# APPENDICES

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# APPENDIX 1

## RATIONALE FOR CREATION OF INTERNAL SERVICE FUND (Attachment to Memorandum, November 9, 1994, From DCFM to Chair of Council Budget and Fiscal Management Committee)

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### *Rationale for Creation of Internal Service Fund*

In the Executive's 1995 Proposed Budget the Facilities Management Division and the DCFM administrative unit have been budgeted as an Internal Service Fund (ISF). Council called for creation of the ISF by January 1995 in a 1994 Budget Ordinance Proviso.

The ISF will bill agencies for basic building maintenance services, as well as for minor renovation work undertaken within allowable limits for in-house work. Each agency will be charged for maintenance on a per-square-foot basis, depending on the building the agency occupies and the specific costs of operating and maintaining that building. Agencies will be charged for renovation work on an hourly basis, reflecting the current wage rates for the existing crews of in-house craft workers. It is assumed in this first year of fund operation that the existing level of staffing on these crews is correct; in subsequent years this assumption can be validated by fund experience.

DCFM and the Budget Division anticipate two major advantages of this move to an internal service fund structure: **enhanced accountability** and **increased visibility of costs. Accountability** will be enhanced because the ISF will provide agencies with a clearer picture of what they are buying, enabling them in turn to make certain that DCFM is providing all of what they're paying for. There will be increased **visibility of costs** because all the costs of building operations/maintenance and of building renovation will be captured in a published rate and budgeted in the fund at their full cost. Under past accounting methods, such full costs were obscured, and were difficult, if not impossible, to calculate. Decisionmakers were stymied when asking such basic questions as: " What are our O & M costs in the Courthouse complex, and how do those costs compare to private sector costs for similar facilities." We can answer these questions much more accurately with the full cost disclosure offered by the use of an ISF.

With regard to the question of equity of services between CX agencies (typically the "have nots" of County government) and Non-CX agencies (the "haves"), DCFM believes that the creation of the fund will have no effect one way or the other on any existing disparities in the "standard of living". DCFM will supply a basic level of building maintenance services and will respond to renovation requests from agencies just as before. Agencies with more available revenues will be able to purchase more services, just as they now can. Resolution of any existing disparities in agency living standard is something that the Council and Executive must address, if they choose to do so, through expenditure policy. The change of accounting method in the move to an ISF will make such policy making easier by providing better financial information, but it will not, in and of itself, have any income redistributive effect.

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# APPENDIX 2

## 2001 SQUARE FOOT RATES

| Building | Sq. Ft. Rate[a] | Overhead | | Bldg. Specific Costs | General Costs | | | | Sq. Ft. (% of Total) |
|---|---|---|---|---|---|---|---|---|---|
| | | Dept. | Div.[b] | | Day Custodial Crew | Maint. Staff | HVAC | Security | |
| Animal Control Shelter | **$8.93** | $1.06 | $1.39 | $4.18 | $0.10 | $1.22 | $0.54 | $0.44 | 11,290 (0.5%) |
| Black River | **$9.63** | $1.06 | $1.39 | $5.26 | $0.10 | $1.22 | $0.54 | $0.07 | 72,503 (3.3%) |
| Cedar Hills | **$9.31** | $1.06 | $1.39 | $4.91 | $0.10 | $1.22 | $0.54 | $0.09 | 55,235 (2.5%) |
| Correctional Facility | **$10.01** | $1.06 | $1.39 | $5.69 | $0.10 | $1.22 | $0.54 | $0.01 | 343,590 (15.8%) |
| Courthouse & Admin.[c] | **$9.02** | $1.06 | $1.39 | $3.91 | $0.10 | $1.22 | $0.54 | $0.81 | 699,010 (32.1%) |
| District Courts | **$11.24** | $1.06 | $1.39 | $6.54 | $0.10 | $1.22 | $0.54 | $0.39 | 100,395 (4.6%) |
| North Rehab. Facility | **$5.57** | $1.06 | $1.39 | $1.18 | $0.10 | $1.22 | $0.54 | $0.08 | 59,565 (2.7%) |
| N. District Multi-Service Ctr. | **$8.23** | $1.06 | $1.39 | $3.76 | $0.10 | $1.22 | $0.54 | $0.16 | 30,045 (1.4%) |
| Sheriff's Office Precincts | **$10.54** | $1.06 | $1.39 | $5.58 | $0.10 | $1.22 | $0.54 | $0.66 | 37,606 (1.7%) |
| Public Health Centers | **$12.67** | $1.06 | $1.39 | $8.09 | $0.10 | $1.22 | $0.54 | $0.27 | 91,218 (4.2%) |
| Regional Justice Center | **$10.45** | $1.06 | $1.39 | $6.12 | $0.10 | $1.22 | $0.54 | $0.03 | 577,057 (26.5%) |
| Yesler | **$10.23** | $1.06 | $1.39 | $3.59 | $0.10 | $1.22 | $0.54 | $2.34 | 97,842 (4.5%) |
| **Total** | | | | | | | | | 2,175,356 (100%) |

[a] Actual square foot rates are carried out to four decimal points. The rates shown here may differ slightly from the sum of the component costs due to rounding.

[b] Division overhead includes the DCFM work order desk, the parking lot at Fifth and Jefferson, and the developmentally disabled housekeeping/grounds crew.

[c] The Administration Building and Courthouse are combined for one charge.

**Note**: The Youth Service Center (YSC) was not included in the 2001 model. DCFM charged the full building-specific costs and $50,000 each for department and division overhead ($0.59 each per square foot), but did not charge for any other overhead or general costs. The resulting square foot rate for the YSC was $20.99. This rate was so much higher than any other that year because it was calculated on only 84,474 square feet, which was incorrect. The 2002 model showed 173,297 square feet and a square foot rate of $14.10.

**SOURCE:** DCFM Square Foot Rate Model for 2001

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## APPENDIX 3

## METHODOLOGY FOR HOURLY RATE MODEL CALCULATIONS

DCFM determined the *Projected Revenue From Hourly Billings* by multiplying total billable hours by the average billable hourly rate. The formula used was:

Billable Hours Per FTE x Billable FTEs = **Total Billable Hours**
Average Hourly Rate x Burden Factor = **Average Billable Hourly Rate**
**Total Billable Hours** x **Average Billable Hourly Rate** = *Projected Revenue From Hourly Billings*

This appendix describes how DCFM calculated the total billable hours, the average billable hourly rate, and the burden factors for the billable capital planning and crafts/hazmat staff, as well as our recalculation of both and the impact of errors in DCFM's calculations on the amount of revenue to be earned through hourly billings for projects.

### I. TOTAL BILLABLE HOURS (Billable Hours Per FTE x Billable FTEs):

DCFM staff calculated the total billable hours for each function by multiplying their estimate of the number of billable hours per FTE by the number of billable FTEs. They estimated the number of billable hours by subtracting holidays, floating holidays, vacation, sick leave, miscellaneous leave (e.g., jury duty, military leave, and bereavement leave), and time worked but not billable (e.g., meeting, training, and other administrative time) from the total number of hours an employee is paid for the year. The factors for vacation, sick leave, miscellaneous leave, and nonbillable time were based on estimates provided by supervisors within DCFM. DCFM's calculations resulted in the following number of billable hours per FTE:

**TABLE 1**
**DCFM'S CALCULATION OF BILLABLE HOURS PER FTE**

| | Capital Planning (based on a 7-hour workday) | Crafts/Hazmat (based on an 8-hour workday) |
|---|---|---|
| Holidays | 70.0 | 80.0 |
| Floating Holidays | 14.0 | 16.0 |
| Vacation | 122.5 | 140.0 |
| Sick Leave | 21.0 | 48.0 |
| Miscellaneous Leave | 14.0 | 40.0 |
| Nonbillable Time Worked | 126.0 | 96.0* |
| Total Nonbillable Hours | 367.5 | 420.0 |
| Total Paid Hours | 1,824.0 | 2,088.0 |
| Less: Total Nonbillable Hours | 367.5 | 420.0 |
| Equals: Total Billable Hours | 1,456.5 | 1,668.0 |

*DCFM staff calculated a separate figure for hazmat staff that used 48 hours of nonbillable time.

