City of Austin

AUDIT REPORT

A Report to the Austin City Council

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Lee Leffingwell

Mayor Pro Tem
Sheryl Cole

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Enterprise Fund Transfers Audit

August 2014

Office of the City Auditor

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REPORT SUMMARY

The Budget Office has established cost allocation plans for the Support Service Fund and the Communication and Technology Management (CTM) Fund. However, improvements are needed to address allocation errors and to fully document the CTM cost allocation plan. Lack of sufficient controls resulted in incorrect allocations of costs to Austin Energy and Austin Water Utility. Additionally, the process of interdepartmental reimbursements does not include procedures to provide documentation to justify the cost of service.

AUDIT NUMBER: AU14105

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GOVERNMENT AUDITING STANDARDS COMPLIANCE

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 objectives.

AUDIT TEAM

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August 2014

Enterprise Fund Transfers Audit

Audit Report Highlights

Why We Did This Audit

This audit was conducted as part of the Office of the City Auditor's (OCA) FY 2014 Strategic Audit Plan.

What We Recommend

The Budget Office should:

- develop, implement, and maintain formal procedures for review of the support services cost allocation plan;
- develop, implement, and maintain a detailed methodology for the CTM cost allocation plan to ensure that costs are allocated to all departments, including AE and AWU, based on level of services received by these departments; and
- develop, implement, and maintain procedures that require departments to support interdepartmental reimbursements with cost estimates or other quantifying documentation.

For more information on this or any of our reports, email oca_auditor@austintexas.gov

Mayor and Council,

I am pleased to present this audit on Enterprise Fund Transfers.

BACKGROUND

The City of Austin has 16 enterprise funds according to the approved budget for FY2013, which account for operations that function similar to private business enterprises. The largest are the Austin Energy (AE) Fund and the Austin Water Utility (AWU) Fund.

The City's Budget Office allocates to departments, including AE and AWU, the cost of internal services funded by the Support Services Fund and the Communications & Technology Management (CTM) Fund. In FY 2013, the Budget Office allocated $18.4 million and $12.3 million, respectively, to AE and AWU for Support Service costs. To recoup the cost of CTM services, the Budget Office allocated $5.8 million and $3.5 million, respectively, to AE and AWU.

City departments may reimburse each other for the cost of certain services, and the Budget Office requires departments making these interdepartmental reimbursements to sign a *Detail Deduction Form* as an agreement between the parties for the service.

OBJECTIVES AND SCOPE

The objectives of the audit were to:

- determine whether the Budget Office has adequately documented the Support Services and CTM cost allocation plans, and confirm whether the plans were reasonable; and
- determine whether reimbursements from enterprise funds to City departments reflect the services provided and benefits received.

The audit scope included the Support Services and CTM cost allocation plans, and their implementation in FY 2013. It also included three interdepartmental reimbursements from enterprise fund departments in FY 2013.

WHAT WE FOUND

The Budget Office has a generally well-documented cost allocation plan for recouping the cost of services provided through the Support Services Fund. However, the FY 2013 cost allocation contained inaccuracies and the Budget Office did not address certain inconsistencies.

The Budget Office does not have a well-documented cost allocation plan for the CTM fund. Implementation of the plan for FY 2013 resulted in incorrect cost allocations to AE and AWU.

The process for interdepartmental reimbursements does not require departments to document and justify the value of services they provide when seeking reimbursements. As a result, AWU and AE may pay for the services that are not provided and that potentially subsidize other departments.

We appreciate the cooperation and assistance we received from the Budget Office, AE, and AWU staff during this audit.

Kenneth J. Mory, City Auditor

BACKGROUND

The City of Austin has 16 enterprise funds according to the approved budget for FY 2013, which account for operations that function in a manner similar to private business enterprises. For fiscal year (FY) 2013, the City budget included $2.2 billion in expenditures and transfers out for its enterprise funds. The City's largest enterprise funds are the Austin Energy (AE) Fund and the Austin Water Utility (AWU) Fund, which together account for $1.8 billion (80%) of the budgeted expenditures and transfers.

