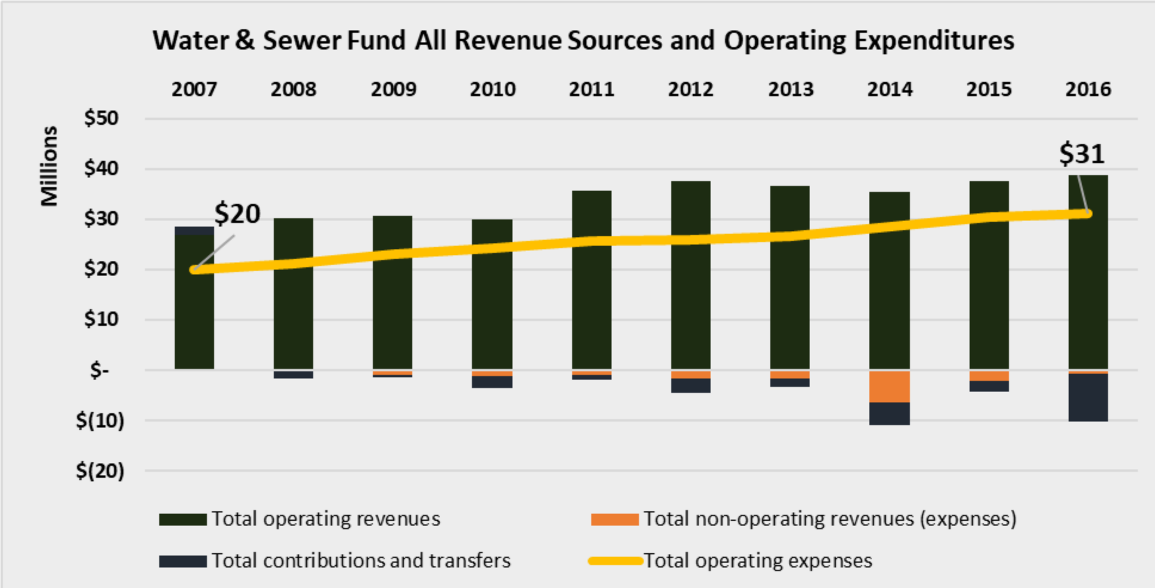


FIGURE 2-25 – City of Killeen Water and Sewer Fund All Revenues and Operating Expenditures FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

Operating revenues exceeded operating expenditures in the Water & Sewer Fund each year and contributed to the $29.5 million increase in the fund's net position from FY 2007 through FY 2016. However, the unrestricted portion decreased to $3 million in FY 2016. **Figure 2-26** provides a summary of the net position of the Water and Sewer fund from FY 2007 through FY 2016.

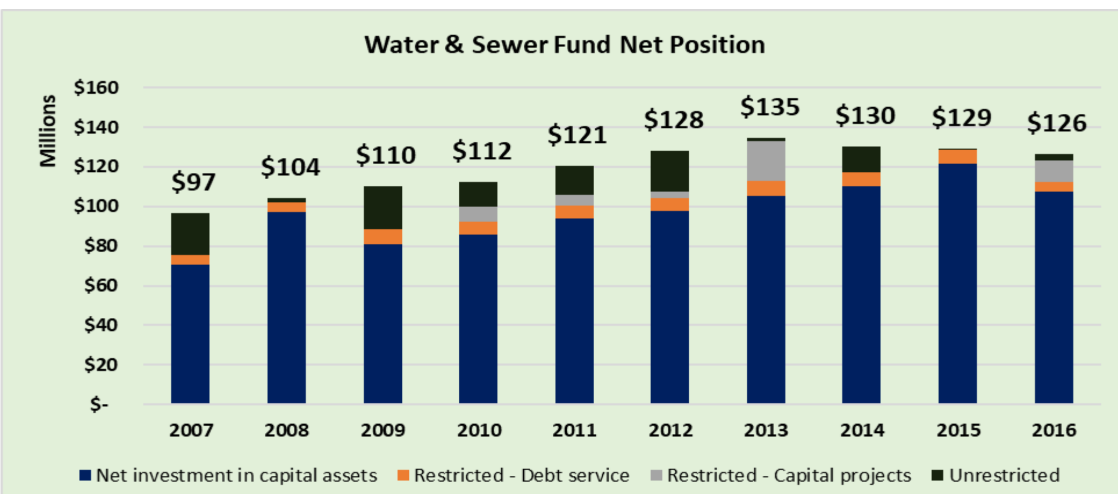


FIGURE 2-26 – City of Killeen Water & Sewer Fund's Net Position FY 2007 through FY 2016
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

Drainage Utility Fund

Operating revenues have exceeded operating expenditures in the City's Drainage Utility Fund for a total of $10,109,416 from FY 2007 through FY 2016. The Drainage Utility Fund's operating revenues have steadily increased to $4.0 million in FY 2016 from $2.1 million in FY 2007, while operating expenditures increased to $3.1 million in FY 2016 from $1.0 million in FY 2007. **Figure 2-27** summarizes operating revenues and expenditures for the Drainage Utility Fund from FY 2007 through FY 2016.

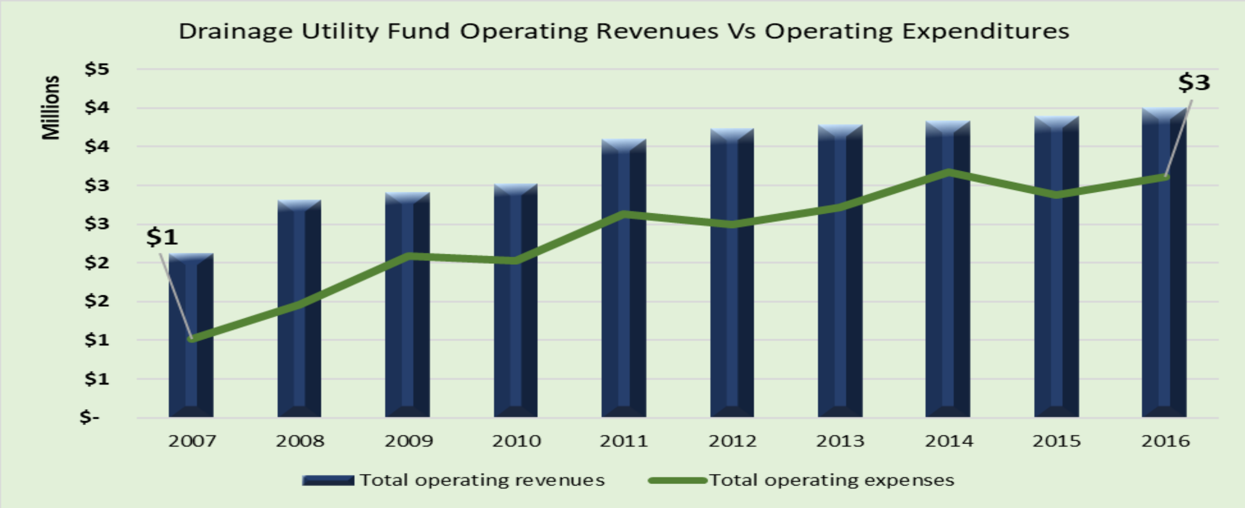


FIGURE 2-27 – City of Killeen Drainage Utility Fund Operating Revenues and Operating Expenditures FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

The Drainage Utility Fund incurred interest expenses related to debt and transferred franchise fees and indirect cost payments to the City's General Fund. **Figure 2-28** compares the Drainage Utility Fund's total revenues to operating expenditures from FY 2007 through FY 2016.

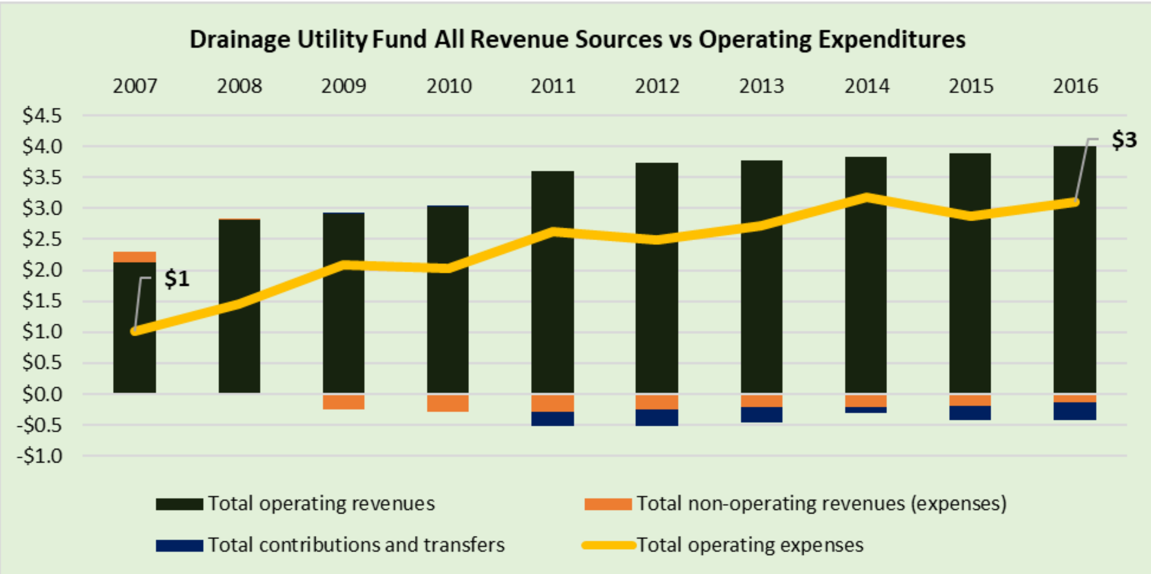


FIGURE 2-28 – City of Killeen Drainage Utility Fund Revenues and Operating Expenditures FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

Operating revenues exceeded operating expenditures in the Drainage Utility Fund each year and contributed to the increase in the fund's net position from FY 2007 through FY 2016. **Figure 2-29** summarizes the net position of the Solid Waste Fund from FY 2007 through FY 2016.

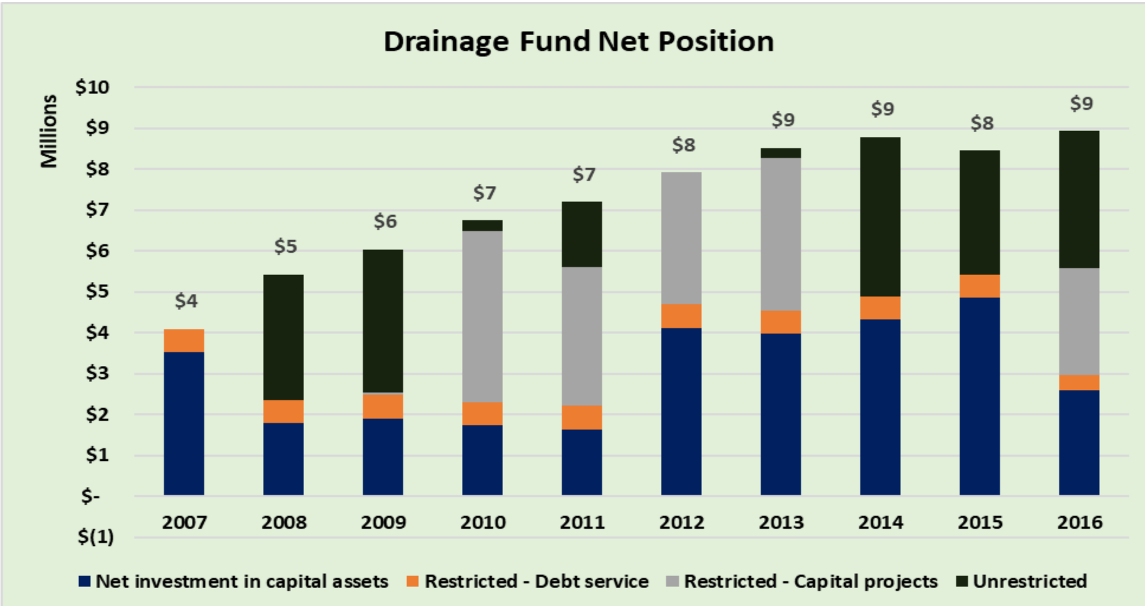


FIGURE 2-29 – City of Killeen Drainage Utility Fund's Net Position FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

Analysis of Governmental Fund Debt

Outstanding debt for governmental activities almost tripled to $208 million from $73 million over the 10-year period. This debt increase is contributed to capital projects such as adding infrastructure; renovating facilities and new buildings**.** The City increased property tax by five cents to fund debt payments. Debt issuance is discussed in Chapter 4 Bond Money Usage and Chapter 3 Capital Outlay. **Figure 2-30** summarizes the City's Governmental Fund debt from FY 2007 through FY 2016.

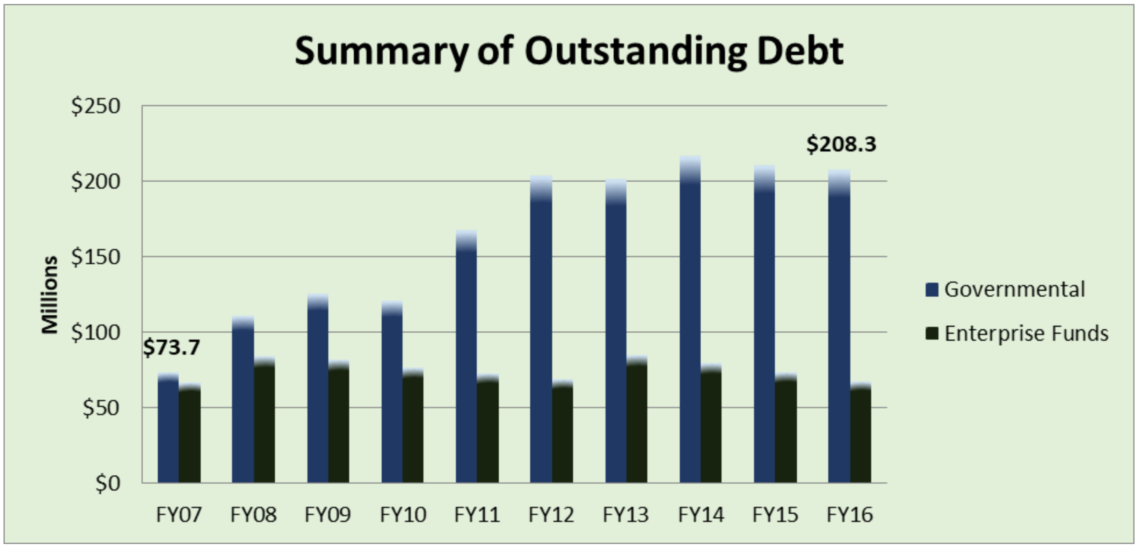


FIGURE 2-30 – City of Killeen Governmental Fund Outstanding Debt FY 2007 through FY 2016.
Source: City of Killeen Comprehensive Annual Financial Report for respective years.

Analysis of Compliance with the City's Fund Balance Policy

The City's Fund Balance and Operating Reserves Fiscal Policy Statement (policy) adopted by city council on September 27, 2011, amended the City's required fund balance reserve ratios. The policy lowered the required minimum fund balance reserve ratios for the City's General Fund to 22 percent from 25 percent of operating expenditures and maintained the same fund balance reserve ratio at 25 percent for Enterprise Funds collectively.

The City's Fund Balance and Operating Reserves Fiscal Policy Statement adopted on September 27, 2011 is not clear on the formula and financial transaction types that should be used to calculate the required fund balance percentages. The policy states that the City will strive to maintain fund balances as a percent of operating expenditures. The policy also states that the City will avoid utilizing such assigned [funds assigned or committed for facilities replacement and equipment] or committed fund balances for operational expenditures.

These statements imply that the total operating expenditures identified in the CAFR would be used as the amount to calculate operating expenditures. However, the CAFR operating expenditures section includes capital outlay and debt service payments that are not normally considered operating expenditures and would normally be identified on the CAFR as non-operating expenditures.

The CAFR Statement of Net Position unrestricted fund balance includes deferred outflows of resources and deferred inflows of resources according to GASB requirements. This provides for the long-term financial obligations, including amounts identified as future pension obligations.

Because the policy is not clear and the CAFR includes non-operating expenditures in the operating expenditures line the fund balance amounts required to meet policy requirements using the CAFR operating expenditures' totals results in higher funds required to meet the City's policy. The Finance Department calculates the Enterprise Funds' fund balance percent based on working capital which is current assets less current liabilities. The working capital formula results in less funds required to meet policy requirements. While this difference is usually less than one percent it demonstrates a need to clarify the City's fund balance policy to include the formula and specific transaction types that must be included in the formula.

Analysis of the City's Budgets

The City has adopted deficit budgets since FY 2008. We spoke with the former city manager, former finance director and current Finance Department staff to determine if this was intentional. All individuals we spoke with stated that the City's past budgeting philosophy was to budget a deficit because actual revenues were always higher than anticipated budgeted revenues. However, our analysis of revenues and expenditures presented earlier in this chapter shows that the City's actual revenues have not exceeded operating expenditures since FY 2008. **Figure 2-31** provides a summary of the City's adopted budgets by fund.

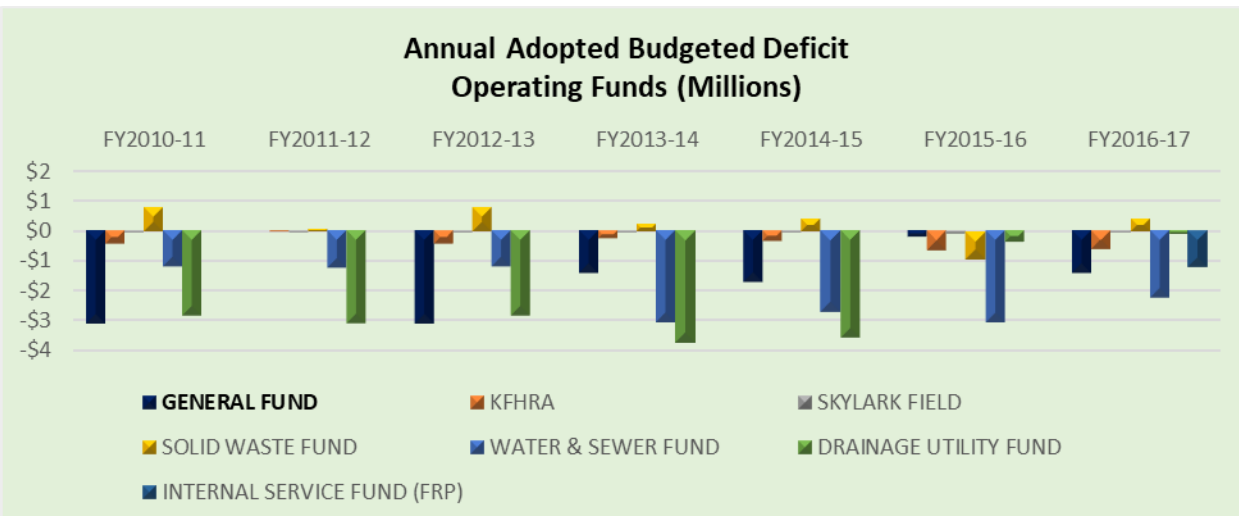


FIGURE 2-31 – City of Killeen Operating Fund Budget FY 2010 – FY 2011 through FY 2016 – FY 2017.
Source: City of Killeen Budgets for respective years published on the City's web site.

CHAPTER 3 – CAPITAL OUTLAY

This section of the report contains an assessment of capital outlays the City of Killeen (the City) made during Fiscal Years (FY) 2006 through FY 2016. The objectives for this area were to perform audit procedures necessary to address the following:

1. Determine if fraud and/or gross mismanagement exists.
2. What were the reasons for the dramatic percentage increase in capital outlay spending between FY 2005 and FY 2006?
3. How were these capital projects financed (e.g., bond issuance, federal/state grants, general fund revenues/reserves)?
4. Were there significant cost overruns (change orders due to renovations, etc.)?

CHAPTER HIGHLIGHTS

- No specific instances or documented evidence of fraud and/or gross mismanagement was provided to us or came to our attention during our work.
- Establishing a comprehensive long-range capital improvement plan would enable the City to better manage construction projects and their associated impact on the City's finances.
- Creating a dedicated capital projects management group within Public Works would take the burden of managing construction projects off department heads for whom construction is not their core competency.
- Expanding and updating existing capital outlay policies and procedures is necessary to strengthen internal controls over capital construction projects and institutionalize process knowledge and experience.
- Better project accounting and reporting is necessary to provide city council, the city manager, project managers, and other stakeholders with critical project information to make informed decisions and control costs.
- Expanding options for listing soft costs in the Capital Improvement Program Budget form would enable the city to proactively identify soft costs at the beginning of a project rather than during or at the end when such costs might be more expensive.
- A document imaging program would enable the City to reduce record storage space; gain faster, easier access to information; adhere to retention requirements; and reduce the volume of paper.

Background

The City defines capital outlay as non-recurring expenditures for improvements that exceed $50,000 and have useful lives exceeding one year. Examples include water and wastewater line replacement, street resurfacing, building construction and renovation, major software and hardware projects, and park improvements. The City incurs capital outlay costs for the acquisition; construction; renovation; and upgrade of streets, roads, buildings, communication systems, and public safety, drainage, solid waste, and various public works facilities. From FY 2006 through FY 2016, which is the scope period for the review of capital outlay, the City incurred approximately $298.4 million in capital outlay costs as shown in **Figure 3-1**, which provides capital outlay costs as well as the amount and purpose of the funding source. Costs accumulated before FY 2006 are not included in the totals.

Fund	Year of Bond Issue	Fund Status as of 2/2017	Purpose	Original Bond Issue	Total Capital Outlay
			CERTIFICATES OF OBLIGATION (CO)		
329	2001	Closed 2015	Designing and constructing an access roadway to the new airport including acquiring right of way and relocating utilities for the roadway.	$6,000,000	$2,998,795
330	2002	Closed 2009	Golf course improvement projects.	2,000,000	21,290*
331	2003	Open	Acquiring, constructing and installing improvements at the Killeen Regional Airport.	9,000,000	3,336,338
332	2004	Closed 2011	Golf course improvement projects.	3,000,000	2,814,805
333	2004	Closed 2015	Golf course and street improvements and purchasing fire, emergency medical, and public works vehicles and equipment.	3,000,000	1,795,983
335	2005	Closed 2016	Construction activities related to improving, acquiring, and/or installing a communications tower, streets, municipal building, heavy equipment, ambulances, solid waste administration facility, solid waste transfer station, and solid waste heavy equipment.	11,500,000	12,864,246
337 Combination CO\GOB Bonds	2007	Closed 2017	Constructing, improving, renovating, and equipping public safety building and facilities including police headquarters, animal control facilities, and Fire Station #8.	41,785,000	42,760,418
340	2009	Open	Street projects and parks and recreation projects.	8,500,000	8,577,153
341	2011	Open	2011A Pass-Thru Financing to fund state highway projects-190/2410.	31,400,000	27,862,480
342	2011	Open	2011 PTF 195/201-Pass-Through Financing to fund state highway projects.	18,060,000	16,411,805
343	2011	Open	Construction and acquisition activities related to infrastructure improvements and upgrades to: (i) Stagecoach Road; (ii) Bunny Trail; (iii) Elms Road; (iv) Cunningham Road, and (v) Killeen Arts and Activity Center (KAAC)	32,040,000	33,553,678
344	2012	Closed 2016	US 190 Expansion & Police Vehicles.	6,765,000	6,757,915
347	2014	Open	2014 Construct and equip Fire Station No. 9; construct and improve parks and community center facilities; and construct and improve streets and roads.	13,060,000	14,987,630

Fund	Year of Bond Issue	Fund Status as of 2/2017	Purpose	Original Bond Issue	Total Capital Outlay
385	2005	Closed 2017	Construction, improvements, renovations related to communications tower, improving streets, purchasing and improving municipal building, and purchasing equipment.	9,100,000	9,613,027
576	2006	Open	2006 Construct, reconstruct, repair, and improve drainage system and making flooding and drainage upgrades.	8,000,000	6,408,297
			Total CO Funded Projects	**$203,210,000**	**$190,763,860**
			GENERAL OBLIGATION BONDS (GOB)		
334	2004	Closed 2015	Construction activities related to improving, remodeling, and or equipping streets, signalization, public safety buildings and facilities, police headquarters, police training facility, two new fire stations, existing fire department facilities and animal control facilities, parks and recreational facilities, and senior citizens facilities.	$16,000,000	$17,437,631
336	2006	Closed 2016	Constructing, improving, renovating, and equipping parks and recreational and senior citizen buildings and facilities.	10,000,000	11,228,774
339	2006	Closed 2016	Constructing, reconstructing, and improving public streets; constructing improving, and equipping parks and recreation buildings and facilities.	13,175,000	15,370,605
345	2012	Open	Community Center renovation and improvements.	1,265,000	2,662,015
348	2014	Open	Constructing, improving, renovating, and equipping public safety buildings and facilities including Fire Station #9.	6,190,000	3,460,285
394	1994	Closed 2016	Construct public safety facilities and make street improvements.	3,750,000	122,728
395	1995	Closed 2016	Construct public safety facilities and make street improvements.	6,745,000	1,209,753
			Total GOB Funded Projects	**$57,125,000**	**$51,491,791**

Fund	Year of Bond Issue	Fund Status as of 2/2017	Purpose	Original Bond Issue	Total Capital Outlay
			REVENUE BONDS		
381	2001	Closed 2017	Improvements to and renovation of water & sewer system.	$8,700,000	$2,432,638
382	2004	Closed 2016	Improvements to construct, improve, and equip the waterworks and sewer system.	20,200,000	19,721,901
384	2007	Closed 2017	Improvements to and renovation of water & sewer system.	21,165,000	22,131,174
386	2013	Open	Improvements to construct, improve, and equip the waterworks and sewer system.	20,200,000	9,977,440
			Total Revenue Bond Funded Projects	**$70,265,000**	**$54,263,153**
			Total Bond-Funded Projects	**$330,600,000**	**$296,518,804**
			NON-BOND FUNDED PROJECTS		
248	n\a	Open	Child Safety Fund	n\a	$231,156
346	n\a	Open	Downtown Improvements Phase II	n\a	222,311
349	n\a	Open	Government Projects	n\a	132,000
350	n\a	Open	Golf course improvement projects	n\a	18,640
351	n\a	Open	Rosewood Extension Grant	n\a	14,264
387	n\a	Open	Water & Sewer Projects	n\a	113,498
526	n\a	Open	Aviation Customer Facility Charge (CFC)	n\a	37,143
528	n\a	Open	Aviation Grant Defense Economic Adjustment Assistance Grant (DEAAG)	n\a	544,499
529	n\a	Open	Aviation Passenger Facility Charge	n\a	601,563
			Total Non-Bond Funded Costs		**$1,915,074**
			Total Capital Outlay Costs		**$298,433,878**

FIGURE 3-1 – Total Capital Costs Incurred-FY 2006 through FY 2016. *The City incurred approximately $298.4 million in capital outlay costs during the 11-year period from FY 2006 through FY 2016.*
Source: Unaudited Capital Project Financial Reports.
**This project closed in 2009. Only costs that accumulated after FY 2006 are shown. When pre-FY 2009 costs are added, the total capital outlay for this project is $2.02 million.*

Between FY 2006 and FY 2016, the City spent an average of $27 million in capital outlay per year. The highest amount spent was during FY 2009 when the City spent $46 million. Nearly half of this amount consisted of spending for the following projects, which total approximately $21 million:

- New Police Headquarters – $11.9 million
- Family Aquatics Center – $4.2 million
- Fire Stations #1 and #8 – $4.9 million
- Various water and sewer projects – $8.7 million

Figure 3-2 presents a trend line of capital outlay spending from FY 2006 through FY 2016.

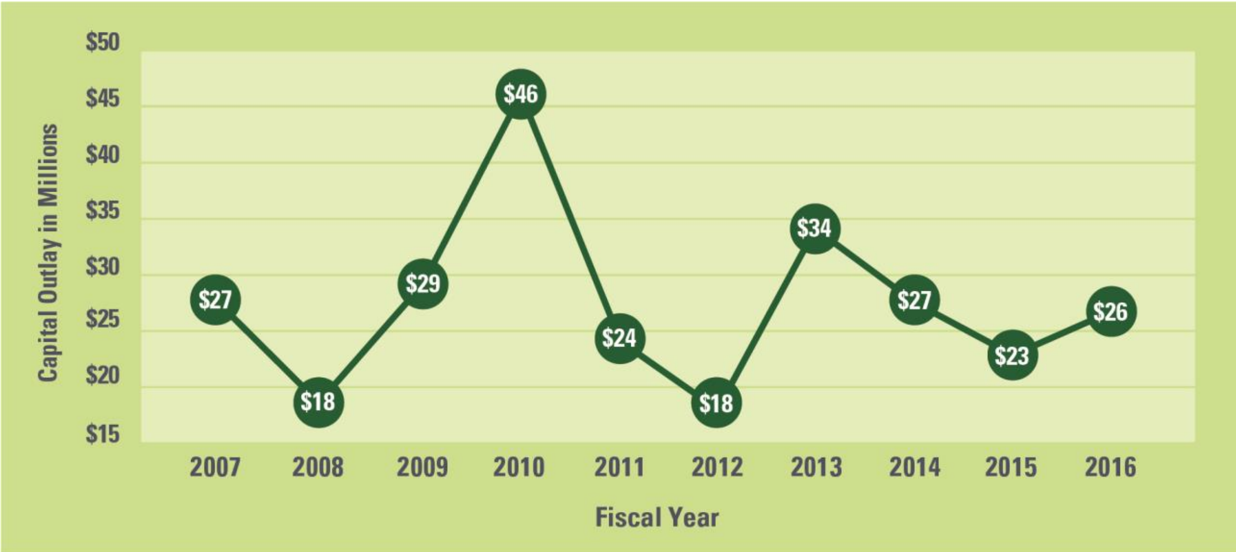


FIGURE 3-2 – Capital Outlay Spending-FY 2006 through FY 2016. *FY 2009 saw a spike in capital outlay spending due to construction of a new police headquarters, two new fire stations, an aquatic center and various water and sewer projects.*
Source: Unaudited Capital Project Financial Reports.

The Public Works Department administers the bulk of the City's capital works projects. The executive director of Public Works reports to the city manager and oversees five divisions responsible for public works and capital outlay. These divisions include Engineering, Environmental Services, Solid Waste, Street Operations, and Water & Sewer. **Figure 3-3** presents the Public Works organization.

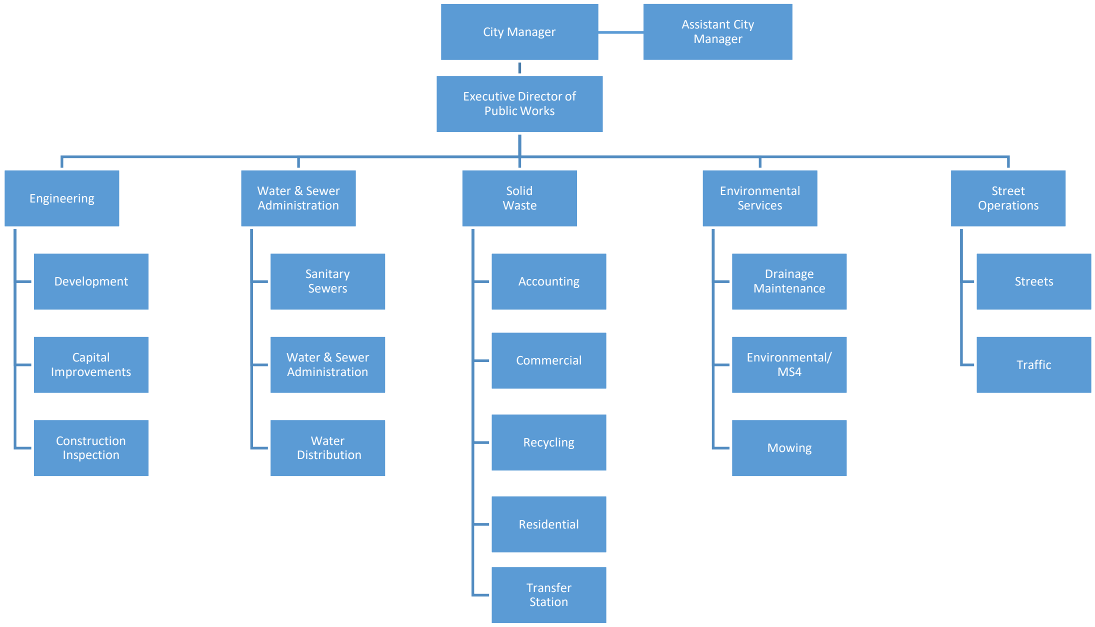


FIGURE 3-3 – City of Killeen Public Works Department Organization. *The executive director of Public Works reports to the assistant city manager and is responsible for most of the City's capital outlay projects.*
Source: City of Killeen, Texas.

Although the executive director of Public Works oversees the bulk of the City's capital outlay dollars, historically, other managers have been responsible for managing capital construction projects. For example, the chief of police was responsible for managing day-to-day project activities for the new police headquarters. In addition, the fire chief managed day-to-day activities when the City built two new fire stations. Finally, the Aviation Department was largely responsible for overseeing airport construction projects.

The City of Killeen has capital outlay master plans for water and sewer, transportation, drainage, aviation, and parks and recreation. Various department heads, Finance, the city manager, and city council all have a role in the capital outlay process. Department heads assess capital outlay needs in their area of responsibility and present their capital outlay requests for approval by completing a Capital Improvements Program Budget form for ongoing and new capital outlay projects.

The form, shown in **Figure 3-4**, requires information such as project name, estimated start and completion dates; project justification and how the project links to the City's 2030 Vision; funding sources; budget; and annual operating impact. The city manager approves the form and includes the project in the annual budget, which city council approves on a project-by-project basis. If a project arises during the year that was not included in the adopted budget, city council considers the specific project as necessary on a case-by-case-basis. Multi-year projects are included in the next budget cycle.

City of Killeen
Capital Improvements Program Budget
FY 2018-2022

Clear Form

Project Name	18" Sewer Gravity Main (11S)	**Priority #**	1
Project Status	Continuing Project	**Department**	Public Works
CCMR #	13-090R/14-097R & TBD	**Division**	Water and Sewer
Construction FY	2017 and 2018	**Account #**	38634958005499
Estimated Start	05/01/2017	**Requestor**	Steve Kana
Estimated Completion	12/31/2018		

Describe/justify the project and explain how it ties into the 2030 Plan or City's mission.

The Public Works Water & Sewer Division has established the 2012 Water & Wastewater MasterPlan in order to satisfy Vision 2030 Goal # 10 "To provide the citizens of Killeen with quality and sound infrastructure". This project relates to Vision 2030 as well as the City's mission. This project diverts sewer flow from the Central Basin to the Trimmier Creek Basin by replacing and upsizing existing force main. It also includes two City Owner Agreements to upsize a sewer main in Prairie View Phase 3 to an 18" line (CCM/R 13-090R) and to construct a portion of the Yowell Creek Tributary Gravity Sanitary Sewer Interceptor as part of the Yowell Ranch, Phase IV Subdivision (CCM/R 14-097).

FUNDING SOURCES

Source	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	5 Year Total
2013 W&S Bond	$ 785,901					$ 785,901
						0
						0
						0
						0
Total	$ 785,901	$ 0	$ 0	$ 0	$ 0	$ 785,901

PROJECT COSTS BUDGET

Components	Projected Cost Through 9/30/2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023 to Completion	Total Project Cost
Design/Engineering								$ 0
Property Acquisition								0
Construction	231,239	785,901						1,017,140
Equipment								0
Other								0
Total	$ 231,239	$ 785,901	$ 0	$ 0	$ 0	$ 0	$ 0	$ 1,017,140

ANNUAL OPERATING IMPACT

Description	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	5 Year Total	Other
Personnel						$ 0	
Operating						0	**Project Type:** Non-Recurring
Capital Outlay						0	
Total	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	**Project #:** 513-004

Notes:

The City's Water & Sewer Division maintains and improves existing as well as newly built infrastructure. Recommended life cycles of assets and proposed time lines for repairs are identified in the Water & Sewer Master Plan which outlines (maintenance as well as improvement) projects over then next 20 years. W&S operating budget is based upon a rate model which analyzes extensive assumptions to include increased operating costs as a result of new infrastructure, inflation rates, changes in personnel as well as procurement of new equipment. Due to the complexity of this process, single measures to reflect the impact on the annual operating budget cannot be determined.

City Manager Decision **Date**

Denied ______________________ ____________

Approved for FY18 Budget ______________________ ____________

FIGURE 3-4 – Capital Improvement Budget Form. *Authorized department personnel submit requests for capital outlay expenditures, which the city manager approves for inclusion in the budget approved by city council.*
Source: City of Killeen Finance Department.

For FY 2017, the City plans to spend $28.5 million or 14 percent of its total budget on capital projects. **Figure 3-5** presents the City's 2017 expenditure budget by fund category.

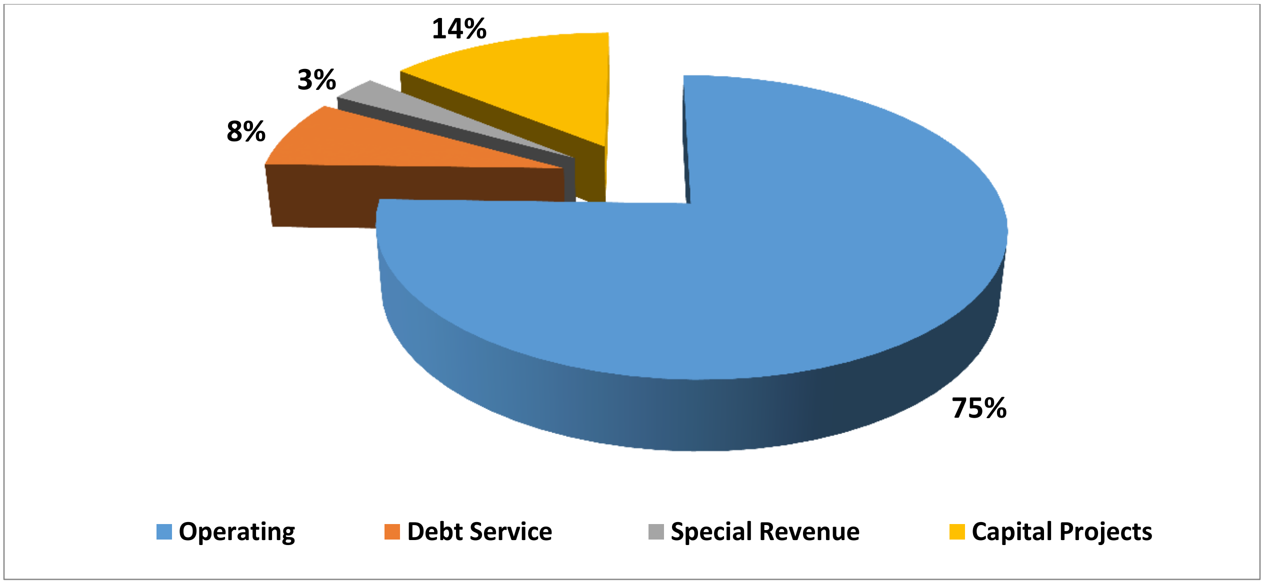


FIGURE 3-5 – City of Killeen FY 2017 Budget. *Capital project expenditures comprise 14 percent of the City's FY 2017 budget.*
Source: Comprehensive Annual Financial Reports, 2006-2016.

