CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Office of the City Auditor

Report to the City Council
City of San José

AUDIT OF THE PARK TRUST FUND

The Department of Parks, Recreation and Neighborhood Services Has Improved Administration of the Park Trust Fund and Can Further Strengthen Its Policies and Procedures

Report 09-07
September 2009

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Office of the City Auditor
Sharon W. Erickson, City Auditor

September 10, 2009

Honorable Mayor and Members
of the City Council
200 East Santa Clara Street
San Jose, CA 95113

Transmitted herewith is the report *Audit of the Park Trust Fund.* This report is in accordance with City Charter Section 805. An Executive Summary is presented on the blue pages in the front of this report. The City Administration's response is shown on the yellow pages before Appendix A.

This report will be presented at the September 17, 2009 meeting of the *Public Safety, Finance & Strategic Support Committee*. If you need any additional information, please let me know. The City Auditor's staff members who participated in the preparation of this report are Steve Hendrickson, Chris Constantin and Avichai Yotam.

Respectfully submitted,

Sharon W. Erickson
City Auditor

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Office of the City Auditor

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AUDIT OF THE PARK TRUST FUND

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Executive Summary

In accordance with the City Auditor's 2009-10 Workplan, we performed an audit of the draft policies and procedures for the administration of the Park Trust Fund (Fund). We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives. We limited our work to those areas specified in the Objectives, Scope, and Methodology section of this report.

The City Auditor's Office thanks the management and staff of the City Manager's Office, the Department of Parks, Recreation, and Neighborhood Services (PRNS), and the City Attorney's Office for their cooperation during the audit process.

Finding I The Department of Parks, Recreation and Neighborhood Services Has Improved Administration of the Park Trust Fund and Can Further Strengthen Its Policies and Procedures

In 2006, the Department of Parks, Recreation and Neighborhood Services (PRNS) conducted an administrative review of the Park Trust Fund (Fund). PRNS identified $766,000 of in-lieu fees and accrued interest that fell through administrative cracks in the management of the Fund. As a result, PRNS returned fees and accrued interest to property owners where possible and made changes to its administration of the Fund, including drafting policies and procedures to address the deficiencies it had found. Although PRNS has improved its administration of the Fund, we identified areas where it can further strengthen the administrative process. Specifically, we found that PRNS:

- Can improve the processes for assessing a Park Trust Fund administrative fee and allocating accrued interest;
- Can improve its project commitment process by documenting key project elements and formal commitments;
- Should attempt to collect interest on the Redevelopment Agency's unpaid park fees;
- Should provide all required annual financial information in a single public report for projects requiring the payment of developer fees;

- Can reduce the risk of uncommitted projects reaching the five-year limit by implementing a notification system; and
- Can make other improvements to the policies and procedures manual, including finalizing the manual, updating several policies, and defining undocumented practices.

Our report includes 14 recommendations to improve aspects of PRNS policies and procedures and strengthen controls. These recommendations may result in the additional collection of approximately $1.65 million in interest for housing developments whose in-lieu fees are due from the Redevelopment Agency.

RECOMMENDATIONS

We recommend PRNS:

Recommendation #1 — **Formalize an administrative fee assessment policy which better aligns when fees are assessed with project activity. (Priority 3)**

Recommendation #2 — **Update the final Policies and Procedures Manual to include criteria for justifiable administration costs, and describe the process for defining and reporting administration costs to the City Council. (Priority 3)**

Recommendation #3 — **Formalize an accrued interest allocation policy which allocates accrued interest to projects on a monthly rather than quarterly basis, accounts for the timing of in-lieu fee deposits, and documents accrued interest allocations in the City's Financial Management System. (Priority 3)**

Recommendation #4 — **Develop and maintain numerically-sequenced memoranda of commitments and amendments for each Park Trust Fund project documenting the following:**

- **Date of Commitment,**
- **Project Name,**
- **Purpose of project,**
- **Location of project and compliance with the nexus requirement,**
- **Amount of in-lieu fees paid by developer, and**
- **PRNS Director, or designee, signed approval of the memorandum. (Priority 3)**

We also recommend that PRNS:

Recommendation #5 **Cross-reference commitment and amendment memoranda to projects shown on internal record keeping systems. (Priority 3)**

We recommend the City Administration:

Recommendation #6 **Attempt to secure interest accrual on in-lieu fees not yet paid by the Redevelopment Agency. (Priority 3)**

Recommendation #7 **Develop and make publicly available the required annual Mitigation Fee Act report with all the required elements. (Priority 3)**

We recommend PRNS:

Recommendation #8 **Formalize and document within the Park Trust Fund Policies and Procedures Manual an internal notification system to inform the PRNS Director, or designee, when uncommitted projects reach 18, 12, and 6 months from the 5-year commitment limit. (Priority 3)**

Recommendation #9 **Finalize the Park Trust Fund Policies and Procedures Manual and document approval by the department director. (Priority 3)**

Recommendation #10 **Update the dedication and in-lieu determination procedure language to match the Municipal Code. (Priority 3)**

Recommendation #11 **Update the final Policies and Procedures Manual to include a description of the Department of Public Works fee collection process. (Priority 3)**

Recommendation #12 **Update the final Policies and Procedures Manual to include a discussion of restrictions on the use of savings from completed projects. (Priority 3)**

Recommendation #13 **Update the final Policies and Procedures Manual to define the process for calculating credits to ensure consistency across turnkey agreements. (Priority 3)**

Recommendation #14 **Update the final Policies and Procedures Manual to include justification and procedures for offering reimbursements to developers from the Park Trust Fund, and for validating expenses developers claim. (Priority 3)**

Introduction

In accordance with the City Auditor's 2009-10 Workplan, we performed an audit of the draft policies and procedures for the administration of the Park Trust Fund (Fund). We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives. We limited our work to those areas specified in the Objectives, Scope, and Methodology section of this report.

The City Auditor's Office thanks the management and staff of the City Manager's Office, the Department of Parks, Recreation, and Neighborhood Services (PRNS), and the City Attorney's Office for their cooperation during the audit process.

Background

The City of San José enacted the Parkland Dedication Ordinance in 1988 to help meet the demand for new neighborhood and community parkland generated by the development of new residential subdivisions. In 1992, the City Council adopted the Park Impact Ordinance, which is similar to the Parkland Dedication Ordinance, but applies to new non-subdivided residential projects such as apartment buildings.

The ordinances generally require developers to dedicate land for parks or pay fees in lieu of land dedication. Fees paid in lieu of land dedication are deposited into the Park Trust Fund. The fees and any accrued interest are expended for the acquisition, development, or renovation of neighborhood and community-serving park facilities, recreation facilities or park and recreation facilities on public agency property pursuant to a joint-use agreement. Under the City's *Greenprint 2000*, neighborhood improvements must be within a ¾ mile radius from the development that generated the fees or within 2 miles for community-serving facilities.

The California Quimby Act, Government Code §66477 (Quimby Act), authorizes the imposition of land dedication and/or payment of fees in lieu of land dedication (in-lieu fees) upon residential developers for the purpose of developing new or rehabilitating existing neighborhood or community park or recreational facilities to serve the subdivision. Upon accepting the land and/or fees, the City becomes responsible for developing the land or using the fees for the benefit of residents of the subdivision generating the land and/or fees. Additionally, the City must develop the park and recreational facilities in accordance to the principals and standards articulated in the adopted general or specific plan. In instances when the developer develops a park or makes improvements to existing parks, the City can credit the value of these improvements in accordance with City ordinances. The credit is provided against the payment of fees or dedication of land required under City ordinances.

