

REPORT TO THE CITY COUNCIL BY THE CITY INTERNAL AUDITOR

SPECIAL REPORT ON FINANCIAL ADVISOR PAYMENTS

INTERNAL AUDIT REPORT 600011-05

December 8, 2011





The Council
City of Shreveport

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December 8, 2011

Councilman Sam Jenkins
Chairman, Shreveport City Council

Dear Councilman Jenkins:

Subject: SR600011-05 — Special Report on Financial Advisor Payments

Attached please find the report mentioned above. Management comments are included in the report.

Sincerely,

Leanis L. Steward, CPA, CIA
City Internal Auditor

SPECIAL REPORT ON FINANCIAL ADVISOR PAYMENTS INTERNAL AUDIT REPORT (IAR) 600011-05

The purpose of the executive summary is to convey in capsule form the significant issues of this special report. The executive summary is a vehicle for reviewing the report and should only be used in conjunction with the entire report.

INTRODUCTION

After a request from the previous City Council Chairman, the Internal Audit Office completed a limited scope review of payments made to the financial advisor from 2007 to 2011. Our objectives were to ensure payments made were in compliance with contract terms and recordkeeping was adequate.

RECOMMENDATION/EVALUATION RISK CRITERIA

The chart below summarizes the recommendations outlined in the report and our evaluation of risk for the recommendations. We evaluated the importance of each audit recommendation by assigning each a level of risk. The risk levels, as defined in the chart below, were determined based on the possible results for the entity if the recommendation is not implemented. This report contains three findings with nine recommendations addressing actions necessary to remedy the observed deficient conditions.

<i>Risk Levels</i>	<i>Recommendations</i>
<p style="text-align: center;"><u>High Risk</u> Possibility of fraud, waste, and abuse of City assets; Interrupted and/or disrupted operations; Entity's mission not being met; Adverse publicity.</p>	<p style="text-align: center;"><u>Finding 1</u></p> <ul style="list-style-type: none"> ▪ The City should maintain all invoices. ▪ The term "bond transaction" should be defined in the contract and payments should be calculated consistent with this definition. ▪ Invoices should be detailed and itemized. ▪ Discounts, if any, should be clearly shown on invoices. ▪ Support should be maintained for out-of-pocket costs. ▪ Management should reconcile underpayments and overpayments.
<p style="text-align: center;"><u>Medium Risk</u> Possibility of continuing, significant operating inefficiencies and high-level non-compliance issues.</p>	<p style="text-align: center;"><u>Finding 2</u></p> <ul style="list-style-type: none"> ▪ Project manager should be assigned for contract.
<p style="text-align: center;"><u>Low Risk</u> Possibility of continuing operating inefficiencies and some low-level non-compliance issues.</p>	<p style="text-align: center;"><u>Finding 3</u></p> <ul style="list-style-type: none"> ▪ Discuss potential conflict of interest with compensation arrangements. ▪ Clarify contract language and ensure most cost-effective compensation arrangement for City.

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FINDINGS

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Attachment A (Chart of Financial Advisory Fees)

SPECIAL REPORT ON FINANCIAL ADVISOR PAYMENTS INTERNAL AUDIT REPORT (IAR) 600011-05

OBJECTIVES

After a request from the City Council Chairman, the Internal Audit Office completed a limited scope review of payments made to the financial advisor from 2007 to 2011. Our objectives were to ensure payments were made in compliance with contract terms and recordkeeping was adequate.

SCOPE AND METHODOLOGY

Our scope included reviewing payments made to the current financial advisor from years 2007 to 2011. The methodology used included review of financial documents and the contract agreement and discussions with various Finance/Accounting Department personnel, Administrative personnel, and Grigsby & Associates personnel.

BACKGROUND

The City of Shreveport and Grigsby & Associates, a Financial Advisory Services entity, have an agreement dated December 1, 2007. In August 2011, after a request from the City Council, the Administration provided a schedule of fees paid to the financial advisor with approximately 14 payment items listed since the contract began. The schedule shows total fees paid to the financial advisor since inception of the contract at approximately \$735,000, which included approximately \$57,000 in out-of-pocket expenses. The Internal Audit Office reviewed the information in this listing provided by the Administration for accuracy and compliance with the contract terms.

Financial advisory fees are paid directly by the City in some cases, but are paid by a third-party trustee in other cases.

CONCLUSIONS/FINDINGS/RECOMMENDATIONS

The Internal Audit Office expresses appreciation to the Administration, employees of the Finance and Accounting Department, and Grigsby & Associates for their assistance provided during the audit.

