# Capital Financing and Planning

March 2015

Steve March
Multnomah County Auditor

**Audit Staff**
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Date: April 2, 2015

To: Chair Kafoury; Commissioners Bailey, Smith, Shiprack and McKeel
Sheriff Staton; District Attorney Underhill

From: Steve March, Multnomah County Auditor

Re: Capital Planning and Financing Audit

The attached report covers our audit of Multnomah County's capital financing and planning efforts. We initiated this audit as an adjunct to the Facilities Audit on Deferred Maintenance (October 2013). We reviewed County policies for capital financing and planning and compared them to industry best practices for local governments. The results of our audit indicated the County has most of the parts needed for capital financing and planning but there are some missing parts and areas for improvement that should be considered.

County projects from the 2014 Capital Budget adopted by the Board totaled about $246 million with total project costs for these projects at about $682 million. The Downtown Courthouse and the Sellwood Bridge together make up nearly 80% of this large total project costs total with capital planning for the Downtown Courthouse project going on for nearly 20 years.

We believe the County needs to improve its monitoring and reporting for capital projects and create a more formalized long-range planning process for capital financing spending. It is our recommendation that the County make monitoring and reporting changes that will improve long-range planning and better inform the Board which will allow for better capital spending decisions. Specifically, we recommend the County create a fiscally prudent master plan (10-25 years) along with multi-year capital plans (3-5 years) that will separate non-routine and major projects from the routine maintenance and repair projects; with more detail for non-routine and major projects and perhaps summary information for routine maintenance and repair projects. Additionally, the multi-year plans should link to the master plan. We also recommend the County create a formal, centralized, process for monitoring and reporting of capital planning and spending. We would like to acknowledge and applaud efforts the County has taken at addressing our recommendations at the time of this report's issuance.

Judith DeVilliers, CPA, (retired) conducted the majority of the work related to this report and Annamarie McNiel, CPA helped carry it to fruition. We want to thank staff from Facilities and Property Management for their assistance and cooperation throughout the audit. We also appreciate the assistance provided by the Finance and Budget offices and various other County staff.

cc: Marissa Madrigal, COO; Mark Campbell, CFO; Sherry Swackhamer; DCA,
Karyne Kieta; DCM Kim Peoples, DCS

# Table of Contents

# Executive Summary

The County needs to improve its monitoring and reporting for capital projects, increase involvement with the Chief Finance Officer and Budget office, and create a more formalized long-range planning process for capital financing and spending.

We looked at the County's processes for capital financing and planning for facilities and compared the process to best practices. We wanted to determine if the Board of County Commissioners, other decision makers and the public had accurate and usable information needed for financing and planning capital projects.

Decisions for capital projects involve large dollar amounts for projects that span multiple years to purchase or create infrastructure and assets that are sometimes expected to last fifty to seventy-five years. Capital spending for facilities totaled over $520 million over the last 20 years. Capital planning for the downtown courthouse has been going on nearly that long.

The results of our audit of capital financing and planning indicated the County has most of the parts needed for capital financing and planning. Missing parts are:

(1) Improved overall capital monitoring and reporting

(2) Additional involvement with the Chief Finance Officer and Budget Office in the financing and planning process, and

(3) A more formalized long-range planning process for all capital financing and spending

Although the scope of our review focused primarily on financing and planning for buildings, we believe many of these recommendations also apply to capital projects for information technology and transportation capital.

## Report Background

Good capital financing and planning are important because planning for capital projects generally spans many years, financing capital projects involves large dollar amounts, and many participants and stakeholders are involved.

***Planning for capital projects generally spans many years:*** Capital spending is generally budgeted and accounted for in capital projects funds, which allow for accounting for restricted resources and spending over multiple years, Major projects take many years from the plan to completion. Recent examples are the East County Courthouse and Data Center and the Downtown Courthouse.

***Financing capital projects involves large dollar amounts:*** Capital financing for buildings and other capital projects involve large dollar amounts. Financing may sometimes compete for resources with annual budget operating program needs and other long-term needs such as existing debt, fixed costs, and unfunded liabilities. Financing large capital projects may also require resources beyond the County's borrowing capacity or current resources. For example, the County had to reach out to the community, engage other partners, and issue a new fee resource for the construction of the Sellwood Bridge.

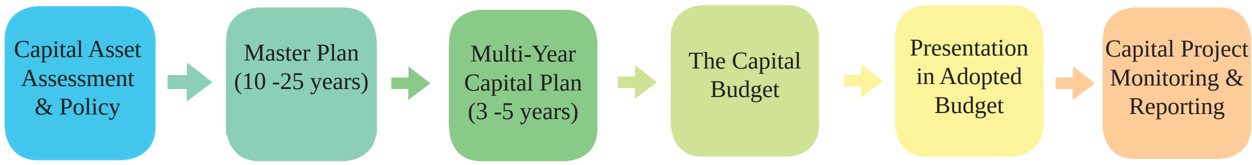
Projects from the 2015 Capital Budget adopted by the Board total $252 million with total known estimated project costs for these projects at $478 million. The Downtown Courthouse fund and the DART Data System Replacement projects total estimated project costs are not included as these amounts are still to be determined. For total known estimated costs the Sellwood Bridge makes up 64% of this large total project cost total.

***Capital financing and planning involves many participants:*** Below are some examples of participants who should be involved in the financing and planning process would include:

- The governing body is ultimately responsible. For the County this would be the Chair and the Board of County Commissioners who should take an active role in capital planning and financing, especially for large capital projects.
- The Chief Financial Officer (CFO) is responsible for financing major capital projects and should also be involved in the early planning process. The CFO is also responsible for accounting and financial reporting for capital projects.

- The Budget Director is responsible for the capital budget and integrating it into the annual budget process. The Budget Director should work closely with the CFO to ensure budgeting and accounting meet best practices.
- Support and technical information needed in the capital budget process should come from departments such as facilities, transportation, and other departments involved. For some organizations these would also provide project management for some capital projects.
- Sponsoring departments in the organization should be involved in both long-range planning and in specific projects. These would be involved in early planning and budgeting process to ensure a project will meet their operational needs. Decisions for new capital also may have financial impact on a department's operating budget. Other significant participants might include the occupants or users of the proposed asset who are not part of the organization.

