COUNTY OF PLACER

ANDREW C. SISK, CPA
Auditor-Controller
E-mail: asisk@placer.ca.gov

NICOLE C. HOWARD, CPA
Assistant Auditor-Controller
E-mail: nhoward@placer.ca.gov

OFFICE OF
AUDITOR-CONTROLLER

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Mr. Jerry Gamez, Director
Placer County Administrative Services Department
2962 Richardson Drive
Auburn, CA 95603

Re: Information Technology Internal Service Fund Follow-up Review

Dear Mr. Gamez:

The Internal Audit Division of the Auditor-Controller's Office recently performed a follow-up review to our review of the Information Technology (IT) Services Division (Division), a division of the Administrative Services Department (Department). The Division's activities are tracked in the IT internal service fund. The objective of our procedures was to determine how recommendations from our previous review were implemented to strengthen internal controls and improve operating policies and procedures. Our procedures included inquiries of Department personnel along with reviews of supporting documentation relating to our recommendations in our original report and how recommendations were utilized along with actions taken.

The following is a summary of observations and recommendations along with the Department's responses from the previous report dated January 13, 2016, which are then followed by the status of the Department's implementation of our recommendations.

Summary of Observations and Recommendations

IT Internal Service Fund's Rate Methodology

Tracking and Allocation of Costs

During our review of the Division's Organization Cost Accounts (OCAs) for tracking costs, we noted that the methodology in place for allocating an OCA's costs to the attributed revenue business lines was based on budgeted and actual amounts in which each expense was allocated to a specific business line. There are always going to be costs that exist that are attributable to multiple business lines and should not be allocated to only one business line. These costs

should be grouped together in a cost pool for allocating to the attributed revenue business lines and allocated based on an allocation plan such as percentages of the total costs in the cost pool.

OCAs related to multiple business lines should be split into more detailed OCAs attributable to one business line or there should be a methodology in place for allocating an OCA's pool of costs to the related business lines. This will simplify the cost allocation process by only requiring a report by OCA to be run and then applying allocation percentages for each business line. Due to the current methodology for allocating costs not including any costs that should be allocated to multiple business lines, the allocation of the costs does not appear accurate. Because the current methodology does not fully allocate the costs in each OCA to each business line, the Division is unable to calculate an accurate breakeven point for each business line, which would assist in developing rates for each business line.

In addition, the methodology for allocating costs to revenue business lines did not include, and therefore did not allocate, any costs to the following business lines: Intergovernmental Service Agreements and External Service Agreements. We also noted that Dedicated Application Support Staff is charged to the department based on actual costs recorded for that business line, but we did not note any infrastructure costs being allocated to this business line. Due to the infrastructure costs supporting all business lines, there should still be an amount of these costs allocated to each business line.

We recommend that the Division create a methodology for tracking costs by creating more OCAs specific to revenue business lines or by creating allocation plans for allocating the costs in each cost pool to the related business lines. For developing cost allocation plans for each cost pool, we recommend that the Division perform time studies or cost studies to understand the percentages of costs attributable to each business line in the cost pool. This will help the Division in considering revenues and costs in establishing breakeven points for each business line. Establishing breakeven points for each business line will further help the Division in determining that the rates being charged will recoup the costs for the business line and ensure that business lines are not being over or undercharged. Further, we recommend that infrastructure costs and any other costs attributable to all business lines be allocated to all business lines.

Department's Response:

The Department agrees with the Auditor-Controller's recommendation and new OCA's have been created to correlate with each billable Line of Business. Costs will be tracked within these OCA's to reflect actual expenditures against revenues by Line of Business. Costs will be analyzed regularly to further assist the Division in ensuring rates for services support a full cost recovery methodology per Line of Business.

Status – Partially Implemented

The Division created multiple OCAs for tracking costs specific to the Division's revenue business lines and utilized priority based budget programs as cost allocation pools based on actual costs adjusted for budget revisions, which appear to reasonably allocate costs for most business lines. However, the methodology did not allocate costs attributable to all business lines, such as infrastructure costs, A-87 costs, or general overhead costs, across all business lines. Since these costs support all business lines, there should be a percentage of these costs allocated to each business line. Therefore, the Division's current methodology does not fully allocate all costs to each attributable business line and the Division is unable to calculate accurate breakeven points and rates for each business line.

