AUDIT REPORT
Budget and Management Office
Indirect Cost Accounting Practices
June 2018

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

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Audit report year: 2018
June 21, 2018

AUDITOR'S REPORT

We have completed an audit of the City and County of Denver’s indirect cost accounting practices. As described in the attached report, our audit revealed that the City’s Budget and Management Office needs to develop a process that provides more oversight of the annual cost allocation process in which the costs of centralized services are assigned to the departments that are consuming the services. Errors were discovered in the 2017 cost plans that could have been avoided and corrected before publication and submission to the state if there had been adequate review and involvement.

Through stronger oversight and participation in the annual cost allocation process, the City’s Budget and Management Office will be able to ensure more accurate cost allocation plans. Our report lists several recommendations that will assist the City in meeting this goal.

This performance audit is authorized pursuant to the City and County of Denver Charter, Article V, Part 2, Section 1, General Powers and Duties of Auditor, and was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We extend our appreciation to the City’s Budget and Management Office, City personnel, and the City contractor who assisted and cooperated with us during the audit.

Denver Auditor’s Office

Timothy M. O’Brien, CPA
Auditor
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June 2018

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

Background
The City provides certain services, such as motor pools, computer centers, purchasing, and accounting, to the City’s operating departments on a centralized basis. The City’s Federal Cost Allocation Plan provides a process whereby these central service costs can be identified and assigned to those departments that are consuming the services. The City’s cost allocation process results in both a Federal Cost Plan & a Citywide Cost Plan.

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

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

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

Lastly, due to a lack of involvement, BMO did not ensure that MGT accurately adjusted the City’s costs for income adjustments, credit adjustments, and unallowable cost adjustments prior to allocating costs. This led to an under allocation by the City’s Technology Services Department and an over allocation by the City’s Human Resources Department.

To enhance the accuracy of the City’s two cost allocation plans and increase BMO’s oversight and involvement in the construction of the plans, we offer six recommendations to BMO.
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BACKGROUND

Governments Use Cost Allocation to Equitably Distribute Indirect Costs among Departments

Cost allocation is the process of accounting and recording the full cost of services delivered by combining direct costs with indirect costs. During the cost allocation process, a government identifies, aggregates, and assigns full costs to different departments, agencies, functions, and projects based on the services they provide to the public and the support they provide or receive from other departments.

What Is the Difference between Direct and Indirect Costs?

Direct costs are costs that directly benefit a specific department, agency, function, or program. These costs can be traced to a cost center, such as a product, federal grant, or project. For example, the cost of the assigned hours an employee works on a specific project could be categorized as a direct cost.

Indirect costs, often referred to as overhead or central services, are costs for support services that are used by multiple departments, agencies, functions, and projects. These costs cannot be easily assigned to a single cost center. For example, the cost of the electricity used to power a government building is billed as one lump sum, yet the electricity is shared among all departments in the building. Cost allocation helps break up that sum so that each department receives allocations only for the electricity it uses. The electricity cost is allocated, or apportioned out, to all benefiting departments to reach a fair and equitable sharing of the total cost. Common indirect costs are human resources, payroll, and information technology services as well as building maintenance expenses. Cost allocation promotes equitable sharing of indirect costs within an organization and helps departments recognize the full cost of their operations. Further, the cost allocation process strengthens budgeting strategies and allows for more detailed management of resources, which helps identify the true costs of doing business. Due to the size of the City and County of Denver (City) and the complexity of performing cost allocation work, the City has contracted with a third party to produce its cost allocation plans.

A Consultant Leads Denver’s Cost Allocation Process

Each year the City embarks on a multi-month process to calculate all direct and indirect costs, ultimately reporting on the cost of services that its central services departments provide to other City departments. This process is conducted by a third-party contractor, MGT Consulting Group (MGT), and monitored by the City’s Budget and Management Office (BMO). The process concludes towards the end of the calendar year when two separate cost allocation plans are produced and distributed to the City. While MGT is responsible for the overall work that goes into the preparation of each plan, BMO is responsible for providing coordination, support, review, and decision making during this process.

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1 A cost center or cost object is a term used to describe something to which a cost may be assigned. The reason for assigning costs to these cost objects is to understand how much that object, or activity, costs to produce or maintain.

2 Citywide central service agencies include, but are not limited to, the Budget and Management Office, Technology Services, Auditor’s Office, City Attorney’s Office, Office of Human Resources, and Purchasing Division.

3 MGT is also formally referred to as MGT of America LLC., a Florida corporation.
The cost allocation process involves many steps, including:

- Meetings between BMO, MGT, and City departments
- Collection of data, such as:
  - Financial data from the City’s financial system
  - Departmental function data from department representatives and subject matter experts
- Creating and reviewing draft plans with City department representatives

**Allocating Departments Provide Central Services and Receiving Departments Benefit from Those Services**

It is important to define the relationships between departments within the City when determining which departments should be reimbursed for their services and which departments should pay money into the general fund for services received internally. The departments that provide the services—the central services entities or support entities—are considered allocating departments. The departments that receive those services are considered receiving departments. They are also referred to as producing departments or operating departments.

An allocating department may not be directly responsible for managing a City project but may provide support to the department that is responsible for the project. For example, the City’s Technology Services department may provide technical support for a receiving department’s laptops to ensure they are functioning each day. The laptops are used by employees in the receiving department to carry out the project. Through the cost allocation process, the City can place a value on the technical support provided by Technology Services and the receiving department can, in a sense, pay Technology Services for the help they received during the course of the project.

**The City Produces Two Cost Allocation Plans**

In addition to its internal benefits, cost allocation is used by state and local governments to request reimbursements for direct and indirect costs associated with administering grant-funded federal programs. Sometimes these reimbursements come directly from the federal government; other times, they come from a state government, which acts as a pass-through entity for federal dollars. Accordingly, the City produces a cost allocation plan specifically for federal reimbursement and a separate cost allocation plan for internal allocation purposes. Both plans calculate the cost of services that allocating departments provide to receiving departments. The plan that is created to seek reimbursement from the State of Colorado and from the federal government is called the Federal Cost Allocation Plan, and the internal City plan is called the Citywide Full Cost Allocation Plan.

