

OFFICE OF THE CITY CONTROLLER



**PUBLIC WORKS AND ENGINEERING DEPARTMENT
MUNICIPAL DRAINAGE UTILITY SYSTEM**

COMPLIANCE REVIEW

Ronald C. Green, City Controller

Courtney E. Smith, City Auditor

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TEXAS

RONALD C. GREEN

December 17, 2014

The Honorable Annise D. Parker, Mayor and Honorable Council Members

**SUBJECT: REPORT #2015-03
PUBLIC WORKS AND ENGINEERING DEPARTMENT (PWE), – MUNICIPAL UTILITY DRAINAGE
SYSTEM COMPLIANCE REVIEW**

Dear Mayor Parker and Council Members:

Based on requests from City Council and constituents, the Office of the City Controller's Audit Division has completed a compliance assessment of the Drainage Fee processes.

The initial scope and objectives were to determine and report compliance with City Ordinance 2011-254 Adopting Article XIV to Chapter 47 of the code of Ordinances of Houston Texas to create a municipal drainage utility system; and City Ordinance 2013-281 Adopting Article XV to Chapter 47 of the Code of Ordinances.

After conducting an initial review of the Ordinances it was determined that Ordinance 2013-281 would not become effective until April 2014. As a result of this review the original objective was modified to cover only Ordinance 2011-254. The modified objectives with respect to Ordinance 2011-254 were as follows:

- Identify the key provisions of the Ordinance
- Identify the processes in place to comply with the Ordinance
- Identify transactions or activities; and
- Perform detailed testing and analysis to determine compliance.

Based on the results of the procedures performed, we determined that the City has complied with the requirements set forth in Ordinance 201-254; specifically policies and procedures have been implemented for billing, collection, recording, and expending municipal utility drainage funds that are adequate to comply with the Ordinance.

We appreciate the time and efforts extended to the Audit Division during the course of the project by the management and staff of the Public Works and Engineering Department.

Respectfully submitted,

Ronald C. Green
City Controller

cc: Dale Rudick, Director, Public Works and Engineering Department
City Council Members
Susan Bandy, Deputy Director, Public Works and Engineering Department
Christopher Newport, Chief of Staff, Mayor's Office
Kelly Dowe, Chief Business Officer, Mayor's Office
Harry Hayes, Chief Operating Officer, Mayor's Office
Shannan Nobles, Deputy Director, Office of the City Controller
Courtney Smith, City Auditor, Office of the City Controller

EXECUTIVE SUMMARY

INTRODUCTION

In November 2010, Houston voters approved Proposition One which amended the City charter (Charter Amendment) by establishing a Dedicated Drainage and Street Renewal Fund (DDSRF) and specifies sources and uses of funding. The Public Works & Engineering (PWE) Department is responsible for administration, planning, maintenance, construction and technical engineering of infrastructure within the City of Houston (City) and was therefore charged with implementing the processes and activities mandated by the passage of Proposition One and subsequent City of Houston Ordinance (Ordinance) changes.

AUDIT SCOPE AND OBJECTIVES

The original scope and objectives of this engagement were broadly defined as the determination of the City's compliance with Ordinances 2011-254 and 2013-281 which includes the billing, collection, record-keeping, and spending/allocation of amounts received as a result of the drainage charge.

After conducting an initial review of the Ordinances it was determined that Ordinance 2013-281 specifically addressed new development and Developer Drainage Impact Fees which would not become effective until April 3, 2014, when the collection of drainage impact fees was scheduled to begin. As a result of this review, the original objective was modified to cover only Ordinance 2011-254 and transactions or activities from July 1, 2011, through January 17, 2014. The modified objectives with respect to Ordinance 2011-254 were as follows:

- Identify the key provisions of the Ordinance;
- Identify the processes in place which comply with the Ordinance;
- Identify transactions or activities; and
- Perform detailed testing and analysis to determine compliance.

PROCEDURES PERFORMED

In order to obtain sufficient evidence to achieve engagement objectives and support conclusions, the engagement team completed the following activities:

- Performed detailed review and analysis of the following:
 - Utility Customer Service (UCS) Customer billings
 - Storm water credit applications
 - New water connect service requests
 - Delinquent balances
 - Cost analysis of City workforce employees assigned to Metropolitan Transit Authority (Metro) related drainage projects
 - Grandfathered exemptions
 - Verification Correction and Appeal requests
- Reviewed ordinances, agreements, policies and procedures, flow diagrams, and funding source descriptions
- Conducted interviews of PWE management and staff



AUDIT METHODOLOGY

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards and the International Standards for the Practice of Internal Auditing as promulgated by the Institute of Internal Auditors. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The scope of our work did not constitute an evaluation of the overall internal control structure of PWE. Management is responsible for establishing and maintaining a system of internal controls to ensure that City assets are safeguarded; financial activity is accurately reported and reliable; and management and employees are in compliance with laws, regulations, and policies and procedures. The objectives are to provide management with reasonable, but not absolute assurance that the controls are in place and effective.

CONCLUSION

We believe we have obtained sufficient and appropriate evidence to adequately support the conclusion provided below as required by professional auditing standards. For detailed information on the finding, recommendation, management response, comments and assessment of response, see the "Detailed Findings, Recommendations, Management Responses, and Assessment of Responses" section of this report.

- Based on the results of the procedures performed, the City has implemented and is following policies and procedures for billing, collection, recording, and expending municipal utility drainage funds which complies with City Ordinance 2011-254. However, several of those policies and procedures have not been formally authorized. **(See Finding)**

ACKNOWLEDGEMENT AND SIGNATURE

The Audit Team would like to thank PWE management and staff for their cooperation, time and effort throughout the course of this engagement. Also, we would like to recognize the management and staff of Horn Solutions, Inc. for the invaluable contribution of detailed research and data analysis that provided the evidence contained in this report.

