



Memorandum

TO: Public Safety, Finance, and Strategic
Support Committee

FROM: Sharon W. Erickson,
City Auditor

SUBJECT: *Audit of Legacy Partners' Museum
Park Development*

DATE: February 10, 2010

This memorandum summarizes the City Auditor's review of the San José Redevelopment Agency's agreements with Legacy Partners for the Museum Park development. Our audit objective was to define the current financing structure of Museum Park and to review Museum Park's revenues and expenses to determine if the Redevelopment Agency is owed any payments on its \$3,249,100 loan. We found that Museum Park generates positive cash flow, and we found an additional \$178,415 in revenue and cost adjustments that could increase cash available to pay debt; however, the cash flow is not sufficient to repay the Agency during the loan term. We recommend the Agency address the income and expense findings with Legacy Partners, and that the Agency request that Legacy Partners provide additional reporting information to show debt/equity balances and annual changes resulting from net cash flow going forward.

In its original agreement with Legacy Partners, the Agency agreed to subordinate its loan to more senior lenders and equity partners. According to the Agency, this was an incentive for developers to begin construction. In 2003 the Agency again agreed to subordinate its loan, as Legacy Partners needed to secure additional financing. Because of the subordinated position of the Agency's loan, the Agency will not receive payments on its loan during the loan term. We recommend that if Legacy Partners proposes a new subordination agreement, the Agency – in its staff report and memoranda to the Board – should fully analyze and evaluate the impact of further subordination and present possible alternatives that could increase the likelihood the Agency recovers its investment.

Introduction

In accordance with the City Auditor's 2009-10 Workplan, we performed an audit of Legacy Partners' Museum Park Development located at 465 West San Carlos Street in San José. 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 finding and conclusions based on our audit objectives. We limited our work to those areas specified in the Objective, Scope and Methodology section of this report.

The City Auditor's Office thanks the management and staff of the Redevelopment Agency, the General Counsel for the San José Redevelopment Agency, the Housing Department, and Legacy Partners for their cooperation during the audit process.

Background

The San José Redevelopment Agency (Agency) partnered with Legacy Partners PERPAP Limited Partnership (Legacy Partners) to develop a 117-unit multi-family rental housing development called Legacy at Museum Park (Museum Park). The development was completed in July 2003 and includes 40 live-work lofts, 47 two- and three-level townhomes, and 30 flats.

Disposition and Development Agreement

In 2000, the Agency and Legacy Partners formalized their relationship by entering into a Disposition and Development Agreement (DDA) to develop Museum Park. The DDA outlines Legacy Partners' obligations in developing Museum Park. The DDA required Legacy Partners to construct 117 for-rent housing units with no fewer than 19 set aside for moderate-income households for 30 years. According to Agency staff, Legacy Partners had already assembled 70 percent of the acreage required for the development through private equity. The DDA provided for the conveyance of additional land from the Agency to Legacy Partners. The DDA also outlined financing terms; described operating and maintenance requirements; and defined the Project's scope. In June 2003, the Agency issued a Certificate of Compliance to Legacy Partners indicating Legacy Partners had complied with the construction requirements of the DDA. Legacy Partners remains obligated to other DDA requirements, such as performance under the Operations & Maintenance Agreement, Promissory Note, and Affordability Restrictions.¹

Redevelopment Agency Contribution To Museum Park

The total development cost for Museum Park was \$32,671,800. Legacy Partners secured loans and partnership equity of \$28,964,000 while the Agency contributed \$3,707,800 in assistance. The Agency's \$3.7 million included \$458,700 for relocation costs, and a \$3,249,100 loan for a \$1.8 million cash contribution and a \$1,449,100 land contribution.

The Agency and Legacy Partners entered into a Promissory Note outlining terms for Legacy Partners' repayment of the \$3,249,100 Agency loan. The terms require Legacy Partners to pay the Agency on a quarterly basis, an amount equal to 30 percent from Museum Park's net cash flow. The loan accrues three percent annual interest on unpaid principal for a period of 30 years. The full loan and remaining unpaid accrued interest becomes due and payable in 30 years; although the Agency Executive Director may extend the loan period for three 5-year terms.

¹ The City's Housing Department monitors Museum Park's compliance with affordable housing requirements.

