

Memorandum



CITY OF DALLAS
(Report No. A16-014)

DATE: September 6, 2016

TO: Honorable Mayor and Members of the City Council

SUBJECT: Audit of Revenue Estimates Included in the Fiscal Year 2016-17 Proposed Annual Budget for the City of Dallas¹

In total, the revenue estimates included in the City of Dallas' (City) Fiscal Year (FY) 2016-17 Proposed Annual Budget appear reasonable (see Table I in Attachment I).

Although the Department of Aviation's (AVI) revenue estimates appear reasonable, for the second consecutive year, AVI's revenue estimate methodologies and calculations were not fully supported and errors and inconsistencies were noted. As a result, AVI's revenue estimate methodologies for Rental on Airport were not clear and properly supported and the underlying calculations and classifications did not always support both the Rental on Airport and the Terminal Concessions revenue estimates.

Overview

- The FY 2016-17 Proposed Annual Budget of approximately \$2.8 billion is \$119.0 million, or 5.6 percent higher, than the FY 2015-16 Estimated Actual Revenues for Major Revenue Sources (see Tables I and II in Attachment I)
- The FY 2015-16 Adopted Annual Budget for Major Revenue Sources of approximately \$2.1 billion is \$5.7 million, or 0.3 percent, above the FY 2015-16 Estimated Actual Revenues for Major Revenue sources (see Table III in Attachment I)

Source: City of Dallas

Other matters came to our attention concerning the revenue estimates for major enterprise operations that deserve mention, including:

¹ The audit objective was to assess the reasonableness of the revenue estimates included in the FY 2016-17 Proposed Annual Budget. City Council Resolution 904027 directs the City Auditor to review and verify the reasonableness of the revenue estimates included in the City Manager's proposed budget. This performance audit was conducted under the authority of the City Charter, Chapter IX, Section 3 and in accordance with the FY 2016 Audit Plan approved by the City Council. This performance 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. We interviewed department personnel, reviewed revenue estimate methodologies and material assumptions for reasonableness, verified mathematical accuracy, traced amounts to the appropriate FY budget documents, and performed various analyses.

- Department of Dallas Water Utilities (DWU) has experienced unfavorable variances between budgeted and actual revenues averaging 4.4 percent under budget since FY 2011-12
- Department of Convention and Events Services (CES) had inadvertent calculation errors resulting in an understatement of estimated revenues for FY 2016-17 of \$3.7 million (seven percent)
- Department of Sanitation (SAN) experienced significant favorable variances between budgeted and estimated actual revenues for each of the past two fiscal years, FY 2014-15 (8.3 percent) and FY 2015-16 (11.2 percent)

Department of Aviation

Although AVI's revenue estimates appear reasonable, the Rental on Airport – Terminal revenue estimate of approximately \$23.4 million is not appropriately supported by: (1) a complete and up-to-date revenue estimate methodology; (2) proper documentation of calculations and assumptions; and, (3) error free calculations. In addition, inconsistencies were noted in revenue classifications between the FY 2016-17 Proposed Annual Budget Financial Summaries and those of the current FY 2015-16 Financial Summaries. For example, Rental Off Airport Revenue was incorrectly classified as Rental on Airport – Field Revenue.

While AVI made progress in preparing the FY 2016-17 Proposed Concessions Revenue, Terminal Concession Revenue, estimated at approximately \$25.4 million, was not consistently classified. The Concession Revenues for the Ground Transportation and Dallas Executive Airport are reported in All Remaining Revenues rather than in the Terminal Concessions Revenue in the FY 2016-17 Proposed Annual Budget Financial Summaries.

Department of Dallas Water Utilities

Since FY 2011-12, DWU has experienced an unfavorable variance between budgeted and actual revenues. The unfavorable variances have increased to over \$30 million over each of the past three years, or approximately five percent of operating revenues. During this five-year period, variances between budgeted and actual revenues averaged 4.4 percent under budget, with a negative 2.4 percent in FY 2012-13 followed by a negative 5.5 percent in FY 2014-15 which was a year with historical record breaking rainfalls.

According to DWU, seasonal fluctuations in rainfall and the effects of water conservation initiatives are continuing challenges to improving the accuracy of revenue estimates. Revenue shortfalls result in reducing expenses where possible and reduced transfers from operations to support planned capital construction projects. While most capital construction continues, additional debt financing is used to off-set the revenue shortfalls. Although the impact of additional debt financing may be insignificant in the current low-interest rate environment, its impact will be greater when borrowing costs begin to rise.

Department of Convention and Event Services

Inadvertent calculation errors resulted in an understatement of CES FY 2016-17 Proposed Hotel Occupancy Tax (HOT) revenues of \$3.7 million (seven percent). According to CES, City management plans to propose increasing the HOT proposed budget from \$55.1 million to \$58.8 million.

Department of Sanitation

The SAN experienced significant favorable variances between budgeted and estimated actual revenues for each of the past two fiscal years (FY 2014-15 and FY 2015-16). For FY 2015-16, there was an 11.2 percent favorable variance between the \$87.2 million FY 2015-16 Adopted Budget and the \$97.0 million FY 2015-16 Estimated Actual Revenues due to unanticipated weather events that increased McCommas Landfill (McCommas) usage by customers from surrounding cities. In order to balance the increased customer demand and McCommas' overall capacity, SAN's FY 2016-17 revenue estimate includes a gate rate increase from \$21.50 to \$25 per ton for non-contracted customers.

Concluding Comments

The Office of the City Auditor (Office) reviewed approximately \$2.2 billion of the \$2.8 billion in proposed revenue estimates for the General Fund, Enterprise Funds, and Debt Service Fund, or 77 percent, of the revenue estimates included in the FY 2016-17 Proposed Annual Budget (see Table I in Attachment I).

