FOLLOW-UP REPORT
Budget and Management Office Audit
March 2017

Office of the Auditor
Audit Services Division
City and County of Denver

Timothy M. O’Brien, CPA
Denver Auditor
The Auditor of the City and County of Denver is independently elected by the citizens of Denver. He is responsible for examining and evaluating the operations of City agencies and contractors for the purpose of ensuring the proper and efficient use of City resources, and providing other audit services and information to City Council, the Mayor, and the public to improve all aspects of Denver's government.

The Audit Committee is chaired by the Auditor and consists of seven members. The Audit Committee assists the Auditor in his oversight responsibilities regarding the integrity of the City's finances and operations, including the reliability of the City's financial statements. The Audit Committee is structured in a manner that ensures the independent oversight of City operations, thereby enhancing citizen confidence and avoiding any appearance of a conflict of interest.

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Report number: A2015-013
March 2, 2017

Stephanie Adams, Director
Budget and Management Office
Department of Finance
City and County of Denver

Re: Audit Follow-Up Report

Dear Ms. Adams:

In keeping with generally accepted government auditing standards and the Audit Services Division’s policy, as authorized by D.R.M.C. § 20-276, our Division has a responsibility to monitor and follow-up on audit recommendations to ensure that audit findings are being addressed through appropriate corrective action and to aid us in planning future audits.

This report is to inform you that we have completed our follow-up effort for the Budget and Management Office (BMO) audit issued December 17, 2015. Our review determined that BMO fully or partially implemented six of the seven recommendations made in the audit report. Despite BMO’s efforts, auditors determined that the risk associated with the audit team’s initial findings has not been fully mitigated. As a result, the Division may revisit these risk areas in future audits to ensure that appropriate corrective action is taken.

For your reference, this report includes a highlights page that provides background and summary information on the original audit and the completed follow-up effort. Following the highlights page is a detailed implementation status update for each recommendation.

This concludes audit follow-up work related to this audit. I would like to express our sincere appreciation to you and BMO personnel who assisted us throughout the audit and follow-up process. If you have any questions, please feel free to contact me at 720-913-5000 or Emily Owens, Internal Audit Supervisor, at 720-913-5016.

Denver Auditor’s Office

Timothy M. O’Brien, CPA
Auditor
Budget and Management Office
March 2017

Status
The Budget and Management Office (BMO) has fully or partially implemented six of the seven recommendations from the December 2015 audit report.

Background
As part of the City’s annual budget development process, City agencies submit budget requests to BMO. Requests include performance measures to help align funding decisions with strategic goals. BMO evaluates the requests and makes recommendations to the Mayor and City Council regarding whether to fund the requests in the budget.

To meet the requirement of a balanced budget and to account for fluctuations in operating revenues and expenditures, the City has established various reserve funds, and policies outlining their use. There are three reserve funds within the City’s general fund: a contingency reserve, an unassigned fund balance, and a TABOR reserve.

Purpose
The purpose of this audit was:

- To determine whether the use of performance information has been incorporated into the City’s budget development process; and
- To assess the City’s approach for ensuring the adequacy of reserve funds and the subsequent use of those funds.

Highlights from Original Audit
In assessing the use of performance measures in the budget development process, we found that budget requests generally included performance measures, which were aligned with Mayoral priorities and agency objectives. However, we identified two areas for improvement. First, we found that neither BMO nor City agencies have established a formal process to validate performance measures provided by agencies during the budget process, and that BMO has not developed a process by which to request, review, and retain documentation needed to support the measures. Second, we found that BMO could enhance transparency regarding how performance measures ultimately impacted budget decisions.

In assessing the City’s approach to setting and using general fund reserves, we found that the City adheres to its financial policy for establishing these reserves, and the policy reflects some current best practice guidance. However, we identified three areas for improvement. First, the policy was established in 2007, and the City has not reviewed or reassessed it for more recent best practice considerations, including performing an analysis of unforeseen risks and their potential financial impact on the general fund. Second, we found that the City has approved the use of general fund contingency reserves for known expenditure needs that were not previously budgeted; the policy does not specifically address this type of use. Finally, we identified supplemental fund requests that lacked formal documentation to support the need and usage of contingency funds.

Findings at Follow-up
BMO has initiated a formal process to validate, support, and enhance transparency with agencies related to how performance measures impact budget decisions. Also, in conjunction with the Government Finance Officers Association (GFOA), BMO has formally initiated a process to conduct an assessment of Citywide risks and the associated potential impact on financial reserves. Lastly, additional criteria for the use of General Fund Contingency Reserves and documentation requirements were established.

