



Lexington-Fayette Urban County Government
OFFICE OF INTERNAL AUDIT

MANAGEMENT ACTION PLAN PROGRESS REPORT

DATE: December 18, 2014

TO: Jim Gray, Mayor

CC: Sally Hamilton, Chief Administrative Officer
Glenn Brown, Deputy Chief Administrative Officer
Aldona Valicenti, Chief Information Officer
William O' Mara, Commissioner of Finance & Administration
Phyllis Cooper, Director of Accounting
Irene Gooding, Director of Grants & Special Projects
Susan Straub, Communications Director
Urban County Council Members
Internal Audit Board Members

FROM: Bruce Sahli, CIA, CFE, Director of Internal Audit
Jim Quinn, CIA, CISA, Internal Auditor

RE: General & Administrative Cost Allocation Management Action Plan Progress Report

EXECUTIVE SUMMARY

On June 17, 2013 the Office of Internal Audit issued a report on General & Administrative Cost Allocation Audit for the period from July 2010 through February 2013. Included in that report were two findings. This follow-up review was conducted to evaluate controls put in place by management to address those specific findings from the June 2013 report.

This review is provided for management information only. It is not an audit and no opinion is given regarding controls or procedures. We interviewed Division of Accounting and Division of Grants & Special Projects staff, viewed updated policies and

procedures, and obtained other audit evidence as necessary to complete our follow-up procedures. The period of review was from November 2013 through May 2014.

A summary of the findings from the original audit report and a summary of the results of our follow-up are provided in the table below. The original findings, management's original responses, and details of the results of this follow-up are contained in the **ORIGINAL AUDIT RESULTS AND FOLLOW-UP DETAILS** section of this report.

Finding	Summary of Original Finding	Follow-Up Results
Finding #1 High Priority	Documented Methodology for Cost Allocation Plan Needed	An Indirect Cost Allocation Proposal has been approved by HUD. Procedures for the Cost Allocation Plan have not been fully completed. The Director of Accounting states the plan methodology and procedures should be completed by January 2015. We recommend a detailed listing of allowable and unallowable costs be included in the cost plan for compliance purposes.
Finding #2 High Priority	Indirect Cost Not Allocated to Grant Funds	HUD has approved an Indirect Cost Allocation Proposal and its indirect cost rates for FYs 2011-2014. Indirect costs are not presently being allocated to any LFUCG grant funds for the current 2015 budget cycle, nor are these costs being submitted to any federal agency for reimbursement. LFUCG should consider seeking retroactive reimbursement from HUD for indirect costs incurred in FY 2011 through FY 2014.

ORIGINAL AUDIT RESULTS AND FOLLOW-UP DETAILS

Original Finding #1: Documented Methodology for Cost Allocation Plan Needed

Priority Rating: High

Condition: There are no formal written procedures for the Cost Allocation Plan to ensure accountability and transparency in the equitable distribution of indirect costs. During an analysis of the Cost Allocation Plan and the supporting spreadsheets, we also noted that documentation supporting the methodology for excluding unallowed costs was not evident for all affected departments.

We also noted that the cost allocation rate methodology used during FY 2011 was based on how much the benefiting funds could bear to pay. Although the Government Finance Officers Association (GFOA) recognizes this approach as an allowable cost allocation process, a more equitable cost allocation rate was used for FY 2012 and FY 2013.

Effect: The absence of a documented Cost Allocation Plan could result in inconsistent and inaccurate allocation of indirect costs between benefitting funds.

Recommendation: The Division of Accounting should develop a thoroughly documented Cost Allocation Plan that includes a detailed methodology of the cost basis and guidelines for calculating allocation rates. The Plan should include allowable and unallowed costs and the justification methodology for cost assignment as it pertains to federal grant funds. The Plan should at a minimum contain guidelines to calculate the allocation rate, as well as the methodology used in determining allowable and unallowed costs. The Cost Allocation Plan should also include a section designed to meet the documentation standards of OMB-87 so that the Plan is acceptable for the allocation of indirect costs to grant related activities. The possibility of allocating operations indirect costs should be considered when documenting the detailed methodology and cost basis.

Director of Accounting Response: Documentation for the Cost Allocation Plan will be created no later than January 31, 2014. The documentation will include details on methodology used, as well as allowable and unallowable costs.

Commissioner of Finance and Administration Response: I concur with the Director's response.

