COUNTY AUDIT DEPARTMENT

REPORT # 372

An Audit of:

WARRANTY BONDS RELEASE PROCESS

OCTOBER 22, 2019
October 22, 2019

The Honorable Lesley “Les” Miller, Jr., Chairman
The Honorable Ken Hagan
The Honorable Pat Kemp
The Honorable Sandra L. Murman
The Honorable Kimberly Overman
The Honorable Mariella Smith
The Honorable Stacy R. White

Dear Chairman Miller and Commissioners:

The Audit Team performed an audit of the Warranty Bonds Release Process (Audit Report #372, dated October 22, 2019). Responses to the Audit Team’s recommendations were received from the Director of Development Services and have been included in the Report after each audit comment and recommendation.

The purpose of this Report is to furnish management independent, objective analysis, recommendations, counsel, and information concerning the activities reviewed. It is not an appraisal or rating of management.

Although the Audit Team exercised due professional care in the performance of this audit, this should not be construed to mean that unreported noncompliance or irregularities do not exist. The deterrence of fraud and/or employee abuse is the responsibility of management. Audit procedures alone, even when carried out with professional care, do not guarantee that fraud or abuse will be detected.

The Audit Team appreciates the cooperation and professional courtesies extended to the auditors by the Directors and personnel of the Development Services Department for this audit.

Sincerely,

Heidi Pinner, CIA, CISA, CFE, CRMA
Director of County Audit

CC: Mike Merrill, County Administrator
    Lucia Garsys, Deputy County Administrator
    Adam Gormly, Director, Development Services
    Mike Williams, Division Director Development Review, Development Services
    Kevin Brickey, Director, Management & Budget Office
    Dan Klein, Chief of Staff, Clerk of Court and Comptroller
    Rick VanArsdall, Chief Deputy, Clerk to the Board
    Tim Simon, Deputy Comptroller
    Julia Poupart, Chief Deputy, Records
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EXECUTIVE SUMMARY

BACKGROUND INFORMATION

A Warranty Bond is a contract between the County, a contractor, and/or a surety company. Warranty bonds guarantee that any work defects found in the original construction will be repaired during the warranty period. Warranty bonds are used to ensure that a project is completed in accordance with the agreement and per construction codes. The bonds serve as a warranty on the project against failure, deterioration, or damage resulting from defects in workmanship or materials. The Board of County Commissioners (BOCC) requires developers to provide 25 month warranty bonds at the end of a construction project. Warranty bonds can be cash or non-cash and generally come in one of three forms.

**Surety Bond:** A legal certificate issued by an insurance surety company or bank, on behalf of the developer, which guarantees that the work will be performed in accordance with contract standards.

**Line of Credit:** Works similar to a surety bond but instead of guaranteeing the work, it guarantees that applicable payments to complete the project will be made to the County.

**Cash Bond:** The County allows the developer the option to provide a cash payment equal to 10% of the total project cost as a form of security deposit. This amount is held by the County in an escrow account for the duration of the 25 month warranty period. Once the project is reviewed and accepted by the County at the end of the warranty period, the cash warranty is eligible for refund back to the developer.

In cases where the contractor fails to meet the project expectations upon evaluation, the County has the right to file a claim against the warranty bond and the surety is obligated to financially compensate the County for losses incurred based on the contract. In the case of cash warranty bonds, the County has the right to forfeit the developer’s 10% cash warranty payment held in the escrow account.

There were 296 cash warranty bonds recorded and 399 non-cash warranty bonds on file as of December 31, 2018.

<table>
<thead>
<tr>
<th>Bond Type</th>
<th>Year of Origin</th>
<th>Total #</th>
<th>Total Value</th>
<th>Not Released</th>
<th>Value of Outstanding Bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>1992 to 2018</td>
<td>296</td>
<td>$2.8 M</td>
<td>70</td>
<td>$484,679</td>
</tr>
<tr>
<td>Non-Cash</td>
<td>2014 to 2018</td>
<td>399</td>
<td>N/A</td>
<td>70</td>
<td>N/A</td>
</tr>
</tbody>
</table>

See Exhibit A at the end of this report for a workflow of the warranty bond release process and Exhibit B which includes a historic chart of all cash warranty bonds and current outstanding bonds waiting to be released.
OBJECTIVE

The objective of the audit was to determine whether or not there are appropriate controls in place to ensure the timely and appropriate release and/or refund of warranty bonds.