Based on our review, we believe management could enhance the control environment by doing the following:

- Ensuring all payments are made in accordance with contract terms.
- Improving recordkeeping and assigning a project manager for the contract.
- Clarifying contract language and ensuring the most cost-effective compensation arrangements for the City.



1. Review of Contract Payments

Criteria: The contract dated December 1, 2007 between the City of Shreveport and its Financial Advisor, Grigsby & Associates, stipulates the following:

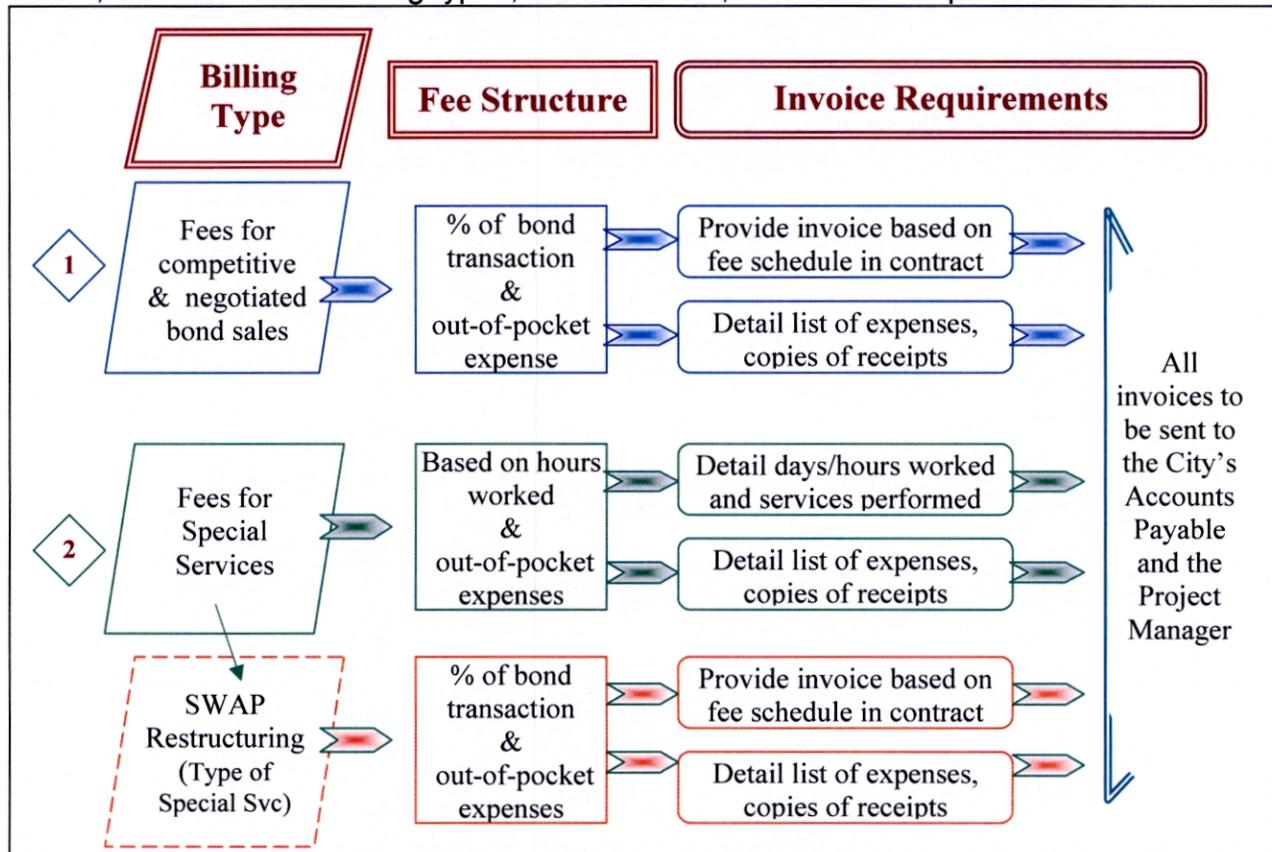
In Section 4. Billings shall be accompanied with all necessary invoices or other appropriate evidence of performance.

Per Exhibit C “Compensation/Payment Schedule” – (Sections 1 and 2) Fees for competitive and negotiated bond sales performed by the financial advisor are based upon schedules outlined in the contract. Invoices for these transactions shall be addressed to the Accounts Payable Finance Department with a copy to the Project Manager. Out-of-pocket expenses...shall not exceed \$10,000 per transaction. **(Section 3)** Maximum annual compensation of \$180,000 for negotiated or competitive bond transactions.

