
OFFICE OF THE CITY AUDITOR

PERFORMANCE AUDIT OF PUBLIC WORKS AND TRANSPORTATION REIMBURSEMENTS

**Thomas M. Taylor, CPA
City Auditor**

Prepared by:

Joe R. Saucedo, Jr., CPA, CFE
Audit Manager

Jing Xiao, CPA
Auditor

Tony Sivasothy
Auditor

**October 24, 2003
Report No. 401**

Memorandum



CITY OF DALLAS

October 24, 2003

Honorable Mayor and Members of the City Council
City of Dallas

We have conducted a performance audit of reimbursements in the Department of Public Works and Transportation (PWT).

As a result of our inquiries, analysis of the transactions, and review of procedures, we conclude that PWT has procedures to identify reimbursable projects and track costs. However, internal personnel costs are not capitalized. This finding was previously noted in the Deloitte Touche report regarding project accounting and in a letter dated August 28, 2003 to the Director of PWT.

PWT appears to have maximized opportunities for reimbursement within its limitations of staff size and capability, but opportunities to achieve \$2.6 million in higher reimbursements are possible and are addressed in the Opportunities for Improvement section.

We appreciate the cooperation of City staff during our examination.

Thomas M. Taylor

Thomas M. Taylor, CPA
City Auditor

c: Teodoro J. Benavides, City Manager

**PERFORMANCE AUDIT OF PUBLIC WORK AND TRANSPORTATION
REIMBURSEMENTS**

CONTENTS

	<u>PAGE</u>
INTRODUCTION	1
Authorization	1
Scope and Methodology	1
Overall Conclusion	2
Background	3
OPPORTUNITIES FOR IMPROVEMENT	5

INTRODUCTION

Authorization

We have conducted an audit of the Public Works and Transportation (PWT) reimbursements for October 1, 2002, through May 31, 2003. This audit was conducted under the authority of Chapter IX, Section 2 of the Dallas City Charter and in accordance with the Annual Audit Plan approved by the City Council.

Scope and Methodology

Our audit was conducted in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States. Accordingly, our audit included inquiries, tests of the records, and other procedures that we considered necessary to meet the scope and objectives.

Our scope was reimbursements¹ from the following areas: (a) Capital Improvement Program, (b) Dallas Water Utilities, and (c) Storm Water Management. These areas comprised 83.5% (\$14,230,775) of anticipated reimbursements for FY03 and are detailed below.

Capital Improvements	\$9,145,866
Storm Water Management	\$3,379,002
Dallas Water Utilities	\$1,705,907

Our audit covered October 1, 2002, through May 31, 2003. However, we reviewed certain events occurring before and after this period to the extent that those events pertained to the audit objectives.

The audit objectives were to determine whether:

- PWT has procedures to identify reimbursable projects.
- PWT has maximized the opportunities of reimbursement.
- PWT has procedures to identify and track appropriate costs for each reimbursable project.
- PWT has implemented Deloitte Touche's recommendation(s) that are related to reimbursable costs.

¹ This does not include revenue from fees and charges for services applicable to 3rd parties.

INTRODUCTION

To assist in our understanding of the relevant activities and processes, our methodology consisted of (but was not limited to) the following:

- PWT staff interviews.
- Reviews of PWT's Annual Work Plan, Labor Distribution Report, and capital projects files.
- Familiarization with PWT's Internal Billing Information System (IBIS).
- Reviews of the City's Indirect Cost Rate Proposal and budgetary and financial data related to reimbursements.
- Review of Deloitte Touche's Performance Audit Report – Department of Public Works and Transportation, dated March 26, 2002.

Costs are accounted for by organizational code, not by project. Therefore, our focus was on selected organizational codes eligible for reimbursable costs. We used judgment sampling to perform our testing, which consisted of:

- Six of eleven organizational codes charged to the Capital Improvement Program.
- Billings to Storm Water Management for October 2002 through May 2003.
- Second quarter billings submitted to Dallas Water Utilities.
- Payroll testing of direct labor hours reported.

