

AUDIT TEAM

Matt Weller, CPA, City Auditor

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GO BOND FUND RESTRICTIONS AUDIT

APRIL 30, 2024

MAYOR AND CITY COUNCIL

<i>David Holt</i>	<i>Mayor</i>
<i>Bradley Carter</i>	<i>Audit Committee, Ward 1</i>
<i>James Cooper</i>	<i>Ward 2</i>
<i>Barbara Peck</i>	<i>Audit Committee, Ward 3</i>
<i>Todd Stone</i>	<i>Audit Committee, Ward 4</i>
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<i>JoBeth Hamon</i>	<i>Ward 6</i>
<i>Nikki Nice</i>	<i>Ward 7</i>
<i>Mark K. Stonecipher</i>	<i>Ward 8</i>



April 30, 2024

The Mayor and City Council:

The Office of the City Auditor has completed an audit assessing the adequacy and effectiveness of controls ensuring proceeds from General Obligation (GO) Bonds authorized in 2017 and sold through December 31, 2022, were allocated and expended in compliance with significant legal and internal policy restrictions.

Based on the results of our audit, we believe that controls were reasonably adequate and effective to ensure GO Bond proceeds examined were allocated and expended in compliance with significant legal and internal policy restrictions; except for controls ensuring internal administrative charges paid from GO Bond proceeds are adequately supported.

Summarized recommendations discussed in more detail in the attached report are as follows:

- Administrative cost reimbursement percentages currently used should be reviewed for validity, all supporting calculations should be documented and retained, and a method for periodically reviewing validity should be developed. See Recommendations 1a and 1b.
- Earnings on invested GO Bond proceeds should be allocated to the correct accounts and the timing should be based on a consistently applied total dollar threshold determined based on typical GO Bond project funding needs and timelines. See Recommendation 2a and 3.
- Proceeds from sales of GO Bond-funded assets should be fully identified and transferred to the GO Bond fund. See Recommendations 4.
- The validity and accuracy of GO Bond issuance costs deducted from GO Bond sale proceeds should be verified. See Recommendation 6.

The content and emphasis of items included in this report have been discussed with appropriate management representatives to assure a complete understanding of the observations arising from our audit. Management responses are attached to this report in their entirety.

Handwritten signature of Matt Weller in black ink.

Matt Weller
City Auditor

Handwritten signature of Lori Rice in black ink.

Lori Rice
Assistant City Auditor

Handwritten signature of Randall E. Daniel in black ink.

