



# Cost Allocation Plan



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# Cost Allocation Plan Audit

## Executive Summary

### Objective

This audit was conducted to evaluate the rationale and consistency of the model used to allocate costs and whether the costs allocated to City services departments are reasonable, accurate, adequately supported and in compliance with federal guidelines.

### Background

The annual Cost Allocation Plan (CAP) is developed by the City of Charlotte Strategy and Budget (S&B) department.

The CAP report provides information on the City's general and administrative overhead, which is used to calculate the fully allocated costs of City services.

For Fiscal Year 2022, the CAP allocated \$98,285,480 across twenty (20) departments.

### Conclusion

The City's Strategy and Budget Department (S&B) has developed a Cost Allocation Plan (CAP) that appropriately allocates support costs to City service departments.

### Highlights

*The CAP appropriately allocated costs to City service departments, with one exception.*

- The indirect allocation method for Innovation & Technology – Enterprise Resource Management was incorrect.
  - Payroll check count was used instead of the number of financial transactions.

*Procedures should be updated to match the current process.*

- The CAP procedures included review by the Director and approval by the City Manager.
  - Only certification from the Chief Financial Officer is required and that has been completed.

### Actions Planned

S&B will update the methodology used for the CAP templates. S&B will modify CAP procedures to reference review by the Budget Director or City Manager's designee.

## Contents

Highlights.....	1
Background.....	3
Objective.....	4
Scope, Methodology, and Compliance.....	4
Findings and Recommendations.....	7
1. <i>The CAP appropriately allocated costs to City service departments, with one exception.</i> .....	7
2. <i>Procedures should be updated to match the current process</i> .....	7
Conclusion.....	8
Distribution of Report.....	8

## Background

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The purpose of the Cost Allocation Plan (CAP) is to allocate the support business units' cost as general and administrative overhead to the service departments. The allocation is made in a two-step process:

1. The support costs are allocated to all business units (both support and service).
2. The allocations received by the support business units in the first allocation are reallocated to the service departments.

The CAP report provides information on the City's general and administrative overhead, which is used to calculate the fully allocated costs of City services. Primarily, the fully allocated costs are used for benchmarking services, determining the cost of General Fund services provided to Enterprise Funds and calculating user fees and charges for services.

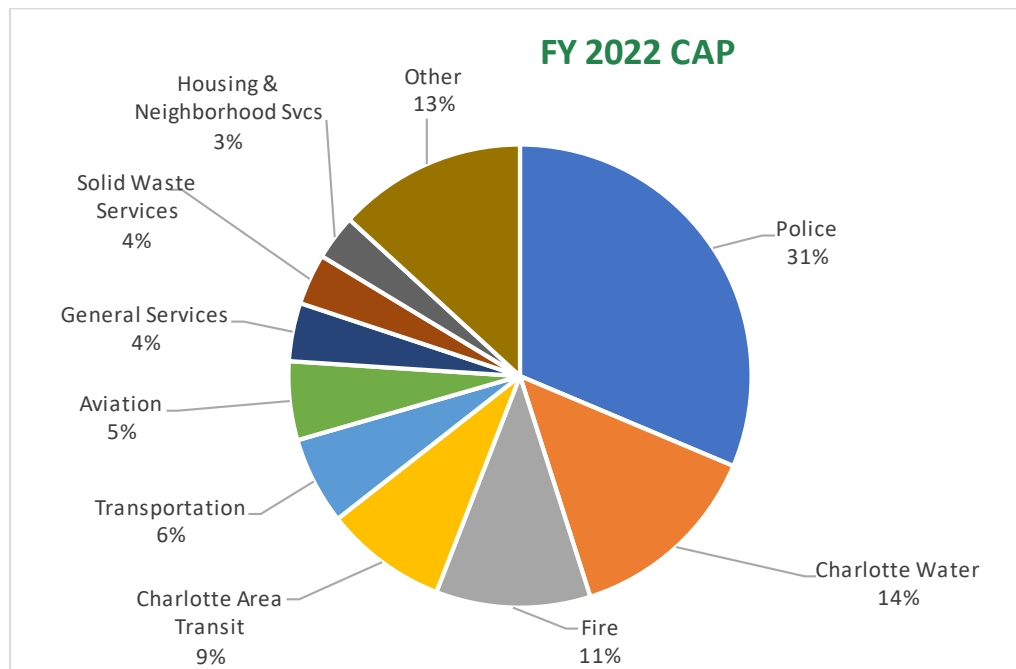
The CAP is developed annually by the Strategy and Budget (S&B) Department. The CAP allocates actual expenditures that meet guidelines for allowability defined in 2 CFR 200 (Code of Federal Regulations), based on the most recent Annual Comprehensive Financial Report (ACFR). The FY 2022 CAP is based on the most recent (FY 2020) ACFR.