For the land and fees collected, the City specifies how, when, and where it will use the land or fees, or both, to develop park or recreational facilities to serve the residents of the subdivision. Any fees collected must be committed within five years after payment of the fees or, in the case of the Parkland Dedication Ordinance, the issuance of building permits on one-half of the lots created by the subdivision, whichever occurs later. Otherwise, the City must distribute the full amount of fees to the then record owners of the subdivision. According to PRNS staff, fees are "committed" when PRNS has earmarked them for a project in a spreadsheet which PRNS staff maintains.

The California Mitigation Fee Act, Government Code §66006 (Fee Act), further requires the City to adhere to certain restrictions regarding the use of fees for public improvements collected under the Park Impact Ordinance.[1] The City must not commingle these fees with any other revenue or funding sources. Any interest accrued on these fees is to be deposited back into the Fund and used only for the purposes for which the original fees were collected. Within 180 days of the close of each fiscal year, the City must make available to the public specific information including a description and amount of fee, beginning and ending fund balances, fees collected, interest earned, and identification of the improvements funded or planned for development.

Land Dedication

The City has established a process for receiving land dedications consistent with the Quimby Act and in accordance with the Municipal Code. Generally, after a developer submits an application for a housing project, PRNS determines, in conjunction with the Department of Planning, Building, and Code Enforcement (PBCE), whether the City shall require the developer to dedicate land for parks, pay in-lieu fees, construct a new park, renovate an existing park, or a combination of these options. When a proposed project includes 50 or fewer parcels and is not a condominium project, stock cooperative or community apartment project, the City cannot require land dedication. If the City decides to require the developer to dedicate land, PRNS, PBCE, and the developer together decide the size and

[1] The Mitigation Fee Act does not apply to fees collected under the Parkland Dedication Ordinance.

location of the park in relation to the development. The City then follows its planning process, obtains Planning Commission and City Council approval, and prepares a parkland agreement to receive the dedicated land and associated grant deed.

Fee Assessment, Collection, and Commitment (Allocation)

If a project includes 50 or fewer parcels as discussed above, or if PBCE and PRNS decide to require payment of in-lieu fees for a project with more than 50 parcels, the developer may pay the in-lieu fees in full prior to the City's approval of the parcel map or final map. Alternatively, the Department of Public Works (DPW) may prepare a parkland agreement between the developer and the City which provides for payment of the in-lieu fees in full, concurrent with the issuance of the first building permit for the developer's project, but no later than one year after the City's approval of the final or parcel map. The City determines the amount of fees the developer must pay in lieu of land dedication based on a fee schedule established and annually updated by City Council resolution. Once the developer pays the required in-lieu fees, DPW deposits the money into the Fund.

The City must commit in-lieu fees to fund appropriate projects in a budget year within five years of their deposit, or in the case of the Parkland Dedication Ordinance, within five years of the issuance of building permits for one-half of the project's lots, whichever occurs later. The City commits funds as described below.

Park and Recreation Improvements

A developer may also agree to improve existing or newly dedicated parkland. Such projects, known as turnkey projects, are initiated with PRNS and PBCE and again involve the execution of a parkland agreement. According to the Quimby Act, the value of the improvements together with any equipment located thereon shall be a credit against the payment of fees or dedication of land required of the developer by City ordinance. The City's Municipal Code further defines the improvements that can earn a developer credit against its parkland dedication or park impact obligation. For instance, the Municipal Code states the City may grant credit up to the actual costs a developer incurs while undertaking public park and recreation improvements to the dedicated or existing public park and recreation facilities. Under certain conditions, a developer may also earn credit for private recreation improvements, trail dedication, and improvements to school district property and public agency property.

PRNS Project Process

According to PRNS staff, PRNS annually formulates recommendations for the expenditure of the fees in the Fund. This includes mapping locations of developments paying the fees to ensure that there is a nexus between the development and where the City plans to place a neighborhood park or recreational facility that is within ¾ of a mile, or a community-serving park or recreational facility that is within 2 miles.[2]

PRNS maintains a database of fees collected, project allocations, and proposed uses for projects funded through the Fund. Funds remain in reserves until such time as there is sufficient funding to complete a specific project. Actual appropriations are approved by the City Council as part of the annual Parks Capital Budget process.

Low- and Very-Low Income Voucher Program

Prior to 1998, housing with occupancy restricted to lower-income households was exempt from dedicating parkland or paying in-lieu fees in accordance with the Parkland Dedication Ordinance and Park Impact Ordinance. In 1998, the City suspended the exemption of new units affordable to low- and very-low income households to ensure that the park and recreation needs of lower-income residents were met. However, in lieu of paying the fees, developers of affordable housing could obtain vouchers (waivers of payment) from the San José Redevelopment Agency, thereby providing funds for parkland development without impacting affordable housing developments. In January 2006, the Low- and Very-Low Income Voucher Program ended, and the City reinstated the exemption for such units.

Park Trust Fund Condition

According to the City's Comprehensive Annual Financial Report for the year ending June 30, 2008, the Fund had a year-end balance of $88.3 million. The exhibit below shows that, although annual revenue has decreased while annual expenditures have increased, the overall fund balance and balance of uncommitted funds have grown since the start of fiscal year 2005-06.

[2] In accordance with the Greenprint 2000, the community-serving park or recreational facility should currently be within 2 miles of the development that generated the fees. However, as of August 2009, PRNS is in the process of updating the Greenprint 2000, which includes a recommendation to Council to expand the nexus to 3 miles, or within the planning area in certain limited situations. PRNS anticipates that it will present the document to Council for approval before the end of calendar year 2009.

Exhibit 1: Park Trust Fund Revenue, Expenditures, and Fund Balance

	2005-06	2006-07	2007-08
Changes to Fund Balance			
Beginning Fund Balance	$61,254,204	$76,646,819	$85,697,796
Revenue			
Fees	14,822,474	12,397,141	7,405,078
Interest	1,561,864	3,197,556	4,415,659
Total Revenue	16,384,338	15,594,697	11,820,737
Expenditures	2,574,045	6,503,720	9,170,867
Other Financing Sources (Uses)	1,582,321	(40,000)	(51,000)
Ending Fund Balance	$76,646,818	85,697,796	$88,296,666
Adjustments to Fund Balance			
Unrealized Gain/Loss on Investments	$380,392	($306,092)	($1,387,377)
Due from Redevelopment Agency	(8,111,800)	(8,111,800)	(8,111,800)
Funds Available[3]	$68,915,410	$77,279,904	$78,797,489
Planned Use of Available Funds			
Committed to Specific Projects	$59,651,907	$57,122,230	$55,947,198
Administrative Overhead	1,377,297	297,328	521,588
Other Allocations	69,262	2,477,021	1,842,869
Uncommitted Funds	7,816,944	17,383,225	20,485,834
Total	$68,915,410	$77,279,804	$78,797,489

Source: PRNS reports to the City Council on the Park Trust Fund.

