

Final Audit

Follow-up

As of March 31, 2010



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

Allocated Costs

(Report #0903 issued December 9, 2008)

Report #1017

June 7, 2010

Summary

DMA has successfully completed most of the actions necessary to address the issues identified in our audit of allocated costs. Responsibility for ensuring completion of the few remaining actions is turned over to management.

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.

In addition to those issues resulting in allocation errors, we identified certain areas during the audit for which we recommended improvements to enhance the existing allocation process.

Nine action steps were developed to address the identified issues and areas. In our follow up reviews we found that DMA Budget and Policy (as well as DMA Accounting Services) has, for the most part, completed those nine action plan steps. Significant actions completed during the current follow up period included:

- Applicable allocation statistics were properly established based on the actual fund from which costs are paid.
- DMA staff obtained proper understandings and interpretations of applicable allocation statistics submitted by City departments and offices.
- DMA conducted appropriate independent reviews of cost allocation worksheets and work papers to ensure most identified errors were corrected.
- Several enhancements to the cost allocation process were implemented.
- Budget determinations were accurately entered into the City's budget database.

Other significant actions completed during the prior follow up period included:

- Appropriate adjustments were made to FY 2008 allocated accounts charges in the City's financial records for the identified under and overcharges.
- Transfers from the Special Insurance Reserve Fund were properly considered in establishing budgeted cost allocations for the Risk Management Fund.

- Vehicle parts and fuel costs, and activity of the Utility Business and Customer Services function, were properly considered in development of budgeted cost allocations for the Fleet Garage Operating Fund.

While DMA has successfully resolved most of the issues and other areas, we noted the following items still need to be addressed:

- Correct development/application of statistics provided by the Risk Management such that:
 - Statistics developed for allocation of property insurance premiums are correctly applied only in the development of allocation statistics for the property management function.
 - Insurance premium costs for the workers' compensation function are correctly treated as applicable to that function.
- Correct allocation of environmental costs applicable to general government activities to the City's General Fund and not to enterprise-funded activities.
- Budgeting cost allocations for the Fleet Garage administrative function on the most appropriate allocation basis (i.e., budgeted allocations are based on the departments' proportional share of total fuel billings while actual allocations are based on each department's proportional share of total City vehicles).
- Commence completion of annual analysis to determine if additional year-end adjustments are needed based on changes in annual service levels in relation to changes in annual internal service fund costs.

DMA management and staff indicated their intent to address and implement those remaining items during the FY 2011 budget process. Accordingly, those remaining items are turned over to management for their resolution and completion.

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 #1017

This is our second and final follow-up on action plan steps identified in audit report #0903. In our initial audit follow up we reported on the status of all action plan steps due for completion as of March 31, 2009 (audit report #0918). The purpose of this final follow up is to report on the progress and status of efforts to complete action plan steps due for completion as of March 31, 2010 (comprised of (1) those steps due for completion as of March 31, 2009, that were not completed by that date and (2) steps not due for completion until after 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.)

In our initial audit, we noted total costs budgeted and charged through the allocated accounts process for FY 2008 totaled approximately \$61 million. For FY 2010, those costs again 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 2008 were used as the basis for establishing budgeted costs allocations for FY 2010 (i.e., at the time the FY 2010 budget was prepared, the most recent year for which complete information was available was FY 2008).

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 plans steps were developed to address the identified issues and audit recommendations. As shown in Table 1 that follows, DMA staff has completed, or is in the process of completing, each of those nine action plan steps.