Operations & Maintenance Agreement

In February 2001, the Agency and Legacy Partners entered into an Operations & Maintenance Agreement (O&M Agreement) which sets forth the terms and conditions to which Legacy Partners shall operate and maintain the Project. The O&M Agreement specifies standards for maintenance, capital improvements and insurance requirements. The Agreement allows Legacy Partners to manage and operate the Project through either a related² or non-related entity. While Legacy Partners may charge reasonable on-site costs to the Project, Legacy Partners is limited to a management fee for administrative expenses when using a related entity. Legacy Partners utilizes a related entity called Legacy Partners Residential. As a result, Legacy Partners can charge a management fee calculated as no more than 5 percent of revenues in-lieu of overhead, staff costs, and miscellaneous costs.

Objective, Scope, and Methodology

Our audit objective was to define the current financing structure of Museum Park and to review Museum Park's revenues and expenses to determine if the Redevelopment Agency is owed any payments on its \$3,249,100 loan.

We reviewed Legacy Partners' general ledger for calendar years 2006, 2007, and 2008 to identify revenue and expense items for review, and obtained supporting documentation and conducted reasonableness tests for a judgmental sample of those items. We also reviewed the DDA and related agreements between Legacy Partners and the Redevelopment Agency, and conducted interviews with staff of the Redevelopment Agency, Housing Department, City Attorney's Office, and Legacy Partners, to verify compliance with affordable housing restrictions and other terms. We reviewed the annual cash flow statements and other reports that Legacy Partners submitted to the Agency for 2006, 2007, and 2008 for any major discrepancies, and for revenue and expense items which did not appear to comply with the terms of the agreements between the Agency and Legacy Partners. We developed projections to determine if Museum Park cash flow would allow payment of the Agency loan.

² The Promissory Note between the Agency and Legacy Partners defines a Related Entity as the (a) developer, (b) any partner or parent holding a ten percent (10%) or greater interest in Developer; (c) any spouse or relative of the above; (d) any corporation, partnership or other entity in which any of the above persons or entities have a ten percent (10%) or greater interest; or (e) any person or entity having a ten percent (10%) or greater beneficial interest, direct or indirect, in any of the above entities.

Museum Park Generates Positive Cash Flow, but the Cash Flow Is Not Sufficient to Repay the Redevelopment Agency for Its \$3,249,100 Loan During the Loan Term

The DDA between Legacy Partners and the Redevelopment Agency states that net cash flow derived from the Museum Park development (revenue less reasonable expenses) remains available to pay down debt and equity obligations. Legacy Partners submits to the Redevelopment Agency annual cash flow statements to verify that Legacy Partners is adhering to the standards prescribed in the DDA. We found that from 2006 through 2008:

- Museum Park generated sufficient revenue to cover operating expenses;
- Revenue and expense adjustments could have increased cash available to pay debt by \$178,415;
- Museum Park financing places the Agency's \$3,249,100 loan subordinate to three other levels of financing;
- Legacy Partners paid \$1,511,989 towards debt and equity obligations in 2008;
- Under the current financing structure and cash flow, the Agency will not recoup any of its \$3,249,100 during the loan term because the Agency's loan is subordinated to obligations which outpace the cash flow generated by Museum Park.

While Legacy Partners provides the Agency with annual cash flow statements, the Agency is not provided information about how the cash flow impacts current debt and equity obligations. We recommend the Agency request Legacy Partners expand their annual reports to show the annual cash flow impact on each level of financing. In the future, the Agency should fully analyze and evaluate alternatives to subordination agreements in order to maximize the likelihood of receiving repayment.

Museum Park's Revenue Sufficiently Covers Operating Expenses

From 2006 through 2008, Legacy Partners successfully operated the Museum Park development generating net income exceeding \$1 million per year. The following exhibit shows income and expenses for 2006, 2007, and 2008.