The Office's review did not include the remaining \$639.1 million in revenue estimates which are mainly derived from department reimbursements and City, employee, and retiree contributions for retirement and health benefits. Five-year budget-to-actual comparisons and the FY 2016-17 Proposed Annual Budget

amounts for the major revenue sources are shown in Attachment II (see Charts I through VIII).

City management is responsible for preparing reasonable revenue estimates for inclusion in the FY 2016-17 Proposed Annual Budget. In preparing these revenue estimates, City management develops revenue estimate methodologies, such as regression analyses and/or historical trends, and documents the significant assumptions used to support those methodologies. This information is reviewed by the Office for reasonableness; however, neither City management nor the Office guarantees the achievement of the FY 2016-17 revenue estimates.

Recommendation

We recommend the Director of OFS works with the Director of AVI to:

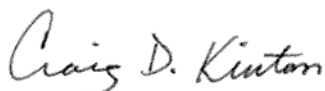
- Correct the errors and misclassifications noted in AVI's FY 2016-17 Rental on Airport and Terminal Concessions revenue estimates to reduce the potential for future errors and misclassifications
- Ensure AVI's FY 2017-18 revenue estimates are: (1) accurately and completely documented in up-to-date methodologies; and, (2) properly supported, including the verification of calculations and internal consistency

Please see Attachment III for management's response to the recommendation.

We would like to acknowledge City management's cooperation in providing the information needed to complete this audit.

If you have any questions or need additional information, please contact me at 214-670-3222 or Carol Smith, First Assistant City Auditor, at 214-670-4517.

Sincerely,



Craig D. Kinton
City Auditor

Attachments

C: A.C. Gonzalez, City Manager
Jeanne Chipperfield, Chief Financial Officer
Ryan Evans, First Assistant City Manager
Eric D. Campbell, Assistant City Manager
Jill A. Jordan, P.E., Assistant City Manager
Mark McDaniel, Assistant City Manager
Joey Zapata, Assistant City Manager
Mark Duebner, Director – Department of Aviation
Kelly High, Director – Department of Sanitation Services
Jack Ireland, Director – Office of Financial Services
Ron King, Director – Department of Convention and Event Services
Jo M. (Jody) Puckett, P.E., Director – Department of Dallas Water Utilities
Sarah Standifer, Director – Department of Trinity Watershed Management
Nick Fehrenbach, Manager (Utility Management) – Office of Financial Services

ATTACHMENT I

Table I

Fiscal Year 2016-17 Proposed Budget Revenue Sources Included in the Office of the City Auditor’s Assessment

Chart	Revenue Sources	Fiscal Year 2016-17 Proposed Revenues
General Fund		
I	Ad Valorem Taxes	\$ 608,880,474
II	Sales Tax	292,188,504
III	Franchise Fees	113,774,789
Enterprise Funds		
IV	Water Utilities	657,464,737
V	Sanitation Service Fees	95,946,054
VI	Aviation - Concessions and Rental on Airport ¹	75,869,094
VII	Convention and Event ² Services – Hotel Occupancy Tax	55,058,476
VIII	Storm Water Fees	50,936,837
Debt Service		
	Ad Valorem Taxes	242,487,406
Total Revenue Estimates Assessed		\$ 2,192,606,371
Revenue Estimates Not Included		639,059,456
Total Fiscal Year 2016-17 Proposed Budget		\$ 2,831,665,827

¹ Amounts for Aviation – Concessions and Rental on Airport were provided by City of Dallas (City) management. The \$75.9 million amount is not individually presented in the Fiscal Year (FY) 2016-17 Proposed Annual Budget.

² City management plans to propose an increase in Hotel Occupancy Tax revenue by approximately \$3.7 million as a result of inadvertent calculation errors identified during this audit.

Source: Revenue Estimates included in the FY 2016-17 Proposed Annual Budget (Unaudited)

Audit of Revenue Estimates Included in the Fiscal Year 2016-17 Proposed Annual Budget for the City of Dallas

Table II

Fiscal Year 2015-16 Estimated Actual Revenues Compared to Fiscal Year 2016-17 Proposed Revenues for Major Revenue Sources

Revenue Sources	Fiscal Year 2015-16 Estimated Actual Revenues¹	Fiscal Year 2016-17 Proposed Revenues	\$ Variance	% Variance
General Fund				
Ad Valorem Taxes	\$ 559,643,502	\$ 608,880,474	\$ 49,236,972	8.8
Sales Tax	283,679,162	292,188,504	8,509,342	3.0
Franchise Fees	106,710,886	113,774,789	7,063,903	6.6
Enterprise Funds				
Water Utilities	614,237,558	657,464,737	43,227,179	7.0
Sanitation Service Fees	96,981,849	95,946,054	(1,035,795)	(1.1)
Aviation	96,366,426	98,173,764	1,807,338	1.9
Convention and Event Services ²	94,973,522	92,605,145	(2,368,377)	(2.5)
Storm Water Fees	50,493,195	50,936,837	443,642	0.9
Debt Service Fund				
Ad Valorem Taxes	230,418,698	242,487,406	12,068,708	5.2
Totals	\$ 2,133,504,798	\$ 2,252,457,710	\$ 118,952,912	5.6

¹ FY 2015-16 Estimated Actual Revenues are based on information provided by City management.

² City management plans to propose an increase in FY 2016-17 Convention and Event Services revenue by approximately \$3.7 million.

