



Audit of Indirect Cost Allocation - #747

Executive Summary

Why CAO Did This Review

Pursuant to Section 5.10 of the Charter of the City of Jacksonville and Chapter 102 of the Municipal Code, we conducted an audit of the City's indirect cost allocation. The indirect cost allocation is utilized by the City's Budget Office and Accounting Division to budget and charge costs incurred by the General Fund/General Services District for the benefit of users. In recent years, there has been debate regarding the amounts allocated to various areas during the City's Annual Budget Hearings; therefore, we felt it was important to audit the study to gain a better understanding and identify any potential issues.

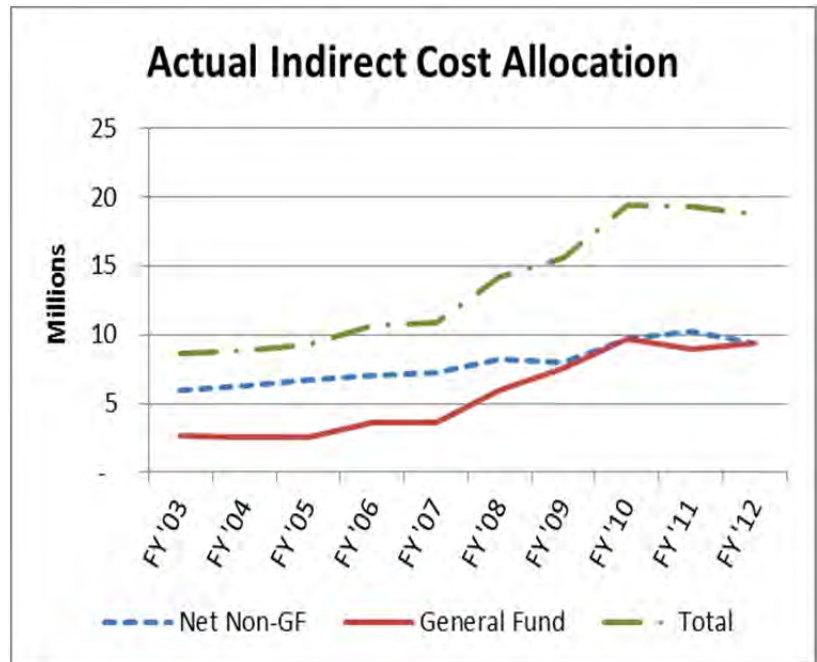
What CAO Recommends

We recommend that the Budget Office establish a set of standard policies and procedures as it relates to the preparation and use of the indirect cost studies. In preparing these policies and procedures, the Budget Office needs to analyze the need for certain areas to be included and consider the use of other cost recovery methods. This could result in users having a better understanding of the indirect cost allocation charges.

What CAO Found

Overall we found that the indirect costs budgeted and actually charged to Departments were supported and the basis for the calculations was reasonable; however, we did note an overall lack of management oversight which contributed to numerous issues that need to be addressed going forward. Specifically we found:

- There were no written policies and procedures that existed to assist individuals in compiling and reviewing the information that is utilized by the consultant to prepare the studies.
- There were numerous issues with the information utilized for the cost drivers to allocate costs from the Business Units to the beneficiaries of the services.
- There did not appear to be a uniform methodology utilized to determine which areas would be allocated indirect costs.





Council Auditor's Office

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November 29, 2013

Report #747

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EXECUTIVE SUMMARY

AUDIT REPORT #747

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OFFICE OF THE COUNCIL AUDITOR
Suite 200, St. James Building



April 17, 2014

Report #747

Honorable Members of the City Council
City of Jacksonville

INTRODUCTION

Pursuant to Section 5.10 of the Charter of the City of Jacksonville and Chapter 102 of the Municipal Code, we conducted an audit of the City's indirect cost allocation. The City of Jacksonville contracts with a third party to prepare a Full Cost Allocation Plan (FCAP) and an A-87 Allocation Plan (A-87). These plans allocate the costs paid by the General Fund/General Services District for Central Services to using departments. The FCAP allocates all costs of these areas to the end users. The A-87 allocates all costs permitted by OMB Circular A-87 to the end users. The OMB Circular A-87 is established by the United States Office of Management and Budget (OMB) and dictates allowable usage of federal assistance received by State, Local and Indian Tribal Governments whether directly or indirectly.