The Division is in the process of incorporating the remaining portion of our recommendation by updating their cost allocation methodology, as part of their Fiscal Year 2017-18 (FY17-18) budget process, to properly allocate all costs attributable to each business line including infrastructure costs, A-87 costs, and general overhead costs, across all business lines.

Projected Revenue Surpluses and Deficits

During our review of the IT Internal Service Fund's Fiscal Year 2015-16 (FY15-16) Rate Methodology (FY15-16 Methodology) and the calculation of these rates, we noted that the budgeted revenues were target amounts to be able to cover total budgeted expenses and reserves. There was not enough historical data of costs recorded at a level to be allocated to each business line to analyze each business line's breakeven point and contribution to the operating reserve. Due to this limitation, we analyzed projected revenues based on actual revenues to date and compared these to the annual budgeted revenues by each business line. Our analysis resulted in revenue business lines that will not meet budgeted revenues and others that will exceed budgeted revenues.

The following business lines are projected to not meet budgeted revenues. Core IT Services is projected to have a deficit of about $353K, which is due to the Division originally planning to charge for ACORN only user accounts, but these user accounts were not charged, and the resulting loss in revenue was not incorporated into the rates for the other user accounts. Server Hosting Services is projected to have a deficit of $157K due to prior service level agreements that charge 58% less than the FY15-16 Methodology for Server Hosting Services. All of these service level agreements are set to expire during FY16-17. We also calculated the projected revenue including the service level agreements that would change to the new methodology rates for FY16-17 and projected the revenues to be $307,500 or $106,500 less than the FY15-16 budgeted revenues.

The following business lines are projected to exceed budgeted revenues. Project Management Services did not have enough data to perform accurate projections, so we utilized very conservative amounts for a conservative projection of revenues and calculated projected

revenues that would exceed budgeted revenues by $70K. The Heat Ticket Billable Services, which includes Department Specific Application Services and Billable Services, is projected to exceed budgeted revenues by $138K.

We recommend that the Division work with the County Executive Office (CEO) for determining the appropriate cost recovery method for the loss of revenue for ACORN only user accounts. We also recommend that the Division consider whether the rates for Server Hosting Services should be increased in the current year to account for the projected deficit in revenues in FY15-16, and the FY16-17 budget should incorporate this decision with regards to this deficit from Service Level Agreements. For the business lines with projected revenues that will exceed budgeted revenues, we recommend that these additional revenues be incorporated into the operating reserve. The Division should reassess the break even points for all business lines and whether rates should be changed when there is enough historical data to do so. This reassessment should occur at least one year after the start of the IT Internal Service Fund's operations.

Department's Response:

The Department has determined that the ACORN system is a true Enterprise wide application supporting Human Resource and payroll services that benefit all County Departments. As such, these costs shall be distributed within the CORE services Line of Business in subsequent fiscal years. During FY 2015-2016 the Department has analyzed current billing trends, July through November 2015 and it is estimated that Billable Services revenue will be much higher than originally budgeted, therefore covering the loss of the revenue budgeted within CORE Services for the ACORN ONLY accounts. The Department has determined that the rates for Server Hosting Services will not be changed for FY 2015-2016, but the submitted FY 2016-2017 Information Technology budget has updated rates for Server Hosting Services to ensure this Business Line breaks even.

Status – Partially Implemented

The Division increased rates for FY16-17 in order to recover costs from ACORN only user accounts and to account for the projected deficit in Server Hosting Services revenues. Though Server Hosting Services rates were increased, we noted the increase was not sufficient to recoup all costs of the business line. Net realized surpluses for the fund, which includes all business lines, were added to the operating reserve. The Division reassessed breakeven points for all business lines, but because the Division's current cost allocation methodology does not fully allocate all costs to each attributable business line, the Division is unable to calculate accurate breakeven points and rates for each business line. We also noted some business lines' rates being based on budgeted revenues instead of budgeted costs when budgeted revenues did not equal budgeted costs. As a result, rates are not based on breakeven points.