Per Attachment to Exhibit C - For Special Services work performed by the Financial Advisor, the monthly invoice should include the following schedules:

1. Monthly accounting of working days devoted to City matters, core services and/or special services performed; and
2. A detailed list, and where applicable, verification of out-of-pocket expense being requested for reimbursement.
3. Copies of original receipts, where applicable.

Below, we illustrate the billing types, fee structures, and invoice requirements:

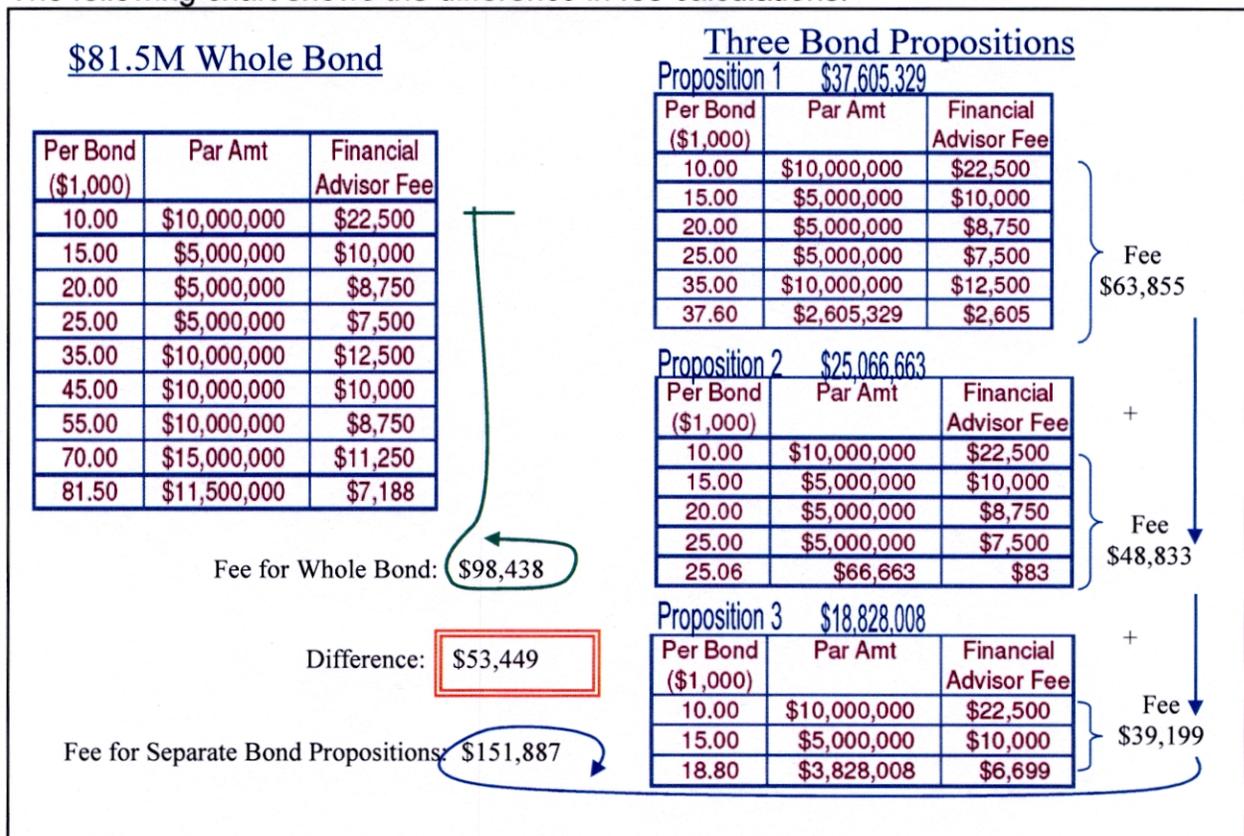




Condition: The City did not consistently maintain invoices and bills from the financial advisor. Those submitted by the financial advisor were not always in itemized, detail formats. Because of this, our office could not always definitively determine what services were being provided and what types of out-of-pocket expenses were being paid. The following was noted regarding the 14 payment transactions provided by the Administration.

