



THE CITY OF SAN DIEGO

DATE: February 28, 2011

TO: Kelly Broughton, Development Services Department Director
Roger Bailey, Public Utilities Department Director

FROM: Eduardo Luna, City Auditor

SUBJECT: **Follow-up Audit of the Development Services Department's
Collection of Water and Sewer Fees**

Summary

In response to a request from the Public Utilities Department (Public Utilities), the City Auditor conducted a performance audit of the Development Services Department's (DSD) collection of water and sewer fees. We issued a report on June 22, 2010 with seven recommendations. The audit found over \$170,000 in uncollected water and sewer fees. However, we reported additional testing of water and sewer fee data would be performed and the results reported in a separate memorandum. This memorandum provides the results of our additional testing.

Based on our testing, we found 14 additional accounts with uncollected water and sewer fees due totaling \$28,042 for completed permits. We provided a listing of these accounts to DSD and Public Utilities. During our testing, we also found that the procedures to record, track, and monitor capacity credits are not well documented. We made two recommendations to address these issues.

We would like to thank the Development Service Department and the Public Utilities Department staff who provided their time and contributed their expertise to this report. We greatly appreciate their time and efforts. The Administration's response to our audit recommendations can be found after page 7.

Background

Just prior to the issuance of our previous report on June 22, 2010, Public Utilities provided a large data set of water and sewer fee accounts that required additional testing. Our testing involved reviewing data from two computer systems used by the Development Services Department (DSD) and the Public Utilities Department to record and collect water and sewer permit fees.

New accounts are created in the Public Utilities Installation Order System (IOS) by DSD staff when a customer applies for a permit requiring water or sewer fees. The IOS accounts list the required work and associated fees, which are due prior to DSD issuing a building permit¹. If fees are not paid and the services are not requested by the customer, the account remains in a “created” status in IOS. In the past, a customer may discontinue a project without notifying the City, which has resulted in a large number of accounts in IOS with no activity. DSD assumes there are no fees due for accounts that are in the “created” status. We tested these accounts to determine if there were any outstanding fees owed to the City.

The second system used to monitor permit status is DSD’s Project Tracking System (PTS), which was designed to track all phases of a building project. Each project may contain multiple permits, so each permit is assigned an approval number in PTS to track individual permits. When an IOS account is created, it is linked to the associated permit in PTS by manually inputting the approval number. On a nightly basis, the status of permits in PTS is transmitted to IOS based on these approval numbers. For example, if a permit is completed in PTS, the status of “complete” will be recorded in IOS the following day. Public Utilities staff monitors IOS reports to identify accounts with completed permits and unpaid fees based on this status.

Audit Objective, Scope, and Methodology

The objective of our audit was to analyze Public Utilities data to determine if water and sewer fees were properly collected. Public Utilities provided a data set of 1,043 unpaid IOS accounts. The IOS status indicated no permits had been issued on these accounts as of June 30, 2009. These accounts were created between September 25, 2003 and June 30, 2009.

To achieve our objective, we performed both statistical and judgmental sampling of this data set. Initially, we identified the status of these accounts at June 30, 2010 and stratified the data into two subsets; 654 accounts with no changes between June 30, 2009 and 2010 and 389 accounts with changes in the status. We then randomly selected a statistical sample of 40 from the 654 accounts without changes utilizing dollar unit sampling². An additional 190 were selected from the 389 accounts for testing based on a judgmental sample.

¹ SDMC 112.0202 states that an application for a permit may be deemed complete and may be processed only after the fees have been paid in full.

² The dollar unit sampling method is a method used to select a sample from the dollars in the population and project errors in the sample to the population as a whole. 46 dollar amounts were statistically selected for testing. This resulted in a test of 40 accounts because one account may represent multiple dollars in the sample.

We took the following steps to test the accounts:

- identified accounts with fees collected in fiscal year 2010;
- updated the June 30, 2009 file of accounts with current PTS and IOS status;
- selected statistical and judgmental samples of accounts for testing based the account codes;
- reviewed the current account information in Public Utilities' Installation Order System (IOS), and, as necessary, verified project status in DSD's Project Tracking System (PTS).

We conducted our review in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We limited our work to those areas specified in the "Audit Objective, Scope, and Methodology" section of this report.

Audit Results

Based on our audit testing, we found no fees owed in the 40 accounts selected for statistical sampling and testing. While statistical sampling does not provide absolute assurance, we found that our testing revealed with 90 percent confidence (+/-5) that the population of accounts did not contain significant fees owed to the City. However, our judgmental sampling of 190 accounts found 14 accounts for completed permits that had uncollected water and sewer fees due totaling \$28,042 based on the information in IOS and PTS. In 10 instances, DSD staff had not issued the invoices to the customers. All fees are required to be paid prior to issuance of a building permit. In all instances, the unpaid fees were for capacity fees. Capacity fees are one time fees paid for new connections or increased water usage caused by additions to structures. Table 1 below shows these accounts. We provided the list of accounts to DSD staff, and they confirmed the amounts were owed to the City.