To validate these calculations, we obtained a payroll download of DCFM capital planning and crafts/hazmat staff and calculated their average amount of vacation, sick leave, and miscellaneous leave usage in 1999. We used 1999 as the basis for our calculations since that was the last year for which DCFM would have had a full year's worth of data at the time they developed the hourly rate models. In 2000, DCFM staff began tracking administrative time (i.e., nonbillable time worked) for capital planning and crafts/hazmat staff. Since this was the only year for which this data was available, we used that data to determine the nonbillable time. Our recalculation of total billable hours based on actual data resulted in the following:

## APPENDIX 3 (Continued)

**TABLE 2**
**AUDIT STAFF'S RECALCULATION OF BILLABLE HOURS PER FTE**

| | Capital Planning (based on a 7-hour workday) | Crafts/Hazmat (based on an 8-hour workday) |
|---|---|---|
| Holidays | 70.0 | 80.0 |
| Floating Holidays | 0.0* | 0.0* |
| Vacation | 122.5 | 140.0 |
| Sick Leave | 31.5 | 72.0 |
| Miscellaneous Leave | 10.5 | 24.0 |
| Nonbillable Time Worked | 140.0 | 92.0 |
| Total Nonbillable Hours | 374.5 | 408.0 |
| Total Paid Hours | 1,824.0 | 2,088.0 |
| Less: Total Nonbillable Hours | 374.5 | 408.0 |
| Equals: Total Billable Hours | 1,449.5 | 1,680.0 |

*There is no need for a separate factor for floating holidays because they are treated as vacation in the payroll system.

After determining the number of billable hours per FTE, DCFM multiplied those hours by the number of billable FTEs in each function to determine the total billable hours per year.

DCFM identified 31.00 billable FTEs and 1,456.5 billable hours per FTE (see Table 1, Capital Planning column), for a total of 45,152 billable hours for capital planning staff; we identified 31.25 billable FTEs and 1,449.5 billable hours per FTE (see Table 2, Capital Planning column), for a total of 45,297 billable hours. (NOTE: The difference in billable FTEs was due to an error in DCFM's spreadsheet that omitted 0.25 FTEs from the total billable FTEs.) Our recalculation identified 145 additional billable hours for capital planning staff.

DCFM identified 34.05 billable FTEs and 1,668 billable hours per FTE (see Table 1, Crafts/ Hazmat column), for a total of 56,795 billable hours for crafts/hazmat staff; our recalculation did not change the number of billable FTEs but resulted in 1,680 billable hours per FTE (see Table 2, Crafts/ Hazmat column), for a total of 57,204 billable hours. Our recalculation identified 409 additional billable hours for crafts/hazmat staff.

### II. AVERAGE BILLABLE HOURLY RATE (Average Hourly Rate x Burden Factor):

DCFM staff calculated the average billable hourly rate by multiplying the average hourly rate by a burden factor to yield the average billable hourly rate for the capital planning and crafts/hazmat functions (see Section III for a discussion of the burden factor). This section discusses how DCFM calculated the average billable hourly rate.

To calculate the average hourly rate for the capital planning staff, DCFM staff summed the actual hourly rates of 33 of the 34 employees who perform directly billable work, divided the total by 35 employees, and multiplied the result by 1.03 to adjust for a three percent cost of living allowance (COLA). (NOTE: DCFM staff were unable to explain why they used numbers different from the actual number of employees in their calculations of the average hourly rates for the capital planning and crafts/hazmat staff.) This calculation did not consider the average hourly rates of administrative staff who performed partially billable work. DCFM's calculation resulted in an average hourly rate of $28.85 per hour.

To calculate the average hourly rate for crafts/hazmat staff, DCFM determined the actual hourly rate for each of the 37 employees who perform directly billable work and adjusted the rates for a

3.11 percent COLA, summed the adjusted hourly rates, and divided the total by 33 employees. Again, this calculation did not consider the average hourly rates of administrative staff who performed partially billable work. DCFM's calculation resulted in an average hourly rate of $26.14 per hour.

We recalculated the average hourly rates for both the capital planning and crafts/hazmat staff to account for the salaries of both direct labor and billable administrative positions, to prorate the rates for staff who perform billable labor on a part-time basis, and to correct the COLA adjustment for capital planning staff. We did this by multiplying the hourly rate for each employee, adjusted for a 3.11 percent COLA, by the number of billable hours per position to determine an annual billable amount per employee. (The billable hours were weighted based on DCFM's estimate of the billable portion of each position[12] and our recalculation of the annual billable hours per FTE, as described above.) We then summed the billable amount for all positions and divided the total by the billable hours for each position to determine the average hourly rate. Our recalculations resulted in an average hourly rate of $32.74 for capital planning staff and $23.31 for crafts/hazmat staff.

## III. <u>BURDEN FACTOR</u>:

The burden factors in the hourly rate models are intended to recover costs not directly billable to projects, including benefits, nonproductive paid time, administrative overhead, and supplies/ services. DCFM used a systematic process for determining the benefits, nonproductive paid time, and supplies/services components of the burden factor; however, they backed into the factor for administrative overhead:

- BENEFITS - The benefits component was set at 30 percent of salaries, which is a figure consistently used throughout the county.

- NONPRODUCTIVE PAID TIME - Nonproductive paid time is the percentage of total paid hours that are not billable and was calculated as described in Section I above. Although DCFM used the result of that calculation to determine the total billable hours, they added a contingency to it for use in the burden factor. The contingency was 15 percent of the total paid hours per FTE for capital planning staff, and five percent for crafts/hazmat staff.

- SUPPLIES/SERVICES - Supplies/services were calculated as a percentage of the salaries budget.

- ADMINISTRATIVE OVERHEAD - DCFM calculated the balance of the burden factor, the administrative overhead component, by computing a plug figure that was the difference between the total burden factor and the sum of the other three components. They calculated the total burden factor through an iterative process that involved trying different numbers that, when multiplied by the average hourly rate and total billable hours, would reconcile the projected revenue from billings with the amount of estimated revenue in the adopted budget. The burden factors that DCFM calculated were 219 percent for capital planning staff and 108 percent for crafts/hazmat staff. [NOTE: DCFM added 100 percent to the factor to account for the base average hourly rate in their calculation (i.e., 319 percent for capital planning staff and 208 percent for crafts/hazmat staff). This eliminated the extra step of adding the base hourly rate to the dollar amount of the burden factor.]

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[12] We did not verify the accuracy of DCFM's billable portion of each position. This would have required a review of all billed hours for the year to determine how much of each FTE had been billed.

## APPENDIX 3 (Continued)

We recalculated the benefits component based on actual benefits expenditures as a percentage of salary expenditures for the Facilities Management Fund during 1999. Our recalculation resulted in a benefits component of 32.5 percent.

We recalculated nonproductive paid time as described in Section I above and added the same percentage contingency that DCFM used; however, we based the contingency on total nonbillable hours because fluctuations will occur in the nonbillable hours rather than the total paid hours (e.g., employees' annual use of leave and other nonbillable hours will vary).