**Federal Cost Allocation Plan**

The federal government provides guidance for local governments to follow when determining how to recover direct and indirect costs associated with carrying out federal grant-funded programs. These guidelines are established by the federal Office of Management and Budget.
and are commonly known as the Uniform Guidance.\textsuperscript{4} This guidance provides a government-wide framework for grants that are awarded to and managed by non-federal entities, including local governments.\textsuperscript{5}

The City uses the Uniform Guidance to seek reimbursement for services provided by Denver Human Services, which provides financial assistance benefits and protection and prevention services to eligible Denver residents. The resulting Federal Cost Allocation Plan (Federal Plan) is used to request a reimbursement from the State of Colorado Department of Human Services (CDHS). CDHS will reimburse up to 32 percent of indirect costs incurred by the City to support Denver Human Services. Table 1 documents the last three years of reimbursement amounts received by the City from CDHS.

\textbf{TABLE 1. Cost Allocation Reimbursement from Colorado Department of Human Services}

<table>
<thead>
<tr>
<th></th>
<th>Fiscal Year 2014</th>
<th>Fiscal Year 2015</th>
<th>Fiscal Year 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total State Reimbursement</td>
<td>$2,652,845</td>
<td>$2,925,199</td>
<td>$2,926,890</td>
</tr>
</tbody>
</table>


Note: The state reimbursement is calculated at a percentage of total costs at 32%.

The Federal Plan serves both internal and external purposes. Internally, the Federal Plan identifies the costs of services provided by the City’s central service departments based on expenditures during a given year. The City can then use the cost allocation information to claim indirect costs as charges against federal grants. BMO is required to certify that all costs included in the Federal Plan are based on final indirect cost rates and are allowable in accordance with the Uniform Guidance. Further, BMO certifies that any unallowable costs have been adjusted for appropriately. Finally, BMO is required to certify that all costs in the final plan are properly allocable and treated with consistency.

\textbf{Citywide Full Cost Allocation Plan}

The Federal Plan is used as a starting point for the development and completion of the second plan, the Citywide Full Cost Allocation Plan (Citywide Plan).\textsuperscript{6} The Citywide Plan is prepared in compliance with Generally Accepted Accounting Principles and identifies the cost of support provided by allocating departments to the receiving departments.

Further, this plan forms the basis for reimbursement of indirect costs from certain agency types to the City’s general fund. For example, the City has several enterprise fund agencies, which are City entities that operate more like a business than a government function. The City has four enterprise fund agencies: Denver International Airport, the Wastewater Management Division, Environmental Services, and Denver Golf. These four agencies are funded by fee-for-service dollars rather than taxpayer dollars. They also serve a subset of the population rather than the entire City tax base. Thus, when an enterprise fund agency receives central services, such as

\textsuperscript{4} The Uniform Guidance is formally titled \textit{Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards}. Also known as the Super Circular, 2 C.F.R. Part 200 is an OMB reform of regulations that apply to federal financial assistance and streamlines the language from eight existing OMB circulars into one consolidated set of guidance in the Code of Federal Regulations. The plan is also referenced as the 2 CFR 200 Plan in communications from MGT.

\textsuperscript{5} Non-federal entities are states, local governments, Indian tribes, institutions of higher education, or non-profit organizations that carry out federal awards.

\textsuperscript{6} This plan is also referred to as the Citywide Cost Allocation Plan or the Full Plan.
technology support, the enterprise fund is receiving tax-funded services. As an enterprise, the fund must reimburse the City for those services out of its own operating budget.

**The Federal Plan is the Foundation of the Citywide Plan** - As with the Federal Plan, the Citywide Plan determines the costs of the support provided by the City’s central service allocating departments to the City’s operating departments. Both the Federal Plan and the Citywide Plan are constructed using the same three primary principles: (1) costs are to be both necessary and reasonable for the proper performance of the City’s departments; (2) costs are charged to City departments relative to the benefits received; and (3) costs are consistently treated as direct or indirect. Sharing these foundational principles means that the Federal Plan and the Citywide Plan are largely the same. As such, the Federal Plan forms the foundation for the Citywide Plan.

The one exception that differentiates the Federal Plan from the Citywide Plan is that the Federal Plan is subject to rules contained in the Uniform Guidance, whereas the Citywide Plan is not. Being subject to the Uniform Guidance means that the Federal Plan only allocates the City’s central service allocating department costs deemed “allowable” under the guidance. All costs identified by the Uniform Guidance as unallowable are removed from the Federal Plan. Since the Citywide Plan is not subject to the Uniform Guidance’s rules of cost allowability, costs allocated in the Citywide Plan include all of the City’s central services allocating department costs. For example, costs incurred by Denver City Council are included in the Citywide Plan but are not allowable under the Uniform Guidance and, therefore, are not included in the Federal Plan.

**The City Allocates Costs Using Bases**

Both of the City’s cost allocation plans use allocation bases to determine how much cost should be allocated to operating departments. Allocation bases—measured in bases units—are designed to be an indicator of how much value a support department allocated to an operating department. Bases units are logical ways to measure the benefit a department receives. Following are some examples from the Federal Plan and Citywide Plan demonstrating the connection between a central services department and the City’s many operating departments:

- Determining the number of computers serviced during the year helps allocate Technology Services’ support costs.
- Tallying the total number of City employees helps allocate the Office of Human Resources’ support costs.
- Calculating the total number of square feet occupied throughout all City buildings helps allocate building maintenance costs.

Using bases units to calculate the division of expenses among all departments ensures that the plan equitably allocates costs for services that benefited those departments. This also ensures that the plan allocates more cost to the departments that benefit more from the costs for the services they received.

**Cost Allocation Also Happens between Central Services Agencies**

The City’s cost allocation process goes beyond quantifying the allocating departments’ contributions to the receiving departments. The Citywide Plan also factors in the support that one central services department receives from another central services department. Allocating costs between central services departments recognizes the cross support provided between departments. For example, Technology Services supports both the airport and Office of Human Resources. The Office of Human Resources supports both the airport and Technology Services.
Technology Services must first recognize some of their incoming costs from OHR before determining the full cost of supporting the airport.

