REPORT TO THE BOARD OF SUPERVISORS
FAIRFAX COUNTY, VIRGINIA

QUARTERLY STATUS REPORT ON OPERATIONS AS OF MARCH 17, 1999

OFFICE OF FINANCIAL AND PROGRAMS AUDITOR

FAIRFAX COUNTY, VIRGINIA

MEMORANDUM

TO: Board of Supervisors

FROM: John J. Adair
John J. Adair, Auditor to the Board
Office of Financial and Programs Auditor

DATE: March 17, 1999

SUBJECT: Quarterly Status Report on Operations

During this reporting period, we continued our review of negative pooled cash account balances, as requested by the Board of Supervisors at its September 28, 1998, board meeting. We focused primarily on the Department of Housing and Community Development's (DHCD) Community Development Block Grant (CDBG) Fund, whose average monthly negative pooled cash account balance during 1998 was about $2.5 million.

We wanted to determine whether it would be possible to eliminate the CDBG Fund's negative pooled cash account balance through an alternative reimbursement procedure.

As discussed below, DHCD took action in 1999 to reduce the CDBG negative pooled cash account balance. Moreover, a joint effort involving DHCD, the Finance Department, and our office has resulted in the testing of a new procedure for more timely reimbursement from the Federal Government's Department of Housing and Urban Development (HUD) for CDBG expenses. This procedure could virtually eliminate future negative pooled cash account balances in that fund, and may have application to other County grant programs as well.

Eliminating the $2.5 million average monthly negative pooled cash account balance in the CDBG Fund would increase the amount available for investment in the County's Pooled Cash Management Program by $2.5 million. This would add about $125,000, at current rates, to the interest income earned annually by the General Fund and other funds with equity in the Pooled Cash Management Program.

In addition to our work at DHCD, on December 29, 1998, we issued our second, and final, report on the operations of the County's Retirement Administration Agency. We concluded that the Agency is carrying out its administrative responsibilities very well. Actions taken in response to issues identified during our review will further improve the administration of retirement funds.

DHCD'S PROGRAMS
AND OPERATIONS

Fairfax County's DHCD provides housing opportunities for low and moderate-income County residents, and assists in the revitalization of neighborhoods. Its programs include rental housing, housing for the elderly, loans for home ownership and home improvement, tenant assistance, community development, and community revitalization.

The DHCD advertised budget for fiscal year 2000 includes expenditures of $58.8 million, to be funded through a combination of local, Federal and State governments, General Obligation bonds, and private sector sources. Receipts from Federal and State sources are expected to be about 53% of total funding.

DHCD's program includes 19 funds either appropriated by the Board of Supervisors or allocated by the Fairfax County Redevelopment and Housing Authority. Of the 19 funds, 11 had negative pooled cash account balances for all or part of 1998. The largest negative pooled cash account balance at the end of 1998 was the $4.8 million balance in the CDBG Fund. Our review focused primarily on the CDBG Fund. We also are reviewing the other DHCD funds with negative pooled cash account balances and will discuss them in our next quarterly status report.

THE CDBG PROGRAM

The CDBG program seeks to stimulate the development and preservation of low and moderate-income housing, and the provision of loans and public facilities and improvements directed toward conserving and upgrading low and moderate-income neighborhoods as well as public services for low and moderate-income residents. The source of revenue is the Federal Government, which provides an annual grant (currently about $6.1 million) to Fairfax county which is an entitlement jurisdiction under the CDBG program. Based on a planning process with extensive citizen input, the Board of Supervisors appropriates these funds to specific projects.

Total disbursements in the CDBG Fund for FY 1998 were about $6.7 million. The adopted budget plan for FY 1999 was about $6.1 million, but at the carryover review, the Board of Supervisors approved an increase of about $7 million due primarily to the carryover of unexpended project balances for multi year projects. Total available revenue for CDBG in the FY 1999 revised budget plan was about $13.1 million. FY 2000 projected CDBG Federal funding is about $6.1 million.

