

# **Budgetary Process Audit**

## **June 2010**

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# ***BUDGETARY PROCESS AUDIT***



Office of the City Auditor

Patrice Randle, CPA  
City Auditor

***Report #10-01***

***June 11, 2010***

## ***Executive Summary***

***The 2010 budget was  
adopted as required by  
law***

***Budget developed in  
accordance with Council  
priorities***

### ***Opportunities for Improvement***

- ***Better communication  
with Mayor and City  
Council***
- ***Formal policies and  
procedures for internal  
service and special  
revenue funds***
- ***Disclose impact of  
personnel changes***
- ***Modify calculation of  
vacancy savings targets***
- ***Consider policy to  
adjust budget for  
significant deviations***
- ***Increase transparency  
related to personnel  
changes, transfers,  
vacancy savings and  
budget analysis reports***

As part of the Fiscal Year 2010 Annual Audit Plan, the City Auditor's Office conducted an audit of the budgetary process. The audit 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. The objectives of the audit were to determine whether:

- effective methodologies were used to develop and maintain a balanced budget;
- revenue and expenditure monitoring practices were effective; and,
- budgetary reporting was adequate and transparent.

The City Auditor's Office concluded that the budgetary process resulted in a Fiscal Year 2010 budget that generally reflects Mayor and City Council priorities. The Financial and Management Resources Department (FMR) has established strong internal controls over the majority of critical budget processes, including:

- the establishment and implementation of the majority of recognized best budgeting practices for governments,
- the review and approval of budget transfers,
- the review, consideration and recommendation of budget issues (additions and deletions to the base budget), and
- the monitoring of budgetary performance.

The findings and recommendations included in this report are presented to further strengthen internal controls and provide stakeholders with additional insight into the budget process. A summary of the findings is presented in the Summary of Audit Results section of this report.

## ***Audit Scope and Methodology***

The audit was conducted in accordance with generally accepted government auditing standards. The following methodology was used in completing the audit.

- Interviewed staff from the Financial and Management Resources Department (FMR) to gain an understanding of the budgetary process
- Surveyed department representatives responsible for budget preparation and monitoring
- Surveyed the Mayor and City Council members to obtain their input
- Reviewed City Council meetings during which the Fiscal Year 2010 budget was discussed
- Reviewed the capabilities and use of the GovMax budget system
- Reviewed budgetary policies and procedures established by FMR
- Reviewed budgetary documentation, including monitoring reports, new program requests, vacancy savings calculators and budget transfer requests

The City Auditor's Office did not include a review of the capital budget process as part of this audit. A review of the capital budget process would have delayed the reporting of the following audit results that can be considered during the FY2011 operating budget process. Since the City of Arlington does not adopt the operating and capital budgets simultaneously, the City Auditor's Office plans to conduct a separate audit of the capital budget process.

## ***Background***

### **Responsibilities**

Under the direction of the City Manager, the Office of Management and Budget (OMB), a division of the FMR Department, has primary responsibility for the coordination and preparation of the annual operating and capital budgets. Additional functions now performed by the OMB include revenue enhancement, position control and organizational effectiveness. OMB consists of a budget manager, three budget administrators, two senior management analysts, one revenue enhancement specialist, one management analyst and one budget office coordinator.

In addition to the OMB, City departments have management analysts and other staff that spend a varied amount of time developing, coordinating, communicating and monitoring budgetary information. The OMB provided the City Auditor's Office with a list of over 100 individuals that have access to the City's GovMax system. GovMax is used to develop and communicate budget issues for inclusion in the City's proposed budget.

Department Heads are responsible for submitting budget proposals that address priorities established by the Mayor and City Council and for ensuring that their department operates within the established budget.

## **Budget Development**

The development of each new fiscal year budget begins around March, when the Mayor and Council establish priorities for the upcoming year. In May, departments are instructed to begin preparing budget allocations for review by their Deputy City Manager. Some Department Heads indicated that they begin their budgetary process earlier with a strategic thought process where their department managers and supervisors sit down and discuss applicable laws, staffing levels, economic conditions, etc. A proposed budget is presented to the Mayor and City Council for adoption no later than September 30<sup>th</sup>, as required by state law. Once the proposed budget is adopted, Department Heads are expected to spend within their authorized appropriations and measure performance against departmental goals and objectives. Reports summarizing the City's budget status are prepared and made available to departments and the Mayor and City Council on a routine basis. A complete calendar of the budgetary process is shown in Exhibit I.

At the City of Arlington, departments are grouped into four service teams: Capital Investment, Economic Development, Neighborhood Services and Strategic Support. Each service team is led by a Deputy City Manager. After the Deputy City Managers have met with their service teams and reviewed revenues, prior year appropriations, budget issues, etc., the Deputy City Managers meet to arrive at a budget to recommend to the City Manager. The City Manager has the final decision regarding the proposed budget. Once the City Manager has decided upon a proposed budget, the OMB prepares budget documents and presentations for the Mayor and City Council.

## **Best Practices**

In 1990, the Government Finance Officers Association (GFOA) Committee on Government Budgeting identified a need for improvement in government budgeting. The GFOA sponsored a national symposium and a national task force to determine the nature and extent of the need. Many government officials and financial industry leaders participated and confirmed the need for improved governmental budgeting guidelines. The effort was intended to be aimed at guidance, not at a requirement. Based on these findings, the GFOA, along with seven other organizations representing state and local governments, formed the National Advisory Council on State and Local Budgeting (NACSLB). In 1995, they began a three-year mission to develop recommended budget practices for state and local governments.

NACSLB developed a comprehensive set of best practices included in a document entitled "Recommended Budget Practices: A Framework for Improved State and Local Government Budgeting." According to the NACSLB, the mission of the budget process is to help decision makers make informed choices about the provision of services and capital assets and to promote stakeholder participation in the process. The NACSLB established five essential characteristics of a good budget process. Such a process:

- Incorporates a long-term perspective;
- Establishes linkages to broad organizational goals;
- Focuses budget decisions on results and outcomes;
- Involves and promotes effective communication with stakeholders; and
- Provides incentives to government management and employees.

The NACSLB makes it clear that the budget process is not simply an exercise in balancing revenues and expenditures one year at a time, but is strategic in nature, encompassing a multi-year financial and operating plan that allocates resources on the basis of identified goals. It further states that “a good budget process moves beyond the traditional concept of line item expenditure control, providing incentives and flexibility to managers that can lead to improved program efficiency and effectiveness.”

### **GovMax**

For developing the Fiscal Year 2010 budget, OMB used GovMax, a web-based application that integrates strategic planning, business planning, performance management and budgeting (operating & capital). GovMax was designed by Sarasota County Government (Florida) to help public sector agencies maximize performance, investments and results.

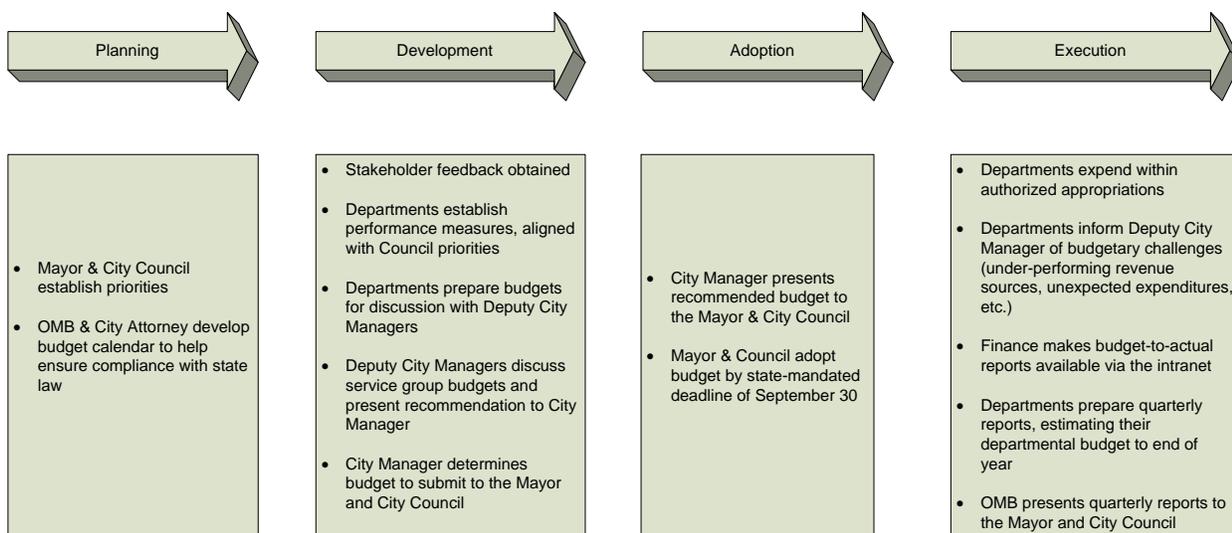
According to the vendor’s website, “GovMax’s flexible yet integrated system architecture allows for cascading-down of organizational priorities, and rolling-up of measures, expenditures and full-time equivalents (FTEs) to provide a crystal clear picture of how every organizational resource is aligned to deliver maximum value to the community.” The three key tenets of GovMax include performance management, day-to-day management of operating and capital budgets (budget vs. actual) and production of GFOA compliant budget documents.

## *Summary of Audit Results*

The City Auditor’s Office noted that FMR has:

- received the “Distinguished Budget Presentation Award” from GFOA;
- implemented new software in Fiscal Year 2009 to aid in the development, publication and monitoring of the budget; and
- proactively responded to challenges posed by the economic crisis in Fiscal Year 2009.

As noted in the following illustration, the City of Arlington’s budgetary framework is structured to include each recommended phase of a governmental budget.



While these accomplishments indicate that the City is committed to producing a budget that is aligned with Mayor and Council priorities, the City Auditor’s Office concluded that several opportunities for improvement exist. These opportunities are presented in the Detailed Audit Findings section of this report, which is organized according to the framework presented above, plus an additional section for transparency. The findings are also summarized below.

### **Planning**

Detailed findings in this section of the report relate to how the City establishes budgetary policies and procedures and prepares for the budget process.

- The City Auditor’s Office concluded that proposed fee increases and the police update should have been presented to the Mayor and City Council as a part of the budgetary process. Instead, these issues were presented after the Fiscal Year 2010 budget presentations.
- The City has not established formal written policies for four of the NACSLB recommended best practices.

- The City has not developed written policies and procedures to guide management in the operation and maintenance of internal service and special revenue funds.
- The City Auditor's Office identified a need for additional user training and enhancements to the City's budgetary software (GovMax).

### **Development**

Prior to presenting a proposed budget to the Mayor and City Council, City management obtains stakeholder feedback, establishes performance measures in alignment with Council priorities and internally discusses proposed new programs and budget balancing strategies. The City Auditor's Office found that:

- In developing the proposed budget, management does not adequately disclose the impact of personnel changes such as reclassifications and promotions.

Internal Audit results indicated that position reclassifications, position trades and promotions have a significant budgetary impact but are not always included in the budget, even when they are processed early enough to be included. The City Auditor's Office estimated that during Fiscal Years 2008 and 2009, position reclassifications, trades and promotions had an impact of over \$1 million on the Fiscal Year 2010 budget. Some departments indicated that they have not considered reclassifications since the downturn of the economy. However, during Fiscal Year 2009, twelve (12) position reclassifications, trades and promotions were processed. Nine of the 12 position changes went into effect early enough to be incorporated into the Fiscal Year 2010 budget. However, the financial impact or a narration describing these position changes were not included in the Fiscal Year 2010 budget. Most of the position changes (8 of 12) were within the FMR Department.

- Vacancy savings targets do not adequately take into account departments' individual vacancy history.

Some departments consistently maintain a high number of vacancies, which provides them with more flexibility and places them at an advantage over other departments. While departments with a high number of vacancies are in a position to benefit from more salary savings, this was not considered when determining how much of the vacancy savings target to allocate to each specific department. As a result, departments with fewer or no vacancies were placed in a more challenging position to meet their vacancy savings targets. Departments with a larger number of vacancies are able to meet their targets with more ease and use additional salary savings elsewhere.

- OMB did not effectively communicate the methodology for calculating the vacancy savings target. Departments understood the need for the vacancy savings target and agreed that the vacancy savings calculator provided by OMB was beneficial. However, departments were unaware of how OMB determined their department's allocation of the vacancy savings target.
- City management made an error in allocating an internal service fund chargeback, resulting in a \$71K overcharge to the Public Works Department.

- The City does not systematically accumulate funds to replace aging equipment. Instead, departments must rely on one-time funding which is less predictable and could result in the City operating with outdated equipment.
- An employee survey was not included in the Fiscal Year 2010 budget process. The survey was not conducted until after it was requested by the Mayor and City Council subsequent to the proposed budget being presented.

### **Adoption**

After reviewing the Fiscal Year 2010 budget process, the City Auditor's Office concluded that there is a need for increased communication between City management and City Council.

- Transfers were budgeted from the internal service funds to the General Fund prior to identifying the appropriate amount of reserves that were necessary within the internal service funds.

### **Execution**

Execution includes the controls used by the City to ensure that departments expend within authorized appropriations. It also includes the systems and reports utilized to monitor and communicate budgetary performance. The City Auditor's Office noted:

- An interfund transfer was performed which violated standard City practice. A \$75K transfer was made from the General Fund to the Information Technology (IT) Fund for a subsequent year purchase. The transfer was coded as an expenditure in the Lawson financial system but appears to be an equity transfer to the IT Fund.
- Fund transfers were not properly communicated to the IT Department.
- The budget is not adjusted to be consistent with revised expectations. The City has not established a policy that identifies when significant deviations from the budget plan merit the recording of adjustments in the budgetary system.
- City management does not routinely provide updates or status reports on the impact of previously presented and approved budget balancing strategies to the Mayor and City Council. City Management should provide status reports or updates on significant budget balancing strategies so that stakeholders have a full understanding of the operational and financial implications of implemented strategies.
- The City does not adequately communicate detail results of budget monitoring to stakeholders. The quarterly Budget Analysis Report (BAR) is not widely publicized and is not presented in sufficient detail to give stakeholders a comprehensive understanding of budgetary performance.

### **Transparency**

Internal audit results indicate that there is a need for more transparency within the City's budgetary process. Vacancy reports provided to the Mayor and City Council do not include

salary savings calculations. The City Auditor's Office concluded that it would be impossible for recipients of the vacancy reports to determine how much savings resulted from the vacancies.

## PLANNING

Planning for the budget process includes establishing Mayor and Council priorities, establishing policies and procedures to facilitate budget development, and communicating with and training budget users on the budgetary process and on the systems used to develop, prepare and monitor the adopted budget. Detailed findings in this section of the report relate to how the City establishes policies and procedures over the budget process. This includes the development of written policies and procedures in accordance with best practices, the establishment of Mayor and City Council priorities, and the training of personnel to make the most effective and efficient use of the City's budgetary information system.

### **1. Issues that influence the budget were not presented during the budgetary process.**

Practice 9.2b of NACSLB's recommended best budgeting practices indicates that "analyses of the effect of pending or potential changes to revenue sources may be undertaken as part of the budget process or may be undertaken as warranted...." Proposed fee changes for the Health and Animal Services Divisions of the Community Services Department were discussed among management prior to and during the Fiscal Year 2010 budgetary process. Although the Mayor and Council indicated that they would like to see a review of Community Services' fees on an annual basis during budget time, the fees were not presented until September 22, 2009. The expected impact of the new fees was an additional \$30,000 in revenue to the General Fund. Since the fee increase was not a part of the budgetary process, the \$30,000 was not reflected in the Fiscal Year 2010 budget, but would be reflected in the first quarter BAR as a revised estimate.

The Mayor and City Council were also presented fee changes pursuant to construction, electrical, gas drilling and production, irrigation, mechanical, plumbing and zoning activities on September 22, 2009. Fee changes related to backflow were presented to the Mayor and City Council on September 1, 2009 (first reading) and September 22, 2009 (second reading). No financial impact was expected from these fee changes.

Practice 1.2 states that "a government should regularly collect and evaluate information about trends in community condition, the external factors affecting it, opportunities that may be available, and problems and issues that need to be addressed. A government must have an understanding of the issues and trends affecting a community in order to establish the most appropriate goals."

Each year, the Police Department provides the Mayor and City Council with an update of crime statistics and police operations. The police update that was presented on November 3, 2009 contained information that would have been considered when formulating the Fiscal Year 2010 budget. However, the Fiscal Year 2010 budget had been approved approximately one month prior to the presentation. During the question/answer session of the presentation, the Police Chief responded that his department was pursuing grant funding to purchase necessary equipment. Although grant funds were available and additional monies were not required of the General Fund, this may not always be the case. Practice 1.2 (stated above) could be interpreted to suggest that the police update be communicated when Council priorities are established. Due

to the specialization of law enforcement, police updates are more effectively communicated by law enforcement staff.

Practice 9.3 states that “a government should prepare and maintain a revenue manual that documents revenue sources and factors relevant to present and projected future levels of those revenues.” Although a revenue manual helps promote a better understanding of the city government’s resources, the two most recent revenue manuals were dated Fiscal Year 2003 and Fiscal Year 2008. There was no revenue manual prepared between these two years. According to FMR management, a revenue manual is not produced annually due to the department workload and because the information in terms of authorization and description does not change very often.

The 2008 Revenue Manual includes information such as title and description of the revenue source, department responsible for the revenue, authorization for the revenue, revenue code to which the revenue source will be accounted, and previous three-year collection history, including a trend graph. Although this information is very helpful in understanding past and current revenues, the manual does not include information that is relevant to future revenue levels. Additional information that could help readers understand future changes includes:

- Any future dedication or earmarking of revenue, either legislated or by other means;
- Impact of legislation, other laws, rate changes, exemptions, etc. on future revenue levels;
- Projected future levels, including the basis for the projection and a graphic presentation; and,
- Economic circumstances and/or other factors that may affect the revenue.

Providing proposed fee increases, crime statistics and an updated revenue manual during the budgetary process enhances decision making. For example, if the impact from fee increases is significant, but not presented within the budget, potential revenue to offset departmental expenditures, fund projects, staffing, etc. may not be considered by the Mayor and City Council. Also, if police statistics indicate a need for additional resources, the budget may be adopted without taking into full consideration the City’s public safety needs. By not making an updated revenue manual available during each budget period, stakeholders may not understand the revenue sources and projection analysis. As a result, management may be directed to identify additional resources and/or make reallocations soon after the budget was adopted.

The City of Arlington has no written policy or procedure regarding when fee increases or police updates should be presented to the Mayor and City Council or how often the Revenue Manual should be prepared. Proposed fee increases and police updates are presented to the Mayor and City Council as directed by the City Manager. The Revenue Manual is updated as circumstances and time dictate.

***Recommendation:***

The City Manager should ensure that fee increases are presented as a part of the budgetary process.

**Management's Response:**

*Concur.* Management indicated that this recommendation is already done when practical. Management indicated that staff makes a concerted effort to bring fee increases forward in a unified package at budget time but that it is not always possible for every fee. Management indicated that issues such as changes in state law may drive fee increases outside the budget process. Please see management's complete response attached to this report.

Target Date: September 9, 2010  
Responsibility: Mike Finley, Assistant Director FMR

**Recommendation:**

The City Manager should require a written policy regarding the establishment of new fees and charges and/or revisions to currently established fees and charges. The written policy should include, but not be limited to how often fee analysis is conducted and when recommended fees should be presented to the Mayor and City Council.

**Management's Response:**

*Concur.* Management stated that there is already a written policy in the City's Financial Principles regarding fee increases. Please see management's complete response attached to this report.

**Recommendation:**

The City Manager should ensure that the police update is presented to the Mayor and City Council during the priority-setting process.

**Management's Response:**

*Do Not Concur.* Management stated that all departments should be included in a status and budget update. The response stated that "each City Service Team presents their budgetary position and any new programs as a part of the presentation of the proposed budget to the City Council." Please see management's complete response attached to this report.

**Audit Comment:**

Given that public safety has traditionally been an established priority of residents and the City Council, the City Auditor's Office believes that the scheduling of an update on public safety should be coordinated with the budget process.

**Recommendation:**

The City Manager should ensure that a revenue manual is prepared annually and includes information relating to future revenues.

**Management's Response:**

*Concur.* Please see management's complete response attached to this report.

*Target Date:* June 30, 2010  
*Responsibility:* April Nixon, Chief Financial Officer

## **2. Written policies need to be adopted relating to budget best practices.**

One of the most important activities of a governmental organization is the budget process which allocates resources to programs and services. The budget involves citizens, employees, government administrators, and elected officials – all stakeholders. In order for the budgetary process to operate smoothly and accurately, there must be a set of well-defined steps taken during the process. Also, written policies should be adopted to guide the process and to ensure consistency.

NACSLB's recommended budget practices consist of a comprehensive set of 59 processes and procedures that define an accepted budget process. Of the 59 practices within this budget framework, 11 relate to the formal adoption of financial policies. A review of the City's financial policies, the Budget Manual, the Annual Business Plan, the Comprehensive Annual Financial Report, and documentation from the OMB indicated that the City has incorporated each of these 11 practices into its budget process. However, there are no formally adopted written policies for the following four best practices.

1. A government should adopt a policy limiting the use of one-time revenues for ongoing expenditures.
2. A government should identify major revenue sources it considers unpredictable and define how these revenues may be used.
3. A government should adopt a policy that encourages a diversity of revenue sources.
4. A government should adopt policies and plans for capital asset acquisition, maintenance, replacement, and retirement.

Without written policies to guide the budgetary process, a lack of consistency is possible and controls could deteriorate. A comprehensive set of written financial policies are necessary to guide staff, facilitate decision-making for elected officials, and improve controls over the City's financial activities. In instances where there is employee turnover, written policies would help a new employee understand the budgetary process, thereby increasing efficiency and reducing errors. Also, when new council members are elected, written policies would help them more fully understand the budgetary process.

### ***Recommendation:***

The City Manager should ensure that written policies relating to the aforementioned best practices are prepared and formally adopted.

