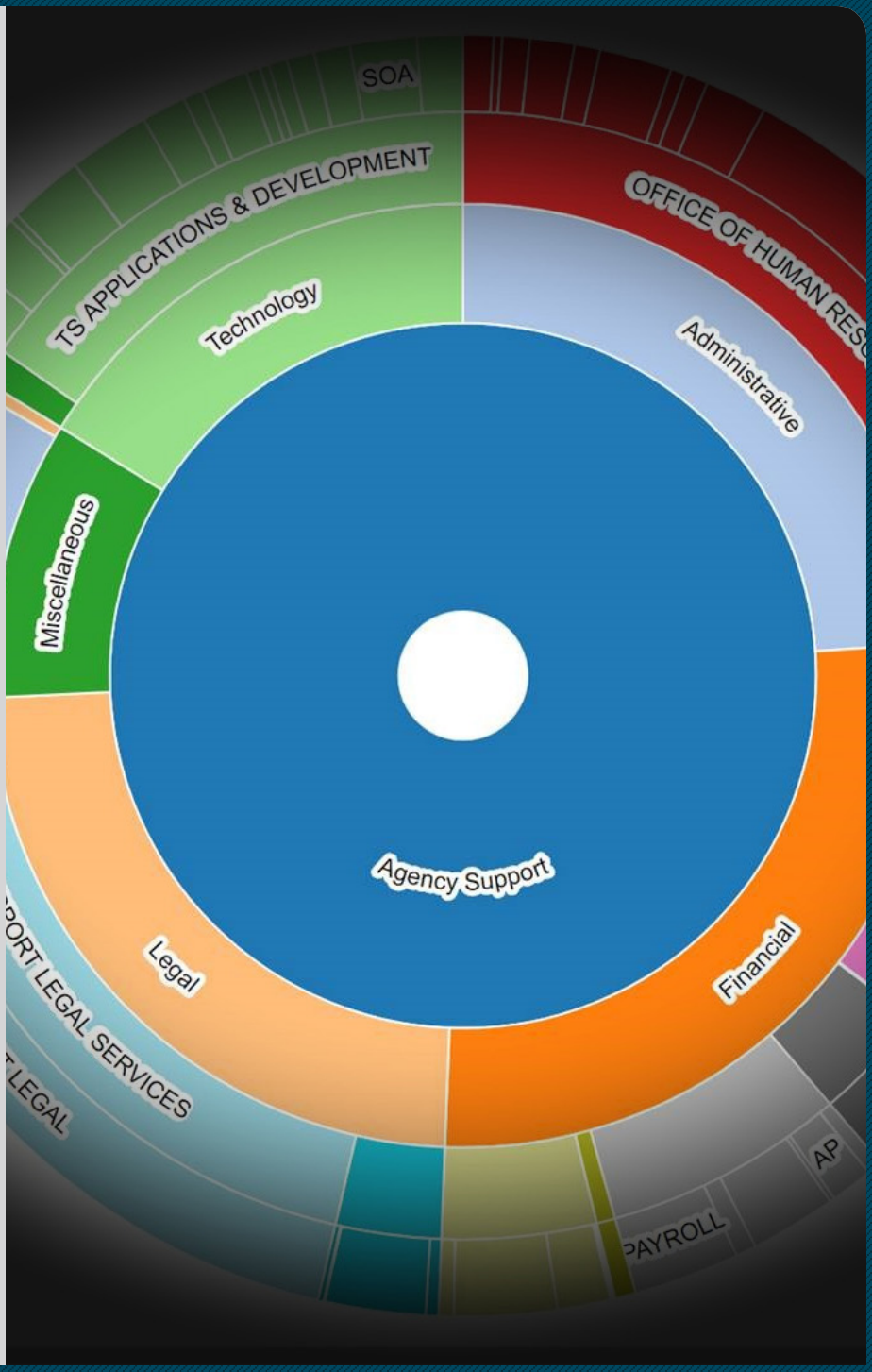
FOLLOW-UP REPORT
Indirect Cost Accounting Practices
Budget and Management Office
December 2019

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

Timothy M. O'Brien, CPA
Denver Auditor



Audit Team

Jared Miller, CFE, CISA, Audit Supervisor
Robert Persichitte, CPA, CFE, Lead Data Analytics Auditor
Chris Wilson, Associate Auditor

Audit Management

Timothy M. O'Brien, CPA, Auditor
Valerie Walling, CPA, Deputy Auditor
Dawn Wiseman, CRMA, Audit Director

Audit Committee

Timothy M. O'Brien, CPA, Chairman
Rudolfo Payan, Vice Chairman
Jack Blumenthal
Leslie Mitchell
Florine Nath
Charles Scheibe
Ed Scholz

You can obtain copies of this report by contacting us:

Office of the Auditor
201 West Colfax Avenue, #705
Denver CO, 80202
(720) 913-5000 ♦ Fax (720) 913-5253

Or download and view an electronic copy by visiting
our website at: www.denverauditor.org.

