

Audit

Follow-up

As of March 31, 2009



Sam M. McCall, Ph.D., CPA, CGFM, CIA, CGAP
City Auditor

Allocated Costs

(Report #0903 issued December 9, 2008)

Report #0918

August 21, 2009

Summary

DMA Budget and Policy has successfully addressed only a portion of the action plan steps due for completion as of March 31, 2009.

In audit report #0903 we noted that, overall, the Department of Management and Administration (DMA) Budget and Policy Section had established a reasonable, appropriate, and logical process for equitably allocating internal service fund costs to benefiting City departments and offices. Several issues were also identified that resulted in less than equitable allocations (charges) of those costs. Those issues primarily pertained to misapplications or misinterpretations of data during the cost allocation process. Because many of those issues offset each other, the final impact on the fiscal year (FY) 2008 budget was not significant to the overall accuracy of the costs allocated for all funds taken as a whole. Nonetheless, there were impacts, ranging from undercharges of \$560,377 to the Water Operating Fund to overcharges of \$328,459 to the Electric Operating Fund.

Nine action steps were developed to address the identified issues, for which six were due for completion as of March 31, 2009. In our follow up we found that the DMA Budget and Policy Section (with assistance from DMA Accounting Services) had completed two of the six steps, and partially completed a third step by:

- Making appropriate adjustments to FY 2008 allocated accounts charges in the City's financial records for the under and overcharges identified in the audit.
- Properly considering transfers from the Special Insurance Reserve Fund in establishing FY 2009 budgeted cost allocations for the Risk Management Fund.
- Properly considering vehicle parts and fuel costs, and activity of the Utility Business and Customer Services function, in development of FY 2009 budgeted cost allocations for the Fleet Garage Operating Fund. (This action pertains to an action step for which other required actions were not completed as described below.)

Actions that were due, but not completed, included:

- Revising the cost allocation process to ensure that allocation statistics are established after correctly considering the actual fund from which costs are paid.
- Providing for an independent review of cost allocation worksheets and work papers for the purpose of identifying logic and other errors.
- Correctly entering all budget determinations from DMA's final cost allocation worksheets into the City's budget database.
- Establishing budgeted costs allocations for the Fleet Garage administrative function

on the most appropriate allocation basis; i.e., proportional share of total City vehicles. (This incomplete action is part of an action step for which other required actions were completed as described above.)

Not completing these action plan steps resulted in several significant errors being repeated in the FY 2009 cost allocation process. If not corrected for FY 2009, those reoccurring errors may result in significant under and overcharges of FY 2009 internal service fund costs to benefiting City departments and offices. Further analysis by DMA Budget and Policy would be necessary to ascertain the actual impact of these reoccurring errors on the FY 2009 cost allocations.

Accordingly, we recommend that DMA Budget and Policy evaluate whether further analysis is warranted. If such analysis is warranted and performed, DMA should correct the FY 2009 cost allocations for any significant under and overcharges resulting from the reoccurring errors. In addition, DMA should take actions to ensure similar issues are not repeated in cost allocations for subsequent years.

We appreciate the assistance and cooperation of DMA staff during this follow-up process.

Scope, Objectives, and Methodology

We conducted this audit follow-up in accordance with the International Standards for the Professional Practice of Internal Auditing and Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit follow-up 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 follow-up objectives.

Report #0903

The scope of report #0903 included a review of the allocation of costs, for 10 City internal service funds, to City departments and offices benefiting from the services accounted for in those funds. The audit focused on the establishment of budgeted allocated costs, and the actual charges of those costs, for FY 2008. The audit also addressed annual adjustments for differences between budgeted and actual costs and service levels.

Report #0918

This is our first follow-up on action plan steps identified in audit report #0903. The purpose of this initial follow up is to report on the progress and status of efforts to complete action plan steps due for completion as of March 31, 2009. To determine the status of the action plan steps, we interviewed staff, made observations, and reviewed relevant documentation.

Background

Costs for the following 10 City internal service funds are charged to benefiting City departments and offices through the City's cost allocation process (also known as "allocated accounts").

1. Information Systems Fund
2. Accounting Fund
3. Purchasing Fund
4. Human Resources Fund
5. Revenues Fund
6. Risk Management Fund
7. Utility Services Fund
8. Fleet Garage Operating Fund
9. Wholesale Energy Services Fund
10. 800-MHz Communications Fund

(Effective FY 2009, costs accounted for in the recently created Environmental Fund are also charged to benefiting City departments through that process.)

For FY 2008, total costs budgeted and charged through the allocated accounts process totaled approximately \$61 million.

Cost are allocated and charged based on recent activity (or service levels) and costs. For example, activity and costs during FY 2007 were used as the basis for establishing budgeted costs allocations for FY 2009 (i.e., at the time the FY 2009 budget was prepared, the most recent year for which complete information was available was FY 2007).

