



# TRANSITION REPORT:

## Key risks for City Council



A report from the Audit Services Division, Office of the City Auditor, City of Portland

July 11, 2013



### Introduction

In 2009, when the last significant Council turnover occurred, we issued our first Transition Report. Because of the recent change in the make up of Council, now is a good time to present our second such review of the major risks the City faces. "Risk" is an important concept and a useful lens through which to view City issues.

Risk is the potential that a chosen action or activity (including the choice of inaction) will lead to a loss or an undesirable outcome. Potential losses themselves may also be called risks.

Portland faces a broad range of risks. Experts say it is important for organizations to assess and to manage this broad notion of risk. Specific risks to City government include legal liabilities and operational risk to City services (like water pipes breaking). General risks to the Portland area include natural disasters and economic conditions. We considered risks from the viewpoint of City government.

Our two objectives in conducting this audit were to:

- a. Determine the City of Portland's current process to assess Citywide risk, identify what City management and Council are doing to manage or accept such risks, and assess the adequacy of the City's risk management practices for Citywide risks.
- b. Identify the major issues facing City government for the next four years.

This audit is not intended to identify all of the potential major risks needing Council and management attention. This audit is one step in assessing and describing the major risks Council may face. We recommend actions City Council should take to mitigate risks. Council members' written responses to our recommendations can be found at the end of this report.

### Key risk areas discussed in this report

- City government lacks formal and Citywide Enterprise Risk Management
- City expenses exceed revenues
- City does not maintain all its major assets in good condition
- City services may not be adequately prepared to withstand a disaster
- City tied to significant pension & debt payments in future years
- City workforce is aging

# City government lacks formal and Citywide Enterprise Risk Management

*“Enterprise Risk Management (ERM) is a systematic approach throughout all functional levels of an organization to continually identify, evaluate and effectively manage real or perceived barriers to the achievement of the organization’s mission (purpose) and strategic goals (objectives).”*

Definition from the State of Oregon website

## Enterprise Risk Management

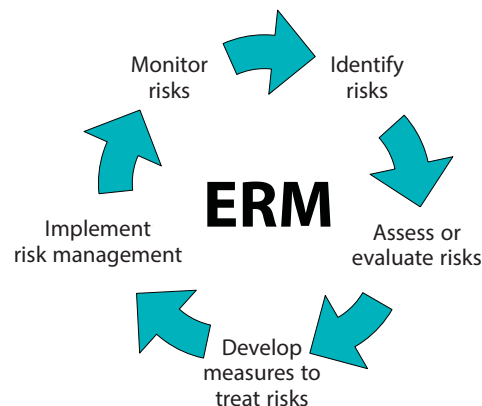
ERM is a relatively recent organizational tool. ERM originated in the commercial world and has been implemented by various government bodies, including Washington state agencies and encouraged by the state of Oregon, among others.

The State of Oregon recognizes several potential benefits of ERM:

- Financial Incentives. Strong ERM practices should increase preparedness before adverse events occur. This helps to minimize operational surprises and losses.
- Enhanced Internal Communications. A consistent ERM vocabulary and methodology may enhance communications across the organization and promote teamwork.
- Improved Decision Making. Informed strategic choices can be made consistent with the organization’s goals and objectives based on a consideration of risks and rewards.
- Enhanced Partnerships. ERM processes may highlight opportunities for working across the organization on providing integrated responses to multiple risks and ways to seize opportunities.

The Government Finance Officers Association, as best practice, recommends “that governments develop a comprehensive risk management program that identifies, reduces or minimizes risk to its property, interests, and employees.” This best practice says the following steps should be included in an effective risk management program:

- Identify risks
- Evaluate risks
- Develop measures to treat risks
- Implement and finance risk management
- Monitor risk management



Source: Audit Services Division, adapted from GFOA Best Practice: Creating a Comprehensive Risk Management Program (2009), and the State of Oregon website

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## City of Portland takes a piecemeal approach to assessing and managing Citywide risk

The City has developed processes to address some forms of risk and to alert Council to them, but there is no formal Citywide ERM.

- Risk Management Division (“City Risk”), in the Office of Management & Finance (OMF), deals mainly with workers compensation and tort liability claims. City Risk processes claims and tries to prevent claims through communications with the other City bureaus. City Risk handles specific types of risk, mostly related to people, including auto liability and occupational health and infectious disease. City Risk’s activities do not cover Portland Development Commission (PDC). According to management, City Risk is one element of ERM for the City. However, the City Risk division is not conducting ERM for the City, nor was it given this responsibility.
- City Risk’s specific duties are in addition to the responsibility of every City manager, including elected officials, to assess and manage risk in all City operations.
- Portland Bureau of Emergency Management – When we audited PBEM in 2010, we recommended the Bureau complete a Citywide risk assessment that includes an evaluation of threats, vulnerabilities, and internal weaknesses. Since then, PBEM has completed the Natural Hazards Mitigation Plan 2010 (required by federal law) which City Council adopted in December 2010. This is a risk assessment for one type of risk. It is not an assessment of the many different types of risk facing the City, such as would be done under ERM.
- Annual Debt Report – the City’s second Annual Debt Report for FY 2011-12 was published by OMF’s Division of Public Finance and Treasury in October 2012. OMF published the City’s first Annual Debt Report, for FY 2010-11, following a recommendation in Audit Services Division’s July 2011 report *Portland’s Fiscal Sustainability and Financial Condition: Actions now can reduce risk of future problems*.
- Annual City Asset Report on the condition of most, but not all, of the City’s physical infrastructure is presented to Council during the annual budget process.
- In November 2012, all City bureaus, at the request of the Chief Administrative Officer, contributed materials to a briefing for the Mayor-elect to bring their “significant issues” to the new Council’s attention.
- Annual Budget Process when Council decides how much money each bureau can have from the forecast revenue available for the next fiscal year.
- Technology Oversight Committee was set up by Council to provide independent oversight of the City’s investments in new technology.

# City government lacks formal and Citywide Enterprise Risk Management

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## **Risk:**

*Without effective Enterprise Risk Management to identify, evaluate and develop measures to treat Citywide risks, the City may not be able to contain the costs and consequences of those risks. The City may not be able to continue to provide all of the services it provides if a major Citywide risk becomes a reality.*

The City has assigned certain types of risk to individual bureaus or functions to deal with, instead of dealing with all major Citywide risks holistically. In our 2009 Transition Report we noted, “The City still lacks an overarching mission statement and a clear set of goals and objectives.” Based on our work and interviews for this new Transition Report, Council lacks a firm list of “core services” the City government should provide, which would be the starting point for identifying the risks to achieving the City’s strategic goals.