Of the $28.5 million in capital outlay the City has budgeted for FY 2017, 35 percent is for water and sewer projects while construction and airport projects will consume 28 percent and 27 percent of the capital outlay budget respectively, as shown in **Figure 3-6**.

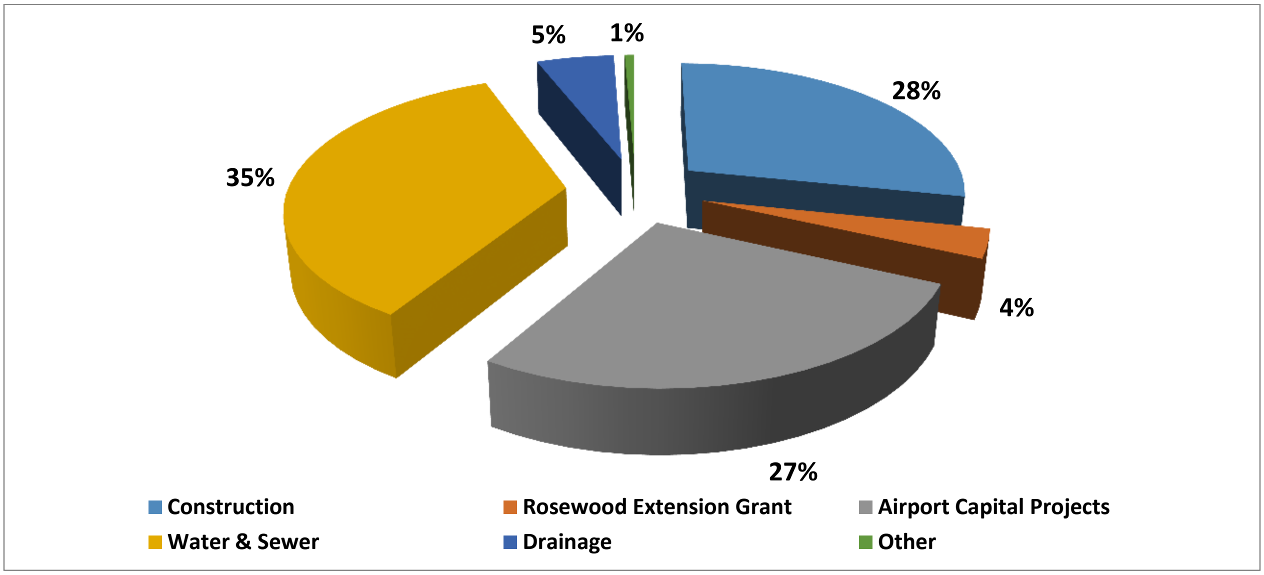


FIGURE 3-6 – Components of FY 2017 Capital Outlay Budget. *Water & Sewer and construction projects comprise 63 percent of budgeted capital outlay costs for FY 2017.*
Source: Comprehensive Annual Financial Reports, FY 2006 – FY 2016.

Bond-funded capital projects receive 87 percent of funding from bonds as shown in **Figure 3-7**, which presents a summary of bond-funded project revenue sources as of February 2017.

Revenue Source	Amount	Percent
Bond Proceeds	$ 330,258,646	87%
Interest Earned	14,125,884	4%
Transfers In	12,745,625	3%
Texas Department of Transportation Projects	5,596,103	1%
Bond Premium	4,648,894	1%
Grant Reimbursements	4,470,388	1%
Passenger Facility Charges	2,409,909	1%
FAA Grant Reimbursements	1,779,575	<1%
Other Income	1,041,267	<1%
Bell County Contributions	1,000,000	<1%
TOTAL	**$ 378,076,291**	**100%**

FIGURE 3-7 – Summary of Bond Fund Revenues-Cumulative from Inception of Bond Funds through February 2017 Summary of Line Items >$500,000 by Bond Fund. *Bond funds comprise 87 percent of funding for bond-financed projects.*
Source: Unaudited Capital Project Financial Reports from FY 2011 through February 2017.

Non bond-funded capital outlay projects receive 68 percent of funding from passenger and customer facility charges collected when travelers purchase airline tickets or rental cars, respectively. These funds are used for projects benefiting the airport. **Figure 3-8** presents funding sources for non-bond funded projects.

Fund	Project Description	Bell County Child Safety Fees	Passenger & Customer Facility Charges	Contributions	Transfers In	Other Income	Total
248	Child Safety Fund	$696,786	$79,803	$0	$0	$0	$776,589
346	Downtown Phase II	$0	$0	300,000	$0	331	300,331
349	Governmental Capital Projects	$0	18	$0	132,000	$0	132,018
350	Golf Capital Projects	$0	48,616	$0	9,352	$0	57,968
351	Rosewood Extension Grant	$0	$0	$0	200,000	186	200,186
387	Water & Sewer (W&S)	$0	23	$0	115,000	$0	115,023
526	Aviation Customer Facilities Charge	$0	1,773,120	$0	$0	$0	1,773,120
528	Aviation Defense Economic Adjustment Assistance Grant (DEAAG)	$0	$0	337,556	$0	$0	337,556

Fund	Project Description	Bell County Child Safety Fees	Passenger & Customer Facility Charges	Contributions	Transfers In	Other Income	Total
529	Aviation Passenger Facilities Charge	$0	1,986,965	$0	$0	1,392	1,988,357
	Total	**$696,786**	**$3,888,545**	**$637,556**	**$456,352**	**$1,909**	**$5,681,148**
	Percentage	**12%**	**68%**	**11%**	**8%**	**<1%**	**100%**

FIGURE 3-8 – Summary of Non-Bond Fund Revenues. *Passenger and customer facility charges comprise 68 percent of funding for non-bond-financed projects.*
Source: Unaudited Capital Project Financial Reports from FY 2011 through February 2017.

Audit Questions' Results

The following tables summarize our conclusions to the four specific questions we were asked to address in the contractual scope of work.

Review Area:	**Capital Outlay**
Objective:	Determine if fraud and/or gross mismanagement exist.
Conclusion:	No instances of fraud and/or gross mismanagement came to our attention during the course of our work. However, capital outlay project accounting and reporting processes require strengthening to prevent or discourage fraud and/or gross mismanagement from occurring.

Review Area:	**Capital Outlay**
Objective:	What were the reasons for the dramatic percentage increase in capital outlay spending between FY 2005 and FY 2006?
Conclusion:	We were unable to determine the specific causes of the 311 percent increase in General Fund capital outlay spending because the City could not provide the information necessary to conduct the analysis. We requested the detailed trial balances schedules for FY 2005 and FY 2006, which shows the account groupings that support capital outlay amounts in question. These work papers would have allowed us to analyze the differences in the underlying accounts to isolate the causes of the variance. Without this detail, the reasons for the 311 percent increase cannot be determined. Finance staff could not provide an explanation of why the work papers could not be located. However, the City is not in violation of its records retention policy since the information was only required to be retained for three years after all audit issues had been resolved. As an alternative procedure, we performed a review of subsequent year General Fund capital outlay spending noting that such expenditures did not correspond to the City's definition of capital outlay, namely the acquisition; construction; renovation; and upgrade of streets, roads, buildings, communication systems, and public safety, drainage, solid waste, and various public works facilities. The General Fund capital outlay expenditures we

Review Area:	**Capital Outlay**
	examined for subsequent years consisted of equipment, furniture and fixtures, and vehicles. It is not unusual for the General Fund to purchase these types of fixed assets.

Review Area:	**Capital Outlay**
Objective:	How were these capital projects financed (e.g., bond issuance, federal/state grants, General Fund revenues/reserves)?
Conclusion:	Bonds comprise 87 percent of funds for capital outlay for bond-funded projects. From FY 2006 through FY 2016, certificates of obligation, general obligation bonds, and revenue bonds comprised 61 percent, 21 percent, and 18 percent of bonds issued, respectively. Passenger and customer facility charges comprise 68 percent of funding for non-bond projects. Bell County child safety fees comprise 12 percent of non-bond funded projects, while various contributions comprise 11 percent, and transfers from other funds comprise 8 percent of funding for non-bond projects.

Review Area:	**Capital Outlay**
Objective:	Were there significant cost overruns (change orders due to renovations, etc.)?
Conclusion:	There were no significant cost overruns for the 12 projects in our sample. We also selected a sample of eight change orders constituting 40 percent of the value of change orders for the projects selected. No exceptions were noted.

Observations and Recommendations

OBSERVATION 3-1: Multi-year Capital Projects Plan

The City does not have a comprehensive multi-year Capital Improvement Plan for capital projects that identifies all projects likely to be constructed within five years. The City can better manage its capital improvement process by implementing a comprehensive multi-year Capital Improvement Plan. Currently, the City does not have such a plan.

Section IIA of the City's Debt Management Policy CCM/R 97.54R, adopted in May 1997, requires the City to develop such a plan. It states the following:

> *The City shall develop a capital planning and financing system for use in preparing a multi-year Capital Improvement Plan for consideration by the City Council as part of the City's budget process. The City Manager shall prepare recommendations to the City Council for projects to be included in a multi-year capital improvements plan. This plan shall be for the coming three fiscal years and shall be updated periodically. The Plan shall contain a comprehensive description of the sources of funds and the timing of capital projects for future operating and*

capital budgets, effect of the projects on future debt sales, debt outstanding, and debt service requirements, and the impact on future debt burdens and current revenue requirements.

All of the City's enterprise funds have capital improvement plans, as does Parks & Recreation and Transportation, which are General Fund departments.

A comprehensive multi-year Capital Improvement Plan is more efficient and manageable than individual department plans. The input and involvement of all stakeholder departments is an indispensable component of a comprehensive plan that would incorporate all departmental plans. To assess the future financial impact on the City, the plan should identify funding sources and estimate the financial impact of future operating expenses necessary to maintain all projects.

The construction of the police headquarters and Fire Station No. 8 are past examples of the need for better planning. On November 5, 2002, Killeen voters passed a bond referendum that included approximately $23.3 million to build a new police department and two new fire stations. These amounts were determined without completing a formal, comprehensive needs assessment. Instead, the City made informal cost estimates to size the bond. A needs assessment is a systematic process for determining and addressing needs, or "gaps" between current conditions and desired conditions or "wants".

In 2007, the City issued general obligation bonds to construct the new police headquarters and Fire Station No. 8 for $14.2 million and $2.3 million, respectively. Prior to issuance of the bonds, the City conducted a formal needs assessment, unlike in 2002 when only an informal cost estimate was done. The formal needs assessment showed a higher cost than the FY 2002 estimated amount used to size the bond. In addition to these difference s in costs, during the five-year delay in construction from 2002 to 2007, construction costs increased, which resulted in a budgetary shortfall of $12.8 million for the police station and $1.2 million for Fire station No. 8. The City funded the shortfalls with certificates of obligation issued in 2007.

RECOMMENDATION 3-1: Multi-year Capital Projects Plan

The City should establish a comprehensive long-range capital improvement plan that considers the future infrastructure requirements of the City, prioritizes capital improvement projects, and identifies funding sources and their impact on the overall financial health and condition of the City. The City should also consider conducting a needs assessment for all capital projects in excess of an established dollar threshold. The city manager should consolidate the capital project improvement plans of each department and initiate a process to develop a single comprehensive capital improvement plan for the City as a whole. The process should identify all stakeholders and assign objectives, responsibilities, and timelines for the completion of the plan. City council should approve the plan, and the city manager should develop processes for monitoring and updating the plan.

OBSERVATION 3-2: Dedicated Capital Project Group

The City does not have a dedicated design and engineering group responsible for overseeing all construction projects throughout the City. As a result, in the past, department heads have been responsible for working with outside construction consultants and construction managers to oversee construction projects. For example, the fire chief presided over the construction of Fire Stations #1 and #8. The City built Fire Station #8 in 2009 and #1 in 2010. Fire Station #8 was the chief's first construction supervision experience, which is not his core competency. The project was over budget, and it was discovered that certain "soft costs" were excluded from the initial estimates. Although the chief was not directly responsible for this oversight, it underscores the need for professional expertise to oversee the City's construction projects. Recognizing the construction experience gap, the fire chief recommended that the city hire a project manager. The city followed the fire chief's recommendation and hired a project manager two months into the construction of Fire Station #8. However, the project manager did not remain to complete Fire Station #1.

Other departments that provided oversight for their own construction projects include the Police and Aviation Departments. The former chief of police led the effort to construct the new police station, although law enforcement, not construction, is his core competency. The City used an onsite representative to oversee construction and executed a construction manager at risk contract.

In 2004, the assistant aviation director was responsible for overseeing airport improvements and construction. Aviation personnel were involved with approving invoices, selecting vendors, and oversight of a project manager the City hired to assist with these activities. The City's Public Works Department also provided assistance but did not have the adequate staff to manage the entire project. Public Works was involved with the bid process and developing specifications. Aviation also worked with the Purchasing Department to design specifications.

RECOMMENDATION 3-2: Dedicated Capital Project Group

The City should create a dedicated design, engineering, and construction team within Public Works to oversee and supervise City construction projects. Public works recently created a transportation team to manage infrastructure projects related to water and sewer, streets and traffic, drainage, and solid waste. They do not handle vertical construction projects. These employees dedicate the majority of their time to project management. However, no other dedicated group exists in the department to oversee vertical construction projects.

The City defines two types of construction: vertical and horizontal. Vertical construction involves buildings and similar facilities built from the ground up. Horizontal construction relates to roads, utilities, drainage, and similar facilities constructed at ground level. Currently, department heads are responsible for managing facility construction, which is not a major issue presently because the City is not engaged in much vertical construction. However, the City should begin working towards creating a dedicated, centralized design, engineering, and construction group in anticipation of increased vertical construction in the future.

The city manager should direct the executive director of Public Works to develop a plan to create a centralized design, engineering, and construction group to oversee construction projects once the need arises when the City is involved in heavy construction activity. This organization should have knowledge and expertise that will serve the City well and provide insight and guidance that may alleviate unnecessary change orders, cost overruns and possibly circumvent construction challenges experienced by non-experienced construction professionals.

OBSERVATION 3-3: Capital Outlay Policies & Procedures

The City lacks comprehensive capital outlay policies and procedures. The Finance Department has financial policies, dated February 2016, that contain limited capital outlay provisions. The policy provides a definition of capital project expenditures and outlines the conditions under which capital projects are to be constructed, which are to:

1. protect, maintain, or improve the community's quality of life and economic vitality;
2. provide significant rehabilitation of City infrastructure for sustained service; and

3. support and service new development.

The policy requires prioritization of projects based on an analysis of needs and available resources. It also requires the City to develop a Capital Improvement Program (CIP) similar to that required by the City's Debt Management Policy. Finally, it requires the establishment of a capital projects review committee appointed by city council to review the CIP annually and provide recommendations.

Although the policy has these provisions and requirements, it has not been fully implemented. Long-range capital outlay deliberations occur during the annual budget process; however, there is no formalized process or plan. The City has a Capital Improvement Program Budget form (See **Figure 3-4**), but the policy makes no reference to the form. The policy also lacks provisions establishing approval requirements and thresholds. For example, it does not specify who can approve projects and at what dollar amounts. It also has no provisions regarding change orders and how they are to be justified, reviewed, approved, documented, and executed. The policy also does not establish project close-out procedures including how project construction, administrative, and financial documentation is to preserved and protected and for how long. It also does not provide close-out procedures outlining how remaining funds are to be used and who is authorized to make the decision. The current policy also does not have procedures for obtaining any necessary additional funding before project closeout.

RECOMMENDATION 3-3: Capital Outlay Policies & Procedures

The city manager should instruct the executive director of Public Works to review Section XI-Capital Project Expenditures of the City's Financial Policies and revise it to include provisions regarding authorization requirements and thresholds, change order processes, and close-out procedures, including use of remaining funds and documentation storage and retention. Once the policy has been enhanced, the city manager should approve the policy and submit it to city council for adoption.

OBSERVATION 3-4: Capital Project Reporting

The City does not generate project budget reports that would allow project managers to review, on a routine basis, budget to actual reports for capital projects. Each project has a one line authorization amount and is assigned an account code to which costs are charged and accumulated as work progresses. Public Works, for example, does not have a formal method of project accounting and reporting. The department maintains its own shadow records in the form of a spreadsheet log to monitor the costs of projects. The log is maintained internally and does not interface with the City's financial accounting system. This method, while useful given the absence of a more efficient process, is not the best approach to provide strong internal controls over project budgets and costs.

The City also does not assign unique account codes to a single project so that all financial transactions for a given project can be captured under a single project code. The City uses fund and accounting codes to capture project costs; however, one project can have more than one fund code and more than one account code. Assigning a unique code to each project would enable the City to capture all costs for individual projects in one place for comprehensive project reporting.

The City also does not have one central repository of project information that includes project descriptions, funding sources, budgeted amounts, change orders, expenditures and estimated costs of completion, anticipated completion dates, and other critical project information. An effective record keeping system is an important component of strong internal controls.

The City uses fund and account numbers to establish accountability over project expenditures. Funds typically include more than one project and identify the project's funding sources. The City assigns a unique account number to each project within a fund. As project costs are incurred, they accumulate under the fund and account numbers on the City's general ledger.

Each month, the Finance Department prepares a capital projects financial report, which provides, for each account within the fund, the authorized amount, revenues, expenditures, commitments, and remaining authorization and cash balance. The reports show the source of funds for the capital projects, such as bond proceeds, interest income, grant proceeds, contributions, donations, transfers, and various other sources of revenue. It also lists capital project expenditures, by project, by fiscal year. See **Figure 3-13** in the Bond Money Usage chapter for an example of the report.

Preparation of the reports dates back to at least FY 2001. Current accounting staff has been preparing the reports since April 2016. When current accounting staff took responsibility for preparing the report they added a control to check the ending cash balance of each fund to ensure that it agreed with the bank statement and cash reconciliation. If the cash remaining in the fund did not agree with the money in the bank, staff conducted a review of the fund to validate its historical information.

The City's Financial Procedures, dated February 2016, states the following regarding monthly reporting:

> *Monthly reports shall be prepared comparing expenditures and revenues to the amended budget. Explanatory notes and charts will be included, as needed. These reports shall be provided to the City Council and Finance Advisory Committee within sixty days following the conclusion of each calendar month. The monthly report format shall be consistent with the format of the annual budget document, and they may also be posted to the City's web site.*

This procedure does not provide preparation standards and techniques to ensure the consistency, accuracy, and quality of the underlying spreadsheets used to prepare the monthly reports. We relied heavily on these spreadsheets to provide information about the City's bonds and capital projects for this engagement. While working with 33 spreadsheets, we noted various deficiencies as shown in **Figure 3-9**.

Deficiency	Occurrences	Percent
No source is provided for the information	33	100%
*Numbers are embedded rather than using formulas	22	67%
Total includes duplicated amounts	3	9%
No excerpt from bond ordinance affixed on spreadsheet	2	6%
No proof of cash section to validate remaining cash balance with bank statement	1	3%
Schedule does not foot	1	3%

FIGURE 3-9 – Deficiencies in Unaudited Capital Project Financial Report Spreadsheets. *The spreadsheets supporting monthly reports contain deficiencies.*
Source: Capital Project Financial Report Spreadsheets.
**This condition may exist only in the versions of the spreadsheets the City provided to MJ; it may not exist in the spreadsheets Finance staff use each month to generate the reports. Nonetheless, the City's financial policies manual should address embedded totals in spreadsheets mandating staff to avoid embedded totals whenever practical.*

RECOMMENDATION 3-4: Capital Project Reporting

The finance director should assist project budget managers by providing the level of detail for their projects that would make project budget-to-actual reports more useful for controlling the costs of each individual project. Finance only recently began providing budget reports to the departments after the month-end closing of the City's books; this previously was not done . The City should also use the account code string in its chart of accounts to establish unique project codes to capture costs for each individual project.

Training should also be provided on how to use the reports, as well as permission granted to give project budget managers read-only access to monitor their budgets in the accounting system. The goal should be for project managers to eliminate shadow recordkeeping. In addition, project managers and the finance director should collaborate to develop a comprehensive database of general project information and other data such as budget amounts, approved change orders, revised budget amount, expenditures to date, estimated cost to complete and anticipated completion date.

In addition, the finance director should establish standards for preparing the Capital Project Financial Report to ensure the highest quality of information included in the spreadsheets. The Finance director should also establish a review and authorization protocol for the spreadsheets. The accuracy of this information is critical because the spreadsheets serve as the basis for management's analysis of capital project revenues and expenditures and for the reports provided to city council. The finance director should update the City's Financial Procedures Manual to include review and approval protocols and preparation standards for the spreadsheets. Staff responsible for preparing the reports should be trained on the updated procedures to ensure they understand the standards and adhere to them. Examples of standards that might be considered include the following:

- Provide a source for the data at the top of the spreadsheet.
- Document when the spreadsheet was last reviewed for quality and by whom.
- Include a proof of cash section on the spreadsheets as well as an excerpt from the bond ordinance where applicable.
- Place similar items in the same column.
- Avoid blank rows and columns in a range.
- Create notes to identify hidden rows and columns in a range.
- Use data format guidelines.
- Use column labels to identify data.
- Use cell borders to distinguish data when separating labels from data.
- Avoid inserting spaces at the beginning or end of a cell to indent data.
- Avoid embedding amounts; use Excel's functions to perform mathematical operations.

OBSERVATION 3-5: Budgeting Soft and Multi-Year Costs

Capital outlay budgets do not always reflect both the hard and soft costs of a project. Soft costs include architectural, engineering, financing, legal fees, and other pre- and post-construction expenses. Consequently, planning for capital projects, in certain instances, is limited. For example, the City funded the capital outlays for the renovation of 101 E. Avenue D, also known as Cornerstone, from the General Fund with an expectation of being reimbursed from the certificate of obligation proceeds. City council approved the City Council Memorandum for Resolution (CCMR) for this project in FY 2015. However, on August 9, 2016, city council rejected a resolution to proceed with the issuance of certificates of obligation to reimburse the General Fund.

The City's financial policies allow for reimbursement of costs and provide guidelines for budgeting soft costs. The following is an excerpt from the policy.

> *Costs incurred for advanced planning of capital projects may be funded from reimbursement of appropriate debt or operating funds. Capital Improvement Planning and Programming shall include the following categories for the determination of funding for individual projects: design costs, right-of-way costs, utility construction/adjustment costs, construction costs, appropriate contingency funds, furnishings and equipment, and direct project administration services provided by City employees or outside forces.*

The form the City uses to request funds for capital projects has a project costs budget section that includes the following five categories:

- Design/Engineering
- Property Acquisition
- Construction
- Equipment
- Other

This form could be expanded to specifically name typical soft costs that are incurred on a construction project.

In addition, the City's current process is to re-appropriate the costs of multi-year projects every year rather than authorizing the project costs for the entire period of the project. Reauthorizing costs annually on a multi-year project is inefficient from an accounting perspective because authorizations of current year expenditure for the project must be made every year.

RECOMMENDATION 3-5: Budgeting Soft Costs

The city manager should instruct the finance director to revise the Capital Improvement Program Budget form to expand the Project Costs Budget to list typical soft costs. The City should keep a record of soft costs incurred that were not anticipated as information that can be used to make more accurate estimates in the future.

In addition, city council should authorize a project for its entire life cycle rather than annually for multi-year projects. This would allow remaining authorization amounts to automatically rollover each year until the total authorized amount is reached. City council should monitor the projects during each year of its multi-year life cycle to determine the accuracy of the multi-year cost estimate and whether adjustments might be necessary. This practice will avoid surprises toward the end of the project's life cycle if additional authorization is required.

OBSERVATION 3-6: Document Imaging and Retention

While the City has document imaging software, it is not being fully used and the City does not have a comprehensive document imaging program. For records retention guidance, the City has adopted

The Texas State Library and Archives Commission's (TSLAC) Local Schedule GR-Retention Schedule for Records Common to All Local Governments (LSGR), which is in the 5th edition effective April 2016.

The City could not provide detailed trial balances supporting the FY 2005 and FY 2006 audits. This documentation is necessary to determine the reason for the 311 percent increase in General Fund capital outlay between these years. The 3rd edition of TSLAC's LSGR states, in Part 2-Financial Records-1025-01e, that the retention period for working papers, summaries, and similar records created for the purposes of conducting an audit is three years after all questions arising from the audit have been resolved. The City meets this requirement since questions regarding the FY 2006 audit have been resolved since FY 2009.

In addition to the audit work papers, the City could not provide accounts payable documentation prior to FY 2011. We requested this information to review capital outlay expenditures associated with projects within the scope period. The 3rd edition of TSLAC's LSGR would have been in effect in FY 2011. The retention period for accounts payable and disbursement records of the type we requested is three years. Consequently, the City is not in violation of records retention requirement for not preserving the information beyond FY 2014.

RECOMMENDATION 3-6: Document Imaging and Retention

The City should adopt a document imaging program to supplement and support its document retention policy. Many organizations have adopted document imaging technology and integrated the technology in all of their business processes. The key benefits of document imaging are the reduced space used for record storage, faster and easier access to information, improved security of information and a major reduction in paper. Files in a digital format are easily duplicated and readily transferable to electronic backup media for onsite or offsite storage.

The city manager should instruct the director of Information Technology to develop a strategy to implement document imaging in the City over the next three years. The director of Information Technology should seek outside expertise on the most effective way to achieve this goal in the most expeditious, cost-effective manner possible.

Capital Outlay Audit Methodology

We performed the following activities to assess capital outlay expenditures from FY 2006 through FY 2016.

- Between March 31, 2017 and June 23, 2017, the management audit team conducted 26 interviews with council members, current city employees, and former city employees to gain a current and historical perspective of processes, internal controls, and management effectiveness. ***Although speculation and suggestions of fraud and/or gross mismanagement were raised during the visioning session and during interviews, no specific instances or documented evidence of fraud and/or gross mismanagement was provided to us or came to our attention during our work.*** We interviewed the following individuals:
  - City attorney
  - City manager
  - Assistant city manager
  - Council members

- Mayor
- Director of Public Works
- City planner
- Director of Planning & Development
- Executive director of Community Development
- Director of Community Service
- Director of Environmental Services
- Fire chief
- Assistant director of Finance
- Accounting supervisor
- Staff accountant
- Executive director of Finance
- Assistant director Aviation
- Aviation accounting specialist
- Interim police chief
- Former city manager
- Former finance director

➲ Compared General Fund capital project costs incurred during FY 2005 and FY 2006 to identify the 311 percent increase between years. We were unable to determine the cause of the 311 percent increase because the City could not provide the information necessary to conduct the analysis. We requested the detailed trial balances for FY 2005 and FY 2006, which shows the account groupings that support the two amounts in the CAFR. These schedules would have allowed us to analyze differences in the underlying accounts to isolate causes of the variance. Without this detail, the reasons for the 311 percent increase cannot be determined. Finance staff could not provide an explanation for why the schedules cannot be located. However, the City is not in violation of its records retention policy since the information was only required to be retained for three years after all audit issues had been resolved. We asked Finance staff to request a copy of the schedules from the former audit firm. The firm responded, but the information it provided was incomplete and, therefore, not useful. **Figure 3-10** shows how the 311 percent increase was determined.

Source of Funds	Description	FY 2005	FY 2006	Percentage Change
General Fund	Capital expenditures made from General Fund	$1,779,070	$7,311,072	311%

FIGURE 3-10 – Analysis of Increase in Capital Outlay Spending Between FY 2005 and FY 2006. *General Fund capital expenditures increased 311 percent between FY 2005 – FY 2006.*
Source: Comprehensive Annual Financial Reports, 2006-2016.

➲ As an alternative procedure, we analyzed General Fund capital outlay expenditures from FY 2008 through FY 2016 detailed trial balances since these documents were available. Although this procedure did not provide an explanation for the 311 percent increase, it did provide insight into the nature of General Fund capital outlay expenditures. We noted that most General Fund capital outlays were neither bond related nor did they correspond to the definition of capital outlay as described in the City's financial policies: …*improvements that exceed $50,000 and have useful lives exceeding one year…Examples include water and wastewater line replacement, street resurfacing, building construction and renovation, major software and hardware projects, and park improvements.*

Instead, we noted that the expenditures were closely aligned with the definition of fixed assets costing $5,000 or more rather than the definition capital outlay described in the financial policies. Based on our review, the only costs that appeared to be bond-related are summarized in **Figure 3-11,** the largest amount which is developer infrastructure contributions. Developer contributions are the value of infrastructure (streets, waterlines, etc.) that a developer installs and dedicates to the City. The approximate $5.9 million, although recorded as capital outlay, was offset by the same amount of revenue.

General Fund Bond-Related Capital Outlay	Amount	FY
Developer Infrastructure Contributions	$5,888,521	2008
Reimbursable Costs / Due From Bond Fund	$798,286	2010
Due From Bond Fund / FY 2011 C/O & Hot-3 Mill	$29,955	2010
Due From Bond Fund / FY 2011 C/O 30 Million	$75,280	2010
Reimbursable Costs / Due From C/O Bond Funds	$465,681	2010
Reimbursable Costs / Due From Bond Fund	$785,969	2011

FIGURE 3-11 – General Fund Bond-Related Capital Outlay-FY 2008 and FY 2016. *General Fund capital outlay expenditures do not correspond to the definition of capital outlay as presented in the City's Financial Procedures. Source: Detailed Trial Balance for Indicated Year.*

- Developed an audit work program that addressed each of the four capital outlay objectives.
- Divided the audit program into the following seven sections and devised audit steps within each section designed to achieve the capital outlay objectives.

Propriety – the specific audit steps in this section were designed to determine whether capital projects undertaken during the scope period (FY 2006-FY 2016) were free of obvious fraud, malfeasance, mismanagement, and/or misappropriation of funds.

Authorization – the specific audit steps in this section were designed to determine whether city council approved capital projects in excess of $50,000 as required by city policy.

Capital Project Budgets – the specific audit steps in this section were designed to determine whether capital projects were budgeted, monitored, and executed effectively.

Change Orders – the specific audit steps in this section were designed to determine whether capital project change orders were properly authorized and approved.

Capital Project Expenditures – the specific audit steps in this section were designed to determine whether capital project expenditures were properly authorized, appropriate to the project plan, accurate, in accordance with the budget, and properly recorded.

Funding Sources – the specific audit steps in this section were designed to determine whether capital projects were adequately funded with approved funding sources appropriate to the nature of the project.

Competitive Bidding – the specific audit steps in this section were designed to determine whether capital projects were competitively bid in accordance with the City's procurement procedures and in accordance with state and federal law, as applicable.

- Performed an analysis of funding sources for capital outlays noting that bonds comprise 87 percent of funds for capital outlay for bond-funded projects. From FY 2006 through FY 2016, certificates of obligation, general obligation, and revenue bonds comprised 61 percent, 21 percent, and 18 percent of bonds issued, respectively. Passenger and customer facility charges comprise 68 percent of funding for non-bond projects. Bell County child safety fees comprise 12 percent of non-bond funded projects, while various contributions comprise 11 percent of non-bond funded projects, and transfers from other funds comprise 8 percent of non-bond funded projects.
- Reviewed documentation such as City Council Memorandum Resolutions (CCMRs), bid documents and tabulations, invoices, checks, purchase orders, contracts, capital outlay project schedules, and other documentation supporting capital outlay costs.

- Reviewed capital outlay policies and procedures to assess whether processes and controls were in place to reduce the risk of fraud, waste, or abuse with respect to capital projects.
- Selected 12 projects for detailed testing. Capital projects selected for detailed testing were selected on a judgmental basis to include projects that were funded by the 2002 bond election and any other projects that were discussed during interviews with city council members and city staff. No projects were selected prior to FY 2011 because the disbursement information, such as vendor invoices and supporting documentation, was not available. This issue is discussed further in the following section.

Substantive Testing Procedures

During initial interviews, we received information from some interviewees about specific projects that should be reviewed and analyzed due to rumors and suspicions of potential fraud and/or gross mismanagement. Accordingly, we included the projects in the sample selection and performed detailed audit procedures to achieve the objectives outlined in the audit program. During our audit testing and analysis of these projects, nothing came to our attention revealing instances of fraud and/or gross mismanagement related to the projects included in our testing sample.

We selected 12 projects for detailed testing. Cumulative capital outlay costs for these projects totaled approximately $80.6 million as of September 30, 2016. This amount represents 27 percent of total capital outlay costs of approximately $298.4 million incurred during the scope period of FY 2006 through FY 2016.

We tested individual invoices for the 12 projects that totaled approximately $54.9 million, or 18 percent of total capital outlay costs incurred during the scope period.

For each of the 12 projects, we obtained a detail of the project's expenditures from the City's Account Activity Reports. These reports show vendor payments. From this detail, we selected 125 individual expenditure line items for testing through examination of purchase orders, invoices, receiving reports, and applications for payment. The 125 expenditure line items were selected judgmentally based on high dollar amount.

Figure 3-12 provides a summary of the 12 projects selected for testing and the coverage achieved.

Capital Project	Fund	Account	Total Invoice Amount Tested	Total Project Costs as of 9/30/2016
Bunny Trail	343	343-3490-800-58-37	$3,348,386	$3,429,545
Cornerstone	10	010-2705-419.61-95	456,343	923,053
Cunningham Road	343	343-3490-800-58-39	1,713,785	2,749,184
Elms Road	343	343-3490-800-58-38	3,048,855	3,715,427
Fire Station No. 9	347	347-3490-800-58-78	3,499,898	3,707,126
Killeen Arts and Activity Center (KAAC)	343	343-3490-800-56-64	1,001,240	1,301,871
Lions Park Hike and Bike Trail	340	340-3490-800-56-99	887,246	1,444,896
Rosewood	341	341-3490-800-58-23	13,121,441	24,495,001
SH 195 / SH 201	342	342-3490-800.58-34	12,263,117	14,376,541
Stagecoach Road	343	343-3490-800-58-36	10,559,071	17,909,666

Capital Project	Fund	Account	Total Invoice Amount Tested	Total Project Costs as of 9/30/2016
Trimmier Road	347	347-3490-800.58-76	3,450,356	4,197,816
Westside Trail	348	348-3490-800-58-81	1,564,997	2,315,421
Total Amount Tested			**$54,914,736**	**$80,565,549**
Total Capital Outlay			**$298,433,877**	**$298,433,877**
Percentage Tested			**18%**	**27%**

FIGURE 3-12 – Overview of Capital Outlay Testing and Sampling Coverage. *Individual line items tested comprise 28 percent of total project costs.*
Source: Monthly Capital Project Financial Reports and Account Activity Reports.

We performed the following procedures on the 12 capital projects selected for detailed testing with the following results.

- Requested the City's long-range capital projects master plan. We noted that the City does not have a long-range capital projects master plan originating from a comprehensive needs assessment that factors in long- and short-term funding needs and includes construction, as well as ongoing management and maintenance costs of facilities and infrastructure.
- Assessed whether capital project records are being maintained in a comprehensive, concise, organized manner to facilitate review, analysis, and reporting. We noted that capital project information is fragmented and disorganized. There are no summary databases, schedules, or reports that combine all relevant details about capital projects in one place. For example, a basic budget-to-actual report for each project is not readily available, but would need to be created from monthly unaudited financial reports, account activity listings, City Council Memorandums for Resolution, and Change Order Summary Reports. The inability of the City to readily provide line item project budgets weakens internal controls over capital outlays and reduces accountability for these funds. **Figure 3-13** provides an example of the type of information an effective project budget would provide.

Bond Fund # / Project Description	Final Authorization	Change Orders	Final Budget	Actual Expenditures	Variance

FIGURE 3-13 – Example of project budget report. *The inability of the City to readily provide line item project budgets weakens internal controls over capital outlays.*
Source: An example of a budget to actual capital report devised by McConnell & Jones LLP.

- We noted that the City does not use line item budgets, but rather singe authorized amounts for each project that city council approves through CCMRs. We noted that city council had approved the authorized amount for all projects in the sample including the following:

- For the Killeen Arts and Activity Center, we noted that approved expenditures for this project were $4.2 million. However, the total actual spend was approximately $4.6 million. City management provided us with CCMRs approving change orders in excess of $50,000 for this project. **Therefore, no exception is noted.**

- Determined whether the capital project was approved by city council.
No exceptions were noted.

- Determined whether capital expenditure invoice amounts were appropriate and consistent with contractual terms. The following was noted:
  - We were unable to substantiate any capital outlays and expenditures prior to September 30, 2011. The assistant director of Finance indicated that the records were not available for review because they had been destroyed in accordance with the City's document retention schedule. The City adopts the retention schedule established by the Texas State Library and Archives Commission (TSLAC). Based upon our review of the 3rd Edition of the TSLAC retention schedule, which was in effect in 2011, this documentation was only required to be retained for three years. Therefore, the City is not in violation of its retention schedule by not having these documents available for our review.

- Determined whether the capital expenditure/invoice was properly authorized.
No exceptions were noted.

- Initially we included the construction of the new Police Headquarters in the testing of the 12 projects summarized in **Figure 3-12.** However, we were unable to examine payment documentation for the police headquarters because invoice copies were unavailable for the projects. Therefore, we performed the following alternative procedures:
  - Obtained the 28 applications for payment associated with the project and noted the amount paid was consistent with the contract amount approved by city council. Also, the amount paid was consistent with the construction contract.
  No exceptions were noted.

- Obtained and reviewed the bid tabulations and award letters for existence and propriety.
No exceptions were noted.

- Conducted a test of a sample of change orders. Public Works maintains a change order log for every project with change orders. Those in excess of $50,000 must be submitted to city council for approval. We judgmentally selected change orders for testing and determined the following:
  - Change orders were less than 10 percent of contract value.
  No exceptions were noted.
  - Change orders were appropriately authorized and approved.
  No exceptions were noted.
  - Change orders had been tracked, recorded, and documented.
  No exceptions were noted.
  - There is a procedure for reviewing, processing, and approving change orders.
  No exceptions were noted.