**Table 1
Action Plan Steps from Audit Report #0903
Due as of March 31, 2010, and Current Status**

Action Plan Steps Due as of March 31, 2010	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>3 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 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 successfully addressed this issue in the FY 2010 cost allocations. Specifically, DMA staff correctly established the allocation statistics based on the actual fund from which the costs will be paid (ISS Fund).</p>
<ul style="list-style-type: none"> • To help ensure accurate and equitable cost allocations, DMA Budget and Policy staff will establish a process to meet with staff of the City departments and offices requested to provide critical allocation data (e.g., statistics and allocation bases). In those meetings DMA Budget and Policy staff will (1) explain the purpose and planned uses of the requested data, (2) ensure a proper, complete, and accurate understanding of the data that is provided, and (3) ensure any significant organizational changes that would impact the cost allocation process are disclosed and understood. 	<p>◆ Proper Actions Initiated and Planned. Based on our follow up review, it was apparent that DMA Budget and Policy staff made a concerted effort to understand the allocation data (statistics and similar data) provided for use in the FY 2010 cost allocation determinations. Furthermore, DMA Budget and Policy management indicated that for FY 2011 cost allocation determinations, staff would meet with all internal service fund departments (i.e., to ensure the best and most appropriate data is submitted and understood).</p> <p><i>Because of the significant corrective actions planned and initiated, this matter is turned over to management for final resolution and completion.</i></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. 	<p>: Mostly Completed. DMA provided for an independent staff review of cost allocation worksheets and work papers for the purpose of ensuring proper logic and accuracy of resulting cost allocations. This was evidenced through our follow up review where we determined that the majority of the significant errors identified during the initial audit had been addressed and corrected during the process of establishing cost allocations for FY 2010. For example,</p>

	<p>the following errors were properly addressed and corrected:</p> <ul style="list-style-type: none"> - Statistics used for cost allocations were established after correctly considering the actual funds from which applicable costs were budgeted and paid. - Statistics provided by the Treasurer-Clerk’s Risk Management section indicating staff efforts on various functions were properly interpreted and applied in developing allocation statistics for the risk management function. - Staff salaries used in developing weighted allocation statistics for the GIS (geographical information system) function within the ISS Fund were correct (i.e., not overstated). - Significant tax revenues were no longer treated as non-tax revenues in the development of allocation statistics for the Revenues Fund. <p>Notwithstanding the independent review and corrections (examples identified above), we did note that those reviews need to be enhanced, as three errors identified in the initial audit were again repeated in the establishment of FY 2010 cost allocations. Specifically:</p> <ul style="list-style-type: none"> - Statistics applicable to and used for cost allocations of commercial property insurance premiums were again incorrectly applied in the development of statistics used to allocate costs of the claims function (general liability, workers’ compensation, and vehicle accident) (Risk Management Fund). - Insurance premium costs for the workers’ compensation function were again incorrectly treated as applicable to the general liability function when developing allocation statistics for those functions (Risk Management Fund). - In developing allocation statistics for the environmental function (Environmental Fund), certain environmental costs that benefited general government activities (funded by the General Fund) were again incorrectly treated as benefiting various enterprise-funded activities. <p>We discussed these three repeated errors with applicable DMA management and staff. They indicated the errors would be corrected in the FY 2011 budget process. We recommend that DMA management enhance subsequent reviews to ensure similar errors do not occur in future cost allocation determinations.</p> <p><i>Because of the significant corrective actions taken to date and management’s stated intent to correct the remaining errors in the FY 2011 budget process, this matter is turned over to management for final resolution and completion.</i></p>
<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 	<p>3 Completed in the prior period as reported in the initial follow up report.</p>

2008 cost allocation charges.	
Enhance the current cost allocation process	
<ul style="list-style-type: none"> • DMA Budget and Policy will review each of the recommended enhancements to the cost allocation process. Those enhancements determined appropriate will be made. 	<p>Mostly Completed. Our review of the FY 2010 budgeted cost allocations showed that DMA Budget and Policy reviewed and implemented several of the recommended enhancements. Specifically:</p> <ul style="list-style-type: none"> – Costs of the Purchasing Fund are now allocated to a third component – the City Purchase Card (P-Card) program. Costs allocated to that component are in turn allocated to benefiting City departments and offices based on their proportional shares of total City P-Card activity. – A portion of City mailroom costs are now allocated to enterprise funded departments (which benefit from mailroom services). – Certain costs previously allocated to the City’s General Fund for commercial property insurance costs are now allocated to the applicable enterprise funded departments that benefit from that insurance coverage. – Three-year claim averages are now used to allocate risk management claim processing costs, instead of using one-year data from the most recently completed year. Use of the three-year averages has the impact of “smoothing” fluctuations in allocated costs from one year to the next. <p>Due to recent organizational changes, other recommended enhancements are no longer appropriate (e.g., those relating to the Municipal Supply Center, or MSC, which ceased to exist as an activity significantly benefiting multiple City departments other than utilities).</p> <p>Based on our discussions, DMA management indicated two of the three remaining recommended enhancements would be implemented in the FY 2011 budget process, and the third recommended enhancement would be reconsidered for implementation. These three enhancements pertain to equitably allocating costs of union contract negotiations between the police and fire departments, allocating administrative costs within Utility Business and Customer Services to each benefiting sub-component, and providing applicable City departments/offices credit for their proportional share of claim recoveries as part of the allocation of claim costs.</p> <p>We commend DMA Budget and Policy for making and/or considering these enhancements. The implementation of the recommended enhancements will/should provide for better and more equitable cost allocations.</p> <p><i>Because of the significant corrective actions taken to date and management’s stated intent to implement and/or reconsider the remaining recommended enhancements in the FY 2011 budget</i></p>