We did not recalculate the supplies/services component because we agreed with DCFM's calculation.

Our recalculations resulted in a burden factor of 171 percent for capital planning staff and 118 percent for crafts/hazmat staff. Table 3 summarizes DCFM's calculation and our recalculation of the burden factors for both the capital planning and the crafts/hazmat staff:

**TABLE 3**
**CALCULATION OF BURDEN FACTOR**

| | DCFM's Calculation | | Audit Staff's Recalculation | |
|---|---|---|---|---|
| **Capital Planning:** | | | | |
| Benefits | | 30.00% | | 32.50% |
| Nonproductive Paid Time | | | | |
| Total Nonbillable Hours (from Section I above) | 367.50 | | 374.50 | |
| Contingency (15%) [a] | 273.60 | | 56.18 | |
| | 641.10 | 35.15% | 430.68 | 23.61% |
| Overhead | | | | |
| Administrative | | 146.08% [b] | | 106.86% [c] |
| Supplies/Services ($133,408 supplies & services ÷ $1,717,181 salaries) | | 7.77% | | 7.77% |
| TOTAL BURDEN FACTOR | | 219.00% | | 170.74% |
| **Crafts/Hazmat:** | | | | |
| Benefits | | 30.00% | | 32.50% |
| Nonproductive Paid Time | | | | |
| Total Nonbillable Hours (from Section I above) | 420.00 | | 408.00 | |
| Contingency (5%) [a] | 104.30 | | 20.40 | |
| | 524.30 | 25.11% | 428.40 | 20.52% |
| Overhead | | | | |
| Administrative | | 48.00% [b] | | 59.69% [c] |
| Supplies/Services ($83,132 supplies & services ÷ $1,593,823 salaries) | | 5.22% | | 5.22% |
| TOTAL BURDEN FACTOR | | 108.33% | | 117.92% |

[a] The contingency calculated by DCFM was a percentage of total paid hours; audit staff's recalculation of the contingency was a percentage of the total nonbillable hours.

[b] The factor for administrative overhead is a plug figure calculated by DCFM by subtracting the sum of the other components of the burden factor (i.e., benefits, nonproductive paid time, and supplies/services) from the total burden factor that they calculated by backing into the amount of revenue needed.

[c] We recalculated the administrative overhead component by dividing the number of billable FTEs by the amount of administrative overhead that DCFM determined they needed to recover and divided the result by our recalculated average salary per billable position:
Capital Planning: [($1,994,269 overhead ÷ 34.05 billable FTEs) ÷ $59,717.76 avg. salary] = 106.86%
Crafts/Hazmat: [($989,274 overhead ÷ 31.25 billable FTEs) ÷ $48,671.28 avg. salary] = 59.69%

## APPENDIX 3 (Continued)

### IV. IMPACT OF ERRORS IN THE HOURLY RATE MODELS:

For billable capital planning staff, the combination of understating total billable hours and the average hourly rate and overstating the burden factor caused DCFM's revenue projections to be overstated. Because the burden factor calculated by DCFM was loaded into the billing system, all hours would have been billed based on the overstated burden factor. Thus, we also calculated the probable revenue projections based on DCFM's overstated burden factor and our corrections to the total billable hours and average hourly rate. This calculation indicated that the revenue likely to have been collected was significantly higher than what DCFM projected.

For billable crafts/hazmat staff, the combination of understating total billable hours and the burden factor and overstating the average hourly rate caused DCFM's revenue projections to be overstated. Because of the significant difference between the average hourly rate calculated by DCFM and audit staff, multiplying DCFM's understated burden factor by our corrections to the total billable hours and average hourly rate indicates that the amount of revenue likely to have been collected was significantly lower than that projected by DCFM.

Table 4 shows the impact of errors in the hourly rate models:

**TABLE 4**
**IMPACT OF ERRORS IN HOURLY RATE MODELS ON PROJECTED REVENUE FOR 2001**

| | DCFM RATE MODEL | AUDIT STAFF RECALCULATION | PROBABLE REVENUE COLLECTIONS |
|---|---|---|---|
| **Capital Planning** | | | |
| Average Hourly Rate | $28.85 | $32.74 | $32.74 |
| x Burden Rate | x 3.19 | x 2.71 | x 3.19 |
| = Average Billable Hourly Rate | $92.02 | $88.73 | $104.44 |
| Number of Billable FTEs | 31.00 | 31.25 | 31.25 |
| x Annual Billable Hours Per FTE | x 1,456.50 | x 1,449.50 | x 1,449.50 |
| = Total Billable Hours | 45,152 | 45,297 | 45,297 |
| Average Billable Hourly Rate | $92.02 | $88.73 | $104.44 |
| x Total Billable Hours | x 45,152 | x 45,297 | x 45,297 |
| = Projected Revenue | *$4,154,732 | *$4,018,983 | *$4,730,833 |
| **Crafts/Hazmat** | | | |
| Average Hourly Rate | $26.14 | $23.31 | $23.31 |
| x Burden Rate | x 2.08 | x 2.18 | x 2.08 |
| = Average Billable Hourly Rate | $54.36 | $50.82 | $48.48 |
| Number of Billable FTEs | 34.05 | 34.05 | 34.05 |
| x Annual Billable Hours Per FTE | x 1,668.00 | x 1,680.00 | x 1,680.00 |
| = Total Billable Hours | 56,795 | 57,204 | 57,204 |
| Average Billable Hourly Rate | $54.36 | $50.82 | $48.48 |
| x Total Billable Hours | x 56,795 | x 57,204 | x 57,204 |
| = Projected Revenue | *$3,087,508 | *$2,906,867 | *$2,773,524 |

*Difference between calculated result shown and actual result is due to rounding during interim steps.

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## APPENDIX 4

## METHODOLOGY FOR INTERNAL SERVICE FUND FINANCIAL PLANS

This appendix describes how the county prepares financial plans for internal service funds. Audit staff prepared this appendix to update and clarify the Budget Office instructions for preparing the financial plans. Starting with the beginning fund balance (prior year's ending fund balance), revenues are added, expenditures deducted and other adjustments are made to arrive at the ending fund balance. Moreover, reserves and designations are deducted from the ending fund balance to arrive at the ending undesignated fund balance.

| Financial Plan Components | Description and Examples |
|---|---|
| **Beginning Fund Balance** | • The beginning fund balance is based on information from the preceding year's final (December 31) "Balance Sheet" in the county's Comprehensive Annual Financial Report (CAFR).<br>• The fund balance is calculated to show *adjusted working capital* (i.e., readily available resources). These are:<br>– Current assets, excluding assets not readily convertible into cash, such as supplies and delinquent receivables.<br>– Less current liabilities, excluding ongoing liabilities for which funds are re-appropriated each year, such as debt repayments and assessments payable. |
| **Add**:<br>Revenues | • The total of all revenue items from the current year's "Statement of Revenues, Expenses, and Changes in Fund Equity" in the CAFR.<br>– Include operating revenues, nonoperating revenues such as interest, and operating transfers such as contributions from another fund.<br>– Revenue items can be combined or major line items, such as service fees and interest, can be presented individually. |
| <**Deduct**>:<br>Expenditures | • Actual expenditures, primarily cash outflows, from the current year CAFR's "Schedule of Annual Budgets and Expenditures and Operating Transfers and Encumbrances."<br>– The expenditures in this schedule are adjusted for the noncash transactions, such as depreciation and interest, included in the expenses shown in the "Statement of Revenues, Expenses, and Changes in Fund Equity."<br>• Expenditures can be combined and shown as one line item, or certain extraordinary items can be shown separately to highlight the transaction. |