A handwritten signature in black ink, appearing to read "Courtney E. Smith", is written over a horizontal line.

Courtney E. Smith, CPA, CIA, CFE
City Auditor



DETAILED FINDINGS, RECOMMENDATIONS, MANAGEMENT RESPONSES AND ASSESSMENTS OF RESPONSES

**FINDING #1 – MISSING POLICY/PROCEDURE AUTHORIZATION AND EFFECTIVE DATES
(IMPACT / MAGNITUDE = MEDIUM)**

BACKGROUND:

A municipal drainage utility system was established with the adoption of City of Houston Ordinance 2011-254 in April 2011. The Ordinance, in Chapter 47 – Water and Sewers Article XIV Division 1 Section 47-805 (a) states that *“The director shall be responsible for...enacting any procedures or policies necessary for the administration of the drainage system and the drainage charges, including establishing and implementing procedures for verification and correction of drainage charges and for appeals”*.

The engagement team requested policies and procedures to facilitate our assessment of the City’s compliance with the requirements of Ordinance 2011-254. We received the following policies / procedures from PWE’s Utility Customer Service Division (UCS):

- Bill Adjustments for Drainage (Initial version)
- Contact Center Drainage (Initial Version)
- Drainage Appeal Utility Hearings (Initial Version)
- Drainage Billing Approval Levels (Initial Version)
- Drainage Collections (Initial Version)
- Drainage Field Inspections and Measurements Inspectors (Initial Version)
- Drainage Hearing Procedures (Initial Version)
- Drainage Plan Analyst Procedures (Initial Version)
- Homeowners Association Correction Intake (Initial Version)
- Municipal Drainage Utility System Billing Policy (Initial Version)
- Standard Operating Procedure – Drainage Verification Field Inspection (Rev 4/20/11)
- UCS Policy Manual (Effective January 1, 2012)

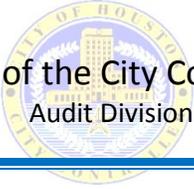
During our review we noted that the activities related to the municipal drainage utility system were being performed in compliance with the requirements set forth in the policies and procedures we received from UCS however, many of those policies had not been formally authorized by management.

FINDING:

Ten of 12 policies and procedures received were the “Initial Version” and had not been formally authorized as of a specific effective date. One policy did not have any indication of approval but was dated April 20, 2011.

RECOMMENDATION:

PWE should complete the policy authorization process to formally codify the policies / procedures and establish effective dates. This is particularly helpful when reviewing or reconciling processes management and staff employ during periods of procedural changes.



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UCS MANAGEMENT RESPONSE:

We agree that some of the policies specifically related to the Drainage Utility did not have a formal approval or effective date.

ESTIMATED COMPLETION DATE: December 31, 2014

**ASSESSMENT OF
RESPONSE:**

The Audit Division agrees with PWE's commitment to complete the process of formally approving the municipal utility drainage system policies and procedures. In addition, we note that PWE has taken the steps necessary to complete this process prior to the estimated completion date.



DETAILED REPORT

BACKGROUND

Passage of Proposition One in November 2010 (during fiscal year 2011) authorized the establishment of a “Dedicated Pay-As-You-Go Fund for Drainage and Streets” known as the Dedicated Drainage and Street Renewal Fund (DDSRF) for Houston drainage and streets. The Charter Amendment provided the foundation for a new initiative now known as Rebuild Houston, and put a mechanism in place to transition from a business model based on acquisition of debt for street and drainage capital improvement and maintenance to a business model based on pay-as-you-go funding generated from an approved drainage charge.

While the Rebuild Houston funding initiative is new, processes, policies, and procedures related to the construction of street and drainage infrastructure were already in existence. The Charter and Ordinances necessitate that those measures needed to implement the municipal drainage system be integrated into those existing processes. The detailed analysis performed by Horn Solutions, Inc. tested compliance with key requirements of the Charter Amendment and Ordinance 2011-254.

CHARTER AMENDMENT

Proposition One amended the City charter by adding Section 22 “Dedicated Pay-As-You-Go Fund for Drainage and Streets”. The amendment required that a Dedicated Drainage and Street Renewal Fund be established (Sec. 22(a)), set boundaries for the amount of annual appropriations to the Fund as well as the type of expenditures allowed from the Fund (Sec. 22(b)), and designated specific sources of funding for the Fund (Sec 22 (b)(i-iv)). The requirements of the Charter Amendment were incorporated into the City’s Code of Ordinances through Ordinance 2011-254.

ORDINANCE 2011-254

In April 2011, City Council adopted Ordinance 2011-254 which laid the groundwork for the establishment and operation of the municipal drainage utility system. Analysis and testing of the City’s compliance with policies, procedures, and processes related to the municipal drainage utility system focused on the specific requirements codified within this Ordinance. Requirements were established for:

- Creation of the System
- Billing
- Funding
- Use of Funds

CREATION OF THE SYSTEM

The municipal drainage utility system was formally created through Chapter 47 – Water and Sewer Article XIV Division 1. In addition to creating the system, Article XIV Division 1 also provides definitions related to words, terms or phrases used, mandates the establishment of a drainage charge and requires the City to provide for the operation and administration drainage services. Drainage as defined in Section 47-802 is: “streets, curbs, bayous, bridges, catch basins, channels, conduits, creeks, culverts, detention ponds, ditches, draws, flumes, inlets, pipes, pumps, rivers, sloughs, treatment works, and other means and appurtenances to those items, whether natural or artificial, or using force or gravity, that are used to draw off surface water from land, carry the water away, collect, store, or treat the water, or divert water into natural or artificial watercourses”. The drainage system is defined as “drainage owned or controlled in whole or in part by the city and dedicated to the service of benefitted property”.