Exhibit 1
Income and Expense Performance³ of Museum Park

	2006	2007	2008
Income			
Gross Rental Income-Residential	\$2,411,400	\$2,540,507	\$2,691,984
Loss due to Vacancies	(\$191,986)	(\$169,309)	(\$194,200)
Collection Losses	(\$40,310)	(\$32,488)	(\$82,973)
Other Rental Income	\$16,869	\$10,399	\$9,909
Operating Income- Rental	\$2,195,974	\$2,349,108	\$2,424,721
Amenities Income	\$3,089	\$3,486	\$4,016
Fee Income	\$25,299	\$23,028	\$22,792
Other Operating Income	\$8,812	\$1,842	\$4,034
Operating Income- Other	\$37,200	\$28,356	\$30,842
Investment Income	\$10,018	\$14,376	\$6,001
Total Income	\$2,243,192	\$2,391,841	\$2,461,564
Expenses			
Operating Expenses	\$886,634	\$904,805	\$894,926
Operating Expenses – Administrative	\$0	\$2,982	\$7,780
Total Operating Expenses	\$886,634	\$907,788	\$904,479
Other Expenses	\$46,726	\$39,608	\$38,660
Total Expenses	\$933,290	\$947,395	\$943,139
Net income/loss⁴	\$1,356,558	\$1,484,053	\$1,557,085

Source: Legacy Partners General Ledger financial information.

Net income increased from 2006 through 2008 because increases in residential rental income, Museum Park's primary source of revenue, outpaced overall expenses.⁵

³ Income and expense performance does not include depreciation/amortization, a non-cash expense, and does not include expenses related to the payment of debt or distributions on equity obligations.

⁴ Net income/loss is accounted on an accrual basis and cash flow is accounted for on a cash basis. Consequently, the cash flow available for payment of debt/equity investments differs from the net income/loss amounts.

⁵ Under Redevelopment Law, the Agency is required to conduct a financial analysis of projects for which land is conveyed. The Agency used a consultant to evaluate the fiscal impact of the Museum Park project. In 2000, the Agency's consultant projected Museum Park's rental income would increase at an average of 3.8 percent annually from 2006 to 2008. Museum Park's actual rental income increased an average of 5.5 percent annually, which exceed the consultant's projections. However, Legacy Partners' gross annual income tracks below the consultant's projections. Museum Park generated about \$800,000 to \$900,000 less annually than projected by the consultant. According to Legacy Partners and Agency staff, the reduced gross annual income is due to a weakened economy.

Revenue and Expense Adjustments Could Have Increased Cash Available to Pay Debt by \$178,415

Legacy Partners submits annual cash flow statements to the Redevelopment Agency to verify that it is adhering to the standards prescribed in the DDA. Our review identified \$137,949 in revenue and \$40,466 in expense adjustments from 2006 through 2008 that could have increased cash available to pay down debt by \$178,415.

Revenue Adjustments

The Disposition and Development Agreement between the Agency and Legacy Partners (DDA) specifies Legacy Partners shall develop 117 “for-rent” units for Museum Park. Legacy Partners financial records show only 115 units available for generating revenue. Legacy Partners utilizes two units as model units, which do not generate revenue. It is standard practice to maintain furnished model units, as prospective tenants want to imagine what their units would look like before deciding to lease. However, the DDA clearly specifies 117 rentable units, and contains no language allowing Legacy Partners to reduce the number of units available to generate revenue. We estimate the two units would have generated \$137,949⁶ in additional revenue between 2006 and 2008 while accounting for vacancies. The 2006, 2007, and 2008 adjustments would increase revenue by \$42,679, \$45,628, and \$49,642, respectively.

Expense Adjustments

Agreements between the Agency and Legacy Partners limit the type of expenses which may be charged against the project. We found Legacy Partners charged management salary and other expenses which do not appear reasonable or were already covered by the management fee. Specifically, Legacy Partners uses a related entity for the operations and maintenance of Museum Park, and thus is restricted to a 5 percent management fee for off-site staff and administration expenses. However, Legacy Partners compensates an employee by crediting rent at Museum Park as salary to the employee. The rent is accounted as a salary expense against Museum Park and thereby reduces the available cash flow available to pay down debt obligations. Legacy Partners' documentation identifies this employee as a District Manager who is off-site and visits Museum Park sporadically. Since Legacy Partners already receives a management fee for off-site staff and administration expenses, this expense appears ineligible. The ineligible expense increased expenses by \$35,271. The 2007 and 2008 adjustments would decrease operating expense by \$6,471 and \$28,800 respectively.