We met with DHCD staff in January 1999 to discuss negative pooled cash account balances in the CDBG Fund. They advised us that there had been some problems getting Federal reimbursement of CDBG expenses, but that they were taking action to reduce negative balances in the CDBG Fund.

DHCD REDUCED THE CDBG FUND'S DECEMBER 1998 NEGATIVE POOLED CASH ACCOUNT BALANCE TO $1 MILLION

The monthly negative pooled cash account balance in the CDBG Fund averaged about $2.5 million in 1998. At the end of that year, the negative pooled cash account balance for the fund was at its highest for the year, about $4.8 million.

DHCD staff said that the negative balance in the CDBG pooled cash account had grown to $4.8 million at the end of 1998 due to problems with the computerized system that HUD requires to be used for reimbursement requests. Instead of making monthly requests for reimbursement from HUD, which was the DHCD policy, sometimes a number of months had elapsed before reimbursements could be requested and received. During those months, the negative pooled cash account balances grew larger.

In addition, DHCD staff told us that a shortage of DHCD accountants had required the attention of staff who would normally be involved in reimbursement requests to be focused on other matters such as payment of expenses and preparation of the annual financial statement.

DHCD staff said in January 1999 that the HUD computer problems recently had been resolved, and the CDBG negative pooled cash account balance could be reduced. However, they said the fund would likely always have a negative balance since the CDBG program has been operated on a reimbursement basis since 1977.

In January 1999 DHCD staff reduced the negative balances in the CDBG Program fund from $4.8 million to $2.4 million dollars by making two requests for reimbursement from HUD. In February 1999, DHCD further reduced the balance to about $1 million.

A NEW PROCEDURE MAY VIRTUALLY ELIMINATE CDBG'S NEGATIVE POOLED CASH BALANCES

Part of the reason for the CDBG pooled cash account balance being negative was the procedure being used for seeking reimbursement. The procedure called for DHCD staff to request monthly reimbursement from HUD for all projects' expenses incurred and recorded in the County's Financial and Management Information System (FAMIS).

In an effort to determine whether reimbursement requests could be made more frequently in order to minimize, if not eliminate, the negative CDBG pooled cash account balance, we worked with DHCD and the Finance Department staffs. Collectively, we discovered that FAMIS could produce a report twice a week, when the Finance Department prepares checks for CDBG expenses, that would enable DHCD staff to request reimbursements almost as quickly as checks are written.

Since HUD can electronically transfer reimbursements to the County's bank account within a day after a request is received from the County, the DHCD could use the new report to request and receive reimbursement on or near the date that CDBG project expenses are being paid. A sample report has been produced by FAMIS and both the Finance Department and DHCD are optimistic about the benefits to be derived from using the new report.

An additional benefit of this report is that it will save DHCD staff time. Currently, DHCD financial management staff, who already have heavy workloads, must make specific inquiries in FAMIS to determine the amounts spent for each of the approximately 80 CDBG projects, by project year, so a reimbursement request can be made to HUD. The new report will eliminate the need for DHCD staff to make these inquiries. It provides all the information, by project and year, that is necessary for DHCD staff to request reimbursement.

DHCD plans to test this procedure by using this new report as a basis for seeking reimbursement from HUD for the CDBG Program as well as the smaller HOME Investment Partnership Grant Program.

We intend to monitor the results of this test during the next quarter. If the test is successful, as expected, this new procedure may have application to other County grant programs as well.

THE IMPACT OF THE NEW PROCEDURE ON THE GENERAL FUND AND OTHER POOLED CASH ACCOUNTS

When DHCD pooled cash accounts are negative, the DHCD, in effect, borrows cash from the County's Pooled Cash Management Program. When this occurs, the County has less money to invest. As a result, the General Fund and other agency funds in the pooled cash management program are credited with less interest income than they otherwise would earn.

