

STATE AUDITOR'S OFFICE PERFORMANCE AUDIT



Local Government Allocating Overhead Costs

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WASHINGTON
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STATE AUDITOR

TABLE OF CONTENTS

Executive Summary 3

Introduction 6

Leading Practices..... 9

Audit Results 13

Recommendations..... 19

Agency Responses20

Appendix A: Initiative 90030

Appendix B: Scope and Methodology.....31

Appendix C: Audit Criteria32

Appendix D: Audit Areas for Each City34

EXECUTIVE SUMMARY

Why we did this audit

Washington's cities spend about \$500 million per year for overhead costs such as information technology, human resources, accounting and facility maintenance. Approximately one-third of these costs are paid from funds whose use is restricted by law, including water, sewer and other utility funds.

As municipalities increasingly face shrinking revenue, they commonly use utility or other dedicated funds to help pay for overhead services. However, our past audits have found cases in which cities overcharged their utilities for overhead, essentially shifting costs onto utility ratepayers that should have been borne by all taxpayers.

We conducted this audit to identify how cities and counties can legally and equitably allocate overhead costs to their utilities and other programs that benefit from centrally provided overhead services. The distribution of costs among city programs is a complex process that demands consistency, fairness and adequate documentation to ensure that charges accurately reflect the services provided and benefits received.

In this audit, we highlight effective allocation practices and evaluate the extent to which eight cities used these practices in fiscal year 2009 to distribute overhead costs to their utility departments. We examined cities of various sizes in urban and rural areas to ensure we obtained a reasonable perspective of the issues and challenges that confront all of the State's nearly 300 cities and 39 counties. We hope this audit will be useful to all municipalities, as cost allocation is an important function of sound financial management practices.

The following cities participated in the audit: Aberdeen, Bainbridge Island, Bellevue, Monroe, Mukilteo, Redmond, Spokane and Tacoma. The cities' annual revenue ranges from less than \$50 million to more than \$1 billion.

We designed the audit to answer the following specific questions:

- **Did the selected cities allocate overhead costs between the general fund and the utility funds in accordance with leading practices and state law?**
- **If not, what was the effect on the general fund and the utility funds?**

Leading practices

We identified leading practices for this audit to help cities and counties improve the effectiveness and fairness of their overhead allocation processes. When organizations use systems based on leading practices, they can achieve desired outcomes more effectively and consistently. In the context of this audit, the "beneficiary pays" principle provides a foundation for leading practices in cost allocation. Under this principle, the extent to which a support service provides a **benefit** to a utility, and the cost of providing those benefits, guides how much of the cost is paid by the utility. Fairly and accurately allocating overhead costs for support services to the benefiting utilities and all other benefiting funds promotes **equity**.

However, to achieve equity, the overhead allocation process must be well designed. By using the following practices, all cities can ensure they fairly allocate costs. We recommend municipalities:

- **Develop and maintain allocation plans** that specify how overhead costs will be allocated. Plans should be updated annually and should clearly state which overhead costs will be allocated, how the process will work, and the rationale for key decisions.
- **Assess overhead charges** only after the services are provided.
- **Charge only for actual costs incurred.** Estimates used for initial calculations should be reconciled against actual expenses at year-end.
- **Maintain appropriate, thorough documentation** to support the allocation process. This is especially important to ensure continuity when staff turnover occurs.

Audit results

We reviewed each city's overhead allocation practices during 2009 and compared them to the leading practices we identified for this audit. We identified the following issues:

- We found opportunities for all eight cities to strengthen their procedures, and several cities improved their practices during the audit.
 - Not all of the cities used allocation plans in 2009 and therefore could not demonstrate they applied overhead charges to all of the departments and programs that received services.
 - Some cities charged overhead costs using allocating factors that did not equitably distribute those costs (for example; outdated square footage as a basis to allocate building maintenance costs)
 - Some cities charged overhead costs before providing the services, or used estimates without reconciling them to actual costs.
- Overhead charges to utilities were not always equitable or did not clearly reflect the benefit received by the utility.
 - We identified overcharges totaling \$1.2 million for services that benefited the utilities but were not calculated correctly. These overcharges do not appear to benefit the utilities.
 - Several cities charged overhead to the utilities that did not clearly benefit them or did not keep adequate records to document their overhead charges. We identified \$2.3 million in charges for which the cities' records did not demonstrate the benefits to the utilities, or what charges were made or how they were calculated.

The cities of Bellevue and Spokane used most of the leading practices we identified and had little or no overcharges to the utilities. The City of Tacoma followed most leading practices but charged some overhead to the utilities that did not clearly benefit the utilities. Monroe and Redmond also charged overhead to their utilities that did not clearly demonstrate a benefit to the utilities. Since the audit, Bainbridge Island, Mukilteo, Monroe, and Redmond have incorporated more leading practices. Tacoma also reported it improved its practices in 2010.

Recommendations

1. We recommend that all eight cities that participated in this audit establish or update their policies, procedures and cost allocation plans to implement any of the leading practices shown in **Exhibit 5** that they do not already follow.
2. We recommend Redmond, Tacoma and Monroe further examine their 2009 overhead charges, verify that the utilities truly benefited from them, and document those benefits. If they cannot do so, we recommend the three cities reimburse their utilities accordingly.

What's next?

This performance audit will be reviewed by the city councils for the municipalities that participated in the audit. Representatives of the State Auditor's Office will be available to review the findings with them as requested.

The individual cities will decide whether to accept the specific recommendations. The State Auditor's Office conducts periodic follow-up evaluations to assess the status of recommendations and may conduct follow-up audits at its discretion.

INTRODUCTION

Audit Overview

Washington's cities and counties must maintain financial and accounting systems to ensure they use public funds legally and appropriately. While it is relatively straight-forward to account for funds used by specific programs, it is more challenging for local governments to correctly allocate the costs of general overhead services used by all departments and programs.

Our past audits have found cases in which cities charged their utility funds for general government services or for more than their share of overhead, in essence shifting costs that should have been paid by their general funds onto utility ratepayers. General government services should be paid for by the general fund, which is financed primarily by sales and property taxes that are unrestricted in how they may be spent. The general fund typically serves as the chief operating fund of the government. It is used to account for all financial resources except those required to be accounted for in another fund. **General government services** include parks and recreation, law enforcement, economic development and other costs that benefit the public at large.

We conducted this audit to identify and share leading practices that cities and counties can use to appropriately and legally allocate overhead costs among the departments and programs that benefit from central services such as payroll and computer support. While we focused on overhead costs allocated to utilities such as water and sewer systems, the leading practices we identified can be applied to the allocation of costs to other programs.

To illustrate effective allocation practices and to identify pitfalls, we evaluated the extent to which eight cities followed the leading practices we identified and determined whether they charged their utility funds too much or too little for overhead costs. In 2009, these eight cities charged a total of \$33 million in overhead costs to their utilities.

Overhead costs consist of the costs of central services or support functions shared across city departments. They may include accounting, human resources, payroll, information technology, janitorial services and others. Overhead costs include not only the salaries, wages and benefits of the employees who work in these departments, but the utilities, supplies, information technology, building maintenance and other costs that support these employees. Typically, such services are initially paid through a city's general fund or an internal service fund and charged back to the departments and programs that directly benefited from them. The cost allocation process is guided by an "**overhead cost allocation plan**" that describes how an entity will allocate costs reasonably and equitably across funds and departments and identifies the documentation required to support the charges. Under state law, city officials may charge a portion of the costs for their central overhead services to city utility funds only to the extent that each utility benefits from those services. City utilities charge user fees based on the cost of operating the utilities, and deposit those fees into utility operating accounts. Cities should not allocate general government service costs, such as public safety, parks and economic development, to the utilities.

Audit scope and methodology

We compared eight cities' overhead cost allocation practices in 2009 to the leading practices and requirements we identified to determine whether they had allocated central overhead costs appropriately between their general funds and utility funds. We selected a cross-section of cities to determine whether smaller cities operated differently than larger cities and to ensure that cities and counties of all sizes could benefit from the audit results.

Of the eight cities we audited, Aberdeen, Bainbridge Island, Monroe and Mukilteo are smaller, with 2009 revenue of less than \$50 million. Bellevue, Redmond, Spokane and Tacoma are larger, with revenue ranging from \$239 million to \$1.2 billion.

We designed this audit to answer the following questions:

- **Did selected cities allocate overhead costs among the general fund and the utility funds in accordance with leading practices and state law?**
- **If not, what was the effect on the general fund and the utility funds?**

We reviewed central overhead costs for accounting, budget, payroll, purchasing, accounts payable, human resources, information technology services, legal, insurance, maintenance and janitorial services, and externally provided utilities. We compared the allocation plan used by each city to leading practices.

We selected two or more overhead cost centers at each city and examined how cities calculated overhead charged to the utilities. We based our selections on the significance of the charges and on whether leading practices were used to calculate those charges. Consequently, we did not audit the same central services for all cities. If a city did not use leading practices, we calculated the costs of not incorporating them.

We conducted the audit under the authority of state law (RCW 43.09.470), approved as Initiative 900 by Washington voters in 2005, and in accordance with generally accepted government auditing standards, prescribed by the U.S. Government Accountability Office. 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 the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Exhibit 1 shows the total overhead that was charged to each city's utilities and the specific overhead charges we audited.

Appendix A describes the provisions of Initiative 900 and how the audit addressed its specific requirements.

Appendix B provides additional information on our scope and methodology.

Appendix C explains the audit criteria we used.

Exhibit 1 Overhead costs audited Calendar Year 2009				
City	Total annual revenue	Overhead charged to utilities	Overhead charges audited	Utilities charged
Aberdeen	\$33 M	\$632,000	\$353,000 for Human Resources, Insurance and Payroll	Water, Sewer, Solid Waste and Storm Water
Bainbridge Island	\$43 M	\$683,000	\$683,000 for Building Maintenance, Finance, Human Resources, Legal, Information Technology and Insurance	Water, Sewer and Storm Water
Bellevue	\$450 M	\$3.5 M	\$2 million for Facilities Maintenance and Information Technology	Water, Sewer and Storm Water
Monroe	\$31 M	\$840,000	\$840,000 for all cost centers	Water, Sewer, Solid Waste, Recycling and Storm Water
Mukilteo	\$32 M	\$195,000	\$195,000 for all cost centers	Storm Water (Only Utility Fund)
Redmond	\$239 M	\$3.1 M	\$1.2 million for Budget, Information Technology, and Facilities Maintenance	Water, Sewer and Storm Water
Spokane	\$651 M	\$6.0 M	\$526,000 for Budget, Human Resources, and Legal	Water, Sewer and Solid Waste
Tacoma	\$1.2 B	\$17.6 M	\$2.7 Million for Accounting (SAP Services) and Human Resources, \$845,000 for Community and Economic Development, Local Employee Apprenticeship Program, Historically Underutilized Business Program, Human Rights and Human Services and Government Relations	Water, Power, Sewer and Solid Waste
Source: Information provided by individual cities.				