- There is a procedure for ensuring that the cost of change orders has not already been included in the original schedule of values and already charged.
  No exceptions were noted.
- Final quantities on the change order request were the same as the amounts authorized. **No exceptions were noted.**
- The actual costs in the change order were equal to or lower than the amount approved. **No exceptions were noted.**

➲ The sample selection for change orders and the resulting coverage is shown in **Figure 3-14.**

Project Name	Total Project		Selected Sample		Percent Testing Coverage	
	Number	Amount	Number	Amount	Number	Amount
Trimmer Road	12	$1,045,917	4	$837,919	33%	80%
Rosewood	62	$2,114,329	2	$351,058	3%	17%
Cornerstone	1	$88,967	1	$88,967	100%	100%
Fire Station #8	5	$54,746	1	$38,555	20%	70%
Total	**80**	**$3,303,959**	**8**	**$1,316,499**	**10%**	**40%**

Figure 3-14 – Project Change Order Testing Coverage. *McConnell & Jones LLP tested 38 percent of change order costs for the projects selected for testing.*
Source: Unaudited Financial Report for February 28, 2017 and Cornerstone CCMR.

CHAPTER 4 – BOND MONEY USAGE

This section of the report contains our analysis of bond money usage during Fiscal Years (FY) 2002 through February 2017. The audit objectives for this chapter were to address the following questions:

- Were bond funds spent legally and for the purpose for which the bonds were approved (e.g., were idle funds used for other purposes)?
- Were funds remaining after project completion, if any, used appropriately and legally?

CHAPTER HIGHLIGHTS

- Reviewing, updating, and complying with the Debt Management Policy would enable the City to be responsive to the current economic environment and financial condition of the City. The revised policy updates should be implemented and adhered to by the City.
- Consolidating the document retention requirements in the City's post bond issuance procedures with those in its retention policy would provide coherence and consistency in the City's records retention policies and practices.
- Investment in a document management program would secure important documents in a single, integrated system to ensure the documents are easily accessible to authorized personnel. The City could benefit from a central repository for bond documents that would facilitate organization, access, retrieval, and storage of such information.

Background

The City of Killeen (the City) issues debt to finance large capital projects such as buildings; airport facilities; roadways; and water, sewer, and drainage facilities. The City issued the following types of debt between FY 2002 and February 2017:

1. **General Obligation Bonds (GOB)** – require voter approval through a bond election. These bonds are not backed by revenue from a specific project, such as toll roads or fees. GOB bonds are backed by the faith and credit of the City and are typically paid from dedicated property taxes and/or other general funds. The City has primarily used GOB bonds to fund infrastructure projects, including public safety buildings and facilities, streets and parks and recreation.
2. **Certificates of Obligation (CO)** – Certificates of obligation do not require public authorization unless five percent of qualified voters within the jurisdiction petition for an election on the spending in question. However, the City must post a description of the projects to be financed in local newspapers at least twice: (1) first more than 30 days before the city council's vote on the CO issuance and (2) again a week after the initial posting. These postings must describe the general purpose and amount of the debt to be issued; name the method of repayment; and list the time and place of the city council's vote. Typically, the City uses CO's when there is a need to finance projects quickly, as with reconstruction after a disaster or as a response to a court decision requiring capital spending. Certificates of obligation may not be issued for projects that have failed in a bond election. The City has primarily used COs to subsidize infrastructure projects for which GOB bond funding was insufficient to cover.

3. **Pass-Through Financing (PTF)** – Pass-Through Financing is a way for local governments to be reimbursed for the upfront costs they incur for constructing or expanding a state highway project. Through a public/private partnership, the City and private developers jointly conceive, develop, finance, construct, maintain, and operate the project. TxDot reimburses the City for a portion of the project cost by making periodic payments to the City for each vehicle that drives on the highway. The City uses COs to fund the upfront costs for its PTF projects; therefore, these bonds are classified with CO bonds.

4. **Revenue Bonds** – The public can authorize revenue bonds through bond elections, but such bonds do not require public authorization. The City repays revenue bonds using specific source of funds such as solid waste fees or sales, fuel, hotel occupancy, or other taxes. The City has issued revenue bonds for drainage and water and sewer projects.

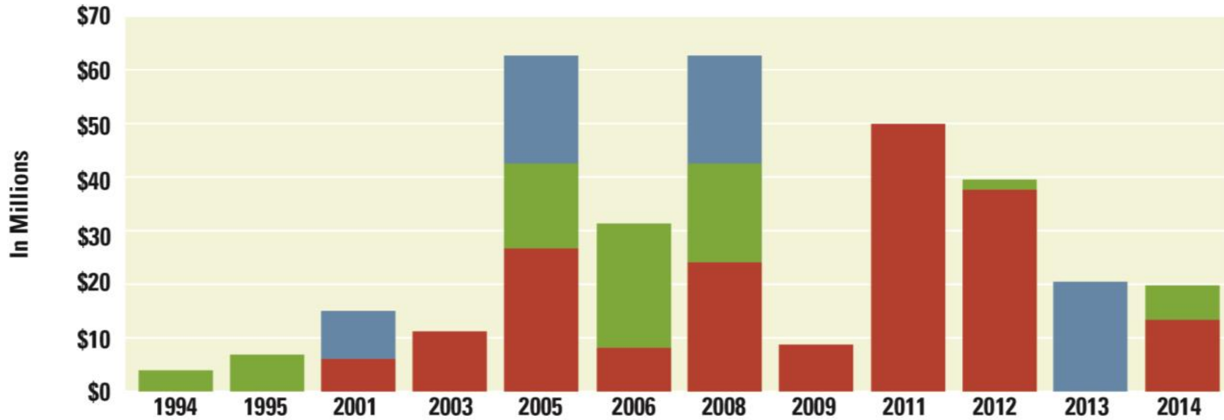
The total value of the bonds included in the audited bond population is $330.6 million, consisting of $185.5 million in certificates of obligation, $74.8 million in general obligation bonds, and $70.3 million in revenue bonds. See **Figure 4-7** for details.

Interest rates charged on long-term debt is dependent upon the City's bond rating that is set by bond rating agencies. These ratings are continuously updated based on several factors, including overall financial strength; ability to pay principal and interest in full and on time; the City's liquidity and additional debt capacity; change in regulatory trends; change in management strategy; and changes in the chief financial officer or finance director.

On September 24, 2002, the Killeen City Council approved the City's first bond election in nearly 10 years. On November 5, 2002, Killeen voters passed the bond referendum, which included the following three propositions totaling $64,295,000:

The public safety buildings and facilities included a new police station and two new fire stations. Streets included new streets and major street rehabilitation. Parks and recreation included a new recreation center and senior center. The City issued the bonds in six tranches from October 2004 through June 2014.

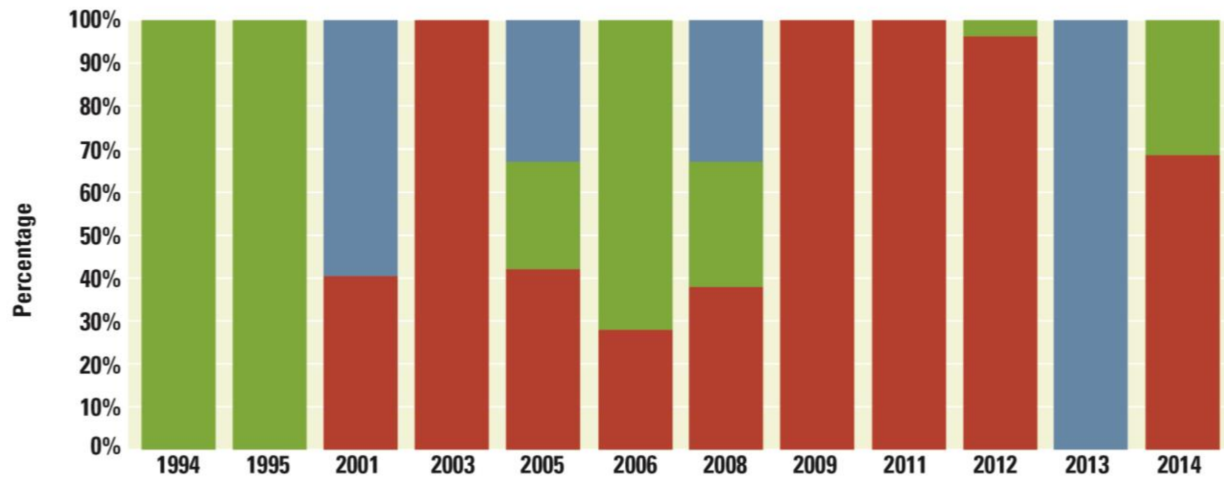
The scope period for review of the City's bond money usage includes bond issues between FY 2002 and February 2017. This also includes bonds issued prior to FY 2002 that made transfers to or received transfers from bonds issued during the scope period. **Figure 4-1** graphically depicts bond issuances by year and type excluding bond refundings, which represent refinancing of existing debt. The bulk of the bond issuances occurred during FY 2005, FY 2008, FY 2011, and FY 2012. The last original issue was during FY 2014; however, refundings occurred in FY 2015 and FY 2016.



	1994	1995	2001	2003	2005	2006	2008	2009	2011	2012	2013	2014
Revenue	$0.0	$0.0	$8.7	$0.0	$20.2	$0.0	$21.2	$0.0	$0.0	$0.0	$20.2	$0.0
GOB	$3.8	$6.7	$0.0	$0.0	$16.0	$23.2	$17.7	$0.0	$0.0	$1.3	$0.0	$6.2
CO	$0.0	$0.0	$6.0	$11.0	$26.6	$8.0	$24.1	$8.5	$50.1	$38.2	$0.0	$13.1

FIGURE 4-1 – Bond Issuances by Year and Type - FY 1994 through FY 2014.
Source: City of Killeen Comprehensive Annual Financial Reports and Monthly Unaudited Capital Financial Reports.

Figure 4-2 presents the percentage of bonds issued each year by type. Since FY 2008, the City has issued a higher percentage of certificates of obligation except in FY 2013 when it only issued revenue bonds.



	1994	1995	2001	2003	2005	2006	2008	2009	2011	2012	2013	2014
Revenue			59%		33%		34%				100%	
GOB	100%	100%			25%	74%	28%			3%		32%
CO			41%	100%	42%	26%	38%	100%	100%	97%		68%

FIGURE 4-2 – Percentage of Bond Issuances by Type and Year - FY 1994 through FY 2014.
Source: City of Killeen Comprehensive Annual Financial Reports and Monthly Unaudited Capital Financial Reports.

Since FY 2002 through FY 2016, the City's bond indebtedness from original issues has increased 240 percent, as depicted in **Figure 4-3**. The City made a deliberate decision not to issue bonds between FY 2002 and FY 2004 because of Operation Enduring Freedom-the Iraq War. The City wanted to ensure the stability of the local economy before issuing debt.

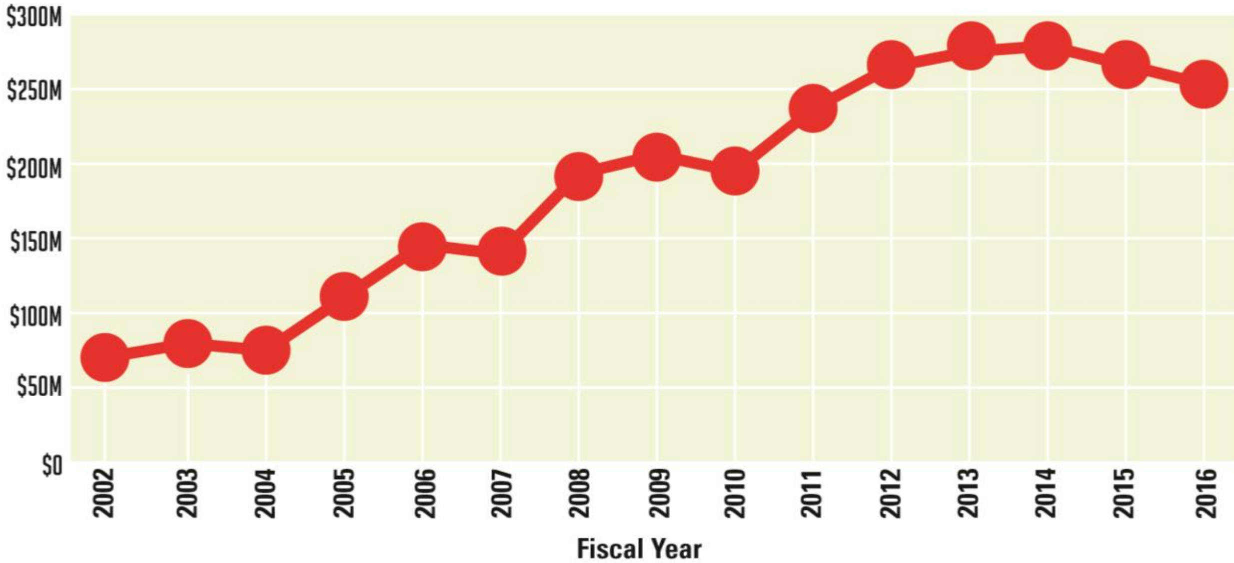


FIGURE 4-3 – Increase in City of Killeen Total Bond Indebtedness - FY 2002 through FY 2016.
Source: Comprehensive Annual Financial reports for FY 2002 through FY 2016.

General obligation bonds (GOB) showed the sharpest increase in the City's bond indebtedness. Between FY 2002 through FY 2016, GOB debt increased 516 percent compared to increases of 214 percent in certificates of obligation (CO), and 64 percent in revenue bonds. These increases are depicted in **Figure 4-4**.

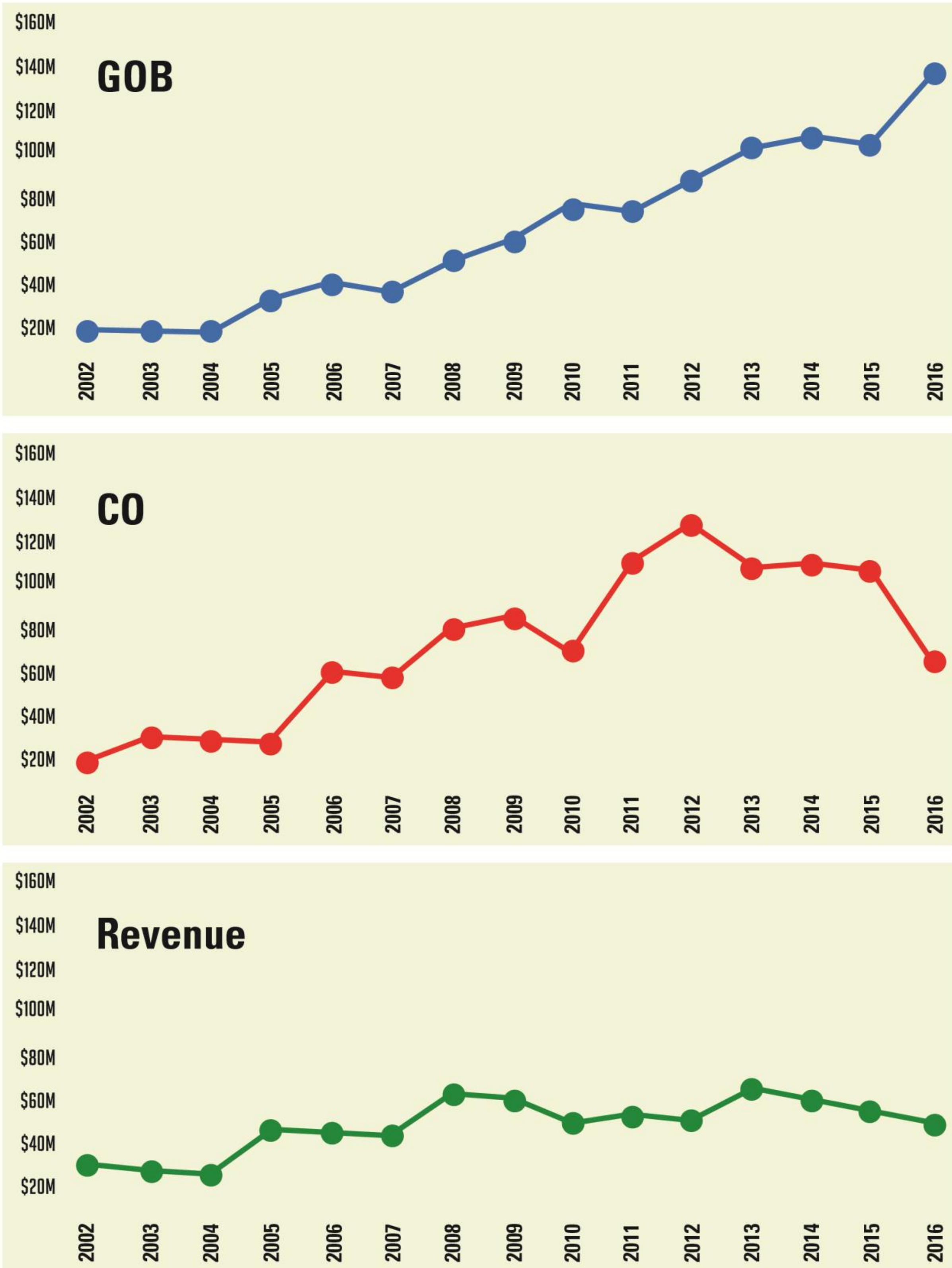


FIGURE 4-4 – Increase in City of Killeen Total Bond Indebtedness by Bond Type - FY 2002 through FY 2016.
Source: Comprehensive Annual Financial reports for FY 2002 through FY 2016.

The amount of bond debt per General Fund dollar increased 150 percent from $4 in FY 2002 to $10 in FY 2016, as shown in **Figure 4-5**.

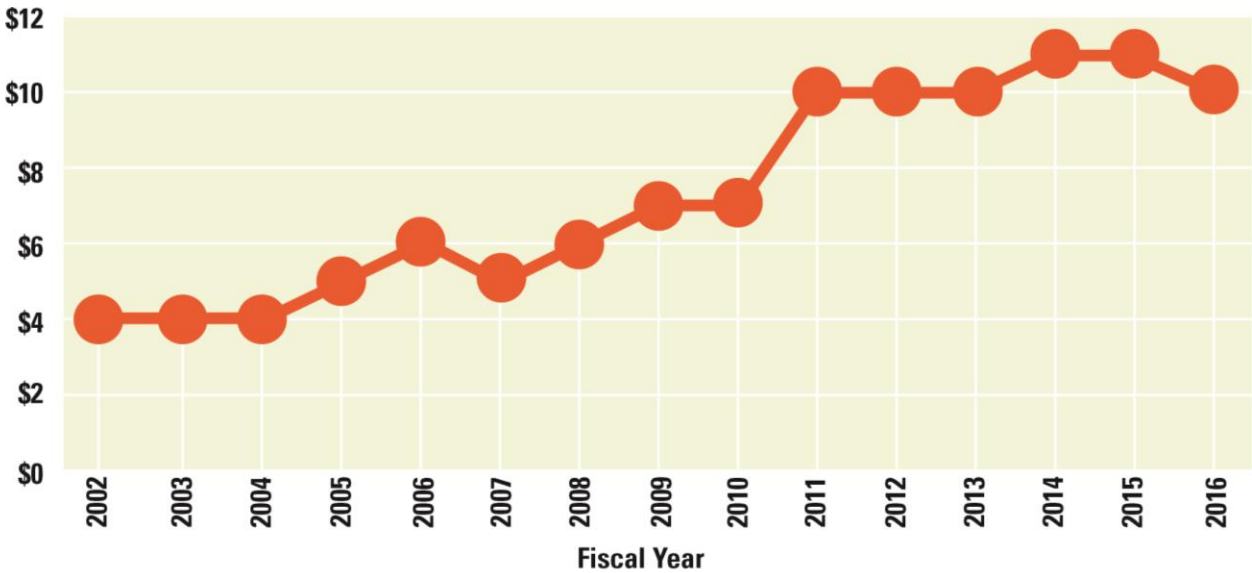


FIGURE 4-5 – Bond Indebtedness per General Fund Dollar - FY 2002 through FY 2016.
Source: Comprehensive Annual Financial reports for FY 2002 through FY 2016.

In addition, the percentage of the City's tax rate dedicated to debt service has increased while the percentage for maintenance and operations has decreased over the period. **Figure 4-6** depicts this relationship.

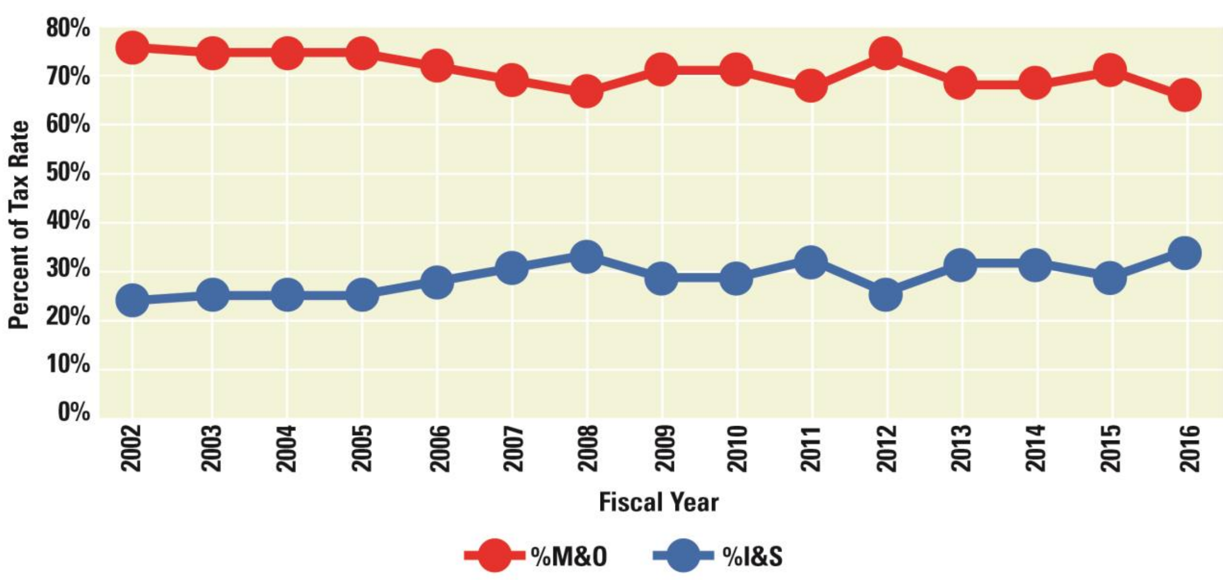


FIGURE 4-6 – Bond Indebtedness per General Fund Dollar - FY 2002 through FY 2016.
Source: Comprehensive Annual Financial reports for FY 2002 through FY 2016.

The City retires or redeems outstanding bonds through refunding when market conditions present an interest savings over the life of the bond. Proceeds from new debt are used to retire an existing issue.

The new issue has lower interest rates than the refunded issue, ensuring reduction in interest expense for the City. Between FY 2002 and February 2017, the City issued $209.7 million of new debt to refund and retire existing debt. This amount consists of $153.6 million to refund general obligation bonds and $56.1 million to refund revenue bonds.

For FY 2016, the City allocated approximately 26 cents of every property tax dollar to debt service. As of September 30, 2016, the City had $252.9 million of debt outstanding as shown in **Figure 4-7,** which presents the bonds included in the scope of this review.

Fund	Year of Issue	Fund Status as of 2/2017	Purpose	Total Issued	Bond Debt Outstanding at 9/30/2016
			CERTIFICATES OF OBLIGATION (CO)		
*329	2001	Closed 2015	Designing and constructing an access roadway to the new airport including acquiring right of way and relocating utilities for the roadway.	$ 6,000,000	$ 0
330	2002	Closed 2009	Golf course improvement projects.	2,000,000	0
331	2003	Open	Acquiring, constructing and installing improvements at the Killeen Regional Airport.	9,000,000	0
332	2004	Closed 2011	Golf course improvement projects.	3,000,000	0
333	2004	Closed 2015	Golf course and street improvements and purchasing fire, emergency medical, and public works vehicles and equipment.	3,000,000	0
335	2005	Closed 2016	Construction activities related to improving, acquiring, and/or installing a communications tower, streets, municipal building, heavy equipment, ambulances, solid waste administration facility, solid waste transfer station, and solid waste heavy equipment.	11,500,000	0
337	2007	Closed 2017	Constructing, improving, renovating, and equipping public safety buildings and facilities including police headquarters, animal control facilities, and Fire Station #8.	24,120,000	0
340	2009	Open	Street projects and park and recreation projects.	6,500,000	915,000
340	2009	Open	Street projects and park and recreation projects.	2,000,000	270,000
341	2011	Open	2011A Pass-Thru Financing to fund state highway projects-190/2410.	31,400,000	25,700,000
342	2011	Open	2011 PTF 195/201-Pass-Thru Financing to fund state highway projects.	18,060,000	4,895,000
343	2011	Open	Constructing and acquisition activities related to infrastructure improvements and upgrades to: (i) Stagecoach Road; (ii) Bunny Trail; (iii) Elms Road; (iv) Cunningham Road, and (v) Killeen Police Department Headquarters.	32,040,000	16,130,000
344	2012	Closed 2016	US 190 Expansion & Police Vehicles.	6,765,000	6,350,000
347	2014	Open	Construct and equip Fire Station No. 9,	13,060,000	12,955,000

Fund	Year of Issue	Fund Status as of 2/2017	Purpose	Total Issued	Bond Debt Outstanding at 9/30/2016
			construct and improve parks and community center facilities, and construct and improve streets and roads.		
385	2005	Closed 2017	Construction, improvements, renovations related to communications tower, improving streets, purchasing and improving municipal building, and purchasing equipment.	9,100,000	0
576	2006	Open	Construct, reconstruct, repair, and improve drainage system and making flooding and drainage upgrades.	8,000,000	0
			Total Certificates of Obligation	**$ 185,545,000**	**$ 67,215,000**
			GENERAL OBLIGATION BONDS (GOB)		
334	2004	Closed 2015	Constructing activities related to improving, remodeling, and\or equipping streets, signalization, public safety buildings and facilities, police headquarters, police training facility, two new fire stations, existing fire department facilities and animal control facilities, parks and recreational facilities, and senior citizens facilities.	16,000,000	0
336	2006	Closed 2016	Constructing, improving, renovating, and equipping parks and recreational and senior citizen buildings and facilities.	10,000,000	0
337	2007	Closed 2017	Constructing, improving, renovating, and equipping public safety buildings and facilities including police headquarters, animal control facilities, and Fire Station #8.	17,665,000	0
339	2006	Closed 2016	Constructing, reconstructing, and improving public streets; constructing improving, and equipping parks and recreation buildings and facilities.	13,175,000	1,230,000
345	2012	Open	Community Center renovation and improvements.	1,265,000	0
348	2014	Open	Constructing, improving, renovating, and equipping public safety buildings and facilities, including Fire Station #9.	6,190,000	0
*394	1994	Closed 2016	Construct public safety facilities and make street improvements.	3,750,000	0
*395	1995	Closed 2016	Construct public safety facilities and make street improvements.	6,745,000	0
			Total General Obligation Bonds	**$ 74,790,000**	**$ 1,230,000**
			REVENUE BONDS		
*381	2001	Closed 2017	Improvements to and renovation of water & sewer system.	8,700,000	0
382	2004	Closed 2016	Improvements to construct, improve, and equip the waterworks and sewer system.	20,200,000	0
384	2007	Closed 2017	Improvements to and renovation of water & sewer system.	21,165,000	0

Fund	Year of Issue	Fund Status as of 2/2017	Purpose	Total Issued	Bond Debt Outstanding at 9/30/2016
386	2013	Open	Improvements to construct, improve, and equip the waterworks and sewer system.	20,200,000	28,040,000
			Revenue Bond Total	**$ 70,265,000**	**$ 28,040,000**
			Total Original Issuances	**$ 330,600,000**	**$ 96,485,000**
			REFUNDING BONDS		
Refunding	2004		2004 GOB Refunding	8,325,000	0
Refunding	2005		2005 Revenue Refunding	16,875,000	0
Refunding	2009		2009 GOB Refunding	744,600	0
Refunding	2009		2009 Revenue Refunding	3,635,400	0
Refunding	2010		2010 GOB Refunding	8,500,000	6,420,000
Refunding	2010		2010 GOB Refunding	4,830,000	3,460,000
Refunding	2010		2010 GOB Refunding	6,870,000	3,335,000
Refunding	2011		2011 GOB Refunding	6,875,000	4,815,000
Refunding	2011		2011 Revenue Refunding	11,135,000	8,650,000
Refunding	2012		2012 GOB Refunding	19,500,000	17,930,000
Refunding	2012		2012 Revenue Refunding	7,365,000	7,170,000
Refunding	2013		2012 GOB Refunding	4,950,000	5,910,000
Refunding	2013		2013 GOB Refunding	37,290,000	36,795,000
Refunding	2013		2013 Revenue Refunding	8,830,000	0
Refunding	2013		2013 Revenue Refunding	8,270,000	3,550,000
Refunding	2013		2013 GOB Refunding	3,935,000	3,880,000
Refunding	2014		2014 GOB Refunding	4,420,000	8,885,000
Refunding	2014		2014 GOB Refunding	1,010,000	360,000
Refunding	2015		2015 GOB Refunding	8,640,000	8,640,000
Refunding	2016		2016 GOB Refunding	35,845,000	34,715,000
Refunding	2016		2016 GOB Refunding HOT	750,000	735,000
Refunding	2015		2015 GOB Refunding	300,000	300,000
Refunding	2016		2016 GOB Refunding	845,000	845,000
			Total Refunding Bonds	**$ 209,740,000**	**$ 156,395,000**
			Total Outstanding Debt		**$ 252,880,000**

FIGURE 4-7 – Original Bond Issuances and Refundings.
Source: Comprehensive Annual Financial Reports for FY 2002 through FY 2016, and City of Killeen Monthly Unaudited Capital Project Financial Report for FY 2011 through February 2017.
**These bonds were issued prior to FY 2002, but transferred money to other bond funds during the scope period and were therefore included in the audit population.*

To establish accountability for bond proceeds and expenditures, the City creates a separate fund in its financial accounting system for each bond. The funds are identified by unique fund numbers. Each month, the Finance Department prepares a capital projects financial report, which provides, for each active and completed project financed by bond funds, the authorized amount, actual income and expenditures, commitments, and remaining authorized and cash balances. The reports show the source of funds for the capital projects, such as bond proceeds, interest income, grant proceeds, contributions and donations, transfers, and various other sources of revenue related to capital projects. It also lists capital project expenditures, by project, by fiscal year for each bond fund.

Finance Department staff have been preparing these reports since at least FY 2001. Current accounting staff have been preparing the reports since April 2016. The current accounting staff added a control to check the ending cash balance of each fund to ensure it agreed with the bank statement and cash reconciliation. If the cash remaining in the fund did not agree with the money in the bank, staff conducted a review of the fund to validate its historical information. We relied on the Monthly Unaudited Capital Project Financial Reports to obtain information about each bond issuance over the scope period. See **Figure 4-12** for an example of the report.

Using the City's audited Comprehensive Annual Financial Report (CAFR) and the Monthly Unaudited Capital Project Financial Reports, we identified all original bond issuances and refundings that occurred during the scope period. We also identified and included in the audit population four bond funds that were issued prior to the scope period, but had made transfers to or received transfers from bonds issued during the scope period.

We used the Monthly Unaudited Capital Project Financial Reports to analyze each bond fund's revenues and expenditures. **Figure 4-8** provides a summary of revenues and expenditures for each bond fund from the date of issuance through February 2017. The table also shows funds remaining in the bond fund as of February 2017 and the percentage of bond expenditures over the authorized amount.

Fund #	Expenditure Authorization	Revenues	Expenditures	Funds Remaining 2/28/2017	Percentage Bond Expenditures Under / (Over) Authorization
329	$13,651,091	$13,651,092	$13,651,092	$0	<1%
330	3,531,604	2,198,007	2,025,815	172,192	43%
331	15,527,004	$15,527,004	15,527,004	0	<1%
332	3,022,281	3,001,307	3,000,928	379	1%
333	3,106,013	3,106,013	3,106,013	0	<1%
334	18,425,512	18,425,512	18,425,512	0	<1%
335	12,890,238	12,890,239	12,890,239	0	<1%
336	11,228,774	11,228,774	11,228,774	0	<1%
337	42,864,846	42,864,847	42,864,847	0	<1%
339	15,370,605	15,370,604	15,370,604	0	<1%
340	8,641,671	8,644,764	8,641,671	3,093	<1%
341	32,458,852	32,459,993	32,291,809	168,184	1%
342	18,886,077	19,195,543	18,342,554	852,989	3%
343	35,586,853	35,242,846	32,827,334	2,415,512	8%
344	6,773,302.50	6,773,302	6,773,302	0	<1%
345	2,812,724	2,794,206	2,662,015	132,191	5%
347	19,448,759	19,091,168	15,180,328	3,910,840	22%
348	10,632,622	8,262,444	6,656,747	1,605,697	37%
381	9,260,446.20	9,260,447	9,260,447	0	<1%

Fund #	Expenditure Authorization	Revenues	Expenditures	Funds Remaining 2/28/2017	Percentage Bond Expenditures Under / (Over) Authorization
382	22,670,333	22,670,333	22,670,333	0	<1%
384	22,462,434	22,462,433	22,462,433	0	<1%
385	9,618,550	9,618,552	9,618,552	0	<1%
386	20,736,040	20,755,081	10,783,135	9,971,946	48%
394	4,541,821	4,541,824	4,541,824	0	<1%
395	9,008,809	9,008,814	9,008,814	0	<1%
576	9,053,655	9,031,142	6,668,973	2,362,169	26%
Total	**$382,210,917**	**$378,076,291**	**$356,481,099**	**$21,595,192**	**7%**

FIGURE 4-8 – Bond Fund Revenues and Expenditures by Fund- Cumulative from Inception of Bond Fund through February 2017.
Source: Unaudited capital project financial reports from FY 2011 through February 2017.

MJ further analyzed bond fund revenues and expenditures to determine the sources and uses of the bond funds. When analyzing revenues for each bond fund, MJ listed revenues greater than $500,000 into separate line items. Revenues less than $500,000 were combined into a single line item. The revenue analysis shows unsurprisingly that bond proceeds comprise 87 percent of capital projects funding followed by interest at four percent and transfers in from other sources at three percent. **Figure 4-9** presents a summary of bond revenue sources as of February 2017.

Revenue Source	Amount	Percent
Bond Proceeds	$ 330,258,646	87%
Interest Earned	14,125,884	4%
Transfers In	12,745,625	3%
TxDot Projects	5,596,103	1%
Bond Premium	4,648,894	1%
Grant Reimbursements	4,470,388	1%
Passenger Facility Charges	2,409,909	1%
FAA Grant Reimbursements	1,779,575	<1%
Other Income	1,041,267	<1%
Bell County Contributions	1,000,000	<1%
TOTAL	**$ 378,076,291**	**100%**

FIGURE 4-9 – Summary of Bond Fund Revenues-Cumulative from Inception of Bond Funds through February 2017 Summary of Line Items >$500,000 by Bond Fund.
Source: Unaudited Capital Project Financial Reports from FY 2011 through February 2017.

MJ used the Monthly Unaudited Capital Project Financial Reports to analyze expenditures. As with revenues, individual line items exceeding $500,000 were listed separately while line items totaling less than $500,000 were combined into one line item. Due the extensive volume of the information, the table only lists individual line items greater than $1,000,000.

The expenditure analysis in **Figure 4-10** shows that the US 190/Rosewood 2410 project consumed a larger percentage of costs than any other project. This project comprises 7 percent of total bond-funded capital project expenditures. The Texas Department of Transportation provided pass-through funding for this project to design, develop, finance, construct, maintain, operate, extend, expand or improve roads on the state highway system located at the intersection of highways 190/2410. The City accounts for this money in Fund 341.

Killeen Police Headquarters, Stagecoach Road improvements, and State Highway 195/201 interchange construction projects comprise the next highest categories of bond-funded capital project expenditures. Together, these projects comprise 17 percent of capital project expenditures. Funds 341, 337, 329/331, 343, and 342, respectively provide the financing for these projects. **Figure 4-10** provides a summary of bond-funded capital project expenditures from inception of the bonds.

Project Name	Amount	Percent
US 190/Rosewood/2410	$ 24,897,569	7%
Killeen Police Headquarters: Construction	22,860,417	6%
Robert Gary Army Airfield (RGAAF)	20,042,501	6%
Stagecoach Improvements	17,183,324	5%
Transfers Out	**17,126,027**	**5%**
SH195/SH201 Interchange and grade separation	16,645,956	5%
Senior and Recreation Center - Construction	10,346,459	3%
City Owner Agreements	8,205,593	2%
Transfer Station & Compost Site	7,173,559	2%
Watercrest Reconstruction	6,114,716	2%
Eastside Infrastructure	5,545,340	2%
Trimmier Road	4,688,454	1%
Fire Station #9	4,625,904	1%
Building Purchase - One Stop	4,363,725	1%
LCP Phase III - Family Aquatics Center Construction	4,113,129	1%
Golf Course Improvements	4,054,163	1%
Downtown Street Eng Phase 1	4,002,480	1%
Elms Road	3,715,427	1%
Station #1: Construction	3,571,883	1%
Bunny Trail	3,429,545	1%
Capitalized Interest	3,210,448	1%
Operations	**3,119,733**	**1%**
US 190 Expansion	3,000,000	1%
Equipment Replacement	2,996,409	1%
Station #8: Construction	2,964,821	1%
Police HQ -	2,895,557	1%
Street Maintenance & Construction Projects	2,811,663	1%
Cunningham Road	2,749,184	1%

Project Name	Amount	Percent
PRJ 2W - Bundrant Expansion	2,693,111	1%
Community Center Renovation	2,640,346	1%
Lift Station #2/Force Main	2,607,023	1%
Downtown Infrastructure Design	2,427,602	1%
Westside Trail	2,397,683	1%
Trimmier Reconstruction	2,361,968	1%
PW - N. Robinett Rd (Cody Poe & Edgefield) Watercrest to Elms	2,227,453	1%
PRJ 3W - Southeast Loop	2,181,333	1%
Equipment - Fire	2,161,845	1%
PW - Elms Road (SH 195 to Clear Creek)	2,030,766	1%
Street Dept Building	1,994,877	1%
PW - South Robinett Road -S. Elms to Stan Schlueter	1,978,989	1%
Hwy 195 Waterline Extension	1,755,739	<1%
Manhole Rehab Phase 2	1,750,675	<1%
PRJ 4S - Lift Station 20/FM/SH195	1,749,280	<1%
East Loop Waterline	1,653,200	<1%
Hwy 195 Wastewater Impr	1,639,323	<1%
Solid Waste Admin Facility	1,595,820	<1%
PRJ 2S - Trimmier Creek	1,570,428	<1%
Motor Vehicles - Police	1,531,570	<1%
Motor Vehicles-Fire Dept.	1,512,086	<1%
PRJ 4W - Pump Station 3 Upgrade	1,495,421	<1%
Aquatic Facility - Construction	1,478,847	<1%
Lions Park Hike & Bike	1,444,896	<1%
Force / Gravity Main LS 20	1,403,928	<1%
Robinett Road Water Line	1,390,850	<1%
Solid Waste Equipment	1,350,575	<1%
KAAC HOT Fund Portion	1,301,871	<1%
Utilities Building	1,300,224	<1%
Elms Road Construction	1,298,288	<1%
W.S. Young\CTE-B. Hwy190	1,267,264	<1%
City Water Reuse Project	1,253,046	<1%
Sewerline Rehab Phase 1	1,225,165	<1%
Old FM 440 Water Line	1,207,810	<1%
16" Waterline 38th Str	1,203,074	<1%
Street Dept. Equipment	1,190,281	<1%
Water Line Rehab PH 1	1,172,484	<1%
Sewer Line Rehab PH 2	1,171,470	<1%
SS Loop Improvements	1,168,500	<1%

Project Name	Amount	Percent
Lift Station #20 & Force Main	1,143,261	<1%
LS23 Expansion / Force & Gravity Main	1,118,804	<1%
C.S. - Design/Engineering LCP Projects	1,075,849	<1%
PRJ 1S - Lift Station #8	1,071,460	<1%
Projects <$500K	69,832,628	20%
TOTAL	**$ 356,481,099**	**100%**

FIGURE 4-10 – Summary of Bond-Funded Capital Project Expenditures-Cumulative from Inception of Bond Funds through February 2017-Summary of Line Items >$1,000,000 by Bond Fund
Source: Unaudited Capital Project Financial Reports from FY 2011 through February 2017.