## Best Practice Process for Capital Financing & Planning




We used the Government Finance Officers' Association (GFOA) best practice reports and guidelines as a systematic way of evaluating the capital financing and planning process for the County. The purpose of the GFOA guidelines is to promote and facilitate positive change in the management of capital assets.

The GFOA best practices, which are illustrated above, identify specific policies and procedures that contribute to improved government management for capital assets. These assets may include buildings, infrastructure, technology, and major equipment. The procurement, construction, and maintenance of capital assets are a critical activity of state and local governments, school districts, and other government agencies.

We believe the key that holds the capital process together is in the capital project monitoring and reporting. Additional monitoring and reporting should be included in and as part of the master plan, the multi-year plans, the capital budget and the adopted budget.

# Capital Asset Assessment & Policy

**Capital Asset Assessment & Policy** → Master Plan (10 -25 years) → Multi-Year Capital Plan (3 -5 years) → The Capital Budget → Presentation in Adopted Budget → Capital Project Monitoring & Reporting

## GFOA Guidelines

*Budgetary pressures often impede capital program expenditures or investments for maintenance and replacement, making it increasingly difficult to sustain the asset in a condition necessary to provide expected service levels. GFOA recommends that local, state and provincial governments establish a system for assessing their assets and then appropriately plan and budget for any capital maintenance and replacement needs. The GFOA urges state and local government officials to extend the involvement of the finance director through all phases of asset management.* [1]

## Responsibility

Asset management responsibilities begin with the Board for adopting policies needed for capital financing and planning. Facilities and Property Management (FPM) should have the responsibility for maintaining the asset inventory and for assessing capital maintenance and replacement needs; and the Chief Financial Officer (CFO) and Budget Director should have the responsibility for appropriately planning, financing and budgeting capital needs.

## Audit Assessment

The County has a system to assess facility assets and has a capital policy; however improvements, as well as additional involvement from the CFO are needed.

- Asset Assessment is something the County has done well in the past. The County evaluated and classified its buildings into three tiers for asset management and based its allocation for maintenance and repairs on that assessment. FPM maintains building asset inventory and is in the process of upgrading its system for evaluating the condition of all buildings.
- Although the County's CFO has responsibility for some parts of the capital decision process, this does not appear to be well coordinated on a county-wide level. Best practices recommend asset management as a function should be shared between finance and engineering. The County lacks integrated

[1]GFOA Best Practice, Capital Asset Assessment, Maintenance and Replacement Policy (1007 and 2010)(CEDCP), and GFOA Best Practice, Role of the Finance Director in Capital Asset Management (2010)(CEDCP)

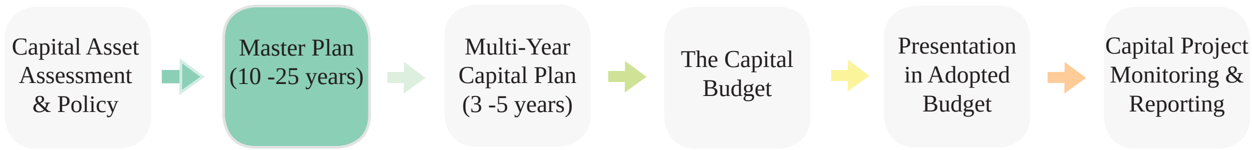
involvement of the CFO through all phases of asset management.

- The County has a policy for capital asset management, however we found it difficult to evaluate or measure compliance with the policy because terminology was undefined.

Recommendation

1. We recommend FPM continue its process for evaluating condition of all buildings and make this assessment of building conditions a priority.
2. We recommend the County's CFO's increase Finance's involvement in the capital decision process on the project level for larger projects, and for the allocation of funding for all capital spending, which would include all financing, budgeting, reporting of resources, and capital spending.
3. We recommend the County change its capital policy so that it is a guideline that is understandable and measurable. In our report on Deferred Maintenance we recommended the County revise the County policy for capital projects to identify capital needs for new facilities and remodeling separately from needs for major system maintenance projects; and to consider using a separate fund for capital projects that are not maintenance and repairs.

## Master Plans (10-25 years)




### GFOA Guidelines

*Jurisdictions may refer to Master Plans by various names, including Comprehensive Plans or General Plans. This Recommended Practice utilizes the title Master Plans to denote the long-range plans (10 - 25 years) that act as a framework for capital project requests that direct the Capital Improvement Plan. GFOA recognizes the role of Master Plans as one of the CIP's important elements and recommends that governments consider the following: (1) Master Plans should provide a vision for capital project plans and investments,… and trends on the government's accomplishments and progress toward these goals. (2) Governments should make capital project investment decisions that are aligned to their long-range Master Plans. (3) The finance officer should play an active role in the early planning process. (4) Financial factors should be considered as part of the development of Master Plans.*[2]

### Responsibility

The responsibility for approving a 10-25 year master plan should be with the Board of County Commissioners, the ultimate decision-makers. The CFO should be responsible for the financing strategy for the master plan. The Budget Director and CFO should be responsible for preparing and coordinating the master plan. The master plan should include the detail information on projects to be provided by FPM for facilities, Information Technology for IT projects, and other departments.

### Audit Assessment

The County does not have a comprehensive 10-25 year master plan; however the County has many of the components for such a plan.

Financing and planning for capital needs is generally done on a project-by-project basis because the County does not have a comprehensive master plan. However we believe the County does base capital decisions on County values and on concepts that have been discussed for many years in budget documents, and on strategic goals and planning documents for facilities.

[2] GFOA Best Practice, The Role of Master Plans in Capital Improvement Planning (2008)(CEDCP).