LEADING PRACTICES

In the context of this audit, the “**beneficiary pays**” principle provides a foundation for leading practices in cost allocation. Under this principle, the extent to which a support service provides a benefit to a utility, and the cost of providing those benefits, guides how much of the cost is paid by the utility. Fairly and accurately allocating overhead costs for support services to the benefiting utilities and all other benefiting funds promotes equity. However, to achieve equity, the overhead allocation process must be well designed. By using leading practices for allocating overhead, cities ensure they charge their utilities and other funds fairly.

To determine the leading practices for allocating overhead among funds and departments, we reviewed the federal Office of Management and Budget’s Circular A-87 and its corresponding Implementation Guide; a study by the U.S. Government Accountability Office; Generally Accepted Accounting Principles; and other performance audits that examined this topic. We also reviewed state laws that relate to allocating overhead costs.

The leading practices and requirements we identified for accurately and equitably allocating overhead costs are summarized in **Exhibit 2** and described in more detail in **Appendix C**.

Exhibit 2 Leading practices for allocating overhead costs

1. **Develop and maintain an overhead allocation plan that reflects decisions about which overhead costs will be allocated to which funds or departments and on what basis.** A well-developed plan should:
 - a. **Include relevant, up-to-date information** about overhead and how to allocate it equitably. It should describe each overhead cost center, which costs are allocable and which are not, and what allocation factors and data sources will be used to calculate the allocations. It should describe the decisions made and the rationale for those decisions. It should contain calculations of overhead charges to each fund and department. Cities should update the plan annually.
 - b. **Use factors that equitably allocate central overhead costs** to each fund or department. Allocation factors are used to allocate overhead costs to departments and funds that benefit from overhead services. Different factors are necessary to equitably allocate the various overhead costs. For example, square footage is an appropriate factor to allocate maintenance and janitorial costs. The number of transactions is an appropriate factor to allocate accounting costs. Good allocation factors result in each fund and department paying only for the overhead services it received. Cities should ensure that allocation factors are based on current and accurate information. If estimates or budgeted figures are used, cities should adjust them to actual at least annually. **Exhibit 3** shows appropriate allocation factors for common types of overhead costs, and **Exhibit 6** shows the extent to which the eight cities used them.
 - c. **Allocate overhead to all benefiting funds and departments** for overhead services received. If cities decide not to charge overhead to a particular fund or department, the general fund must absorb that fund or department’s share of the costs. Excluding a fund or department from the calculation results in overcharges to all remaining funds and departments.

- d. **Ensure that general government costs or questionable costs** that do not clearly benefit the utilities are charged entirely to the general fund. General government programs serve the public at large. Charging their costs to the utilities is questionable because they do not support the utilities. The costs of such programs are typically paid by all taxpayers, not the utility ratepayers.

2. Properly charge departments:

- a. **Charge departments** and funds only after overhead services are provided. Overhead allocation plans allow a city to forecast the amount of overhead it will charge each department in a given year. Although costs can be charged quarterly, monthly or more frequently, they should *always* be charged after services are rendered. If the general fund charges overhead costs before services are rendered, it has inappropriately borrowed money from other funds in violation of state law (RCW 43.09.210).
- b. **Charge departments and funds only for actual costs.** If cities charge departments and funds based on estimated overhead costs, they should reconcile and adjust those estimates to actual costs at least once a year.

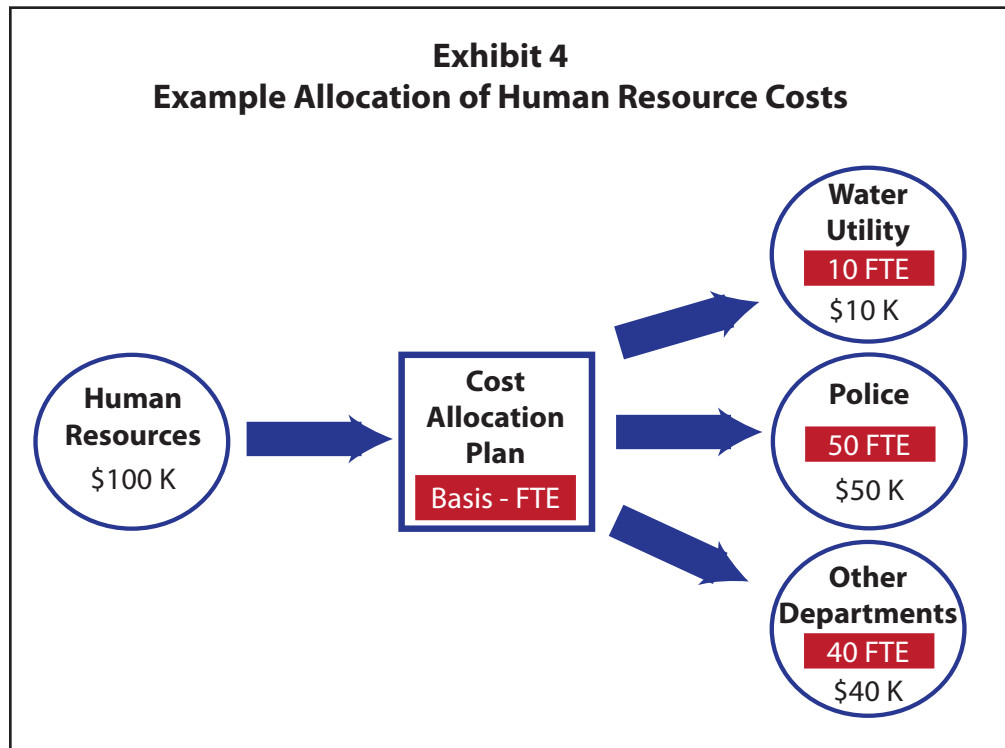
- 3. Maintain appropriate documentation** to support what overhead costs were charged to each department and fund, the amount of the charge and how it was determined. State law (RCW 43.09.210) says that when one fund charges another for services provided, the receiving fund should pay the full value of the services and no more. Cities cannot demonstrate compliance with this law unless they maintain documentation that shows (1) the cost of each overhead cost center, (2) the level of service each provided to benefiting funds and departments and how it was determined, and (3) the amount charged to each fund and department.

Sources: Federal sources, state laws and generally accepted accounting principles as detailed in **Appendices B and C.**

Exhibit 3 shows allocation factors used to equitably allocate overhead costs across multiple funds and departments. We identified these factors in part from the sources described on page 9. We also considered the work of other auditors and consultants who reviewed cost allocation practices. Finally, we reviewed 2009, 2010 and 2011 cost allocation plans used by the eight cities included in this audit.

Exhibit 3	
Typical factors used to allocate overhead costs	
Type of costs	Factors used to calculate overhead costs
Maintenance and janitorial	Square footage
Electric and other externally provided utilities	Square footage
Accounting	Actual expenses or number of transactions
Budget	Actual expenses, budgeted expenses or number of staff (FTE) (a)
Payroll	Number of staff (FTE) or payroll warrants
Human resources	Number of staff (FTE)
IT services	Number of computers, servers, databases or ports (b)
Legal – indirect costs	Actual expenses or hours worked
Insurance	Number of staff (FTE), claims or loss history, square footage, property values insured, and risk factor
Accounts payable	Number of transactions (including vouchers or invoices)
Purchasing	Number of transactions (procurements)
<p>Sources: State Auditor's Office, based on OMB Circular A-87, studies by other auditors and consultants, and the leading practices of the eight cities in this audit.</p> <p>Notes:</p> <p>(a) Using actual expenses, budgeted expenses, the number of staff – or a combination of the three – are leading practices. Cities should document why they used the specific approach.</p> <p>(b) Ports alone may not be the best basis for cities that have moved to a wireless network model.</p>	

Exhibit 4 illustrates how human resources costs could be distributed across the multiple funds and departments that receive those services.



AUDIT RESULTS

We reviewed each city's practices for charging overhead to the utilities and compared them with leading practices and state law. We identified the following issues:

- **Most cities could strengthen their practices as shown at Exhibit 5.**
- **Some overhead charges did not clearly demonstrate the benefit received by the utilities.** We identified \$1.2 million in overcharges to the utilities and another \$2.3 million in potential overcharges or charges that did not clearly benefit the utilities given the documentation available.

Exhibit 5, on page 14 identifies the leading practices used by the eight cities during 2009 to ensure that their overhead charges to the utilities were equitable and legal.

Exhibit 7, on page 18 summarizes the cities' charges.

The cities of Bellevue and Spokane exhibited most leading practices and had little or no overcharges to the utilities. The City of Tacoma followed most leading practices but charged some overhead to the utilities that did not clearly benefit the utilities. Monroe and Redmond also charged overhead to their utilities that did not clearly demonstrate a benefit to the utilities. Since this audit, Bainbridge Island, Mukilteo, Monroe, and Redmond have incorporated more of these leading practices. Tacoma also reported it improved its practices in 2010.

Exhibit 6 on page 15 shows how each city calculated overhead charges to its utilities. The shaded boxes indicate where cities should use different factors to allocate their overhead or should document the factors that they used. The most equitable allocation factors (leading practices) are unshaded in the exhibit and are consistent with those listed in **Exhibit 3**. Other unshaded boxes show overhead costs that were not allocated or were directly charged to the utilities – which is also appropriate.