In general, the City's Budget Office and Accounting Division utilize these plans to budget and charge indirect costs to end users outside of the GF/GSD. The indirect cost allocation is utilized by the City's Budget Office and Accounting Division to budget and charge costs incurred by the GF/GSD for the benefit of users. Due to the nature of how the plans are put together and billed, there is a two-year delay from when the charges occurred in the Central Service to when the beneficiaries are charged. For example, the FCAP dated September 30, 2011 was utilized by the Budget Office to allocate costs and by the Accounting Division to charge costs for the fiscal year ended September 30, 2013.

Both studies are prepared using the same format. For example, in the FCAP for the period ended September 30, 2011, there were 37 unique Central Service areas (e.g. Mayor's Administration, Administrative Services, General Accounting, etc.) identified. Each Central Service had anywhere from 1 to 16 Business Units (e.g. General Accounting has Payroll, Accounts Receivable, Accounts Payable, etc.). In total, there were 128 Business Units. These Business Units had numerous end users who are the beneficiaries of the service and are thus allocated the costs of the Business Units based on a cost driver (e.g. headcounts, expenses, payments processed, etc.). In fiscal year 2012/13, the City budgeted to receive \$17,683,206 in revenue from indirect costs, of which \$8,728,088 was from funds outside the GF/GSD. The FCAP had a total indirect cost to be billed of \$84,787,118, of which \$27,189,807 was from outside the GF/GSD; however, not all areas are eligible to be charged the FCAP rate and instead are to be charged at the A-87 rate.

STATEMENT OF OBJECTIVE

To determine whether the indirect costs budgeted and charged to Departments were adequately supported and the basis for calculation was reasonable.

STATEMENT OF SCOPE AND METHODOLOGY

In general, we utilized the FCAP for the fiscal year ended September 30, 2011, which was utilized for the budget approved by City Council for the fiscal year ended September 30, 2013. Here is an overview of the steps performed:

- Identified every Central Service in the study and its Business Unit(s).
- Determined whether the cost in the study of each Central Service matched the cost in the City's accounting system.
- Determined whether the allocation from the Central Service to the Business Unit(s) tied to the support provided by the Central Service.
- Identified and reviewed every allocation basis from each Business Unit to the end users to determine whether it was reasonable (or accurate, when feasible).
- Confirmed the amounts budgeted to be charged to users in the fiscal year ended September 30, 2013 tied to amounts in the study.
- Compared the amounts charged during the fiscal year ended September 30, 2012 to the amounts in the FCAP and A-87 dated September 30, 2012 to confirm accuracy of actual billings.

We excluded from testing compliance with OMB Circular A-87 related to whether costs allocated to grants were eligible. Also, we limited our testing related to the allocation of the Council Auditor's Office costs due to the possible perception of a lack of independence since we are involved with creating the allocation basis for our office.

REPORT FORMAT

Our report is structured to identify Internal Control Weaknesses, Audit Findings, and Opportunities for Improvement as they relate to our audit objectives. Internal control is a process implemented by management to provide reasonable assurance that they achieve their objectives in relation to the effectiveness and efficiency of operations and compliance with applicable laws and regulations. An Internal Control Weakness is therefore defined as either a defect in the design or operation of the internal controls or is an area in which there are currently no internal controls in place to ensure that objectives are met. An Audit Finding is an instance where management has established internal controls and procedures, but responsible parties are not operating in compliance with the established controls and procedures. An Opportunity for Improvement is a suggestion that we believe could enhance operations.

STATEMENT OF AUDITING STANDARDS

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.

AUDITEE RESPONSES

Responses from the auditee have been inserted after the respective finding and recommendation. We received these responses from the City's Budget Officer Glenn Hansen in a memorandum dated April 9, 2014.

AUDIT CONCLUSIONS

Overall we found that the indirect costs budgeted and actually charged to Departments were supported and the basis for the calculations was reasonable; however, we did note an overall lack of management oversight which contributed to numerous issues that need to be addressed going forward.

AUDIT OBJECTIVE

To determine whether the indirect costs budgeted and charged to Departments were adequately supported and the basis for calculation was reasonable.

