

FINAL

MANAGEMENT AUDIT REPORT
OF
CITYWIDE
FISCAL YEAR 2002 YEAR-END CLOSE

REPORT NO. 03-101B



**CITY OF ALBUQUERQUE
OFFICE OF INTERNAL AUDIT**



City of Albuquerque
P.O. BOX 1293 ALBUQUERQUE, NEW MEXICO 87103
Office of Internal Audit

Martin J. Chavez, Mayor

February 13, 2003

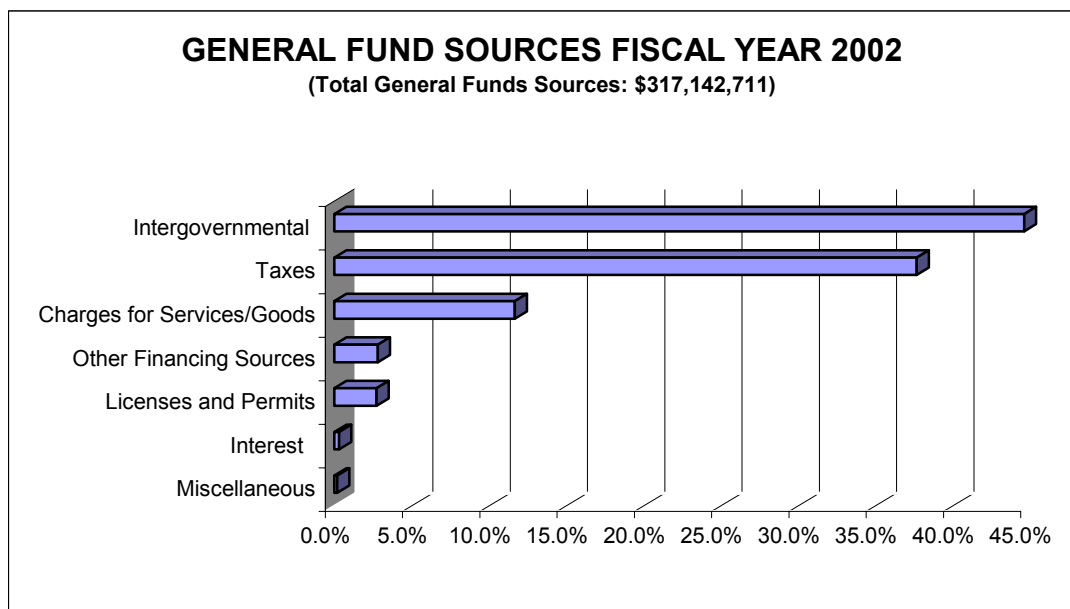
Internal Audit Committee
City of Albuquerque
Albuquerque, New Mexico

Audit: Citywide
Fiscal Year 2002 Year-End Close
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INTRODUCTION

The City of Albuquerque (the City) operating budget is prepared annually for the General Fund, six enterprise, and several special revenue, internal service, debt service and project funds. Each year the City is required to have a balanced budget so that expenditures cannot exceed revenues and other sources. Sources of funding for the City's General Fund are as follows:

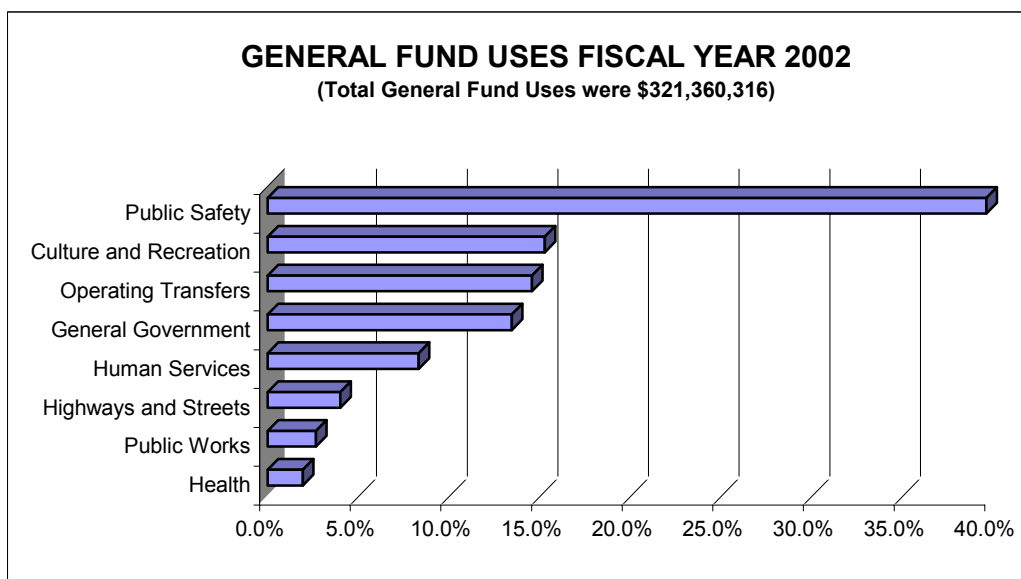


The City makes appropriations at the program strategy level. Expenditures may not exceed appropriations at this level. Budgetary control is maintained by a formal appropriation and encumbrance system. The Mayor has authority to move program strategy appropriations by the lesser of five percent or \$100,000 without City Council approval, provided the fund appropriation does not change. With the exception of project funds, appropriations revert to fund balance to the extent they have not been expended or encumbered at fiscal year end.

As required by the City charter, the annual budget (the Proposed Budget) is formulated by the Mayor and the Office of Management and Budget (OMB) and submitted to the City Council by April 1 for the fiscal year (FY) commencing July 1. City Council can amend the budget and votes on the budget at a meeting in May. The budget, as amended by the City Council is published as the Approved Budget.

A cleanup resolution may be performed in the middle of the fiscal year to make adjustments to anticipated revenues and expenditures. At the conclusion of each fiscal year the Mayor and City Council compare the budgeted versus actual revenues and expenditures. Any budget adjustments required are completed in a final "cleanup resolution" proposed by the Administration and amended by City Council. OMB management reports that cleanup bills will be proposed to City Council only when over-expenditures occur at the fund level. The midyear cleanup resolution for FY02 increased the City's General Fund budget appropriations from \$324 million to \$327 million. The final FY02 cleanup resolution had not been considered by the City Council and the Comprehensive Annual Financial Report (CAFR) had not been published at the completion of our fieldwork. The final cleanup resolution was considered by City Council on December 2, 2002. The CAFR was submitted to the New Mexico State Auditor's Office on December 23, 2002.

General fund uses are as follows:



Each year the City publishes the result of its revenues and expenditures in its CAFR. The CAFR is audited by the City's external auditors and should be filed with the New Mexico State Auditor's Office by December 1.

The Office of Internal Audit conducted the audit of the FY02 year-end cleanup in accordance with City Ordinance section 2-10-9 ROA 1994. This report and its conclusions are based on information taken from a sample of transactions and do not purport to represent an examination of all related transactions and activities. Our fieldwork was completed on November 18, 2002. The audit report is based on our examination of the City's activities through the completion of our fieldwork and does not reflect events or accounting entries after that date. The audit was conducted in accordance with Governmental Auditing Standards, except Standard 3.33, requiring an external quality control review.

SCOPE

Our audit did not include an examination of all the functions, activities, and transactions of the June 30, 2002 Citywide close. Our audit test work was limited to the following areas:

- Compile a schedule of appropriations and actual expenditures identified by program, department and fund.
- Obtain explanations from the Administration regarding over and under expenditures by the lesser of five percent or \$100,000 of the program appropriated amounts.
- Examine transfers – all funds.
- Examine encumbrances – all funds.
- Review changes in internal controls over expenditures as they relate to the City's budget.

FINDINGS

The following findings concern areas, which we believe would be improved by the implementation of the following recommendations.