### ***Management's Response:***

*Do Not Concur. Management believes that the City has adequate policies for the development of the budget. Please see management's complete response attached to this report.*

***Audit Comment:***

Management references the City's Financial Policies and the FY 2010 Operating Budget as sources for existing policies. The City Auditor's Office views the budget as a result of implementing and following established policies.

**3. City management has not established adequate policies and procedures regarding the use of internal service and special revenue funds.**

Internal service funds are used to account for the financing of materials and services provided by one department of the city to other departments of the city, generally on a cost-reimbursement basis. Special revenue funds are used to account for proceeds of special revenue sources that are legally restricted to expenditures for specified purposes.

Internal service and special revenue funds should be adequately safeguarded in order to be used appropriately. In order for these funds to be properly safeguarded and to perform efficiently and effectively, the following guidelines should be developed and maintained:

- the methodology for determining revenue (service rates/user fees/donations/grants/etc.);
- the department or person that is responsible for preparing the budget for the fund;
- the appropriate reserve balance to be maintained;
- the appropriate use of funds/reserves (when to be used and for what types of expenditures);
- who is authorized to approve the use of funds, including operating transfers from reserves;
- process to recoup funds/reserves, should the balance drop below the minimum established level;
- the department or person that is the owner of the fund (ultimately responsible, including on-going monitoring); and,
- maintenance and replacement of equipment for internal service funds.

As shown in Finding #14, a \$75,000 fund transfer was made from the General Fund to the Information Technology Fund. However, no documented correspondence was provided to IT to indicate when the transfer would be made or that the transfer was made. Also, budgeted transfers from the Group Health Fund (\$700,000) and the General Services Fund (\$150,000) to the General Fund were later reversed at year-end. These types of transfers should be properly controlled through the use of written policies and procedures.

Currently, the City has six internal service funds. Four of these six funds (Knowledge Services, Fleet Services, Technology Services, and Group Health) were selected for review during this audit. The other two funds, Workers' Compensation and Arlington Property Finance Authority, were not reviewed. The City has 38 special revenue funds from which the following seven were selected for review: Street Maintenance, Federal Emergency Management Agency (FEMA),

Gas Lease, Convention and Events Services, Emergency Physicians' Advisory Board (EPAB), Gifts and Donations, and Infrastructure Maintenance Reserve.

Currently, there are limited policies within the City that serve to guide the operation and maintenance of internal service and special revenue funds. With regard to internal service funds, the Group Health Fund has a policy that establishes the methodology for calculating rates and for who is responsible for the fund. The Knowledge Services Fund has a policy that includes the appropriate use of fund balance and who is authorized to approve the use of funds. The Fleet Services and Technology Services Funds do not have any written policies.

With regard to special revenue funds, there are documents which establish the reason for and the use of funds relating to the Street Maintenance, FEMA and Gas Lease Funds. However, there did not appear to be any documents relating to the Convention and Event Services Fund. In addition, the EPAB, which is funded through the ambulance service contract, is divided into two accounting units. Accounting unit 790103 has a document which established guidelines relating to the Medical Director. However, there were no guidelines for accounting unit 790201 which is used for emergency medical services expenditures. There were also no guidelines or policies which covered the Gifts and Donations Fund or the Infrastructure Maintenance Reserve Fund.

With no written policies and procedures to help guide management in the operation and maintenance of internal service and special revenue funds, the funds are less protected. Problems that could occur include, but are not limited to:

- a miscalculation of service rates that would not cover the full cost of providing a service, thereby leading to an inadequate reserve balance;
- a miscalculation of user fees (revenues) that would result in not recovering a determined amount of program costs; and,
- the misuse of fund/reserve balances.

***Recommendation:***

The City Manager should ensure that policies and procedures are developed relating to the operation and maintenance of each internal service and special revenue funds.

***Management's Response:***

*Do Not Concur. Management did not concur with this recommendation, stating that "management believes the City has adequate policies for the development of the ISFs in the City's budget." Please see management's complete response attached to this report.*

***Audit Comment:***

Management's response includes a statement that it is entirely appropriate to return ISF transfers to the General Fund so that available resources in the General Fund are sufficient to cover the fund's Council-authorized appropriations during the year. However, management did not provide the City Auditor's Office with any written policy that states this. Management's response also implies that policies on the appropriate use of reserves are not needed for internal service funds, except in cases where fund balances are designed to

increase over time to fund major capital purchases. In Finding #12, the City Auditor's Office noted that the Worker's Compensation, Group Health (Health Insurance), Fleet Services and Knowledge Services internal service funds have had "excess" fund balances (or "reserves") returned to the General Fund. The City Auditor's Office agrees that these funds may accumulate reserves for specific purposes (equipment purchases, large-loss claim insurance, etc.). However, internal control is strengthened when written policies guide the usage of such reserves.

#### **4. Additional GovMax user training is needed.**

As noted by NACSLB's Practice 11.2, a government should evaluate its financial performance relative to the adopted budget. Regular monitoring of budgetary performance provides an early warning of potential problems and gives decision makers time to consider actions that may be needed. In order to ensure that users effectively identify potential problems, users should be appropriately trained in utilizing budgetary information systems that facilitate the preparation of budgets and the review of budgetary performance.

GovMax is not currently utilized by most City users for budgetary monitoring and planning. Each night, a summary of expenditure transactions is downloaded from the Lawson financial system to GovMax. This download enables users to utilize GovMax to monitor budgetary performance. However, during interviews with the City Auditor's Office, most users expressed unfamiliarity with the ability to use GovMax as a tool to monitor financial performance/budget monitoring, as the system was purchased by the City primarily for its budget preparation usefulness. Some users noted that GovMax reporting did not meet their needs which resulted in their use of external spreadsheets to produce desired reports and monitoring tools.

Some users were not clear with how to use GovMax for budget preparation. For example, the City Auditor's Office noted that some users were not familiar with how to utilize GovMax to input detail data supporting specific budget line items. GovMax allows users to input multiple supporting entries for one account. For example, a department can enter detail membership data for each professional organization in its "Memberships" account, with the total of the individual transactions becoming the "budgeted" amount for the membership account. OMB stated that users were trained to enter separate line items that would "roll up" into one total line item. The City Auditor's Office noted that some departments entered detail transactions in a text-based comment field. Departments also varied in the level of detail provided to support account totals. For example, for the Special Services account (used to account for professional service contracts), some departments identified specific anticipated costs for individual contracts or programs while others provided a more general estimate of total anticipated costs.

OMB provided training to GovMax users prior to Fiscal Year 2010 budget preparation. During audit fieldwork, OMB indicated that additional GovMax training would be provided to users during spring 2010. Lack of adequate training could result in incorrect usage of GovMax, which could result in increased time to prepare and monitor the budget. It also could result in less accurate or informative supporting documentation for budget entries.

***Recommendation:***

The Financial and Management Resources Director should ensure that GovMax users receive additional training as planned.

***Management's Response:***

*Concur. Management intends to continue providing ongoing training opportunities, and stated that a training manual is available on-line. Please see management's complete response attached to this report.*

*Target Date: Ongoing*  
*Responsibility: April Nixon, Chief Financial Officer*

***Recommendation:***

The Financial and Management Resources Director should solicit feedback from GovMax users for desired reporting features that would reduce reliance on external spreadsheets and increase efficiency and control.

***Management's Response:***

*Concur. Management indicated that staff has been working with the developers of the software on an ad hoc reporting tool that will allow for custom built reports. Please see management's complete response attached to this report.*

*Target Date: November 15, 2010*  
*Responsibility: Mike Finley, Assistant Director FMR*

**5. Software enhancements are needed to fully utilize GovMax as a budget preparation and monitoring tool.**

A 2006 GFOA market research report (Budgeting Technology Solutions) describes the essential functionalities available through commercial products for meeting public sector budget requirements. The report outlines key requirements for user input, building budget requests, process management and budget analysis. The report identified major capabilities and indispensable features of budgeting systems. These include the ability to forecast salaries and benefits, the ability to allow for multiple scenarios and perform "what if" analysis, the ability to monitor and track versions and the ability to publish the resulting budget.

To prepare and monitor the City's budget, the City utilizes external spreadsheets created and maintained by user departments, the budget module of the Lawson Financial System, GovMax, spreadsheets created and maintained by the OMB and a word processor version of the proposed and final budgets. To ensure that data is presently accurately in published documents requires reconciliation from one source to the next. The City does not currently use GovMax to produce the printed proposed and adopted budgets, although OMB management indicated that they plan to do so in the future.

GovMax is missing some functionality that would make its use more effective and efficient. According to the OMB, a recent enhancement was made to GovMax that would allow departmental users to input their fiscal year estimates into GovMax during the quarterly BAR process. However, because this was considered tedious, for the 2010 first quarter BAR, users input estimates to Excel spreadsheets and the OMB then uploaded estimates to GovMax. According to OMB management, the City is working with GovMax to build a calculation component into the estimate process. For now, FMR management feels that the ability to record calculations from external spreadsheets to GovMax is adequate.

The City currently utilizes GovMax to perform “what-if” analysis, but the ability of the system to perform “what-if” analysis in real-time is limited. For example, although it would be fairly simple to identify the impact of a proposed 1%, 2% or 3% pay raise across the board, it would be much more time consuming to calculate the impact of a proposed 3% pay increase to employees making under \$50,000 per year. Such an analysis would most likely be done outside of GovMax. The City can also use GovMax to track different versions of the budget so that draft, approved, adopted and appropriated statuses can be tracked with auditable changes. Currently, this must be done by copying and saving multiple versions of a budget, rather than having the functionality to perform this within one budget file. During the audit, the City Auditor’s Office had a difficult time verifying the base budget and that communicated changes/impacts were recorded in GovMax as presented.

The City did not utilize GovMax to prepare the five-year forecast included in the adopted budget, although GovMax appears to produce multiple year forecasts. Instead, the OMB utilized an Excel spreadsheet to prepare and present the five-year plan included in the proposed and adopted budgets. According to OMB management, resource and time constraints led to a decision to use the Excel file instead of GovMax.

The City Auditor’s Office noted that the GovMax system also lacks some audit trails. While the system tracks changes made to account detail, other critical data is not monitored. For example, the City Auditor’s Office noted that gaps exist in the numerical sequence of budget issues, which result in the inability to determine whether budget issues were appropriately considered, accidentally deleted or intentionally removed from the system. Budget issues are used to request changes to the base budget for new program requests or program reductions.

The City Auditor’s Office noted that GovMax appears to be a significant improvement over the prior practice of linking numerous Excel files to produce the budget. According to OMB management, GovMax was purchased by the City primarily for its budget preparation usefulness. Because the software was developed by another entity, the ability to customize and enhance the software is limited.

Underutilization of GovMax could result in increased time to prepare and monitor budget documentation. It also could result in less accurate calculations as input is required from Excel spreadsheets and other sources to GovMax. OMB management indicated that they planned to work with the developer of GovMax to enhance its potential utilization.

***Recommendation:***

The Financial and Management Resources Director should ensure that OMB continues to work with the developer of GovMax to enhance the software and increase its usefulness beyond budget preparation.

***Management's Response:***

*Concur. Management intends to work with the vendor to provide additional enhancements to the software. Please see management's complete response attached to this report.*

*Target Date: Ongoing*

*Responsibility: Mike Finley, Assistant Director FMR*

## DEVELOPMENT

Prior to presenting a proposed budget to the Mayor and City Council, City management obtains stakeholder feedback, establishes performance measures in alignment with Council priorities and internally discusses proposed new programs and budget balancing strategies. The City Auditor's Office found that while the method used to obtain the most beneficial employee feedback was effective, management did not solicit feedback in a timely manner. In developing the proposed budget, management does not adequately disclose the impact of personnel changes such as reclassifications and promotions. In addition, the City Auditor's Office noted that City management made an error in allocating an internal service fund chargeback, did not effectively communicate the methodology for calculating the vacancy savings target, and does not allow for a systematic accumulation of funds to replace aging equipment.

### **6. Personnel changes with significant impact should have been included in the Fiscal Year 2010 budget.**

Budget guidelines and best practices recommended by NACSLB (section 9.5) suggest that decision makers and stakeholders should have an understanding of the financial implications of revenue and expenditure options being considered in the budget process. However, the impact on the budget due to personnel changes such as reclassifications, position trades and promotions are not adequately disclosed in City of Arlington budget documents. Disclosure of personnel changes, including the quantity and value of reclassified positions, promotions and traded positions provides perspective to the stakeholders when considering employee-related expenditure options (pay raises, cuts, benefit reductions, etc.) in the budget process.

The City has an established position classification process. The goal of the process is to ensure that employees receive fair compensation for duties performed. If an existing position has a significant change in job responsibilities, a supervisor may seek Department Head approval to request a position study. The Workforce Service Department will conduct interviews and arrange a Hay Committee meeting. The Hay Committee, generally made up of selected Workforce Services employees, will conduct an evaluation and recommend an appropriate classification.

The City Auditor's Office reviewed 2008 and 2009 position reclassifications, position trades and promotions to determine if the impact on the City's budget is significant. The City Auditor's Office estimated that position reclassifications, trades and promotions over the last two years had an impact of over \$1 million on the Fiscal Year 2010 budget.

The City Manager also noted that budget implications associated with position reclassifications is significant. In a March 2009 memorandum, the City Manager noted that the City would be implementing further budget controls on vacant positions, as well as new controls on position reclassifications. The memorandum required that any future reclassifications be presented to the City Manager's Office prior to being submitted to Workforce Services. The memorandum further stated that presentations must outline additional responsibilities, potential salary increases, and the impact if not approved. If a position reclassification resulted in a salary increase, the department was required to identify equivalent cost savings elsewhere in the current year budget before implementing the reclassification.

The following schedule summarizes the number and dollar value of increases associated with position reclassifications, trades and promotions, as identified by the City Auditor's Office:

CITY OF ARLINGTON						
ESTIMATED IMPACT OF POSITION RECLASSIFICATIONS						
RECLASSIFICATIONS PROCESSED IN FY 2008 and FY 2009						
Department	Two-Year Total	GovMax Position Budget Summary 2010	Pct. Of 2010 Salaries and Benefits	Total # of Employees	# of Employees Reclassified	Pct. Of Employees Reclassified
Aviation	\$ 53,324	\$ 512,840	10.40%	8	2	25.00%
Community Services	245,736	4,579,177	5.37%	75	20	26.67%
Financial and Management Resources	185,279	6,097,340	3.04%	85	20	23.53%
Convention Center	38,906	1,952,911	1.99%	32	7	21.88%
Parks and Recreation	109,130	10,230,213	1.07%	190	5	2.63%
City Auditor's Office	4,432	457,611	0.97%	5	1	20.00%
Police	112,498	11,794,827 *	0.95%	179	6	3.35%
Fire	80,820	9,114,029 *	0.89%	149	9	6.04%
City Attorney's Office	27,342	3,288,816	0.83%	38	1	2.63%
Public Works	94,246	12,928,999	0.73%	208	9	4.33%
Library	26,684	4,053,032	0.66%	69	6	8.70%
Community Development and Planning	28,018	5,062,111	0.55%	68	3	4.41%
Information Technology	20,928	4,824,055	0.43%	53	6	11.32%
Water Utilities	20,407	12,711,041	0.16%	219	2	0.91%
City Manager's Office	-	844,266	0.00%	4	-	0.00%
Economic Development	-	282,870	0.00%	3	-	0.00%
Judiciary	-	639,149	0.00%	6	-	0.00%
Workforce Services	-	1,726,604	0.00%	20	-	0.00%
Municipal Court	-	1,849,674	0.00%	42	-	0.00%
Total	\$ 1,047,750	\$ 92,949,565	1.13%	1,453	97	6.68%

\* - Adjusted to exclude sworn personnel

Source: Auditor-generated from Lawson payroll data and GovMax

While the total impact attributed to personnel changes is just over 1% of total budgeted salary and benefit costs, the schedule above indicates that some departments have reclassified a higher percentage of employees than other departments. The City Auditor's Office did not perform a comprehensive review of whether positions were appropriately reclassified. That was considered beyond the scope of this audit. However, the City Auditor's Office did review the extent to which the above changes were disclosed to City Council through budgetary documents.

The reclassified positions shown in the chart includes 63 positions that were reclassified in 2008 and 34 employees that were reclassified in 2009. The reduced number of reclassifications in 2009 is most likely due to budgetary pressures resulting from a weakened economy and the increased controls over position reclassifications introduced by the City Manager.

Appendix 1 to the Fiscal Year 2010 budget includes a schedule of full-time authorized positions. The City Auditor's Office noted that a total of 16 out of 34 position changes in Fiscal Year 2009 were not included in the list of authorized full-time positions presented in the Appendix. In addition, the dollar impact (approximately \$200,000) of the position changes was not included in the budget. Details of the position changes in Fiscal Year 2009 that were excluded are listed in the following chart.

<b>FY 2009 Position Changes Not Reflected in FY 2010 Budget</b>					
<b>Approval Date</b>	<b>Effective Date</b>	<b>Prior Title</b>	<b>New Title</b>	<b>Type of Change</b>	<b>Department</b>
4/6/2009	11/30/2009	2 Programmer Analysts	2 Application Specialists	Position Trade	IT
5/18/2009	6/1/2009	Treasury Analyst	Action Center Manager	Position Trade	FMR
5/18/2009	9/7/2009	Financial Consultant	Asst. Director Fin/OPS	Reclassification	FMR
5/18/2009	10/5/2009	Budget Manager	Asst. Director Budget/Treasury	Position Trade	FMR
5/20/2009	10/5/2009	3 Financial Accountants	3 Sr. Financial Accountants	Reclassification	FMR
5/20/2009	10/5/2009	Staff Accountant	Financial Accountant	Reclassification	FMR
5/20/2009	6/1/2009	Action Center Agent	Action Center Supervisor	Position Trade	FMR
6/8/2009	10/5/2009	Purchasing Assistant/Administrative Aide II	2 Buyers	Position Trade	FMR
6/8/2009	10/5/2009	Purchasing Agent	Senior Purchasing Agent	Reclassification	FMR
8/6/2009	8/24/2009	Youth Coordinator	Community Support Manager	Position Trade	Police
8/27/2009	11/30/2009	Field technician	Streetlight Specialist	Position Trade	PW
8/27/2009	9/21/2009	Heavy Equipment Operator II	Crew Leader	Position Trade	PW

The above changes were not included in the Fiscal Year 2010 budget document because the current process is to use March 31<sup>st</sup> as a cutoff date for positions to be included in the subsequent year budget. However, the current cutoff date appears to be unreasonable. For example, the Fiscal Year 2010 budget calendar (see Exhibit 1) listed April 24<sup>th</sup> as a deadline for departments to submit base budgets and shows planning activity through the month of July. There appears to be adequate time to include the positions and costs associated with the majority of positions that were not included. Only three of the 16 positions were approved for reclassifying/trading after June 2009. Even though the positions listed above were excluded from Appendix 1 of the 2010 budget, the overall position count citywide remains accurate because the previous position title is included in the appendix.

The budgeted salary expense for 14 of the 34 Fiscal Year 2009 position changes was included in department salary projections. However, the budget did not separately summarize or detail the impact these changes had on the Fiscal Year 2010 budget. For example, salary increases of \$30,000 that were implemented prior to the March 31<sup>st</sup> deadline would be included in the department's total salary projections but not separately summarized on the department's highlights page, in a manner similar to how new programs or program reductions are presented.

The current process for new or reclassified positions does not consist of a deadline for departments that are considering personnel changes. Job reclassifications are performed by

Workforce Services staff throughout the year and appear to be absorbed into existing departmental budgets if approved, without adequate reflection in budgetary documents. OMB has not previously considered it necessary to disclose the financial impact of position changes.

City Council and other stakeholders would gain a better understanding of the budget if city management provided them with detail or summarized information regarding the impact of position changes. During times of economic difficulties, the City Manager has instructed departments to freeze vacant positions and has implemented more stringent controls over hiring. Failure to disclose the impact of position changes could have a negative impact on employee morale. It could be perceived that employees within selected departments receive pay raises while an overwhelming majority of City employees do not.

***Recommendation:***

The City Manager should ensure that a revised cutoff date is established (beyond March 31<sup>st</sup>) for the incorporation of position changes in the budget.

***Management's Response:***

*Do Not Concur. Management stated that since position reclassifications are now required to have a net zero impact on the budget, there is no need for a "cutoff date" to incorporate changes. Please see management's complete response attached to this report.*

***Recommendation:***

The City Manager should require that position reclassifications and trades are submitted prior to the revised cutoff date so that the impact of position changes is included in the budget.

***Management's Response:***

*Do Not Concur. Management stated that a cutoff date is unnecessary, as the net cost will be \$0. Please see management's complete response attached to this report.*

***Recommendation:***

The City Manager should ensure that the impact of position reclassifications, promotions and trades are disclosed so that the year-to-year financial impact can be easily identified in budgetary documents.

***Management's Response:***

*Do Not Concur. Management believes disclosure of the impact due to position reclassifications is not necessary since there should be a zero net impact to the budget based on the referenced March 2009 City Manager memo. Please see management's complete response attached to this report.*

***Audit Comment:***

Even if the net bottom-line dollar impact is zero, the City Auditor's Office concluded that disclosure of the corresponding reduction would improve accountability and transparency by disclosing what services were reduced or eliminated (if any) to fund personnel changes.

Management's response also indicates that the number of civilian employees within the Fire Department was incorrectly presented in the audit report. The report indicates that sworn officers were excluded. However, only the Fire Operations accounting unit was excluded. The City Auditor's Office considered it necessary to include Communication Services (Fire Dispatch) since there were employee reclassifications within this accounting unit.

**7. Vacancy savings targets do not adequately take into account departments' individual vacancy history.**

NACSLB Practice 10.1b states that the budget and the budget deliberation process should highlight key issues and decisions. Identification of key issues and decisions focuses attention on the most critical areas, improves the likelihood that an appropriate level of deliberation will occur regarding decisions in these areas, supports the notion of government accountability to stakeholders, and promotes trust. Key issues and decisions may be programmatic, financial, or process-oriented. The goal is to provide for disclosure, appropriate analysis, and discussion of these issues so that well-considered budgetary decisions may be made.