The Division is in the process of incorporating the remaining portion of our recommendation by updating their cost allocation methodology, as part of their FY17-18 budget process, to properly allocate all costs attributable to each business line enabling the Division to calculate accurate breakeven points and rates for each business lines.

Operating Reserves

Incremental Implementation of A-87 Costs Rate Increases

During our testing of the IT Internal Service Fund's reserve amounts, the Division had originally budgeted for saving one-third of projected A-87 costs as a reserve in FY15-16, which the full amount of A-87 costs will be charged in year three of operation (FY17-18). This was established in order to incrementally increase the rates charged for IT services. During inquiries with Division management about the plans for future reserves, the Division plans to save one-third of the A-87 amount each year for the first three years and then increase rates to account for the full A-87 amount in year four, which would be paying for A-87 costs on a current basis where the revenues and A-87 costs are collected and paid in the same year. In order to consider the increase to be incremental, there should be an increase in rates each year to build up to the rates that accommodate the full A-87 costs.

We recommend that the Division plan and budget for a true incremental increase in rates over the three years. This would include a budgeted increase in reserves in each year as follows: one-third of A-87 in year one, two-thirds of A-87 in year two, and three-thirds or 100% of A-87 in year three. This plan will also allow for the Division to have a full year's A-87 costs saved in reserves to pay for the following year's A-87 costs.

Department's Response:

The Department agrees and in consultation with the County Executive Office has identified and will develop a plan to align rates to fund A-87 costs. The submitted FY 2016-2017 Information Technology budget includes these adjusted revenue alignments.

Status – Implemented

The Division has budgeted for an increase of $447,114 in reserves for FY16-17 which is within a reasonable range of the recommended two-thirds of the estimated A-87 costs.

Reasonableness of Operating Reserve

During our testing of the reasonableness of the IT Internal Service Fund's reserves, we noted that the Fund had budgeted for a total operating reserve of $941,364 or 5.7% of the total operating expenses of $16,449,150. During our research of comparable-sized California

counties with IT internal service funds, we noted that an appropriate reserve amount is in the range of 10-15% of total annual operating costs for the fund. According to the Handbook of Cost Plan Procedures for California Counties, dated October 2012, "Unrestricted, undesignated net assets up to the amount required to pay for 60 days of average cash expenses are considered a reasonable working capital reserve." This means that the maximum amount of operating reserves that the Fund can maintain is 60 days of operating expenses or 16.4% of annual operating costs.

We recommend that the Division create a plan for increasing the current operating reserve to be within the industry standards range of 10-15% of annual operating costs within the next 5 years. This amount of time will allow sufficient time for incorporating this increase in reserves into the rates for IT services for future years. Further, we recommend that the Division strive to maintain an operating reserve of about 12.5% of annual operating costs, but not to exceed the cost plan requirements of a maximum of 16.4% of annual operating costs.

Department's Response:

The Department acknowledges the Auditor-Controller's recommendation and in consultation with the County Executive Office will work to identify and develop a plan that addresses the Auditor-Controller's recommendations pertaining to the Information Technology Internal Service Fund's operating reserves.

Status – Implemented

The Division increased reserves to be within the industry standards range of 10-15% of annual operating costs and has not exceeded the cost plan requirements of a maximum of 16.4% of annual operating costs.

Though the Division has increased the operating reserves to an allowable amount, we noted the rate at which operating reserves are increasing is on pace to exceed the cost plan maximum reserve limits within the current fiscal year. After the Division develops a cost allocation plan and determines break even points for all business lines, the Division will be able to determine which business line rates to reduce in order to maintain an allowable amount of operating reserves per cost plan requirements.