Portland City Council hears about some risks – sometimes every year – but it does not hear about all the major risks the City government faces, nor does it have a process to systemically assess, rank and manage these risks, and responses to them.

The City is not conducting ERM, and our assessment of the City’s risk management practices for Citywide risks finds these processes inadequate.

The Government Finance Officers Association wrote, “Effective risk management ensures the continuity of government operations.” Without an effective ERM to identify, evaluate and develop measures to treat Citywide risks, the City of Portland may not be able to contain the costs and consequences of harmful or damaging incidents arising from those risks. The City may not be able to continue to provide all of the services it provides to the people of Portland if a major Citywide risk becomes a reality, depending on the nature and severity of that risk.

Meanwhile, Council shares money among bureaus and projects during the year and at the annual budget adoption, without the benefit of a uniform ERM method to rank the risks to the City’s property, services, and employees. Some decisions are made by Council in response to political pressure from the constituents who lobby hardest and loudest. It would benefit the city as a whole for City government to have a transparent ERM policy and process, with a formal way to evaluate Citywide risks to achieving the Council’s objectives in the provision of services.

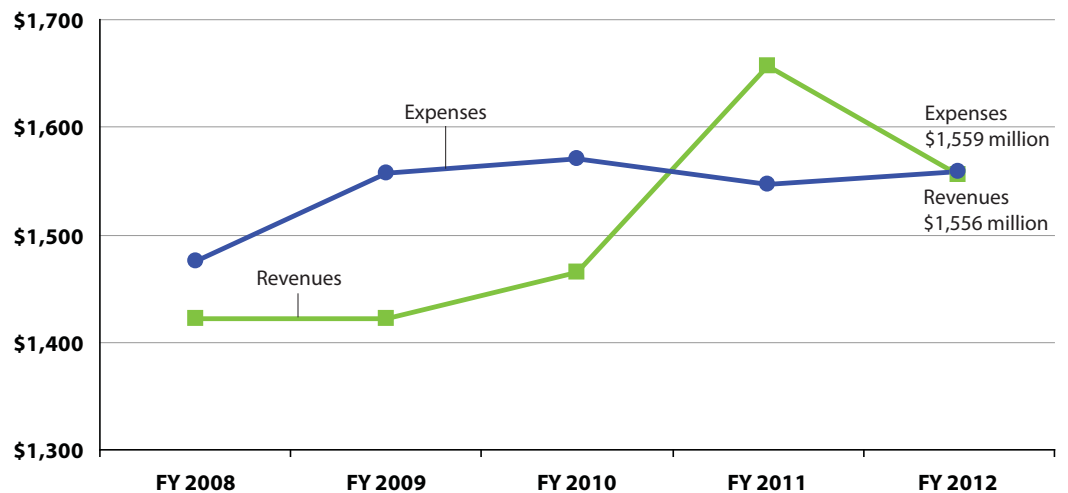
# City expenses exceed revenues

One of the major risks facing the City of Portland is that its expenses exceed its revenues. The City's expenses were more than revenues in eight of the last ten years.

## City revenues and expenses (millions, adjusted)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Total revenues	\$1,421	\$1,421	\$1,464	\$1,657	\$1,556
Total expenses (including PDC)	\$1,475	\$1,558	\$1,571	\$1,547	\$1,559
<b>Total revenues minus expenses</b>	<b>-\$54</b>	<b>-\$137</b>	<b>-\$106</b>	<b>\$110</b>	<b>-\$3</b>

## Gap between City revenues and expenses (millions, adjusted)



Source: Audit Services Division analysis of data from City of Portland, Oregon Comprehensive Annual Financial Report (CAFR), Fiscal Years ended June 30, 2003 through 2012 Government-Wide Statement of Activities.

Common sense says you should live within your means. The City of Portland has not done this in recent years. The City has taken on \$10.3 million in new program additions over the last four years, while making cuts across existing programs. The 2012-13 Adopted Budget included \$7.1 million to help Portland school districts, which are separate taxing entities, and cut \$14.7 million of ongoing General Fund services in order to balance.

Oregon law requires cities to balance the total expenditures and other requirements to the total resources in their budgets. The City is balancing its budget, in part by making cuts to existing programs. However, it is possible to have a balanced budget under local budget law while still having less revenue than expenditures. The City does this by using other resources, such as debt proceeds and opening fund balances. Having a balanced budget does not mean that Portland is living within its means.

# City expenses exceed revenues

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## Risk:

*The City will not have enough revenue to cover its expected costs in FY 2013-14. City bureaus may have to decrease their service levels to the public further in FY 2013-14 and future years.*

## Mitigating actions for City Council

*The Council can mitigate this risk by cutting costs, by increasing revenues, or by some combination of both. City Council is attempting to find new revenue by increasing the land line phone tax and approving paid parking in Washington Park. Costs might be cut by improving the efficiency of operations, and/or by ending some City services. Council should prioritize which services would be cut if that becomes necessary.*

## Reasons for the City's funding problem vary

There are several reasons for the City having insufficient funds for its services, or for the City's expenses exceeding its revenues. In addition to taking on new programs, these reasons include:

- The economic recession – recent economic forecasts suggest that the recovery from the recent recession has started, but will continue slowly.
- Property tax compression.
- The "TIF cliff," reaching the maximum limits on tax increment financing (TIF).
- Declining grants from the federal government.

## Tax compression is expected to increase

All general government property taxes must fit within a limit of \$10 per \$1,000 of real market property value. This includes not only City of Portland taxes, but also Multnomah County, Metro, the Port of Portland, and other taxing districts.

Reductions in real market value due to declining home prices, combined with increases in Portland's Fire and Police Disability and Retirement Fund costs and increased urban renewal debt, have increased compression. In 2010, the City lost \$14 million (adjusted for inflation) to compression. In 2012 the City had over \$23 million in property tax losses due to compression. The November 2012 election created a Library Funding District which now shares compression with other permanent levies in the general government bracket of capped property tax. Therefore, the City's property tax revenue will endure further tax compression in future years, starting with an estimated \$9 million loss in revenue in 2013-14 due to the Library District.

## Tax increment financing is reaching the maximum limit

The City incurs debt to pay for improvements in Urban Renewal Areas (URAs). The debt is repaid from the additional taxes generated from the increased assessed value of properties in the URA. Revenue generated in this way is referred to as "tax increment financing" (TIF). Our recent audit of the City's development agency, PDC, found that real market value of the URAs increased from 1996 to 2010 by almost twice as much as some control areas selected for the audit and the city as a whole. TIF revenue makes up more than 80 percent of PDC's funding.