Objectives, Scope, and Methodology

The objective of our audit was to review the draft policies and procedures for the administration of the Park Trust Fund. In 2006, PRNS completed an administrative review of the Fund from its inception in 1988. PRNS reconciled revenue and expenditures and identified a need to improve recordkeeping, interdepartmental coordination, and the timely disbursement of funds. PRNS drafted policies and procedures to address these issues, and recommended an audit of the proposed policies and procedures. Therefore, we reviewed the draft policies and procedures and other documents related to the administration of the Fund to identify recommendations for improvement. We focused on policies and procedures that address the deficiencies PRNS identified in the areas of reconciling revenue and expenditures, recordkeeping, interdepartmental coordination, and timely disbursement of funds.

[3] The PRNS report to the City Council on revenue, expenditures, and available funds in fiscal year 2006-07 included an immaterial mathematical discrepancy that resulted in a disparity of $100 between "Funds Available" and "Total" planned use of available funds.

Additionally, we verified that, since PRNS' administrative review in 2006, no collected fees had remained in the Fund for five years without commitment for use to acquire or improve parkland. We did not recreate PRNS' administrative review.

We also tested PRNS' reconciliation process on a limited, sample basis. Specifically, we judgmentally selected one period and verified the accuracy and completeness of PRNS' reconciliation of revenue and expenditures in accordance with draft policies and procedures. Further, we selected a sample of fees collected since PRNS' administrative review and verified that PRNS records agreed with those of other departments. To the extent PRNS had committed or used selected fees for parkland acquisition or improvement, we verified PRNS made the commitment within five years and that planned/executed uses complied with relevant City ordinances and State law. We did not review the City's fee collection process.

Lastly, we interviewed City staff and reviewed documentation concerning the Redevelopment Agency's obligation to the Fund.

Finding I The Department of Parks, Recreation and Neighborhood Services Has Improved Administration of the Park Trust Fund and Can Further Strengthen Its Policies and Procedures

In 2006, the Department of Parks, Recreation and Neighborhood Services (PRNS) conducted an administrative review of the Park Trust Fund (Fund). PRNS identified $766,000 of in-lieu fees and accrued interest that fell through administrative cracks in the management of the Fund. As a result, PRNS returned fees and accrued interest to property owners where possible and made changes to its administration of the Fund, including drafting policies and procedures to address the deficiencies it had found. Although PRNS has improved its administration of the Fund, we identified areas where it can further strengthen the administrative process. Specifically, we found that PRNS:

- Can improve the processes for assessing a Park Trust Fund administrative fee and allocating accrued interest;
- Can improve its project commitment process by documenting key project elements and formal commitments;
- Should attempt to collect interest on the Redevelopment Agency's unpaid park fees;
- Should provide all required annual financial information in a single public report for projects requiring the payment of developer fees;
- Can reduce the risk of uncommitted projects reaching the five-year limit by implementing a notification system; and
- Can make other improvements to the policies and procedures manual, including finalizing the manual, updating several policies, and defining undocumented practices.

Our report includes 14 recommendations to improve aspects of PRNS policies and procedures and strengthen controls. These recommendations may result in the additional collection of approximately $1.65 million in interest for housing developments whose in-lieu fees are due from the Redevelopment Agency.

PRNS Park Trust Fund Administrative Review

In fiscal year 2005-2006, PRNS, with assistance from the Finance Department, conducted a review of the Park Trust Fund (Fund) and reported to the City Council its findings and recommended changes to the Fund's administration. The report included an accounting of the $90.4 million in revenues received, starting from the Fund's inception in 1988 through the end of the fiscal year 2004-2005.[4] It also provided a summary of the allocation of revenues and the status of the fund balance, which included committed and uncommitted funds through June 30, 2005. In June 2006, the City Council approved the Review of the Park Trust Fund report, including recommendations for the use of uncommitted funds.

During the review, PRNS determined that, as of June 2005, about $766,000 in fees and accrued interest were not committed to projects within the five-year window required by the Quimby Act and City ordinances. According to the Parkland Dedication Ordinance, the City had to reimburse the current property owners of record these fees and accrued interest. However, due to a loss of records, PRNS was unable to identify the developments or projects that generated $351,000 of those fees, and therefore could not determine the current property owners of record to whom those fees would have been paid. As a result, PRNS recommended allocating the $351,000 to Happy Hollow Park and Zoo since the Park and Zoo would benefit all residents of San José. The remaining $415,000 in uncommitted funds and accrued interest was to be returned to property owners of record.

Additionally, PRNS identified a need for improved recordkeeping, better interdepartmental coordination, and the timely disbursement of funds. As a result of the review, PRNS added an analyst position in 2006-07 who now maintains an ongoing reconciliation of the Fund, and as part of that year's budget, established a $500,000 administrative reserve to offset possible future fluctuation in revenue.

[4] PRNS reported the Fund had received revenue as follows: 63 percent fees paid by developers in lieu of parkland dedication, 26 percent fees paid by the Redevelopment Agency on behalf of developers through the Low- and Very-Low Income Voucher Program, 10 percent accrued interest, and 1 percent other miscellaneous revenue. PRNS also reported that $34.2 million had been expended in the following manner: 11 percent land acquisition, 40 percent park development, 32 percent park improvements, and 17 percent renovation.

Further, PRNS drafted a policies and procedures manual for the administration of the Fund to address issues related to recordkeeping, coordination, and the timely disbursement of funds. The policies and procedures included the following key activities:

- Determination of Land dedication and/or Payment of Parkland Fees,
- Collection of In-Lieu Fees,
- Collection and Recording of Revenues, and
- Allocation of Funds.

Our limited testing of the Fund from 2005-06 to present did not identify any instances where PRNS needed to refund in-lieu fees to current property owners. Furthermore, we found PRNS was accurately reconciling its data on the Fund with other available sources in accordance with its draft policies and procedures.

PRNS Can Improve the Processes For Assessing A Park Trust Fund Administrative Fee and Allocating Accrued Interest

According to State law and City ordinance, the in-lieu fees and interest generated by the in-lieu fees shall accrue and be used to benefit the development where in-lieu fees were collected. San José Municipal Code sections 14.25.380A and 19.38.350A state that in-lieu fees, also known as parkland fees, shall be deposited into the Park Trust Fund. The in-lieu fees are restricted for use for the development, including acquisition of, or renovation of park or recreational facilities which serve or benefit the residential project that paid the in-lieu fees. Additionally, the Municipal Code requires interest generated due to the deposit of in-lieu fees shall be used to benefit the development whose in-lieu fees generated the interest.