Each year, OMB obtains employee turnover data as of March 31 for each of the past three years. The three-year data is averaged, spread across departments and then incorporated into the base budget. During the Fiscal Year 2010 budgetary process, employee turnover equivalent to approximately \$1.8M was applied to all General Fund departments, except those led by Council appointees. This \$1.8M represented a budget reduction for the estimated turnover factor.

During the Fiscal Year 2010 budget presentations, the City Manager proposed a 1% pay cut and a TMRS decrease, equivalent to approximately \$2.5M in savings. The City Manager's proposal was not supported by the Mayor and Council. However, staff was authorized to use \$1.5M of unallocated reserves and was instructed to find the remaining difference elsewhere. OMB determined that an additional vacancy savings, totaling approximately \$837,000, was necessary to balance the budget. The \$837,000 was allocated across all General Fund departments by using the percentage of positions within the Fire and Police Departments and the percentage of payroll for all other departments. Each department was given their allocation of the vacancy savings target and was expected to manage their vacancies to help balance the budget. The Fiscal Year 2010 vacancy savings target totaled \$2,683,253 (\$1,845,800 first round and \$837,453 second round).

As previously stated, management included departments led by Council appointees (mostly small departments) only during the second round of salary savings. However, there were other small departments (e.g. Aviation and Economic Development) that were included in both rounds. Management indicated that all departments reporting to the City Manager were included in the

first round since other departments reporting to the City Manager could help absorb the savings requirement.

The City Auditor's Office found no evidence that departmental vacancies were considered when determining the vacancy savings target allocated to each department. Applying General Fund employee turnover evenly across General Fund departments and allocating an additional vacancy savings target based on percentage of payroll or number of employees may be an acceptable methodology. However, small departments, departments with little to no turnover and/or departments that do not maintain a high level of vacancies are less able to absorb a vacancy savings target established under this methodology.

As illustrated in the following chart, departments tend to maintain a consistent level of vacancies. There may be some reluctance regarding the elimination of vacant positions, in fear that if a position is eliminated but needed in future years, the new position request may be denied if it is not considered a priority when compared to other new program requests.

Department	Vacancies		Authorized FTEs		Total Vacancy Savings Target	Budgeted Personnel Services
	FY2009 Average	As of 11/15/09	FY2009	FY2010		
Police	15	11	816	781	\$ 419,709	\$ 66,283,612
Parks	7	9	122	118	261,747	6,802,168
Finance & Management Resources	9	7	76	74	230,709	8,954,285
Information Technology	5	7	34	32	127,802	2,994,374
Library	5	5	71	69	167,675	4,730,594
Public Works	3	3	91	89	274,227	7,157,822
Planning & Development	5	3	73	68	216,126	4,984,554
Community Services	4	2	83	75	193,348	4,663,466
Fire	2	1	320	318	520,195	32,193,104
City Attorney	1	1	38	38	47,497	3,315,450
Municipal Court	1	1	46	42	77,044	2,267,063
Workforce Services	.8	1	23	20	72,330	1,702,644
Economic Development	.1	1	3	3	12,127	271,435
Aviation	.5	0	8	8	21,095	568,210
Environmental Services	0	0	4	3	13,739	299,809
City Manager (includes \$29,658 budgeted personnel for the Office of Mayor and Council)	0	0	4	4	12,173	896,373
Judiciary	0	0	6	6	9,174	775,813
Internal Audit	.2	0	6	5	6,535	465,820
Totals			1,824	1,753	\$2,683,252	\$ 149,326,596

Source: OMB and Fiscal Year 2010 Adopted Budget

While all City departments should participate in absorbing budget deficits, methodologies used to allocate vacancy savings targets should take into account other factors that give some departments more savings opportunities than others. Under the current methodology, departments may hold positions vacant, shift additional job responsibilities to existing staff, but still have a challenge meeting their established vacancy savings target.

Departments with a larger number of vacancies have more flexibility reaching their vacancy savings target. They have the flexibility to spend their excess vacancy savings to fund temporary help, contract labor, budget issues that were presented but not recommended by the City Manager, and/or any other items, as long as they do not exceed their departmental budget. In contrast, departments with little to no vacancies may be placed in a position to cut back on operations and/or operate with an inappropriate staff level (e.g., holding vacant positions open longer in order to satisfy the savings requirement). This approach could result in an unnecessary reduction in services to our citizens and could negatively impact employee morale.

A November 15, 2009 vacancy report indicated that six positions had been vacant for more than one year (four of the six positions were in one department) and 15 positions had been vacant from six to 12 months. Thirty-one vacant positions had only been vacant for less than six months. The City Auditor's Office did not determine whether the positions vacant for an extended period of time were considered critical and was not provided a written policy stating that the positions must be considered for elimination prior to establishing a vacancy savings target.

The following chart illustrates total funds available for operations after payroll, interdepartmental charges (such as information technology and general services), and the vacancy savings target.

Department	FY2010 Budget	Payroll & Interdepartmental Charges (\$)	(% of Budget)	Non-Payroll & Interdepartmental Expenditures	Total Vacancy Target	Total Remaining Budget for Operations	Authorized FY2010 FTEs	Budgeted FY2009 FTEs
City Auditor's Office *	\$491,472	\$486,775	99.0%	4,697	\$6,535	(\$1,838)	5	6
Judiciary *	811,089	791,398	97.6%	19,691	9,174	10,517	6	6
City Manager's Office *	964,384	938,395	97.3%	25,989	12,173	13,816	4	4
Economic Development	331,768	283,269	85.4%	48,499	12,127	36,372	3	3
Aviation	750,214	599,715	79.9%	150,499	21,095	129,404	8	8
Municipal Court	3,054,676	2,797,110	91.6%	257,566	77,044	180,522	42	46
City Attorney's Office *	3,705,142	3,470,395	93.7%	234,747	47,497	187,250	38	38
Environmental Services	746,132	399,023	53.5%	347,109	13,739	333,370	3	4
Community Development & Planning	6,030,766	5,384,486	89.3%	646,280	216,126	430,154	68	73
Community Services	6,385,691	5,433,162	85.1%	952,529	193,348	759,181	75	83
Information Technology	4,305,190	3,333,541	77.4%	971,649	127,802	843,847	32	34
Workforce Services	2,896,804	1,855,953	64.1%	1,040,851	72,330	968,521	20	23
Library	6,879,260	5,328,865	77.5%	1,550,395	167,675	1,382,720	69	71
Finance & Management Resources Δ	8,061,466	5,862,960	72.7%	2,198,506	230,709	1,967,797	74	76
Fire	38,535,711	35,934,542	93.2%	2,601,169	520,195	2,080,974	318	320
Public Works & Transportation	11,638,266	7,614,174	65.4%	4,024,092	274,227	3,749,865	89	91
Police	80,122,827	75,372,417	94.1%	4,750,410	419,709	4,330,701	781	816
Parks and Recreation	13,906,861	7,715,997	55.5%	6,190,864	261,747	5,929,117	118	122
<b>Subtotals</b>	<u>\$189,617,719</u>	<u>\$163,602,177</u>		<u>\$26,015,542</u>	<u>\$2,683,252</u>	\$23,332,290	1,753	1,824
Office of Mayor & City Council	62,614							
Non-Departmental	4,900,621							
Transit Support (Park & Ride)	40,617							
<b>Total Budget General Fund Expenditures</b>	<u>\$194,621,571</u>							

***Recommendation:***

The City Manager should establish and enforce a written policy requiring that non-critical positions vacant for an extended period of time be eliminated from the base budget prior to calculating a vacancy savings target.

***Management's Response:***

*Do Not Concur.*

***Recommendation:***

To help ensure that the vacancy savings target is applied equitably across departments, the City Manager should require that each department's vacancy history and available non-payroll funding be considered when determining how much of the vacancy savings target to allocate to departments.

***Management's Response:***

*Do Not Concur. Management believes that adopting this recommendation would dramatically reduce one of the key components of flexibility that City management has at their disposal for administrating the operating budget throughout the year. Please see management's complete response attached to this report.*

***Audit Comment:***

The City Auditor's Office agrees that City management should have flexibility when administering the operating budget throughout the year. However, the audit recommendation is intended to reduce or eliminate a negative impact on departments with little to no vacancies, regardless of the department's size.

**8. The calculation of the vacancy savings target was not clearly communicated.**

Governmental budgets should provide a full disclosure of relevant fiscal information to its stakeholders. The transparency should not be limited to presenting the information, but should also allow an understanding of what is being presented.

During Fiscal Year 2010, each department's budget was reduced by a vacancy savings target amount. The vacancy savings target represented the salary and related benefit savings derived from vacant positions that each department was required to achieve by fiscal year end. Departments were given the option of keeping positions vacant and/or identifying non-personnel expenditures to offset the vacancy savings target.

During audit interviews, departments indicated that they were aware of the vacancy savings target, considered the vacancy savings calculator (see Exhibit 2) very helpful, but did not know how OMB determined their vacancy target amount. OMB responded by stating that the "what" and "why" were explained at the July 21, 2009 third quarter budget meeting (shown in the following chart) and by presenting each department's vacancy savings target amount in GovMax.

**Turnover Factor/Salary Savings**

**Why we do it**

- Actual salaries determined March 31
- Employee terminations natural with corresponding position vacant time
- Intended to reflect the above, not as a budget balancing strategy

**What it gets us**

- \$3.2M in FY 09 (equivalent to 60 positions)
- Reduced to \$2.0M in FY10 (equivalent to 36 positions)

Source: OMB

Although the “what” and “why” may have been explained, communicating the “how” is just as important in the budgetary process. Ineffective communication could cause departments to feel that the allocations are not equitable.

***Recommendation:***

The City Manager should require that OMB provide departments with details for calculating target amounts that reduce departmental budgets.

***Management’s Response:***

*Concur. Management stated that, in the future, the OMB will distribute the vacancy savings distribution calculations to the departments. Please see management’s complete response attached to this report.*

*Target Date: August 3, 2010*

*Responsibility: Mike Finley, Assistant Director of FMR*

**9. There is no systematic accumulation of funds for equipment replacement.**

In a technology-driven society, adequate information technology is pertinent to the success of a business. Information technology departments need to be equipped with equipment that has the capacity to handle software programs used by individual departments. In order to equip information technology departments with such technology, it is good business practice to have a systematic process that promotes the timely replacement of computer equipment.

The City created the IT Fund in Fiscal Year 2001. The purpose for the fund, then and now, was to account for activity related to telephone installation, maintenance and data cable capabilities, and telephone training. The IT Fund is set up to recover costs that the IT Department incurs when providing user departments with network services (network and telephone ports), server support (e-mail accounts, storage/backup, and enterprise application servers) and customer support (desktop hardware, software and service requests). There is no process to systematically

accumulate funds to replace information technology equipment when its useful life has expired. This excludes computers which the City leases.

IT indicated that over the past few years, the City has used one-time funds to replace computer equipment. IT submits a Budget Issue to OMB, requesting funding for new IT equipment. If funding is identified and the IT equipment is a priority of the City Manager, the Budget Issue is approved and the IT equipment is included in the budgeted appropriations. As noted in the following chart, IT records indicate that as of February 2009, a majority of the City's IT inventory is within its estimated useful life. Approximately 88% of the City's telephone system is at or beyond its useful life. However, management indicated that approximately \$1.7M was received in Fiscal Year 2010 to replace the aged telephone system and some of the switch and wireless equipment. The source of that funding was CO Bonds.

Asset Type	Useful Life	Current Age of Asset							Estimated Replacement Cost
		Less than one year old	1 – 2 years old	2 – 3 years old	3 – 4 years old	4 – 5 years old	5 – 6 years old	6 years old & older	
Fiber	25	20%	17%	4%	0%	19%	0%	40%	\$ 6,700,000
Security Equipment	5	6%	41%	12%	18%	11%	10%	2%	160,000
Server Equipment	5	7%	19%	17%	20%	11%	7%	19%	2,000,000
Switch & Wireless Equipment	5	7%	16%	14%	24%	11%	13%	15%	850,000
Telephone	7	4%	4%	4%	0%	0%	0%	88%	1,400,000
Total									\$ 11,110,000

Source: Information Technology Department (not verified by Internal Audit)

A significant percentage of the City's inventory could become obsolete within a span of three years, provided there are no one-time funds and no systematic accumulation of funds to replace the equipment. For example, IT records indicate that 19% of the City's server equipment is currently beyond its useful life. If none of the server equipment is replaced over a span of three years, the percentage of equipment that would exceed its estimated useful increases from 19% to 57%. It should be noted that the chart above does not include some IT equipment that is used specifically for public safety by the Police and Fire Departments.

By charging for depreciation through monthly rate allocations, necessary appropriations could be established to cover the full cost of replacing the equipment. As a result, the City has more control over equipment replacement costs. By charging for depreciation, the City could also eliminate the need to rely on one-time funds to meet specific equipment replacement needs. The potential for computer equipment to become outdated is increased when relying upon excess capacity to fund the replacements.

***Recommendation:***

The City Manager should require that departments be charged for depreciation, each month, to cover future equipment replacement costs. The City Auditor's Office understands that it

may not be feasible to implement depreciation charges at this time, due to current economic conditions. However, depreciation charges should be strongly considered when the economy strengthens.

***Management's Response:***

*Do Not Concur. Management's response indicated that the above recommendation is policy-setting, which is the prerogative of the City Council. Management indicated that unless directed otherwise by Council, funding for these items will compete for appropriated funding along with everything else during the annual budget process. Please see management's complete response attached to this report.*

***Audit Comment:***

Management's response indicated that the recommendation failed to recognize the fiscal exigencies facing the City every year. The audit recommendation states that current economic conditions may prohibit implementation at this time.

**10. The Public Works Department was over-charged for IT services.**

The IT Department provides user departments with network services (network and telephone ports), server support (e-mail accounts, storage/backup, and enterprise application servers) and customer support (desktop hardware, software and service requests). User departments are billed for these services based upon an allocation methodology established by the IT Department. For example, IT's charge for e-mail service is based on the number of e-mail accounts within each department and server charges are based on the number of active directory accounts within each department. These charges that are billed to user departments are referred to as "charge-backs."

In theory, total costs billed to user departments should equal total revenue budgeted within the IT Fund. The revenue is received from user departments to recover costs of IT services provided. For Fiscal Year 2010, total revenue budgeted within the IT Fund was \$6,115,985. However, total IT charges budgeted within user departments totaled \$6,186,541, a difference or over-charge of approximately \$71,000.

IT's cost allocation indicated that a total of \$5,682,850 should be charged back to user departments in Fiscal Year 2010. IT forwarded their cost allocation, by department, to OMB for inclusion in the annual budget. However, since departmental Budget Issues were due after IT's cost allocation, OMB had to allocate additional costs for IT-related Budget Issues approved by the City Manager. There were three approved IT Fund Budget Issues, totaling \$433,135. OMB indicated that, except for the Public Works Department, the \$433,135 was reallocated to departments in the same proportion as IT's cost allocation.

Public Works requested that OMB reallocate their costs to 20 accounting units, spread among the General, Street Maintenance and Storm Water Funds. IT had charged Public Works' costs to two Public Works accounting units, both of which were in the General Fund. OMB indicated that they reallocated Public Works' costs as requested by the Public Works Department and ended up with the over-charge questioned by the City Auditor's Office and shown in the

following chart. Per OMB, the approximate \$71,000 excess is allocable to the Street Maintenance Fund. The City Auditor's Office was unable to verify the source of the misallocation but did note that Public Works' allocation was based on full-time equivalents versus the number of active directories, telephones, etc. used in IT's allocation.

Fiscal Year 2010				
IT Cost Allocation [A]	Approved Budget Issues [B]	Revised Allocation* [A + B]	OMB's Cost Allocation [C]	Excess Charge-backs [C-(A+B)]
\$5,682,850	\$433,135	\$6,115,985	\$6,186,541	\$70,556

\* Amount to be charged to user departments. Agrees with total revenue budgeted within the Information Technology Fund.

IT provided the following examples of why their cost allocation was not detailed to the 20 accounting units within the Public Works Department. All data, whether generated within a small department or a large department, has to have an owner (e.g., a specific division). However, there will always be some data that must be shared within the entire department.

OMB did not perform a reconciliation of the total that should have been charged-back to departments and the total that was actually budgeted as charge-backs. As a result, budgeted IT charge-backs are overstated by approximately \$71,000, which may be attributed to an error made by staff in conducting the reallocation.

***Recommendation:***

The City Manager should require that Department Heads with divisions in multiple funds meet with the IT Director to develop a methodology by which IT's cost allocation can be spread among the appropriate accounting units/funds. This should help alleviate any unnecessary burden to the General Fund and help ensure that the IT Director is aware of departments requiring allocations beyond those initially recommended.

***Management's Response:***

*Concur.*

*Target Date: June 30, 2010*  
*Responsibility: Louis Carr, IT Director*

***Recommendation:***

The City Manager should require that the IT Department prepare a departmental cost allocation to support each proposed Budget Issue. If the Budget Issue is approved, OMB should reallocate costs as recommended by the IT Department.

***Management's Response:***

*Partially Concur. Management believes that this recommendation, if fully implemented, would impose unnecessary burdens on the IT Department to prepare multiple iterations of*

*their chargeback allocations. Please see management's complete response attached to this report.*

*Target Date: July 28, 2010*  
*Responsibility: Louis Carr, IT Director*

***Audit Comment:***

Interviews conducted with IT staff, during audit fieldwork, did not indicate an additional burden.

***Recommendation:***

The Financial and Management Resources Director should confirm the overcharged department(s), require a journal entry to correct the approximate \$71,000 over-billing, and notify the affected department(s) of the correction.

***Management's Response:***

*Concur.*

*Target Date: June 10, 2010*  
*Responsibility: Mike Finley, Assistant Director of FMR*

**11. Employee Opinion Surveys were not a part of the budgetary process.**

NACSLB states that mechanisms to identify stakeholder concerns, needs and priorities should be developed in a timely manner to allow adequate consideration of stakeholder feedback into the budgetary process and to help facilitate timely adoption of the budget. Among mechanisms to be considered are surveys and meetings with government employees.

Budget strategies initially presented to the Mayor and City Council took into account employee feedback. During the June 9<sup>th</sup> work session, the Mayor and City Council were informed that employee input into the Fiscal Year 2010 budgetary process was received via Employee Budget Summits, EthicsPoint, and an Employee Taskforce. The City Auditor's Office obtained the following information regarding the three resources identified by the City Manager.

- *Employee Budget Summits* - During the April Employee Budget Summits, employees were given an overview of the City's budgetary status (e.g., revenue and expenditure projections) and the opportunity to submit suggestions, concerns, questions, etc. directly to the City Manager. While some employees took advantage of and provided valuable feedback, most attendees did not openly ask questions nor make suggestions to the City Manager. Since there was no sign-in sheet, the number of employees that attended the summits could not be determined.
- *EthicsPoint* - In April, employees were encouraged to comment via an on-line suggestion box within EthicsPoint. EthicsPoint is the City's on-line system that was implemented for employees to report ethics violations. The decision to comment anonymously is at the

employee's discretion. A total of 121 reports were made via EthicsPoint, less than 5% of the City workforce.

- *Employee Taskforce* - The TMRS Employee Taskforce, created in January 2008, consists of nine employees from nine different departments. TMRS Taskforce members indicated that their main task was to address the City's under-funded TMRS liability (e.g., vesting requirements, lobbying in Austin, etc.). However, there was some discussion in Fiscal Year 2009 regarding the Fiscal Year 2010 budget.

Management felt that the Employee Budget Summits, EthicsPoint, and the Employee Taskforce provided them with a good perspective of the general consensus of employees. The City Manager also published monthly "Thoughts from the City Manager." The February 2009 issue emphasized the City Manager's desire to communicate and engage with employees. He also informed employees that management would be meeting with employees over the next few months to discuss the budget and to receive input. The April 2009 issue informed employees of Employee Budget Summits scheduled as follows.

4/13/09 at 10:00 a.m. – South Police Station  
4/14/09 at 3:30 p.m. – Ott Cribbs Patrol Briefing Room  
4/15/09 at 2:30 p.m. – Council Chambers  
4/27/09 at 2:00 p.m. – Fire Training Center  
4/28/09 at 9:00 a.m. – Council Chambers

Within the June 2009 issue, the City Manager informed employees of an \$11.1 million shortfall, revenue projections, and a three-pronged approach to balancing the budget (service reductions, one-time revenues and compensation and benefit reductions). The City Manager also stated that a framework for balancing the Fiscal Year 2010 budget would be presented to the City Council on Tuesday, June 9<sup>th</sup>. The City Manager concluded by stating that "as the process continues through the summer of finalizing the budget, we on the management team hope to hear from you...."

Conducting a comprehensive employee survey was not part of the Fiscal Year 2010 budget process. However, after being recommended by the Mayor and City Council, an Employee Opinion Survey was made available to employees from August 6<sup>th</sup> through noon of August 10, 2009 – after the June 9<sup>th</sup>, June 23<sup>rd</sup>, and August 4<sup>th</sup> budget presentations to the Mayor and City Council. There were a total of 986 respondents (approximately 40% of the City workforce).

As shown in the following chart, survey respondents preferred non-retiree sick leave pay-out, sick leave sell-back and reducing or suspending the TMRS COLA/USC as the top three cuts. There was no clear fourth cut selected by respondents. However, stability pay, 401(k) match, a pay cut and furloughs were chosen as the fifth, sixth and last options, respectively. It should be noted that survey responses did not take into consideration the dollar impact of each budget balancing option.

