



AUDITOR GENERAL

WILLIAM O. MONROE, CPA



FLORIDA KEYS AQUEDUCT AUTHORITY

Operational Audit

SUMMARY

The Auditor General is authorized by State law to perform independent audits of independent special districts in Florida. Pursuant to Section 11.45(2)(a), Florida Statutes, the Legislative Auditing Committee, at its July 19, 2005, meeting, directed us to conduct an audit of the Florida Keys Aqueduct Authority. The summary of our findings for the period October 1, 2004, through November 30, 2005, and selected actions taken prior and subsequent thereto, is as follows:

Finding No. 1: We disclosed several matters in this report in which we question the public purpose served by incurring certain operating expenses or providing specific benefits to certain Authority employees. The Authority has no funding source for operating purposes, other than user fees. Accordingly, the decision to provide these expenses affects the fees charged water and wastewater users.

Finding No. 2: The Board had not established policies and procedures clearly establishing the level of budgetary control for monitoring Authority expenditures. Also, budgetary comparison reports provided to the Board did not include all expense categories.

Finding No. 3: The Authority did not consider all prior year net assets balances in preparing its 2004-05 or 2005-06 fiscal year budgets.

Finding No. 4: Bank account reconciliations were not always prepared on a timely basis.

Finding No. 5: The Authority could have increased investment earnings during the 2004-05 fiscal year by investing with the State Board of Administration.

Finding No. 6: The Authority could realize a cost savings and improved efficiency if it changed its payroll processing from weekly to biweekly or monthly.

Finding No. 7: The Authority's employment agreements with its current and former General Counsel and Executive Director contain provisions for severance pay without documenting in its public records the public purpose served. In addition, the severance pay provisions do not require cost savings to the Authority as a prerequisite to severance pay upon early termination.

Finding No. 8: The wording of health and life insurance provisions in certain employment agreements, as well as the personnel policy, is insufficient to clearly determine what benefits the eligible employees are entitled to receive and to ascertain what liability the Authority is agreeing to assume for employees upon retirement.

Finding No. 9: The Authority did not document in its public records, the public purpose served or the legal basis used, in incurring \$49,271 for employee awards and banquets.

Finding No. 10: The Authority’s policies and procedures for completing travel vouchers and documenting travel and training expenses could be improved.

Finding No. 11: Meal allowances for day travel (Class C travel) were not reported to the Internal Revenue Service as taxable wages to the employee, contrary to Internal Revenue Service regulations.

Finding No. 12: The Authority did not allocate \$160,000 paid by the wastewater system for the portion applicable to improvements to the water system. Additionally, some indirect costs for administrative support functions were not allocated to the wastewater system.

Finding No. 13: Contracts with, and invoices from, consultants and outside attorneys did not contain specific deliverables or otherwise provide a basis for payments.

Finding No. 14: The Authority used continuing contracts with engineering firms for projects costing over \$1 million, contrary to Section 287.055, Florida Statutes, which requires a competitive selection process.

Finding No. 15: The Authority did not consider directly purchasing materials for major construction projects or, awarding bids by major components.

Finding No. 16: The Authority overpaid some engineering firms, made a final payment prior to completion of the work, and paid for some charges not included in contracts. Additionally, the Authority paid for some services without the use of competitive bids, contrary to its policies.

Finding No. 17: The Authority did not always establish substantial and final completion dates for wastewater projects or document the reasons for delays in meeting these dates. As a result, the Authority may not have assessed contractors for liquidated damages provided for in their contracts.

Finding No. 18: During the 2003 calendar year, the Authority utilized a law firm that was affiliated with its General Counsel, an employee, thus violating Section 112.313(3), Florida Statutes.

INTRODUCTION

The Florida Keys Aqueduct Authority (FKAA) was created in 1937 by the Florida Legislature and was recreated as an independent special district by Chapter 76-441, Laws of Florida, as amended by Chapter 77-605, Laws of Florida. Under these laws, the primary purpose of FKAA was to obtain, supply, and distribute an adequate water supply to the citizens of the Florida Keys.

In 1998 and 2002, the Authority's enabling legislation was amended to redefine the primary purpose of the Authority to include collecting, treating and disposing of wastewater in certain areas of the Florida Keys.

FINDINGS AND RECOMMENDATIONS

Financial Management

Finding No. 1: Administrative Expenses

The Florida Keys Aqueduct Authority (Authority) does not receive specific funding to finance its administrative expenses. Administrative costs, such as salaries and benefits, travel, utilities, and administrative facilities, are financed with user fees for water and wastewater services. Accordingly, management’s decisions as to the level of spending and the nature of specific spending activities for administrative expenses have an impact on the fees charged to water and wastewater users.

We disclosed several matters in this report in which we question the efficiency of certain management practices and the public purpose served by incurring certain expenses or providing certain benefits to Authority employees; specifically, findings No. 5, Investment Practices; No. 6, Weekly Payroll Processing; No. 7, Severance Pay; No. 8, Insurance Benefits Upon Retirement; No. 9, Employee Awards

and Banquets; and No. 10, Travel Expense Reimbursements. Since the Authority has no funding source for operating purposes, other than user fees, the justification for these expenses should be demonstrated by the Authority when setting fees to be charged water and wastewater users.

Recommendation: Since administrative expenses are financed from user fees, the Authority should carefully evaluate management practices and public purposes served and, as appropriate, document the level and nature of expenses necessary to operate the Authority.

Budgetary Controls

Finding No. 2: Budgetary Level of Control

Section 189.418(3), Florida Statutes, requires the governing body of a special district to adopt a budget by resolution each fiscal year and provides that the budget must regulate expenditures of the special district, and that it is unlawful for any officer of a the special district to expend or contract for expenditures in any fiscal year except in pursuance of budgeted appropriations. However, it does not establish the level of detail at which budgeted appropriations are to be made. Likewise, Chapter 76-441, Section 7, Laws of Florida, requires the Board of Directors of the Florida Keys Aqueduct Authority (Board) to adopt a budget, but does not establish the level of detail for the budget. The Authority’s policies and procedures do not establish the legal level of budgetary control. However, the Authority’s comprehensive annual financial report for the fiscal year ended September 30, 2005, stated that the budget is reviewed at various levels of classification detail within the water and wastewater funds. Expenses may not legally exceed the budget. It is incumbent on the Board to make appropriations and adopt a budget at the level of detail that it deems necessary. Once the legal level of control (i.e., the level at which expenditures may not legally exceed amounts budgeted) has been established by the Board, expenditures must be limited accordingly.

For the 2004-05 and 2005-06 fiscal year budgets, Authority personnel prepared a budget for presentation to the Board showing budgeted revenues and expenditures at the object level, generally by department, for the water and wastewater funds. The Board adopted these budgets by Board agenda items. The budget agenda items did not specifically address the legal level of budgetary control. However, the Board minutes indicated that the Board adopted the budgets that had been prepared by the Authority personnel. Therefore, absent any policy establishing a different level of budgetary control, the level of control was established at the department and object level.

The Authority’s accounting records provided for a comparison of actual to budgeted expenditures at the department and object level, and budget amendments for the 2004-05 fiscal year were made for the department level, as well as the object level. Budget amendments at the fund level were approved by the Board whereas budget amendments at the department and object level were approved by the Executive Director. While the Authority’s total actual expenses for the water and wastewater funds for the 2004-05 fiscal year did not exceed the total budgeted expenses for the respective funds, we noted 6 and 11 object level expense categories that were overspent totaling approximately \$567,842 and \$335,907, respectively, at September 30, 2005, for the water and wastewater funds, respectively.

In addition, the budgetary comparison schedule submitted monthly to the Board presented a comparison of the budget-to-actual operating and capital expenses, excluding debt service and construction project expenses. Construction project expenses are presented to the Board by project and include the respective contracted amount and the percentage of completion, but not a comparison to the budgeted amounts. In the absence of monthly budgetary reports that present a budget-to-actual comparison for all expense categories, Board members may not have a full understanding of the financial status of the Authority.