Timothy M. O'Brien, CPA
Auditor

City and County of Denver

201 West Colfax Avenue, #705 • Denver, Colorado 80202
(720) 913-5000 • Fax (720) 913-5253 • www.denverauditor.org

December 5, 2019

AUDITOR'S LETTER

In keeping with generally accepted government auditing standards and Auditor's Office policy, as authorized by city ordinance, the Audit Services Division has a responsibility to monitor and follow up on audit recommendations to ensure audit findings are addressed through appropriate corrective action and to aid us in planning future audits.

I am very pleased to report that in our follow-up effort for the Indirect Cost Accounting Practices audit issued June 21, 2018, we determined the city's Budget and Management Office has fully implemented all recommendations made in the audit report.

The Highlights page in this report provides background and summary information about the original audit and the completed follow-up effort. Following the Highlights page is a detailed implementation status update for each recommendation.

I would like to express our sincere appreciation to the city's Budget and Management Office personnel who assisted us throughout the audit and the follow-up process. For any questions, please feel free to contact me at 720-913-5000.

Denver Auditor's Office

Timothy M. O'Brien, CPA
Auditor

REPORT HIGHLIGHTS

Indirect Cost Accounting Practices

December 2019

Follow-Up Status

The city's Budget and Management Office has fully implemented all six recommendations made in the June 2018 audit report.

Objective

The 2018 audit sought to determine whether:

1. The data being input into the city's 2017 Federal Cost Allocation Plan was accurate, allowable, and allocable;
2. The methodology used for allocating costs in the 2017 Federal Cost Allocation Plan was accurate and in accordance with the method disclosed in the plan; and
3. The 2017 rates from the Indirect Cost Rate Proposal and Colorado Department of Human Services reimbursement were calculated correctly.

Background

The city provides certain services, such as motor pools, computer centers, purchasing, and accounting, to the city's operating departments on a centralized basis. The "indirect costs" for these services must be assigned to the agencies using them.

Highlights from Original Audit

Our evaluation of the City and County of Denver's annual cost allocation process identified weaknesses in the city's Budget and Management Office (BMO) practices that impacted the city's ability to provide an accurate and consistent process for compiling its cost allocation plans.

We found that BMO did not have a process in place to ensure the state of Colorado reimbursement schedule is accurate and consistent with supporting schedules contained in the Federal Cost Allocation Plan. This led to BMO submitting an incorrect reimbursement to the state of Colorado in 2017.

Additionally, we found that BMO did not ensure the city's contractor, MGT, accurately allocated costs. Further, we identified instances where the bases used to allocate costs were not supported by adequate documentation. These oversights led to an underpayment from one of the city's Enterprise funds to the city's General Fund. Further, we were unable to verify the accuracy of some of the cost allocations performed in the two plans due to a lack of supporting documentation.

Lastly, due to a lack of involvement, BMO did not ensure that MGT accurately adjusted the city's costs for income adjustments, credit adjustments, and unallowable cost adjustments prior to allocating costs. This led to an underallocation by the city's Technology Services agency and an overallocation by the city's Office of Human Resources.

To enhance the accuracy of the city's two cost allocation plans and increase BMO's oversight and involvement in the construction of the plans, we offered six recommendations to BMO.

For a copy of this report, visit www.denverauditor.org or contact the Auditor's Office at (720) 913-5000.

RECOMMENDATION — STATUS OF IMPLEMENTATION

FINDING 1 – Lack of Oversight by and Involvement from the City's Budget and Management Office Resulted in Errors and Inconsistencies in the City's 2017 Federal Cost Allocation Plan.

Recommendation

1.1 **Review Future Reimbursements to State and Rectify Settlement Process** – The city's Budget and Management Office needs to develop a documented procedure by which the Federal Cost Allocation Plan's summary schedule is reconciled to the state's reimbursement schedule prior to submitting a reimbursement request to the state. Further, the Budget and Management Office should ensure that the settlement process between the State of Colorado and City and County is resolved.