Follow-Up Detail Results:

The Division of Accounting submitted an Indirect Cost Allocation Proposal to HUD in March 2014. HUD is LFUCG's cognizant granting agency for federal grant awards. Final indirect cost rates in this Proposal, along with its supporting

documentation, were accepted and approved for FY 2011-2014 by HUD (see Follow-Up Results for Finding #2 for more details). This indicates that the description of allowable and unallowable costs provided by LFUCG in its proposal and used in its calculation of indirect cost rates were acceptable and sufficient, at least for the purposes of establishing these rates.

The Division of Accounting has begun drafting procedures for calculating indirect cost rates and preparing the Cost Allocation Plan. The Director of Accounting indicated the draft has not been fully completed and is not expected to be completed until the beginning of calendar year 2015. We reviewed the draft in its present unfinished form. The present draft gives comprehensive procedures on how indirect costs are allocated and on how the indirect cost rates are calculated. However, details of allowable and unallowable costs are not specified in the draft. The draft simply states that cost principles found in OMB Circular A-87 are used to determine allowable and unallowable costs for the indirect cost rates calculation, but doesn't provide specific explanation as to how allowable and unallowable costs were determined.

We recommend that the Director of Accounting include a separate schedule listing each allowable and unallowable cost individually in the Cost Allocation Plan. This would provide additional evidence of compliance if LFUCG is audited by HUD for indirect costs submitted to them for reimbursement.

Director of Accounting Response:

The A-133 has been updated recently, and renamed the “Uniform Grant Guidance” or “Super Circular”. Changes in the new procedures will be effective for non-federal entities for all new federal awards and additional funding to existing awards made after December 26, 2014. Given this information, the Division of Accounting will respond after implementing the required changes. The changes include using “old” regulations on existing grants and adoption of “new” requirements. Some new requirements include mandatory disclosures; performance management reporting; internal controls; and sub-recipient monitoring and management. The impact of the new procedures will be primarily in grants administration and reporting. However, the full scope of new requirements will impact the Division of Accounting. Once all of the new requirements have been implemented, the Division of Accounting will conduct a review.

Commissioner of Finance & Administration Response:

I concur with the Director of Accounting's response.

Original Finding #2: Indirect Cost Not Allocated to Grant Funds
Priority Rating: High

Condition: General and administrative expenditures are not being allocated to grant funds. The Director of Accounting stated that a Cost Allocation Proposal was submitted in May 2012 to the U.S Department of Housing and Urban Development but the granting agency has not approved the plan. The Cost Allocation Proposal was reviewed for compliance with OMB Circular A-87, State/Local Wide Central Service Cost Allocation Plans. It appears that the grant proposal does not include some basic requirements. According to OMB A-87, “all proposed plans must be accompanied by... an organization chart...a copy of the Comprehensive Annual Financial Report... a brief description of the service...the method used to distribute the cost of the service....” The proposal submitted did not include the aforementioned requirements.

Effect: Not allocating general and administrative costs to grant funds excludes grants from bearing the true costs of providing services. Additionally, submitting a Cost Allocation Proposal without the requested documents may delay the approval of the proposal.

Recommendation:

The Director of Accounting and the Director of Grants & Special Programs should collaborate on this project to ensure that the Cost Allocation Proposal includes all required documentation. Using OMB Circular A-87, the Cost Allocation Proposal should be re-submitted to include all documents under the “Documentation Requirements for Submitted Plans”. Once the proposal has been approved and indirect costs are identified, a request should be made to the granting agency for additional funds since the costs to administer the program may increase once indirect costs are allocated to them.

Director of Accounting Response:

The Directors of Accounting and Grants & Special Projects collaborated on the submission of the Cost Allocation Proposal to the state. The proposal was submitted for the first time and has been approved for review by the granting agency. The Directors of Accounting and Grants & Special Projects will continue to work with the grantors to provide any additional data requested.

Commissioner of Finance and Administration Response:

I concur with the Director’s response.

Follow-Up Detail Results:

As indicated above, an Indirect Cost Allocation Proposal was submitted to HUD in March 2014, and indirect cost rates calculated and contained in this proposal for

FYs 2011-2014 were accepted and approved by HUD. According to the Directors of Accounting and Grants & Special Projects, a decision on the use and implementation of these rates will be made in early 2015 for use in the FY 2016 budget cycle. The approved indirect cost rate for FY 2014 was not applied to grant funds through the LFUCG budgeting process. In addition, these approved rates have not been used to seek reimbursement from the federal government on actual indirect costs incurred with these grants during FYs 2011-2014.