The City's URAs have finite lives. Three URAs have expired and eight more will expire within the next 12 years. Council's creation of new URAs in FY 2011-12 brought the land used for URAs to 14.26 percent of the City's total acreage. By state law, the City's URAs cannot exceed 15 percent of the land area. So Portland's geographical area has nearly reached its limit to produce TIF revenue. As TIF revenue dries up, PDC and other City bureaus will need to find other funding sources for their projects.

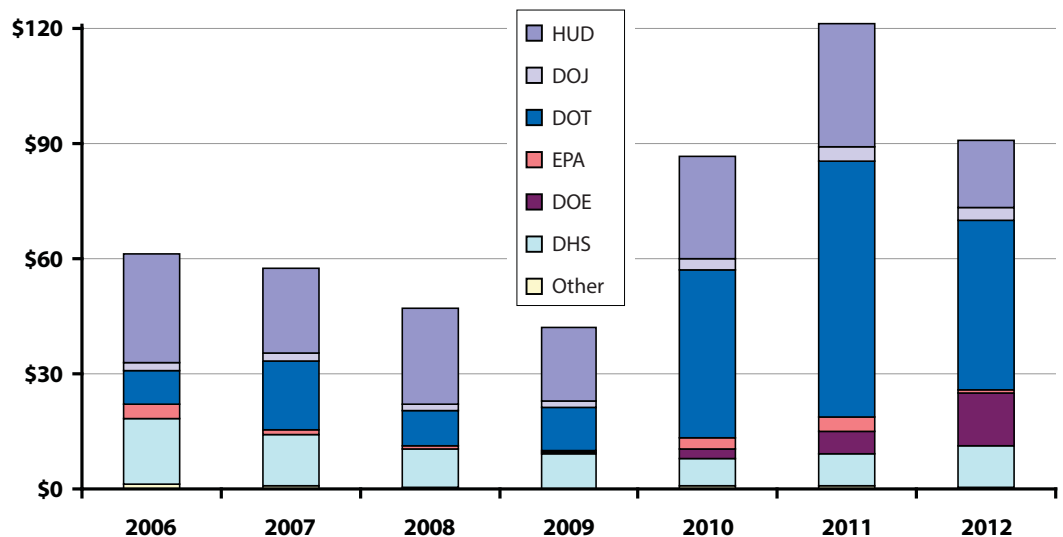
## Grant funding is expected to fall

A large amount of some City bureaus' resources have come from federal grants. These were declining in the years before the American Recovery and Reinvestment Act of 2009 (ARRA). There has been an increase in grant funding in recent years, partly due to ARRA. 37 percent of the City's federal funding in FY 2011-12 came from ARRA grants, but that was the last year for ARRA funding for the City.

Several federal departments provide grant funding to the City of Portland. In FY 2011-12, the U.S. Department of Transportation (DOT) granted Portland \$44 million, 49 percent of the City's total federal grant funding that year. The U.S. Department of Housing and Urban Development (HUD) gave the City \$17 million in FY 2011-12.

The federal government is facing a huge deficit and it needs to reduce spending by \$85 billion in 2013. It would be unwise to expect that the City will receive as much federal grant funding in the future as it has in past years.

### Federal grant funding (millions, adjusted per fiscal year)



Source: Audit Services graph of audited data in the City's Schedule of Expenditures of Federal Awards

## Funding problems continue to reduce City service levels

FY 2012-13 was the fourth year of budget cuts to City bureaus. Bureaus have cut costs, reducing levels of some City services. The cuts to administrative and accounting staff Citywide makes it harder to maintain internal controls and comply with regulatory requirements, according to City managers. The City is not spending enough to fully maintain its infrastructure. The City faces a \$22 million budget shortfall in FY 2013-14.

This funding condition is a difficult situation for the City because the Council will require money to manage or mitigate the City's other big risks.



# City does not maintain all of its major assets in good condition

## Assets in poor condition



Source: Portland Bureau of Environmental Services



Source: Audit Services Division

The City of Portland owns a significant set of assets. Replacement value was estimated to be \$30 billion on June 30, 2012. These infrastructure assets include roads, pipes, treatment facilities, parks, buildings and technology systems. In our 2009 Transition Report, we identified preserving valuable infrastructure as a key challenge for Council. The current state of the City's infrastructure, including the information technology assets, remains a major risk.

Under The Portland Plan, the City needs to actively manage its assets in order to provide reliable and quality basic services. It is City policy to maintain the City's assets and infrastructure in good working order to protect capital investments and to minimize future costs of maintaining and replacing them. It can cost more to repair assets once they have deteriorated or failed than it costs to maintain them in good condition.

However, the City does not maintain all its major physical assets in good condition. For example, according to the City Asset Managers Group, 74 percent of the Water Bureau terminal storage is in poor to very poor condition. In 2009, City Council passed a policy to eliminate paving work on local streets. This meant that approximately 60 percent of the City's pavement system would go without preventive maintenance or rehabilitation. In our recent audit of street pavement practices, we noted that in 2012, the Portland Bureau of Transportation rated 44 percent of all City streets in poor or very poor condition. Significant rehabilitation or reconstruction is needed to return them to acceptable condition.

Other cities in America are facing similar infrastructure problems. Part of the reason for Portland's current infrastructure condition is its age. The average age of the City's water infrastructure is about 75 years old, and some parts of it are 100 to 125 years old. Our past audit of sewer maintenance reported that about 30 percent of the sewer and stormwater collection system pipes were over 80 years old. Age is not the only reason for failing infrastructure. Around World War II, concrete was not readily available. Some of the wastewater pipes were laid using poorer materials, and these pipes can fail before they are 100 years old.

## Mitigating asset management practices

The City Asset Managers Group (CAMG) is made up of asset managers from various bureaus. The participating bureaus strive to follow internationally recognized asset management principles, such as using risk assessment and the need to consider risk mitigation. The Portland Housing Bureau and Portland Development Commission are not participating on CAMG. CAMG prepares an annual report, to provide an overview of the status and condition of most, but not all, of the City's physical infrastructure. CAMG presents this report to Council during the budget process, including an estimate of the annual funding gap.



## The funding gap

An additional estimated \$210 million is needed each year to maintain existing facilities (by repair, rehabilitation and replacement) and meet regulatory requirements. This is the gap between the funding currently available and the funding needed. Despite the annual report of the condition and funding gap for the Citywide infrastructure assets, Council has not stopped the funding gap from growing since our 2009 Transition Report, when the annual funding gap was \$137 million (adjusted for inflation). These funding gap figures ignore the estimated capacity funding gap to establish the same level of service across the City. The latest funding gap excludes PBOT and BES support facilities, and will likely grow for each of the next 10 years.