Randall Daniel
Audit Manager

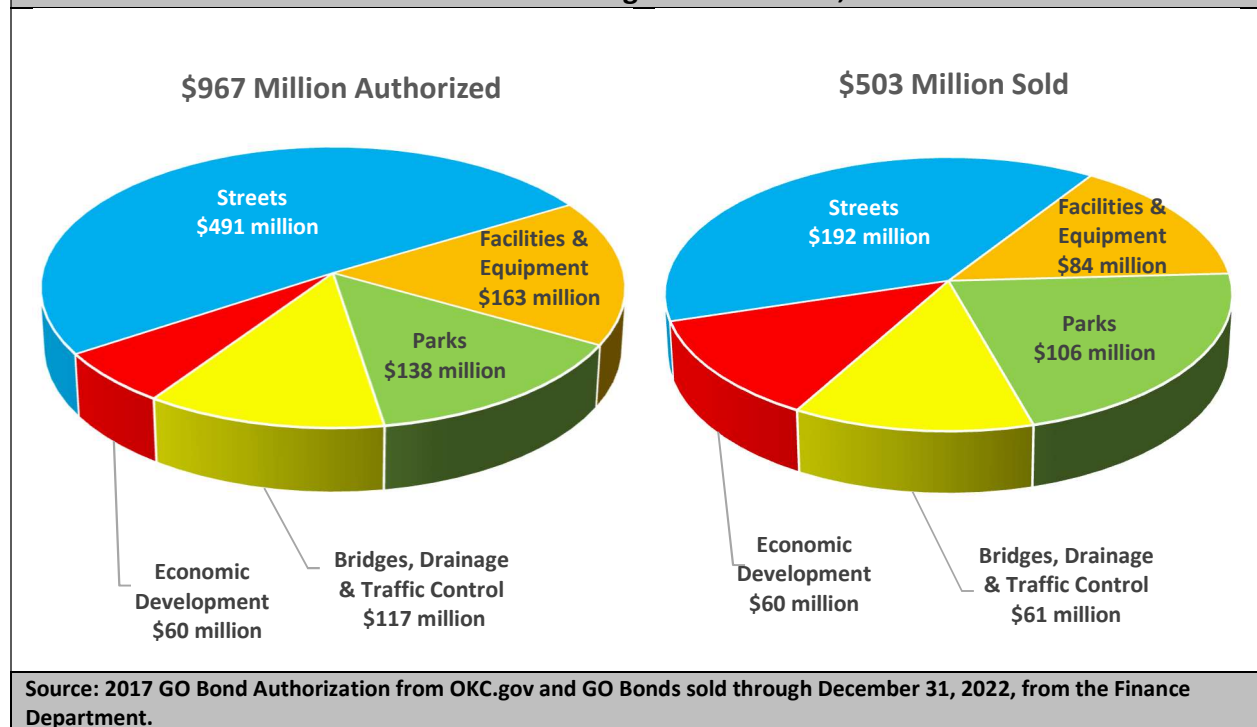
GO BOND FUND RESTRICTIONS AUDIT

AUDIT OBJECTIVE, BACKGROUND, SCOPE, AND METHODOLOGY

The objective of this audit was to assess the adequacy and effectiveness of controls ensuring allocations and expenditures of proceeds from General Obligation (GO) Bonds authorized in 2017 and sold through December 31, 2022, complied with significant legal and internal policy restrictions.

Oklahoma City residents authorized issuance of GO Bonds totaling \$967 million in 2017 and \$503 million, or just over half, had been sold from the 2017 authorization through December 31, 2022, as shown in Exhibit 1.

Exhibit 1. 2017 GO Bond Authorization Through December 31, 2022



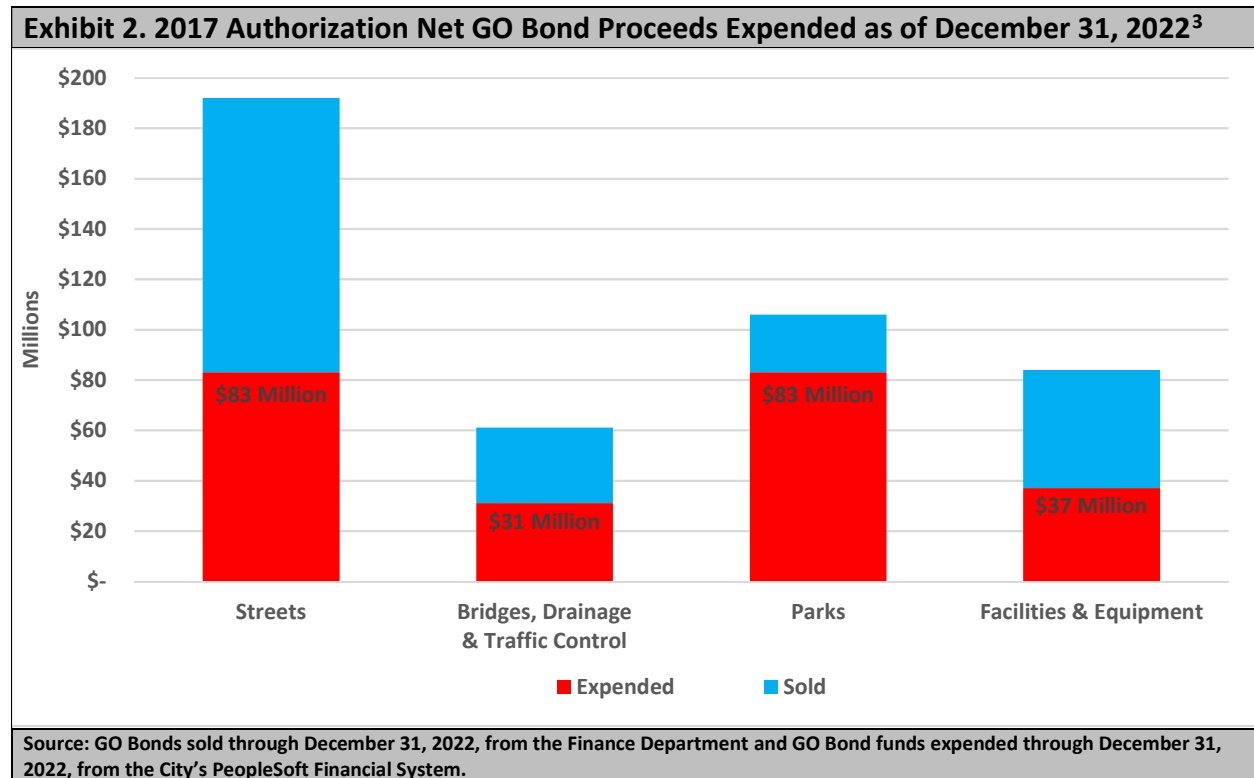
The Oklahoma Constitution, Statutes and case law govern the use of GO Bond proceeds by municipalities¹. Additionally, the Internal Revenue Code administered by the Internal Revenue Service (IRS) includes certain spending requirements that must be met for issued tax-exempt GO Bonds to remain tax-exempt². The City has developed various internal policies and procedures to ensure GO Bond funds are allocated and expended in compliance with these state and federal laws.