The Directors of Accounting and Grants & Special Projects should consider seeking retroactive reimbursement from HUD for indirect costs incurred on HUD grants during the period FY 2011 through FY 2014. The Directors of Accounting and Grants & Special Projects should also consider applying these rates to grant awards received from other federal granting agencies such as the Departments of Agriculture, Justice, Transportation, Health and Human Services, and the Homeland Security Office. Some of these grants are passed through the Commonwealth of Kentucky and, as a sub-recipient, LFUCG must submit cost information for these grants to the State for reimbursement.

Director of Accounting Response:

The Division of Grants and Special Programs is tasked with administering federal awards to maximize program outcomes. In addition, the Director of Grants and Special Programs has completed a significant amount of research on the impact of charging indirect cost both retroactively and moving forward on the grant awards for the Government's major programs. Accordingly, the Division of Accounting concurs with the Director of Grants & Special Projects' response.

Commissioner of Finance & Administration Response:

I concur with the Director of Accounting's response.

Director of Grants & Special Projects Response:

The Office of Internal Audit has asked that Division of Grants and Special Programs consider seeking retroactive reimbursement from HUD for indirect costs incurred on HUD grants during the period FY 2011 through FY 2014. The chart below depicts the amount of personnel costs that were charged to HUD grants (fund 3120) for each of these years. I have also added an estimated amount for Fiscal Year 2015. To proceed as recommended by the Internal Auditor will mean adding \$291,219.11 to our administrative costs in Fiscal Year 2015.

Up to 20% of the annual CDBG grant may be expended for administration (Current year award of \$2,044,247 x 20% = \$408,849), and up to 10% of the HOME award (Current year award of \$1,027,599 x 10% = \$102,760).

As of this date, HOME admin is budgeted at its maximum for projected administrative costs, and CDBG is budgeted for \$300,000 (app 15%) for projected administrative costs. If we amended the current CDBG budget, eliminating some funding for projects that have already been approved, we could still only expend an additional \$108,849 for administrative costs. We are required to submit annual financial and program reports by late September of each year. Once these reports are submitted and approved by HUD, they cannot be re-opened so the burden of retroactive indirect costs will fall on Fiscal Year 2015..

	HUD-funded personnel costs	Indirect Cost Rate	Indirect Costs
2011	556,893.01	9.06	50,454.51
2012	580,402.65	9.06	52,584.48
2013	509,439.07	10.36	52,777.89
2014	519,629.72	12.90	67,032.23
2015	530,000 (estimated)	12.90	68,370
Total			291,219.11

Also, as recommended by the Office of Internal Audit, I have reviewed other LFUCG grants for consideration of indirect cost allocations. These are grants that contain significant personnel costs which are the basis for indirect costs. Information is still being collected on other grants that include personnel costs. All grants can be analyzed for application of indirect costs; however, most have funding caps, which will mean that more funding pressure will be placed on the general fund, if funds are diverted to indirect costs.

A trend of decreasing federal funds from all programs is also a consideration. The federal Sequester, agreed to by Congress and the President, is a ten-year event that promises 10% automatic, arbitrary and across the board budget cuts starting in 2013. While we have not seen all of these cuts, we should still anticipate them.

U.S DEPARTMENT OF JUSTICE

COPS Hiring Program (CHP)

This application was submitted in May 2011. Since no indirect cost allocation plan had been approved at that time, no funds were requested for indirect costs.

Indirect costs were an eligible expense; however, only with the submission of an approved indirect cost allocation plan. The Final Financial Clearance Memo and Final Funding Memorandum provide for only personnel and fringe benefits for 25 entry level police officers. These are the only amounts for which our agency was approved. In accordance with the program guidance: "*Your agency may not use CHP funds for any costs that are not identified as allowable in the Final Funding Memorandum and Financial Clearance Memorandum.*" The award was signed by the Mayor on December 27, 2011, with a performance period through August 31, 2014. This has now been extended through March 30, 2016. To charge indirect costs at this point would require a modification that must be justified by us and approved by the COPS office. Grant guidance indicates that the COPS office will review modifications due to changes in an agency's fiscal or law enforcement situation—changes in a fiscal situation usually refer to economic changes that result from disasters, major plant closings, etc.