Recommendation: The Board should establish a policies and procedures clearly setting forth the level of budgetary control for monitoring Authority expenses. The Board should also ensure that the monthly budgetary reports provided to the Board include a budget-to-actual comparison for all expense categories, including debt service and construction expenses.

Finding No. 3: Budget Preparation

Section 189.418(3), Florida Statutes, requires that special district budgets include amounts carried over from prior fiscal years. Our review of the Authority’s 2004-05 and 2005-06 fiscal year budgets for the water and wastewater funds disclosed that prior year net assets balances were not carried over and included in the budgets as a source of funds, as noted below:

- The Authority’s staff indicated that the prior year net assets balances carried over for the initial 2004-05 fiscal year budget were included in the budget with amounts identified as “reserves and other capital funding sources.” However, Authority staff could not identify prior year net assets balances within that account. Amounts reported as reserves and other capital funding sources for the initial 2004-05 fiscal year budgets totaled \$17,973,060 and \$1,371,000 for the water and wastewater funds, respectively. Ending net assets for the 2003-04 fiscal year totaled \$26,380,441 and \$5,663,536 for the water and wastewater funds, respectively. Therefore, at least \$12,699,917 in prior year net assets for the two funds combined do not appear to have been carried over to the 2004-05 fiscal year budgets.
- For the initial 2005-06 fiscal year budgets, the Authority reported \$1,282,000 as “other financing sources” in the wastewater fund budget which, according to management, represented estimated prior year net assets balances, but did not report any amount

representing estimated prior year net assets balances in the water fund budget. Ending net assets for the 2004-05 fiscal year totaled \$21,989,730 and \$7,882,608 for the water and wastewater funds, respectively. Therefore, at least \$28,590,338 in prior year net assets for the two funds combined do not appear to have been carried over to the 2005-06 fiscal year budgets.

In addition, we noted that the Authority did not amend the 2004-05 and the 2005-06 fiscal years budgets to adjust estimated prior year net assets balances to the actual net assets available from the 2003-04 and 2004-05 fiscal years. Net assets represent a governmental entity’s net available resources. Although some portion of ending net assets may be reserved for specific purposes and not be available for immediate expenditure in the subsequent fiscal year, estimated prior year ending net assets should be carefully considered and included in the budget since these amounts have a direct impact on the amount of additional funds needed to finance the cost of operations. If balances carried over are significantly underestimated, the amount of other revenue sources contemplated in the proposed budgets may be increased beyond those amounts necessary to carry out planned expenditures.

Recommendation: The Authority should determine the best available estimates of the prior year net assets balances in initial budgets submitted for public consideration and adoption by the Board. In addition, the budgets should be amended, as necessary, to report the actual net assets available from the prior fiscal year.

Cash

Finding No. 4: Bank Account Reconciliations

An essential element of control over assets entrusted to a governmental organization is the periodic comparison of such assets actually determined to be on hand with the recorded accountability for the assets. Because of the susceptibility of cash to loss,

this is particularly important for deposits and withdrawals from banking institutions. Accountability for transactions is accomplished by the preparation of bank reconciliations as soon as practicable after the receipt of monthly bank statements. In the event of a loss of cash or unauthorized withdrawal, failure to reconcile bank accounts to the accounting records in a timely manner could result in a failure to detect and recover the loss.

Our tests of a sample of the Authority’s bank reconciliations for three bank accounts disclosed nine bank reconciliations completed 42 to 69 days after the bank statement’s date. Effective internal control procedures require that bank account reconciliations be promptly performed on a routine basis and reviewed by supervisory personnel. This provides reasonable assurance that cash assets agree with recorded accountability and facilitates the prompt detection and correction of unrecorded or improperly recorded transactions.

Recommendation: The Authority should improve its procedures to provide for the timely reconciliation of its bank accounts.

Finding No. 5: Investment Practices

Section 218.415, Florida Statutes, governs the investment of surplus funds by local governmental entities and authorizes various types of investments including the Local Government Surplus Funds Trust Fund administered by the Florida State Board of Administration (SBA), money market funds, interest-bearing time deposits, savings accounts, and direct obligations of the United States Treasury. The Board has adopted an investment policy that includes all the elements required by Section 218.415, Florida Statutes.

The Authority invests surplus funds in overnight repurchase agreements and certificates of deposits. In addition, the Authority maintains four money market accounts. Our comparison of the average yield earned by the Authority to comparable rates offered by the State Board of Administration (SBA), an investment

option of the Authority, indicated that the yield on the Authority’s investments in certificates of deposits exceeded the yield available at SBA. However, our comparison of the average monthly yield of the funds invested in repurchase agreements to the SBA interest rates for the 2004-05 fiscal year, indicated that SBA interest rates consistently exceeded the average monthly yield on the repurchase agreements. This comparison indicated that the Authority could have earned approximately \$57,000 more by investing with SBA. Our comparison of interest rates on the Authority’s largest money market account to SBA for the same period indicated that SBA interest rates consistently exceeded the average monthly yield on the money market account. This comparison indicated that the Authority could have earned approximately \$303,000 more by investing with SBA.

Recommendation: The Authority should assess the feasibility of investing with SBA as an alternative to money market and repurchase accounts, as market conditions fluctuate.

Payroll and Personnel Administration

Finding No. 6: Weekly Payroll Processing

The Board established a weekly pay period, as opposed to other governmental agencies in Monroe County (specifically, Florida Keys Community College, Monroe County District School Board, and Monroe County Board of County Commissioners) that have established biweekly pay periods. Approximately 176 of the Authority’s 257 employees (at December 31, 2005) were classified as “bargaining” employees. Time worked by these employees is documented by weekly time sheets. The remaining 81 employees are classified as “non-bargaining” employees, who are paid on a basis of a 40-hour week. Accordingly, processing the Authority’s payroll is a labor-intensive and inefficient process in that staff in the Finance and Accounting Department must review and enter the hours reported on the time sheets for all bargaining employees into the payroll system on a weekly basis.

Additionally, hours worked, leave taken, and compensatory time earned and used must be accounted for and reconciled to employee records for all employees on a weekly basis.

If the Board adopted a biweekly or monthly pay period, resulting in one-half or one-fourth the pay periods annually, some cost savings would be realized. In October 2003, Authority staff presented the Board with a biweekly pay period proposal for discussion purposes which anticipated annual savings of \$49,000 due to the elimination of one position. The Board did not change the payroll period, but did eliminate one position. However, the Authority could still realize a cost savings and improve efficiency by adopting less frequent pay periods.

Recommendation: The Board should again consider the costs and benefits of weekly versus biweekly or monthly pay periods to determine whether it would be more cost-effective and efficient for the Board to change pay periods.

Finding No. 7: Severance Pay

On December 22, 2005, the Board terminated its General Counsel's employment agreement effective January 27, 2006, and agreed to eliminate the existing position of Assistant General Counsel, pursuant to the Chair's recommendation. According to the Board minutes, the Chair stated she had met with the Executive Director and General Counsel and had determined that the Authority did not need two staff attorneys and that the General Counsel was considering retiring at the end of his current contract (November 22, 2006). The General Counsel subsequently filed his application for retirement benefits under the Florida Retirement System and the Assistant General Counsel was retained as General Counsel at a salary that approximated the former General Counsel's salary. As a result of the termination and pursuant to the employment agreement terms, the Authority granted the General Counsel six-months severance pay totaling \$60,059 and certain insurance benefits.