Lack of funding is cited by managers as a cause of the infrastructure problem. The City does not have the funds available to fix things as they break, and there has been insufficient maintenance of the infrastructure in the past in some bureaus. CAMG reports that Parks and Recreation and the Bureau of Transportation lack a reliable rate base to invest in maintaining their assets adequately, which means levels of service will decline by default. The City's ability to finance its infrastructure needs is a huge risk in itself. City managers say there is a lack of funds for major maintenance and replacement of IT infrastructure, such as the email system.

Sometimes the City turns to debt financing to fund its infrastructure needs. Voters approved a \$72 million bond, in part to cover the cost of replacing the City's obsolete emergency communication system. The City is expecting to issue \$657 million of sewer revenue bonds in the next four years, partly to pay for maintenance of old infrastructure. Portland Parks and Recreation is considering a \$200-\$250 million parks bond in the future to address Parks' deteriorating infrastructure.

When funds do exist, the City sometimes choses to spend on things other than maintenance. Our past audit of sewer maintenance reported that funding for needed preventive maintenance on the sewer and stormwater collection system must compete with other Bureau priorities. Our recent audits of PBOT found that revenues have actually increased in recent years and that inadequate spending on maintenance is due at least in part to spending on other policy choices.

### Risk:

*At current funding levels, some of Portland's infrastructure will continue to deteriorate and bureaus may have to decrease their service levels. The City runs the risk that some parts of its infrastructure will break, which will disrupt delivery of City services such as easy transportation by streets, clean water, and sanitary disposal of wastewater. In its current condition, the City's infrastructure may fare poorly in, and slow down the City's recovery after, a large Citywide event, like an earthquake.*

*In addition, as our recent audit of street pavement shows, the consequence of the City allowing 44 percent of streets to reach poor or very poor condition is that those streets can no longer be maintained or improved at low cost.*



Source: Audit Services Division

*The Portland Plan says that Plan partners, such as the City of Portland, "must make complex choices about how and where to invest in public services. On a daily basis, and over the next 25 years, they must balance maintaining existing public services and infrastructure with bringing new or improved services to underserved and new residents and businesses."*

# City services may not be adequately prepared to withstand a disaster



Damage from 2001 Nisqually Quake, Olympia, Washington

Source: Washington Emergency Management Division

## Risk:

*Without a good, Citywide continuity of operations plan, City bureaus may not be able to provide services to residents during or after a big disaster. The lack of some City services will be mildly inconvenient to the public, but other services provided by the City are life-saving (from the public safety bureaus), life-giving (clean water), and life-sustaining (sewage removal).*

Some of the risks Portland faces are related to a big disaster, which could be a natural event, a health epidemic or another disruptive event. Depending on its type and size, a disaster could cause deaths, severely disrupt City services and paralyze City government.

## A major earthquake is the number one hazard to Portland

The City's 2010 Natural Hazard Mitigation Plan committee ranked an earthquake as the number one threat to the Portland area, due to the potential impact on the city. There are three faults in the earth's crust under the city, each of which can generate earthquakes. City zoning allows for construction on steep slopes and liquefaction areas. Many of Portland's buildings, roads, bridges and utility networks were built before building codes recognized the threat of great earthquakes. The City's infrastructure is insufficiently maintained, and in its current condition may fare poorly in a large earthquake and slow down recovery afterward. A disaster like this could have a devastating impact on the City's ability to deliver services.

## The City does not have a continuity of operations plan

A good continuity of operations plan (COOP) is essential to mitigate the impact "risk" of a disaster. Audit Services' last audit of emergency management reported in May 2010 that the City had no Citywide COOP identifying the priorities for restoring services after a disaster. Some City services relate directly to public health and safety, such as clean water, sewage treatment, police and fire services. City government must be able to resume these services as quickly as possible if they are disrupted.

Audit Services just completed a follow-up audit of the Portland Bureau of Emergency Management (PBEM). The effort to provide an integrated Citywide COOP is still in process. PBEM cannot complete a Citywide plan until all bureaus complete their individual COOPs. PBEM asked bureau directors to ensure their bureau COOPs are done by June 2013, then PBEM plans to spend the next six months producing the City's COOP.



Flood of 1894, at Front and Morrison Streets, downtown Portland, Oregon

Source: Portland Archives and Records Center

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## **The City's information technology (IT) systems are also at risk of a disaster**

### **Risk:**

*In the event of a disaster that destroys the City's data center, the City could be without its finance and payroll systems, remote access and email communications for days or weeks. During this time, City employees will not be able to telecommute and the City will be unable to pay its vendors or its employees.*

The City does not have a funded and defined disaster recovery plan for the City's IT systems. A rigorous IT disaster recovery plan will have a range of costs to implement, depending on how many systems it covers. Bureaus say every system is critical.

According to management, if a disaster destroys the building, or the servers that host the City's data center, the Bureau of Technology Services does not have the ability to recover quickly. The City does not have IT systems ready to continue operations at another site. Depending on how long it would take to rebuild or replace the IT systems, it could be days if not weeks before the City's finance and payroll systems, remote access and email communications are restored. During this time, City employees will not be able to telecommute and the City will be unable to pay its vendors or employees.

The City should rank its systems in terms of priority for those considered most critical. This would enable the City to know the order in which it would restore systems following a disaster and also help to manage user expectations. With the systems ranked, resources could be spent on the most critical systems. This would allow the City to restore at least some operations.

## **The City is working to reduce the impact of a disaster**

City has been taking steps to reduce the impact of a disaster, especially a big earthquake. City Council adopted the updated Natural Hazard Mitigation Plan in December 2010. In April 2012, PBEM produced the City's Earthquake Response Appendix to the City's Basic Emergency Operations Plan. This describes how the City will respond to, and begin recovering from, a strong earthquake. The last fire station seismic rehabilitation was completed in 2012 to allow firefighters and their equipment to effectively respond to an earthquake.

The City now owns a west side emergency operations center, but it is not yet operational. A new emergency coordination center is under construction in southeast Portland. The Portland Water Bureau has constructed the Westside Header pipe in downtown Portland. This project will help keep the water delivery system to the west side of the city working if some of the six Willamette River crossing pipes fail during an earthquake. The Water Bureau is seeking funding to continue planning a project which includes a new pipe under the Willamette, designed to survive a magnitude 9.0 quake. If it gets funding, this project will finish construction in FY 2016-17.