## APPENDIX 4 (Continued)

| Financial Plan Components | Description and Examples |
|---|---|
| **Add**/<**Deduct**>:<br>Other Fund Transactions | • Irregular transactions that do not fit into any other category, such as adjustments and carryovers, shown for the purpose of reconciling to budget. |
| <**Deduct**>:<br>Underexpenditures Assumptions | • Across the board spending limit imposed to cap department and/or fund expenditures.<br>• Used for budgeted financial plan presentation only. |
| **= Ending Fund Balance** | • Beginning fund balance plus revenues (resource inflows) and minus expenditures (resource outflows). |
| <**Deduct**>:<br>Designations and Reserve | • Show portions of the fund balance earmarked for specific purposes, including funds designated for future needs, such as replacement costs, encumbrances, and reappropriation requests. |
| **= Ending Undesignated Fund Balance** | • Net resources available for the fund's immediate operating needs. |
| Target Fund Balance | • Specific level of fund balance unique to each fund, tailored to the fund's operation(s), as determined by the fund manager(s). (The method used to calculate the target should be footnoted.) |

**Note**: A "Schedule of Revenues, Expenditures, and Charges in Retained Earnings: budget (non-Generally Accepted Accounting Principles budgetary basis) and actual" is prepared by the Finance and Business Operations Division. The schedule presents and reconciles all the elements of budgetary vs. actual financial statement data, including the required adjustment to show "adjusted working capital." The schedule is available to assist the Budget Office and agency staff in preparing each fund's financial plan.

The "ending fund balance" calculated above should reconcile to the "net adjusted working capital" ending fund balance (i.e., the beginning fund balance for the next year's financial plan).

# APPENDIX 5

## 1998 – 2002 Financial Plans
## Facilities Management Fund (No. 5511)

| | 1998 | | | 1999 | | | 2000 | | | 2001 | | 2002 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Adopted Budget | Actual (DCFM) | Actual (Auditor's) | Adopted Budget | Actual (DCFM) | Actual (Auditor's) | Adopted Budget | Actual (DCFM) | Actual (Auditor's) | Adopted Budget | Actual (DCFM) | Proposed Budget |
| **Beginning Undesignated Fund Balance** | 480,941 | 1,126,015 | 1,241,164 | 911,647 | 717,171 | 717,171 | 699,059 | 88,703 | 88,703 | 7,327 | 150,602 | 523,803 |
| **Revenues** | | | | | | | | | | | | |
| Operating Revenue | 22,298,944 | 22,292,664 | 22,295,029 | 23,956,605 | 22,673,286 | 22,673,286 | 25,147,545 | 24,843,198 | 27,165,894 | 32,252,591 | 32,407,058 | 34,793,493 |
| CX Transfer | | | | | | | | 2,322,696 | | | | |
| DYS Reorganization | | | | | | | 1,550,644 | | | | | |
| **Total Revenues** | 22,298,944 | 22,292,664 | 22,295,029 | 23,956,605 | 22,673,286 | 22,673,286 | 26,698,189 | 27,165,894 | 27,165,894 | 32,252,591 | 32,407,058 | 34,793,493 |
| **Expenditures** | | | | | | | | | | | | |
| Operating | (22,282,202) | (22,600,120) | (22,819,057) | (24,081,800) | (23,301,752) | (23,301,754) | (27,005,619) | (27,103,995) | (27,103,995) | (32,211,505) | (29,558,481) | (33,219,536) |
| Logan/Knox | (439,237) | | | | | | | | | | | |
| Carryover Items | | | | | | | (25,000) | | | | | |
| **Total Expenditures** | (22,721,439) | (22,600,120) | (22,819,057) | (24,081,800) | (23,301,752) | (23,301,754) | (27,030,619) | (27,103,995) | (27,103,995) | (32,211,505) | (29,558,481) | (33,219,536) |
| **Estimated Underexpenditures** | 227,214 | | | 240,818 | | | 472,598 | | | 322,460 | | 332,195 |
| **Other Fund Transactions** | | | | | | | | | | | | |
| Adjustment to balance to CAFR | | (144,150) | | | | | | | | | | |
| **Total Other Fund Transactions** | 0 | (144,150) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Ending Fund Balance** | 285,660 | 674,409 | 717,136 | 1,027,270 | 88,705 | 88,703 | 839,227 | 150,602 | 150,602 | 370,873 | 2,999,179 | 2,429,955 |
| **Reserves & Designations** | | | | | | | | | | | | |
| Reserve for Equipment Replacement | | (50,000) | | (75,000) | | | (50,000) | | | | | (75,000) |
| Reserve for Utility Increases | | | | | | | | | | | | (100,000) |
| Reserve for Class & Comp | | | | | | | | | | | | (400,000) |
| **Total Reserves & Designations** | 0 | (50,000) | 0 | (75,000) | 0 | 0 | (50,000) | 0 | 0 | 0 | 0 | (575,000) |
| **Ending Undesignated Fund Balance** | 285,660 | 624,409 | 717,136 | 952,270 | 88,705 | 88,703 | 789,227 | 150,602 | 150,602 | 370,873 | 2,999,179 | 1,854,955 |
| **Target Fund Balance** | 589,626 | 587,603 | 593,295 | 626,127 | 605,486 | 605,846 | 628,516 | 704,704 | 704,704 | 838,395 | 738,962 | 1,660,977 |

**Note: DCFM generally defines its target fund balance as "one pay period's wages and benefits" (approximately 2.6% of the fund expenditures).**
In 2002 and in future years, target fund balance is set at 5% of operating expenditures.

SOURCE: Budget Books, ARMS, and CAFR.

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# APPENDIX 6

## EXECUTIVE RESPONSE

**King County**
**Ron Sims**
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RECEIVED
MAY 23 2002
KING COUNTY AUDITOR

May 23, 2002

Cheryle A. Broom
King County Auditor
516 Third Avenue, Room W1020
Seattle, WA 98104-3272

Dear Ms. Broom:

The purpose of this letter is to respond to your Preliminary Review Draft Report – Financial Related Audit of the Facilities Management Fund. I appreciate your staff's efforts to improve the way King County agencies conduct their business. Your report contains helpful recommendations that will be implemented or recommended actions already contemplated by the Facilities Management Division or other units in King County government. Your input will help the Division more effectively undertake those actions. Because some of your recommendations fall outside the purview of the Facilities Management Division, this response has been coordinated through the Finance and Business Operation Division of the Department of Executive Services (DES) and the Office of Budget.

Overall your report is viewed as a tool to assist King County improve its administration even though we do not agree with all of your findings. We do not agree that because of the rates models in effect, the Facilities Management Fund has accumulated excess fund balances without timely adjustments of charge rates. We also have concluded that some of the Audit report suggestions seem immaterial given the financial framework of the Facilities Management Fund but will be considered as we move forward with 2003 rate calculations for the Fund. Finally, our response will attempt to address your recommendations in the context of King County's annual budget process. We believe that your report does not recognize the oversight overlay created by that budget process and we hope to clarify that overlay.

Cheryle Broom
May 23, 2002
Page 2

The creation of the Facilities Management Fund was a move in the right direction resulting in substantial progress in accountability and financial management of building operations and capital project support. Your report will help us progress further in this regard.

Attached you will find a detailed response to your audit findings and recommendations.