Table 1 – Accounts with Unpaid Capacity Fees

No.	NSSQ Date	NSSQ #	PTS #	Building Permit Status	Unpaid Capacity Fees	Invoice Issued Yes or No
1	12/04/2003	118832	24093	Completed	\$ 2,151.00	No
2	12/15/2003	118953	25137	Completed	1,075.65	No
3	02/23/2004	119730	30953	Completed	3,944.05	No
4	05/17/2004	121119	35390	Completed	2,509.85	No
5	08/12/2004	122283	47420	Completed	358.55	Yes
6	08/30/2004	122509	49890	Completed	1,689.25	No
7	02/15/2005	124121	60198	Completed	6,633.18	No
8	04/05/2005	124651	65694	Completed	1,075.65	No
9	11/02/2005	127058	86727	Completed	2,868.40	No
10	04/05/2007	132263	127570	Issued [1]	2,868.40	No
11	04/11/2007	132305	126816	Completed	717.10	No
12	09/04/2008	136268	164691	[2]	717.00	Yes
13	09/16/2008	136341	165366	[2]	717.00	Yes
14	09/18/2008	136392	165384	[2]	717.10	Yes
Total					\$ 28,042.18	

Source: Based on OCA tests of data provided by Public Utilities.

[1] Completed final structural inspection 3/17/08.

[2] The building permit is in a Created status, no fees due. The plumbing permits were issued without collecting fees. The water and sewer fees pertain to the plumbing permit.

We found that DSD's controls associated with the collection of water and sewer fees were not adequate to ensure the timely collection of the capacity fees owed for the accounts listed in Table 1. These two internal controls and why they were not effective for the collection of these capacity fees are described below.

- One control is that fees must be paid in advance of work being performed. The system, IOS, is programmed to prevent a work order from being sent to Public Utilities crews if an account is not paid.

However, this control is not effective when capacity fees are assessed for increased water usage but Public Utilities does not perform work. Capacity fees are one time fees paid for new connections or increased water usage caused by additions to structures. DSD invoices the customer based on plans submitted when a structure is going to be expanded. For example, a customer may add a bathroom which does not require an increased meter size (no work is performed) but may increase water usage resulting in a capacity fee being assessed. DSD is supposed to assess, track, and collect capacity fees based on regulations established by Public Utilities. The 14 accounts with uncollected fees were all for water and/or sewer capacity fees that did not require any work to be performed by Public Utilities.

- The second control identified is that Public Utilities staff reviews reports to identify unpaid IOS accounts. Public Utilities staff receives reports on permitting activity based on account codes, which they review to identify discrepancies. However, accounts with incorrect status codes may be excluded from these reports. In all but three instances, manual data entry errors by DSD resulted in incorrect status codes which led to unpaid IOS accounts being reported to Public Utilities as having no activity when permits had been recorded as completed in DSD's Project Tracking System. Had the accounts been correctly coded, Public Utilities may have identified monies owed.

Additionally, we found that the procedures to record, track, and monitor capacity credits are not well documented. To verify the accuracy of the fees collected during our testing, we recalculated some water and sewer capacity credits, which offset fees due. Credits are recorded when fixtures are removed by the customer. For instance, a developer may demolish a building which previously had paid capacity fees. The credits then offset capacity fees when a structure is added to the property in the future because capacity fees are one time payments. Credits amounts vary but may involve significant amounts. For example, credits exceeding \$1.6 million were issued on one account. The lack of documented procedures for capacity credits increases the risk of errors and potential misappropriation of assets.

In our previous audit report, we recommended that DSD should revise and document their collection processes to ensure that building permits and certificates of occupancy are not being issued to customers prior to full payment of all development fees including water fees. When implementing the prior recommendations, management should ensure the documentation of processes includes DSD's administration of water capacity fees and credits.

Recommendations:

1. The Development Services Department should notify customers of the fees due and take appropriate actions to resolve these unpaid accounts. (Priority 2)
2. The Public Utilities Department in conjunction with the Development Services Department should examine and document the controls over the assessment, recording, collection and monitoring of water and sewer capacity fees, including credits issued in lieu of capacity fees. Design processes in SAP to automate and facilitate the assessment, tracking and monitoring of capacity credits. (Priority 3)

Conclusion

Our previous audit report, issued June 22, 2010, determined that internal controls need to be improved to ensure all water and sewer fees are collected timely. Our subsequent testing showed the controls that were in place did not ensure the timely invoicing and collection of all water and sewer capacity fees owed to the City. The lack of controls has resulted in uncollected capacity fees of \$28,042 in addition to the \$171,342 of uncollected fees previously reported in the June 2010 audit report.