Source: FY 2016-17 Proposed Annual Budget (Unaudited)

Audit of Revenue Estimates Included in the Fiscal Year 2016-17 Proposed Annual Budget for the City of Dallas

Table III

Fiscal Year 2015-16 Adopted Budget Revenues Compared to Estimated Actual Revenues for Major Revenue Sources

Revenue Source	Adopted Budget	Estimated Actual Revenues¹	\$ Variance	% Variance
General Fund				
Ad Valorem Taxes	\$ 559,636,084	\$ 559,643,502	\$ 7,418	0.0
Sales Tax	281,271,586	283,679,162	2,407,576	0.9
Franchise Fees	107,198,289	106,710,886	(487,403)	(0.5)
Enterprise Funds				
Water Utilities	645,128,387	614,237,558	(30,890,829)	(4.8)
Sanitation Service Fees	87,188,361	96,981,849	9,793,488	11.2
Aviation	93,875,967	96,366,426	2,490,459	2.7
Convention and Event Services	83,996,067	94,973,522	10,977,455	13.1
Storm Water Fees	50,452,299	50,493,195	40,896	0.1
Debt Service Fund				
Ad Valorem Taxes	230,475,333	230,418,698	(56,635)	0.0
Totals	\$ 2,139,222,373	\$ 2,133,504,798	\$ (5,717,575)	(0.3)

¹ FY 2015-16 Estimated Actual Revenues are based on information provided by City management.

Source: FY 2016-17 Proposed Annual Budget (Unaudited)

ATTACHMENT II

Charts I to VIII shown on the following pages are based upon analyses of Fiscal Year (FY) 2012 through FY 2017 actual and budget revenues and current year estimates included in the FY 2016-17 Proposed Annual Budget presented as of August 9, 2016. Descriptions for the revenue sources were provided by management or taken from the Office of Financial Services' (OFS) FY 2016-17 Proposed Budget Appendices, *Major Revenue Sources*.

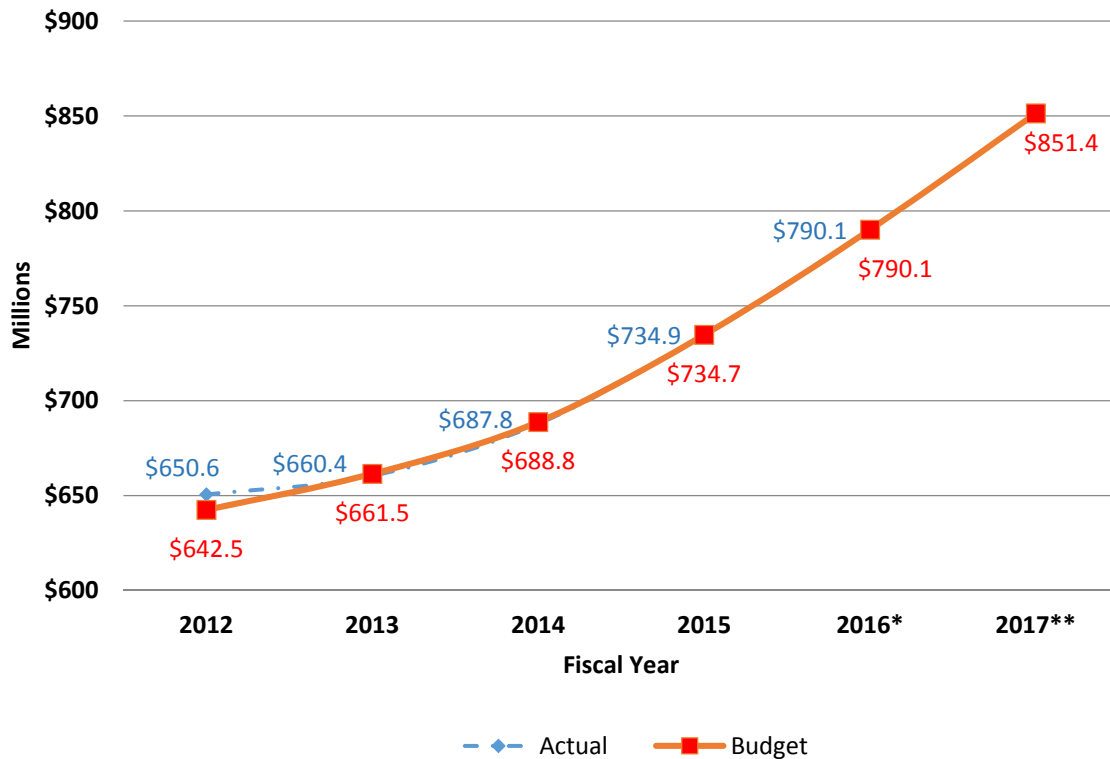
The Charts provide comparisons of the Adopted FY 2012 to FY 2015 budgets versus actual revenues collected for the same period. In addition, the Charts show the FY 2016 Adopted Budget versus Estimated Actual Revenues and the FY 2017 Proposed Annual Budget.

Ad Valorem Tax Revenue

Ad Valorem (Property) Tax is the largest revenue source for the General Fund and Debt Service Fund. Assessed property values are established by the Central Appraisal Districts in the four counties (Dallas, Collin, Denton, and Rockwall) in which the City of Dallas (City) is located and are certified by the individual Appraisal Districts (Appraisal Review Boards).

Chart I

**Ad Valorem Tax Revenue
Analysis of Actual and Budget
FY 2012 to FY 2017**



* FY 2016 revenues, including estimates for the remaining months, were provided by City management.