The Federal Transit Administration (FTA) is the federal agency that provides the City with the largest share of direct grant funds, it acts as the cognizant agency for the City. The FTA is responsible for reviewing, negotiating and approving the City's CAP on behalf of all other federal agencies.

Annually, S&B appoints an internal CAP Administrator; hires a CAP Consultant; determines the deadline for producing the CAP which will meet the needs of the budget process; and reviews the Federal Register for any changes in federal requirements. In addition, S&B reviews the city organizational chart to determine if the CAP templates should be revised; prepares the City CAP templates for distribution; and contacts Human Resources and Finance for related employee and accounting information.

Each year in October, S&B holds a kickoff meeting with the department contacts and provides instructions for completing the CAP templates (including the exclusion of unallowable costs). Throughout the process, S&B reviews the allocations and meets with contacts to address questions about any information that may be treated differently from the prior year. The allocations are due from departments in early December, with a preliminary CAP published in early February, which is provided to the enterprise funds' contacts for review. The CAP is certified by the Chief Financial Officer in March and submitted to the FTA.

The FY 2022 CAP allocated \$98,285,480 across twenty (20) departments.



## Objective

This audit was conducted to evaluate the rationale and consistency of the model used to allocate costs and whether the costs allocated to City Services departments are reasonable, accurate, adequately supported and in compliance with federal guidelines.

## Scope, Methodology, and Compliance

### Scope

The audit focused on the methodology used by Strategy and Budget (S&B) to develop the FY 2022 CAP for the period, July 1, 2021 to June 30, 2022.

### Methodology

To achieve the audit objectives, auditors performed the following:

- Interviewed the S&B CAP team and CAP contacts for selected departments;
- Reviewed the FY 2022 CAP to ensure that all City departments were included, and support costs were allocated to service departments;
- Reviewed the oversight that is performed for the CAP;
- Reviewed the appropriateness of selected department allocation bases; and
- Reviewed the FY 2022 CAP and supporting documentation for selected departments.

Internal Audit reviewed the Summary of Allocation Methods from the FY 2022 CAP and noted that four support departments (Innovation & Technology, General Services, Human Resources and Finance) had sub-departments and multiple allocation methods, which increased the risk of error and complexity in allocating costs. Auditors selected these four departments for detailed review, which represented \$63.3 million (77%) of the \$81.6 million total allocated support costs for FY 2020 (adding a reconciling adjustment for actual cost results in a total allocation for FY 2022 of \$98.3 million).

Department	1 <sup>st</sup> Allocation (\$ million)	% of Total Allocation	Number of Allocation Methods
Innovation & Technology	\$ 42.6	52%	6
General Services	7.7	9%	5
Human Resources	6.5	8%	2
Finance	6.5	8%	3
<b>Subtotal</b>	<b>\$ 63.3</b>	<b>77%</b>	
Char Meck 311	5.8	7%	1
City Attorney	3.8	5%	1
Communications	2.8	3%	1
City Manager	2.5	3%	1
Strategy & Budget	2.1	3%	1
Internal Audit	1.3	2%	1
<b>Total Allocated Costs</b>	<b>\$ 81.6</b>	<b>100%</b>	
Reconciliations FY 20 Actuals	16.7		
<b>Total Allocated Costs + Reconciliations</b>	<b>\$ 98.3</b>		

As necessary, each department provides information from the Munis financial system (or other applicable systems) to support its allocation. Auditors evaluated S&B's review of the allocations from each department to ensure that they were properly allocated. Auditors obtained an understanding of the controls in place to ensure that total allocable expenses from Munis are included in the CAP and that adjustments are made to reconcile actual costs in subsequent years.

