

10-C-0034

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A COMMUNICATION BY CITY AUDITOR LESLIE WARD:

SUBMITTING A PERFORMANCE AUDIT REPORT FOR INDIRECT COST ALLOCATION.

Filed

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Committee _____
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First Reading

Committee: Finance/Executive
 Date: 1/13/10
 Chair: [Signature]
 Action: Fav, Adv, Hold (see rev. side)
 Other: [Signature]

Members

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Committee 23

Date

Chair

Action: Fav, Adv, Hold (see rev. side)
 Other: [Signature]

Members

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Committee: Finance/Executive

Date: 2/24/10

Chair: [Signature]

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Atlanta City Council

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10-C-0054

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AUDITR REPORT FOR INDIREC.COST ALLOC.
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CITY OF ATLANTA

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Donald T. Penovi, CPA, Vice Chair
Robert F. Ashurst, CPA
Cecelia Corbin Hunter
Council President Lisa Borders

TO: Mayor Franklin, President Borders, and City Council members

FROM: Leslie Ward *LW*

DATE: December 21, 2009

SUBJECT: Performance Audit: Indirect Cost Allocation

10-C-0054

The report listed above is attached for your review. Because of the transition, no discussion of the report with the City Council committee of purview has been scheduled yet. Feel free to contact me if you have questions or want to discuss the report.

Cc:

Gregory Giornelli, Chief Operating Officer
Luz Borrero, Deputy Chief Operating Officer
Greg Pridgeon, Chief of Staff
Beverly Isom, Director of Communications
Rhonda Dauphin Johnson, Municipal Clerk
Jim Glass, Chief Financial Officer
Roger Bhandari, Acting City Attorney
Ginny Looney, Ethics Officer
Allison Lehr, Controller
Roosevelt Council, Budget Chief
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Robert Hunter, Watershed Management Commissioner
Ben DeCosta, Aviation General Manager
Mario Diaz, Aviation Deputy General Manager
Dan Smith, Chief Information Officer
Mayor-elect Kasim Reed
City Council Members-elect
Peter Aman
Audit Committee

**Performance Audit:
Indirect Cost Allocation**

December 2009

**City Auditor's Office
City of Atlanta**

File #09.04



CITY OF ATLANTA

City Auditor's Office
Leslie Ward, City Auditor
404.330.6452

December 2009

Performance Audit:

Indirect Cost Allocation

Why We Did This Audit

We undertook this audit because senior management from the departments of aviation and watershed management questioned whether the city's plan for allocating indirect costs overcharged enterprise funds and expressed concern about the lack of transparency in the allocation methods. We also noted instances in which the enterprise funds seemed to be underpaying for citywide expenses, such as the \$41.6 million Oracle implementation.

What We Recommended

To ensure that the cost allocation plan is equitable, the Chief Financial Officer should:

- Make appropriate adjustments to the financial statements for fiscal year 2008.
- Document cost allocation procedures to include department meetings, timeframe for submissions, and schedule for plan completion.
- Establish a policy to meet annually with applicable city departments to explain the planned uses of the source data; review the allocation bases; and identify any significant organizational changes that would impact the cost allocation plan.
- Simplify central service departments and plan methodology to allocate indirect costs at the fund level only, rather than to departments within funds.
- Independently review city departments' allocation data for logic and accuracy, and that the bases reasonably reflect workload and benefits.
- Rebid the cost allocation contract and include performance measures.
- Eliminate direct bill full-time equivalents for overhead departments.
- Allocate Oracle implementation costs by annual depreciation through the cost allocation plans or charge funds directly, using a combination of transactions and full-time equivalent employees.
- Allocate Oracle operating costs among funds beginning with fiscal year 2009, using the same method.

For more information regarding this report, please contact Eric Palmer at 404.330.6455 or epalmer@atlantaga.gov.

What We Found

Errors in the city's fiscal year 2008 cost allocation plan resulted in \$11 million in net overcharges to the enterprise funds. Incorrect data and errors in methodology contributed to the overcharges. In some cases, we were unable to quantify the effect of errors. Plan complexity and lack of city oversight obscured the errors and lack of communication allowed errors to be repeated year to year.

A systematic error affected allocations of all departments that have direct funded positions and provide work effort data as an allocation basis for indirect charges. Since direct appropriations from enterprise funds for support services increased in fiscal year 2008, the magnitude of errors increased as well. Thus, even though errors were repeated from year-to-year, the magnitude was significantly less in fiscal year 2007.

The city did not allocate \$41.6 million spent implementing its Oracle system. These costs were not included in any of the cost allocation plans. Because the system benefits all of the departments, the implementation costs should be shared among funds.

The plan makes it difficult to understand where costs originate and provides a level of detail that the city does not use. The double-step down method is more complicated than necessary to meet the city's needs. The criteria for defining a central service department is unclear. The city's practice of funding some support positions through direct appropriations from the enterprise funds then allocating credit for the amounts directly billed complicates the plan. The plan does not summarize fund-level information to explain the net effect of the allocations, making it difficult for receiving departments to track what was allocated to them.

Finance shifted the timeframe for plan completion to suit its schedule, compressing the data collection schedule and reducing time for quality assurance. More time to review data submitted and overall plan for material errors could have prevented some of the errors.

The city's contract with Maximus does not define responsibilities for ensuring data reliability. The contract also lacks a mechanism for evaluating contractor performance. City oversight of contract performance was minimal and the contractor did not perform all required activities.