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Or contact the Auditor’s Office at 720-913-5000
# Recommendations: Status of Implementation

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<th>Recommendation</th>
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<td><strong>FINDING 1:</strong> The Budget and Management Office Should Enhance Performance Measure Practices in the Budget Development Process</td>
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<td><strong>1.1</strong> Establish a formal process to ensure that performance information is reliable. Specifically, BMO should:</td>
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<td>a. Require that agencies provide BMO with the supporting documentation for performance measures included in agency budget proposals. This support should include, at a minimum, the source of the data, any limitations or assumptions associated with the data or measures, and whether the data was validated by the agency and the process used to validate, if applicable.</td>
<td>During the 2017 budget process, BMO created a Performance Measure Validation form for City agencies to use to validate their budget book performance measures. The form includes the source of data, limitations/assumptions, and whether the data has been validated by the agency. BMO did not submit the form to agencies during the 2017 budget process. BMO will begin working with agencies to complete the form in May 2017 for the 2018 budget process.</td>
<td>Partially Implemented</td>
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<td>b. Develop a process to determine when to assess agency documentation for reliability. This could include establishing a risk-based approach that includes set criteria that would prompt the need for additional review and independent validation of the data.</td>
<td>During the 2018 budget process, BMO will select one performance measure from each department to determine the validity of the measure. The criteria used to determine the reliability of the data will be drawn from the Performance Measure Validation form. If the data has not been validated by the agency and obtained from a reliable source, BMO will request additional information from the agency to ensure that the measure is accurate.</td>
<td>Partially Implemented</td>
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### Recommendations: Status of Implementation

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<td>1.2</td>
<td>Enhance communication to all applicable agency personnel at the end of the budget process. In this communication, BMO could provide additional feedback regarding the reasons why budget requests were denied and whether performance measures submitted with a request could be enhanced or alternate or additional measures could be developed to better support a subsequent similar budget request.</td>
<td>After 2017 budget decisions were finalized, BMO provided agencies with a list of all their respective change requests. The list provided information regarding whether the change request was approved or declined and a brief explanation of the reason the request was declined, if applicable.</td>
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<td><strong>FINDING 2: The Budget and Management Office Can Take Steps To Enhance the Determination of Unassigned General Fund Balance and Contingency Reserves Documentation</strong></td>
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| 2.1 | In conjunction with other Department of Finance divisions, the Budget and Management Office should periodically assess the policy that establishes the unassigned general fund balance.  
   a. As part of this assessment, BMO should identify best practices and should conduct an analysis of Citywide risks, which should take into account what other reserves are available to address some of those risks, and then ultimately determine the total dollar amount that is needed from the unassigned general fund balance to address remaining needs. Due to potential limitations in City resources and expertise, BMO should determine whether this assessment is performed by internal resources or by utilizing an external source that is knowledgeable in this approach.  
   In February 2017, BMO contacted the Government Finance Officers Association (GFOA) and discussed conducting an analysis of potential Citywide risks that also accounts for other reserves to identify the dollar amount needed from the unassigned general fund balance to address the identified risks. After further coordination with GFOA, BMO will decide whether to perform the study internally or to obtain GFOA’s services for the analysis. BMO is committed to completing the analysis either internally or through GFOA. | Partially Implemented |
## Recommendations: Status of Implementation

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<td>b. After performing a risk-based assessment and establishing unassigned general fund balance reserves, the General Fund Reserve policy should be updated to communicate results of the risks identified and how they affected the determination of unassigned general fund balance.</td>
<td>Once the overall analysis has been completed, the Department of Finance and BMO will use the findings from the assessment to determine whether to recommend modifications to the City's reserve policies as well as contingency and fund balance levels.</td>
<td>Not Implemented</td>
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2.2 In conjunction with other Department of Finance divisions, the Budget and Management Office should expand City General Fund Reserve Policy language to incorporate the usage of contingency reserves for purposes not clearly identified in the established criteria, such as foreseen expenditures not budgeted in the current year.

In 2017, BMO established additional criteria for the uses of General Fund contingency reserves in the Mayor's budget. Specifically, the Budget includes additional criteria related to “planned one-time expenditures that advance a programmatic or financial outcome.”

Implemented

2.3 The Budget and Management Office should develop a formal supplemental request process that includes a structured request document to ensure documentation is provided and retained to support the need and use of general fund contingency reserves.

In 2016, BMO developed a formal supplemental request form that included agency justification detailing why additional budget will be needed above a department’s original appropriation. The supplemental form resides in Questica (the City’s budgeting software) and is accessible to all agency financial contacts.

Implemented
Conclusion

While the Budget and Management Office has fully implemented three of the seven recommendations made in the Budget and Management Office audit report, others have yet to be completely implemented. Two recommendations aimed at enhancing performance measurement practices in the budget development process were partially implemented because the necessary performance measure reporting forms, although developed and ready for use in the 2018 budget process, were not used in the 2017 budget process, as expected. Another recommendation was partially implemented because the Budget and Management Office only recently contacted the Government Finance Officers Association about conducting a risk-based analysis of General Fund reserve requirements despite having committed to complete the analysis in 2016. A corresponding recommendation to update the City’s General Fund Reserve Policy based on the results of the risk-based analysis is considered not implemented as the Budget and Management Office has not yet taken action to update this policy. Despite the Budget and Management Office’s efforts, auditors determined that the risk associated with the audit team’s initial findings has not been fully mitigated. As a result, the Audit Services Division may revisit these risk areas in future audits to ensure that appropriate corrective action is taken.

On behalf of the citizens of the City and County of Denver, we thank staff and leadership from the Budget and Management Office for their cooperation during our follow-up effort and their dedicated public service.