



# Fairfax County Internal Audit Office

**Department of Public Works and Environmental Services  
Developer Performance Deposit Audit  
Final Report**

**August 2010**

# Background

Land development projects in the county are required to be bonded to ensure that developers fulfill their obligations to satisfy all project requirements, as established by county staff in the Land Development Services (LDS) sub-agency of the Department of Public Works and Environmental Services (DPWES). To protect the county from financial loss resulting from a developer's default or failure to satisfy project requirements, engineers in the Environmental and Facilities Inspection Division (EFID) of LDS estimate the costs to complete a development project and apply certain factors to arrive at the required surety value amount to be required from the developer. Such a surety guarantee may be in the form of a surety bond, a letter of credit or set aside letter issued by a bank, or cash. The Department of Finance (DOF), Accounts Payable Section has central secondary approval and oversight over the county's refund of developers' cash deposits and accrued interest earnings. For fiscal years 2009 and 2008, the Bonds & Agreements branch of LDS reviewed approximately 220 new project deposits totaling \$81.8 million and 309 deposits totaling \$50.2 million respectively, and authorized the release of 499 developer deposits totaling \$69.8 million and 467 deposits totaling \$47.6 million during those respective years as well.

## Executive Summary

Our audit focused primarily on internal controls over the establishment, reduction, and release of developer performance deposits. The most critical objectives of our audit were to determine if developers' deposits were properly accounted for and that the refunds of deposits or release of performance guarantees to developers were properly authorized only after all developer obligations had been completed. We found the developer deposits were generally well accounted for and the releases and reductions of such deposits appeared to be appropriate. We also noted the following areas of control weaknesses which provide opportunities for improvement:

- Cash deposits for future construction bonds and conservation agreements recorded in the Land Development Services/Plan and Waiver computer system (LDS/PAWS) were not reconciled to the county's financial system (FAMIS).
- Insufficient actions were taken to resolve or close out four of the 25 older development projects (more than 10 years) we reviewed. They did not appear to be active, ongoing projects, as three of them were at least 30 years old, another nearly 20 years old, and the files did not include documentation indicating any activity or efforts to complete the projects or release the deposits had occurred during the past several years. Additionally, developer deposits for four other projects incorrectly remained in the LDS/PAWS system with a balance after they had been liquidated.
- Three of the 42 released deposits reviewed were missing the required EFID approval signature on the Letter 18 checklist.

- File maintenance and retention issues were noted, as three of 25 older (more than ten years) developer deposits reviewed were missing the required surety value estimates, so we could not readily determine the nature or requirements of the projects. Also, it took over six months, after several requests, for LDS to locate the files for three of 42 released developer deposits we selected for review.

## Scope and Objectives

This audit was performed as part of our fiscal year 2009 Annual Audit Plan and was conducted in accordance with generally accepted government auditing standards. Our audit covered developer deposits which had been released, reduced, or defaulted during the audit period. Additionally, we reviewed developer deposits more than 10 years old as of the end of the audit period. The audit covered the period of April 1, 2008, through March 31, 2009, and the audit objectives were to determine if:

- Developers' accounts were properly credited for a monetary deposit made to the county
- Refunds or releases of performance guarantees to developers were properly authorized only after developer obligations had been completed
- Duplicate or erroneous refund payments were made
- Sufficient account records and supporting documents were on file to accurately track the receipt and refund/release transaction history of developer deposits and bonds
- Sufficient controls and procedures were in place to ensure that financial activity for each development project was tracked separately, and not commingled with other projects

## Methodology

Our audit approach included reviewing policies and procedures and interviewing the management and staff of the Environmental and Facilities Inspection Division of the Department of Public Works and Environmental Services, Land Development Services, to obtain an understanding of the requirements for the developer surety bond and deposit processes. We performed analytical procedures on the audit population data and identified potentially higher risk sub-populations of developer deposit and surety bond transactions to conduct specific audit tests. We also obtained samples of deposit supporting documents for our review. Our audit did not examine all significant system controls over the county's financial system (FAMIS) or the land development service system (LDS/PAWS). Our transaction testing did rely on those controls; however, this was not a scope limitation. The potential impact of this circumstance on our findings was that some portion of transaction data from LDS/PAWS or FAMIS may have been erroneous, but this would not have affected the conclusions of the audit.

# Findings and Recommendations

## 1. Reconciling Cash Deposits

We noted opportunities for LDS to strengthen its reconciliation process regarding developer deposits paid in cash. For new future construction cash bonds, LDS staff did perform an initial reconciliation between LDS/PAWS and FAMIS to ensure the cash receipts data was initially entered correctly and consistently, as required by county policy in Accounting Technical Bulletin ATB 40070, but LDS staff in the Bonds and Agreements section said they did not do this for conservation agreements. LDS also did not perform subsequent monthly reconciliations for either future construction or conservation agreement cash deposits, as required by county policy detailed in Accounting Technical Bulletin ATB 10020. Failure to reconcile cash transactions increases the risk that erroneous or fraudulent posting or non-posting of cash receipts to the appropriate systems could go undetected or not be corrected in a timely manner. The reconciliation provides a means of ensuring that all cash monies received from developers are properly credited and accounted for.