Project Management Services

Services Performed Without Approved Agreement

During our testing of Project Management Services, we noted that the Division was performing services on projects for which they did not have a signed and approved agreement (Scope of Work document). This was the result of the quick change in billing methodology from having these services not billed in FY14-15 to being billable services in FY15-16. Due to the priority and

necessity of project completion for these projects, the Division still rendered services for each customer without a signed Scope of Work document. At the beginning of the fiscal year when the new methodology for charging for IT services was in effect, the Division visited each department and informed them about the change in billing methodology and that these services would be billable for the new fiscal year. Each customer had to agree to having the Project Management Services still performed without an established amount, but there were no written agreements. The Division is currently in the process of developing Scope of Work documents for each project and having each customer sign and approve these documents.
We recommend that the Division not agree to and perform work on any new projects, until a signed Scope of Work document has been obtained. This will ensure that there are no legal issues in the work performed and the amount to be charged for services. Further, we recommend that the Division continue to create Scope of Work documents and obtain signatures of approval for each existing project.

Department's Response:

The Department concurs with the Auditor-Controller's recommendations and has implemented the necessary business processes to ensure that work is not performed for any new project until a signed Scope of Work has been obtained from authorized users within the requesting department and the Information Technology Division's Management Team.

Status – Implemented

The Division has created procedures to clearly define the requirements for obtaining a Scope of Work document, and it appears the Division is properly obtaining Scope of Work documents for new and existing projects.

Heat Ticket Billings

Billable and Non-billable Time Recorded in Same OCA

During our testing of Heat Ticket billings, we noted that IT staff records all of their time on County timesheets to OCAs related to their Division Unit. These OCAs did not differentiate between billable time and non-billable time (i.e. administrative work), and made it impossible to compare time in the Heat Ticketing system to time recorded on employees' timesheets. Time in the Heat Ticketing system is manually input into the system by each IT staff according to their assessment of time worked on each Heat Ticket. There is no process in place for comparing Heat Ticket time per employee to actual time worked by that employee, which presents the risk of time in the Heat Ticketing system being overstated/understated and departments being overbilled/underbilled.

We recommend that the Division implement the use of new time reporting OCAs to account for non-billable work, which would be considered in the overhead cost pool and allocated to the

various IT business lines. We also recommend that management implement a review process for comparing billable time to time recorded in the Heat Ticketing system and incorporate this into the normal timesheet review process. This will prevent the overbilling or underbilling to departments and present better tracking of costs for use in determining rates to be charged and the break-even point for each business line.

Department's Response:

The Department concurs with the Auditor-Controller's recommendation and has created new time reporting OCAs that correspond to all lines of business. Managers will be responsible for the accurate reporting of all billable and non-billable time within their respective programs.

Status – Partially Implemented

The Division has implemented the use of new OCAs to account for non-billable work but not all the new OCAs were effective in differentiating between billable time and non-billable time (i.e. administrative work) and made it impossible to compare billable time recorded in the ServiceNow Ticketing system to billable time recorded on employees' timesheets. Also, the Division currently does not have a review process for comparing billable time recorded on timesheets to time recorded in the ServiceNow Ticketing system. Going forward, the Division plans to incorporate this comparison into their timesheet review process.

Non-billable Services Charged to Department

During our testing of Heat Ticket billings, we noted that there was a Heat Ticket billing that was attributable to CORE IT charges and not billable to a department. This billing was still billed out to the department, but was later credited and moved to non-billable CORE IT Charges after the department refuted the charge. The IT Heat Ticketing system has mechanisms in place for identifying which charges are non-billable, but these did not prevent this charge from being billed out to the department.

We recommend that the Division update the Heat Ticketing system to track all non-billable costs so they will not be billed out to departments. We also recommend that the department implement a review process for management to be able to identify non-billable costs before they are billed out to departments.

Department's Response:

The Department concurs with the Auditor-Controller's recommendations and has implemented the necessary modifications to the HEAT system to ensure non-billable services are not billed out to County Departments. In addition, efforts are underway to ensure that the new ServiceNow Ticketing & Billing system is configured to comply with this recommendation.

Status – Partially Implemented

The Division currently tracks non-billable work within ServiceNow and has a review process in place for management to be able to identify non-billable costs before they are billed out to departments. During our testing of ServiceNow tickets, we identified tickets that were incorrectly classified as billable or non-billable. As a result, the Division's review process is not effectively identifying all non-billable costs before they are billed out to departments. We note that the Division could benefit from implementing a preventative control to classify tickets as billable or non-billable during the in-take or creation of ServiceNow tickets.