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SECTION 47-803

The municipal drainage utility system was created by Section 47-803 in accordance with Subchapter C of Chapter 552 of the Texas Local Government Code (the Municipal Drainage Utility Systems Act) and the Charter Amendment. The Municipal Drainage Utility Systems Act authorizes municipalities to establish, administer, and operate municipal drainage utility systems within an established service area. Section 47-803 gives the City full authority to operate the system through the Director of the Public Works and Engineering Department.

SECTION 47-801

Section 22(b)(ii) mandated that the City fund the DDSRF by establishing a drainage charge to be imposed equitably to recover allocable costs of providing drainage. Similarly, Section 47-801 required the City to establish a schedule of drainage charges for all benefitted real property in the City and to provide drainage service on nondiscriminatory, reasonable and equitable terms upon payment of the drainage charge unless the property is exempt from such payment. Benefitted property refers to a lot or tract of real property that discharges directly or indirectly into drainage owned or controlled in whole or in part by the City and does not fall within an exemption. The engagement team obtained and reviewed the agenda and minutes from the City Council (Council) meeting held on April 6, 2011, and noted that item 20b Ordinance 2011-282, a “schedule of rates to establish and levy drainage charges for the implementation of a Municipal Drainage Utility System” recommended by the Director of PWE was adopted (**See Appendix A**). We further noted that the City had processes in place to provide drainage service prior to the formal establishment of the municipal drainage utility system. The approved rates were as follows:

Residential curb & gutter, non residential	3.20¢
Residential open ditch	2.60¢

At the adoption of these rates the City fulfilled the requirements of Section 22(b)(ii) of the Charter Amendment and Section 47-801(1) of the Ordinance.

The Ordinance (Section 47-823) mandates that rates established on April 6, 2011, will not be increased for a minimum of ten years unless necessitated by the enactment of state law that directly and negatively impact drainage charge collection.

SECTION 47-805

Section 47-805 mandates two important aspects of the Ordinance. Section 47-805(a) places the responsibility for the administration and operation of municipal drainage services under the authority of the Director of PWE and specifically requires that policies and procedures be enacted. The engagement team obtained and reviewed the Municipal Drainage Utility System Billing Policy¹, the Drainage Plan Analyst Procedures², and the Standard Operating Procedure – Drainage Verification Field Inspection³. The Billing Policy, Analyst Procedures, and Drainage Verification Field Inspection procedures were developed as a result of the creation for the drainage utility system. The existence of drainage system policies and procedures satisfies the Ordinance requirement that governing documents be in place, however, while the policies and procedures are being followed on a day-to-day basis, we were not provided with versions of these policies that had been formally approved.

¹ UCS Municipal Drainage Utility System Billing Policy (draft 15c): (Initial Version)

² PWE UCS Standard Operating Procedures – Drainage Plan Analyst Procedures: (Initial Version)

³ UCS Standard Operating Procedure Drainage Verification Field Inspection: (April 2011)