To capture the value of the cross support, the City’s cost allocation plans use what is known as the double-step down method. In the first step, the plan calculates the benefit provided by all support departments to all operating departments as well as to other support departments. Then, in the second step, indirect costs allocated between support departments are ultimately allocated out to the operating departments. The order of departments becomes important in the second step because support departments can still allocate costs to other support departments that have not yet allocated funds during the second step. In other words, departments allocate to other support departments that come earlier in the plan only in the first step, not the second. This added degree of complication means that the bases units are allocated across fewer departments during the second step.

Because the details in the plan are so interconnected, a small change in the plan can have far reaching effects. If a single department’s costs or bases are misstated, it will cause the entire plan to be misstated. For example, if a department’s expenses are overstated, there will be a direct effect and an indirect effect on the plan. First, the direct effect is that expenses are overstated in every connected operating department. Second, the other connected support departments will also have overstated expenses that indirectly trickle down to all the operating departments they support. By the time the secondary effects reach the operating departments, the effect is very diluted with only a small percentage of the original error included in any individual operating department’s costs. But the effect, however small, will make an impact on every operating department in the plan. To completely correct for such errors, the entire plan would need to be restated. Figure 1 illustrates how indirect costs are allocated between the first and second steps. Notice that the support departments receive and allocate indirect costs in the second step.

**FIGURE 1.** The Two Steps Prior to Final Cost Allocation

Source: Auditors’ re-creation of data within the Federal Cost Allocation Plan.

Note: Auditors simplified the plan by consolidating departments displayed in this visualization.
OBJECTIVE

The audit had three objectives:

1. To determine whether the data used in the City’s 2017 Federal Cost Allocation Plan is accurate, allowable, and allocable;

2. To determine whether MGT’s methodology used for allocating costs in the 2017 Federal Cost Allocation Plan resulted in correct re-calculation in accordance with the method disclosed in the Federal Plan; and

3. To determine whether the 2017 rates from the Indirect Cost Rate Proposal and Colorado Department of Human Services reimbursement were calculated correctly.

SCOPE

The scope of the audit was to review how indirect costs are calculated and cost recoveries are managed and allocated to various City funds and programs, which included assessing the Federal Cost Allocation Plan, prepared by MGT through a contract agreement with the City and County of Denver. While the audit scope did not solely focus on the Citywide Full Cost Allocation Plan, some testing procedures covered elements of this plan.

According to Generally Accepted Government Auditing Standards, “auditors should report any significant constraints imposed on the audit approach by information limitations or scope impairments, including denials or excessive delays of access to certain records or individuals”. During the audit, we encountered significant constraints involving the ability to observe working meetings between MGT and City departments. In addition, we were never made fully aware of ongoing contacts between MGT and City departments, further preventing the team from being able to randomly choose which encounters would be best suited for observation. While the audit team was able to observe and conclude on some meetings between MGT and City departments, this limitation did call into question our ability to observe MGT’s process in a complete and objective capacity.

METHODOLOGY

We used various methodologies during the audit to gather and analyze information pertinent to the audit scope and to assist with developing and testing the audit objectives. These methodologies included the following:

- Attending and observing meetings between MGT and central services allocating departments
- Interviewing and surveying City department cost allocation liaisons
- Completing a trend analysis of the cost pools and allocation bases
- Sampling allocation bases used in creating the 2017 Federal Cost Allocation Plan, determining whether information was current and accurate
- Comparing data from the Federal Cost Allocation Plan with City’s general ledger and CAFR data
- Reviewing the 2017 Federal Cost Allocation Plan and identifying central services allocating departments that generated program revenue
- Using software tools to perform a recalculation of the 2017 Federal Cost Allocation Plan to assess the accuracy of the MGT methodology
- Determining whether the required certifications were included in the 2017 Federal Cost Allocation Plan and 2017 Indirect Cost Rate Proposal
- Determining whether the 2017 Federal Cost Allocation Plan met the requirements stated in 2 CFR 200 Appendix V, Sections 1-2 and Appendix VII, Sections 1-2
- Verifying that the 2017 Federal Cost Allocation Plan and the 2017 Indirect Cost Rate Proposal were submitted within the timeframe listed in 2 CFR 200 Appendix V, Section D and Appendix VII, Section D
- Tracing indirect costs allocated in the 2017 Indirect Cost Rate Proposal and verifying that rates were correct and accurate
- Assessing the accuracy of MGT’s methodology used to produce the 2017 Indirect Cost Rate Proposal
- Reviewing the Denver Human Services reimbursement schedule within the 2017 Federal Cost Allocation Plan and determining whether the state reimbursement amount was correct and accurate
- Determining whether supporting documentation for the 2017 Colorado Department of Human Services reimbursement to Denver Human Services was received and accounted for
FINDING

Lack of Oversight by and Involvement from the City’s Budget and Management Office Resulted in Errors and Inconsistencies in the City’s 2017 Federal Cost Allocation Plan

The City provides certain services, such as motor pools, computer centers, purchasing, and accounting, to the City’s operating departments on a centralized basis. The City’s Federal Cost Allocation Plan provides a process whereby these central service costs can be identified and assigned to benefiting departments on a reasonable and consistent basis. After assessing how the City’s Budget and Management Office (BMO) oversees the preparation of the City’s Federal Cost Allocation Plan, we identified three areas that require improvement to increase the accuracy of the plan. First, BMO needs to review the Federal Cost Allocation Plan reimbursement schedule for accuracy prior to submitting it to the Colorado Department of Human Services. Second, BMO should ensure the cost allocation methodology used is properly applied and all costs and other data allocated in the Federal Cost Allocation Plan are supported by formal accounting and other records. Third, BMO needs to ensure that the necessary adjustments are made to the City’s central service department costs prior to allocating them out to the City’s operating departments.

The City’s Request for Reimbursement of Human Services Indirect Costs was Inaccurate for 2017

The federal government funds nearly one-third of state budgets, supporting a wide range of public services from human services to transportation. State governments receive more than half of their funding for health care and public assistance from federal grants. In Colorado, human services programs are administered and carried out at the county level rather than at the state level. Recognizing the overhead associated with providing health care services and public assistance programs, counties are also entitled to partial reimbursement for the indirect costs incurred. To help the counties cover these additional administrative costs, the Colorado Department of Human Services (CDHS) reimburses a portion of each county’s indirect costs. Currently, this partial reimbursement rate is set at 32 percent of the indirect costs associated with services provided by the City’s central service departments to Denver Human Services.