Our review of general ledger transactions revealed a number of meal/entertainment expenses as well as political campaign contributions which do not appear reasonable to operate the Museum Park facility. Excluding these ineligible items would decrease expenses by about \$12,093.

⁶ The increased revenue derived from the two model units would result in a corresponding increase in the management fee expense due to Legacy Partners. The adjustments would increase expenses by \$6,897.

Current Museum Park Financing Places the Agency Loan Subordinate to Three Other Levels of Financing

The original development costs for Museum Park were \$32,671,800, with net cash flow from the development expected to pay down debt and equity obligations incurred to finance the project. At the onset of the development, Legacy Partners secured a construction loan and partnership equity of \$28,964,000 while the Agency contributed \$458,700 for relocation costs and a \$3,249,100 loan.

Additional Financing Added in 2003 and 2004

In 2003, Legacy Partners refinanced its construction loan and obtained term financing. However, the lender did not fully refinance the construction loan principal. According to staff of Legacy Partners and the Redevelopment Agency, Museum Park faced lower-than expected rental income and declining property values due to an economic downturn. These factors, according to staff, limited Legacy Partners' ability to secure favorable financing with its existing lenders, lowered Museum Park's cash flow, and put the project at risk of foreclosure. Specifically, the primary lender at the time (Bank One) was willing to offer a permanent loan that was \$4.7 million less than the outstanding balance of the construction loan. In order to close the gap, Legacy Partners secured a second mortgage from Camden USA for \$3.6 million and additional developer equity of \$1.45 million. According to Agency staff, Camden's funding and the additional developer equity was contingent on their position being senior to the Agency's position. Considering the options available at the time, Redevelopment Agency staff proposed, and the Redevelopment Agency Board subsequently approved the first amendment to the Operations and Maintenance Agreement (O&M) of June 2003. The amendment to the O&M introduced an additional layer of investor equity senior to the Redevelopment Agency. This \$1.45 million in investor equity earns a cumulative rate of return of 22.5 percent and is called Preferred Developer Equity.

The amendment to the O&M and its related subordination agreements allowed for investors to contribute additional capital called "protective advances"⁷ that would be senior to the Redevelopment Agency's loan. Protective advances were to allow Legacy Partners to contribute additional investor capital to the project in the case any future refinancing required additional funding. By the end of 2004, Legacy Partners refinanced into the current financing structure and had collected an additional \$1.429 million in such protective advances bringing the Preferred Developer Equity balance to \$2,879,379. As of the end of 2008, Museum Park had over \$36 million in debt and equity obligations.

⁷ "Protective advances" are essentially additional developer financing to bridge the gap created by any future refinancing. The contribution of protective advances does not require additional Agency Board approval so long as the sum of the advances and refinanced obligation do not exceed the total amount of financing previously senior to the Agency debt.

Priority Order of Payment of Current Debt and Equity Obligations

The DDA requires Legacy Partners to use net cash flow from the Museum Park development to pay down debt and equity obligations. The current obligations are prioritized and paid in the following priority order:

1. **Bank of America Loan:** The original principal balance was \$18.9 million with a 5.05% interest rate. Legacy Partner pays interest only on the loan.
2. **Mezzanine Equity:** After interest is paid on BofA Loan, Legacy Partners pays principal and interest on the Mezzanine Equity whose principal balance was \$1.75 million with a 12% cumulative rate of return.
3. **Preferred Developer Equity:** After total balance for Mezzanine Equity is paid, Legacy Partners pays principal and interest on the Preferred Developer Equity whose principal balance was about \$2.9 million at a 22.5% cumulative rate of return.
4. After fully paying Preferred Developer Equity, Legacy Partners and the Agency share remaining payments on a 70%/30% split, respectively, until developer's equity is fully paid.
 - 4a. **Developer Equity:** Legacy Partners pays principal and interest on Developer Equity whose principal balance was \$4.1 million. The Developer Equity accrues 12% non-cumulative interest for the first 10 years and 10% non-cumulative interest afterwards until full payment.
 - 4b. **Agency Loan:** Legacy Partners pays accumulated interest, then principal on the Agency's \$3,249,100 loan. The loan accrues a 3% cumulative interest rate.

