



CITY OF WILMINGTON

Internal Service Funds

Internal Audit Review

December 14, 2017

City Auditor's Office

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City Auditor
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Highlights

Why We Did This Audit

The Internal Audit Department (IA) performed a scheduled audit of Internal Service Funds. The audit was in accordance with the 2016 Internal Audit Plan.

Methodology

The objectives were met by interviewing personnel in the Accounting division, the Office of Management and Budget (OMB), Public Works-Motor Vehicle division (Motor Vehicles), and the Department of Integrated Technologies, reviewing a prior year's internal audit report, reviewing internal controls and written summaries provided by OMB and Motor Vehicles, reviewing the historical usage and budget history for the internal service funds for fiscal years 2013-2016 as of March 30, 2016; testing a sample of 32 journal entries for chargebacks and testing of four year-end adjusting journal entries.

Audit Review Committee:

Robert C. Johnson, Chair
Ciro Adams
Marchelle Basnight
Angelique Dennis
Bud Freel
Ronald Pinkett
Tanya Washington

Objective and Scope

As part of our audit plan, we conducted a limited scope performance audit of the Internal Service Funds (ISF) for the period commencing July 01, 2015 to June 30, 2016. Our objectives were to determine that operating procedures and internal controls are in place to ensure that internal service funds are properly and accurately accounted for, and to determine that the computations for departmental chargebacks for internal service funds were accurate and based on established procedures/policies or properly supported with documentation of direct costs, if cost allocation was utilized to reimburse costs. IA documented ISF areas where inefficiencies exist and where internal controls may be strengthened or improved. IA believes that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We conducted our audit in accordance with Generally Accepted Government Auditing Standards ("GAGAS"). These 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.

Background

According to the Government Finance Officers Association, "Internal Services are those responsibilities a government provides to support its own internal operations. Common examples of internal services include information technology, payroll, motor pool, budgeting, legal, accounting, and human resources. Certain management objectives are served by creating a system to assign prices for use of these internal services, which are then assessed to the departments that use the services."

Typically, the goals of an administrative ISF are to take advantage of economies of scale, avoid duplication of efforts, and provide detailed cost of specific inter-government services.

The City's ISF set its rates to recover the full cost of providing each service which has a direct impact on the operating budgets for each City department. For the fiscal year ended 2015, the total costs of internal services exceeded \$24.5 million (*this total includes totals for general liability and worker's compensations costs, as well*). City departments received cost recovery charges (chargebacks) for the cost of these services, based on each department's usage and/or budget. Non-administrative services such as the ISF of the Human Resources department: Risk Management, Workers' Compensation, and Health and Welfare were excluded from the audit.

ISF are used to summarize City-wide common expenditures and to allocate such expenditures to various departments based on budget and actual usage. The IS budget amounts are calculated by OMB based on historical actual expenditures. Specific funds are set up in the general ledger that capture expenditures that are related to these general services. These funds are established from the administrative services provided by the departments and divisions whose primary purpose is to serve City departments. The funds are listed below:

Table 1

Internal Service (Fund)	Department
1. Duplication and Reproduction (504)	Department of Integrated Technologies
2. Mapping and Graphics (505)	Department of Integrated Technologies
3. Communications (<i>includes Telephone, Cell phone, and Radio usage</i>) (507)	Department of Integrated Technologies
4. Data Processing (501)	Department of Integrated Technologies
5. Document Management (502)	Department of Integrated Technologies
6. Mail Service (503)	Department of Integrated Technologies
7. Motor Vehicle (506)	Department of Public Works

Primary revenues for the ISF are derived from charges (chargebacks) to the operating budgets departments that utilize internal services. The primary purpose of chargebacks is to recover the costs of services provided by the funds. At the end of the fiscal year, revenues and expenditures of the IS funds must equal, therefore, no surplus or deficit should be the final result. All expenditures relating to usage are processed through the ISF and are charged back to the departments on a monthly or quarterly basis based on the reports given to Finance by the Internal Service Managers (ISM). Each fund has an ISM from within its department that is responsible for gathering data, invoices, and other documentation related to usage of services. The Department of Public Works uses a third party to collect and report data for the Motor Vehicle fund. The data from ISM is given to the Department of Finance periodically for the chargeback and allocation of costs among the ISF.