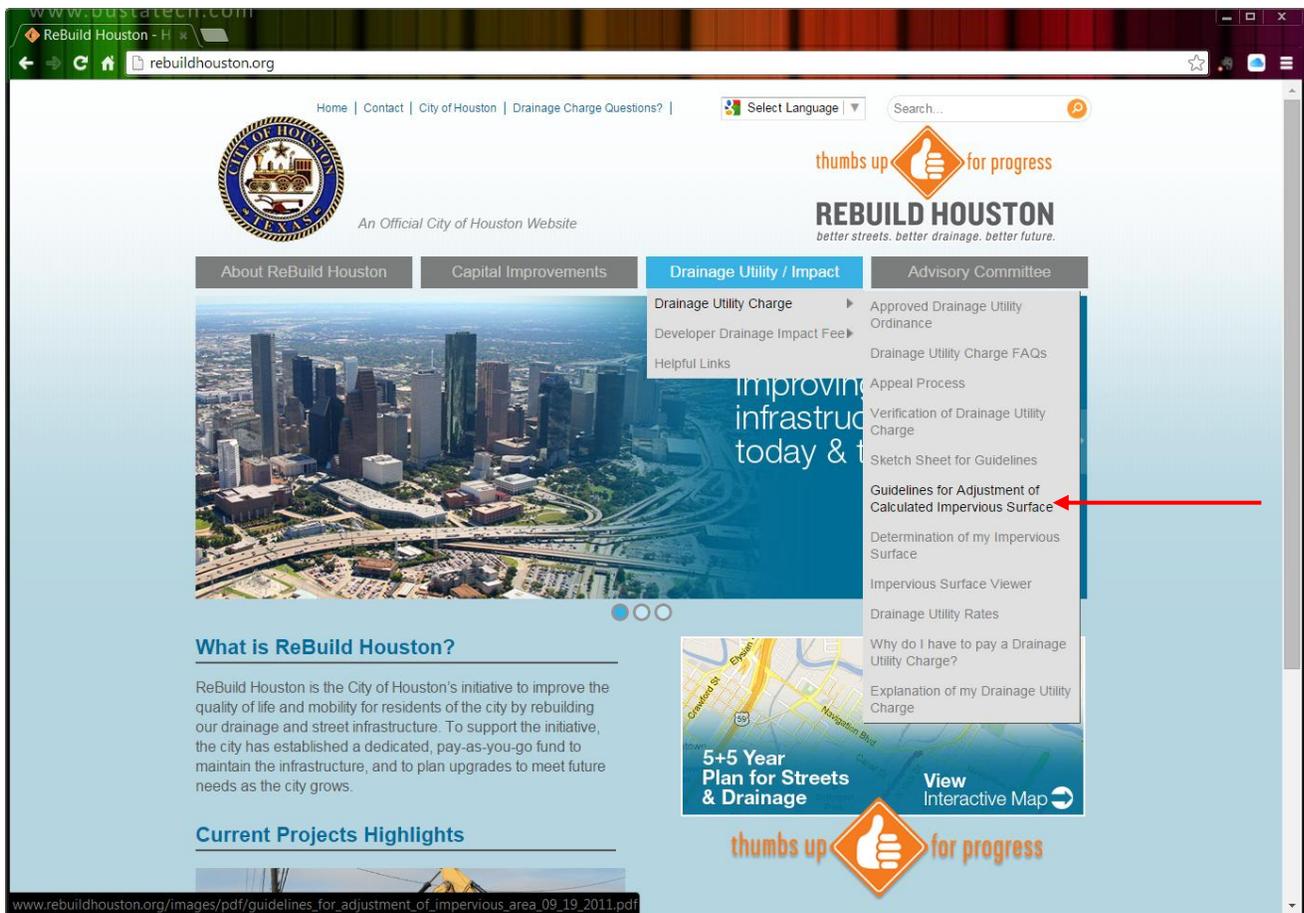


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Section 47-805(b) mandates that calculation of impervious surface, defined as “any area compacted or covered such that it does not readily absorb water or does not allow water to percolate through to undisturbed underlying soil strata”, be adjusted based on utilization of approved stormwater management techniques on benefitted property. Those techniques are to be identified and described in detail with the information made readily available to the public.

The engagement team obtained the *Guidelines for Adjustment of Calculated Impervious Surface Based on Approved Stormwater Management Techniques* effective September 19, 2011. We noted that approved management techniques are described in detail in Section X (page 7) of the guidelines. In addition, the guidelines we reviewed could be found on the Rebuild Houston website (www.rebuildhouston.org) by navigating to Drainage Utility / Impact, Drainage Utility Charge, Guidelines for Adjustment of Calculated Impervious Surface (**Exhibit 1**). The existence of guidelines and posting them to the website fulfill the requirements mandated in Section 47-805(b). During our review, we noted the presence of several guidelines and process descriptions on the Rebuild Houston website.

Exhibit 1
Rebuild Houston Website





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BILLING

Billing of the drainage charge is a key element of the Rebuild Houston business model and is addressed in Division 3 Chapter 47 Article XIV of the City’s Ordinances. Customer billing and payment, delinquent charges and penalties, and determination of payment responsibility are covered under Billing.

SECTION 47-841

Section 47-841 prescribes the method and manner of customer billing and payment specifically, 1) how drainage accounts are established, 2) requiring notification of the initial drainage charge and changes to the charge, and 3) what constitutes the receipt of the bill and when payment is due.

The engagement team reviewed the billing process by performing detailed testing and analysis of routine billing, new water connections, and the process for including changes to impervious surface included in customer billing. In reviewing routine customer billing, the team requested and obtained an electronic file from UCS containing all customer invoices from July 1, 2011 to December 31, 2013. For each population, we tested for compliance by agreeing the service address, parcel number from Harris County Appraisal District, the type of charge (curb & gutter or open ditch), the type of property (commercial or residential), the initial customer notification letter and recomputed the annual charge by multiplying the impervious square footage by the rate for that type of charge.

There were a total of 521,849 customer accounts from which we selected a sample of 50 billings. The sample selected included annual, bi-monthly, monthly, and quarterly accounts. Each of the 50 samples tested was compliant with requirements of the Ordinance.

**Exhibit 2
Customer Accounts by Type**

Type of Billing	# of Accounts
Annual *	84,339
Bi-Monthly (sewer only (no water) + drainage)	703
Monthly (Water, Sewer & Drainage)	392,963
Quarterly (Drainage only)	43,844
Total	521,849
*94% have annual charges less than \$60, the remainder have never remitted a drainage payment	

To ensure drainage was included in billing for new water connections, we requested and obtained new water connection requests. As of December 31, 2013 a total of 9,394 requests had been processed from which the engagement team selected a sample of 15 for review and testing. Each of the 15 samples tested was found to be in compliance with requirements of the Ordinance.

UCS is responsible for obtaining and using the best available data to ensure customer billings are correct. Variance audits based on fly-over imagery⁴ of the benefitted drainage service area

⁴ Flyover imagery – aerial or satellite images



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and ad hoc reviews of subdivisions and commercial properties are conducted by UCS to determine changes in impervious surface. Large construction projects such as hospitals, master-planned housing developments and apartment complexes are reviewed through coordination with City planning and permitting. UCS periodically reviews available data obtained through these processes to verify the amount of impervious surface for benefitted property. UCS also proposes updates where appropriate to the calculations of the square footage of impervious surface for purposes of determining the drainage charge for benefitted property. Proposed updates as a result of this internal process are called service requests.

The engagement team requested and obtained service requests initiated through this internal review process as of December 31, 2013, and received a total of 5,543 requests by category from which a sample of 15 was selected. The review of samples from this process revealed no exceptions.

Exhibit 3
Service Requests by Status
As of December 31, 2013

Status	# of Request
Open	534
Approved	4,669
Cancel	19
CSComp	41
Denied	62
Duplicate	215
Reject/Return	3
Total	5,543

SECTION 47-842

Per Section 47-842 of the Ordinance, drainage charges that are not remitted in a timely manner may be subject to late charges, reconnection fees, and/or discontinuance of utility services. The UCS Collections Policy Manual details the approved procedures for delinquent accounts⁵. The team requested and obtained a listing of customer accounts with delinquent balances invoiced during December 2013. Of the 35,583 delinquent accounts provided to us by UCS, 25 were selected to determine if late charges were appropriately assessed by recalculating the late charge assessed from the previous month's bill and agreeing that amount to the current month bill. We determined that late charges were appropriately assessed. In this population of accounts, utility service was **not** discontinued and our review verified that customers were not assessed a reconnection fee which was the appropriate treatment.