Separate Business Lines Recorded in Same General Ledger Account

During our testing of Heat Ticket billings, we noted that Department Specific Application Services and Billable Services were stated in separate classifications, which is in line with the Information Technology Division's Service Descriptions and Rates document. When tracing these revenues to the general ledger (GL), we noted that both business lines were being recorded in the same object level 3 account. There is a discrepancy in how the business lines are identified and how they are recorded in the GL.

We recommend that the IT charges for Department Specific Application Services and Billable Services be recorded in separate object level 3 accounts or the Division can choose to combine these business lines into one description in the Information Technology Division's Service Descriptions and Rates document and not track the business lines separately in the Heat Ticketing System. The business lines' descriptions should be consistent with how these services are recorded in the GL.

Department's Response:

The Department agrees and created a new object level 3 to capture billable services separately from department specific application services.

Status – Implemented

The Division has created and is recording revenues to separate object level 3 accounts for Department Specific Application Services and Billable Services.

Flat Rate Charge on Computer Deployments

During our testing of Heat Ticket billings, we noted that for deployments of computers, the Division charges a flat rate per computer deployment. In order to substantiate this methodology of charging a flat rate, the Division needs to perform a time study on computer deployments and verify that the flat rate of hours being charged is at the average amount of

hours per deployment. The Division was unable to provide this supporting documentation for this flat rate charge.
We recommend that the Division perform a time study on computer deployments in order to justify an average rate to be charged for all computer deployments. We also recommend that the Division explore the most cost effective method for performing computer deployments whether it be outsourced or performed internally.

Department's Response:

The Department concurs with the Auditor-Controller's recommendations to conduct a time study of computer deployments in order to justify a rate billable for computer deployments. The study will also include the most effective method for performing the computer deployments, whether it is in-house or outsourced.

Status – Implemented

The Division performed a computer deployment time study to justify the average rate charged per computer deployment. The Division also explored the most cost effective method for computer deployments by having internal IT staff coordinate with outside vendors' services for computer deployments when it's more cost effective and efficient.

IT Consolidations

Lack of Document Retention

Over the past few years, the Division has conducted two IT consolidations which merged departmental IT staff into the Division to have IT services for those departments centrally located in the Division. These two consolidations occurred with the Health and Human Services' (HHS) Management Information Systems' (MIS) staff and the Library IT staff. During our testing of the IT consolidations, we noted that the Division was unable to provide all supporting documentation for the pre and post-consolidation assessment and the plans and status updates for implementation. The Division claimed that the retention period for these documents had passed, so not all of the supporting documentation could be provided. Per the County's Record Retention Manual (Manual), Appendix B – Resolution No: 2006-213 Countywide Accounting and Administrative Retention (CAAR) Schedule, CAAR – 110, Correspondence – Policy, "Records that document and support the formation of a specific policy and/or the decision making process to arrive at this policy...shall be maintained by the originating department permanently." The Manual further states, "Examples include major decisions affecting...organizational changes." We assess the documentation related to the IT consolidations to be considered organizational changes due to these events reorganizing the structure of IT services and staffing related to the Division, HHS, and the Library.

We recommend that the Division review the Manual and assess what documentation areas are affected by the Manual's document retention timelines to ensure the proper retention of Division documentation. In the future, any policies and supporting documentation in developing the policies related to organizational changes should be maintained by the Division permanently.

Department's Response:

The Department agrees with the Auditor-Controller's recommendation and has reviewed the Records Retention Manual with all IT Division Managers. In the future, any policies and supporting documentation in developing the policies related to organizational changes will be maintained by the Division in accordance with the County's approved Records Retention Policy.

Status – Implemented

Though there were no significant organizational changes between the issuance of the original report and the date of our testwork, the Division created and implemented a Significant Organizational Changes Procedure document, which includes document retention procedures related to significant organizational changes.

Nonperformance of Post-Implementation Assessment

During our testing of the HHS and Library IT consolidations, we noted that the Division did not perform a post-consolidation assessment to determine if the proposed benefits were realized. Best practice for implementing significant organizational changes is to identify proposed benefits before implementation and to assess whether the proposed benefits were realized after implementation. This justifies and provides support for the implementation of the significant organizational change.