During the creation of the Federal Cost Allocation Plan (Federal Plan), MGT creates a document referred to as the “summary schedule,” which summarizes all costs allocated from the City’s central service departments to the City’s operating departments. As one of the City’s operating departments, Denver Human Services is included within the summary schedule along with all costs that were allocated to it from each of the City’s central service departments. In the 2017 Federal Cost Allocation Plan, 20 central services departments were listed as having allocated costs to Denver Human Services.

Once the Federal Plan’s summary schedule is completed, the information reflecting the costs allocated to Denver Human Services are included in a reimbursement schedule. This reimbursement schedule is then submitted to CDHS, and the state will reimburse the City for 32 percent of the total costs indicated on the schedule.
Errors in the Reimbursement Schedule Resulted in Overbilling the State

To determine whether the City was reimbursed appropriately, we reconciled the summary schedule against the reimbursement schedule. We found that the amounts allocated to Denver Human Services in the summary schedule did not match with the amounts recorded on the reimbursement schedule submitted to the state for 2017. We identified this discrepancy by reconciling the amounts allocated from each of the City’s 20 central services departments to the corresponding data on the plan’s summary schedule. The totals submitted to CDHS did not reconcile to the summary schedule, differing by $36,575. Specifically, the total costs reflected on the reimbursement schedule totaled $8,238,125 while the total costs reflected on the summary schedule totaled only $8,201,550.

When investigating the underlying cause of this discrepancy, MGT personnel stated that the reimbursement schedule was a draft and did not reflect accurate information from the summary schedule. In addition, we asked BMO personnel whether they could have potentially caught this error. BMO personnel explained that they rely on MGT to maintain the accuracy of the plan. This oversight and lack of review resulted in the City overstating expenses to the State of Colorado by $36,575.

After bringing this error to the attention of MGT in March 2018, the City immediately submitted a corrected reimbursement schedule to the State of Colorado. However, as of the completion of our audit fieldwork, the City had yet to complete the settlement process due to state processing time.

Inconsistencies Were Identified within the Reimbursement Schedule

We identified multiple instances of mismatched organization numbers and mismatched department descriptions within the reimbursement schedule. When comparing the reimbursement schedule to the summary schedule, 12 of 22 organization numbers did not match and 10 of the 22 organization numbers did not include matching department descriptions. As with the error that led to the overbilling, insufficient review contributed to these inconsistencies being included in the summary schedule that was submitted to the state. Describing the same department with different organization numbers and descriptions makes it difficult for readers of the Federal Plan, such as CDHS, to understand and follow an already complex analysis.

Both Appendix V of the Uniform Guidance and the contract between the City and MGT specify that the Federal Plan must be signed by an MGT partner and a City official certifying that they have reviewed the final plan and ensured it is accurate to the best of their knowledge. Although the plan was signed and certified by both parties, the errors and inconsistencies uncovered by this audit demonstrate that the current review process is insufficient and needs to be reevaluated to ensure that future plans are accurate.

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7 The plans are based off the prior year’s data. The plans are used for budgeting decisions in future calendar years but produced in current years. For example, the 2017 plan is based on calendar year 2016 data but used for 2018 budget decisions.
RECOMMENDATION 1.1

The City’s Budget and Management Office needs to develop a documented procedure by which the Federal Cost Allocation Plan’s summary schedule is reconciled to the state’s reimbursement schedule prior to submitting a reimbursement request to the state. Further, the Budget and Management Office should ensure that the settlement process between the State of Colorado and City and County is resolved.

Agency Response: Agree, Implementation Date – July 31, 2018

Errors in the Application of the Cost Allocation Methodology Lead to Misallocation of Costs

During our audit, we identified errors in the application of the methodology used to prepare both the Federal Plan and Citywide Cost Allocation Plan (Citywide Plan), which resulted in subsidies to the operations of one of the City’s enterprise funds. These errors included inactive accounts, unused function entries, and incorrect basis calculations.

Departments That Were Inactive Incorrectly Received Cost Allocations

Every account number listed in the Federal Plan should correspond with an active department that is operating and receiving services from one or more of the central services agencies. However, we identified seven accounts that received a total of $18,599 in allocations with each account receiving at least one allocation.

The names of four of the seven accounts indicated that they may not be active: “5021000 NOT USED PW FPM D&C,” “5031000 NOT USED,” “5036000 NOT USED PWPKG PARKING,” and “5037000 NOT USED PWSCI MAJOR.” We confirmed that these accounts did not have substantive activity for 2016. Three additional accounts also received allocations but should not have because they were only included in the plan as placeholders. These accounts were active at one time but did not incur any direct or indirect expenses in 2016. According to MGT, these accounts were included in the plans because the City may use them actively again in a future year.

Placeholder Functions Were Also Identified – We also identified functions included in the plans that acted as placeholders for new functions, but had no activity associated with them. Functions represent activity from central service allocating departments. For example, within the final version of both cost allocation plans, MGT included functions titled “new function 1” and “new function 2” but did not allocate expenses to or from them.
Some Allocation Bases Were Not Supported

In addition to the placeholder accounts and functions, we found that some allocation bases used in the Federal Plan were not allocated accurately when compared with supporting data. Allocation bases support the amounts allocated from a function. An allocation base acts as the unit of measurement for the benefits received from a central service allocating department. We tested a small non-statistical sample of bases units used within the Federal Plan by tracing supporting documentation to the units allocated to each City department. We noted five instances where supporting documentation did not match with the units entered into the plan.

For example, costs associated with the City’s Peak Academy function are allocated based on the number of trainees that attend Peak Academy trainings. In other words, one trainee equals one basis unit for the Peak Academy function. However, upon review, we found that some trainees were not allocated to the correct departments and other trainees were not allocated to any department. Specifically, we found that eighteen trainees were allocated to the Office of the Controller when only one of those trainees was actually an employee of that department. Further, nine trainees were not allocated to any department because they had left the City before or during the plan’s creation. At the time of the training, these employees belonged to identifiable cost centers, and therefore costs could have been allocated based on the department they worked in at the time they received training from Peak Academy.