¹ Article X, Section 27 of the Oklahoma Constitution, and 62 O.S.571-577 of Oklahoma Statutes known as the Bond Issue Proceeds Act, governs expenditure of GO Bond proceeds by municipalities.

² 26 U.S.C. §149 (g)(3)(A) requires that 85% of spendable bond proceeds from the bond issue be spent to carry out the governmental purposes of the issue within 3 years of issuance to remain tax-exempt. Failure to maintain the tax-exempt status of bonds could result in a requirement for the City to pay bond proceed investment earnings exceeding investor earnings based on the bond interest rate to the Federal government.

The Public Works Department (Public Works) is responsible for managing the GO Bond program including project design and construction. The Finance Department (Finance) is responsible for overall financial management of the GO Bond program and managing projects funded by economic development bonds. GO Bond program financial management includes administering bond sales, managing overall debt, investing unspent proceeds, allocating earned interest, ensuring budgetary and administrative policy compliance, processing bond fund expenditures, and accounting for all bond fund activities.

Approximately \$234 million of \$442 million in net proceeds from GO Bonds sold from the 2017 authorization, excluding those sold for economic development, had been expended as of December 31, 2022, as shown by general project type in Exhibit 2 below³.



Procedures performed during this audit included interviews with staff in Finance, Public Works, Parks, Fire, Police, and the Municipal Counselor's Office; review of relevant sections of the State Constitution, State Statutes, Internal Revenue Code, and related internal policies and procedures; examination of GO Bond fund allocations and expenditures, allocations of interest earned on unspent GO Bond funds, and accounting for proceeds from sold assets purchased or constructed with GO Bond funds; and assessment of procedures for allocating internal project-related administrative costs and complying with IRS spending requirements.

³ The net proceeds amount excludes proceeds from GO Bonds sold for economic development totaling \$60 million and approximately \$1.5 million in bond issuance costs. Economic development GO Bond sale proceeds are transferred to the Oklahoma City Economic Development Trust (OCEDT) upon receipt. While those proceeds are accounted for separately as restricted funds in OCEDT, the proceeds and related expenditures are not accounted for by bond sale. Therefore, economic development GO Bond sale proceeds from the 2017 GO Bond authorization expended as of December 31, 2022, are not specifically quantifiable.

We did not audit the adequacy and effectiveness of controls ensuring sales of GO Bonds, overall City debt management or investments of GO Bond proceeds complied with significant legal and internal policy restrictions.

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

The following section of this report includes recommendations intended to provide constructive suggestions for improving controls ensuring GO Bond proceed allocations and expenditures comply with significant legal and internal policy restrictions. Each recommendation included in this report is immediately followed by *management's response*, which is also attached to this report in its entirety.