Sincerely,

Ron Sims
King County Executive

cc: Paul Tanaka, County Administrative Officer, Department of Executive Services (DES)
Bob Cowan, Manager, Finance and Business Operations Division, DES
Steve Call, Director, Office of Budget (OB)
Pat Steel, Manager, Facilities Management Division, DES
Dave Lawson, Internal Audit Manager, OB

Attachment

**Response to Preliminary Review Draft Report – Financial Audit of the Facilities Management Fund**

The preliminary report uses some of the same negative conditions in multiple findings. Accordingly, this response will address identified negative conditions rather than specific findings cited throughout the report. The negative conditions cited were:

- Client agencies were not provided sufficient information to determine what they were getting for their money (Finding 2-1).
- The rate models did not result in an equitable allocation of costs. Specifically:
    1. Allocation of some costs was inconsistent with the general methodology, made with calculation errors, or was made with a flawed methodology (Findings 2-1 and 2-2).
    2. Adjustments were not made to account for offsetting revenues (Finding 2-1).
    3. The rate models were never reviewed or validated (Findings 2-1 and 2-2).
- Accounting for parking revenues was inconsistent with requirements for internal service funds (Finding 2-3).
- Accounting for parking revenues did not comply with State Law (Finding 2-3).
- The Facilities Management Fund's actual fund balance differs significantly from budget and target fund balances (Finding 3-2).
- The Fund does not comply with the County's fund balance policy for Non-CX funds (Finding 3-2).
- Fluctuations in the fund balance may indicate improper charges for services and could disrupt DCFM Operations (Finding 3-2).

The Preliminary Report Finding 3-1, "The Financial Plan for the Facilities Management Fund Was Adequately Prepared", did not cite a negative condition but criticized the Executive for not distributing adequate procedures or providing adequate training.

> **Recommendations:**
> <u>3-1-1 Prepare clearly written financial plan instructions</u>
> A financial accountant and a budget analyst have met and updated the financial plan instructions. The results of this effort will be reviewed by FBOD management and further developed if deemed necessary.
>
> <u>3-1-2 FBOD should conduct periodic training for agency and Budget Office</u>
> Financial Accounting will team with the Budget Office to provide such training. In addition, Financial Accounting volunteers to prepare the "Actual" (as distinguished from "Target" and "Budget") portion of the proprietary fund financial plans.

This response will address each of these negative conditions and, if applicable, will identify an action plan for improvement.

## APPENDIX 6 (Continued)

**Agencies were not provided sufficient information to determine what they were getting for their money (Finding 2-1)**

The draft report contends that the Facilities Management Division could improve accountability by publishing rates and the details of rate calculations and by including details for building operations costs and charges to capital projects with billings or requested interfund transfers. Cited as examples:

- Agencies received quarterly invoices for their square foot charges that showed only their overall charge
- Cost estimates for work billed by the hour contained only summary level data rather than detailed data such as the number of labor hours, the hourly rate, and the specific materials and their associated costs.

The Facilities Management Division agrees that the basis for rates should be published and distributed to all client agencies as an enhancement to communications even though these details have been provided on request and through the budget process. Since the periodic billings are nothing more than a fraction of the annual charges, it will be unnecessary to revise the quarterly per square foot invoices as recommended by the auditor.

The Facilities Management Division agrees that certain interfund transfer invoices for work billed by the hour could be improved. The Division is currently planning for a new work order system that will enhance the information accompanying both work authorizations and interfund transfer documents for major and minor capital projects.

**Allocation of some costs was inconsistent with the general methodology, made with calculation errors, or was made with a flawed methodology (Findings 2-1 and 2-2)**

Before addressing individual findings, the overall concept of internal service funds needs to be discussed. These funds are intended to provide a methodology for certain activities to develop cost data, develop a charging system that is roughly equitable for all users and to maintain a fund balance that is, in broad general terms, neither too large, nor too small. The Facilities Management Fund (ISF) did just that. While numerous findings indicated minor errors and conceptual design flaws, this fund achieved its primary goal of providing a mechanism to allocate costs to users in a reasonably simple and reasonably accurate way.

When dealing with issues of cost accounting, there are numerous possible ways to allocate costs and it will always be possible to develop a more accurate model or a billing methodology that may be more refined. Sometimes the benefits of achieving more accuracy must be balanced with the associated costs as is the case for some of the report recommendations. OMB Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments, provides that ISFs must attempt to balance accuracy with reasonableness. We believe that the implementation actions required to satisfy some of the Audit report concerns would not withstand this test by requiring a disproportionate effort to achieve more accuracy. While this ISF failed to develop a model that included all necessary charges, i.e. depreciation expenses or equipment replacement, and failed to include all possible credits i.e. parking fees, it did develop a charging methodology that was remarkably accurate. Certainly, the Facilities Management Division will strive to achieve the best costing model possible. However, the Division will not lose sight of the fact that final bottom line results are much more important than the steps along the way. These results will be discussed in more detail in the Division's response to the auditor's complaints about the accumulation of fund balance and use of the ISF financial plans.

Many times, ISF cost recovery models will have major offsetting errors, which ultimately result in roughly equitable results. As long as the billings result in roughly equitable charges for all users, the ISF has accomplished its goal.

The Facilities Management Division plans to simplify its rate models, enhance the accuracy of these models when appropriate and cost effective, and better document those models. All of the above considerations as well as the audit report recommendations will be considered in this effort. The Facilities Management Division plans to have the Finance and Business Operations Division review the revised model and to use that model as a basis for the 2003 operating charges.

Following is a detailed response to audit report criticisms of the rate models currently in place.

| Audit Finding Condition | Response |
|---|---|
| **Allocation of Some Costs Was Inconsistent With the General Methodology** | |
| A disproportionately high share of department overhead, which was allocated based on FTEs, was paid through per square foot charges and hourly rate clients. Specifically:<br>• Property Services, with 10 percent of employees, paid no overhead. | It is true that Property Services, as a CX agency, was not allocated overhead charges. However, the Property Services has its own administrative staff dealing with personnel and accounting functions. A full allocation of Department overhead based on FTE's would have disproportionately charged Property Services for the Department's administrative costs. As a CX agency, Property Services was exempted from Central Overhead charges both direct and through the Department's overhead allocations. We estimate that the legitimate allocation should have been less than \$50,000, an immaterial impact to DCFM's recovery rates. This condition will be eliminated once Property Services is merged into the internal service fund, an upcoming proposal of the Division's 2003 Budget Request. |

# APPENDIX 6 (Continued)

| | |
|---|---|
| • Airport, with 13 percent of the FTE's, paid only three percent of the department's overhead. | Similarly, the Airport was paying central overhead as an enterprise fund and was staffed up administratively. Allocating Department overhead to the Airport based on FTE's would have resulted in the Airport paying more for department overhead than the relative benefits derived. An allocation of 3 percent was closer to relative benefits derived than the 13 percent suggested by the Auditor. The 2002 reorganization eliminated this as an issue as the Airport is no longer a unit reporting to the Facilities Management Division manager. |
| The formula used to allocate security staff among buildings did not reflect staff assignments or benefits received because a portion of security costs were charged out for on-call services. | It is clear that on-call services are being rendered and an indirect cost grouping was established that represented a percent of time estimated for on-call services. These costs, incurred for a common or joint purpose, were not readily assignable to the cost objectives specifically benefited, without effort disproportionate to the results achieved. Maintaining detailed accounting records costing out the various on call services would be costly to achieve. Accordingly, an appropriate allocation basis was used to distribute these costs to benefiting buildings. This allocation was based on square foot occupancy. |
| Costs of daytime custodial crew were allocated evenly even though staff assignments were not documented. | The daytime custodial crew is assigned to multiple buildings and is generally on call for various service requests. These costs, incurred for a common or joint purpose, were not readily assignable to the cost objectives specifically benefited, without effort disproportionate to the results achieved. Maintaining detailed accounting records costing out the various on call services would be costly to achieve. Accordingly, an appropriate allocation basis was used to distribute these costs to benefiting buildings. This allocation was based on square foot occupancy. |
| Costs of the parking garage and parking lot were allocated to all county buildings as overhead in the square foot model. | Considering the fact that parking revenues were not included within the per square foot rate model, this treatment was appropriate. However, if the revised models for the ISF use parking revenues as a cost offset, this condition would be eliminated. Alternatively, the Division could consider parking as a |