Budget Balancing Option	Employee Responses		
	EthicsPoint	Employee Task Force	Employee Opinion Survey
Sick Leave Pay-Out *	0	Not Applicable	1 <sup>st</sup> -- 39.4%
Sick Leave Sellback *	4	Not Applicable	2 <sup>nd</sup> -- 35.8%
COLA/USC *	1	Not Applicable	3 <sup>rd</sup> -- 19.2%
Stability Pay *	0	Not Applicable	5 <sup>th</sup> -- 24.1%
401(k) *	2	Not Applicable	6 <sup>th</sup> -- 22.0%
1% Pay Cut *	0	Not Applicable	Last -- 27.5%
Unpaid Furlough *	19	Not Applicable	Last -- 20.1%
Reduced Work Week	10	Not Applicable	Not Applicable
Gas Funds	7	Not Applicable	Not Applicable
Early Retirement	4	Not Applicable	Not Applicable
No Change to Sick Leave/Vacation Sellback	5	Not Applicable	Not Applicable
No Change to COLA	1	Not Applicable	Not Applicable
No Change to Stability	1	Not Applicable	Not Applicable
Miscellaneous/Other †	109	Not Applicable	Not Applicable

\* Options provided to employees via the Employee Opinion Survey

† Included suggestions such as reducing outside consultants, controlled office thermostats, use of solar power, etc. No more than five EthicsPoint reports were received on any given suggestion.

The Budget Summits and EthicsPoint were both valuable communication tools. The Employee Budget Summits allowed employees to voice their concerns and gave employees an opportunity to hear about the City's financial position and future projections. However, employee feedback may have been limited to employees who were comfortable speaking in an open setting and/or did not fear retribution. EthicsPoint provided employees an opportunity to anonymously make suggestions. However, due to the anonymity factor, there was no control to help ensure that employees did not file multiple reports. Also, employees did not prioritize their suggestions, and management had to manually tabulate responses received. The Employee Survey resulted in the most participation by City employees, and appeared to be the quickest way to obtain quantifiable feedback that could be summarized and reported to management, the legislative body and employees. However, due to the limited time that staff was allowed to develop and conduct the survey, significant issues such as the dollar impact of each budget balancing option was not included. The City Auditor's Office concluded that the employee survey should have been included as an additional method to obtain employee feedback. Planning an employee survey as a part of the budgetary process allows staff more time to create survey questions and thus incorporate significant issues that would impact employee feedback regarding proposed budget strategies.

***Recommendation:***

The City Manager should consider including employee opinion surveys as a part of the budgetary process.

***Management's Response:***

*Do Not Concur. Management indicated that they have begun implementing a more exhaustive plan to communicate with employees on the FY 2011 budget.*

## ADOPTION

In the process of developing a recommended budget, City management solicits input from the Mayor and City Council. This input is used to prepare a proposed budget for City Council adoption. After reviewing the Fiscal Year 2010 budget process, the City Auditor's Office concluded that there is a need for increased communication between City management and City Council.

### **12. City management proposed transfers without establishing and communicating the methodology used to determine that sufficient reserves existed.**

As noted in finding #3, specific written policies and procedures guiding the use of internal service fund reserves do not exist. Therefore, sound business practices would appear to dictate that the use of any reserves should be in accordance with the stated purpose of the internal service fund. For example, expenditures from the Health Insurance Fund should be used to pay health claims, administrative fees, costs related to the wellness program and other expenses directly related to the management of the employee's health benefit programs.

In addition, federal grant guidelines establish specific requirements for billed central services when there is a difference between the revenue generated by each billed service and the actual allowable costs. The March 2009 OMB Circular A-133 Compliance Supplement suggests that refunds, credits and adjustments to future billing rates should be utilized to equitably allocate any "excess" fund balance.

City management initiated equity transfers from internal service fund reserves without a methodology to calculate the amount of required reserves. Management also did not present sufficient detail regarding the transfers that may have led City Council to ask additional questions related to the nature of the transfers. If operating transfers from internal service funds are not made in accordance with established policies and procedures, it may lead to an undesired impact on the amount of reserves needed to adequately fund intended operations. Management has not established specific policies and procedures to guide the use of reserves in internal service funds.

City management has periodically budgeted operating transfers to the General Fund from the Health Insurance, Workers' Compensation, Fleet Services and Knowledge Services (previously General Services) Funds. When budgeted, City management has generally identified "excess" funds in the associated internal service fund that could be transferred to the General Fund. The following schedule shows the budgeted and actual amounts transferred to the General Fund over the past several years.

Internal Service Fund Operating Transfers FY 2008 - FY 2010						
Internal Service Fund	2008		2009		2010	
	Budgeted	Actual	Budgeted	Actual	Budgeted	Actual
Workers' Compensation	\$ 2,000,000	\$ 2,000,000	\$ 2,000,000	\$ 2,000,000	\$ -	-
Health Insurance	1,800,000	1,800,000	700,000	-	-	-
Fleet Services	-	-	500,000	500,000	-	-
Knowledge Services	-	-	150,000	-	-	-
Total	\$ 3,800,000	\$ 3,800,000	\$ 3,350,000	\$ 2,500,000	\$ -	\$ -

Source: Lawson Financial System

As shown above, in Fiscal Year 2009, budgeted transfers from the Health Insurance and Knowledge Services Funds were processed in October 2008. Subsequently, journal vouchers were prepared in December 2009 and November 2009, respectively, to reverse the transfers. According to OMB management, the transfers (totaling \$850,000) were reversed because it was subsequently determined that the funds were not needed. OMB management stated that they would communicate the transfer reversals to the Mayor and City Council when presenting the Fiscal Year 2009 CAFR.

The City Auditor's Office noted that an outside consultant identified specific reserve requirements for the Health Insurance fund in April 2009. As a result, no transfers from the Health Insurance Fund were planned for Fiscal Year 2010, as it was expected that the 2009 ending fund balance would not exceed the calculated reserves. When the Fiscal Year 2009 transfers were processed from the Health Insurance Fund, management had not established a specific reserve requirement nor had a reserve requirement been calculated by an outside consultant.

The City Auditor's Office noted that the General Fund accounts for approximately 85% of the contributions to the Health Insurance Fund. As a result, 85% of any "excess" fund balance can generally be attributed to the General Fund. The remaining amount is attributed to the Water Utilities Fund, various grant funds, other special revenue funds and employee contributions. Therefore, any transfers out of the fund for non-health insurance related items will increase the need for future employee contributions.

Funds and employees that contributed to the "excess" fund balance in internal service funds did not receive refunds or adjustments to internal service fund charges. Non-general funds that contributed to the "excess" fund balance did not receive their allocable share of the "excess". According to federal grant guidelines, "excess" fund balances in internal service funds indicates that the grant was overcharged for internal services. This could lead to questioned costs or a reduction in future grant opportunities, if the non-compliance was considered material by the granting agency.

***Recommendation:***

The City Manager should ensure that operating transfers from internal service funds are made in accordance with established policies and procedures.

***Management's Response:***

*Concur. Although management concurred with the recommendation, they disagreed with the finding. Please see management's complete response attached to this report.*

***Recommendation:***

The City Manager should consider establishing a policy that requires that any "excess" fund balances in internal service funds be distributed equitably to the original source.

***Management's Response:***

*Concur. Management concurred with this recommendation as related to returning grant funds.*

*Target Date: As transfers are initiated*  
*Responsibility: Mike Finley, Assistant Director of FMR*

## EXECUTION

Execution includes the controls used by the City to ensure that departments expend within authorized appropriations. It also includes the systems and reports utilized to monitor and communicate budgetary performance. The City Auditor's Office noted that management could more clearly communicate the results of budget monitoring, including providing updates on previously presented budget balancing strategies.

### **13. An interfund transfer was performed which violated standard City practice.**

FMR management stated that because appropriations are approved at the fund level, it is a City practice not to allow interfund budgetary transfers. Therefore, a fund with unspent appropriations may not transfer budgeted amounts to another fund.

GASB-34 states that interfund transfers are a type of nonreciprocal transaction that represents interfund activities whereby the two parties to the events do not receive equivalent cash, goods, or services. Governmental funds should report transfers of this nature in their fund operating statements as other financing uses and other financing sources of funds. Proprietary funds should report this type of transfer in their activity statements after non-operating revenues and expenses.

FMR processed a \$75,000 journal voucher on October 29, 2009 to transfer funds from the General Fund to the IT (internal service) Fund. Rather than use accounts established to record interfund transfers, FMR coded the transaction to an expense account in the General Fund and a revenue account in the internal service fund. Because no goods or services were exchanged between the two funds, governmental GAAP requires that this transaction be recorded as an equity transfer, not as an expenditure and revenue.

The City plans to acquire professional services through Lawson to install and set up the Strategic Sourcing module, which is expected to be a labor saving technology improvement. FMR stated that they held a Purchasing Agent position vacant during fiscal years 2009 and 2010 in order to purchase the module. The total cost is estimated at \$150,000. Per the IT Department, only Lawson is certified to install the software.

Although FMR stated that the source of the funding was vacancy savings from a Purchasing Agent position, FMR actually processed a budget transfer in June 2009 to transfer \$55,643 associated with the eliminated Government Affairs Officer position to the Purchasing Division. The remaining \$19,357 came from the Executive and Legislative Support accounting unit.

Comments received from other departments during the audit indicated that if the procurement was department-specific, that department would not transfer money to the IT Fund. Instead, the purchase would be made from a budgeted line item. For comparative purposes, if the Strategic Sourcing Module procurement were to cost \$150,000, FMR's Fiscal Year 2010 budget would only be impacted by \$75,000 -- the difference between the amount of the Strategic Sourcing Module procurement (\$150,000) and the amount transferred to the IT Fund in Fiscal Year 2009 (\$75,000). The impact to other departmental budgets would be the entire \$150,000. FMR

processed this transaction in order to transfer General Fund vacancy savings from Fiscal Year 2009 to the Information Technology Fund, although that is not in compliance with stated policy.

The \$75,000 “expenditure” transferred unspent 2009 funds from the General Fund to the IT (internal service) Fund, resulting in the IT Fund having an additional \$75,000 in unrestricted, unreserved fund balance. However, it was not until this audit that IT management was aware of this additional available fund balance. Since the \$75,000 should have been recorded as a transfer, this transaction resulted in a \$75K overstatement of General Fund expenditures, with a corresponding understatement of operating transfers out.

***Recommendation:***

The City Manager should require that FMR employees process transactions in accordance with established policies and procedures.

***Management’s Response:***

*Concur. Management concurred with the recommendation, but not the finding. Please see management’s complete response attached to this report.*

***Recommendation:***

The City Manager should ensure that nonreciprocal transactions between funds are reported in accordance with governmental generally accepted accounting principles.

***Management’s Response:***

*Concur. Management concurs with the recommendation but stated that no violation of practice or policy occurred. Management believes that the finding and recommendations are partially inaccurate and misleading. Please see management’s complete response attached to this report.*

**14. Fund transfers were not properly communicated to the IT Department.**

Whenever there is the intent to transfer funds, it is good business practice to communicate such intent to individuals who are responsible for providing services that are accounted for within the receiving fund. Such communication should take place prior to the funds being transferred.

- In Fiscal Year 2010, OMB allocated an additional \$504,000 to total charge-backs recommended by the IT Department. IT’s recommended charge-backs were increased by approximately \$433,000 to fund an increase in the Lawson/Kronos software maintenance, the E-Discovery and records retention project and the public safety network/infrastructure redesign project. Although IT was aware that the aforementioned projects were approved by the City Manager’s Office, IT was not required to allocate the monies to user departments. OMB allocated the monies as IT charge-backs, but did not notify IT.
- In October 2009, as a Fiscal Year 2009 closing entry, a \$75,000 transfer was made from the General Fund to the IT Fund without being discussed or brought to the attention of the IT

Department. The IT Department was aware of the planned procurement. However, IT was under the impression that the procurement would be made from the department's line item budget. IT's conclusion was that FMR's request to fund the Strategic Sourcing Module from the General Fund was denied by the City Manager's Office. FMR management indicated that the Strategic Sourcing Module budget issue was denied because FMR knew that they could pay it from the IT Fund. FMR felt that funding was available from one of two ways: 1) IT had available appropriations (because they were under spending in other areas) and cash or 2) FMR could lower its expense in the IT Fund account code and then purchase the module from the Purchasing accounting unit.

If a transfer that IT was not aware of had been made that increased the IT Fund's fund balance, the IT Department may presume that the fund balance is available for them to use as they deem necessary, provided CMO approval is obtained.

***Recommendation:***

The City Manager should require that fund owners be notified when FMR initiates transactions that impact their fund.

***Management's Response:***

*Concur. Management concurs with the recommendation, but indicates that fund transfers were properly communicated to the IT department. Please see management's complete response attached to this report.*

*Target Date: Ongoing*  
*Responsibility: Mike Finley, Assistant Director OMB Treasury*

***Audit Comment:***

During audit fieldwork, the IT Department indicated that they were not aware of the \$75K transfer.

**15. The budget is not adjusted to be consistent with revised expectations.**

As noted by NASCLB best practices (Practice 11.2), a government should evaluate its financial performance relative to the adopted budget. Regular monitoring of budgetary performance provides an early warning of potential problems and gives decision makers time to consider actions that may be needed. Best practices (Practice 12.1) also dictate that the budget should be adjusted during the budget period should unforeseen events require changes to the original budget.

Governments should have procedures in place to determine when deviations from the budget plan merit adjustments to the budget. Budget adjustments, whether to programs or to revenues and expenditures, should be made as appropriate so that the budget is consistent with revised expectations. Final changes to the budget should be reported. Guidance states that the timing and manner in which this is done depends on the stakeholder group and the level of materiality of the changes.

Although the City evaluates its financial performance relative to the adopted budget, it does not have procedures in place to determine when deviations from the budget merit adjustments to the budget, as presented in the City's financial reporting system and GovMax.

At the City of Arlington, budget amendments (the formal process of legally changing the authorized appropriation by ordinance) result in budget adjustments that are reflected in the City's budgetary reports that are used for periodic monitoring. If the budget is not legally changed (amended), then adjustments are not recorded in the budgetary system and monitoring reports will document the original adopted budget.

The City adjusts the budget as a result of ordinances that amend the General Fund operating budget. For example, in Fiscal Year 2008, the budget was adjusted to reflect Ordinance 08-034, an ordinance amending the operating budget for the City of Arlington, Texas for Fiscal Year 2008. The ordinance increased the General Fund appropriation by \$1.4 million, mainly for the cost of hiring 13 additional police officers and to remodel City Hall. As a result of the ordinance, the adopted budget was amended and subsequent budget monitoring reports were based on the amended budget.

In Fiscal Year 2009, significant economic downturn resulted in the City implementing program reductions. The Mayor and City Council approved a resolution authorizing a reduction in positions. The reductions were expected to result in a \$1.4 million impact to the General Fund, spread across numerous departments. City management communicated an expectation to department directors that the "revised" 2009 budget incorporated these program reductions. Although these reductions could be considered significant, the budget was not amended (or adjusted) to reflect the revised expectations. As noted by FMR management, because the Fiscal Year 2009 budget was not amended, the original adopted budget was still the legal appropriation. Management noted that the "history" of the revised expectations would be identified by the variances between the original adopted budget and actual expenditures.

To support its compliance with best practice 12.1, the Office of Management and Budget provided the City Auditor's Office with procedures on how to do a budget transfer and Ordinance 08-034, provided as an example of adjusting the budget. No specific policies or procedures exist that indicate that the budget should be adjusted for significant deviations from expectations. However, if the budget is not adjusted to be consistent with revised expectations, the ability to monitor the budget effectively on an on-going basis is reduced. External systems or spreadsheets must be used to monitor and review performance. As a result, additional time is necessary to perform monitoring activities and an increased risk of error is introduced. In addition, stakeholders (council members, citizens, auditors) with access to budget reports may not be aware of adjustments necessary to see the revised expectations.

If the budget is not adjusted to reflect revised expectations, inconsistent budget transfers could occur. For example, one of the Fiscal Year 2009 program reductions was an elimination of the vacant Government Affairs Officer position, with a corresponding outsourcing of monitoring and legislative liaison activities. The expected net savings for eliminating the position in 2009 was reported in the first quarter 2009 BAR as \$54,142. The following schedule documents the

budget for the Intergovernmental Relations accounting unit at various points during Fiscal Year 2009.

<b>Intergovernmental Relations Fiscal Year 2009 Budget</b>					
<b>Description</b>	<b>Adopted Budget (Z200, 10/31/08)</b>	<b>Revised Budget (Z200, 3/31/09)</b>	<b>Final Adjusted Budget (Z200, 9/30/09)</b>	<b>Actual Expenditures (Z200, 9/30/09)</b>	<b>Variance c - d</b>
	<b>a</b>	<b>b</b>	<b>c</b>	<b>d</b>	<b>c - d</b>
Salaries	\$ 73,265	\$ 38,265	\$ -	\$ -	\$ -
Fringe Benefit	17,378	17,378	-	-	-
Services and Supplies	169,523	204,523	204,523	191,253	13,270
Travel and Training	13,566	13,566	13,566	10,636	2,930
<b>Total Budget</b>	<b>\$ 273,732</b>	<b>\$ 273,732</b>	<b>\$ 218,089</b>	<b>\$ 201,889</b>	<b>\$ 16,200</b>

Source: Z200 reports from Financial Services website

The Financial and Management Resources Department initiated and processed a budget transfer to move \$35,000 from the salary line item to the special services line item to reflect the revised expectation that the City would use a professional consultant instead of a full-time employee (columns a & b above). Although the position was eliminated, FMR did not reduce the budget for the Intergovernmental Relations accounting unit by the expected savings. Subsequently, although the position was already eliminated, FMR transferred the remaining salaries and benefits of \$55,643 (\$38,265 + \$17,378) from the Intergovernmental Relations accounting unit to the Purchasing Division accounting unit. As a result, the ending fiscal year budgetary reports indicated that the accounting unit was \$16,200 under budget as shown in the chart above.

Actual expenditures for the accounting unit were within revised expectations, but published budget reports did not indicate that the City “saved” the \$54,142 as expected. Although FMR management stated that the history of transactions would be detailed in the variance reports, the ending Fiscal Year 2009 budgetary reports do not accurately reflect the savings resulting from the elimination of the Government Affairs Officer. The following chart indicates how the final Fiscal Year 2009 budget statement should have appeared for the Intergovernmental Relations accounting unit.

<b>Intergovernmental Relations FY 2009 Budget to Actual</b>			
<b>Description</b>	<b>Final Adjusted Budget</b>	<b>Actual Expenditures</b>	<b>Variance</b>
Salaries	\$ 38,265	\$ -	\$ 38,265
Fringe Benefit	17,378	-	17,378
Services and Supplies	204,523	191,253	13,270
Travel and Training	13,566	10,636	2,930
<b>Total Budget</b>	<b>\$ 273,732</b>	<b>\$ 201,889</b>	<b>\$ 71,843</b>

Source: Auditor-prepared

The above chart indicates that the expected \$54,142 in savings is included in the \$71,843 variance between budgeted and actual expenditures.

***Recommendation:***

The Director of Financial and Management Resources should consider establishing a practice of adjusting the budget to be consistent with revised expectations.

***Management's Response:***

*Do Not Concur. Management indicated that they comply with both practices referenced in the finding. The response also states that budget adjustments may be administrative or legislative depending on the government's procedures and on statutory requirements. Management stated that the budget reductions that occurred after the 1<sup>st</sup> Quarter Budget Analysis Report (BAR) in FY 2009 were communicated to department directors in a March 2009 memo from the City Manager. Please see management's complete response attached to this report.*

***Audit Comment:***

The audit recommendation was to adjust the budget for revised expectations *as reflected in the City's financial reporting system and GovMax*. Such an administrative adjustment would not result in the abandonment of the adopted budget, but it would increase accountability by presenting significant revised expectations in the systems used to monitor and report budget progress.

**16. City management does not routinely provide updates or status reports on the impact of previously presented and approved budget balancing strategies.**

GFOA best practices (Principle 9.5) suggest that a key component of the budget process is determining whether a package of revenue and expenditure options being considered will maintain, erode or improve a government's financial position in the budget period and longer term.

Principle 12.2 (Adjust Policies, Plans, Programs, and Management Strategies) states:

*"Adjustments should be based on findings obtained from monitoring and assessing program and financial results, stakeholder input, and external circumstances. Regular briefings to senior program officers, management, and elected officials on the contents of the reports permit timely adjustments as needed to the plan or program activities."*

In order to fully adopt these principles, best practices suggest that periodic analysis of significant revenue or expenditure options (including those previously implemented) should be performed and results communicated to elected officials.

The City does not routinely provide updates or status reports on the impact of significant budget options, whether presented as a part of the annual budget process, ongoing budget monitoring and review, or internal or external analysis.

The City monitors budgetary performance through the quarterly BAR process. Results of these reviews are presented to the City Council as part of the subsequent year's budget process. In some cases, significant deviations from original expectations are specifically disclosed in the BAR report. For example, the first quarter 2010 BAR indicates that the animal licensing initiative has not been implemented as quickly as assumed in the Fiscal Year 2010 Budget. However, specific details, including the dollar impact, are not included in narrative form in the BAR.

During the Fiscal Year 2010 budget process, the City Manager recommended over \$7 million in budget balancing strategies. Most city departments were represented on the list of strategies. There were 13 strategies that had an expected impact of more than \$100,000 each. Many of the strategies involved salaries only (two Fire clinical coordinator positions, two Community Services employees, etc.), with a corresponding decrease to personnel costs in the Fiscal Year 2010 budget. This type of reduction would appear to pose limited risk of not meeting future expectations and therefore would not require follow-up. Other strategies involve outsourcing or insourcing operations with expected cost savings that could depend on multiple factors. The true impact of these strategies may or may not result in meeting the original expectations due to changing economic conditions, legislation, mandates, weather, etc. Communicating the status of significant budget balancing strategies to elected officials and other stakeholders would allow them to make timely adjustments as needed to the budget or program activities based on the most current relevant information.

The City Auditor's Office did not perform a detail review of all budget balancing strategies. However, during the course of fieldwork, the City Auditor's Office noted several specific examples that demonstrate the need for consistency and standards related to how revised expectations should be presented in budget documents and that the status of significant budget balancing strategies should be communicated to City Council.