RESULTS OF WORK PERFORMED

The results of our audit indicate that controls were reasonably adequate and effective to ensure allocations and expenditures of GO Bond proceeds examined complied with significant legal and internal policy restrictions; except for controls ensuring internal administrative charges paid from GO Bond funds are adequately supported.

GO Bond Project Administrative Cost Charges

The City incurs personnel costs relating to employee time spent administering the completion of GO Bond projects. The original funding sources for the personnel costs (e.g., General Fund) are reimbursed for these administrative costs using GO Bond proceeds.

While calculations of administrative cost reimbursements by Public Works were based on the actual cost of direct time spent by employees on GO Bond projects until 2019, administrative cost reimbursements for economic development projects administered by Finance continue to be based on the actual cost of estimated direct time spent by employees on the projects.

Public Works changed the methodology for calculating administrative cost reimbursements from GO Bond proceeds in 2019 to alleviate the administrative burden of tracking direct time spent by employees on bond projects. Administrative cost amounts to be reimbursed from GO Bond proceeds are currently calculated as a varying percentage, depending on project type (e.g., streets, parks, facilities, etc.), of total project costs. The administrative cost percentages used in these calculations were reportedly developed by calculating the ratio of historical administrative cost reimbursements to total historical project costs by general project type.

Comment 1

The percentages used by Public Works to calculate administrative cost reimbursements from GO Bond proceeds are not supported and are not periodically reviewed for validity. Historical administrative cost reimbursements and total project costs by project type used to determine percentages for calculating future reimbursements were not retained after development in 2019. Further, a method for periodically determining if the administrative cost percentages used continue to reasonably represent the actual cost of personnel time spent on completing GO Bond projects has not been developed.

State Constitution and Statutes require proceeds of bond issues approved by State residents be expended only for the purposes or projects for which the bond issue was approved⁴. Additionally, spending requirements for maintaining the tax-exempt status of issued bonds administered by the IRS also require bond proceeds to be spent on the governmental purposes of the bond issue.

Administrative costs reimbursed by Public Works from proceeds of GO Bonds authorized in 2017 and issued through December 31, 2022, totaled approximately \$10.4 million. Expending GO Bond proceeds for administrative costs without a reasonably verifiable relationship to the purposes or projects for which the bonds were issued increases the risk of noncompliance with governing State statutes and Internal Revenue Code spending requirements.

Recommendation 1a

Public Works should review the percentages currently used to calculate administrative cost reimbursements from GO Bond proceeds for reasonable representation of the actual cost of personnel time spent on bond project completion. Any inaccurate percentages found should be revised and calculations supporting all percentages used should be documented and retained.

Public Works Response 1a

Agree with recommendation. The department will review GO Bond Administrative Charge percentages in the coming year; keep back up documentation on file; develop a simple methodology for periodic reviews and document the process in the GO Bond policies and procedures; and revise inaccurate percentages, if any. Changes or updates to methodology or percentages would be reviewed and approved by bond counsel. (Target completion: June 30, 2025.)

⁴ Article X, Section 16 of Oklahoma Constitution states that borrowed money shall be used for no other purpose than what it was authorized for, and 62 O.S. §572 states that the purpose of the Bond Issue Proceeds Act is to guarantee to the citizens of the State of Oklahoma that the proceeds of bond issues approved by them will be expended only for the purposes or projects for which any such bond issue was approved.

Recommendation 1b

Public Works should develop a methodology for periodically reviewing percentages used to calculate administrative cost reimbursements for reasonable representation of the actual cost of personnel time spent on bond project completion. The methodology developed should be approved by bond counsel and documented in GO Bond policies and procedures.

Public Works Response 1b

Agree with recommendation. The department will review GO Bond Administrative Charge percentages in the coming year; keep back up documentation on file; develop a simple methodology for periodic reviews and document the process in the GO Bond policies and procedures; and revise inaccurate percentages, if any. Changes or updates to methodology or percentages would be reviewed and approved by bond counsel. (Target completion: June 30, 2025.)

GO Bond Proceed Investment Earning Allocations

The proceeds from each annual sale of GO Bonds are accounted for separately and allocated to each project specifically listed (listed project) in the GO Bond ballot proposition (proposition)⁵. Sale proceeds allocated to fund projects not specifically listed in propositions (unlisted funds) are also accounted for separately until those funds are allocated to specific projects⁶.