Status: Implemented (Original target date for completion: July 31, 2018)

Agency Action

The Budget and Management Office developed a documented procedure outlining the steps the office staff should take to ensure the cost allocation plans are accurate and submitted in a timely manner. The procedure includes explicit steps to reconcile the Federal Cost Allocation Plan's summary schedule to the state's reimbursement schedule. The procedure also states this reconciliation should be completed prior to submitting a reimbursement request to the state.

Further, the office has ensured the settlement process between the state of Colorado and the city has been resolved. The audit report found the total costs on the reimbursement schedule submitted to the state for the allocation to Denver Human Services totaled $8,238,125. This amount was $36,575 more than the costs listed on the allocation's summary schedule. To correct this overstatement of expenses, the office worked with Denver Human Services to request the state's reimbursement be reduced. The office provided us with a breakdown between the original plan and the revised plan to demonstrate how the reduced payment was calculated. The revised plan lists the correct total reimbursement costs for Denver Human Services of $8,201,550. After applying the correct reimbursement rates to these costs, the state arrived at a reduction payment of $23,408.

Recommendation

1.2 **Develop Policies and Procedures** – The city's Budget and Management Office should develop and incorporate a well-documented review process with corresponding written procedures that cover the primary elements included in both cost allocation plans specific to the supporting schedules to ensure submitted reimbursement requests are supported, accurate, and complete. Procedures should include:

a) Ensuring uniform department descriptions, fund numbers, and organizational codes within both plans; and

b) Collaboration between the city's Budget and Management Office and MGT to ensure that changes to either plan are fully documented to ensure accuracy.

Status: Implemented (Original target date for completion: Aug. 31, 2018)

Agency Action

The Budget and Management Office developed a written procedure covering the primary elements of both cost allocation plans. We reviewed this procedure to ensure it includes steps for the review of department descriptions, fund numbers, and organization codes. In addition, the office developed specific instructions to collaborate with MGT to ensure changes to either plan are documented.

The Budget and Management Office incorporated these procedures during the development of the 2018 allocation plans. For instance, the Budget and Management Office documented review steps to ensure the accuracy of department descriptions, fund numbers, and organization codes in a spreadsheet. And the office documented any issues identified during the review process in the spreadsheet. Budget and Management completed the review process for the 2018 plans and sent MGT the spreadsheet to ensure MGT addressed the inaccuracies noted in the review.

Recommendation

1.3 **Address the Understatement to the Airport** – The city's Budget and Management Office should work with the airport to rectify the $108,541 understatement that occurred as a result of the 2017 Citywide Cost Allocation Plan.

Status: Implemented (Original target date for completion: Dec. 31, 2018)

Agency Action

The Budget and Management Office worked with MGT to consolidate the two department funds identified during the original audit that resulted in a $108,541 understatement in the 2017 Citywide Cost Allocation Plan. After consolidating these two department funds, Budget and Management staff explained that the results increased the airport's billing by $24,019. However, neither the office nor MGT considered the impact to other enterprise funds during this adjustment. This oversight resulted in additional costs of approximately $3,689 that could have been recovered from the other enterprise funds through increased billings.

After auditors brought these errors to the attention of Budget and Management staff, Budget and Management staff and MGT revised the 2018 Citywide Cost Allocation Plan to incorporate increases to the Wastewater and Environmental Health enterprise funds. These increases totaled $1,251 and $173 respectively. Budget and Management staff said the increase to the Golf enterprise fund would have resulted in an increase of $2,277, but since Denver Golf's bill is regularly reduced to match 5% of operating expenses, there will be no change to the fund's final bill.

Recommendation

1.4 **Develop Written Policy** – The city's Budget and Management Office should develop a written policy to increase its involvement in the preparation of the Federal Cost Allocation Plan incorporating the following activities:

a) Actively participating in meetings between MGT and city departments;

b) Using its knowledge of the city's departments and functions to assist MGT in the proper identification of necessary adjustments from gross costs;

c) Retrieving supporting documentation when MGT is unable to obtain it; and

d) Reviewing the types, amounts, and departments that MGT has identified as having adjustments from gross costs to identify potential overlooked items or incorrect adjustments.