The City's Budget Office, a division of the Financial Service Department, is responsible for allocating to departments, including AE and AWU, the cost of internal services provided by other departments and funded by the Support Services Fund and the Communications & Technology Management (CTM) Fund. The Budget Office recoups these costs using the Support Services Cost Allocation Plan and the CTM Cost Allocation Plan. In FY 2013, the Budget Office allocated costs to AE and AWU to recoup the support services costs and CTM costs, as shown in Exhibit 1.

EXHIBIT 1
FY 2013 Support Service and CTM Costs Allocated (Millions)

Cost Allocation Plan	Total Allocated	Allocated to AE	Allocated to AWU
Support Services Fund	$83.5	$18.4	$12.3
Communications & Technology Management	$39.7	$ 5.8	$ 3.5

SOURCE: Cost allocation plans received from Budget Office, January 2014

In addition to the allocations made by the Budget Office, City departments may reimburse each other for the cost of certain services. The Budget Office requires departments that make these interdepartmental reimbursements to sign a *Detail Deduction Form* as an agreement between the parties for the service.

OBJECTIVES, SCOPE, AND METHODOLOGY

The Enterprise Fund Transfers Audit was conducted as part of the Office of the City Auditor's (OCA) FY 2014 Strategic Audit Plan, as presented to the City Council Audit and Finance Committee.

Objectives

The objectives of the audit were to:

- determine whether the Budget Office has adequately documented the Support Services and CTM cost allocation plans, and confirm whether the cost allocations were reasonable; and
- determine whether reimbursements from enterprise funds to City departments reflect the services provided and benefits received.

Scope

The audit scope included the City's cost allocation plans for Support Services and CTM, and their implementation in FY 2013. It also included transfers and interdepartmental reimbursements from enterprise fund departments to City departments in the FY 2013 approved budget. Based on an assessment of risk, auditors limited the scope to the following:

- reimbursements from AE and AWU to Internal Service Funds - Support Services and CTM,

- reimbursements by AE and AWU to the Austin Police Department (APD), and
- reimbursements by AWU to the Austin Fire Department (AFD).

Methodology

To accomplish our audit objectives, we:

- reviewed best practice criteria for cost allocation plans, including from the Office of Management and Budget and the Government Finance Officers Association;
- conducted interviews with management and staff from the Budget Office, the Contract and Land Management Department (CLMD), AE, AWU, AFD, APD, and CTM;
- analyzed the Budget Office's process for allocating costs from the Support Service Fund and CTM Fund;
- tested a judgmental sample of cost allocations considered to be material or assessed as high risk; for the selected sample, which consisted of five services provided by the Support Services Fund and five services provided by the CTM Fund, we performed test work to determine that the cost allocation was accurate, reasonable, and sufficiently documented;
- reviewed supporting documents for a judgmental sample of interdepartmental reimbursements considered material by the auditors and other reimbursements assessed as high risk; and
- evaluated risks of fraud, waste, and abuse and information technology risks relevant to the audit objective.

AUDIT RESULTS

The Budget Office has established cost allocation plans for the Support Service Fund and the Communication and Technology Management (CTM) Fund, as shown in Exhibit 2. However, they can enhance their cost allocation process by improving controls to address certain allocation errors and fully document the CTM cost allocation plan. Lack of sufficient controls resulted in incorrect allocations of costs to AE and AWU.

EXHIBIT 2
Cost Allocation Plans

Cost Allocation Plan	Purpose	Amount Allocated
Support Services Fund	To identify as closely as possible the cost of services that the support or service departments provide to the direct or receiving departments within the City.	$83.5 million
Communications & Technology Management	To identify as closely as possible the cost of services that the other City departments receive from CTM.	$39.7 million

SOURCE: Cost allocation plans received from Budget Office, January 2014

We also found that the process of interdepartmental reimbursements does not include procedures that require departments to provide documentation quantifying the cost of services. The Austin Energy (AE) and the Austin Water Utility (AWU) reimburse both the Austin Fire Department (AFD) and the Austin Police Department (APD) for the cost of services provided by those public service departments. However, neither the utilities nor the departments have documentation that supports the amounts of three reimbursements that auditors selected for testing.

Finding 1: Although the Budget Office has a generally well-documented Support Services Cost Allocation Plan, stronger controls would help to enhance the allocation's accuracy and consistency.