We recommend that the Division perform a post-implementation assessment for all future significant organizational changes. This assessment should identify any proposed cost savings or increased efficiency performance metrics and compare them to the actual outcomes.

Department's Response:

The Department agrees with the Auditor-Controller's recommendation and has implemented a procedure to perform a post-implementation assessment for all future significant organizational changes. This assessment will identify any proposed cost savings or increased efficiency performance metrics and compare them to the actual outcomes.

Status – Implemented

Though there were no significant organizational changes between the issuance of the original report and the date of our testwork, the Division created and implemented a Significant Organizational Changes Procedure document, which includes procedures for performing a post-implementation assessment for significant organizational changes.

Countywide Enterprise Services

Complex Process of Charging for Countywide Systems Services and Not All Countywide Systems' Costs Flowing Through Countywide Systems Fund

During our review of the support for the Division's Countywide Enterprise Services, we noted that these services were also being covered under the various Countywide Systems' services. According to the Information Technology Division's Service Descriptions and Rates document and inquiries with the Division and the CEO, the Division's Countywide Enterprise Services business line covers support costs of the following systems: Automated County On-Line Resource Network (ACORN), Performance Accounting Series (PAS), SIRE, and Megabyte. Countywide Systems covers the infrastructure costs for these systems as well as all costs for other systems such as Board media, e-performance, job applications, permits, etc. All departments pay Department 10 (managed by the CEO) for Countywide Systems services. Then Department 10 reimburses the Division for the support costs for the Countywide Systems mentioned above that the Division incurs. The support costs that were budgeted to be reimbursed to the Division during FY15-16 were only a portion of the ACORN support costs and did not include support costs for PAS, SIRE, or Megabyte. Due to these costs not being reimbursed from Department 10 (Countywide Systems), these are included in the Division's overhead costs, which are being allocated to and subsequently billed out to all departments through the Core IT Services business line. We note that this can present some confusion for an individual department's understanding of what is considered Countywide Systems and what is considered the Division's Countywide Enterprise Services. We also note that the process for billing departments for Countywide Systems can be simplified by having one department charge all departments for IT services and Countywide Systems, which are also related to IT services.

We recommend that the Division and the CEO work together to converge the services for Countywide Enterprise Services and Countywide Systems into one fund to be managed, supported, and billed by one department. As Countywide Systems is considered a type of IT service, the Countywide Systems should be tracked in the IT Internal Service Fund. Until these departments have fully converged these services into one fund and department, the departments should work together to create an informational document to explain the difference between Countywide Systems charges and the Division's Countywide Enterprise Services and how these services are billed out to all departments. This informational document should be provided to all departments and agencies being charged for County IT services.

Department's Response:

The Department acknowledges the Auditor-Controller's recommendation and will have further discussions with the County Executive Office on the convergence of Countywide Enterprise Services and Countywide Systems into one fund to be managed, supported and billed by one department.

The County Executive Office also acknowledges this recommendation and will evaluate the Administrative Services Department's IT Division internal control improvements commensurate with the business need for separate internal service funds prior to considering consolidation of the Countywide Systems appropriation into the IT Internal Service Fund.

Status – Still Being Evaluated

Currently, the CEO and the Division have not come to an agreement to converge the IT Internal Service Fund (which includes the Countywide Enterprise Services business line) and the Countywide Systems Internal Service Fund into one fund. With the County about to replace our existing Enterprise Resource Planning (ERP) systems, this topic will be revisited after our new ERP system is implemented. The Division plans to work with CEO to develop a single document that combines descriptions of each service that are already stated in pre-existing County documents.

The Administrative Services Department's responses to our recommendations identified in our original report dated January 13, 2016 are included above. We did not audit their responses and, accordingly, we do not express an opinion on them.

We appreciate the courtesy and cooperation of the Department's staff throughout the course of this review.

Respectfully,

Nicole C. Howard, CPA
Assistant Auditor-Controller

cc: Melissa Spak, Administrative and Fiscal Operations Manager, Administrative Services Department
Jarrett Thiessen, Deputy Director of Information Technology
Chad Fenstermacher, Budget Analyst, CEO
Placer County Audit Committee