Exhibit 5 Leading practices used by the audited cities Calendar Year 2009								
Leading practices (detailed in Exhibit 2)	Larger cities				Smaller cities			
	Bellevue	Redmond	Spokane	Tacoma	Aberdeen	Bainbridge	Monroe	Mukilteo
1. Develop and maintain an overhead allocation plan that reflects decisions about which overhead costs will be allocated, to which funds or departments, and on what basis. To do this, the plan must:								
a. Be up-to-date and detail the basis for overhead charges.	✓	X	✓	✓	X	X	✓	X
b. Use allocation factors that equitably allocate overhead to each fund and department. See Exhibits 3 and 6 .	✓	✓	✓	✓	X	X	X	X
c. Allocate overhead to all benefiting funds and departments, or charge the general fund for any overhead the city chooses not to charge to some benefiting funds and departments.	✓	X	✓	X	?	?	X	?
d. Ensure that general government costs or costs that do not clearly benefit the utilities are charged entirely to the general fund.	✓	✓	✓	X	✓	✓	✓	?
2. Properly charge departments from that plan:								
a. Charge departments and funds only after services are provided.	✓	✓	✓	✓	✓	✓	X	✓
b. Charge departments and funds only for actual overhead costs incurred. If estimated overhead costs are charged to the utilities, the city reconciles and amends these estimates to actual costs at least yearly to ensure charges are equitable.	X	X	✓	✓	✓	✓	X	?
3. Maintain documentation that shows what overhead costs were charged to the utilities, the amount of the charge and how it was determined.	✓	✓	✓	✓	✓	✓	✓	X
Notes: ✓ = Yes or Mostly Yes, X = No, ? = Could not determine based on available documentation.								

Exhibit 6

Allocation factors used by the audited cities

Shaded boxes indicate where cities should use different factors or better document the factors they do use

	Larger cities				Smaller cities			
	Bellevue	Redmond	Spokane	Tacoma	Aberdeen	Bainbridge Island	Monroe	Mukilteo
Maintenance & Janitorial	Square feet	Outdated square feet	Square feet	NA - Direct charged	Not charged	Not charged	Not Allocated	City records do not show what costs were charged to the utilities
Electric Utilities	Square feet	Outdated square feet	NA – Direct charged	NA - Direct charged	Not charged	Not charged	Not Allocated	
Accounting	Number of trans-actions	Budget	Number. of trans-actions	Percentage by utility	Staff time (no support) (2)	Staff time (no support) (2)	Budget	
Budget	FTEs (1)	Budget	Operating Expenses	FTEs (1)	Staff time (no support) (2)	Staff time (no support) (2)	Budget	
Payroll	Number on payroll	FTEs	Number of checks	FTEs	Not charged	Staff time (no support) (2)	Budget	
Human Resources	FTEs	FTEs	FTEs	FTEs	Not charged	Staff time (no support) (2)	Budget	
IT Services	Number. of PC's and printers on the network	Number of PCs	FTEs	Number of PCs, servers, data-bases	Not charged	Staff time (no support) (2)	Budget	
Legal - Indirect Costs	Hours worked	FTEs	Hours worked & expenses	Hours worked	Not charged	Staff time (no support) (2)	Budget	
Insurance	Loss history & claims	Assigned risk factor	NA – Direct charged	NA – Direct charged	Property values/risk	Square feet, loss history , FTEs	Not Allocated	
Purchasing	Number of trans-actions	Budget	Number of trans-actions	Number of trans-actions	Staff time (no support) (2)	Staff time (no support) (2)	Budget	
Accounts Payable	Number of trans-actions	Budget	Number of trans-actions	Number of trans-actions	Staff time (no support) (2)	Staff time (no support) (2)	Budget	

Source: State Auditor's office, based on information reviewed in 8 cities.

Notes: (1) FTEs may not be an equitable factor when funds and departments rely heavily on vendors. As discussed in the first footnote under Exhibit 3, cities should document why the allocations factors they selected to allocate overhead costs are appropriate. (2) Although more burdensome than other allocation factors, using staff time to allocate overhead is appropriate so long as those allocations are based on recorded staff time (not unsupported estimates).

Most cities could strengthen their practices

Almost all of the cities we reviewed used at least one of the leading practices we identified, but the larger cities – Bellevue, Redmond, Spokane and Tacoma – used more of them. We identified the following opportunities:

- **Cities should use current and sufficiently detailed overhead allocation plans.** Bainbridge Island, Monroe, Mukilteo and Redmond established or updated plans for 2010 or 2011 that appear to incorporate more leading practices. Except for Bellevue, Tacoma and Spokane, other cities either did not have plans or used incomplete or outdated plans in 2009. As a result, they either overcharged the utilities or lacked support to show that charges were appropriate. Cities should always thoroughly document the appropriateness of overhead charges and use a cost allocation plan.
- **Cities should use allocation factors that equitably distribute costs.** As shown in **Exhibit 6**, half the cities used allocation factors that closely aligned with the type of service provided by each overhead cost center – for example, using the number of transactions to allocate accounting costs. Cities experienced the most difficulty when they used allocation factors that were outdated or based on estimates. For example, Redmond used square footage from 2002 to allocate costs in 2009, even though square footage had significantly increased. Others based their allocations on estimated staff time but did not reconcile those estimates to actual staff time. In other instances, cities chose factors that resulted in less precise or equitable cost allocations than other available factors. These departures from leading practice typically resulted in the cities charging the utilities more than they otherwise would have charged.
- **Most cities should do more to ensure they charge all departments and programs that benefit from overhead services.** Bellevue and Spokane charged all funds and departments that benefited from the overhead services we audited. However, Monroe, Redmond and Tacoma did not charge some departments or programs that should have been charged, and Monroe charged overhead only to its utility funds, the general fund and one capital project fund. Records for Bainbridge Island, Aberdeen and Mukilteo did not indicate whether all funds and departments had been charged for overhead services.

- **Cities should stop charging general government costs to the utilities or clarify the benefits to the utilities.** Because general government costs do not directly benefit the utilities, cities should not charge them to the utilities. Most of the cities did not. We were unable to determine if Mukilteo did, because its records were insufficiently detailed. Spokane and Tacoma charged general government costs to their utilities. Spokane's charges were minimal, were done in error, and have been reversed. However, Tacoma charged general government costs to its utilities, some of which may have benefited the utility funds, but did not clearly document or quantify the benefits to the utilities for these charges. See **Appendix D** for details.
- **Cities should carefully consider whether to charge the costs associated with elected officials to the utilities.** We found half the cities charged the utilities for costs related to the activities of the mayor or city council. The majority of sources we examined on this topic suggested mayor and city council costs are general government in nature and should not be paid by the utility funds. However, a recent court case suggests county council costs can be charged to the utilities. This case is on appeal. Because of this uncertainty, if cities choose to allocate mayor and council costs to their utilities, they should exercise caution and should maintain documentation to show that those charges are equitable and reflect the cost of actual services provided to the utilities.

The State Auditor's Office plans to review this topic further and will consider providing future guidance in its Local Government Budgeting, Accounting and Reporting System Manual.

- **Cities should not charge overhead costs before services are provided.** Seven of the cities charged their utility funds only for actual costs, but Monroe charged its utility for services before they were provided. It did this because the general fund needed money to cover payroll and other costs while the city waited for property tax revenues. These advance charges to the utilities represent an unauthorized loan to the general fund, which did not pay any interest to the utilities. This violates state law (RCW 43.09.210), which says one fund cannot receive a zero-interest loan from another.
- **Cities should reconcile cost estimates with actual costs.** Aberdeen, Bainbridge Island, Spokane and Tacoma charged actual overhead costs to their utilities in 2009. The other four cities used estimates but did not reconcile them to actual costs at year-end. As a result, Bellevue charged its utilities less than actual costs while Monroe and Redmond charged more.

Cities cited several reasons why they did not use leading practices more extensively, including:

- Pressure to reduce general fund spending.
- Cost to change existing practices would have exceeded any increase in overhead charges to the utilities.
- Staff in some cities were not aware of all leading practices.
- Turnover occurred in some finance director positions, but records of past overhead charges and the supporting rationale were not always shared with the new directors. As a result, the new finance directors made allocations based on past practices without determining if they were still appropriate.

All cities were open to recommendations for improvement, and some made corrections before we completed the audit.

Overhead charges to utilities were not always equitable or did not clearly reflect the benefit received by the utilities.

For the charges we examined, we calculated the effects on those charges when cities did not use all of the leading practices we identified. **Exhibit 7** shows the effects we identified. **Appendix D** discusses the results for each city in detail.

As shown in **Exhibit 5**, the cities of Bellevue and Spokane exhibited more leading practices than the other cities. Consequently, charges to these two cities' utilities were fully supported. Both cities had little or no overcharges to the utilities.

Overhead charges to city utilities contribute to the costs each utility must recover through its rates. Making sure these charges are fully documented, accurate and equitable could reduce costs for the utility ratepayers, and improve overall accountability and transparency.

Exhibit 7 Summary of overhead charges for the eight cities	
Utility revenues: Water, power, sewer and solid waste.	\$1.2 billion
Total overhead charged to utilities	\$33 million
Total amounts selected for audit	\$9.2 million
RESULTS	
Overcharges to the utilities: Services that benefited the utilities, but the cities charged too much. These overcharges do not appear to benefit the utilities. Over \$1 million of this amount was from the cities of Redmond and Monroe.	\$1.2 million
Potential overcharges to the utilities OR can't tell: Charges that did not clearly benefit the utilities given the documentation available. Or documentation was insufficient for us to determine either what was charged or the basis used to calculate the amounts. Nearly \$844,000 was from Tacoma.	\$2.3 million
Source: State Auditor's office tabulation of audit results.	

RECOMMENDATIONS

1. We recommend the cities that participated in this audit work to establish or update their policies, procedures and cost allocation plans to implement any of the leading practices shown in **Exhibit 5** that they do not already follow.
2. We recommend Redmond, Tacoma and Monroe further examine their 2009 overhead charges, verify that the utilities truly benefited from them, and document those benefits. If they cannot do so, we recommend the three cities reimburse their utilities accordingly.

AGENCY RESPONSES

City of Aberdeen's Response:

The City of Aberdeen has approached cost allocation conservatively; being cautious of the amount of time spent performing the accounting exercise and the relationship to the benefit received by the funds.

The Finance Department performs the billing and cash receipting functions for the utility funds. The employees that directly perform these functions were allocated based on a logical analysis of time spent on these functions, in relation to their other duties. Documentation related to the costs allocated existed in the form of a spreadsheet. Additionally, transaction analysis related to the receipting function also supported the cost allocation made to the utility funds. This detail was provided for 2010. Property insurance costs were allocated based on property values within each of the funds. The liability insurance was allocated based on a risk assessment basis.

The City plans to more formally document the procedures related to cost allocation in 2012. However, comparing a cost allocation plan / procedures from a City with a \$10 million utility budget to a City with a \$121 million or \$232 million utility budget is unrealistic. Obviously, the complexity and formality of the cost allocation plan is directly related to the staff resources available or the funds available to hire consultants to prepare the plan.