** FY 2017 is proposed; therefore, actual is not available.

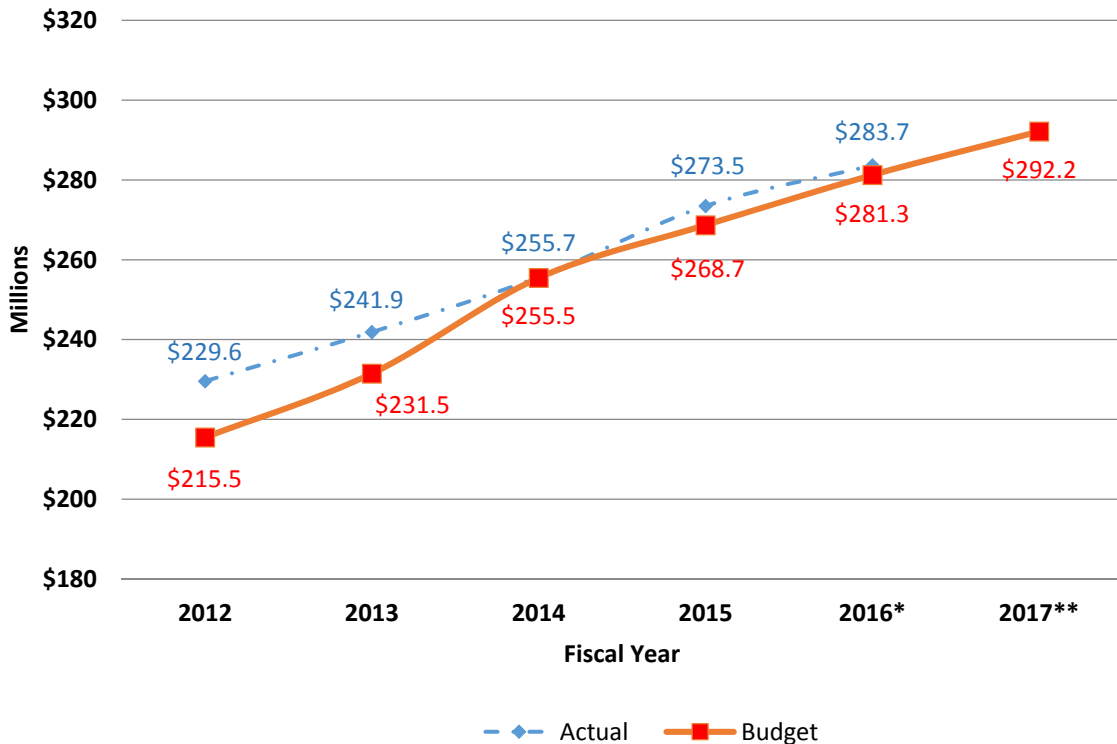
Source: City of Dallas Adopted Annual Budgets and FY 2016-17 Proposed Annual Budget (Unaudited)

Sales Tax Revenue

Sales tax is the second largest revenue source for the General Fund. The sales tax rate in the City is 8.25 percent of taxable goods or services sold within the City limits. The sales tax is collected at the point of sale and forwarded to the Texas State Comptroller's Office on a monthly or quarterly basis. Of the 8.25 percent collected, the State retains 6.25 percent and distributes one percent to the City and one percent to the Dallas Area Rapid Transit transportation authority.

Chart II

**Sales Tax Revenue
Analysis of Actual and Budget
FY 2012 to FY 2017**



* FY 2016 revenues, including estimates for the remaining months, were provided by City management.

** FY 2017 is proposed; therefore, actual is not available.

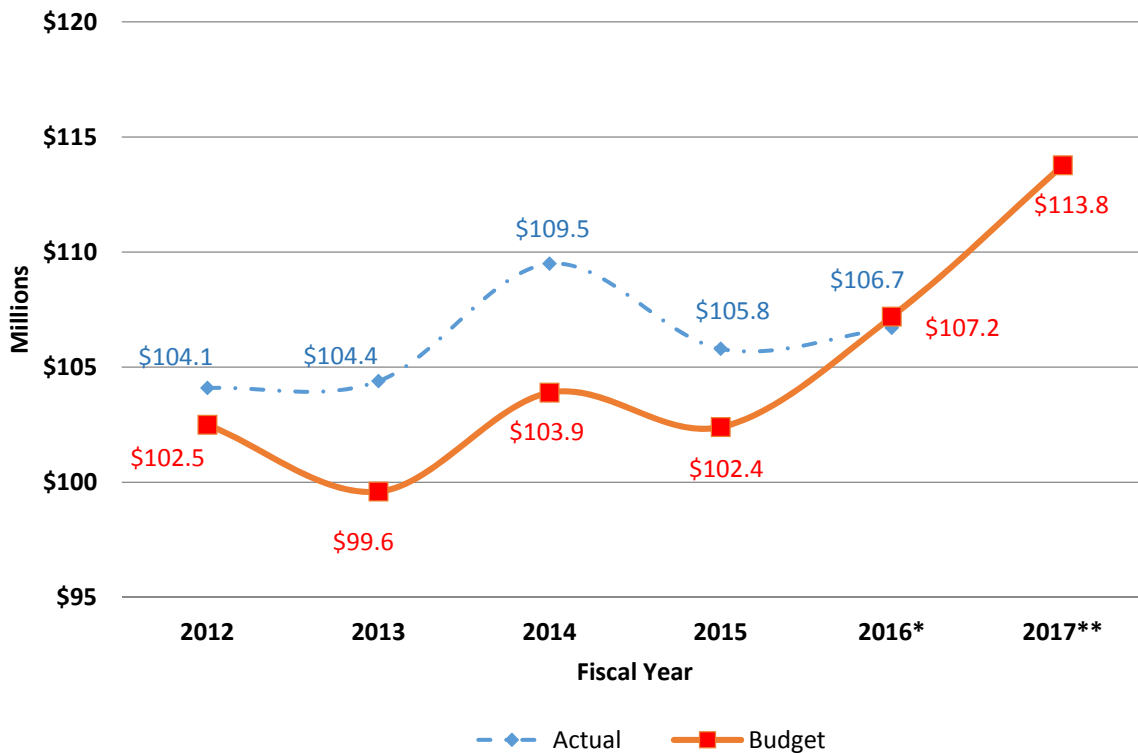
Source: City of Dallas Adopted Annual Budgets and FY 2016-17 Proposed Annual Budget (Unaudited)

Franchise Fees Revenue

The City maintains non-exclusive franchise agreements with utilities and other service providers that use the City’s rights-of-way to provide services to the public. These franchise agreements provide for compensation to the City in the form of franchise fees. These fees are in lieu of all other fees and charges related to the use of the rights-of-way.