## **More preparation is needed**

To be fully prepared to respond to a disaster, the City needs to plan for, and invest in, steps to mitigate the impact of different disaster scenarios. Doing this will require funds. Since funds are scarce, the Council should rank, in advance, which City services and critical IT support systems will be restored first in a Citywide disaster. This will enable Council to prioritize which disaster preparation steps get the available funds.



# City tied to significant pension and debt payments in future years



Source: Audit Services Division

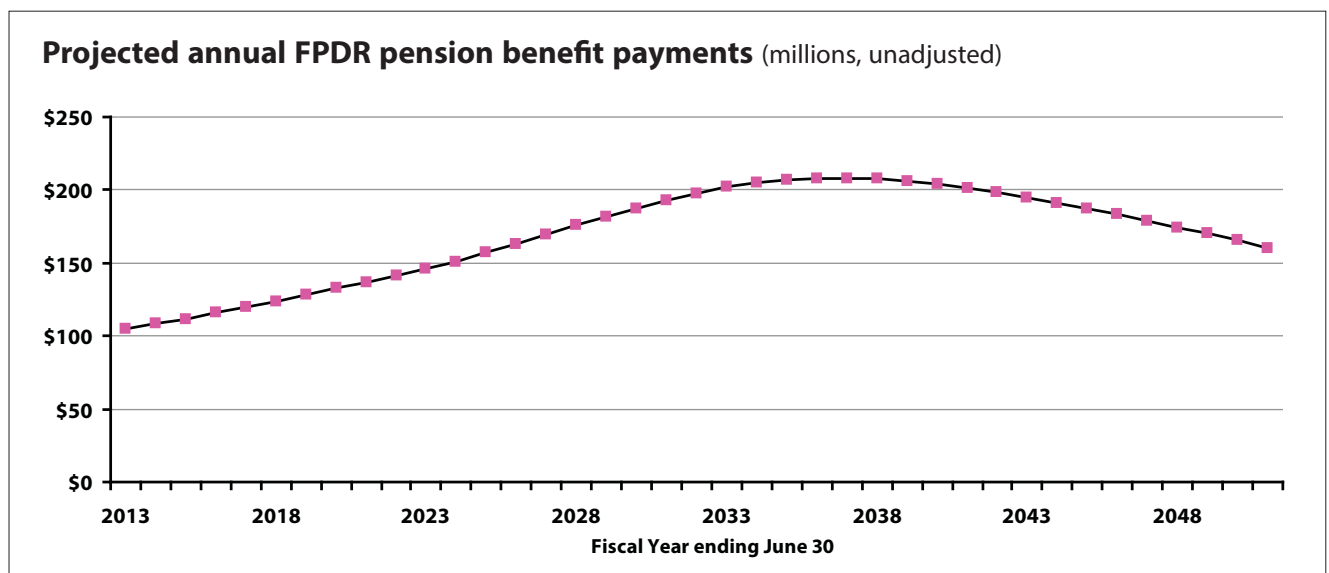
Due to decisions made in prior years by City Council, the state legislature, and Portland voters, the City is obligated to pay large pension and debt costs for many years to come.

## The City has a significant liability for police and fire pensions

As we reported in past audits, Portland's Fire and Police Disability and Retirement Fund (FPDR) was set up in 1948 as a pay-as-you-go retirement system. A pay-as-you-go plan does not set aside funds to pay for future benefits. FPDR must collect sufficient revenues through property taxes each year to pay the annual costs. In 2006, Portland voters approved reforms to FPDR which shifted new sworn police and fire employees' pensions to Oregon's pre-funded pension program, the Public Employees Retirement System (PERS). This change made the FPDR pension system more fiscally sound in the long term.

The projected FPDR pension benefit payments shown below will be funded on a pay-as-you-go basis for FPDR One and Two members and beneficiaries during their retirement years. In addition, the City will be paying the Oregon PERS "OPSRP" program for FPDR Three members, who have their retirement benefits pre-funded during their working years. The FPDR property tax levy will be funding two generations of FPDR members simultaneously until at least 2055.

FPDR's tax levy is subject to the total general government tax limit referred to under Tax Compression in previous pages. Although FPDR increased its tax levy in FY 2012, from \$1.32 to \$1.34 per \$1,000 value, the property tax collected for FPDR decreased by \$4.7 million due to tax compression. There is a 5 percent chance starting in FY 2028, growing to almost a 10 percent chance in FY 2031, that the \$2.80 levy per \$1,000 of property value limit set for this fund by City Charter will not be enough to pay FPDR's total requirement. If that occurs, the difference would be paid out of the City's General Fund.



Source: Audit Services' graph of data from Milliman Actuarial Valuation & Levy Analysis, City of Portland Fire & Police Disability & Retirement (FPDR) Fund, as of June 30, 2012

## City's contribution to PERS will increase

All civilian City employees, and nearly all sworn fire and police personnel hired after December 31, 2006 participate in PERS, the retirement plan for the State and many local governments in Oregon. PERS is a funded retirement plan, which sets aside and invests funds to pay for future benefits. PERS set higher employer contribution rates to make up the plan's 2008 investment loss. In FY 2012, the City's contribution to PERS for general service employees rose from 4.30 percent to 9.30 percent of covered payroll. On July 1, 2013, this rate will increase to 13.74 percent.

### Observation on City debt

*In FY 2011-12, the City paid \$149 million total interest on all City debt in addition to making timely payment of over \$174 million in principal. The City needs to pay more than \$100 million in interest in each of the next six fiscal years. The City will be making debt service payments (interest and principal) on its current level of debt through FY 2036.*

