



**Office of the City Auditor**

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**Report to the City Council  
City of San José**

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**DEVELOPMENT PARTNERS'  
WORK-IN-PROGRESS  
RESERVES: BETTER  
MONITORING CAN ENSURE  
RESERVES ALIGN WITH  
RESOURCE NEEDS**

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**Report 20-05  
September 2020**

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September 11, 2020

Honorable Mayor and Members  
Of the City Council  
200 East Santa Clara Street  
San José, CA 95113

### **Development Partners' Work-in-Progress Reserves: Better Monitoring Can Ensure Reserves Align with Resource Needs**

The City's Development Partners (Planning, Building and Code Enforcement (PBCE); Public Works; and the Fire Department) are collectively responsible for ensuring that new construction complies with the City's laws and regulations. The Development Partners issue building permits, conduct inspections, and provide plan reviews and other services throughout the development process. The Development Partners charge fees based on estimates of the costs necessary to deliver the service. Projects often take more than one year to complete, so they may be completed in a different fiscal year than when the fee is paid. When fee revenues are not used within the same fiscal year as collected, they are budgeted in the Development Partners' respective work-in-progress reserves. The objective of this audit was to review how the City's Development Partners track development fee work-in-progress reserves.

#### **Finding 1: The Development Partners' Reserves Did Not Reflect the Cost of Remaining Work on Current Projects**

- Reserves have grown significantly in the past decade, primarily from the growth in development activity, but also because of interest earnings and unused fees from expired permits.
- We estimated that on June 30, 2020, the estimated reserve balances did not reflect the cost of the outstanding work on unfinished projects.
- PBCE's Building Division appeared to have additional reserves of more than \$7 million. Planning, Fire, and Public Works faced shortfalls in reserves as of June 30, 2020.

#### **RECOMMENDATIONS**

We made several recommendations to improve the management of work-in-progress reserves. The Development Partners should:

- Develop procedures to track the work in progress on current development projects
- Develop reserve policies or guidelines around the appropriate uses of funds, including work-in-progress reserves

The Finance Department should:

- Determine the proper accounting treatment for fees collected for projects still in progress

- With the exception of Building, the Development Partners generally do not track their progress on projects program-wide in a manner that allows them to estimate the reserve needed for current development projects.

This report has five recommendations. We plan to present this report at the September 22, 2020 meeting of the City Council. We would like to thank the Budget Office, the Fire Department, Public Works, and Planning, Building and Code Enforcement for their time and insight during the audit process. The Administration has reviewed the information in this report, and its response is shown on the yellow pages.

Respectfully submitted,



Joe Rois  
City Auditor

finaltr  
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This report is also available online at [www.sanjoseca.gov/audits](http://www.sanjoseca.gov/audits)

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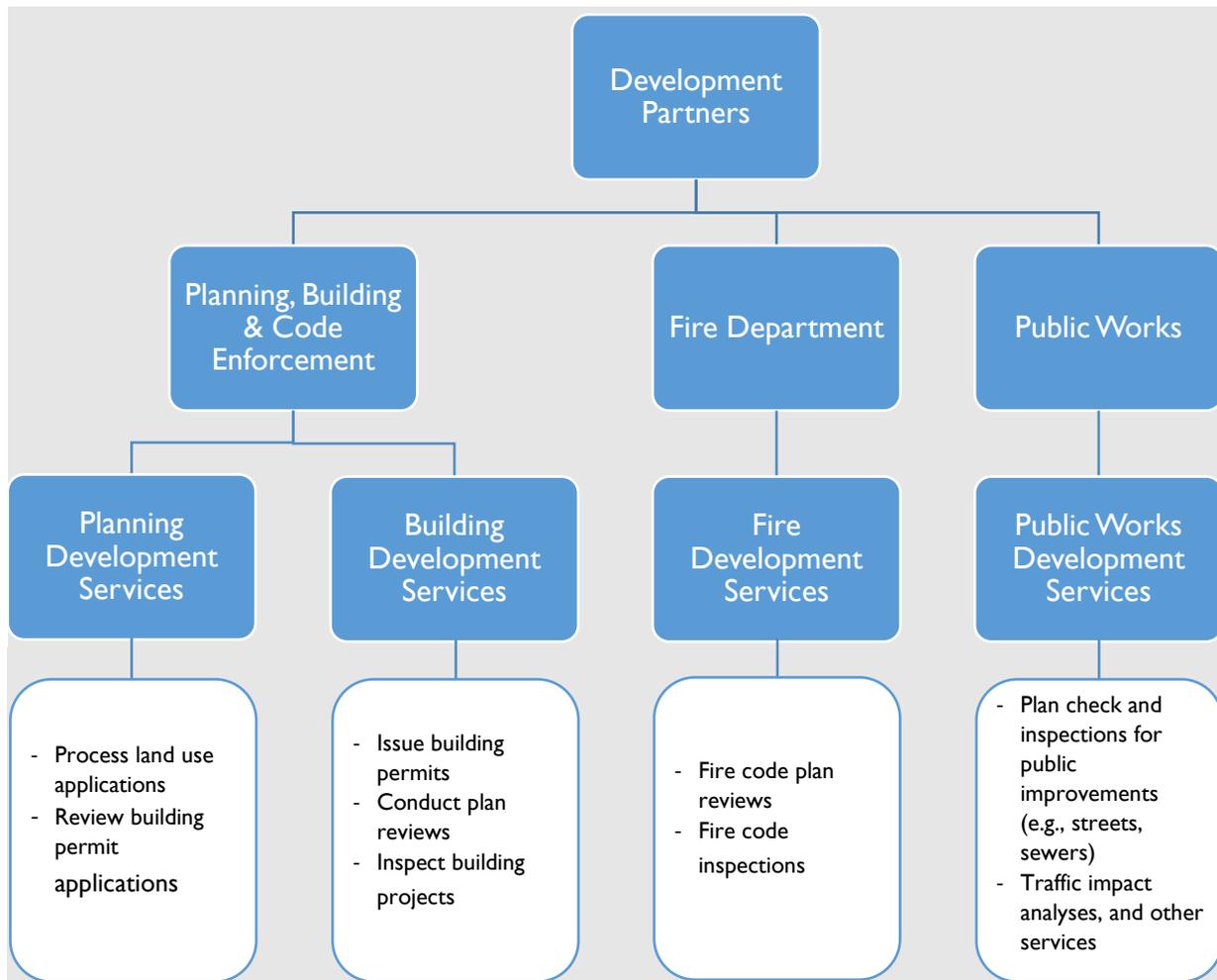
## Background

The City of San José's Development Services Partners (Development Partners) are responsible for ensuring that new construction complies with City laws and regulations. To this end, they provide services to developers, such as reviewing planning applications, issuing building permits, and scheduling inspections. A new development may require multiple services (e.g., a plan review, building permit, and fire inspection). In fiscal year (FY) 2018-19, the Development Partners issued 38,700 building permits, served nearly 59,000 Permit Center customers, and processed nearly 2,200 planning applications.

