Audit of Budget and Management Office

December 2015

Office of the Auditor
Audit Services Division
City and County of Denver

Timothy M. O'Brien, CPA
Auditor

The Auditor of the City and County of Denver is independently elected by the citizens of Denver. He is responsible for examining and evaluating the operations of City agencies for the purpose of ensuring the proper and efficient use of City resources and providing other audit services and information to City Council, the Mayor and the public to improve all aspects of Denver's government. He also chairs the City's Audit Committee.

The Audit Committee is chaired by the Auditor and consists of seven members. The Audit Committee assists the Auditor in his oversight responsibilities of the integrity of the City's finances and operations, including the integrity of the City's financial statements. The Audit Committee is structured in a manner that ensures the independent oversight of City operations, thereby enhancing citizen confidence and avoiding any appearance of a conflict of interest.

Audit Committee

Timothy M. O'Brien, CPA, Chairman
Rudolfo Payan, Vice Chairman

Robert Bishop	Jack Blumenthal	Jeffrey Hart
Leslie Mitchell	Ed Scholz	

Audit Management

Valerie Walling, CPA, CMC®, Deputy Auditor
Kip Memmott, MA, CGAP, CRMA, Director of Audit Services

Audit Staff

Robyn Lamb, Audit Supervisor
Nancy Howe, MPA, CRMA, Lead Auditor
Ronald F. Keller, CIA, CFE, Senior Auditor
Jared Miller, Senior Auditor

You can obtain copies of this report by contacting us at:

Office of the Auditor
201 West Colfax Avenue, Department 705 ◆ Denver CO, 80202
(720) 913-5000 ◆ Fax (720) 913-5247

Or download and view an electronic copy by visiting our website at: www.denvergov.org/auditor
Report number: **A2015-013**

City and County of Denver

201 West Colfax Avenue, Dept. 705 • Denver, Colorado 80202

720-913-5000 • Fax 720-913-5253 • www.denvergov.org/auditor

Timothy M. O'Brien, CPA
Auditor

December 17, 2015

AUDITOR'S REPORT

We have completed an audit of the Budget and Management Office. The purpose of the audit was twofold. First, the audit sought to determine whether the use of performance information has been incorporated into the City's budget process to allow budget decisions to be made on useful, reliable, and validated performance metrics. Second, the audit assessed whether the City's approach to ensuring the adequacy of reserve funds and determining the need and subsequent use of those funds is effective.

Audit work resulted in two findings. The first relates to the use of performance measures in the budget process, where we found that, for the agencies reviewed, performance measures are included in and related to budget requests, and are aligned with mayoral and agency objectives. However, we also found that documentation to support performance measures is often lacking and performance data is not validated, making it more difficult to ensure that budget decisions are based on reliable and accurate information. In addition, enhanced transparency regarding how performance measures ultimately impact budget decisions would educate agencies about the importance of those measures.

The second finding relates to general fund reserves. In this area, we found that the City has developed and complied with its policy for establishing and using its general fund reserves. However, as the policy was established in 2007, we recommend that the City review and reassess this policy for more recent best practice considerations. The current 15 percent unassigned general fund balance requirement could be adjusted by analyzing unforeseen risks and their potential financial impact on the fund. We also found that general fund contingency monies have been used for known expenditure needs that were not previously budgeted and therefore, were not unforeseen or unanticipated. Finally, we identified requests for supplemental funds that lacked formal documentation to support the need and usage of contingency funds.

Our report includes recommendations that address these findings.

This performance audit is authorized pursuant to the City and County of Denver Charter, Article V, Part 2, Section 1, *General Powers and Duties of Auditor*, and was conducted 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.

We extend our appreciation to the Budget and Management Office Director and other personnel who assisted and cooperated with us during the audit.

Sincerely,

Timothy M. O'Brien, CPA
Auditor

City and County of Denver – Office of the Auditor
Audit Services Division

REPORT HIGHLIGHTS

Audit of Budget and Management Office
December 2015

The audit assessed the Budget and Management Office's use of performance information to help guide the establishment of the annual budget and its approach for setting and using general fund reserves.

Background

As part of the City's annual budget development process, City agencies submit budget requests to BMO. Requests include performance measures to help align funding decisions with strategic goals. BMO evaluates the requests and makes recommendations to the Mayor and City Council regarding whether to fund the requests in the budget.

To meet the requirement of a balanced budget and to account for fluctuations in operating revenues and expenditures, the City has established various reserve funds, and policies outlining their use. There are three reserve funds within the City's general fund: a contingency reserve, an unassigned fund balance, and a TABOR reserve.

Purpose

The purpose of this audit was:

1. To determine whether the use of performance information has been incorporated into the City's budget development process

2. To assess the City's approach for ensuring the adequacy of reserve funds and the subsequent use of those funds

Highlights

In assessing the use of performance measures in the budget development process, we found that budget requests generally included performance measures, which were aligned with Mayoral priorities and agency objectives. However, we identified two areas for improvement. First, we found that neither the Budget and Management Office (BMO) nor City agencies have established a formal process to validate performance measures provided by agencies during the budget process, and that BMO has not developed a process by which to request, review, and retain documentation needed to support the measures. Second, we found that BMO could enhance transparency regarding how performance measures ultimately impacted budget decisions.

In assessing the City's approach to setting and using general fund reserves, we found that the City adheres to its financial policy for establishing these reserves, and the policy reflects some current best practice guidance. However, we identified three areas for improvement. First, the policy was established in 2007, and the City has not reviewed or reassessed it for more recent best practice considerations, including performing an analysis of unforeseen risks and their potential financial impact on the general fund. Second, we found that the City has approved the use of general fund contingency reserves for known expenditure needs that were not previously budgeted; the policy does not specifically address this type of use. Finally, we identified supplemental fund requests that lacked formal documentation to support the need and usage of contingency funds.

For a complete copy of this report, visit www.denvergov.org/auditor
Or Contact the Auditor's Office at 720.913.5000

TABLE OF CONTENTS

INTRODUCTION & BACKGROUND 1

Denver's Budget and Management Office 1

Budget Requirements and Process 5

Denver's Budget Methodology 10

City and County of Denver's General Fund Reserves 12

SCOPE 18

OBJECTIVE 18

METHODOLOGY 18

FINDING 1 20

The Budget and Management Office Should Enhance Performance Measure Practices in the Budget Development Process 20

RECOMMENDATIONS 28

FINDING 2 29

The Budget and Management Office Can Take Steps To Enhance the Determination of Unassigned General Fund Balance and Contingency Reserves Documentation 29

RECOMMENDATIONS 35

APPENDICES 36

Appendix A – Denver's 2015 Budget Process 36

Appendix B – Budget and Management Office's 2015 Decision Package Form 37

AGENCY RESPONSE 38

INTRODUCTION & BACKGROUND

Denver's Budget and Management Office

The City's Budget and Management Office (BMO) is one of seven divisions residing within the Department of Finance (DOF). DOF's mission is "to ensure the delivery of effective and efficient City services through sound financial management."[1] To help DOF achieve this mission, BMO established the following vision: "to be the [City's] trusted partner in fiscally-sound decision making."[2] BMO strives to achieve its vision by enabling agencies to provide service delivery in a fiscally responsible manner. BMO facilitates fiscal responsibility by managing the City's annual budget and Citywide capital plan and by working with agencies to provide solutions to help realize more efficient and effective operations. BMO developed five strategies for meeting its vision. For the 2015 budget year, these five strategies include:

1. Developing and maintaining effective and efficient operating processes within BMO to ensure support to department and Citywide programs is accurate, timely, and responsive
2. Managing a balanced annual budget and strategic Citywide capital plan by providing sound financial planning, analysis, and reporting
3. Facilitating a comprehensive performance management system to ensure fiscally responsible service delivery
4. Supporting customers by providing business process improvement training and fostering innovation in the City workplace
5. Replacing the City's outdated legacy budget software with a new budget system that will improve user experience, budget development, and fiscal reporting[3,4]

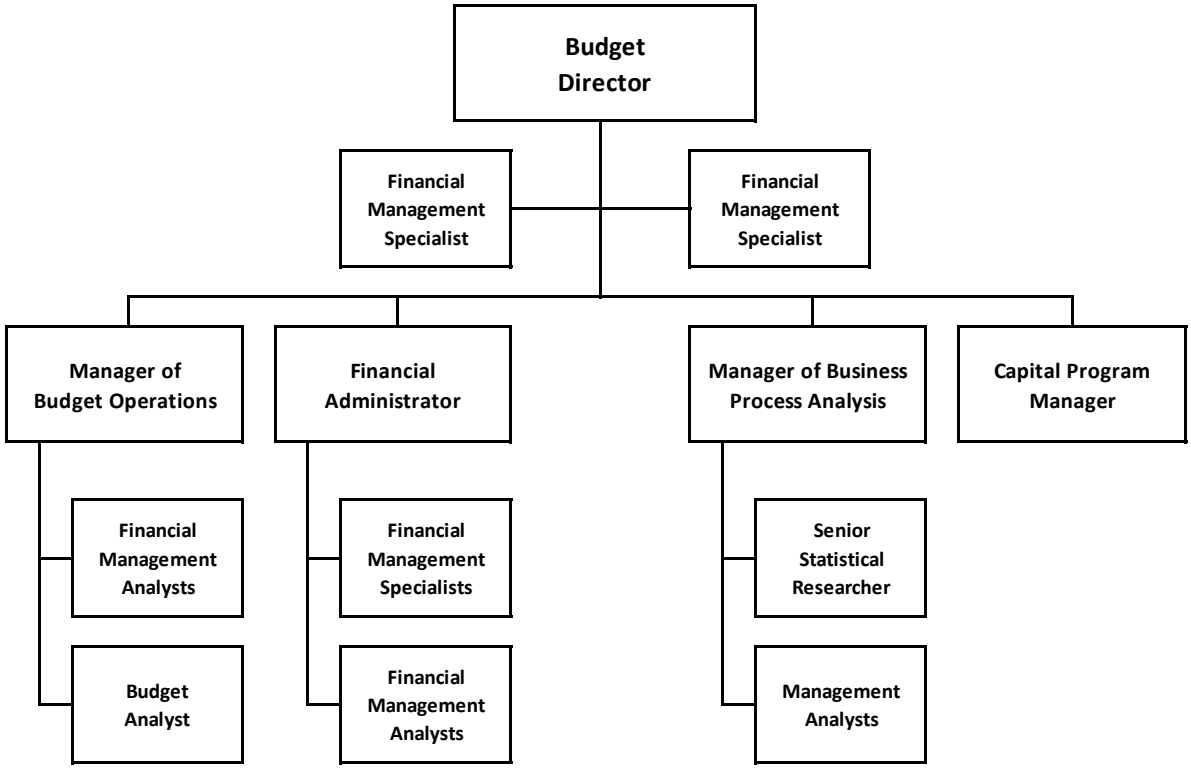
BMO's Structure

BMO is overseen by the Budget Director under the direction of the Chief Financial Officer (CFO). For 2015, BMO received annual general fund appropriations of approximately $3.3 million and a staff of 26.5 to carry out its duties.[5] For the upcoming 2016 budget year,

[1] City and County of Denver Mayor's 2016 Proposed Budget, page 345, accessed on October 22, 2015, https://www.denvergov.org/content/dam/denvergov/Portals/344/documents/Budget/MayorsProposedBudget_2016.pdf.
[2] Budget and Management Office webpage, accessed on October 22, 2015, https://www.denvergov.org/content/denvergov/en/denver-department-of-finance/budget-and-management.html.
[3] City and County of Denver Mayor's 2015 Budget, page 332, accessed on October 22, 2015, https://www.denvergov.org/content/dam/denvergov/Portals/344/documents/Budget/Mayors_Budget.pdf.
[4] In 2015, BMO implemented a new web-based budget software system, Questica, to help improve the efficiency of the budget development and monitoring processes.
[5] City and County of Denver Mayor's 2015 Budget, page 334, accessed on October 22, 2015, https://www.denvergov.org/content/dam/denvergov/Portals/344/documents/Budget/Mayors_Budget.pdf.

the Mayor proposed that BMO receive $3.7 million in annual appropriations and 27.5 staff.[6] Figure 1 provides a graphical representation of BMO's organizational structure.