- The Budget Director's Message in the annual budget provides an overview of the long-range planning for major capital projects for the public. The Capital Budget section provides additional information and project details.
- Facilities has consistently created and maintained strategic plans, which sets goals and priorities for the master plan. The Board adopted the Facilities Strategic Plan in 2005; and FPM presented a draft of a revised plan in 2012. We did not look at goals or strategic plans for transportation or information technology capital.
- We believe financial factors are lacking in the process for creating a master plan because the County's CFO is not an active and integral part of the process.
- Without a formal master plan the County has not had a way to report to the Board or public on its accomplishments and progress in meeting its long-range capital plans and goals.

## Recommendation

1. We recommend the County's Budget Director or the CFO create a fiscally prudent 10-25 year master plan that includes the capital needs and associated costs and revenue streams for facilities, information technology, and other major capital spending.
    a. The plan would include input from FPM, IT, and other departments.
    b. The plan should identify the ability of the County to finance needed capital projects as well as the gaps in the ability to do so.
    c. The plan should be designed so that the accomplishments and progress toward the goals can be measured.
    d. The plan should be in a format that is clear, concise, and available to the public and other stakeholders.

e. We believe all capital projects should be included in the master plan, even those that may lack potential funding or supporters. The master plan could be used to keep track of these for future years, and also provide awareness that there may be other alternatives to meet those needs.

2. We recommend the County use the master plan as an integral part of the capital financing and budgeting process as it relates to multi-year plans and the annual capital budget.

## Multi-Year Capital Plans (3-5 years)

Capital Asset Assessment & Policy → Master Plan (10 -25 years) → **Multi-Year Capital Plan (3 -5 years)** → The Capital Budget → Presentation in Adopted Budget → Capital Project Monitoring & Reporting

### GFOA Guidelines

It is extremely difficult for governments to address the current and long-term needs of their constituents without a sound multi-year capital plan that clearly identifies capital and major equipment needs, maintenance requirements, funding options, and operating budget impacts. … A prudent multi-year capital plan identifies and prioritizes expected needs based on the long-range master plan, establishes project scope and cost, details estimated amounts of funding from various sources, and projects future operating and maintenance costs. A capital plan should cover a period of at least three years, preferable five or more to: (1) identify needs, (2) determine costs, (3) prioritize capital requests, and (4) develop financing strategies.[3]

### Responsibility

The multi-year plan provides essential information for the Board, other decision-makers, stakeholders, and the public. The multi-year plan should be based on the long-range master plan. The Budget Director, CFO, and responsible departments, such as FPM should be involved in the process to identify needs, determine costs, prioritize capital requests, and develop financing strategies. The Board should be responsible for approving the multi-year plans.

### Audit Assessment

The County has five-year plans for facilities and transportation capital; however we believe the format of the facilities five-year plan could be improved to provide transparency for decision-makers and the public.

- The County has five-year capital plans for facilities and for transportation capital needs, which are the basis for the County's annual capital budget.

[3] GFOA Best Practice, Preparing and Adopting Multi-Year Capital Planning (2006)(CEDCP).

- The five-year plan for facilities is detailed, from 250 to 300 projects, which include both non-routine and routine maintenance and repair projects in the Asset Preservation and Capital Improvement funds. We believe these documents are overly complex. Complexity is due to the amount of detail in these plans and significant changes from year to year, including budget changes and movement of financing from project to project. The result is a decrease in overall transparency and an inability to measure the accomplishments and progress of projects.
- The basis for the facilities five-year capital plan is FPM's prioritization of projects and includes maintenance and repairs as well as new buildings and major renovation and remodeling projects. We believe the decision process for prioritizing individual routine maintenance and repair projects should be based on FPM's systems and expertise. However, non-routine projects and major renovation and remodeling (not maintenance and repairs) projects should be on a master plan. See our recent audit *Facilities Management: Deferred Maintenance* issued October 15, 2013, which recommends separation of maintenance and repair projects from other capital projects.
- The five-year plans for transportation capital are approved by the Board, this process is not done for facilities five-year plans.

Recommendation

1. We recommend the five-year plans separate non-routine and major projects from routine maintenance and repair projects, with more detail for non-routine and major projects and perhaps summary information for routine maintenance and repair projects. See our audit recommendations in the Deferred Maintenance Audit.
2. We recommend information and format of the five-year plans include some of the following:
    a. The plan should link to the master plan. Understandably projects that were not on the master plan may take priority for any number of reasons and significant additions of these projects should be noted and the reason for their priority explained.

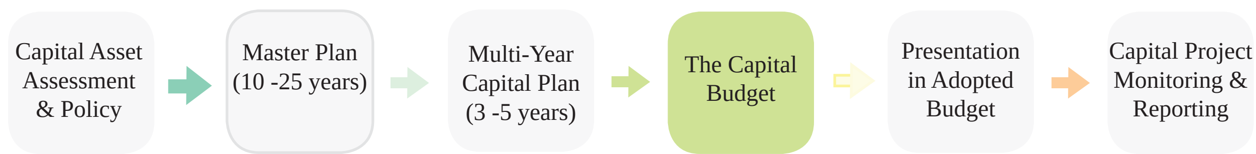
b. The plan should include financing sources or potential sources for all projects and clearly identify any restricted resources.

c. The plans should include information based on the multi-year nature of capital projects and reflect the entire project budget which would include prior as well as current and anticipated future years' budget estimates.

d. The five-year plan should show changes in budget estimates since they are the basis for the capital budget and adopted budget.

e. The five-year plans should be presented to the Board for consideration in adopting the plan.

## The Capital Budget




### GFOA Guidelines

*Once a government entity has adopted a multi-year capital plan (3-5 years), the next step in the capital process is to develop and implement a capital budget. … Most capital budgets are formally adopted as part of the annual or bi-annual budget process, officially incorporating the appropriate year(s) of the multi-year capital plan into the budget.*

*Because of the unique nature of capital projects, the processes for preparing, prioritizing and presenting them to the governing body may be different from the operating budget. Capital project budgets may also require additional information such as geographic location, multi-year funding sources, and impact on the operating budget. After the capital budget is adopted, it is important that an adequate system is in place to initiate and manage each authorized project through completion.*

*The capital budget should be directly linked to, and flow from, the multi-year capital improvement plan. Modifications may be necessary based on changes in project scope, funding requirements, or other issues. If these modifications are material, jurisdictions should consider the impacts these may have on their multi-year capital and financial plans.*[4]

### Responsibility

The Budget Director has the responsibility for the budget process along with the CFO who should be responsible for determining the financing resources and strategies for capital spending. The multi-year plan should be the primary source of information for the capital budget. The Board should be responsible for the formal adoption of the budget, which may include the capital budget.