## APPENDIX 6 (Continued)

| | |
|---|---|
| | separate cost center changing the treatment in this area altogether. |
| The rate model inconsistently applied discounted per square charges for storage space. | Although immaterial, this condition will be considered in the Division's revised methodology. |
| **The rates were not adjusted to account for offsetting revenues.** | |
| Costs of the parking lot at Fifth Avenue and Jefferson Street were allocated to all county buildings as overhead with revenues going directly to fund balance. | The existing methodology could be improved by netting out parking expenditures from revenues with the residual offsetting building operating costs. This would result in reduced square foot charges of about 10 cents a square foot or about 1% of the rates. However, a continuation of the current practice results in an increased fund balance that in the end is recovered through Budget Office or Council mandated fund balance adjustments. These adjustments are implemented in the per square foot model. In effect, these are offsets to the rates. |
| The crews assigned to building operations also did work on an hourly charge basis resulting in additional revenues that should have offset building operations costs. | Many times the staff members assigned to hourly charge work were backfilled by temporary employees thereby not duplicating charges. A likely proposal for 2003 is to consolidate the crafts crew and bill out activities to both building operations and capital projects. Thus, this condition would be eliminated. |
| The square foot rate for the Bellevue District Court included the full cost of utilities even though revenue was collected for non-County tenants in the facility. | Although immaterial, this needs correction in the revised rate models. |
| Interest earnings should have offset either the square foot or hourly rate models. | A continuation of the current practice results in an increased fund balance that in the end is recovered through Budget Office or Council mandated fund balance adjustments. In effect, these are offsets to the rates. This condition would only be effectively addressed by creating sub-funds or separate internal service funds for the various lines of business being carried out through the internal service fund. This effort would be disproportionate to the results achieved. Furthermore, if the interest earnings were to be used to offset model costs, it would be treated as an |

| | |
|---|---|
| | adjustment to Division overhead benefiting all activities. The bottom line would be the same. The treatment of interest earnings will be reconsidered as the rates models are revised. |
| The rate models were never reviewed or validated | We agree that such a review and validation would be helpful. The Audit report expressed concerns that the internal services fund is a profit making entity. It is clear from the history of mandated fund balance adjustments that the fund, over the long term, is not going to be allowed to build up excessive fund balance by either the Budget Office or the County Council. The appropriate level of fund balance will be discussed later in this response. |
| **Conceptual framework for the rate models was reasonable: however,** | |
| • Rate models were not adjusted annually to reflect actual results. Specifically, the realized revenues were less than budgeted expenditures for all years. | The rate models have not been adjusted to reflect actual results. However, the rate models have been updated based on the financial plan for the internal service fund.<br><br>There are a number of variables from budget to actual that would cause the condition cited by the Audit report. Through the normal course of events, the bottom line fund balance would increase or decrease depending on the results of operations. The most significant variances would be caused by circumstances unique to the operations for that particular period. For example, during 2001 the agency went through unanticipated consolidation reductions, hiring freezes, freezes in capital projects, and unanticipated increases and then decreases to utility rates. All of these factors led to a higher than expected year-end 2001 fund balance. Except for, perhaps, the charging out for crafts that are budgeted in building operations, these variables had a much more significant impact to the bottom line than minor technical issues surrounding the rate methodologies.<br><br>The only significant positive variances to the fund balance since ISF inception have resulted in adjustments to the rates as evidenced by a year 2002 rate reduction and a one-time return of unexpended 2001 utility costs to benefiting funds. |

## APPENDIX 6 (Continued)

| | |
|---|---|
| There were flaws in the rate model methodologies because DCFM did not pay for its space in county buildings and did not track lost revenues. | Again, we do believe that an annual reconciliation and methodology confirmation would be helpful. The step down approach applied with the existing methodology treats space costs as overhead by, in effect, including those costs in rates paid by agencies. The lost revenues would be offset by the space costs resulting in no bottom line impact to the internal service fund.<br><br>There are many acceptable ways to handle allocation of administrative costs. Some accountants develop complex double step-down models wherein administrative costs are allocated to all direct and indirect functions. Then the indirect functions are reallocated to all direct activities. That is a perfectly acceptable method. Other accountants choose to allocate costs only to direct program functions. That too is a completely acceptable method. A third method would be to allocate administrative costs in a single step-down method that accomplishes much the same result as the other methods described. In fact, when one compares the double step-down method to the single step-down method, often, the results are remarkably similar. Most times the results of the two methods, as measured by total cost allocated to benefiting functions, are within pennies. The methodology used by the current models was appropriate and did not result in a material variance from the method preferred by the auditor.<br><br>However, this issue will be revisited when the ISF rate models are revised. |
| The burden factors used in the hourly rate models were intended to recover costs not directly billable to projects. They were determined by backing various numbers into the adjusted budgeted revenue until it reconciled with the projected revenue from billable labor. The approach meant that the final burden factor was simply the number that would yield the difference between the revenue needed and the revenue to be generated from actual billings. | The calculation of burden rates will be changed to fully comply with OMB Circular A-87. Thus, total costs in the various cost pool will be allocated by dividing those costs by either square feet for per square foot charges or direct salaries and wages for the hourly rate calculations. The impact of this change to charged parties has not yet been determined at this time. |

| | |
|---|---|
| A factor for building in fund balances was not incorporated into the models. | Fund balance accumulations or reductions were managed through the financial plan because outside revenues and under-expenditure assumptions were dealt with outside the rate models. If the revised rate models implement the audit report recommendations, a factor for fund balance accumulation or reduction will need to be built into the rate models. The current practice of treating outside revenues and under-expenditure assumptions outside the rate models would offset this condition and with a net $0 impact. |
| Parking revenues were not used to reduce rates. | This duplicates other conditions cited in the Audit report. |

**Accounting for parking revenues was inconsistent with requirements for internal service funds (Finding 2-3)**

The parking operations for the Division are immaterial when compared to total financial activities and, therefore, creation of an enterprise fund would not be cost effective. Furthermore, the Division believes that the base amount of parking revenues allowed to be treated as revenues to the ISF were intended to cover the costs of parking operations and parking facility maintenance and operation. However, the County's accounting is not the responsibility of the Facilities Management Division. Accordingly, the Division will implement any directions received from the Finance and Business Operation Division.

**Accounting for parking revenues did not comply with State Law (Finding 2-3)**

The County Council made specific policy choices with regard to Current Expense parking revenues. They first chose to allow a base level of Current Expense parking revenues to be treated as ISF revenues. These revenues were designed to cover the Division's costs of operating and maintaining parking facilities. The second choice was to take another portion, represented by a rate increase, and dedicate that Current Expense revenue to the poor and infirm through Health and Human Services. The third choice was to take another portion, represented by the 2002 rate increase, and dedicate that the parking garage major maintenance. These policy choices seem appropriate. However, the Facilities Management Division will request a legal opinion from the Prosecuting Attorney's Office to settle this matter.