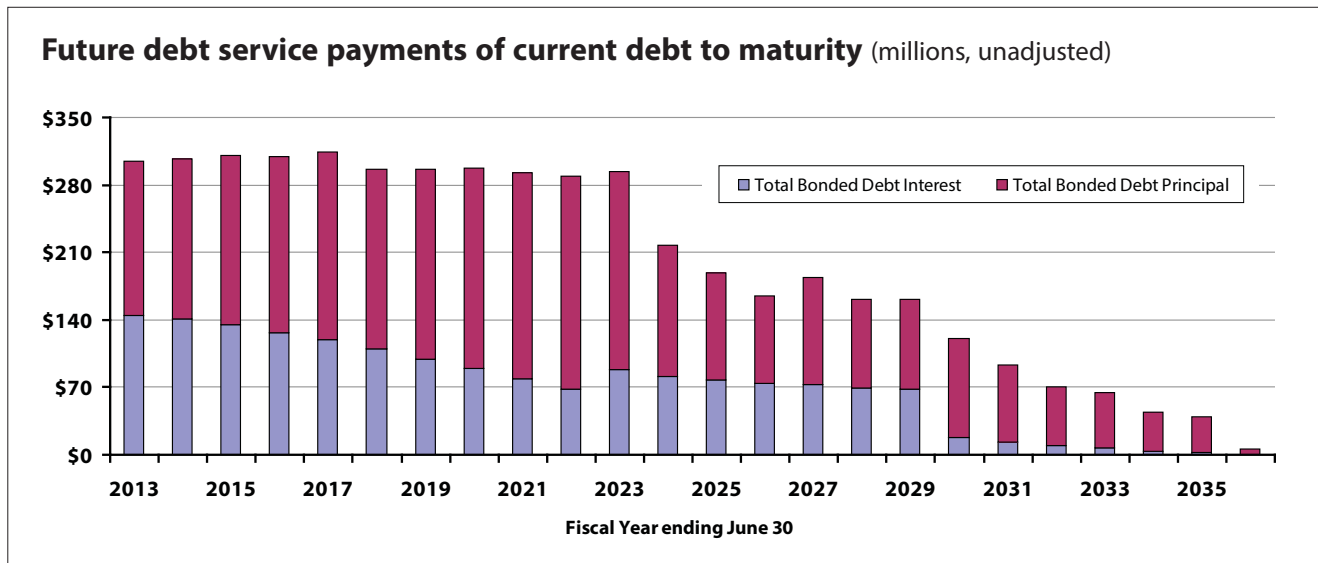
*While the City pays its debt service and its pension costs, it loses the opportunity to spend this money on other needs.*

## Debt repayment will take decades

The City had \$3.2 billion of total debt outstanding as of June 30, 2012. According to OMF, the City uses debt to pay for large capital assets, and spreads the cost over time among all users of a financed asset. Management emphasizes that the City's increased debt has offsetting assets purchased with debt financing. However, 16 percent of the total debt outstanding (\$508 million) was for Urban Renewal and Redevelopment Bonds, which do not directly increase the City's physical assets.

### Risk:

*City Council has less freedom to choose to spend on new projects or services. The City is tied to making these debt and pension payments by contract or law or Ordinance/ballot. If City revenues fall, the Council is more likely to cut to existing services than to default on a debt payment. Defaulting would jeopardize the City's bond ratings.*



Source: Audit Services' graph of data in City of Portland CAFR FY 2012 and Audit Schedules for CAFR

# City workforce is aging

Over the next three years, one-third of the City's workforce will be eligible for retirement under PERS, according to data provided by the Bureau of Human Resources (BHR) and by PDC. For some City bureaus, as shown below, more than half the employees will be eligible to retire within the next three years.

## Employees eligible for PERS retirement within next three years (January 2013)

Bureau / Office	Number of Total Employees	Number of Retirement Eligible Employees	Percentage of Retirement Eligible Employees
Office of Equity and Human Rights	9	5	56%
Bureau of Development Services	192	100	52%
Bureau of Fire & Police Disability & Retirement	16	8	50%
City Attorney's Office	58	26	45%
Office of Management & Finance	619	272	44%
Bureau of Parks and Recreation	385	165	43%
Portland Water Bureau	581	239	41%
Bureau of Environmental Services	513	204	40%
Portland Bureau of Transportation	676	267	39%
Portland Development Commission	125	48	38%
Office of Neighborhood Involvement	37	13	35%
City Auditor's Office	46	16	35%
City Council members and staff	46	16	35%
Portland Housing Bureau	49	15	31%
Portland Police Bureau	1,177	352	30%
Bureau of Planning and Sustainability	103	29	28%
Portland Fire and Rescue	709	180	25%
Bureau of Emergency Communications	132	20	15%
Office of Government Relations	7	1	14%
Portland Bureau of Emergency Management	15	1	7%
<b>Total</b>	<b>5,495</b>	<b>1,977</b>	<b>36%</b>

Source: Data provided by BHR and by PDC; percentage calculated by Audit Services Division.



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## Negative impact of a large number of retirements

A stable workforce with a balance of age groups with different levels of experience will enable the City to work more efficiently, with less disruption to its services. The City is facing the potential loss of institutional knowledge if retirees do not document their knowledge of processes and/or have sufficient overlap time to teach their successors. OMF management fears that the loss of retirees will be felt especially at the higher levels of management. Additional costs to recruit and train replacement employees could come at a time when the City's funding resources are stretched.

A quarter of Portland Fire and Rescue employees and nearly a third of Police Bureau employees will be eligible to retire over the next three years. This will lead to increased payment of retiree pensions in the Fire & Police Disability & Retirement Fund, for which benefits are paid out of property taxes received each year, instead of being pre-funded.

## Some good news about these retirements

Not everyone who can retire will do so as soon as they become eligible. BHR is reporting this aging workforce to bureau directors, and some bureaus started succession planning to replace the retiring staff.

Although 38 percent of the Portland Development Commisison's current staff are retirement eligible, PDC management does not perceive this as a problem. PDC management needs to reduce costs, and they hope that these retirement eligible staff will retire, or will take early retirement. Other City bureaus may, like PDC, use the upcoming retirements to reduce the impact of possible future staff cuts.

### Risk:

*The City could lose more than a third of its workforce in the next three years to retirements at a time when funding may not allow the City to replace all these staff. This could have a large, negative impact on the service levels provided by City bureaus. This negative impact will persist if the retirees' institutional knowledge and their knowledge of business processes are not adequately documented before they leave.*



Police Horse: from 2012 CAFR, Lois Summers

# Recommendations

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Source: Audit Services Division

## City government lacks formal and Citywide Enterprise Risk Management

We recommend that:

- 1. The Mayor and City Commissioners define the core services that the City will provide.**

In this way, risks can be identified and evaluated against the objective of providing these services.

- 2. City Council adopt an ERM policy to study, prioritize and manage risk systematically across the City, in a way that best uses the existing pieces of risk management within the City.**

In this way the Council will be aware of the range of differing, major risks facing the City when Council makes key decisions. The risk management prioritization methodology will require Council to weigh the likelihood of various risks occurring, and the consequences to Portland residents and City employees should they occur, against other risks and demands for City resources. This Transition Report has identified some Citywide risks, but there may be others. For all the major risks identified under a future ERM policy, Council will need to balance the cost of risk mitigation efforts against the cost of inaction.

## City expenses exceed revenues

The Council can mitigate the risk of further cuts to core services by cutting costs, improving efficiency of service delivery, increasing revenue, or by some combination of all these. Therefore, we recommend that:

- 3. Once the Mayor and City Commissioners define the City's core services, the Council should use this list to cut costs where it can by methodically reducing non-core City services.**

City Council could rank core services for prioritized funding by those considered most critical. Council could use results-oriented decision making based on service/program performance data, as recommended in our 2009 Transition Report.