Chart III

**Franchise Fees Revenue
Analysis of Actual and Budget
FY 2012 to FY 2017**



* FY 2016 revenues, including estimates for the remaining months, were provided by management.

** FY 2017 is proposed, therefore actual is not available. The FY 2017 Proposed Revenue includes the majority of a one-time settlement from a utility service provider. In 2014, the City hired a consultant to conduct a Franchise Fees Audit to ensure the City receives appropriate revenue from utilities and other service providers. Based on the audit result, the City expects to receive approximately \$4.1 million one-time settlement: \$3.5 million in FY 2017 and \$0.6 million in FY 2018.

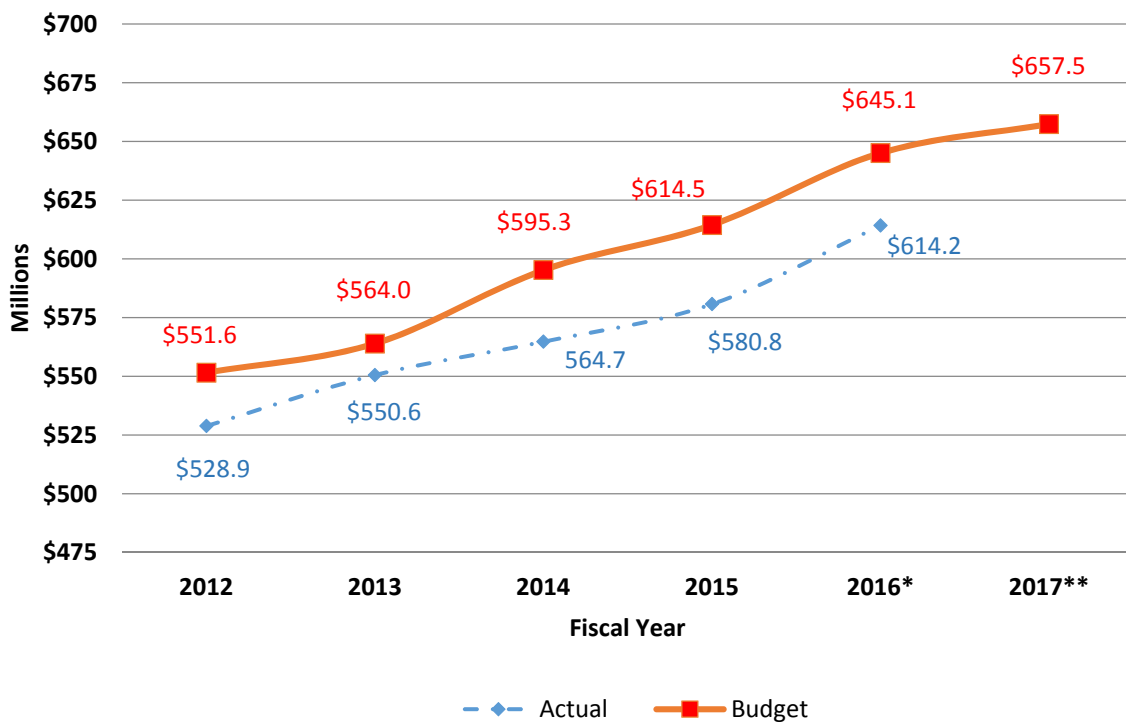
Source: City of Dallas Adopted Annual Budgets and FY 2016-17 Proposed Annual Budget (Unaudited)

Water Utilities Revenues

The Department of Dallas Water Utilities (DWU) revenues are obtained through the sale of water and wastewater services in five customer classes: Residential, General Service, Municipal, Optional General Service, and Wholesale. The wholesale customer class is comprised of 23 communities outside the City which receives treated water service and 11 communities which receive wastewater service. Rates for each class are determined by a cost of service study that assigns costs to each customer class based on the department’s cost to provide these services.

Chart IV

**Water Utilities Revenues
Analysis of Actual and Budget
FY 2012 to FY 2017**



* FY 2016 revenues, including estimates for the remaining months, were provided by City management.
 ** FY 2017 is proposed; therefore, actual is not available.
Source: City of Dallas Adopted Annual Budgets and FY 2016-17 Proposed Annual Budget (Unaudited)