Eliminating the $2.5 million average monthly negative pooled cash account balance in the CDBG Fund would increase the amount available for investment in the County's Pooled Cash Management Program by $2.5 million. This would add about $125,000, at current rates, to the interest income earned annually by the General Fund and other funds with equity in the Pooled Cash Management Program.

The accuracy of interest income distribution to the General Fund is important because the General Fund provides money for most Fairfax County programs and operations. A shortfall in General Fund revenue reduces the amount available to pay for programs and operations. Over a period of years, such shortfalls can become a factor in decisions involving increases or decreases in taxes.

In commenting on this issue, DHCD officials agreed that the new report will permit a significant reduction in the negative balances in this fund; however, they cautioned that it may not entirely eliminate them since there will always be some slight lag between disbursements and reimbursements. They also said that some reduction in pooled cash interest is the "cost" of receiving the $6 million in Federal funds.

We will continue to work with the DHCD staff as it tests the possibility of reducing CDBG negative pooled cash balances. We also will be reviewing the remaining negative pooled cash balances contained in other DHCD funds, in accordance with the request of the Board of Supervisors at its September 28, 1998 meeting. We will report the results of that work in our next quarterly status report.

We want to express our appreciation for the cooperation and assistance provided by staff from the DHCD and the Department of Finance on this issue to date.

REPORT ON RETIREMENT
ADMINISTRATION AGENCY
OPERATIONS

We completed our report on the operations of the Retirement Administration Agency. We concluded that the Retirement Administration Agency is administering the Supplemental, Police Officers, and Uniformed Retirement Systems very well. Actions taken by the Retirement Administration Agency in response to issues identified during our review will further improve the administration of retirement funds.

Appendix I is the Executive Summary to our report. It provides more detail on the results of our work. Appendix II is the written response to our report from the Executive Director of the Retirement Administration Agency.

EXECUTIVE SUMMARY

Fairfax County contributes to five retirement systems for County and school employees. Three of the retirement systems – Supplemental, Police Officers, and Uniformed Retirement Systems – are overseen by their respective Boards of Trustees and are administered daily by Fairfax County's Retirement Administration Agency (RAA). The Virginia Retirement System and the Educational Employees Supplemental Retirement System of Fairfax County are operated by the Commonwealth of Virginia and the Fairfax County Public Schools (FCPS), respectively, and were not included in our review.

This is the second and final report of our review of the three retirement systems, which was undertaken at the request of the Board of Supervisors. Our first report concerned the financial condition of these retirement systems and whether Fairfax County was contributing an appropriate amount to each of the three systems. That report, entitled, "Retirement Systems: Excellent Financial Condition; County Contribution Rates Appropriate; And Fiscal Year 1999 Contributions Projected To Be Significantly Lower," was issued on February 27, 1998.

This report focuses on the results of the second part of our review that concerns the effectiveness of the Retirement Administration Agency's day-to-day administration of the three retirement systems. Overall, we believe that RAA's staff of 21 is administering the three retirement systems, which have over 18,000 active and retired members and investments valued at over $2.7 billion, very well. The actions it has taken on issues identified during our review will further improve the administration of retirement funds. Actions taken include:

- Meeting with FCPS officials in April 1998, to expedite the transfer of their employee and employer contributions (approximately $1 million per month) to the Supplemental Retirement System. These contributions help fund monthly System expenses and permit more of the System's assets to remain invested.

- Refining cash management practices to ensure that minimum cash balances are maintained in the three systems' cash accounts that are pooled with County funds thereby maximizing their investment strategies and avoiding negative balances in their cash accounts.

- Adjusting 54 FCPS retirees' annuities who retired between April 1, 1997 and October 31, 1998. Thirty-three retirees will receive upward adjustments and twenty-one retirees will receive downward adjustments. RAA has taken corrective action so this situation will not recur.