The four Development Partners are Planning Development Services (Planning), Building Development Services (Building), Fire Development Services (Fire), and Public Works Development Services (Public Works). Building and Planning are separate divisions within the Department of Planning, Building and Code Enforcement (PBCE). Planning issues planning permits and provides services, such as zoning and environmental review. Building issues building permits and oversees construction on private property. Public Works ensures that developments comply with regulations and provide appropriate public infrastructure, such as sidewalks, traffic signals, and streetlights. The Fire Department provides operational and construction permits and inspections to ensure that the development meets the City's fire code.

The Development Partners use the City's integrated permitting system, AMANDA, to track the development process. An upgraded AMANDA system was deployed in 2019.

**Exhibit I: Development Partners' Organization and Services**



Source: Auditor analysis of Development Partners' websites and guides

**Development Partners' Fees**

The Development Partners' programs are meant to be fully cost recovery (i.e., fee revenue is expected to cover all associated costs). Both state law and the City's municipal code put restrictions on the amount of fees charged and the uses the fees may be spent on.

The Development Partners set fees for services based on estimates of personnel, material, and overhead costs necessary to deliver the service. The Development Partners report that the fee may be revised downward (and not be fully cost recovery) to avoid sharp fee increases for developers. The fees are presented to

the City Council to be approved as part of the Budget process in the Proposed Fees and Charges report.<sup>1</sup>

### **Development Partners' Work-in-Progress Reserves**

The Development Partners charge fees up front, even though the development project may take several years to complete. In addition, a developer may pay multiple fees across the different Development Partners, including: a site development permit fee for Planning; fees for a building permit and building inspections for Building; an improvement plan fee for Public Works; and fees for plan checks and fire inspections for Fire. Some of this work (e.g., plan checks) is performed very early in the process, while other work (e.g., inspections) is performed toward the end.

Because of the length of some development projects, annual fee revenue may vary from annual expenditures. For example, in a fiscal year, many new development projects may be started, which leads to an influx of fees. However, expenditures may not similarly increase because work on the project (such as inspections) might not occur until the following year. Alternatively, in another year, there may be fewer new development projects, which leads to lower fee revenue, but expenditures may remain stable due to completing work from previous years.

As required in the City Charter, the Budget Office issues an Annual Report that reconciles the City's actual revenues and expenditures with the budgeted activity for the fiscal year. To ensure that any development fees paid are used to support development services, any revenues collected over the Development Partners' annual expenditures are included in their respective work-in-progress reserves. The reserves also serve to ensure that the Development Partners have enough resources to complete work remaining on open projects.

The following exhibit shows how much each of the reserves was estimated to have at the end of FY 2019-20.<sup>2</sup>

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<sup>1</sup> The FY 2019-20 Adopted Operating Budget estimated that the overall cost recovery rate for FY 2019-20 would be 86 percent. It projected it to range from about 81 percent to 93 percent across the Development Partners.

<sup>2</sup> These estimates may be adjusted after the Budget Offices completes its reconciliation and releases its Annual Report. Throughout the rest of the audit, Modified Budget amounts are used to provide historical data on the growth of these reserves.

**Exhibit 2: Development Partners' Estimated Ending Reserve Funds FY 2019-20<sup>3</sup>**

Building	\$23,900,000
Planning	\$2,100,000
Fire	\$6,100,000
Public Works	\$4,300,000
Total	\$36,400,000

Source: Budget Office estimates as of July 8, 2020

Through FY 2019-20, the Development Partners' activities were accounted for in separate allocations within the City's General Fund. The Budget Department moved the Development Partners' activities, which includes work-in-progress reserves, to separate budgeted funds during the FY 2020-21 budget cycle.<sup>4</sup>

**2016 Management Partners Report<sup>5</sup>**

The City contracted with Management Partners and NBS Consulting to perform a fee structure study, develop a new fee structure model for the Development Partners, and determine the cost of each Development Partners' remaining work on ongoing projects. The report provided recommendations around the Development Partners' cost recovery, the overall development process, methods to calculate unearned revenue, and the refunds process. This report was presented to the City Council in November 2016.

Management Partners estimated that certain individual fees and charges categories were set at levels that were below the costs for providing those services, where others were set at or above the level of costs incurred for providing those services. They also noted that the City had not regularly updated its fees since 2008.

As part of the study, NBS Consulting, a sub-consultant to Management Partners, developed workbooks that enabled the Development Partners to determine their hourly rate, inclusive of overhead, and set fees accordingly. The workbooks take multiple factors into account, including staff salary and benefits, available staff work hours, time allocated by program area, hours allocated to each activity, the labor cost allocated to each activity, and certain recurring non-labor expenditures. These workbooks are still in use to set fees.

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<sup>3</sup> In April 2020, Council reduced Public Works' reserve by \$3.5 million and Planning's reserve by \$1.75 million to address revenue shortfalls as a result of COVID-19 impacts to the City's budget. These actions are included in these estimates.

<sup>4</sup> The new funds are: Planning Development Fee Program Fund, Building Development Fee Program Fund, Public Works Development Fee Program Fund, and Fire Development Fee Program Fund.