Figure 1. Budget and Management Office Organizational Chart



Source: Developed by auditors using the Budget and Management Office's Organizational Chart, obtained July 2015.

BMO's Responsibilities

BMO's responsibilities include preparing the City's annual budget; monitoring the annual budget; preparing the City's capital improvements program; providing oversight over Citywide grants; and supporting Denver's Peak Performance initiative. BMO personnel also: review and assess major policy issues and City ordinance requests to determine financial impact, conduct surveys of citizens to report on Citywide outcomes, and provide financial management consulting services to agencies, as necessary.[7]

Preparation and Monitoring of Annual Budget—BMO works with City agencies to prepare the City's annual budget and monitors spending throughout the year to ensure that expenditures do not exceed revenues. BMO develops the Mayor's annual budget, which is proposed to City Council for approval. In 2015, City Council approved $1.72 billion in spending appropriations for all funds. City Council appropriated approximately $1.212

[6] City and County of Denver Mayor's 2016 Proposed Budget, page 368, accessed October 22, 2015, https://www.denvergov.org/content/dam/denvergov/Portals/344/documents/Budget/MayorsProposedBudget_2016.pdf.

[7] Examples of consulting services provided to agencies include investment returns, fee studies, financing alternatives, resource models, program evaluation, long term financial planning, and fiscal impact statements.

billion to the City's general fund, $530 million to the City's enterprise funds, and $297.3 million to the capital projects budget for the annual Capital Improvement Plan (CIP).[8]

BMO is responsible for evaluating City agency initiatives and program proposals to provide the Mayor and City Council with recommendations regarding the inclusion of these items in the annual budget. These proposals may include suggested changes in City ordinances establishing taxes, fees, charges, and other types of revenue enhancements. BMO also develops revenue and expenditure projections and monitors actual budget performance. When BMO identifies budgetary concerns, such as revenues coming in less than originally projected or a higher rate of spending than originally expected, BMO personnel work with agencies to address additional resource needs and take corrective action. Once a corrective action plan is developed, BMO's Budget Director and agency management are responsible for presenting the action to the Mayor for approval. Corrective action could include:

BMO evaluates City agency initiatives and program proposals and recommends to the Mayor and City Council the inclusion of these items in the annual budget.

- Reallocating budgeted funds out of personnel service and capital equipment categories to other budget categories
- Recommending, to City Council for approval, supplemental appropriations and/or reductions in previously approved appropriations
- Revising the agency's planned service delivery[9]

BMO's role in the budget process is discussed in more detail later in the Introduction and Background section of the report.

Preparation and Monitoring of City Capital Improvement Plan—BMO also manages the annual Citywide CIP, which outlines the City's capital asset expenditures for the current and near-future years. City Charter mandates the Mayor develop a long range plan for capital improvements and a six-year CIP.[10] Although the CIP is a six-year plan, it is updated annually as part of the budget process. BMO's Capital Program section helps develop the CIP with the involvement of City agencies, the City's Executive Development Council, the Mayor's Office, and City Council.

City agencies are responsible for defining capital program needs into three expenditure categories: required payments, annual maintenance requirements, and discretionary projects. Required payments include contractual obligations, debt-financing for capital

[8] City and County of Denver Mayor's 2015 Budget, page 19, accessed October 22, 2015, https://www.denvergov.org/content/dam/denvergov/Portals/344/documents/Budget/Mayors_Budget.pdf. Amounts appropriated to the capital projects budget include transfers from the City's general fund. The general fund is the main operating fund of the City. Most City agencies are funded through this fund. The City's four enterprise fund agencies – DIA, Wastewater, Golf, and Environmental Services – are financed and operated in a manner similar to private business and are funded by fee-for-service dollars.

[9] *Ibid.*, page 31.

[10] The requirement to prepare a six-year capital improvements program is required by City and County of Denver Charter, Article VII, Part 1, Section 2, *Budget Calendar; Budget Estimates; Capital Improvements Program*. The most recent six-year capital improvements plan, for 2013 to 2018, is available at the City's Transparent Denver webpage, accessed October 23, 2015, https://www.denvergov.org/transparency/budget.

project work, ongoing partnerships, and internal budget transfers for capital improvements. Capital maintenance requirements comprise the majority of the capital program. City agencies are required to submit annual maintenance program plans to BMO each year. After City funds are allocated for required payments and maintenance, remaining capital revenue is available for agency discretionary projects. The City and County of Denver Mayor's 2015 Budget identifies that current available capital revenue is generally committed to the three expenditure categories in the following approximate percentages: 10 percent to required payments, 67 percent to annual maintenance programs, and 23 percent to discretionary projects. Table 1 identifies how the 2015 capital projects budget appropriation of $297.3 million would have been apportioned using these percentages.[11]

Table 1. 2015 Capital Projects Budget, by Expenditure Category

Expenditure Category	Estimated Percent of Capital Budget	Estimated Dollar Amount of Capital Budget
Annual Maintenance	67%	$199.2 million
Discretionary Projects	23%	$68.4 million
Required Payments	10%	$29.7 million
Totals	**100%**	**$297.3 million**

Source: Developed by auditors based on City and County of Denver Mayor's 2015 Budget information.

BMO assesses agency payment and maintenance needs for appropriateness and presents new required payments, annual maintenance, and discretionary capital projects budget requests to the City's *Executive Development Council* (Council) for approval.[12] The Council is responsible for aligning the capital budget with important City initiatives. The BMO Capital Program Manager provides Council members with analyses that aid in decision-making. The Council then recommends to the Mayor which discretionary projects should be funded and included in the annual budget, which is ultimately approved by City Council.

Throughout the year, BMO, in conjunction with City agencies, monitors the schedule, cost, and scope of capital projects to ensure that projects are completed in a reasonable timeframe and in accordance with annual budget appropriations.

Oversight of Citywide Grants—In addition to developing the annual budget and CIP, BMO is also responsible for providing oversight of the City's federal, state, and private source grant resources. BMO reviews City agencies' grant proposals, as provided for in

[11] City and County of Denver Mayor's 2015 Budget, pages 19 and 164, accessed October 22, 2015, https://www.denvergov.org/content/dam/denvergov/Portals/344/documents/Budget/Mayors_Budget.pdf.

[12] According to the City and County of Denver Mayor's 2015 Budget, pages 164 to 165, the Executive Development Council represents Citywide agencies at the cabinet level and includes representatives from the Mayor's Office; the Departments of Finance, Public Works, Parks and Recreation, Community Planning and Development, and Environmental Health; Denver International Airport; City Attorney's Office; and the Office of Economic Development. The Denver Urban Renewal Authority is also represented.

Fiscal Accountability Rule 9.1.[13] This rule requires City agencies to notify BMO of any intent to apply for grant funding prior to submission. This notification must include information such as any local match or continuous funding requirements, the total grant award, the project scope and schedule, and the hiring of any staff necessary to execute the grant. BMO then reviews the grant notifications and proposals to determine whether proposals are consistent with City priorities, to facilitate coordination with existing City programs, and to evaluate the current and long-term financial impacts the grant may have on the City.

BMO also coordinates agencies' use of the City's grant services contractor. This contractor provides grant writing and funding research services to City agencies. In addition, BMO's Grant Administrator facilitates the monthly Grants Policy Advisory Committee meetings.[14] The meetings provide agencies the opportunity to regularly report on potential grant applications, to discuss upcoming needs for the City's grant services contractor, and to provide updates on compliance with grant-related City rules.

Supporting the City's Peak Performance Initiative—BMO analytics personnel provide operational and fiscal analysis to support the Peak Performance initiative, Denver's performance management framework. BMO personnel assist agencies with Peak Performance-related tasks such as strategic planning and annual performance reviews, which provide an avenue for highlighting agency accomplishments and for identifying and prioritizing improvement areas. BMO's Peak Academy section is responsible for training City employees in process improvement techniques and facilitating continuous improvement events to support innovations identified by City employees.[15]

The following section of the report's Introduction and Background outlines the City's budget requirements delineated in City Charter and the budget process that was developed to address those requirements. In addition, the following section includes a more detailed discussion of BMO's role in the budget process.

Budget Requirements and Process

The Mayor is responsible for developing the City's annual budget in accordance with City Charter.[16] The City's fiscal year begins on January 1 and ends on December 31. Table 2 summarizes the budget timeline established in City Charter:[17]

[13] City and County of Denver Fiscal Accountability Rule 9.1, *Grant Application and Awards*, accessed October 23, 2015, http://www.denvergov.org/content/denvergov/en/denver-department-of-finance/fiscal-accountability.html.
[14] This committee's members include the BMO Grant Administrator and liaisons from City agencies that are tasked with representing their agencies' grant needs and priorities.
[15] In October 2015, the City and County of Denver Auditor's Office issued a performance audit of Peak Academy. The audit assessed the effectiveness of Peak Academy in helping Denver's Peak Performance program foster a culture of continuous improvement throughout the City.
https://www.denvergov.org/content/dam/denvergov/Portals/741/documents/Audits_2015/PeakAcademyAuditReport_10-15-15.pdf.
[16] City and County of Denver Charter, Article VII, Part 1, *Budget*.
[17] City and County of Denver Charter, Article VII, Part 1, Sections 2 to 8.

Table 2. City Charter Budget Timeline Requirements

Date	Action
May 1	Mayor prepares a budget timeline and appropriate budget preparation procedures
July 1	Agencies, offices, departments, boards, commissions, and other spending agencies submit estimates of revenues and spending requirements to the Mayor and City Council[18]
September 15	Mayor submits the draft proposed budget
Third Monday in October	Date by which the Mayor submits the proposed budget to City Council
Fourth Monday in October	Date by which City Council holds a public hearing on the proposed budget
First November City Council meeting	Date by which City Council may amend the proposed budget by a vote of a majority of its members
Noon, Friday following first November City Council meeting	Date and time by which the Mayor must notify City Council which budget amendments he accepts and which he rejects[19]
Second November City Council meeting	Date by which City Council approves the annual budget
December 15	Agencies, offices, departments, boards, commissions, and other spending agencies submit to the Mayor expenditure plans, work programs, and budget allotments according to the adopted budget

Source: Developed by auditors based on requirements outlined in City and County of Denver Charter, Article VII, Part 1, Sections 2 to 8.

To meet the requirements of City Charter, BMO performs many key functions on the Mayor's behalf. The following sections detail the annual budget framework established by BMO, which encompasses major milestones of the budget process.

Establishing the Budget Calendar and Procedures

BMO's first step in the annual budget process, which begins in April, is preparing the budget calendar and budget procedures.[20] This includes providing agencies with instructions for the capital improvement budget process and six-year capital improvements plan, instructions for the Innovation Fund proposal process, and the Budget Manual and corresponding forms for the operating budget.[21,22] The Budget

[18] These estimates of revenues and spending requirements, termed budget proposals, are submitted by BMO on behalf of the various City organizations.
[19] City Council may override any amendment the Mayor rejected with a vote of at least two-thirds of its members.
[20] See Appendix A for a graphical representation of the 2015 budget process adopted by BMO.
[21] The City and County of Denver Mayor's 2015 Budget, page 85, specifies that the Innovation Fund "provides funding for the implementation of projects designed to improve City operations and efficiencies through automation and business process improvements for agencies within the general fund."
https://www.denvergov.org/content/dam/denvergov/Portals/344/documents/Budget/Mayors_Budget.pdf.

Manual provides information such as key dates in the budget calendar, economic assumptions, Peak Performance's vision and goals, and instructions on how to determine revenue estimates, and complete their budget proposals or *decision packages*. BMO also provides agencies with information on how to make their budget proposals competitive. Specifically, agencies are encouraged to ensure that their decision packages clearly support the Mayor's priorities and tie to the agency's strategic plan; provide data to support requests, including back-up calculations for performance data, cost estimates, and revenue changes; and include performance data to quantify the impact that changes in resources will have on outcomes and operations.