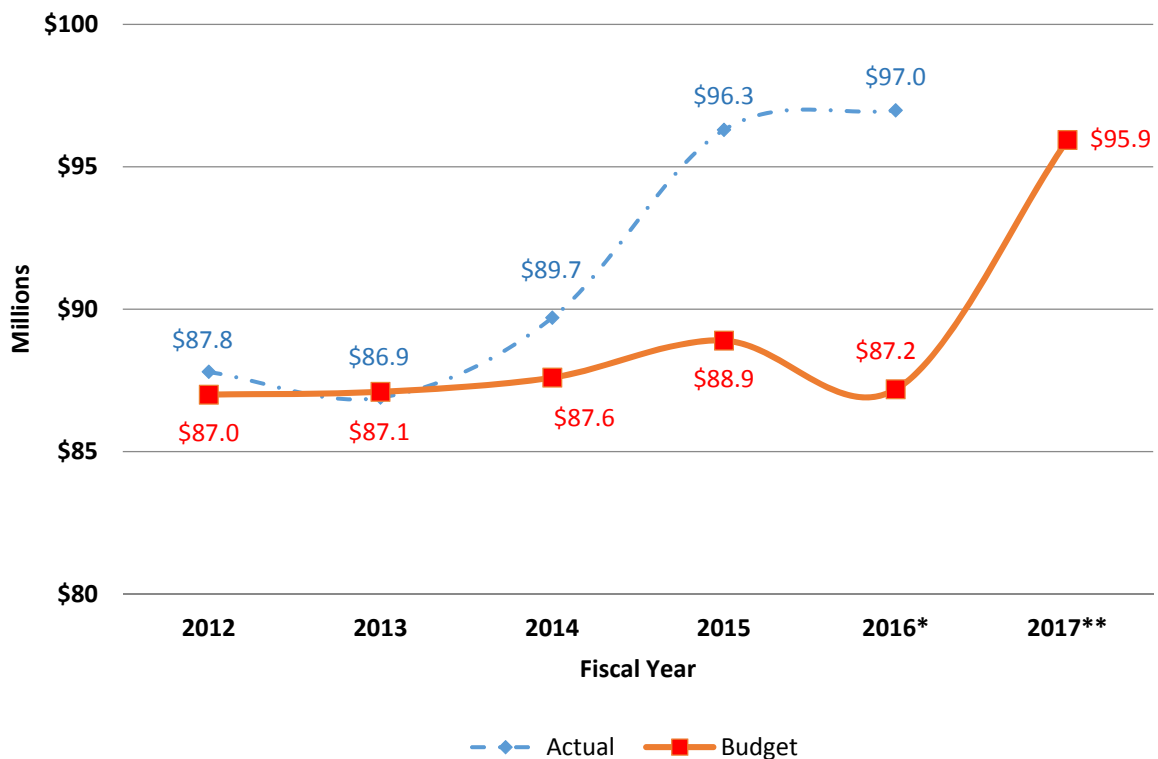
Sanitation Services Fees Revenue

Sanitation Services Fees Revenue is collected to match the cost of providing garbage collection, brush and bulky collection, and recyclables collection services for residential customers and a few small commercial customers. This revenue is based on fees, which are collected through the monthly water bills issued by DWU. In addition, fees are charged to non-Dallas residents and commercial waste haulers for disposing of solid waste at the McCommas Bluff Landfill and the Northwest (Bachman) Transfer Station.

The Department of Sanitation Services (SAN) converted to an enterprise fund in FY 2015-16. According to management, after conversion of two revenue sources, the McCommas Site Rental and Commercial Container Fee will remain in the General Fund.

Chart V

**Sanitation Services Fees Revenue
Analysis of Actual and Budget
FY 2012 to FY 2017**



* FY 2016 revenues, including estimates for the remaining months, were provided by City management.

** FY 2017 is proposed; therefore, actual is not available.

Source: City of Dallas Adopted Annual Budgets and FY 2016-17 Proposed Annual Budget (Unaudited)

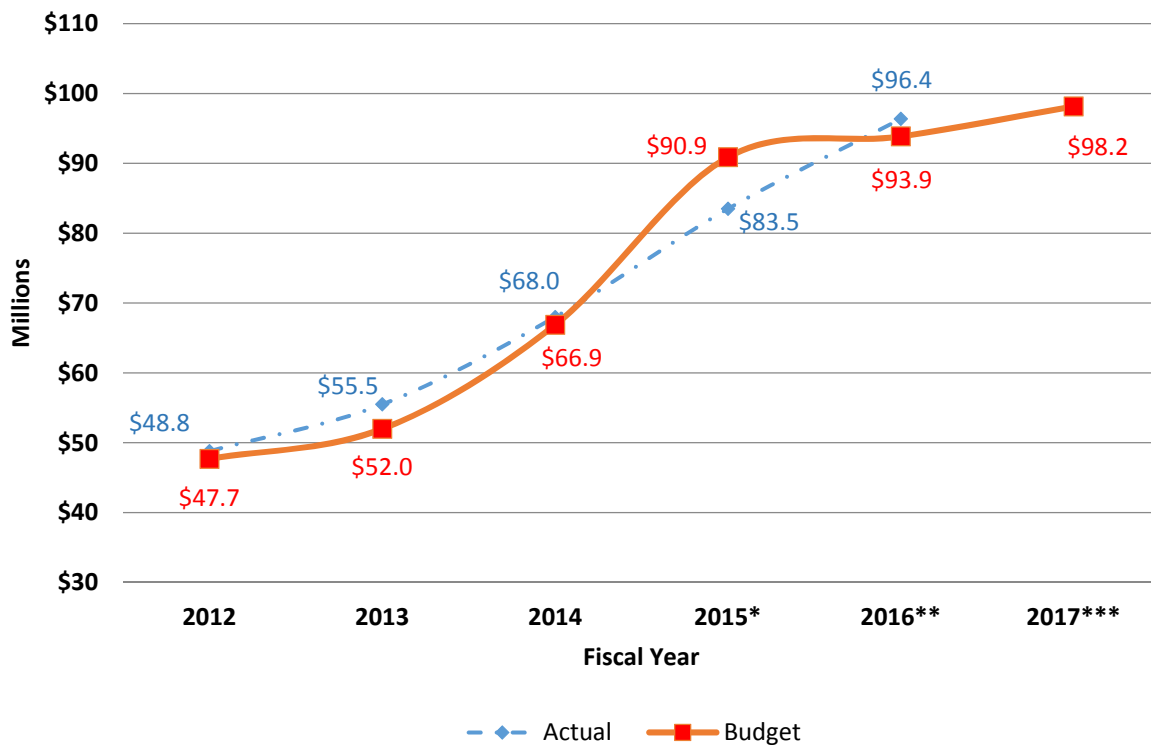
Aviation Revenues

The Department of Aviation (AVI) manages operations for both Dallas Love Field, Dallas Executive airports, and the downtown Vertiport. Revenues are comprised of landing fees, property rentals, and concessions. Airport businesses with concessions contracts are obligated to pay the City a percentage of their monthly gross revenues or a guaranteed minimum payment. Concession agreements include parking, food and beverage services, retail stores, advertising, car rental agencies, shoe shine services, and bag cart rental. Rental on Airport revenues are rental payments received from leased property at Dallas Love Field and Dallas Executive Airport. The leased property includes rent for airfield (ground) space, terminal building space, cargo building space, associated shop and warehouse space.