The Budget Office has a generally well-documented cost allocation plan for allocating the City's $83.5 million cost of support services to 24 departments that receive those services. The cost allocation plan includes documentation of the plan's purpose, a description of the support service costs to allocate, and the method used for allocating the costs.

In addition, auditors reviewed the allocation for FY 2013 and found the allocated amounts tied to the supporting documentation. However, the allocation contained errors related to structural changes in City operations that the Budget Office had not integrated into the plan. In addition, the Budget Office did not address inconsistencies in the way certain enterprise funds categorize budgeted operating expenses. These inaccuracies indicate that the Budget Office needs to improve its process for reviewing the cost allocation data.

Auditors tested the Budget Office's calculations and the supporting documentation used to allocate a sample of 10 costs, totaling $34.3 million, included in the Support Service cost allocation plan. Calculations performed for two of the cost allocation basis contained computational errors, as shown in Exhibit 3.

EXHIBIT 3
Cost Allocation Computational Errors

Cost Allocation Basis	Computational Errors
Departmental Operating Budget	Auditors found that the Budget Office's allocation of 4 out of 10 support service costs was based on the departmental operating budget. However, the allocation did not consider differences in how "operating expenses" are defined in each department's budget. For example, budgeted operating expenses for AWU do not include all the items included in AE's operating expenses. As a result, the Budget Office understated AWU's budgeted operating expenses for the cost allocation plan by approximately $19 million. In addition, the Budget Office counted budgeted conservation rebate expenses twice for both AE and AWU, resulting in overstatements of $19 million and $3 million, respectively, in budgeted operating expenses used for the cost allocation plan. These errors resulted in understating the cost allocation to AWU by $ 8,848 and overstating the allocation to AE by $174,238. The amounts of the errors identified in the sample tested may be insignificant. However, since the same cost basis is used for the allocation of other costs and the Budget Office has used the same process both in prior years and in FY 2014, the cumulative amounts may be significant.
Value of Contracts	Another service cost allocated to departments is the expense of operating the Contract and Land Management Department (CLMD). The Budget Office uses the value of contracts for allocating 40% of the CLMD cost. CLMD provides the value of contracts to the Budget Office. However, for FY 2013, CLMD made an error in computing the value of contracts that resulted in the cost being over-allocated to AE by $109,641 and under-allocated to AWU by $35,898.

SOURCE: OCA review of supporting documents for cost allocation basis received from Budget Office in March 2014

Finding 2: The Budget Office does not have a well-documented Communication and Technology Management Cost Allocation Plan and stronger controls would help to enhance reasonableness of the allocations.

The Budget Office has not sufficiently documented its plan for allocating the cost of services provided by the City's CTM department. In addition, implementation of the plan in FY 2013 led to cost allocation errors related to the level of service received by utility departments.

CTM provides various technology-related services to the City's 35 departments. The Budget Office is responsible for allocating expenses related CTM's services to the receiving departments. However, the CTM cost allocation plan documents do not state the plan's purpose or the methodology for identifying and allocating costs. Instead, the plan consists of various spreadsheets that do not contain sufficient detail to identify the services provided by CTM for allocation to City departments.

Further, auditors found that selected CTM services were not allocated to AE and AWU based on their usage of these services, as detailed in Exhibit 4 below:

EXHIBIT 4
CTM Services in Cost Allocation

CTM Services	Auditor Observations
PC Refresh and Microsoft Software License Agreement	CTM provides these services to General Fund departments. The utility departments use their own resources and do not rely on CTM for these services. However, the Budget Office allocated the cost of these services to the utilities in FY 2013.
Help Desk and PC Lifecycle Management	CTM provides these services to General Fund departments. The utility departments use their own IT staff and do not rely on CTM for these services. However, the Budget Office allocated the CTM cost of these services to the utility departments.
Voice Over Internet Protocol (VOIP):	AE uses its own Information Technology staff to maintain voice mail and does not rely on CTM for those services. AWU uses CTM services for this to a limited extent; however, the Budget Office allocated CTM costs for these services to both utilities on the same basis used to allocate the costs to General Fund departments.

SOURCE: OCA analysis based on information obtained from the Budget Office, CTM, AE, and AWU during the course of audit

These allocation errors indicate that the Budget Office needs to identify and document usage of CTM services by AE and AWU for allocation.