The employment agreement presented the payment of severance pay as a payment for the General Counsel's relinquishment of his right to sue the Authority for the agreement's early termination. However, it is a basic tenet of law that the disbursement of public funds must be primarily for a public purpose. Accordingly, the expenditure of public funds must meet a public purpose, rather than a private purpose. The Authority has wide discretion in determining what constitutes a public purpose. Since any early termination of the employment agreement would have entitled the General Counsel to six months severance pay regardless of the time remaining on the agreement, whether it was one day or ten months, the payment of severance pay of \$60,059 to the General Counsel appears so favorable to the General Counsel, and so disadvantageous to the Authority, it is not apparent that this expenditure was primarily for a public purpose. Also, there were no provisions for any damages, liquidated or otherwise, owing to the Authority if the General Counsel voluntarily terminated the employment agreement.

Current employment agreements between the Authority and the current General Counsel and the Executive Director contain provisions for payment of \$75,000 to the employees if the agreements are terminated by the Board "without cause" with no consideration given to the length of time remaining on the contract or eligibility for retirement benefits at the time of termination. "With cause" is defined in each of the contracts and includes various forms of misconduct by the employee, such as conviction of a felony, fraudulent acts, and violation of the Code of Ethics of the State of Florida. While the Authority may have realized cost savings in terminating the former General Counsel as discussed above, the employment agreements do not require cost savings to the Authority as a prerequisite to severance pay upon early termination.

Recommendation: The Authority should review the provisions of current and future employment agreements, including the agreements with the current General Counsel and Executive Director, regarding the benefit to the Authority, and the public purpose served, of providing severance pay for early termination of employment agreements.

Finding No. 8: Insurance Benefits Upon Retirement

The Authority entered into three employment agreements with employees providing that upon retirement, the Authority shall continue to provide the employees with life insurance (inclusive of death and dismemberment insurance) and shall continue to provide family medical coverage (inclusive of health, prescription, dental, and vision) for the employee and dependents. The health and life provision, excluding family coverage, is also contained in the Authority's non-bargaining health and life insurance benefits policy for 16 management employees, such as the General Counsel, Executive Director, and division and department directors, hired on or prior to June 30, 2004. The wording of this provision in the employment agreements, as well as the personnel policy, is unclear as to the benefits the eligible employees are entitled to receive and the liability the Authority is agreeing to assume for this classification of employee upon retirement. For example, it is not clear as to how these benefits should be modified, if any, to account for factors such as the retiree becoming eligible for Medicare coverage or insurance coverage provided by another employer or the intent of the policy to continue family insurance indefinitely, even for adult dependents.

Recommendation: The Authority should consult with legal counsel to determine if modification of employee benefits policy is possible regarding the provision of continuing medical coverage for the employee upon retirement to clearly define the benefits and related liability to the Authority.

Finding No. 9: Employee Awards and Banquets

Expenditures of public funds must be authorized by applicable law; reasonable in the circumstances, and necessary to the accomplishment of authorized purposes of the Authority; and in pursuit of a public, rather than a private, purpose. Documentation of expenses in sufficient detail to establish the authorized public purpose served, and how that particular expense serves to further the identified public purpose of the Authority, should be present for payment of funds. The Attorney General has indicated on numerous occasions that documentation of expenses must be in sufficient detail to demonstrate to the post-auditor and the public the authorized public purpose served by such expense.

The Authority provided its employees with safety, service, and blood drive awards which totaled \$30,466 for the period October 1, 2004, through December 31, 2005, as follows:

- The Authority has adopted a Safety Awards Program for the stated purpose of working towards the common goal of avoiding accidents. All permanent employees that were employed during the entire fiscal year and have not had a "disqualifying event" are eligible for an award of \$35. A disqualifying event is defined in the employee manual as most workers' compensation claims and all chargeable/avoidable vehicle accidents. Safety awards for the period October 1, 2004, through December 31, 2005, totaled \$13,135.
- The Authority has adopted a Service Awards Program for the stated purpose of recognizing an employee's contribution to the Authority and is based on years of employment with the Authority. Awards are presented beginning with the completion of two years of service, then at five years of service, and in five year increments thereafter. The awards consist of various commemorative items such as rings,

watches, binoculars, and world globes. Individual costs ranged from \$100 to \$540, with total service award costs for the period October 1, 2004, through December 31, 2005, of \$15,706.

- The Authority gave a \$25 gift certificate to each employee that donated blood at an Authority-sponsored blood drive. Blood drive awards totaled \$1,625 for the period October 1, 2004, through December 31, 2005.

The Authority also sponsored two employee banquets, one on December 11, 2004, and another on December 17, 2005, for presenting the above awards. The Board approved these banquets for the stated purpose of promoting employee morale and enhancing a unified agency with the employees. The banquets included a discussion of past-year achievements, awards, dinner, and entertainment. Costs included hotel rooms (\$7,253) for out-of-town employees, food (\$10,352), and entertainment (\$1,200). Costs totaled \$6,915 and \$11,890 for the December 11, 2004, and December 17, 2005, banquets, respectively. Total costs for the safety, service, and blood drive awards and the employee banquets totaled \$49,271.

The Authority's position regarding the payment of awards is that the costs result in improved employee morale, reduce employee turnover, and promote employee safety. While there may be a perceived benefit to the Authority for providing employees with these awards and banquets, the awards and banquets appear to be more of a personal benefit to the employees rather than a benefit to the public. These payments are in addition to the longevity payments of \$309,980 to bargaining and non-bargaining employees as well as longevity steps in its adopted salary schedule as part of the compensation package, in part, to assist in reducing employee turnover.

Recommendation: The Authority should incur costs for employee awards and banquets only upon documenting in its records the public purpose served.

Procurement of Goods and Services

Finding No. 10: Travel Expense Reimbursements

According to the Authority's records, the Authority spent \$121,900 in the 2004-05 fiscal year for travel and training-related expenses. These expenses included charges for registration, hotel, airfare, meal allowances, and incidentals. The Authority's Travel and Business Expense Policy states that employees must complete a Voucher for Reimbursement of Traveling Expenses (hereinafter, referred to as travel voucher) to document and certify that expenses were actually incurred as necessary traveling expenses in the performance of the Authority's official business, and that the travel voucher should be completed in detail to document the nature and purpose of the travel expense, with all applicable receipts attached.

Our tests of travel vouchers indicated deficiencies in the preparation of travel vouchers and the documentation of travel and training expenses, as noted below:

- Travel vouchers generally did not include all costs related to the travel or training event for which reimbursement was made. The vouchers generally included amounts allowed by Authority travel policy for meal allowances, mileage, and incidentals (e.g., parking, tolls, taxi). However, hotel, conference registration, and airfare charges were generally paid through the Authority's purchasing card system and the charges were not included on the employees' travel vouchers. Accordingly, personnel approving travel vouchers did not have all information readily available to determine whether per diem, room charges, meals, length of stay, and miscellaneous reimbursements were appropriate for each travel or training event. Consequently, the travel vouchers did not represent all costs related to the travel or training event and, for

travel expenses charged to purchasing cards, there were no statements from the travelers certifying that the expenses were actually incurred as necessary traveling expenses in performing their official duties.

- Travel vouchers often did not show the time of departure and return. Without this information, the travel voucher does not demonstrate the extent to which the traveler is entitled to meals or per diem reimbursements.
- Travel vouchers for Board members were prepared and signed, as the authorizing signature, by the Director of the Executive Department. The authorizing signature indicates certification by the traveler that the travel was for official business of the Authority and was performed for the purposes stated in the travel voucher. However, the travel vouchers were not signed/certified by the travelers (i.e., Board members).
- The registration fee of \$765 for attendance to the annual American Water Works Association conference included a \$70 fee for a banquet; however, there was no adjustment to the \$12 dinner allowance paid each of the three Board members. The Authority’s Travel and Business Expense Policy indicates that no one shall be reimbursed for any meal included in a convention or conference registration fee paid by the Authority.