Management Responses to Audit Recommendations

Summary of Management Responses		
Recommendation #1:	Make appropriate adjustments to the financial statements for fiscal year 2008.	
Response & Proposed Action:	Adjustments were made to the 2009 financials for both the 2007 and 2008 impacts.	Agree
Timeframe:	Completed	
Recommendation #2:	Document cost allocation procedures to include department meetings, timeframe for submissions, and schedule for plan completion.	
Response & Proposed Action:	Manual will be compiled, explained, and distributed to impacted departments.	Agree
Timeframe:	May 2010	
Recommendation #3:	Establish a policy to meet annually with city departments to explain the uses of the source data; review the bases; and identify any organizational changes that would impact the plan.	
Response & Proposed Action:	This will be part of the manual and should be part of the annual budgeting process.	Agree
Timeframe:	May 2010	
Recommendation #4:	Simplify and consistently identify central service departments.	
Response & Proposed Action:	Accounting and Finance team needs to be developed to address and document.	Agree
Timeframe:	May 2010	
Recommendation #5:	Simplify plan methodology to allocate indirect costs at the fund level only, rather than to departments within funds.	
Response & Proposed Action:	Finance needs to complete an analysis to assess the impact of simplification on costs charged back to appropriate grants.	Partially Agree
Timeframe:	May 2010	
Recommendation #6:	Independently review city departments' allocation data for logic and accuracy, and that the bases reasonably reflect workload and benefits.	
Response & Proposed Action:	This should be part of the process manual.	Agree
Timeframe:	May 2010	
Recommendation #7:	Rebid the cost allocation contract and include performance measures.	
Response & Proposed Action:	The RFP needs to be rebid now.	Agree
Timeframe:	No later than March 2010	
Recommendation #8:	Eliminate direct bill full-time equivalents for overhead departments.	
Response & Proposed Action:	Accounting and budget team needs to be created to discuss the best approach for this.	Partially Agree
Timeframe:	May 2010	
Recommendation #9:	Allocate Oracle implementation costs by annual depreciation through the cost allocation plan or charge funds directly for a share of the implementation costs.	
Response & Proposed Action:	Accounting, budget, and information technology will form a team to pull and validate data and communicate the impact to various funds for these costs.	Agree
Timeframe:	April 2010	
Recommendation #10:	Allocate Oracle operating costs among funds beginning with fiscal year 2009.	
Response & Proposed Action:	Accounting and budget team will discuss the best approach.	Agree
Timeframe:	April 2010	
Recommendation #11:	Allocate Oracle implementation using a combination of transactions performed and budgeted full-time equivalent employees as allocation basis.	
Response & Proposed Action:	Will be implemented with the previous two recommendations.	Agree
Timeframe:	April 2010	



CITY OF ATLANTA

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AUDIT COMMITTEE
Fred Williams, CPA, Chair
Donald T. Penovi, CPA, Vice Chair
Cecelia Corbin Hunter
Council President Lisa Borders

December 21, 2009

Honorable Mayor and Members of the City Council:

We initiated the audit of the indirect cost allocation plan because senior management from the departments of aviation and watershed management questioned whether the city's plan overcharged the enterprise funds and expressed concern about the lack of consistency and transparency in the allocation methods. We also noted instances in which the enterprise funds seemed to be underpaying for citywide expenses, such as the \$41.6 million Oracle implementation.

We assessed whether the plan was reasonable, accurate, and timely; whether the method was consistent and equitable; and if the city adequately monitored the performance of the contractor that creates the annual plan. We found that errors in the plan overcharged the enterprise funds \$11 million in fiscal year 2008. The review process for the allocation plan and data submissions did not include checks for reasonableness, accuracy, appropriateness of the bases, or correction of incomplete or omitted data. The plan complexity and lack of time for quality assurance obscured some of these errors. Strengthened contract management could reduce the risk of future errors.

Our recommendations focus on establishing policies, simplifying the process, ensuring consistency and accuracy, and methods for allocating Oracle costs. Management has agreed or partially agreed with our recommendations. Their responses to our recommendations are included in Appendix A.

The Audit Committee has reviewed this report and is releasing it in accordance with Article 2, Chapter 6 of the City Charter. We appreciate the courtesy and cooperation of city staff throughout the audit. The team for this project was Lesia Johnson, Dawn Williams, and Eric Palmer.


Leslie Ward
City Auditor


Fred Williams
Audit Committee Chair

Indirect Cost Allocation

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Introduction

We conducted this performance audit of the city's indirect cost allocation pursuant to Chapter 6 of the Atlanta City Charter, which establishes the City of Atlanta Audit Committee and the City Auditor's Office and outlines their primary duties. The Audit Committee reviewed our audit scope in August 2009.

A performance audit is an objective analysis of sufficient, appropriate evidence to assess the performance of an organization, program, activity, or function. Performance audits provide assurance or conclusions to help management and those charged with governance improve program performance and operations, reduce costs, facilitate decision-making, and contribute to public accountability. Performance audits encompass a wide variety of objectives, including those related to assessing program effectiveness and results; economy and efficiency; internal controls; compliance with legal or other requirements; and objectives related to providing prospective analyses, guidance, or summary information.¹

We undertook this audit because senior management from the departments of aviation and watershed management questioned whether the city's plan for allocating indirect costs overcharged enterprise funds and expressed concern about lack of consistency and transparency in the allocation methods. We also noted instances in which the enterprise funds seemed to be underpaying for citywide expenses, such as the \$41.6 million Oracle implementation.

Background

Cost allocation plans are a tool for estimating the full costs of services by apportioning overhead – ongoing costs not directly attributable to a specific service such as administration, accounting, auditing, general legal services, building maintenance, utilities, and depreciation – to the direct costs of providing services. Identifying the full cost of delivering government services helps in budgeting, setting fees, and recovering administrative costs in grant-funded

¹Comptroller General of the United States, *Government Auditing Standards*, Washington, DC: U.S. Government Accountability Office, 2007, p. 17-18.