For cost allocation plans, organizations should have a process whereby these central service costs are identified and assigned to receiving departments on a reasonable and consistent basis. Further, a written narrative documenting the cost allocation methodology should be developed and maintained. The Budget Office stated that they were assigned the responsibility for administrating the CTM cost allocation plan in FY 2013 and there was no documentation available from CTM for the plan at that time.

Finding 3: The Budget Office's process for interdepartmental reimbursements does not require departments to provide documentation quantifying the cost of services.

AE and AWU reimburse both AFD and APD for the cost of services provided by those public service departments. However, neither the utilities nor the departments have documentation that supports the amounts of all three reimbursements OCA selected for testing. In addition, the amounts of the selected reimbursement are not based on cost estimates or other documentation quantifying the cost of the provided services.

The City's Budget Office requires City departments that reimburse other departments for services to prepare and sign a *Detail Deduction Form* as an agreement between the parties for the service. However, the form does not include supporting documentation quantifying the cost and level of the services. As a result, AWU and AE may pay for the services that are not provided and that potentially subsidize other departments. Conversely, AWU and AE could be receiving more services than they are paying for.

Reimbursement by AE and AWU to APD for Homeland Defense

Beginning with FY 2002, AE and AWU have reimbursed APD annually for expenses related to homeland defense. A City Ordinance[1] mandated FY 2002 reimbursement amounts of $903,764 and $1,355,647 to APD from AE and AWU, respectively. Although the original ordinance only pertained to FY 2002, the departments have continued paying the annual reimbursement. The amounts paid were reduced in subsequent years, though without documentation justifying the reductions.

APD has not provided documentation to justify the cost of services provided to AE and AWU. Moreover, APD has asserted that it does not track the time devoted by officers to providing services to the utilities. An APD memo to AE and AWU dated April 28, 2011 states that "The department realizes that the disbursement of dedicated unit throughout the department may have caused some concerns; however, the department continues to provide security patrols to the municipal utility facilities through both directed and regular patrol as per the agreement. Officers also continue to be available to respond immediately to alarm calls from any utility site." However, AE and AWU management expressed a belief that services received from APD have been reduced significantly since 2002. Without sufficient documentation of the cost and level of services provided to the departments, there is a risk that the reimbursement amounts may be incorrect, and misunderstandings regarding the services may increase.

Subsequent to OCA's initiation of this audit, the Budget Office decided to eliminate the expense reimbursement from AE and AWU for homeland defense from the FY 2015 proposed budget.

Reimbursement by AWU to AFD for Hazard Mitigation

AWU reimburses $445,000 to AFD annually for costs related to hazard mitigation. According to AFD, the Department helps prevent contamination of City water sources by mitigating fuel leaks from auto accidents or other types of hazardous spills. AFD asserts that this service helps AWU comply with Federal Water Regulations without additional equipment or staff.

AFD initially stated to auditors that the Department did not have a study or analysis available to demonstrate how the reimbursement amount was originally determined. However, AFD subsequently provided documentation to support an estimate of $487,624 for the costs of services provided to AWU, based on a five-year average.

Unlike the reimbursement described in the above section, this reimbursement was not established by City ordinance. The amount of the reimbursement has not been reassessed and changed since the 1990s.

Observation: The City may not be able to quantify benefits received by some special revenue funds that receive interdepartmental transfers from AE and AWU.

Interdepartmental transfers from AE and AWU to some City special revenue funds, including the Economic Incentive Fund, Environmental Remediation Fund, and Sustainability Fund are not based on cost studies, estimates, or other quantifying documentation. For these transfers, there is a risk that departments may not be able to quantify the benefits received in utility rate cases.

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[1] Austin City Ordinance No. 20011101-10, November 1, 2001

RECOMMENDATIONS

The recommendations listed below are a result of our audit effort and subject to the limitation of our scope of work. We believe that these recommendations provide reasonable approaches to help resolve the issues identified. We also believe that operational management is in a unique position to best understand their operations and may be able to identify more efficient and effective approaches and we encourage them to do so when providing their response to our recommendations. As such, we strongly recommend the following:

1. **The Budget Office should develop, implement, and maintain formal procedures for review of the support service cost allocation plan.**

   MANAGEMENT RESPONSE: **Concur.** Refer to Appendix A for management response and action plan.