Proceeds from each annual GO Bond sale are deposited upon receipt by Finance into separate bank accounts and held until needed for expenditures. Investment earnings on the deposited funds accumulate in the bank accounts monthly. Finance reviews investment earnings quarterly and has an informal policy of allocating and posting the earnings between propositions funded by each bond sale when total accumulated earnings reach \$1 million. Earnings are allocated in proportion to the remaining unspent balance for each proposition funded by the bond sale. Investment earnings are treated like unlisted funds after allocation.

Comment 2

Investment earnings on proceeds from GO Bonds sales in 2018 and 2019 were not correctly allocated. The 2018 and 2019 sales both included GO Bonds separately authorized in 2017 and 2007. The proceeds from each sale were deposited into separate individual bank accounts. However, the resulting investment earnings were allocated entirely to propositions relating to the sold bonds authorized in 2007 and no earnings were allocated to propositions related to the 2017 authorization.

⁵ Each sale of economic development bonds is not accounted for separately as discussed in footnote 3.

⁶ Each GO Bond ballot proposition includes an amount of funds known as unlisted funds that can be used for any project within the general purpose (streets, bridges, etc.) of the proposition.

Allocated investment earnings, like unlisted funds, are used to fund cost overruns on listed projects in addition to funding other unlisted projects since the funds are only restricted to use for the general purpose of the proposition. Finance does not currently have a procedure to ensure investment earnings on proceeds from sales of GO bonds authorized at different times but deposited in the same bank account are allocated to the correct propositions.

Finance estimates that, to date, \$3.7 million in investment earnings relating to proceeds from bonds authorized in 2017 were incorrectly allocated to propositions for bond sales authorized in 2007 and subsequently spent for the most part⁷. The risk of needing to identify alternative funding sources to complete listed projects is increased when investment earnings are not allocated to the correct propositions and available to fund cost overruns.

Recommendation 2a

Finance should develop a procedure for allocating investment earnings to the correct propositions when the proceeds from a bond sale are from bonds authorized at different times but are deposited into a single bank account. The developed procedure should be documented in GO Bond policies and procedures and followed consistently.

Finance Response 2a

Agree. Accounting Services has an existing monthly process for distributing pooled interest. This process will be modified to incorporate interest distribution to the appropriate proposition by July 1, 2024. The next GO Bond Administrative Procedures revision will be completed by December 31, 2024, and will include this policy.

Recommendation 2b

Finance should work with Public Works to determine if remaining incorrectly allocated investment earnings are needed to fund listed projects included in the 2017 GO Bond authorization. If deemed necessary, those remaining funds should be transferred to the appropriate propositions relating to issued bonds authorized in 2017.

Finance Response 2b

Agree. Finance will work with Public Works to determine whether the transfer of the remaining funds is appropriate. This will be completed by July 1, 2024.

Comment 3

The investment allocation policy is not documented and the informal policy of allocating investment earnings when earnings total \$1 million is not being followed consistently. A

⁷ Remaining unencumbered investment earnings allocated to accounts for the 2007 GO Bond authorization totaled \$315,251.43 as of February 15, 2024.

twelve-month period in which related investment earnings accumulated to a total of \$3 million before being allocated was identified during the audit.

The risk of needing to identify alternative funding sources to complete listed GO Bond projects is increased without a documented allocation policy ensuring investment earnings are allocated timely enough to be available to fund cost overruns.

Recommendation 3

Finance should work with Public Works to determine a reasonable dollar amount threshold for allocating investment earnings based on typical GO Bond project funding needs and timelines. The allocation policy and agreed upon threshold should be documented in GO Bond policies and procedures and followed consistently.

Finance Response 3

Agree. Finance will work with Public Works to develop a formal investment earnings allocation policy containing an agreed-upon threshold for allocating investment earnings. This policy will be documented and implemented by July 1, 2024. We will ensure consistent adherence to this policy and procedures as we advance. The next GO Bond Administrative Procedures revision will be completed by December 31, 2024, and will include this policy.