<sup>5</sup> *City of San José Development Services Cost Recovery Analysis, Process Improvements, Calculation of Unearned Revenues, and Refund Processing*, Management Partners, 2016, found at [http://sanjose.granicus.com/MetaViewer.php?view\\_id=&event\\_id=2292&meta\\_id=606812](http://sanjose.granicus.com/MetaViewer.php?view_id=&event_id=2292&meta_id=606812)

# Finding I      The Development Partners’ Reserves Did Not Reflect the Cost of Remaining Work on Current Projects

## Summary

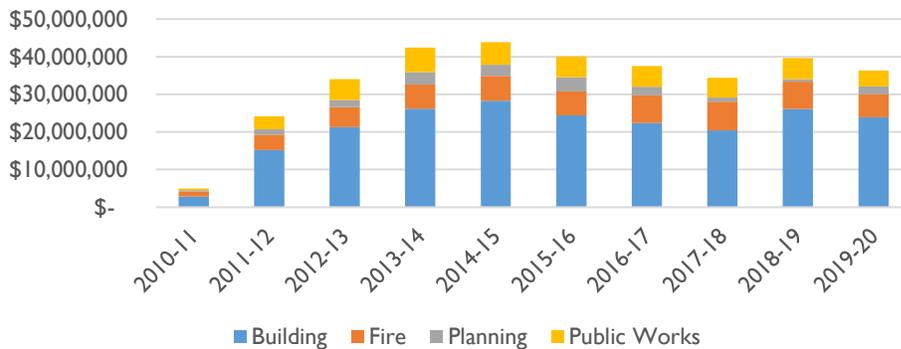
The Development Partners’ reserves have grown significantly in the last decade. The primary reason for the growth has been increased development activity. In addition, the growth can be attributed to interest earnings and unused fees from expired permits. As a result, the amounts held in reserve do not accurately reflect the outstanding workload for unfinished projects. We estimated that Building has additional reserves, while Planning, Fire, and Public Works face a shortfall. This analysis is only an estimate because not all of the Development Partners track labor hours on individual projects, making it difficult to accurately estimate the cost of the remaining work in progress program-wide. We recommend that the Development Partners track hours or milestones moving forward to estimate work in progress, and work with the Budget Office to develop reserve policies for the new development fee funds. The City should also work with its outside financial auditors to determine the proper accounting treatment of development fee revenues that have been collected for projects still in progress.

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## Development Partners’ Reserves Have Grown Significantly Over the Past Decade

The Development Partners’ reserves have grown substantially in the last decade, as shown in Exhibit 3. In FY 2010-11, the budgeted amount for these reserves was roughly \$4.9 million, as compared to an estimated \$36.4 million in FY 2019-20.

**Exhibit 3: Development Partners’ Budgeted Reserves Have Grown Over Time**

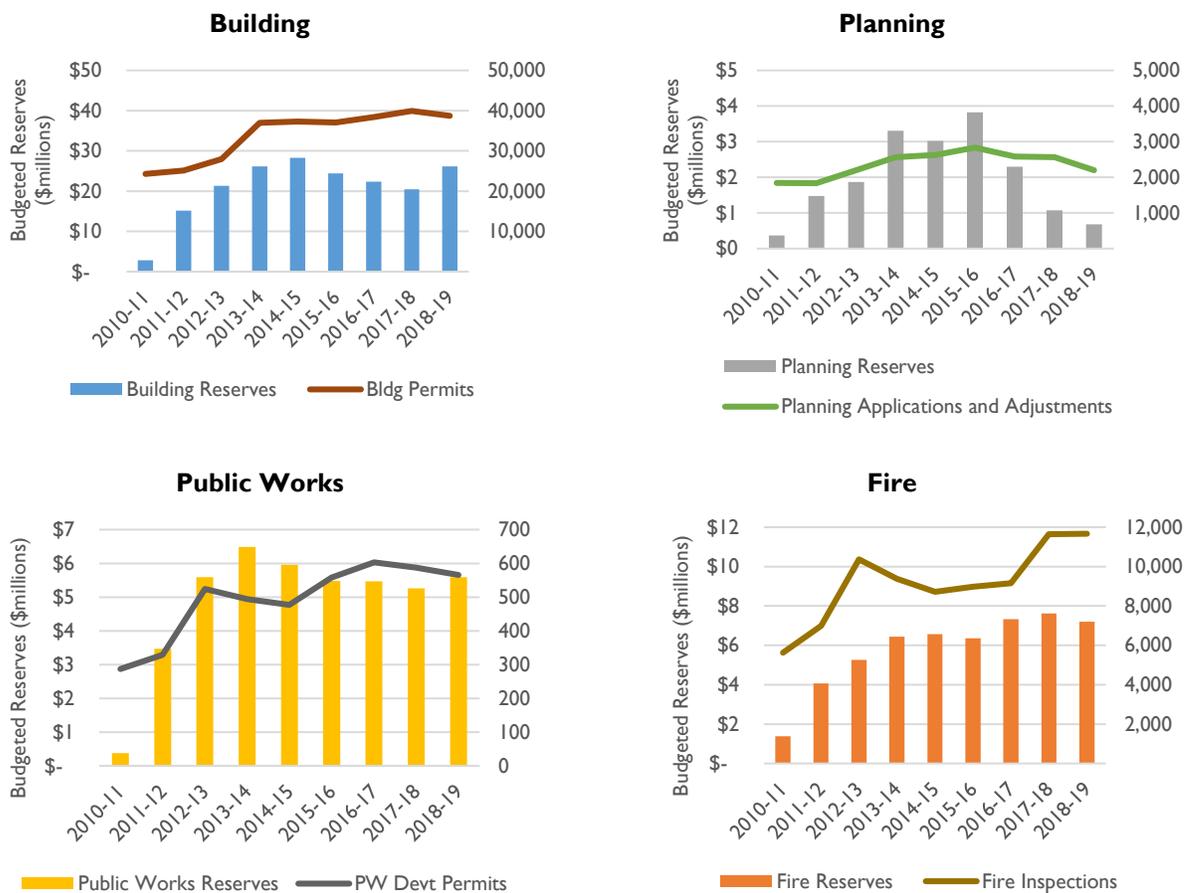


Source: Auditor analysis based on Modified Budgets for FYs 2010-11 through 2018-19 and Budget Office estimates for FY 2019-20

### Growth in Development Activity Has Contributed to the Growth in Reserves

The primary driver of this increase has been increased development activity. For example, the annual number of building permits issued grew from 21,000 in FY 2009-10 to 39,000 in FY 2018-19.<sup>6</sup> Because of the multi-year nature of many projects, this growth in development activity directly affects the amount held in work-in-progress reserves. Each of the Development Partners saw similar growth in development activity and growth in reserves, though it has leveled off or come down slightly in some cases in more recent years. Exhibit 4 shows the growth in the Development Partners' workload compared to reserves over time.

**Exhibit 4: Development Partners' Reserves Grew with Workload<sup>7</sup>**



Source: Auditor analysis of Budget documents and data provided by departments for the City's Auditor's Annual Services Report

<sup>6</sup> Although the number of building permits does not reflect all the work that Building performs, it acts as an indicator of overall division workload.

<sup>7</sup> The Development Partners' workload data for FY 2019-20 will be available when the Annual Report on City Services is released later this year.