Peak Performance Reviews

Included in the Budget Manual is a description of Peak Performance's vision and goals. The Peak Performance management program "seeks to ensure that every dollar is spent as efficiently as possible toward improving our quality of life and fulfilling our Citywide vision: We will deliver a World-class City where everyone matters."[23] In addition to BMO's Budget Manual, the City's Chief Performance Officer provides annual guidance to agency executive leadership detailing the evolution of performance reporting and the budget process. For example, the most recent issuance of Peak Performance guidelines, issued in 2015, provided an overview of the past year's progress towards an integrated approach in performance and budgeting. Specifically, the guidelines outline how some agencies differentiate among activity (what they did), output (what was produced from that activity), and outcomes (how what they produced compared to what they set out to achieve) compared to other agencies that do not convey these advanced concepts and cover topics unrelated to their overall strategic plan. Additionally, the guidelines outline acceptable metrics and key performance indicators, which assist in laying the groundwork for agencies to better understand what kind of metrics should be developed and used to measure outcomes.

Peak Performance helps integrate performance reporting into the budget process.

Beginning in 2011, Peak Performance paired with City agencies to develop strategic plans with outcome-based performance measures for agencies to report to City leadership how they are making Denver "better, stronger, and faster." In 2014, Peak Performance was further integrated into the fabric of City operations through formal meetings with City agencies during February, March, and April to perform an annual performance review. During a review, agency leaders are required to report strategic plan results from the previous years and to articulate their innovation plans for the current year. The performance reviews are presented orally, using a PowerPoint template as a visual aid, to a group of City leaders that includes the Mayor or his Chief of Staff, Controller, BMO Director, Chief Information Officer, Office of Human

---

[22] In July 2015, the City and County of Denver Auditor's Office released a performance audit of the Innovation Fund (iFund.) The audit reviewed whether the iFund has a transparent and equitable structure and whether the iFund's financial tracking and reporting is accurate. http://denvergov.org/Portals/741/documents/Audits%202015/Innovation_Fund_Audit_Report_07-13-15.pdf.

[23] BMO's 2015 Budget Manual, page 3.

Resources Director, Chief Sustainability Officer, and other Mayor's Office and BMO personnel. The presentation includes elements such as an overview of the agency's strategic plan and agency's mission-level outcome metric performance, employee engagement, and how budget expansion updates affected performance.

Agency Proposals and Financial Estimates

Between April and June, City agencies are responsible for preparing operating and long-range capital program proposals and submitting them to BMO.[24] BMO analysts review the proposals to ensure they align with Mayoral, City Council, and agency priorities, that they include reasonable performance measures to support the requests, and to gain an understanding of what is being requested and why it is needed. After gaining an understanding of the proposals, BMO analysts provide agencies with guidance on what may be needed to better support the proposal. Working with BMO analysts, agencies then finalize their proposed revenues and expenditures for submittal to the Mayor and City Council prior to July 1. Revenue estimates are classified by fund type and income source. Expense estimates are classified by fund type, character, and object. The development of agency budget proposals takes into consideration four elements.

- The City's strategic framework[25]
- Council priorities
- Agency strategic plans and work programs
- Capital improvement priorities

Chief Financial Officer Budget Reviews

In July of each year, after articulating the results and outcomes of strategic plan strategies via the Peak Performance Reviews, BMO and agency officials attend CFO Budget Reviews. These reviews entail a meeting with the CFO and BMO Director that allows agencies to explain their budget year proposals based on how they fit into the agency's strategic plan and the Mayor's Citywide vision. These meetings are not open to the public.

Mayor Budget Reviews

In August, after the CFO budget review meetings have concluded and agencies have submitted budget proposals, BMO and agencies participate in budget meetings with the Mayor. These meetings are held to provide agencies the opportunity to present their

[24] Agency operating proposals provide a plan for current expenditures and the means of financing the expenditures. Agency capital program proposals provide a plan for expenditures that will result in the acquisition of or addition to fixed assets, and the means of financing the expenditures.

[25] In 2015, the City's strategic framework reflected the Mayor's priorities and encompassed *Youth* – investing in Denver's youth; *Jobs* – supporting the economy through business development, workforce development, lending, and investment; *Safety/Safety Net* – protecting and serving every resident, including the most vulnerable and needy, to provide the opportunity to live in a safe and healthy environment; *Sustainability* – securing an economically, socially, and environmentally sustainable city for future generations; and *Customer Experience* – improving the experience customers have when interacting with city government.

budget requests and supporting documentation to the Mayor. These meetings are not open to the public.

After these meetings, the Mayor approves agencies' budget proposals to be included in the proposed budget, and works with BMO to finalize his proposed budget to be presented to City Council.

City Council Briefings and Approval of Annual Budget

On or before September 15, the Mayor briefs the City Council on his draft proposed budget. The City Council provides the Mayor feedback to the draft proposed budget, which is considered by the Mayor when developing the final proposed budget. The final Mayor's proposed budget is presented to City Council. City Council then opens the proposed budget up to the public for comment at a public hearing held during a meeting of the entire City Council. City Council may make revisions to the proposed budget. Pursuant to City Charter, City Council is required to adopt the annual budget by the second regular City Council meeting in November. If City Council fails to adopt the budget by this meeting, the Mayor's proposed budget automatically becomes the official budget.[26] After the budget is adopted, City Council then passes an ordinance appropriating amounts to City agencies for the upcoming budget year. The various City Council briefings and adoption of the budget are open to the public, televised, and archived on the Denver 8 TV website.[27]

Appendix A provides a flow chart representing key tasks and milestones of the annual budget process for 2015.[28]

City Council Approval of Supplemental Appropriations

After City Council passes the annual appropriation ordinance, agencies cannot exceed their set appropriations without City Council's approval of a supplemental appropriation request. Supplemental appropriations may be necessary when an agency encounters an unforeseen circumstance after the budget is established. During the course of the budget year, agency managers are responsible for identifying significant changes in planned services, planned spending, or actual revenue received and notifying BMO of changes that will ultimately affect the budget. BMO also reviews monthly actual expenditure and revenue reports and meets with agency personnel routinely to monitor agency budget progress. When a valid need is identified, BMO recommends to the Mayor and City Council that a supplemental appropriation request be approved from the City's general fund contingency reserve. This reserve is discussed in more detail later in the Introduction and Background section of this report.

While this section of the Introduction and Background outlined Denver's budget requirements and process, the following section discusses the City's specific budget methodology.

---

[26] City and County of Denver Charter, Article VI, Part 1, Section 7.1.7, *Failure by Council to adopt budget*.
[27] Denver 8 TV is the municipal access television station for the City and County of Denver, accessed online at denver8.tv.
[28] This flow chart was developed using BMO's 2015 Budget Manual instructions. Areas outlined in red indicate Charter requirements. The yellow Peak call-outs represent instances within the budget timeline where Peak Performance is involved.

Denver's Budget Methodology

BMO utilizes a hybrid budget methodology that incorporates three different budgeting practices: incremental line-item budgeting, zero-base budgeting, and performance-based budgeting.[29]

Incremental Line-Item Budgeting

Denver's budget model incorporates components of three different budgeting philosophies.

BMO uses an incremental line-item budget practice as part of its budget methodology. This type of budgeting "divides a budget into specific categories (account codes, e.g. minor office supplies . . . postage, etc.) and permits the annual expansion of each item based on a given inflationary percentage or dollar amount."[30] City agencies begin with their base budget, which includes all personnel costs, supplies and materials, and internal service fund charges needed to maintain the current level of services. Agencies also specify how elements of the base budget support the achievement of the Mayor's priorities. The base budget does not include additional items such as additional personnel, service enhancements or expansions, increases to overtime and on-call hours, new equipment, and new revenue streams. Each year, BMO defines what level of impact incremental changes will have on the base budget, and for the 2015 budget year, incremental changes were expected to be minimal and near zero growth for account codes under an agency's control.[31] BMO uses the incremental line-item budgeting method to help establish agencies' base budgets.

Zero-Base Budgeting

In addition to incremental line-item budgeting, BMO also applies a zero-base budgeting practice to the previous budget year's expenditures for certain account codes that generally contain one-time expenditures. This budget method "defines what is needed to deliver a service at a particular level of quality, for a period of time, regardless of what was budgeted in prior periods."[32] Account codes containing one-time expenditures should be zeroed out each year, and agencies are required to explain the budget needs for these codes. In 2015, BMO applied this philosophy to eighteen different account codes, such as the professional services account code, travel airfare/rail expense and travel incidental expense account codes, and dues or membership fees account code. In the event that an agency has multiple contracts encompassing one account code's budget, the agency must explain each contract separately. BMO uses the zero-based budgeting method to help establish agencies' base budgets.

---

[29] For the upcoming 2016 budget, BMO implemented a new web-based budget software system, Questica, to help improve the efficiency of the budget development and monitoring processes. BMO updated the budget development instructions it provides annually to agencies to reflect the implementation and changes that occurred in the budget process. The discussion of Denver's budget model is based upon a review of BMO's processes in place to develop the 2015 budget.

[30] BMO's 2015 Budget Manual, page 43. BMO allows budgetary account codes to be expanded up to an established inflationary percentage or dollar amount, if necessary, rather than each budgetary account code being expanded by a set percentage.

[31] *Ibid.*, page 11.

[32] *Ibid.*, page 47.

Performance-Based Budgeting

In addition to the two previously discussed budget methods, BMO also utilizes the performance-based budgeting practice, as the City strives to integrate principles of the Peak Performance initiative into the budget process. BMO defines performance budgeting as a method that "ties resources to projected outputs and/or performance results within a program rather than inputs or presumed service needs or activities conducted."[33] This budgetary method focuses on the relationship between program funding levels and expected results or outcomes.[34]

Performance-based budgeting involves the use of performance data in decision-making.

Performance-based budgeting incorporates principles of *performance management*. BMO defines performance management as a process that allows organizations to align their resources, systems, and employees to strategic objectives and priorities. BMO further defines that this process should incorporate actions that help guarantee that goals are met in an effective and efficient manner.[35] BMO considers a comprehensive performance management program to include strategies, mission-level metrics, workload measures, and targets for operational measures. In order to improve results, the data collected and reported upon must be used in decision-making and is ideally integrated into all aspects of an organization's work with the ultimate goal of providing better results for the public.

Within BMO's process of performance management, various performance measures are recorded, tracked, and collected. A performance measure is a description of an agency's work and the results of that work. In addition, performance measures should be based on data, tell a story about whether an agency, program, or activity is achieving its objectives, and determine whether progress is being made toward achieving policy or organizational goals. Specific examples of performance measures include inputs, outputs, and outcomes.[36]

Input Measures—Inputs are the resources required to deliver a service or produce a product at some desired level. For example, a City agency may require safety gear to protect personnel, as suggested to be replaced on a set schedule by federal standards. A basic numeric measure tracking the total gear needs of the agency represents an input measure.

Output Measures—Output measures are measures that generally try to quantify services provided or products produced by an agency, program, or activity. For example, if a City agency performs inspections, and measures the total number of inspections completed on an annual basis, that agency is utilizing an output measure.

Outcome Measure—Outcome measures are the result or consequence of what an agency, program, or activity did or achieved. For example, using information gained

[33] BMO's 2015 Budget Manual, page 44.
[34] *Ibid.*, page 4.
[35] *Ibid.*, page 4.
[36] *Ibid.*, pages 4-5.

through an infrastructure condition rating methodology to identify the annual infrastructure repair program needs, is an example of utilizing an outcome measure.

BMO uses the performance-based budgeting method to provide agencies an avenue to highlight agency accomplishments, identify and prioritize improvement areas, and support additional funding needs. As previously discussed, agencies use the annual Peak Performance reviews to report on the previous year's performance. In addition to these reviews, BMO requires agencies to use performance information, in the form of mission-level metrics, to support funding proposals.[37]

During the 2015 budget preparation cycle, agencies supplied BMO with Microsoft Excel decision package forms identifying funding proposals (budget requests) to be considered by the Mayor.[38] These funding proposals were for items not already included in the agencies' base budget. The decision package form requires agencies to identify the need for the proposal (e.g., legal mandate or risk to public or employee safety), provide a description of the proposal and one to three mission-level metrics that will be affected if the budget proposal is approved and implemented, and the budgetary effects of the proposal in cost and personnel. The 2015 decision package form is provided at Appendix B.