### 1. Outsourcing Animal Services License Revenue

Although expected to save approximately \$192,000 (by increasing the initially budgeted license revenue) in Fiscal Year 2010, the City Auditor's Office noted that the savings amount presented in the Fiscal Year 2010 proposed budget balancing strategies list was incorrectly calculated. The revised budget for the account should have been increased *to* \$192,000, not *by* \$192,000. As a result, the budget was overstated by \$60,000, the initial budgeted amount. In addition, as noted in the 1<sup>st</sup> quarter 2010 BAR, delays in implementing the program further reduced the expected benefits, resulting in a Fiscal Year 2010 revenue estimate of \$111,479. Although this variance is documented in the 1<sup>st</sup> quarter BAR, the reason for the \$140,000 variance is not specifically explained, other than stating that the implementation was not performed as quickly as expected.

### 2. Outsourcing of the Risk Management Function

During Fiscal Year 2009, a decision was made to outsource the risk management function. Although salary savings (approximately \$140,000) were expected from terminating two employees, this was off-set by increased contract service expense. During the Fiscal Year 2010 budget process, City management approved a \$70,000 Budget Issue to fund outsourcing of risk functions, including claims, subrogation, and safety. This is in-line with the reported expected savings, as the Fiscal Year 2010 budget for the division was \$72,000 less than the previous year. Review of budgetary reports through February 2010 indicated that none of the \$70,000 had been expended in the accounting unit established for risk management. According to Workforce Services management, expenditures related to a new contract for third party administration of the risk management function had not yet been recorded in the Risk Management accounting unit. This example illustrates that expected savings can be identified in the budget for some divisions/departments. However, a status report would be helpful to document that the expected benefits of outsourcing were achieved.

### 3. Outsourcing of Health Inspectors

Also during Fiscal Year 2009, a decision was made to outsource food-based health inspections, which resulted in the elimination of five Environmental Health Specialists. In March 2009, budget documents indicated that the Fiscal Year 2009 budget for the Environmental Health accounting unit was \$449K, a decrease of \$111K from the start of the fiscal year. During the Fiscal Year 2010 budget process, additional funds were requested to fund the projected number of inspections considered necessary to meet state minimum regulations. The City Manager's Office did not approve the request. The City Auditor's Office noted that Fiscal Year 2010 contract expenditures (through February 2010) are within the budgeted amounts. Contract expenditures for inspections in 2009 were approximately \$200,000 for seven months, while the total Fiscal Year 2010 budget for contract services for the Environmental Health accounting unit is only \$207,836. Although the City Auditor's Office did not perform a detailed review of the outsourcing, it appears possible that the expected results are not being obtained, or that service levels have decreased from Fiscal Year 2009 levels.

#### 4. Outsourcing of the Accounts Payable Function

City management projected to save approximately \$90,000 over a five-year period from outsourcing the accounts payable function. The 2010 budget did not include any specific reductions for the expected outsourcing, as none were expected in the first year. The 2010 budget also did not incorporate any specific changes related to the outsourcing, such as a reduction in salaries expense and an increase in contract services expense. This seems reasonable due to the timing of the approval of the arrangement, which may have been too late to record the expected impact in the Fiscal Year 2010 budget. However, the contract for outsourcing the accounts payable function included \$60,000 in transition fees (some of which were paid in Fiscal Year 2009), which would have required additional funding. Transparency and accountability would be improved if City Council received an update on the status of this cost saving measure and management verifies that the intended benefit is properly reflected and disclosed in the Fiscal Year 2011 budget.

Without obtaining balancing strategy updates, decision makers may not have a thorough understanding of the financial implications of revenue and spending options, including the ability of the government to sustain programs or services in the long run. Failure to disclose and discuss the positive and negative results of budget balancing strategies results in less transparency and accountability. City management has not previously seen a need to disclose the evaluation of budgetary balancing strategies but has recently recognized a need for increased communication with City Council.

#### ***Recommendation:***

The City Manager should create and maintain a listing of significant budget balancing strategies based on City Council input and should provide periodic updates on the effectiveness of those strategies.

#### ***Management's Response:***

*Concur. Management concurs with the recommendation but not the finding. Management's response indicates that they report significant unexpected and unplanned costs to the City Council. The response further indicates that current practice allows the City Council to direct the City Manager to report on the status of any item previously presented to the Council. Please see management's complete response attached to this report.*

#### **17. The City does not adequately communicate detail results of budget monitoring to stakeholders.**

As noted by GFOA best practices (Practice 11.2), a government should evaluate its financial performance relative to the adopted budget. GFOA states that "Consistency and timeliness are particularly important when implementing this practice: it is essential that reports are prepared on a routine, widely-publicized basis. In addition to monitoring budget-to-actual results, reasons for deviations should be evaluated."

The City evaluates its financial performance relative to the adopted budget on a periodic basis and presents the results of those evaluations in quarterly Budget Analysis Reports (BAR). However, it does not have procedures in place to widely publicize the BAR to stakeholders. In addition, the City Auditor's Office noted that significant deviations and adjustments to the adopted budget are not communicated in the BAR.

As noted earlier, significant economic downturn resulted in the City implementing program reductions in Fiscal Year 2009. These reductions resulted in a \$1.4 million impact to the General Fund. This was communicated in the Fiscal Year 2009 first quarter BAR, with the notation that General Fund expenditures were projected to be under budget by \$1,408,117. The BAR further stated that the reduction was primarily attributable to the \$1,433,347 in budget reductions that were presented to the City Council in February, 2009. Although incorporated in the estimated expenditure amounts presented in the BAR, the list of reductions was not included. Also not presented in the BAR was a separate list of \$1.15 million in expenditure reductions identified by departments. These include savings due to delaying a police academy, reducing part-time and hourly wages at Municipal Court (resulting in reduced operating hours) and moving some supply expenditures to the Street Maintenance Fund. Although the financial impact of these changes was communicated to Council and incorporated in the BAR, they were not explained in the BAR.

Transparency would increase if all significant changes were incorporated and widely published in the BAR. One way to widely publicize the BAR is to include it on the City's website. The proposed and adopted budgets include estimated and actual expenditures for the third and fourth quarters, respectively. According to OMB management, the City intends to publish the Fiscal Year 2010 first quarter BAR on the City's website. If results of budget monitoring are not adequately communicated to stakeholders, sufficient information may not be available to assess the significance of variations and to determine if they are expected to be temporary or longer-term in duration.

***Recommendation:***

The Director of Financial and Management Resources should ensure that detailed results of periodic budget monitoring are publicized widely and that BARs include detail on significant deviations.

***Management's Response:***

*Partially Concur. Management states in their response that the current process achieves the recommendation. Management noted that the FY 2010 1<sup>st</sup> Quarter BAR is available on the City's website.*

## TRANSPARENCY

The City Manager informed readers of the FY2010 Budget that the budget was presented at a time of unprecedented financial uncertainty. During times of “unprecedented financial uncertainty,” the need for more information and transparency is necessary to promote public trust and establish accountability. The City Auditor’s Office concluded that there should be more transparency related to savings that result from vacant positions.

### **18. Vacancy reports provided to the Mayor and City Council do not provide information regarding salary savings.**

NACSLB’s Practice 10.1.d states that “... a government shall make available sufficient information about its operations so that the interested stakeholder has an understanding of the programs and services provided, can identify goals and priorities of each program, and can place resource needs for those programs and services into an appropriate context...”.

OMB prepares vacancy reports at the end of each pay period, and provides those reports to the Mayor and City Council on a routine basis. The vacancy reports include the names of departments, divisions, positions, number of pay-periods and months the positions were vacant. The vacancy reports provided to the Mayor and City Council include no salary information. OMB prepares another report that includes vacancies, overfills and associated salaries. This report is not presented to the Mayor and City Council. Instead, OMB uses the report to monitor overall salary expense.

The Mayor and City Council are not provided pertinent information that could impact their decision regarding budgetary matters at the City of Arlington. The City Auditor’s Office concluded that neither of the vacancy reports prepared by OMB disclosed actual vacancy savings. For example, we noted one incident where a vacant Accounts Payable Clerk position was loaned the Public Works Department until grant funding became available in January. FMR indicated that the Public Works Department needed a position, had available funds, but had no additional authorized positions. Per FMR, the vacant Accounts Payable Clerk position was purposely held vacant due to the accounts payable outsourcing arrangement. However, since the transition to the outsourcing vendor is substantially complete, the vacant Accounts Payable Clerk position would be eliminated by the March 31<sup>st</sup> position change cut-off date discussed in Finding #6. In this one incident, since the Public Works Department was required to use a budgeted line item (later reimbursed by the granting agency) to fund the loaned position, FMR recognized a savings because they were not paying the salary associated with the vacant Accounts Payable Clerk position. Under the current vacancy reporting process, the loaned position would not appear on the vacancy report and associated savings would not be disclosed.

Vacancy savings are not necessarily equivalent to the salaries associated with vacant positions. True vacancy savings have to take into account salaries associated with vacant positions, reduced by the amount paid for contract, temporary and/or overtime labor. OMB management stated that reports provided to the Mayor and City Council are not intended to be vacancy savings reports, but are only intended to report the number of vacancies, as requested by the Mayor and City Council. Disclosing total vacancy savings could also help the Mayor and Council assess how

those savings are being used to address programs/services that otherwise would not have been funded.

The City does not restrict the use of funds made available due to personnel vacancies. After a department has reached its vacancy savings target, vacancy savings can be used to offset personnel and/or non-personnel expenditures.

***Recommendation:***

The City Manager should require that OMB prepare a vacancy savings report, by department, on at least a monthly basis. OMB should present the report to the Mayor and City Council on a routine basis and/or as requested.

***Management's Response:***

*Concur. Financial and Management Resources provides a vacancy report to the City Council. It will be augmented to add a list of savings for each vacant position.*

*Target Date: June 2010*

*Responsibility: Mike Finley, Assistant Director FMR*

During the review of position reclassifications, trades and promotions, the City Auditor's Office noted that management did not comply with the City's personnel policies when hiring a Financial Consultant. The City signed a six-month employment offer at a salary of \$8,300 every two weeks beginning in early December and ending June 30<sup>th</sup>. The official offer of employment indicated that in addition to the regular job duties outlined in the Financial Consultant's job description, the Financial Consultant would be asked to perform projects noted in the following chart.

**Key Projects  
Per Employment Offer Letter**

- Review of existing processes, procedures and controls in the Finance Division
- Development of a three-year strategic plan for the Finance Division
- Training for managers on overseeing financial functions
- Assistance as a Treasury Manager acting as a liaison, for Finance, on major Economic Development projects
- Assistance in recruitment for the Treasury Manager, Purchasing Agent, and TIRZ Coordinator in the Finance Division
- Assistance in relationship development with our new Financial Advisory Consultant.

The Financial Consultant was hired as a full-time employee with benefits. Per section 102.02.A.5 of the Personnel Policy Manual, temporary employees are in a position for a specified length of time to perform work assignments of a limited nature. Such employees have definite starting and ending dates of employment, and the length of employment rather than number of hours worked is a distinguishing feature. Based on this referenced personnel policy, the City Auditor's Office concluded that the Financial Consultant should not have been classified as a full-time employee.

During audit fieldwork, the City Auditor's Office was unable to locate an approved job description for the Financial Consultant position in the Workforce Services personnel files. Subsequently, the FMR Director provided the City Auditor's Office with a job description signed by the FMR Director. However, Workforce Services staff was unaware that a job description for the Financial Consultant had been finalized.

The employment offer, signed by the Deputy City Manager and FMR Director, indicated that the position was eligible for the standard benefit package offered to all regular full-time employees. The Financial Consultant was paid medical and dental benefits, vacation pay, authorized leave with pay, paid holidays, retirement contributions and a cell phone allowance. City policy does

not allow benefits for temporary employees. FMR management stated that the department used vacancy savings to fund these expenditures.

Although classified as a full-time position, the new position was not subjected to a review by the City's Hay Committee, which determines compensation for full-time positions based on job requirements, skills and abilities. FMR initially classified the position as an Assistant Director which normally is assigned Hay levels ranging from 650 to 750, per Lawson human resource system records. The proposed salary for the Assistant Director position, as initially proposed, would have skewed Lawson analytical reports used for salary comparisons. As a result, the City's Workforce Services staff assigned the position a Hay level of 1801 based on the amount of salary offered.

After the six-month employment period, the Financial Consultant was retained to provide professional consulting services for a period of three weeks, at a cost of \$19,870. Although advanced payments to contractors are generally not recommended unless significant costs are incurred by the vendor while preparing to deliver goods or services, the consultant billed the City and was paid on the first day of his consulting duties. Management indicated that due to an inadvertent error, this agreement was not included on the quarterly listing of professional service contracts under \$25,000 that are presented to the Mayor and City Council.

***Management's Response:***

*Although the City Auditor's Office did not include any recommendations related to this finding, management provided a response. Management indicated that employees can be classified as temporary, full-time employees, and that policy does not prohibit benefit provisions for temporary employees. The response further states that the "non-traditional" hire was needed to help the City get through and develop a plan for one of the worst economic downturns in our nation's history. Please see management's complete response attached to this report.*

***Audit Comment:***

Management's response to this finding included a well-written analysis and justification for the hiring of a Financial Consultant for a specific need. The City Auditor's Office suggests that when extraordinary times require "non-traditional" approaches, such analysis and justification should be documented during the hiring process and retained.

Management stated that this audit finding is incorrect because 1) employees can be classified as temporary, full-time employees and 2) the policy does not prohibit benefit provisions for temporary employees. This indicates that clarification is necessary within the City's Personnel Policy Manual. While the Personnel Policy Manual does indicate that a temporary employee may be full-time or part-time, the Policy also states that all full-time employees in paid status are granted paid holiday leave, but temporary, seasonal and part-time employees will be paid at their regular rates on a holiday only if required to work. The Policy is unclear as to whether the "full time employees in paid status" is referring to regular full-time employees and/or temporary full-time employees. The Personnel Policy Manual also indicates that all full-time employees may be granted use of accrued paid vacation leave.

However, accrued vacation leave may not be taken during the first six (6) months of employment.

## Exhibit 1 – Fiscal Year 2010 Budget Calendar

Wed., April 1	Budget Kickoff
Fri., April 24	Base Budget Submission Due
Thurs., May 7	Business Plan Proposals (BPPs) due
Fri. – Tues., May 8 – 11	Analysts compile department information
Tues. – Fri, May 12 – 22	Departmental Budget Reviews with Deputy City Managers
Tues. – Fri, May 26 – June 19	Build Preliminary Budget
Tues., June 23	Preliminary Budget Framework Presentation to Council
Fri., July 24	Certified Roll available
Wed., July 29	City Manager’s Final Decisions
Tues., Aug. 4	FY10 Budget Presentation to City Council Submit Proposed Budget to City Secretary’s Office/Public on Website
Tues., Aug 11	City Service Team Presentations to Council
Tuesday, Aug. 18	Summary Budget Presentation to City Council
Thurs., Aug. 20	Public Notice for Public Hearing on the Budget Town Hall Meeting
Tues., Sept 1	Council Worksession on Budget
Thurs., Sept. 10	1st Reading of Budget 1st Reading of Tax Rate
Tues., Sept. 15	2nd Reading of Budget/Public Hearing 2nd Reading of Tax Rate
Wed., Sept. 16	Tax Rate to County

## Exhibit 2 – Vacancy Savings Calculator

Vacancy Savings Calculator (General Fund)						
<b>Vacancy Savings Target</b>				Instructions: Departments should only enter numbers in the blue highlighted areas.		
Vacant positions as of 10/1	Annual cost w/benefits	Payperiod cost w/benefits	Proposed Hiring Date	Cost of Hire		
Parttime and Hourly	5000	-		-	Will not use PT/Hourly staff	
		-		-		
		-		-		
		-		-		
		-		-		
Positions Vacant after 10/1	Termination Date	Annual Cost w/benefits	Partial year savings	Payperiod cost w/benefits	Proposed Hiring Date	Cost of Hire
Staff Auditor	N/A		1,989	-	N/A	-
additional vacancy			-	-		-
additional vacancy			-	-		-
additional vacancy			-	-		-
additional vacancy			-	-		-
additional vacancy			-	-		-
<b>Annual Vacancy Savings</b>				<b>Cost of Hiring Plan</b>		
Remainder Savings (must be positive number)				-		
<p>Note: If the remainder savings number above (in red) is negative, your department must identify non-personnel savings to offset filling a position. Each offset listed will improve the "remainder savings" number. As the year progresses if your department incurs additional vacancies this worksheet should be updated and submitted to the OMB.</p>						
<u>Supplies/Travel/Capital Savings:</u>						
Account	Description of Cut	Amount of cut	Impact Statement			
account number here						
account number here		-				
account number here		-				
account number here		-				
Total non-personnel savings		-				
Department Head Signature _____			Deputy City Manager Signature _____			

## *Management's Responses*

# City Manager's Office and Financial and Management Resources Audit Responses

## Introduction

On October 26, 2009, the City's Internal Audit Office began a six-month review of the City's budget process. Prior to responding to the audit recommendations, city management believes that some context and definition should be added to this report.

## Background

A budget is a plan for the City's resource distribution for the year. It is a policy document outlining how the City is going to accomplish the community's priorities with its people, money, and facilities. Unlike the City's Comprehensive Annual Financial Report and end of year audit, a budget is not a look back on or an accounting of specific transactions from the previous year. It is a plan for and an estimation of resource allocation in the future.

In any budget cycle, one will find variances related to revenues and expenditures throughout the year that reflect normal operational adjustments consistent with business initiatives and imperatives. This year, however, was anything but typical. Meeting the community's needs, in the face of recent economic challenges, required innovative and creative approaches. These business imperatives and the importance of management's judgment are critical components to consider when examining the City's budget and budget process.

Many of the suggestions in this audit appear to be transactional and technical in nature related to a subset of the funds in the City's Operating Budget. Consequently, many of the responses will appear technical in nature. However, if this is to be an overall view of the budget, it is incumbent on management to provide context and a view of the more strategic role the City's budget plays in the overall financial health of the City.

## **Budget's Contribution to the Financial Health of the Organization**

Maintaining the City's financial position over the last five years has been challenging. While faced with growing service delivery needs, the unstable economy has created significant issues for the City. The budget is the City's policy document related to resource allocation. With input from employees, citizens, and the City Council, the budget has played an integral role in the City's ability to deliver high quality services in as efficient and effective a manner as possible.

The work of the City's Office of Management and Budget (OMB) has a major role in maintaining Arlington's healthy financial position. Unlike some budget offices in the public sector, Arlington's OMB does not simply report the numbers and financial challenges to management. The staff takes an active role in identifying innovative solutions that make cash/resources available to meet the Council and community's priorities. Thanks to proactive, aggressive work by the budget team, the City Council, and our stakeholders, significant deficits between expenditures and revenues have been overcome in recent years, and balanced budgets have been achieved that meet Council priorities.

## **Roles In the Budget Process**

The City's budget has numerous stakeholders, all of whom play a part in its development and implementation. The City Council kicks off the City's budget development process each year by outlining the community's priorities in the spring. City staff then formulates a proposed budget for Council consideration that focuses on the community's priorities. Staff recommendations are considered and the City Manager formulates the proposed budget. By state law, in a City Manager form of government, the Manager is required to provide a proposed balanced budget for City Council consideration. It varies based on the community's needs and desires, as well as the local, state, and national economy.

As a creative process, the system is designed to be nimble within the confines of sound financial principles. The City Council and City Management agree on revenue estimates and expected expenditures. They decide on the type of information needed in the proposed budget for the Mayor and City Council to debate, discuss, and ultimately approve a budget for the City. City Management presents the budget, and then the Council and Management receive input from budget stakeholders. By September 30, the City Council approves the budget for the upcoming fiscal year. The Council approves positions and expenditures at the fund level (i.e. General Fund total expenditures, total position allocation). City Management is then charged with managing and administering City resources based on the policy guidelines approved in the budget by the City Council.

The audit makes several recommendations related to how City Management should do their jobs with regard to the budget and certain employee/position matters at the City. City Management's role relative to the budget is outlined in the City Charter. According to Article IX of the City's Charter the City Manager is to "prepare a budget annually, submit it to the governing body for approval, and be responsible for its administration following adoption. Keep the governing body advised of the financial condition, administrative activities and future needs of the City, and make such recommendations as may seem desirable." Also, the Charter states, "The governing body and each of its members shall hold the City Manager responsible for the proper administration of all affairs of the City, but neither the governing body nor any board or Commission created by it, nor any member thereof, shall dictate the appointment of any person to his removal from office or employment with the City, or in any manner interfere in the appointment of officers and employees in the departments of administrative service vested in the City Manager by this Charter." The audit mentions ambiguity about the "owner" of certain internal service funds, etc. While departments initially plan their budgets and present their ideas to the Manager's Office, CMO is the "owner" or ultimate responsible party for the resources outlined in the budget. While there are many inputs in the proposed budget process, and many may have opinions about individual management decisions made throughout the year, final decisions about the proposed budget to City Council are the City Manager's. Then the City is managed within the parameters authorized by the City Council when the budget is adopted.

Managing a community of almost 400,000 requires sound judgment and the freedom to respond to a variety of business imperatives. The City Manager and City staff make daily decisions about the most efficient and effective way to manage the organization, and often those decisions are made within a policy framework. However, management discretion must be employed. Otherwise staff would not be

able to react to the changing economy or changing dynamics in our community. By constraining certain decision points, Management is not able to use its best judgment to maximize the output of the City's fiscal resources.

### **City Budget Recognized for Quality**

The FY 2010 Budget was particularly challenging. As is obvious in the attached calendar, the FY 2010 budget process was the most comprehensive that the City has undertaken related to the budget in the last two decades. The amount of community input, employee input, and time spent by staff and the City Council on its preparation was extensive. It was a well-thought out plan that has allowed for the effective management of City resources this fiscal year.