The engagement team also obtained the lists of accounts that had service disconnected between July 1, 2011, and December 31, 2013. From the 78,285 service disconnections provided by UCS, we selected 25 samples for further testing and analysis. In addition, we also requested a Drainage Lien Report from UCS and selected 3 of the 35 liens perfected by the City to determine if the proper processes from the UCS Policy Manual were followed. We recalculated the delinquent amounts and late charges and verified that procedures performed related to service

⁵ UCS Policy Manual – Effective January 1, 2012



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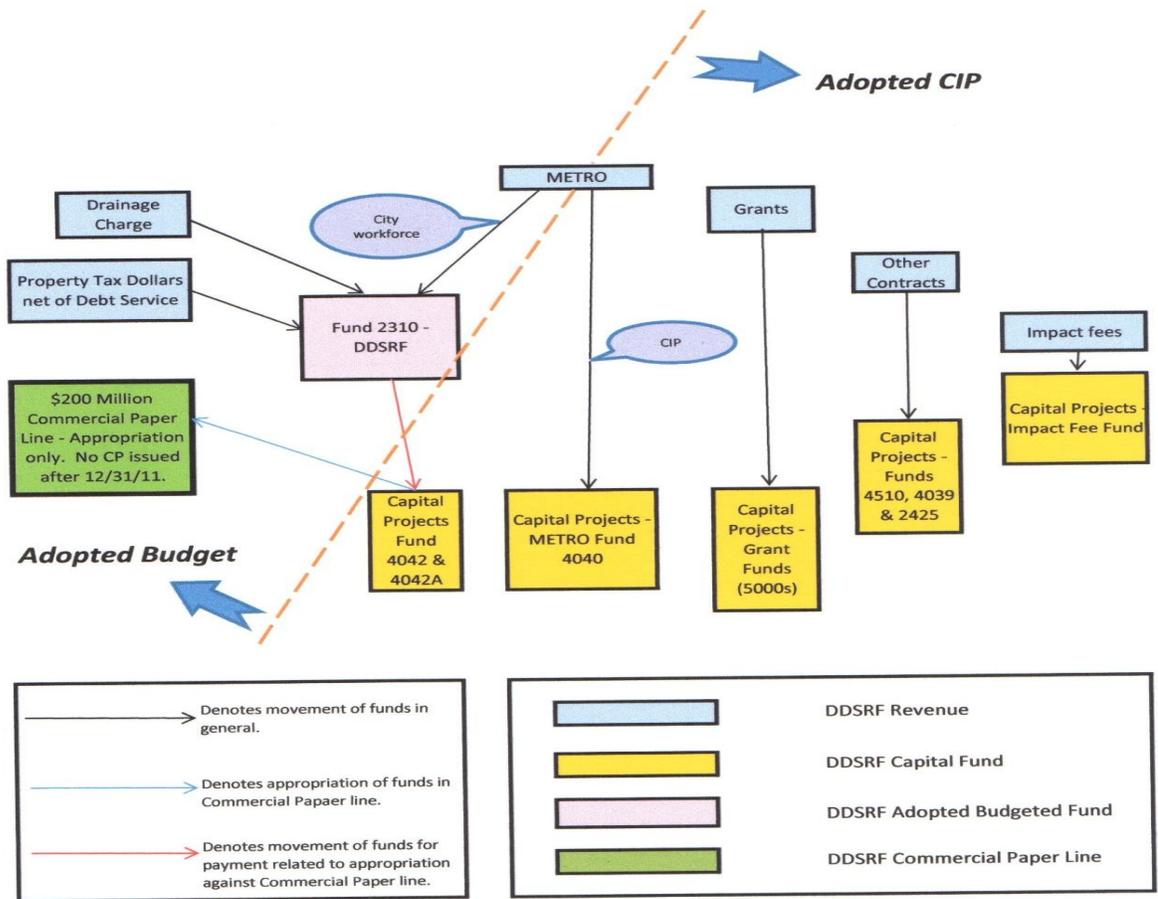
disconnections and liens were in accordance with the authorized policy. The procedures followed, including the calculated amount of late charges and customer notifications, were compliant with UCS policy.

FUNDING

Division 2 of Chapter 47 Article XIV of the City’s Code of Ordinances specifically addresses funding for the municipal drainage utility system. In reviewing this section of the Ordinance for compliance, the engagement team met with PWE management and staff to determine how DDSRF funding sources flow through designated Funds. Through interviews, review of graphical presentations, and financial data we verified that DDSRF Fund 2310 (used to record drainage dollars) was added in fiscal year 2012 and is used in conjunction with Funds that were in existence prior to implementation of the drainage charge. **Exhibit 4** depicts (Fund 2310) in relation to other Funds in use by PWE.

Exhibit 4

**Dedicated Drainage and Street Fund Group (DDSRF)
Funds Flow**



Source: Public Works and Engineering Department



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SECTION 47-821

Section 47-821 mandates that drainage charges collected by the city or other monies available for the purpose of drainage “shall be used exclusively for creation, operation, planning, engineering, inspection, construction, repair, maintenance, improvement, reconstruction, administration and other reasonable and customary expenses associated with the cost of service to provide drainage serves within the service area”. Financial data from SAP was obtained for fiscal years 2012 through 2014 to verify the flow of funds and recording of revenue into Fund 2310. More than 96% of revenue recorded to Fund 2310 for the periods reviewed were from the drainage charge, ad valorem taxes, and third party funds from Metro.

Sources of Funds Recorded into Fund 2310:

- Drainage Charge
- Ad Valorem (Property Taxes)
- Third Party Funds

Drainage Charge – The drainage charge is a new funding source comprised of monies collected through periodic billing and collection as established by the Ordinance. Customer billing and payment receipt occur on a daily basis.