- For three bond transactions, we could not recalculate and verify the fees paid based upon the terms of the contract in the Compensation/Payment Schedule. In one instance, our recalculation showed an overpayment of \$13,100. In two instances, our recalculation showed underpayments that totaled \$35,600.
- Additionally, we reviewed the payment transaction for the \$81.5 million bond issue that occurred after the transaction information was provided by the Administration. The contract requires that fees shall be based on each competitive bond transaction. However, the term “competitive bond transaction” was not clearly defined in the contract. The amount of fees was calculated based on treating the \$81.5 million bond issue as three separate transactions because of the three propositions. The following was stated by the City Attorney’s Office after our request for an opinion regarding this issue. “Based on the contract with Grigsby and Associates and the bond authorization ordinance, I do not think it was appropriate for them to charge the unit fee as if there were three separate transactions. There was one ordinance, one bid (see paragraph 3 of the ordinance) and one type of bond. I do not see any basis for this to be characterized as three separate transactions.” There is a difference of over \$53,000 when calculated as one transaction versus three transactions.

The following chart shows the difference in fee calculations.





- ◆ The contract states that the Accounting Department and Project Manager should maintain invoices. City management could not provide invoices or other adequate supporting documentation for at least 6 (approximately 40%) of the 14 transactions listed in the spreadsheet to the City Council. We followed up by requesting invoices from the paying agent bank (third-party trustee) who did provide the remaining invoices.
- ◆ Although permitted by the contract, there was no support (e.g., detailed listing or receipts) requested by the Administration or provided by the financial advisor for out-of-pocket expenses totaling over \$57,000 identified in the original listing. **<AUDITOR'S NOTE>** Additional out-of-pocket expenses not included on the listing (see Finding 2 below) totaled approximately \$24,000 (excluding expenses for the 2011 General Obligation Bond), for a combined total of approximately \$81,000.
- ◆ For the 2011 General Obligation Bond transaction, the out-of-pocket costs of \$15,000 exceeded the maximum allowed per transaction of \$10,000. **<AUDITOR'S NOTE>** During the audit, a detailed listing was provided for these charges.
- ◆ In year 2008, we noted that total annual payments to the financial advisor for the negotiated bond sales were over \$230,000. This exceeded the \$180,000 maximum amount that is allowed by the contract.

Effect:

- Potential for inaccurate payments to the Financial Advisor.
- Failure to follow the terms of the contract.
- Lack of ability to reconcile invoices and bills.
- Inadequate verification of expenses.

Cause: Lack of adequate review of contract terms. Lack of communication between Financial Advisor and the City.

Recommendation: Management should ensure all future payments to the financial advisor are made in accordance with the terms and stipulations of the contract.

- ◆ The City should request the financial advisor provide itemized detail invoices to the Accounting Department with verifiable expenses and fees and the City should maintain all invoices.
- ◆ The term "bond transaction" should be clearly defined in the contract and fees should be calculated consistent with this definition.
- ◆ Invoices should always include detailed descriptions of services, including hours and rates.
- ◆ If discounts are provided, they should be clearly indicated on the invoice.
- ◆ In addition, applicable receipts and other appropriate documentation for out-of-pocket costs should be requested by the Administration. The out-of-pocket costs should not exceed \$10,000 per transaction. Also, the annual maximum payment of \$180,000 should not be exceeded.

Management should reconcile the overpayments and underpayments.



Management Plan of Action:

Review of Contract Payments—Conditions

The finding of the Internal Auditor in terms of maintaining bills/invoices is duly noted. The payment system of the city and a third party issuing payments provided a disjointed recordkeeping process, especially when combined with the lack of an identified project manager with specific custodial duties. In the transition from prior management to interim and subsequently confirmed new management, some aspects of tracking/accounting became less clarified; ie, the identification of a project manager. The format of the invoices, level of detail and receipt requirements is reported by the Financial Advisor to be the result of verbal directives and prior practice of the previous project manager(s). Although the Financial Advisor has subsequently presented information based upon verifiable travel and activity that supports the expenses, the lack of detailed documentation within the files is an area specifically addressed with new directives to the Financial Advisor that all invoices must be properly documented, including receipts, before any subsequent payments are made.

The payment associated with the recent \$81.5 million issue is the subject of some disagreement as noted in the IA report. Because of the lack of clarity with the term “competitive bond transaction”, the Financial Advisor operated under the practice of treating separate bond propositions as separate transactions. This was in keeping with the mandated requirements for separate accounting for separate propositions and the contingency aspect of nonpayment for work on a proposition that fails. Now that the City Attorney’s office has presented the opinion that the contract and the bond authorization ordinance appear to consider this as a single transaction, we will review this issue as we conduct our reconciliation.

The out-of-pocket costs of \$15,000 associated with the 2011 bond issue exceed the \$10,000 limit because of the same position that this was three (3) transactions as opposed to one. At \$10,000 per transaction, the cap would have been \$30,000.

