



## **City Auditor's Office**

# **Financial Services-Full Cost Allocation Audit**

**Report Issued: August 30, 2023**

Audit Report No. 23-04

Auditor-In-Charge: Andrea R. Russell, CPA, CFE, CIA, CGMA

Auditor: Philip Toby, CGFM



TO: Mayor Gunter and Council Members

FROM: Andrea R. Russell, City Auditor *ARR*

DATE: August 30, 2023

SUBJECT: Financial Services-Full Cost Allocation Audit

The City Auditor's Office has completed the audit of Financial Services Full Cost Allocation process. The audit was conducted in conformance with Generally Accepted Government Auditing Standards by the authority granted through City Ordinances 28-02 and 79-10.

We would like to express our sincere appreciation to the Financial Services Department and the Office of Management and Budget management and staff for the courtesy, cooperation and proactive attitude extended to the team members during the audit. If you have any questions or comments regarding this audit, please contact Andrea Russell at 242-3380.

C: Michael Ilczyszyn, Interim City Manager  
Connie Barron, Assistant City Manager  
Aleksandr Boksner, City Attorney  
Kimberly Bruns, City Clerk  
Mark Mason, Financial Services Director  
Nicole Reitler, Management Budget Administrator  
Audit Committee

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## EXECUTIVE SUMMARY

The City Auditor's Office conducted a performance audit of the Financial Services full cost allocation process. This audit is included in the City Auditor's FY23 approved Audit Plan.

Based on the test work performed and the audit recommendations noted below, we concluded overall that policies and procedures are in place and operating effectively to provide for accurate cost allocation of certain central services expenditures. There are additional central services expenditures the City currently tracks but does not allocate. Although this is not a control weakness, allocating the maximum expenditures possible is important when considering limitations on taxes, combined with increasing costs, and the need for additional local revenue sources. Preparing and publishing a formal cost allocation plan would improve transparency by documenting the methodology for allocation. For further details on this finding and recommendations, see the Finding and Recommendations section. We noted no control deficiencies.

## BACKGROUND

The City utilizes a Cost Allocation Plan (CAP) to allocate certain central services overhead costs to operating departments. Cost allocation plans can assist management in many ways including recovering indirect costs from federal or state funding; more accurately determining fees-for-services; and recognizing cost drivers and benchmarking. The CAP is prepared in accordance with *2 CFR 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards: Special Considerations for States, Local Governments, and Indian Tribes - Section 200.416 Cost allocation plans and indirect cost proposals*.

Budgeted expenditures for City Council, City Attorney, City Auditor, City Manager, City Clerk, Financial Services, Human Resources, and Information Technology Services are allocated to various funds. Central services provided by the General Fund are charged to the City's Special Revenue, Internal Service, and Enterprise Funds for reimbursement. These funds include Building, Community Development Block Grant, Golf Course, Stormwater, Water and Sewer, and Yacht Basin funds. Management determines which funds are charged for centralized services.

## AUDIT OBJECTIVE

To determine whether the full cost allocation budgeted and charged to departments was adequately supported, the basis for calculation was reasonable, and the allocation followed applicable regulations, policies, and procedures.

## 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.

## FINDING AND RECOMMENDATIONS

### **FINDING 2023-01: Financial Services Should Develop a Full Cost Allocation Plan** **Rank: Medium**

#### **Condition:**

Financial Services determines the allocation bases for costs. For example, to allocate Financial Services procurement costs to the Building Fund, the number of purchase orders processed by Finance for the Building Division is used to determine a percentage of total expenditures to allocate. The allocation bases utilized in the CAP include: the number of full-time equivalents; number of devices (Information Technology); number of retirees; number of accounting transactions; number of accounts payable transactions; budgeted expenditures; files imaged; number of complaints or inquiries; number of internal audit hours; number of council agenda items; number of real estate items for council action; and the number of personnel requisitions.

The City only allocates the selected central service expenditures to the above noted funds but could include additional funds, such as the Parks and Recreation or Transportation Capital Projects funds, as well as additional central service expenditures, such as the Communications Office or Facilities Management expenditures. Best practices recommend a formal documented CAP to facilitate transparency. The only documentation Financial Services currently has is the detailed procedural “how to” document and a general overview of the process in the budget document. The methodology is described in sufficient detail in internal documentation and applied fairly and consistently. A stand-alone CAP can communicate details such as types of expenditures, allocation bases, and the time period used for expenditures in the plan. This information is included in the internal documents used for the allocation, but would provide more transparency if details were provided in a stand-alone CAP.

#### **Criteria:**

- 2 CFR 200; 200.416
- Formal documented Full Cost Allocation Plan

#### **Cause:**

- No formal CAP document
- Incomplete allocation of costs

#### **Effect:**

- Lack of transparency regarding cost allocation
- Understated cost allocation

#### **RECOMMENDATIONS:**

**2023-01a:** Develop a formal, Cost Allocation Plan to be included in the City’s annual budget.

**2023-01b:** Analyze unallocated costs and determine if any additional amounts can be incorporated into future full cost allocations.