When revenues and expenses are analyzed by bond fund, five funds comprise the bulk of total revenues and expenditures. Funds 337, 343, 341, 382, and 384 comprise 41 percent of bond-funded revenues and 43 percent of bond-funded expenditures. **Figure 4-11** provides an overview of these funds and their purpose.

Fund	Revenues (Millions)	Expenditures (Millions)	Purpose
337 2007 CO and GOB	$42.9	$42.9	• Constructing, acquiring, improving, extending expanding, upgrading, and/or developing City streets, roads, bridges, sidewalks, intersections and related traffic improvements. • Costs of purchasing rights of way. • Acquiring and purchasing vehicles and equipment for the City public works, fire and police departments. • Constructing, acquiring, improving and equipping a new police headquarters. • Constructing, acquiring improving, renovating and equipping City park and recreational facilities. • Constructing, acquiring improving, renovating, expanding and equipping Fire Station No. 8 and Fire Station No. 1. • Constructing, acquiring, improving, renovating and equipping animal control facilities. • Acquisition and installation of an early warning system.
343 2011 CO	$35.2	$32.8	• Constructing, acquiring, reconstructing, improving, repairing, extending, expanding, upgrading and/or developing streets, roads, bridges, sidewalks, payment of any related acquisition of land, fights-of-way, drainage, lighting, landscaping and easements including: (i) Stagecoach Road; (ii) Bunny Trail; (iii) Elms Road; and (iv) Cunningham Road. • Constructing, renovating, acquiring, improving and equipping City facilities located at 802 North 2nd Street, Killeen, Texas. • Professional services fees and other costs.
341 2011 CO	$32.5	$32.3	• Pass through funds from the Texas Department of Transportation to design, develop, finance, construct, maintain, operate, extend, expand or improve roads on the state highway system located at the intersection of highways 190/2410.

Fund	Revenues (Millions)	Expenditures (Millions)	Purpose
382 2004 Revenue	$22.7	$22.7	• Improvements to construct, improve, and equip the City's waterworks and sewer systems.
384 2007 Revenue	$22.5	$22.5	• Acquiring, constructing and installing additions, improvements and extensions to the City's waterworks and sewer system.
Subtotal	**$155.8**	**$153.1**	
Total All Bonds	**$378.1**	**$356.5**	
Percentage	**41%**	**43%**	

FIGURE 4-11 – Top Five Bond Funds-Amounts in Millions.
Source: Unaudited Capital Project Financial Reports from FY 2011 through February 2017.

Audit Questions' Results

The following table summarizes our conclusions regarding the two specific questions defined in the management audit contract in addition to other observations noted.

Review Area:	**Bond Money Usage**
Objective:	Were bond funds spent legally and for the purpose for which the bonds were approved (e.g., were idle funds used for other purposes)?
Conclusion:	As depicted in **Figure 4-13**, we reviewed approximately $3.4 million in costs that were paid by bond funds between FY 2002 and February 2017 that did not appear consistent with the authorized purpose of the bond. Based on our further assessment of this amount, $3 million (89 percent) was deemed to be inconsistent with the purpose of the bond, $240,416 (7 percent) was consistent with the purpose of the bond, and $115,153 (3 percent) was undeterminable. To place the total $3.4 million in perspective, it represents approximately one percent of total bond expenditures during the scope period of $356.5 million. We evaluated all bond fund transfers greater than $30,000, identifying $17 million in bond transfers. We deemed $13.4 million, or 78 percent of the transfers to be consistent with the purpose of the bond making the transfer. We noted $488,300, or 3 percent, that did not appear consistent, and $3.2 million, or 19 percent that were indeterminable. This analysis is presented in **Figure 4-17**. The City's process for approving bond transfers is to include the respective bond transfers in the fiscal year budget adoption or approve a budget amendment through an ordinance. Additionally, Section 71 of the city charter allows the city manager to initiate and approve transfers. We deemed transfers that were not approved or amended by a budget or not initiated by the city manager to be unapproved. Of the $17 million bond transfers evaluated, we noted $14.5 million, or 85 percent, that were properly approved $2.4, or 14.3 percent that we deemed not properly approved, and $101,865 that were undeterminable. We could not account for $3.2 million, as depicted in **Figure 4-15**, in funds transferred into two bond funds from the Aviation Passenger Facility Charge Fund #529. We noted funds being transferred into the bond funds but could not trace the transfer out of the Aviation Passenger Facility Charge Fund. Management represented that it could be a case of misclassification by City Finance staff employed at the time, but could not be certain since 97 percent of the transfers occurred between FY 2005 and FY 2009. To put fund transfers into perspective, they do not represent an exchange of physical cash but a reassignment of claims on cash between or among

Review Area:	Bond Money Usage
	funds on the City's books. We also noted that the City was in violation of its bond document retention requirements for bond fund 344-2012/CO (See **Figure 4-18**). We were unable to trace the initial proceeds of the bond fund to the investment statements because the statements were not available. According to the City's retention schedule, the investment statements should have been retained at least through August 2017.

Review Area:	Bond Money Usage
Objective:	Were funds remaining after project completion, if any, used appropriately and legally?
Conclusion:	We noted two bond funds with total remaining balances of $488,300 that were transferred to other funds that did not appear to have a consistent purpose with the bond. These transfers were discussed in the previous objective.

Observations and Recommendations

OBSERVATION 4-1: Debt Management Policy

The Debt Management Policy has not been updated since 1997. Economic, social, and political circumstances have changed over the past 20 years creating different challenges, opportunities, and conditions than those existing in 1997. These changes, coupled with changes in the City's finances, require that the City's Debt Management Policy be reviewed and updated.

In addition, the City has not adhered to the provisions of its Debt Management Policy. For example, the City has not developed a formal capital planning and financing system as required by the policy. Moreover, the City's lack of planning and reserving for ongoing maintenance needs has placed financial pressure on the City's budget over the years. The need for enforcing, documenting, and monitoring compliance with the policy is further underscored by the 516 percent increase in the City's bond debt since FY 2002

RECOMMENDATION 4-1: Debt Management Policy

The City should update and revise the Debt Management Policy to include provisions governing spending bond funds outside of the purpose for which they were authorized. The procedure should reflect the impact of restrictive bond covenants, outline approval and documentation requirements, provide conditions under which bond counsel should be consulted, and describe conditions under which city council approval is required. Also, the City should revise the Debt Management policy to address the City's current challenges, financial circumstances, and strategic direction.

OBSERVATION 4-2: Retention Requirements

Retention requirements in the post bond issuance procedures are not consistent with the City's document retention policy. Retention requirements in the post bond issuance procedures are too general and do not specify retention periods for specific categories of bond-related documents. The City's retention policy, which follows the Texas State Library and Archives Commission's (TSLAC) retention schedules, establishes different periods for different types of bond documents. Moreover, the three-year period in the City's post bond issuance procedure is shorter than that required by the City's retention schedules for certain bond documents. For example, the period for documentation related to investment of public funds is five years, and the period for documents related to the calculation of arbitrage is six years after retirement of the last obligation of the issue

RECOMMENDATION 4-2: Retention Requirements

The City should update and revise its Debt Management Policy to outline how remaining bond funds are to be used and the priorities of such usage, including how usage of remaining bond funds is to be authorized and executed. The provisions should also outline procedures for transferring funds to other bond and non-bond funds, including approval, justification, documentation, and appropriateness based on the purpose of the bond.

The City should revise retention requirement in its post bond issuance procedures to mirror the general retention policy of the City, which reflects the retention schedule of the Texas State Library and Archives Commission's Local Schedule GR-Retention Schedule for Records Common to All Local Governments. Once updated, the City should adhere to the post bond issuance procedure, particularly with respect to the development of a formal capital planning and financing system.

OBSERVATION 4-3: Document Management System

The City does not use a document management system for bond and related legal documents. Many organizations use document management software to secure important documents in a single, integrated system to ensure the documents are easily accessible to authorized personnel. The City could benefit from a central repository for bond documents that would facilitate organization, access, retrieval, and storage of such information. Many document management systems have a workflow feature to facilitate movement, review, and approval of important documents. Coupled with document imaging, a document management program would also help the City adhere to document retention requirements enabling the City to secure important documents while reducing paper volume, preserving space, and reducing storage costs.

We noted that the City was in violation of its bond document retention requirements for bond fund 344-2012/CO (See **Figure 4-18**). We were unable to trace the initial proceeds of the bond fund to the investment statements because the statements were not available. According to the City's retention schedule, the investment statements should have been retained at least through August 2017. A document management system would help the City avoid violations such as this and better manage its document retention requirements.

RECOMMENDATION 4-3: Document Management System

The City should invest in document management software to manage bond and other important documents. The software would provide the City with a central database of bond-related documents that includes document images as well as relevant information about the documents. For example, for bond documents, the document management database would include the fund name and number, purpose, issue date, maturity date, authorized amount, issue amount, premium, discount, net issue costs, net proceeds, restrictive bond covenants, and other information pertinent to the bond.

Bond Money Usage Audit Methodology

In this section of the chapter, we describe MJ's general methodology for performing the review of Bond Money Usage. On April 10, 2017, the audit team conducted a kickoff meeting with City leadership to discuss project objectives, expectations, schedules, needs, and logistics. We conducted onsite activities during the weeks of April 10th and 17th during which we collected information, scheduled and conducted interviews and began executing our audit plan. We interviewed the following positions.

- City attorney
- City manager
- Deputy city manager
- Council members
- Mayor
- Director of Public Works
- City planner
- Director of Planning & Development
- Executive director of Community Development
- Director of Community Service
- Director of Environmental Services
- Fire chief
- Assistant director of Finance
- Accounting supervisor
- Staff accountant
- Executive director of Finance
- Assistant director of Aviation
- Aviation accounting specialist
- Interim police chief
- Former city manager
- Former finance director

Before fieldwork activities began, we provided City staff with an initial list of bond-related data needed for the review. We received, organized, and reviewed the information to provide context and perspective for the interviews. Our activities were focused around achieving the two objectives of the review of Bond Money Usage.

The scope period for the review was bonds issued from FY 2002 to February 2017. We also included in the population any bond issued prior to FY 2002 that had a transfer from or to a bond issued during the scope period. Four bonds met these criteria.

One of the audit team's first tasks was to prepare a schedule of the total bond population. We used both audited and unaudited information to identify the bond population. Governmental accounting principles require the City to make various bond disclosures in its annual audited financial report. Accordingly, we used the City's Comprehensive Annual Financial Reports (CAFR) from FY 2002 through FY 2016 to identify bond issuances during this period. We also used the City's Monthly Unaudited Capital Project Financial Reports to validate and construct the total bond population. The Monthly Unaudited Capital Project Financial Report is the City's primary reporting tool for bond and capital project activity. **Figure 4-12** provides an example of the report.

CITY OF KILLEEN, TEXAS
WATER AND SEWER REVENUE BONDS SERIES 2013 - FUND 386
UNAUDITED CAPITAL PROJECT FINANCIAL REPORT
FOR THE MONTH ENDED FEBRUARY 28, 2017

	Account #	Amended Project Authorizations	Activity through 9/30/2016	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	Total	Funding Commitments	Total	Remaining Balance
Funding												
Interest Income	386-0000-361-05-00	$ 274,224.57	$ 224,224.57	$ 30,355.74	$ 66,198.75	$ 57,840.14	$ 69,829.94	$ 24,540.81	$ 248,765.38	$ -	$ 248,765.38	$ 25,459.19
Investment Expense	386-0000-361-99-00	(31,384.77)	(25,384.77)	(3,309.51)	(10,511.62)	(7,539.95)	(4,023.69)	(586.10)	(25,970.87)	-	(25,970.87)	(5,413.90)
Sale of Bonds	386-0000-391-05-00	20,200,000.00	20,200,000.00	20,200,000.00	-	-	-	-	20,200,000.00	-	20,200,000.00	-
Transfer from Fund 381	386-0000-371-93-81	2,051.71	1,025.71				1,025.71	-	1,025.71	-	1,025.71	1,026.00
Transfer from Fund 384	386-0000-371-93-84	662,076.55	331,260.55				331,260.55	-	331,260.55	-	331,260.55	330,816.00
Total Funding		21,106,968.06	20,731,126.06	20,227,046.23	55,687.13	50,300.19	398,092.51	23,954.71	20,755,080.77	-	20,755,080.77	351,887.29
Expenditures												
Completed Projects												
Sewer Line SSES Ph3	386-3495-800-54-77	371,844.35	371,844.35	-	89,496.31	282,348.04		-	371,844.35	-	371,844.35	-
12" Stagecoach Water Line	386-3495-800-54-82	752,640.00	752,640.00	-	752,640.00	-		-	752,640.00	-	752,640.00	-
8" Onion Road Water Line	386-3495-800-54-84	687,859.01	685,716.01	-	-	73,714.50	612,001.51	2,143.00	687,859.01	-	687,859.01	-
12" Trimmier RD Water Line	386-3495-800-54-88	690,613.40	690,613.40	-	635,749.60	54,863.80		-	690,613.40	-	690,613.40	-
LS23 Expansion / Force & Gravity Main	386-3495-800-54-89	1,118,804.20	1,118,804.20	-	748.20	1,046,266.35	71,789.65	-	1,118,804.20	-	1,118,804.20	-
Manhole Rehab PH 3	386-3495-800-54-93	133,623.96	133,623.96	-	97,287.76	36,336.20	-	-	133,623.96	-	133,623.96	-
WW Main Replacement Central Basin	386-3495-800-54-95	477,348.38	477,348.38	-	-	-	477,348.38	-	477,348.38	-	477,348.38	-
Machinery & Equipment	386-3495-800-61-35	15,950.00	15,950.00	-	-	-	15,950.00	-	15,950.00	-	15,950.00	-
Sewerline Reroute (10-S)	386-3495-800-58-45	47,819.80	47,819.80	-	-	-	47,819.80	-	47,819.80	-	47,819.80	-
W&S Operations	386-3415-437-xx-xx	907,707.01	907,707.01	-	491,998.16	284,326.77	131,382.08	-	907,707.01	-	907,707.01	-
Total Completed Projects		5,204,210.11	5,202,067.11	-	2,067,920.03	1,777,855.66	1,356,291.42	2,143.00	5,204,210.11	-	5,204,210.11	-
Active Projects												
Other Projects	386-3495-800-54-01	2,218,597.00	-	-	-	-		-	-	-	-	2,218,597.00
Septic Tank Elimination	386-3495-800-54-56	700,000.00	-					-	-	-	-	700,000.00
Little Trimmier Creek Gravity Main	386-3495-800-54-76	161,456.00	-	-	-	-		-	-	161,455.69	161,455.69	0.31
Water System Improvements	386-3495-800-54-81	404,778.34	104,026.34	-	39,630.44	22,007.70	42,388.20	6,809.79	110,836.13	9,711.80	120,547.93	284,230.41
Water Line Rehab PH 1	386-3495-800-54-83	2,098,005.98	532,560.98	-	2,899.70	38,031.00	491,630.28	639,923.47	1,172,484.45	512,719.50	1,685,203.95	412,802.03
Airport Pressure Plane LP	386-3495-800-54-85	205,640.00	-	-	-	-	-	-	-	-	-	205,640.00
Mohawk Dr / Clear Creek WL	386-3495-800-54-86	1,375,565.86	198,014.86	-	-	198,014.86	-	-	198,014.86	54,994.60	253,009.46	1,122,556.40
Water Line Rehab PH 2	386-3495-800-54-87	300,000.00	-	-	-	-	-	-	-	-	-	300,000.00
Force / Gravity Main LS 20	386-3495-800-54-91	1,573,677.88	1,403,927.88	-	136,297.05	1,094,849.59	172,781.24	-	1,403,927.88	169,750.38	1,573,678.26	(0.38)
City Water Reuse Project	386-3495-800-54-92	1,834,961.24	1,227,063.24	-	963,146.40	107,154.47	156,762.37	25,982.76	1,253,046.00	24,591.00	1,277,637.00	557,324.24
Sewer Line Rehab PH 2	386-3495-800-54-94	1,569,080.70	1,008,058.70	-	12,638.95	660.80	994,758.95	163,411.69	1,171,470.39	54,710.72	1,226,181.11	342,899.59
LIFT STAT 20 Expansion	386-3495-800-54-96	291,650.00	-	-	-	-	-	-	-	-	-	291,650.00
LIFT STAT 22 Expansion	386-3495-800-54-97	268,800.00	-	-	-	-	-	-	-	-	-	268,800.00
18" Gravity Main (11S)	386-3495-800-54-99	231,239.00	-				-	-	-	231,239.13	231,239.13	(0.13)
Wastewater Metering	386-3495-800-57-79	65,810.00	21,810.00	-	-	-	21,810.00	10,905.00	32,715.00	10,905.00	43,620.00	22,190.00
St Elms Road	386-3495-800-58-46	369,389.34	139,955.34	-	-	-	139,955.34	96,476.59	236,431.93	132,957.37	369,389.30	0.04
Water Supply Project	386-3495-800-58-47	1,863,179.00	-	-	-	-	139,955.34	-	-	-	-	1,863,179.00
Total Active Projects		15,531,830.34	4,635,417.34	-	1,154,612.54	1,460,718.42	2,160,041.72	943,509.30	5,578,926.64	1,363,035.19	6,941,961.83	8,589,868.51
Total Expenditures/Commitments		$20,736,040.45	$ 9,837,484.45	$ -	$ 3,222,532.57	$3,238,574.08	$3,516,333.14	$ 945,652.30	$ 10,783,136.75	$ 1,363,035.19	$ 12,146,171.94	$ 8,589,868.51
Unassigned Project Funding												$ 19,040.32
Unexpended Cash Balance												$ 8,608,908.83

FIGURE 4-12 – Example of Unaudited Capital Project Financial Report.
Source: Unaudited Capital Project Financial Report.

Once the population of bonds was identified, we performed the following activities to achieve the audit's objectives with respect to Bond Money Usage.

- Used information obtained from initial interviews and review of initial data received to assess audit risks and devise an audit approach.
- Obtained and reviewed the City's bond policies and procedures.
- Obtained and reviewed City Council Memorandum for Resolution (CCMR), bond-related notes to the CAFR, bond ordinance documents, Unaudited Capital Project Financial Reports, arbitrage reports, and bond legal documents to gain an understanding of the purpose of each bond issued, financial position, status, and restrictive bond covenants, if any. Refer to **Figure 4-7** for a summary of bond funds and their purpose.
- Developed an audit work program that addressed the Bond Money Usage objectives.
- Divided the audit program into the following four sections and devised audit steps within each section designed to achieve the audit objectives.

Authorization – the audit steps in this section were designed to determine whether city council approved the issuances of bonds and certificates of obligation.

Existence – the audit steps in this section were designed to determine whether the proceeds from the issuances of bonds and certificates of obligation were actually received by the City and if cash remaining in the bond fund as of February 2017 could be traced to the investment account.

Disclosure – the audit steps in this section were designed to determine whether the issuances of the bonds and the certificates of obligation were properly disclosed in the Comprehensive Annual Financial Report (CAFR).

Propriety – the audit steps in this section were designed to determine whether the proceeds from the bonds and certificates of obligation were spent for the purposes for which the issuances were approved by city council and whether such expenditures were in accordance with bond covenants. This step also included determining whether funds remaining on closed projects were used appropriately based on the authorized purpose and any restrictive bond covenants.

- Performed general analytical procedures for bond revenues and expenditures during the scope period to provide perspective and a context for performing more detailed substantive procedures on specific bond funds. Much of this work is summarized in the background of this chapter.
- Executed the audit program steps and performed the detailed audit procedures described in the Substantive Testing Procedure and Results section below.

Substantive Testing Procedures and Results

We performed the following substantive audit procedures to achieve the objectives for Bond Money Usage.

- Conducted a detailed review of expenditure categories on the Monthly Unaudited Capital Project Financial Report to determine if the expenditure descriptions were consistent with the purpose of the bond. A more detailed examination of bond project expenditures was performed during our review of Capital Outlay. See the Capital Outlay chapter for procedures performed and the results.

  Expenditures for each project financed by bonds are listed on the Monthly Unaudited Capital Project Financial Reports. We noted the following two categories that were not described as a specific project: (1) **Operations**-representing expenditures used for operations rather than for construction-related activities; and (2) **Transfers**-representing transfers out of the bond fund to other funds. These categories are depicted in bold in **Figure 4-10**.

  We performed a detailed analysis of these categories to determine if bond funds had been used for purposes other than for which the bonds had been authorized. The analysis of the Operations category resulted in questioned costs of approximately $3.4 million. **Figure 4-13** presents the results of this analysis. We describe the procedures we performed on transfers in the next bullet, and the results are presented in **Figure 4-17**.

Fund and Purpose	Amount	Rationale & Conclusion
<u>332\2004 GOB</u> **Authorized Purpose:** Golf Course Improvements **Actual Usage:** Pay operational expenses in Fiscal 2005, 2006, and 2007.	FY 2005 **$115,153**	These bond funds were used to pay operational expenses in the years indicated. Operational reimbursements are permissible in some instances when costs related to the intended purpose of the bonds are incurred prior to the issuance of the bond proceeds or such operational costs are directly related to the bond issuance. However, in this instance, management could not substantiate why these costs were charged to the bond fund. Therefore, **we could not determine whether the use of these bond funds was appropriate or inappropriate based on the purpose of the bond.**
<u>334\2004 GOB Construction Fund</u> **Authorized Purpose:** Per Ordinance 04-84: $10.0 million for streets; $4.0 million for public safety buildings and facilities; and $2.0 million for parks and recreation. **Actual Usage:** Fund operational expenses in Fiscal 2005, 2006, and 2007.	**Total $146,687** FY 2005--$47,950 FY 2006--$71,389 FY 2007--$27,348	Finance staff were unable to justify the use of bond fund to finance operations, which is **inconsistent with the purpose of the bond.**

Fund and Purpose	Amount	Rationale & Conclusion
341/2011 Pass-Through Fund **Authorized Purpose:** Per bond documents and transcript of the legal proceedings: Construction of US 190 / Rosewood / 2410. **Actual Usage:** Payment of Transportation employee salaries capitalized as bond operational expenses.	**Total $1,140,629** FY 2011-$52,804 FY 2012 $160,497 FY 2013 $193,247 FY 2014 $299,000 FY 2015 $100,032 FY 2016 $335,049	Finance staff told MJ that these operational costs were salaries for transportation employees hired to work exclusively on a bond-related project. To support its assertion that these employees were chargeable to the bond, finance staff provided a list of the employees showing their job classification, annual salary, date of hire, and date of termination, if applicable. This documentation is insufficient to justify paying the employees with bond funds. Finance staff did not provide timesheets, level of effort reports indicating how much of the employees' time was spent on the project, approved time sheets, or other documentation to support that the employees' time was properly chargeable to the bond. Therefore, we were unable to determine if these costs were properly chargeable to the bond. Further, there was no opinion letter or other guidance from the City's bond counsel indicating that these costs are properly charged to the bond. This amount also includes other operational costs such as machinery, maintenance, tools, supplies, and uniforms, and dues and memberships. However, the City did not provide sufficient supporting documentation to justify whether these operational costs were properly chargeable to the bond. **Therefore, our assessment is that the use of bond fund appears inconsistent with the purpose of the bond.**
Fund 342/2011 Pass-Through Fund **Authorized Purpose:** Per tolling agreement: Construction of SH 195 / SH 201. **Actual Usage:** Payment of operational expenses.	**Total $222,615** FY 2011 $29,805 FY 2012 $82,214 FY 2013 $106,493 FY 2014 $4,103	Finance staff was unable to substantiate the purpose and appropriateness of this operational reimbursement. **The alternative use of bond funds appears to be inconsistent with the intended purpose of the bond.**
Fund 343/2011 CO Construction Fund **Authorized Purpose:** Purpose per Bond Documents and transcript of the legal proceedings: Street projects/Killeen Arts and Activity Center. **Alternate Usage:** Operational expenses.	**Total $586,943** FY 2011 $49,511 FY 2012 $136,568 FY 2013 $176,899 FY 2014 $223,966	Finance staff was unable to substantiate the purpose and appropriateness for this operational reimbursement. **This alternative purpose appears to be inconsistent with the intended purpose of the bond.**

Fund and Purpose	Amount	Rationale & Conclusion
Fund 384/2007 Water and Sewer Revenue Bonds **Authorized Purpose:** Per bond documents and transcript of the legal proceedings: Waterworks and Sewer System improvements. **Actual Usage:** Construction of Aquatics Center.	FY 2009 **$240,416**	Finance staff represented these costs were expended for waterlines at the Aquatics Center. However, the City could not provide the invoices to substantiate the appropriateness of such costs. Based on review of CCMR 08-174R, which authorized construction of the Aquatics Center, we noted that fund 384 was cited as a funding source. Additionally, the City provided the drawings for the Aquatics Center, which detailed the water and sewer lines. Based on the information that was provided, **this use appears to be consistent with the original purpose and intent of the bond.**
Fund 386/2013 Water and Sewer Revenue Bonds Stated Purpose per Ordinance 13-010: Water and sewer system projects. **Alternate Use:** Capitalize salaries as bond operational costs.	**Total $907,707** FY 2014 $491,998 FY 2015 $284,327 FY 2016 $131,382	Finance staff told us that these operational costs were capitalized salaries for water and sewer employees hired to work on this project. Therefore, we requested documentation supporting management's assertion that these employees were properly chargeable to the bond. The City provided a list of employees showing their job classification, annual salary, date of hire, and date of termination. This documentation is insufficient to justify the employees being charged to the bond. The City did not provide job descriptions; timesheets, level of effort reports indicating how much of the employees' time was spent on the project, approved time sheets, or other documentation to support that the employees' time was properly chargeable to the bond. Therefore, we were unable to determine if these costs were properly chargeable to the bond. Further, there was no opinion letter or other guidance from the City's bond counsel indicating that these costs are properly charged to the bond. This amount also includes other operational costs such as machinery, maintenance, tools, supplies, and uniforms, and dues and memberships. However, the City did not provide any supporting documentation justifying that these operational costs were properly charged to the bond. **Therefore, our assessment is that the use of bond fund appears inconsistent with the purpose of the bond.**
Total Questioned Costs	**$3,360,150**	

FIGURE 4-13 – Questionable Bond Money Usage.
Source: McConnell & Jones LLP's Analysis of Operations Expenditures.

- Attempted to reconcile transfers to and from bond funds and non-bond funds for mathematical and classification accuracy. **Figure 4-9** shows that transfers into bond funds totaled $12.7 million and comprise 3 percent of bond fund revenue sources. **Figure 4-10** shows that transfers out of bond funds total $17.1 million and comprise 5 percent of total expenditures. Transfers out should equal transfers in, which would suggest that the transfers were properly recorded, classified, and are mathematically accurate. We noted a $4.4 million difference between transfers in and transfers out.

Our attempt to reconcile the difference resulted in a $3.2 million unreconciled difference as shown in **Figure 4-14**.

Description	Transfers In	Transfers Out	Difference
Total Transfers	$ 12,745,625	$ 17,126,027	$ (4,380,402)
Transfers from non-bond funds	$ (3,020,558)		$ (3,020,558)
Transfers to non-bond funds		$ (10,594,493)	$ 10,594,493
Transfers among bond funds	$ 9,725,067	$ 6,531,534	$ 3,193,533

FIGURE 4-14 – Reconciliation of Transfers in and Out of Bond Funds.

We used the Monthly Unaudited Capital Project Financial Report to identify the cause of the difference. We noted that funds 329/2001 CO and 331/2003 CO showed transfers in from Fund 529/Aviation Passenger Facility Charge of $1,293,049 and $1,904,390, respectively. However, Fund 529's Monthly Unaudited Capital Project Financial Report showed only $3,909 transfers out to bond fund 331 and zero for bond fund 329. This resulted in the difference of approximately $3.2 million ($1.3 + $1.9 = $3.2).

Finance staff told us that the transfers to funds 329 and 331 were recorded in previous years and the accounting staff at that time did not record the transfers correctly, which resulted in the imbalance. Management represented that it could be a case of misclassification of the transfer by the receiving bond funds, but could not be certain since 97 percent of the transfers occurred between FY 2005 and FY 2009. **Figure 4-15** summarizes the transfers as shown on the Monthly Unaudited Capital Project Financial Report for the two funds.

Fiscal Year of "Transfer"	Transfers In		Transfers Out
	Fund 329	Fund 331	Fund 529
2005	$320,626	$320,626	$0
2006	$243,742	$243,742	$0
2007	$229,516	$418,058	$0
2008	$50,000	$50,000	$0
2009	$449,165	$760,490	$0
2010	$0	$81,121	$0
2011	$0	$4,030	$0
2012	$0	$10,163	$0
2014	$0	$12,250	$0
2016	$0	$3,910	$3,910
Total	**$1,293,049**	**$1,904,390**	**$3,910**
Total Difference	**$3,193,529***		

FIGURE 4-15 – Analysis of unreconciled bond transfers.
Source: Unaudited Capital Project Financial Report.
** The $4 difference with the total in **Figure 4-15** is due to rounding.*

- We conducted an analysis of transfers into and out of bond funds to determine if they were appropriate and approved. **Figure 4-16** presents an analysis of bond transfers to and from various bond and non-bond funds. The table groups non-bond fund transfers together.

Fund#		329	331	337	340	341	343	345	347	348	384	386	Non-Bond Funds	
Transfers To Funds Above	Amount of Transfers In	$4,385	$1,908	$15	$26	$62	$948	$1,524	$2,990	$556	$2	$332	$10,594	Variance
Transfers From Funds Below	Amount of Transfers Out													
329	($322)						$145						$177	$0
330	($15)												$15	$0
331	($4,187)	$776											$3,411	$0
332	($102)												$102	$0
333	($1)						$1							$0
334	($441)						$19						$421	$0
335	($26)				$26									$0
337	($104)									$37			$67	$0
340	($27)						$27							$0
341	($4,027)								$1,100				$2,927	$0
342	($1,931)								$300				$1,631	$0
344	($15)			$15										$0
347	($2,453)						$734			$519			$1,200	$0
348	($3,114)							$1,524	$1,590					$0
382	($2)										$2			$0
381	($1)											$1		$0
384	($331)											$331		$0
385	(5)												$5	$0
394	($7)						$7							$0
395	($15)						$15							$0
Non-Bond Funds	(3,020)	$3,609	$1,904			$62							$638	$3,193

FIGURE 4-16 – Summary of Bond Transfers-Cumulative from Inception of Bond Funds through February 2017-In Thousands.

Source: Unaudited Capital Project Financial Reports from FY 2011 through February 2017.

- Reviewed bond transfers greater than $30,000 to determine whether they were approved. The City's process for approving bond transfers is to include the respective bond transfers in the fiscal year budget adoption or approve a budget amendment through an ordinance. Additionally, Section 71 of the city charter allows the city manager to initiate and approve transfers. We deemed transfers that were not approved or amended by a budget or not initiated by the city manager to be unapproved. Of the $17 million bond transfers evaluated, we noted $14.5 million, or 85 percent, that were properly approved $2.4, or 14.3 percent that MJ deemed not properly approved, and $101,865 that were undeterminable.

- Reviewed bond transfers greater than $30,000 to determine whether they were used consistent with the purpose of the bond fund making the transfer. Of the $17.0 million evaluated, we deemed $12.2 million or 72 percent to be consistent, $488,300, or 3 percent, to be inconsistent, and $4.3 million, or 25 percent, to be undeterminable. **Figure 4-17** below summarizes exceptions noted.

From	To	Amount	Assessment
329 2001 CO ($321,713)	343 2011 CO	$144,513 FY 2015	The purpose of Fund 329 is to pay for contractual obligations for constructing and improving streets, including acquisition of rights-of-way of airport access roads. This appears consistent with the purpose of Fund 343, which is for the construction and acquisition activities related to infrastructure improvements and upgrades to streets. **This transfer appears to be a proper use of bond funds.** **This budget transfer was initiated by the respective city manager in FY 2015 per Section 71 of the City Charter which allows the city manager to initiate and approve such transfers**
	525 RGAAF (Regional Airport)	$177,200 FY 2007	While Fund 525 is for the airport, it is not known how the funds were actually spent; therefore the appropriateness of the transfer cannot be determined without additional information. **Indeterminable.** **This transfer was approved by Ordinance 07-017.**
331 2003 CO ($4,186,994)	329- 2001 CO	$776,018 FY 2009	The purpose of Fund 331 is to acquire, construct, and install improvements to the airport. This appears consistent with the purpose of Fund 329, which is to construct and access road to the new airport. **This transfer appears to be a proper use of bond funds.** **However, this transfer is not included in the FY 2009 budget nor were budget transfer documents provided. Therefore, is not an approved transfer.**
	431-Tax Interest & Sinking Fund-CO 2003	$1,617,000 $490,000 FY 2009 $750,000 FY 2011 $367,000 FY 2012	Section 8.03-Construction Fund of Ordinance 3-29 authorizing the issuance of Fund 331 bonds, states that all amounts remaining in the Construction Fund after the accomplishment of the purposes for which the bonds were issued shall be deposited into the Interest and Sinking Fund. **This transfer appears to be a proper use of bond funds.** The transfers for FY 2009 and FY 2011 are approved in the respective budgets. The transfer for FY 2012 is approved for $760,000. However, only $367,000 was transferred to Fund 431 and the remaining $393,000 was transferred to Fund 446, as noted below. **These are approved transfers.**
	446-2011 GO Refunding bond (RFDG) BOND Interest & Sinking Fund	$393,000 FY 2012	Section 8.03-Construction Fund of Ordinance 3-29 authorizing the issuance of Fund 331 bonds, states that all amounts remaining in the Construction Fund after the accomplishment of the purposes for which the bonds were issued shall be deposited into the Interest and Sinking Fund. This transfer is for the Interest and Sinking Fund of a refunding bond. The ordinance does not specify which interest and sinking fund. **We deem this transfer to be an**

From	To	Amount	Assessment
			appropriate use of bond funds. **This is an approved transfer that was adopted by the FY 2012 budget.**
	525 RGAAF (Regional Airport)	$1,400,976 $600,000 FY 2005 $500,000 FY 2006 $300,000 FY 2007 $976 FY 2017	Although this fund is associated with the airport, it is not known how the funds were actually spent; therefore the appropriateness of the transfer cannot be determined without additional information. **We deem the proper use of this bond transfer to be indeterminable.** **The transfers are included in the respective fiscal year budgets and are approved transfers.**
332 2004 CO ($101,865)	530 Golf Course Fund	$101,865 FY 2005	The purpose of the bond is for paying for contractual obligations to be incurred for constructing and improving the City's municipal golf course, constructing and improving streets, and purchasing fire, emergency medical, and public works vehicles and equipment. The transfer of funds from Fund 332 to the Golf Course Fund appear to be consistent with the original intent and purpose of Fund 332 which includes improvements to the City's municipal golf course. **This transfer appears to be a proper use of bond funds.** **The transfer documents for this transfer were not available as this transfer occurred in FY 2005 and was not required to be retained. Therefore, we could not assess the approval for this transfer.**
334 2004 GOB ($440,514)	343 2011 CO	$19,397 FY 2015	Section 7.03d of bond Fund 334's documents state that the proceeds are for street construction and improvements. This purpose is consistent with that of bond Fund 343, which is to also for street construction. **This transfer appears to be a proper use of bond funds.** **The bond transfer documents provided indicated $4,035 was approved, while $15,362 was not approved.**
	246 Fire Special Revenue	$421,117 FY 2011	Fund 246 is Fire Department Special Revenue Fund that is unrelated to the purpose of the bond. **This transfer appears to be inconsistent with the original purpose and intent of Fund 334.** **Approximately $392,000 was approved by the adoption of the FY 2011 budget and the remaining $29,000 was approved by a budget amendment per Ordinance 11-053.**
337 2007 GOB\CO ($104,428)	348 2014 GOB	$37,245 FY 2016	Bond Fund 337 is for constructing, improving, renovating, and equipping public safety buildings and facilities including police headquarters, animal control facilities, and Fire Station #8. The purpose of Fund 348 is for constructing, improving, renovating, and equipping public safety buildings and facilities including Fire Station #9. These appear to be compatible purposes and consistent with the intent of the bond documents. **This transfer appears to be a proper use of bond funds.** **This transfer was approved by a budget amendment per**