[4] GFOA Best Practice, Incorporating a Capital Project Budget in the Budget Process (2007)(CEDCP and BUDGET)

## Audit Assessment

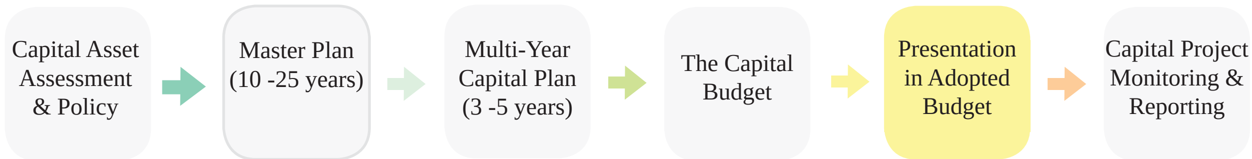
The County's capital budget is a component of the operating budget, rather than as a separate capital budget. The information included in the budget meets best practice criteria for budgeting.

- The capital budgets for facilities and transportation are based on five-year plans. The five-year plan for transportation capital is formally adopted by the Board prior to inclusion in the budget process. This step is not done for facilities five-year plans.
- The County does not have a capital budget document, other than the component included in the annual budget process. Information presented to the Board consists of slides and discussion of the capital budget components, rather than a formal report.
- The capital budget component in the County's operating budget includes information suggested by the GFOA.

## Recommendation

1. We recommend the Budget Director create a separate capital budget, which would be incorporated into the annual operating budget in summary form.
    a. This document would be approved by the Board during the budget process and would provide additional details that could link to the master plan and five-year plans, and better reflect the multi-year nature of capital projects which is not included in the annual operating budget.
    b. Such a document would provide the Board with more information for making capital budget decisions serve, as a communication tool for the public, and also provide a basis for monitoring the County's capital programs. See recommendations in the following section on "Capital Project Monitoring and Reporting."

## Presentation in the Adopted Budget




### GFOA Guidelines

*After the capital budget or multi-year capital plan is adopted, a government should decide how to best present major capital program highlights in the operating budget document. An exceptional capital presentation enhances the transparency and accountability to citizens. It gives a broader context for citizens to understand major components of the capital budget and its relationship to the operating budget.*

*Presentation of the capital section should include a summary of the multi-year capital plan as well as detailed information related to the budget. Each government will need to establish the appropriate balance between summary-level and detailed information.*

### Responsibility

The County Chair and the Budget Director should have ultimate responsibility for the budget, including the capital budget. The Commissioners review and approve the budget.

### Audit Assessment

While the annual budget is a legal document that must comply with Oregon's Local Budget Law, it also serves as a communication tool to citizens about how their tax dollars are being spent. Some improvements would make this a better tool for reporting on capital spending.

- We believe the Budget Director provides good information about major capital spending in the Budget Director's Message for capital spending. The capital budget information in the budget includes a detail listing of routine capital projects.
- As noted in the previous section, the County's capital budget goes through the same process as the annual operating budgets and contains most of the information recommended by the GFOA.

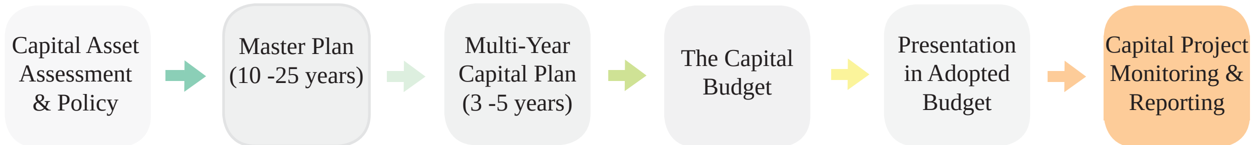
[5] GFOA Best Practice, Incorporating a Capital Project Budget in the Budget Process (2007)(CEDCP and BUDGET and CEDCP)

- The capital budget lacks historical context; it does not reflect the multi-year nature of capital spending, nor does it even reflect prior year's spending for projects as do the annual operating budgets.

Recommendation

1. We recommend the Budget Director create a separate capital budget, which would be incorporated into the annual operating budget in summary form. See recommendations in the prior section on "The Capital Budget."
2. We recommend less detail be included in the annual capital budget document, which would result in more transparent and useful information for citizens. The detail should be included in a separate capital budget document, as described above.

# Capital Project Monitoring & Reporting




## GFOA Guidelines

*The financial management of capital projects requires a substantial commitment of organizational time and resources. Given their scale and cost, capital projects can represent a significant risk for local governments. Consequently, governmental entities should establish policies and procedures to support effective capital project monitoring and reporting to mitigate such risks. Such efforts can improve financial accountability, enhance operational effectiveness and promote citizens' confidence in their government.*[6]

*In many jurisdictions, finance officials are called upon to oversee or directly perform capital project monitoring and reporting activities. GFOA recommends that jurisdictions establish policies and processes for capital project monitoring and reporting.*

## Responsibility

The CFO and Budget Director should be responsible for capital project monitoring and reporting using financial information and project information from County departments and project managers.

## Audit Assessment

The County has no formal process for capital project monitoring or reporting.

- We had difficulty identifying where the money went for General Fund transfers for capital spending and for some bond funds. Accounting for these resources by project is not done in SAP, which makes it difficult for monitoring and reporting. General Ledger tracks restricted funds such as bond funds and grants on spreadsheets because this information is not in the accounting system.
- Financing designations made by the Board in the budget process or by resolution are not formally monitored. For example, the Board by Resolution may specify the use of proceeds from the sale of a building; however there is no process to monitor and report back to the Board what actually happened.