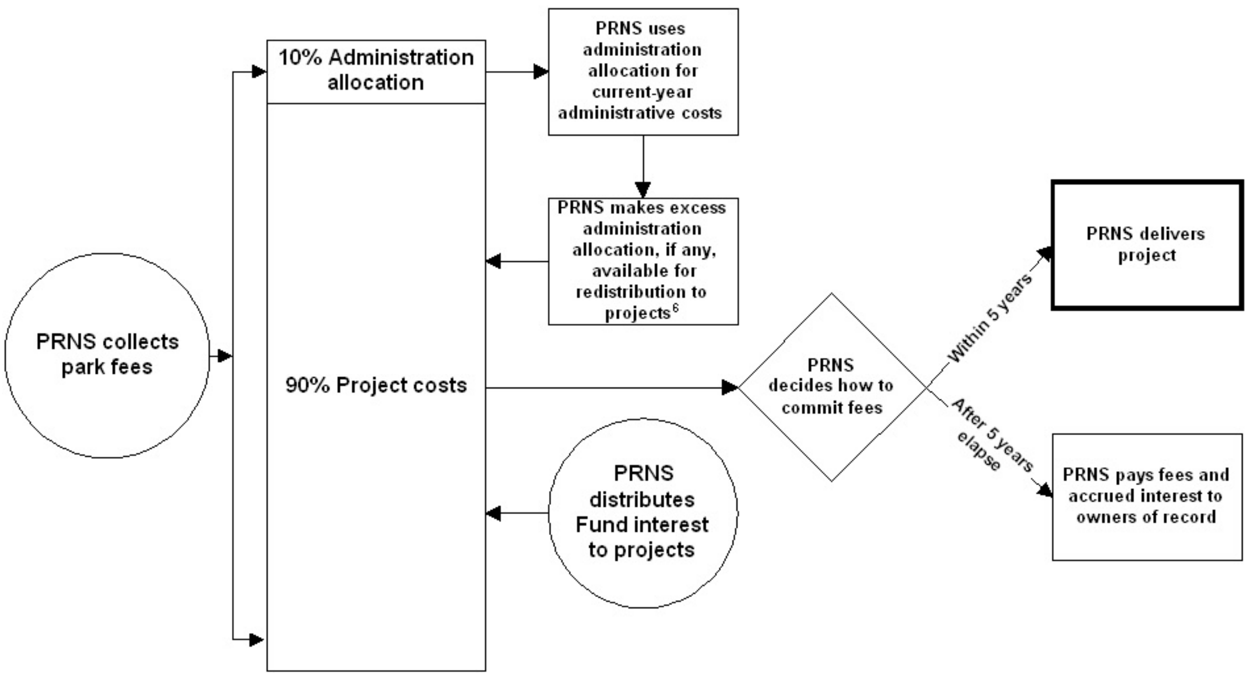
PRNS Should Better Align Administrative Charges to Activity

PRNS assesses administrative charges to projects when in-lieu fees are initially deposited into the Park Trust Fund without consideration for the amount of administrative activity that usually occurs at that point in time. Specifically, the City collects and PRNS immediately assesses a one-time 10 percent charge on each development paying an in-lieu fee to cover its costs for administering the Fund. As a result, in some years, PRNS has collected and retained more administrative fees than necessary to cover annual administrative costs, which are either then redistributed to projects in the Fund or used for administrative costs for the following years. To minimize any excess accumulations in a particular year, PRNS makes excess administrative fees available for redistribution to each of the projects[5] in the Fund on an annual basis.[6]

Since the Fund also generates significant interest earnings, PRNS distributes the accumulated interest to each project in the Fund using the same method as the excess administrative fees, but the interest allocation occurs on a more frequent, usually quarterly basis.

The following exhibit highlights the administrative cost and interest allocations for a typical project.

Exhibit 2: Administrative Cost and Interest Allocation



Source: Parks, Recreation and Neighborhood Services Department information.

[5] Projects may refer to both committed and uncommitted projects. Committed projects are projects where PRNS has identified the project scope and location for a development in-lieu fee. An uncommitted project represents fees collected from a developer for a project whose scope and/or location is not identified.

[6] We should note that according to PRNS staff, PRNS sometimes rolls excess administrative charges collected into the next year to offset next year administrative costs.

According to PRNS staff, PRNS uses the pooled administrative allocations from in-lieu fees to cover staff, planning, and coordination costs for all Park Trust Fund activities. Since PRNS does not directly bill these activities to specific projects, the pool of administrative fees goes to cover the costs for all projects. Administrative fees in excess of what PRNS needs to cover its costs are available for redistribution back to all Fund projects based on the amount of in-lieu fees remaining in the Fund for each project.

This process appears to work well for projects that are completed soon after PRNS collects in-lieu fees. However, since some projects span numerous years, this process may disproportionately impact projects which remain inactive, and to which PRNS assesses an administrative fee up front, compared to projects in active construction. PRNS allocates quarterly interest to projects on the basis of fees remaining in the Fund for each project. The up front assessment of 10 percent to projects where little activity occurs for numerous years reduces the amount of fees remaining and therefore could reduce the amount of interest allocated to that specific project.[7]

We found numerous projects where PRNS assessed the 10 percent administration fee up front, but had few, if any, project expenditures for several years. Some fees, although "committed," have sat in the Fund for more than 10 years with minimal project expenditures.[8] As a result, many of these inactive projects earned less in interest. For example, PRNS allocated to one inactive project $5,700 less in interest earnings, because 10 percent of the fee was immediately assessed for administration. The following exhibit shows how lost interest could be exacerbated over the course of several years.

[7] According to PRNS staff, basic administrative activities, such as planning and tracking projects, and allocating interest, begin as soon as PRNS collects a fee and occur on an ongoing basis.

[8] We should note PRNS appears to have committed these fees in compliance with City ordinances and State law. According to PRNS staff, nearly all of the fees that have spent more than 10 years in the Fund are either budgeted for use in the next two fiscal years or are being held until sufficient funding accumulates to move forward with a project. Additionally, according to City staff, there are various levels of administrative activity on all of these fees.

Exhibit 3: Impact of PRNS' Administrative Cost Allocation Process on A Project's Interest Accrual (in thousands)

Method	Initial Allocations	Interest Earned					Total Interest Earned	Additional Interest Earned
		Year 1	Year 2	Year 3	Year 4	Year 5		
Current: Assess 10 percent administrative charge upon receipt of fee								
for project	$2,262	$85	$88	$92	$95	$99	$459	n/a
for administration	251						n/a	
Alternative 1: Assess 10 percent administrative charge in 2 installments—upon receipt of fee and at time of commitment (assuming 5 years)								
for project	2,387	90	93	97	100	99	479	**$20**
for administration	126					125	n/a	
Alternative 2: Assess 10 percent administrative charge at time of commitment (assuming 5 years)								
for project	2,513	95	98	102	106	100	500	**41**
for administration						251	n/a	

Source: City Auditor's Office analysis of prospective interest accrual on an assumed in-lieu fee of $2,512,930 that is committed five years after receipt. We further assumed interest accrued quarterly at the average rate of the City's investment pool over the last five years.

In our opinion, PRNS can improve its assessment and allocation process by better aligning when administrative charges are assessed based on project activity. While some projects may not show activity for many years, PRNS staff indicated that some of the larger projects may entail more up-front administrative activity, such as working with the community to determine the scope of a park project, prior to the commitment of funding.

We recommend PRNS:

Recommendation #1

Formalize an administrative fee assessment policy which better aligns when fees are assessed with project activity. (Priority 3)

The Policy Manual Needs to Define How PRNS Justifies and Reports Administrative Costs to the City Council

PRNS' 2006 administrative review identified lapses in fund administration as a contributing factor to the loss of records concerning the receipt and use of park fees. As a result, starting with fiscal year 2006-07, PRNS assigned an analyst to maintain an ongoing reconciliation of the data systems tracking in-lieu fees. PRNS charged the Fund for 2.35 full-time equivalent employees (FTE) during fiscal year 2008-09, as shown in the following exhibit, and has budgeted an additional 2.65 FTE for fiscal year 2009-10.