Recommendation: The Authority should require all travel and training expenses, including those paid using a purchasing card, to be included on the travel voucher. The Authority should also modify its travel voucher to provide for the reporting of all expenses directly related to the travel or training event. Provisions should be made on the travel voucher to indicate whether the expenses were paid using a purchasing card or by the individual requesting reimbursement. Travelers should also be required to indicate the time of departure and return so that meals and per

diem reimbursements can be verified in accordance with the Authority’s Travel and Business Expense Policy. Board members should sign the certification included on the travel voucher, thereby attesting to the accuracy of the reimbursement request and the public purpose served by the trip. Finally, meal allowances should be reduced when a meal is included in a registration fee.

Finding No. 11: Class C Travel Reimbursements

Meals for day travel (not away from official headquarters overnight), defined in Section 112.061(2), Florida Statutes, as Class C travel, was reimbursed to travelers either by check or by petty cash; however, Class C travel reimbursements were not reported to the Internal Revenue Service (IRS) as taxable wages, subject to withholding for payment of Federal income tax and other employment taxes. It was not practical on audit for us to determine the amount of Class C travel reimbursements processed by the Authority; however, over an 11-day period, there were 23 travel vouchers submitted for Class C travel reimbursement totaling \$690.

Internal Revenue Code Section 162(a)(2), provides that there shall be allowed as a deduction all the necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including travel expenses while “away from home.” The United States Supreme Court has interpreted the “away from home” requirement as requiring that the taxpayer be away from home overnight or at least long enough to require rest or sleep. Class C travel does not involve travel away from home overnight and, therefore, Class C meal allowances are not considered to be deductible traveling expenses. United States Treasury Regulation Section 1.62-2 provides that reimbursements for nondeductible traveling expenses must be reported as wages or other compensation on the employee’s Form W-2, and are subject to withholding and payment of employment taxes.

On April 7, 2006, Authority staff distributed instructions to implement procedures, effective May 1, to report Class C travel as taxable wages.

Recommendation: The Authority should continue to implement procedures ensuring that Class C travel reimbursements are reported to IRS as taxable wages. The Authority should also consult with IRS to determine what actions, if any, should be taken for Class C travel reimbursements paid but not reported.

Finding No. 12: Allocation of Costs

In its Recommended Practices, *Measuring the Cost of Government Service (2002)*, the Government Finance Officers Association (GFOA) recommends that governments calculate the full cost of the various services they provide. The full cost of a service encompasses all direct and indirect costs related to that service. Direct costs include the salaries, wages, and benefits of employees while they are exclusively working on the delivery of the service, as well as the materials and supplies, and other associated operating costs. Indirect costs include shared administrative expenses within a department and in one or more support functions outside a department (such as legal, finance, human resources, and information technology). These shared costs should be apportioned by some systematic and rational allocation methodology and that methodology should be disclosed, particularly in situations where costs are fully or partially recovered through user charges.

The Authority maintains separate financial accountability for the operation and construction of the water and wastewater systems. Our tests indicated that direct costs for salaries and materials were properly charged to either the water or wastewater systems. However, we did note payments, totaling approximately \$160,000, to an engineering firm for the construction phase on Bay Point and Conch Key water and wastewater system improvements were charged to the wastewater system, with no allocation to the water system for its portion of the charges. The invoices did not indicate an allocation of the charges.

The Authority has not adopted a written policy regarding the allocation of indirect costs between the water and wastewater systems. Except for a monthly facility charge of \$600, the Authority does not allocate indirect costs to the wastewater system. For example, certain administrative support functions, such as human resources, legal, purchasing, and information technology perform services for both the water and wastewater systems; however, no costs for these functions are allocated to the wastewater system. In the absence of an allocation process, the water system is indirectly providing financial support for the wastewater system. Authority staff indicated that the wastewater system is still in the developing stages and has limited operating income. Accordingly, wastewater system costs are limited, at this time, to only direct charges. As the operation expands and becomes fully developed, an allocation plan will be approved and implemented by the Authority. Although the wastewater system has limited operating income, it is still incurring shared costs that are not being allocated to it and a calculation of all such costs is necessary for a determination of the actual cost of providing the wastewater services.

Recommendation: The Authority should review the engineering firm charges of \$160,000 and allocate an appropriate portion of the charges that represent work on the water system. The Authority should also develop policies and procedures for allocating indirect costs to the wastewater system.

Contractual Services

The Authority is responsible for establishing internal controls that provide assurance that the process of acquiring contractual services is effectively and consistently administered. As a matter of good business practice, procurement of services should be done using a competitive selection process to provide an effective means of equitably procuring the best quality services at the lowest possible cost. In addition, contractual arrangements for services should be evidenced by written agreements embodying all provisions and conditions of the procurement of such

services. The use of a formal written agreement protects the interests of the Authority, identifies the responsibilities of both parties, defines the services to be performed, and provides a basis for payment.

Finding No. 13: Consultant and Attorney Services

The Board entered into two lump-sum consultant arrangements, without following a competitive selection process, to provide lobbying and Legislative contacts for the advancement of Authority purposes. Payments to these consultants totaled \$147,550, including out-of-pocket and travel expenses, for the period October 1, 2004, through November 30, 2005. Fees totaling \$61,800 were paid according to a written retainer agreement approved by the Board, and fees totaling \$85,750 were paid according to Board-approved agenda items and written proposals by the consultants. The documents indicated a variety of general consulting services to be provided to the Authority, such as lobbying, monitoring legislative or executive initiatives, sharing experiences, and providing advice and research. Also, the written proposals and the retainer agreement did not identify the responsibilities of the Authority and the consultants, specific work products or deliverables, or require the consultants to submit written reports summarizing the results of their work.

We requested Authority staff to provide us with written contracts, reports, or other documentation indicating specific services or products provided as a result of these financial arrangements and to provide periodic evaluations as to the performance of these consultants in meeting the objectives of the Board. The Authority's Internal/Compliance Auditor provided us with copies of minutes dated July 28, 2005, in which one consultant provided a summary of State Legislative activity, and minutes dated August 25, 2005, and a report dated March 13, 2006, in which another consultant provided a summary of Federal Legislative activity. However, neither summary presented an explanation of specific services or products provided. The report stated that meetings

were held and contributed to funding received by the Authority, but did not contain any specific work product or details as to the number and dates of meetings held, who the meetings were with, or specific accomplishments. Also, no written evaluations of the services provided by the consultants were prepared by the Board as to the satisfaction of work provided, other than annual renewals of the financial arrangements.

The Authority also utilized the services of six different independent law firms to provide a variety of legal services, such as employee relations and arbitration, general liability matters, water and wastewater issues, and consumption use permit application process. Fees paid to these firms totaled approximately \$204,000, including out-of-pocket and travel expenses, for the period October 1, 2004, through November 30, 2005, and were based upon specific agenda items approved by the Board. The law firms were selected without following a competitive selection process. Although requested, Authority staff was unable to provide us with current written contracts for these services. Invoices presented by the attorneys were in sufficient detail to indicate the services provided and reimbursable costs were supported. However, absent written agreements specifying the nature of the services to be performed and the amount of compensation to be provided, the Authority has limited assurance that the payments are in compliance with the intent of the Board and that the Authority received the services to which it is entitled at agreed upon prices.

Recommendation: Although not required to do so by law, sound business practices suggest that the Authority should follow a competitive selection process when entering into such arrangements. The Authority should also develop written agreements for future financial arrangements with the consultants and attorneys, documenting specific deliverables and work products. Also, the Authority should formally evaluate, at least annually, the effectiveness of these consultants and attorneys prior to renewing the agreements.

Finding No. 14: Competitive Selection of Engineers

Section 287.055, Florida Statutes (the Consultants' Competitive Negotiation Act), provides that professional services, including architectural, professional engineering, landscape architecture, and registered surveying services, be acquired pursuant to a formal competitive selection and negotiation process. The Act generally requires that the Authority publicly announce, in a uniform and consistent manner, each occasion when professional services must be purchased for a project with a basic construction cost that is estimated by the agency to exceed \$250,000, or when a planning or study activity fee is estimated to exceed \$25,000. Additionally, the Act provides that a continuing contract for professional services may be entered into for construction projects when the

construction costs do not exceed \$1 million, for a study activity when the fee for such professional service does not exceed \$50,000, or for work of a specified nature as outlined in the contract.