[6] GFOA Best Practice, Capital Project Monitoring and Reporting (2007)(CEDCP)

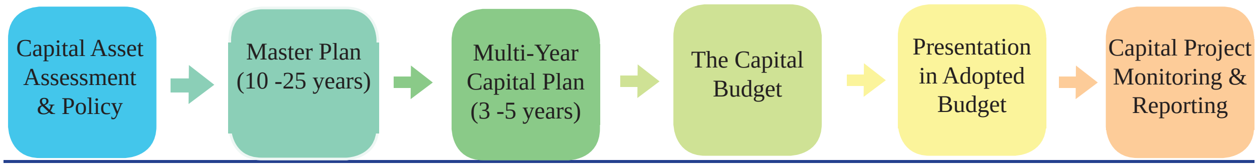
- We only reviewed one major non-routine capital project; the East County Courthouse. We recognize that this was a very complex project and the budgeted amount changed from year to year. We were told by FPM that the project's spending was monitored by that division. However, we could not find a financial summary of the project that showed the total budget, budget modifications, total spending or the financing sources for the project.
    - To piece this information together for financing resources we had to search for Board resolutions. There were 19 from 2004 to 2010; the project was completed in 2012.
    - FPM presented a project summary to the Board in December of 2012, which was comprehensive; but only included one piece of the entire project. Citizens and Board might mistakenly have made the assumption that the East County Courthouse was a successful $19.4 million project based on the budget amount in the presentation; rather than that it was a successful $28.5 million project because spending for the land and for the data center was not included.
- We believe some of the lack of fully accounting for projects is because the CFO and Finance are not fully involved in the capital planning process.
- FPM prepares two reports for the board in the form of a Mid-Year and End-of-Year report. These reports lack adequate monitoring information as they do not report on a project in total for all years involved, but like the budgets are on projects based on only one year. Also the reports do not show the original budget as adopted by the board and the budget modifications, and do not show how designated or restricted funding sources were spent.

Recommendation

1. We recommend the County create a formal process for monitoring and reporting capital spending. We believe the CFO and Budget Director should be involved early in the planning process and provide guidance for accounting for capital financing and spending to include involvement in (a) a well structured multi-year capital plan, (b) accurate and clear multi-year plans, and (c) as recommended, a separate detailed capital budget that would assist in the monitoring and reporting process.

2. We recommend the CFO monitor capital projects on a regular basis, rather than leaving the monitoring to department project managers. This change in practice would provide an independence from department management responsible for the project and improve accuracy and transparency of reporting.
3. We recommend the CFO and Budget Director provide the Board and other decision-makers with clear concise reporting for all major and non-routine capital projects that includes some the following information for all years of a project (Also see Appendix A for details of best practices for monitoring and reporting capital spending):
    a. The original adopted budget amount for the project and any budget changes for both project cost and project funding sources.
    b. Actual spending for the project by year, with additional spending details for larger projects based on the project plan.
    c. Budgeted and actual funding resources used for the project, and status of any restricted funding sources.
    d. The above level of reporting could be on a summary level for routine capital projects under $1 million or some established dollar amount.
    e. Exception to (d) above is when the Board allocates General Fund or other restricted or designated dollars for a project or multiple projects. The CFO should report on spending for all projects designated for that resource.

## Recommendations Summary




### Capital Asset Assessment & Policy

1. We recommend FPM continue its process for evaluating condition of all buildings and make this assessment of building conditions a priority.
2. We recommend the County's CFO's increase Finance's involvement in the capital decision process on the project level for larger projects, and for the allocation of funding for all capital spending, which would include all financing, budgeting, reporting of resources, and capital spending.
3. We recommend the County change its capital policy so that it is a guideline that is understandable and measurable. In our report on Deferred Maintenance we recommended the County revise the County policy for capital projects to identify capital needs for new facilities and remodeling separately from needs for major system maintenance projects; and to consider using a separate fund for capital projects that are not maintenance and repairs.

### Master Plan (10-25 years)

1. We recommend the County's Budget Director or the CFO create a fiscally prudent 10-25 year master plan that includes the capital needs and associated costs and revenue streams for facilities, information technology, and other major capital spending.
   a. The plan would include input from FPM, Information Technology, and other departments.
   b. The plan should identify the ability of the County to finance needed capital projects as well as the gaps in the ability to do so.
   c. The plan should be designed so that the accomplishments and progress toward the goals can be measured.
   d. The plan should be in a format that is clear, concise, and available to the public and other stakeholders.
   e. We believe all capital projects should be included in the master plan, even those that may lack potential funding or supporters. The master plan could be used to keep track for these for future years, and also provide awareness that there may be other alternatives to meet those needs.

2. We recommend the County use the master plan as an integral part of the capital financing and budgeting process as it relates to multi-year plans and the annual capital budget.

### Multi-Year Capital Plans (3-5 years)

1. We recommend the five-year plans separate non-routine and major projects from routine maintenance and repair projects; with more detail for non-routine and major projects and perhaps summary information for routine maintenance and repair projects. See our audit recommendations in the Deferred Maintenance Audit.

2. We recommend that the information and format of the five-year plans include some of the following:
   a. The plan should link to the master plan. Understandably projects that were not on the master plan may take priority for any number of reasons; significant additions of these projects should be noted and the reason for their priority explained.
   b. The plan should include financing sources or potential sources for all projects, and clearly identify any restricted resources.
   c. The plans should include information based on the multi-year nature of capital projects and reflect the entire project budget which would include prior as well as current and anticipated future years' budget estimates.
   d. The five-year plan should show changes in budget estimates since they are the basis for the adopted capital budget.

### The Capital Budget

1. We recommend the Budget Director create a separate capital budget, which would be incorporated into the annual operating budget in summary form.
   a. This document would be approved by the Board during the budget process and would provide additional details that could link to the master plan and five-year plans, and better reflect the multi-year nature of capital projects which is not included in the annual operating budget.
   b. Such a document would provide the Board with more information for making capital budget decisions, serve as a communication tool for the public, and also provide a basis for monitoring the County's capital programs. See recommendations in the following section on "Capital Project Monitoring and Reporting."