These errors resulted in an over-allocation of approximately $42,000 to the Office of the Controller for this function within the plan’s first allocation step. In addition, the nine unallocated trainees resulted in an under allocation of approximately $22,000 to all other departments. It is important to note that the during the second allocation step, the impact is much smaller for each department because these costs are further apportioned amongst receiving departments. However, the distributed errors still affect all receiving departments in the plan. While individually small, these types of errors can compound, having a greater effect.

BMO’s Review Process Is Not Detecting Errors

We found that when reviewing the Federal Plan, BMO’s process lacks structure and documentation. Even though the plan has grown in complexity, the review process only focuses on superficially reviewing substantial changes to the plan. BMO does not retain any documentation of this review process and could not give examples of any changes made to the plan resulting from reviews.

The Uniform Guidance places the ultimate responsibility on the City for ensuring that the plan is properly supported. The guidelines require the plan to “support the accumulation of costs.” In addition, a review guide published by the U.S. Office of Management and Budget suggests, “All costs and other data used to distribute the costs included in the plan should be supported by formal accounting and other records that will support the appropriateness of costs assigned to the federal awards.”

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Uniform Guidance requires that the Federal Plan is properly supported

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8 This review guide is intended to help state, local, and Indian tribe governments comply with federal grant requirements. Because the Department of Human Service’s reimbursement through the State of Colorado is ultimately reimbursed by the federal government, we must comply with the rules of reimbursement submission. Additionally, the Federal Cost Allocation Plan is used in grant reimbursement calculations, which commonly require adherence to the federal reimbursement guidelines.
supported and therefore should not be included in the plan. The Uniform Guidance is also clear about the City’s responsibility for establishing review procedures that will ensure an accurate final product:

The [City] in recognition of its own unique combination of staff, facilities, and experience, has the primary responsibility for employing whatever form of sound organization and management techniques may be necessary in order to assure proper and efficient administration of the Federal award.

Therefore, BMO’s review processes must include procedures that effectively find entries that are not supported and ensure they are removed from the plan.

**Errors in the Citywide Cost Allocation Plan Created a Subsidy for an Enterprise Fund**

An error in the 2017 Citywide Plan understated the amount that an enterprise fund was required to reimburse the general fund for central services received.\(^9\) The Federal Cost is the foundation for the Citywide Plan. Accordingly, the placeholder departments included in the Federal Plan are carried forward to the Citywide Plan. According to the 2017 Citywide Plan, the four enterprise funds received more than $13 million in support from agencies within the City. To ensure taxpayers are not subsidizing enterprise funds, enterprise funds repay the general fund for central services they receive based on the results of the Citywide Plan. Payment for support services are billed from the enterprise funds and deposited into the City’s general fund. Money placed into the general fund helps support Denver’s general government activities. In the 2017 Citywide Plan, the payment billed to Denver International Airport (airport) was understated by $108,541, which will ultimately be subsidized by the general fund.

This understatement occurred because MGT continued to allocate indirect costs to a department that had been consolidated elsewhere in the plan. Prior to the consolidation, allocations to the airport from the support department were captured in a unique account. In other words, the plan included one support unit for services provided to the airport and one support unit for services provided to general fund departments—even though both allocations originated from the same department. In a sense, this made it seem like there were two central services departments even though there was only one. This is a permissible method for organizing department accounts only if the expenses are ultimately carried through to the cost centers they support.

For 2017, MGT consolidated allocations coming out of these two units into a single department. When using the double step-down method, support departments first allocate their direct costs, and subsequently allocate a portion of their own operating costs to other central service departments. The $108,541 understatement stemmed from incoming costs only allocated to the unit supporting the general fund departments. Incoming costs for the unit supporting the airport were left in a separate account. This account was not ultimately allocated to the airport.

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\(^9\) The Full Cost Allocation Plan is based off the 2CFR 200 plan. This error is present in both plans, but the 2 CFR 200 plan is not used for reimbursements and therefore only the error in the citywide full cost allocation plan has a direct impact on transactions within the City.
The Citywide Cost Allocation Plan Could Mislead Management

In addition to the understatement, we identified other errors in the 2017 Citywide Plan that could cause City management to make decisions based on inaccurate reports. Beyond achieving equitable payment for central services, the Citywide Plan is also used by City agencies in understanding the true costs of the programs they implement. An error in the plan’s summary page—the supporting section in the report that details the total expenses allocated to operating departments—overstated two departments’ indirect costs by a total of more than $40 million. Had these two departments relied on this information, they would have overestimated the cost impact of indirect expenses. After the error was detected through the audit process, MGT released a revised copy of the Citywide Plan with the figures corrected. In Table 2, the amounts reported field represents the totals reported in the summary schedule, and the amounts calculated field represents the department total as supported by details in the Citywide Plan.

**TABLE 2.** Difference between Amount Reported and Amount Calculated in the 2017 Citywide Cost Allocation Plan

<table>
<thead>
<tr>
<th>Department</th>
<th>Amount Reported</th>
<th>Amount Calculated</th>
<th>Difference ($)</th>
<th>Difference (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>3521000 FD</td>
<td>$18,496,089</td>
<td>$6,512,333</td>
<td>$11,983,756</td>
<td>184%</td>
</tr>
<tr>
<td>ADMINISTRATION</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>351100 PD</td>
<td>40,493,801</td>
<td>11,611,629</td>
<td>28,882,172</td>
<td>249%</td>
</tr>
<tr>
<td>ADMINISTRATION</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>$58,989,890</td>
<td>$18,123,962</td>
<td>$40,865,928</td>
<td>225%</td>
</tr>
</tbody>
</table>

Source: 2017 Citywide Cost Allocation Plan and calculations performed by auditors.

MGT's procedures allow for details in the Citywide Plan to be edited. MGT’s procedures for delivering the plan require them to first export it from their proprietary system, then convert the file to a PDF format. According to MGT, the totals identified above were changed at some point during the export process. In this instance, the final Citywide Plan was not reviewed for mathematical accuracy. Reviewing for mathematical accuracy could be challenging given the length and complexity of the plan.