The FY 2015-16 Proposed Budget for AVI has significantly increased due to the completion of the Love Field Modernization Program and the elimination of the Wright Amendment which increased projected revenues for property rentals, landing fees, and parking.

Chart VI

**Aviation Revenues
Analysis of Actual and Budget
FY 2012 to FY 2017**



* FY 2015 Adopted Budget was \$86,544,784. According to the FY 2015-16 Adopted Financial Summaries, the FY 2015 Budgeted Revenue was \$90,944,784. The Office of Financial Services stated that the increase of \$4.4 million was due to the mid-year appropriation adjustment.

** FY 2016 revenues, including estimates for the remaining months, were provided by City management.

*** FY 2017 is proposed; therefore, actual is not available.

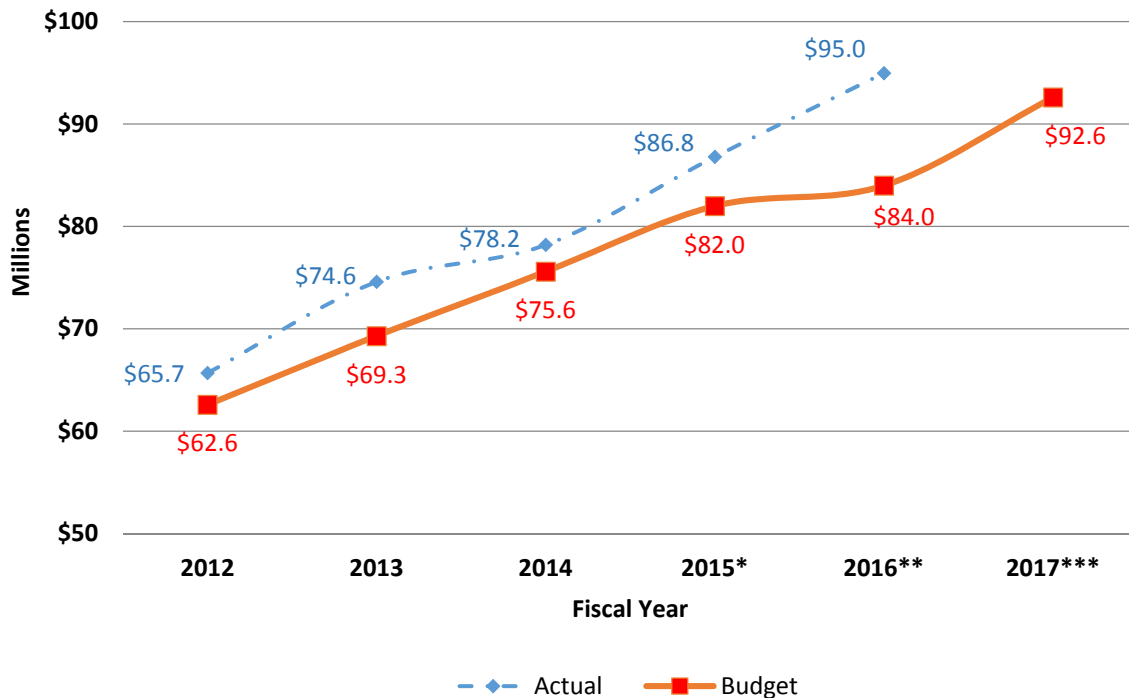
Source: City of Dallas Adopted Annual Budgets and FY 2016-17 Proposed Annual Budget (Unaudited)

Convention and Event Services Revenues

The major revenue source for the Department of Convention and Event Services (CES) is from the Hotel Occupancy Tax (HOT). The HOT rate in the City is 13 percent of the room rate charged within the City limits. The HOT tax is collected by the hotel at the point of sale and forwarded to the State (six percent) and to the City (seven percent) on a monthly basis. Of the seven percent, remitted to the City, approximately 30 percent is allocated to the Kay Bailey Hutchison Convention and Visitors Bureau (DCVB) to market and promote the City as a convention and tourist destination. Approximately 67 percent is allocated to the Kay Bailey Hutchison Convention Center to support operations and capital improvements and approximately three percent is allocated to the Office of Cultural Arts to encourage, promote, and improve the arts. Other revenue sources for CES include Contract Services, Alcohol Beverage Tax, and other miscellaneous revenues.

Chart VII

**Convention and Event Services Revenues
Analysis of Actual and Budget
FY 2012 to FY 2017**



* FY 2015 Adopted Budget was \$77,391,801. According to the FY 2015-16 Adopted Financial Summaries, the FY 2015 Budgeted Revenue was \$82,045,050. The Office of Financial Services stated that the increase of approximately \$4.7 million was due to the mid-year appropriation adjustment.

** FY 2016 revenues, including estimates for the remaining months, were provided by City management. CES collected \$11 million (or 13 percent) more than the Adopted Budget. According to CES, the increase is mainly contributed by Alcohol Beverage Tax revenue and show/event related revenues.

*** FY 2017 is proposed; therefore, actual is not available. City management plans to propose an increase in Convention and Event Services revenue by approximately \$3.7 million.