1. THE ADMINISTRATION SHOULD ENSURE THAT ALL PROGRAMS DO NOT OVERSPEND THEIR APPROPRIATIONS

The purpose of public budgeting is to provide government with a mechanism to allocate resources for the pursuit of goals that are consistent with community preferences and needs. The City budgets at the program level. Programs are contained within the City's different funds and are managed by departments.

A summary of the City's FY02 appropriations and actual expenditures by program, fund and department are on the following Budget to Actual Expenditures Table:

For FY02 the City had 103 General Fund programs with appropriations totaling \$327,341,676 and 106 non-General Fund programs with appropriations totaling \$580,630,302. In FY02, eleven of these programs were overspent totaling \$2,209,465. This is a noted improvement from FY01 where 72 programs totaling \$22,989,327 were overspent. The FY02 overspent programs are as follows:

Fund	Program	Appropriations	Expenditures	Variance
110	Xfer to operating grants	\$ 3,307,000	\$ 3,573,436	\$ (266,436)
110	Early retirement	\$ 3,928,000	\$ 4,603,690	\$ (675,690)
110	Fire dept. training & safety	\$ 1,394,000	\$ 1,735,188	\$ (341,188)
260	Corrections/Detention	\$ 29,875,000	\$ 30,100,892	\$ (225,892)
260	Alternatives to sec. detent.	\$ 749,000	\$ 798,243	\$ (49,243)
621	San Juan/Chama	\$ 2,027,000	\$ 2,152,407	\$ (125,407)
621	Low income utility credit	\$ 228,000	\$ 234,250	\$ (6,250)
622	Sustainable water supply	\$ 7,009,000	\$ 7,322,993	\$ (313,993)
651	Solid Waste collections	\$ 17,174,000	\$ 17,177,544	\$ (3,544)
651	Clean city section	\$ 3,066,000	\$ 3,071,357	\$ (5,357)
715	Materials management	<u>\$ 512,000</u>	<u>\$ 708,465</u>	<u>\$ (196,465)</u>
Total		<u>\$ 69,269,000</u>	<u>\$ 71,478,465</u>	<u>\$ (2,209,465)</u>

As a result of various program over-expenditures, certain adjustments were made by City management. These adjustments were made as follows:

- \$407,487 of expenditures were transferred from the Albuquerque Fire Department (AFD) Training and Safety program to the AFD Paramedic Rescue program. These expenditures were training related. Moving expenditures would have shown misleading program expenditures in both programs. AFD management reports that during FY02 they projected the Training and Safety program to overspend its appropriation. AFD was advised to transfer expenditures by its OMB Budget Analyst.

OMB management reports that AFD's Training and Safety program has not been adequately funded in the City's approved budget. This program has historically been funded by moving expenditures to other programs that have salary savings due to vacancies. The AFD Training and Safety program should have an adequate appropriated budget set at the beginning of the year. OMB and AFD should discontinue transferring expenditures. In accordance with explanation number 3 from the Chief Administrative Officer (see below), this transfer was reversed before the FY02 general ledger was closed.

- In FY02 the City Council Amended the FY02 budget and combined the Sunride Downtown Trolley and Nob Hill/Old Town Trolley services into one route. However, these two routes had separate program appropriations that were not combined by City Council. Transit Department management reports that since these services were combined into one route, they were not able to distinguish expenditures between the two separate programs. As a result, in order to keep the programs from overspending, various unsupported journal vouchers moving expenditures between the two programs were required. Although expenditures in total appear to be accurate, assigning the cost to two separate programs is meaningless. When program functions are combined, the corresponding program appropriations should also be combined.

In FY02, in order to reduce expenditures, the Administration implemented a hiring freeze on all non public safety departments and prohibited departments from purchasing any supplies and capital items without permission from the Administration.