The City of Arlington's Operating Budget has been recognized by the Government Finance Officers Association with the distinguished budget award for each of the last 25 years. This involves a peer review of the budget based on 27 criteria. Additionally, GFOA outlines 59 Best Practices for Municipal Budgeting, the City has followed them, and City Management is committed to them.

Prudent financial policies, as well as discipline and responsible decision-making, are key parts to the Arlington's budget processes. This has been recognized by bond rating agencies. The City saw bond rating improvements for both the Water Utility and the City's General Fund in 2008. Those ratings were maintained in 2009, and Arlington's budget practices were noted by the rating agencies.

"The Aa2 rating reflects the city's large tax base and solid reserve levels both within the general fund as well as those resources available in other funds. Additionally the rating reflects Moody's expectation that, despite the current economic conditions that are impacting the city a satisfactory financial position will be maintained through strong budget management." – Moody's 2009

The City now enjoys bond ratings of AA1 from Moody's and AA+ from Fitch. Higher ratings allow the City to save money when issuing debt, and provide a level of confidence among taxpayers that resources are being properly managed.

Finally, the budget process is often less precise than accounting. This is primarily because a budget is an estimate of and a judgment about certain assumptions into the future, while accounting is the recording of events and expenditures that have already occurred. However, it should be noted that every year, as a part of the external auditor's (Deloitte) review of the City's balance sheets, special attention is paid to the previous year's budget to ensure budget compliance. Variations from budget are outlined in the Management Discussion and Analysis in the CAFR. In the last several years, Arlington has had an unqualified or "clean" opinion from the external auditor about the budgeting of City's funds.

## **Other Information Related to the Executive Summary of the Audit**

The Audit Report has 18 findings, most related to either the absence of, or non-compliance with, established policies. There are, however, a number of critical areas to which a budget must conform to be a useful management tool.

- State Law
- Council Priorities
- Financial Principles
- Best Practices

### **State Law**

The report only mentions compliance with the state laws in passing. However, this is a very time consuming and important process, and not just for the budget. Financial and Management Resources Department (FMR) is also responsible for the Notice and Hearing (property tax calculation and reporting) components. Adopting a budget carries with it certain requirements on length of time the Council reviews it, notice of public hearing, public hearing, ordinance passage, and recording the budget with both the City Secretary and County Clerk. The process to adopt a tax rate is even more onerous.

### **Council Priorities**

Each year a retreat is held between January and March to brief the Council on budgetary issues facing the City, and to obtain Council direction on these priorities. Please see Attachment VI for the FY 2011 preparation manual, which contains the FY 2010 priorities. Increases in Police, Fire, and Code Enforcement as well as technology are substantial, as Council directed.

### **Financial Principles: Budget**

The City Council has adopted seven principles directly related to budget adoption and monitoring. They are as follows:

- The City shall prepare an Annual Operating Budget and submit it for City Council approval prior to September 30.
- The Annual Operating Budget shall be prepared such that current revenues plus net operating transfers will be sufficient to support current expenditures.
- Expenditures from all operating funds shall not exceed the budgeted appropriations (as amended) for these funds.
- An adequate level of maintenance and replacement will be funded each year to ensure that all capital facilities and equipment are properly maintained.
- Charges for services and other revenues will be annually examined and adjusted as deemed necessary to respond to cost increases or any other changing circumstances.
- A three-year financial forecast shall be prepared annually projecting revenues and expenditures for all operating funds. This forecast shall be used as a planning tool in developing the following year's operating budget.

- The City shall submit the Annual Operating Budget to the Government Finance Officers Association for the purpose of earning the Distinguished Budget Presentation Award.

#### Budget Approval by September 30

Complete. Please see Attachment VII, budget adoption ordinance.

#### Balanced Budget

Although the language may appear to leave some ambiguity, the OMB has historically used this as language to indicate a policy against utilizing one-time revenue to offset ongoing expenditures, as well as the need to present a balanced budget. This policy is rigorously adhered to. However, as a result of the challenging FY 2010 budget process, Council directed City Management to utilize reserves to balance the budget. While the action was inconsistent with adopted procedures, it demonstrates that the ability to maintain discretion is essential at various levels in the budget development process and implementation.

#### Maintenance Funding

In the numerous findings in the Audit report regarding lack of policies, the fact that the Operating Budget is itself a series of policies is overlooked. While funding for facilities and equipment and maintenance and replacement is not ideal, these items are considered every year when discussing the proposal and adoption of the budget. The funding included in the budget is, in the truest sense, the policy for that fiscal year.

#### Charges Examined

This written policy will be discussed in more detail relating to the finding that there is no written policy on this.

#### Financial Forecast

Complete. Please see pages 27 and 28 of Attachment VI, *Priority Setting Session*.

#### GFOA Distinguished Budget Award

Complete. We have received this for 26 years. Please see the score sheet and copy of award (Attachment VIII ). It should be noted that Mike Finley has been a Distinguished Budget Award reviewer for the last four years.

#### **Financial Principles: Reserves**

In addition, there are four reserve requirements stipulated in the Financial Principles:

- The City's working capital reserve in the General Fund shall be maintained at a minimum level of 8.33% (1/12<sup>th</sup>) of annual General Fund expenditures.

- The City's General Fund unreserved ending balance may only be used for one-time purchases such as capital equipment.
- The total General Fund balance shall be maintained at a minimum of 15% of annual General Fund expenditures.
- The fund balance in the debt service fund shall be maintained at a minimum level of 4.0% of annual debt service expenditures.

#### Working Capital Reserve

Because the City does not receive the major influx of *Ad Valorem* taxes until December, the first two months of the fiscal year are the lowest from a General Fund cash-flow perspective. In order to alleviate this, the City adopted a working capital reserve, which is stated to be one month worth of expenditures. The FY 2010 budget is \$194,621,571 (Page 60 of the FY 2010 operating budget, it is also several other places.) Multiplied by .0833 yields \$16,218,464 (Page 64 of FY 2010 Operating Budget, Page 22 of the CAFR). The reserve meets the requirement.

#### Ending Balance

The City has used General Fund, undesignated unreserved fund balance for one time employee payments and equipment, but we do not utilize this for ongoing expenditures.

#### Total General Fund Balance

The totals of the Working Capital, Unallocated, and Landfill reserves (Page 64 of FY 2010 Operating Budget, Page 22 of the CAFR) total \$42,044,111. This is 21.6% of the FY 2010 General Fund Operating budget of \$194,621,571. The Financial Principle requires 15%. The total reserves exceed the requirement.

#### Debt Service Fund Balance

The debt service fund balance is required to be 4% of the debt service payment. This payment for FY 2010 is \$39,986,927, therefore the fund balance is required to be \$1,599,477. The reserve exceeds this requirement.

Reserves are a crucial indicator of the City's financial health. Bond rating agency reviews indicate that the City has adequate reserves.

#### **Best Practices**

The National Advisory Council on State and Local Budgeting (NACSLB) in association with the GFOA developed the Best Practices in Public Budgeting. This is a comprehensive program designed to result in superior budget products. It contains four principles, and a total of 59 practices. FMR follows all 59 to the extent practical.

Binders containing specific information about the City's compliance with these practices have been provided to you under separate cover.

## Audit Response

**Finding 1.** Issues that influence the budget were not presented during the budget process.

### Recommendation

The City Manager should ensure that fee increases are presented as a part of the budget process.

**Response** - The City staff makes a concerted effort to bring these items forward in a unified package at budget time; however, that is not always possible for every fee. Issues such as changes in state law may drive fee increases outside the budget process.

The timing of new or revised fees is established by City ordinance, resolution, or contract; an example would be the City's Landfill Lease with Republic Waste Services, which stipulates certain adjustments to coincide with the lease year beginning May 1. Another example would be Municipal Court fines, which are set at the discretion of the Court Judiciary and subject to limits contained in applicable state laws.

The City Council directed staff to do an annual review of fees. This occurs during budget development, and throughout the year as needed.

*Already Done When Practical – Concur*

*Person Responsible – Mike Finley, Assistant Director FMR*

*Date – September 9, 2010*

### Recommendation

The City Manager should require a written policy regarding the establishment of new fees and charges and/or revisions to currently established fees and charges. The written policy should include, but not be limited to, how often fee analysis is conducted and when recommended fees should be presented to Council.

**Response** - The City has a written policy concerning the revision of fees. As stated in the City's Financial Principles, "Charges for services and other revenues will be annually examined and adjusted as deemed necessary to respond to cost increases or any other changing circumstances." (Adopted Financial Principles)

*There is already a written policy - Concur*

### Recommendation:

The City Manager should ensure that the Police Update is presented to the Mayor and City Council during the priority-setting process.

**Response** - Our Police Department is an integral and critical part of service delivery to the citizens of Arlington. Other departments such as Parks, Library, Fire, and Public Works also have significant investments of citizen resources, and the work they do impacts the quality of life of residents as well. In order to present a full view of all City services and their resource needs, each City Service Team presents their budgetary position and any new programs as a part of the presentation of the proposed budget to the City Council.

On August 11, 2009, management provided a presentation on the status of all department budgets, projects, and initiatives. Additionally, the Police Update noted in the Audit represented the FY 2009 year in review and thus coincided with the end of the fiscal year.

*All departments should be included in a status and budget update – Do not concur*

**Recommendation**

The City Manager should ensure that a revenue manual is prepared annually and includes information relating to future revenues.

**Response** - Management concurs that an annual revenue manual is desirable. The minimal changes that typically occur from one year to the next, have served to lessen the priority of an annual revenue manual. However, management will work diligently to prepare annual revenue manuals in the future.

*Concur*

*Person Responsible – April Nixon, CFO*

*Date- June 30, 2010*

**Finding 2.** Written policies need to be adopted relating to budget best practices.

**Recommendation**

The City Manager should ensure that written policies relating to the aforementioned best practices are prepared and formally adopted.

**Response** - The audit discusses four areas for which the City does not have written policies. Each of these is discussed below.

**1. Limiting the use of one-time revenues for ongoing or recurring expenditures.**

The City already has a written policy:

The City's Financial Principles state that, "The Annual Operating Budget shall be prepared such that *current revenues* plus net operating transfers will be sufficient to support *current expenditures*." (Adopted Financial Principles)

In addition, the City's Budget Glossary of Terms includes the following:

“Balanced Budget - As required by law\*, revenues and interfund transfers must equal or exceed expenditures for all funds. *Additionally, one-time funds cannot be used for recurring expenditures.*” (FY 2010 Adopted Budget, p. 335)

\* Texas Constitution, Article 11, Sec. 5

Because the ordinance adopting the annual operating budget states that the budget is “incorporated [into the ordinance] by reference as if copied verbatim”, these written statements have been formally adopted by the City Council.

## **2. Evaluating the appropriate use of unpredictable revenues.**

Most of the City’s revenue sources are unpredictable beyond a certain confidence level. Sales tax revenues can serve as a useful example. The FY 2010 budget for General Fund sales tax revenues is \$45.6 million. OMB is 100 percent confident that the City will receive \$35 million, 99 percent confident that the City will receive \$40 million, and 98 percent confident that the City will receive \$43 million. Beyond that level, confidence (and therefore, absolute predictability) declines. The General Fund’s revenue budget cannot be prepared without some degree of unpredictability; otherwise, the revenue total would be far less than actually budgeted, necessitating dramatic expenditure reductions to balance the budget. Among the largest sources of revenue for the General Fund, only property taxes, landfill revenues, and Court fines could be considered fairly predictable, and in the case of property taxes, only after the certified values for the coming tax year are made available from the appraisal district. The other large revenue sources, including sales taxes and franchise fees, can fluctuate depending on factors as varied as the local and regional economy to the weather. Unpredictability of revenues is part of the environment in which a municipal budget office must routinely operate.

OMB is familiar with policies like the one recommended. However, they have implications. For example, if use of interest earnings was limited. FY 2010 interest earnings are probably as low as the City will see, on equivalent amounts of corpus. The City could certainly have a policy that states that, “Any interest revenues in excess of 1% earnings will be dedicated to one-time expenditures.” In that case, the City would have to determine if it was willing to lay off employees to meet such a policy. If City Management decides to establish a policy with regard to all of the City’s unpredictable revenues, it must understand the potential limitations such a policy would put on budget balancing for both the City Council and Management.

## **3. Diversity of revenues**

In an effort to diversify its revenue sources, in FY 2007 the City initiated a Revenue Enhancement effort within the FMR. The goal of this effort is to identify and pursue new revenue sources, particularly in the areas of grant and sponsorship opportunities, to alleviate

the City's reliance on its traditional revenue sources. This goal is best articulated in the Manager's Message of the FY 2009 Budget:

"We will work with our public, private, and non-profit partners to find new solutions and strategies, and we will seek out grants, corporate sponsorships, and other new revenue sources, aside from property taxes, to accomplish the important work we do." (FY 2009 Adopted Budget, p. 6)

City Management has made revenue enhancement a priority for the organization. Examples of these efforts would be the City's contract with Coke and the contract for parking at the City's downtown facilities.

**4. A government should adopt policies and plans for capital asset acquisition, maintenance, replacement, and retirement.**

The City already has a written policy:

- An adequate level of maintenance and replacement will be funded each year to ensure that all capital facilities and equipment are properly maintained. (FY 2010 Operating Budget)

This effort presents ongoing challenges for the City, particularly in difficult economic conditions. Funding for the maintenance and replacement of the City's capital assets competes for funding along with everything else during the annual budget process. Examples include:

The Public Works and Transportation Department maintains a list of capital maintenance needs related to the City's buildings and facilities, but funding for these projects, in both the General Fund and the Infrastructure Maintenance Reserve, is not adequate to fully address all of the maintenance concerns. The Fire Department has a comprehensive apparatus replacement program. A portion of the City's vehicle fleet is replaced each year as funding allows; however, a significant number of currently-operated vehicles are beyond their useful service lives as specified in the contract between the City and the contract maintenance vendor.

Unfortunately, economic realities often intrude. Departments are very aware of their needs, and plans as referenced in the recommendation are required to be able to compete in the budget process for additional funding.

*Management believes the City has adequate policies for the development of the budget – Do not concur*

**Finding 3.** City management has not established adequate policies and procedures regarding the use of internal service and special revenue funds.

## **Recommendation**

The City Manager should ensure that policies and procedures are developed relating to the operation and maintenance of each internal service and special revenue fund.

**Response** - The audit raises several issues related to Internal Service Funds (ISF):

**Methodology for determining revenues** – These are developed and maintained by operating departments. In addition, OMB has prepared an overview of chargeback methodologies for the ISF.

**Responsibility for preparing the ISF budgets** – The department director who manages the fund is identified in the operating budget. They develop a proposed budget for the fund that ultimately receives City Management approval, in the context of the overall budget strategy.

**Appropriate reserves** – None are needed in internal service funds, except in cases where fund balances are designed to increase over time to fund major capital purchases in the future. The fund's annual expenditure budget is fully funded through chargebacks, except in the case of Knowledge Services, the revenues for which are demand-driven and based on actual usage of the fund's services by City departments.

**Appropriate use of reserves** - In ISFs, the use of the term "reserves" is somewhat confusing. A "reserve" in these funds is simply the fund's budgeted beginning balance. Using this "reserve" requires approval from Council for expenditures to exceed revenues during the year, which will result in a year-end balance that is smaller than the beginning balance. As with all budgeted appropriations, authorization for this is received from the City Council when the ordinance adopting the operating budget is approved.

Another use of an ISF's available fund balance can occur when excess fund balance in one of these funds is returned to the General Fund. When the City faces revenue shortfalls (particularly in sales taxes) due to a weakened economy, it is entirely appropriate to return ISF transfers to the General Fund so that available resources in the General Fund are sufficient to cover the fund's Council-authorized appropriations during the year. Available resources in all of the City's operating funds are continuously reviewed by OMB, in consultation with the Chief Financial Officer and the City Manager's Office. Adjustments are made throughout the year to ensure that resources are adequate to support Council's program priorities and corresponding appropriations, and to preserve a balanced budget.

**Authorization to approve the use of reserves and operating transfers** - This would be determined by the responsible department head, in consultation with the City's Chief Financial Officer and the Assistant Director for Budget and Treasury, with the established authorization granted by the City Council with the budget adoption.

**Recouping Reserves** - As noted above, reserves are not necessary in ISFs. End-of-year fund balances cannot be negative. Beyond that, there is no need to replenish reserves. The fund's appropriations are fully met each year through chargebacks.

*Management believes the City has adequate policies for the development of the ISFs in the City's budget – Do not concur*

#### **Finding 4: Additional GovMax user training is needed**

**Recommendation** - The Financial and Management Resources director should ensure that GovMax users receive additional training as planned.

**Response** – When the audit began, GovMax had been in use for seven months. The OMB provided initial training on GovMax before the Budget Kick-Off for FY 2010 to get users familiar with the new system. Eight designated classes were offered throughout the month of February, with a minimum of fifteen seats available for each class. In addition, several departments and users were given individualized training.

In the report, the City Auditor’s Office states that “GovMax is not currently utilized by most city users for budgetary monitoring and planning.” All departments submitted their base budgets and budget requests in GovMax for FY 2010. About one-fifth of the authorized GovMax users would be considered “power” users, meaning that they are actively involved in the budget development and monitoring process. These heavy users represent almost every department in the City. They use GovMax for budget development and report development, and these reports are then provided to management. Most department directors, for example, do not use GovMax on a frequent basis. However, they rely on data and reporting provided by their budget analysts.

*Management intends to continue providing ongoing training opportunities, and the manual is available on-line – Concur*

*Person Responsible – April Nixon, CFO*

*Date - Ongoing*

**Recommendation** - The Financial and Management Resources director should solicit feedback from GovMax users for desired reporting features that would reduce reliance on external spreadsheets and increase efficiency and control

**Response** – The OMB understands the desire for less redundancy and increased capability within GovMax. Staff has been working with the developers of the software on an ad hoc reporting tool that will allow for custom built reports. GovMax users will be able to develop reports that will reduce reliance on external spreadsheets. As with any other new software program that is implemented, it is a gradual process by which users migrate from one system to another, and then identify additional functionality for the new system. While the OMB does intend for users to increase their reliance on GovMax for all budget development and monitoring, for the first year of implementation, there was no expectation that departments would completely abandon their existing system within the span of less than one complete budget cycle.

*Concur*

*Person Responsible – Mike Finley, Assistant Director FMR*

*Date – November 15, 2010*

**Finding 5. Software enhancements are needed to fully utilize GovMax as a budget preparation and monitoring tool.**

**Recommendation:** The FMR Director should ensure that OMB continues to work with the developer of GovMax to enhance the software and increase its usefulness beyond budget preparation.

**Response -** After spending almost a year thoroughly evaluating the options available, FMR chose GovMax as the City's budget reporting system. Upon receiving Council's approval to proceed in the summer of 2008, implementation and testing took approximately six months. City-wide training of users occurred in February of 2009 and users began accessing the system in April 2009 to prepare the FY 2010 budget. The system had been fully operational for approximately seven months at the time the audit review began. The OMB manager discussed with the City Auditor that budget staff as well as department users were still developing familiarity with the system, and as a result the full functionality of the system was in the process of being phased-in.

The audit report states:

"The City currently utilizes GovMax to perform 'what-if' analysis but the ability of the system to perform 'what-if' analysis in real time is limited. For example, although it would be fairly simple to identify the impact of a proposed 1%, 2%, 3% pay raise across-the-board, it would be much more time consuming to calculate the impact of a proposed 3% pay increase to employees making under \$50,000 per year. Such an analysis would most likely be done outside of GovMax. "

As discussed, GovMax was chosen after careful review and evaluation of multiple budgeting system options. GovMax is the only integrated system of its type designed specifically for government organizations. "What if" scenarios, by definition, are very wide ranging. FMR was asked by Audit if GovMax could perform a number of complex analyses. While it can, it is not always the best tool for the job. The Audit report does not address what systems could do what they describe, nor does it in any way take into account price or cost of implementation. While the GovMax system is not capable of performing every potential "what-if" scenario possible in seconds, it addresses the need for which it was purchased.

The audit report further states that during the audit, the City Auditor's Office had a difficult time verifying the base budget, and changes/impacts that were recorded in GovMax. The OMB manager specifically responded to the City Auditor by walking through the changes between base budget, proposed budget, and adopted budget. While it may require attention to detail to verify some of the changes, it is not difficult. All information is available within the system, and the audit report does not point to any specific communicated change or impact that was not recorded in GovMax.

Finally, even though the audit report acknowledges that the system tracks all changes made to account detail, it is reported that GovMax lacks audit trails because "other critical data" is not monitored. The

data in question is referred to in GovMax as a “budget issue.” To clarify, when a department submits a request for new funding in the proposed budget, the system requires that an electronic form called a budget issue be completed. The form collects information such as department name, a narrative describing what is being requested, potential offsetting revenue, performance impact if approved, and dollar amount requested. Each budget issue created is given a number within the system. If a department makes a mistake on the issue, duplicates a budget issue, or decides against submitting the request, the budget issue is deleted from the system, thus leaving a gap in the sequential order of the numbered budget requests. The audit report states that this is a weakness in the system because a budget issue could be accidentally or intentionally deleted. Throughout the budget process, reports are run in the system detailing and/or summarizing departmental budget requests. Leaving incorrect or unwanted budget requests in the system would render such reports useless. Additionally, the process itself provides a control. Each department meets with its respective Deputy City Manager and OMB staff to review and discuss each budget request. If a department had submitted a request that was now missing, it would become apparent in this meeting where all parties are present.

As would be expected with the implementation of any new technology or recently purchased system, OMB staff routinely work with the developer of GovMax to enhance the software and increase its use.

*Management intends to work with the vendor to provide additional enhancements – Concur*

*Person Responsible – Mike Finley, Assistant Director FMR*

*Date - Ongoing*

**Finding 6. Personnel changes with significant impact should have been included in the Fiscal Year 2010 budget.**

The chart in the audit report that presents the estimated financial impact of position reclassifications is somewhat misleading. It should be noted that the financial impact, or cost, of reclassifications presented in the audit chart is for two years. The dollar value is then compared to one year of budget. This overstates the financial impact of reclassifications. To demonstrate, the chart below takes the same information but compares one year of financial impact to one year of budgeted expenditures.