**Management Response and Corrective Action Plan:**

**2023-01a:** Select one of these boxes: ☒ **Agree** ☐ **Partially agree\*** ☐ **Disagree\***

**\*For partially agree or disagree a reason must be provided as part of your response:**

**2023-01a:** We agree that a more detailed and formal plan should be developed, maintained, and updated annually in the City's Annual Budget to create the necessary transparency to understand what the Full Cost Allocation is, why it is necessary, when it is updated and why, and how the calculations work. The City has purchased a Cost Allocation Software and are in the process of implementation. Once the implementation is complete and a full analysis of the process is analyzed, a more detailed and thorough Cost Allocation Plan will be developed and included within our Budget Book.

**2023-01a: Management Action Plan Coordinator:** Financial Services Director

**2023-01a: Anticipated Completion Date:** 1/4/2023

**2023-01b:** Select one of these boxes: ☒ **Agree** ☐ **Partially agree\*** ☐ **Disagree\***

**\*For partially agree or disagree a reason must be provided as part of your response:**

**2023-01b:** The City has implemented this recommendation and will do so one more time with the implementation of the new software for full cost allocations. The city has purchased a Full Cost Allocation Software and is currently in the process of implementation. In FY 2023 the City evaluated the Full-Cost Allocation process and made some changes to the Fund allocations in preparation of the implementation. Included in the changes, the Parks and Recreation Fund and the Golf Course Fund moved out of Special Revenue Funds and into the General Fund. The Fire Operations moved out of the General Fund and into the Special Revenue Fund. Also, within our Capital Transportation Fund, the sidewalk crew was moved out and reallocated to the General Fund. Due to these changes, we re-evaluated the Funds receiving the allocation and expanded the scope of allocation to also include the Solid Waste Fund and the Gas Tax Fund as well as the new Fire Operations Fund and removing the Parks and Recreation and Golf Course Funds. The expenditures included are also being re-evaluated and in FY 2024 the facilities costs are being included as a part of the total expenditures for allocation. Throughout the implementation process, we will continue to evaluate potential costs for allocation and will document any changes in the updated Cost Allocation Plan.

**2023-01b: Management Action Plan Coordinator:** Financial Services Director

**2023-01b: Anticipated Completion Date:** 10/2/2023

## SCOPE AND METHODOLOGY

Based on the work performed during the planning and the assessment of risk, the audit covers the full cost allocation process used for FY22 and FY23<sup>1</sup>. We performed testing using applicable policies and procedures as well as federal regulations for cost principles that were in place during the scope.

Original files were used as support for testing evidence and verified through physical examination. Sample size and selection were based on the CAO Sample Methodology. To gain a better understanding of the process for allocation and to ensure compliance with budget policies and procedures, we conducted walkthroughs with the Office of Management and Budget and Financial Services personnel. We utilized judgmental sampling to select allocation bases to trace to source reports, documents and to recalculate amounts used in selected allocations.

To achieve the audit objective, we used data from the City's financial accounting system. The information is tested by the external auditors as part of the Annual Comprehensive Financial Report. Based on the results of their procedures, no additional data reliance testing was deemed necessary.

Unless specifically stated otherwise, based on our selection methods, and testing of transactions and records, we believe that it is reasonable to project our results to the population and ultimately draw our conclusions for testing, findings, and recommendations on those results. Additionally, for proper context we have presented information concerning the value and/or size of the items selected for testing compared to the overall population and the value and/or size of the exceptions found in comparison to the items selected for testing.

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<sup>1</sup> Full cost allocations are determined at the beginning of the fiscal year for inclusion in the current (FY24) budget.

## APPENDIX A

### Finding Classification

Findings are grouped into one of three classifications: High, Medium or Low. Those findings that are categorized as low are not included in the report but rather are communicated separately to management. Classifications prioritize the findings for management to address and also indicate the level of testing required to determine if a finding's Corrective Action Plan is fully implemented in accordance with recommendations and Management's Response.

**High:** A finding that is ranked as "High" will have a significant impact on the organization. It is one that *prevents* the achievement of a substantial part of significant goals or objectives, or noncompliance with federal, state or local laws, regulations, statutes or ordinances. Any exposure to loss or financial impact for a High finding is considered *material*. Examples include direct violation of City or Department policy, blatant deviation from established policy and procedure, such as actions taken to circumvent controls in place, material non-compliance with federal, state or local laws, regulations, statutes or ordinances, or an area where significant cost savings could be realized by the Department or the City through more efficient operations.

High findings require immediate management attention and should take management's priority when considering implementation for corrective action.

**Medium:** A "Medium" finding is one that *hinders* the accomplishment of a significant goal or objective or non-compliance with federal, state or local laws, regulations, statutes or ordinances, but can't be considered as preventing the accomplishment of the goal or objective or compliance with federal, state or local laws, regulations, statutes or ordinances. Exposure to loss or potential or actual financial impact is *significant but not material* to the Department or City. Examples include lack of monitoring of certain reports, insufficient policies and procedures, procedure in place or lack of procedure that can result in *potential* noncompliance with laws and or regulations.

Medium findings require management attention within a time frame that is agreed upon by the Department and the City Auditor. Priority for implementation of management's corrective action should be considered in light of other High or Low findings.

**Low:** A "Low" finding is one that warrants communication to management but is one that isn't considered as hindering the accomplishment of a significant goal or objective and isn't causing noncompliance with federal, state or local laws, regulations, statutes or ordinances. Financial impact or risk of loss is minimal to none; however, low findings can *hinder the effectiveness or quality of department operations and thus are communicated to management separately. Low ranked findings are not included in the final audit report.*

The City Auditor's Office will not follow up on the status of Low findings communicated to Management.