Exhibit 4: The Park Trust Fund Pays For Several Staff Positions

Position	2008-09 FTE	2009-10 FTE
Analyst II	1.00	1.00
Division Manager	0.20	0.20
Parks Manager	0.70	2.20
Planner II	0.20	1.20
Recreation Superintendent	0.25	0.25
Senior Analyst	-	0.15
Total FTE	**2.35**	**5.00**

Source: Department of Parks, Recreation and Neighborhood Services.

Administrative costs should be justified and minimized to the greatest extent possible. Although PRNS' draft manual references a policy on administrative costs, the draft does not include a policy or criteria for determining what are justifiable administrative costs. Additionally, the draft states PRNS should include the total amount set aside for administration of the Fund as part of the annual status report on the Fund that the Mayor and City Council requested in September 2006. However, the manual does not define what cost elements are considered administration costs for the purposes of the report.

We found that, in the 2007-08 report to the City Council, PRNS reported about $170,000 set aside for public art acquisition, pursuant to the City's Public Art Program, as funds available for "administrative overhead." Additionally, the 2007-08 report showed the $500,000 reserve for administration, approved by the City Council as an administrative set-aside to offset possible future fluctuation in revenue as recommended in the 2006 review of the Park Trust Fund, as part of "other miscellaneous allocations." Clearer definition of what should be included in these categories is needed.

We recommend PRNS:

Recommendation #2

Update the final Policies and Procedures Manual to include criteria for justifiable administration costs, and describe the process for defining and reporting administration costs to the City Council. (Priority 3)

PRNS Should Formalize an Accrued Interest Policy That Accounts For the Timing of Fee Deposits

Further, the PRNS accrued interest allocation process does not take into account timing of in-lieu fee deposits. PRNS calculates and allocates accrued interest in the Fund to each project quarterly based on the balance of in-lieu fees for each project. As a result, projects whose in-lieu fees were deposited just prior to the interest allocation date receive an interest allocation as if they were in the Fund for the entire quarter where interest accrued. Another concern we have is that PRNS maintains these allocations in an internal spreadsheet, but does not record the allocations of interest in the City's Financial Management System (FMS). Specifically, PRNS records capital budget appropriations in FMS, along with reserves for future projects, but it does not distribute accrued interest to the reserves.

The following exhibit highlights the impact of PRNS' allocation of accrued interest on a new fee collection. Specifically, it shows how PRNS' allocation of accrued interest favored a fee that had been recently deposited, allowing the project to earn $37,562 more in interest than if the project were only credited for interest based on when fees were actually deposited.

Exhibit 5: Impact of PRNS' Allocation Process on Interest Earned By New Fee

	Action	Current Method of Allocating Interest	More Equitable Method of Allocating Interest	Net Impact
1	Receive and deposit fee into Park Trust Fund on May 13, 2008	$2,261,637	$2,261,637	
2	Allocate interest accrued in Fund from January 1 to June 30, 2008 based on funds from step 1	51,505		
	Alternative: Account for timing of fee receipt		13,943	($37,562)
3	Calculate new balance of fee and accrued interest	$2,313,142	$2,275,580	

Source: City Auditor's analysis of data from the Department of Parks, Recreation and Neighborhood Services.

PRNS has the opportunity to reduce this timing impact by allocating accrued interest on a monthly basis and accounting for the timing of in-lieu fee deposits.

We recommend PRNS:

Recommendation #3

Formalize an accrued interest allocation policy which allocates accrued interest to projects on a monthly rather than quarterly basis, accounts for the timing of in-lieu fee deposits, and documents accrued interest allocations in the City's Financial Management System. (Priority 3)

PRNS Can Improve Its Project Commitment Process By Documenting Key Project Elements and Formal Commitments

PRNS "commits" in-lieu fees to park projects by entering project name and fee information into a spreadsheet. In some cases, the spreadsheet does not track sufficient information to address key commitment items such as scope of work and location (if available) of project. For example, in one case, fees were shown as *committed* on the spreadsheet without documenting the name of the park to which PRNS committed the fees.

Recordkeeping for these project commitments is important. As noted earlier, PRNS' 2006 review revealed over $700,000 in uncommitted fees that had to be refunded to current property owners of record or reallocated.[9] The draft PRNS policies and procedures manual describes how PRNS allocates fee revenues to projects; however, the draft policies and procedures do not articulate a formalized, documented commitment process.

Since project commitment is an important control to ensure in-lieu fees are not lost in the future, PRNS can strengthen their commitment process by establishing a procedure that requires a written commitment memo documenting key project requirements and establishing a formal department approval date as the date of commitment. Key requirements for commitment may include identifying a location, scope of the project, estimated completion date, and formalizing the commitment by establishing a date of commitment.

To enhance the coordination of these written commitment memos with the manual spreadsheet, PRNS can issue unique, serialized numbers which can cross reference a specific project. These improvements will create a written record of each committed project. PRNS also occasionally amends its commitment decisions and allocates funds to new or revised uses. These amendments should be documented and approved in the same manner as the original decision to create a thorough record of decisions and amendments.

[9] We should note that the City reallocated about $351,000 to a Citywide park because it was unable to determine the appropriate owners of record to provide the refunds. According to PRNS staff, the problem resulted from lost records.

We recommend PRNS:

Recommendation #4

Develop and maintain numerically-sequenced memoranda of commitments and amendments for each Park Trust Fund project documenting the following:

- **Date of Commitment,**
- **Project Name,**
- **Purpose of project,**
- **Location of project and compliance with the nexus requirement,**
- **Amount of in-lieu fees paid by developer, and**
- **PRNS Director, or designee, signed approval of the memorandum. (Priority 3)**

Recommendation #5

Cross-reference commitment and amendment memoranda to projects shown on internal record keeping systems. (Priority 3)

PRNS Should Attempt to Collect Interest on the Redevelopment Agency's Unpaid Park Fees

From 1998 through 2005, developers whose units were subject to recorded affordability restrictions were able to apply to the Housing Department for a voucher to satisfy payment of in-lieu fees under the City's Low- and Very-Low Income Voucher Program. According to PRNS, the program provided a valuable incentive for developers of low-income and very-low-income units by allowing them to obtain a voucher from the Housing Department requiring the Redevelopment Agency (Redevelopment) to pay park fees on the developer's behalf. Once a project was under construction, PRNS invoiced Redevelopment for these fees and fees were deposited into the Fund for allocation to future park acquisition and/or renovation projects, subject to the same nexus requirements as any other developer's park fees.

Through January 2006, Redevelopment paid approximately $22.3 million on behalf of 43 developments, but then exhausted its budget for the Low- and Very-Low Income Voucher Program. Since then, the City's annual cooperation agreements with Redevelopment have deferred Redevelopment's payment of park fees totaling about $8.1 million for 8 qualifying developments. Specifically, the City and Redevelopment have agreed to delay the repayment of this obligation through various payment schedules and the current timetable does not require payment in full until October 2011.

It is a customary and normal practice for government agencies to charge interest on unpaid obligations. However, in May 2009, the City and Redevelopment agreed to a payment plan that, like others before it, does not discuss interest the Fund could have accrued to date, or could accrue during the planned repayment in annual installments from October 2009 to October 2011. This plan was approved by the City Council and Redevelopment Agency Board as part of the cooperation agreement between the City and Redevelopment. We estimate the Fund would have earned approximately $1.4 million in interest revenue through June 2009, assuming historical earned interest yields from the City's investment portfolio, for low-income developments as shown in the exhibit below.