### **Actual Revenues and Expenditures Vary from Budgeted Expectations**

As described in the Background, the cost of the Development Partners' services is funded through fees charged for development, including fees for permits, plan checks, inspections, and other services. The cost of the service is intended to be fully reimbursed by the fees, or 100 percent cost recovery. Fees are based on expected activity and costs, which can vary from actual development activity and costs that are incurred during the year. Development activity can be higher or lower than expected; similarly, expenditures can vary from what is expected.

Fee revenues and expenditures have varied, sometimes significantly, from budgeted expectations in recent years, which has contributed to changes in year-end reserve levels. For example, in FY 2017-18, due in part to higher than expected revenues and lower than expected expenses, Building reserves grew by \$4.8 million more than budgeted. The following year, on the other hand, Building ended the year with \$5.4 million less in its reserves than it had budgeted.

One of the sources of lower expenses has been vacancies within each of the Development Partners. Each has seen vacancies, and in some cases a significant number of vacancies, over the past decade. Each City department has a budgeted vacancy rate; over the last three years, the budgeted rate has ranged from 1-2.75 percent across the Development Partners' departments. During that time, each of the Development Partners had vacancy rates of 5 percent or higher. Cumulatively, these yearly fluctuations should cancel each other out, but on a year-to-year basis they can lead to a growth in the Development Partners' reserves.

### **Some Past Revenues Do Not Reflect Works-in-Progress**

In addition to fees collected for ongoing projects, some portion of the reserves reflect other revenues that are not committed to individual projects. These include interest earnings on fund balances and prior fees from projects that are no longer progressing and whose permits have expired.

#### *Interest Earnings Are Allocated to Each Development Partners' Reserve*

Over the course of each year, the City's fund balances generate interest earnings. As part of its annual budget reconciliation process, the Budget Office allocates interest earnings to each of the Development Partners' reserves based on the level of the reserve. In total, interest earnings over the past decade have totaled more than \$3 million across the four Development Partners.

Building, with the largest reserve among the Development Partners, has had the most interest earnings, accumulating \$2.2 million in interest in the last decade. During FY 2018-19 alone, Building accumulated \$500,000. Fire and Public Works each also accumulated interest earnings of roughly \$400,000 in the last decade, while Planning earned \$140,000 over the same period.

Because the reserves have historically been located within the General Fund, the interest earnings allocated to the reserves have not always been transparent. Starting in FY 2020-21, development fee activity has moved to separate, budgeted funds within the City's Operating Budget, so interest earnings will be more transparent for the different partners.

### *Expired Permits May Contribute to Building's Excess Reserves*

The permits issued by the Development Partners expire after a certain amount of time. Once permits are expired, the Development Partners pause working on those projects. Developers have the option of re-opening expired permits to continue work. However, some developers do not re-open permits once they expire, and do not request a refund within 12 months of paying the fees. When this happens, the unused fees stay in the work-in-progress reserve.

Planning, Fire, and Public Works have not had many expired permits over the last decade, but Building has. Since collecting the permit fees, Building conducted various amounts of work on these permits and spent some amount of the development fees. However, it is difficult to estimate how much money remains for these permits in Building's current work-in-progress reports. Currently, any unused money is in Building's work-in-progress reserve, and could help explain why Building has additional money in its reserve.

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### **As of June 30, 2020, One Development Partner Had Additional Money in Reserves; Others Had a Shortfall**

Because the development fees are intended to be cost-recovery, the amount in the reserves should generally reflect the cost of incomplete work. However, an analysis of reserve levels shows that they do not reflect the amount necessary to complete projects. Building reserves exceed the cost of work in progress, while Planning, Fire, and Public Works reserves are less.

Management Partners, in its 2016 Cost Recovery Analysis for the City, noted that the Development Partners' fund balances held in reserve represented surplus funds maintained to provide future services. However, the report distinguished between those amounts held in reserve "from fees and charges that have been received for services not yet provided" (i.e., work in progress), and surplus funds that are uncommitted to future projects.

As noted in the Background, Management Partners pointed out that the Development Partners had not increased their fees, on a regular basis, since 2008. Further, they found that development fees were not set to 100 percent cost-recovery. They estimated that, on average, the City was only recovering 81 percent

of its costs for fee-based services.<sup>8</sup> According to Development Partners staff, in order to avoid sharp increases in fees, they may not raise fees to the amount necessary to fully recover costs.

Management Partners' also noted that Building staff tracked their time in AMANDA by development project and could estimate the amount of their work-in-progress liability (i.e., the cost of remaining work on ongoing projects). Using that data, at that time Management Partners estimated that of Building's \$17.6 million fund reserve, roughly \$13.7 million was held for work in progress and the remaining \$3.9 million was uncommitted to future work. Unfortunately, Management Partners could not estimate work in progress in the same way for the other Development Partners, because the others do not track their time in the same manner as Building. However, they did estimate that Fire likely had fund balances held in reserve greater than its work in progress, but Planning and Public Works' reserve balances were "likely more precarious than Building."

### **Current Reserve Balances Do Not Equal Work in Progress**

As noted by Management Partners, Building tracks staff time on development projects and is able to estimate its work-in-progress liability. Based on this estimate, at the end of FY 2019-20, Building had a work-in-progress liability of \$16.5 million. However, the amount held in reserve totaled \$23.9 million, or nearly \$7.4 million in excess of that needed to complete open projects.

Working with the Development Partners to estimate progress on projects based on their internal reports or status code<sup>9</sup> in the AMANDA permitting system, we estimated that as of June 30, 2020, Building had more money in its reserve than its cost of remaining work, and Planning, Fire, and Public Works had less money in their reserve than their cost of remaining work. For Planning, Fire, and Public Works, this means there are not enough resources set aside to complete work on open projects.

Exhibit 5 shows estimated work-in-progress liabilities for each of the Development Partners. Please note that we provided, in some cases, a wide range for the estimated work-in-progress liabilities. This was a result of how the different partners use status codes in AMANDA. For example, different projects under the same status code could be anywhere between 20 to 80 percent complete. The greater the variation, the greater the range for the estimated work-in-progress liability. Appendix B has more information.

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<sup>8</sup> Despite an overall 81 percent cost-recovery rate, Management Partners stated that certain individual fees and charges categories were set at levels that are below the costs for providing those services, where others were set at or above the level of costs incurred for providing those services.

<sup>9</sup> AMANDA status codes represent different sections of the permit process. For example, a permit application in the plan review process would be marked as Review. Status codes do not indicate how much work remains on the specific portion of the project.