**Exhibit 5
FY 2014 Drainage Charge
Billing and Collections**

	# of Accounts	Net Billed	Collected YTD
Annual	42,157	\$ 3,231,939.46	\$ 1,401,151.64
Bi-Monthly	653	\$ 142,781.89	\$ 103,859.54
Monthly	387,587	\$ 80,579,571.78	\$ 76,859,110.52
Quarterly	34,483	\$ 28,613,826.55	\$ 26,531,873.15
Subtotal	464,880	\$112,568,119.68	\$ 104,895,994.85
City	14	\$ 1,613,999.71	\$ 1,613,999.71
Grand Total	464,894	\$114,182,119.39	\$ 106,509,994.56

Ad Valorem (Property) Taxes – Ad Valorem taxes are a funding source that existed prior to implementation of the drainage charge. For fiscal years 2012, 2013, and 2014 11.8¢ of every \$100 of property value collected goes to pay debt that was incurred on previous street and drainage projects as required by Charter Amendment Section 22 (b) (iii). Ad Valorem funds in excess of the debt service payment are transferred from the General Fund (Fund 1000) into Fund 2310 for use on street and drainage projects.

In reviewing the financial data related to ad valorem taxes, it was noted that these funds are received by the City throughout the year and recorded to the General Fund (Fund 1000). The Finance Department (Finance) manages the recording of these funds into Fund 1000. The amount of ad valorem tax revenue designated for street and drainage is reduced by debt service payments related to existing street and drainage debt. The remaining ad valorem tax revenue is transferred from Fund 1000 into Fund 2310 in June of each fiscal year. SAP transactions related to this process were reviewed and the amount of revenue transferred into Fund 2310 was verified without exception for each fiscal year in the review period.

Exhibit 6
Dedicated Drainage & Street Renewal Ad Valorem Tax Revenue
 (amounts expressed in thousands)

	FY2012	FY2013	FY2014
Property Tax Revenue (General Fund) (\$0.118 of City's Ad Valorem Tax Levy)	\$ 156,570	\$ 160,552	\$ 178,282
(Less) Street & Drainage Debt Service (General Fund)	(147,377)	(149,655)	(156,172)
Captured Revenues	\$ 9,193	\$ 10,897	\$ 22,110
<i>(Transferred to Dedicated Drainage & Street Renewal Fund)</i>			

Third Party Funds – Funding from several sources may be included in Fund 2310 if they are dedicated for drainage and street projects. Typically, funding from third parties is project specific, which restricts their use to the designated project. Currently, the primary source of third party funding comes from the Metro General Mobility Program (GMP).

Third party funding for clearly defined projects such as those for street and drainage construction, operation and maintenance for streets and traffic, traffic signalization, hike and bike trails, or sidewalks is recorded to Funds 2310, 4040, 4040A, 4510, 5000, 5400, 5410 and 5430. Since FY 2012, over 99% of third party funding to Fund 2310 has been from Metro.

In 1999 the City entered into an agreement, the *Transportation Improvement Agreement for Designated and Future Designated Projects*, with Metro in connection with the General Mobility Program (GMP). During the review period, it was noted the agreement as amended in November 2010 governed transactions for GMP. GMP is the program through which Metro makes 25% of the available sales tax revenue for “Eligible Transportation Projects” within the Metro service area. The agreement defines Eligible Transportation Projects as one or more of the following:

- Special City Projects;
- All or part of the costs to address congestion mitigation and traffic management problems by constructing or maintaining streets, roads, bridges and grade separations, installing or operating traffic control signals and improvements, constructing or maintaining sidewalks, hiking and biking trails, streetlights and making drainage improvements; and
- All or part of the cost to acquire, design, construct, improve or beautify a state or local highway, turnpike, road or street project.

Under this agreement, specific projects and project costs are approved in advance. Section 3 (f) of the agreement denotes how funding will occur:

“All projects invoiced on a unit-rate basis shall be paid on a reimbursement basis as work is actually performed and invoiced. These projects include, but are not limited to, the City’s Safe Clear Program, the Traffic Signal Maintenance/Intelligent Transportation Systems, and that portion of the City Overlay Program which is performed by City employees.”

The engagement team requested and obtained invoices totaling \$9M prepared by PWE and sent to Metro dated April 17, 2014. The invoices represented billings for work performed by City employees on projects for:



-
- Bridge replacement
 - Pavement marking
 - Sign maintenance
 - Street concrete repair and replacement
 - Street overlay
 - Street repairs
 - Traffic signal work

Each of the project activities in the April 2014 invoices are allowed under the agreement with Metro and performed by City employees. We were able to trace the invoices to SAP transactions representing accounts receivable. We further verified the subsequent receipt of those funds from Metro into the City's cash account and Fund 2310.

Fund 2310 Expenditures:

As previously noted, monies available for drainage must only be used for the creation, operation, planning, engineering, inspection, construction, repair, maintenance, improvement, reconstruction, administration and other reasonable and customary expenses related to the cost of providing drainage services.

Expenditures from Fund 2310 occur in 1 of 4 ways:

- **Made directly from Fund 2310**
- **Transfer from Fund 2310 to Fund 4042**
- **Transfer from Fund 2310 to Fund 4042A**
- **Transfer from Fund 2310 to Fund 2302**

Fund 2310 – As previously noted, Metro is invoiced for work performed on the GMP program by city employees. The receipt of those funds from Metro is recorded into Fund 2310 and personnel costs for those employees assigned to Metro GMP projects is directly charged to Fund 2310. We obtained and reviewed cost and FTE data for those employees as shown in **Appendix B**. Personnel costs for these employees have remained relatively stable before and after implementation of the drainage charge. In addition, the funding source for these employees has not changed since the implementation of the drainage charge. Personnel costs increased between fiscal years 2013 and 2014 primarily due to a pay increase of 3% to all city employees.