Because these are intergovernmental funds, no monetary exchange occurs. Accounting entries are made to reflect the transactions. At the end of each fiscal year, the expenses and revenues are reconciled and adjustments are made so that each ISF does not show a profit from the chargebacks. Overages in ISF expenditures are included in OMB's periodic reporting to the Expenditure Review Committee.

Key Statistics:	FY15	FY14
Expenses		
Data Processing	\$4.3M	\$4.2M
Duplication/Reproduction	\$150K	\$222K
General Liability	\$5.1M	\$3.5M
Mapping/Graphics	\$313K	\$343K
Motor Vehicle	\$7.4M	\$7.4M
Postage	\$297K	\$255K
Radio Usage	\$735K	\$798K
Telephone	\$1.2M	\$1M
Word Processing	\$264K	\$405K
Worker's Compensation	\$4.7K	\$3.1K
Total	\$20.4M	\$21.4M

What we found

Key Findings

Following are key issues that resulted in a process/area to be risk rated a three or four. See **Attachment A** for the detail of these and all comments identified during the review.

Risk Ranking:		(See Attachment B for full rating definitions)			
Process / Area	Process / Area Owner	1 Strong Controls	2 Controlled Effectively	3 Controlled - Improvement Required	4 Significant Improvement Required
Chargeback Process	Patrick Carter Demond May				√
Policies and Procedures	Robert Greco Patrick Carter Demond May				√

1. Chargeback Process

Controls need strengthening regarding how ISF are monitored, due to inaccurate data, untimely processing, and unevenly distributed allocations being performed. Below are a few examples of the exceptions that were noted during testing:

- Seventeen (53%) of 32 chargebacks tested had variances between the chargeback allocation set by the fund budget and the calculated allocation of actual charges at fiscal yearend.
- Eight (25%) of 32 chargebacks were untimely, due to journal entries occurring more than 30 days after the effective date of the request.
- Six of seven ISFs had errors when source documentation was compared to costs charged.

2. Policies and Procedures

Lack of policies and procedures exist surrounding how ISF should be allocated and charged back to City departments. Due to the lack of an ISF policy, inconsistencies were noted where some departments were inaccurately being charged for usage, while the actual department responsible for the usage were not being charged for services.

Management Responses to Audit Recommendations

Summary of Management Responses

Recommendation #1: Accounting should review data submitted by ISMs for accuracy prior to posting a journal entry. Discrepancies in allocation or budget amounts should be discussed with OMB and ISMs as appropriate. Where feasible, chargebacks should occur within 30 days of the expense being incurred. Management should review chargeback data for accuracy and completeness prior to submission to Accounting.

Radio purchases should only be charged back to the departments that use the equipment as identified on invoices or management directive. IT's tracking of each Department's usage of radio parts and equipment should be supported by invoices or purchase orders that capture the costs. The Department of IT should document and clearly communicate radio parts and equipment charges to Accounting for accurate journal entry.

Agree

Management response & action plan: IT Management plans to move to a direct charge model which would alleviate the need for chargebacks in the upcoming budget cycle. This is the same model used by the Department of Technology and Information at the State of Delaware. They also plan to have the software in place for Q1/Q2 projects starting March 1, 2018 and plan to complete their inventory by March 30, 2018.

Completion Date: Completed.

Recommendation #2: Management should develop an ISF policy and procedures manual to help govern how allocations and chargebacks are applied to each department and define the process for escalating pertinent matters to the Expenditure Review Board and Finance Issues Committee.

Cost accounting methodologies should be used to accurately capture true costs of services, including indirect costs. This method will give the City the ability to substantiate reimbursement requests from federally awarded grants and create savings in the General Fund which is currently absorbing indirect costs for grant activities.

The City should follow best practices as recommended by the Government Finance Officers Association (GFOA) regarding pricing of Internal Services. (<http://www.gfoa.org/pricing-internal-services>).

Under the leadership of the Chief of Staff, a joint task force comprised of OMB, Finance, IT and other departments/divisions as deemed necessary, to decide about how the City's general administrative services should be structured.

In addition, the task force should consider exploring structural alternatives to the City's ISFs, such as forming a separate division specifically for the administration of general services. Alternative approaches may include assigning the responsibility of monitoring and maintenance to Finance or OMB.

Once a decision is made, City Code should be updated to reflect the general provisions for the establishment and management of Internal Services.

Agree

Management response & action plan: Management is aware and will be working to create a general services division. This new structure will be set-up in the Fiscal Year 2019 budget.

Completion Date: June 30, 2018

Audit Team

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Tamara Thompson, Audit Manager