**Exhibit 5: Comparison of Reserve Balances and the Estimated Cost of Remaining Work (FY 2019-20)**

<b>Development Partner</b>	<b>Estimated Reserve (\$millions)</b>	<b>Est. Cost of Remaining Work (\$millions)</b>	<b>Difference (\$millions)</b>
Building	\$23.9	\$16.5	\$7.4
Fire	\$6.1	\$7.1 - \$9.5	(\$1) - (\$3.3)
Planning	\$2.1	\$5.1 - \$12.1	(\$3.0) - (\$10.0)
Public Works	\$4.3	\$12.8 - \$15.5	(\$8.5) - (\$11.2)

Source: Auditor analysis of Building's Work-in-Progress Liability reports, AMANDA data, and Budget estimates as of July 8, 2020.

Note 1: We calculated Building's liability using their Work-in-Progress Liability reports, which is why there is not a range.

Note 2: We calculated the estimated cost of remaining work using three years of workload data. However, Public Works requested that we calculate its liability using five years of workload data. With the larger time frame, Public Works' liability is (\$13.6) - (\$17.7) million.

**Some Development Partners Are Not Tracking Costs Associated with Work in Progress**

The Development Partners have varying methods of tracking their hours and milestones for work in progress. During our audit period, Building was the only Development Partner that consistently tracked its hours spent on a permit in AMANDA. Building uses a custom AMANDA module to identify where in the process a project is. Building uses this information to identify how many hours of work remain on projects, and the cost of those hours program-wide.

The other Development Partners historically have not tracked their hours in AMANDA in this way. According to Development Partners' staff, AMANDA was set up to track development progress by the status of applications and permits, and not to track staff hours. Although this helps determine the general progress of projects, it does not easily allow staff to estimate the cost of the remaining work.

The City recently upgraded the permitting system, AMANDA. The new version of AMANDA went live in November 2019, and its software provides the Development Partners the technical tools to track their time. For example, Planning recently has had its staff start tracking hours in AMANDA, and also re-structured how it uses permit statuses in AMANDA. Fire has also been working towards measuring its development workload that is assigned to be completed. As of July 2020, Public Works had not started tracking hours or milestones in AMANDA for development permit work in progress because of the nature of their work.

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*Work in Progress May Be Determined by Triggers or Milestones Achieved*

In its 2016 report, Management Partners recommended that the City should adopt the accounting standard that incoming fees are treated as “unearned revenue” until the service is completed. This “unearned revenue” represents the cost of services remaining on development project-related work still in progress. Management Partners stated, “A best practice employed by many local government agencies identifies the trigger in which revenues should be considered earned.” They provided examples of what such a triggering event may be, such as issuing a permit, completing a plan check, or finalizing a project closeout.

This is not the only approach. San Francisco takes another approach: “unearned revenue” is counted as “earned” on a straight-line basis. For example, if a project is expected to take five years, a fifth of the fee would be “earned” each year.

Given that some projects take several years, the Development Partners should measure how much work has been completed for each project and, by extension, the cost of the remaining work. By keeping track of this, they will be able to determine whether their reserves will cover the cost of the remaining work for projects in progress.

As Management Partners noted, this could also help standardize the accounting treatment of development fees. This could allow the Finance Department to consider fees as “earned” for financial reporting purposes based on a project’s percentage of completion. They could then count the remainder as “unearned revenue”. For example, fund balance reserves greater than the cost of work in progress would represent surplus funds. In contrast, unearned revenues would “represent a liability ... [for] services that have been paid for, but due to the difference in timing of collection and service delivery, have not yet been delivered.”

**The Development Partners Do Not Have Reserve Policies**

The difference between the Development Partners’ reserves and the cost of remaining work shows why it is important for them to be able to track their work progress in AMANDA. If the Development Partners could regularly determine their cost of remaining work, they could tell if they had a shortfall or surplus in reserves. The Development Partners could use this information to ensure they have enough resources set aside to complete their work, as well as to set their development fees accurately.

As noted by Management Partners in 2016:

*Currently a reserve policy does not exist that sets forth a targeted minimum reserve for the respective Partners’ funds in the City’s general ledger. The City has established a minimum reserve policy for its General Fund equal to 10% of annual operating expenditures. Logically, funds such as the development services funds for Planning, Building, Fire, and Public Works should also*

*have a minimum reserve level that ensures an adequate level of resources are forecast into the City's long-term financial plan.*

*Unfortunately, state law concerning the charging of regulatory fees such as fees for development permits does not provide clear guidance to allow establishing reserves for funding development services during an economic downturn.*

**Recommendation #1: To better assess workload and resources, Planning, Building and Code Enforcement's Planning Division should develop and implement procedures to track the work in progress on current development projects, based on staff hours worked, milestones, or some other metric.**

**Recommendation #2: To better assess workload and resources, Public Works Development Services Division should develop and implement procedures to track the work in progress on current development projects, based on staff hours worked, milestones, or some other metric.**

**Recommendation #3: To better assess workload and resources, the Fire Department's Fire Code Compliance Division should develop and implement procedures to track the work in progress on current development projects, based on staff hours worked, milestones, or some other metric.**

**Recommendation #4: To ensure that the Development Partners have adequate funding to support their development work, Public Works, the Fire Department, and Planning, Building and Code Enforcement should work with the Budget Office and the City Attorney's Office to develop reserve policies or guidelines around the appropriate uses of funds, including work-in-progress reserves.**

**Recommendation #5: To properly account for development fee revenues, the Finance Department should work with the City's external financial auditor to determine the proper accounting treatment of development fee revenues that have been collected for projects still in progress.**

## Conclusion

The City's Development Partners (Development Services within Planning, Building and Code Enforcement; Public Works; and the Fire Department) maintain reserve funds that are meant to account for the cost of development-related work still in progress. However, the current work-in-progress reserves do not accurately reflect their cost of providing remaining services. Building appears to have funds held in reserve greater than the cost of their remaining work in progress; Fire, Planning, and Public Works appear to have less. We recommend the Development Partners better monitor and track progress on projects within the upgraded AMANDA permitting system to better estimate the cost of remaining work on open projects, and develop reserve policies for the new development fee program funds.

### RECOMMENDATIONS

#### **Finding 1: The Development Partners' Reserves Do Not Accurately Reflect Their Remaining Work**

Recommendation #1: To better assess workload and resources, Planning, Building and Code Enforcement's Planning Division should develop and implement procedures to track the work in progress on current development projects, based on staff hours worked, milestones, or some other metric.