The Authority entered into continuing contracts with three professional engineering firms in 1999 and 2003 to provide general water and wastewater consulting and design engineering services. The continuing contracts entered into as a result of the selection process did not identify or list individual construction projects or outline and describe any work of a specified nature. The contracts provided that the Authority would issue task orders to authorize work, projects, and services, and to describe the scope of work to be performed. Compensation for the services performed on each task order was to be based on a negotiated lump sum amount, or a not-to-exceed budgeted amount based on time charges and the hourly rates listed in the contracts, plus actual reimbursable expenses. The Board reaffirmed the contracts annually, and periodically approved adjustments to the hourly rates listed in the contracts.

The Authority issued continuing contract task orders for the design, permitting, bidding, and construction phase engineering services to one engineering firm for four wastewater projects in which construction costs exceeded \$1,000,000, as follows:

<u>Project</u>	<u>Range of Dates Task Orders Issued</u>	<u>Task Order Engineering Fees</u>	<u>Total Project Construction Costs</u>
Little Venice & Little Venice Expanded	6/16/99 – 4/16/04	\$1,532,992	\$11,311,394
Bay Point	8/28/00 – 5/08/04	525,127	5,192,140
Conch Key	8/28/00 – 7/29/04	337,917	1,390,642
Big Coppitt Key	11/02/05	1,135,553 (1)	23,575,000 (2)
(1) Amount is for the design phase only			
(2) Estimated construction costs reported in the 5-year capital improvement plan			

Under these conditions, the engineering firms were hired to perform professional engineering services for construction projects without going through the public announcement and formal competitive selection and negotiation process, although the estimated construction costs exceeded the thresholds specified in Section 287.055, Florida Statutes. The Legislature has recognized in Section 287.001, Florida Statutes, that fair and open competition is a basic tenet of public procurement, and that such competition reduces the appearance and opportunity for favoritism and inspires public confidence that contracts are awarded equitably and economically. Absent utilization of the required competitive selection process, the Authority's ability to demonstrate the fair, equitable, and economical procurement of professional services is limited.

In March 2006, the Authority published a request for qualifications from professional engineering consulting firms interested in entering into engineering services contracts with the Authority for individual capital improvement projects. A total of 27 water and wastewater capital improvement projects were identified in the request for qualifications. We were advised by Authority personnel that continuing contracts for engineering services would not be used for the projects identified in the request for qualifications, and that continuing contracts would no longer be used for any professional services for construction projects in which estimated construction costs exceed \$1 million.

Recommendation: The Authority should establish written policies and procedures to ensure that professional services are obtained pursuant to competitive selection and negotiation when the construction cost or the fee for professional services is estimated to exceed the thresholds specified in Section 287.055, Florida Statutes.

Finding No. 15: Awarding of Wastewater Construction Contracts

The Authority has recently completed, or is in the process of completing, several wastewater projects with construction costs totaling approximately \$23.2 million. Our review of projects either completed or underway disclosed the following:

- The Authority's construction contracts generally do not provide for the direct purchase of construction materials and, as a result, sales tax is included in the construction costs of water and wastewater system facilities and improvements. Section 212.08(6), Florida Statutes, provides an exemption from the Florida sales tax to governmental entities when payments are made directly to the vendor by the governmental entity. Although it may not be feasible to directly purchase all construction materials, the Authority could have directly purchased a large portion of the required construction materials for those projects and benefited from the sales tax savings. For example, major equipment for the Little Venice Wastewater System, excluding the collection system, was estimated by the Authority's contracted engineer to cost \$1,129,000, on which sales tax would have totaled \$67,740 (6 percent of \$1,129,000). Although there would be some cost to the Authority to directly purchase materials, such as staff time and storage of material prior to installation, these costs should be weighed against the sales tax that would be incurred if the Authority did not directly purchase the materials. Direct purchase of materials would entail separation between materials and labor costs on bid proposals. During the audit period, the Authority did not require competitive bid proposals to contain separate costs for materials and labor for wastewater projects. The practice of direct purchases is being utilized by other governmental entities,

such as district school boards, community colleges, and universities within the State as a cost-saving measure.

- Bids were required to be separated by major components (e.g., water main replacement, sewer system, treatment plant) and activities (e.g., installation of sewer main). The bids, which usually included labor and materials combined into a single amount, varied widely for the individual project components and activities, even though total costs for a given project may not have varied widely among the bidders. For example, bids on the Bay Point

project were comprised of (A) water main replacement, (B) vacuum collection system, and (C) wastewater treatment plant. Bids received were as follows for each of the major components (a seventh bid was excluded from this analysis as it included additional equipment):

Component	Bid 1	Bid 2	Bid 3	Bid 4	Bid 5	Bid 6
A	\$ 520,265	\$ 433,020	\$ 483,000	\$ 392,604	\$ 566,681	\$ 574,860
B	2,756,906	3,027,125	3,802,535	2,688,011	3,095,788	3,111,194
C	2,392,129	2,131,590	1,881,000	2,643,871	2,127,680	2,220,000
Totals	\$5,669,300	\$5,591,735	\$6,166,535	\$5,724,486	\$5,790,149	\$5,906,054

Indicates lowest bid received

The Authority awards the entire project to one contractor. As a result, the project may cost more than if bids were awarded by components. For Bay Point, the lowest bids received on components total \$4,961,615 (\$392,604 + \$2,688,011 + \$1,881,000) whereas the lowest bid on the entire project totaled \$5,591,735.

Though it may not have been feasible or cost-effective to bid each major component separately, it may have been feasible for the Bay Point project to have bid the wastewater treatment plant (component C) separately. The combined amount bid on components A and B on Bid 4 was \$379,530 less than the combined bid for those components by the selected bidder (Bid 2) and the bid amount on component C on Bid 3 was \$250,590 less than the bid for that component by the selected bidder (Bid 2). Had the bidders been informed that the project may be awarded by component, the bids by component may have varied

from those listed above due to several factors, such as mobilization and the need to coordinate with other contractors at the job site. However, the potential for savings suggests that the bidding of projects by major component should be considered.

The direct purchasing of construction materials, and basing the selection of the contractor on the cost of the entire project rather than separable major components, may have resulted in a more cost-efficient method for constructing wastewater projects.

Our review of the Authority’s water and wastewater five-year capital improvement plans, dated July 2005, disclosed that the Authority anticipates spending approximately \$89 million and \$144 million for water and wastewater system construction projects, respectively, during the 2005-06 through 2009-10 fiscal years. Given the significant size of the Authority’s planned capital construction expenditures, it would be in the best interest of the Authority and its stakeholders to implement procedures to require

competitive bid proposals to contain separate costs for materials and labor for construction projects and to provide for the direct purchase of construction materials.

Recommendation: The Authority should consider implementing procedures to require competitive bid proposals to contain separate costs for materials and labor for construction projects and to provide for the direct purchase of construction materials whenever it would be more cost effective. Further, the Authority should consider awarding contracts based on the lowest bid by major component when such components are unrelated sufficiently to the remainder of the project so as not to hinder the timely completion or coordination of the project. Such procedures, if effectively implemented, would enable the Authority to better evaluate bids and could result in cost savings in capital construction projects.