Allocation bases (or statistics) are developed for the purpose of ensuring reasonable, equitable, and efficient allocations to benefiting City departments and offices. Allocation bases, or statistics, vary widely and include, for example:

- Staff efforts spent on specific activities or services.
- Relative number or amount of transactions or items processed, installed, assigned, issued, or maintained.
- Actual usage and activity (i.e., when known).

DMA Budget and Policy staff create numerous, complex worksheets and work papers to assist in the establishment of each year’s budgeted cost allocations.

For the most part, charges are based on the budgeted amounts. Year-end adjustments are generally made to address any differences

between budgeted and actual costs within the respective internal service funds.

Previous Conditions and Current Status

In report #0903, we noted that, overall, the DMA Budget and Policy Section has established a reasonable, appropriate, and logical process for equitably allocating internal service fund costs. Several instances were also identified that resulted in less than equitable allocations (charges) of those costs. Those instances were primarily attributable to misapplications or misinterpretations of data during the cost allocation process. Because many of those instances offset each other, the final impact on the fiscal year (FY) 2008 budget was not significant to the overall accuracy of the costs allocated for all funds taken as a whole. Nonetheless, there were impacts, ranging from undercharges of \$560,377 to the Water Operating Fund to overcharges of \$328,459 to the Electric Operating Fund. Recommendations were made to address the identified issues.

Nine action plan steps were developed to address the identified issues and audit recommendations. Of those nine steps, six were initially due for completion as of March 31, 2009. Table 1 that follows provides a summary of those six action plan steps and their current status.

**Table 1
Action Plan Steps from Audit Report #0903
Due as of March 31, 2009, and Current Status**

Action Plan Steps Due as of March 31, 2009	Current Status
Ensure accurate and complete cost allocations	
<ul style="list-style-type: none"> • Cost allocation statistics will be established based on the actual fund from which costs will be paid. 	<p>x Not Completed. In the initial audit, we found certain cost allocation statistics were incorrectly established on the premise that specific software costs (as well as some debt service costs) were paid by the Accounting, Human Resources, Utility Services, and/or Revenues Funds. Those costs were actually paid by the Information Systems (ISS) Fund. That incorrect premise resulted in inappropriate allocation statistics. Those inappropriate statistics resulted in significant under and overcharges of internal service fund costs to benefiting City</p>

	<p>departments and offices. Not considering impacts of other issues, those under and overcharges exceeded \$500,000 for some funds, including the General Fund.</p> <p>In our follow-up fieldwork, we found that DMA Budget and Policy staff partially addressed this issue in the FY 2009 cost allocations. Specifically, DMA cost allocation “worksheets” were revised to show the applicable software and debt service costs as being paid by the Accounting, Human Resources, Utility Services, and Revenues Funds. Notwithstanding, the applicable software and debt service costs continued to be budgeted in and paid by the ISS Fund. As a result, there will continue to be under and overcharges of allocated account costs (and revenues) within the respective funds in FY 2009.</p> <p>We acknowledge that the annual adjustment process should identify the resulting under and overcharges. However, as adjustments to address those under and overcharges are done using “composite statistics” developed for each fund and not the unique statistics pertaining to the software and debt service functions, the annual adjustment process will likely not result in equitable adjustments.</p> <p>We recommend that DMA evaluate whether further analysis is needed to ascertain the impact of this reoccurring error. If such analysis is warranted and performed, DMA should correct the FY 2009 cost allocations for any significant over and under allocations. In addition, for FY 2010 and future years, DMA should establish applicable statistics based on the actual fund from which costs will be paid.</p>
<ul style="list-style-type: none"> • DMA will provide for an independent review of cost allocation worksheets and work papers for the purpose of identifying logic and other errors. 	<ul style="list-style-type: none"> x Not Completed. We reviewed the FY 2009 cost allocation process and resulting allocated account charges and revenues to ascertain whether 10 of the more significant allocation errors noted in the initial audit report were resolved. We found that: <ul style="list-style-type: none"> – Five errors were repeated in FY 2009. – Two errors were partially repeated in FY 2009. – Three errors were resolved and not repeated in FY 2009. <p>The errors that were repeated in FY 2009 included the following:</p> <ul style="list-style-type: none"> – Incorrectly establishing cost allocation statistics on the basis that certain costs would be paid by a fund other than the fund actually incurring and paying those costs (i.e., as addressed in the previous action step within this table). – Misinterpreting statistics provided by Risk Management staff regarding staff efforts spent on four functions accounted for in the Risk Management Fund (i.e., functions for general liability, vehicle accidents, workers’ compensation, and property loss).