CITY OF BAINBRIDGE ISLAND

November 14, 2011

Larisa Benson, Director of Performance Audit
Office of the State Auditor
Insurance Building, Room 200
P.O. Box 40021
Olympia, WA 98504-0021

Ms. Benson,

We have received your Preliminary Draft report of the Local Government Performance Audit related to Allocating Overhead Costs. The City of Bainbridge Island (City) views itself as a steward of the taxpayer's money and welcomes the opportunity provided by the audit to review our approach to allocating overhead costs. We see audits as a collaborative effort and value the increase in our knowledge of, and approach to, cost allocation.

As discussed, it is the intention of the City of Bainbridge Island to allocate costs for necessary overhead functions such as payroll, information technology and insurance based on the leading practice of "beneficiary pays." Dividing a cost among funds using a proxy that fairly associates the proportion of cost with the amount of the service used serves all funds well. Overcharging one fund or activity unfairly burdens that function, while undercharging a fund or activity creates a subsidy to that function.

We appreciated your definition of overhead costs as "overhead costs include not only the salaries, wages and benefits of the employees who work in these departments, but the utilities, supplies, information technology, building maintenance and other costs that support these employees."ⁱ Applying this definition to the overhead that we allocate will assist us as we update our cost allocations in coming years.

The City also appreciated your review of our cost allocation practices. As you noted, "The City did not have an overhead allocation plan in place for 2009, but still allocated overhead in a logical fashion."ⁱⁱ We see that of the seven points you assessed for each jurisdiction, you found that the City used best practices in four cases, you were unable to tell in one case, and in two cases you suggest we adopt a leading practice. In particular, you have recommended that the City move away from reliance on estimates of staff time as a method of allocation where possible. We agree with you, and have moved to develop a plan including more numerical

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SCHROER/BENSON
NOVEMBER 14, 2011
PAGE 2 OF 2

proxies. In the report, you state that you did not identify any unusually high allocations to the utilities.

In some cases, the City had already begun before the audit to take corrective steps in relationship to points raised in your report. In 2009, the City hired outside experts to prepare a cost allocation plan. You reviewed the plan prepared by this consultant for the City, and stated that it appears to contain allocation factors that are most consistent with the leading practicesⁱⁱⁱ. While the City has not yet adopted this plan, your review will assist City decision makers as we continue to consider the plan and its implementation.

Thank you for the opportunity to respond to your draft report.

Sincerely yours,



Ellen Schroer
Director of Finance and Administrative Services

ⁱ Local Government Performance Audit: Allocating Overhead Costs (Washington State Auditor), 6.

ⁱⁱ Ibid, 29.

ⁱⁱⁱ Ibid, 29.



Post Office Box 90012 • Bellevue, Washington • 98009 9012

November 15, 2011

Brian Sonntag
State Auditor
PO Box 40021
Olympia, Washington 98504-0021

RE: PERFORMANCE AUDIT REPORT — ALLOCATED OVERHEAD COSTS

Dear Mr. Sonntag:

On behalf of the Bellevue City Council and our citizens, we thank you for the time and energy invested in conducting the Allocated Overhead Cost audit and your identification of best practices that we and other public agencies may use to continuously improve the effectiveness and fairness of our overhead allocation process.

The City of Bellevue is pleased with its performance in this audit and the "culture of compliance" we have achieved at the City. As a City, we are committed to financial stewardship and have established high standards, consistent with the leading practices identified in the performance audit report.

The City has reviewed your recommendation to true up to actuals at year end and has compared this to the practices and procedures in our overhead allocation plan. The City is continually evaluating the cost benefit of performing a true up at the end of the year. Our current process sets fund balance targets for each allocated internal service fund consistent with our fund policies. When actual fund balance is in excess of target at the end of the year, the City refunds allocations to achieve target levels. This process ensures we are not overcharging our customers. Over time, undercharges are caught up as we rebuild reserve levels in subsequent forecast cycles.

We would like to extend our appreciation to your audit staff and thank you for your feedback on ways to improve our overhead allocation process.

Sincerely,

A handwritten signature in black ink, appearing to read "Jan Hawn".

Jan Hawn
Finance Director



November 4, 2011

Official Response
To the
Local Government Performance Audit
On
Allocating Overhead Costs

The City of Monroe thanks the State Auditors' Office for their assistance and guidance from this audit report. The City was aware that there were some deficiencies in the past practices of overhead cost allocation. In 2009 and 2010 there was staff turnover in the Finance Director position that caused some disconnect in continuity of record keeping. As stated in the audit, the City has since adopted and updated our cost-allocation plan for overhead charges. Going forward the City is further adopting ALL leading practices identified in the audit.

Sincerely,

A handwritten signature in black ink, appearing to read "Gene R. Brazel".

Gene R. Brazel
City Administrator

**THE ADVENTURE
STARTS HERE!**

City of Monroe
806 West Main Street, Monroe, WA 98272
Phone (360) 794-7400 Fax (360) 794-4007
www.ci.monroe.wa.us



City of Spokane

November 11, 2011

Larissa Benson
Director of Performance Audit
Washington State Auditor's Office
PO Box 40022
Olympia, WA 98504-0022

Dear Ms. Benson,

The City of Spokane would like to take this opportunity to thank the Washington State Auditors Office for their implementation of Citizen's Initiative 900 and the resulting objective analysis of the efficiency and effectiveness of the policies and operations of local governments.

The development and execution of Overhead Allocation Plans are an important means to spread the cost of centrally provided services to those cost centers that benefit from these services. Accordingly, we are extremely proud that the State Auditors' Office recognized in this report that the City of Spokane effectively and fairly allocates their overhead costs to their utility funds and other cost centers by utilizing the following best practices as identified in the report:

- Adopting overhead cost plans that contain appropriate rationales and drivers for the allocation methods.
- Applying the cost plan to actual overhead costs that have already been incurred by the City.
- Charging overhead costs to funds and departments that benefit from the central services.
- Maintaining accurate and current documentation of the plan to ensure that the process works consistently over time.

The City appreciates the State Auditors Office's efforts to provide this valuable information to our citizens, and to assist us in our continuous improvement efforts.

Sincerely,

A handwritten signature in blue ink that reads "Mary B. Verner".

Mary B. Verner
Mayor

A handwritten signature in black ink that reads "Alexander J. Shogan, Jr.".

Alexander J. Shogan, Jr.
City Council President
Spokane City Council

cc: Gavin Cooley, CFO, City of Spokane

"Spokane – Near Nature, Near Perfect"

808 W. Spokane Falls Blvd., Spokane, Washington 99201-3335
Phone: (509) 625-6250 FAX: (509) 625-6563



City of Tacoma
City Manager

November 15, 2011

The Honorable Brian Sonntag
Washington State Auditor's Office
Sunset Building
3200 Capitol Boulevard
P.O. Box 40031
Olympia, WA 98504-0031

Re: City of Tacoma Response to Allocating Overhead Costs Performance Audit Report

Dear Mr. Sonntag:

Thank you for your office's work on the overhead cost performance audit. Stewardship and accountability are two of the City of Tacoma's seven guiding principles and I appreciate the scrutiny that your auditors placed on our practices. The partnership between the General Government and our utilities is important to ensuring that the basic needs of our community are met. I appreciate the opportunity that we have to further consider your recommendations as we continue to strengthen that partnership. The leading practices identified in the report provide a good platform for evaluation of our assessment methodology in the future.

Please express my thanks to the audit team as I believe they tried to understand a series of very detailed and complicated transactions. I appreciate the recognition that was provided that the City is using most of the leading practices. I also valued the opportunities for our organization to provide feedback and appreciate that some of our suggestions were considered.

Below, I have included responses to the findings in the report.

Finding/Issue 1: The City of Tacoma did not allocate overhead to all funds that benefitted from services in 2009.

City of Tacoma Response: As briefly addressed in the audit, based on a 2008 report on Tacoma's cost allocations and overhead from Miller & Miller, P.S., the City of Tacoma initiated two changes to its allocation system. As was reflected in your report, the City of Tacoma shifted from budget-based assessments to assessments based on actual cost in 2009. A second change, shifting from a multi-tier to single tier assessment system, could not be implemented in the 2009-10 biennium due to

Honorable Brian Sonntag
City of Tacoma Response
November 15, 2011
Page 2

programming changes to the City's budget and accounting (SAP) system. This change was made in conjunction with our 2011-12 biennial budget preparation process. When the City made this change, this finding was addressed.

Finding/Issue 2: The City of Tacoma did not clearly link the charges for marketing services, purchasing programs, assistance provided Human Rights and Human Services, and Government Relations with service levels to utilities.

City of Tacoma Response: While the City will continue to evaluate the feedback provided by the State Auditor's Office, I continue to believe that the assessments for both the City's HUB and LEAP programs to our utilities and the marketing assistance to TPU are appropriate. While I believe that documentation and methodology could be improved for Human Rights and Human Services and Government Relations, I believe that the utilities are receiving services for which the General Fund must be reimbursed. I have previously committed to a process for collaborative review with our utilities of all assessments in advance of the 2013-14 biennium, and will place particular focus on the assessments covered in your report. I have included additional information below for each area.

Community and Economic Development Department Marketing Assistance

Though not precedent setting, I appreciate your report's reference to Okeson vs. City of Seattle, King County Superior Court No. 02-2-05774-8SEA. While not binding, the case provides a helpful reference in evaluating assessments. While your report only spoke to the case's ruling on a contribution of the utility to the City of Seattle Small Business Assistance (SBA) program, I find Community and Economic Development's support of TPU to be more similar to the case's consideration of assistance provided by Seattle's Office of Housing to the utility. It found that paying expenses of the Office of Housing to promote weatherization and other conservation programs was appropriate. The agreement to provide services to TPU to the extent of their need and within the restraints of the law provides a valuable service. However, I will continue to work with the Director of TPU to confirm the desired level of service and the appropriate level of documentation for future accountability and transparency.

Historically Underutilized Business Purchasing Program (HUB) and Local Employment Apprenticeship Program (LEAP)

I do not believe that HUB and LEAP are comparable to the SBA example provided in the report, but are more similar to the Okeson case's finding that work done by the Seattle Planning Department on the utility's behalf, like updating the energy code, was appropriate. HUB and LEAP specifically serve the needs of Tacoma Public Utilities.

Honorable Brian Sonntag
City of Tacoma Response
November 15, 2011
Page 3

HUB and LEAP were developed with TPU to: comply with federal and state public works contracting laws (RCW 35.22.570); anti-discrimination laws related to public contracting (RCW49.60.400); to promote hiring of local labor; and to train apprentices to develop a qualified workforce for use by TPU and the City. In addition, LEAP participation allows TPU to receive tax credits for apprenticeship utilization provided by Initiative 937.