Complexity, which could be reduced by eliminating placeholders, could be a contributing factor to the errors in the plan. The plan is inherently complex given the amount of detail it must contain. The 2017 Citywide Plan has 215 functions allocating costs to 168 receiving departments. The plan’s summary schedule includes figures describing the relationship between every function and every department. Additionally, the plan contains schedules that detail the source of costs for every function, and every function needs to include its own schedule. The functions’ schedules show how funds have been allocated to departments from that function. The functions and departments are interrelated, so removing a function could have an impact on reporting for many departments. Likewise, it is challenging to quantify the effect of allocations to a department because a single allocation can have effects through the entire plan.
RECOMMENDATION 1.2

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

- Ensuring uniform department descriptions, fund numbers, and organizational codes within both plans; and
- Collaboration between the City’s Budget and Management Office and MGT to ensure that changes to either plan are fully documented to ensure accuracy.

Agency Response: Agree, Implementation Date – August 31, 2018

RECOMMENDATION 1.3

The City’s Budget and Management Office should work with the airport to rectify the $108,541 understatement that occurred as a result of the 2017 Citywide Cost Allocation Plan.

Agency Response: Agree, Implementation Date – December 31, 2018

Incorrect Adjustments to Costs Leads to Improper Allocation

Audit work found that costs allocated from some of the City’s central service departments were not properly adjusted prior to allocating those costs out to the City’s operating departments. Two factors contributed to this improper allocation of costs: net costs were not properly calculated, and the Uniform Guidance was misapplied.

Income Adjustments and Adjustments for Credits Received Were Not Properly Deducted

Before a central service department can allocate its costs to the City departments that received its services during the year, the central service department must first determine its total costs and make certain adjustments. Specifically, total costs, also referred to as “gross costs,” must be reduced by any income generated and any credits received by the central service department to arrive at “net costs.” It is only this net cost that the central service department can then allocate to operating departments. Without making this adjustment prior to the allocation, operating departments would end up receiving allocations for costs that they did not incur.

Adjusting for Income – Section 200.80 of the Uniform Guidance defines income as revenue that a central service department generates during the course of its annual operations. For the City, examples of income include fees for services performed, rental fees, and license fees. A specific example from the 2017 Federal Plan is revenue generated by the Office of Human Resources for copies of records requested by current and former City employees. According to

Net Costs = Gross Costs Less Income Adjustments and Credits Received
Section 200.307 of the Uniform Guidance, the Office of Human Resources must reduce its total costs, or gross costs, by the amount of revenue it generated from these records copies. The result is the total net costs that the Office of Human Resources could then allocate among the operating departments that directly received its services.

**Adjusting for Credits** - In addition to adjusting for income, a central service department must also adjust its total costs by removing any credits it receives during the year. Credits, which are more common than income for central service departments, are defined by Section 200.406 of the Uniform Guidance as offsets or reductions of costs that can be allocated.\(^{10}\) Examples of common credits as listed in Section 200.406 are as follows:

- Purchase discounts
- Rebates or allowances
- Recoveries or indemnities on loses
- Adjustments of overpayments
- Insurance refunds or rebates

As part of our analysis of the 2017 Federal Plan, we examined the adjustments MGT made to the City’s central service departments’ gross costs. Our audit work had three steps:

1) We determined whether the income and credit adjustments MGT made were made in accordance with the Uniform Guidance.
2) We determined whether the income and credit adjustment amounts matched the supporting documentation.
3) We sought to identify any adjustments that MGT should have made to the central service departments’ gross costs that were overlooked.

Our examination revealed that MGT did not correctly reduce the total amount of the central service departments’ gross costs when compiling the 2017 Federal Plan. Among the central service departments, there were six income and credit adjustments made. We examined all six adjustments and identified two errors. In one instance, the adjustment amount made did not match the amount in the supporting documentation. In the second instance, MGT overlooked an adjustment for a credit that should have been made. The following paragraphs describe these errors in greater detail.

**Wrong Adjustment Amount** - The first adjustment-related issue involved the operations unit within the City’s Technology Services department (TS Operations), a central service department. After the gross-to-net cost adjustment process, we found that MGT made an $856,105 adjustment to TS Operations’ costs. However, the underlying support documentation revealed the correct amount to be $774,685, an $81,420 adjustment error. This resulted in MGT reducing TS Operations’ gross costs by $81,420 more than it should have. As a result, TS Operations under-allocated $81,420 in costs among the City departments that directly received its services.

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\(^{10}\) Central service departments rarely generate income because their missions are centered around supporting other City departments, not directly serving or interacting with citizens.
**Overlooked Credit** - The second issue, related to the overlooked credit, involved the Office of Human Resources. During 2016, the Office of Human Resources received a $3.2 million credit from United Healthcare, one of the City’s healthcare providers. This credit is referred to as a “performance reward.” With the performance rewards program, the City funds its healthcare premiums each year. Then, at the end of the annual policy period, United Healthcare determines the actual plan cost. If the City’s claims experience shows a positive balance in relation to a predetermined target, a portion of the premiums previously paid are credited back to the City. In other words, the City receives a refund on the cost of providing healthcare benefits to its employees. According to Section 200.402 of the Uniform Guidance, this credit should have reduced the Office of Human Resources’ gross costs by $3.2 million to arrive at net costs that could then be allocated among the operating departments. This resulted in a $3.2 million over-allocation of costs, meaning that the operating departments collectively received an allocation from Human Resources that exceeded the cost of the services the office provided.

The audit team determined the following to be the causes of the $81,420 incorrect income adjustment and the $3.2 million overlooked credit:

- BMO is not involved in the cost allocation process with MGT to the extent that personnel could assist in identifying possible adjustments that should be removed from gross costs.
- BMO relies entirely on MGT to prepare the Federal Plan.
- BMO lacks an adequate understanding of the sections of the Uniform Guidance that dictate which adjustments should be made to gross costs, specifically Sections 200.400, 200.402, and 200.406.