Finding 1 of this report addresses concerns regarding the use of performance measures in making budget decisions.

City and County of Denver's General Fund Reserves

According to the Government Finance Officers Association (GFOA), most state and local governments are required by law to pass a balanced budget.[39] Therefore, GFOA suggests that governments adopt a formal policy requiring a structurally balanced budget.[40] The City's balanced budget requirement, established by City Charter, states that, "The budget proposed by the Mayor shall not propose expenditures in excess of estimated opening balances and anticipated income."[41] This requirement applies to all City funds.

GFOA guidance also suggests that governments establish a minimum amount of funds to be held in reserve.[42] GFOA defines *reserves* as, "the portion of fund balance that is set aside as hedge against risk."[43] GFOA specifies that reserves maintained at their preferred levels may indicate a government is maintaining a structurally balanced budget, whereas declining reserves are a possible indication of an imbalanced budget because

[37] BMO defines mission-level metrics as high-level performance indicators that directly reflect progress toward departments achieving their mission. BMO's 2015 Budget Manual, page 43.
[38] In 2015, the budget request process changed with the implementation of Questica, and the decision package form is no longer used.
[39] Government Finance Officers Association, *Achieving a Structurally Balanced Budget* best practice, February 2012, accessed October 23, 2015, http://www.gfoa.org/achieving-structurally-balanced-budget.
[40] *Ibid.*
[41] City and County of Denver Charter, Article VII, Part 1, Section 4, *Balanced Budget; Emergencies; Contingency Reserve*, accessed October 23, 2015, https://library.municode.com/index.aspx?clientID=10257&stateID=6&statename=Colorado.
[42] Government Finance Officers Association, *Achieving a Structurally Balanced Budget* best practice, February 2012, accessed October 23, 2015, http://www.gfoa.org/achieving-structurally-balanced-budget.
[43] *Ibid.*

reserves might be funding on-going expenditures. In the event reserves are used to help balance a government's budget, the government should have a plan in place "to return to structural balance, replenish fund balance, and ultimately remediate the negative impacts of any other short-term balancing actions that may be taken."[44] Further, the government's plan should indicate time requirements for these activities to occur.

Furthermore, GFOA best practice guidelines discuss the importance of governments maintaining "adequate levels of fund balance to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenditures) and to ensure stable tax rates." Further, the guidelines encourage governments to establish a formal policy to address the appropriate level of unrestricted fund balance to be maintained and to provide guidance on how fund balance will be replenished if it falls below the target level.[45] GFOA provides guidelines for determining the appropriate level of unrestricted general fund balance stating, "The adequacy of unrestricted fund balance in the general fund should take into account each government's own unique circumstances. . . . Articulating these risks in a fund balance policy makes it easier to explain to stakeholders the rationale for a seemingly higher than normal level of fund balance that protects taxpayers and employees from unexpected changes in financial condition." Although GFOA discusses taking a risk-based approach to setting unrestricted general fund balance, this best practice also states that at a minimum, a government should maintain a balance of no less than two months of regular general fund operating revenues or expenditures, based on what is more predictable for a government.[46]

City's General Fund Reserve Financial Policy

The City's current General Fund Reserve Policy (GFR policy) was adopted in 2007 as a result of guidance provided by a task force established to review the City's financial organizational structure and reserve policies. In 2006, to address concerns highlighted by the City's independent external auditor and to evaluate the City's reserve policy for compliance with best practices and Generally Accepted Accounting Practices, Mayor John Hickenlooper created the Financial Management Task Force (Task Force).[47] The Task Force included ten individuals

The City has established various general fund reserves and a policy outlining their use.

[44] *Ibid.*

[45] While the City and County of Denver's financial reserve policies address the funding levels of the *unassigned* general fund balance, the Government Finance Officers Association (GFOA) speaks to the adequacy of *unrestricted* general fund balance. Unrestricted general fund balance encompasses three of the five separate categories of fund balance required for financial statements presented using Generally Accepted Accounting Principles (GAAP). GAAP separates these fund balance categories based on the type and source of constraints placed on usage, with the non-spendable and restricted fund balance being the most constrained, as the spending constraints are required from outside the government organization. The committed, assigned, and unassigned fund balance categories are deemed the least constrained as any spending constraints are imposed by the government itself. Therefore, GFOA defines unrestricted fund balance as the total of the amounts in the last three categories

[46] Government Finance Officers Association, *Appropriate Level of Unrestricted Fund Balance in the General Fund* best practice, September 2015, accessed October 26, 2015, http://www.gfoa.org/appropriate-level-unrestricted-fund-balance-general-fund.

[47] City and County of Denver press release, *Mayor Hickenlooper Announces Financial Management Task Force*, March 13, 2006, accessed October 23, 2015, https://www.denvergov.org/content/denvergov/en/mayors-office/newsroom/2006/mayor-hickenlooper-announces-financial-management-task-force.html.

from outside the City with both private- and public-sector experience. The Task Force was launched to develop recommendations on how to improve upon the City's decentralized and fragmented organizational structure of its financial functions and to develop fiscally sound reserve policies. As there had been debate within the City on the amount of reserves that should be set aside in its general fund, the Task Force was charged with evaluating the City's current reserves, benchmarking against other cities' reserves, and reviewing reserve best practices to develop recommendations on the appropriate amount of general fund reserves and when and how they can be used.[48]

Current City General Fund Reserve Policy

To help achieve City Charter requirements of a balanced budget and other legal requirements, address best practice fund balance guidelines, and account for fluctuations in operating revenues and expenditures, the City has established three general fund reserves–contingency reserve, unassigned fund balance, and TABOR reserve–and a GFR policy outlining their use.[49] The City's GFR policy addresses a tiered approach in how the three reserves should be used. In 2015, the amount of these three reserves combined to provide the City over 20 percent of budgeted expenditures, as follows:

- Contingency Reserve—2 percent of expected general fund expenditures
- Unassigned General Fund Balance—15 percent of annual general fund expenditures
- TABOR Reserve—3 percent of all covered funds

Contingency Reserve—City Charter requires the City establish a contingency reserve fund of at least 2 percent of budgeted general fund expenditures specifically for expenses arising from any "casualty, accident, or unforeseen contingency" after the yearly budget has been approved by City Council.[50] Charter also specifies that revenues earned during the year over those originally projected to be received and a beginning fund balance higher than estimated Increase the contingency reserve balance. In 2015, the City's general fund contingency reserve was established at $36.6 million.

The City's GFR policy addresses these City Charter requirements. According to the policy, this reserve is the most flexible of any other reserves in relation to its uses, and thus, is the first reserve the City will draw upon in the event revenue shortfalls or unanticipated expenditures occur after City Council passes the annual appropriation ordinance approving the City and County of Denver Mayor's Budget. BMO assumes that part of this reserve will be used in almost every year. BMO establishes the general fund contingency

[48] The general fund is the main operating fund for the City and County of Denver. This fund accounts for all general government activity that is not accounted for in other funds. The fund includes most tax revenues and fund activities traditionally associated with local government including public safety, public works, parks and recreation, health, and administration.

[49] The City also maintains contingency reserves in other City funds' budgets, such as the Capital Improvement Fund. Reserves held outside the City's general fund were not within the scope of this audit and therefore, not reviewed.

[50] City Charter states that, "The proposed budget for the general fund shall also include an amount, not less than two (2) percent of the total estimated expenditures set forth in the general fund for the ensuing year, for the payment of any expense, the necessity of which is caused by any casualty, accident or unforeseen contingency, after the passage of the annual appropriation ordinance." City and County of Denver Charter, Article VII, Part 1, Section 4, *Balanced Budget; Emergencies; Contingency Reserve*, https://library.municode.com/index.aspx?clientID=10257&stateID=6&statename=Colorado.

reserve amount and manages the request for and use of these funds through the annual supplemental appropriation process. The usage of these funds increases an agency's appropriation authority and therefore, City Council has final approval authority through the ordinance process.[51]

The policy addresses six criteria for the use of these reserves to increase agency operating budgets.

1. An unexpected event such as a natural disaster or an accident
2. Large unexpected retirement payouts or unrealized vacancy savings
3. A change in work program initiated or approved by the Mayor's Office
4. Prior year budget for a specific item that lapsed before the purchase
5. A technical correction of the original budget
6. A change in legislation creating an unfunded mandate

Finding 2 of this report addresses concerns noted in regards to the use of the City's general fund contingency reserve.

Unassigned General Fund Balance—In 2007, the Task Force recommended that the City maintain a target unassigned general fund balance (fund balance) reserve of 15 percent of expenditures, taking into consideration such factors as the City's current reserves, other cities' reserves, and reserve best practices. In addition, the Task Force recognized the volatility of Denver' sales tax revenue and TABOR restrictions when setting the target reserve. The City's GFR policy defines that, unless a severe economic or other crisis occurs, the reserve amount should not be set below 10 percent of expected expenditures. In 2015, the City's unassigned general fund balance reserve was budgeted to be $186.0 million, or 15.3 percent of operating expenditures.

Although the policy expresses that it is suitable to use fund balance to respond to a severe economic downturn, fund balance should not and cannot be used as a long-term approach to balancing budget concerns. Finally, the policy articulates that fund balance may be used when it has increased beyond reserve requirements due to more revenues being received than expected. In the event excess revenues occur, fund balance can be used for one-time expenditures, but not to supplement on-going operational expenses.

The policy also groups the usage of the fund balance reserves into three categories: the use of reserves above 15 percent, the use of reserves between 10 and 15 percent, and the use of reserves less than 10 percent.[52]

1. **Reserves Greater than 15 Percent—**When the unassigned general fund balance reserve is greater than 15 percent of expenditures, reserves may be applied to one-time expenditures, capital expenditures, and to reduce the City's

[51] BMO defines an appropriation as "an authorization, by ordinance, to a specified agency, program, project, or transfer fund to incur obligations and to expend from public money or anticipated public money." BMO's 2015 Budget Manual, page 39.
[52] City and County of Denver Mayor's 2015 Budget, pages 32 to 33, accessed October 22, 2015, https://www.denvergov.org/content/dam/denvergov/Portals/344/documents/Budget/Mayors_Budget.pdf.

outstanding debt. Policies further define that reserves in this category provide flexibility in their use, and are available for strategic investment and problem solving.

2. **Reserves between 10 and 15 Percent—**When the unassigned general fund balance reserve is between 10 and 15 percent of expenditures, reserves may be applied for two reasons: one-time expenditures and budget stabilization during normal economic cycles when less than historical average revenue growth occurs. The policy provides that reserves should only be used to offset revenue shortfalls or extraordinary expenditure demands.

   In addition, when revenue growth is below the historical average, the City should only use these reserves to provide a short-term solution to maintaining services until a balanced budget can be achieved through revenue growth or expenditure reductions. Further, expenditure reductions that do not affect essential City services should be implemented prior to the use of these reserves, and these reserves should be used very selectively.

3. **Reserves Less than 10 Percent—**When the unassigned general fund balance reserve is less than 10 percent of expenditures, reserves may only be used in response to "a severe crisis, economic or otherwise" and can only be used "in the most unusual or unexpected situations."

Additionally, per City policy, a replenishment plan should accompany any use of general fund balance reserves under the 15 percent target. When these reserves are established at less than 10 percent, the City should not allow discretionary expenditure growth until it is restored to 10 percent.

TABOR General Fund Reserve—Policy also addresses the Taxpayer Bill of Rights (TABOR), the 1992 amendment to Colorado's constitution, and its effect on the City's general fund balance. TABOR applies to all levels of government, including local government. It restricts a government from raising taxes without voter approval and prohibits a government from spending revenues collected from taxes when revenues grow faster than the rate of inflation and local growth without voter approval. In addition, TABOR requires a government to establish an emergency reserve fund of 3 percent of all covered funds, which can be met through a combination of cash reserves and real estate assets. There are restrictions on the use of these funds. For example, the funds cannot be used for economic conditions, revenue shortfalls, and salary and benefit increases. There are also replenishment requirements for the use of TABOR reserve funds. Any TABOR reserve funds must be replenished within one year. Because of these restrictions and replenishment requirements, the City's financial policy specifies that TABOR general fund reserves will only be used in the event of an extreme disaster.