While the record keeping for HUB and LEAP are very detailed and provide a great deal of accountability and transparency, I will continue to work with the directors of TPU and Public Works to identify reasonable opportunities to improve recordkeeping.

Human Rights and Human Services

Unfortunately, the City's long-tenured Human Rights and Human Services (HRHS) Department Director retired during this audit. It was difficult for the City to respond to the audit in this time of transition, but the Okeson case reinforces that Human Services charges can be appropriate. It found that services by the Seattle Human Services Department to screen senior citizens and low-income citizens for certain low-income utility rates were appropriate. I am confident that charges to TPU from the HRHS Department for services provided to the utility like direct training on the City's domestic violence policy, ADA compliance assistance, and direct childcare assistance programs are appropriate. The cost allocation for Human Rights and Human Services received scrutiny in the 2011-2012 budget process, and I will work with the directors of TPU and Public Works to establish appropriate levels of service, allocation, and documentation for the 2013-14 biennium.

Government Relations Office

While the department of Tacoma Public Utilities has stated that it finds value in the Government Relations Office, similar to Human Rights and Human Services allocation, the Government Relations Office level of cost allocation received scrutiny in the 2011-12 budget process. I will work with the TPU Director and Public Works Director to establish appropriate levels of service, allocation, and documentation for the 2013-14 biennium.

Honorable Brian Sonntag
City of Tacoma Response
November 15, 2011
Page 4

Once again, thank you for the thoughtful consideration of Tacoma assessments. I look forward to the opportunity to improve our assessment methodology and documentation in partnership with our utilities for the 2013-2014 biennium.

Sincerely,

A handwritten signature in black ink, appearing to read 'Rey Arellano', with a stylized flourish at the end.

Rey Arellano
Interim City Manager

cc: Tansy Hayward, Acting Deputy City Manager
Bill Gaines, Director, Tacoma Public Utilities
Dick McKinley, Director, Public Works Dept.
Bob Biles, Director, Finance Dept.
Scottie Nix, Internal Auditor

APPENDIX A: INITIATIVE 900

Initiative 900, approved by Washington voters in 2005 and enacted into state law in 2006, authorized the State Auditor's Office to conduct independent, comprehensive performance audits of state and local governments.

The law directs the Auditor's Office to "review and analyze the economy, efficiency, and effectiveness of the policies, management, fiscal affairs, and operations of state and local governments, agencies, programs, and accounts." Performance audits are to be conducted according to U.S. General Accountability Office government auditing standards.

In addition, the law identifies nine elements that are to be considered within the scope of each performance audit. The State Auditor's Office evaluates the relevance of all nine elements to each audit. The table below indicates which elements are addressed in this audit. Specific issues are discussed in detail in the Audit Results and Recommendations sections of this report.

I-900 Element	Addressed in Audit
1. Identification of cost savings	Yes. The audit identified potential savings for some cities' utility funds. However, overhead costs not charged to a utility would have to be paid by the general fund.
2. Identification of services that can be reduced or eliminated	No. The audit identified charges to the utilities for programs and services that did not benefit them. Although the audit recommends that cities discontinue these charges, cities may continue these programs and services with other funding sources.
3. Identification of programs or services that can be transferred to the private sector	No. The audit makes no recommendations to transfer services to the private sector in order to more equitably allocate overhead between the general fund and the utilities.
4. Analysis of gaps or overlaps in programs or services and recommendations to correct gaps or overlaps	Yes. The audit identified leading practices for equitably allocating overhead between the general fund and the utilities but determined some cities were not using them.
5. Feasibility of pooling information technology systems within the department	No. The audit makes no recommendations to pool information technology systems in order to more equitably allocate overhead between the general fund and the utilities.
6. Analysis of the roles and functions of the department, and recommendations to change or eliminate departmental roles or functions	No. Our audit makes no recommendations to change or eliminate departmental roles and functions.
7. Recommendations for local government statutory or regulatory changes that may be necessary for the department to properly carry out its functions	No. The audit makes no recommendations for statutory or regulatory changes.
8. Analysis of departmental performance data, performance measures, and self-assessment systems	No. The audit makes no recommendations regarding performance data, performance measurement or self-assessment systems.
9. Identification of best practices	Yes. The audit identifies leading practices for cities and other local governments to use to ensure overhead is allocated equitably between the general fund and the utilities.

APPENDIX B: SCOPE AND METHODOLOGY

We conducted this performance audit in accordance with generally accepted government auditing standards, prescribed by the U.S. Government Accountability Office. 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. The approach we used is summarized as follows:

To identify leading practices for allocating overhead across multiple funds and departments we identified leading practices from the federal Office of Management and Budget's (OMB) Circular A-87 and its corresponding Implementation Guide, a study by the U.S. Government Accountability Office, Generally Accepted Accounting Principles, and other performance audits that examined this same topic.

To identify typical allocation factors, we reviewed the OMB Circular A-87 Implementation Guide, other performance audits and consultant reports that examined this same topic, and the leading practices we observed across the eight cities included in this audit.

To gain an understanding of each city's practices for allocating overhead equitably among the general fund and the utility funds, we:

- Reviewed prior audits and studies of each city that examined overhead allocation practices to identify potential risks and to obtain an understanding of the leading practices in place to equitably and legally allocate overhead among the general fund and the utility funds.
- Reviewed charges to each city's utility funds to determine whether they were charged overhead costs.
- Interviewed budget and utility personnel who were responsible for ensuring overhead was equitably and legally allocated among the general fund and the utility funds.

To assess whether each city's practices resulted in overhead costs that were equitably allocated between the general fund and the utility funds, we analyzed whether the eight cities applied leading practices for sharing overhead costs between their utility funds and the general fund. We assessed whether the allocation factors used were equitable for distributing overhead costs. We also audited two or more overhead cost centers, where possible, to determine the degree to which cities used leading practices to allocate overhead. If leading practices were not used, we calculated the cost impact of incorporating the missing leading practices.

While performing our audit, if we noticed other unusual overhead costs allocated to the utility funds, we examined the city's support for these costs and assessed whether they provided a service or benefit to the utility funds. Our audit examined the equity of each city's overhead allocation methodologies, not the accuracy and completeness of city records used to calculate and distribute overhead. We recalculated certain overhead charges using leading practices and each city's records to determine whether those charges were equitable and accurately calculated. This audit did not evaluate the accuracy and completeness of those city records.

To assess what types of overhead costs can be allocated legally to the utility funds, we researched relevant court cases, other performance audits looking at this same topic and applicable state statutes. We identified applicable legal criteria and other sources that helped us understand that criteria.

Using these criteria, we analyzed each city's overhead charges to determine whether the city shared overhead legally and consistently with leading practices. Any questionable overhead charges were analyzed. We also tested overhead charges shared between the general fund and the utility funds to determine whether amounts were supported, accurate and truly benefited the utility funds. This work was done for those overhead services shown at **Exhibit 1**.

APPENDIX C: AUDIT CRITERIA

This appendix provides a framework to compare cities' cost allocation practices with leading practices, as derived from state law and federal sources as cited below.

- 1. Develop and maintain an overhead allocation plan that reflects decisions about which overhead costs will be allocated, to which funds or departments, and on what basis.** A plan is an essential tool. It is used to calculate overhead allocations, document key information about each overhead cost center, and determine how it will be allocated and what data will be used to calculate those allocations. A well-developed plan should:
 - a. Include relevant, up-to-date information about overhead and how to distribute it equitably.** It should describe each overhead cost center, which costs are allocable and which are not, and what allocation factors and data sources will be used to calculate the allocations. It should describe the decisions made and the rationale for those decisions. It should contain the calculations of overhead charges to each fund and department. Cities should update the plan annually.
Source: "Cost Principles for State, Local, and Indian Tribal Governments (OMB Circular A-87)." Federal Register 70:168 (31 August 2005) p. 51922, A (1).
Available: http://frwebgate.access.gpo.gov/cgi-bin/getpage.cgi?position=all&page=51922&dbname=2005_register
 - b. Use factors that equitably allocate central overhead costs to each fund or department.** Allocation factors are used to distribute overhead costs to departments and funds that benefit from overhead services. Different factors are necessary to equitably allocate the various overhead costs. For example, square footage is an appropriate factor to allocate maintenance and janitorial costs. The number of transactions is an appropriate factor to allocate accounting costs. Good allocation factors result in each fund and department paying only for the overhead services it received. Cities should ensure that allocation factors are based on current and accurate information. If estimates or budgeted figures are used, cities should adjust them to actual at least annually.
Source: U.S. Department of Health and Human Services. Cost Principles and Procedures for Establishing Cost Allocation Plans and Indirect Cost Rates for Agreements with the Federal Government (ASMB C-10). (Washington: GPO, 1997) p. 66, 4.6.2.
Available: <http://rates.psc.gov/fms/dca/asmb%20c-10.pdf>
 - c. Allocate overhead to all benefiting funds and departments for overhead services received.** If cities decide not to charge overhead to a particular fund or department, the general fund must absorb that fund or department's share of the costs. Excluding a fund or department from the calculation results in overcharges to all remaining funds and departments.
Sources: "Cost Principles for State, Local, and Indian Tribal Governments (OMB Circular A-87)." Federal Register 70:168 (31 August 2005) p. 51922, A (1).
Available: http://frwebgate.access.gpo.gov/cgi-bin/getpage.cgi?position=all&page=51922&dbname=2005_register. RCW 43.09.210;
Available: <http://apps.leg.wa.gov/rcw/default.aspx?cite=43.09.210>

- d. **Ensure that general government costs or questionable costs that do not clearly benefit the utilities are charged entirely to the general fund.** The primary purposes of general government programs are to serve the public at large. Charging such costs to the utilities is questionable because they do not support the utilities. The costs of such programs are typically paid for by all taxpayers, not the utility ratepayers.

Sources: OMB Circular A-87, p. 51918, 19 (a).

Available: http://frwebgate.access.gpo.gov/cgi-bin/getpage.cgi?position=all&page=51918&dbnme=2005_register; RCW 43.09.210.

Available: <http://apps.leg.wa.gov/rcw/default.aspx?cite=43.09.210>

2. Properly charge departments from that plan:

- a. **Charge departments and funds only after overhead services are provided.** Overhead allocation plans allow a city to forecast the amount of overhead it will charge each department in a given year. Although costs can be charged quarterly, monthly or more frequently, they should always be charged after services are rendered. If the general fund charges overhead costs before services are rendered, it has inappropriately borrowed money from other funds in violation of state law.