Department	Estimated Value of FY '09 Reclasses	GovMax Position Budget Summary 2010	Pct. Of 2010 Salaries and Benefits	Total # of Employees	# of Employees Reclassed
Aviation	\$ 15,761	\$ 512,840	3.07%	8	1
Community Services	53,918	4,579,177	1.18%	75	3
Financial and Management Resources	129,165	6,097,340	2.12%	85	13
Convention Center	13,137	1,952,911	0.67%	32	3
Parks and Recreation	-	10,230,213	0.00%	190	
City Auditor's Office	-	457,611	0.00%	5	
Police	58,227	11,794,827	0.49%	179	4
Fire	-	9,114,029	0.00%	34	
City Attorney's Office	-	3,288,816	0.00%	38	
Public Works	43,018	12,928,999	0.33%	208	5
Library	8,962	4,053,032	0.22%	69	1
Community Development and Planning	-	5,062,111	0.00%	68	
Information Technology	21,193	4,824,055	0.44%	53	3
Water Utilities	8,668	12,711,041	0.07%	219	1
City Manager's Office	-	844,266	0.00%	4	
Economic Development	-	282,870	0.00%	3	
Judiciary	-	639,149	0.00%	6	
Workforce Services	-	1,726,604	0.00%	20	
Municipal Court	-	1,849,674	0.00%	42	
<b>Total</b>	<b>\$ 352,049</b>	<b>\$ 92,949,565</b>	<b>0.38%</b>	<b>1,338</b>	<b>34</b>

As shown in the table above, the value of reclassifications in FY 2009 was \$352,049 or .38% of the total budget. Additionally, the Auditor's table contains incorrect information. For example, there are only 34 civilian employees in the Fire Department, not 149 as the audit chart shows. Using an incorrect employee count skews the results of the finding.

Additionally, the audit report notes that the chart "indicates that some departments have reclassified a higher percentage of employees than other departments." Reclassifications, as acknowledged in the audit report, are triggered by a significant change in an employee's job responsibilities. They are driven by business necessity and the City's pay philosophy has been to pay what the job is worth. The budget is still managed within authorized full-time employees and expenditures. Since reclassifications are dependent upon a change in job duties, attempting to manipulate the number of reclassifications allowed in order to equalize the percentages across all departments is not a sound business practice, could expose the City to litigation, and disrupt City operations.

**Recommendation:**

The City Manager should ensure that a revised cutoff date is established (beyond March 31<sup>st</sup>) for the incorporation of position changes in the budget.

**Response** - By recommending a revised "cutoff date" for position reclassifications to be incorporated in the budget, the audit report does not acknowledge new controls implemented by the City Manager on March 4, 2009. The City Manager's memo clearly states:

"If a reclassification is expected to require a salary increase, the department will be required to identify equivalent cost savings elsewhere in the budget before implementing the reclassification. "

*Since position reclassifications are now required to have net zero impact on the budget, there is no need for a “cutoff date” to incorporate changes – Do not concur*

**Recommendation:**

The City Manager should require that position reclassifications and trades are submitted prior to the revised cutoff date so that the impact of position changes is included in the budget.

**Response** - The report states that “Job reclassifications are performed by Workforce Services staff throughout the year, and appear to be absorbed into existing departmental budgets if approved without adequate reflection in budgetary documents. OMB has not previously considered it necessary to disclose the financial impact of position changes.” If the cost of the position upgrades are “absorbed” into departmental budgets, there is no impact.

On March 4, 2009, the City Manager sent a memo to all departments requiring that all job reclassifications be:

- 1) approved by the CMO prior to submission to Workforce Services
- 2) be at \$0 cost.

The OMB will remove the amounts from department budget required for reclassifications.

*The cutoff date is unnecessary, as the net cost will be \$0 – Do Not Concur*

**Finding 7.** Vacancy savings targets do not adequately take into account departments’ individual vacancy history.

**Recommendation**

To help ensure that the vacancy savings target is applied equitably across departments, the City Manager should require that each department’s vacancy history and available non-payroll funding be considered when determining how much of the vacancy savings target to allocate to departments.

It should be noted that Recommendation #12 of the Animal Services Staffing Analysis (2008) stated, “The Financial and Management Services Department should consider the nature of each department’s work prior to applying employee turnover factor.”

**Response** - Several observations are worth noting in response:

Adopting this recommendation would dramatically reduce one of the key components of flexibility that the City Management has at their disposal for administering the operating budget throughout the year. Holding existing (and funded) positions vacant for certain time periods is one the most effective strategies for containing expenditures. These positions can be filled later when economic conditions improve.

The recommendation appears to be targeted toward larger departments that may have several vacancies, to eliminate their perceived “advantage” in managing their vacancies and overall budgets. Budget balancing is not equitable by department. There are clear priorities as directed by Council.

Over a three-year period, Internal Audit has saved almost \$80,000 more than its vacancy target amount. A year with no vacancies will show a small department not meeting its vacancy target, a year with vacancies will result in substantial savings over the target. Vacancy savings tends to average out over time. Two years is not long enough to see this trend.

It is also worth noting that the City often discusses how much it is allocating for various categories of services, such as public safety, code enforcement or recreational opportunities, with the City Council and members of the public. Quite often, these service areas involve large departments with substantial interaction with citizens, such as Police, Community Services, or Parks and Recreation. Disproportionately allocating a higher vacancy savings percentage to these larger departments would not only penalize them simply for being “large,” but would reduce the amounts dedicated to these service areas in the budget. It goes without saying that large departments with more employees will have higher likelihood of vacancies; these departments also contribute disproportionately to expenditure savings when hiring freezes are imposed.

Vacancy savings (Turnover Factor) is a simple recording of what will occur naturally across the organization in a given year as employees terminate from the City.

Finally, management disagrees with the recommendation for two additional reasons. First, the funds appropriated are to be used to deliver services. Full-time salaries are just one of the mechanisms for delivering service. Even if vacancy rates are higher, service may still be delivered to our citizens via third party contracts, part time employees, or contracted employees. The savings may be utilized for technology or facility improvements that lower the need for personnel costs. Second, increasing the turnover factor has an unintended consequence of lowering service delivery. Since it is illegal to exceed budget, departments will almost always come under their budget. For example, a department with a \$5,000,000 budget may have \$25,000 in salary savings. It would seem logical that you would, in the subsequent year, lower their salary savings by that \$25,000. However, because the department must come in under, you would actually see a larger cut.

*Do not concur*

**Finding 8.** The calculation of vacancy savings targets was not communicated

**Recommendation:** The City Manager should require OMB to provide departments with details for calculating vacancy savings target amounts that reduce budgets.

**Response -** The “how” of vacancy savings is a relatively simple calculation - a percentage applied to salary and benefit codes that equals current turnover trends. That target was clearly communicated in the 7/21/09 executive team quarterly meeting. This information has always been available for departments.

*In the future, the OMB will distribute the vacancy savings distribution calculations to the departments - Concur*

*Person Responsible – Mike Finley, Assistant Director of FMR*

*Date – August 3, 2010*

**Finding 9.** There is no systematic accumulation of funds for equipment replacement

**Recommendation**

The City Manager should require that departments be charged for depreciation, each month, to cover future equipment replacement costs. The City Auditor’s Office understands that it may not be feasible to implement depreciation charges at this time, due to current economic conditions. However, depreciation charges should be strongly considered when the economy strengthens.

**Response -** The recommendation is policy-setting, which is exclusively the prerogative of the City Council. It also fails to recognize the fiscal exigencies facing the City every year. Funding for the maintenance and replacement of the City’s capital assets does not automatically receive higher priority than other expenditure proposals during the development of the annual budget. Unless directed otherwise by Council, funding for these items will compete for appropriated funding along with everything else during the annual budget process.

*Do not concur*

**Finding 10.** The Public Works Department was over-charged for Information Technology services.

**Recommendation**

The City Manager should require that department heads with divisions in multiple funds meet with the IT Director to develop a methodology by which IT’s cost allocation can be spread among the appropriate accounting units/funds. This should help alleviate any unnecessary burden to the General Fund and help ensure that the IT Director is aware of departments requiring allocations beyond those initially recommended.

**Response – Concur**

*Person Responsible – Louis Carr, IT Director*

*Date – June 30, 2010*

**Recommendation**

The City Manager should require that the IT Department prepare a departmental cost allocation to support each proposed budget issue. If the budget issue is approved, OMB should reallocate costs as recommended by the IT Department.

**Response** - Management believes that this recommendation, if fully implemented, would impose unnecessary burdens on the IT Department to prepare multiple iterations of their chargeback allocations. For the FY 2011 budget, OMB will request that the IT Department prepare and submit a revised chargeback allocation to reflect any increases necessary to cover the costs associated with approved budget issues, if applicable.

*Partially Concur*

*Person Responsible – Louis Carr, IT Director*

*Date – July 28, 2010*

**Recommendation**

The Financial and Management Resources Director should confirm the overcharged department(s) require a journal entry to correct the approximate \$71,000 over-billing, and notify the affected department(s) of the correction.

**Response – Concur**

*Person Responsible – Mike Finley, Assistant Director of FMR*

*Date- June 10, 2010*

**Finding 11: Employee Feedback**

**Recommendation**

The City Manager should consider including employee opinion surveys as a part of the budgetary process.

**Response** - Input during the budget development process will be sought from all stakeholders (citizens, employee, City Council, etc.). However, the method for collecting that input may vary and is at the discretion of the City Manager until the budget is proposed and City Council thereafter.

City Management has begun implementing a more exhaustive plan to communicate with employees on the FY 2011 budget.

*Do not concur*

**Finding 12.** City management proposed transfers without establishing and communicating the methodology used to determine that sufficient reserves existed.

**Recommendation 1**

The City Manager should ensure that operating transfers from internal service funds are made in accordance with established policies and procedures.

**Response** - Transfers are made only after reserve policies are met, thus in accordance with fund requirements. Transfers at that point are the prerogative of management. Management believes it is important to note that “established policies and procedures” can guide decisions only so far, and that ultimately, they are not an adequate substitute for sound financial judgment. All of the operating transfers noted in this finding of the audit report were proposed at a time of extraordinary fiscal circumstances, and were designed to achieve the over-arching legal requirement that the General Fund’s budget be balanced (available resources equaling or exceeding operating expenditures) at year’s end. As part of its core responsibilities, the OMB and the City Manager’s Office are required to make judgments about likely future revenue and expenditure trends. Determining the sufficiency and availability of reserves in any given fund is a product of that exercise, and is part of the operational responsibilities of OMB.

*Concur with recommendation, not finding.*

**Recommendation 2**

The City Manager should consider establishing a policy that requires that any “excess” fund balances in internal service funds be distributed equitably to the original source.

**Response** - *Concur with portion of the recommendation related to returning grant funds.*

*Person Responsible – Mike Finley, Assistant Director of FMR*

*Date – As transfers are initiated*

**Finding 13. An interfund transfer was performed which violated standard City practice.**

**Recommendation**

The City Manager should require that FMR employees process transactions in accordance with established policies and procedures.

**Recommendation**

The City Manager should ensure that nonreciprocal transactions between funds are reported in accordance with governmental generally accepted accounting principles.

This finding and subsequent recommendations are partially inaccurate and misleading. The audit report incorrectly states that an interfund transfer was performed which violated standard City practice. The transaction in question was not an “interfund transfer” nor was it a “budget transfer,” both terms that the audit report uses interchangeably throughout this finding. Not only do these terms have completely different meanings, neither term applies to the \$75,000 transaction in question.

To clarify, when Council adopts a budget, it is appropriated at the fund level, i.e. budget can be transferred *within* a fund (from one department to another), but budget cannot be transferred from the General Fund to the Water Utilities Fund. To demonstrate, observe that the FY 2010 General Fund Expenditure Budget is \$194,621,571 (p. 66 of the budget book). If, hypothetically, one were to try to

initiate a budget transfer of \$1,000,000 from the General Fund to the Water Utilities fund (FY 2010 Expenditure Budget of \$95,499,994, p. 121 of the budget book), the end result of the transfer would look like the following:

	Budget Before Transfer	Budget After Transfer
General Fund	\$194,621,571	193,621,571
Water Utilities Fund	\$95,499,994	\$96,499,994

As shown above, an actual budget decrease of \$1,000,000 would occur in the General Fund along with an associated increase of the same amount in the Water Utilities Fund. The Audit report is stating that this is what occurred in this situation. But this type of transaction would never be processed for a myriad of reasons. It would be a violation of City policy; it would create a structural imbalance unless revenues were also redirected; and in some circumstances, it would redirect dedicated revenues that are intended for specific purposes. For example, the largest revenue source in the Convention and Event Service Fund is the Hotel Occupancy Tax. This tax must be used for explicit purposes, the promotion of tourism, and therefore cannot be transferred for use by another fund.

The Audit report states that a City practice was violated because FMR performed a transfer of budget between two funds. As demonstrated in the table above, a budget transfer would result in one fund's budget appropriation increasing and another decreasing. However, since the transaction was not a budget transfer, this did not occur. Attached are two budget reports, one run before the transaction and one run afterwards. It should be noted that in both cases, the budget appropriation remains exactly the same.

The transaction in question is the first of two annual installments toward the cost of implementing the Purchasing Division's Strategic Sourcing Module. It allowed the City to use salary savings to pre-fund a portion of the cost of the software. Despite what the Audit report inaccurately states in two different findings in the report (see finding # 15), FMR held a Purchasing Agent position vacant in order to save money to pay for the software. At year end, these savings would have simply become ending balance, or cash, in the General Fund. Instead, FMR recorded an expense from the General Fund to the Internal Service Fund in order to pre-fund a portion of the purchase. This is not a violation of City practice, nor is it a violation of GAAP requirements.

It is very common for ISFs to pre-fund anticipated expenses in this manner. For example, both the Risk and Health Insurance ISFs receive revenue from other funds in anticipation of future claims. Page 112 of the Governmental Accounting, Auditing, and Financial Reporting source guide (GAAFR) states that premiums received by these funds should be treated as revenue. Furthermore, this type of pre-funding, or excess funding, is justified if it is part of a systematic funding method designed to match revenue and expenses over a reasonable period of time. Only funding in excess of probable and measurable costs must be reported as a transfer. Therefore, per the GAAFR, the treatment of the \$75,000 transaction as

a revenue to the ISF and an expenditure in the General Fund is appropriate, because it is part of a systematic funding method to acquire the Strategic Sourcing module over a reasonable two-year time period.

Finally, the Audit report attempts to make the point that other departments stated that they would not be permitted to make such a transaction. The fact is that this type of transaction would be permitted in any appropriate, applicable situation. FMR and OMB are resources that are available to assist any City department in understanding and navigating financial transactions. Departments are not expected to have this type of financial expertise.

With regard to the specific example cited in the FMR budget, funds were shifted between divisions in the department with the approval of City Management. These shifts can occur for various reasons, like taking advantage of cost saving opportunities or other business imperatives. The fundamental issue is whether the department met its budget objectives for the year. As seen in the chart below, the Financial and Management Resources Department managed its resources effectively in FY 2009.

A temporary employee was charged to Purchasing that actually assisted the entire FMR department. The funding was moved from other line items to reimburse Purchasing for the cost of this employee. The effort was to true up Purchasing and recognize the savings from the Purchasing Agent position in that division. In the spirit of “transparency” noted in the audit, it would probably have been clearer to move funds from FMR Administration (rather than the Intergovernmental Relations Division) into Purchasing to ensure that the expenses for the temporary employee, who assisted the entire department, were lodged in the most accurate accounting unit. The bottom line is however, Council cut the IGR position from FMR and expected \$55,600 in savings. That was achieved. FMR held a Purchasing Agent position vacant and expected \$75,000 in savings. That was achieved. FMR, CMO, and the City Council expected FMR to save \$139,900 as a result of vacancies and budget reductions. That was not only achieved but surpassed.

FMR Adopted FY 2009 Budget	Mid-Year (Following Budget Reductions)	Budget Reductions	FY 2009 Actual
\$13,799,943	\$13,660,019	Eliminated: <ul style="list-style-type: none"> <li>- Intergovernmental Liaison</li> <li>- Council Assistant</li> </ul> Removed from General Fund Budget: <ul style="list-style-type: none"> <li>- Revenue Enhancement Specialist</li> <li>- Management Analyst</li> </ul>	\$12,837,976

*Management agrees that all employees should process transactions in accordance with established policies and procedures. However, no violation of practice or policy occurred. Concur with recommendation, not with finding.*

**Finding 14.** Fund transfers were not properly communicated to the IT Department.

### **Recommendation**

The City Manager should require that fund owners be notified when FMR initiates transactions that impact their fund.

**Response** – The Deputy City Manager, the FMR Director, and the IT Director discussed the prefunding of the Strategic Sourcing Module before the transaction occurred. Consequently, the IT Director was aware of the transaction.

As discussed in the response to the preceding finding, the issue referenced here did not involve a “fund transfer” or a “budget transfer.” An expenditure was reflected in Purchasing, and a revenue was reflected in IT, for Strategic Sourcing. The mechanism is not different from the monthly chargebacks that fund the IT Department’s operations. In this case, the expenditure was not scheduled to occur until the following year, and the revenue simply increased the FY 2010 beginning balance in IT’s ISF.

OMB met with the IT Director and members of his staff to discuss the interaction among beginning balances, budgeted revenues, budgeted expenditures, and projected ending balances. This transaction did not increase IT’s authority to spend money in FY 2010; as with all budgeted funds, the department remains constrained by its Council-approved expenditure budget for the year. This mechanism simply allowed the FY 2010 chargebacks from FMR to IT to be reduced.

*Concur with recommendation, not finding.*

*Person Responsible – Mike Finley*

*Date - Ongoing*

### **Finding 15. The budget is not adjusted to be consistent with revised expectations.**

### **Recommendation**

The FMR Director should consider establishing a practice of adjusting the budget to be consistent with revised expectations.

**Response** - The OMB’s written policy on amending the budget appears in Appendix 4 of the budget document. It states that “formal Council approval is required to move appropriations from one fund to another or to increase authorized appropriations in any fund.” These two specific circumstances are the only time the budget would be amended.

The City of Arlington currently complies with both best practices referenced in the finding. Practice 11.1 states that a government should periodically evaluate the performance of the programs and services it provides. The practice goes on to explain that performance measures should be presented in basic budget materials and available to stakeholders and that more formal reviews and documentation of those reviews should be carried out as part of the overall planning, decision-making, and budget process. The City of Arlington has been utilizing performance measures and presenting them in the budget document since FY 2003. Additionally, program performance measures are updated and

reported on quarterly in the Business Plan document and reviewed and discussed at quarterly executive management meetings.

Practice 12.1 states that the budget should be adjusted during the budget period should unforeseen events require changes to the original budget plan. The practice clearly states that budget adjustments may be administrative or legislative depending on the government's procedures and on statutory requirements such as the legal level of control of the budget appropriations. The budget reductions that occurred after the 1<sup>st</sup> Quarter Budget Analysis Report (BAR) in FY 2009 were communicated to department directors in a March, 2009 memo from the City Manager and throughout the year by the OMB.

The FY 2008 budget amendment (Ordinance 08-034) referred to in the audit report was conducted because it was required by law. The adopted budget is a legal limit that cannot be exceeded except by legislative action, i.e. an ordinance. Hiring 13 additional police officers mid-year would have caused General Fund expenditures to exceed the adopted budget; therefore an amendment was legally required. In FY 2009, expenditures were reduced as a result of the downturn of the economy as reported in the FY 2009 1<sup>st</sup> Quarter BAR. A reduction in expenditures is not required by law.

The adopted budget is a plan that represents what the City Council and City Management intend to accomplish for the year. Potentially temporary and constantly fluctuating revenues are not a reason to abandon that plan.

*Do not concur*

**Finding 16.** City Manager does not routinely provide updates or status reports on the impact of previously presented and approved budget balancing strategies.

**Recommendation:** The City Manager should create and maintain a listing of significant budget balancing strategies based on City Council input and should provide periodic updates on the effectiveness of those strategies.

**Response-** It is the responsibility of the City Manager to report on the effectiveness of *all* strategies, and to highlight variances, whether positive or negative, for Council consideration.

During the budget process, packages of revenue and expenditure options are considered and proposed to City Council (or not) based on whether the City Manager feels the options presented to him will maintain, erode, or improve the City's financial position. His decisions are based on financial analysis presented to him at the time by departments and by the OMB. Additionally, periodic analysis of significant revenue and expenditures options is performed and communicated to elected officials. The BAR is a quarterly assessment of the performance of the City's revenues and expenditures. Elected officials receive the results of the BAR several times during the year. Principal 9.5 does not recommend, nor does it mention, updates or status reports on the impact of previously approved budget balancing strategies.

Regarding the specific examples the Audit Report cites, here is the chronology of events.

**Animal Services License Revenue** - The Community Services Department presented outsourcing animal licenses to the City Manager's Office in addition to expenditure cuts requested by the City Manager of all departments to balance the FY 2010 budget. The Community Services Department stated the revenues from the outsourcing program would be \$191,721. Neither the Community Services Department nor the City Auditor's Office has presented any information to the OMB manager that this amount was overstated by \$60,000. As reported in the audit, the 1st Quarter BAR documented the variance and stated it was due to the program taking longer than anticipated to implement. The audit report states that the variance is not "specifically explained" but a delay in program implementation is a specific explanation. The variance represents .07% of total General Fund revenues.

**Outsourcing of Health Inspections** – As presented by the City Manager, the adoption of the FY 2009 budget included the elimination of funding for 19 positions. These budget cuts were distributed based on the history of vacancies in that department, i.e. a department with a historically higher number of vacant positions would have lost funding for a proportional amount of the 19 positions.