Internal Control Weakness 1 *Lack of Policies and Procedures*

There were no written policies and procedures to provide guidance to employees charged with coordinating the indirect cost study. For any reoccurring activity, it makes sense to have a set of policies and procedures to assist in creating a consistent and accurate work product. This reduces errors and inconsistencies caused by different employees performing the work. The employee turnover appears to be part of the reason why no policies and procedures exist; however, this turnover supports the need to maintain written policies and procedures. The lack of policies and procedures detailing the compilation of the input data brings into question the legitimacy of the final product.

Recommendation to Internal Control Weakness 1

A detailed set of policies and procedures needs to be prepared that states the overall goals and guidelines for the indirect cost study and details the standard procedures to meet said goals.

Auditee Response to Internal Control Weakness 1

Agree Disagree Partially Agree

The Indirect Cost study is completed by Maximus a recognized vendor in this field. Maximus provides information and some training to using departments. We agree that the combination of Maximus materials and augmentation by Finance in the form of a user manual would be useful.

Finding 1 *Inaccuracy of Costs to be Allocated*

For 1 of the 37 Central Service areas (equipment depreciation), the total cost that was attributed to the Central Service was not supported. In trying to determine how the cost was calculated, we looked at two separate areas. For the first area, the study appeared to utilize the current fiscal year's depreciation, which was stated to be the practice. For the second area, the amount charged was completely inconsistent with any methodology. We requested further information from the Budget Office; however, a reasonable explanation was never provided. We did not perform further work due to the amount of the difference and the fact no explanation was ever provided.

Recommendation to Finding 1

There needs to be better review by the Budget Office of the information they are obtaining that is being utilized as the basis for the allocation. Costs need to be allocated in a consistent and accurate manner to enhance the legitimacy of the entire study.

Auditee Response to Finding 1

Agree Disagree Partially Agree

We will develop and document data review standards in the user manual.

Finding 2 *Inaccuracies with Allocation of Costs from Central Services to Business Units*

We found 2 out of 115 Business Units had issues where the support for the allocation did not reasonably match the allocation basis in the study. Based on the testing performed, within the Administrative Services area, the amount to be allocated to the Time and Attendance Business Unit is overstated and the amount to the Administrative Support Business Unit is understated. The information presented by the Central Services should match what is being utilized to allocate out costs. The result was that users of the Time and Attendance function were slightly over allocated costs while users of the Administrative Support function were slightly under allocated costs.

Recommendation to Finding 2

There needs to be a verification procedure to confirm that information provided by the Central Services is being accurately input into the study. Whenever an alteration to the information is

required, there should be something in writing from the Central Service requesting or approving the change.

Auditee Response to Finding 2

Agree Disagree Partially Agree

Clarification of verification process will be included in the user manual.

Finding 3 *Inaccuracies with Allocation from Business Units to End Users/Beneficiaries*

We noted numerous issues with the allocation to the users of the Business Units. In total, 37 out of 102 Business Units we tested for reasonableness and 4 out of 11 we tested for accuracy had some form of issue. In total, we had 59 total exceptions made up of 9 different types of issues. Below is an explanation of each type of issue with the various cost drivers:

- 1) City Hall Square Footage Issue - The allocation of square footage for City Hall was drastically inaccurate since it included over half of the building's square footage being allocated to Adult Services, which only had a small office in the building. This impacted the allocation of costs to 4 of 102 Business Units tested for reasonableness.
- 2) Yates Building Square Footage Issue - The allocation of square footage for the Yates Building was inaccurate since it did not include the space utilized by the Parking Office located in the building. This impacted the allocation of costs to 4 of 102 Business Units tested for reasonableness.
- 3) Employee Headcount Issue - The employee headcount by area that was used as the cost driver for Business Units, which only included City Departments (i.e. no Independent Agencies), was off by 1 out of 10,587. There is some significance added to this finding since the single employee missing represented an entire activity. This impacted the allocation of costs to 5 of 102 Business Units tested for reasonableness.
- 4) Employee Allocation Flaw #1 - We found that the supporting documentation utilized for the headcount allocation for City employees was flawed. It did not distinguish full-time, part-time or partial year employees from each other and employees were 100% allocated to the last organization they worked for during the fiscal year. For certain Central Services, it may be acceptable to credit full-time and part-time employees the same weight; however, for no area does it make sense to allocate the final place the employee worked the entire amount as they did not work the entire year for that organization. This impacted the allocation of costs to 20 of 102 Business Units tested for reasonableness.
- 5) Employee Allocation Flaw #2 - The above-mentioned issue creates an additional problem for allocations that include independent agencies since they did not utilize the same methodology. Instead, independent agencies used authorized positions or the number of filled positions on 9/30/11. This inconsistency impacted the allocation of costs to 8 of 102 Business Units tested for reasonableness.
- 6) Flaw in Basis for Allocation – Independent Agencies were included in the allocation of costs for eight business units which allocated costs based on headcounts. We question the appropriateness of utilizing the headcount methodology in six of these eight areas. This impacted the allocation of costs to 6 of 102 Business Units tested for reasonableness.