Recommendation #2: To better assess workload and resources, Public Works Development Services Division should develop and implement procedures to track the work in progress on current development projects, based on staff hours worked, milestones, or some other metric.

Recommendation #3: To better assess workload and resources, the Fire Department's Fire Code Compliance Division should develop and implement procedures to track the work in progress on current development projects, based on staff hours worked, milestones, or some other metric.

Recommendation #4: To ensure that the Development Partners have adequate funding to support their development work, Public Works, the Fire Department, and Planning, Building and Code Enforcement should work with the Budget Office and the City Attorney's Office to develop reserve policies or guidelines around the appropriate uses of funds, including work-in-progress reserves.

Recommendation #5: To properly account for development fee revenues, the Finance Department should work with the City's external financial auditor to determine the proper accounting treatment of development fee revenues that have been collected for projects still in progress.

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# APPENDIX A

## Audit Objective, Scope, and Methodology

The mission of the City Auditor's Office is to independently assess and report on City operations and services. The audit function is an essential element of San José's public accountability and our audits provide the City Council, City management, and the general public with independent and objective information regarding the economy, efficiency, and effectiveness of City operations and services. In accordance with the City Auditor's Fiscal Year (FY) 2020-21 Audit Work Plan, we have completed an audit of the Development Partners' Work-in-Progress reserves. The audit was conducted at the request of the Administration.

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.

The objective of this audit was to review how the City's Development Partners track the development fee work-in-progress reserves. To understand management controls over development fee work-in-progress reserves and meet our audit objectives, we did the following:

- To understand the legal requirements surrounding development fees, we:
  - Reviewed the City's Municipal Code and state law to understand legal authority to charge fees for services.
- To understand historical development fees reserves' levels, we:
  - Reviewed the City's annual Fees and Charges Report, FYs 2011-12 through 2018-19.
  - Reviewed the City's Adopted Operating Budgets, FYs 2010-11 through 2019-20.
  - Reviewed the City's Comprehensive Annual Financial Reports, FYs 2009-10 through 2017-18.
  - Reviewed *Development Services Cost Recovery Analysis, Process Improvements, Calculation of Unearned Revenues, and Refund Processing*, Management Partners, November 2016
  - Reviewed reports from the City's Financial Management System (FMS) for each of the Development Partners and reviewed the annual reserve levels.
  - Reviewed budget reconciliation spreadsheets created by the Budget Office for preparation of the City's Annual Reports.
  - Reviewed vacancy reports for July 1, 2007 through 2020 and for January 1 in 2008 through 2019.
- To estimate Work-in-Progress liabilities for the Development Partners as of June 30, 2020:
  - Reviewed status reports on open projects in AMANDA.
  - Interviewed Development Partners' staff to estimate the percent completion of projects based on different status codes within AMANDA and the controls surrounding status changes.
  - Identified the total amount of development fees paid for open projects in AMANDA

- Calculated the amount of work still to be completed on open projects, and how much it would take to complete that work
- To understand the Development Partners' workload, we:
  - Interviewed staff in the Fire Department Development Services division; Public Works Development Services division; and Planning, Building and Code Enforcement's Planning division and Building division.
  - Interviewed staff in the City's Budget Office about creating the City's Budgets and Annual Reports.
  - Reviewed the City Auditor's Annual Services reports, FYs 2009-10 through 2018-19.
- To understand best practices for managing fees for development services, we:
  - Interviewed development staff in Berkeley, Los Angeles, Mountain View, and San Francisco to understand their processes for tracking development fees and workload.

We would like to thank the Budget Office, the Fire Department, Public Works, and Planning, Building and Code Enforcement for their time and insight during the audit process.

## APPENDIX B

### Development Partners' Work-in-Progress Estimates

We developed a method to estimate the amount of work in progress the Development Partners had at the end of FY 2019-20, and how much money it would take to complete this work. To make this estimate, we did the following:

- Searched AMANDA data to determine the number of open folders<sup>1</sup> each Development Partner had in the last three full fiscal years (7/1/2017 through 6/30/2020).<sup>2</sup>
- Sorted AMANDA data for each Development Partner by time period and project status.
- Identified the total amount of fees developers paid related to these projects.
- Worked with the Development Partners to determine the estimated % complete (how much work had been done on each project based on its status).
- Calculated how much of the fees the Development Partners needed to pay to complete work in progress.

Note: because there were over 100,000 different data points in our calculation, we were only able to estimate a range of each Development Partner's cost of remaining work.

#### Planning Division Work-in-Progress Estimate

Project Status	# of Open Folders	Fees Collected	Estimated % Complete	Estimated Remaining Work in Progress
<b>Newly Filed (Not Yet Assigned)</b>	8	\$11,317	0% - 5%	\$10,751 - \$11,317
<b>Newly Filed</b>	3	\$2,790	0% - 5%	\$2,651 - \$2,790
<b>New</b>	186	\$125,637	0% - 5%	\$119,355 - \$125,637
<b>Pending</b>	322	\$409,766	5% - 15%	\$348,301 - \$389,278
<b>Notice Sent</b>	45	\$1,158,532	20% - 40%	\$695,119 - \$926,825
<b>Review Letter Sent</b>	179	\$3,632,318	20% - 40%	\$2,179,391 - \$2,905,854
<b>Under Review</b>	775	\$7,991,147	20% - 80%	\$1,598,229 - \$6,392,918
<b>Noticed for Hearing</b>	21	\$326,692	20% - 80%	\$65,338 - \$261,354
<b>Waiting for resubmittal</b>	4	\$177,960	20% - 80%	\$35,592 - \$142,368
<b>Preparing for Hearing</b>	8	\$129,365	20% - 80%	\$25,873 - \$103,492
<b>Pending Closeout</b>	17	\$18,182	20% - 80%	\$3,636 - \$14,546
<b>Tentative Denial</b>	1	\$2,596	20% - 80%	\$519 - \$2,077
<b>Denied</b>	15	\$155,023	20% - 80%	\$31,005 - \$124,018
<b>Appealed</b>	1	\$4,074	20% - 80%	\$815 - \$3,259
<b>Scope of Work Review Prior to Full Project Completed</b>	1	\$582	20% - 80%	\$116 - \$466

<sup>1</sup> A single development project can have many permit folders associated with it.

<sup>2</sup> We also gathered Public Works' data for the past five fiscal years, per their request.