Overall Conclusion

PWT does have procedures to identify reimbursable projects and to identify and track costs for each reimbursable project. However, internal personnel costs are not capitalized. This finding was also noted in the Deloitte Touche report regarding project accounting. We addressed this subject separately to the Director of PWT in a letter dated August 28, 2003. PWT appears to have maximized opportunities for reimbursement within its limitations of staff size and capability, but there is potential for greater reimbursements, which is addressed in the Opportunities for Improvement section.

INTRODUCTION

Background

The department manages its capital projects to comply with project scopes and budgets approved by the Council and voters within bond propositions. Based on the level of resources devoted to the City's capital infrastructure needs, the department utilizes sound budgetary management practices to operate within budgeted amounts. Any changes to projects and requirements for additional funding are communicated to Council through change orders.

The Financial Services Section of this department is responsible for all financial matters for the department. This section is staffed by 16 FTEs² (for FY03) to support financial activities. The main duties of this section are:

- Develop and manage the capital and operating budgets.
- Review and process all financial transactions.
- Produce monthly reports.
- Manage data in the EPIC (Essential Project Information Control) system.

Financial Services is responsible for working with the City's Budget Office to establish and monitor project budgets at the organizational level. Financial Services personnel are responsible for establishing project-specific budgets in order to ensure that sufficient funds are available for each project prior to awarding contracts, processing necessary budget transfers, and closing out project budgets upon work completion.

PWT is reimbursed for designing, surveying, and monitoring of all reimbursable projects. Generally all projects listed in the bond program are reimbursable. All expenses are initially charged to the General Fund, and journal vouchers are initiated for reimbursable expenses. Historically, reimbursements have averaged about 50% of the department's expenditures.

² To be reduced to 8 FTEs for FY03-04.

INTRODUCTION

Reimbursable cost is exclusively determined by the direct labor hour information tracked by the IBIS, an internally created software application. IBIS is not interfaced with the City's HRIS (Human Resource Information System). Employees report their chargeable hours via weekly timesheets that are approved by inspectors or program managers and entered into IBIS.

PWT has an approved indirect cost rate of 27.7% for FY02-03. The City's consultant establishes the indirect cost rate annually. The consultant utilizes direct personal services costs (i.e., salary, premium pay, paid time off, and all fringe benefits) as the basis for computing departmental indirect cost rates. Indirect cost is a reimbursable cost.

Deloitte Touche conducted a performance audit in 2002. The purpose was to evaluate the effectiveness of the department's management of capital projects, with a primary focus on the following areas:

- Project Management Activities
- Project Inspection Activities
- Financial Management and Cost Accounting

The report detailed thirteen opportunities for improvement. As part of our scope, we reviewed those opportunities for improvement and determined that one (Project Accounting) had a correlation to reimbursable costs.

OPPORTUNITIES FOR IMPROVEMENT

We identified certain policies, practices, and procedures that should be improved. Our audit was not designed or intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the opportunities for improvement presented in this report may not be all-inclusive of areas where improvement may be needed.

1. Reimbursement calculations should include all personal services costs.

PWT uses direct labor costs (DLC) as its primary basis for computing reimbursements. To determine DLC, PWT uses IBIS to track employees' time on projects and activities. The individual's hourly rate (annual salary/2080 hours) is applied to the direct labor hour(s) to yield reimbursable salary. Added to the reimbursable salary is: pension cost (11% of the reimbursable salary), health benefit (\$4088/employee/year for CY03), and Service Incentive Pay. However, PWT does not include any paid time off (i.e., sick, vacation, or holidays) in calculating its billings for reimbursements. Paid time off is not included because:

- The methodology for calculating reimbursements has been a long-standing practice inherited by the current staff and has not been evaluated for updates.
- The completeness of data is not emphasized since these are internal billings.

The City's consultant utilizes direct personal services costs (which is the 1000 series object codes) as the basis for computing departmental indirect cost rates. Thus, for billing purposes, the indirect cost rate should be applied to all direct personal services costs applicable to the billing period. Paid time off is a benefit that is considered by the City's consultant when developing its annual indirect cost rate proposal and is an eligible cost for reimbursement.