GO Bond-Funded Asset Sale Proceeds

The Oklahoma Supreme Court ruled in 1932 that Oklahoma Constitution restrictions on the use of voter-approved borrowed funds should also apply to the proceeds from the sale of property purchased with voter-approved borrowed funds⁸. Proceeds from sales of assets purchased with GO Bond funds were not consistently recorded as restricted GO Bond funds until the middle of calendar year 2021. Proceeds from previous sales were recorded in restricted Special Purpose funds⁹.

Comment 4

Proceeds from sales of GO Bond-funded assets not recorded as restricted GO Bond funds have not been fully identified and transferred. Proceeds totaling approximately \$686,000 from the sale of four assets funded by GO Bonds were identified during the audit in a Special Purpose fund containing approximately \$1.7 million. It is possible that this Special Purpose fund and others may contain other proceeds from such sales that have not been identified.

⁸ In 1932 OK 711, 160 Okla 3, 15P.2d 995, the Supreme Court of Oklahoma rules with respect to Constitutional restrictions on the use of borrowed money that the provisions of sections 16 and 27 of article 10 of the Oklahoma Constitution are applicable to not only the immediate use of the money borrowed, but to any subsequent use thereof. These restrictions also apply to the proceeds of the sale of property purchased with the money borrowed.

⁹ Special Purpose funds are used to account for funds restricted for specific purposes other than GO Bond projects.

Though the use of Special Purpose funds is restricted for specific purposes, those purposes may not align with the intent of the original GO Bond proposition that funded the asset purchase. The risk of GO Bond-funded asset sale proceeds being used for a purpose other than what was originally approved is increased if those proceeds are not recorded as restricted GO Bond funds.

Recommendation 4

Finance should identify proceeds from sales of GO Bond-funded assets recorded in Special Purpose funds and transfer those proceeds to the appropriate restricted accounts in the GO Bond fund.

Finance Response 4

Agree. Finance will endeavor to identify all GO Bond-funded asset sales recorded in the Special Purpose fund and transfer them to the GO Bond fund by December 31, 2024.

Comment 5

Department staff with GO Bond-related responsibilities were not aware of where proceeds from certain GO Bond-funded asset sales were recorded. Staff with GO Bond-related responsibilities interviewed in Public Works, Fire, and Police were not aware of where the proceeds from certain sales of GO Bond-funded assets were recorded or of the availability of those proceeds. Proceeds from such sales are not currently addressed in GO Bond policies and procedures.

GO Bond policies and procedures should be complete and fully communicated to staff with GO Bond-related responsibilities. The risk of noncompliance with GO Bond policies and procedures ensuring compliance with applicable laws and regulations is increased when those policies and procedures are incomplete or are not fully communicated.

Recommendation 5

Finance should include procedures for recording proceeds from sales of GO Bond-funded assets in GO Bond policies and procedures. Those policies and procedures should be distributed to all staff with GO Bond-related responsibilities and should include enough guidance to ensure such proceeds available can be located and restrictions on how the proceeds may be used are clear.

Finance Response 5

Agree. Finance has preexisting guidelines governing the use and recording of proceeds from the sale of assets funded by GO Bonds. Finance is revising these guidelines to be incorporated into the next GO Bond Administrative Procedures update, which will be completed by December 31, 2024. Finance will provide training to all parties involved in the process, including pre-sale activities, proper sale documentation, and how sale proceeds are to be recorded and utilized.

GO Bond Issuance Cost Verification

Costs for advisory, legal, credit rating, printing, and other miscellaneous services related to GO Bond issuances (bond issuance costs) are paid to the service provider by the bond paying agent bank (paying agent) and deducted from the GO Bond proceeds received by the City.

Comment 6

GO Bond issuance costs deducted from GO Bond sale proceeds are not verified for validity and accuracy. Issuance costs totaling \$1.765 million were deducted by the paying agent from GO Bond sale proceeds totaling approximately \$503 million for GO Bonds authorized in 2017 and issued through December 31, 2022. The validity and accuracy of issuance costs totaling \$340,000 relating to the 2022 GO Bond sale were verified during the audit.