From	To	Amount	Assessment
			Ordinance 16-047.
	246 Fire Special Revenue	$67,183 FY 2011	Fund 246 is Fire Department Special Revenue Fund that is unrelated to the purpose of the bond. **This transfer appears to be an inconsistent with the original purpose and intent of Fund 337.** **This transfer was approved by a budget amendment per Ordinance 11-053.**
341 – 2011 PTF – 190/2410 ($4,026,761)	347 – 2014 CO	$1,100,000 FY 2016	This is a PTF fund that has the purpose of funding state highways 190 and 2410. Bond Fund 347 is for Fire Station #9, park facilities, and street improvements. The City provided an internal memorandum regarding this transfer. However, the information included in the memorandum is inconclusive and does not appropriately substantiate this transfer. **We deem this transfer to be consistent with the purpose of the bond.** **This budget transfer was initiated by the respective city manager in FY 2016 per Section 71 of the City Charter which allows the city manager to initiate and approve such transfers.**
	448 – PTF Debt Service	$1,280,176 $640,088 FY 2014 $640,088 FY 2015	This transfer was used to pay down the associated debt and is appropriate based on the original purpose and use of the fund. **This transfer appears to be a proper use of bond funds.** **The budget transfer for FY 2014 was initiated by the respective city manager in FY 2014 per Section 71 of the City Charter which allows the city manager to initiate and approve such transfers. The transfer for FY 2015 was included in the FY 2015 budget and is an approved transfer.**
	10 – General Fund	$1,646,585 FY 2012	This amount was not transferred, but was a direct payment of General Fund operational costs. In some circumstances, such payments can be permissible when costs related to the intended purpose of the bonds are incurred prior to the issuance of the bond proceeds or such operational costs are directly related to the bond issuance. However, in this instance management could not substantiate why these costs were charged to the bond fund. Management represented that the amounts were for salaries of personnel hired directly to administer the respective bond projects. However, management did not provide information regarding that dates of hire, job description nor annual compensation for the individuals whose salaries were allocated to bond operations. Thus, management was unable to justify why such salaries could be paid with bond funds. We could not determine whether the use of bond funds for operational purposes was, in fact, appropriate. **Therefore, the proper use of bond funds in this instance is indeterminable.** **However, this transfer is not included in the FY 2012 budget nor were budget transfer documents provided. Therefore, is not an approved transfer.**

From	To	Amount	Assessment
342 – PTF SH 195 / SH 201 ($1,930,750)	347 – 2014 CO	$300,000 FY 2016	The purpose of Fund 342 is to design, develop, finance, construct, maintain, operate, extend, expand, or improve roads on the state highway system located in the city. Fund 347 includes street improvements. Since the purposes of Funds 342 and 347 appear to be compatible, **We deem this transfer to be consistent with the purpose of the bond.** **The budget transfer for FY 2016 was initiated by the respective city manager in FY 2016 per Section 71 of the City Charter which allows the city manager to initiate and approve such transfers.**
	400 – Debt Service	$1,200,000 FY 2016	The ordinance for bond fund 342 states, "Any sale proceeds of the Bonds remaining after making all deposits and payments provided for above shall be deposited into the Interest and Sinking Account and applied to the payment of principal of and interest on the bonds. This transfer was used to service the City's debt service fund, but not for a specific related bond indebtedness. Finance staff indicated that the City's bond counsel advised that a single debt service account was appropriate and common practice. Based on this advice**, we deem the transfer to the generic Fund 400 debt service fund to be an appropriate use of bond funds.** **The budget transfer for FY 2016 was initiated by the respective city manager in FY 2016 per Section 71 of the City Charter which allows the city manager to initiate and approve such transfers**
	447 – PTF Debt Service	$430,750 FY 2015	This transfer was used to pay down the associated debt and is appropriate based on the original purpose and use of the fund. **This transfer appears to be a proper use of bond funds.** **The budget transfer for FY 2015 was initiated by the respective city manager in FY 2015 per Section 71 of the City Charter which allows the city manager to initiate and approve such transfers.**
347 – 2014 CO ($2,453,000)	343 – 2011 CO	$734,000 $300,000 FY 2015 $434,000 FY 2016	The transfer from Fund 347 to Fund 343 is consistent with the original purpose and intent of Fund 347 which includes street improvements. **This transfer appears to be a proper use of bond funds.** **These budget transfers for FY 2015 and FY 2016 were initiated by the respective city manager per Section 71 of the City Charter which allows the city manager to initiate and approve such transfers.**
	348 – 2014 GOB	$519,000 $256,000 FY 2015 $263,000 FY 2016	The transfer from Fund 347 to Fund 348 is consistent with the original purpose and intent of Fund 347 which includes constructing and equipping Fire Station No. 9. **This transfer appears to be a proper use of bond funds.** **These budget transfers for FY 2015 and FY 2016 were initiated by the respective city manager per Section 71 of the City Charter which allows the city manager to initiate and approve such transfers.**
	351 –	$200,000	The transfer from Fund 347 to Fund 351 is consistent with the

From	To	Amount	Assessment
	Rosewood Extension Grant	FY 2016	original purpose and intent of Fund 347 as the purpose of Fund 347 includes street improvements. **This transfer appears to be a proper use of bond funds.** **The budget transfer for FY 2016 was initiated by the respective city manager in FY 2016 per Section 71 of the City Charter which allows the city manager to initiate and approve such transfers.**
	601 – Fire Department Fleet ISF	$1,000,000 FY 2016	The transfer to the 601 ISF is consistent with the purpose of Fund 347 as its purpose includes the purchase of fire vehicles and equipment. **This transfer appears to be a proper use of bond funds.** **This transfer was approved by a budget amendment per Ordinance 16-010.**
348 – 2014 GOB ($3,114,200)	345 – 2012 GOB	$1,524,200 $1,404,200 FY 2015 $120,000 FY 2016	The transfer from Fund 348 to Fund 345 is consistent with the original purpose and intent of Fund 348 which includes parks and recreation. **This transfer appears to be a proper use of bond funds.** **These budget transfers for FY 2015 and FY 2016 were initiated by the respective city manager per Section 71 of the City Charter which allows the city manager to initiate and approve such transfers.**
	347 – 2014 CO	$1,590,000 FY 2015	The transfer from Fund 348 to Fund 347 is consistent with the original purpose and intent of Fund 348 which includes Fire Station No. 9. **This transfer appears to be a proper use of bond funds.** **The budget transfer for FY 2015 was initiated by the respective city manager in FY 2015 per Section 71 of the City Charter which allows the city manager to initiate and approve such transfers**
384 – 2007 Water and Sewer Revenue Bond ($331,261)	386 – 2013 Water and Sewer Revenue Bond	$331,261 FY 2016	The transfer from Fund 384 to Fund 386 is consistent with the original intent and purpose of Fund 384 which is to acquire, construct and install additions, improvements and extensions to the City's waterworks and sewer systems. **This transfer appears to be a proper use of bond funds.** **The budget transfer for FY 2016 was initiated by the respective city manager in FY 2016 per Section 71 of the City Charter which allows the city manager to initiate and approve such transfers**
Total Transfers Evaluated		**$17,011,486**	

FIGURE 4-17 – Bond Transfers Assessment.
Source: McConnell & Jones LLP's Analysis of Bond Transfers.

- Reviewed the population of bond funds identified in the scope period to assess which funds had remaining balances either at the time the bond fund closed or as of February 2017 if the bond fund was still active. We noted three categories of bonds:
  - Bonds closed during the scope period that had no funds remaining. No assessment was necessary for these bonds because no funds remained. **No exceptions were noted**.
  - Bonds that closed during the scope period and had remaining balances. The City transferred the remaining balances to other funds. We reviewed the propriety of these transactions during the review of bond transfers discussed above.
    Two exceptions were noted and are summarized in Figure 4-18.
  - Bonds that remained open as of February 2017. We traced the remaining balances to the investment statement noting that the remaining cash was on deposit.
    No exceptions were noted. With respect to the future use of these remaining funds, City management makes these decisions as they arise.
- Reviewed the City's Debt Management Policy CCMR 97-54R adopted in May 1997 and its post bond issuance procedures, effective August 2013. CCMR 97-5 establishes guidelines for planning, implementing, and evaluating the City's debt program and its ability to service its debt. The intent of the policy is to establish guidelines for the evaluation of acceptable levels of debt and the implications of debt issuance upon tax and fee increases as project requests are evaluated and funding decisions are considered. The policy addresses the following areas:
  - The acceptable levels of debt which the City may incur. This criterion is evaluated in terms of the maximum amount of debt allowed by the City Charter and State Law and also by the acceptable level of debt that can be incurred without jeopardizing the City's credit ratings.
  - The purpose for which debt will be issued and the appropriate type of debt to be issued.
  - Guidelines for issuance of short-term debt and evaluation of the debt service fund using recognized criteria and performance measurement standards. Use of tax-supported, general obligation bonds versus self-supporting, revenue bonds.
  - The evaluation of "pay-as-you-go" financing versus debt financing.
  - Use of fixed versus variable rate debt; and the structure of each type of debt issued.
  - Debt maturity schedules.
  - Selection of Financial Consultants, Legal Bond Counsel, Bond Underwriters, Paying Agents, and other service providers.
  - Use of bond credit rating agencies.
  - Other matters which are relevant to the City's credit standing.

The policy also addresses ongoing maintenance, debt authorization, and capital planning and financing as follows:

Maintenance, Replacement and Renewal

Consistent with its philosophy of keeping its capital facilities and infrastructure systems in good repair and to maximize the capital stock's useful life, the City should set aside sufficient current revenues to finance ongoing maintenance needs and to provide reserves for periodic replacement and renewal.

Debt Authorization

No City debt issued for the purpose of financing capital projects shall be authorized by the city council unless it has been included in a report of the impact of the contemplated borrowing on the existing Capital Improvement Plan and recommendations as to the financing arrangements from the finance director.

Capital Planning and Financing System

The City shall develop a capital planning and financing system for use in preparing a multi-year Capital Improvement Plan for consideration by the city council as part of the City's budget process. The city manager shall prepare recommendations to the city council for projects to be included in a multi-year capital improvements plan. This plan shall be for the coming three fiscal years and shall be updated periodically. The Plan shall contain a comprehensive description of the sources of funds and the timing of capital projects for future operating and capital budgets, effect of the projects on future debt sales, debt outstanding, and debt service requirements, and the impact on future debt burdens and current revenue requirements.

The City's post bond issuance procedures address compliance with federal tax requirements. These procedures outline the City's obligations with respect to Sections 103 and 141 through 150 of the Internal Revenue Code of 1986, as amended, which governs the issuance of tax-exempt bonds. The purpose of these written procedures is to provide the City with an outline that describes actions to be taken in order to comply with bond covenants including applicable IRS Tax Code provisions and regulations and also to specify who is responsible for such action.

The tax code and associated regulations also impose record retention requirements with respect to bonds. The City's post bond issuance procedures state the following with respect to record retention requirements for bonds:

"The Responsible Person will maintain or cause to be maintained all records relating to the investment and expenditure of the proceeds of the Bonds and the use of any facilities financed or refinanced thereby for a period ending three (3) years after the complete extinguishment of the Bonds. If any portion of the Bonds is refunded with the proceeds of another series of tax-exempt bonds, the Responsible Person will maintain or cause to be maintained all of such records until three (3) years after the refunding bonds are completely extinguished. Such records may be maintained in paper or electronic format."

In addition to the records retention guidelines in the post bond issuance procedures, the City implemented a new record's retention policy on January 23, 2014. This policy outlines the purpose, intent, and goals of the City's document retention program and defines the process of records management. It provides definitions, describes departmental responsibilities and discusses broad record types such as email, electronic files, and scanned records. It also gives guidelines for permanent records and records destruction.

The City adopts the same records retention schedule as the schedule established by the Texas State Library and Archives Commission (TSLAC). Government Code, Section 441.158, provides that TSLAC shall issue records retention schedules for each type of local government, including a schedule for records common to all types of local government. Accordingly, TSLAC establishes document retention periods for state agencies and local governments. The retention periods are outlined in TSLAC's *Local Schedule GR-Retention Schedule for Records Common to All Local Governments* (LSGR). The most current is the 5th edition, is effective as of April 2016. The third and fourth editions were effective as of November 1, 1995 and July 4, 2012, respectively.

Figure 4-18 compares retention periods for bond-related schedules from all three editions. The schedules have remained substantially the same except there was no specific bond-related accounts payable requirement in the fifth edition, and the requirement to maintain bond-related accounts payable and disbursement records increased from three to five years between editions three and four, but was reduced back to three years in edition 5.

Section	Document Description	Retention Requirements		
		(5th Edition-Effective 4/17/2016	(4th Edition-Effective July 4, 2012	(3rd Edition-Effective 11/1/1995
GR 1025-03	Bond administrative records consisting of preliminary studies, proposals and prospectuses, authorizations and certifications for issuance or cancellation, and related policy correspondence.	Permanent	Permanent	Permanent
GR1025-03b	Bond certificates and redeemed coupons.	1 year after payment	1 year after payment	1 year after payment
GR1025-03c	Bond registers.	Permanent	Permanent	Permanent
GR1025-03d	Records relating to the exchange, conversion, or replacement of bonds by bondholders.	1 year if information is contained in a bond register; **permanent** if information is not contained in a bond register.	1 year if information is contained in a bond register; **permanent** if information is not contained in a bond register.	1 year if information is contained in a bond register; **permanent** if information is not contained in a bond register.
GR 1025-09	Documentation relating to the investment of public funds (e.g., certificates of deposit) that evidences the investment of funds, the performance or return of investments, the cancellation or withdrawal of investments, and similar activity.	5 years	5 years	5 years
GR1025-09b	Documentation related to the calculation of arbitrage rebate amounts, if any, on proceeds from the sale of tax-exempt bonds.	Retirement of the last obligation of the bond issue + 6 years	Retirement of the last obligation of the bond issue + 6 years	Retirement of the last obligation of the bond issue + 6 years
GR1025-26a	Claims, invoices, statements, copies of checks and purchase orders, expenditure authorizations, and similar records that serve to document disbursements, including those documenting claims for and reimbursement to employees for travel and other employment-related expenses.	Fiscal Year end of date of last bond payment + 3 years	Accounts payable and disbursement records for bond-funded projects must be maintained until Fiscal Year end of date of last payment +5 years	3 years

Section	Document Description	Retention Requirements		
		(5th Edition-Effective 4/17/2016	(4th Edition-Effective July 4, 2012	(3rd Edition-Effective 11/1/1995
GR1025-26d	Accounts payable records for bond-funded projects.	Fiscal Year end of date of last bond payment + 3 years	Fiscal Year end of date of last bond payment + 3 years	None specific to bonds

FIGURE 4-18 – Texas State Library Archives Commission Bond Document Retention.
Source: TSLAC's Local Schedule GR-Retention Schedule for Records Common to All Local Governments, 3rd through 5th Editions.

- We judgmentally selected 6 bond funds created from the issuances related to the 2002 bond election, plus 10 other bond funds based on their size and anecdotal information received during interviews of staff and city council members. We obtained copies of bond covenants, city ordinances, official issue statements and/or notices of intent to determine if the bond issuances were properly authorized and approved. **No exceptions were noted**.
- Reviewed the authorized bond amounts established by city council for each bond fund as documented in City Council Memorandums for Resolution or Bond Ordinance documents and compared authorized to actual expenditures to ensure the bond issuance amounts authorized were not exceeded. See **Figure 4-8**. **No exceptions were noted**.
- Reviewed arbitrage reports to determine if there have been any arbitrage issues or if the City has paid any arbitrage fees. **No exceptions were noted**.
- Reviewed the investment pool statements and bond closing letters for each bond fund to trace the net proceeds from the issuance of the bond to the investment pool account to ensure that the initial bond proceeds were deposited timely and in the correct amount. **For the investment pool statements and bond closing letters that were available, no exceptions were noted.**

Bond issuance closing letters reconcile the total bond issuance amount to the actual proceeds deposited to the investment fund. Bond closing letters were not available for four bond funds. Although we were able to trace the net proceeds of these four bond funds to the investment statement, we were not able to reconcile the difference between the issuance amount of the bonds and the net proceeds. Typically, such differences include bond premium, issuance costs, interests, bond council fees, and other costs.

We reviewed the applicable edition of TSLAC's document retention requirements to determine if the City was in violation of bond closing letter retention requirements for these four bonds. We used March 21, 2017, as the document retention evaluation date because this is the effective date of McConnell & Jones LLP's audit contract with the City. No documents should have been destroyed after this date, even if allowed by the retention schedule. Our review indicated that the City was not in violation of its retention schedule with respect to closing letters for these bonds.

- Investment pool statements were not available for 12 of the 26 bond funds in the population because the City did not retain the statements. We reviewed the applicable edition of TSLAC's document retention requirements to determine if the City was in violation of investment statement retention requirements. We used March 21, 2017, as the document retention evaluation date because this is the effective date of McConnell & Jones LLP's audit contract with the City. No documents should have been destroyed after this date even if allowed by the retention schedule. Of the 12 bonds examined, one was out of compliance as shown in
Figure 4-19.

Fund	Year of Issuance	Applicable TSLAC Retention Schedule	TSLAC Effective Date	Allowable Disposal Date (5 years from Issue Date)	In Compliance?
344	**8/22/2012**	**5th**	**4/17/2016**	**8/21/2017***	**No**
384	10/1/2007	5th	4/17/2016	9/29/2012	Yes
385	9/15/2005	4th	7/4/2012	9/14/2010	Yes
332	10/1/2004	3rd	11/1/1995	9/30/2009	Yes
333	10/1/2004	4th	7/4/2012	9/30/2009	Yes
334	10/1/2004	4th	7/4/2012	9/30/2009	Yes
382	10/1/2004	4th	7/4/2012	9/30/2009	Yes
330	12/1/2002	4th	7/4/2012	11/30/2007	Yes
381	6/26/2001	3rd	11/1/1995	6/25/2006	Yes
329	6/15/2001	3rd	11/1/1995	6/14/2006	Yes
395	1995	3rd	11/1/1995	6/22/2000	Yes
394	1994	2nd	11/1/1995	6/21/1999	Yes

FIGURE 4-19 – Unavailable Bond Investment Statements. *Of the 12 unavailable investment fund statements, the disposal of one was in violation of the City's and TSLAC's document retention requirements.*
Source: MJ's work papers and TSLAC's Local Schedule GR-Retention Schedule for Records Common to All Local Governments, 3rd through 5th Editions.

- Obtained the February 2017 investment fund statements and reconciliations for each bond fund still active as of that date. We followed the bond money trail for these bonds from receipt of initial proceeds, to the expenditure of the proceeds, to the cash balance remaining at February 2017. We performed detailed testing of actual bond project expenditures in connection with our work on capital outlays, which is discussed in the Capital Outlay section of this report. Finally, we traced and agreed the ending cash balances for each fund to the February 2017 investment statements and reconciliations. **No exceptions were noted**.

CHAPTER 5 – INTER-FUND TRANSFERS

This section of the report contains our analysis of interfund transfers (IFT) executed by the City of Killeen finance team between FY 2010 and FY 2017. The contracted scope of services for this focus area included conducting a thorough risk-based analysis, within the scope periods delineated, to determine if fraud, and/or gross management exists, and quantify, if applicable, the City's financial losses relative to incidents identified. Specifically, we were contracted to determine the following with regard to interfund transfers:

1. Were transfers from restricted funds allowable and legal?
2. Were the transfers authorized?
3. Are the City's policies governing interfund transfers adequate to prevent misuse or misallocation of restricted funds?

Interfund transfers are an accounting mechanism to redistribute money or resources from one account (fund) to another account (fund).

CHAPTER HIGHLIGHTS

- Instances of fraud or abuse did not come to our attention based on documentation we were provided and we tested.
- Develop and implement polices to govern Enterprise Funds, including purposes, operations, revenues, expenditures and transfers.
- Develop and implement policies to govern interfund transfers, including dollar thresholds and purposes that require city council approval; informing city council of all interfund transfers; and supporting documents that must be included and retained.
- Adjust franchise fees and indirect cost allocation transfer amounts to be based on actual expenses rather than budgeted expenses.
- Include discussion of the purpose of interfund transfers in notes included in the Comprehensive Annual Financial Report (CAFR).

Background

Statement No. 34 of the Governmental Accounting Standards Board (GASB 34) establishes financial reporting standards for state and local governments. GASB 34 requires the following basic financial statements:

- Government-wide financial statements which distinguish between governmental and business-type activities; and
- Fund financial statements which report the activities of the major governmental and enterprise funds.

Within fund financial statements, interfund activity includes interfund loans, interfund services provided and used, and interfund transfers. Interfund activities among the three fund categories (governmental funds, proprietary funds and fiduciary funds) should be classified as follows:

Reciprocal interfund activities:

- Interfund loans
- Interfund services provided and used

Nonreciprocal interfund activities:

- Interfund transfers
- Interfund reimbursements

One purpose of annual financial statement disclosures is to allow for inquiry about the reasons why the City shifted resources between funds and whether the interfund transactions were in compliance with any restrictions on the use of resources.

City of Killeen Interfund Transfers

The City of Killeen's (City) Comprehensive Annual Financial Report's (CAFR) Fund Financial Statements reports two major types of funds: Governmental Funds and Enterprise Funds. The City's financial system contains over 60 different funds. Each fund is assigned a unique three-digit fund code.

Within the Funds Financial Statements for Enterprise Funds, there are four Enterprise Funds and one Internal Service Fund (ISF). The total annual transfer of funds between Enterprise Funds and other funds increased to $14.3 million in FY 2016, from $5.6 million in FY 2010. **Figure 5-1** provides a summary of the City's interfund transfers between FY 2010 and FY 2016.

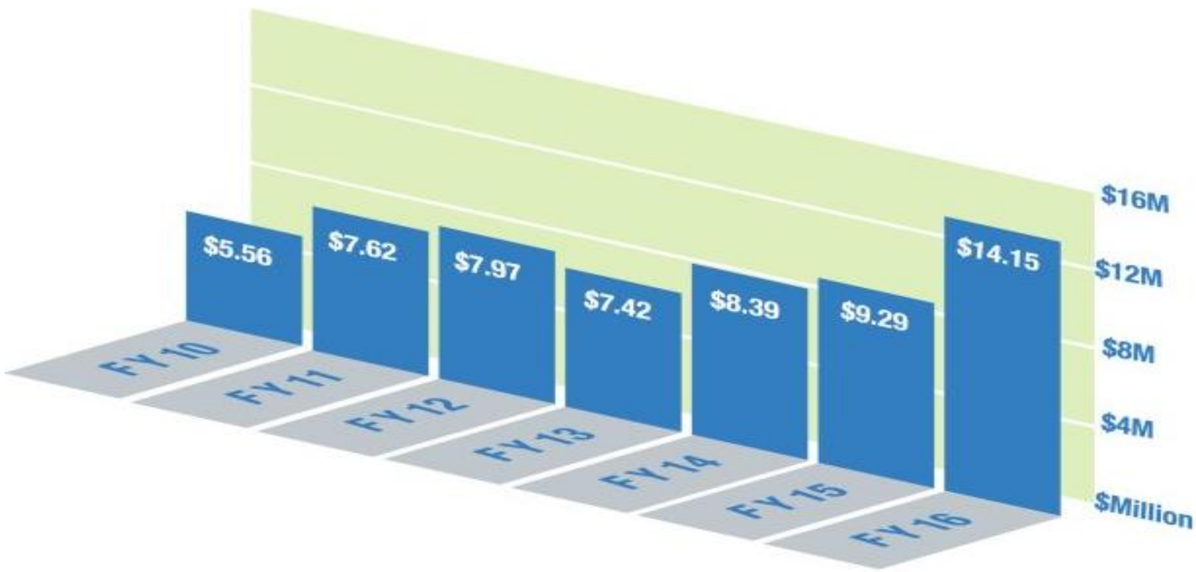


FIGURE 5-1 – City of Killeen Interfund Transfers Summary FY 2011 – FY 2016. *The City's interfund transfer totals were relatively consistent each year. The spike in FY 2016 was due to establishing an Internal Service Fund for the fleet program.*
Source: City of Killeen trial balances for respective fiscal years.

Our analysis of the purposes for interfund transfers between Enterprise Funds and Governmental Funds includes the following:

- ***Transfer from Enterprise Funds to the General Fund for franchise fees:*** Solid Waste and Water & Sewer funds pay the General Fund a percentage of annual budgeted revenues as franchise fees. This fee is adopted as part of the City's annual budget. The franchise fees increased to nine percent in FY 2016, from seven percent in FY 2011. **Figure 5-2** provides the percentage of franchise fees the Solid Waste and Water & Sewer funds paid to the General Fund, by year, for FY 2011 through FY 2016.

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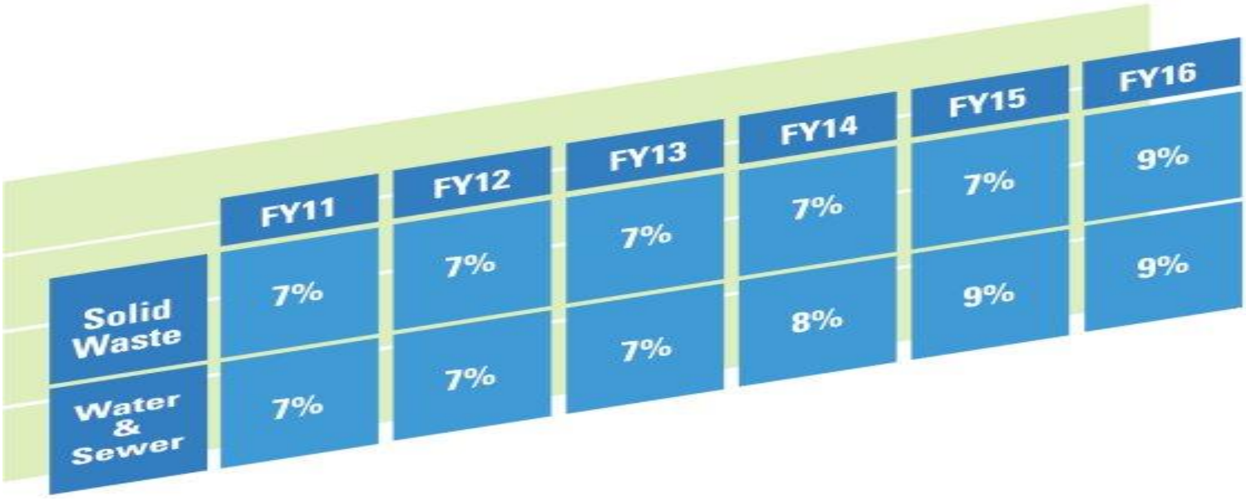


FIGURE 5-2 – City of Killeen Franchise Fee Percentages Paid by the Solid Waste and Water & Sewer Funds, FY 2011 – FY 2016. *The percentage of franchise fees Solid Waste and Water & Sewer funds paid the General Fund remained at seven percent for several years, and increased to nine percent in FY 2016.*

- ***Transfer to/from General funds for Indirect Cost Allocation:*** Administrative expenses, including city council expenses; city manager, city auditor, finance, human resources, information technology (IT) salaries; and operating costs are allocated to the Solid Waste Fund, Water & Sewer Fund and Drainage Fund. The allocation percentage is determined by calculating the percentage of budgeted direct expenses and projected payroll expenses that each fund incurs in proportion to the total of all City funds. The FY 2016 cost allocation percentages by fund are shown below.

We noted instances where Information Technology related expenses are allocated between Enterprise Funds and the General Fund as incurred by direct charge, and then also reallocated as part of the annual indirect cost allocation. Effectively, the portion charged to General Fund constitutes both direct cost and indirect cost. The City's internal auditor raised this issue in May 2016 as a result of an audit. The City's Finance Department is aware of the "double charging" and is working with Information Technology staff to resolve the issue. However, the Finance Department has not resolved the double charging issue as of the date of this audit report.

- ***Transfer from Enterprise Funds to Internal Service Fleet Fund:*** In FY 2016 the City decided to fund the new Fleet Replacement Program with $4.5 million transferred from Enterprise Funds.
- ***Other Transactions:*** Most of these interfund transactions reflect "Budget-to-GAAP" adjustments. The City's accounting system captures all expenditures throughout the year based on the expenditure's approved budget codes. At the end of the year, the Finance Department manually records "Budget-to-GAAP" journal entries to move expenditures incurred from bond funds to the Enterprises Fund's asset or expenditure accounts. For example, a purchase of a major capital asset will be recorded as expenditure in a bond fund. The "Budget-to-GAAP" entry then reallocates the expenditure from the bond fund to the associated Enterprise Fund, and reclassifies the expenditure from expense accounts to the Enterprise Fund's capital asset account. These "Budget-to-GAAP" transactions are a timing adjustment and have zero net effect on the Enterprise Funds.

Figure 5-3 provides a summary of the purposes for interfund transfers from FY 2011 to FY 2016.

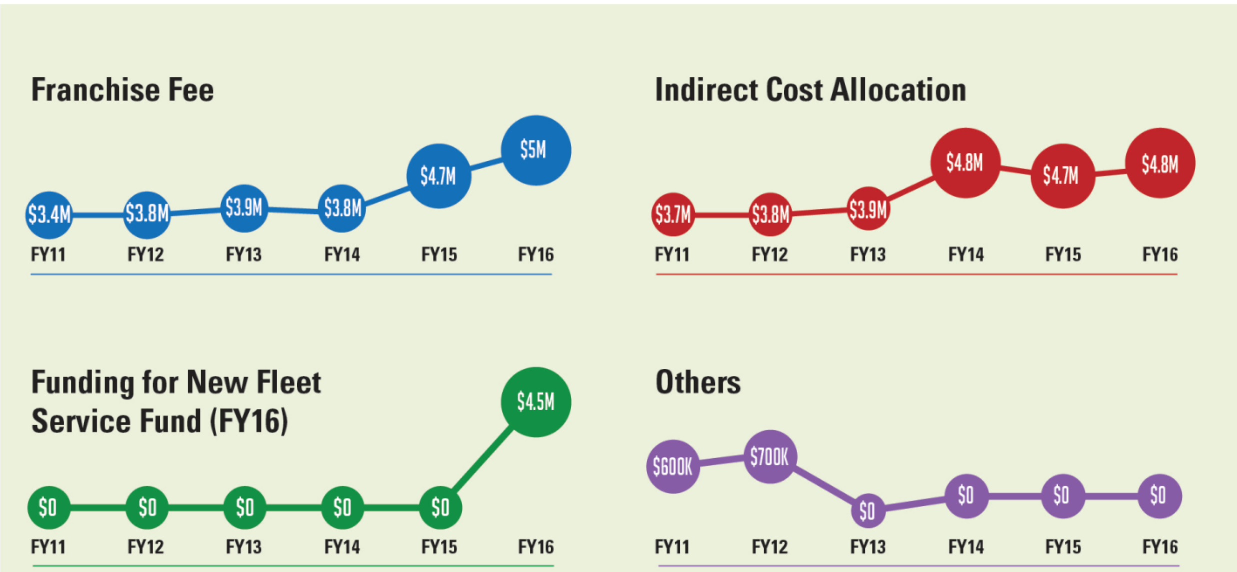


FIGURE 5-3 – City of Killeen FY 2011 – FY 2016 Purpose of Interfund Transfers. *The primary purposes for the City's interfund transfers are for franchise fees and indirect cost allocations.*
Source: City of Killeen trial balances and interfund transfer schedules for respective fiscal years.

Audit Questions' Results

The following tables summarize our conclusions to the three specific questions we were asked to address in the contractual scope of work.

Review Area:	**Interfund Transfers**
Objective:	Were the transfers authorized?
Conclusion:	City Charter authorizes the city manager to initiate transfers. Therefore, transfers are not required to be approved by city council. For this reason not all bond transfers are provided to city council for approval or informational purposes.

Review Area:	**Interfund Transfers**
Objective:	Were transfers from restricted funds allowable and legal?
Conclusion:	Transfers from Enterprise Funds are allowable and legal under accounting principles. However, the City did not establish written policies to govern each Enterprise Fund's purpose, responsibilities, revenue generation and revenue usage. Therefore, there are no established policies and guidelines defining "allowable" expenditures for management to reference when making decisions related to authorizing interfund transfers.

Review Area:	**Interfund Transfers**
Objective:	Are the City's policies governing interfund transfers adequate to prevent misuse or misallocation of restricted funds?
Conclusion:	The City's policies governing interfund transfers are not adequate to prevent misuse or misallocation of restricted funds. However, no instances of misuse or misallocation came to our attention. The majority of interfund transfers were for franchise fees, indirect cost allocation, debt service and the Internal Service Fund (fleet replacement program). ➲ There are no specific restrictions regarding the type of transfers that can be made specified for individual funds. ➲ There are no policies and procedures establishing guidelines for authorizing, approving and managing interfund transfers. ➲ There are no policies and procedures governing the Fleet Vehicle Program as a whole, or governing the accounting treatment for transactions within and outside the funds.

Observations and Recommendations

OBSERVATION 1: Enterprise Fund Policies

The City did not develop or adopt written policies to govern each Enterprise Fund's purpose, responsibilities, revenue generation and revenue usage. Therefore, there are no established policies and guidelines defining "allowable and legal" expenditures for management to reference when making decisions related to authorizing interfund transfers and evaluating the City's practices related to the legality and allowability of interfund transfers to and from Enterprise Funds.

While accounting principles do not disallow transferring Enterprise Fund resources to other funds, we recommend that there be a governing document for each Enterprise Fund. It is important to note that policies do not determine legality. They can only set boundaries on authorized purposes. Legality is determined through law.

We noted that significant funds were transferred from Enterprise Funds to the Internal Services Fund (ISF) to fund the Vehicle Replacement Fund and the City purchased vehicles from the ISF fund that did not benefit the respective Enterprise Services Fund from which the funds were transferred.

RECOMMENDATION 1: Enterprise Fund Policies

1. The city manager should develop and city council should adopt policies to govern each Enterprise Fund. The policies should be specific as to whether revenues should be restricted for use in the fund's operations; what expenses are allowable within the fund; and under what conditions funds can be transferred to other funds. Once the policies are adopted, specific processes and related training should be implemented to ensure transfers from restricted funds are properly executed and authorized in accordance with appropriate procedures and guidelines.
2. Although the Fleet Vehicle Program was terminated, the City should ensure that there are policies developed to govern any similar program that may be put into place in the future. The policies should be specific as to the purpose of the program; specific roles and responsibilities of management and city council related to the program; the type of transactions related to the program; the execution of the budgeting process related to the Fleet Vehicle Program; how the program will be funded; and allowable expenses.

OBSERVATION 2: Interfund Transfer Policies and Practices

The City's policies governing interfund transfers are not adequate to prevent misuse or misallocation of restricted funds. However, instances of fraud or abuse did not come to our attention based on documentation we were provided and we tested.

There are no written policies governing interfund transfers and interfund transfers related to bond funds are not consistently authorized by city council.

The absence of written policies has created the current environment where there are no restrictions specified for the transfer of individual funds. We also noted the following weaknesses in managing interfund transfers.

- The City Charter authorizes the city manager to initiate transfers and does not require city council authorization. We noted that the Finance Department does not present all bond-related interfund transfers to city council for informational purposes.
- The Finance Department established an escrow account in the City's financial system to record transactions that were later adjusted through an interfund transfer. Examples of transactions recorded in this account include:
  - Liabilities for the Child Safety Escrow Fund ($307.09)
  - Sidewalk construction at Ellison High School ($79,131.69)
  - Insurance reimbursement ($114,000.00) and subsequent repurchase of vehicle ($114,000.00)
  - Vehicle repair ($25,462.00)
  - Front loader ($85,538.00)

These transactions should have been recorded to the correct account when the revenues were received and the costs were incurred.

The City implemented a program and fund where vehicles are purchased with funds from a dedicated fleet vehicle program account. City departments are then charged "lease" fees based upon their respective vehicle activities. Although there are policies and procedures for Fleet Vehicle Program operations at the user levels, there are no policies and procedures governing the program as a whole, or specifying the appropriate accounting treatment of the transactions within the Fleet Vehicle Program. Finance Department roles and responsibilities for establishing funding levels, authorizing expenditures and allocating the costs also are not clearly identified.

RECOMMENDATION 2: Interfund Transfer Policies and Practices

The city manager should develop and city council should adopt the following written policies.

1. Policies requiring the city manager to obtain city council approval for major interfund transfers or for transfers above specific dollar thresholds established by city council.
2. Policies and procedures to govern all interfund transfers, including recurring transfers. The policies should include establishing and enforcing authorization levels, requiring documented justification for the transfers, and minimum documentation requirements for all interfund transfers.

OBSERVATION 3: Interfund Transfer Disclosures in Annual Financial Reports

The notes included in the City's Comprehensive Annual Financial Report (CAFR) do not provide adequate disclosures and presentations about the nature of interfund transfers. Governmental Accounting Standards Board (GASB) statement No. 38 Certain Financial Statement Note Disclosures, Paragraph 15 Interfund Balances and Transfers and the Governmental Accounting, Auditing and Financial Reporting, page 384 states "The notes should disclose the intended purpose and amount of significant transfers that do not occur on a routine basis or are inconsistent with the activities of the fund making the transfer".

The City's CAFR disclosures do not include a description of the nature or purpose of interfund transfer transactions and a summary of the source fund and destination fund. **Figure 5-4** provides the City's September 30, 2016 CAFR Interfund Transfer schedule.

M. Interfund Transfers

The composition of interfund transfers for the year ended September 30, 2016, is as follows:

	Transfers In	Transfers Out
General Fund	$ 9,830,769	$ -
Debt Service Fund	3,010,129	1,810,129
Other Governmental Funds:		
Capital Project:		
2007 G.O. & C.O. Bonds	-	37,245
2009 C.O. Bonds	-	27,338
2011A Pass Thru Financing 190/2410	-	1,100,000
2011 Pass Thru Financing 195/201	-	1,500,000
2011 C.O. Bonds	461,338	-
2012 G.O. Bonds	120,000	-
2014 C.O. Bonds	1,400,000	1,897,000
2014 G.O. Bonds	300,245	120,000
Rosewood Extension Grant	200,000	-
Total Other Governmental Funds	2,481,583	4,681,583
Total Governmental Funds	15,322,481	6,491,712
Enterprise:		
Solid Waste	-	4,371,315
Water & Sewer	-	9,671,755
Drainage Utility	-	287,699
Total Enterprise Funds	-	14,330,769
Internal Service Fund	5,500,000	-
Total Transfers	$ 20,822,481	$ 20,822,481

FIGURE 5-4 – City of Killeen FY 2016 CAFR Interfund Transfer Disclosure.
Source: Ciy of Killeen Comprehensive Annual Financial Report, Fiscal Year Ended September 30, 2016, page 67.

Figure 5-5 on the following page provides an example of a city's CAFR that provides a detailed discussion of the purpose of selected interfund transfers in addition to the interfund schedule.