Finding No. 16: Contract Payments

Our review of wastewater expenditures disclosed that the Authority needs to improve its procedures for monitoring compliance with certain vendor contract terms to ensure that established purchasing policies and procedures are followed for the acquisition of all services, as discussed below:

- The Authority paid a wastewater engineering firm a total of \$2,226 in two payments for professional services associated with the final certification of the South Florida Water Management District (SFWMD) permit for the Little Venice wastewater treatment plant. The payments were made pursuant to a task order issued to the engineering firm for General Engineering Services for the 2005-06 fiscal year. The same engineering services were provided for in the task orders issued, and in the engineering fees paid, for the construction phase of the project. Consequently, the Authority paid the engineering firm twice for the same services.
- The Authority paid two wastewater engineering firms at hourly rates that were in

excess of the hourly rates stated in their contracts and for other expenses that were not provided for in the contracts. Nine payments totaling \$133,559 to one engineering firm included excess hourly rate billings totaling \$6,673 and charges totaling \$779 and \$4,390 for communications and computer usage, respectively, which were not provided for in the engineering firm's contract. One payment of \$22,628 to the other engineering firm included excess hourly rate billings totaling \$287, and a charge for inter-company services of \$6,328, which was not provided for in the engineering firm's contract.

- On October 27, 2004, the Authority made the final payment of \$9,414 to an engineering firm for the construction phase of the Little Venice wastewater treatment plant and collection system before the firm completed all of the contracted services. Documentation attached to the payment voucher indicated that the engineering firm still needed to finalize record drawings for submission to the Authority and to finalize and officially submit the operations and maintenance manual information pending additional information from the contractor. The Authority subsequently received the final record drawings and operations and maintenance manual information.
- The contract with one engineering firm provided that the Authority reimburse the firm for the actual cost of certain expenses and for transportation and subsistence costs in accordance with Section 112.061, Florida Statutes, and the Authority's travel policy. The Authority's travel policy required that all travel expenses must be supported by receipts which indicate the amount paid and date. We noted three payments totaling \$74,222 to the engineering firm that included reimbursements for travel and other expenses totaling \$8,255. Receipts for the travel and

other expenses were not attached to the travel voucher or otherwise included in the Authority's records to support the travel and other expenses reimbursed to the engineering firm.

- Three payments totaling \$43,866 were made to a vendor during November and December 2005 for pumping and disposing of wastewater and sludge from the Authority's Little Venice wastewater treatment plant and the Little Venice and Conch Key lift stations. Although required by the Authority's written purchasing policies and procedures, which requires competitive bids for purchases over \$25,000, competitive bids were not obtained and a requisition and purchase order were not issued for acquisition of the services. The Authority's records did not document the basis for excluding competitive bids and for not issuing a requisition and purchase order for the services.

Recommendation: The Authority should enhance its procedures to ensure that payments to vendors are not duplicative and are consistent with approved contract provisions and its purchasing policies and procedures. Required competitive bidding procedures should be followed or the basis for not utilizing such procedures should be documented, for all purchases over \$25,000. The Authority should also ensure that payments are not made until all services have been performed and adequate supporting documentation has been provided. Finally, the Authority should seek to recover duplicate payments and overcharges from the firms discussed above, and request documentation for unsupported travel and other expenses paid.

Finding No. 17: Substantial and Final Completion Dates

The Authority's contracts for the construction of wastewater facilities (treatment plants and collection systems) provided that time was of the essence and that the Authority would suffer financial loss if the

work was not completed within the times specified in the contracts, plus any time extensions granted by the Authority. Contracts for the construction of the Little Venice, Little Venice Expanded, Conch Key, City of Layton, and Bay Point wastewater projects required the contractors to reimburse the Authority for additional expense and damage for each calendar day that the work remained uncompleted after the required dates for substantial and final completion. Substantial completion and final completion were defined in the contracts, as follows:

- **Substantial Completion** – The degree of completion of the project or a defined portion of the project, as evidenced by the Authority's written notice of substantial completion, sufficient to provide the Authority the full-time use of the project or defined portion of the project for the purposes for which it was intended. Substantial completion of an operating facility shall be that degree of completion that has provided a minimum of seven continuous days of successful, trouble-free operation, which period shall begin after all performance and acceptance testing has been successfully demonstrated to the Authority. All equipment contained in the work, plus all other components necessary to enable the Authority to operate the facility in the manner that was intended, shall be complete on the substantial completion date.
- **Final Completion** – The completion of all work under the contract documents, including all conditions to final payment as set forth in the general conditions portion of the contract, including inspection and acceptance of completed work by the Authority.

The contracts also provided that the amounts of additional expense and damage incurred by reason of failure to complete the work on time were at the rates of \$1,500 to \$2,500 for substantial completion, and \$500 for final completion, for each day that expired after the dates required by the contract. The amounts

were considered to be liquidated damages, not penalties.

Our review of the Little Venice, Little Venice Expanded, Conch Key, and Bay Point wastewater projects disclosed that the Authority needs to improve its procedures for monitoring and documenting contractor compliance with meeting substantial and final completion dates to determine whether liquidated damages should be assessed against contractors, as discussed below:

- Little Venice – The last change order (No. 6) approved by the Authority on July 28, 2005, for the Little Venice wastewater project established October 22, 2004, as the final completion date of the project. The certificate of completion issued by the Authority on July 29, 2005, stated that the work on the project was completed June 21, 2005. Although the Authority's records indicate that the contractor was 242 days late in meeting the required final completion date, the Authority did not assess liquidated damages at \$500 per day, or \$121,000. The Authority did assess the contractor liquidated damages at \$2,500 per day, or \$95,000, on change order No. 6, for not meeting substantial completion until June 2, 2004, instead of the required date of April 25, 2004. However, the Authority's records did not include documentation which explained why it did not assess liquidated damages against the contractor for failing to achieve final completion by October 22, 2004.
- Little Venice Expanded – The certificate of substantial completion for the Little Venice Expanded wastewater project indicated an actual substantial completion date of September 9, 2004, 38 days after August 2, 2004, the date required in the contract. The Authority's records did not include documentation which explained why it did not assess liquidated damages of \$2,500 per day, or \$95,000, against the contractor for failing to meet the substantial completion date.
- Conch Key - The certificate of substantial completion for the Conch Key wastewater project indicated that substantial completion was achieved by the contractor on June 12, 2005, 10 days after the required date of June 2, 2005. The Authority's records did not include documentation which explained why it did not assess liquidated damages of \$2,500 per day, or \$25,000, against the contractor for failing to achieve the substantial completion date.
- Bay Point – Change orders extended the dates for substantial and final completion to May 30, 2005, and July 29, 2005, respectively. Authority records indicate that the contractor requested substantial and final completion dates of June 15, 2005, and August 15, 2005, respectively. However, the certificate of substantial completion was not issued by the Authority as of May 4, 2006, over 10 months after the requested date for substantial completion. We were advised by Authority personnel that the delay was due to Authority management waiting for testing of the plant to ensure that it was operational and complied with standards. Test results in April 2006, indicated deficiencies that need correction.

Authority personnel explained that, although consideration was given to assessing contractors

liquidated damages when substantial and final completion dates were not met, they did not prepare written justifications and did not always obtain approval by the Board when liquidated damages were not assessed.

Recommendation: The Authority should enhance its procedures for monitoring and documenting contractor compliance with required substantial and final completion dates and assessing liquidated damages when appropriate.

Other

Finding No. 18: Conflict of Interest

According to Authority records, in 1992 the Authority hired an attorney as a full-time employee to be its General Counsel pursuant to an employment contract. The contract provided that litigation services and customary fees for bond work would be billed separately. On November 22, 2000, the Authority extended the employment agreement to November 22, 2003, with a provision that the agreement would be automatically renewed unless one of the two parties notifies the other 60 days prior to the expiration date. The agreement indicated that the attorney would provide continuous services to the Authority as its General Counsel to handle and care for the legal affairs and litigation of the Authority. The contract provided for a salary, to be adjusted annually for cost-of-living and merit as provided by the Authority to its exempt employees. The General Counsel also received all other benefits afforded the Authority's exempt employees. Section 3 of the contract provided that, in addition to the annual salary and benefits provided for in the contract, the General Counsel may also be entitled to bill the Authority separately for additional litigation and bond sale fees at certain hourly rates.