**Recommendation:** An initial reconciliation of cash receipts to the LDS/PAWS and FAMIS systems should be performed for conservation agreement deposits. Additionally, LDS should perform a monthly reconciliation of all outstanding cash deposit balances. Documentation supporting the reconciliations should be maintained, and the reconciler should sign and date the reports to evidence that the reconciliations are being performed in a timely manner by someone independent of the recording and approval of the cash transactions in the LDS/PAWS and FAMIS systems.

**Management Response:** LDS staff will perform a reconciliation of cash deposits received and posted in FAMIS against the deposits posted to PAWS as of September 2010. The difference, if any, will be noted as an unreconciled difference to be researched at a later date when resources become available. For each subsequent month, the same process will be repeated and the unreconciled difference identified from the September 2010 reconciliation should remain constant. Any future variances from the September 2010 unreconciled difference will be researched and resolved. Documentation supporting the reconciliations will be maintained in the Cashiers' Office and the appropriate reports will be dated and signed by the reconciler. Once there is sufficient staff in Financial Management, a complete reconciliation will be performed to bring PAWS and FAMIS in agreement.

## 2. Secondary Approvals

We noted that three of 42 released bonds reviewed were missing the required EFID approval signature. The potential effect is that a developer could be issued a final project release, and have his performance deposit funds or other bonding instrument returned without having completed all project requirements. This could

result in a financial loss to the county if it must spend county funds to complete the project requirements not satisfied by the developer.

We also noted that for forms requiring two separate approval signatures, there were incidences where a lower lever staff person was designated to sign on behalf of a higher level manager, but no other staff member performed the secondary review. In those instances, only one person performed the review and approval process which was designed to be performed by two separate people.

**Recommendation:** We recommend that Land Development Services implement a management control by which staff periodically spot checks a sample of Letter 18 checklists and bond release packages to ensure that all required approval signatures have been obtained prior to issuing final release. Ideally, the person(s) performing the spot checks should not be directly responsible for signing any of the Letter 18 checklist items. We also recommend that LDS implement a policy for when staff is delegated signatory authority on behalf of a higher level manager for documents requiring two levels of review and/or approval. On such occasions, another staff member should separately sign to indicate that the first level of review and approval was performed.

**Management Response:** The missing signatures appear to have been an oversight that will be corrected by better internal quality control, which we continually try to improve. EFID has multiple checks and balances in place. Letter 18 forms are required to be complete prior to bond release, and are approved by the inspector assigned to the job, his supervisor, and bond staff. Once these sign-offs are obtained, the contractor signs the letter 18 prior to a final bond release letter being signed by the director of EFID. With these controls it is highly unlikely, and almost impossible, for a project to be released without all the contractor obligations being complete.

The internal forms have been revised to remove the signature for the chief of Bonds. Due to the extensive review process that all new and extended bonds go through during their approval process, a secondary level of approval is no longer considered to be necessary.

### 3. Resolution of Old Development Project Deposits

There were issues with resolving or closing out old development projects noted during our review of 25 developer surety bonds and deposits more than ten years old. Four of the 25 old deposits did not appear to be active, ongoing projects. Three of them were at least 30 years old, another nearly 20 years old, and the files did not have documentation indicating any activity or efforts to complete the projects or release the deposits during that time. Additionally, we could not determine the nature or requirements of three of the four noted projects, since the surety value estimates normally prepared by a professional engineer were missing. Land development project requirements not completed after several decades

increases the potential risk of loss to the county as surety amounts become insufficient to cover inflationary costs. Additionally, the surety instruments may be drawn against banks or insurance companies which may no longer meet county requirements for acceptable credit or solvency ratings, or may have gone out of business. Per our discussions with Bonds and Agreements staff responsible for defaulted projects, it is possible one or more of the very old developer deposits could have been for a project that was successfully completed, but the county is not currently pursuing unclaimed developer deposits, and had not yet researched Virginia statutory requirements and criteria for escheatment of unclaimed developer deposits.

Four of the 25 old deposits reviewed incorrectly remained in the LDS/PAWS system with a balance after they had been liquidated upon default. Bonds & Agreements staff responsible for defaulted projects said the project files and related monies had been transferred to the Office of Capital Facilities to fund the completion of the projects, but no one had initiated the “release” action in the LDS/PAWS system to remove them. Additionally, two other deposits related to landfills that had been closed down (i.e., “capped”) for a number of years remained in the system, but Bonds & Agreements staff had not sufficiently researched the landfill closure and monitoring legal requirements to be able to determine if the deposits should be returned to the developers, or if they were appropriately still on the county’s books. Keeping inactive or defaulted projects as active projects in the LDS/PAWS system rather than removing them may decrease the accuracy and reliability of management reports and statistics for developer deposits.