All public fund expenditures should be supported by documentation allowing for an assessment of the necessity and validity of the provided services and the accuracy of the associated charges. The risk of unnecessary, excessive, or inaccurate charges going undetected is increased without a process in place for reviewing the validity and accuracy of those charges.

Recommendation 6

Finance should obtain documentation supporting bond issuance costs paid by the paying agent and review those costs for validity and accuracy. Procedures for performing this review should be documented in GO Bond policies and procedures.

Finance Response 6

Agree. Beginning in fiscal year 2023, Finance started to formally review and document bond issuance costs that were withheld from the bond proceeds and distributed by the paying agent as ordered in the official closing memorandum for each bond sale. The next GO Bond Administrative Procedures revision will be completed by December 31, 2024, and will include this policy.

ATTACHMENT A
MANAGEMENT RESPONSES



MEMORANDUM

The City of
OKLAHOMA CITY



TO: Matt Weller, City Auditor

THROUGH: Craig Freeman, City Manager

FROM: Debbie Miller, P.E., Director
Public Works / City Engineer

DATE: April 18, 2024

SUBJECT: Audit 23-02 Citywide GO Bond Fund Restrictions – Public Works Response

The following is management's response to recommendations outlined in the recent G.O. Bond Audit:

- I. Public Works Response 1a - Agree with recommendation. The department will review GO Bond Administrative Charge percentages in the coming year; keep back up documentation on file; develop a simple methodology for periodic reviews and document the process in the GO Bond policies and procedures; and revise inaccurate percentages, if any. Changes or updates to methodology or percentages would be reviewed and approved by bond counsel. (Target completion: June 30, 2025.)
- II. Public Works Response 1b - Agree with recommendation. The department will review GO Bond Administrative Charge percentages in the coming year; keep back up documentation on file; develop a simple methodology for periodic reviews and document the process in the GO Bond policies and procedures; and revise inaccurate percentages, if any. Changes or updates to methodology or percentages would be reviewed and approved by bond counsel. (Target completion: June 30, 2025.)

Thank you for your review of this program.

pc: Laura Johnson, Assistant City Manager
Billy Little, CPA, Public Works Business Manager



MEMORANDUM

The City of
OKLAHOMA CITY



TO: Matt Weller, City Auditor

THROUGH: Craig Freeman, City Manager *CF*

FROM: Brent Bryant, Chief Financial Officer *BWB*

DATE: April 18, 2024

SUBJECT: 23-02 Finance Department, Citywide General Obligation Bond Fund Restrictions Audit

Finance Response 2a - Agree. Accounting Services has an existing monthly process for distributing pooled interest. This process will be modified to incorporate interest distribution to the appropriate proposition by July 1, 2024. The next GO Bond Administrative Procedures revision will be completed by December 31, 2024, and will include this policy.

Finance Response 2b - Agree. Finance will work with Public Works to determine whether the transfer of the remaining funds is appropriate. This will be completed by July 1, 2024.

Finance Response 3 - Agree. Finance will work with Public Works to develop a formal investment earnings allocation policy containing an agreed-upon threshold for allocating investment earnings. This policy will be documented and implemented by July 1, 2024. We will ensure consistent adherence to this policy and procedures as we advance. The next GO Bond Administrative Procedures revision will be completed by December 31, 2024, and will include this policy.

Finance Response 4 - Agree. Finance will endeavor to identify all GO Bond-funded asset sales recorded in the Special Purpose fund and transfer them to the GO Bond fund by December 31, 2024.

Finance Response 5 - Agree. Finance has preexisting guidelines governing the use and recording of proceeds from the sale of assets funded by GO Bonds. Finance is revising these guidelines to be incorporated into the next GO Bond Administrative Procedures update, which will be completed by December 31, 2024. Finance will provide training to

all parties involved in the process, including pre-sale activities, proper sale documentation, and how sale proceeds are to be recorded and utilized.

Finance Response 6 - Agree. Beginning in fiscal year 2023, Finance started to formally review and document bond issuance costs that were withheld from the bond proceeds and distributed by the paying agent as ordered in the official closing memorandum for each bond sale. The next GO Bond Administrative Procedures revision will be completed by December 31, 2024, and will include this policy.