<b>Rejected</b>	14	\$15,108	90% - 100%	\$0 - \$1,511
<b>Withdrawn</b>	292	\$2,325,793	95% - 100%	\$0 - \$116,290
<b>Cancelled</b>	18	\$28,446	95% - 100%	\$0 - \$1,422
<b>Approved with Conditions</b>	9	\$39,097	95% - 100%	\$0 - \$1,955
<b>Approved</b>	5,037	\$9,296,262	95% - 100%	\$0 - \$464,813
<b>Recomd Approval</b>	84	\$551,266	95% - 100%	\$0 - \$27,563
<b>Tentative Approval</b>	53	\$117,167	95% - 100%	\$0 - \$5,858
<b>Approved/ Certified</b>	13	\$6,012	95% - 100%	\$0 - \$301
<b>Complete</b>	1,567	\$766,155	95% - 100%	\$0 - \$38,308
<b>Closed</b>	37	\$5,419	95% - 100%	\$0 - \$271
<b>Inactive</b>	10	\$139,179	95% - 100%	\$0 - \$6,959
<b>Legacy</b>	93	\$210	95% - 100%	\$0 - \$11
<b>TOTAL</b>	<b>9,011<sup>3</sup></b>	<b>\$27,436,096</b>		<b>\$5,116,692 - \$12,071,460</b>
			Reserve Balance	\$2,068,956
			Variance	(\$10,002,504) – (\$3,047,736)

<sup>3</sup> The total number of open folders filed this period was 9,013. This analysis reflects 100% percent of the total.

## Fire Work-in-Progress Estimate

Project Status	# of Open Folders	Fees Collected	Est % Completed	Estimated Remaining Work in Progress
<b>Found Within Fire Folders</b>				
Intake	33	\$9,856	0% -5%	\$9,363 - \$9,856
Review	276	\$587,230	45% - 55%	\$264,253 - \$322,976
Under Review	91	\$176,604	45% - 55%	\$79,472 - \$97,132
Expired	844	\$1,070,115	45% - 55%	\$481,552 - \$588,563
Review Complete - Fees due	16	\$9,486	55% - 65%	\$3,320 - \$4,269
Under Inspection	196	\$302,170	55% - 65%	\$105,759 - \$135,976
End process billing	14	\$18,815	90% - 100%	\$0 - \$1,882
Approved	1,821	\$4,906,788	90% -100%	\$0 - \$490,679
Ready to Issue	7	\$814	95% - 100%	\$0 - \$41
Closed	3,690	\$5,412,640	95% - 100%	\$0 - \$270,632
Cancelled	53	\$34,027	95% - 100%	\$0 - \$1,701
<b>Subtotal</b>	<b>7,041<sup>4</sup></b>	<b>\$12,528,546</b>		<b>\$943,720 - \$1,923,707</b>
<b>Found Within Building Folders</b>				
Intake	5,868	\$1,516,369	0% - 5%	\$1,440,551 - \$1,516,369
Technical Review	5,738	\$7,006,011	45% - 55%	\$3,152,705 - \$3,853,306
Expired	7,803	\$1,254,708	45% - 55%	\$564,618 - \$690,089
Under Inspection	12,727	\$2,756,891	55% - 65%	\$964,912 - \$1,240,601
Finalized	48,505	\$1,578,372	95% - 100%	\$0 - \$78,919
Closed	1,948	\$3,345	95% - 100%	\$0- \$167
Ready to Issue	1,599	\$106,227	90% - 100%	\$0 - \$10,623
Permit(s) Issued	1,610	\$2,625,440	95% - 100%	\$0 - \$131,272
Cancelled	7,100	\$116,025	95% - 100%	\$0 - \$5,801
<b>Subtotal</b>	<b>92,898<sup>5</sup></b>	<b>\$16,963,387</b>		<b>\$6,122,786 - \$7,527,147</b>
<b>TOTAL</b>	<b>99,939</b>			<b>\$7,066,506 - \$9,450,854</b>
			Reserve Total	\$6,109,226
			Variance	(\$3,341,628) - (\$957,280)

<sup>4</sup> The total number of open folders filed this period was 7,041. These statuses reflect 100% of the total.

<sup>5</sup> The total number of open folders filed this period was 94,501. These statuses reflect 96.6% of the total.

**Public Works Development Services Estimated Work-in-Progress<sup>6</sup>**

Status	# of Open Folders (3 year data)	Fees Collected	Est % Completed	Est. Remaining WIP
<b>Intake</b>	741	\$856,671	0% - 5%	\$813,837 - \$856,671
<b>Accepted</b>	1,209	\$254,640	25% - 35%	\$165,516 - \$190,980
<b>In Process</b>	320	\$0	25% - 35%	\$0
<b>Under Review</b>	1,516	\$6,572,953	25% - 35%	\$4,272,420 - \$4,929,715
<b>Technical Review</b>	428	\$207,529	25% - 35%	\$134,894 - \$155,647
<b>Tech Review Complete</b>	24	\$10,089	35% - 45%	\$5,549 - \$6,558
<b>Pending Approval</b>	134	\$849,225	40% - 50%	\$424,612 - \$509,535
<b>Ready to Issue</b>	133	\$76,487	45% - 55%	\$34,419 - \$42,068
<b>Expired</b>	1,387	\$31,724	45% - 55%	\$14,276 - \$17,448
<b>Under Inspection</b>	369	\$10,875	50% - 60%	\$4,350 - \$5,438
<b>Issued</b>	4,147	\$580,501	50% - 60%	\$232,200 - \$290,251
<b>Approved</b>	5,127	\$16,730,558	50% - 60%	\$6,692,223 - \$8,365,279
<b>Completed</b>	4,838	\$363,271	90% - 100%	\$0 - \$36,327
<b>Closed-out</b>	123	\$943,575	95% - 100%	\$0 - \$47,179
<b>Finald</b>	43	\$149	95% - 100%	\$0 - \$7
<b>Recorded</b>	123	\$155,014	95% - 100%	\$0 - \$7,751
<b>Cancelled</b>	495	\$769,131	95% - 100%	\$0 - \$38,457
<b>TOTAL</b>	<b>21,213<sup>7</sup></b>	<b>\$28,412,391</b>		<b>\$12,794,296 - \$15,499,308</b>
			Reserve Total	\$4,262,484
			Variance	(\$8,531,812) – (\$11,236,824)

<sup>6</sup> This table reports numbers for the past three years. Public Works reports that they often continue working on projects for the last five years. Using those figures, Public Works has a workload liability of about \$19.9 million, which amounts to a shortfall of \$15.6 million.

<sup>7</sup> The total number of open folders filed this period was 21,277. These statuses reflect 99.6% of the total.