Source: RCW 43.09.210.

Available: <http://apps.leg.wa.gov/rcw/default.aspx?cite=43.09.210>

- b. **Charge departments and funds only for actual overhead costs incurred.** If cities charge departments and funds based on estimated overhead costs, they should reconcile those estimates to actual costs at least once a year and make adjustments as needed.

Sources: OMB Circular A-87, p. 51916, 5 (e).

Available: http://frwebgate.access.gpo.gov/cgi-bin/getpage.cgi?position=all&page=51916&dbnme=2005_register; RCW 43.09.210.

Available: <http://apps.leg.wa.gov/rcw/default.aspx?cite=43.09.210>

3. **Maintain appropriate documentation to support the plan and the overhead costs charged to each department and fund.** State law (RCW 43.09.210) says that when one fund charges another for services provided, the receiving fund should pay the full value of the services and no more. Without documentation that shows (1) the cost of each overhead cost center, (2) the level of service each provided to benefiting funds and departments and how it was determined, and (3) the amount charged to each fund and department, cities cannot demonstrate compliance with this law.

Sources: RCW 43.09.210.

Available: <http://apps.leg.wa.gov/rcw/default.aspx?cite=43.09.210>; OMB Circular A-87, p. 51922, A. 1.

Available: http://frwebgate.access.gpo.gov/cgi-bin/getpage.cgi?position=all&page=51922&dbnme=2005_register

APPENDIX D: AUDIT AREAS FOR EACH CITY

1. **Aberdeen**
2. **Bainbridge**
3. **Bellevue**
4. **Monroe**
5. **Mukilteo**
6. **Redmond**
7. **Spokane**
8. **Tacoma**

1. City of Aberdeen

The City did not follow most leading practices, and subsequently its records did not adequately demonstrate the appropriateness of overhead charges to the utility funds in 2009.

As shown in **Exhibit 8**, Aberdeen did not follow all leading practices for charging overhead to the utilities.

Exhibit 8 Leading practices used by Aberdeen Calendar Year 2009	
1. Develop and maintain an overhead allocation plan that reflects their decisions about which overhead services they will charge to the various funds and departments and what factors they will use to determine the actual costs. To do this, the plan must:	
a. Be up-to-date and detail the basis for overhead charges.	X
b. Use allocation factors that equitably allocate overhead to each fund and department. See Exhibits 3 and 6 .	X
c. Allocate overhead to <u>all</u> benefiting funds and departments, or charge the general fund for any overhead the city chooses not to allocate to some benefiting funds and departments.	?
d. Ensure that general government costs or costs that do not clearly benefit the utilities are allocated <u>entirely</u> to the general fund.	✓
2. Properly charge departments from that plan:	
a. Charge departments and funds only after services are provided.	✓
b. Charge departments and funds only for actual overhead costs incurred. If estimated overhead costs are charged to the utilities, the city reconciles and amends these estimates to actual costs at least yearly to ensure charges are equitable.	✓
3. Maintain documentation that shows what overhead costs were charged to the utilities, the amount of the charge and how it was determined.	✓
Notes: ✓ = Yes or Mostly Yes, X = No, ? = Could not determine based on available documentation.	

The City charged about \$632,000 in overhead to its utility funds without a formal overhead allocation plan. Those charges were for Finance Department staff and insurance. Staff costs were charged based on estimates of time spent on each fund and department. Insurance costs were charged, in part, based on the City's estimated risk-exposure for each department/fund.

Although Finance Department costs may be charged to utility funds, the City does not have records to show how much time employees spent on utility-related work. Insurance costs also may be allocated based on an assessment of each fund and department's liability risk, but again the City lacks records to support its assessment. Consequently, it cannot show these charges were equitable. For example, if it had used actual expenses to allocate insurance costs to the utilities, it would have charged them about \$179,000 less. Although an imperfect method for insurance costs, it's the only supportable comparison available.

As shown in **Exhibit 6**, the City did not charge its utility funds for all overhead services provided. For example, it did not charge the utility funds for costs related to payroll or human resources, although it could have charged them about \$50,000. It also did not charge the utilities for legal or information technology services. Because the City was concerned citizens would oppose rate increases, it was reluctant to pay for efforts to identify and tally other possible overhead it could charge to the utility accounts.

Exhibit 9 summarizes the City's annual utility revenue, the amount of overhead charged to its utilities, what overhead cost centers were audited, and the effects we identified.

Exhibit 9 Evaluation of 2009 overhead charges – summarized	
Utility revenues (water, sewer, solid waste and storm water)	\$9,500,000
Total overhead charged to utilities	\$632,000
Overhead cost centers selected for audit	Finance - \$279,000 Human Resources - \$0 Insurance - \$353,000 Payroll - \$0
RESULTS	
Overcharges to the utilities. Services that benefit the utilities but the City charged too much.	\$0
Potential overcharges to the utilities OR can't tell. Charges that do not clearly benefit the utilities given the documentation available. Or documentation is insufficient to tell either what was charged or the basis used to calculate the amount. These amounts may include likely or actual overcharges or undercharges.	\$632,000

2. City of Bainbridge Island

Bainbridge is one of the four cities in our audit that have since adopted or updated their cost-allocation plan for overhead charges. However, as the City did not follow most leading practices, its records did not adequately demonstrate the appropriateness of overhead charges to the utility funds in 2009.

As shown in **Exhibit 10**, Bainbridge Island did not follow all leading practices for charging overhead to the utilities.

Exhibit 10 Leading practices used by Bainbridge Island Calendar Year 2009	
1. Develop and maintain an overhead allocation plan that reflects their decisions about which overhead services they will charge to the various funds and departments and what factors they will use to determine the actual costs. To do this, the plan must:	
a. Be up-to-date and detail the basis for overhead charges.	X
b. Use allocation factors that equitably allocate overhead to each fund and department. See Exhibits 3 and 6 .	X
c. Allocate overhead to <u>all</u> benefiting funds and departments, or charge the general fund for any overhead the city chooses not to allocate to some benefiting funds and departments.	?
d. Ensure that general government costs or costs that do not clearly benefit the utilities are allocated <u>entirely</u> to the general fund.	✓
2. Properly charge departments from that plan:	
a. Charge departments and funds only after services are provided.	✓
b. Charge departments and funds only for actual overhead costs incurred. If estimated overhead costs are charged to the utilities, the city reconciles and amends these estimates to actual costs at least yearly to ensure charges are equitable.	✓
3. Maintain documentation that shows what overhead costs were charged to the utilities, the amount of the charge and how it was determined.	✓
Notes: ✓ = Yes or Mostly Yes, X = No, ? = Could not determine based on available documentation.	

The City did not have an overhead allocation plan in place for 2009 but still allocated overhead in a logical fashion. For example, it charged insurance costs based on each fund's risk history, and the debt service for bonds used to purchase facilities was charged based on each fund's proportionate use of those facilities. It also charged salaries and benefits for Finance, Executive and Public Works staff to the utility and other funds based in large part on managers' estimates of how much time staff spent on the utility funds and other departments. City records indicate that about \$618,000 of the nearly \$1.8 million in charges for salaries and benefits was for the overhead services we examined. Although we did not identify any unusually high allocations to the utilities when we reviewed Finance and Executive staff allocations, the City lacked time records to support them. Therefore, it cannot show it equitably charged the utility funds.

The City's new overhead allocation plan indicates it did not charge the utilities in 2009 for some services provided.

As shown at **Exhibit 6**, the City did not charge its utilities for all overhead services it provided them. It had not committed the time or resources to identify these costs. To address this, it hired a consultant in late 2009 to study overhead costs for all programs and to establish a comprehensive overhead allocation plan. Its staff have drafted and submitted the resulting plan to the Council for approval. Although our audit focused on 2009 allocations, the new plan appears to contain allocation factors that are mostly consistent with the leading practices. However, some allocations still are based on unsupported estimates of how much time staff spend supporting each fund and department. If approved, the new plan indicates the City will increase its overhead charges to the utilities for those cost centers examined.

Exhibit 11 summarizes the City's annual utility revenue, the amount of overhead charged to its utilities, what overhead cost centers were audited, and the effects we identified.

Exhibit 11 Evaluation of 2009 overhead charges – summarized	
Utility revenues (water, sewer and storm water)	\$15,467,000
Total overhead charged to utilities for cost centers examined	\$683,000
Overhead cost centers selected for audit	Building Maintenance - \$0 Finance - \$401,363 Human Resources - \$18,129 Legal - \$ 32,175 Information Technology - \$166,719 Insurance -\$64,162
RESULTS	
Overcharges to the utilities. Charges that benefit the utilities but the City charged too much.	\$0
Potential overcharges to the utilities OR can't tell. Charges that do not clearly benefit the utilities given the documentation available. Or documentation is insufficient to tell either what was charged or the basis used to calculate the amount. These amounts may include likely or actual overcharges or undercharges.	\$618,000

3. City of Bellevue

The City used most leading practices to allocate overhead.

Bellevue was one of two cities (with Spokane) that used most leading cost-allocation practices. Bellevue not only has a well-constructed overhead allocation process, but goes farther by sharing planned charges in advance with the departments that will be charged. This leading practice enhances organizational transparency and reduces the likelihood of errors and inequitable charges.

As shown in **Exhibit 12**, Bellevue followed most leading practices for charging overhead to the utilities.

Exhibit 12 Leading practices used by Bellevue Calendar Year 2009	
1. Develop and maintain an overhead allocation plan that reflects their decisions about which overhead services they will charge to the various funds and departments and what factors they will use to determine the actual costs. To do this, the plan must:	
a. Be up-to-date and detail the basis for overhead charges.	✓
b. Use allocation factors that equitably allocate overhead to each fund and department. See Exhibits 3 and 6 .	✓
c. Allocate overhead to <u>all</u> benefiting funds and departments, or charge the general fund for any overhead the city chooses not to allocate to some benefiting funds and departments.	✓
d. Ensure that general government costs or costs that do not clearly benefit the utilities are allocated <u>entirely</u> to the general fund.	✓
2. Properly charge departments from that plan:	
a. Charge departments and funds only after services are provided.	✓
b. Charge departments and funds only for actual overhead costs incurred. If estimated overhead costs are charged to the utilities, the city reconciles and amends these estimates to actual costs at least yearly to ensure charges are equitable.	X
3. Maintain documentation that shows what overhead costs were charged to the utilities, the amount of the charge and how it was determined.	✓
Notes: ✓ = Yes or Mostly Yes, X = No, ? = Could not determine based on available documentation.	