In November 2012, Denver voters approved Ballot Initiative 2A, effective in 2013, allowing the City to collect, retain, and spend all tax revenue earned from existing gross tax rates when revenues exceed TABOR's limitation on tax revenue. However, this ballot initiative did not eliminate the emergency fund requirement. In 2015, the City's TABOR reserve was budgeted at $39.1 million. This audit did not assess the adequacy or use of the City's TABOR reserve.

Finding 2 of this report addresses concerns noted with the ongoing review and updating of City reserve fund policies and addresses the City adopting a risk-based approach to establishing general fund reserves.

SCOPE

This audit assessed the effectiveness of the Budget and Management Office's budget practices specific to the use of performance measures in budget decisions and the approach for setting and using the City's general fund reserves.

During the course of the engagement, at the request of the City's Chief Financial Officer (CFO), we did not attend the CFO or Mayor Budget Review meetings that are held as part of the budget process. During these meetings, agencies' budget requests are discussed. These meetings are not open to the public and discussions are not documented. As a result, we were unable to acquire certain information that would have made our review more complete. However, we believe that the evidence we obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

OBJECTIVE

This audit had the following two objectives:

1. To determine whether performance measures are being used in the City's budget development process and the extent to which performance information is based on reliable data
2. To assess the City's approach for setting and using general fund reserves, and to determine whether BMO is in compliance with its established reserve fund requirements, and whether reserve funds are being used in accordance with policy

METHODOLOGY

The methodologies utilized to achieve the audit objectives included, but were not limited to:

- Reviewing BMO and City policies and other information related to the City's budget process, including the process for agencies to submit budget expansion requests and the process for providing information on funding decisions to agencies
- Reviewing City Charter and other guidance regarding the establishment and use of the general fund contingency reserve and the unassigned fund balance
- Reviewing best practice literature related to performance based budgeting and the use of performance information in budget decision-making and best practices for the establishment and use of contingency reserves and unassigned fund balances
- Interviewing Budget and Management Office and Peak Performance personnel

- Selecting a sample of agencies for testing. To select the sample, auditors included only agencies that are funded by the general fund, considered maturity ratings assigned to agencies by the City's Chief Performance Officer, and ensured that each agency had a different BMO analyst assigned to it. Further, auditors excluded agencies the performance measures of which had previously been assessed by the Auditor's Office.
- Interviewing financial employees in four City agencies who are involved in developing and reporting performance information for their agency's budget requests
- Testing a sample of budget requests from four City agencies for performance measures and alignment of the measures with strategic objectives and goals
- Assessing the performance measures and other performance information submitted with the budget requests for the four agencies
- Reviewing quality assurance controls related to agencies' submission of performance information with their budget expansion requests and related to their supplemental budget requests
- Reviewing and comparing the City's General Fund Reserve Policy for best practice considerations
- Trending the unassigned fund balance over ten years to assess compliance with the City's minimum balance requirements
- Testing whether the City met the 2 percent contingency reserve and it was used as prescribed by law and City policy

FINDING 1

The Budget and Management Office Should Enhance Performance Measure Practices in the Budget Development Process

While agency budget requests include performance measures aligned with Mayoral priorities and agency objectives, audit work revealed that neither the Budget and Management Office (BMO) nor City agencies have established a formal process to validate performance measures provided by agencies during the budget process. Such a process is necessary to ensure that performance measures can be relied upon to make fully informed budget decisions. In addition, BMO has not developed a process by which to request, review, and retain documentation needed to support the measures.

We also found that, to increase transparency in the budget decision-making process, BMO could provide agencies with better information regarding how performance measures ultimately impact budget decisions. Upon completion of the budget process, BMO does provide some feedback to agencies. However, this feedback is largely verbal, limited, and does not address whether or how the performance measures impacted funding decisions, or the quality of the performance measures included with budget requests. When BMO does not fully convey how performance measures are used to make budget decisions, agencies cannot improve future proposals and may become less supportive of the performance budgeting philosophy. Accordingly, we make recommendations to enable better-informed decision making and increase transparency of the process.

Performance Measures Used To Support Budget Requests Are Not Validated

Collecting and reporting performance measures are a key component of the City's budget process because performance measures help the City make informed budget decisions that facilitate continuous improvement of City programs and services. To evaluate the quality of the performance measures being used during the budget process, we reviewed a sample of decision packages to determine whether measures are being consistently included, aligned with City and agency goals, and relevant to what is being requested.[53,54] We found no concerns in these areas. Considering the importance of these measures, we also sought to determine whether there are processes in place to ensure that the measures are supported by timely and accurate data. Through interviews, BMO analysts reported that they review the performance measures

[53] The decision package is a form that identifies an agency's request, the amount of funding required, the reason the funding is necessary, and performance metrics to support the need. See Appendix B for the 2015 decision package form. The terms *decision package*, *proposal*, and *request* are used interchangeably throughout this report.

[54] We reviewed a sample of 2015 budget requests from four City agencies: the Denver Fire Department, the Denver Public Library, the Department of Environmental Health, and the Department of Public Works.

for reasonableness. However, neither BMO nor agencies have established a formal process by which to validate performance measures with supporting documentation.[55]

Audit work identified issues related to performance measure validation. For example, one budget request, for the hiring of an additional social worker to staff a City-managed location visited by the public, explained that difficult customers who visit these types of locations often require intervention by security or police. The agency reasoned that an additional social worker would reduce the need for security or police and increase the level of comfort and safety experienced by customers. Specifically, the request cited an anticipated 25-percent increase in how comfortable and safe customers would feel at the location with the additional social worker. Although the request was funded, BMO did not validate the accuracy of the 25-percent projection documented within the request or obtain and review the supporting data or data-collection methodology that was used to develop the projection.

In another instance, we found that an agency used data generated by another agency to support a budget request but did not validate the data for accuracy. The budget request was for one full-time equivalent (FTE) and was accompanied by statistical information from the City's Risk Management Office Workers' Compensation Unit. The information accompanying the request was noted by auditors as potentially containing inconsistencies, which could arise from changes in coding, reporting parameters, or other requirements. However, agency personnel stated that there is no process they follow by which to validate Risk Management Office data to ensure the reliability of the information being provided. When agencies utilize data from another agency to support performance measures, it is even more imperative that this data is validated to ensure reliability.

In these examples, agencies did have documentation that could have been used to evaluate the validity of their performance measures; however, BMO has not developed a process by which to request, review, and retain such information. Prior to each budget cycle, BMO develops a Budget Manual that provides agencies with an overview of the upcoming budget process, including guidance regarding how to include performance measures to support budget requests. Although the guidance suggests that an agency consider whether reliable data is available, it does not specify how an agency should go about determining whether the data is indeed reliable. Further, nothing in the manual requires agencies to provide supporting information for the measures used or require that supporting documentation be retained by either the agency or BMO.

[55] We found requests that did not include performance measures. However, performance measures were not needed or useful for these requests. For example, one was a request to provide benefits for an on-call employee that did not previously have them, but benefits for this position are required as part of the federal Affordable Care Act. Another request included a metric that was more a goal than a true performance measure, but the request related to the remediation of a fuel leak, so it was necessary to take action to repair the leak. Although performance measures are desirable, it is unnecessary to develop and track them for a request related to circumstances such as a legal mandate or a price increase associated with a contract that is already in place.

Not validating the information that supports performance measures can result in budgetary decisions being made based on inaccurate performance information. For example, a request for expansion of services should be supported by data that demonstrates an increased demand for those services. However, if the data is flawed, the City could be spending money to expand services that are not truly needed. External stakeholders, including citizens, should be assured that budget decisions are based on reliable performance information.

Not validating the information that supports performance measures can result in budgetary decisions being made based on inaccurate performance information.

Other Organizations Have Identified Ways To Include Reliable and Supported Performance Information in Budget Decision-Making

We identified several organizations that have established methods by which to ensure that quality performance information is well supported and reliable. The State of Washington's Budget Division conducts regular formal reviews of performance measures to determine whether the objectives and measurements submitted by agencies demonstrate progress toward the purpose of the proposed activities and statewide priorities.[56] These performance assessments stress the importance of reliability, specifically that performance measures are supported by data that is verifiable, free from bias, and accurate. Lastly, these assessments make recommendations to agencies about how to improve the quality of their performance measures, including the need for alternative or additional measures.[57]

The City of Portland has had a long history of focusing on performance and results. In 1973, the Management Analysis and Review organization was created to provide in-depth management reviews of Portland agencies accompanied by recommendations for performance improvement. Performance measures were incorporated into Portland's budget documents in 1977, and since then, the city has explored various performance management systems. Currently, Portland utilizes the following data collection methodology in its budgeting process that incorporates six characteristics of effective performance measures: [58]

- **Simple—**Keeping measures simple and straight forward
- **Results-oriented—**Focusing measures primarily on outcomes, efficiencies, and outputs
- **Selective—**Concentrating on the most important indicators of performance

[56] The Budget Division uses criteria to determine whether performance measures are relevant, understandable, timely, comparable, reliable, and cost-effective.
[57] State of Washington, Office of Financial Management, *Performance Measure Guide*, July 2014, accessed October 23, 2015, http://www.ofm.wa.gov/budget/instructions/other/performancemeasureguide.pdf.
[58] The City of Portland Oregon, City Budget Office, Performance Management Manual, Transitioning the City from measurement and reporting to management and improving, December 2014, accessed September 29, 2015, https://www.portlandoregon.gov/cbo/article/513721.

- **Useful—**Providing information of value to the agencies operations and decision-makers
- **Reliable—**Providing accurate, consistent information over time
- **Comparable—**Allowing benchmarking against past performance, other cities, best practices, and an internal strategic plan

In addition, the City of Portland requires agencies to submit a methodology appendix for each key performance measure.

To address the weaknesses identified, we recommend that BMO establish a formal process to ensure that performance information is reliable. Specifically, BMO should require agencies to provide supporting documentation for performance measures included in agency budget proposals. This support should include, at a minimum, the source of the data, any limitations or assumptions associated with the data or measures, and whether the data was validated by the agency and the process used to validate, if applicable. BMO should then develop a process to determine when to assess agency documentation for reliability. This could include establishing a risk-based approach that includes set criteria that would prompt the need for additional review and independent validation of the data.

Enhanced Transparency Is Needed Regarding How Performance Information Impacts Budget Funding Decisions

Audit work identified a lack of transparency regarding how performance measures ultimately impact budget request decisions. We were unable to determine whether or how performance metrics impacted the decision to accept or deny a budget request. In addition, agency personnel reported that they receive limited information regarding the reasons a budget request was accepted or denied, and expressed that additional information would be helpful for preparing future budget requests. Finally, we identified instances where the performance measures used to support budget requests could be enhanced. Additional feedback from BMO could enhance transparency in the budget process and help agencies continue to improve the quality of their performance measures and budget requests.

Audit work was conducted during a portion of the City's 2016 budget process, so we were not able to evaluate the full budget process for the current year. Further, at the request of the Chief Financial Officer (CFO), we did not attend the CFO or Mayor Budget Review meetings that are held as part of the process. During these meetings, agencies informed auditors that their budget requests are discussed. These meetings are not open to the public and discussions are not documented. As a result, we were unable to assess whether and how performance information is used when making decisions to accept or deny agency budget requests.

As part of audit work, we interviewed personnel from four City agencies who were involved in submitting the 2015 budget proposals for their agencies. All four indicated that the reasons behind funding decisions are not always clear. For example, agency personnel stated that when a request is denied, agencies receive limited feedback

explaining why. One respondent characterized the process as a "black box" where the agency does not know how funding decisions are made.

These employees expressed that it would be helpful to them if BMO provided more specific feedback regarding how the ultimate funding decisions were made. More formal and specific feedback could help their agencies determine how to enhance future requests and the associated performance measures. Enhanced feedback could also help agency personnel assess whether they should continue to utilize resources to develop and submit a similar budget request in a subsequent year, or whether the chance of funding is so low that even different performance measures would not result in the request being accepted. These employees noted that preparing the decision packages, the required performance metrics, and the various presentations throughout the budget process takes a significant amount of employee time. Therefore, any information that could make the process more efficient and effective would be highly valued.