Legacy Partners Paid \$1,511,989 Toward its Debt and Equity Obligations in 2008

In 2008, Legacy Partners paid \$1,511,989 in obligations to Bank of America and Mezzanine Equity partners. The following exhibit shows the priority order of payments for 2008.

Exhibit 2
Debt and Equity Obligations, Accruals, Payments and Balances⁸

	Balance as of December 2007	→	Activity in 2008		→	Balance as of December 2008
			Accruals	Payments		
1 Bank of America Loan	\$18,900,000	→	\$970,358 interest	\$970,358 interest-only payments	→	\$18,900,000
2 Mezzanine Equity	\$1,731,631	→	\$201,450 cumulative returns	\$541,631 equity distributions	→	\$1,391,450
3 Preferred Developer Equity	\$6,387,623	→	\$1,437,016 cumulative returns	\$0	→	\$7,824,839*
4a Developer Equity	\$4,100,000	→	\$492,000 non-cumulative returns	\$0	→	\$4,100,000
4b Agency Loan	\$3,711,744	→	\$111,352 interest	\$0	→	\$3,823,096
				\$1,511,989		
				Total Payments		

Source: Auditor's review of Legacy Partners' financial information.

As shown above, the Bank of America loan takes first priority for payment from net cash flow. In 2008, the loan accrued \$970,358 in interest. Legacy Partners paid the monthly interest to sufficiently cover the interest. As a result, the beginning and ending balance for the loan remains unchanged at the original \$18.9 million. After paying down interest, the remaining cash flow funds junior obligations.

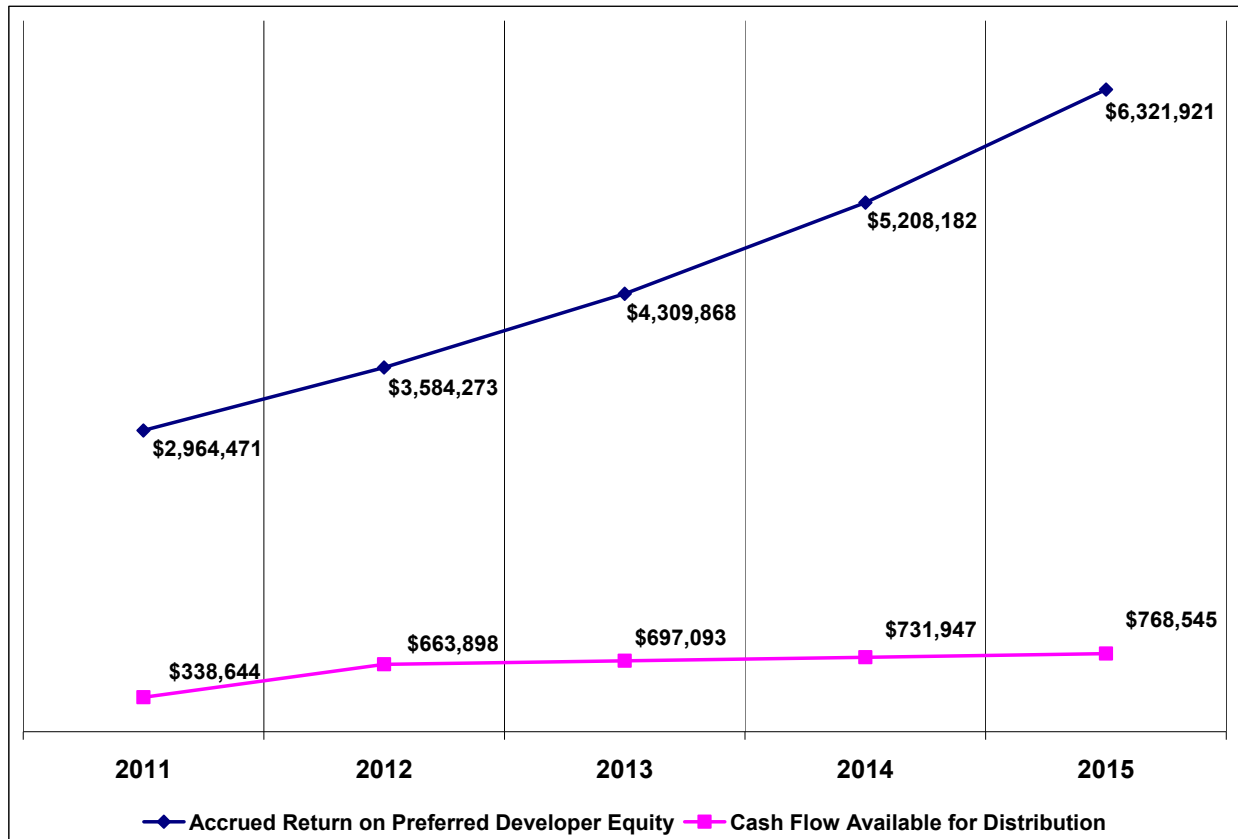
In 2008, the Mezzanine Equity (the second priority for payment from net cash flow) accrued \$201,450 in returns for the partners. Legacy Partners made \$541,631 in distributions to the partners, which fully paid the \$201,450 return and brought down the balance to \$1,391,450. The Preferred Developer Equity (the third priority for payment from net cash flow) accrued \$1,437,016 in additional partnership return, but Museum Park did not generate sufficient cash flow to make any distributions for Preferred Developer Equity, Developer Equity, or the Agency's loan.