Respectfully Submitted,



Eduardo Luna

City Auditor

cc: Honorable Mayor Jerry Sanders
Honorable City Council Members
Honorable Audit Committee Members
Jay M. Goldstone, Chief Operating Officer
Mary Lewis, Chief Financial Officer
Jan Goldsmith, City Attorney
Andrea Tevlin, Independent Budget Analyst

Appendix A – Definitions of Priority 1, 2, and 3 Audit Recommendations

The Office of the City Auditor maintains a classification scheme applicable to audit recommendations and the appropriate corrective actions as follows:

Priority Class³	Description⁴	Implementation Action⁵
1	Fraud or serious violations are being committed, significant fiscal or equivalent non-fiscal losses are occurring.	Immediate
2	A potential for incurring significant or equivalent fiscal and/or non-fiscal losses exist.	Six months
3	Operation or administrative process will be improved.	Six months to one year

³ The City Auditor is responsible for assigning audit recommendation priority class numbers. A recommendation which clearly fits the description for more than one priority class shall be assigned the higher number.

⁴ For an audit recommendation to be considered related to a significant fiscal loss, it will usually be necessary for an actual loss of \$50,000 or more to be involved or for a potential loss (including unrealized revenue increases) of \$100,000 to be involved. Equivalent non-fiscal losses would include, but not be limited to, omission or commission of acts by or on behalf of the City which would be likely to expose the City to adverse criticism in the eyes of its residents.

⁵ The implementation time frame indicated for each priority class is intended as a guideline for establishing implementation target dates. While prioritizing recommendations is the responsibility of the City Auditor, determining implementation dates is the responsibility of the City Administration.



CITY OF SAN DIEGO

MEMORANDUM

DATE: February 11, 2011

TO: Eduardo Lora, City Auditor

FROM: Kelly Brubaker, Development Services Department Director
Rogee Briley, Public Utilities Department Director

SUBJECT: Response to the Follow-up Audit of the Development Services Department Water and Sewer Fees (05 Fees) Collection Process

The Development Services Department (DSD) and Public Utilities Department (Utilities) have reviewed the follow-up audit to the Joint Water and Sewer Fee Collection Audit.

As a result of the audit, the City was advised that the audit report issued to the City was dated 11/11/10. The first paragraph in the report stated that all of the errors were corrected prior to the time the original audit began, this was in a \$178,888 in overpayments that had been added to the City's 12/1/10 and 12/1/10 audit. The error was identified in prior years.

For this follow-up audit, the additional uncollected fees (\$18,042) identified also occurred during a period of time (1/10/10) - 09/11/1008) prior to the changes implemented by DSD in conjunction with Utilities Department staff. DSD and Utilities staff continue to monitor the current DSD system and feel that the corrections have been identified and added problems identified by both the original and this follow-up audit.

Response to the recommendations of this follow-up audit are described below:

Recommendation #1:

The Development Services Department should notify customers of the fees due and late appropriate actions to resolve these uncollected accounts. (Priority 2)

A DSD audit was implemented. Customers have already been notified of the

and the DSD will follow the established process to resolve accounts in

collaboration with the City Auditor.

Department Responses

Water and Sewer Permit Fees (IOS) Collection Process Follow-up Audit
February 25, 2011

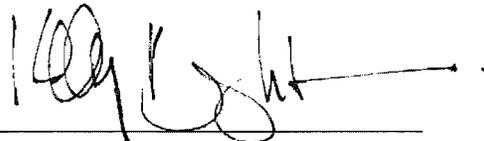
Recommendation #2:

The Public Utilities Department in conjunction with the Development Services Department should examine and document the controls over the assessment, recording, collection and monitoring of water and sewer capacity fees, including credits issued in lieu of capacity fees. Design processes in SAP to automate and facilitate the assessment, tracking and monitoring of capacity credits. (Priority 3)

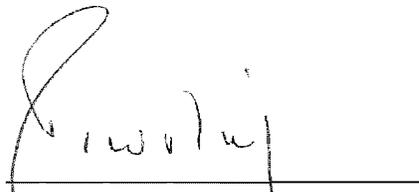
Response: Agree with recommendation. The Public Utilities Customer Care Solutions Utility Billing (CCS) project, formerly referred to as CIS/IOS Replacement project, includes the replacement of the IOS system and functionally. Key objectives of this project include focusing on efficiency through maximizing opportunities for automation and controls over assessment, recording, collection and monitoring of water capacity fees including credits.

Relevant Development Services staff members are working with Utilities staff on this project implementation scheduled for completion September 2011.

Respectfully Submitted:



Kelly Broughton, Director
Development Services Department



Roger Bailey, Director
Public Utilities Department

cc: Jay Goldstone, Chief Operating Officer
Wally Hill, Assistant Chief Operating Officer