**The Facilities Management Fund's actual fund balance differs significantly from budget and target fund balances (Finding 3-2)**

The Facilities Management Division disagrees with the Audit report's assertion that the significant variability from budgeted to actual fund balances was a negative condition. Fluctuations in operating are unavoidable. Cost accounting - especially the estimating portion of cost accounting, is part art and part science. The overall objective of no significant rate increases was met with reasonable variance between estimated balances and actual.

## APPENDIX 6 (Continued)

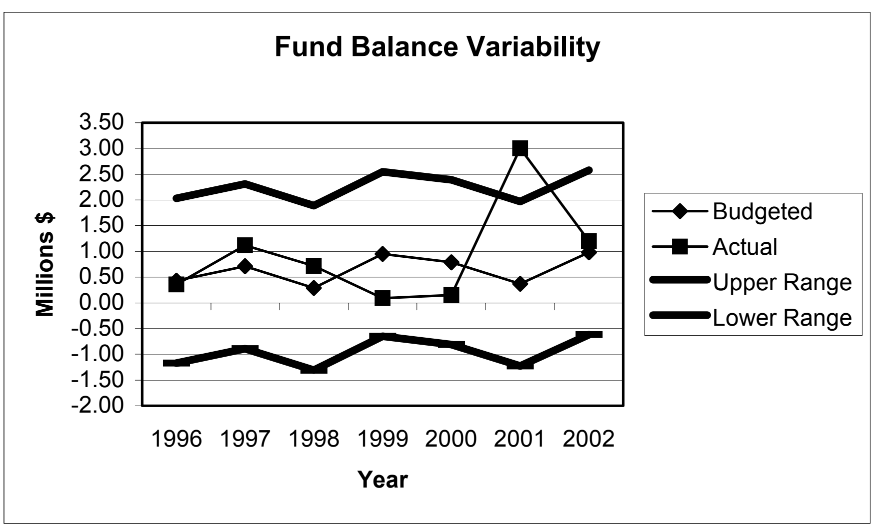
Last fall the Facilities Management Division proposed a fund balance target of 5% rather than the historical target of one pay period's wages and benefits. The justification for this change was to account for the very large real risks of projecting volatile utility rates. This position was supported by the need during 2001 to request a very large supplemental appropriation and cash infusion to cover unanticipated utility rate increases.

The Facilities Management Division estimates that, under normal circumstances, the risks associated with the variables built into the rate models deal specifically with utility rates, the impact of weather on energy costs, billable hours, and building security can result in actual fund balance deviations from budget of plus or minus $1.6 million. This variance was estimated as follows:

| Category | Annual Expense or Cost Factor/Yr 2002 | Variability | Annual Fund Balance Impact |
|---|---|---|---|
| Utility Rates Variance | $7,860,000 | + or – 10% | $ 786,000 |
| Utility Weather/Building Use Variance | $6,370,000 | + or – 5% | $ 318,500 |
| Billable Hours Variance Crafts* | 53710 hours @ $61.53/hr | + or – 5% | $ 165,500 |
| Billable Hours Variance CIP* | 42966 hours @ $99.61/hr | + or – 5% | $ 210,000 |
| Security Costs | $1,200,000 | + 10% | $ 120,000 |
| **Total** | | | **$1,600,000** |

- Annual Fund Balance Impact calculated by applying 5% to billable hours and multiplying that result by the hourly rates.

With the lone exception of 2001, actual financial results have fallen within normal parameters. The following chart shows these results.



## APPENDIX 6 (Continued)

For the purposes of this chart, the variability of the models was kept at constant levels rather than adjust backward for inflation. As can be seen, the year 2001 financial results did fall outside the expected variances. This occurred because an unanticipated reorganization resulted in significant budget savings in administrative costs and a late year supplemental for utility costs lead to a significant utility underexpenditure. A 2002 adopted one-time fund balance reduction of $1.4 million and required utility savings transfer of $800,000 has brought the estimated 2002 ending fund balance back within the expected variance. Please note that given the historical budgeted fund balances, a potential low-end financial outcome would result in a negative fund balance. This, then, demonstrates that external factors outside the influence of the rate model results in timely adjustments to charges to the various client agencies. Furthermore, one could expect a natural variance in financial outcomes based on model assumption variances alone.

The Facilities Management Division underwent significant changes in management during the latter part of last year. Nevertheless, the Division recognized the level of actual ending fund balance with the 13$^{th}$ Month reports and rates adjustments have been required well within, if not earlier than, a reasonable time period. We believe the Audit report criticisms in this area are unwarranted.

**The Fund does not comply with the County's fund balance policy for Non-CX funds (Finding 3-2)**

The Facilities Management Division does not agree with the Audit Report's assertion that positive fund balances accrued because there were errors in the rate models and fund balance accumulation or reduction were not built into the models. The volatility of baseline assumptions and management of billable hours led to a successful conclusion to 2001 financial operations. Revisions to the models will, perhaps, lead to more equitable allocation of costs but will not remove the volatility of certain of the baseline variables that the model is built on.

The Facilities Management Division agrees wholeheartedly with the recommendation that the optimum level of fund balance, all facts considered, should be identified and built into the rates. We believe that the historical target fund balance is too low.

The Division's preliminary assessment of acceptable fund balances is as follows.

The average fund expenditures for the past two years amounted to roughly $28.3 million. The working capital needs are based on an average billing cycle of two weeks. This resulted in needed working capital of approximately $1.1 million ( 14/365 X $28,328,708). Note that OMB Circular A-87 provides for 60 days of working capital and more if necessary as reasonable. The necessary fund balance to cover 60 days working capital would be roughly $4.7 million (60/365 X $28,328,708)

In addition to ordinary working capital, a fund must be designed to be able to respond to possible price fluctuations in labor or raw materials. In the case of the Facilities Management, utilities are a significant portion of the billing rate (Roughly $7.8 million in the budget for 2002.) As we have seen in recent months the price of utilities can be extraordinarily volatile. Given the unusual volatility of energy prices we believe it is reasonable to include in the needed fund balance at least 15 to 20% of the average cost of utilities, to avoid disruptions of services and sudden rate fluctuations. Based on the cost of utilities budgeted for 2002, we estimate the fund balance should include at least $1,200,000 ($6,000,000*.20) to cover possible price fluctuations.

An additional factor that must be considered when setting fund balances is variability in labor costs. Naturally certain factors such as budgeted pay raises and budgeted fringe benefit costs should be factored in. However governmental units often see significant labor cost variances due to hiring freezes and sudden layoffs. This variability may have as much as a $500,000 million impact to the fund balance.

Finally there is the issue of asset replacement. While the DCFM has only equipment assets carried on its books, the accumulated depreciation on those assets is over $1.4 million with annual depreciation in excess of $250,000 per year. This then would argue for a rather large reserve for equipment replacement.

Based on all the factors under consideration the Facilities Management Division believes that an acceptable fund balance for the ISF for 2003 would be in the range of $2,500,000 to $3,500,000. The Division's 2003 proposed budget will specifically address this issue.

Federal audits of fund balances typically reflect the need for rate adjustments only when the fund balances are significantly excessive for at least three years in a row. Federal cost principles recognize that it is unrealistic to expect a fund to achieve its fund balance goals every year. Large State ISF's have seen large fund balances significantly out of sync with expenditure patterns resulting in <u>all</u> billing activity ceasing for three years to get the balance back where is should have been. Even then, no Federal sanctions were deemed necessary.