⁸ 2008 Preferred Developer Equity balance varies slightly from Legacy Partners' financial information due to interest calculation differences (shown in table with *).

Under the Current Financing Structure and Cash Flow, the Agency Will Not Recoup its \$3,249,100 During the Loan Term

The Agency's \$3,249,100 loan to Legacy Partners shares a fourth level financing behind the Bank of America loan, the Mezzanine Equity, and the Preferred Developer Equity. Assuming a 5 percent annual increase in cash flow to pay down obligations and no changes to the current financing structure, we estimate Legacy Partners will fully pay down Mezzanine Equity by around 2011. At or around 2011, the continued distributions would begin to pay down the Preferred Developer Equity. However, the Preferred Developer Equity maintains a 22.5 percent cumulative return and by 2008 had accrued a balance of \$7.8 million. The following exhibit projects five years of Preferred Developer Equity accrued return and the projected cash flow available for distributions.

**Exhibit 3
Comparison of Cash Flow and Annually Accrued Return for the Preferred Developer Equity**



Source: Auditor's projections based on 5% annual increase to cash flow available for distributions.

As shown in the exhibit above, the annually accrued return for the Preferred Developer Equity is projected to be much larger than the available cash flow to pay down debt. Until the annual cash flow for distributions exceeds the annual return, Legacy Partners will not make any headway in paying down the Preferred Developer Equity. According to our projections, Museum Park will

not generate sufficient cash flow to pay down the Preferred Developer Equity. Since the Agency's loan is subordinated to the Preferred Developer Equity, the Agency will not see any repayment during the loan term.

The Agency Can Benefit from Additional Information of the Details of Refinancing and the Use of Net Cash Flow

In 2003, Legacy Partners requested the Redevelopment Agency to consider subordinating the Agency loan to new developer financing as part of an overall refinancing of Museum Park's debt. Legacy Partners informed the Agency that without approval of the additional financing, the project faced foreclosure. Given the Agency's priority of keeping Museum Park viable, the Agency recommended, and the Agency board approved, subordinating the existing \$3,249,100 Agency loan to a new level of financing called Preferred Developer Equity. The negative effect that \$1.45 million with a 22.5 percent cumulative rate of return would have on the Agency's ability to collect on its loan may not have been clear to all parties; neither may have been the potentially negative consequences to the Agency of Legacy Partners' ability to increase its Preferred Developer Equity at any time (by providing additional capital investment in the form of protective advances).

Legacy Partners reports that it will shortly need to find new alternative financing for its largest debt obligation (the interest rate on the \$18.9 million Bank of America loan was expected to increase significantly as of January 2010). Should Legacy Partners propose another subordination agreement with the Agency, we recommend the Agency analyze and evaluate alternatives that could increase the likelihood of the Agency recovering its investment. These alternatives could include renegotiating the current split of cash flow available for repayment, or negotiating a provision guaranteeing annual payments to begin at a date certain.