Recommendations/Plan of Action:

Detailed invoices with sufficient documentation and detail are now required of the Financial Advisor and the Director of Finance has been specifically tasked with maintenance, review, and approval of invoices prior to payment, including out-of-pocket or miscellaneous expenses.

Additionally, the payment methodology and clarification of terms such as “bond transaction” will be addressed in conjunction with the City Attorney’s office with the goal of a revised contract that accounts for changes such as the recommendations in the 2010 Frank-Dodd Act that is referenced later in this report.

While we believe these steps to be critical to moving forward, we will continue to pursue reconciliation of over and/or under payments to the Financial Advisor based upon the agreed upon terms of the contract. Based upon legal parameters, we will pursue all options, including requests for refund and or credit as applicable. We expect to have this reconciliation completed within 30 days pending clarification from legal on issues indicated above.



2. Recordkeeping and Contract Monitoring/Project Manager

Background: Payments to the Financial Advisor were being made by several different methods and funds. In some cases, direct payments were made by the City by check or wire transfer. The overall bond issuance costs were posted to many different accounting funds (generally based on the type of activity being performed by the financial advisor - e.g., Certificate of Indebtedness 2010, Water System Infrastructure Improvements Program, 2005 W&S Revenue Bonds, Convention Center Hotel and Assoc. Improvements, etc.) and also to different types of accounting codes (debt issuance costs, professional services, legal costs, fiscal charges, bond amortization costs, etc.).

In other cases, payments to the financial advisor were being made by a third-party trustee from bond proceeds that the trustee held. Although total bond issuance costs paid by the trustee are posted to the City accounting system, the individual professionals and consultants that are paid bond issuance costs (which includes the financial advisor) are generally not maintained in the City's accounting system.

Criteria: Payments to vendors should be accurately tracked and reconciled. The contract designates that a project manager should be assigned for this contract.

Condition: The listing compiled by the Administration and provided to the City Council in August 2011 of payments made to the financial advisor was incomplete. The payment information for the following transactions was subsequently obtained by Internal Audit from reviewing City Accounting division and third-party trustee records; however, it was not on the original listing provided to the City Council.

- \$149,606.25 for Shreveport Convention Center Hotel Remarketing in May 2010
- \$25,730 for Financial Advisory Services on DEQ Series 2010 Bonds in June 2010
- \$53,340 for Convention Center Hotel Synthetic Fixed Rate SWAP in June 2008
- \$55,081.25 for 2008 Independence Stadium Refunding Bonds in August 2008
- \$31,625 for Shreveport Water Improvement Project Series 2010 in December 2010

In addition, after initiation of the audit, the financial advisor has claimed that these prior services had not billed.

- \$53,746.25 for Independence Stadium Synthetic Fixed Rate SWAP in August 2008.
- \$41,000.00 for Shreveport Series 2001 GOB Redemption in December 2010.
- Partial payment of \$25,300.00 for LCDA Series 2007 Bonds for work in December 2007. **<NOTE>**There were 2 different invoices for this transaction. Although the total amounts on the invoices are the same, the allocation between expenses and fees is different for each invoice.

If these additional transactions are included, the total amount of fees assessed by the financial advisor since inception of the contract is increased by at least \$380,000 (approximately 50%) from the original \$735,000 amount included on the listing. Consequently, the total amount of fees assessed by the financial advisor is over \$1 million since inception of the contract.



<NOTE> See **Attachment A** for chart prepared by Internal Audit detailing payments made to Financial Advisor since inception of contract.

Effect:

- Potential for inaccurate payments to Financial Advisor.
- Inaccuracies and inefficiencies in compiling financial data.
- Incomplete picture of what each professional/consultant is paid.

Cause: Possibly due to turnover in the designated Project Management position, there did not seem to be an assigned project manager responsible for monitoring and overseeing this contract. Also, it was difficult to track, retrieve, and compile documentation for overall payments made to the Financial Advisor because of the various ways the vendor was being paid and the numerous accounts that the payments were posted.

Recommendation: For future bond payments made to the Financial Advisor, management should develop a more efficient and effective system to track payments due and paid to the Financial Advisor. As stipulated in the contract with the financial advisor, management should assign a project manager the responsibility for reviewing, approving, and maintaining financial advisor invoices before payment is made by the third party trustee and the City. This system should also be used to track payments to other service providers such as attorneys, trustees, underwriters, etc. in order to trace overall bond costs to individual vendors.