2. **The Budget Office should develop, implement, and maintain a detailed methodology for the CTM cost allocation plan to ensure that costs are allocated to all departments, including AE and AWU, based on level of services received by these departments.**

   MANAGEMENT RESPONSE: **Concur.** Refer to Appendix A for management response and action plan.

3. **The Budget Office should develop, implement, and maintain procedures that require departments to support interdepartmental reimbursements with cost estimates or other quantifying documentation.**

   MANAGEMENT RESPONSE: **Concur.** Refer to Appendix A for management response and action plan.

APPENDIX A

MANAGEMENT RESPONSE

MEMORANDUM

TO: Ken Mory, City Auditor

FROM: Elaine Hart, Chief Financial Officer, Financial Services Department (FSD)

DATE: August 8, 2014

SUBJECT: FSD Management Response to the *Enterprise Funds Transfers Audit Report*

Budget Office staff and I have reviewed the City Auditor's ***Enterprise Funds Transfers Audit Report*** and concur with the Auditor's recommendations.

Cost Allocation Plans
The Budget Office assumed responsibility for preparing both Support Services and CTM Cost Allocation Plans in recent years. Your findings and recommendations validate those we had already identified and enhancements we have made.

The auditor's review of supporting documentation identified that the budget amount used as a basis for a portion of Austin Energy's allocation was overstated by $19 million (2%). This resulted from departments' inconsistent reporting of operating expenses in the fund summaries. Budget Office staff had identified this and in FY 2012-13 implemented a standard reporting method for fund summaries. Likewise, the reporting for value of contracts, used to allocate a portion of Contract Management's costs, was corrected in the FY 2013-14 Plan.

These identified errors resulted in insignificant variances in allocation results. When the restated values for the AE budget and value of contracts were run through the plan, the total change to both AE and AWU was less than 1% of their total annual allocation. While our goal is always to be accurate, I also believe it is important to put the magnitude of the issues in context. Adjustments have been made for both of these findings.

Interdepartmental Reimbursements
During budget development, departments including expense reimbursements from other departments in their proposed budgets are required to submit a *Deduction Detail Form* signed by both parties. This form is written confirmation that both the department receiving the service and the department providing the service acknowledge the cost/reimbursement amount and also understand the nature and extent of the services being provided. In future budgets, the Budget Office will require a detailed cost analysis also be included as backup for the *Deduction Detail Form*.

I appreciate the work of the Auditor's Office on this audit. Your auditor's review of the Cost Allocation Plans was very thorough and provided my office with valuable, timely feedback that we incorporated into the FY 2014-15 Plans. I appreciate the opportunity to provide this response.

APPENDIX A

xc: Marc Ott, City Manager
Assistant City Managers
Deputy Chief Financial Officers
Stephen Elkins, Chief Information Officer

ACTION PLAN

Enterprise Fund Transfers Audit

Recommendation	Concurrence and Proposed Strategies for Implementation	Status of Strategies	Proposed Implementation Date
1. The Budget Office should develop, implement, and maintain formal procedures for review of the support service cost allocation plan.	**FSD management Concurs.** While informal procedures are currently in place for review of the Support Services Cost Allocation Plan, we will develop formal review procedures for the plan used in the FY 2015-16 budget.	Underway	October 1,2014
2. The Budget Office should develop, implement, and maintain a detailed methodology for the CTM cost allocation plan to ensure that costs are allocated to all departments, including AE and AWU, based on level of service received by these departments.	**FSD management Concurs.** The Communication and Technology Management (CTM) Cost Allocation Plan (cost pools, allocation basis) will be reviewed for improvements. Documentation will be developed for the Plan similar to that for the Support Service Cost Allocation Plan.	Underway	April 1, 2015

APPENDIX A

Recommendation	Concurrence and Proposed Strategies for Implementation	Status of Strategies	Proposed Implementation Date
3. The Budget Office should develop, implement, and maintain procedures that require departments to support interdepartmental reimbursements with cost estimates or other quantifying documentation.	**FSD management Concurs.** The *Deduction Detail Form* and instructions for completing the form provided to departments via the *Budget Manual* will be revised to require a detailed cost estimate.	Planned	January 15, 2015