## City does not maintain all its major assets in good condition

If the Council allocates more financial resources to maintain, repair or replace major assets before they break, this will help reduce the disruption of City services provided by these assets. In addition to the current asset management best practices of the City Asset Managers Group, the top levels of City government need to provide more direction to asset management to help mitigate this risk. Therefore, we recommend that:

- 4. City Council require all City bureaus that own or manage infrastructure assets to join the City Asset Managers Group and to establish meaningful asset management programs and practices specific to each bureau's assets.**

- 
- 5. City Council approve funding for some of the funding gap each year, according to a logical criteria compatible with a Citywide risk management policy.**

This will require Council to weigh the funds available to spend on such mitigation efforts each year against the request of the City Asset Managers Group and the bureaus' CIP budget requests. Spending resources to narrow this funding gap is better than doing nothing at all, since assets do not maintain themselves.

### **City services may not be adequately prepared to withstand a disaster**

To be fully prepared to respond to a disaster, the City needs to plan for, and invest in, steps to mitigate the impact of different disaster scenarios. Therefore, we recommend that:

- 6. City Council rank, in advance, the services provided by the City, and the City's IT systems, in terms of priority/those considered most critical.**

Ranking or prioritization of City services by the Council would assist PBEM and the City bureaus to coordinate and integrate their plans. When prioritizing service restoration, Council needs to consider the complex inter-related nature of City services. For example, Fire & Rescue needs water to fight fires, but they also need roads to reach fires. Council could also use criteria such as: first preserve lives, then protect health and safety, etc.

- 7. City Council approve funding of some disaster preparedness work, including plans to recover truly critical IT systems, based on this ranking/prioritization.**

This would allow the City to restore at least some operations in the event of a disaster. With the City services and IT systems ranked, resources could be spent on the most critical services and systems to prepare them for and to restore them first after a Citywide disaster.

### **City workforce is aging**

We recommend that:

- 8. City Council direct the Bureau of Human Resources and PDC's HR Department to regularly inform management across the City biannually about the aggregate number of employees who are or soon will be eligible for retirement.**
- 9. City Council direct the Bureau of Human Resources and PDC's HR Department to work with management on succession planning and assist management to adequately document institutional knowledge and knowledge of business processes before employees retire.**

# Response to the Audit



OFFICE OF MAYOR CHARLIE HALES  
CITY OF PORTLAND

July 1, 2013

Dear Auditor Griffin – Valade,

Thank you for the opportunity to provide comment on the *Transition Report: Key Risks for City Council*. I appreciate the work you have done in assembling this report. I share your concern in mitigating City risk. Together with my Council colleagues, I have taken several steps toward that end, and will continue to take do so throughout my administration.

Though your report covers many important areas of the City's enterprise, I want to highlight a few for particular attention.

First, to be effective, I believe our effort to define the City's core services must begin with delineating City and County responsibilities. I have started this process through discussions with Chair Cogen, other local leaders and community stakeholders. I look forward to clearly identifying the specific services each local government will provide and the role each will play on behalf of our common constituents so the City can move to the next step of ranking/prioritizing those services.

Second, regarding the important issue of revenue shortfalls, we experienced success in this year's foundational budget process by implementing a zero-based budgeting policy. Some version of this approach may be continued in future budget cycles and, when coupled with the projected economic growth, should ensure that spending levels match the reality of City revenues. The council and I will also explore practical methods of generating new revenue to help bridge any gaps where shortfalls persist.

One reason new revenue may be needed is to ensure proper asset maintenance. Indeed, taking care of our current assets is a key element of the back to basics approach of my administration. Almost universally, maintenance is a better investment than replacement. That is why in, for example, the 2013-2014 Transportation Bureau's budget, I prioritized money to repave 100 lane miles of roads throughout our city. A similar effort will continue across many infrastructure bureaus led by my Council colleagues, and I will encourage Bureau directors to view asset maintenance as a long-term cost savings investment tool.

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Finally, I recognize the City's workforce is aging and the financial and operational risks this can pose. That is why I have emphasized succession planning with my Bureau directors. Citywide, the recent Voluntary Retirement Incentive Program the Bureau of Human Resources developed also helped mitigate risks, even while it minimized the need for layoffs in this year's budget. Now, newer hires and younger employees are able to stay on the job and continue to learn from senior staffers, creating a pipeline effect that adds diversity to the workforce while stemming the tide of drastic turnover that would otherwise be caused by larger, future retirements.

Again, thank you for this helpful report for the City of Portland.

Sincerely,



Charlie Hales  
Mayor of Portland



# Response to the Audit



CITY OF  
**PORTLAND, OREGON**  
OFFICE OF PUBLIC SAFETY

COMMISSIONER STEVE NOVICK  
1221 SW 4th Ave. Suite 210  
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July 3, 2013

Dear Auditor Griffin-Valade:

Thank you for completing the "Transition Report: Key risks for City Council." As the newly appointed Commissioner in Charge of the Bureaus of Transportation, Emergency Management and Emergency Communications, risk management and risk mitigation are a top priority for me.

As the Transportation Commissioner, I am committed to seeking adequate funding to maintain our roads, bridges and other transportation infrastructure. As you point out, if we don't act soon with needed investments, we will pay more for significant repairs in the long run. Although additional investments are needed, we are already making progress toward better maintenance. This spring, I joined Mayor Hales in announcing that the City will re-focus on preventive maintenance for city streets, including completion of 100 miles of maintenance projects this year. We are spending money as frugally as possible; for example, we are using a relatively new product, fog seal, to do preventive maintenance on some streets. Fog seal costs between \$7,500 and \$10,000 per lane mile to apply, as opposed to \$100,000 to \$150,000 per lane mile for 'grind and pave' maintenance, or \$1 to \$4 million per lane mile to completely rebuild streets.

However, ultimately we are going to have to increase transportation revenues to meet our maintenance needs. Although, as you say, we could have invested more in street maintenance in the past if we had not spent money on other projects, to a great extent our hands are now tied: we cannot back out of our commitments re: the Sellwood Bridge and Portland-Milwaukie light rail. So we will need to raise more revenue. As you have stated, we would need to spend \$85 million per year – as opposed to our current figure of approximately \$10 million per year – over the next ten years to meet our street condition goals. I have tried to start a conversation with the public about that need by pointing out that although \$85 million per year is a lot of money, people, businesses and other entities spend a total of \$244 million per year in Portland on *car* maintenance and repair.