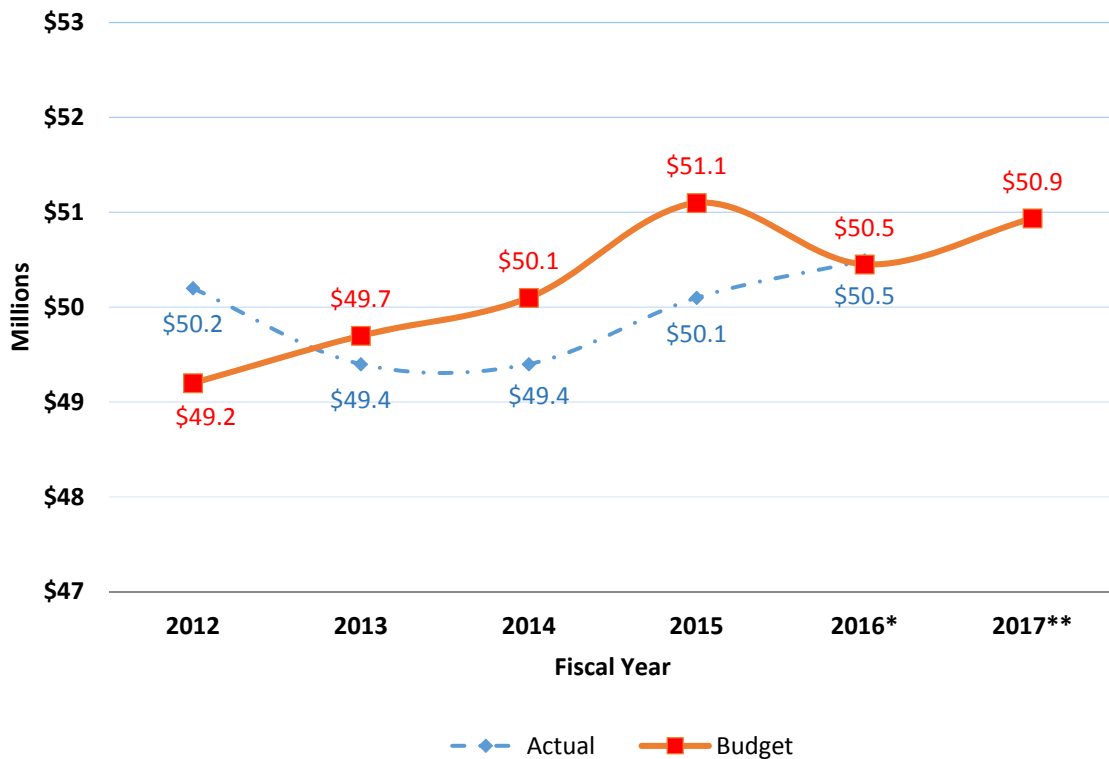
Source: City of Dallas Adopted Annual Budgets and FY 2016-17 Proposed Annual Budget (Unaudited)

Storm Water Fees Revenue

The Storm Water Drainage Management Utility Revenue is collected to support the cost of operating and maintaining the City’s storm sewer system; maintenance of creeks, rivers and levees; monthly sweeping of the City’s major thoroughfares; water quality activities required by storm water permit (e.g., sampling, testing, monitoring, public education, and hazardous spill cleanup and disposal); and, engineering, design, and inspection of storm sewer infrastructure. Utility fees are billed and collected through the monthly water bills.

Chart VIII

**Storm Water Fees Revenue
Analysis of Actual and Budget
FY 2012 to FY 2017**



* FY 2016 revenues, including estimates for the remaining months, were provided by City management.

** FY 2017 is proposed; therefore, actual is not available.

Source: City of Dallas Adopted Annual Budgets and FY 2016-17 Proposed Annual Budget (Unaudited)

ATTACHMENT III

Management's Response

Memorandum

RECEIVED

SEP 02 2016

City Auditor's Office



CITY OF DALLAS

DATE: September 1, 2016
TO: Craig D. Kinton, City Auditor
SUBJECT: Response to Audit Report:
Audit of Revenue Estimates Included in the Fiscal Year 2016-17 Proposed Annual Budget for the City of Dallas

Our responses to the audit report recommendations are as follows:

Recommendation I

We recommend the Director of OFS work with the Director of AVI to:

- Correct the errors and misclassifications noted in AVI's FY 2016-17 Rental on Airport and Terminal Concessions revenue estimates to reduce the potential for future errors and misclassifications
- Ensure AVI's FY 2017-18 revenue estimates are: (1) accurately and completely documented in up-to-date methodologies; and, (2) properly supported, including the verification of calculations and internal consistency

Management Response / Corrective Action Plan

Agree Disagree

The Department of Aviation has made improvements regarding the methodology issues identified last year, however additional improvements will be made to correct the misclassifications and errors identified by the City Auditor for the FY 2016-17 Rental on Airport and Terminal Concessions revenue estimates. The department continues to improve and refine the financial controls for the budget, especially with regard to the Rates & Charges Methodology agreed to by the City in the Amended and Restated Use and Lease Agreement with the airlines.

The Department of Aviation's revenue estimation process will be well documented for FY 2017-18 and the Department looks forward to continue to work the City Auditor and the consultant on a revised Rates & Charges Model to clarify revenue streams, appropriately modify City budget documents, and reduce confusion regarding application of revenues to expenses.

Audit of Revenue Estimates Included in the Fiscal Year 2016-17 Proposed Annual Budget for the City of Dallas

Implementation Date

July 21, 2017

Responsible Manager

Director, Department of Aviation
Director, Office of Financial Services

Sincerely,



Mark Duebner, Director
Department of Aviation



Ryan S. Evans
First Assistant City Manager



Jack Ireland, Director
Office of Financial Services



Jeannette Chipperfield
Chief Financial Officer