State of North Carolina June 30, 2014

NOTES TO THE FINANCIAL STATEMENTS

B. Interfund Transfers

Transfers in/out of other funds for the fiscal year ended June 30, 2014 consisted of the following (dollars in thousands):

Transfers Out	Transfers In: General Fund	Highway Fund	Other Governmental Funds	Unemployment Compensation Fund	EPA Revolving Loan Fund	NC Turnpike Authority Fund	Other Enterprise Funds	Internal Service Funds	Total
General Fund	$ —	$ —	$ 258,713	$ 10,000	$ 7,002	$ —	$ 7,168	$ 2,055	$ 284,938
Highway Fund	266,054	—	1,051	—	—	—	—	—	267,105
Highway Trust Fund	346	32,501	—	—	—	61,201	—	—	94,048
Other Governmental Funds	133,348	6,799	11,937	—	7,484	—	—	23	159,591
Unemployment Compensation Fund	1,878	—	—	—	—	—	—	—	1,878
EPA Revolving Loan Fund	707	—	—	—	—	—	—	—	707
NC State Lottery Fund	503,135	—	1,000	—	—	—	—	—	504,135
NC Turnpike Authority	—	14,646	—	—	—	—	—	—	14,646
Other Enterprise Funds	813	—	486	—	—	—	—	—	1,299
Internal Service Funds	57	—	—	—	—	—	—	4,800	4,857
Total	$ 906,338	$ 53,946	$ 273,187	$ 10,000	$ 14,486	$ 61,201	$ 7,168	$ 6,878	$ 1,333,204

Transfers are primarily used to (1) transfer revenues and bond proceeds from the fund required by State statute or budget to collect the revenue to the fund required by State statute or budget to expend them, (2) provide unrestricted revenues collected in the General Fund to finance operating and capital programs accounted for in other funds in accordance with budgetary authorizations, and (3) reflect reversions of State funds from other funds to the General Fund in accordance with Office of State Budget and Management or legislative requirements.

House Bill 817 [Session Law 2013-183], amends the law that created the Highway Trust Fund. The amendment directs that funds are to be transferred to the N.C. Turnpike Authority (NCTA) to pay debt service or related financing expenses on revenue bonds or notes issued for the following toll road construction projects: Triangle Expressway and Monroe Connector/Bypass. Debt has been issued for the Triangle Expressway and the Monroe Connector/Bypass, and $49 million was transferred to the NCTA during fiscal year 2014.

In compliance with the North Carolina State Lottery Act, House Bill 1023 [Session Law 2005-344], all "Net Revenues" of the N.C. State Lottery Fund are required to be transferred to the Education Lottery Fund (General Fund) for educational purposes. The total transfer for this fiscal year was $503.14 million, as set forth in General Statute 18C-164.

FIGURE 5-5 – Comparative CAFR Interfund Transfer Schedule and Disclosure.
Source: North Carolina June 30, 2014 Comprehensive Annual Financial Report.

RECOMMENDATION 3: Interfund Transfer Disclosures on Annual Financial Reports

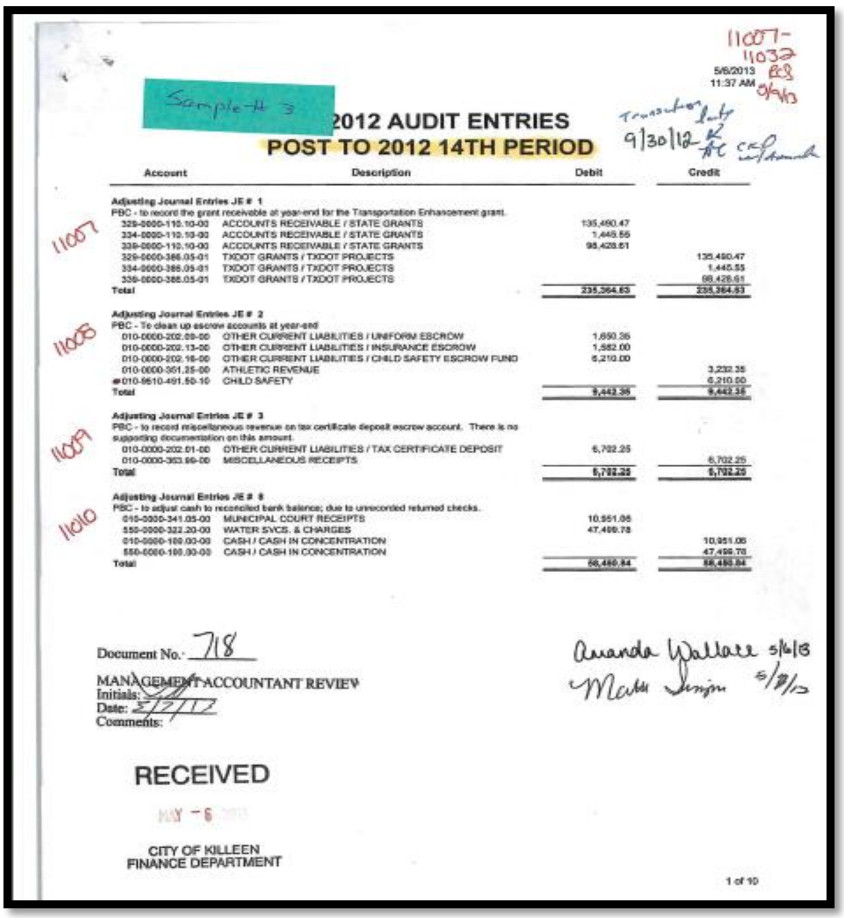
Ensure that the City's Comprehensive Annual Financial Report complies with GASB statement 38 requirements by providing more descriptive information regarding the amount and purpose of all interfund transfers in notes to the financial statements related to interfund transfers.

OBSERVATION 4: Required Documentation Retention

The City does not have written policies and procedures related to the documentation required to support interfund transfers and journal entries. Furthermore, supporting documents for journal entries are inadequate to follow a complete audit trail for specific transactions. The audit team could not verify many transactions for completeness and accuracy because of the absence of supporting documentation, which would have included invoices to substantiate the cost being adjusted; reconciliations to substantiate adjustments for reconciling differences; system-generated reports to show transactions that need to be adjusted; and cover sheets to prove the journal entries were properly authorized.

Eight of our interfund transfer sample selections were for transactions that occurred between FY 2011 and FY 2015, and supporting documents were not maintained by the City.

Additionally, the Finance Department authorizes and records “Budget-to-GAAP” entries in the City’s books and records without proper supporting documentation. The “Budget-to-GAAP” adjustment process is that at the end of each fiscal year. The Finance Department generates a report listing all assets purchased (i.e., account numbers ending in 6000). They then review the report listing all asset purchases and reconcile the report to the Capital Fund. Once the reconciliation is completed, the Finance Department makes the respective adjusting journal entries in the financial system. The Finance Department also makes adjusting journal entries based upon schedules prepared by the department and reviewed by the City’s external auditors. The Finance Department provided the audit team copies of the adjustments, but could not provide supporting documentation for us to verify authorization, accuracy or reasonableness. Supporting documentation should include the account balances before the transfers or the list of transactions to be affected, along with authorization forms or signatures of the appropriate manager. **Figure 5-6** provides an example of interfund transfer entries made based on schedules prepared by the Finance Department where supporting documentation was not maintained.



11007-11032

5/6/2013
11:37 AM

Sample # 3

2012 AUDIT ENTRIES
POST TO 2012 14TH PERIOD

9/30/12

Account	Description	Debit	Credit
Adjusting Journal Entries JE # 1			
PBC - to record the grant receivable at year-end for the Transportation Enhancement grant.			
329-0000-110.10-00	ACCOUNTS RECEIVABLE / STATE GRANTS	135,490.47	
334-0000-110.10-00	ACCOUNTS RECEIVABLE / STATE GRANTS	1,445.55	
339-0000-110.10-00	ACCOUNTS RECEIVABLE / STATE GRANTS	98,428.61	
329-0000-386.05-01	TXDOT GRANTS / TXDOT PROJECTS		135,490.47
334-0000-386.05-01	TXDOT GRANTS / TXDOT PROJECTS		1,445.55
339-0000-386.05-01	TXDOT GRANTS / TXDOT PROJECTS		98,428.61
Total		235,364.63	235,364.63
Adjusting Journal Entries JE # 2			
PBC - To clean up escrow accounts at year-end			
010-0000-202.09-00	OTHER CURRENT LIABILITIES / UNIFORM ESCROW	1,650.35	
010-0000-202.13-00	OTHER CURRENT LIABILITIES / INSURANCE ESCROW	1,582.00	
010-0000-202.16-00	OTHER CURRENT LIABILITIES / CHILD SAFETY ESCROW FUND	6,210.00	
010-0000-361.25-00	ATHLETIC REVENUE		3,232.35
010-0610-491.50-10	CHILD SAFETY		6,210.00
Total		9,442.35	9,442.35
Adjusting Journal Entries JE # 3			
PBC - to record miscellaneous revenue on tax certificate deposit escrow account. There is no supporting documentation on this amount.			
010-0000-202.01-00	OTHER CURRENT LIABILITIES / TAX CERTIFICATE DEPOSIT	6,702.25	
010-0000-363.99-00	MISCELLANEOUS RECEIPTS		6,702.25
Total		6,702.25	6,702.25
Adjusting Journal Entries JE # 8			
PBC - to adjust cash to reconciled bank balance; due to unrecorded returned checks.			
010-0000-341.05-00	MUNICIPAL COURT RECEIPTS	10,951.06	
550-0000-322.20-00	WATER SVCS. & CHARGES	47,499.78	
010-0000-100.00-00	CASH / CASH IN CONCENTRATION		10,951.06
550-0000-100.00-00	CASH / CASH IN CONCENTRATION		47,499.78
Total		58,450.84	58,450.84

11007 11008 11009 11010

Document No. 718

MANAGEMENT ACCOUNTANT REVIEW
Initials:
Date: 5/7/12
Comments:

Amanda Wallace 5/6/13

RECEIVED
MAY -6
CITY OF KILLEEN
FINANCE DEPARTMENT

1 of 10

FIGURE 5-6 – City of Killeen FY 2012 Audit Entry Schedule. *This audit entry schedule is prepared by the City’s Finance Department and reviewed by the City’s external auditors prior to posting the journal entry. Source: City of Killeen Finance Department March 2017.*

Furthermore, there are no policies and procedures related to the financial statement closing process that would identify potential adjustments to interfund transfers and the process for reconciling differences.

The State of Texas document retention requirements outlined in the Texas State Library and Achieves Commission Local Schedule GR fourth edition effective July 4, 2012 and the fifth edition effective April 17, 2016 include the following requirements:

- Record Number GR1025-04e Budgets and Budget Documentation requires budget change documentation, including line item or contingency/reserve fund transfers and supplemental budget requests to be retained for two years.
- Record Number GR1025-30d Ledgers, Journals and Entry Documentation requires journal vouchers and entries or similar posting control forms (including supporting documentation such as correspondence and auditor adjustments that evidence journal entries and amendments) to be retailed for five years after the fiscal year in which the entry occurred.

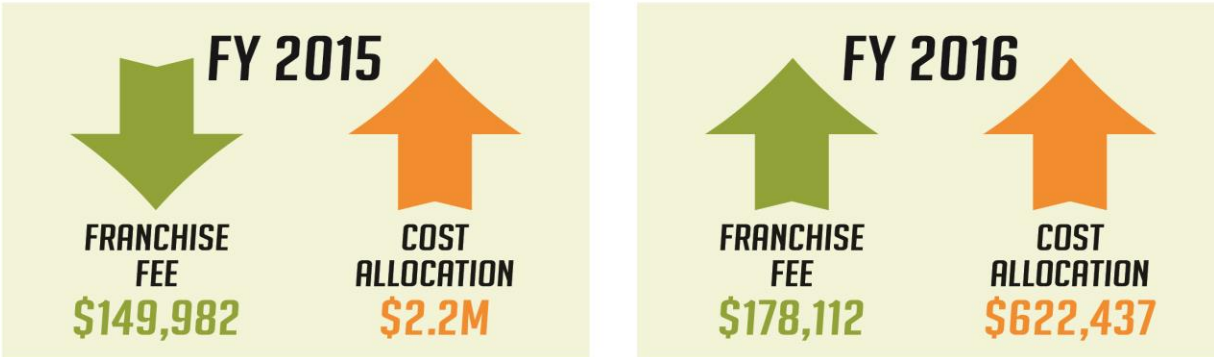
Therefore, these interfund transfers and journal entries were not in compliance with State records retention requirements.

RECOMMENDATION 4: Required Documentation Retention

The city manager should develop and city council should adopt written policies and related procedures to govern monthly and annual closing processes to ensure that potential adjustments related to interfund transfers are identified, reconciled, and posted. The procedures also should include the required supporting documents that must be included with all transfers and adjustments.

OBSERVATION 5: Franchise Fees and Indirect Cost Allocation

The process for calculating franchise fees and cost allocation results in inaccurate charges to Enterprise Funds. We noted that Enterprise Funds have been overcharged and undercharged for franchise fees, and overcharged for the cost allocation. Franchise fees and the allocation of costs to Enterprise Funds are based on budgeted amounts rather than actual revenues and expenses. We calculated what the franchise fees and cost allocation would have been if actual revenue and expense amounts were used, rather than budgeted revenue and expenses. Our calculations resulted in the following differences. The down arrow means that the Enterprise Funds should have been charged $149,982 less than what they were charged in FY 2015. The up arrows mean that the Enterprise Funds should have been charged more than what they were charged in FY 2015. However, it is important to note that this is based on actual expenses and approved franchise fee and indirect cost allocation percentages. We did not assess, nor were we tasked with assessing, the appropriateness of the approved allocation percentages.



Some Information Technology expenditures are charged directly to the General Fund and subsequently allocated using a city-wide entry for cost allocation. Other Information Technology expenditures are allocated between funds before the city-wide cost allocation entry. This process results in potential "double charging" the Enterprise Funds. For example, the purchase of CityWorks software from Azteca System totaling $25,540 was allocated 25 percent to General Fund and 75 percent to Enterprise Funds according to usage. The City's general IT expenditures are charged to General Fund under account code 010-2705-419, and are allocated to Enterprise Funds using an indirect cost allocation rate. As the result, the 25 percent portion that was charged to the General Fund would then be allocated to Enterprise Funds, causing a double charge. **Figure 5-7** demonstrates how the $25,540 was allocated to the Enterprise Funds.

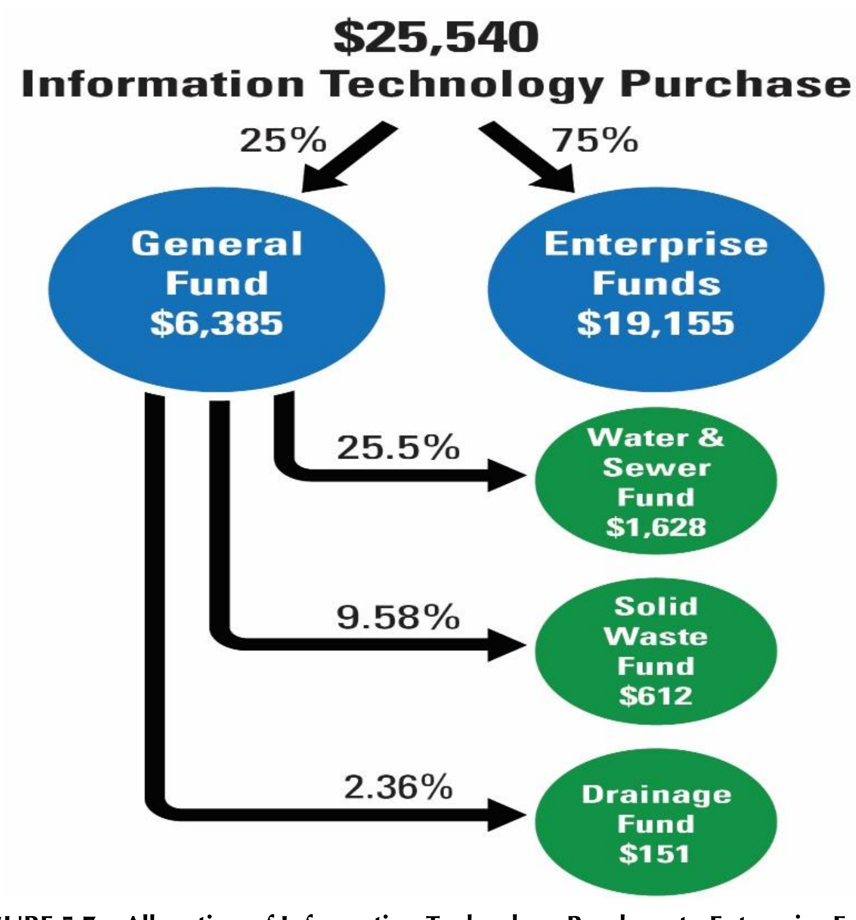


FIGURE 5-7 – Allocation of Information Technology Purchase to Enterprise Funds.

RECOMMENDATION 5: Franchise Fees and Indirect Cost Allocation

1. Determine the amount franchise fees paid by Enterprise Funds to the General Fund using "actual" rather than "budgeted" revenue. The City can align budgeted to actual revenues at the end of each fiscal year and make the appropriate adjustment to the calculation of franchise fees paid by the Enterprise Funds.
2. Update the cost allocation annually and develop a methodology to ensure that Enterprise Funds are not charged twice for direct and indirect costs.

Interfund Transfer Audit Methodology

MJ performed the following activities in reviewing interfund transfers between FY 2010 and FY 2017:

- Conducted interviews with the City's Finance Department staff to understand current and prior processes, practices and purposes for interfund transfers.
- Conducted interviews with the City's former finance director to understand interfund transfer practices between FY 2010 and FY 2012.
- Requested policies and procedures for interfund transfers.
- Requested policies governing Enterprise Funds to determine allowable expenses and potential restrictions regarding the use of revenue, including expenses charged through interfund transfers.
- Reviewed the City's CAFR for notes related to interfund transfers and discussion of the purpose of interfund transfers.
- Reconciled the City's trial balances to the City's CAFRs to determine completeness and accuracy.
- Summarized interfund transfers by year and purpose.
- Selected samples of interfund transfers for testing and analysis. Samples and testing results are discussed in substantive testing procedures outlined below. Supporting documentation requested included:
  - Schedules calculating indirect cost allocations.
  - Schedules calculating franchise fees.
  - Schedules calculating bond payments.
  - Purchase requisitions, purchase orders, payment authorizations and check copies.
  - Unmodified transaction listings from AS400 system.
  - Authorized journal vouchers.
  - Applicable City Council Memorandum (CCM/R) or meeting minutes.

Substantive Testing Procedures and Results

Review of Interfund Transfer

MJ judgmentally selected a sample of 25 interfund transfer transactions totaling $35,298,394.95 (i.e., 24 totaling $35,798,394.95 and one for $500,000.00) for substantive testing. Our sample selection ensures we substantially tested all types of interfund transfer transactions that occurred between FY 2010 and FY 2017. Out of the 25 samples:

4 Transfers totaling $3,696,444.78 from bond funds to operations:

- 1 in the amount of $502,967.88 from Fund 331 Aviation Capital Improvement 2003 to Fund 525 Killeen Fort Hood Regional Airport (KFHRA).
- 1 in the amount of $169,262.90 from Fund 382 Water & Sewer Bond 2004 to Fund 550 Water & Sewer.
- 1 in the amount of $2,962,848.00 from Fund 386 Water & Sewer Improvement 2013 to Water & Sewer.
- 1 in the amount of $61,366.00 from Fund 384 Water & Sewer Bond 2007 to Fund 550 Water & Sewer Fund.

2 Transfers totaling $83,580.25 to transfer expenditures to bond funds:

- 1 in the amount of $12,250.00 from Fund 525 KFHRA to Fund 331 Aviation Capital Improvement 2003. The expense was for waiting area seating.
- 1 in the amount of $81,120.91 from Fund 525 KFHRA to Fund 331 Aviation Capital Improvement 2003. This did not have supporting documentation to determine what the expense was related to.

1 Entry in the amount of $20,200,000.00 to Fund 386 Water & Sewer Improvement 2013 to record bond refunding funds received.

1 Transfer in the amount of $16,753.17 from Fund 525 Drainage Utility to Fund 576 Drainage Utility 2006 C.O. Bonds for debt service payment.

6 Transfers totaling $1,353,583.30 from Enterprise Funds to Interest & Sinking Funds.

2 Transfers totaling $389,745.25 were from Enterprise Funds for franchise fees.

4 Transfers totaling $163,989.21 were from Enterprise Funds for indirect cost allocation charges.

1 Transfer in the amount of $1,595,100.93 from Fund 819 Payroll to Fund 805 Concentration for payroll costs.

1 Transfer in the amount of $7,248,870.28 from Fund 550 Water & Sewer Fund to Fund 550 Water & Sewer Fund. The notation is to close out/post new. This transaction occurred in FY 2010 and there were no additional supporting documents maintained to support this entry. ***The documentation retained for this entry does comply with the state's document retention requirements.***

1 Transfer in the amount of $548,724.00 from Fund 575 Drainage Utility to debt payment. The notation is to transfer from Fund 596. However, there is no Fund 596. This transaction occurred in FY 2015 and there were no additional supporting documents maintained to support this entry. ***The documentation retained for this entry does not comply with the state's document retention requirements.***

2 Transactions totaling $1,603.78 from Fund 540 Solid Waste were for service charges paid with a City procurement card.

Review of Fleet Internal Service Fund

We reviewed the activity listing for the Vehicle Replacement Program Fund 601 Internal Service Fund (subsequently referred to as Fleet Funding Program) from FY 2011 to FY 2016. Per interviews with the director of Finance and the assistant director of Finance, there were no policies and procedures documented for the operations for the Fleet Services Program established in FY 2011. The City does have standard operating procedure documents for the operation of the fleet; however, the procedures do not identify roles and responsibilities for any positions and does not prescribe how program funding sources and amounts are determined or how purchase requests are prioritized.

We judgmentally selected 15 sample transactions from the Fleet Service Program for testing, with a net total of $11,001,247.67. We selected 11 transactions totaling $11,001,247.67 and four transactions totaling ($3,509,709.20). The following is a summary of our testing results.

1 Transaction in the amount of $1,000,000.00 from Fund 347 Certificate of Obligation 2014 to Fund 601 Internal Service Fund (Fleet). This transfer was supported by an authorized Journal Entry Form, a copy of the financial system journal entry report and a copy of the signed CCM/R.

1 Transaction in the amount of $854,223.05 from Fund 540 Solid Waste to Fund 601 Internal Service Fund (i.e., fleet) to transfer the cost of vehicles purchased. This transfer was supported only with an authorized journal entry form and a copy of the FY 2012-13 budget. The support documents do not include copies of the original vehicle purchase order(s), receiving report(s) and payment authorization(s). This transaction occurred in FY 2013.

7 Transactions totaling $2,439,086.37 from Fund 601 Internal Service Fund were for the purchase of vehicles, parts and an air compressor. These transfers were supported with copies of the original purchase order(s), receiving report(s) and payment authorization(s).

1 Transaction in the amount of ($1,300,000.00) from Fund 601 Internal Service Fund to Fund 540 Solid Waste. The notation is to reduce the ISF balance. This transfer was supported only by an authorized Journal Entry Form and a copy of the financial system journal entry report. There should have been a communication and formal authorization to close the fund as part of the supporting documents. This transaction occurred in FY 2016.

1 Transaction in the amount of ($388,969.00) from Fund 601 Internal Service Fund to Fund 540 Solid Waste. The notation is to close the ISF. This transfer was supported only with an authorized Journal Entry Form. . There should have been a communication and formal authorization to close the fund as part of the supporting documents. This transaction occurred in FY 2013.

1 Transaction in the amount of $24,518.25 from Fund 243 Photo Red Light Enforcement to Fund 601 Internal Service Fund (i.e., fleet). There was no notation of the purpose on the journal entry document. This transaction occurred in FY 2012 and there were no additional supporting documents maintained to support this entry.

1 Transaction in the amount of $183,420.00 from one budget line item in Fund 601 Internal Service Fund (i.e., fleet) to another budget line item in Fund 601 Internal Service Fund (i.e., fleet). The notation of the purpose on the journal entry document is Budget to GAAP adjustment. This transaction occurred in FY 2017 and there were no additional supporting documents maintained to support this entry.

1 Transaction in the amount of ($1,007,295.75) from Fund 601 Internal Service Fund (i.e., fleet) to Fund 243 Photo Red Light Enforcement. The notation of the purpose on the journal entry document is transferring PD vehicle purchases to Fund 243 Photo Red Light Enforcement. This transaction occurred in FY 2013 and there were no additional supporting documents maintained to support this entry.

1 Transaction in the amount of ($813,444.45) from Fund 601 Internal Service Fund (i.e., fleet) to Fund 10 General Fund. The notation of the purpose on the journal entry document is payment of vehicles purchased from Caldwell Country on 11/15/13. The follow-up explanation for this transaction is that it was a correction entry for vehicle expenses booked in FY 2014 but should have been booked in FY 2013. The City's Finance Department does not know why the entry was charged to Fund 10 General Fund. This transaction occurred in FY 2013 and there were no additional supporting documents maintained to support this entry.

Review of Escrow Accounts

The Finance Department established an escrow account in the City's financial system to record transactions that were later adjusted through an interfund transfer. The City uses a concentration account for all cash receipts. The term "escrow account" refers to money received by the City that was recorded as credit amounts to liability accounts rather than as revenues. We asked the current Finance Department staff, the former city manager and former finance director about escrow account practices in place during their tenure with the City. Each person we spoke with stated that this was a practice established by a predecessor finance director.

There are no records of when the escrow account was established, who established it, why it was established and for what purposes it was established. **Figure 5-8** provides a snapshot of some escrow account transactions.

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PROGRAM  GM360L
City of Killeen
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GROUP   PO   ACCTG   ----TRANSACTION----
 NBR   NBR    PER.  CD   DATE     NUMBER    DESCRIPTION                                 DEBITS
----------------------------------------------------------------------------------------------
FUND 010 GENERAL FUND
 010-0000-202.16-00 OTHER CURRENT LIABILITIES / CHILD SAFETY ESCROW FUND        continued
                                                MISC RECEIVABLES
 9196         11/14 AJ 07/31/14 MR
                                                MISC RECEIVABLES
 9507         11/14 AP 07/31/14 0003137    CITIBANK                                  307.90
             KELLYMOORE PAINT CO                INV 1413-23611475
 9693         11/14 AP 07/31/14 0214383    DAVID L KING CONSTRUCTION INC          79,131.69
             ELLISON HS SIDEWALK IMPRV          PAY #1
 9151         10/14 AJ 07/30/14 MR
                                                MISC RECEIVABLES
 9507         11/14 AP 07/30/14 0003137    CITIBANK                                   45.54
             LOWES #00209                       INV 68072
 9507         11/14 AP 07/30/14 0003137    CITIBANK                                   45.00
             SMITH & SMITH PROPANE              INV 0002
 9091         10/14 AJ 07/29/14 MR
                                                MISC RECEIVABLES
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GROUP   PO   ACCTG   ----TRANSACTION----
 NBR   NBR    PER.  CD   DATE     NUMBER    DESCRIPTION                                 DEBITS
----------------------------------------------------------------------------------------------
FUND 550 WATER AND SEWER FUND

FUND 550 WATER AND SEWER FUND
                                FUND TOTAL                                     21,691,522.62
FUND 550 WATER AND SEWER FUND
 550-0000-202.59-00 OTHER CURRENT LIABILITIES / VEHICLE REPLACEMENT
10041         12/11 AJ 09/30/11 10041
10041         12/11 AJ 09/30/11 10041
10516         14/11 AJ 09/30/11 10516     AUDIT ENTRY - FLT REPLACE                56,830.68
10146         12/11 AJ 09/27/11 10146     LOAN PROG CHRG MAY-AUG11
10975         13/12 AJ 09/30/12 10975                                              56,830.68
10985         13/12 AJ 09/30/12 10985     PERIOD 13                                44,491.68
10985         13/12 AJ 09/30/12 10985     PERIOD 13
11026         14/12 AJ 09/30/12 11026     FY12 FIXED ASSETS CORR                   44,491.68
11027         14/12 AJ 09/30/12 11027     FY12 CORR TRNSFRS
 9970         12/12 AJ 09/07/12 9970      FLEET LEASE REIMB
 9970         12/12 AJ 09/07/12 9970      FLEET LEASE REIMB
 9131         11/12 AJ 08/09/12 9131      MOVE VEHICLE REPLCMNT FND                56,830.68
 6993         08/12 AJ 05/31/12 6993      AUDIT REVERSAL ESCROW C-O
                                ACCOUNT TOTAL                                     259,475.40
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PREPARED 05/30/2017, 10:09:03                         ACCOUNT ACTIVITY LISTING
PROGRAM  GM360L
City of Killeen
----------------------------------------------------------------------------------------------
GROUP   PO   ACCTG   ----TRANSACTION----
 NBR   NBR    PER.  CD   DATE     NUMBER    DESCRIPTION                                 DEBITS
----------------------------------------------------------------------------------------------
FUND 540 SOLID WASTE
 540-0000-202.59-00 OTHER CURRENT LIABILITIES / VEHICLE REPLACEMENT
10544         14/11 AJ 09/30/11 10544     AUDIT ENTRY- TML REIMB                  114,000.00
 7472         10/11 CR 07/06/11 0397397   TML #4749
                                          SHERIL     07/06/11 06
10975         13/12 AJ 09/30/12 10975                                             114,000.00
10985         13/12 AJ 09/30/12 10985     PERIOD 13
11019         14/12 AJ 09/30/12 11019     FY12 REC SW FIXED ASSETS
 9131         11/12 AJ 08/09/12 9131      MOVE VEHICLE REPLCMNT FND                 3,000.00
 6993         08/12 AJ 05/31/12 6993      AUDIT REVERSAL ESCROW C-O
 5490         07/12 AP 03/28/12 0186515   CHASTANGS ENTERPRISES                    25,462.00
             K120017
 5490         07/12 AP 03/16/12 0186623   MCNEILUS - VEHICLE ONLY                  85,538.00
             K120016
                                ACCOUNT TOTAL                                     342,000.00

PREPARED 05/30/2017, 10:09:03                         ACCOUNT ACTIVITY LISTING
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FIGURE 5-8: City of Killeen Escrow Account. *The City used escrow accounts within funds to record revenues and expenditures.*

The City's Annual Single Audit for the Fiscal Year Ended September 30, 2008, noted a material weakness related to the City's use of escrow accounts. The auditors recommended that the City discontinue use of the various escrow accounts and record the revenues and expenditures in the general ledger. Management's response was that the escrow accounts will be properly budgeted and recorded in FY 2008-09, and restricted balances will be identified as such. However, the City continued to use the escrow accounts.

Figure 5-9 provides a snapshot of the September 30, 2008 Single Audit finding and management response.

Finding 2008.2:

Escrow Accounts

At present, the City utilizes escrow accounts classified as current liabilities to account for restricted cash items. In doing so, the City is not recording revenue and expenditures that would normally be included in the Statement of Activities. Additionally, this is resulting in liability, revenue and expenditure accounts to be misstated. We recommend that the City discontinue use of the various escrow accounts and instead record the revenues and expenditures in the general ledger. Additionally, we recommend that the City restrict cash and designate fund balances to reflect the amounts that are restricted.

Response 2008.2:

The escrow accounts will be properly budgeted and recorded in 2008-09 and restricted balances will be identified and recorded as such.

FIGURE 5-9 – City of Killeen September 30, 2008 Single Audit Finding. *The City's use of escrow accounts was noted as a material weakness in FY 2008.*

The City's external auditor's management letter regarding accounting practices and internal control structure September 30, 2011 issued on April 24, 2012, noted that the City continued to use escrow accounts. They recommended that transactions be recorded to the proper income and expense accounts when the revenue is received or the expense is incurred.

Figure 5-10 provides a snapshot of the external auditor's April 24, 2014 management letter comment.

Escrow Accounts

During our audit we noted that the City continues to use various escrow accounts to record transactions that are either funds being held for another entity or restricted in nature. To be in compliance with governmental accounting standards, if transactions involve holding and managing net assets for specific individuals or other external parties, the activities should be reported in an agency fund. When the transactions are restricted in nature, we recommend that the transactions be recorded in the proper income and expense category as received or incurred and not be manually adjusted at year end to the appropriate accounts.

FIGURE 5-10 – External Management Letter Comment April 24, 2012. *The City's continued use of escrow accounts was noted again in the FY 2011 annual financial audit.*

Our review of the transaction listing noted that in addition to miscellaneous donations and cash receipts there were expenditures for sidewalk improvements and vehicles included in the escrow accounts. The accounts were closed out at the end of FY 2015. We noted that some of the revenues were funds the City held on behalf of the Texas A&M Foundation for fundraising events.

In addition, we also noted large purchase orders that were recorded to the account and subsequently reversed. We tested three samples and verified that the large transactions were related to vehicles, and were approved by the purchasing manager, finance director and city council. Only transactions related to fiduciary responsibility should be recorded in an escrow account. The City's recording of revenues and expenditures in the escrow accounts did not allow for an accurate reflection of activities to be reported in the City's financial reports.

CHAPTER 6 – PAY INCREASES

This section of the report contains our analysis of the cost of living adjustment (COLA) pay increases provided to all City employees in June 2014 and the pay adjustment provided to civil service (public safety) employees in October 2014. The contracted scope of services for this focus area was to:

- Review the City's fiscal planning for the short-term funding and long-term impact of the 3 percent city-wide cost of living adjustment (COLA) and the 8 percent pay adjustment for civil service (public safety) positions implemented in June 2014 and October 2014, respectively.

During the March 21, 2017 city council visioning session, this scope was further refined to address the following questions:

1. Were funding sources identified for the initial four months (approximately $500,000) and what were those funding sources? Were funding sources identified to continue to fund the pay increases in the following periods? Were funds transferred to cover the increase?
2. Were any changes made to job classification levels and staff position levels during the period (e.g., job title, etc.), which resulted in a "double pay increase," requiring additional funding needs?
3. Were salary adjustments paid retroactively?

Background

The City of Killeen provides two types of employee pay increases: (1) annual merit increases based upon the results of employee performance evaluations; and (2) cost of living adjustments (COLA). The exact percentage of the merit-based pay increase depended upon the results of employees' performance evaluations. Civil service (public safety) employees receive merit based pay increases based on established pay scales in approved pay plans.

Based on the City's practices, if an employee does not receive an annual performance evaluation by their anniversary date, the City applies the merit increase retroactively to the employee's anniversary date once the Human Resources Department acknowledges receipt of the employee's completed performance evaluation. We were informed by the executive director of Human Resources that prior to 2016, retroactive pay adjustments ranged from adjustments covering a period of a few months to adjustments covering a year or more. The Human Resources Department has recently implemented processes to require employee performance

CHAPTER HIGHLIGHTS

- Overall, the City has processes in place to ensure employee paychecks are accurate.
- Overall, the approved three percent City-wide COLA increase and the eight percent civil service employee pay adjustment were accurately applied to employee paychecks. We noted nine errors in the three percent increase and five errors in the eight percent increase. The financial impact of these errors is minimal.
- The weaknesses noted with regard to the COLA and pay adjustment increases are related to financial analysis and planning activities, not the application of the approved pay increase.
- The City should adopt a formal written policy specifying if retroactive pay increases will be permitted and when such increases will be permitted.
- The City should conduct a comprehensive financial impact analysis for all proposed COLA and pay adjustment increases, including identifying anticipated funding sources.
- The city manager should reassign position control responsibility from the Human Resource Department to the Finance Department.

evaluations before the month of the employee's anniversary date. However, employee pay is still retroactively adjusted to their employment anniversary date.

The City and Human Resources Department do not have written policies in place to govern retroactive pay increases and the related consequences for supervisors not submitting employee performance evaluations by the employees' anniversary date. The city council authorizes pay plans through the annual budget adoption process, which incorporates performance-based merit increases. COLA increases also require city council authorization.

Employee salaries are maintained in the City's AS400 system, which is a dynamic system that only shows employees' detailed employment profiles from the last salary action and a summary of their historical salary records. Detailed information related to each change in an employee's salary is maintained in the notes and comments section of the AS400 system, which requires manual review.

The City maintains all salary expenses in one budget line item for salaries and does not prepare separate budget accounts for salaries and pay raises. Therefore, we were unable to determine if funds allocated to the approved pay raises were used to hire additional employees. However, we did compare the number of individuals employed by the City in FY 2014, to the number of individuals employed by the City in FY 2015. The number of employees on the City's payroll increased by 31 employees (to 1,303 in FY 2015 from 1,272 in FY 2014) during a one year period. Salaries for these additional employees were itemized and approved in the FY 2014 budget.

The City employed approximately 160 more individuals in FY 2016 than in FY 2010. Total salaries increased from approximately $50 million in FY 2010 to slightly more than $60 million in FY 2016. **Figure 6-1** shows the total number of City employees and total employee salaries from FY 2010 – FY 2016.

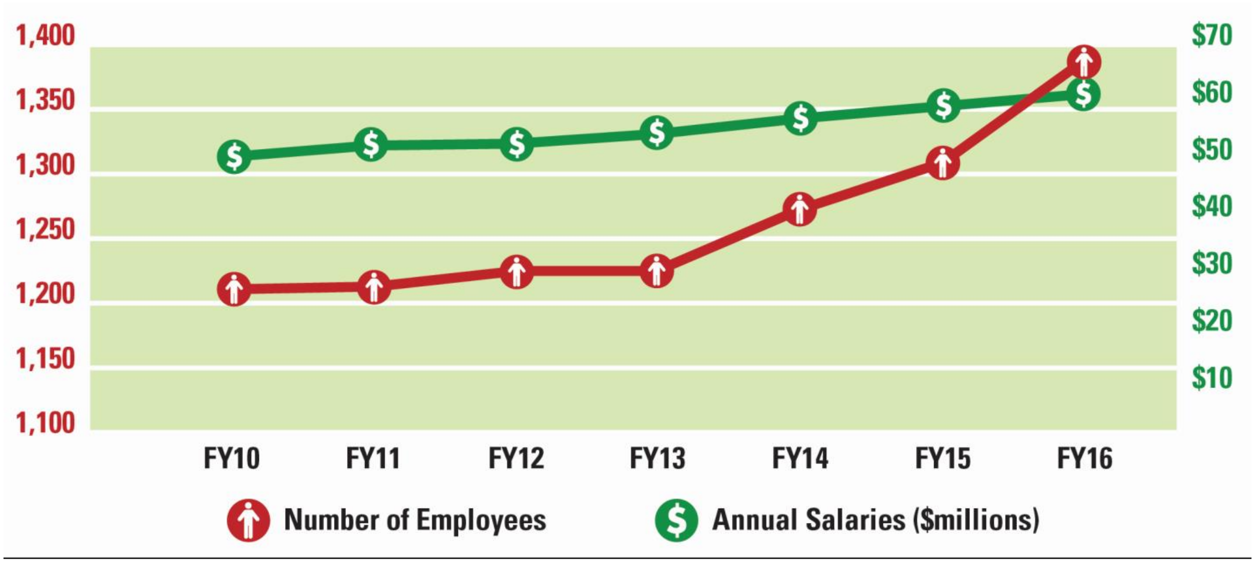

FIGURE 6-1 – City employees and total salaries from FY 2010 to FY 2016. *The City's total employees have increased by approximately 150 individuals over six years, while at the same time total salaries have increased by slightly more than $10 million.*
Source: City of Killeen FY 2016 CAFR and trial balances.

Employee COLA pay increases were different between employee groupings for three of the six years where COLA pay increases occurred. The City did not provide COLA increases in five of previous 11 calendar years. **Figure 6-2** on the following page depicts COLA pay increases and pay adjustments for City employees between FY 2007 and FY 2017.