**RECOMMENDATION 1.4**

The City’s Budget and Management Office should develop a written policy to increase its involvement in the preparation of the Federal Cost Allocation Plan incorporating the following activities:

- a) Actively participating in meetings between MGT and City departments
- b) Using its knowledge of the City’s departments and functions to assist MGT in the proper identification of necessary adjustments from gross costs
- c) Retrieving supporting documentation when MGT is unable to obtain it
- d) Reviewing the types, amounts, and departments that MGT has identified as having adjustments from gross costs to identify potential overlooked items or incorrect adjustments

**Agency Response: Agree, Implementation Date - August 31, 2018**
RECOMMENDATION 1.5

The City’s Budget and Management Office should review the federal Uniform Guidance that dictates allocable costs to gain an understanding of the composition of costs that are permitted to be allocated. The Budget and Management Office should then ensure MGT gains a similar understanding and applies the provisions in the ongoing and future cost allocation process.

Agency Response: Agree, Implementation Date - July 31, 2018

Federal Guidelines for Determining Allowability of Costs Were Applied Inconsistently

In addition to determining that indirect costs were incorrectly adjusted for income and credit adjustments, we also found that MGT inconsistently applied the Uniform Guidance when determining the allowability of certain types of costs. Determination of allowability of a given expenditure is based on specific federal cost principles laid out in the Uniform Guidance. This guidance identifies specific costs and categories of costs that cannot be charged, directly or indirectly, against a federally sponsored program or grant. Unallowable costs are never allowed on federally sponsored programs nor can they be charged to funds that will be treated as a part of indirect cost pools. Examples of specific cost categories that must be assessed for allowability are advertising, equipment, employee health care, and employee travel.

For each category of cost, the guidance offers three potential options: allowable, unallowable, or allowable in some, but not all, instances. Furthermore, the Uniform Guidance lists requirements that must be met for a cost category to be allowable. Determining allowability becomes more difficult when dealing with a cost category that is allowed only in certain instances, such as employee travel. Specifically, travel is an allowed cost only if incurred by an employee traveling on official City business. Additionally, the travel costs are allowable only to the extent they do not exceed charges normally allowed by the City’s written travel policies. Therefore, travel not for official business or unreasonable in amount would be an unallowable cost.

We found that MGT was inconsistent in the application of Uniform Guidance when determining allowability of some of the City’s central service department costs. Using a judgmental sample of 40 travel-related expenditures from the City’s central service departments, we sought to determine whether the expenditures were allowable under the Uniform Guidance. We found 5 out of 40 costs that were classified as unallowable that should have been classified as allowable.

MGT’s practice for determining allowability of costs is not sufficient to properly identify unallowable costs. We learned that MGT determines allowability based solely on the name of the expenditure account. In other words, MGT performs a blanket analysis of expenditures when determining expenditure allowability. For example, general ledger account 620200 in the City’s accounting system is titled “repairs and maintenance.” Since the Uniform Guidance allows repairs and maintenance costs, MGT would classify all expenditures recorded to account 620200 as allowable costs. The problem with this approach is that it does not allow for a more detailed analysis of all costs recorded to the general ledger accounts. Since some categories of costs are permitted by the Uniform Guidance in some, but not all, instances, MGT’s approach does not adequately differentiate allowable costs from unallowable costs within an expenditure account. Accordingly, some costs will be incorrectly allocated out as allowable, or some costs will be incorrectly labeled...
as unallowable and will go unallocated. Based on MGT's practice for determining allowability of costs, it is likely that other expenditures were incorrectly identified as unallowable outside of the accounts we analyzed with our testing.

Incorrectly identifying allowable and unallowable costs leads to an inaccurate Federal Plan. This Federal Plan is relied upon for determining the amount to be reimbursed by the Colorado Department of Human Services as well as determining indirect costs that can be charged against a federal grant. Inaccuracies in the plan permeate through and affect the accuracy of amounts the City requests for reimbursement from the Colorado Department of Human Services and the federal government.

**RECOMMENDATION 1.6**

The City’s Budget and Management Office should develop a process to analyze expenditures for allowability at a more detailed level. For example, the Budget and Management Office could consider using the City’s financial system, Workday, to facilitate a more detailed description of specific expenditures.

*Agency Response: Agree, Implementation Date - December 31, 2018*
RECOMMENDATIONS

We make the following recommendations to the City's Budget and Management Office to improve the accuracy of the City's cost accounting practices:

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

**Auditee Response: Agree, Implementation Date - July 31, 2018**

Auditee Narrative: The State will adjust their Reimbursement to the City in the amount of $23,408 (of the total annual reimbursement of $2,903,482), in their next quarterly payment (on 6/31/18). Note that this is due to the fact that the State only reimburses the City and County at a 32% rate. The Budget and Management Office will develop a documented procedure to reconcile the summary schedule with the reimbursement schedule prior to the submission to the State.

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

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

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

**Auditee Response: Agree, Implementation Date - August 31, 2018**

Auditee Narrative: The Budget and Management Office will develop a review process that will cover the primary elements of both plans.

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

**Auditee Response: Agree, Implementation Date - December 31, 2018**

Auditee Narrative: Once the two departments that were identified in the audit are appropriately consolidated, there will be an offset that will result in the need to reconcile $24,019 of the $108,541 identified in the audit and of the total DEN $16.5 million payment. The Budget and Management Office will work with the airport to address the understatement from 2017 during the 2018 cost allocation process.
1.4 **Develop Written Policy**—The City’s Budget and Management Office should develop a written policy to increase its involvement in the preparation of the Federal Cost Allocation Plan incorporating the following activities:

a) Actively participating in meetings between MGT and City departments

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

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

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

**Auditee Response: Agree, Implementation Date - August 31, 2018**

Auditee Narrative: The Budget and Management Office will document its practices as well as outline the review elements of the Federal Cost Allocation Plan. The New Legislative Financial Specialist has been actively participating in meetings between MGT and City departments. The Budget and Management Office has and will continue to leverage its knowledge regarding departments and functions to assure an accurate allocation of funds. If there are outstanding supporting documents needed from agencies, the Budget and Management Office will assist in obtaining these documents.

1.5 **Review Federal Guidelines**—The City’s Budget and Management Office should review the federal Uniform Guidance that dictates allocable costs to gain an understanding of the composition of costs that are permitted to be allocated. The Budget and Management Office should then ensure MGT gains a similar understanding and applies the provisions in the ongoing and future cost allocation process.