Exhibit 6: Interest Accrual on the Redevelopment Agency's Unpaid Park Fees

Development	Fees	Interest Revenue to June 2009[10]
Almaden Family	$2,341,500	$439,665
Corde Terra	$2,190,300	$338,394
Art Ark	$1,533,000	$274,710
Delmas Park Teacher	$1,281,000	$247,077
Others	$713,800	$122,454
Total	**$8,059,600**	**$1,422,300**

Source: City Auditor's analysis of data from Parks, Recreation and Neighborhood Services Department and quarterly investment reports from the Finance Department.

Furthermore, in the future the Fund could earn an additional $244,000 in interest during Redevelopment's planned 2-year repayment period of October 2009 to October 2011, if the City is able to secure interest accrual on any remaining unpaid park fees in future cooperation agreements with Redevelopment.[11]

State law and the San José Municipal Code require that the City use any interest earned on a park fee for the same purpose as it used the original park fee. Thus, when a developer pays park fees for a development, the

[10] Interest revenue is calculated from the date by which each developer would have had to pay park fees, which differs for the listed projects.

[11] This amount assumes the most recent City and Redevelopment payment plan, and interest accrued at the lowest earned rate the City's investment portfolio has realized since June 2004.

City must use the interest earned on the fees to further improve parkland around the development. Therefore, if PRNS does not collect interest on Redevelopment's obligations, it potentially disadvantages neighboring residents who would otherwise be able to benefit from additional parkland and/or renovations made possible by interest revenue.

We recommend the City Administration:

Recommendation #6

Attempt to secure interest accrual on in-lieu fees not yet paid by the Redevelopment Agency. (Priority 3)

The City Should Provide All Required Annual Financial Information In A Single Public Report For Projects Requiring the Payment of Developer Fees

During our review, we found the City does not offer for public review a single annual report of the Fund with all the information required by the California Mitigation Fee Act (Fee Act). The Fee Act requires the City to annually make available a report of mandatory fees assessed against a development. Specifically, the Fee Act requires the City to make available to the public the following information concerning Park Impact Ordinance fees within 180 days after the last day of the fiscal year:

- Description of the type of fee,
- Amount of the fee,
- Beginning and ending balances of the fund,
- Amount of fees collected and the interest earned,
- Identification of each public improvement on which fees were expended and the amount of the expenditures on each improvement, including the total percentage of the cost of the public improvement that is funded with fees, and
- Description of interfund transfers or loans, date of loan repayment, and rate of interest that the fund will receive.

The City makes part of the required information publicly available in the annual Park Trust Fund report to the City Council. However, the City has not made the remaining required information readily available to the public. The City can better comply with the Fee Act's reporting requirement and open access to the status of in-lieu fee projects by consolidating required information into a single report.

We recommend the City Administration:

Recommendation #7

Develop and make publicly available the required annual Mitigation Fee Act report with all the required elements. (Priority 3)

PRNS Can Reduce the Risk of Uncommitted Projects Reaching the Five Year Limit By Implementing A Notification System

In 2006, PRNS conducted a Park Trust Fund administrative review and found a number of instances where the City did not commit funds within five years as required by the Quimby Act and Municipal Code. As a result, the City was forced to refund the fees to current property owners of record. Since that time PRNS has made some administrative improvements, including hiring an analyst to oversee the Fund. PRNS staff told us that, in practice, staff review all uncommitted fees and identify those that are within 18 to 24 months of the 5-year limit during the annual capital budget development process, and subsequently allocate them to projects or to reserves. However, we found that PRNS still does not have a formal procedure for identifying uncommitted projects which are close to the 5-year limit.

According to PRNS, 18-months notice would allow PRNS to determine an appropriate project and commit uncommitted in-lieu fees. The following exhibit shows the Park Trust Fund projects within 18 months of the 5-year limit.

Exhibit 7: PRNS Must Commit Fees From 3 Projects to Use Within 18 Months as of March 2009

		Months Until 5-Year Limit			
		12 to 18	6 to 12	6 or fewer	**Totals**
Committed Projects	Number of Projects	27	30	18	75
	Fee Amounts and Accrued Interest	$3,524,980	$6,153,526	$4,436,548	$14,115,054
Uncommitted Projects	Number of Projects	2	1	-	3
	Fee Amounts and Accrued Interest	$2,374,216	$22,600	-	$2,396,816
Totals		$5,899,196	$6,176,126	$4,436,548	$16,511,870

Source: City Auditor's Office analysis of electronic records from the Department of Parks, Recreation and Neighborhood Services.

Although only 3 uncommitted projects were within 18 months of the 5-year limit as of March 2009, PRNS can further minimize the risk that uncommitted projects reach the 5-year limit by formalizing an internal notification procedure. The procedure should identify projects within 18 months of the limit, and establish a reporting requirement to PRNS senior staff to ensure staff are aware of the project and have an opportunity to commit the funds prior to the 5-year limit.

We recommend PRNS:

Recommendation #8

Formalize and document within the Park Trust Fund Policies and Procedures Manual an internal notification system to inform the PRNS Director, or designee, when uncommitted projects reach 18, 12, and 6 months from the 5-year commitment limit. (Priority 3)

PRNS Can Make Other Improvements to the Policies and Procedures Manual

During our review of the draft Park Trust Fund Policies and Procedures Manual, we found additional areas where PRNS can improve.

The Draft Manual Needs To Be Finalized

The current manual remains in draft form and is dated June 2008. In reviewing the manual, we found that some references to the Municipal Code were wrong or referenced sections which did not exist. Additionally, the manual did not contain any indication it was approved for use by the department director.

We recommend PRNS:

Recommendation #9

Finalize the Park Trust Fund Policies and Procedures Manual and document approval by the department director. (Priority 3)

The Policy Manual Criteria For Land Dedication and/or In-lieu Fees Should Match the Municipal Code

We found the land dedication and/or in-lieu fee determination criteria in the draft manual, while reasonable, do not match the criteria articulated in the Municipal Code. According to the Municipal Code, the Director of PRNS shall consult with the directors of the departments of Public Works and

Planning, Building, and Code Enforcement in making the determination whether to require the dedication of land, payment of a fee in lieu of dedication, or a combination of both. The Municipal Code states the determination is to be based on, but not limited to:

- General Plan of the City,
- City's policies for the development of park and recreation facilities,
- Topography, geology, access, and location of land in the subdivision that is suitable for the development or renovation of park and recreation facilities,
- Size and shape of subdivision and land available for dedication, and
- Location of existing or proposed park sites and trails.

The current draft manual identifies several factors such as number of housing units being proposed, size of the housing site, and the location of the housing site in relation to existing park and school recreation. These factors appear reasonable, and PRNS should integrate the Municipal Code language into the manual where applicable.

We recommend PRNS:

Recommendation #10

Update the dedication and in-lieu determination procedure language to match the Municipal Code. (Priority 3)

The Policy Manual Should Outline the Department of Public Works Fee Collection Process

The draft manual makes reference to the inclusion of the Department of Public Works fee collection process; however, a discussion of the process is absent from the Manual. PRNS' 2006 administrative review identified coordination between Public Works' database systems and PRNS administration as an issue contributing to the breakdowns found in the Park Trust Fund. The Public Works fee collection process is important as it affects the fees deposited into the Fund.