COLA[1,2]

	2007	2008*	2009	2010	2011*	2012	2013	2014	2015*	2016	2017
Police	4.00%	6.00%	0.00%	0.00%	4.00%	0.00%	2.00%	3.00%	8.00%	0.00%	0.00%
Fire	4.00%	6.00%	0.00%	0.00%	4.00%	0.00%	2.00%	3.00%	8.00%	0.00%	0.00%
Non-Civil Service	4.00%	4.00%	0.00%	0.00%	3.00%	0.00%	2.00%	3.00%	0.00%	0.00%	0.00%

1- In addition to COLA increases:

Civil service employees receive an annual step increase based on the established pay plan.

Non-civil service employees receive an annual step increase based on their performance appraisal:

FY 2007 - FY 2011 - Employees eligible for a 2%, 4%, or 6% increase dependent upon their performance appraisal score.

FY 2012 - Current - Employees eligible for a 2% step increase dependent upon their performance appraisal score.

*2- Civil service employees received a pay adjustment in addition to a COLA in Fiscal Years 2008, 2011, and 2015.

FIGURE 6-2 – History of City COLA pay increases. *The City provided employee COLA pay increases in five of the previous 11 fiscal years.*
Source: City of Killeen executive director, Human Resources, March 2017.

Audit Questions' Results

The following tables summarize our conclusions to the three specific questions defined in the March 21, 2017 city council visioning session in addition to other observations we noted.

Review Area:	**Pay Increases**
Objective:	➲ What was the City's fiscal planning for the three percent city-wide COLA increase: – What was the City's fiscal planning for the short-term and long-term impact of the three percent City-wide cost of living adjustment (COLA) implemented in June 2014? ➲ Were funding sources identified for the initial four months and the following periods? Were funds transferred to cover the increase?
Conclusion:	➲ The city manager presented a single dollar amount to city council for approval. However, no long-term budget impact was considered. The FY 2014 budget was amended to include $547,000, which was only sufficient to cover the marginal increase for the last four months of FY 2014. The General Fund and the four Enterprise Funds were the funding sources for the $547,000 increase. ➲ The City added $1.915 million in the FY 2015 budget for the pay increase. ➲ We estimated that the three percent COLA increase would result in an annual increase in base pay of $1.66 million.

Review Area:	**Pay Increases**
Objective:	What was the City's fiscal planning for the short-term and long-term impact of the eight percent pay adjustment for civil service (public safety) positions implemented in October 2014?
Conclusions:	The City conducted no long-term planning or analysis of the fiscal impact of the eight percent pay adjustment granted for civil service (public safety) positions in October 2014. ➲ City management did not separately quantify the fiscal impact of the eight percent civil service (public safety) employee pay adjustment in the annual FY 2015 budget submitted to city council. ➲ City management did not present the long-term impact of the eight percent civil service (public safety) employee pay adjustment to city council. ➲ The eight percent civil service (public safety) employee pay adjustment was absorbed into the City's pay plan and funded through a $2.43 million budget amendment approved by city council on September 22, 2015. ➲ Two council members expressed concerns opposing the pay adjustment during the July 22, 2014 special session, but their concerns were not addressed during that session. ➲ We estimated that the eight percent civil service (public safety) employee pay adjustment would result in an annual increase in base pay of $2.05 million.

Review Area:	**Pay Increases**
Objective:	Were staff pay increases paid retroactively?
Conclusion:	Yes; staff pay increases were paid retroactively. ➲ The June 2014 city-wide three percent COLA increase was applied to the June 4, 2014 paycheck, which retroactively applies to the two weeks of service before June 2014. ➲ The eight percent civil service (public safety) employee pay adjustment approved for FY 2015 was applied only to the period of performance beginning October 1, 2014, and paychecks were prorated accordingly.

Review Area:	**Pay Increases**
Objective:	Were the budgeted funds for the three percent COLA and eight percent pay adjustment used to hire additional FTE's?
Conclusion:	➲ The City did not designate separate budget line item for COLA and pay adjustment, therefore the answer to this question is no. However, we did note that the City's FTE's increased by an additional 31 FTE's during FY 2015.

Review Area:	**Pay Increases**
Objective:	Were there positions with changes in job classification in addition to the pay increases?

Review Area:	Pay Increases
Conclusion:	No. City employees did not receive changes in job classification in addition to the pay increases. ➲ We identified one instance of a change in job classification during the period of the eight percent civil service (public safety) employee pay adjustment. This individual's positions before and after this change were both non-civil service (public safety) positions and, therefore, this change does not indicate a risk of using pay increase funds for changes to job classification or positions.

June 2014 and October 2014 COLA Pay Increases

On June 10, 2014, city council approved the city manager's proposed three percent COLA increase for all city employees (excluding the city manager), effective June 2014. The increase was applied to all city employees who were employed as of June 1, 2014, except the city manager. The amended FY 2014 budget reflects the $547,000 impact for the remainder of FY 2014.

There was some confusion and discussion surrounding the eight percent pay adjustment granted to civil service (public safety) employees in October 2014.

- During the July 22, 2014 special session, city council discussed the civil service (public safety) employee pay adjustment. The discussion centered around the need to increase the pay for civil service (public safety) employees.
- On July 22, 2014, during the FY 2015 annual budget discussion, city management proposed three scenarios for percentage adjustments for civil service (public safety) employee for consideration: (1) one scenario for six percent; (2) one scenario for seven percent; and (3) one scenario for eight percent. Two city council members voiced concerns about the funding and structuring of the pay adjustment for civil service (public safety) employees, and were against approving the pay adjustment.

The concerns of these two city council members were not addressed during the meeting on July 22, 2014. However, at the end of the meeting, the former city manager provided verbal assurance on the FY 2015 budget, and the mayor called for a verbal polling to obtain consensus among city council members to move forward with the eight percent pay adjustment, stating that *"three percent plus five percent equals eight percent."* As a result, the specific percentage of the pay adjustment was not clear when the mayor polled city council members to obtain their consensus, and the specific percentage of the pay adjustment was not documented in minutes of the August 12, 2014 meeting.

Furthermore, the eight percent pay adjustment was not presented in a city council meeting for formal discussion, consensus, and approval. Additionally, the eight percent adjustment for civil service (public safety) employees was not included in the FY 2015 adopted budget. The funding for this pay increase was achieved through a budget amendment adopted by city council on September 22, 2015. The consensus action by city council resulted in an eight percent salary adjustment for civil service (public safety) employees rather than five percent, which totaled 11 percent for the calendar year after adding the three percent pay adjustment increase approved in the June 10, 2014 city council meeting.

The city manager did not present to city council the fiscal impact of the COLA and pay adjustment increase on budgets in subsequent fiscal years, nor the source of funds to be used to pay for the increases. We estimate that the June 2014 COLA increased salaries by $1.6 million annually and the October 2014 pay adjustment increased salaries by and additional $2.0 million annually.

Observations and Recommendations

OBSERVATION 6-1: Financial Impact Analysis and Planning

Overall, there were significant weaknesses in the process related to consideration and approval of the 2014 COLA pay increases. City staff focused solely on the short-term financial impact associated with the COLA pay increases. The financial impact did not consider funding sources and the impact of payroll and related benefits costs in subsequent years on the City's ability to meet its financial obligations. As a result, the adopted budget for the General Fund and various Enterprise Funds were amended to increase salary expenses without a corresponding increase in revenues. We estimated that the annual fiscal impact of the three percent COLA increase in June 2014 and the eight percent pay adjustment in October 2014 is $3.7 million. This impact is calculated based on employees' base salary and does not include the incremental costs associated with benefits and overtime.

City management did not present the long-term impact of the pay increases, nor did the city council request such analysis. However, some city council members did express concerns in the workshops of how the proposed pay raises would be funded.

The City hired Public Sector Personnel Consultant (consultant), an independent compensation consultant, to conduct a comprehensive salary study. The consultant presented the results of the compensation study to city council on July 15, 2014. We reviewed this presentation and listened to the corresponding city council workshop audio file.

The results of the compensation study indicated that the City's public safety pay scales were below market by an average of 13 percent for fire employees and eight percent for police employees. One of the recommendations made in the presentation was to increase the pay scales for public safety departments by an additional five percent in FY 2015 so that the City can get within five percent of the benchmark salaries included in the compensation study. This recommendation of a five percent increase considered the three percent increase provided in June 2014. However, city council decided that the five percent pay adjustment was not sufficient and the majority of city council decided to increase the civil service (public safety) pay adjustment to eight percent. Accordingly, we believe that the eight percent civil service (public safety) employee pay adjustment in October 2014 did not align with the recommendation included in the consultant's compensation study and should have been five percent rather than eight percent.

RECOMMENDATION 6-1: Financial Impact Analysis and Planning

To reasonably ensure that the City can meet its future financial obligations and needs, City staff must prepare and present a complete financial analysis for all proposed COLA and merit-based pay increases and salary adjustments. The comprehensive fiscal impact should include salaries, payroll taxes and benefits, estimated increases in overtime pay, and revenue sources for the next three to five years. Furthermore, City staff should present decisions with a long-term fiscal impact, such as pay increases, to city council for separate consideration and deliberation before including these items in the annual budget.

OBSERVATION 6-2: Retroactive Pay

We noted that the City's practice has been to approve retroactive pay for any merit-based pay increase. We also noted that the City does not maintain their retroactive pay calculations in notes recorded in its AS400 information system. When we inquired about retroactive payments, Human Resources Department staff needed to manually recalculate the amounts of employees' paychecks. Multiple employees' supervisors submitted their employee's performance evaluations late into the year, and the performance evaluations submitted resulted in increases in pay rates. These increases were applied retroactively to the employee's anniversary evaluation date.

Texas Attorney General (AG) Abbott issued an AG opinion on October 21, 2005 stating that *"Article III, section 53 of the Texas Constitution prohibits the Soccorro Civil Service Commission from granting a pay increase to municipal employees effective from the date of their last evaluation, unless a policy for such pay increase was already in existence prior to the evaluation"* The City does not have a written policy stating retroactive pay increases will be allowed. Therefore, the City's practice of retroactive pay could be considered a violation of the Texas Constitution based on the Texas AG's opinion.

In addition to retroactive merit-based pay increases, we noted that the June 2014 three-percent COLA pay increase and merit-based pay increases were paid retroactively. The estimated fiscal impact of this retroactive application of the COLA pay increase is $60,000.

The Human Resources Department updated its employee policy in August 2017 to state retroactive pay will be allowed. The city attorney has reviewed the policy, but the Human Resources Department has not presented the policy to city council for approval.

RECOMMENDATION 6-2: Retroactive Pay

The Human Resources Department staff must monitor and consistently apply pay increases. This begins by establishing clear policies and writing clear procedures on retroactive pay; establishing deadlines for performance evaluations and merit based-pay increases; enforcing established deadlines; and not applying merit-based pay increases retroactively unless the written policy clearly states under what conditions retroactive pay increases are allowed.

OBSERVATION 6-3: Pay Errors

We noted that salary history data in the City's payroll information system contained nine instances in which the employee's pay history did not agree with the actual personnel actions for employees who received retroactive merit-based pay increases close to the June 2014 COLA increase and October 1, 2014 pay adjustment. The COLA increases and pay adjustments were shown as if they were applied on the same date as the merit-based pay increases. Our audit testing concluded that, while the payroll system reflects inaccurate data, paychecks were manually calculated and, therefore, were accurate.

Additionally, our detailed testing identified instances of incorrect employee paychecks as a result of misapplied timing of normal merit increases. We also noted that two City employees received the eight percent civil service (public safety) pay adjustment although their job positions are not included in civil service (public safety) employee categories that should have received the pay raises. One of the two employees returned the pay raise. The second individual is no longer with the City. The annual fiscal impact of the incorrectly applied COLA increase and pay adjustment is $10,347.

RECOMMENDATION 6-3: Pay Errors

The executive director of Human Resources should design and implement additional review procedures to detect errors in handling pay increases when entering data and also before issuing pay checks. The city manager should be made aware of instances of over/underpayment due to payroll system errors.

OBSERVATION 6-4: Position Control

During the course of this audit we noted that the Human Resources Department manages the City's electronic position control system rather than the Finance Department. Position control is a critical tool used to ensure that employees are not added to the City's payroll unless the position was budgeted and is vacant. Position control is an automated system that links each position to funding sources for the City's budget. Because position control is tied to budget management, this function is traditionally managed by the Finance Department.

RECOMMENDATION 6-4: Position Control

The city manager should reassign the position control responsibility and management to the City's finance director.

Pay Raise Audit Methodology

MJ performed the following activities in reviewing the June 2014 city-wide three percent COLA pay increase and the October 2014 eight percent civil service (public safety) employee pay adjustment:

- Conducted interviews with the Human Resource Department staff and Finance Department staff to obtain understanding of the City's pay increase practices in addition to the specific events related to COLA pay increase and pay adjustment.
- Reviewed all FY 2014 city council minutes recorded for city council meetings for any reference related to pay increases and adjustments.
- Listened to audio files of the city council workshop on July 22, 2014 and special session on August 12, 2014, where the discussions related to the pay adjustment occurred.
- Obtained the pay increase history file extracted from the payroll system to review 100 percent of employee pay changes occurring during 2014. We analyzed the data to identify all potential exceptions to the three percent COLA increase on June 1, 2014, and eight percent civil service (public safety) employee pay adjustment on October 1, 2014.
- Selected a judgmental sample of 20 paychecks for October 8, 2014, to test whether the amount actually paid to the employee agrees to the approved salary rate. We reviewed salary file notes and related paychecks.
- Reviewed employee pay policies.
- Reviewed City budget documents for FY 2014 and FY 2015.
- Reviewed the compensation consultant's compensation study report presented to city council on July 15, 2014.

- Reviewed budget reports and budget amendments for FY 2014 and FY 2015.
- Spoke with the former city manager to obtain his perspective of the events and city council discussions leading to the eight percent civil service (public safety) employee pay adjustment in 2014.

Substantive Testing Procedures and Results

June 2014 Three Percent COLA pay increase

The former city manager proposed a three percent increase in salary for all city employees, except for himself during the June 10, 2014 city council meeting. The budget impact was noted as an increase in expenditures of $414,429 in the General Fund and $120,472 in total for the four Enterprise Funds. City council approved the increase with a five-to-two vote. Two council members expressed concern about the across-the-board pay increase.

We noted that:

- There was no consideration of corresponding revenue increases (funding sources) to cover the proposed pay increase.
- The budget amount approved by city council covered only the remaining four months of FY 2014. It is the City's practice to only look at the current year impact when there is a mid-year pay increase. The impact on subsequent years is built in the respective year's annual budget for consideration.
- The financial impact on subsequent years was not considered. We estimated that the annual increase in base salary for the three percent COLA is $1.66 million.
- The pay increase was approved before the official workshop presenting the independent consultant's compensation study.

Our analysis of pay increase history files for potential exceptions to the three percent city-wide increase in June 2014 noted the following:

7 Seven employees' three percent COLA increase was applied to their June 18, 2014 payroll check instead of the June 4, 2014 payroll check. This resulted in a total underpayment of $277.44.

1 One employee received incorrect salary rate from April 9, 2014 to June 6, 2014, resulting in a total underpayment of $275.08. The error was corrected for the June 18, 2014 paycheck going forward.

1 One employee's three percent COLA increase was applied to the incorrect salary base. The employee received a COLA increase on April 1, 2013, and then a merit-based performance increase on March 9, 2014. The three percent COLA increase was applied to the April 1, 2013, salary instead of the more recent salary on March 9, 2014.

1 One employee's merit-based pay increase was after the COLA increase but the increase was applied to the whole paycheck. The increase should have been prorated between two periods. The employee was overpaid by approximately $104.51.

October 2014 civil service (public safety) employee eight percent pay adjustment

We performed analysis on the City's electronic salary files before and after the pay adjustment to identify salaries with increases larger than eight percent. From this data set, we judgmentally selected 20 civil service (public safety) employees and five non-civil service (public safety) employees to review the October 8, 2014 paychecks.

Out of the 20 civil service (public safety) employees reviewed:

15 Paychecks were properly calculated based on the new pay rate with the eight percent adjustment and were properly prorated between FY 2014 and FY 2015 rates.

1 Civil service (public safety) employee's October 8, 2014 paycheck did not include the pay adjustment. The employee was underpaid for the portion of service from October 1, 2014 to October 3, 2014.

4 Paychecks were properly calculated based on the new pay rate with the eight percent adjustment. However, these checks were not prorated between FY 2014 and FY 2015 rates. All five paychecks are for fire rescue officers.

Out of the five non-civil service (public safety) employees reviewed, none received the pay increase. The changes in salary amounts were attributed to adjustments related to overtime pay, sick leave and retirements. Therefore, no exceptions were noted for these employees.

Job classification changes in addition to the pay increases

Were there positions with changes in job classification in addition to the pay increases?

Based on our audit testing of 100 percent of the pay increase population, we did not identify instances where individuals received a change in job classification in addition to the approved three percent city-wide COLA pay increase or the civil service (public safety) employee eight percent pay adjustment. However, we did note what appear to be inconsistencies in how pay increases are applied. These are noted within the COLA increase results discussion above.

Retroactive pay increases

Were staff pay increases paid retroactively?

The COLA increase was retroactively applied to the June 4, 2014 payroll check. This retroactive pay covered the last two weeks of May 2014. The fiscal impact of the applied retroactive pay was approximately $60,000.

Out of approximately 1,300 active employees, seven received the three percent COLA in the June 18, 2014 payroll check rather than the June 4, 2014 payroll check.

Using pay increase funds to hire additional FTE's

Were the budgeted funds for the three percent COLA and eight percent pay adjustment used to hire additional FTE's?

The City maintains all salary expenses in one budget line item for salaries and does not prepare separate budget accounts for salaries and pay raises. Therefore, we were unable to determine if funds allocated to the approved pay raises were used to hire additional employees. However, we did compare the number of individuals employed by the City in FY 2014 to the number of individuals employed in FY 2015. The number of employees on the City's payroll increased by 31 employees (to 1,303 in FY 2015 from 1,272 in FY 2014) during a one year period.

Personnel action documentation

In addition to specific testing around the payroll dates of June 1, 2014 and October 1, 2014, we judgmentally select a sample of 75 personnel actions from the population of 4,056 personnel actions that occurred in 2014 to review supporting documentation related to the personnel actions.

Of the 75 transactions selected for testing we noted the following:

59 The City maintained adequate supporting documentation for 59 of the 75 (79 percent) changes in employees' status, including:

1 FLSA Change Exemption,

1 new hire,

1 pay change,

1 position transfer,

1 inactive,

13 promotions,

2 rehires,

2 reinstatements,

3 reclassifications, and

34 COLAs.

2 There was no supporting documentation maintained for two error corrections. There is not a policy that states that Human Resources should retain documentation to support corrections of errors; therefore, we could not confirm the reason for the transaction or compliance with internal policies.

14 We noted inconsistent documentation to support performance appraisals. Out of 14 performance appraisals tested (six civil service (public safety) and eight Non-civil service (public safety)), adequate supporting documentation was provided for 11 performance appraisals and a CCMR for the city manager. However, an appraisal for a civil service (public safety) employee and one personnel action form for a civil service (public safety) employee were not provided. These documents should have been retained according to the following requirements of the Texas State Library and Archives Commission Local Schedule GR revised 4th edition effective July 4, 2012.

GR1050-24 Documents used by personnel officers to create or change information in the personnel records of individual employees concerning hiring, termination, transfer, pay grade, position or job title, leaves of absence, name changes, and similar personnel actions except those noted elsewhere in this part should be retained for two years from the creation date or personnel action involved. Therefore, the City is following retention requirements for personnel action forms.

GR1050-21 Job evaluations, performance appraisals, or other similar documents used to evaluate the performance of employees should be retailed for two years after they have been superseded by another evaluation.

CHAPTER 7 – CITY/OWNER AGREEMENTS

This section of the report addresses the following management audit objectives:

1. Is the City's participation in keeping with best practices?
2. Did the City pay amounts over the existing approved City/Owner agreements?
3. Is the volume of agreements disproportionally high?
4. Were agreements applied evenly? Was there a pattern?

Background

According to Killeen Code of Ordinances Section 26-85 Agreements with the City (Ordinance), the City of Killeen may enter into a contract with a developer of a subdivision or land within the city to construct public improvements, not including a building, related to development. Under City/ Owner Agreement contracts, the developer constructs the improvements and the City participates in the associated oversizing costs. All agreements under the Killeen Code of Ordinances Section 26-85 are required to be in writing and set forth in a formal agreement approved by the city attorney.

The Killeen Code of Ordinances Section 26-85 outlines specific requirements and conditions under which a City/Owner Agreement will be authorized. The two criteria outlined in the Ordinance with related fiscal impact to the City include:

- The City/Owner Agreement must establish the City's participation at a level not to exceed 30 percent of the total contract price. **The City has never participated, at any level, with regard to contributing to the Owners' development costs.**
- Additionally, the City may bear up to 100 percent of City-required oversizing costs. The City is liable only for the agreed payment of its share of the contract which shall be determined and executed in advance. **The City's participation in City/Owner Agreements has been limited to oversizing.**

CHAPTER HIGHLIGHTS

- The City's process for managing City/Owner agreements is in compliance with City Ordinance.
- The city manager, in consultation with city council, should develop a long-range plan that includes the strategic execution and timing of City/Owner Agreements to accommodate the City's rapid growth and associated infrastructure needs. This participation plan and the related financial requirements should also be incorporated into the City's long-term capital improvement planning process.
- The City/Owner Agreements should be revised to reflect dual execution dates for the City and the owner so that there is no confusion regarding propriety and authorization by city council.
- The City should establish a dollar threshold that triggers an audit of the owner's financial records related to amounts expended by the City/Owner to ensure the actual costs expended for oversizing are consistent with the estimated costs that developers/owners presented to the City.

The City executed 61 City/Owner Agreements from October 1, 2001 through September 30, 2016 with a cost to the City totaling $14,050,836. This represents an average of four City/Owner Agreements executed annually. The City incurred costs for less than 60 percent of the City/Owner Agreements executed. **Figure 7-1** below presents a summary of costs incurred for City/Owner Agreements from FY 2002 through FY 2016.

Fiscal Year	Total Capital Outlay	
2002	$	–
2003	$	367,510
2004	$	2,244,295
2005	$	1,996,884
2006	$	1,502,324
2007	$	2,342,511
2008	$	497,383
2009	$	1,243,577
2010	$	467,884
2011	$	854,550
2012	$	442,927
2013	$	1,914,794
2014	$	45,266
2015	$	–
2016	$	130,931
TOTAL	**$**	**14,050,836**

FIGURE 7-1 – Costs Incurred by the City for City/Owner Agreements, FY 2002 – FY 2016
Source: City/Owner Agreement Audit Schedule provided by Public Works.

Based on the average number of City/Owner agreements the City executed, we believe the number of agreements executed is not disproportionally high. However, we did note that primarily four developers were involved with the 61 City/Owner Agreements that were executed from October 1, 2001 through September 30, 2016. These four developers included: (1) W& B Development; (2) the Purser Family; (3) Reeces Creek Development; and (4) RSBP Developers, Inc. These developers are members of the Killeen community and Chamber of Commerce and are responsible for a large portion of development in the City. Ultimately, they are contributors to the economic development of the City. *Note, MJ did not normalize the City/Owner data and compare it to the total number of lots platted by each developer.*

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Audit Questions' Results

The following tables summarize our conclusions related to the four specific questions defined in the scope of work in addition to other observations we noted.

Review Area:	**City/Owner Agreements**
Objective:	Is the City's participation in City/Owner Agreements keeping with best practices?
Conclusion:	The City's participation in City/Owner Agreements is based on Killeen Code of Ordinances Section 26-85 Agreements which governs the process. However, the City is not following the best practices listed below. ➲ Assessing the cost/benefit of the prospective City/Owner Agreement. ➲ Maintaining a better database of all City/Owner Agreements. ➲ Establishing criteria for auditing owner records.

Review Area:	**City/Owner Agreements**
Objective:	Did the City pay amounts over the existing approved City/Owner Agreements?
Conclusion:	No, the City did not pay amounts over the original/existing approved City/Owner Agreements.

Review Area:	**City/Owner Agreements**
Objective:	Is the volume of agreements disproportionally high?
Conclusion:	The City executed 61 City/Owner Agreements from October 1, 2001 through September 30, 2016. This represents an average of four City/Owner Agreements being executed annually. Additionally, the City only incurred costs for less than 60 percent of the City/Owner Agreements executed. Based on these averages, we believe the number of City/Owner Agreements executed is not disproportionally high.

Review Area:	**City/Owner Agreements**
Objective:	Were agreements limited to certain developers or were City/Owner Agreements open to all developers? Was there a pattern?
Conclusion:	City/Owner agreements are open to all developers. We did note that there were primarily four developers that were used for more than 60 percent of the City/Owner Agreements that were executed from October 1, 2001 through September 30, 2016. These four developers included: (1) W& B Development; (2) the Purser Family; (3) Reeces Creek Development; and (4) RSBP Developers, Inc. These developers are members of the Killeen community and Chamber of Commerce and are responsible for a large portion of development in the City.

Observations and Recommendations

OBSERVATION 7-1: Long-Term Planning

While the City has plans for thorough fares, water and sewer and drainage, the City does not have a specific long-range plan that includes the strategic execution and timing of City/Owner Agreements to accommodate the City's rapid growth and associated infrastructure needs. This plan would traditionally be incorporated into the City's long-term capital improvement planning process.

RECOMMENDATION 7-1: Long-Term Planning

The city manager, in consultation with city council, should develop a long-range plan that includes the strategic execution and timing of City/Owner Agreements to accommodate the City's rapid growth and associated infrastructure needs. This participation plan and the related financial requirements should also be incorporated into the City's long-term capital improvement planning process.

The long range plan should also identify opportunities for developers to participate and invest in the long-term growth of the City.

OBSERVATION 7-2: Compliance

In four instances, the City/Owner agreements appear to have been executed by the Owners prior to the approval of city council. The four instances noted included the following:

- The City Owner Agreement for White Rock Estates, Phase Two was executed on December 13, 2004 and approved by City Council with a CCMR dated December 21, 2004.
- The City Owner Agreement for Trimmier Estates, Phase One was executed on October 14, 2007, notarized on December 14, 2007 and approved by City Council with a CCMR dated January 8, 2008.
- The City Owner Agreement for Goodnight Ranch Addition, Phase Thirteen was executed on August 14, 2013 and approved by the City Council with a CCMR dated August 27, 2013.
- The City Owner Agreement for The Landing at Clear Creek, Phase III Subdivision was executed on September 25, 2013 and approved by the City Council with a CCMR dated October 8, 2013.

RECOMMENDATION 7-2: Compliance

Management represented that the city manager does not sign the City/Owner Agreement until it is approved by the city council. The City/Owner Agreements should be revised to reflect dual execution dates for the City and the owner so that there is no confusion regarding propriety and authorization by city council.

OBSERVATION 7-3: Expenditures

We noted that, while the City did not pay amounts exceeding costs of the original or existing City/Owner Agreements, the City did pay for its participation in the oversizing of two City/Owner Agreements for which the amount of the expenditure was not allocated or budgeted to a particular funding source, as with the other City/Owner Agreements that have typically been funded with bond funds. These two agreements were funded by the general fund:

- 11-038R Goodnight Ranch – Bunny Trail in the amount of $1,003,036.03.
- 13-119R/130120R The Landing at Clear Creek, Phase 3 in the amount of $360,366.68.

RECOMMENDATION 7-3: Expenditures

Because City/Owner Agreements result in capital improvements, the City should include City/Owner Agreements in its long-term capital planning and budgeting process.

OBSERVATION 7-4: Owner Cost Verification

The City's participation in City/Owner Agreements is based on the Killeen Code of Ordinances Section 26-85 Agreements. However, in certain instances, the City has not implemented or enforced all of the stipulations included in the Ordinance. For example, the Ordinance states that the owners should leave their records open for City inspection. The City has never exercised its option to audit the owner's records to verify that the original estimated costs for oversizing were the actual costs owners incurred.

RECOMMENDATION 7-4: Owner Cost Verification

The City should establish a dollar threshold that triggers an audit of the owner's financial records related to amounts expended by the City/Owner to ensure the actual costs expended for oversizing are consistent with the estimated costs that developers/owners presented to the City.

City/Owner Agreements Audit Methodology

We interviewed the following individuals regarding City/Owner Agreements:

- Current city attorney
- Current city manager
- Deputy city manager
- Council members
- Current mayor
- Director of Public Works
- City planner
- Deputy city attorney, Public Works

We performed the following activities in reviewing City/Owner Agreements from FY 2002 through FY 2016.

- Obtained and reviewed a master schedule of all City/Owner Agreements executed from October 1, 2001 through September 30, 2016.
- Created a summary of costs incurred by the City for participating in City/Owner Agreements from FY 2002 through FY 2016.
- Developed an audit work program that addressed each of the objectives for City/Owner Agreements.
- Divided the audit program into the following four sections and devised audit steps within each section designed to achieve the City/Owner Agreements objectives.

Propriety – the specific audit steps in this section were designed to determine whether the original intent of the City/Owner Agreement was being maintained.

Compliance – the specific audit steps in this section were designed to determine whether the City/Owner Agreements were in compliance with the contractual terms and in keeping with the original intent of the City.

Authorization – the specific audit steps in this section were designed to determine whether city council authorized the execution of such City/Owner Agreements.

Approval – the specific audit steps in this section were designed to determine whether the funds expended by the City for the City/Owner Agreements were within the limits approved by city council.

- Conducted interviews with city council members and current City employees to gain a current and historical perspective of processes, internal controls, and management effectiveness. We also inquired about the existence of potential compliance issues related to City/Owner Agreements.
- Reviewed various documentation such as City Council Memorandums for Resolution (CCM/Rs), City/Owner Agreements, and invoices and check copies to substantiate amounts disbursed by the City in relation to City/Owner Agreements.
- Requested policies and procedures governing City/Owner Agreements to review and assess whether processes and controls existed to reduce the risk of fraud, waste or abuse with respect to City/Owner Agreements.
- Selected a judgmental sample of 12 City/Owner Agreements for detailed testing.

Substantive Testing Procedures

We judgmentally selected a sample of 12 City/Owner Agreements for detailed testing. This selection was based on the date the City executed the agreement and dollar amount, extracted from an audit schedule the City prepared listing all City/Owner Agreements executed during the scope period from FY 2002 – FY 2016. **Figure 7-2** provides a summary of the 12 City/Owner Agreements selected for detailed testing. These agreements represent 41.3 percent of the $14,050,836 in costs incurred by the City for City/Owner Agreements from FY 2002 through FY 2016.

Agreement Name	Date	Purpose	Partner / Owner	City Costs Incurred
Condor Valley Phase IV - Ext. Elms Road	12/16/2003	Oversize and extension of Elms Road.	Winfield Group, Ltd.	See below for modification
Extension of Elms Road - Modification to Agreement	11/09/2004	Additional base for oversizing Elms Road.	Winfield Group, Ltd.	$ 643,898
White Rock Phase II	12/21/2004	Oversize Rosewood and Sulfur Spring Drives, oversize water distribution line and construct lift station and force main.	Gary W. Purser 1999 Trust, John Helen Purser 1999 Trust 4 and Killeen Hymesa, Ltd.	$ 578,325
Goodnight Ranch Phase I - Modified	08/23/2005	Oversize water main.	Reeces Creek Developers, LTD	$ 450,332
Bridgewood Addition Phase II Widening	10/25/2005	Oversize Bridgewood, Golden Gate, and Jack Barnes Streets.	W&B Development, Ltd.	$ 340,406
Trimmier Estates, Phase I	12/20/2005	Oversize Atlas Avenue, sewer and water main; drainage.	RSBP Developers, Inc.	$ 653,668
Lonesome Dove Phase 6 Subdivision	03/13/2007	Oversize Elms Road and water main.	Reeces Creek Developers, LTD	$ 454,624
White Rock Phase Seven	05/08/2007	Oversize Rosewood Drive and water line.	RSBP Developers, Inc. and Killeen Hymesa, LTD	$ 424,469

Agreement Name	Date	Purpose	Partner / Owner	City Costs Incurred
The Landing at Clear Creek Phase I - Mohawk	09/13/2011	Oversize Mohawk Drive.	WBW Development, LTD	$ 663,081
Bunny Trail Estates Phase I	03/12/2013	Oversizing of Jack Barnes Avenue, Great Divide Road and Cottonpatch Drive; and sewer main.	RSBP Developers, Inc.	$ 795,544
Goodnight Ranch Phase Thirteen	08/27/2013	Oversize water main and sanitary sewer main.	Reeces Creek Developers, LTD	$ 247,228
The Landing at Clear Creek Phase 3	10/08/2013	Oversize water transmission main, Mustang Creek Road and Prewitt Ranch Road.	WBW Development, LTD	$ 552,032
Total Costs Tested				**$ 5,803,607**
Total Costs Incurred				**$ 14,050,836**
Percentage of Total Costs Tested				**41.3%**

FIGURE 7-2 – Summary of City/Owner Agreement Selected for Detailed Testing FY 2002 – FY 2016.

MJ performed the following procedures on the 12 City/Owner Agreements selected for detailed testing with the following results:

- Read and gained an understanding of the City/Owner Agreements.
  No exceptions were noted.
- Ensured the contractual terms of the City/Owner Agreement were maintained and consistent with the terms and provisions that were presented to and approved by city council.
  No exceptions were noted.
- Confirmed disbursements by the City in relation to the City/Owner Agreement and ensured the appropriate approval was obtained before the City made the respective disbursement. Disbursements made for City/Owner Agreements executed before October 1, 2010 could not be verified as the City's retention practices only requires such information to be maintained for a period of five years. However, these documents should have been retained according to the following requirements of the Texas State Library and Archives Commission Local Schedule GR revised 3rd edition effective, November 1, 1995.
  – GR0175-16a requires records concerning the planning, design, construction, conversion, or modernization of local government-owned facilities, structures, infrastructure (i.e., electrical lines, underground water lines), and systems, including feasibility, screening, and implementation studies; topographical and soil surveys and reports; architectural and engineering drawings, elevations, profiles, blueprints, and as-builts; inspection and investigative reports; laboratory test reports; environmental impact statements; construction contracts and bonds; correspondence; and similar documentation to be retained permanently.
- Recalculated disbursement amounts to determine that disbursements made by the City to the counterparty did not exceed pre-approved limits and/or amounts.
  No exceptions were noted.

- Ensured the counterparty obligations were satisfied with respect to the City/Owner Agreement. We noted the following outstanding counterparty obligations.
  - The City/Owner agreement for Prairie View Estates Phase Three was executed on August 13, 2013. Construction plans for this project have been approved, but construction has not yet started. The City has not made any payments on this agreement as of the date of the audit report.
  - The City/Owner Agreement for Heritage Oaks Phase I was executed on May 13, 2014. This project has been completed. However, the City did not accept the construction of the project. The City has not paid an invoice for $161,455.69 for its oversizing costs.
- Obtained copies of the respective CCM/Rs to ensure city council approval was obtained prior to execution of the City/Owner Agreements. **No exceptions were noted.** However, we noted the City/Owner Agreements only included one execution date, which made it difficult to determine when the agreements were executed by the City and when the agreements were executed by the owner. In four instances, it appeared the City/Owner Agreement was executed before obtaining approval from city council. Management represented that the city manager does not sign the agreement until it is approved by city council. The City/Owner Agreements should be revised to reflect dual execution dates for the City and the owner so that there is no confusion regarding propriety and authorization by city council.

CHAPTER 8 – ROADWAY OWNERSHIP

This section of the report addresses the following management audit objectives:

- Compare the City's private roadway ownership and City participation to best practices to assess the overall efficiency of the City's arrangements.
- At what point was the City authorized to spend money; were funds expended before the City owned the road?
- What are the monetary obligations for the roads?

CHAPTER HIGHLIGHTS

- The City should establish and adopt policies and procedures regarding county road annexations. These policies and procedures should include: (1) performing formal due diligence assessments; (2) establishing criteria outlining when and under what conditions the City should annex county roads; (3) requiring City staff to complete and maintain formal due diligence reports; and (4) requiring City staff to conduct a formal cost-benefit analysis for each annexation before presenting the annexation to city council for approval.
- The City should assess and evaluate all county roads annexed in FY 2004 and FY 2008 to determine the nature, extent, timing and cost of upgrades necessary to convert annexed county roads to City standards in its long-term capital improvement planning and budgeting process.

Background

Annexation of roadways enables the City to expand its infrastructure and provides an additional revenue stream in terms of ad valorem tax, sales tax and rate-based customers using City services. The City of Killeen owns approximately 542.5 centerline miles of highway. The City annexes county roads and, at times, these annexations will also include private roads.

The City of Killeen's annexation eligibility is governed by the following:

- Home Rule Charter Section 7:
  - Authorizes the city council to extend the City's boundary lines and annex additional territory adjacent to the City of Killeen.
- Local Government Code Section 43.055:
  - Authorizes the city council to annex in any one calendar year only territory equivalent in size to 10 percent of the total corporate area of the City.
  - If the City does not annex in a calendar years or years they are authorized to annex a maximum amount of territory up to 30 percent of its total area as of the first day of the calendar year.

The City authorized and executed two separate roadway annexations during the FY 2002 through FY 2016 scope period for the management audit, including:

- Property annexed March 16, 2004, which is located in the south central portion of the City of Killeen extraterritorial jurisdiction.

- Property annexed January 22, 2008 which is generally described as the unincorporated areas to the north and south of Stagecoach Road, extending from approximately Cunningham Road on the east to the western boundary of the Stagecoach Road and Wagonwheel Subdivisions on Stagecoach Road.

Each of these two annexations grew the City by less than 10 percent. **Figure 8-1** provides a summary of these roadway annexations.

Fiscal Year	Annexation Authority Eligibility	Annexation Date	Actual Annexation Square Miles
FY 2004	10.85 square miles	March 16, 2004	8.598 square miles
FY 2008	13.5 square miles	January 22, 2008	2.03 square miles

FIGURE 8-1 – City of Killeen Roadway Annexations from FY 2002 through FY 2016. *The two roadway annexations grew the City by less than 10 percent with each annexation.*

The City's management team represented to the audit team that operational due diligence conducted on these roadways prior to annexation included reviewing the widths of the existing rights-of-way; reviewing functional roadway classification; reviewing paving widths and existing curbs and gutters before assuming responsibility for a road. However, City staff did not prepare formal due diligence reports or conduct feasibility studies or analyses for each annexation transaction.

Audit Questions' Results

The following tables summarize our conclusions to the three specific questions defined in the scope of work in addition to other observations we noted.