In addition, the administrative costs allocated to the UCS, Financial Accounting, and Office of the Director within PWE are charged directly to Fund 2310. These costs are allowed under Section 47-821 of the Ordinance.

Fund 4042 – Projects implemented from the City's Capital Improvement Program (CIP) for streets, traffic, and drainage are set up in this Fund. Implemented projects are approved by City Council on a project by project basis. Funding in Fund 4042 is replenished by Fund 2310, therefore two costs centers set up in Fund 2310 (2000050002 and 2000050033) are used to distinguish between projects or project components that are eligible or ineligible to use drainage funds. Projects or project components that are ineligible to receive funding from drainage charges are funded through ad valorem tax funds that flow through Fund 2310.

Fund 4042 receives funding on a reimbursement basis through an application in SAP developed by the City's IT department that transfers cash from Fund 2310 to Fund 4042 each time a payment is made out of Fund 4042.

Fund 4042A – If PWE determines that there is more cash available than originally planned; cash is transferred up-front from Fund 2310 (unlike Fund 4042 which is funded on a



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reimbursement basis). This is the result of higher than budgeted property tax allocation or slower cash outflow from current projects that allows for more funding availability for CIP projects. This cash is used to fund additional Street and Drainage projects. In April 2014, \$15,000,000 was available and transferred to Fund 4042A for Pay-As-You-Go funding.

Fund 2302 – Funds are transferred from Fund 2310 to Stormwater Fund 2302 annually to cover a portion of the Stormwater’s business unit’s Operations and Maintenance expenses related to drainage infrastructure. Currently, Fund 2302 is co-funded by the Combined Utility System Fund and DDSRF is scheduled to fund 2302 on an incremental basis each fiscal year as part of a phase-in process to move Stormwater’s entire operation into DDSRF.

SECTION 47-822

This section of the Ordinance establishes the drainage charge, delineates how the rates are to be applied, and creates specific exemptions. The engagement team requested and obtained a listing of the total population of exempt properties as of December 31, 2013. The population of 13,282 is categorized as:

**Exhibit 7
Drainage Charge Properties by Category**

Category	# of Properties
Curb & Gutter	4,079
Open Ditch	3,562
Grandfathered	5,641
Total	13,282

Grandfathered properties are defined as those school districts or religious organizations whose impervious surface at April 6, 2011 was exempt but new impervious surface subsequent to that date is non-exempt. We selected a sample of 25 exempt parcels and obtained and reviewed supporting documentation to determine whether property was appropriately classified as exempt. We reviewed supporting documentation including Harris County Appraisal District exemption status, calculation of impervious surface at April 6, 2011, procedures performed, and communication and found no exceptions in the sample items tested. We also requested the population of denied exemption requests. As a result to this request, we received a listing of the 459 exemption requests denied as of December 31, 2013 and selected a sample of 10 for review and testing. We found no exceptions in our testing and determined that all of the requests sampled from the population of denials were properly classified as non-exempt.

SECTIONS 47-824 & 47-825

Sections 47-824 and 47-825 mandate that a mechanism for verification, correction and appeal (VCA) be established. The engagement team reviewed the Municipal Drainage Utility System Billing Policy and determined that a formal process for VCA was put in place. We further observed that 1) the Verification of Drainage Utility Charge and 2) the Appeal Process descriptions were made available on the Rebuild Houston and the Utility Customer Service websites. We requested a listing of VCA requests as of December 31, 2013 from UCS and received a listing of 40,936 requests categorized as follows:

Exhibit 8



Office of the City Controller
Audit Division

Verification, Correction and Appeal Requests

Category	# of Requests
Drainage Verification	39,684
Drainage Appeal Hearing	1,147
Drainage Post Hearing	105
Total	40,936

From this listing we selected a sample of 40 VCA requests for review and testing. We tested each sample to determine compliance by agreeing the service address, parcel number from Harris County Appraisal District, the type of charge (curb & gutter or open ditch), and the type of property (commercial or residential). We then performed a recalculation of the drainage charge by multiplying the impervious square footage by the rate for type of charge.

We verified the Verification of Drainage Utility Charge and Appeal Process was followed by reviewing documents sent to the customer including the initial notification letter, request for appeal from the customer and Notification of Outcome letter. Our review of this information for each sample revealed no exceptions. In addition, we compared the publicly available information from the websites with the requirements of the Municipal Drainage Utility System Billing Policy and verified that the language in each document was consistent.

USE OF FUNDS

Chapter 47 – Water and Sewer Article XIV Division 4 Section 47-861 of the City’s Code of Ordinances mandates the creation of an oversight committee by July 1, 2011, whose members are to advise the city on drainage project priorities and processes. We noted the existence of an Advisory Committee consisting of nine members; 5 members appointed by City Council and 4 members appointed by the Mayor as required by Ordinance. We verified formal confirmation of committee member appointments by reviewing Houston City Council meeting agenda and meeting minutes for May 11, 2011, as well as press releases and Council member newsletters to ensure the committee was established prior to the date mandated by the Ordinance. The Rebuild Houston Advisory Committee can be found on the list of Boards and Commissions on the City’s official website. Committee meeting agendas and meeting minutes are posted to the Rebuild Houston website and the site also notes that meetings are open to the public. The Chair of the Flooding and Drainage Committee (Mayoral appointee) serves as an Ex-Officio member of the Advisory Committee.

This section also requires the oversight committee involvement in a 10 year plan identifying drainage and street improvements recommended for construction with drainage charge funding. The committee provided input on weighting prioritization factors as well as the funding allocation by component. The committee’s meeting minutes, document committee member discussion, analysis and deliberations as well as PWE presentations regarding what is referred to as a “5 + 5 Plan”. The plan is the combination of a 5 year CIP plan and a “+5” plan based on need. The 5 + 5 Plan is updated annually. Committee involvement in this process fulfills the Ordinance requirement.