In accordance with City Ordinance, we requested that the CAO respond to each program that was over or under-spent the lesser of five percent or \$100,000. The Chief Administrative Officer's (CAO) explanation of the over and under-expenditures listed above is as follows:

1. ***“Your report identifies 32 General Fund programs and 41 Other Fund programs as underspending their appropriated budget for the fiscal year by \$100,000 or five percent. As your report indicates, the appropriation level for many of these programs was revised at mid-year to reflect the anticipated spending level. Departments were encouraged to closely track spending and exercise restraint where possible. As I reported in my memo of May 3, 2002, responding to your third quarter FY/02 expenditure projections, the Mayor stated that any director that overspends a budget shall be dismissed. Penalties for overspending adopted by City Council in O-7 requires termination of department directors for overspending in two years during a four-year period and disciplinary action, including demotion and transfer for the responsible program manager. (Although not affecting the FY/02 behavior, effective October 7, 2002, there is a new Administrative Instruction on Budgetary Control Responsibilities directing all employees with budgetary control over a program strategy to accomplish their tasks within the approved budget.) The end result was favorable. Departments produced nearly \$6 million in General Fund reversions. This amount is critical in addressing the \$10.6 million revenue shortfall the General Fund experienced in the final months of FY/02.”***

2. ***“Two General Fund programs and five Other Funds programs are identified as overspending their appropriated budgets for the fiscal year by \$100,000 or five percent.***
 - a. ***“General Fund: City Support Functions; Transfer to Operating Grants Fund was overspent by \$266,436. FY/02 grants requiring City cash match or additional indirect cost exceeded the estimated appropriation. OMB staff is tracking this program more closely in FY/03.***
 - b. ***“General Fund; City Support Functions; Early Retirement was overspent \$675,690. The incentive program to address revenue shortfalls successfully enticed employee retirements after the mid-year cleanup was final.***
 - c. ***“Corrections and Detention Fund; Corrections Department; Corrections/Detention was overspent by \$225,892. The overexpenditure was due to an unforeseen increase in the contract to Metro Court for approximately \$100 thousand and additional costs in the medical contract for drugs issued to inmates.***
 - d. ***“Corrections and Detention Fund; Corrections Department; Alternative to Secured Detention was overspent \$49,243. This is a successful program in deterring the number of inmates incarcerated. This reflects an increase of inmates in the Community Custody program and associated costs for drug testing and electronic monitoring.***
 - e. ***“Joint Water and Sewer Operating Fund; Public Works Department; San Juan/Chama was overspent by \$125,407. The Bureau of Reclamation closed out the 30-year project and determined the original project cost was higher than previously stated; therefore, the debt service payment was increased mid-year by \$70 thousand. In addition, the repairs and maintenance costs of that agreement were higher than originally budgeted.***
 - f. ***“Sustainable Water Supply Operating Fund; Public Works Department; Sustainable Water Supply was overspent by \$313,993. Several large invoices that should have been paid out of the Strategy Implementation Capital Fund (North I-25 Phase I) were paid out of this operating fund. At the time the department realized this program would exceed budget, the capital project had been closed out. These contracts are ultimately being paid from the same dedicated funding source.***
 - g. ***“Supplies Inventory Management Fund; Finance and Administrative Services Department; Materials Management is reported overspent by \$196,456. Actual expenditures of \$462,311 are within the appropriation of \$512,000. The encumbrances of \$246,154 should not be reported against these operating funds. These are encumbrances for inventory items that will be reported as an asset on the balance sheet when purchased and not an operating expense.”***
3. ***“Your report recommends adjustments in two Fire Department programs, Paramedic Rescue, and Training and Safety, effectively reversing four journal vouchers. We agree with your recommendations. Once the JV’s are reversed, the***

Training and Safety program will be overspent. We do not intend to ‘clean-up’ these programs as we are only taking actions when a fund is overspent. Cadet attrition classes have never been budgeted, but rather are funded from vacancy savings created when firefighters retire. In FY/03 and future years, we will adjust the Fire Department program appropriations at mid-year to more accurately reflect actual expenditures as a result of attrition cadet classes. In FY/04 we will budget for salaries associated with cadet attrition classes, as well as track expenditures to adjust program appropriations at mid-year.