SCOPE

The audit was conducted in conformance with the Generally Accepted Government Auditing Standards and the International Standards for the Professional Practice of Internal Auditing. These Standards require that County Audit plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the audit comments and conclusions based on the audit objectives. County Audit believes that the evidence obtained provides this reasonable basis.

This audit was limited to a review of the processes associated with the release of warranty bonds and related authorizations by the Board of County Commissioners as of March 2019.

OVERALL EVALUATION

There are opportunities to improve controls and ensure the timely and appropriate release of warranty bonds.

Process Strengths:
- All project documentation (Land Use Agenda Meetings; Developers’ agreement; Acceptance/Release memos) was properly recorded and maintained.
- Released cash warranty bonds are refunded back to the same name and address listed in the original contract.

Control Improvement Opportunities:
- Opportunities exist to improve the timeliness of warranty bond releases:
  - Thirty five (35) of the 44 CASH warranty bonds received between 2014 and 2016, have expired but are still held in escrow.
  - Seventy (70) of the 215 NON-CASH warranty bonds received between 2014 and 2016 are beyond their expiration date and were not released in the Board records documents.
- Proper inspection documentation could not be confirmed for 77% of the warranty bonds tested (20 out of 26).
- Formal procedures and processes have not been defined for warranty bond releases.

Full testing results are included on Page 4 of this report.
The control environment relative to the warranty bonds release/refund process is at a repeatable maturity level. This means that established controls are generally structured but lack formal policy and depend on individuals to properly execute procedures. This level of control maturity has a higher potential for errors and can mean a higher cost due to inefficiencies. Opportunities were identified to strengthen the controls related to the release and/or refund of warranty bonds back to developers as well as the process to timely schedule and perform project inspections 90 days before warranty bond expiration. Addressing these opportunities will enhance the overall control structure and provide increased consistency and assurance.

Exit conferences were held on August 6, 2019 and September 17, 2019.

Other minor concerns not included in this Report were communicated to management and/or corrected during fieldwork.

AUDITED BY

Heidi Pinner, CIA, CISA, CFE, CRMA, Director of County Audit
Margaret Brown, CIA, Audit Manager
Raul Cardona, CIA, CISA, CAMS, Senior Internal Auditor
AUDIT COMMENT & RECOMMENDATION

There are opportunities to improve controls and ensure the timely and appropriate release of warranty bonds.

The objective was to determine whether or not controls are in place to ensure that cash and non-cash warranty bonds are appropriately processed and timely released/refunded back to project developers. The Audit Team performed an aging analysis on warranty bonds and assessed the warranty bond process from acceptance to release/refund.

Aging Analysis

The population of CASH warranty bonds dates back to 1992 and was obtained from the Clerk’s Office, County Finance Department. The population of NON-CASH warranty bonds dates back to 2014 and was obtained from the Clerk’s Office, Board Records Department. For consistency, the Audit Team used the five (5) year period from 2014 to 2018 to perform the aging analysis on both CASH and NON CASH bonds.

As depicted in this chart, the majority of warranty bonds received (81%) are NON CASH bonds. CASH bonds accounted for, on average, 19% of the total bonds for the five year period.
Results of Analysis

At the time of testing, 35 out of 44 (80%) of the CASH warranty bonds accepted between 2014 and 2016, had expired but were still held in escrow waiting to be refunded, as shown in the chart to the left. These 35 bonds have a total value of $316,650.

As shown in the chart below, 70 out of 215 (33%) of the NON CASH warranty bonds accepted between 2014 and 2016 remained on hold beyond their expiration date. These bonds retain no value beyond their expiration but could be procedurally released.

Based on the aging analysis performed, the timeliness of warranty bond refunds back to developers could be improved. This includes coordination with Public Works/Public Utilities Department (PW/PUD) for performance of the 90 day inspections prior to bonds expiration.