APPENDIX SECTION



Office of the City Controller
Audit Division

Appendix A

MOTION NO. 2011 0282

MOTION by Council Member Gonzalez that the recommendation of the Director of the Department of Public Works and Engineering, for approve a schedule of rates to establish and levy drainage charges for the implementation of a Municipal Drainage Utility System, be adopted, and the following Annual Rate per square foot of Impervious Surface, is hereby approved by the City Council:

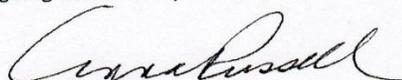
<u>Proposed Rate</u>	(per sq ft of impervious surface per year)
Residential curb & gutter, non residential	3.20¢
Residential open ditch	2.60¢

Seconded by Council Member Noriega and carried.

Mayor Parker, Council Members Stardig, Johnson, Clutterbuck, Adams, Hoang, Pennington, Gonzalez, Rodriguez, Costello, Lovell, Noriega and Jones voting aye
Council Members Sullivan and Bradford voting no

PASSED AND ADOPTED this 6th day of April, 2011.

Pursuant to Article VI, Section 6 of the City Charter, the effective date of the foregoing motion is April 12, 2011.


City Secretary

Appendix B

**SOURCE:
PUBLIC WORKS AND ENGINEERING DEPARTMENT
RESOURCE MANAGEMENT DIVISION
BUDGET GROUP FY11-FY14 Metro Personnel Costs**

		Prior to DDSRF- General Fund	DDSRF	DDSRF	DDSRF
Division	Funds Ctr	FY 2011	FY 2012	FY 2013	FY 2014
SDD	2000010001	2,004,966.71	2,349,544.87	2,373,545.97	2,357,077.67
SDD	2000010002	4,486,228.32	4,671,451.81	4,894,954.46	5,352,912.64
SDD	2000010003	3,123,567.04	3,304,038.01	3,474,740.01	3,672,304.62
SDD	2000010004	2,244,594.88	2,001,668.00	2,153,060.20	2,090,604.28
SDD	2000010005	532,402.63	560,356.70	472,991.20	566,561.45
SDD	2000010008	2,534,484.05	2,455,943.50	2,431,701.78	2,551,763.26
Total-Street and Drainage Division (SDD)		14,926,243.63	15,343,002.89	15,800,993.62	16,591,223.92
TOD	2000020002	943,994.42	727,984.81	762,801.71	781,658.03
TOD	2000020003	1,741,053.55	1,789,295.34	1,888,185.18	2,224,553.49
TOD	2000020004	3,817,886.65	4,881,412.40	4,828,556.00	5,198,212.63
TOD	2000020005	1,418,876.19	313.37		
TOD	2000020006	1,863,990.71	2,671,192.42	2,724,589.03	2,683,471.61
TOD	2000020008	827,275.71			
TOD	2000020011	730,718.85	789,960.05	847,952.93	852,421.40
TOD	2000020013		776,911.51	803,365.34	783,261.47
Total-Traffic Operation Division (TOD)		11,343,796.08	11,637,069.90	11,855,450.19	12,523,578.63
IT	2000080001	298,523.70	236,979.06	322,896.64	318,718.76
Total-Information Technology Branch (IT)		298,523.70	236,979.06	322,896.64	318,718.76
MSB	2000090003	127,259.39	144,468.86	135,770.93	132,534.02
Total-Management Support Branch (MSB)		127,259.39	144,468.86	135,770.93	132,534.02
Grand Total		26,695,822.80	27,361,520.71	28,115,111.38	29,566,055.33
Increase over Prior Year			2.4%	2.7%	3.4%

Appendix B (con't)

**SOURCE:
PUBLIC WORKS AND ENGINEERING DEPARTMENT
RESOURCE MANAGEMENT DIVISION
BUDGET GROUP FY11-FY14 Metro Funded Actual FTE**

Division	Funds Ctr	Prior to DDSRF- General Fund	DDSRF	DDSRF	DDSRF	Average
		FY 2011	FY 2012	FY 2013	FY 2014	
SDD	2000010001	29.2	31.0	32.2	31.2	30.9
SDD	2000010002	96.5	93.5	94.5	96.7	95.3
SDD	2000010003	57.7	56.4	59.4	61.6	58.8
SDD	2000010004	40.1	34.7	36.0	36.0	36.7
SDD	2000010005	8.7	9.4	7.4	9.4	8.7
SDD	2000010008	48.3	45.7	46.7	46.0	46.7
Total-Street and Drainage Division (SDD)		280.5	270.7	276.2	280.9	277.1
TOD	2000020002	11.9	8.3	7.9	8.0	9.0
TOD	2000020003	29.8	31.3	29.6	31.9	30.7
TOD	2000020004	57.7	67.3	63.4	66.8	63.8
TOD	2000020005	17.2	0.0	0.0	0.0	4.3
TOD	2000020006	25.0	32.3	30.4	28.6	29.1
TOD	2000020008	12.2	0.0	0.0	0.0	3.1
TOD	2000020011	14.7	14.0	14.3	13.6	14.2
TOD	2000020013	0.0	15.0	15.0	14.6	11.2
Total-Traffic Operation Division (TOD)		168.5	168.2	160.6	163.5	165.2
IT	2000080001	3.6	2.9	3.4	3.1	3.3
Total-Information Technology Branch (IT)		3.6	2.9	3.4	3.1	3.3
MSB	2000090003	1.8	2.0	2.0	2.0	2.0
Total-Management Support Branch(MSB)		1.8	2.0	2.0	2.0	2.0
Grand Total		454.4	443.8	442.2	449.5	447.5