Status: Implemented (Original target date for completion: Aug. 31, 2018)

Agency Action

The Budget and Management Office has developed a written policy outlining each activity listed in Recommendation 1.4. For instance, the policy requires staff to coordinate and attend meetings between MGT and city agencies. During these meetings, staff are responsible for coordinating any of MGT's data requests with each city agency's budget analyst. Additionally, the procedures contain several reminders for staff to follow up on any data requests submitted by MGT throughout the preparation of the Federal Cost Allocation Plan. Lastly, the procedures state staff should generate a report from Workday — the city's financial system — that includes revenues by account codes and revenue categories within the general fund. Budget and Management staff reviews each revenue code and category to ensure accuracy of the types, amounts, and departments to be included in the cost allocation plan.

We reviewed documentation supporting the implementation of each of these activities for the preparation of the 2018 allocation plan. Specifically, we reviewed a spreadsheet staff used to track the meetings between MGT and city agencies. Budget and Management staff filled in the spreadsheet throughout the preparation of the 2018 allocation plan. We also reviewed a spreadsheet containing a list of 2018 revenues from the general fund. Staff used this spreadsheet to ensure all revenues included in the plan were appropriate.

Recommendation

1.5 **Review Federal Guidelines** – The city's Budget and Management Office should review the federal Uniform Guidance that dictates allocable costs to gain an understanding of the composition of costs that are permitted to be allocated. The Budget and Management Office should then ensure MGT gains a similar understanding and applies the provisions in the

ongoing and future cost allocation process.

Status: Implemented (Original target date for completion: July 31, 2018)

Agency Action

The Budget and Management Office staff participated in a webinar on allowable costs on June 21, 2018. The webinar specifically discussed how to determine the allowability of a cost per the federal Uniform Guidance rules. We also received a document used by MGT and Budget and Management Office staff summarizing major categories of costs. The document explains whether each category of costs is allowable and the corresponding section the information is pulled from in the federal Uniform Guidance. Staff explained they use this document to ensure they share a similar understanding of allowable costs with MGT.

Additionally, we conducted an interview with staff to ensure they had gained a better understanding of allocable costs. To do this, we created a list of hypothetical scenarios and asked whether a certain cost was allocable. Using descriptions of allocable costs from the federal Uniform Guidance, we determined staff had gained an adequate understanding of how to determine whether a cost is allocable.

Recommendation

1.6 **Develop Process to Analyze Expenditures** – The city's Budget and Management Office should develop a process to analyze expenditures for allowability at a more detailed level. For example, the Budget and Management Office could consider using the city's financial system, Workday, to facilitate a more detailed description of specific expenditures.

Status: Implemented (Original target date for completion: Dec. 31, 2018)

Agency Action

The Budget and Management Office developed procedures to analyze the allowability of expenditures at a detailed level. The procedures state the Controller's Office creates a Workday report showing expenditures by spend category. MGT should then use this report to flag unallowable accounts. Next, Budget and Management Office staff are supposed to review the report to ensure all spend categories that are unallowable were correctly left out of the cost allocation plan.

The team reviewed the Workday report used to identify unallowable accounts for the 2018 allocation plans. The report contained a list of highlighted items under each spend category that should be removed from the plans. Staff said they reviewed the report to ensure unallowable expenditures were all identified. Once the review was completed, they sent the report back to MGT.

CONCLUSION

We found the city's Budget and Management Office has fully implemented all recommendations and adequately mitigated the risk identified during the original audit. As a result, we conclude our follow-up effort related to the Indirect Cost Accounting Practices audit report.

On behalf of the citizens of the City and County of Denver, we thank staff and leadership from the city's Budget and Management Office for their cooperation during our follow-up effort and for their dedicated public service.

Office of the 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 and contractors for the purpose of ensuring the proper and efficient use of City resources. He also provides other audit services and information to City Council, the Mayor, and the public to improve all aspects of Denver's government.

The **Audit Committee** is chaired by the Auditor and consists of seven members. The Audit Committee assists the Auditor in his oversight responsibilities regarding the integrity of the City's finances and operations, including the reliability 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.

201 West Colfax Avenue, #705

Denver CO, 80202

(720) 913-5000 ♦ Fax (720) 913-5253

www.denverauditor.org

Our Mission

We deliver independent, transparent, and professional oversight in order to safeguard and improve the public's investment in the City of Denver. Our work is performed on behalf of everyone who cares about the City, including its residents, workers, and decision-makers.