Arrest Policies Program from the Office on Violence Against Women

This Grant provides funding for a police-based victim advocate for a 3-year period and overtime for Police Officers who are pursuing DV offenders who have fled the scene(s) and offenders who are in violation of protective orders. The total amount of personnel costs budgeted for the 3-year period is \$189,000. No indirect costs were budgeted at the time of submission because there was no approved indirect cost allocation plan. We requested the maximum award amount of \$300,000 for a three year period. In addition to personnel costs, these funds are used by partner agencies—GreenHouse17, Bluegrass Rape Crisis, Fayette County Domestic Violence Prevention Board, and for training required by OVW. In order to charge for indirect costs, we would have to submit a budget amendment request to OVW and get their approval; however we will still be obligated to provide for salary and personnel costs of the victim advocate for a 3-year period. Reducing budgeted amounts for these personnel costs will put pressure on the general fund budget. Since this is our fourth consecutive award from this program, we believe that continuation funding is unlikely.

U.S. DEPARTMENT OF HOMELAND SECURITY

SAFER Grant provides federal funding for hiring of 28 firefighters. The grant guidance lists indirect costs as an ineligible expense.

KENTUCKY TRANSPORTATION CABINET—U.S. DEPARTMENT OF TRANSPORTATION

All funds coming to the LFUCG from U.S. DOT flow through the Kentucky Transportation Cabinet.

The Division of Planning has 9 full-time employees charged to FHWA Planning, FTA, and SLX funds. These funds are available to LFUCG because it hosts the Lexington Metropolitan Planning Organization (MPO). All other transportation improvement projects are dependent upon the MPO's successful planning activities that result in long-range plans. I have asked the advisor assigned to LFUCG from KYTC Division of Planning about charging indirect costs to FHWA Planning and SLX funds. He has indicated that a mid-year adjustment of this magnitude would be difficult, that this change would be easier to put in place at the beginning of the fiscal year, and that impact on salary costs would be significant. Advisor at the Office of Transportation Delivery (FTA funds) has indicated that indirect costs can only be added when the UPWP is being developed. Both KYTC divisions will have to review and approve the Indirect Cost Allocation Plan.

At current rates of pay (adjusted for MAG study), the estimated personnel costs of the 9 employees in the MPO for FY 2016 is approximately \$751,790 (this assumes no pay increases). Indirect costs at the rate of 12.9% will be \$96,980. With other operating costs (equipment, training, professional services, PSAs, supplies, etc), the total cost for the support of this planning section will be \$997,820. Given current levels of funding at \$857,500, there will be a shortfall of \$140,320. This shortfall may be covered by the General Fund, or a request can be made for increases in SLX funds for planning activities. A note of caution: increasing SLX funds for planning decreases the amount of funds available for transportation improvement projects (new turn lanes, new signals, etc.) SLX is the dedicated surface transportation funds for Lexington and is not unlimited. Increases in SLX funds for planning purposes will have to be approved by the local MPO governing body and also by KYTC. Also note that SLX funds come from the Federal Highway Trust Fund, which is in danger of running out of money.

Division of Police receives federal transportation dollars for the Motor Carrier Safety Assistance Program and other safety programs for police overtime. The state agency (Kentucky State Police, Commercial Vehicle Enforcement Division) that administers these programs has indicated that indirect costs are not eligible for reimbursement.

U.S. DEPARTMENT OF HUD—CDBG, HOME, ESG, and HOPWA grants for FY 2016

Division of Grants and Special Programs charges an estimated 9.00 FTE employees to the following HUD-funded grants: Community Development Block Grant Program (CDBG), HOME Investment Partnerships Program, Emergency Solutions Grant Programs (ESG), and Housing Opportunities for Persons with AIDS (HOPWA). At current rates of pay (adjusted for MAG study), application of indirect cost rate of 12.9% will result in indirect charges of approximately \$70,000 for CDBG-funded activities and \$13,000 for HOME-funded activities for fiscal year 2016. Use of funds for indirect costs will mean that other eligible activities will not be funded. LFUCG can elect to charge the indirect cost in Fiscal Year 2016, but will do so at the cost of other programming. CDBG funds are used primarily to fund public improvements (new sidewalks, streets, and storm water drainage improvements) in low-income neighborhoods, other public facilities for low-income persons (parks, service buildings, homeless shelters), housing rehabilitation for low-income homeowners, fair housing activities, and supportive services for low-income at-risk youth and homeless households.

Chief Administrative Officer Response:

I think this issue is one that is relatively complex and needs a thorough discussion with Grants & Special Projects, Finance, and Internal Audit. I intend to schedule such a meeting or meetings in January 2015.