During the period that this individual was employed as the Authority's General Counsel, the Authority continued to use the law firm, in which the individual was a partner, for certain legal services. Section

112.313(3), Florida Statutes, prohibits a public employee from acting in a private capacity to sell any services to the employee's own agency (i.e. the Authority). Accordingly, this arrangement violated State law resulting in a conflict of interest between the General Counsel and the Authority.

We reviewed all payments to the General Counsel for the 2003, 2004, and 2005 calendar years and determined that no payments were made to him for additional litigation and bond sale fees. However, the General Counsel's law firm received payments totaling \$34,000 for such legal services provided to the Authority during the 2003 calendar year. On December 22, 2005, the Authority terminated the General Counsel's contract effective January 27, 2006, thereby resolving this conflict of interest.

Recommendation: The Authority should ensure that future employment agreements are free of provisions that violate Section 112.313(3), Florida Statutes, resulting in potential conflicts of interest.

SCOPE AND OBJECTIVES

The scope of this audit included transactions during the period October 1, 2004, through November 30, 2005, and selected transactions taken prior and subsequent thereto, related to allegations concerning the Authority's wastewater operations to determine whether such transactions were executed, both in manner and substance, in accordance with governing provisions of laws, rules, bond covenants, and other guidelines.

Our audit did not extend to an examination of the Authority's financial statements. The Authority's financial statements for the fiscal year ended September 30, 2005, were audited by a certified public accounting firm, and the audit report is required to be filed as a public record with the Authority.

Our audit objectives for the scope of this audit were to:

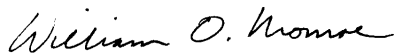
- Document our understanding of the Authority's management controls relevant to the areas identified by specific allegations. Our purpose in obtaining an understanding of management controls and making judgments with regard thereto was to determine the nature, timing, and extent of substantive audit tests and procedures to be performed.
- Evaluate management's performance in administering its assigned responsibilities in accordance with applicable laws, ordinances, bond covenants, and other guidelines.
- Determine the extent to which the Authority's management controls promoted and encouraged the achievement of management's objectives in the categories of compliance with controlling laws, rules, and other guidelines; the economic and efficient operation of the Authority; the reliability of financial records and reports; and the safeguarding of assets.

METHODOLOGY

The methodology used to develop the findings in this report included the examination of pertinent Authority records in connection with the application of procedures required by generally accepted auditing standards and applicable standards contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

AUTHORITY

Pursuant to the provisions of Section 11.45(2)(l), Florida Statutes, I have directed that this report be prepared to present the results of our operational audit of the Florida Keys Aqueduct Authority for the period October 1, 2004, through November 30, 2005, and selected actions taken prior and subsequent thereto.



William O. Monroe, CPA
Auditor General

MANAGEMENT RESPONSE

The Authority's response is included in this report as Appendix A.

This audit was conducted by James E. Raulerson, CPA. Please address inquiries regarding this report to James M. Dwyer, CPA, Audit Manager, via e-mail at jimdwyer@aud.state.fl.us or by telephone at (850) 487-9031.

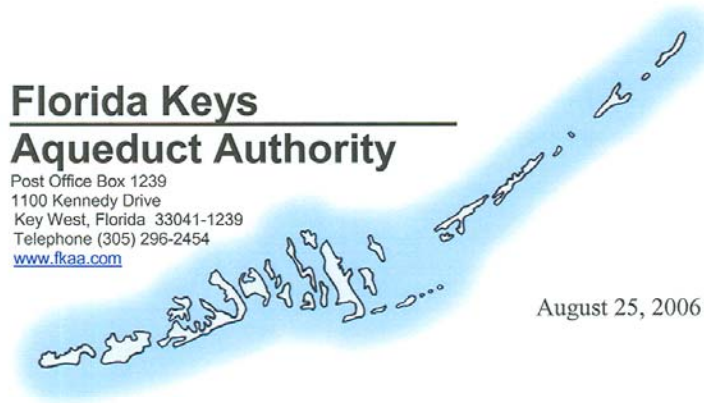
This report, and other audit reports prepared by the Auditor General, can be obtained on our Web site at <http://www.state.fl.us/audgen>; by telephone at (850) 487-9024; or by mail at G74 Claude Pepper Building, 111 West Madison Street, Tallahassee, Florida 32399-1450.

**APPENDIX A
MANAGEMENT RESPONSE**



**Florida Keys
Aqueduct Authority**

Post Office Box 1239
1100 Kennedy Drive
Key West, Florida 33041-1239
Telephone (305) 296-2454
www.fkaa.com



August 25, 2006

Mary L. Rice
Chairman
Marathon

J. Robert Dean
Vice-Chairman
Key West

Elena Z. Herrera
Secretary/Treasurer
Rockland Key

Rose M. Dell
Big Pine Key

David C. Ritz
Key Largo

James C. Reynolds
Executive Director

William O. Monroe
Auditor General
State of Florida
G-74 Claude Pepper Building
111 West Madison Street
Tallahassee, Fl. 32399-1450

Dear Mr. Monroe:

The Board of Directors of the Florida Keys Aqueduct Authority received the list of preliminary and tentative audit findings on July 31, 2006. The Board reviewed the findings at a Board Meeting held on August 24, 2006. Please find enclosed the Authority's written statement of explanation concerning all of the findings, including our actual or proposed corrective actions.

Response No. 1 – Administrative Expenses

The Board is keenly aware of the impact of rates and fees on our customers. Annually the Board publishes its proposed budget and holds public hearings to receive comments and recommendations from our customers. Rate studies are prepared to ensure that our rates are fair and equitable. The Board will carefully evaluate management practices and public purposes served and, as appropriate, document the level and nature of expenses necessary to operate the Authority.

Response No. 2 - Budgetary Level of Control

The Board, pursuant to its Enabling Legislation, adopts an annual budget after a series of public hearings. The Board monitors the budget at the fund level and requires that any additions to the overall budget come before it for approval. The Board has ensured that expenditures have never exceeded the budget at the fund level. The Board receives a monthly informational agenda item comparing actual operating expenditures to the adopted budget and citing any transfers between budget categories that have been approved by the Executive Director. Budget amendments at the fund level are decided by the Board. The Board will adopt a policy to formally establish the level of budgetary control.

The Board will add to their monthly budgetary reports a budget-to-actual comparison for all expense categories, including debt service and construction expenses.

APPENDIX A (CONTINUED)
MANAGEMENT RESPONSE

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Response No. 3 - Budget Preparation

The ending year net assets and available cash reserves are detailed in the Authority's Comprehensive Annual Financial Report (CAFR) which is published each year. The annual budget has reflected the amount of available reserves that may be required to fund operations and capital improvements within that budget year. The Authority has adopted a new format for the 2006-2007 Budget. This format will disclose not only budgeted sources and use of funds but also the projected ending cash reserves available for future year expenditures. Further, the best available estimates of the prior year net assets balances will be presented in initial budgets and submitted for public consideration and adoption by the Board.

Response No. 4 - Bank Account Reconciliations

The Authority monitors its cash position on a daily basis. Reconciliations between cash in the bank and the general ledger fell behind last year due to the impact on staff of three Mandatory Evacuations and substantial damage sustained from Hurricane Wilma. All reconciliations are now current.

Response No. 5 - Investment Practices

The Board, pursuant to Florida Statute, has adopted and follows a written investment plan. The plan is structured to place the highest priority on the safety of principal and the liquidity of funds. The Auditor General's findings, having the advantage of hindsight, point out that the Florida State Board of Administration (SBA) earnings were higher than some of the Authority's investments during the audit period. The Authority will continue to monitor all investment options available, including the SBA, and invest funds pursuant to the "Prudent Person Rule", which states that: "Investments should be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived from the investment".