A key element of enhanced communication by BMO concerns feedback on the quality and relevance of performance measures submitted by agencies in their budget proposals. We tested nine budget requests for the presence of outcome measures. Testing revealed that all nine contained at least one outcome measure. However, audit work also revealed that the performance measures supporting some budget requests could be enhanced. For example, one budget request we tested related to expanding the hours that a City building is open to the public. This request included three performance measures, and we determined that all three represent outcome measures. Although the measures are outcome measures, one of them relates to an increase in the number of members that might visit this building, but this measure appears to be a Citywide measure rather than a measure for the specific building associated with the request. Although it is reasonable to project increased membership if a building is open to the public more hours each week, increased Citywide membership does not provide information related to demand for services provided by the specific location for which the additional hours are requested. In this example, the measure is not specifically connected to what the agency is requesting, inhibiting decision-makers' ability to assess how funding will impact demand at this location. If this or a similar request was denied based on the quality of the performance measures used to support it, the agency would benefit from BMO providing this feedback so the agency can work to improve the measures.

We identified another example associated with a budget request that was not part of the sample we tested. In this example, the agency supported their request for additional inspectors with a measure related to the number of permits issued. Although inspectors' duties in this agency include issuing permits, agency personnel reported that their goal is to have inspectors conducting inspections rather than issuing permits. In this example, the measure is not wrong, but it does not tell the whole story of what the agency is trying to achieve. If the number of permits issued increases in subsequent years, it will appear to be a positive outcome when it actually represents a negative outcome. In this case, a different performance measure is needed.

BMO could provide agencies with more detailed and formal feedback regarding the reasons for accepting or denying budget requests, more information regarding how the performance information submitted with their budget requests was used to make budget decisions, and feedback regarding how agencies could improve the quality of the performance measures. Agency personnel reported that when final budget decisions have been made, BMO communicates with them regarding which requests were funded and which were not. However, information regarding the reasons for funding or declining to fund requests is limited. Further, no information is provided regarding whether or how the performance measures impacted the final decision, or regarding the quality of the performance measures included with the budget requests.

> BMO could provide formal feedback regarding how performance information was used to make budget decisions.

Currently, BMO does provide agencies some feedback after funding decisions have been made. Specifically, the BMO Director calls each agency director to discuss final funding decisions; these discussions are not formalized or documented. Additionally, BMO sends each agency director an email with a list of the agency's proposals and the corresponding final funding decisions. This document relates primarily to which requests were accepted and which were denied, and it does contain a notes column for information related to funding decisions. However, the notes tend to be general in nature and limited. For example, for one agency, twelve of thirteen denied FTE requests had the same note: "Limited GF FTE capacity." GF refers to the City's general fund, so this just means there was limited capacity in the general fund for funding FTE requests. However, this type of explanation does not provide the agency with the specific reasons why these requests were denied or why other requests for additional FTEs were approved. This type of explanation does not provide any feedback regarding whether or how performance information factored into the final funding decision.

BMO communications for four of the twelve denials citing "Limited GF FTE capacity" provided some limited information in the notes column, but this information is not related to the reasons behind the funding decision. For example, the note for one of the denials directs the agency to leverage consolidated staff from another division in the agency. However, other requests for additional FTE by the same agency were accepted without a detailed explanation regarding why. Additional feedback regarding why some FTE requests were approved while others were not would be helpful to the involved agency.

During audit work, the BMO analysts and agency personnel we interviewed reported that communication between them during the budget process is largely through face-to-face meetings or telephone calls. They reported that analysts and agency personnel often discuss the agency's performance measures and the analysts will request agencies to develop more or better performance measures. However, the BMO analysts are not involved in final funding decisions, so all were consistent in reporting that they cannot provide their assigned agencies with specific reasons behind funding decisions or how performance metrics impacted the decision.

The Mayor's 2016 budget was being finalized as we concluded audit work. We followed up with agency personnel to determine whether BMO communicated budget decisions in the same way for 2016 budget decisions. Agencies reported that information regarding the reasons for budget decisions and how performance information factored into those decisions was not relayed to them for 2016 budget decisions. We obtained copies of three of the emails that BMO analysts sent to agency personnel. Two of these emails, sent by two different analysts, contained the same language: "Resources were primarily dedicated to external customer experience improvements, improvements to Denver's multimodal transportation choices, the city's safety net and implementation of reform at the Denver Sheriff's Department."[59] This feedback speaks to the overall concepts guiding funding decisions, but does not provide the agency with specific information about their requests, the reasons they were or were not funded, or how their performance measures impacted funding decisions.

The Lack of Transparency Related to Funding Decisions Has Negative Effects

The lack of transparency regarding funding decisions has two primary negative effects. First, the City cannot provide assurance that budget decisions are based on performance information. Second, agency frustration with the process may negatively impact buy-in regarding the use of performance information in budget decision-making.

The City strives to provide the most effective and efficient services to the Denver community. A key strategy to achieve this goal is to align resources and strategies with the outcomes an agency or program hopes to achieve.[60] For budget requests, agencies are asked to explain how resource changes will impact the Citywide goals as well as their own strategies and goals. However, the full realization of this strategy requires that, in addition to funding *requests* being aligned with strategies and goals, the City's funding *decisions* should also be aligned with strategies and goals. Without communication regarding how performance information impacted final funding decisions, the City cannot provide assurance to stakeholders, including agency personnel and citizens, that budget decisions were based on performance information. Further, stakeholders do not know how performance information was utilized in the decision-making process.

Limited feedback regarding how the City arrived at budget decisions can also result in frustration with the process. Our interviews with personnel from four City agencies revealed some negative perceptions of the process for accepting or denying budget funding requests. For example, interviewees questioned why some requests deemed high priority by an agency do not get funded while low-priority requests do get funded. Others expressed concern that agencies try to "game" the budget process at times, for example by inflating the amount of a request that they believe has a good chance of being funded. Some also suggested that, under certain circumstances, political considerations may influence funding decisions more than performance information.

BMO conducts an annual customer service survey provided to agency leadership and budget personnel, the results of which were more positive than our interviews. BMO's 2015 survey included a question regarding how well BMO communicates budget

[59] Source: Emails obtained from agency personnel involved in the 2016 budget request process.
[60] BMO's 2015 Budget Manual, page 3.

decisions to agencies. According to survey results provided by BMO, approximately 80 percent of the respondents agreed or strongly agreed that the reasons behind budget decisions were clearly communicated and well understood. Although the responses to BMO's survey indicate a more positive sense of satisfaction in this area than our interviews, the discrepancy indicates that there is room for improvement.[61]

Transparency regarding funding decisions is particularly important for the City and County of Denver's budget process. Because Denver has a hybrid budgeting process rather than a strict performance-based process, the Mayor and City Council have significant authority to make funding decisions. The Mayor has communicated the importance of performance measures by stating that budget decisions will be based on measures to ensure that resources align with strategic goals. Communicating how performance information impacted budget decisions will enable the full realization of the goal to base budget decisions on performance information by enhancing transparency in this key part of the budget cycle and help to help maximize the degree to which budget funding decisions are based on performance information.

Like the City and County of Denver, the State of Washington's Office of Financial Management (OFM) requires state agency budget requests to be linked to performance measures so decision-makers can understand what results or improvements to expect from an investment of resources.[62] In addition, OFM is required to conduct regular formal reviews of agency performance measures. These performance assessments include recommendations to agencies regarding how to improve the quality of measures, including alternative or additional measures. OFM personnel also provide training to agencies on performance measurement. Although BMO and agency personnel indicated that BMO often provides this type of assistance, developing a more formal approach to providing feedback would ensure it is done on a consistent basis.

To increase transparency in the budget request process, we recommend that BMO enhance communication to all applicable agency personnel at the end of the budget process. In this communication, BMO could provide additional feedback regarding the reasons why budget requests were denied and whether performance measures submitted with a request could be enhanced or alternate or additional measures could be developed to better support a subsequent similar budget request.

[61] The 2015 annual customer service survey was provided after audit fieldwork was completed and therefore we did not validate the results of the survey.

[62] *Performance Measure Guide*, State of Washington Office of Financial Management, June 2014, last accessed on October 29, 2015. See http://www.ofm.wa.gov/budget/instructions/other/performancemeasureguide.pdf.

RECOMMENDATIONS

To ensure that the performance measures used in budget requests are reliable and to improve transparency regarding how performance measures impact budget decisions, the Budget and Management Office should:

1.1 Establish a formal process to ensure that performance information is reliable. Specifically, BMO should:

a. Require that agencies provide BMO with the supporting documentation for performance measures included in agency budget proposals. This support should include, at a minimum, the source of the data, any limitations or assumptions associated with the data or measures, and whether the data was validated by the agency and the process used to validate, if applicable.

b. Develop a process to determine when to assess agency documentation for reliability. This could include establishing a risk-based approach that includes set criteria that would prompt the need for additional review and independent validation of the data.

1.2 Enhance communication to all applicable agency personnel at the end of the budget process. In this communication, BMO could provide additional feedback regarding the reasons why budget requests were denied and whether performance measures submitted with a request could be enhanced or alternate or additional measures could be developed to better support a subsequent similar budget request.

FINDING 2

The Budget and Management Office Can Take Steps To Enhance the Determination of Unassigned General Fund Balance and Contingency Reserves Documentation

Although the City has established a General Fund Reserve Policy (GFR policy) and adheres to this policy when setting general fund budgeted reserves, the audit identified three areas for improvement. First, the Budget and Management Office (BMO) has not reviewed or reassessed the policy in light of recent best practice considerations for setting unassigned general fund balance. Second, general fund contingency reserves have been used for known expenditure needs that were not previously budgeted and therefore do not appear to be unforeseen or unanticipated, as required by the City's GFR policy. Third, we identified that supplemental fund requests lack formal supporting documentation. By addressing these three areas, BMO can better ensure that it has established appropriate reserves to address Citywide risks and allow for fully informed decisions regarding the use of contingency funding.

BMO Should Consider Recent Best Practices To Determine Unassigned General Fund Balance

In assessing BMO's approach to setting and using the City's general fund reserves, we found that the City's GFR policy is in compliance with legal requirements set forth in City Charter. The City abides by this reserve policy when BMO establishes budgeted general fund reserve balances each year. The City's GFR policy is communicated through the annual City and County of Denver Mayor's Budget.

The City's General Fund Reserve Policy is in compliance with legal requirements and reflects some current best practice guidance.

The City's GFR policy reflects some current best practice guidance. Specifically, the policy addresses the following Government Finance Officers Association's (GFOA's) best practice guidance: that a government should establish a formal policy for the level of unreserved fund balance that should be maintained in the general fund and adopt a structure and method for increasing or decreasing the unrestricted general fund balance level over time, specifically addressing how fund balance will be replenished when the level falls below the minimum set in the policy. However, the policy has not been reviewed or reconsidered to address more recent updates to the best practice issued by GFOA.[63] In

[63] The Government Finance Officers Association (GFOA), founded in 1906, represents public finance officials throughout the United States and Canada, with members are federal, state/provincial, and local finance officials. The GFOA's mission is to enhance and promote the professional management of governmental financial resources by identifying, developing, and advancing fiscal strategies, policies, and practices for the public benefit. The GFOA provides best practice guidance, consulting, networking opportunities, publications including books, e-books, and periodicals, recognition programs, research, and training opportunities for those in the profession. http://www.gfoa.org/

addition, recent consulting services provided by GFOA indicate that the adoption of a risk-based approach when determining undesignated general fund reserve needs is an emerging method used to accomplish an element of GFOA best practice and, as such, should be considered for the City.

BMO Should Consider Using a Risk-Based Approach To Determine the Appropriate Level of Unassigned General Fund Balance

While the City's GFR policy addresses some of GFOA's current best practice guidance, there are other areas of the City's policy that should be reviewed to reflect newer guidance.[64] The City's GFR policy establishes a 15 percent unassigned general fund balance target with a minimum of 10 percent. BMO budgeted for an unassigned general fund balance of approximately $94 to $186 million for the budget years 2011 through 2015. These amounts fell within the acceptable range established by the City's policy. However, BMO and other Department of Finance (DOF) divisions have not reviewed the policy to account for updated best practice guidance that suggests a level different than 15 percent may be warranted based on a government's size and unique circumstances.