Subsequently, Resolution #08-0443 was passed by Council on November 18th. The resolution addressed 18 General Fund positions. With the exception of the Environmental Health Inspectors, all of the affected positions were either vacant or were filled but transferred out of the General Fund instead of cut. (Ultimately only 18 positions were cut as Police was allowed to cut two instead of three positions.)

The FY 2009 budget reduction impact on the Community Services Department was \$110,000, which is the equivalent of two positions. Rather than cutting two vacant positions, the Community Services Department addressed this funding cut by outsourcing City health inspections which resulted in the elimination of five full-time positions, all of which were filled at the time of elimination. The total salary and benefits associated with these five positions were approximately \$310,000. Since the targeted savings amount was only \$110,000, the remaining savings of \$200,000 were kept in the Community Services Department budget to pay for the contract cost of the outsourced inspections.

During the FY 2010 budget process, the Community Services Department submitted a budget request for an additional \$206,864 for the health inspection contract. Approval of the request would have put the contracted cost for FY 2010 at \$414,700. Not only would the original \$110,000 savings not have been achieved, but the cost of the contract would have exceeded the cost of providing the service in-house by \$104,700. At the time of the City Manager's budget review, Community Services provided the OMB with a spreadsheet (attached) that showed the contract costs for varying levels of inspection service - the same level of service, an increased level of service, and an optimum level of service. The spreadsheet showed that the cost of providing the same level of service (as was provided before outsourcing) was \$197,400. The department's current budget was \$207,836. However, the department's FY2010 request for additional funding was for an increased level of service. Since the impetus for privatizing the health inspections process in the first place was to save money rather than to increase levels of service, the budget request was denied.

While the contract cost in FY 2009 was approximately \$200,000 for seven months, the health inspectors were notified of layoff only six weeks into the fiscal year. After the layoffs were announced, annual inspections were delayed or on hold for a time period. Since the contract costs are charged on a per inspection basis, it is likely that the contractor was able to perform the required inspections in seven months.

**Outsourcing Risk Management** – As a result of declining sales tax revenue, the City Manager’s Office directed departments to reduce expenditures in March of 2009. The Workforce Services Department proposed cutting two positions in the Risk Management function and reported full-year expenditure savings of approximately \$140,000. Two months later in May of 2009, the Workforce Services Department determined that it would be necessary to hire a third party administrator to perform the subrogation and claims duties formerly assigned to the eliminated employees at a cost of \$70,000.

**Outsourcing of Accounts Payable** – FMR proposed outsourcing the Accounts Payable function in the summer of 2009. The audit report correctly states that no FY 2010 savings were reported or expected. The audit report also correctly states that timing of the approval occurred too late to be reflected in the budget. Since budget adoption, transfers have been made to move salary budget to supplies and services in order to pay for the contract. The audit report states that a one-time transition fee of \$60,000 required additional funding, however this is incorrect. No additional funding was necessary as the department absorbed the cost of the transition fee using budget savings from vacant positions. It should be noted that the staff report presented to City Council proposing this outsourcing communicated this one-time transition fee. Furthermore, the staff report stated that cost savings were not the only motivation for the decision to outsource as numerous other efficiencies and improvements were considered as part of the proposal.

Throughout any given fiscal year, a myriad of unexpected and unplanned costs can occur along with expenditures increases, expenditure decreases, revenue increases, and revenue decreases, some significant and some not. Significant occurrences of these are reported to City Council by the City Manager and are addressed in a timely manner. Current practice allows the City Council to direct the City Manager to report on the status of any item previously presented to the Council.

*Concur with the recommendation, not the finding. They are provided now.*

**Finding 17.** The City does not adequately communicate detailed results of budget monitoring to stakeholders.

**Recommendation**

The Director of Financial and Management Resources should ensure that detailed results of periodic budget monitoring are publicized widely and that Budget Analysis Reports include detail on significant deviations.

**Response** - The City of Arlington Budget is in compliance with best practice 11.2. The BAR is produced quarterly as discussed throughout this report and Management’s response. The BAR addresses a variety of conditions and circumstances depending upon the financial environment at the time of the report. Results of the BAR analysis are included in the proposed budget and therefore are available to stakeholders during discussions related to budget preparation and adopting. Furthermore, the City Manager gives presentations to Council throughout the year in order to keep the Council up-to-date on financial conditions as needed. Additionally, the FY 2010 1<sup>st</sup> Quarter BAR was compiled and included, along with the year’s Business Plan, in the materials presented to City Council at the FY 2011 Priority Setting Session on March 10, 2010, along with an accompanying PowerPoint presentation and subsequent discussion. Also, the FY 2010 1<sup>st</sup> Quarter BAR is available on the City’s website. It should be

noted that the City has just received the Gold Leadership Circle for financial transparency by the State Comptroller's Office.

The Audit Report discusses the \$1.4 million in General Fund expenditure reductions that were taken by the City Manager in March 2009 to address declining sales tax revenues. These cuts were presented to the City Council in a staff report on March 10<sup>th</sup> and discussed in a public meeting. The resolution (09-043) was passed by Council on the same day. Due to the many steps involved in producing the BAR, e.g. "closing" of monthly expenditures in the financial system, preparing of estimate instructions, completion of estimates by departments, and finalizing the report itself, the BAR is typically not produced and available until the first week in April. Waiting until this time to inform Council and stakeholders about expenditure and service cuts would not be timely or efficient for City operations. Additionally, notice must be given to affected employees as soon as possible, not only so they may begin the job search process but also because expenditure savings will be negatively impacted by unnecessary delays.

Additionally, the audit cites a "separate list" of \$1.15 million in expenditure reductions that were identified by departments to help balance the FY 2009 1<sup>st</sup> Quarter BAR. The list is not a separate list of additional reductions but rather a list of changes made to original departmental projections. Sometimes changes are necessary because departments can make errors or omissions in expenditure and revenue projections. It is the responsibility of the OMB to review these estimates for accuracy and make corrections or changes as needed. Changes are then addressed with and reported back to the original department. It would be unnecessary to report on errors or omissions such as these, as they are corrected prior to publication of the document and discussion of the results with Council.

In addition to changes made to the BAR due to error, changes are made to estimates due to operational issues. While the list did include reducing hours at the Municipal Court, the decision to do so was not driven by the need to reduce costs, but rather it was due to address staffing issues at the court as well as mandatory staff training on new court software. Additionally, the delay of the police academy was reported to Council in a public meeting.

The process of estimating expenditure and revenue estimates and then reporting on them is one that involves much analysis and discussion on the part of departments, the OMB, and the City Manager's Office. Reporting on every change made to estimates, whether due to errors, operational changes, or management prerogative, would require unnecessary staff time and delay reporting of information to stakeholders in a timely manner. Management feels that the current process ensures that detailed results of periodic budget monitoring are publicized widely and that BARs include detail on significant deviations.

**Recommendation:**

The Director of Financial and Management Resources should ensure that detailed results of periodic budget monitoring are publicized widely and that BARs include detail on significant deviations.

**Response -** *City Management believes current process achieves the recommendation. Partially concur.*

**Finding 18.** Vacancy reports provided to the Mayor and City Council do not provide information regarding salary savings.

**Recommendation:**

The City Manager should require that OMB prepare a vacancy savings report, by department, on at least a monthly basis. OMB should present the report to the Mayor and City Council on a routine basis and/or as requested.

**Response** - Financial and Management Resources provides a vacancy report to the City Council. It will be augmented to add a list of savings for each vacant position – *Concur*

*Person Responsible – Mike Finley, Assistant Director FMR*

*Date – June 2010*

### **Response to the Financial Consultant Position Supplemental Finding:**

This finding is incorrect. According to the City's Workforce Services Department, employees can be classified as temporary, full-time employees, and the policy does not prohibit benefit provisions for temporary employees. It does indicate the following:

Section 102.03 of the City's Personnel Policy Manual states that "Personnel from temporary agencies...receive their benefits through their employment agency and so are not eligible to participate in the City's health, pension, leave, or other benefit plans." The employee noted in the audit finding was a full-time employee with the City of Arlington, not an employee working for a temporary agency.

FMR and the City Manager's Office signed off on the overall job responsibilities, the project list, and the salary. The City Manager is the final approval on issues related to positions in the Personnel Policy Manual. Pursuant to Section 101.02 of the City's Personnel Policy, City Management possesses the authority to administer City operations. The City Manager has the authority to, "determine the methods, means, and allocation/assignment of personnel needed to carry out the City's mission...and delete positions, reclassify positions, and/or reassign employees to different positions with different classifications and/or pay as required by business necessity."

### **Background**

In August 2008, the City Manager authorized the merger of the Financial Services Department and the Management Resources Department. Director of the Financial Services Department had resigned, and the department had experienced a difficult, uncertain period of management. There had been seven Finance Directors for the department over a nine-year period leading to inconsistent direction and delayed decision making regarding the selection of key personnel vacancies. There had also been a recent substantial theft by a Finance employee, which became a material finding in the City's FY 2007 Comprehensive Annual Financial Report and external audit, and created a sense of distrust and a perception of poor management performance for the department.

As the two departments were combined, City Management made it clear that Finance needed to be returned to a level of unquestioned credibility; that staffing, processes, and controls needed to be re-evaluated; that the culture of the department had to change; that key positions needed to be filled; and that a multi-year plan for the department's future was critical.

In addition to these projects, the workload in Finance was heavy that fall. Staff was working on the Cowboy Refinancing, several economic development projects, training a new Payroll staff, addressing an audit of the Lawson system, etc. The market failure was affecting the City's investment returns, and the City's banking agreements were changing as a result of government involvement in the economy. Also occurring simultaneously, the CAFR and external audit were underway, and a clean audit was essential.

As a result of the theft, several audits were conducted of Finance, and one in particular identified a lack of close oversight and attention to the department as a contributor to the fraud and dysfunction that had occurred. In late summer 2008, there were seven vacancies in Finance. Key among them were the Finance Director, Treasury Manager, Treasury Analyst, and two Purchasing Agents.

The expectations for the department were reasonable but challenging. Dedicating full-time resources for an extended period of time would be critical for a successful merger. Unfortunately, that fall, the economy began to rapidly deteriorate.

For purposes of context, FMR merged on August 25, Lehman Brothers declared bankruptcy on September 15, and the Federal government agreed to bail out AIG on September 16. Locally, there were warning signs that the City's sales tax would decline precipitously during FY 2009, and representatives from the Tarrant Appraisal District told the City that property values were expected to drop by 3 – 5 %. Revising the City budget -- the financial plan for the year -- became one of the City's most significant priorities. Revenues were expected to decline, and there was a need to significantly decrease expenditures, almost immediately after the fiscal year began. City Management needed the financial staff focused on budget balancing solutions and new planning efforts. The full-time resources needed to provide direction and stabilization for Finance were divided, as staff also worked on expenditure and revenue management and reduction. These circumstances took a significant amount of the time previously dedicated to the plan of work needed to stabilize Finance.

The City needed help to tackle all these internal challenges in the face of an uncertain economy. A staff person was needed who could step in and assist in the day-to-day management of Finance for six months. FMR Management believed it would take that long to determine where the economy was going and to get established in both Budget and Finance. FMR and City Management talked to people in the finance industry about possibilities, and then a significant resource became available that fall. Wayne Usry, former Finance Director and Assistant City Manager in Grand Prairie, former partner at Arthur Anderson, and most recently a finance and IT consultant with another local consulting firm, had decided to leave his position. He had spent the last several years analyzing finance departments in the public and private sectors and offering advice for improvement and restructuring. City Management realized Usry could help not only with the day-to-day management of Finance, he could also assist in getting FMR started on the special projects and initiatives that had been developed with the City Manager's Office. FMR could bring him on as a staff member to do the needed day-to-day management and also provide the specialized knowledge necessary to assist with the initiatives FMR needed to get started. He was the person at that time that was needed to help FMR get through this uncertain period.

FMR briefed the City Manager's Office in October about the need for additional staff resources in Finance and then briefed them on the possibility of hiring Usry and his qualifications in early November 2008. Deputy City Manager Bob Byrd and the FMR Director interviewed him in early November, where discussed six months of employment and the salary for the position were negotiated. A vacant position and vacancy savings were used to fund the position.

Usry's employment began on December 15, 2008 and ended June 30, 2009. Following that, he worked as a special projects consultant during July 2009.

*Significant Accomplishments Achieved While this Employee Was at the City:*

- Reviewed the Finance team to determine strengths and development opportunities for each staff member.
- Began implementation of best practices in managing the Finance function.
- Analyzed and documented Finance's internal control procedures. (Accomplished in house. Estimated cost to outsource the review of control procedures - \$20,000)
- Led the development of the five-year Finance Strategic Plan. (Accomplished in house. Estimated cost to outsource the development of a Strategic Plan - \$25,000)
- Led the efforts to outsource Accounts Payable. (Saving the City an estimated \$90,000)
- Reviewed Accounts Payable policy and Made Modifications. (Saving the City an estimated \$75,000 annually)
- Did an assessment of outsourcing Payroll and some Human Resources functions.
- Reviewed and gave input about the City's financial policies.
- Assisted in developing expanded training for the Lawson financial system.
- Worked with Information Technology to negotiate with the COG and Velocity on various components and modules of the Lawson system.
- Assisted in the development of the interlocal agreement with the North Central Texas Council of Governments related to assisting them with their investments.

*Consulting Contract Information*

At the end of June, the City Manager's Office and FMR determined that some additional special project work was needed. Usry was no longer involved in the day to day management in Finance. He continued working on special projects for the FMR department and the City Manager's Officers for the month of July.

*The following responses are provided to address the other specifics noted in the audit.*

- Lack of a Job Description in Workforce Services – The job description originally constructed by FMR and reviewed by Workforce Services was in the personnel file for the Financial Consultant position in FMR.
- Various points about the title and Hay points - FMR worked with Workforce Services on the job description and Hay points for the position. Workforce Services identified the title for the position and the Hay level. Workforce Services reviewed the offer of employment letter.
- Hay level for temporary employees – According to Workforce Services, every City position is assigned a Hay level for purposes of determining pay ranges with the exception of seasonal positions. The City's policy on the categories and classifications of City workers does not state that temporary positions will not be evaluated for Hay level purposes. On the contrary, temporary positions are compared to full-time positions to find an equivalent Hay level and if an

equivalent is not found, the position would be "slotted" based on the agreed upon salary for the position.

- Failure to Add the Contract to the Quarterly List Provided to City Council - The FMR Director inadvertently missed adding the consulting contract to the list of consultants that is sent quarterly to City Council. The contract was added to the list when the oversight was recognized.

### *Conclusion*

It is not surprising that the Internal Auditor would have an interest in this particular hire. It was a non-traditional hire.

However, the bigger picture is this: Management moved swiftly and aggressively to address a pending problem with huge potential ramifications - the Mayor and City Council expect no less. Failure to provide proper oversight of a Finance operation is a recipe for disaster. We have seen it happen in our organization, most recently with the Municipal Court, and in other regional cities' Finance Departments. We were able to get through these uncertain economic times and actually make the City's financial operation stronger with the department consolidation and the hiring of this temporary employee.

Sometimes to make change and improve things, non-traditional strategies have to be employed. Hiring a highly qualified employee for six months to help us get through and develop a plan for one of the worst economic downturns in our nation's history is non-traditional. However, it was better to move rapidly to find a solid solution to our challenges in Finance at the time, than report to you that we delayed or did nothing and it resulted in problems related to the integrity of the City's financial operations.

This employee made a valuable contribution at a critical time to our organization, and Management would employ the same strategy again.

# Report Generation

Detail Listing of Obligations vs. Budget  
 with Percent Expended (History)  
 For Budget Fiscal Year 2009 through September 30, 2009  
 Run Date: 10/08/09  
 Run Time: 08:01

City of Arlington  
 Purchasing  
 140301

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Acct	Description	Budget Appropriation	Current Monthly Expenditures	Expenditures to Date	Outstanding Encumbrances	Unencumbered Unexpended Bal	%Exp
50000	SALARIES: SUPERVISION	75,956	8,359.69	79,088.57		3,132.57	104.12
50001	SALARIES: CLERICAL & PROF	73,209	8,057.30	76,214.11		3,005.11	104.11
50002	SALARIES: OPERATIONS	137,385	10,953.35	107,714.16		29,670.84	78.40
50004	BENEFITS: LONGEVITY/STABILIT	2,340		3,095.56		755.56	132.29
50006	SALARIES: OVERTIME	400		198.20		291.80	27.05
50010	SALARIES: TERMINAL PAY			948.05		948.05	
50021	SALARIES: CONTRACT LABOR		4,670.40	7,886.30		7,886.30	
	Salary & Wage Total	289,290	32,040.74	275,054.95		14,235.05	95.08
55000	BENEFITS : WORKER'S COMP	4,301	361.28	3,419.26		881.74	79.50
55001	BENEFITS : EMPLOYEE RETIREME	48,143	4,245.13	41,052.25		7,090.75	85.27
55002	BENEFITS : DISABILITY INC PL	1,944	173.00	1,672.45		271.55	86.03
55003	BENEFITS : EMPLOYEE INSURANC	21,839	515.04	5,663.55		16,175.46	25.92
55005	BENEFITS : MEDICARE	4,547	392.93	3,840.00		707.00	84.45
55008	BENEFITS : THRIFT PLAN	1,479	201.61	1,877.12		398.12	126.92
55999	PAYROLL NON-CASH EXPENSE		95.54	95.54		95.54	
	Fringe Benefit Total	82,253	5,984.53	57,620.17		24,632.83	70.05
60000	OFFICE SUPPLIES	3,641	674.72	2,665.70		975.30	73.21
60002	SUPPLIES/COMPUTER SOFTWARE		1,043.69	2,297.69		2,297.69	
60016	SUPPLIES/COMPUTER HARDWARE			537.32		537.32	
60017	OFFICE FURNITURE/EQUIPMENT	520				520.00	
	Supply & Material Total	4,161	1,718.41	5,500.71		1,339.71	132.20
61000	RENTAL	500	126.15	576.51		76.51	115.30
61002	SPECIAL SERVICES	84,000		15,870.58		68,129.42	18.89
	Purch/Spec/Contract Total	84,500	126.15	16,447.09		68,052.91	19.46
63115	MAINT OF OFFICE EQUIPMENT	312				312.00	
	Maint. & Repair Total	312				312.00	
65101	ADVERTISING	3,121		1,121.00		2,000.00	35.92
	Misc. Operating Exp Total	3,121		1,121.00		2,000.00	35.92
66001	TRAVEL/TRAINING-NON METROPLE	1,500		465.09		1,034.91	31.01
66002	TRAVEL/TRAINING-METROPLEX	2,700		525.00		2,175.00	19.44
66003	MEMBERSHIP	1,380	35.00	1,210.00		170.00	87.68
	Travel & Training Total	5,580	35.00	2,200.09		3,379.91	39.43
67000	GENERAL SERVICES CHARGES	6,303	9.00	5,329.94		973.06	84.56
	Intdepartmental Exp Total	6,303	9.00	5,329.94		973.06	84.56

# Report Generation

Detail Listing of Obligations vs. Budget  
 with Percent Expended (History)  
 For Budget Fiscal Year 2009 through September 30, 2009  
 Run Date: 11/02/09  
 Run Time: 08:46

City of Arlington  
 Purchasing  
 140301

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 Report ID: Z200H

Acct	Description	Budget Appropriation	Current Monthly Expenditures	Expenditures to Date	Outstanding Encumbrances	Unencumbered Unexpended Bal	%Exp
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50006	SALARIES: OVERTIME	400		108.20		291.80	27.05
50010	SALARIES: TERMINAL PAY			948.05		948.05	
50021	SALARIES: CONTRACT LABOR		5,504.40	8,720.30		8,720.30	
	Salary & Wage Total	289,290	32,874.74	275,888.95		13,401.05	95.37
55000	BENEFITS : WORKER'S COMP	4,301	361.28	3,419.26		881.74	79.50
55001	BENEFITS : EMPLOYEE RETIREME	48,143	4,245.13	41,052.25		7,090.75	85.27
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55003	BENEFITS : EMPLOYEE INSURANC	21,839	515.04	5,663.55		16,175.45	25.93
55005	BENEFITS : MEDICARE	4,547	392.93	3,840.00		707.00	84.45
55008	BENEFITS : THRIFT PLAN	1,479	201.61	1,877.12		398.12	126.92
	Fringe Benefit Total	82,253	5,888.99	57,524.63		24,728.37	69.94
60000	OFFICE SUPPLIES	3,641	733.68	2,724.66		916.34	74.83
60002	SUPPLIES/COMPUTER SOFTWARE		1,041.69	2,297.69		2,297.69	
60014	OTHER SUPPLIES		785.38	785.38		785.38	
60016	SUPPLIES/COMPUTER HARDWARE			537.32		537.32	
60017	OFFICE FURNITURE/EQUIPMENT	520				520.00	
	Supply & Material Total	4,161	2,562.75	6,345.05		2,184.05	152.49
61000	RENTAL	500	211.20	661.56		161.56	132.33
61002	SPECIAL SERVICES	84,000	75,000.00	90,870.58		6,870.58	108.18
	Purch/Spec/Contract Total	84,500	75,211.20	91,532.14		7,032.14	108.32
63115	MAINT OF OFFICE EQUIPMENT	312				312.00	
	Maint. & Repair Total	312				312.00	
65101	ADVERTISING	3,121		1,121.00		2,000.00	35.92
	Misc. Operating Exp Total	3,121		1,121.00		2,000.00	35.92
66001	TRAVEL/TRAINING-NON METROPLE	1,500		465.09		1,034.91	31.01
66002	TRAVEL/TRAINING-METROPLEX	2,700		525.00		2,175.00	19.44
66003	MEMBERSHIP	1,380	35.00	1,210.00		170.00	87.68
	Travel & Training Total	5,580	35.00	2,200.09		3,379.91	39.43
67000	GENERAL SERVICES CHARGES	6,303	189.25	5,510.19		792.81	87.42
	Intdepartmental Exp Total	6,303	189.25	5,510.19		792.81	87.42