We recommend PRNS:

Recommendation #11
Update the final Policies and Procedures Manual to include a description of the Department of Public Works fee collection process. (Priority 3)

The Policy Manual Should Define the Process For Using Savings From Completed Projects

According to PRNS staff, PRNS commits in-lieu fees to park projects based on project cost estimates. Initial estimates, which are at a budgetary or program level, are further refined as a project progresses. Occasionally, PRNS' commitments, and interest accrued on committed in-lieu fees, exceed the amount necessary to complete a park project.[12] PRNS labels the excess fees or accrued interest as "savings" on the completed projects and makes them available for use on new projects that benefit the area that generated the fees. For example, PRNS committed several collections of in-lieu fees that totaled $361,867, including accrued interest, to a park project at a youth sports field. The project eventually cost $350,000, and PRNS made available the remaining $11,867 but did not retain in its internal spreadsheet key data on the source location of the money. State law and the San José Municipal Code require that the City use any interest earned on a park fee for the same purpose as it used the original park fee. However, the draft manual lacks a discussion of restrictions on the use of savings. A policy governing the use of "savings," including interest accrued in excess of the cost to complete a park project, is important to help ensure compliance with state and local law.

We recommend PRNS:

Recommendation #12
Update the final Policies and Procedures Manual to include a discussion of restrictions on the use of savings from completed projects. (Priority 3)

[12] According to PRNS staff, the final cost of a park project may be less than the estimate upon which PRNS planned to use funds.

The Policy Manual Should Articulate the Criteria For Calculating Credits Against a Developer's Obligation to the Park Trust Fund

The Quimby Act states that if a developer provides park and recreational improvements to dedicated land, the value of the improvements together with any equipment located thereon shall be a credit against the payment of park fees or dedication of land required by local ordinances. The City's Municipal Code elaborates that a developer can earn credit towards its obligation up to the actual cost of public park and recreation improvements to property dedicated to the City or to existing park facilities or recreational facilities. PRNS administers this section by entering into "turnkey parkland agreements" with developers, whereby the developer constructs ready-to-use park or recreational improvements for the City and receives a commensurate credit against the developer's in-lieu fee requirement. Although PRNS' draft manual explains in great detail the steps a developer must take to enter into a turnkey agreement with the City, it does not articulate how PRNS determines the actual cost of park improvements required by a turnkey agreement.

In practice, PRNS values improvements using a cost estimate—including a contingency allowance of 10 to 15 percent—provided by the developer and reviewed by the Department of Public Works for reasonableness. According to PRNS staff, the majority of cost estimates on turnkey projects are performed at the conceptual stage; however, on occasion, certain projects are more fully developed at the time of cost estimation. Cost estimates prepared at later stages of the construction of a park or improvements are likely to be more precise than those estimates prepared at earlier stages of construction. Because PRNS uses cost estimates to fulfill the Municipal Code's actual cost requirement, PRNS should define the process for calculating credits to ensure consistency across turnkey agreements.

We recommend PRNS:

Recommendation #13

Update the final Policies and Procedures Manual to define the process for calculating credits to ensure consistency across turnkey agreements. (Priority 3)

The Policy Manual Should Include Justification and Procedures For Reimbursing Developers For Costs in Certain Situations

Additionally, PRNS should document its practice of reimbursing developers from the Fund in certain situations. PRNS' boilerplate language for turnkey agreements states that the developer "shall be responsible for all costs incurred for planning, design, construction, and supervision of the construction of all Park Improvements, including without limitation, [the] City's plan review and inspection." Therefore, when PRNS anticipates a developer will exceed its obligation—for example, if a developer agrees to construct a two-acre park when obligated to construct a one-acre park—the turnkey agreement includes the following clause:

> *Developer shall provide the City with receipts, invoices and other documentation requested by City demonstrating that Developer has expended at least [the estimated cost] in monetary funds for the construction of the Park Improvements described in this Agreement. Upon City's acceptance of the Park Improvements and receipt of Developer's receipts, invoices and other requested documentation and request for reimbursement, the City shall process a reimbursement to the Developer.*

City staff indicated this language is necessary because the City cannot legally require a developer to exceed its obligation. Nonetheless, the draft manual lacks any discussion of the option to offer a developer reimbursement for costs when PRNS anticipates the costs of public park improvements will exceed the developer's obligation. Moreover, the draft manual does not explain how staff will ensure that claimed costs are appropriate and acceptable.

We recommend PRNS:

Recommendation #14

Update the final Policies and Procedures Manual to include justification and procedures for offering reimbursements to developers from the Park Trust Fund, and for validating expenses developers claim. (Priority 3)

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: Sharon W. Erikson
City Auditor

FROM: Albert Balagso

SUBJECT: SEE BELOW

DATE: September 4, 2009

Approved Deanna Santana Date 9/9/09

SUBJECT: **THE ADMINISTRATION'S RESPONSE TO THE *AUDIT OF THE PARK TRUST FUND***

The Department of Parks, Recreation and Neighborhood Services (Department) has reviewed the "*Audit of the Park Trust Fund*" (Audit), and is generally in agreement with the findings, and concurs with the recommendations made for improvement.

It is important to note that it is upon the request of the Department that this audit was conducted. The request was made to ascertain whether the draft policies and procedures that the Department developed and started to implement after its administrative review of the Park Trust Fund (Fund) in 2006 effectively address deficiencies that the Department identified in the prior administrative review. Specifically, the Department's goals in developing the draft Policies and Procedures are as follows: 1) to put sufficient internal controls in place to avert potential risks or exposures related to Fund's compliance with laws, regulations, and ordinances; and 2) to provide a guide allowing staff to efficiently and effectively manage the Fund.

The Audit confirms that since the Department's administrative review of the Fund in 2006, the Department has significantly improved its administration of the Fund. Specifically,

- The Department has committed collected in-lieu fees for use within five years as required by the Municipal Code and that the Audit found no instances where the Department needed to refund in-lieu fees to property owners.
- The planned and/or executed uses of in-lieu fees complied with relevant City Ordinances and State law.
- As shown on Exhibit 1 on page 6, the Department has consistently made significant strides in spending Park Trust Fund revenues to provide park and recreation opportunities to benefit the residents that generated the fees (i.e. $2.6 M in FY 2005-06, $6.5 M in FY 2006-07 and $9.2 M in FY 2007-08).

The Department thanks the City Auditor's Office for identifying areas where it can further strengthen its administrative process. The Department is committed to implementing these recommendations within the recommended implementation timeframe, if not sooner.

Following are the Department's response to each recommendation:

Recommendation #1: *Formalize an administrative fee assessment policy which better aligns when fees are assessed with project activity. (Priority 3)*

Agreed: Administrative activities on collected in-lieu fees starts prior to, upon receipt, and after collection of the fees and varies from project to project depending on the complexity of the project or the area's needs and the project's development stage. The Department believes that there is a reasonable relationship between the current practice of assessing a ten percent (10%) administrative charge on the total amount collected for each project and the level of administrative activity that will occur during the life of the project. However, the Department agrees with the Audit that there may be other ways to improve upon this method of assessing administrative fees. In terms of Alternative 3 on page 13, assessing the administrative charge at time of commitment does not account for administrative activities that occur prior to commitment of the funds, nor does it account for the level of administrative work on funds that are committed to a reserve versus committed and appropriated to a live project. Therefore, a two-phased method of assessing administrative fees will likely be more aligned with administrative activities on any given project. Staff is currently developing a process to assess administrative charges in two installments: upon receipt of fees and at time of commitment to a project. This revised process will be incorporated into the final Polices and Procedures Manual.