Review Area:	Roadway Ownership
Objective:	Compare the City's roadway ownership and City participation to best practices to assess the overall efficiency of the City's arrangements.
Conclusion:	The City of Killeen does not have formal policies and procedures in place to monitor roadway ownership. City staff performs cursory reviews and adds or removes roadways based on the best knowledge of professionals performing the cursory review for roadway ownership and related maintenance plans. The City does not adequately assess county roadway annexations before requesting authorization from city council. We noted the City has not incorporated the following best practices into its roadway annexation processes: 1. Conduct formal operational due diligence on roadways considered for annexation and prepare formal operational due diligence reports. 2. Estimate the costs to upgrade the roadways to City standards, along with how and when the roadway upgrades will be funded. 3. Determine and provide estimates of the cost to maintain the annexed roadways, and include these costs in the annual budgeting process. 4. Execute formal roadway annexation agreements. 5. Include in the long-term capital improvement planning and budgeting process the nature, extent, timing and cost of upgrades necessary to convert annexed county roads to City standards.

Review Area:	Roadway Ownership
	National best practices, as included in annexation studies conducted for the cities of San Antonio, Texas and Annapolis, Maryland, included the following: 1. Developing an annexation plan, including an inventory of current public services provided to the area and developing a service plan for the proposed annexation area, including the costs to provide such services. 2. Providing a multi-year analysis to determine long-term trends in revenues and expenditures. 3. Adopting different growth assumptions based on actual and current data. 4. Using conceptually rigorous, demand-driven or supply-driven methods to project growth in sales tax revenue based on actual and current sales or business establishment data. 5. Conducting a detailed marginal expenditure analysis for major cost drivers—such as public safety—in lieu of cost projections based on per capita estimates. 6. Including pension contributions, active and retiree health insurance, overtime and other premium pay when estimating salary-related expenditures. 7. Streamlining projections for minor revenues and expenditures by using per capita estimates.

Review Area:	Roadway Ownership
Objective:	At what point was the City authorized to spend money; were funds expended before the City owned the road?
Conclusion:	The City assumes responsibility for the routine maintenance and repair of county roads at the time that they are annexed and ownership transfers to the City. However, we noted the City of Killeen spent $7,265 on chipseal maintenance for four roadways before conveyance of ownership. These four roads were conveyed to the City by Bell County in January 2008. However, the City incurred expenditures for maintaining the roads in FY 2007 and prior fiscal years. The actual amount of funds and resources expended on county roadways prior to conveyance of ownership could not be quantified because City staff do not track this information.

Review Area:	Roadway Ownership
Objective:	What are the monetary obligations for the roads?
Conclusion:	The City does not incur costs for annexation. However, the City has future obligations to repair and maintain annexed county roadways and upgrade annexed roads to City standards. For example, the City has incurred significant capital outlays in relation to county roadways that were annexed in FY 2004 and FY 2008. Those county road annexations included Trimmier Road and Stagecoach Road. Based on information City staff provided for our audit sample tested in the Capital Outlays chapter of this report, the City spent approximately $10.5 million to widen and reconstruct Trimmier Road and $17.9 million on a two-phased project for the reconstruction of Stagecoach Road.

Observations and Recommendations

OBSERVATION 8-1: Roadway Annexation Policies

The City of Killeen does not have formal policies and procedures in place to monitor roadway ownership. City staff performs cursory reviews and adds or removes roadways based on the best knowledge of professionals performing the cursory review for roadway ownership and related maintenance plans.

RECOMMENDATION 8-1: Roadway Annexation Policies

The City should establish and adopt policies and procedures regarding county road annexations. These policies and procedures should include: (1) performing formal due diligence assessments to determine historical roadway maintenance costs and whether or not roadways should be annexed to prevent additions of undesirable roads; (2) establishing criteria outlining when and under what conditions the City should annex county roads; (3) requiring City staff to complete and maintain formal due diligence reports; and (4) requiring City staff to conduct a formal cost-benefit analysis for each annexation before presenting the annexation to city council for approval.

OBSERVATION 8-2: Roadway Annexation Financial Impact Analysis and Planning

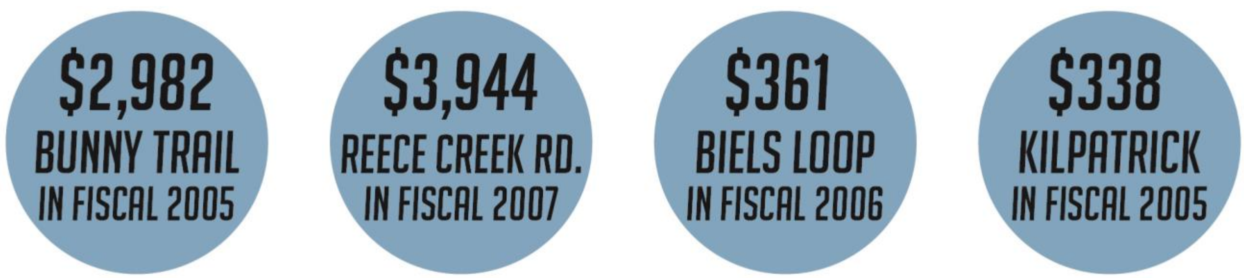
The City does not adequately assess county roadway annexations before requesting authorization from city council. The management audit team's review noted the following findings:

1) The City does not conduct formal operational due diligence on county roads that it annexes and does not prepare formal operational due diligence reports.
2) At the time of annexation, the City does not provide city council with estimates of the cost to maintain the annexed county roads, or how the City intends to fund the roads. Therefore, these costs are not considered in the annual budgeting process.
3) The City does not execute formal agreements related to its annexation of county roads.
4) The City does not develop long-term plans to assess and evaluate upgrades to the condition of annexed county roads to meet City standards, including the projected time schedules and related costs to complete the upgrades.

We noted that, although the City does not incur costs for annexation, it has future obligations to repair and maintain annexed county roads, and must convert annexed county roads to City standards at some time in the future. For example, the City has incurred significant capital expenditures for Trimmier Road and Stagecoach Road, county roads the City annexed in FY 2004 and FY 2008, respectively. Based on information City staff provided for our audit and tested in our sample included in the Capital Outlays chapter of this report, the City spent a total of $28.4 million on these two roadway projects.

The City does not conduct short-term or long-term planning for the costs of converting county roads to City standards.

The City assumes responsibility for the routine maintenance and repair of county roads upon annexation of such roads as the annexation of such county roads consummates ownership. However, we noted the City spent $7,265 on chipseal maintenance for four roadways before conveyance of ownership. Bell County conveyed these four roads to the City in January 2008. However, the City incurred expenditures maintaining the roads in FY 2007 and prior fiscal years. While the expenditure is not a material amount, it does indicate that the City must improve controls and related monitoring activities for expenditures related to annexed roadways. Maintenance expenditures the City incurred for each road are detailed in the graphic below.



We could not quantify the actual amount of maintenance expenditures for county roadways before conveyance of ownership to the City because City management could not validate the completeness and accuracy of information provided to the audit team related to county road annexations that occurred in FY 2004 and FY 2008, as City staff tracked maintenance expenditures related to county road annexations in spreadsheets, which did not capture or record all of the expenditure data. Beginning in FY 2012, the City tracks its roadway maintenance expenditures in its Cityworks work order system. However, the City still does not track roadway maintenance expenditures by major county road or thoroughfare within the Cityworks system.

The City has an annual budget for street maintenance. From FY 2002 through FY 2016, annual budgeted expenditures for street maintenance averaged $681,589, as compared to the annual actual expenditures for street maintenance averaging $599,891. The budget for street maintenance increased from $712,000 in FY 2007 to $945,000 in FY 2008, a noted increase of $233,000, or 32.7%. During this same fiscal year, FY 2008, the actual street maintenance expenses increased approximately $500,000. This was attributable to the fact that the City has deferred maintenance in excess of $40.0 million and a portion of those deferred maintenance costs were expended in

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FY 2008. Also, in FY 2008, the year the City's last annexation occurred, actual road maintenance expenditures exceeded budgeted road maintenance expenditures by $220,212, or 23.3 percent.

Figure 8-2 compares budgeted to actual street maintenance expenditures for FY 2002 through FY 2016.

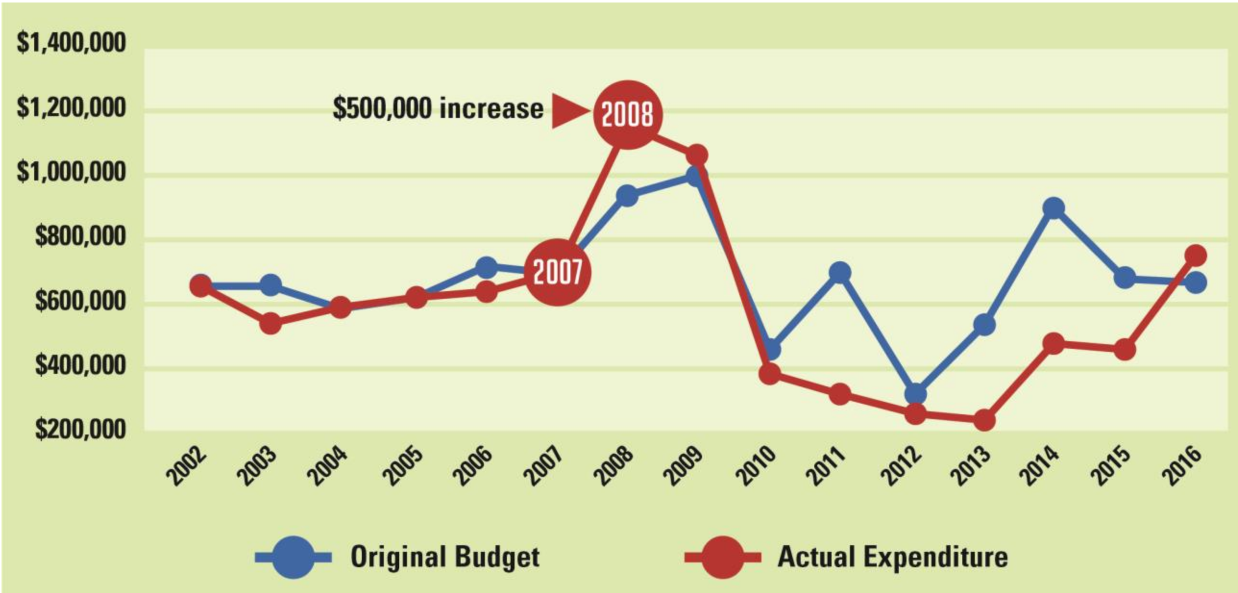

FIGURE 8-2: City of Killeen Street Maintenance Costs. *The City's street maintenance costs increased $500,000 between FY 2007 and FY 2008.*

RECOMMENDATION 8-2: Roadway Annexation Financial Impact Analysis and Planning

The City should assess and evaluate all county roads annexed in FY 2004 and FY 2008 to determine the nature, extent, timing and cost of upgrades necessary to convert annexed county roads to City standards in its long-term capital improvement planning and budgeting process.

The City should build and maintain a database of all the roadways it currently owns and create a mechanism to track roadway annexations so that it may accurately monitor the costs incurred for repairs, maintenance, and reconstruction of annexed roads.

The City should develop internal processes to confirm the City's ownership of roadways before using City resources to repair annexed roads. This process should include establishing a dollar threshold for repair and maintenance expenditures which would require city council approval, as well as programming the Cityworks work order system to track roadway repairs by each road. For example, the Cityworks system could be programmed to create project codes for each roadway to capture major capital outlays incurred to repair individual roads (i.e., costs in excess of $1.0 million, if this were the pre-established threshold).

Private Roadway Ownership Audit Methodology

We interviewed the following individuals regarding roadway ownership:

- Current city attorney
- Current city manager
- Deputy city manager
- Council members
- Former council member
- Mayor
- Director of Public Works
- City planner
- Director of Planning & Development

We performed the following activities in reviewing roadway ownership from FY 2002 through FY 2016.

- Requested that City Public Works management provide a schedule of roadway annexation and costs. From this information, we created a summary of costs incurred by the City from FY 2002 through FY 2016 for county roadway annexations. This summary is shown below.

Fiscal Year	Costs Incurred	
2002	$	–
2003	$	–
2004	$	–
2005	$	4,966
2006	$	281
2007	$	13,574
2008	$	–
2009	$	23,688
2010	$	–
2011	$	40,864
2012	$	62,480
2013	$	–
2014	$	100,507
2015	$	33,607
2016	$	–
Total	**$**	**279,967**

Source: City of Killeen Public Works Department, July 2017.

- Developed an audit work program that addressed each of the objectives for roadway ownership.

- Divided the audit program into the following three sections and devised audit steps within each section designed to achieve the roadway ownership objectives.

  - **Propriety** – the specific audit steps in this section were designed to determine whether the original intent of the roadway ownership agreement was being maintained.
  - **Compliance** – the specific audit steps in this section were designed to determine whether the roadway ownership agreements were in compliance with the contractual terms.
  - **Authorization** – the specific audit steps in this section were designed to determine whether the annexations of roadways were authorized by city council.

- Obtained and reviewed a master schedule of all roadway annexations executed from October 1, 2001 through September 30, 2016.

- Reviewed City Council Memorandum for Resolutions (CCM/Rs) in relation to county road annexations.

- Requested policies and procedures governing roadway annexation and ownership agreements to assess whether processes and controls were in place with respect to monitoring and executing these agreements. *Note: We determined that formal, documented roadway annexation policies and procedures do not exist.*

- Selected six county roadway annexations for detailed testing. The City provided a schedule of road annexations that occurred from FY 2002 through FY 2016. We noted that only two roadway annexations occurred during the audit scope period. Accordingly, we judgmentally selected the six roads with the greatest amount of maintenances costs.

Substantive Testing Procedures

We selected the following six (6) roadway annexations for detailed testing. This selection represents 72.4 percent of the total maintenance costs of $279,967 incurred by the City for roadway annexations from FY 2002 through FY 2016.

Road Name	Annexation Date	Maintenance Costs Incurred
Featherline Road	04/30/2004	$62,480
Featherline Road	05/01/2004	$40,864
Flanigan Drive	04/30/2004	$16,140
Flanigan Drive	05/01/2004	$11,328
Rein Drive	01/28/2008	$36,386
Wagon Wheel Drive	01/28/2008	$35,417
Total Costs Tested		**$202,615**
Total Costs		**$279,967**
Percentage Coverage		**72.4%**

We performed the following procedures on the six roadway annexations selected for detailed testing with the following results:

- Requested roadway annexation agreements. We were told by City management that roadway annexation agreements do not exist.
- Determined compliance with contractual terms and provisions of the agreements. We were unable to determine compliance with contractual terms and provisions, as we were told by City management that these agreements do not exist.
- Analyzed the timing of repair and maintenance expenditures as compared to the actual date the City assumed ownership of roadways by comparing the date of the City's ownership of the roadway to the period during which repair and maintenance expenditures were incurred, noting the following exceptions:
  - Bunny Trail was annexed on January 28, 2008, but maintenance expenditures for chipseal in the amount of $2,982 were incurred in FY 2005.
  - Reece Creek Road was annexed on January 28, 2008, but maintenance expenditures for chipseal in the amount of $3,664 were incurred in FY 2007.
  - Biels Loop was annexed on January 28, 2008, but maintenance expenditures for chipseal in the amount of $281 were incurred in FY 2006.
  - Kilpatrick Road was annexed on January 28, 2008, but maintenance expenditures for chipseal in the amount of $338 were incurred in FY 2005.
  - Requested invoices and/or other supporting documentation to verify maintenance expenditures incurred. Management represented and we noted that this information does not exist.

Inherent Scope Limitations

With the exception of the two annexation ordinances for county road annexations in FY 2004 and FY 2008, roadway ownership agreements and other supporting documentation did not exist. Accordingly, we had inherent scope limitations and the following procedures could not be performed:

- Assess the provisions of the roadway owner agreements and compare them to the best practices of other cities.
- Compare the City's criteria for acquiring roadways to other cities.
- Identify written policies and procedures for roadway agreements.
- Select a sample of roadways and determine compliance with the policies and agreements.
- Obtain a listing of roadway agreements where the City has outstanding financial obligations.

CHAPTER 9 – POST-RECALL PERIOD SPENDING

This section of the report contains our analysis of the expenditures made between November 2011 and May 2012 (post-recall period spending). The contracted scope of services for this focus area was to:

- Review significant expenditures during the six-month period without a fully seated council to determine the following:
  - Did council ratify expenditures, as required?
  - Is there any evidence of fraud or abuse of funds during the period?

During the March 21, 2017 city council visioning session, this scope was further refined to address these questions:

- Was an emergency declaration declared?
- Did city council ratify expenditures as required?
- Is there any evidence of fraud or abuse of funds during the period?
- What is the process now?
  - Are procedures, contingency plans and frameworks in place for the future?

CHAPTER HIGHLIGHTS

- No instances of purchasing fraud or abuse during the post-recall period came to our attention.
- Develop a policy for how to manage the City in the event that a full city council is not seated or a crisis affects the ability to establish a quorum for an extended period of time.
- The City should take appropriate measures to enhance its overall internal control environment. This begins with ensuring appropriate policies, people, processes and technology are in place to manage financial transactions from the budgeting and planning processes through the financial obligation payment process.
- The finance director should ensure that all departments/ divisions using QuickBooks or any other recordkeeping software programs to track expenses, issue invoices and record receipts, immediately cease using the systems. All financial activities must be recorded in the City's official financial system (Sungard AS400). *Update: The City removed access to all QuickBooks software during this audit.*

Background

The adoption of the City Charter in 1949 established the "council-manager" form of government the City of Killeen uses today. The City Charter established the city council's seven member representation with the authority to set all policy as it pertains to the City of Killeen (Charter, Article I, §2). The seven member city council is comprised of three at-large and four district representatives with the directive from the City Charter that four members are needed to establish a quorum in accordance with the provisions of V.T.C.A., Government Code, § 551.001 et seq. Councilmembers serve two-year terms with a three consecutive term limitation for each office. The three at-large members are elected in even numbered years and the four district representatives are elected in odd numbered years (Charter, Article III, §22).

The City of Killeen's purchasing policy affirms that the city council must approve expenses over $50,000. A City Council Memorandum for Resolution (CCM/R) must be completed to approve expenses over $50,000, and includes the following information:

- CCM/R number and date;
- originating department requesting resolution;
- background information regarding the expense or history;
- discussion/conclusion of the expense;
- fiscal impact to the City of Killeen;
- recommendation to city council; and
- resolution and statement of approval by the city council noting the approval date for the expense; a quorum was present; signatures of the mayor, city attorney, and city secretary; and the City of Killeen's seal.

City Council Recall Event and Interim City Purchasing Process

The city council recall process began on April 5, 2011 and ended with the recall election held on November 8, 2011. One member resigned and the other member vacated their position after losing the election in May 2011 . Therefore, only five council members and the mayor were included on the ballot as part of the November 2011 recall election. The final results of the recall election led to the removal of the five sitting council members, which left the City of Killeen with no city council or official quorum to conduct City business. The State of Texas does not have a statute that gives directives to a city regarding the actions that should occur during a recall event. Consequently, the City must continue doing business as outlined in its City Charter.

Post-Recall Period Purchasing Process

The City of Killeen's interim city manager drafted a memorandum on December 5, 2011, addressed to department directors outlining an interim policy as requisite guidance for the absence of a city council quorum and the limited authority the city manager holds to approve expenses over $50,000. The memorandum outlined the process and specifically noted the responsibility of department directors to ensure transparency and accountability as it pertained to the management of expenses over $50,000. The memo also included the following directives related to change orders:

- Change orders and construction amendments must be approved in advance by the interim city manager prior to the work being charged to the project manager.
- Change orders must adhere to the City's purchasing policy. The purchasing policy documents the required supporting documentation and the CCM/R for future city council consideration.
- CCM/Rs must contain detailed and comprehensive information of the fact and circumstances surrounding the change order.
- Each change order will be considered on its own merit. If the change order does not seem necessary for the project, it will be denied until a city council is in place to review the expense.
- Splitting change orders into increments that cannot be justified is a criminal offense and is not permitted.

The approval of expenses $50,000 and below would have continued to follow the City of Killeen's purchasing policy despite the recall election. **Figure 9-1** provides the City's purchasing policy approvals required and related dollar thresholds.

Required Approval	Procurement Card Purchases $0 - $3,000	Procurement Card Purchases $0 - $10,000	Purchase Orders and Invoices $10,000.01 - $50,000	Purchase Orders and Invoices $50,000.01 - Above
Department/Division Manager	✓	✓	✓	✓
Purchasing Division	✓	✓	✓	✓
Accounting Manager		✓	✓	✓
Assistant Director of Finance/Designee		✓	✓	✓
Executive Director of Finance/Designee				✓
City Council Prior Approval				✓

FIGURE 9-1 – City of Killeen Purchasing Approval Criteria.
Note: The assistant director of finance position at the time of the recall election did not exist.
Source: City of Killeen Purchasing Policy and Procedure.

According to the transaction activity listing generated from the City of Killeen's SunGard financial system (SunGard), City expenditures paid during the post-recall period totaled $111,750,418. **Figure 9-2** provides a summary of expenditures by the 29 high-level categories used in the City's expenditure coding chart.

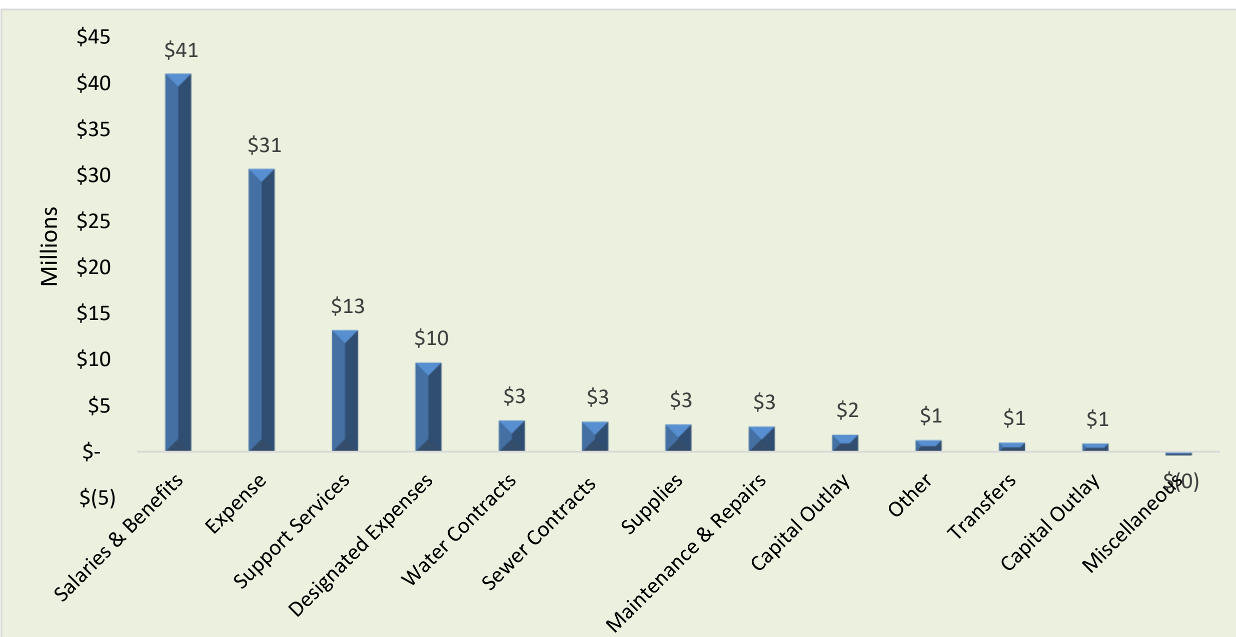

FIGURE 9-2 – Summary of Post-Recall Expenditures by Expenditure Coding Chart.

Three-fourths of the expenses were associated with three expenditure categories. Salaries and benefits comprised 37 percent of total expenses during the post-recall period; operating expenses comprised 27 percent of total expenses, and support services comprised 12 percent of total expenses.

Audit Questions' Results

The following tables summarize our conclusions to the four specific questions defined in the March 21, 2017 city council visioning session in addition to other observations we noted.

Review Area:	**Post Recall Expenses**
Objective:	Was an emergency declaration declared?
Conclusion:	➲ The City did not declare an emergency declaration. However, the interim city manager issued instructions on how expenses over $50,000.01 were to be handled. ➲ One CCM/R approval occurred after the May 2012 election with 99 percent of CCM/R approvals occurring before the recall election. ➲ Declaring an emergency declaration when there are no council members seated is not a practice that is outlined in the City Charter or mandated by the State of Texas.

Review Area:	**Post Recall Expenses**
Objective:	Did the city council ratify the expenditures as required?
Conclusion:	➲ Yes. City council ratified post recall expenditures as required.

Review Area:	**Post Recall Expenses**
Objective:	Is there any evidence of fraud or abuse of funds during the period?
Conclusion:	➲ Based on the audit procedures we applied, we did not see indicators of fraud or abuse. ➲ We did note a weak internal control environment that could result in potential fraud going undetected. However, expenditure samples tested for the post-recall period indicate the necessary approvals and supporting documentation were present in accordance with City policy for vendor payments.

Review Area:	**Post Recall Expenses**
Objective:	What is the process now? Are procedures, contingency plans and frameworks in place for the future?
Conclusion:	➲ The City follows the existing Purchasing Department procurement processes that establish procurement methods and dollar thresholds for purchasing approval authority. ➲ There is neither a contingency plan nor framework in place in the event that a full city council is not seated.

Summary of Observations and Conclusions

OBSERVATION 9-1: City Management Policy

The City of Killeen does not have a policy governing how the City will be managed in the event that the city council is unable to perform its governing duties. While a full city council recall is a rare event in any municipality, a crisis may affect the ability for the City to establish the quorum needed for city council to conduct emergency business.

RECOMEMNDATION 9-1: Long-Term Planning

The city manager in consultation with the mayor and city council should develop a policy for how to manage the City in the event that a full city council is not seated or a crisis affects the ability to establish a quorum for an extended period of time. This includes what purchases will be allowed, how purchases will be approved and when they will be ratified by city council.

OBSERVATION 9-2: Internal Control Environment

We noted a weak internal control environment that is pervasive throughout the City. This could result in potential procurement and payment fraud going undetected. Examples of weak internal controls related to the procurement and payment process include:

- The following departments/divisions use a second set of electronic record keeping software (QuickBooks) to track expenses, issue invoices and record receipts. Additionally, these departments receive payments directly for invoices they issue. The departments then provide the City's Finance Department with high-level information to record in the City's financial system.
  - Aviation Department
  - Killeen Civic and Conference Center (KCCC) (for alcohol contract and tracking)
  - Volunteer Services
  - Senior Center
  - Cemetery
- The Purchasing Department does not maintain weekly detailed procurement card transaction reports provided by Citi Bank to the Purchasing Department, and do not provide these transaction reports to the Finance Department as support for payment authorization. Additionally, the Purchasing Department does reconcile the weekly procurement card transaction download to the monthly statement received by the Finance Department to ensure that all charges are accounted for and are for authorized City purposes.
- The Finance Department records Journal entries to move expenses from one fund to another, rather than record the expenses to the correct department/division as the expenses are incurred.

RECOMMENDATION 9-2: Internal Control Environment

The City should take appropriate measures to enhance its overall internal control environment. This begins with ensuring appropriate policies, people, processes and technology are in place to manage financial transactions from the budgeting and planning processes through the financial obligation payment process.

Additionally, the finance director should ensure that all departments/divisions using QuickBooks or any other recordkeeping software programs to track expenses, issue invoices and record receipts, immediately cease using the systems. All financial activities must be recorded in the City's official financial system (Sungard AS400).

Post-Recall Period Spending Audit Methodology

MJ performed the following activities in reviewing the expenditures from November 2011 through May 2012 (the post-recall period):

- Conducted research on the city council recall event for documentation of the event, applicable state statutes, and city governance.
- Conducted interviews and walk-throughs with staff in the City's Finance Department.
- Conducted interviews with staff in the City's Legal Department.
- Conducted interviews and walk-throughs with staff in the City's Purchasing Department.
- Requested and reviewed policy and procedures applicable to the post-recall event.
- Reviewed the City's purchasing policy.
- Reviewed memorandum that the interim city manager drafted to ensure purchasing governance during the post-recall period.
- Generated the transaction activity in the SunGard system for expenses that occurred during November 2011 – May 2012.
- Identified documentation requirements outlined in the City's purchasing policy and used the information below to test transactions for compliance.
  - Supporting documentation is defined as a purchase order, unless deemed an emergency purchase, and the detailed receipt documentation to support the expense.
  - Documentation for all purchases must include packing slips, haul tickets, pick tickets, detailed receipts, etc.
  - Any purchases made in violation of the purchasing policy will not be processed and will be referred to the Finance Department.
  - Emergency purchases are allowable without a purchase order. An acute need for an item due to lack of planning does not constitute an emergency. When there is an emergency outside of regular business hours, a department/division head may release a verbal order to the vendor and then submit a requisition to the Purchasing Division with an explanation of the emergency within 24 hours, or the next business day. After approvals are obtained, a purchase order will then be issued to match the vendor invoice. However, the purchasing policy does not define criteria or provide examples of wat constitutes and emergency.

- Judgmentally selected 199 expense transactions less than $50,000, and tested the transactions against documented purchasing approval criteria included in Purchasing Department policies summarized in **Figure 9-1**. Although expenditures of less than $50,000 were not affected by the recall, we performed this audit procedure to answer the question: "is there any evidence of fraud or abuse of funds during the period?"
- Judgmentally selected 66 expense transactions greater than $50,000, and tested the transactions against documented purchasing approval and CCM/R criteria.

Substantive Testing Scope Limitation, Procedures and Results

We could not perform standard data analytics tests such as Bedford's Law and electronic testing of 100 percent of the population for compliance and reasonableness because of the following conditions:

- The City's AS400 system architecture is based on a series of tables and is not a database where queries can be designed for data extraction.
- The table size limitations within the AS400 system does not allow for files to be stored as they would be in a database environment. The city does backup key files on microfiche, but these type of files cannot be digitally extracted.
- Purchases made using procurement cards go through a different approval process and the transactions are entered into the AS400 system on a consolidated basis. The detail transaction level is maintained in the bank's credit card transactions reports (statements) that were not maintained in electronic format by the Purchasing Department.

Therefore, we were faced with scope limitations and modified our testing approach for post-recall expenditures to selecting random and judgmental samples based on high-risk transactions and high-risk populations. We determined that purchases under $3,000 during the post-recall period posed minimal risk to the City. Therefore, we concentrated our audit efforts on transactions of $3,000 and above. Our sample ensured that we tested all transaction types, regardless of the dollar amount. **Figure 9-3** provides a comparison of the total expenditure population for the post-recall period and our sampling.

	<$0 *	$1.00 - $3,000.00	$3,000.01 - $50,000.00	>$50,000.01 **	Total
Number of Transactions in the Population	1,069	17,504	689	98	19,360
Transaction Tested	2	118	79	66	265
Percentage of Transactions Tested	0.2%	1%	11%	67%	1.4%
Total Population Value	$ (1,028,108)	$ 4,232,403	$ 7,376,903	$ 15,891,063	$ 27,500,369
Total Value Tested	$ (24,479)	$ 100,045	$ 982,015	$ 8,413,146	$ 9,495,206
Percentage of Value Tested	2%	2%	13%	53%	35%

FIGURE 9-3: Summary of City Expenditures During Post-Recall Period and Sampling.
The negative numbers in the less than $0 column represents credits and account transfers or adjustments.
** Additional adjustments and transfers were also tested in the Interfund focus area.*
*** 100 percent of one-time payments were tested, as well as a sample of recurring, payroll, benefit and contract payments.*
Note: Additional expenditure documentation and city council authorization was also tested with the Capital Outlay focus area.

City of Killeen Expenses Less Than $0 – $50,000

MJ selected a judgmental sample of 199 expense transactions that were less than $50,000 to test for compliance with the City's purchasing policies. We also reviewed these expenses for reasonableness. Specifically, we:

- Obtained copies of supporting purchase orders, packing slips (if applicable), invoices and payment vouchers to determine the following:
  - Were required documents provided?
  - Were all required documents obtained prior to payment?
  - Do documents support the expenditure?
- Reviewed approvals in the respective documents.
  - Were the required approvals obtained prior to payment?
- Reviewed the purchase for reasonableness:
  - Was the purchase in line with the City's activities?

Our detailed testing sample resulted in the following:

99% Complied with the City's purchasing and payment policies.

1 Transaction was an exception to the City's purchasing policy based upon a business decision to acquire equipment that voters and election workers were familiar with. This purchase was authorized by city council. While this is an exception, there was a business need and a transparent procurement process. Therefore, this does not represent fraud or abuse.

Elections Systems & Co. $37,776.20

3 Transactions for which support doucments could not be located.

2 Transactions did not have the recieving report and check payment vouchers with the required Finance Department approvals, although the approved CCM/R was on file.

Caldwell County Chevrolet $40,360

City of Killeen Expenses $50,000 and Above

Expenses paid during the recall period totaled $111,750,419 according to the activity listing extracted from the City of Killeen's SunGard system. MJ filtered the activity listing for all expenses $50,000 and above. The largest expenditures were related to debt payments, employee benefits, payroll, utilities and budget transfers. Each of these categories pose minimal risk to the City since they are recurring transactions authorized at the time annual budgets are approved. Budget transfers also pose minimal risk because these transactions do not directly relate to actual monetary expenditures. The appendix at the end of this chapter provides a summary of spending transactions during the post-recall period.

For the $50,000 and above category, we separated the population into (1) recurring transactions (such as debt payments, energy, communications and insurance); (2) transactions that would have received prior approval through the budget process or a contract authorization (such as Bell County appraisal); and (3) unique one-time purchases. We sampled from recurring purchases approved through the budget process and transactions that would have received prior approval. We tested 100 percent of unique transactions greater $50,000. Ninety-eight transactions totaling $15,891,063 (20 percent of total expenditures greater than $50,000 per transaction during the post-recall period) remained in our sample once we excluded the following transactions:

- Payroll (salaries), since salaries are based on employee time worked and employment contracts.
- Budget transfers, which move funds between accounts and were not directly associated with payments of expenditures.
- Repetitive transactions due to recurring payments such as BlueCrossBlueShield (we tested two transactions), Reliant Energy (we tested two transactions, and Waste Management (we tested three transactions).

We selected 66 transactions for detailed testing as follows:

- Obtained copies of supporting purchase orders, packing slips (if applicable), invoices and payment vouchers to determine the following:
  - Were required documents provided?
  - Were all required documents obtained prior to payment?
  - Do documents support the expenditure?
- Obtained CCM/Rs and reviewed each CCM/R for completeness, city council approval, and proper execution.
- Reviewed approvals in the respective documents.
  - Were the required approvals obtained prior to payment?
- Reviewed the purchase for reasonableness:
  - Was the purchase in-line with the City's activities?

Our detailed testing of expenditure transactions $50,000 and above resulted in the following:

100% Compliant with supporting documentation requirements.

100% Compliant with CCM/R information, documentation and approval requirments.

8 Transactions were journal entries for fleet management costs.

44 CCM/Rs were approved on or before November 8, 2011.

1 CCM/R was approved after November 8, 2011.

13 Transactions had the proper supporting documentation and approvals necessary to meet the City's payment approval process. These expense transcations are summarized in the table below.

Vendor	Expense Explanation	Number of Transactions	Support Reasoning
Bell County Appraisal District	Taxing Unit Fee	3	Taxing Unit Fee - Approved in FY 2011 – FY 2012 Budget - Ordinance #11-084, Contractual Obligation based on tax levies.
Bell County Auditor	2nd Qtr. Interlocal Agreement FY 2011 – FY 2012 Communication/ Media	1	Paid Quarterly. Transaction item was approved/included in the annual budget process.
Bell County Public Health District	1st & 2nd Qtr. – Full Member Contribution Due	2	Paid Quarterly. Transaction Item was approved/included in the annual budget process.
BlueCross-BlueShield	Employee Benefits	2	Recurring payment with interoffice memo of payment and approval.
Hill Country Transit District	Professional/Admin. Services	1	Grant to a transit distrcit. Transaction Item was approved/included in the annual budget process.
Bank of New York	Debt Service Payment	1	Debt service payment. Transaction item was approved/included in the annual budget process.
Waste Management	Waste Disposal	3	Recurring contract. Approval was approved/included in the annual budget process.

We identified three transactions in our sample with change orders and tested those transactions to ensure compliance with the post-recall memorandum and payment approval process. The table below summarizes these change orders.

Vendor	Audit Findings:
Ballou Pavement Solutions, Inc.	Change order requested after the May 2012 election. This would have been approved by the new city council. ***No Exception Noted***
Bell County Water Control and Improvement District No. 1	CCM/R completed. ***No Exception Noted***
TTG Utilities	Change order was less than $50,000.01 amount and would not have required an approval from city council. Documentation noted the interim city manager was aware of, and approved changes based on supporting documentation. ***No Exception Noted***

Appendix 9-1 – Post Recall Period Spending Summary

Category	Less Than $0 (Non-Expense Entries)	$0 - $3,000	$3,000 - $50,000	> $50,001	Total
Total Population - Number	1,310	23,793	2,077	286	27,466
Total Population - Value	$ (1,388,477.97)	$ 7,571,143.40	$ 24,975,816.72	$ 80,591,936.78	$ 111,750,418.93
Payroll (Number)	9	5,891	1,352	111	7,363
Payroll (Total Value)	$ (2,751.85)	$ 3,229,807.76	$ 16,971,706.99	$ 48,337,357.68	$ 68,536,120.58
Over/short (Number)	136	98	3	-	237
Over/short (Total Value)	$ (66,941.39)	$ 9,289.10	$ 53,259.94	$ -	$ (4,392.35)
AJE (Number)	86	288	9	22	405
AJE (Total Value)	$ (262,954.34)	$ 94,103.07	$ 52,973.41	$ 3,704,438.61	$ 3,588,560.75
Transfers (Number)	7	9	19	36	71
Transfers (Total Value)	$ (845.76)	$ 3,947.54	$ 481,251.20	$ 6,676,567.98	$ 7,160,920.96
Bank Charges (Number)	3	3	5	-	$ 11.00
Bank Charges(Total Value)	$ (26,876.25)	$ 1,592.90	$ 39,722.41	$ -	$ 14,439.06
Bond Interest (Number)	-	-	-	19	19
Bond Interest(Total Value)	-	-	-	$ 5,982,509.77	$ 5,982,509.77
Net Expenditures (Number)	**1,069**	**17,504**	**689**	**98**	**19,360**
Net Expenditures (Total Value)	**$ (1,028,108.38)**	**$ 4,232,403.03**	**$ 7,376,902.77**	**$ 15,891,062.74**	**$ 26,472,260.16**

Note: The negative numbers in the less than $0 column represents credits and account transfers or adjustments.