With this correction made to the retirement benefit computations for FCPS retirees, we have concluded that the methodology followed for the retirement benefit computations for all three retirement systems results in the calculation of retirement benefits as intended by governing Fairfax County Ordinances.

In his response to our report (which is included in its entirety in Appendix II), the RAA's Executive Director concurred with our report and pointed out that our review helped RAA to focus on opportunities to improve operations. Examples of these improvements included the more timely transfer of the Public Schools System's contributions to the Supplemental Retirement System, better reporting of the status of retiree health premium payments, and a better process for acting on any overdue amounts from retirees.

Additionally, RAA's Executive Director stated that RAA has rectified the one inconsistency we found in RAA's use of a computer program for calculating an adjustment factor to offset the impact of deferred merit increases in Fiscal Years 1992 and 1993. RAA has clarified instructions for staff and now the correct adjustment factor is being produced by the computer program for use in computing Supplemental Retirement System retirement annuities. Also, RAA has taken action to adjust payments to those retirees whose benefit amounts were incorrect.

Lastly, RAA's Executive Director pointed out that RAA has strengthened its cash forecasting process and improved the monitoring of cash balances to ensure that future negative balances are avoided. This will eliminate any future negative impacts on the allocation of interest earnings to other County funds. He added that RAA is continuing to review its process for projecting and monitoring the timing of major disbursements to strike the right balance between the cost of frequent transfers from investment accounts and maintaining the minimum possible balance in the County's pooled cash account.

We concur with the actions taken by the RAA and believe that these actions will further improve the administration of the three retirement systems. Because RAA already has taken these actions, we are making no recommendations for remedial action.

FAIRFAX COUNTY, VIRGINIA

MEMORANDUM

TO: John J. Adair
Auditor to the Board of Supervisors

FROM: Laurnz A. Swartz, Executive Director *LAS*
Retirement Administration Agency

DATE: December 22, 1998

SUBJECT: Audit Report - Phase II

This memorandum is in response to your report on the second and final phase of your review of the Supplemental, Police Officers, and Uniformed Retirement Systems.

As the new Executive Director to the Retirement Boards, your audit review was timely in that it assisted me in meeting my personal objective of reviewing the existing controls in Retirement Administration and the accuracy of our benefit calculations. I was pleased that no serious shortcomings were identified and that you confirmed that benefits are being calculated according to the ordinances governing the retirement systems.

The issues identified in your review and noted in your report have helped us to focus on opportunities to improve our operations and our controls. We have improved our coordination with the Public Schools System and contributions continue to be transferred on a timely basis. We have also improved our reporting of the status of retiree health premium payments and strengthened our process for acting on any overdue amounts.

Your thorough review of the process used to adjust average final compensation to offset the impact of deferred merit increases in fiscal years 1992 and 1993 was particularly helpful in that you confirmed that our procedures and program continue to accomplish the intent of the March 1993 Ordinance changes. We have rectified the one inconsistency in the use of our calculation program by clarifying instructions for staff and by adjusting payments for the retirees whose benefit amounts were incorrect.

Finally, now that we are aware that negative balances in the County's Pooled Cash Account adversely affect the allocation of interest earnings to other funds, we have strengthened our cash forecasting process and improved the monitoring of our cash balances to ensure that we avoid future negative balance situations. We are continuing to review our process for projecting and monitoring the timing of our major disbursements to strike the right balance between the cost of frequent transfers from investment accounts and maintaining the minimum possible balance in the County's pooled cash account.

The manner in which your office conducted the audit has benefitted the County and the retirement systems. We were able to approach your independent review of the Retirement Administration Agency with the common objectives of assessing our effectiveness and identifying opportunities for improvement. I appreciate the time you and your staff devoted to Retirement Administration and your recognition that RAA staff is dedicated to the quality of our work and service to members. I can assure you that we will continue to search for and be alert to opportunities to build on that strong foundation.

cc: Members, Boards of Trustees
Police Officers Retirement System
Supplemental Retirement System
Uniformed Retirement System