The Redevelopment Agency Can Improve Monitoring by Requesting Additional Information

Legacy Partners' current annual cash flow statements do not show how Legacy Partners uses net cash flow. The lack of debt and equity information impacts the Agency's ability to monitor Legacy Partners' use of annual net cash flow. Legacy Partners provides the Agency with annual net cash flow reports. However, since the 2003 financing change, Legacy Partners has the ability to add Preferred Developer Equity and make certain refinancing decisions on the Bank of America loan without Agency approval. The reports Legacy Partners currently submits do not include information regarding the debt and equity balances and annual changes resulting from generated cash flow. As a result, the Agency may not be kept fully aware of the current status of debt and equity obligations or how Legacy Partners is using cash flow to pay down these obligations. Although this information is not required by existing agreements, we recommend the Agency request Legacy Partners provide this information with its annual cash flow reports.

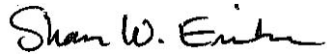
We recommend the Redevelopment Agency:

Recommendation #1:

Address the income and expense findings with Legacy Partners, and request that Legacy Partners provide additional reporting information to show debt/equity balances and annual changes resulting from net cash flow. (Priority 3)

Recommendation #2:

If Legacy Partners proposes a new subordination agreement, the Agency, in its staff report and memoranda to the Board, should fully analyze and evaluate the impact and implications of further subordination and present possible alternatives that could increase the likelihood the Agency recovers its investment. (Priority 3)



Sharon W. Erickson
City Auditor

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0704M

cc: Harry Mavrogenes Sydney Chui
Debra Figone Peter Larko
Deanna Santana Tom Murtha
Abe Andrade

THE REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

MEMORANDUM

TO: SHARON ERICKSON CITY AUDITOR	FROM: HARRY S. MAVROGENES EXECUTIVE DIRECTOR
SUBJECT: SEE BELOW	DATE: FEBRUARY 10, 2010

SUBJECT: THE AGENCY'S RESPONSE TO THE CITY AUDITOR'S
MEMORANDUM ON THE REVIEW OF THE LEGACY AT MUSEUM
PARK DISPOSITION AND DEVELOPMENT AGREEMENT

BACKGROUND

In January 2008, the Redevelopment Agency of the City of San Jose (Agency) requested that the City Auditor audit the Disposition and Development Agreement (DDA) for the Legacy at Museum Park project for compliance with its agreement and to ensure that the Agency received all revenues that it was entitled to receive. In accordance with the Agency's request and the City Auditor's 2009-10 Workplan, the Auditor's Office completed its review of the DDA and on January 8, 2010, presented its summary report and findings to the Agency.

ANALYSIS

The Agency reviewed the City Auditor's memorandum and based on its review, concurs with the report and its findings. The Agency plans to forward a copy of the final audit report to Legacy Partners so that it may address the income and expense findings from the report. Agency staff will also request that Legacy Partners provide additional reporting information to show debt/equity balances and annual changes resulting from net cash flow going forward.


HARRY S. MAVROGENES
Executive Director

APPENDIX A

DEFINITIONS OF PRIORITY 1, 2, AND 3 AUDIT RECOMMENDATIONS

The City of San Jose's City Policy Manual (6.1.2) defines the classification scheme applicable to audit recommendations and the appropriate corrective actions as follows:

Priority Class¹	Description	Implementation Category	Implementation Action³
1	Fraud or serious violations are being committed, significant fiscal or equivalent non-fiscal losses are occurring. ²	Priority	Immediate
2	A potential for incurring significant fiscal or equivalent fiscal or equivalent non-fiscal losses exists. ²	Priority	Within 60 days
3	Operation or administrative process will be improved.	General	60 days to one year

¹ The City Auditor is responsible for assigning audit recommendation priority class numbers. A recommendation which clearly fits the description for more than one priority class shall be assigned the higher number.

² For an audit recommendation to be considered related to a significant fiscal loss, it will usually be necessary for an actual loss of \$50,000 or more to be involved or for a potential loss (including unrealized revenue increases) of \$100,000 to be involved. Equivalent non-fiscal losses would include, but not be limited to, omission or commission of acts by or on behalf of the City which would be likely to expose the City to adverse criticism in the eyes of its citizens.

³ The implementation time frame indicated for each priority class is intended as a guideline for establishing implementation target dates. While prioritizing recommendations is the responsibility of the City Auditor, determining implementation dates is the responsibility of the City Administration.