Note: Warranty bonds accepted in 2017 and 2018 have not reached their maturity/expiration date as of the time of testing, and therefore, are not included in the calculation above.

Warranty Bonds Sample Testing

The Audit Team selected a judgmental sample of 15 CASH warranty bonds and 17 NON CASH warranty bonds for testing. Testing was performed to determine whether or not:

1. Supporting documentation was properly completed and maintained.
2. Project inspections were performed by the County’s Public Works or Public Utilities Departments timely (approximately 90 days prior to warranty bond expiration dates).
3. Bonds were refunded to the appropriate parties.
1. Supporting Documentation

The Audit Team:

- Reviewed support for the Board of County Commissioners approval of the project and the warranty bond acceptance.
- Reviewed the agreement to ensure it was properly signed and that the warranty bond amount was included in the agreement.
- Confirmed that the original developer's agreement was sent to the developer in a timely manner.
- Reviewed the warranty bond acceptance and release memos to ensure they were properly issued and maintained.

Results of Testing:

All warranty bonds in the sample had the appropriate supporting documentation properly maintained on file.

2. Project Inspections

Project inspections are to be conducted 90 days prior to the expiration date of the warranty bond. For the 32 warranty bonds in the sample, the Audit Team requested the inspection forms maintained by Public Works and Public Utilities to ensure that inspections were performed, completed timely, and were properly supported.

Results:

- A 90 day inspection was not required for 6 warranty bonds in the sample.
- Six inspections were completed and supported. Of these 6 inspections, 4 did not have a date recorded on the form.
- The remaining 20 warranty bonds did not have documentation to support an inspection being completed.
3. Refund Process

The Audit Team compared the name and address from the refund check issued by County Finance to the information shown in the Developer's agreement to ensure that the cash warranty bond was refunded back to the original developer.

Results:

All cash warranty bonds in the sample were refunded back to the same name and address listed in the original development contract.
RECOMMENDATIONS

Management should:

1. Partner with Board Records and County Finance to coordinate the release of all outstanding expired warranty bonds back to the corresponding developer.
   - If the original developer cannot be located, cash warranty bonds should be sent to the State of Florida as unclaimed funds.
   - For non-cash bonds, determine whether or not a formal release is necessary.

2. Create a formal policy for the complete process of warranty bonds. The policy should include all roles and responsibilities as well as the steps to be followed by each of the departments involved in the process, including:
   - The initial acceptance of the project by the Board.
   - The steps performed by Public Works and Public Utilities for the timely scheduling and completion of inspections.
   - The final release/refund of warranty bonds back to developers.

3. Establish a centralized system or repository of warranty bond information that is accessible to all those involved in the warranty inspection process prior to warranty bond expiration. The system should facilitate the communication and sharing of information between Development Services, Public Works and Public Utilities, and allow staff to retrieve project tasks, locations and timelines, follow up on items due, update, close tasks and communicate completion. A formal inspection record at a minimum should contain the following data elements:
   - Project name and ID.
   - Warranty expiration date.
   - Inspection requested and completion dates.
   - Items inspected and applicable deficiencies noted.
   - Recommendation to release or hold the warranty bond.
   - Reason behind the rejection to release a warranty bond.
   - Inspector’s name and signature.

4. Ensure that adequate resources are available to create redundancy for the processes of recording, tracking and managing warranty bonds and their respective expiration dates.
CLIENT RESPONSE:

1. Concur
2. Concur
3. Concur
4. Concur

CORRECTIVE ACTION PLAN:

1. This recommendation addresses warranty securities for which the warranty period has expired and the remitter has not requested a return of the security. Staff will contact Board Records and County Finance to obtain the most current lists of warranty bond providers along with relevant bond (i.e. acceptance/expiration date, amount, project, etc.) information. We will ask the Board of County Commissioners for permission to release those accounts where the warranty period has expired and then attempt to contact the original cash providers. Funds will be returned to those we are able to contact. If we cannot locate the owner, we will request that County Finance escheat the funds to the State of Florida per state law. For paper bonds, the process will be the same except that we are in the process of determining whether the State will accept the bonds as unclaimed funds. If they will not accept, we will hold the bonds in accordance with applicable retention requirements partner with the Clerk’s Office to determine the appropriate method of disposition.