	<ul style="list-style-type: none"> - Incorrectly over-weighting statistics for the property loss function within the Risk Management Fund. - Incorrectly assigning certain premium costs for the workers' compensation function to the general liability function (Risk Management Fund). - Materially overstating certain staff salaries used in development of weighted allocation statistics for the GIS (geographical information system) function within the ISS Fund. - Incorrectly treating certain tax revenues as non-tax revenues in the development of allocation statistics for the Revenues Fund. - Incorrectly treating certain environmental costs that benefit general government activities (funded by the General Fund) as benefiting various enterprise funded activities (Environmental Fund). <p>The reoccurrence of these errors may have resulted in significant inequitable allocations of applicable internal service fund costs. The reoccurrence also is indicative independent reviews were not performed of the FY 2009 cost allocation worksheets and process.</p> <p>Accordingly, we recommend DMA Budget and Policy:</p> <ul style="list-style-type: none"> - Evaluate whether further analysis is warranted to ascertain the impact of these reoccurring errors and, if such analysis is warranted and performed, correct the FY 2009 cost allocations for any identified significant under and over charges. - Provide for appropriate and adequate independent reviews of cost allocation worksheets and processes prepared for subsequent years.
<ul style="list-style-type: none"> • DMA will evaluate the under and overcharges presented in Table 3 of audit report #0903 and make appropriate adjustments to the FY 2008 cost allocation charges. 	<ul style="list-style-type: none"> ✓ Completed. Appropriate adjustments were made by Accounting Services to the FY 2008 allocated account charges for the applicable under and overcharges identified in the initial audit. Those adjustments ensured equitable allocations of internal service fund costs for FY 2008.
<p>Ensure accurate and appropriate “budgeted” cost allocations</p>	
<ul style="list-style-type: none"> • In future budgets (starting with FY 2009), the cost allocation budget for the Fleet Garage Operating Fund will be developed using the most appropriate and complete statistics available from the FASTER System. 	<ul style="list-style-type: none"> ◆ Partially Completed. In the initial audit, we identified three issues that impacted the development of FY 2008 budgeted allocated costs for the Fleet Garage Operating Fund. In our follow-up fieldwork, we found that DMA Budget and Policy addressed and resolved two of those three issues when developing the FY 2009 budget. Specifically: <ul style="list-style-type: none"> - In FY 2009, parts and fuel costs were properly and correctly considered in the development of budgeted cost allocations.

	<ul style="list-style-type: none"> - Activity incurred by the Utility Business and Customer Services function was correctly included and considered in development of FY 2009 budgeted cost allocations. <p>However, as described below, the third issue was not addressed or resolved for FY 2009.</p> <ul style="list-style-type: none"> - In regard to the Fleet administrative function, we found that budgeted costs continued to be established based on the user departments' shares of total fuel billings. As noted in the initial audit, a more appropriate allocation basis is the user departments' proportional share of total City vehicles. In fact, the user departments' proportional share of total City vehicles is the basis for "actual" charges in FY 2009 (as was done in FY 2008). <p>We recommend that subsequent budget determinations for the Fleet administrative function be established using the most appropriate and logical allocation basis.</p>
<ul style="list-style-type: none"> • In future budgets (starting with FY 2009), budgeted transfers to and from the Special Insurance Reserve Fund will be properly considered in the establishment of budgeted cost allocations for the Risk Management Fund. 	<ul style="list-style-type: none"> ✓ Completed. In our follow-up fieldwork, we found that DMA Budget and Policy properly considered transfers from the Special Insurance Reserve Fund in establishing FY 2009 budgeted cost allocations for the Risk Management Fund.
<ul style="list-style-type: none"> • DMA will continue efforts to ensure that budget determinations are accurately entered into the City's budget database. 	<ul style="list-style-type: none"> x Not Completed. We reviewed the FY 2009 cost allocation worksheets and amounts recorded in the City's budget database ("filetran"). We found: <ul style="list-style-type: none"> - Total costs for three of the 11 internal service funds as determined by DMA staff in the final cost allocation process were different from the corresponding amounts recorded in the budget database. The differences ranged from a \$1 million understatement to a \$1.5 million overstatement. The three internal service funds were the (1) ISS Fund, (2) Accounting Fund, and (3) Utility Services Fund. - For 25 of the 169 individual cost allocations, the amounts budgeted as revenues in the applicable internal service funds differed from the amounts budgeted as expenses in the funds established for the benefiting entities/programs. In 9 of those 25 instances the differences exceeded \$10,000, and in one instance the difference was \$151,000. <p>In response to our inquiry on this matter, DMA staff indicated that adjustments were made to initially determined amounts on the cost allocation worksheets, but corresponding corrections were not made to the budget database. We acknowledge those differences may not be material from an overall perspective and are likely to be resolved through the year-end adjustment process. However, not correcting the database results in differences in presentations of budgeted cost allocations;</p>