Recommendation #2: *Update the final Policies and Procedure Manual to include criteria for justifiable administration costs, and describe the process for defining and reporting administration costs to the City Council. (Priority 3)*

Agreed: Staff will finalize the Policies and Procedures Manual and include criteria for justifiable administrative costs and the process for reporting these costs to the City Council.

Recommendation #3: *Formalize an accrued interest allocation policy which allocates accrued interest to projects on a monthly rather than quarterly basis, accounts for the timing on in-lieu fee deposits, and documents accrued interest allocations in the City's Financial Management System. (Priority 3)*

Agreed: Staff will finalize the Policies and Procedures Manual and include procedures for allocating interest to projects on a monthly basis that accounts for the timing of in-lieu fee deposits.

Collected in-lieu fees are accounted for in the City's Financial Management System's (FMS) expenditure reports as appropriated projects, appropriated reserves, or Ending Fund Balance (EFB). Collected fees are appropriated to projects in the fiscal year that the projects are ready to proceed to construction. Otherwise, collections that are committed to projects in the Department's database are accounted for in the EFB in FMS. Until appropriated to a project or a reserve, accrued interest is also accounted for in the EFB.

The Department can commit to documenting accrued interest in FMS for collections that are already appropriated to projects and/or reserves. To document accrued interest allocations in FMS, staff will add the interest to a project's appropriation or to a reserve. Since a project's appropriation is based on the cost required to deliver the project, accrued interest will only be added to the project's appropriation as needed. Otherwise, accrued interest will be added to an existing or a newly created reserve to benefit the development that generated the fees. Since Council action is required to appropriate these accrued interest so that they can be accounted for in FMS, the Department will include these actions at three separate times: 1) in June, in conjunction with the Budget Process, 2) at Mid-year and 3) at year end as part of the Annual Report.

Staff is currently researching whether accrued interest for collections that are appropriated to the EFB (i.e. uncommitted collections and committed collections that have not yet been appropriated to projects or reserves) can be documented in FMS at the project commitment level.

Recommendation #4: *Develop and maintain numerically sequenced memoranda of commitments and amendments for each Park Trust Fund project documenting the following:*

- *Date of Commitment*
- *Project Name*
- *Purpose of Project*
- *Location of project and compliance with the nexus requirement*
- *Amount of in-lieu paid by developer, and*
- *PRNS Director, or designee, signed approval of the Memorandum (Priority 3)*

Agreed. The Department has started implementing Recommendation #4 by documenting the current commitments in a memorandum to the PRNS Director dated September 1, 2009.

Recommendation #5: *Cross-reference commitment and amendment memoranda to projects shown on internal record keeping systems. (Priority 3)*

Agreed. Staff has included a field in the Department's database to capture the Commitment Numbers starting with Commitment Number 1 dated September 1, 2009, that documents commitments to date.

Recommendation #6: *Attempt to secure interest accrual on in-lieu fees not yet paid by the Redevelopment Agency. (Priority 3)*

Agree. If the City Council approves the City Auditor's recommendations, the City will discuss with the Agency as part of any negotiation relating to the modification of the current cooperation agreement which sets the timeline for payment of the in-lieu fees from Agency to City.

Interest payment was not included in previous cooperation agreements or the current cooperation agreement approved by the City Council and the Agency Board for the payment of in-lieu fees from Agency to City. In recent conversations with Agency, Agency is not in support of including interest.

Recommendation #7: *Develop and make publicly available the required annual Mitigation Fee Act report with all the required elements. (Priority 3)*

Agreed. The Department currently complies with the reporting requirements of the California Mitigation Fee Act by making the information available for public review through various documents and reports. Consolidating information contained in these reports into the Annual Park Trust Fund report to the City Council will provide the public with easy access to the information. The Department will consolidate all required information in the Annual Report for FY 2008-2009 for submission to the City Council in December 2009.

Recommendation #8: *Formalize and document within the Park Trust Fund Policies and Procedures Manual an internal notification system to inform the PRNS Director, or designee, when uncommitted projects reach 18, 12, and 6 months from the 5-year commitment limit. (Priority 3)*

Agreed. Staff has recently added an advanced warning system (i.e. an "ALLOCATE" note appears) in its database for collections that have reached 18, 12, and 6 months of the 5-year commitment limit. Additionally, staff will formalize its notification procedure by sending a memorandum listing these collections to the Department Director, Deputy Director, and Division Manager.

Recommendation #9: *Finalize the Park Trust Fund Policies and Procedures Manual and document approval by the department director. (Priority 3)*

Agreed. Staff intends to finalize the Policies and Procedures Manual for the Department Director's approval in March 2010.

Recommendation #10: *Update the dedication and in-lieu determination procedure language to match the Municipal Code. (Priority 3)*

Agreed. Staff will incorporate the recommendation into the final Policies and Procedures Manual. However, it should be noted that the Municipal Code sets forth a non-exhaustive list of criteria that the City should evaluate to determine land dedication or payment of in-lieu fees. The final Policies and Procedures Manual may contain other factors that could be evaluated that are not outlined in the Municipal Code.

The Department also agrees with Recommendations #11 through #14 as follows:

Recommendation #11: *Update the final Policies and Procedures Manual to include a description of the Department of Public Works fee collection process. (Priority 3)*

Recommendation #12: *Update the Policies and Procedures Manual to include a discussion of restrictions on the use of savings from completed projects. (Priority 3)*

Recommendation #13: *Update the final Policies and Procedures Manual to define the process for calculating credits to ensure consistency across turnkey agreements. (Priority 3)*

Recommendation #14: *Update the final Policies and Procedures Manual to include justification and procedures for offering reimbursements to developers from the Park Trust Fund, and for validating expenses developers claim. (Priority 3)*

Recommendations 11 through #14: **Agreed.** As recommended, Staff will finalize the Policies and Procedures Manual and include the following:

- a description of the Department of Public Works' fee collection process
- a discussion of restrictions on the use of savings from completed projects
- the process for calculating credits
- Reimbursements to developers from the Park Trust Fund and for validating expenses that developers claim delete period to be consistent.

Again, I personally thank the City Auditor and her staff for reviewing the Department's draft Parkland Dedication Ordinance (PDO) and Park Impact Fee Ordinance (PIO) Policies and Procedures Manual and for recommending measures to strengthen the Department's controls over its Program. The Department is committed to immediately implementing improvements as recommended in this Audit and to finalizing the Policies and Procedures Manual by March 2010.

Albert Balagso

ALBERT BALAGSO
Director of Parks, Recreation
and Neighborhood Services

APPENDIX A

DEFINITIONS OF PRIORITY 1, 2, AND 3 AUDIT RECOMMENDATIONS

The City of San Jose's City Policy Manual (6.1.2) defines the classification scheme applicable to audit recommendations and the appropriate corrective actions as follows:

Priority Class[1]	Description	Implementation Category	Implementation Action[3]
1	Fraud or serious violations are being committed, significant fiscal or equivalent non-fiscal losses are occurring.[2]	Priority	Immediate
2	A potential for incurring significant fiscal or equivalent fiscal or equivalent non-fiscal losses exists.[2]	Priority	Within 60 days
3	Operation or administrative process will be improved.	General	60 days to one year

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1 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.

2 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 citizens.

3 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.