The City has identified and is charging all common overhead costs to its utility funds and is mostly using sound allocation factors to support those charges and ensure they are equitable. It charged overhead through the use of a regularly updated overhead allocation plan to all benefiting departments after the costs were incurred. It did not allocate charges to non-benefiting funds and departments. Its allocation calculations were based on appropriate data such square footage and transaction counts.

The City takes its overhead allocation process one step further. It shares planned charges with the overhead departments and the departments served. Departments evaluate the overhead charges and formally agree on the amounts to be charged. This leading practice enhances organizational transparency and reduces the likelihood of errors and inequitable charges.

The City charged budgeted overhead costs but did not adjust to reflect actual costs.

The City charged budgeted overhead because actual overhead costs were unknown when the allocation plan was developed. This approach is appropriate as long as cities reconcile budgeted costs to actual at year end and make adjustments for significant differences. Because the City did not do this, it cannot be sure its overhead allocations are accurate and equitable. For example, a reconciliation of budgeted costs to actual costs showed the City would have charged its utility funds \$5,000 less for Building Maintenance and about \$74,000 more for Information Technology.

The City has discontinued certain charges to its utilities.

In light of a 2004 court case (Okeson vs. City of Seattle, King County Superior Court, No. 02-2-05774-8SEA), the City of Bellevue no longer charges its utility funds for costs related to its elected officials and its Office of Economic Development.

Exhibit 13 summarizes the City's annual utility revenue, the amount of overhead charged to its utilities, what overhead cost centers were audited, and the effects we identified.

Exhibit 13 Evaluation of 2009 overhead charges – summarized	
Utility revenues (water, sewer and storm water)	\$121,789,000
Total overhead charged to utilities	\$3,515,000
Overhead cost centers selected for audit	Facilities Maintenance - \$740,771 Information Technology - \$1,270,625
RESULTS	
Overcharges to the utilities. Charges that benefit the utilities but the City charged too much.	\$0
Potential overcharges to the utilities OR can't tell. Charges that do not clearly benefit the utilities given the documentation available. Or documentation is insufficient to tell either what was charged or the basis used to calculate the amount. These amounts may include likely or actual overcharges or undercharges.	\$0
Potential undercharges to utilities Charges that could have been allocated to the utilities but were not.	\$69,000

4. City of Monroe

Monroe is one of the four cities in our audit that have since adopted or updated their cost-allocation plan for overhead charges. However, during the period we evaluated, the City did not use most leading practices to share overhead costs, and charges to its utilities varied significantly over the past few years.

As shown in **Exhibit 14**, Monroe did not follow most leading practices for charging overhead to the utilities.

Exhibit 14 Leading practices used by Monroe Calendar Year 2009	
1. Develop and maintain an overhead allocation plan that reflects their decisions about which overhead services they will charge to the various funds and departments and what factors they will use to determine the actual costs. To do this, the plan must:	
a. Be up-to-date and detail the basis for overhead charges.	✓
b. Use allocation factors that equitably allocate overhead to each fund and department. See Exhibits 3 and 6 .	X
c. Allocate overhead to <u>all</u> benefiting funds and departments, or charge the general fund for any overhead the city chooses not to allocate to some benefiting funds and departments.	X
d. Ensure that general government costs or costs that do not clearly benefit the utilities are allocated <u>entirely</u> to the general fund.	✓
2. Properly charge departments from that plan:	
a. Charge departments and funds only after services are provided.	X
b. Charge departments and funds only for actual overhead costs incurred. If estimated overhead costs are charged to the utilities, the city reconciles and amends these estimates to actual costs at least yearly to ensure charges are equitable.	X
3. Maintain documentation that shows what overhead costs were charged to the utilities, the amount of the charge and how it was determined.	X
Notes: ✓ =Yes or Mostly Yes, X = No, ? = Could not determine based on available documentation.	

Overhead charges to the utility funds have varied significantly in recent years. The City's records show it charged 45.8 percent or \$793,000 of its total overhead costs to the utilities in 2008, 51.5 percent or \$840,000 in 2009, and 19.4 percent or \$369,000 in 2010. At the beginning of audit, the City could not provide us with an overhead allocation plan or other records to support the amounts charged in 2009 or the methodology and allocation factors used to determine them. Therefore, it could not show that actual costs were charged. Before we published the report, the City provided records that identified the overhead costs charged in 2009. Those records show the City did not share overhead to all benefiting funds in 2009. Instead, it charged estimated overhead costs primarily to the general fund, utility funds and one capital projects fund. Although leading practices require different factors to allocate the various types of overhead costs, the City allocated all overhead costs using each fund's share of budgeted operating expenditures.

The City was unfamiliar with leading practices for calculating and equitably charging overhead costs to its funds and departments. We estimated these charges using leading practices and 2009 costs. We determined the 2009 charges should have totaled about \$468,000 less.

The City also charged its utility funds for overhead services from general fund departments before those services were provided. It did this to cover general fund shortfalls in 2008, 2009 and 2010. For example, the City's general fund ran low on money in 2010 and it charged the utilities in advance to cover payroll while it waited for April's property tax revenue. These advance charges represent an unauthorized loan to the general fund, which did not pay any interest to the utility funds. This practice violates RCW 43.09.210.

The City established a new overhead allocation plan in 2010. The new plan allocated all budgeted overhead to all funds based on each fund's percentage of budgeted expenditures. However, the City did not consider the degree to which all funds benefited from these overhead costs. Although the City adjusted these charges throughout the year to keep them close to actual costs, it did not perform a year-end reconciliation. Moreover, budgeted expenditures is not an equitable allocation factor for some overhead costs. As shown in **Exhibit 6**, multiple allocation factors are necessary to equitably share different types of overhead cost. Payroll, human resources and information technology costs are not equitably allocated across funds based on budgeted expenditures. For example, the City would have charged the utility funds about \$22,000 less in 2010 for information technology costs if it had used ports to allocate these costs. Using budgeted expenditures also results in questionable allocations of payroll and human resources costs to the debt service and capital projects funds, which have few if any employees.

Exhibit 15 summarizes the City's annual utility revenue, the amount of overhead charged to its utilities, what overhead cost centers were audited, and the effects we identified.

Exhibit 15 Evaluation of 2009 overhead charges - summarized	
Utility revenues (water, sewer, solid waste, recycling and storm water)	\$11,626,000
Total overhead charged to utilities	\$840,000
Overhead cost centers selected for audit	All cost centers - \$840,000
RESULTS	
Overcharges to the utilities. Services that benefit the utilities but the City charged too much. These overcharges do not appear to benefit the utilities.	\$468,000
Potential overcharges to the utilities OR can't tell. Charges that do not clearly benefit the utilities given the documentation available. Or documentation is insufficient to tell either what was charged or the basis used to calculate the amount. These amounts may include likely or actual overcharges or undercharges.	\$0

5. City of Mukilteo

Mukilteo is one of the four cities in our audit that have since adopted or updated their cost-allocation plans for overhead charges. However, the City did not follow most leading practices and it lacked an allocation plan or other records to support overhead charged to its utility fund in 2009.

As shown in **Exhibit 16**, Mukilteo did not follow most leading practices for charging overhead to the utilities.

Exhibit 16 Leading practices used by Mukilteo Calendar Year 2009	
1. Develop and maintain an overhead allocation plan that reflects their decisions about which overhead services they will charge to the various funds and departments and what factors they will use to determine the actual costs. To do this, the plan must:	
a. Be up-to-date and detail the basis for overhead charges.	X
b. Use allocation factors that equitably allocate overhead to each fund and department. See Exhibits 3 and 6 .	X
c. Allocate overhead to <u>all</u> benefiting funds and departments, or charge the general fund for any overhead the city chooses not to allocate to some benefiting funds and departments.	?
d. Ensure that general government costs or costs that do not clearly benefit the utilities are allocated <u>entirely</u> to the general fund.	?
2. Properly charge departments from that plan:	
a. Charge departments and funds only after services are provided.	✓
b. Charge departments and funds only for actual overhead costs incurred. If estimated overhead costs are charged to the utilities, the city reconciles and amends these estimates to actual costs at least yearly to ensure charges are equitable.	?
3. Maintain documentation that shows what overhead costs were charged to the utilities, the amount of the charge and how it was determined.	X
Notes: ✓ = Yes or Mostly Yes, X = No, ? = Could not determine based on available documentation.	

The City did not have an overhead allocation plan to support \$195,000 in overhead charged to its Surface Water Management Fund. It had been charging its utilities overhead for years with no understanding or justification for the amounts charged. Information about the allocations was not communicated to the new finance director hired by the City in 2007. The City lacks records to explain the overhead it charged for many years and is uncertain whether it overcharged or undercharged the fund.

Mukilteo established an overhead allocation plan in 2010 for use in 2011.

During the audit, the City recognized it should evaluate the types and amounts of overhead it should charge the Surface Water Management Fund. It identified its overhead cost centers and developed the allocation factors it would use to charge them. Some factors were leading practices, others were not. Based on these efforts, the City estimated it could have allocated slightly more overhead to the fund in 2009 than it did.

Exhibit 17 summarizes the City's annual utility revenue, the amount of overhead charged to its utilities, what overhead cost centers were audited, and the effects we identified.

Exhibit 17 Evaluation of 2009 overhead charges - summarized	
Utility revenues (storm water – only utility fund)	\$1,334,000
Total overhead charged to utilities	\$195,000
Overhead cost centers selected for audit	All cost centers - \$195,000
RESULTS	
Overcharges to the utilities. Services that benefit the utilities but the City charged too much.	\$0
Potential overcharges to the utilities OR can't tell. Charges that do not clearly benefit the utilities given the documentation available. Or documentation is insufficient to tell either what was charged or the basis used to calculate the amount. These amounts may include likely or actual overcharges or undercharges.	\$195,000

6. City of Redmond

Redmond is one of the four cities in our audit that have since adopted or updated its cost-allocation plan for overhead charges. Although the City used most leading practices, the 2009 allocation plan we evaluated was outdated, some allocation factors did not follow leading practices, and some funds and departments weren't charged overhead but should have been.

As shown in **Exhibit 18**, Redmond did not follow all leading practices for charging overhead to the utilities.