**Auditee Response: Agree, Implementation Date - July 31, 2018**

Auditee Narrative: Given the transition of roles in the Budget and Management Office, we have already planned a training on Uniform Guidance. Upon completion of this training, the Budget and Management Office will meet with MGT to ensure that the application of Uniform Guidance as it relates to the City of Denver’s structure and policy is aligned.

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

**Auditee Response: Agree, Implementation Date - December 31, 2018**

Auditee Narrative: The Budget and Management Office will work with the Controller’s Office to leverage the City’s financial system to identify specific expenditure categories that should reasonably include allowable costs. Additionally, reports may be developed that will streamline the process for the 2019 Cost Allocation Plan reflecting only those expenditure categories as determined by BMO and the Controller’s Office.
This is a process and policy that will be developed prior to the start of the cost allocation process to ensure consistency.

The 2018 Federal Cost Allocation Plan (based upon 2017 actual expenditures) will be due August 31, 2018. Much of the current year’s process has already been completed.

Given that the 2018 Federal Cost Allocation Plan and Citywide Plan are nearing completion, we believe that implementation of many of the recommendations will primarily impact the 2019 Federal Cost Allocation Plan and Citywide Plans. We look forward to improving the oversight of the Federal Cost Allocation Plan and the Citywide Full Cost Allocation Plan.
APPENDICES

Appendix – Definition of Terms

**Allocable cost** – A central service department cost that is permitted to be allocated to other City departments because the cost is assignable to a federal award or cost objective in accordance with relative benefits received.

**Allocating department** – City and County department that provides support to other City and County departments and is commonly referred to as a central service department.

**Allocation** – Process of assigning a cost, or a group of costs, to one or more cost objective(s), in reasonable proportion to the benefit provided.

**Cost objective** – A function, organizational subdivision, contract, grant, or other activity for which costs data are needed and for which costs are incurred.

**Direct cost** – Costs that can be identified specifically with a final cost objective.

**Disallowed cost** – Charges to a federal award that the federal awarding agency determines to be unallowable, in accordance with the applicable federal statutes, regulations, or the terms and conditions of the federal award.

**Enterprise fund** – A type of proprietary fund that closely resembles private sector accounting, in which fees are charged for the goods and services provided. Government entities use enterprise funds to account for business type activities.

**Federal cost allocation plan** – The documentation compiled using the rules set forth in the Uniform Guidance (2 CFR 200) that identifies, accumulates, and allocates or develops billing rates based on the allowable costs of services provided by a governmental unit on a centralized basis to its departments. The information in this plan is available to be used to request reimbursement for indirect costs. See “Uniform Guidance.”

**General fund** – A type of governmental fund primarily funded by general sales and property taxes, expenses from which are for basic government functions.

**Indirect cost** – A cost incurred for a common or joint purpose benefitting more than one cost objective and not readily assignable to the cost objectives specifically benefitted, without effort disproportionate to the results achieved.

**Program income** – Gross income earned by a City department that is directly generated by a support activity or earned as a result of the federal award. Program income includes fees for services performed, rental payments, royalty payments, license fees.

**Receiving department** – City and County department that receives support from other City and County departments.

**Uniform Guidance** – The federal guidelines outlined in Title 2 of the Code of Federal Regulations Part 200 (2 CFR 200) that sets forth the rules related to uniform administrative requirements, cost principles, and audit requirements for federal awards or grants.
June 11, 2018

Auditor Timothy O'Brien, CPA
Office of the Auditor
City and County of Denver
201 West Colfax Avenue, Dept. 705
Denver, Colorado 80202

Dear Mr. O'Brien,

The Office of the Auditor has conducted a performance audit of Indirect Cost Accounting Practices.

This memorandum provides a written response for each reportable condition noted in the Auditor's Report final draft that was sent to us on May 18, 2018. This response complies with Section 20-276 (c) of the Denver Revised Municipal Code (D.R.M.C.).

The Budget and Management Office would like to acknowledge and thank the Audit Team for their recommendations for improvements to the process for producing the Federal Cost Allocation Plan and the Citywide Full Cost Allocation Plan (CAP).

The City is fortunate to contract with MGT Consulting Group who is a nationally recognized specialist in developing cost allocation plans and conducts this work for approximately 300 other government entities.

In 2017, between these two plans, the City was able to identify and allocate over $250 million of costs representing 215 functions to 168 agencies throughout the City. We look forward to improving the process and are pleased that the audit's findings are approximately 1% of the total costs allocated. We will continue to increase the accuracy of the reports and work with agencies to assure a broader understanding of the plans and reconciliation of numbers.

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

RECOMMENDATION 1.1
The City's Budget and Management Office needs to develop a documented procedure by which the Federal Cost Allocation Plan's summary schedule is reconciled to the state's reimbursement schedule prior to submitting a reimbursement request to the state. Further, the Budget and Management Office should ensure that the settlement process between the State of Colorado and City and County is resolved.
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<tr>
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<td>Stephanie Adams 720.913.5512</td>
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</table>

Narrative for Recommendation 1.6
The Budget and Management Office will work with the Controller's Office to leverage the City's financial system to identify specific expenditure categories that should reasonably include allowable costs. Additionally, reports may be developed that will streamline the process for the 2019 Cost Allocation Plan reflecting only those expenditure categories as determined by BMO and the Controller's Office. This is a process and policy that will be developed prior to the start of the cost allocation process to ensure consistency.

The 2018 Federal Cost Allocation Plan (based upon 2017 actual expenditures) will be due August 31, 2018. Much of the current year's process has already been completed.

Given that the 2018 Federal Cost Allocation Plan and Citywide Plan are nearing completion, we believe that implementation of many of the recommendations will primarily impact the 2019 Federal Cost
Allocation Plan and Citywide Plans. We look forward to improving the oversight of the Federal Cost Allocation Plan and the Citywide Full Cost Allocation Plan.

Please contact me, Stephanie Karayannis Adams at 720.913.5512 with any questions.

Sincerely,

Stephanie Karayannis Adams
Budget and Management Director

cc: Valerie Walling, Deputy Auditor, CPA, CMC
Heidi O’Neil, CPA, CGMA, Director of Financial Audits
Jared Miller, CISA, CFE, Audit Supervisor
Brendan Hanlon, Chief Financial Officer, Department of Finance
Dave Edinger, Chief Performance Officer, Mayor’s Office