## Compliance

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Government auditing standards require that we determine which internal controls are material to the audit objective and obtain an understanding of those controls. To evaluate internal controls, the City Auditor's Office follows the Committee of Sponsoring Organizations of the Treadway Commission's Internal Control – Integrated Framework (COSO Framework) as included in Standards for Internal Control in the Federal Government (GAO Green Book).

In planning and performing the audit, auditors obtained an understanding of the processes used to produce the CAP and the associated internal controls; assessed the internal control risks and determined the following internal control components were significant:

- Risk Assessment – Annual assessment by S&B staff of organizational changes and other factors that could impact the internal control system.
- Control Activities – The review and approval of allocation bases by an external consultant and S&B staff.

Auditors found that the key internal control (review and approval of the allocated costs) was performed informally and undocumented. As a result, auditors re-performed this control as part of the testing described in the Methodology section of this report.

The internal control deficiencies that are significant within the context of the audit objective are stated in the Findings and Recommendations section of this report.

## Findings and Recommendations

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### 1. *The CAP appropriately allocated costs to City service departments, with one exception.*

Auditors selected four of the ten support departments from the FY 2022 CAP for detailed review. These departments appropriately allocated allowable costs to service departments. However, auditors noted an error in the indirect allocation method for Innovation and Technology – Enterprise Resource Management (ERP), which represents 3% of the total City-wide allocation. CAP guidelines indicate that the number of financial transactions (1,439,883) is used for allocation purposes. However, the payroll check count (431,992) was used, which resulted in an over- and under-allocation error of \$878,883.

S&B confirmed that the error occurred and provided auditors with a revised ERP allocation showing the correct indirect cost calculation. There was no significant impact on the enterprise funds (Aviation, Charlotte Area Transit, Charlotte Water and Storm Water) as they were under-allocated \$264,074 in total, compared to \$29.3 million in total allocations (less than 1%). While the overall impact is minimal, the ERP allocation variance for several departments (General Services, Housing and Neighborhood Services and Police) exceeded \$100,000 and could adversely impact cost of service calculations.

**Recommendation:** Strategy and Budget should implement an improved control to ensure that departments use the correct allocation base.

**Value Added:** Compliance; Risk Reduction

**Strategy and Budget Response:** Agreed. S&B will implement a process by December 31, 2021 to automate methodologies that are used across multiple CAP templates. This automated data will be used as an additional quality control measure to verify units provided to departments that will match the documentation included with final CAP submissions.

### 2. *Procedures should be updated to match the current process.*

The 2 CFR section 200.415 states:

*A proposal to establish a cost allocation plan or an indirect cost rate, whether submitted to a Federal cognizant agency for indirect costs or maintained on file by the non-Federal entity, must be certified by the non-federal entity using the Certificate of Cost Allocation Plan or Certificate of Indirect Costs. The certificate must be signed on behalf of the non-Federal entity by an individual at a level no lower than vice president or chief financial officer of the non-Federal entity that submits the proposal.*

The Cost Allocation Plan and Overview outlines the procedures for developing the CAP and indicates that the:



- Budget Director reviews the printable and publishable draft CAP
- Chief Financial Officer certifies the final draft
- City Manager approves the final CAP and includes with the annual budget proposal

However, there was no evidence of the Budget Director's review and the City Manager's approval. The Chief Financial Officer certifies the final CAP as required by 2 CFR 200.415. S&B noted that the evidence of the certification by the Chief Financial Officer is key and there is no need to retain evidence for the Budget Director review and the City Manager approval, which are implied through inclusion in the annual budget proposal.

**Recommendation:** Procedures should be modified to indicate that the S&B Director informally reviews, and the City Manager informally approves, the CAP.

**Value Added:** Compliance; Risk Reduction

**Strategy and Budget Response:** Agreed. The procedures will be updated by September 30, 2021 to read as follows:

- Budget Director or the City Manager's designee reviews the printable and publishable draft CAP
- Chief Financial Officer certifies the final draft
- City Manager includes the final CAP in the annual budget proposal

## Conclusion

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The City's Strategy and Budget Department (S&B) has developed a Cost Allocation Plan (CAP) that appropriately allocates support costs to City service departments.

## Distribution of Report

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This report is intended for the use of the City Manager's Office, City Council, and all City departments. Following issuance, audit reports are sent to City Council and subsequently posted to the [Internal Audit website](#).