For the County, the annual budget process gives internal service funds the opportunity to make appropriate rate adjustments through a technical update of estimate costs, established financial targets, and reconsideration of fund balance needs. Thus, an accumulated fund surplus would normally result in rate reductions two years hence. This oversight overlay gives ample opportunity to consider changing economies, financial constraints, and County Council policy debate.

**<u>Fluctuations in the fund balance may indicate improper charges for services and could disrupt DCFM Operations (Finding 3-2)</u>**

This Audit report conclusion is highly speculative and unwarranted. As previously stated, operating results have generally been well within expectations. Normally anticipated fluctuations could put the ISF fund in a deficit fund balance position. Accordingly, the Facilities Management Division's 2003 proposed budget will address a revised fund balance target for the Fund. See discussion immediately above.

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## APPENDIX 7

## AUDITOR'S COMMENTS TO EXECUTIVE RESPONSE

The executive response indicates that the audit will be used as a tool to assist in improving the administration of King County. Although the response disagrees with some of the audit findings, DCFM management subsequently indicated that they intend to review the rate models and implement our recommendations in the 2003 budget process. We believe that DCFM's proposal for revising the rate models will enhance accountability and increase visibility of costs by minimizing fluctuations in the fund balance, enabling management to project revenues more accurately, and ensuring equitable charges among agencies. Our comments below discuss the main areas of disagreement regarding the audit findings.

The executive states that some deficiencies cited in the audit are not material and do not have an impact on the bottom line of the fund. The response also indicates that outside factors have a greater impact on the revenues and expenditures in the fund than many of the issues that we raised in the audit.

- Our concerns regarding materiality are that the deficiencies are material to the agencies who pay the charges to DCFM and, in aggregate, are material to the rate models.

- The executive concludes that major offsetting errors are acceptable if they ultimately result in roughly equitable results, and changes that do not impact the bottom line of the fund are unnecessary. Our audit identified several examples why managing to the bottom line of the fund is not a good management practice, including inequitable distribution of charges among agencies and noncompliance with Generally Accepted Accounting Practices (GAAP) and state law.

- We agree that certain outside factors can impact the fund's revenues and expenditures. Nevertheless, the audit demonstrated that errors in calculations and methodology in the rate models had a significant impact on DCFM's ability to project its revenues and charge agencies accurately.

Finally, we have a concern regarding DCFM's proposal to move Property Services into the Facilities Management Fund in 2003. DCFM staff indicated that this move is primarily for convenience since Property Services is the only function in DCFM that is not part of the fund. While we recognize DCFM's desire to improve efficiency by doing this, we are not certain that the Property Services functions are true internal service fund activities and question whether they belong in the fund. Furthermore, because Property Services provides money to the CX Fund through leases of county property and the sale of surplus property, the move raises concerns of compliance with GAAP and state law, similar to those addressed in the audit regarding the county parking lots.

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## GLOSSARY

**Actual Fund Balance** – The amount of money in a fund at the end of the year.

**Adjusted Budgeted Revenue** – Budgeted revenue, adjusted to deduct costs of anticipated vacancies and to add an allowance for department overhead and a contingency factor. The adjusted budgeted revenue is used as the basis for determining the amount of revenue that DCFM needs to collect through billable labor and is therefore the starting point for backing into the burden factor.

**Average Billable Hourly Rate** – The average rate that DCFM estimates it will charge for billable labor. Separate rates are developed for the crafts/hazmat and capital planning functions. The rates are determined by multiplying the average hourly rate by the burden factor for each function.

**Average Hourly Rate** – The sum of the actual hourly rates for staff billed on an hourly basis, divided by the number of billable FTEs. DCFM staff developed separate average hourly rates for the crafts/hazmat and capital planning functions. The average hourly rate was multiplied by the burden factor to calculate an average billable hourly rate.

**Billable FTEs** – DCFM's estimate of the number of FTEs that can be charged to agencies for billable labor in the crafts/hazmat and capital planning functions. Billable FTEs include all of the positions that are fully chargeable to billable labor plus the fractions of the positions that are only partially chargeable to billable labor.

**Billable Hours Per FTE** – The average number of hours that DCFM can charge agencies for billable labor performed by a single employee in a year. The billable hours per FTE is determined by subtracting the average number of absence and administrative hours from the total hours an employee is paid in a year.

**Billable Labor** – Crafts/hazmat and capital planning labor that is billed out to agencies on an hourly basis for nonroutine building maintenance and minor renovation work.

**Budgeted Fund Balance** – The estimated amount of money to be in the fund at the end of the year, based on the adopted budget.

**Budgeted Revenue** – The amount of revenue estimated to be earned, per the adopted budget.

**Burden Factor** – A factor that is added on to the average hourly rate as a means of recovering indirect costs associated with billable labor but not directly billed to projects. The burden factor recovers the costs of employee benefits, nonproductive paid time, administrative overhead, and general supplies.

**Department Overhead** – The estimated amount of annual expenditures for operating the Director's Office. These costs are allocated to facilities management and capital planning through the square foot and hourly rate models.

**Designated Fund Balance** – The portion of the fund balance reserved for specific purposes, such as asset replacement.

**Enterprise Fund** – "(1) A fund established to account for operations financed and operated in a manner similar to private business enterprises (e.g., water, gas and electric utilities; airports; parking garages; or transit systems). In this case the government body intends that costs (i.e., expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. (2) A fund established because the governing body has decided that periodic determination of revenues earned, expenses incurred and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes." (*GAAFR*, p. 328.329)

**Financial Plan** – "A summary by fund of planned revenues and expenditures, reserves, and undesignated fund balance." (*Quarterly Report Instructions for 2001)*

**Fund Balance** – "The difference between fund assets and fund liabilities of governmental and similar trust funds." (*GAAFR*, p. 332)

**Hourly Rate Model** – The models developed by DCFM to establish the rates for capital planning and crafts/hazmat staff that are billed on an hourly basis. The models calculate a burden factor that, when multiplied by the actual hourly labor rates, are intended to recover the indirect costs of billable labor (e.g., employee benefits, nonproductive paid time such as vacation and administrative time, and overhead).

**Internal Service Fund** – "A fund used to account for the financing of goods or services provided by one department or agency to other departments or agencies of a government, or to other governments, on a cost-reimbursement basis." (*GAAFR*, p. 338)

**Nonbillable Time Worked** – Hours that an employee works but that cannot be billed to a specific project. These hours include administrative time for items such as meetings and training.

**Nonproductive Paid Time** – Hours for which an employee is paid but that cannot be billed to a specific project. These hours include holidays; vacation, sick, and other types of leave; and nonbillable time worked.

**Projected Revenue** – The amount of revenue that DCFM estimated it would earn based on its average hourly rate, burden factor, billable FTEs, and billable hours per FTE for billable labor in the crafts/hazmat and capital planning functions.

**Square Foot Rate Model** – The model developed by DCFM to establish "rent" for tenants of county buildings. The model establishes an annual square foot rate for each building and is based on building-specific costs (e.g., utilities and custodial staff assigned to the building); overhead costs; and general costs (e.g., routine building maintenance and repairs, daytime custodial staff, HVAC staff, and security staff).

**Target Fund Balance** – The amount of money that DCFM determines it wants to have remaining in the fund at the end of the year, generally to meet its immediate operating needs for the beginning of the next year.

**Total Billable Hours** – DCFM's estimate of the number of hours it will charge out annually for billable labor. Total billable hours are calculated by multiplying the available hours per FTE by the billable FTEs for the crafts/hazmat and capital planning functions.

**Undesignated Fund Balance** – The amount of the fund balance that is not reserved for any specific purpose and that is readily available to finance a department or agency's immediate operating needs.