### Presentation in the Adopted Budget

1. We recommend the Budget Director create a separate capital budget, which would be incorporated into the annual operating budget in summary form. See recommendations in the prior section on "The Capital Budget."
2. We recommend less detail be included in the annual capital budget document, which may result in more transparent and useful information for citizens.  The detail should be included in a separate capital budget document, as described above.

### Capital Project Monitoring & Reporting

1. We recommend the County create a formal process for monitoring and reporting capital spending. We believe the CFO and Budget Director should be involved early in the planning process and provide guidance for accounting for capital financing and spending to include involvement in (a) a well structured multi-year capital plan, (b) accurate and clear multi-year plans, and (c) as recommended, a separate detailed capital budget that would assist in the monitoring and reporting process.

2. We recommend the CFO monitor capital projects on a regular basis, rather than leaving the monitoring to department project managers. This change in practice would provide an independence from department management responsible for the project and improve accuracy and transparency of reporting.
3. We recommend the CFO and Budget Director provide the Board and other decision-makers with clear concise reporting for all major and non-routine capital projects that includes some the following information for all years of a project (Also see Appendix A for details of best practices for monitoring and reporting capital spending):
   a. The original adopted budget amount for the project and any budget changes for both project cost and project funding sources.
   b. Actual spending for the project by year, with additional spending details for larger projects based on the project plan.
   c. Budgeted and actual funding resources used for the project, and status of any restricted funding sources.
   d. The above level of reporting could be on a summary level for routine capital projects under $1 million or some established dollar amount.

e. Exception to (d) above is when the Board allocates General Fund or other restricted or designated dollars for a project or multiple projects. The CFO should report on spending for all projects designated for that resource.

## Objective, Scope and Methodology

Our audit objectives were: to evaluate the financing sources and spending for capital projects; to evaluate the accuracy and usability of information to the Board for capital spending decision-making on an annual and project basis; and, to provide transparency of information to the public.

Our audit review of capital financing and spending focused pOur audit review of capital financing and spending focused primarily on capital for buildings and our examples were limited to that review. However best practices for financing and planning for capital would also include information technology and transportation capital financing and planning.

Data for our review came from the County's adopted budgets, Board resolutions, policies and rules, Comprehensive Annual Financial Reports, the enterprise accounting system (SAP), and reports from FPM.
To get a better understanding of financing (where did the money come from?) and spending (where did the money go?) for capital spending, we analyzed County financial data for a twenty-year period, with a closer look at a sample of a few larger more recent capital projects.

We reviewed best practices for financing and planning capital projects and took related training classes from the Government Finance Officers Association (GFOA) for "Communicating Capital Needs." We used GFOA best practice guidelines for capital planning; these identify specific policies and procedures as contributing to improved government management.

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

# Response

Office of the Chief Operating Officer 501 SE Hawthorne Blvd Ste 600, Portland, Oregon 97206

March 17th, 2015

Auditor Steve March
501 SE Hawthorne Blvd, Ste 600
Portland, Oregon 97206

Dear Auditor March:

Thank you for the work you and your staff put into the recent audit on Capital Financing and Planning. The report contains many specific recommendations that will provide guidance in improving and strengthening our capital planning efforts. Your attention to this matter has been helpful in highlighting the County's responsibility to prioritize, and plan for, long-term capital investments. We are in agreement that many of the components necessary for a capital planning process that reflects best practices are already in place. However, additional attention and resources will be required to support a more fully integrated countywide process.

As we consider how to move forward in implementing your recommendations it is important to consider where we have come from. Since the beginning of the "great recession" the County has focused its financial resources on two main priorities:

- Maintaining safety net services to the County's vulnerable and underserved populations; and
- Improving the County's overall financial stability.

The County was able to achieve these goals through the leadership of the Board of County Commissioners and application of financial management practices that included prudent use of one-time-only revenues and restoration of General Fund reserves. Credit rating agencies took notice of these actions and recently recognized the County with upgrades to our bond rating.

It is safe to say that Multnomah County emerged from the economic downturn in as good, if not better, financial shape than most local governments in Oregon. We are now poised to tackle some major infrastructure needs that will support the vital services we provide into the future.

Current State

Multnomah County has responsibility for three major categories of capital investments:

- Facilities

- Transportation (Roads and Bridges)
- Information Technology

The county also maintains a fleet of standard and specialized vehicles.

We believe the initial focus in developing a countywide capital planning process should be on Facilities and Information Technology, both of which are primarily supported by the General Fund. Transportation projects have historically been financed with resources dedicated to them (i.e., Gas Tax, Vehicle Registration Fees).

The sum total of all capital projects has a bearing on the amount of debt financing to support them as state statute sets a limit on how much the County can borrow. Currently, the County is well below the statutory debt limits.

It is also well below the limits outlined in the Board's adopted "Financial and Budget Policies". The policy on debt issuance states that debt service for General Fund supported debt cannot exceed 5% of General Fund revenues. As of July 1, 2014 General Fund supported debt service equals about 1.3% of General Fund revenues. That additional capacity translates to approximately $200 million of potential capital projects.

This untapped debt capacity, along with a change in the "Financial and Budget Policies" related to the use of one-time-only revenues, can be used to support a number of Facilities and IT capital projects. The County now has a very good financial framework in place that will provide the backdrop for implementing the recommendations included in this audit report.

As you note, there are many elements of a capital planning process that are already in place within the County's departments. For example, both Facilities and Transportation present annual and five-year capital plans to the Board of County Commissioners. Facilities recently completed Phase II of its strategic plan for assessing and evaluating the condition of the County's building portfolio. The Information Technology division has begun an evaluation of major computer systems and has identified a number of critical, "at risk" applications. What we lack is a comprehensive, countywide perspective that aligns infrastructure needs with financial resources.

<u>Response to Recommendations</u>

Rather than addressing the specific recommendations made in the Capital Financing and Planning Audit we would like to articulate a vision for how we can achieve the goal of improving the capital planning and monitoring process. We propose that this will be a multi-year plan and will involve many stakeholders.