**Recommendation:** We recommend that LDS management resolve old developer performance deposits still remaining in the LDS/PAWS system and FAMIS, especially ones that are more than ten years old and have not had any action taken on them in recent years. LDS should research the state’s escheatment requirements to ensure the county is in compliance, and make an effort to either resolve outstanding project issues or handle them as defaulted projects. The old projects determined to be in default should be indicated accordingly in the computer systems, and the related funds and files should be transferred to Office of Capital Facilities or other appropriate county agency for final resolution.

**Management Response:** For the outstanding list of conservation escrows (CE), EFID has undertaken an effort to evaluate all old sites with outstanding CE money, determine if these projects can be considered to be complete, and have the CE money released. We have already identified approximately two hundred projects that can be released, and are now working to identify the developers in an effort to release this money to them. We are undertaking a similar effort for future construction escrows, but have involved the Planning and Design Division, Streetlight Section, and the Department of Transportation to determine if specific monies related to projects completed by the county can be released to the county. In implementing both these efforts, we will coordinate with the County Attorney for verification and authorization of the ability to release certain escrow monies to the

county, if the original entity who posted the bond cannot be located. For landfills, we are researching the monitoring and testing reports, which are required after a landfill is completed, to determine how long the escrows can be held until the county is satisfied that there are no environmental issues and the monies can be released. The anticipated completion is within one year.

## Other Observations

### 1. **Additional Costs to Correct or Rebuild Faulty Infrastructure Construction or Land Grading**

We noted during our audit that for a small percentage of projects which developers defaulted without completing the project requirements, the surety values or deposit amounts were significantly below the county's costs to complete the projects. From our review of files and discussions with the responsible staff in the Office of Capital Facilities and Land Development Services, we learned that several of the surety amounts were related to infrastructure or other high cost requirements, including such items as stormwater ponds, streets, and land excavation. It appeared some of these projects cost more to complete than originally estimated because the county had to tear down and rebuild certain project components, or re-grade a land parcel. Correcting or removing prior construction work and rebuilding is typically more costly than building from scratch, and these extra costs were not included in the original surety estimates. Examples were the Meadowmere project (008056 SD-001), which was bonded for \$47,180 but will cost the county \$189,820 to complete; the Tysons Executive Village project (008370 SD-001), which had a remaining bond amount of \$23,200 at time of default but cost the county \$130,000 to complete; the Parvis Estates project (008779 SD-001), which was bonded for \$29,800 but cost the county \$117,800 to complete; the stormwater drain for the Browns Mill Forest project (006621 SD-001), which was bonded for \$214,000 but cost the county \$288,000 to rebuild; the landscaping required for the Westbriar Metroplace at Dunn Loring project (007462 SP-007), which was bonded for \$72,042 but cost the county \$154,300 to complete; the correction of defective soil conditions for the Clifton Pines project (008699 SD-001), which was bonded for \$154,000 but cost the county \$195,000 to complete, and the construction of stormwater infiltration trenches and a park trail for the Hastings Crest project (001903 SD-001), which was bonded for \$55,900 but cost the county \$155,400 to complete.

For higher risk projects which require particularly costly items such as infrastructure or extensive land grading, LDS should consider revising its current practice of returning to developers the ten percent surety value amount for general conditions at the time a reduction amount for a project bond or deposit is determined and approved. If LDS retains the bonding or deposit for general conditions until a project has been completely finished and approved for release, then there will be more funds available to the county to complete defaulted projects.

## 2. **File Maintenance and Retention**

File maintenance and retention issues were noted during our audit, as four of the 25 older (more than ten years) developer deposits we reviewed lacked sufficient account records and supporting documents, and three of these files were also missing the required surety value, so we could not determine the nature or requirements of the projects. The county's "Public Facilities Manual" requires that all developer bond and agreement amounts be supported by a surety value estimate prepared by the developer's professional engineer showing each required improvement included in the approved plan, that the estimate be reviewed by the county for completeness and accuracy, and that the county prepare a bond package.

Also, it took over six months for LDS to locate the files for three of 42 released developer deposits we selected for review. We first requested the files at the end of August 2009, but they were not located and provided for our review until March 2010, after numerous requests. EFID management stated that documents in project files are the 'documents of record' upon which decisions are made, rather than the LDS/PAWS computer system, so it is crucial that all files be properly secured and maintained. LDS should review its current filing system for released projects to determine if changes need to be made to improve its ability to locate files in a timely manner.