# Memorandum

**TO:** JOE ROIS, CITY AUDITOR

**FROM:** Kip Harkness

**SUBJECT:** SEE BELOW

**DATE:** September 10, 2020

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Approved

Date

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**SUBJECT: RESPONSE TO “DEVELOPMENT PARTNERS’ WORK-IN-PROGRESS RESERVES: BETTER MONITORING CAN ENSURE RESERVES ALIGN WITH RESOURCE NEEDS”**

The Administration has reviewed the report from the City Auditor (*Development Partners’ Work-In-Progress Reserves: Better Monitoring Can Ensure Reserves Align With Resource Needs*) and agrees with the five recommendations identified in the report. This memorandum captures the Administration’s response to each recommendation and presents an overview of the work required to fully implement the recommendations and the associated timeframes for completion. The Administration greatly appreciates the work of the City Auditor and his staff for this evaluation and looks forward to improving its Development Partners Work-In-Progress accounting.

**BACKGROUND**

The Development Services Partners Fee Programs are operated as cost recovery funded by development application fees. The current fee structure calculates fees based on a number of project criteria including square footage, occupancy type and number of floors, in addition to administration and service costs. In 2016, the Development Services Partners conducted a study of each partner’s cost recovery structure and processes with the external vendor Management Partners. The report found that the fee structure and hourly rates had not been significantly or regularly updated since 2008 while the cost of providing services had increased. The report concluded that the City was recovering approximately 81% of the costs to provide services, with the remainder funded through the use of unearned revenue reserves, staff vacancies and suboptimal services. To align more with actual costs, hourly rates and fee structures were updated for Planning and Public Works in Fiscal Year (FY)17-18, FY18-19, FY19-20, and FY20-21; Building and Fire hourly rates and fee structures were updated in FY18-19, FY19-20 and FY20-21.

The 2016 report included recommendations that are reinforced by the recommendations of the Auditor’s report “Development Partners’ Work-In-Progress Reserves: Better Monitoring Can Ensure Reserves Align with Resource Needs.” The Development Services Partners agree with the report finding and offer responses to each of the Auditor’s recommendations below.

## **RECOMMENDATIONS AND ADMINISTRATION’S RESPONSE**

### **Finding 1: The Development Partners’ Reserves Did Not Reflect the Cost of Remaining Work on Current Projects**

**Recommendation #1:** To better assess workload and resources, Planning, Building and Code Enforcement’s Planning Division should develop and implement procedures to track the work in progress on current development projects, based on staff hours worked, milestones, or some other metric.

**Administration’s Response:** The Administration agrees with this recommendation.

**Green** – Planning, Building and Code Enforcement will expand on its existing time tracking for the Planning Division and continue to monitor time entered into AMANDA as identified in the Auditor report. This effort has been part of the Development Services Transformation initiative. In the third quarter of 2019, the Planning Division’s time tracking had improved by 179%, corresponding with the upgrade of AMANDA 7 in November 2019. To fulfill this recommendation, time tracking data will need to be aggregated and analyzed to accurately develop procedures for tracking work in progress. A sufficient collection of data will need to be collected of hours entered for planning permits. As some of these permits can take over a year to complete, data should be collected over a sufficient time period to accurately assess future projects’ work in progress.

Target Date for Completion: September 30, 2021

**Recommendation #2:** To better assess workload and resources, Public Works’ Development Services Division should develop and implement procedures to track the work in progress on current development projects, based on staff hours worked, milestones, or some other metric.

**Administration’s Response:** The Administration agrees with this recommendation.

**Green** – The Administration agrees with this recommendation and will develop and implement procedures to track the work in progress on current development projects based on milestones. Public Works will create AMANDA reports to track projects based on certain milestones and compare the estimated cost of work in progress against current reserve level.

Target Date for Completion: June 30, 2021

**Recommendation #3:** To better assess workload and resources, the Fire Department’s Fire Code Compliance Division should develop and implement procedures to track the work in progress on current development projects, based on staff hours worked, milestones, or some other metric.

**Administration’s Response:** The Administration agrees with this recommendation.

**Green** – The Fire Department will expand existing time tracking and continue monitoring time entered into AMANDA as identified in the Auditor report. The Fire Department will continue to evaluate the current work in progress AMANDA report and continue staff training to improve time reporting data quality. To fulfill this recommendation, aggregated time tracking data will need to be analyzed to accurately develop procedures for tracking work in progress. Coordination with Development Partners for consistency in procedures will improve uniformity in time tracking for Fire Development permits/projects.

Target Date for Completion: September 30, 2021

**Recommendation #4:** To ensure that the Development Partners have adequate funding to support their development work, Public Works, the Fire Department, and Planning, Building and Code Enforcement should work with the Budget Office and the City Attorney’s Office to develop reserve policies or guidelines around the appropriate uses of funds, including work-in-progress reserves.

**Administration’s Response:** The Administration agrees with this recommendation.

**Green** –The Development Services Partners will work with the City Manager’s Budget Office and the City Attorney’s Office to establish guidelines for the cost recovery Divisions. The creation of these guidelines will consider existing City policy and State law that govern regulatory fees and identify what portion of the work in progress budgeted reserves are unearned revenue/cost of remaining work and what is surplus.

Target Date for Completion: September 30, 2021

**Recommendation #5:** To properly account for development fee revenues, the Finance Department should work with the City’s external financial auditor to determine the proper accounting treatment of development fee revenues that have been collected for projects still in progress.

**Administration’s Response:** The Administration agrees with this recommendation.

**Green** – The Finance Department has developed a draft accounting treatment with its external auditors and will work with the Development Services Partners and the City Manager’s Budget Office to ensure that the accounting methodology allows reserves to be drawn down appropriately and that revenue forecasts appropriately reflect available revenue to offset anticipated expenditures. While the revised accounting treatment is close to completion, implementing the new treatment will impact the budgeting of revenues and expenses. Full

CITY AUDITOR  
September 22, 2020

**Subject: Response To “Development Partners’ Work-In-Progress Reserves: Better Monitoring Can Ensure Reserves Align With Resource Needs”**

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implementation of this recommendation will first require a more precise estimate of the work-in-progress reserves.

Target Date for Completion: December 31, 2021

## **CONCLUSION**

The Administration appreciates the audit for the Development Services work-in-progress reserve. The recommendations of this report align with several of the recommendations from the Management Partners 2016 study which are currently on the roadmap for the Development Service Transformation initiative. The Development Services Partners would like to thank the City Auditor and staff for their findings and recommendation.

/s/  
KIP HARKNESS  
Deputy City Manager