2. Since the time of the inspections noted in the audit, improvements have been made to the warranty inspection process that include the assignment of staff to receive copies of all project acceptance letters and enter key warranty information into a tracking system that is used to ensure that all warranty inspections are performed prior to the expiration of the warranty period.

Although the current improved system works well to ensure that no warranty inspections are missed, staff is currently working on a project to improve the efficiency of the process by moving the warranty inspection tracking process into a GIS system. The GIS system will have the ability to maintain all project data associated with the warranty bonds including expiration of warranty periods and inspection results in one common location that will be accessible by staff from the Development Services, Public Works and Public Utilities departments.

To support this new tracking system, a documented process will be developed that will include the roles and responsibilities as well as the steps to be followed by each of the departments involved in the process, including:

• The initial acceptance of the project by the Board.
• The steps performed by Public Works and Public Utilities Departments for the timely schedule and completion of inspections.

• The final release/refund of warranty bonds back to developers

3. Please refer to management response #2.

4. The GIS system referenced in response 2 will provide an additional resource for tracking warranty bond information. In addition, Development Services will cross-train additional staff members to provide redundancy in the administration of the warranty bond acceptance and release process.

**TARGET COMPLETION DATE:**

1. 10/15/2020
2. 5/1/2020
3. 5/1/2020
4. 12/31/2019
Overall Controls and Improvements of the Warranty Bond Release Process

1. Board reviews developer agreement and approves project together with the acceptance of project’s warranty bond.
2. PW and/or PUD perform “End of Warranty Bond” inspection 90 days prior Expiration Date of WB (Control weakness identified).
3. Development Services reviews inspection performed by PW/PUD to ensure project conformity before processing WB release/refund.
4. Board Records / County Finance Divisions receive request (by memo) to release or refund warranty bond back to developer.
5. Controls/processes identified for improvement.

~ START ~

BOCC Accepts the Project together with the Warranty Bond for a period of 25 months

Warranty Inspection Form is Reviewed by Development Services to make sure project is in optimal condition based on agreement

Project Inspection performed 90 days Prior to Expiration of Warranty Bond

“End of Warranty Inspection” Form is Filled Out and Recommendation to Hold or Release the Warranty Bond is Provided

Notice of “Completion of Warranty Inspection” is Sent to Development Services’ Review Department

Warranty Inspection Form is Reviewed by Development Services to make sure project is in optimal condition based on agreement

Warranty Bond needs BOCC Release Approval?

Yes

Yes

 memo to release or refund warranty bond back to developer.

No

No

Prepares Warranty Bond “Administrative Release Memo”

Memo is sent to BOARD RECORDS and/or COUNTY FINANCE for Processing

Warranty Funds / Certificate are Returned to Developer

Warranty Bond Release Process PAGE 11

~ END ~

Board Records releases the Non-Cash WBs and/or COUNTY FINANCE creates Journal Entry Refund

BOARD RECORDS / COUNTY FINANCE creates Journal Entry Refund

BOCC Release Approval?

Agenda Item Presented at Next BOCC Land Use Meeting

Developer is Required to Extend Warranty Period Until Project Completion

Release Approved by BOCC?
The population of CASH warranty bonds was obtained from County Finance records. The records contained a total of 296 cash warranty bonds received since 1992, of which 70 (24%) are still held in escrow. These 70 bonds have a total value of $484,679 and range in value from $103,117.30 to $417.60. The median value for these 70 CASH bonds is $3,350 and the average is $6,924. Cash warranty bonds accepted by the BOCC in 2017 and 2018 have not reached their maturity/expiration date as of the time of testing and thus were not included in the chart above.

NOTE:

Prior to December 2015, to have a warranty bond released, a developer was required to submit a refund request and have it approved by the Board prior to release. In December 2015, Development Services updated the language in the developer contracts to grant the Development Review Division the administrative rights to release the warranty security upon expiration of the warranty period, warranty inspection and correction of any failure, deterioration or damage to the Improvement Facilities.