Management Plan of Action:

Contract Monitoring and Recordkeeping/Project Manager—Condition

As noted in discussion with the Internal Auditor and as indicated above, the lack of an identified project manager hindered delivery of an accurate listing in August, 2011. Although the information was subsequently gained and available, we recognize that maintenance of a central repository and file within City Hall is critical to oversight and accountability.

The Financial Advisor has indicated and the Auditor notes that some invoices/billings were not previously submitted because of oversight on their part. Although the contract does not appear to speak to a time limit on submission of invoices, this is an area that we will also seek legal advice on in terms of the validity of the invoices, as well as, include this as a matter for consideration in a revised agreement. We note that these invoices are directly connected to actual transactions where work was performed.

Recommendations/ Plan of Action:

As indicated above, the Director of Finance will serve as the Project Manager and custodian of all records, including payments to all other parties. Although the information exists in various places, including the SBC (State Bond Commission) and Trustee, we recognize the need to have a more complete file here. The Director of Finance is reviewing internal records for completeness and working to ensure we have appropriate information from other agencies/parties involved with this process.



3. Contractual Compensation Arrangements

Criteria: The 2010 Frank-Dodd Act passed by Congress states that independent municipal financial advisors must register with the SEC (Securities and Exchange Commission) and MSRB (Municipal Securities Rulemaking Board) and meet various other regulatory requirements set forth by the SEC and the MSRB. **<AUDITOR'S NOTE>** The financial advisor was registered with these agencies.

The MSRB has outlined certain fiduciary standards regarding compensation of financial advisors in relation to conflicts of interest.

Condition: The compensation schedule delineated in the City's contract with the financial advisor poses potential conflicts of interest issues as outlined by the MSRB. These compensation arrangements include:

- **Hourly Fees:** Under an hourly fee form of compensation, the municipal advisor is paid an amount equal to the number of hours worked by the advisor times an agreed-upon hourly billing rate. This form of compensation presents a potential conflict of interest if the client and the advisor do not agree on a reasonable maximum amount at the outset of the engagement, because the advisor does not have a financial incentive to recommend alternatives that would result in fewer hours worked. In some cases, an hourly fee may be applied against a retainer (e.g., a retainer payable monthly), in which case it is payable whether or not a financing closes.
- **Fees based upon principal or notional amount:** Under this form of compensation, the municipal advisor's fee is based upon a percentage of the principal amount of an issue of securities (e.g., bonds) or, in the case of a derivative, the present value of or notional amount and term of the derivative. This form of compensation presents a conflict of interest because the advisor may have an incentive to advise the client to increase the size of the securities issue or modify the derivative for the purpose of increasing the advisor's compensation.
- **Fee contingent upon the completion of a financing or other transaction:** Under a contingent fee form of compensation, payment of an advisor's fee is dependent upon the successful completion of a financing or other transaction. Although this form of compensation may be customary for the client, it presents a conflict because the advisor may have an incentive to recommend unnecessary financings or financings that are disadvantageous to the client. For example, when facts or circumstances arise that could cause the financing or other transaction to be delayed or fail to close, an advisor may have an incentive to discourage a full consideration of such facts and circumstances, or to discourage consideration of alternatives that may result in the cancellation of the financing or other transaction.

Effect:

- Potential conflicts could result in increased costs for the City.

Cause: Contract was written before passage of the 2010 Frank-Dodd Act.



Recommendation: As suggested by the MSRB, we recommend the financial advisor and city management discuss these potential conflict of interest issues to ensure that the City understands the conflicts associated with the various forms of compensation.

Additionally, the City should refine the compensation arrangements included in the contract with the financial advisor and determine the most cost-effective compensation arrangement for the City that will clarify and simplify billings by the financial advisor.

Management Plan of Action:

Contractual Compensation Types—Condition

As noted, the current contract appears to involve 3 different methods of calculating payment based upon activity.

Recommendations/Plan of Action:

As previously indicated, we will work with the City Attorney to develop a new contract with clearer and cleaner provisions related to methods of payment and invoicing. We understand the current contract was a bit of “cut and paste” from previous agreements/arrangements; however, changes in practices, as well as, items such as the Frank-Dodd Act call for revisions and updating that serve the best interest of the City.