As the Commissioner of Emergency Management and Emergency Communications, I am working to make sure that these vital emergency responder bureaus are ready to serve the public as needed. As you acknowledge in your recent follow up audit, the Bureau of Emergency Management has made strides in the past two years and now has a multi-year strategic plan that effectively guides our emergency management goals from one week to the next. Thanks to the hard work of staff at the bureau, we have measurably improved coordination among key partners and increased public alert and notification capabilities.

Director Merlo notes that:

- The City's migration to Office 365 is being done in large part to ensure the resilience of email and other systems in a disaster.
- The website PublicAlerts.org administered by PBEM on behalf of the region recently migrated from Portland-based servers to the cloud.
- Key public safety bureaus - including Police and Fire - already have procedures in place to ensure essential services are maintained if a disruption occurs.



I appreciate the fact that you noted that all bureaus were asked to submit Continuity of Operations Plans by the end of June. Most but not all bureaus have submitted their COOPs. I will be working with fellow Council members and the bureaus to remedy this.

I appreciate the fact that you have pointed out in this audit that a major earthquake is the number one hazard to Portland. We and our public and private sector partners need to take action on numerous fronts to improve our level of preparedness. I want to give you a quick summary of a few of the earthquake-specific initiatives Director Merlo and I are pursuing:

- PBEM is looking into partnerships with the private sector to bolster energy and liquid fuel infrastructure lifelines in the NW industrial area.
- The City's new emergency coordination center is designed to be able to function following a catastrophic earthquake.
- BDS has a seismic strengthening program to educate homeowners on ways to better prepare their homes to withstand an earthquake. Clean Energy Works has agreed to add seismic strengthening work to the loan packages they offer for energy efficiency projects. With the assistance of Congressman Blumenauer, we plan to seek FEMA "pre-disaster mitigation" grant funds from FEMA to help pay for at least some home retrofits.
- Director Merlo met with Portland Public Schools to begin to explore the possibility of using those schools designated to be retrofitted (as part of the bond work) as family reunification sites.

As a final note, although I realize this is something of a side issue, I have to take issue with the statement at page 7 of your report that "the federal government is facing a huge deficit and it needs to reduce spending by \$85 billion in 2013." Most rational economists believe that with unemployment still at outrageously high levels, the Federal government should not be reducing job-creating or job-preserving investments at this time. Moreover, the Federal deficit, while still large, is rapidly diminishing. While I agree with your assessment that the City cannot count on continuing to receive as much Federal grant funding as in the past, any reduction in such funding will be the result of political choices in Washington, not based on a "need" to reduce the deficit. Reductions in military spending (of which Oregon receives a miniscule fraction) and restoration of Federal revenues to a normal percentage of the economy, plus innovations to control rising health care costs, can reduce the deficit to manageable levels without reducing the kind of Federal investments the City and its partners have historically received.

Thank you again for providing this analysis. I look forward to working with you and my colleagues as we chart a course toward a more secure future for the City of Portland.

Sincerely,



Steve Novick  
Commissioner  
City of Portland

# Response to the Audit



Commissioner Nick Fish  
City of Portland

July 3, 2013

Dear Auditor Griffin-Valade:

Thank you for the opportunity to respond to the Final Internal Advisory Communication (I.A.C.) of the Transition Report on risks. I appreciate the Auditor's review and analysis of key risks facing the City.

While your report covers a range of risks to the City, it highlights the City's lack of an enterprise management system (ERM). I wholeheartedly agree that the City would benefit from a systemic approach to identify, evaluate and manage risks. Currently, risk assessments are too often made in a piecemeal fashion by individual employees, workgroups or bureaus, without consistent guidelines or clear priorities.

We appreciate your thoughtful recommendations.

Sincerely,

A handwritten signature in black ink, appearing to read 'Nick Fish', is written over a light blue horizontal line.

Nick Fish

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# Response to the Audit



CITY OF  
**PORTLAND, OREGON**

**Dan Saltzman, Commissioner**  
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July 8, 2013

City Auditor LaVonne Griffin-Valade,  
1221 SW 4<sup>th</sup> Ave, Rm 310  
Portland, OR 97204

Dear Auditor Griffin-Valade,

Thank you for allowing me to review the Final Internal Advisory Communication (I.A.C) of your Transition Report on Portland's Citywide risks. I welcome this second Transition Report and agree that the timing is advantageous considering the new Council leadership and portfolio responsibilities.

I have reviewed the report and read with interest the section on the City's responsibilities to cover significant pension and debt payments in future years, particularly as they relate to Portland's Fire and Police Disability and Retirement Fund (FPDR). As you note, the 2006 voter-approved reforms to FPDR did create a more financially sound system in the long term. Still, I remain concerned that the levy's \$2.80 per \$1,000 of property value limit set by City Charter will not be enough to cover the Fund's requirements and put the City's General Fund at risk in the future.

I also agree with your recommendations regarding the need to protect our critical Information Technology infrastructure in the event of a disaster, as well as on asset management and our aging workforce. I look forward to working with you, Council and our staffs to ensure these risk areas are properly addressed.

Thank you again for the opportunity to respond.

Sincerely,

Dan Saltzman

## Scope and Methodology

To accomplish the objectives set out in the Introduction, we interviewed the City Commissioners at the end of 2012, most of the bureau directors and some senior managers of the City. We reviewed audit reports we have issued over the years. During our research, we reviewed relevant literature, including documents relating to Enterprise Risk Management for governments, the City's assets, funding and local budget law. In order to account for inflation, we adjusted to 2012 dollars the prior year dollar amounts, as indicated in this report. In some cases, tables may not add to the exact total due to rounding.

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 objects.

## Who we are, and what we do

The Audit Services Division (ASD) reports to the independently elected City Auditor, and has the mission to promote honest, efficient, effective, and fully accountable City government.

To fulfill its mission, ASD issues public reports recommending improvements to City operations. Since 1984, our Division released nearly 250 reports and special projects containing hundreds of recommendations to bureaus and City Council.

Our mandate to conduct performance audits is included in the City Charter, which also gives audit staff authority to review all records of City operations.

ASD's independence from City Council and other City operations is key to providing valuable, objective information for making operational improvements, and to meet our requirement to follow national government auditing standards.

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*Transition Report: Key risks for City Council*

Report #438, July 2013

Audit Team: Fiona Earle

LaVonne Griffin-Valade, City Auditor  
Drummond Kahn, Director of Audit Services

**Other recent audit reports:**

*Emergency Management: Coordination improved and most essential functions complete*  
(#441, June 2013)

*Portland's Fiscal Sustainability and Financial Condition: Long-term financial position needs attention* (#443, June 2013)

*Portland Development Commission: Records management systems in place, but support and direction needed* (#442, April 2013)

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