At the time the City adopted its GFR policy, GFOA recommended that general-purpose governments, regardless of size, maintain unreserved general fund balance of at least 5 to 15 percent of regular general fund operating revenues, or of no less than one to two months of regular general fund operating expenditures. GFOA now recommends that at a minimum, general-purpose governments, regardless of size, maintain the general fund unrestricted budgetary fund balance at no less than two months of regular general fund operating revenues or regular general fund operating expenditures. In addition, GFOA's guidance further specify that for states and the nation's largest governments, an unrestricted fund balance lower than the recommended minimum may be suitable and that government organizations should assess the adequacy of this balance based upon their own specific conditions.

> Establishing an unrestricted fund balance different than the recommended minimum may be suitable for larger municipal governments such as Denver.

To help local governments determine the optimal level of unrestricted general fund balance reserves, GFOA has been developing a risk-based approach for establishing reserves. Recent consulting practices provided by GFOA to local government organizations reflect this approach, which identifies and weighs risks and determines a dollar amount necessary to mitigate those risks. This contrasts with the City's current approach of using a flat percentage when setting unrestricted fund balance. A number

[64] In 2002, the Government Finance Officers Association (GFOA) developed a best practice on determining the appropriate level of unrestricted general fund balance. GFOA subsequently revised this best practice in 2009 and again in September 2015. The more recent updates specifically clarify the minimum level of undesignated general fund reserves most governments should have in place. In addition, current GFOA consulting practices have identified the potential to determine undesignated general fund balance needs by identifying a City's general fund risks and determining the dollar amount of money necessary to address those risks. Source: Government Finance Officers Association, *Determining the Appropriate Level of Unrestricted Fund Balance in the General Fund (CAAFR, Budget) (2015)*, accessed October 19, 2015, http://gfoa.org/appropriate-level-unrestricted-fund-balance-general-fund.

of local governments have used the GFOA general framework. The City of Colorado Springs, Colorado, is an example of a local government that applied the risk-based model.

Colorado Springs engaged GFOA to help them determine the appropriate level of unrestricted general fund reserves it should maintain. Working together, the GFOA and Colorado Springs analyzed the risks that influence the level of reserves the City needs as a hedge against uncertainty and loss. The GFOA utilized the following "Triple-A" approach in helping Colorado Springs determine the appropriate size of its reserve.

1. **Accept** that the government organization is subject to uncertainty, including events that have not yet been imagined.
2. **Assess** the potential impact of the uncertainty. Applying historical reference cases may be useful in establishing a baseline of uncertainty.
3. **Augment** the uncertainty identified because the range of uncertainty actually faced will almost always be greater than assessed. While historical reference cases may provide a basis for augmentation, they may not be sufficient to account for all future possibilities.

The Colorado Springs assessment identified three primary risks: volatility of sales tax revenue; the potential for the city's storm sewer and bridge infrastructure to fail; and the city's vulnerability to extreme events such as wildfires, floods, and snowstorms. Secondary risk factors were also examined and identified, including cash flow, pension fund obligations, and the potential for unexpected spikes in expenditures. The results of this analysis identified a set dollar amount of necessary unrestricted fund balance that should be maintained by Colorado Springs, which was then converted into a percentage. This is in contrast to establishing a set percentage that may not fully address all of a government's needs.

Such an approach to analyzing a government's specific risks to determine the appropriate level of reserves needed to address those risks is similar to *Enterprise Risk Management* (ERM) in the private sector. According to the Committee of Sponsoring Organizations of the Treadway Commission (COSO), all entities are faced with certain levels of uncertainty, and must determine what level of uncertainty they are willing to accept, also known as *risk appetite*. ERM begins with assessing senior management's risk appetite, and then determining the response or what action will be taken to address the identified risks. Ways in which the risks can be addressed include to avoid the risk, reduce the risk, share the risk (e.g., by obtaining insurance), or accept the risk.[65]

The Standards for Internal Control in the Federal Government (Standards), as promulgated by the U.S. Government Accountability Office, also provide guidance related to identification, analysis, and response to the potential impact of risks on a government's internal controls.[66] For example, if a government organization identifies a

[65] Committee of Sponsoring Organizations of the Treadway Commission, *Enterprise Risk Management—Integrated Framework Executive Summary*, September 2004, accessed October 30, 2015,http://www.coso.org/documents/coso_erm_executivesummary.pdf.

[66] United States Government Accountability Office, *Standards for Internal Control in the Federal Government*, page 37, accessed November 4, 2015, http://www.gao.gov/assets/670/665712.pdf.

risk of volatility and dependence on sales tax revenues, the Standards emphasize management needs to closely monitor sales tax revenues and other linked economic indicators.

BMO has not considered using a risk-based approach to determining the actual dollar amount needed in the unassigned general fund balance and therefore, has not assessed the appropriateness of this balance based upon the City's size and specific conditions or risks. Instead, BMO establishes the budgetary unassigned general fund balance according to its current policy target of 15 percent, with a minimum of 10 percent. Determining the City's unassigned general fund balance based upon risks is important because every government is unique in its specific circumstances and risks are real and must be addressed to ensure the City meets its ongoing obligation to provide services to its constituents. Furthermore, as a result of factoring in size and unique circumstances when establishing this fund balance, some government organizations may require an amount different than the GFOA's recommended two months of operating revenues or expenditures.[67]

Therefore, we recommend that BMO, in conjunction with other Department of Finance divisions, periodically assess the policy that establishes the unassigned general fund balance. As part of this assessment, BMO should identify best practices and should conduct an analysis of Citywide risks, which should take into account what other reserves are available to address some of those risks, and then ultimately determine the total dollar amount that is needed from the unassigned general fund balance to address remaining needs. Due to potential limitations in City resources and expertise, BMO should determine whether this assessment is performed by internal resources or by utilizing an external source that is knowledgeable in this approach. In addition, after performing a risk-based assessment and establishing unassigned general fund balance reserves, it will be important to update the GFR policy to communicate results of the risks identified and how they affected the determination of unassigned general fund balance. This will help explain and provide increased transparency to stakeholders regarding the rationale behind the level of fund balance established and how that balance will help protect stakeholders from unexpected changes in financial condition.

The City's General Fund Reserve Policy Should Be Expanded for Additional Contingency Reserve Usage

We found that general fund contingency reserves were expended in 2013, 2014, and 2015 for reasons other than unforeseen or unexpected contingencies. These expenditures do not appear to comply with City policy as written. The City's general fund contingency reserve is established pursuant to City Charter and requires that a reserve balance of at least 2 percent of estimated expenditures be set aside to cover expenditures arising after City Council passes the annual appropriation ordinance that

[67] For example, a government organization with a well-diversified revenue base may need lower levels of unrestricted general fund reserves. In comparison, a government organization that is highly dependent on volatile sales tax revenues or government grant aid may require a higher level of unrestricted general fund balance.

result from a "casualty, accident, or unforeseen contingency."[68] City Charter also specifies that unanticipated revenues earned above original projections or a beginning fund balance higher than estimated automatically increase the contingency reserve.

The term "unforeseen contingency" has been deemed flexible in its interpretation by both BMO and the City Attorney's Office.[69] The City's contingency reserve policy addresses Charter requirements and expands upon the idea of flexibility in the use of reserves. However, the policy describes specific allowable criteria for the use of the reserves to increase an agency's operating budget. These criteria include unexpected events, retirement payouts, or unrealized vacancy savings; a change in an agency's work program initiated or approved by the Mayor's Office; an amount budgeted in the prior year that lapsed prior to the related item being purchased; a correction to the original budget; and legislative change that creates an unfunded mandate.

> The City's interpretation of "unforeseen contingency" does not align with the contingency reserve policy.

General fund contingency reserves are expended through the City's supplemental appropriation request process, which is managed by BMO. Agency managers are responsible for identifying significant changes in the expected level of services provided or work performed, planned spending, or actual revenue received and notifying BMO of these changes that ultimately affect the budget. BMO also reviews monthly actual expenditure and revenue reports and meets with agency personnel routinely to monitor agency budget progress. These processes help identify whether a supplemental budget request is necessary.

The City's Policy Regarding the Use of Funds for Unforeseen Contingencies Does Not Reflect Its Practice

To determine whether general fund contingency reserves are being spent in accordance with policy, we reviewed five supplemental requests.[70] We found that while some reserves were expended for items provided for in the policy, there were also expenditures for items not specifically identified in the established criteria and could have been characterized as foreseeable and anticipated. For example:

- $750,000 in contingency reserves were approved for various agencies to become current on computer and radio equipment replacement schedules, which had fallen behind while the City recovered from the 2007 to 2009 economic downturn.

[68] City and County of Denver Charter, Article VII, Part 1, Section 4, *Balanced Budget; Emergencies; Contingency Reserve*, https://library.municode.com/index.aspx?clientID=10257&stateID=6&statename=Colorado.

[69] City and County of Denver, Office of the Auditor, performance audit report of *Finance Office Budget Process*, issued June 2006, accessed on October 29, 2015, https://www.denvergov.org/content/dam/denvergov/Portals/741/documents/Finance_Office_Budget_Process_Performance_Audit.pdf

[70] The five supplemental requests reviewed involved multiple City agencies and totaled over $13 million in additional appropriations approved from the general fund contingency reserve. Three of the supplemental requests reviewed were approved from the 2014 budgeted contingency reserve, while the other two were from the 2013 and 2015 budgeted contingency reserves, respectively.

- $1.65 million in contingency reserves were approved for a project that assessed the condition of all City facilities, which had been identified as necessary several years earlier.

When events or circumstances that were foreseeable at the time the annual budget was developed are not included as part of the budget and are then funded through contingency reserves, as discussed above, it reduces the amount of reserves available in the event a truly unforeseen or unanticipated event arises. As a result of the City's flexible interpretation regarding use of contingency reserves, we recommend that BMO, in conjunction with other DOF divisions, expand City GFR policy language to incorporate the usage of these reserve funds for purposes not clearly identified in the established criteria, such as foreseen expenditures not budgeted in the current year.

Supplemental Requests Should Include More Formal Documentation To Support the Need for and Use of General Fund Contingency Reserves

BMO recommended, and City Council ultimately approved, supplemental requests from the general fund contingency reserve that lacked complete documentation supporting the need for and usage of the funding. During our review of five general fund contingency reserve supplemental requests and discussion with agency personnel, we found that although the City's GFR policy provides guidance on the use of contingency funds, BMO should establish additional guidance regarding how agencies request and support their supplemental requests.

An approved supplemental request increases an agency's available spending after the annual budget has been established. During the regular budget development process, agencies must provide standard decision packages to document and support their requests. The decision package is a form that identifies an agency's request, the amount of funding required, the reason the funding is necessary, and performance metrics to support the need.[71] We noted no such form or level of documentation to support supplemental funding requests.

Formalizing the supplemental request process, including documentation necessary to support these requests, should facilitate and expedite BMO's review and help ensure that contingency funds are used in accordance with documented guidelines. Therefore, we recommend that BMO develop a formal supplemental request process that that includes a structured request document to ensure appropriate documentation is provided and retained to support the need and use of general fund contingency reserves.

[71] The decision package form is documented at Appendix B.

RECOMMENDATIONS

To better determine the City's unassigned general fund balance needs and to enhance the City's General Fund Reserve Policy and use of general fund contingency reserves, we make the following recommendations:

2.1 In conjunction with other Department of Finance divisions, the Budget and Management Office should periodically assess the policy that establishes the unassigned general fund balance.

a. As part of this assessment, BMO should identify best practices and should conduct an analysis of Citywide risks, which should take into account what other reserves are available to address some of those risks, and then ultimately determine the total dollar amount that is needed from the unassigned general fund balance to address remaining needs. Due to potential limitations in City resources and expertise, BMO should determine whether this assessment is performed by internal resources or by utilizing an external source that is knowledgeable in this approach.