Prepared by:

Brian Nguyen
Associate Auditor

Approved by:

Leanis L. Steward, CPA, CIA
City Internal Auditor

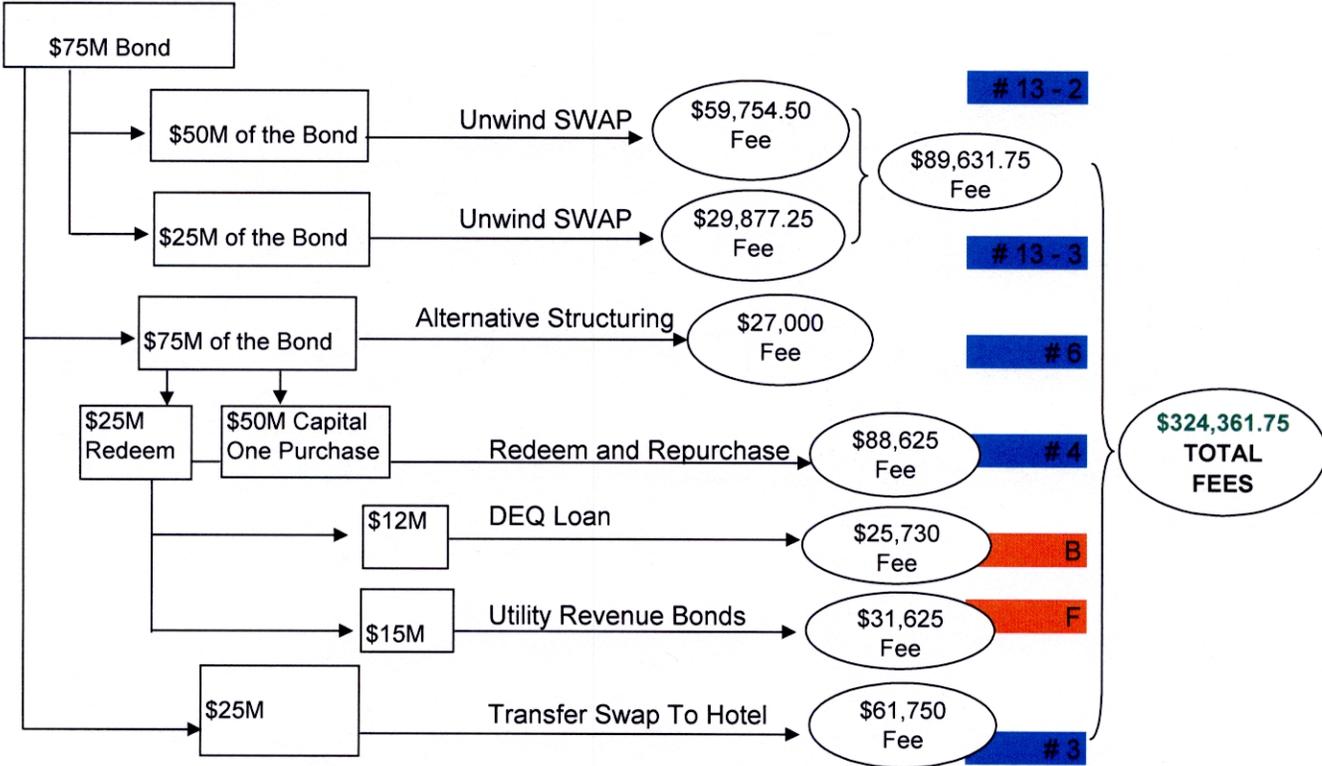
nw

- c: Mayor
- CAO
- City Council
- Clerk of Council
- City Attorney
- External Auditor
- Finance Director