- 7) Inaccurate Plant Renewal Allocations - There was a discrepancy in the costs utilized for Plant Renewal compared to the amount actually charged. This inaccuracy impacted the allocation of costs to 1 of 102 Business Units tested for reasonableness.
- 8) Total Expense Issue – Business Units that utilize expenses for the cost driver had significant issues since "All Years" subfunds include costs from an "All Years" perspective and regular subfunds only include current year expenses. This resulted in the allocations being drastically off. This error impacted the allocation of costs to 4 of 11 Business Units tested for accuracy.
- 9) Inadequate Support - We were not provided adequate support for the basis of which areas were included in the allocation of costs for 7 out of 113 Business Units tested; therefore testing for reasonableness or accuracy was impractical.

The purpose of having the FCAP performed is undermined if the data utilized to allocate costs is inaccurate. This appears to be caused by a lack of standard operating procedures and management review. The accuracy of the entire study is put into question when areas are being over and under allocated costs throughout the City and its agencies.

Recommendation to Finding 3

The Budget Office needs to create a standard set of policies and procedures that details the process from data collection to budget proposal.

Furthermore, the Budget Office point of contact needs to review the data being provided to the consultant and the data in the report prior to it being finalized for accuracy and reasonableness.

Auditee Response to Finding 3

Agree Disagree Partially Agree

See above.

Finding 4 *Issues with Consistency of Billing Indirect Costs*

Based on the testing performed, we believe that the City was not charging indirect costs to everyone that it should. Although we identified potential issues with \$14,818,651 not being allocated to areas outside of the GF/GSD, we do recognize that a large portion of this did not negatively affect the GF/GSD after transfers from and billings to the GF/GSD are taken in to account.

However, it still does appear the City needs to be more consistent in treating subfunds the same within each category. For example, either all internal service and enterprise subfunds should be charged their portion of the indirect cost amount or none should be. Also, the fact that a subfund cannot afford to handle the indirect cost allocation is not reason enough to not charge the allocation.

We believe this inconsistency was caused by a lack of standard policies and procedures. The City was not consistently allocating costs and was not recouping all expenses that it should have been.

Recommendation to Finding 4

As recommended in Finding 3 above, the Budget Office needs to create a standard set of policies and procedures that details the process from data collection to budget proposal.

Auditee Response to Finding 4

Agree Disagree Partially Agree

No further comment.

Finding 5 *Inaccuracy of Budgeting*

The City budgets to receive indirect cost recovery revenue from agencies which receive grants that are not a part of the annual budget process (i.e. the revenue is budgeted, but there is no corresponding expense budgeted in the agency's budget). This practice appears logical from a budgetary perspective; however, there are some issues with these projections. For example, the GF/GSD received \$63,353 less revenue than the amount budgeted to be received in FY 2011/12. Specifically, the GF/GSD was budgeted to receive \$447,450, but only received \$384,097.

Recommendation to Finding 5

We recommend the Finance Department reassess how indirect costs are allocated to areas that are not included in the normal budget process.

Auditee Response to Finding 5

Agree Disagree Partially Agree

We will work with the vendor to ensure the development of appropriate allocation schemes.

We appreciate the assistance and cooperation we received from the Budget Office through the course of this audit.

Respectfully submitted,

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Council Auditor

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