

MEMO TO: Members of the City Council

FROM: John Marchione, City Mayor

DATE: January 17, 2012

SUBJECT: **PERFORMANCE AUDIT – ALLOCATING OVERHEAD COSTS**

**I. RECOMMENDED ACTION:**

State law relating to performance audits call for a public hearing to be held by the City Council on the findings in the performance audit. Additionally, State laws require the City to determine how it will respond to recommendations in the audit and provide that response to the State Auditor's Office.

This public hearing is being held on January 17, 2012, in order to comply with this requirement. Staff will present the report and a summary of the comments received during the hearing. Staff recommends that as a result of the changes implemented in the 2011-2012 budget, no further response to the audit is necessary.

This matter was brought before the Public Administration and Finance Committee for discussion in December 2011.

**II. DESCRIPTION:**

During much of 2011 the State Auditor's Office (SAO) has been conducting an audit on the topic of Allocating Overhead Costs. The audit was to highlight effective allocation practices and evaluate the extent to which eight cities used these practices to distribute overhead costs. Including Redmond, this audit reviewed the cities of Aberdeen, Bainbridge Island, Bellevue, Monroe, Mukilteo, Spokane, and Tacoma. The final report is available at the State Auditor's web site at [www.sao.wa.gov](http://www.sao.wa.gov) and has been provided to the Council.

This memo addresses the process results of the Allocating Overhead Costs audit.

**Process:**

The audit was conducted by a combination of the SAO's local audit team and the performance audit team based in Olympia. The team used 2009 as a baseline for their analysis due to the lack of more current data in some of the cities that were audited. This was unfortunate from Redmond's standpoint, as 2009 was the last year we used an outdated process first established in 2003. Knowing that our 2003 process needed revision, staff, including the Council, spent a significant amount of time revising this approach in 2009. We used the revised approach for the 2011-2012 budget; however, the audit reflects the shortcomings from the older approach.

Before the audit began, the Finance Department expressed concern about the audit focusing on an outdated model that we no longer used. The SAO responded to this by including a comment on the bottom of page 47 in the audit report, stating that the City's new plan appears to include most of the leading practices identified. The dialog in the report prior to that point spoke to the shortcomings of the outdated 2003 approach. We believe that the audit was conducted in a commendable manner – notwithstanding the concerns about the audit period covered.

**Results:**

The audit found:

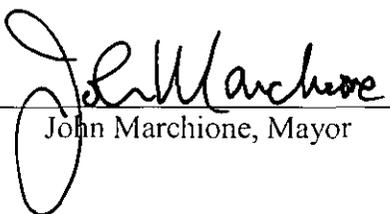
- In 2009 the City used outdated practices that conformed to few of the “leading practices” identified by the SAO (3 of the 7 identified);
- Some changes to the original charges in 2009 related to the 2003 plan were difficult to trace (e.g. 14% increase in IS charges for Storm Water);
  - We worked to explain the rationale behind those types of changes to the auditor but their comments remained in the report.
- The City did not reconcile the budget based charges for overhead to actual expenditures;
- The City did not use “leading practices” in the allocation methods;
  - We currently use leading practices in the revised allocation plan.
- The City did not allocate to all funds that benefited from the shared services;
  - The auditor agreed with us that the City has the discretion not to allocate overhead costs to some funds. Their concern was that these were not then further allocated (for instance to the utility funds) resulting in overcharging these funds. We confirmed that this was not the case.
- As a result of the use of a different allocation factor than a leading practice, the report concluded that the City may have overcharged the utility funds for building maintenance, IT costs, and budget department costs. The amount of the potential overcharge was reported to be \$564,000.
  - We believe that all funds were appropriately charged for overhead based on the allocation methods in place at the time. We do not recommend refunding for allocated costs to the utility funds.

**III. LIST OF ATTACHMENTS:**

None.

  
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Mike E. Bailey, Finance Director

1/6/12  
Date

Approved for Council Agenda   
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John Marchione, Mayor

1/9/12  
Date