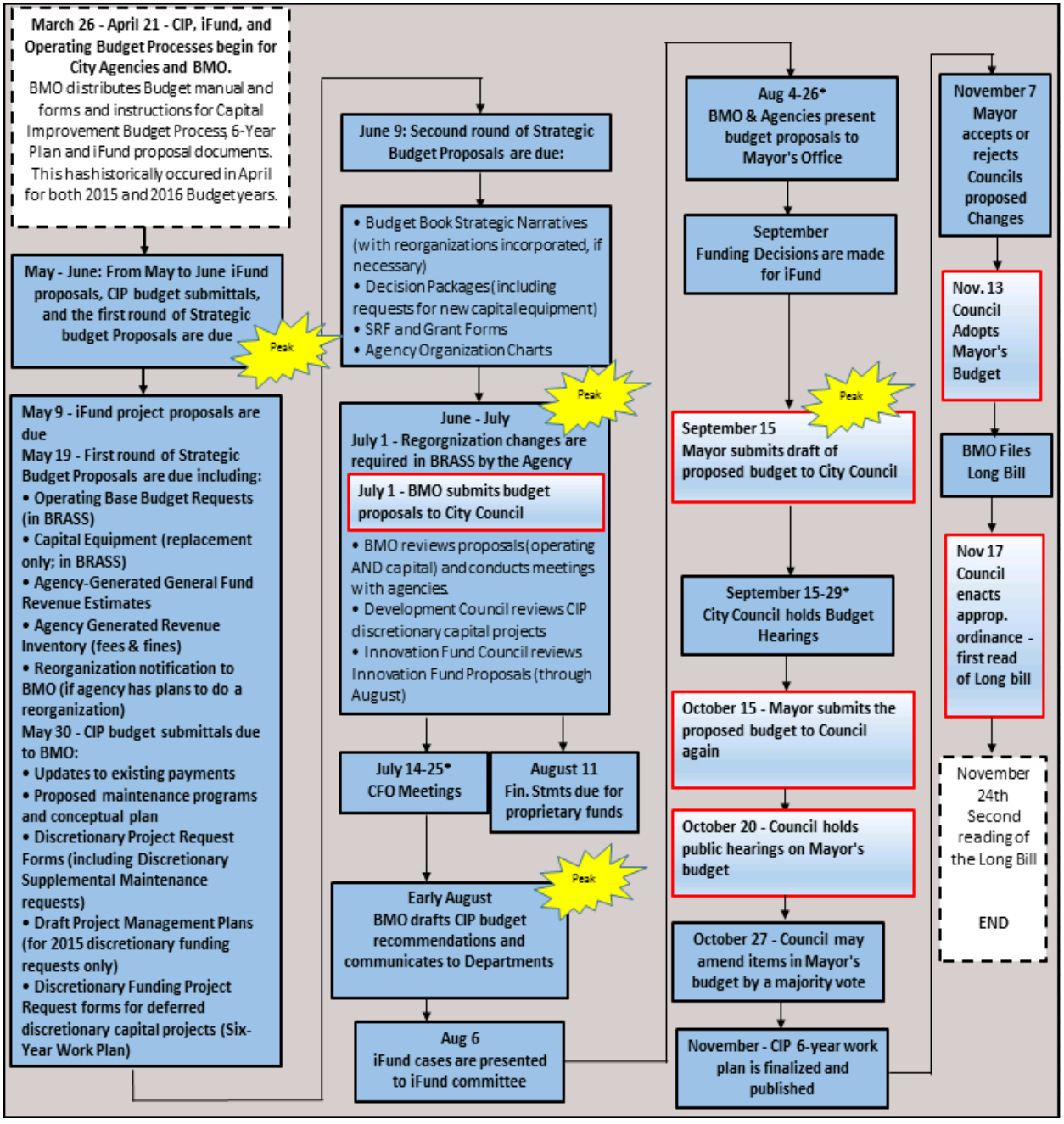
b. After performing a risk-based assessment and establishing unassigned general fund balance reserves, the General Fund Reserve policy should be updated to communicate results of the risks identified and how they affected the determination of unassigned general fund balance.

2.2 In conjunction with other Department of Finance divisions, the Budget and Management Office should expand City General Fund Reserve Policy language to incorporate the usage of contingency reserves for purposes not clearly identified in the established criteria, such as foreseen expenditures not budgeted in the current year.

2.3 The Budget and Management Office should develop a formal supplemental request process that includes a structured request document to ensure documentation is provided and retained to support the need and use of general fund contingency reserves.

APPENDICES

Appendix A – Denver's 2015 Budget Process



Source: Developed by auditors using the Budget and Management Office's 2015 Budget Manual instructions.

Appendix B – Budget and Management Office's 2015 Decision Package Form

2015 Decision Package

Please fill out one tab for each Decision Package.

Department:

Contact Person:

Phone:

Excel Tab No.:	DP 1

Fund	Control Org

Mayor's Priority/Goal:
**Use drop down list to select Peak Priority*

Primary Program Affected:
**Use drop down list to select a program from the Program Inventory*

Is proposal directly due to any of the following:	Yes / No	If yes, please explain
Legal mandate		
Risk to public or employee safety		
Next phase to implement a project already started		

Department priority #:
(Assign priority numbers with an "R" first for reductions and an "E" first for expansions. For example, R1, R2 and E1, E2, etc.)

Duration:
Use Drop Down List

Proposal Description

Title of Proposal:	
Brief Description of Proposal:	
Results/Outcome Proposal Seeks to Achieve:	

Mission-level Metrics -- List 1 to 3 mission level metrics that will be "moved" by implementing the proposal

Metric 1:	
Metric 2:	
Metric 3:	

Detailed Proposal Resources -- List the resources needed to achieve the intended results and "move the needle" on the metrics

Personnel Resources *(see comment box for instructions ->)*

Tracking Org. Number	Position Number (For FTE reductions)	Quantity (+/-)	Job Code	Job Title	Salary (Always enter as a positive #.)	Salary Total	Benefits (+/-)	Total
						$0		$0
						$0		$0
						$0		$0
						$0		$0
	2015 Total FTE:	0.00				2015 Total FTE Costs:		$0

Supplies, Services & Equipment Resources *(see comment box for instructions ->)*

Tracking Org. Number	Explanation	Total
		$0
		$0
		$0
		$0
	2015 Total Costs:	$0

Revenue Changes

Description	Amount (+/-)
	$0
	$0
2015 Revenue Total:	$0
NET FINANCIAL IMPACT:	$0

Please provide any other information relevant to the proposal:	

Source: Obtained from a City agency when reviewing 2015 decision packages submitted to the Budget and Management Office.

AGENCY RESPONSE

Department of Finance
Budget and Management

201 W. Colfax Ave
Dept 1010
Denver, CO 80202
p: 720.913.5500
f: 720.913.5599

DENVER
THE MILE HIGH CITY

December 4, 2015

Mr. Kip R. Memmott, MA, CGAP, CRMA
Director of Audit Services
Office of the Auditor
City and County of Denver
201 West Colfax Avenue, Dept. 705
Denver, Colorado 80202

Dear Mr. Memmott:

The Office of the Auditor has conducted a performance audit of the Budget and Management Office.

This memorandum provides a written response for each reportable condition noted in the Auditor's Report final draft that was sent to us on November, 24, 2015. This response complies with Section 20-276 (c) of the Denver Revised Municipal Code (D.R.M.C.).

AUDIT FINDING 1
The Budget and Management Office Should Enhance Performance Measure Practices in the Budget Development Process

RECOMMENDATION 1.1
Establish a formal process to ensure that performance information is reliable.
Specifically, BMO should:

a. Require that agencies provide BMO with the supporting documentation for performance measures included in agency budget proposals. This support should include, at a minimum, the source of the data, any limitations or assumptions associated with the data or measures, and whether the data was validated by the agency and the process used to validate, if applicable.
b. Develop a process to determine when to assess agency documentation for reliability. This could include establishing a risk-based approach that includes set criteria that would prompt the need for additional review and independent validation of the data.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
Agree	April 2016 Annual Budget Instructions	Steve Bohn 720.913.5501

FOR CITY SERVICES VISIT DenverGov.org | CALL 311

Narrative for Recommendation 1.1
Recommendation 1.1.A. When agencies submit performance data during the budget process, agencies will be required to fill out a form identifying the source of performance data, any limitations or assumptions associated with the performance data, in addition to if the data was validated by the agency and the process used to validate the data.

Recommendation 1.1.B. During the budget cycle, BMO will select at least one performance measure from each agency to review and validate. Criteria will be created to prompt BMO to request additional inquiry of all agency performance measures if discrepancies are identified during the initial review process.

RECOMMENDATION 1.2
Enhance communication to all applicable agency personnel at the end of the budget process. In this communication, BMO could provide additional feedback regarding the reasons why budget requests were denied and whether performance measures submitted with a request could be enhanced or alternate or additional measures could be developed to better support a subsequent similar budget request.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
Agree	October 2016	Steve Bohn 720.913.5501

Narrative for Recommendation 1.2
Recommendation 1.2. At the end of the budget process, after funding decisions are finalized, BMO will provide a brief description explaining why a request was declined. For proposals that are declined due to inadequate performance information, BMO will provide an explanation on how the measures can be enhanced and whether or not new and/or additional performance measures will be needed to support future requests.

AUDIT FINDING 2
The Budget and Management Office Can Take Steps To Enhance the Determination of Unassigned General Fund Balance and Contingency Reserves Documentation

RECOMMENDATION 2.1
In conjunction with other Department of Finance divisions, the Budget and Management Office should periodically assess the policy that establishes the unassigned general fund balance.

a. As part of this assessment, BMO should identify best practices and should conduct an analysis of Citywide risks, which should take into account what other reserves are available to address some of those risks, and then ultimately

determine the total dollar amount that is needed from the unassigned general fund balance to address remaining needs. Due to potential limitations in City resources and expertise, BMO should determine whether this assessment is performed by internal resources or by utilizing an external source that is knowledgeable in this approach.

b. After performing a risk-based assessment and establishing unassigned general fund balance reserves, the General Fund Reserve policy should be updated to communicate results of the risks identified and how they affected the determination of unassigned general fund balance.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
Agree	2nd Quarter 2016	Brendan Hanlon 720.913.5510

Narrative for Recommendation 2.1

Recommendation 2.1.A & B - An assessment will be completed in the first quarter of 2016 to identify potential risks to the City's financial condition. The Department of Finance and BMO will use the findings from this assessment to recommend modifications to the City's reserve policies as well as contingency and fund balance levels if needed based on the assessment as part of the 2017 budget.

RECOMMENDATION 2.2

In conjunction with other Department of Finance divisions, the Budget and Management Office should expand City General Fund Reserve Policy language to incorporate the usage of contingency reserves for purposes not clearly identified in the established criteria, such as foreseen expenditures not budgeted in the current year.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
Agree	September 2016 Proposed 2017 Budget	Brendan Hanlon 720.913.5510

Narrative for Recommendation 2.2

Recommendation 2.2. The Department of Finance and BMO will revise the City General Fund Reserve Policy language to incorporate contingency reserves uses to be administered towards foreseen expenditures not budgeted in the current year appropriation.

RECOMMENDATION 2.3

The Budget and Management Office should develop a formal supplemental request process that includes a structured request document to ensure documentation is provided and retained to support the need and use of general fund contingency

reserves.		
Agree or Disagree with Recommendation	**Target date to complete implementation activities (Generally expected within 60 to 90 days)**	**Name and phone number of specific point of contact for implementation**
Agree	March 1, 2016	Steve Bohn 720.913.5501

Narrative for Recommendation 2.3
Recommendation 2.3. BMO will develop a formal supplemental request form which will include an agency justification requesting additional budget above their current year appropriation.

Please contact Steve Bohn at 720-913-5501 with any questions.

Sincerely,

Brendan J. Hanlon
Budget Director

cc: Cary Kennedy, Chief Financial Officer
Janice Sinden, Chief of Staff
Beth Machann, City Controller
David Edinger, Chief Performance Officer
Kelly Greunke, Budget Manager
Steven Bohn, Budget Manager
Laura Perry, Capital Program Manager