4. ***“Finally, your report asks for an explanation of underexpenditures in seven programs associated with debt service.***
 - a. ***“Sales Tax Refunding Debt Service Fund; City Support Functions; Debt Service was underspent by \$1,277,718. The under expenditures were due to favorable variable interest rates.***
 - b. ***“General Obligation Bond Debt Service Fund; City Support Functions; Debt Service was underspent by \$4,397,930. The underexpenditure was due to favorable variable interest rates as well as anticipated loss of property tax revenues. Principal payments were adjusted downward.***
 - c. ***“Aviation Operating Fund; Aviation Department; Transfer to Airport Debt Service was underspent by \$1,220,178. Because of the substantial fund balance in Fund 615, and in light of reduced expenditures due to low variable rates and other factors (see 4.d. below), the Aviation Department reduced the Transfer to Debt Services as year-end approached, to avoid an excessive (and restricted) fund balance in Fund 615.***
 - d. ***“Airport Revenue Bond Debt Service Fund; Aviation Department; Debt Service was underspent by \$5,293,934. Several factors contributed to this result: favorable variable interest rates on Series 1996A and Series 2000 A&B; and early redemptions on the 1996A bonds (paid with PFC revenues) were intentionally kept low, (approximately \$2 million under budget), pending a review and reconciliation of all PFC revenue received and interest earned since the inception of the program. Now the reconciliation has been accomplished and all outstanding 1996A bonds will be redeemed on November 6, 2002. The 2001 Refunding resulted in savings to the department (underexpenditure) in excess of \$2 million.***
 - e. ***“Joint Water and Sewer Revenue Bond Debt Service Fund, Public Works Department, Debt Service was underspent by \$233,201. In December 2001, \$30 million in revenue bonds were issued with a lower interest rate than was budgeted ten months earlier.***
 - f. ***“Parking Facilities Revenue Bond Debt Service Fund; Transit/Parking Department; Transfer to Sales Tax Refunding Debt Service Fund was underspent by \$1,030,737. The bond payment in FY 2002 was originally calculated using a 6.5% interest rate. The actual payment was closer to a 3.5% interest rate and resulted in a savings of approximately \$700 thousand. In***

addition, the construction of the final parking structure to be constructed with the bond proceeds was deferred and resulted in approximately \$300 thousand in additional interest earning on the bond proceeds. These interest earning were used to pay a portion of the bond debt and together with the lower interest payment rate, resulted in a reduction of approximately \$1 million to Transfer to Sales Tax Refunding Debt Service Fund from Parking Facilities.

- g. ***“Golf Courses Debt Service Fund; Parks and Recreation Department; Debt Service was underspent by \$66,106. This item was accrued in the FY/01 audit rather than expensed on January 1, 2002 when transmitted to the fiscal agent.”***

RECOMMENDATION

The CAO should ensure that all programs spend within the appropriated levels. In addition, programs should be adequately funded at the beginning of the year. OMB should discontinue the practice of moving expenditures to ensure budget compliance.

EXECUTIVE RESPONSE FROM THE CAO

“The Mayor and CAO have been unquestionably clear that departments are to hold expenditures within the appropriation. The Mayor has advised each department director that the individual will be terminated if they overspend their budgets at year-end. This is the ultimate incentive for directors to ensure full budget compliance. Administrative Instruction No. 2-20, Budgetary Control Responsibilities, the Administration’s policy to maintain a fiduciary financial responsibility in the operation of City government, was issued October 7, 2002. Beginning with the fiscal year 2003 year-end close, OMB will discontinue the practice of moving expenditures to ensure budget compliance.”

2. OMB SHOULD WORK WITH THE DEPARTMENTS TO ESTABLISH REALISTIC PERFORMANCE MEASURES

It is the City’s intent to utilize performance based budgeting where inputs such as appropriations require certain outputs such as tons of refuse to be collected. In FY02, the City Council adjusted the appropriations for 123 of the City’s 209 operating programs. However, none of the corresponding program strategies were adjusted to reflect the new funding levels. When budgets are changed throughout the year and corresponding changes to the performance plan are not made, unrealistic goal expectations may be formed by the Administration, the Council and the Citizens of Albuquerque. For any changes in funding levels, the Administration should view the performance measures as an integral part of the budget process and ensure that the appropriate performance