

## Surprise accounting goofs accumulate to \$73 million bill

by **Dustin Gardiner** - Dec. 4, 2010 12:00 AM  
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Surprise mismanaged tens of millions of dollars over the past decade and built a glimmering new \$61 million City Hall with funds that were improperly accounted for, according to a city investigation.

Poorly trained finance employees were shuffling money from one account to another to pay for projects the city couldn't afford or should have borrowed money to build, city officials said.

The improper fund transfers depleted an account to upgrade roads, renovate buildings and make other repairs across the city.

Now, Surprise must take out loans from other city accounts to cover shortfalls and come up with nearly \$73 million that was wrongly allocated to build City Hall, police and fire headquarters, recreation facilities and other projects.

The city's new chief financial officer, Scott McCarty, said the problem centered on the city's handling of impact fees, one-time levies paid by builders to fund infrastructure for new construction.

Because Surprise needed a larger city hall to support a growing population, it assessed an impact fee intended to cover more than half of the cost of the building. But then, the city paid for the entire building from other

accounts.

It's illegal under Arizona law for cities and towns to charge an impact fee and not use the money for listed improvements.

Money collected was, for the most part, spent on other projects allowed under the fee, but revenue was far less than the amount spent.

McCarty said there appears to have been no criminal intent behind the moves, just shoddy accounting. Former city managers and finance officials have been blamed for the missteps.

Connie Wilhelm, president of the Home Builders Association of Central Arizona, said the findings raise red flags. She said the group had concerns about Surprise's use of impact fees several years ago, but staff assured the group that everything was fine.

"We're very surprised to hear all of a sudden that there are these issues now," Wilhelm said. The association will ask to meet with Surprise officials to discuss what happened.

The blunder is the latest financial

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embarrassment for Surprise, which last year came under scrutiny from the City Council after its finance department overpaid severance to 21 former employees and made a budgeting error that created a \$4.5 million shortfall.

The most recent mistakes were uncovered in the spring after city officials became suspicious about accounting discrepancies and hired an outside firm to investigate.

### Impact fees misused

What they found was startling. From 2000 to 2009, Surprise repeatedly moved millions of dollars from one bank account to another, sometimes regardless of what project they had been earmarked for, according to city officials. The fund transfers were rarely recorded.

McCarty said the questionable transfers could have jeopardized the city's impact-fee program and, if not corrected, could have forced the city to lower its fees or pay money back to developers.

Cities that charge impact fees operate under a "growth pays for growth" policy, meaning that taxpayers should not have to shoulder the cost of bringing utilities, roads and other services to new neighborhoods.

With its City Hall complex, Surprise deviated from that strategy.

The impact-fee fund should have paid for more than half of the project. Instead, city officials pulled money from the capital-improvement fund to pay the entire \$61 million cost.

Capital-improvement funds, which primarily

come from construction sales taxes, are meant to pay for non-growth-related projects that impact fees don't, such as road widening and maintenance, building renovations and other repairs.

The city was allowed to use capital-improvement funds for City Hall construction. But the City Hall was built large enough to handle the city's growth over the next 20 years; therefore, the extra size should have been funded by impact fees.

### Paying for City Hall

The four-story glass-and-stone City Hall, surrounded by courts, fire and police buildings near Bell and Litchfield roads, opened in the summer of 2009. It is a far cry from the cramped, storefront maze of offices that served city employees and residents for many years.

At the time, city leaders boasted that City Hall had been paid for in cash.

"Like hell we did," Councilman Mike Woodard said. "We thought we did, but we didn't. We just borrowed from ourselves to do it."

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Now, council members said, reality is setting in: Money that should have been used for road improvements and other upgrades is gone.

In essence, Surprise spent money it never had. Taking a look at the project's available funds could have meant deciding to scale back, questioning whether the city could afford the City Hall or following the more traditional method of issuing city bonds to supplement impact fees.

Surprise began restructuring its financial division more than a year ago, after the earlier financial mistakes about the severance overpayments and budget shortfall came to light.

It merged the budget and finance departments, hired McCarty as the new chief financial officer and brought in an internal auditor. An outside auditor was also hired to look for irregularities.

More errors were soon uncovered. McCarty and auditors noticed ominous signs earlier this year, including perplexing deficits in impact fees and undocumented transfers among accounts.

McCarty took his concerns to the City Council in April and got approval to hire a consultant to review the city's use of impact fees over the past decade.

The firm's findings were presented to council members during a lengthy closed-door meeting early last month and later were made public during a council session.

McCarty said Surprise must now backtrack to document the accounting moves. The city will create internal loans to be repaid using future impact fees, eventually replenishing

depleted funds.

He said the city is not trying to determine who was at fault. High-level employees who oversaw the misuse of impact fees, including the former finance director and past city managers, no longer work for the city.

"I think when something like this happens, it's safe to say everybody could have done a better job," McCarty said.

The mistakes occurred during a period of record-setting growth for Surprise, when the small farming community transformed seemingly overnight.

Its population ballooned from about 30,000 to more than 100,000 in a decade. It also saw the influx of about \$100 million from building permits, construction sales taxes and other sources.

"Money was flowing and nobody was looking far enough into the future to plan for a time when things would get tight," Mayor Lyn Truitt said. "We're just growing up."

Council members said although reforms in the finance department have been

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promising, they plan to push for more safeguards, such as using an outside auditor regularly and having the council ratify transfers among accounts.

"Going forward, we are not going to have blinders on," Vice Mayor Richard Alton said.

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