Exhibit 18 Leading practices used by Redmond Calendar Year 2009	
1. Develop and maintain an overhead allocation plan that reflects their decisions about which overhead services they will charge to the various funds and departments and what factors they will use to determine the actual costs. To do this, the plan must:	
a. Be up-to-date and detail the basis for overhead charges.	X
b. Use allocation factors that equitably allocate overhead to each fund and department. See Exhibits 3 and 6 .	✓
c. Allocate overhead to <u>all</u> benefiting funds and departments, or charge the general fund for any overhead the city chooses not to allocate to some benefiting funds and departments.	X
d. Ensure that general government costs or costs that do not clearly benefit the utilities are allocated <u>entirely</u> to the general fund.	✓
2. Properly charge departments from that plan:	
a. Charge departments and funds only after services are provided.	✓
b. Charge departments and funds only for actual overhead costs incurred. If estimated overhead costs are charged to the utilities, the city reconciles and amends these estimates to actual costs at least yearly to ensure charges are equitable.	X
3. Maintain documentation that shows what overhead costs were charged to the utilities, the amount of the charge and how it was determined.	✓
Notes: ✓ = Yes or Mostly Yes, X = No, ? = Could not determine based on available documentation.	

The City used an out-of-date overhead allocation plan to charge overhead to its utilities in 2009. This plan was established in October 2003. Since 2005, the City has used the factors in this 2003 plan to allocate overhead between the general fund and the utility funds. Rather than update the plan, the City increased its charges by the estimated increase in the central service departments' budgets. For example, the City applied a 14 percent adjustment to the 2008 Information Services charge of \$133,062 to the Storm-water Fund for a 2009 charge of \$151,719. It made these adjustments annually but did not reconcile these charges to what they would have been if actual costs and updated allocation factors had been used.

The City used allocation factors that did not align with leading practices for five of 11 commonly allocated overhead cost centers. For example, it used each fund's percentage of total budgeted expenditures to allocate purchasing and accounts payable costs. Basing the allocation on the number of vouchers processed would have shared these costs more equitably. Although the City did not update other allocation factors annually, some were otherwise consistent with leading practices:

- Information technology costs were allocated based on the number of personal computers a department or fund uses.
- Building maintenance costs were allocated based on the square footage a department or fund occupies.
- Payroll and human resources costs were allocated based on each fund or department's employees.

When the City allocated overhead costs to its utilities, it excluded other funds and departments that benefited from that overhead. These exclusions occurred because the plan had not been updated since 2003. Because the City used outdated square footage figures to allocate building maintenance, allocated budgeted and not actual overhead costs, and did not charge all funds and departments that received overhead services, it overcharged its utility funds in 2009 as follows:

- Building Maintenance \$196,000
- Information Technology \$270,000
- Budget Department \$98,000

The City updated its overhead allocation plan in 2010 for use in 2011.

The City began updating its allocation plan before the audit started, when its new Finance Director recognized shortly after his arrival that the plan was outdated. The City began using the new plan in 2011. The new plan appears to incorporate most of the leading practices we identified.

Exhibit 19 summarizes the City’s annual utility revenue, the amount of overhead charged to its utilities, what overhead cost centers were audited, and the effects we identified.

Exhibit 19 Evaluation of 2009 overhead charges - summarized	
Utility revenues (water, sewer and storm water)	\$65,090,000
Total overhead charged to utilities	\$3,102,000
Overhead cost centers selected for audit	Budget - \$205,236 Information Technology - \$382 ,028 Facilities Maintenance \$613,125
RESULTS	
Overcharges to the utilities. Services that benefit the utilities but the City charged too much. These overcharges do not appear to benefit the utilities.	\$564,000
Potential overcharges to the utilities OR can’t tell. Charges that do not clearly benefit the utilities given the documentation available. Or documentation is insufficient to tell either what was charged or the basis used to calculate the amount. These amounts may include likely or actual overcharges or undercharges.	\$0

7. City of Spokane

The City used most leading practices to allocate overhead between the general fund and the utility funds.

Spokane was one of two cities (with Bellevue) that used most leading cost-allocation practices.

As shown in **Exhibit 20**, Spokane followed most leading practices for charging overhead to the utilities.

Exhibit 20 Leading practices used by Spokane Calendar Year 2009	
1. Develop and maintain an overhead allocation plan that reflects their decisions about which overhead services they will charge to the various funds and departments and what factors they will use to determine the actual costs. To do this, the plan must:	
a. Be up-to-date and detail the basis for overhead charges.	✓
b. Use allocation factors that equitably allocate overhead to each fund and department. See Exhibits 3 and 6 .	✓
c. Allocate overhead to <u>all</u> benefiting funds and departments, or charge the general fund for any overhead the city chooses not to allocate to some benefiting funds and departments.	✓
d. Ensure that general government costs or costs that do not clearly benefit the utilities are allocated <u>entirely</u> to the general fund.	✓
2. Properly charge departments from that plan:	
a. Charge departments and funds only after services are provided.	✓
b. Charge departments and funds only for actual overhead costs incurred. If estimated overhead costs are charged to the utilities, the city reconciles and amends these estimates to actual costs at least yearly to ensure charges are equitable.	✓
3. Maintain documentation that shows what overhead costs were charged to the utilities, the amount of the charge and how it was determined.	✓
Notes: ✓ = Yes or Mostly Yes, X = No, ? = Could not determine based on available documentation.	

The City has identified and is charging all common overhead costs to its utility funds and is mostly using sound allocation factors to support those charges and ensure they are equitable. It charged overhead through the use of a regularly updated overhead allocation plan to all benefiting departments after the costs were incurred. It did not allocate charges to non-benefiting funds and departments. Spokane allocated historical actual overhead costs, which is a reasonable allocation approach so long as it is done consistently from year to year.

The City had questionable allocation charges

While the City mostly used leading practices in 2009, it allocated \$111,266 in legal costs for the mentally ill to the utility funds and other funds and departments. The utility funds were charged about \$19,000 for these services that do not benefit them. These charges do not benefit the operation of the utility funds. The City indicates these charges were made in error and will be refunding the utility funds.

Exhibit 21 summarizes the City's annual utility revenue, the amount of overhead charged to its utilities, what overhead cost centers were audited, and the effects we identified.

Exhibit 21 Evaluation of 2009 overhead charges - summarized	
Utility revenues (water, sewer and solid waste)	\$231,910,000
Total overhead charged to utilities	\$5,950,000
Overhead cost centers selected for audit	Budget – \$78,869 Human Resources \$278,452 Legal - \$171,017
RESULTS	
Overcharges to the utilities. Services that benefit the utilities but the City charged too much.	\$0
Potential overcharges to the utilities OR can't tell Charges that did not benefit the utilities. Or documentation is insufficient to tell either what was charged or the basis used to calculate the amount. These amounts may include likely or actual overcharges or undercharges.	\$19,000

8. City of Tacoma

City incorporated most leading practices

As shown in **Exhibit 22**, Tacoma followed most but not all leading practices for charging overhead to the utilities.

Exhibit 22 Leading practices used by Tacoma Calendar Year 2009	
1. Develop and maintain an overhead allocation plan that reflects their decisions about which overhead services they will charge to the various funds and departments and what factors they will use to determine the actual costs. To do this, the plan must:	
a. Be up-to-date and detail the basis for overhead charges.	✓
b. Use allocation factors that equitably allocate overhead to each fund and department. See Exhibits 3 and 6 .	✓
c. Allocate overhead to <u>all</u> benefiting funds and departments, or charge the general fund for any overhead the city chooses not to allocate to some benefiting funds and departments.	X
d. Ensure that general government costs or costs that do not clearly benefit the utilities are allocated <u>entirely</u> to the general fund.	X
2. Properly charge departments from that plan:	
a. Charge departments and funds only after services are provided.	✓
b. Charge departments and funds only for actual overhead costs incurred. If estimated overhead costs are charged to the utilities, the city reconciles and amends these estimates to actual costs at least yearly to ensure charges are equitable.	✓
3. Maintain documentation that shows what overhead costs were charged to the utilities, the amount of the charge and how it was determined.	✓
Notes: ✓ =Yes or Mostly Yes, X = No, ? =Could not determine based on available documentation.	

The City used an up-to-date overhead allocation plan in 2009. It charged actual overhead as costs were incurred and used equitable allocation factors to calculate these charges. However, it did not always allocate overhead to all funds and departments that benefited from that overhead. Because not all funds and departments paid their fair share, the utilities paid \$176,000 more than they should have. This amount consists of \$32,000 for the Human Resources Department and \$144,000 for the City's accounting system.

Potential overcharges to the utilities.

For the programs listed in **Exhibit 23**, the City could not clearly link the service or level of service provided to the amount charged to the utility funds.

For example, although the City indicates its Community and Economic Development Department helps Tacoma Public Utilities market its services to developers, some Community and Economic Development activities did not clearly benefit the utility funds. Although some of the charges may have benefited the utility funds, the City did not have sufficient documentation to support the appropriateness of the amounts charged.

Exhibit 23 Questionable costs charged to utilities	
Cost category	2009 charges to utility funds
Community and Economic Development Department	\$ 147,681
Local Employee Apprenticeship Program	\$ 125,976
Historically Underutilized Business Program	\$ 177,402
Human Rights and Human Services	\$ 156,371
Government Relations	\$ 237,496
Total	\$844,926*
Note: *Although some of the charges may have benefited the utility funds, the City did not have sufficient documentation to support the appropriateness of the amounts charged.	

As discussed earlier, the City of Bellevue once charged its economic development program to its utility funds but stopped doing so because it believed the costs were unallowable. A 2004 court case (Okeson vs. City of Seattle, King County Superior Court, No. 02-2-05774-8SEA) ruled that Seattle's Small Business Assistance program served the general government and overall interests of the City, not its utility. The court found these costs should be paid for entirely by the City's general fund and not by the citizens' utility rates.

Exhibit 24 summarizes the City's annual utility revenue, the amount of overhead charged to its utilities, what overhead cost centers were audited, and the effects we identified.

Exhibit 24 Evaluation of 2009 overhead charges – summarized	
Utility revenues (water, power, sewer and solid waste)	\$732,963,000
Total overhead charged to utilities	\$17,598,000
Overhead cost centers selected for audit	Accounting - \$1,562,385 Human Resources - \$1,127,660
RESULTS	
Overcharges to the utilities. Services that benefit the utilities but the City charged too much. These overcharges do not appear to benefit the utilities.	\$176,000
Potential overcharges to the utilities OR can't tell. Charges that do not clearly benefit the utilities given the documentation available. Or documentation is insufficient to tell either what was charged or the basis used to calculate the amount. These amounts may include likely or actual overcharges or undercharges.	\$844,000