In order to support this vision we will require:

- Development of comprehensive long-term, short-term, and annual capital plans accompanied by appropriate financing strategies; and
- Investment in increasing internal expertise and capacity for countywide capital planning and monitoring.

The first step in this process will be the creation of a **Capital Projects Steering Committee** comprised of the Chief Operating Officer, the Directors of the Department of County Assets and Department of Community Services, the Director of the Facilities and Property Management Division, the Deputy Chief Information Officer, the Chief Financial Officer, and the Budget Director. This group will be charged with high level evaluation and recommendation of projects to the Chair and Board of County Commissioners. In addition, it will receive regular reports on the status of ongoing projects. The Capital Projects Steering Committee will also play a key role in the development of an overall capital master plan.

This committee will be supported by a **Capital Projects Technical Workgroup** that will be comprised of subject matter experts from the departments that manage capital projects along with representatives from the Budget Office and the Office of the CFO. This group will review financing strategies, provide input on planning and spending assumptions, and develop reporting criteria for both long-term and annual capital project monitoring.

Both these groups will be staffed by a **Long Range Capital Asset and Strategic Planning Group** reporting to the Chief Operating Officer. The purpose of this highly focused team is to provide a centralized, specialized group to plan for, balance and manage capital assets. Its placement among other centralized corporate functions reporting to the COO will ensure that the overall strategic goals of the county as well as impact to ongoing operations are being considered. Additionally, this group will provide a critical and formalized link between Facilities & Property Management, Information Technology and Central Budget & Finance.

We agree that the current capital plan for Facilities includes many maintenance and repair projects. We will be moving to a reporting model that separates those projects from major recapitalization/remodeling and new construction projects. We have begun to address that concern over the past couple of years by creating separate funds for the Sellwood Bridge, the Downtown Courthouse, and Health Department Headquarters projects. This is a reporting structure we envision applying as we go forward.

The challenge in developing a long-term master plan for capital projects is that each category of project has a distinct life cycle. For example, a new bridge may be designed to last 75-100 years while the pace of change in information technology limits long-term planning for application replacement to 10 –

15 years and in some instances, 5 - 10 years. We believe we can integrate the majority of our infrastructure needs into a Master Plan that will have a 10 – 20 year timeframe.

As noted in the audit report, planning for major capital projects typically takes years. It is important that a Master Plan take into consideration the planning, design, and construction phases for all categories of projects. But, it is also our goal to incorporate an overlooked element of capital planning – total cost of ownership – into these efforts. Each iteration of the plan (the Master Plan, the Multi-Year Plan, and the annual Capital Budget) will include this total cost of ownership analysis specific to the timeframe associated with the plan.

In conclusion, we have reviewed, and are in agreement with, the recommendations outlined in the Capital Planning and Financing audit. This will be a major effort, with input and participation from many County stakeholders, which will require us to view capital projects from a countywide perspective. Given the many infrastructure needs facing the County, our ability to make this shift in current practices will be crucial to our long-term success. We believe, and have confidence, that this transformation can happen and this audit report has provided us with a good roadmap to assist us in those efforts.

Sincerely,

Marissa Madrigal
Chief Operating Officer

# Appendices

**GFOA BEST PRACTICE**

**Capital Project Monitoring and Reporting (2007) (CEDCP)**

**Background.** The financial management of capital projects requires a substantial commitment of organizational time and resources. Given their scale and cost, capital projects can represent a significant risk for local governments. Consequently, governmental entities should establish policies and procedures to support effective capital project monitoring and reporting to mitigate such risks. Such efforts can improve financial accountability, enhance operational effectiveness and promote citizens' confidence in their government.

In many jurisdictions, finance officials are called upon to oversee or directly perform capital project monitoring and reporting activities. To successfully perform those activities, finance officials should be familiar with project management practices, software systems for project management and project accounting, and capital project reporting procedures.

**Recommendation.** The Government Finance Officers Association (GFOA) recommends that jurisdictions establish policies and processes for capital project monitoring and reporting. GFOA advises officials to:

1. **Identify and incorporate legal and fiduciary requirements into capital monitoring and reporting.** Because finance officials are typically entrusted with ensuring that capital project activity is consistent with pplicable laws and organizational rules and procedures, initial efforts should focus on understanding requirements related to:
   - Auditing and financial reporting consistent with generally accepted accounting principles
   - Auditing and financial reporting consistent with generally accepted accounting principles and jurisdictional accounting and grant requirements.
   - Arbitrage regulations, bond covenants, and/or bond referenda requirements related to long-term debt.

Source: GFOA Best Practice, Capital Project Monitoring and Reporting (2007)(CEDCP)

- State and local laws, including such areas as debt capacity limits, voter authorization, as well as public bidding and reporting requirements.
- Capital project contract language and the jurisdiction's contracting practices.
- The relationship between each project and the jurisdiction's planning processes, including specific plans and master plans.

2. **Identify external and internal stakeholder information needs**. Finance officials may be called upon to compile cost and performance data for diverse stakeholders. With this in mind, financial officials responsible for capital monitoring and reporting should:
   - Identify key audiences involved in capital projects, for example, project engineers, contractors, finance and budget staff, executive management, elected officials, and constituents.
   - Identify the business needs of key participants, including timing status, cost activity, and project scope.
   - Establish project performance measures based on stakeholder needs and legal and fiduciary requirements.
   - Collaborate with participants to determine the content of reports and the preferred reporting tools of various stakeholders, including the depth and frequency of information, established expectations and notable variances.

3. **Plan and design systems to collect, store, and analyze project data and to report results**. Often, more than one system or technological solution is required to properly address all informational requirements. To simplify this process, responsible officials should:
   - Decide which system will be the main system for storing capital project financial and operational data.
   - When establishing a data system specifically for capital projects, take the following factors, (at minimum) into consideration:
     - o The appropriate technological solutions for project accounting, scheduling and reporting. Solutions may include spreadsheets, customized databases, ERP systems, or project management software.
     - o Positional roles, including access, input and editing privileges for system users who will be charged with compiling, analyzing and reporting financial and management information.