Response No. 6 - Weekly Payroll Processing

The Authority has a long history of utilizing a weekly payroll. The Board previously requested the Executive Director to review the savings that could be obtained by going to a bi-weekly payroll versus any negative impact to the employees. The Board will consider the costs and benefits of weekly versus bi-weekly or monthly pay periods to determine whether it would be more cost-effective and efficient to change pay periods.

APPENDIX A (CONTINUED)
MANAGEMENT RESPONSE

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Response No. 7 - Severance Pay

The Board made the decision that it did not require the services of both a General Counsel and an Assistant General Counsel. The General Counsel indicated to the Chairman of the Board that he was considering retiring at the end of his contract. The Chairman recommended terminating the General Counsel's contract effective January 27, 2006 pursuant to the terms of his contract. The Authority realized a savings with this termination.

It is a common practice to place a severance pay provision in professional employee contracts. It is a practice that is seen in many governmental employment contracts in Monroe County. This practice has been implemented to attract and retain professionals. The Board has found that this practice is a benefit to the Authority. The Authority has two contract employees, the Executive Director and General Counsel. The Authority's employee contracts provide that the severance will not be paid if there is "just cause" for a termination. The severance is only paid in the event the contract employee is terminated "without cause". The Board will determine, in its consideration of future employment contracts, whether the inclusion of a severance pay provision remains beneficial to the Authority and serves a public purpose.

Response No. 8 - Insurance Benefits Upon Retirement

The Authority has, in practice, interpreted how insurance benefits for employees will be provided after retirement. For example, the Authority presently pays a Medicare supplement when a retiree reaches age eligibility, which is less costly than healthcare benefits paid to non-Medicare eligible employees. The Authority will amend its insurance benefits policy to ensure that the written policies reflect current practices, and to provide an explicit description of the benefits that will be provided to retirees.

The Authority does not provide insurance benefits upon retirement to any employee hired after June 30, 2004.

Response No. 9 - Employee Awards and Benefits

The Authority always carefully considers the public purpose to be served when any costs are incurred. The Authority, along with most other private and public employers in Monroe County, has been experiencing high turnover rates among its employees over the last few years. It has become much more difficult to attract and retain qualified employees. The Authority has looked to award programs to improve employee morale and to encourage existing employees to remain with the Authority. Awards and employee recognition programs improve morale which may lead to a lower turnover rate, which provides a cost savings, which is in the public interest.

The Authority will review all of its benefits and award programs and provide documentation in its records of the public purpose served.

APPENDIX A (CONTINUED)
MANAGEMENT RESPONSE

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Response No. 10 - Travel Expense Requirements

The Authority is now utilizing the State of Florida travel reimbursements form for travel reimbursement. All travel for a single trip is now contained in one document. Prior to the adoption of this procedure, all employees' travel costs were documented and accounted for but not combined in one document. This new process will make any future audit of travel expenses much easier. The findings report an overpayment of \$12.00 in the reimbursement of three meal allowances. This was an oversight. Meal allowances are not paid when a meal is included in a registration fee.

Response No. 11 - Class C Travel Reimbursement

The Authority has implemented procedures to ensure that all Class C travel reimbursements are reported to the IRS as taxable wages. The Authority will consult with the IRS to determine what actions, if any, should be taken for Class C travel reimbursements paid but not reported.

Response No. 12 - Allocation of Costs

The Authority will develop additional written policies and procedures for allocating indirect costs to the wastewater system. It is the policy of the Authority to allocate an appropriate portion of charges that represent work between water and wastewater systems. The Authority, in conjunction with the engineering firm for the construction phase on Bay Point and Conch Key water and wastewater system improvements, has determined that \$1,951 should be allocated to the Conch Key water system and \$540 to the Bay Point water system. The remaining amounts of the \$160,000 cited in the findings were properly allocated to the appropriate wastewater system. The Authority will make the necessary correction to the allocations between the water and wastewater systems on the Bay Point and Conch Key projects.

Response No. 13 - Consultant and Attorney Services

The Authority's procurement practices for attorneys are in compliance with Chapter 287.057 of the Florida Statutes. The Authority will develop written guidelines and procedures to better document the criteria considered by the Authority in its procurement of government consultants and attorneys.

Every consultant and attorney retained by the Authority has been approved by the Board. Their duties are set out in agreements, engagement letters or by direction of the Board in an agenda item. The Authority will develop standard contracts that will be utilized for the retaining of governmental consultants and attorneys.

The Authority has approved relationships with three consultants that provide governmental relations services. Their duties are set out in written agreements and an engagement letter. It is common for cities, counties, special districts, and state agencies to retain governmental consultants. The governmental consultants contact and report to the Authority on a regular basis. Their work is monitored by Authority staff and the Board. The Board annually assesses the need for both state and federal representation based on funding and legislative opportunities.

The Authority staff and Board will annually evaluate the performance and service provided by the governmental consultants before approving a new contract.

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MANAGEMENT RESPONSE

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Response No. 14 - Competitive Selection of Engineers

Section 287.055 of the Florida Statutes provides for the acquisition of professional architectural, engineering, landscape architectural or surveying and mapping services. It establishes a competitive selection process based on qualifications, rather than compensation. The Authority solicits engineers pursuant to the provisions of this statute.

The Authority is currently in compliance with the provisions of Section 287.055 of the Florida Statutes.

Response No. 15 - Awarding of Wastewater Construction Contracts

It is the practice of the Authority to consider the cost benefits of the direct purchase of certain materials, thereby receiving a sales tax savings. The Authority has directly purchased materials, such as large generators and pump-station pumps, on previously procured projects and will continue to consider this option on all future projects if a savings will be realized. The Authority will also consider modifying its construction contract documents to allow for the direct purchase of materials on a more regular basis.

For its first several wastewater projects, the Authority procured the projects as one large system. The reason for this process was to provide for a single point of responsibility through a general contractor for the entire project. This process relieved the Authority of any responsibility or risk associated with the coordination of the interfacing of the sewer collection system with the sewer treatment plant. This interfacing is especially critical with a vacuum sewer system.

The Authority is now designing the Big Coppitt Wastewater System which includes a wastewater treatment plant and a gravity collection system. This project will be procured by major components with the collection system bid separately from the treatment plant. The Authority will also consider this procurement option on future projects.

Response No. 16 - Contract Payments

The Authority retains an internal auditor and is subject to an annual audit by an independent auditor. The items of concern mentioned in this finding have been audited by the Authority's internal auditor whose recommendations of specific procedures to enhance related internal controls have been implemented. The Authority will bill the engineering firms involved to recover any amounts due to the Authority.

The instance cited regarding non-competitive bidding for pumping and disposal of wastewater sludge is an isolated instance. The Authority originally bid the pumping and disposal of wastewater sludge as part of contractual services for plant operation, but the results indicated that this service was too costly. The vendor was utilized first on an emergency basis, and later used due to twenty four (24) hour service availability and Florida Department of Environmental Protection permit requirements that disposal be made by way of Monroe County transfer stations. The vendor utilized has a contract with Monroe County for sludge disposal. The Authority will ensure that future routine pumping and disposal of wastewater and sludge from the Authority's wastewater projects will be procured by competitive bidding.

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Response No. 17 - Substantial and Final Completion Dates

The Authority always reviews projects to determine if it is in the best interest of the Authority and its customers to seek liquidated damages on its construction projects when a project is completed outside the contract dates. The projects mentioned in the findings were reviewed by the Authority in regard to the assessment of liquidated damages.

The Authority will enhance its monitoring procedures and ensure that it documents its rationale for determining whether liquidated damages will be sought in all future projects.

Response No. 18 - Conflict of Interest

The Authority will ensure that future employment agreements are free of provisions that may violate Section 112.313(3) of the Florida Statutes, which may result in potential conflicts of interest.

On behalf of the Florida Keys Aqueduct Authority Board and Staff, I would like to take this opportunity to thank you and your Staff for the professionalism exhibited in conducting this audit.

Sincerely,



Mary L. Rice, Chairman
Florida Keys Aqueduct Authority
Board of Directors

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