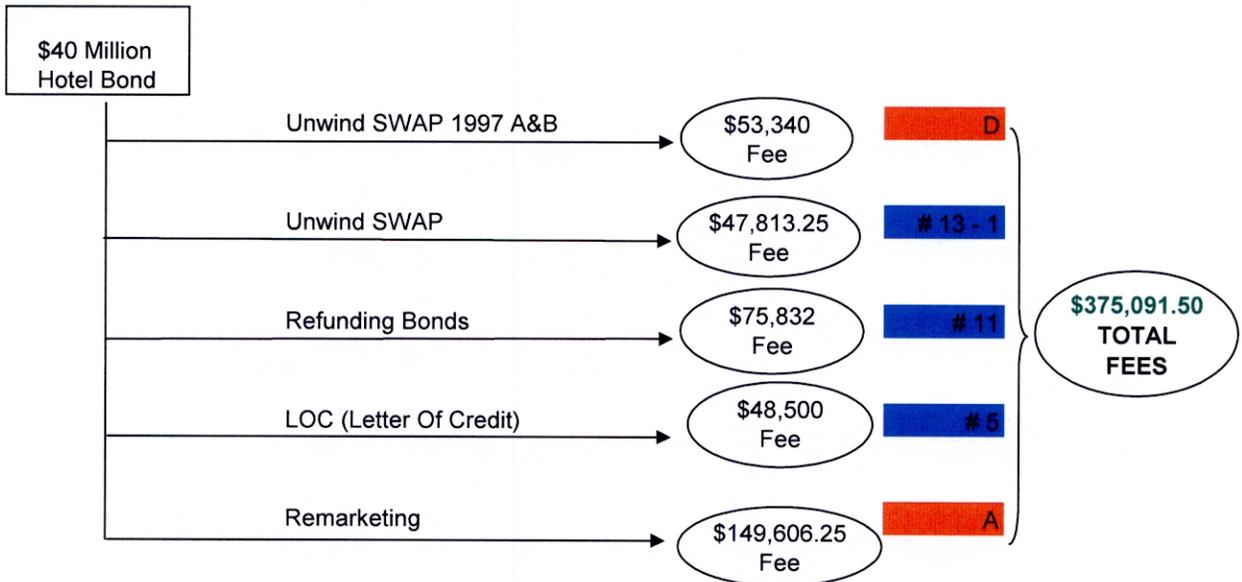
Attachment A

Financial Advisory Fees

UTILITY SYSTEM BOND



HOTEL BOND

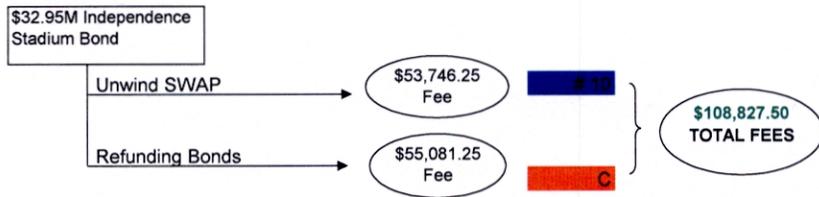


= On original listing of 14 payments
 = Additional payments identified

Attachment A Continued

Financial Advisory Fees

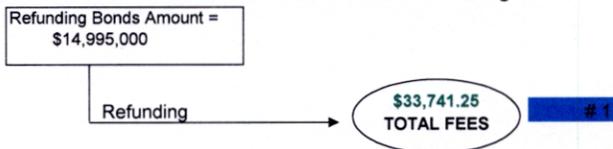
Independence Stadium



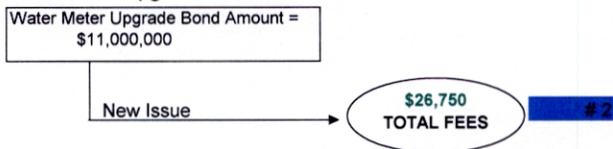
Airport Bonds



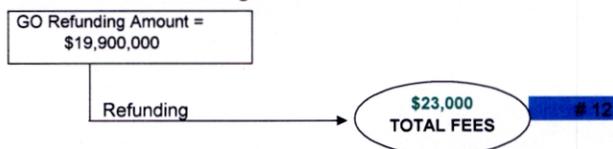
Certificate of Indebtedness Series 2010 A&B Refunding Bonds



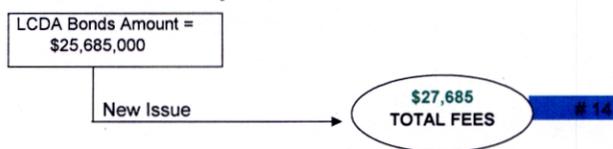
Water Meter Upgrade Series 2009 A&B



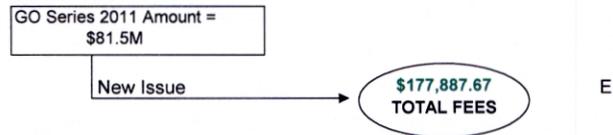
GO Series 2008 Refunding Bonds



LCDA Series 2007 Utility Bonds



GO Series 2011 Bonds



\$324,361.75	
\$375,091.50	
\$108,827.50	
\$131,324.00	
\$33,741.25	
\$26,750.00	
\$23,000.00	
\$27,685.00	
\$1,050,781.00	Total of ALL FEES

(excluding \$81.5M GO Series 2011 Bonds - E)

 = On original listing of 14 payments
 = Additional payments identified

<Auditor Note> Fees of \$41,000 for Shreveport Series 2001 GOB Redemption in 2010 and partial payment of \$25,300 for LCDA Series 2007 Bonds are not on the chart because they were not billed until after the audit was initiated.