	<p>especially when budgeted revenues and expenses for the same services differ in amounts.</p> <p>We again recommend that DMA continue efforts to ensure that budget determinations are accurately entered into the City's budget database.</p>
--	---

Table Legend:

- Issue addressed in the original audit
- ✘ Issue not addressed and completed
- ✓ Issue addressed and completed
- ◆ Issue partially addressed and resolved

Conclusion

As described in Table 1 above, management completed only a portion of the action plan steps due as of March 31, 2009. Not completing some of these action plan steps resulted in reoccurrence of several significant errors (i.e., identified in the initial audit) during the FY 2009 cost allocation process. Those reoccurring errors may have resulted in significant inequitable cost allocations in FY 2009. For example, in regard to the Risk Management Fund, our audit calculations show that, if not corrected, the applicable errors will result in allocation errors ranging from a \$936,000 undercharge to the General Fund to an overcharge of \$2,100,000 to the Electric Operating Fund. (NOTE: Based on audit calculations performed in the initial audit, the under and overcharges noted by this example may be offset, to some degree, by the other repeated errors. For instance, based on the initial audit the other repeated errors may have resulted in significant overcharges to the General Fund, potentially in an aggregate amount greater than the undercharge noted above.)

We recommend that DMA Budget and Policy evaluate whether further analysis is warranted to determine the impact the reoccurring errors had on FY 2009 costs allocations. If such analysis is warranted and performed, corrections should be made to the FY 2009 costs allocations to correct any identified significant under and overcharges. We also recommend DMA strengthen the action plan and independent review processes to ensure that proper allocations are made in FY 2010.

In our final discussions on this matter, DMA indicated consideration was being given to

development and implementation of a new cost allocation process that will be less complex and complicated than the current methodology, and thereby less prone to the type errors identified by our audit. To the extent that such a new allocation process will provide equitable cost allocations, we are supportive of those efforts.

We appreciate the cooperation and assistance provided by DMA staff during this audit follow-up.

Appointed Official's Response

City Manager:

We appreciate the continued work by the City Auditor and audit staff on the internal service fund allocation process. Our objective in the allocation process is to assure that central service costs are apportioned to user departments in a fair and equitable manner, based on reasonable assumptions. The City Auditor's office concurs that the process achieves these goals.

In an effort to increase the accuracy of departmental allocations, the process used by DMA is far more complex and captures far more cost elements associated with each service than a majority of other governments. The complexity of the formulas used, although leading to greater accuracy in determining proper cost allocations, unfortunately also allows for greater probability of errors. Compounding this issue is the fact that this process must occur in a relatively short time frame toward the end of each budget development process. A single change in any allocation causes changes throughout every part of the budget and therefore, unless material, changes are impractical and difficult to make at that point. Given that

fewer staff are now available to develop and monitor this process, management is considering changing the methodology for FY11 or later by either using fewer data elements in the allocation model or by incorporating some or all of the central services in the cost allocation plan. This would be comparable to the way most local governments handle allocations, and will still provide a fair and reasonable method of distributing costs that can be completed with considerably less staff time.

In the original report, the auditor pointed out a number of errors, both material and immaterial on an individual basis, but with an overall insignificant impact to the accuracy of the costs allocated. Although the audit report was released subsequent to finalization of the FY09 budget, budget staff worked with audit staff prior to release of the report to correct some of the errors contained in the report for FY09 and also later with Accounting Services to make year-end adjustments for FY08 as recommended. With the exception of the fleet garage allocation issue, DMA, Budget and Policy, will continue to work on the remaining five items to assure that corrections are made or the process improved, as may be appropriate for the FY10 budget. For the

Fleet allocation, as with all of the allocations, DMA will continue to review allocation statistics to assure that those selected result in a fair and equitable distribution of costs. Also, as recommended in the follow-up report, we will evaluate whether the benefits of correcting the errors noted in the follow-up report warrant the extensive amount of staff time required to make these changes.

We recognize the amount of work put into this report by the audit staff and appreciate all of their efforts to help us make improvements in the quality and accuracy of the allocation process.

Copies of this audit follow-up #0918 or audit report #0903 may be obtained from the City Auditor's website (<http://talgov.com/auditing/index.cfm>) or via request by telephone (850 / 891-8397), by FAX (850 / 891-0912), by mail or in person (Office of the City Auditor, 300 S. Adams Street, Mail Box A-22, Tallahassee, FL 32301-1731), or by e-mail (auditors@talgov.com).

Audit follow-up conducted by:
T. Bert Fletcher, CPA, Sr. Audit Manager
Sam M. McCall, Ph.D., CPA, CGFM, CIA, CGAP, City Auditor