Source: GFOA Best Practice, Capital Project Monitoring and Reporting (2007)(CEDCP)

- o The process for controlling and managing project changes.
- o Accountability and data integrity within the financial management system.
- o Data accuracy. This is particularly important when there are interfaces between separate information systems, such as geographic information systems, project management systems and financial systems. Careful consideration should be given to avoid duplicative data among these different systems.
- o Triggers and protocols for identifying and addressing project cost overruns.

- Assure that appropriate system controls and security have been incorporated, consistent with the jurisdiction's technology standards.
- Strive for consistency and standardized language when compiling information from various sources.

4. **Regularly monitor capital projects' financial and project activity information.** Once legal, fiduciary, and informational requirements have been established and information systems are in place, finance officials should monitor capital project activity on a regular basis. At a minimum, such monitoring should include:
   - Confirmation that a project plan exists that identifies all required resources and milestone work products and assurance that the project plan is being followed.
   - Confirmation that the project's scope has been clearly identified upon completion of final design and that he project stays within scope or that changes to scope have been made consistent with an established process.
   - A review of project-related financial transactions to support budget review, auditing and asset management.
   - A review of expenditures, both in relation to the current budget, and over the entire project life.
   - Review of encumbrances and estimates of planned expenditure activity.
   - Confirmation of continued availability and appropriateness of revenue sources identified in the capital budget.
   - Confirmation of the adequacy of cash flow in relation to project requirements.
   - Review of the timing of investment maturities compared to planned project disbursements.
   - Review of sources and project uses of bond proceeds and grants.
   - Results compared to established measures of performance.

Source: GFOA Best Practice, Capital Project Monitoring and Reporting (2007)(CEDCP)

5. **Report on project status and activities**. Producing project status reports will help officials make informed decisions regarding scheduling and cost. (In establishing report content and frequency it is important for fficials to keep in mind that high profile projects often require more extensive reporting of activity compared to a jurisdiction's more routine capital projects.) It is important to be consistent and use plain language when compiling information from various sources and reporting it to multiple stakeholders. Meaningful reports should provide straightforward project information for executive leadership and internal staff as well as citizens and the media, and, at minimum:
   - Provide a comparison of actual results to the project plan, including:
     - o Percent of project completed
     - o Percent of project budget expended
     - o Progress on key project milestones
     - o Contract status information
     - o Revenue and expenditure activity
     - o Cash flow and investment maturities
     - o Funding commitments
     - o Available appropriation
     - o Comparison of results in relation to established performance measures
- Highlight significant changes to project scope or costs.

6. **Project close-out.** Upon project completion, ensure that actions are taken to finalize project activity, including, at minimum:
   - Confirming that the project is closed out appropriately within all systems used to manage, monitor and report on the project.
   - Confirming that the established procedures for user acceptance of project work and final project completion have been followed.
- Confirming that new infrastructure assets are properly recorded.

7. **Evaluate monitoring and reporting activities.** In order to assure that capital project monitoring and reporting practices continue to be effective and relevant to the organization, jurisdictions should conduct a periodic review of these practices, including at minimum:
   - An inspection of reporting data for accuracy and completeness.
   - The existence and adequacy of measures used for quality assurance and control in each phase of capital projects.

Source: GFOA Best Practice, Capital Project Monitoring and Reporting (2007)(CEDCP)

- Solicitation of feedback (using surveys, interviews and other feedback mechanisms) from stakeholders on the adequacy and relevance of reports and reporting tools, including the extent to which business needs are being addressed.
- A comparison of the organization's report format and content to other agencies' practices.
- An assessment of the adequacy of communication between various organizational units.

**References**


- *Capital Improvement Programming: A Guide for Smaller Governments*, GFOA, 1996
- *Recommended Budget Practices: A Framework for Improved State and Local Government Budgeting,* National Advisory Council on State and Local Budgeting, 1998.
- "Managing the Capital Planning Cycle: Best Practice Examples of Effective Capital Program Management," *Government Finance Review,* GFOA, 2004.
- *Capital Budgeting and Finance: A Guide for Local Governments*, ICMA, 2004.
- *Preparing High Quality Budget Documents*, GFOA, 2006.
- "Staying on Track: Crafting a Capital Program Reporting System," Government Finance Review, GFOA, 2006.
- Distinguished Budget Presentation Awards Program, *Awards Criteria and Explanations of the Criteria*, GFOA.


Approved by the GFOA's Executive Board, October 19, 2007.

Source: GFOA Best Practice, Capital Project Monitoring and Reporting (2007)(CEDCP)

Below is a list of a few resources used in this review of Capital Financing and Planning. The first on the list below is our reference source for best practice guidelines used in this report from the Government Financie Officers Association (GFOA). In our review of best practices we found consistency in the guidelines of what constitutes best practices.

- GFOA best practice guidelines are from their web site www.gfoa.org under "Best Practices & Advisories" using the Category "Economic Development and Capital Planning"

- "Guidebook on Capital Investment Planning for Local Governments" – Urban Development Series can be found at www.worldbank.org, [or Google the title]

- Wendorf, Jill (2005) "Capital Budgeting from a Local Government Perspective," SPNA Review: Vol. 1: Iss. 1, Article 6. Available at: http://scholarworks.gvsu.edu/spnareview/vol1/iss1/6

- "Multiyear Capital Planning" – Local Government Management Guide from Division of Local Government and School Accountability, Office of the New York State Comptroller. http://www.osc.state.ny.us/localgov/pubs/lgmg/capital_planning.pdf

- San Francisco's Capital Planning Program. Example of capital planning can be found at http://onesanfrancisco.org

- The auditor also took a training class from the GFOA "Communicating Capital Needs" in addition to some of the selected research for best practices listed above. The trainers in this class included Brian Strong, director of San Francisco's capital planning program (a very large organization), and Jeffrey Yates (from a small county in North Carolina). The class illustrated application of best practices for capital financing and planning regardless of the size of the organization.