	<p><i>process, this matter is turned over to management for final resolution and completion.</i></p>
<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. 	<p>3 Mostly 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 prior follow-up engagement, we reported DMA Budget and Policy addressed and resolved two of those three issues when developing the FY 2009 budget. Specifically:</p> <ul style="list-style-type: none"> – Parts and fuel costs were properly and correctly considered in the development of budgeted cost allocations. – Activity incurred by the Utility Business and Customer Services function was correctly included and considered in development of budgeted cost allocations. <p>However, as described below, the third issue was not, in our opinion, satisfactorily resolved for FY 2009 or FY 2010.</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 2010 (as was done in FY 2008 and FY 2009). <p>In response to this matter, DMA Budget and Policy stated their intent to revise the allocation process for the Fleet administration function such that budgeted allocations are based on user department’s proportional share of total City vehicles. We recommend this be done during the FY 2011 budget process.</p> <p><i>Because of the significant corrective actions taken to date and DMA’s stated intent to address the third issue, this matter is turned over to management for final resolution and completion.</i></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. 	<p>3 Completed in the prior period as reported in the initial follow up report.</p>
<ul style="list-style-type: none"> • DMA will continue efforts to ensure that budget determinations are accurately entered into the City’s budget database. 	<p>3 Completed. We reviewed the FY 2010 cost allocation worksheets and amounts recorded in the City’s budget database (“filetran”). We found total costs for the 11 internal service funds as determined by DMA staff in the final cost allocation process agreed to the corresponding amounts recorded in the budget database. Additionally, the amounts budgeted as revenues in the applicable internal service funds agreed with the amounts budgeted as</p>

	<p>expenses in the funds established for the benefiting entities/programs.</p>
<ul style="list-style-type: none"> • DMA Accounting Services will monitor changes in annual service levels to determine their significance in relation to changes in annual internal service fund costs. Those reviews will be used to ascertain the necessity and feasibility of making year-end adjustments that address differences in charges that would be appropriate based on current year (actual) service levels. 	<ul style="list-style-type: none"> ◆ Proper Actions Initiated and Planned. DMA management agrees analyses of annual service level changes in relation to changes in annual internal service fund costs are appropriate to determine if periodic adjustments to actual charges should be made. At the time of our audit fieldwork, DMA Accounting Services was beginning the process of collecting prior-year data needed to commence those analyses. <i>Because of the significant corrective actions planned and initiated, this matter is turned over to management for final resolution and completion.</i>

Table Legend:

- Issue addressed in the original audit
- ◆ Actions planned and/or initiated should ensure applicable issues are adequately addressed/resolved; turned over to management for resolution and completion
- 3 Issue addressed and completed
- : Actions taken to date have adequately addressed/resolved the majority of the applicable issues; actions necessary to satisfactorily address remaining issues turned over to management for resolution and completion

Conclusion

As described in Table 1 above, management has completed or is in the process of completing the nine action plan steps developed to address the issues identified in the initial audit. Successful completion of those steps has and will result in better and more equitable allocations of costs to applicable City departments and offices.

We commend DMA for their efforts in addressing the issues. We also recommend DMA Budget and Policy continue their efforts to successfully complete the remaining actions identified in Table 1 above.

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

Appointed Official's Response

City Manager: We appreciate the level of effort provided by the City Auditor and his staff in reviewing and suggesting improvements for this complicated process and are pleased that we have been able to substantially implement the suggested improvements. Our staff will continue to work on implementing additional improvements to assure that the allocation process is fair and equitable for all of our funds.

Copies of this audit follow-up #1017 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