Our test sample covered six organizational codes billable for reimbursable costs related to the Capital Improvement Program. Our tests revealed that paid leave was an average of 12.07% of total personal services costs. Since these costs would be subject to the indirect cost rate (27.7% for FY03), the potential for under billing is increased. By including paid leave and applying the indirect cost rate, we identified an additional \$115,893 eligible for reimbursement and an under billing average of 26.68%.

Applying this under billing average of 26.68% to PWT's FY03 forecasted reimbursable direct salaries (\$9,768,513)³ could yield an additional \$2,606,239 in reimbursements. Therefore, billings submitted for reimbursements have been understated, and the General Fund is bearing more than its fair share of costs since paid time off has not been a component in PWT's computations.

We recommend that the Director of PWT modify reimbursement procedures to ensure that paid time off is included in the computations to maximize reimbursements from the

³ \$1.07 million direct salary for Storm Water Management was excluded.

OPPORTUNITIES FOR IMPROVEMENT

appropriate funds and minimize the financial burden on the General Fund.

Paid time off can be included by utilizing IBIS' capability to track direct labor hours:

- Compute a direct labor costs ratio to total org code salary costs.
- Use the direct labor cost ratio to compute reimbursable benefits (i.e., all 1000 series object codes less salary times the direct labor cost ratio).
- Apply the approved indirect cost rate to the sum of direct labor costs and reimbursable benefits.
- Apply the direct labor cost ratio to the 2000 and 3000 series object codes as is already performed.

Management's Response:

PWT agrees that paid time off (i.e., sick vacation, or holidays) should be calculated in billings for reimbursements and has modified procedures as suggested up to the appropriation level. Paid time off was included in final billings for FY 02-03.

2. Reimbursement process should be based on written policy and procedures.

Reimbursable cost is exclusively determined by the direct labor hour information tracked by IBIS and by formulas embedded in spreadsheets; however, not all PWT employees are required to be tracked by IBIS. The type of employees and conditions not subject to IBIS reporting was not clearly communicated.

The current practice has been in place for many years and has relied on the employees' knowledge and experience. Thus, all eligible cost components may not always be included in the calculations for reimbursable costs.

Written policy and procedures are a component of administrative internal controls by (a) ensuring that requirements are defined and communicated and (b) procedures are standardized and implemented in a consistent manner. Written procedures serve as a reference and are integral to proper administration, especially in an environment of staff turnover due to personnel reductions and hiring freezes.

IBIS did not capture all reimbursable salary costs. We selected thirty employees for our payroll testing and discovered that three employees were not reported in IBIS. Our follow up determined that two of the employees were not required to be reported in IBIS and that the third employee was an Assistant Director whose salary (according to the Labor Distribution Report) was programmed to be 50% reimbursable. As a result, approximately \$89,217 (50% of salary and benefits plus indirect cost) was not submitted as a reimbursable cost.

We also noted that the Storm Water billing did not include indirect cost. PWT's July billing for reimbursable costs was for actual costs incurred from October 2002 through

OPPORTUNITIES FOR IMPROVEMENT

May 2003 in the amount of \$833,451 (personal service costs of \$587,557). Application of the indirect cost rate ($\$587,557 \times 27.7\%$) would yield an additional \$162,753 in reimbursable costs from a special revenue fund.

Written procedures provide assurance that all reimbursable costs will be properly reported for payment. PWT did have written procedures but were not inclusive of all cost components.

We recommend that the Director of PWT:

- Ensure that written policy and procedures (e.g., checklist, flowcharts) are developed and that they adequately identify:
 - All costs components that should be included in computations for reimbursements.
 - Employees that should be accounted for in IBIS.
 - Conditions that exempt employees from IBIS reporting.
 - Procedures for preparing and submitting reimbursements.
- Submit corrected billings for additional reimbursable costs.

Management's Response:

PWT agrees that written policies and procedures should be updated to ensure that all eligible cost components, identification of employees eligible and exempt from reporting and preparation of reimbursement documents are included. Policies and procedures revisions will occur during the first quarter of FY 03-04.